

**Australian Government
Treasury**

BLACK ECONOMY TASKFORCE INTERIM REPORT (MARCH 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 Interim Report (March 2017). 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 that the Black Economy Taskforce investigate the merits of introducing a Director Identification Number ('DIN') to combat illegal phoenix activity, which has been recognised by the Taskforce as a specific problem within the black economy.¹ The DIN would also reduce regulatory noise, another problem identified by the Taskforce,² by decreasing the mismatching of director records. This recommendation aligns with the Taskforce's guiding principles 1 (transparency), 2 (identification and verification), 6 (reducing regulatory burden) and 7 (utilising new technologies). The additional transparency and uniformity produced by the DIN would counteract the erosion of trust in the business sector and facilitate a whole-of-government use of data in tackling the black economy.

The DIN has been recommended by the following bodies:

- the Productivity Commission inquiry into business set-up, transfer and closure;³
- the Productivity Commission inquiry into the workplace relations framework;⁴
- the Senate Economics References Committee inquiry into insolvency in the Australian construction industry;⁵
- the Senate Economics References Committee inquiry into corporate tax avoidance;⁶

¹ Black Economy Taskforce, *Black Economy Taskforce: Interim Report* (March 2017) 41.

² Ibid 18.

³ Productivity Commission, *Business Set-up, Transfer and Closure*, Report No 75 (2015) recommendation 15.6 ('*Business Set-up Report*').

⁴ Productivity Commission, *Workplace Relations Framework*, Report No 76 (2015) vol 1, 48, vol 2, 915, 938.

⁵ 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*').

- the Senate Economics References Committee inquiry into superannuation guarantee non-payment;⁷
- the Australian Restructuring, Insolvency and Turnaround Association ('ARITA');⁸ and
- Governance Institute of Australia ('GIA').⁹

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);¹⁰
- 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);¹¹
- 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).¹²

The Australian Government, in its response to the Productivity Commission's recommendation to introduce a DIN, has stated that it 'will give this proposal further consideration as part of its ongoing work on insolvency reforms.'¹³

Background: Phoenix Activity

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 here 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: Introduce a Director Identification Number ('DIN') to Combat Illegal Phoenix Activity and Reduce Regulatory Noise

All existing and new directors should be required to have a director identification number ('DIN') that would allow ASIC and other regulators to accurately track repeat players.¹⁴

⁶ Senate Economics References Committee, Parliament of Australia, *Corporate Tax Avoidance – Part 1: You Cannot Tax What You Cannot See* (2015) recommendation 16.

⁷ Senate Economics References Committee, Parliament of Australia, *Superbad – Wage Theft and Non-Compliance of the Superannuation Guarantee* (2017) recommendation 20.

⁸ Australian Restructuring Insolvency and Turnaround Association, *Policy Positions of the Australian Restructuring Insolvency and Turnaround Association* (February 2015) policy 15-05.

⁹ Governance Institute of Australia, 'Identification Numbers Will Make It Easier to Track Directors' (Media Release, MR/2015/13, 10 July 2015).

¹⁰ Survey on file with authors.

¹¹ Survey on file with authors.

¹² 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.

¹³ Australian Government, *Australian Government Response to the Productivity Commission Inquiry into Business Set-up, Transfer and Closure* (May 2017).

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.¹⁵ ASIC’s form¹⁶ does not ask for the prior corporate history of its 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.¹⁷

Accurate identity information assists regulators in locating and monitoring those individuals against whom enforcement action might be taken.¹⁸ 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.¹⁹ 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.²⁰ The advantages of a DIN are obvious for agencies such as the Australian Criminal Intelligence Commission (a merger of the Australian Crime Commission and CrimTrac as of 1 July 2016) and the Australian Federal Police, who are seeking to identify and monitor those associated with organised crime²¹ and complex illegal phoenix activity.²² The DIN would also be of benefit to businesses, as the

¹⁴ 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.

¹⁵ *Corporations Act 2001* (Cth) s 117(2) (*‘Corporations Act’*).

¹⁶ ASIC, *Form 201: Application for Registration as an Australian Company* (11 December 2012, last updated 1 July 2014); *Corporations Act* s 117(4).

¹⁷ This true example was cited in *SERC Construction Insolvency Report*, above n 5, [12.31]. Mr Nadinic acknowledged registering 32 to 33 companies under these names.

¹⁸ Productivity Commission, *Business Set-up Report*, above n 3, 425: ‘The Commission considers that rather than crafting new offences, improvements in the detection and enforcement of existing laws are likely to be the best option for creating a genuine disincentive for directors contemplating phoenix action.’

¹⁹ For example, their duties as directors under *Corporations Act* pt 2D.1.

²⁰ 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.

²¹ See, eg, Australian Crime Commission, *Organised Crime in Australia* (May 2015) 8, 25–6, 65–6.

²² 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*

additional transparency would assist in restoring fair competition and trust to the business sector.

The DIN should also be widely circulated.²³ 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.

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,²⁴ and broadly supported the idea before the Productivity Commission²⁵ but sounded this warning:

ASIC is concerned, however, about the cost of implementing this draft recommendation and how it would work in practice. It would be extremely costly to build a stand-alone authentication process and implement it across our technology and services. ASIC would need to modify registers, portals, machine to machine services with software developers etc. Further, most registrations (over 90%) are made via third party agencies.²⁶ Any reform proposal would need to develop a solution for effecting identification checks by third parties. Finally, ASIC could not support in-person interactions at our offices. If we could not collect 100 points of identity proof on-line it may be necessary to engage a third party like Australia Post to perform this function.²⁷

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 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

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>>; ABC, above n 20.

²³ 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: see the concerns of Governance Institute of Australia discussed in Productivity Commission, *Business Set-up Report*, above n 3, 428. 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. 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: *Companies Act 2014* (Ireland) s 150(11); *Companies Act 2014 (Section 150) (No. 2) Regulations 2015* (Ireland).

²⁴ 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 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].

²⁵ ASIC, Submission No DR 58 to Productivity Commission, *Inquiry into Business Set-up, Transfer and Closure*, July 2015, [55]–[59].

²⁶ We recommend that the government review the desirability of business service providers selling aged shelf companies: see Helen Anderson, Ian Ramsay, Michelle Welsh and Jasper Hedges, 'Phoenix Activity: Recommendations on Detection, Disruption and Enforcement' (Research Report, Centre for Corporate Law and Securities Regulation, The University of Melbourne, February 2017) 8–10. However, our DIN proposal could accommodate third party registration.

²⁷ ASIC, above n 25, [57].

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.

The DIN proposal is not to be confused with the Coalition Government's 'streamlining business registration' initiative.²⁸ It was announced under the *Growing Jobs and Small Business* package that the government would develop a single online portal for business and company registration and establish a single business identifier.²⁹ The underlying requirements for various registrations would not change; rather, a single portal would accommodate multiple registrations, such as for business names, goods and services tax ('GST') or fringe benefits tax ('FBT').

ASIC seemed concerned about overlapping projects in its response to the Productivity Commission:

In light of these concerns, we do not believe that ASIC should develop a stand-alone identity authentication service. Indeed it would be inconsistent with the work being undertaken by the Digital Transformation Office to develop a Trusted Digital Identity Framework ('the Framework') to support the government's Digital Transformation Agenda. We understand the Framework will involve establishing a common strategic approach to identity across government and preventing agencies from investing in bespoke solutions. This will mean that individuals and businesses will no longer have to prove their identity multiple times to government when accessing services.³⁰

Here we stress the difference between the DIN *for the purpose of individuals incorporating companies*, which is what we are proposing, and a single identifier for businesses and *for individuals conducting businesses as individuals*, as proposed by the Trusted Digital Identity Framework.³¹ We agree that a plethora of numbers – ACNs, ABNs, tax file numbers, Auskey numbers – adds to the cost of doing business, and we support measures to reduce these. But the DIN process, while it could be added to the Trusted Digital Identity Framework, has a distinct and separate justification. We urge the government not to lose sight of the significance of proving directors' identities *before* allowing them to incorporate companies that are then allocated a Trusted Digital Identity.

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 first of these is discussed below under the heading 'The DIN and the Incorporation Process'. The second could be achieved by the directors of existing companies being required to provide their DIN as part of the completion of the annual review process³² or annual reporting.³³ The third – information

²⁸ See Australian Government, Business.gov.au, *Streamlining Business Registration* <<https://www.business.gov.au/for-government/Streamlining-business-registration>>.

²⁹ Ibid. The *Streamlining Business Registration* website notes that '[t]he Government is considering the findings of an implementation study which assessed the economy-wide impacts of adopting a single business identifier. If the Government proceeds with a single business identifier, the Australian Business Number (ABN) may replace Australian Company Numbers (ACNs) for new company registrations, and replace non individual Tax File Numbers (TFNs) for other non-individual businesses. A single business identifier may remove the need for businesses to use multiple identifiers with government.'

³⁰ ASIC, above n 25, [58].

³¹ See Australian Government, Digital Transformation Agency, *Trusted Digital Identity Framework* <<https://www.dta.gov.au/what-we-do/budget/trusted-digital-identity-framework/>>.

³² *Corporations Act* ch 2N.

about associations with previously deregistered companies – could be required from directors as part of the process of obtaining DINs.³⁴ A penalty for false statements would apply, as it does to all other documents lodged with ASIC.³⁵

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 DIN and the Incorporation Process

The incorporation process can be useful in detecting the creation of companies being set up to engage illegal phoenix activity. The DIN, used as part of the company registration process, would provide significantly more information to ASIC 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.³⁶ Directors with existing and previous directorships would cite their DIN and the incorporation application form would pre-populate with those details. If our suggestion above – that directors of existing companies should be required to quote their DIN at the time of companies' annual reviews or annual returns – is adopted, it should only take one annual cycle for the system to accumulate this information. First-timers would have little to complete after giving their DIN.

The aim here is to equip ASIC with information about this person, allowing the regulator to take appropriate action which may include placing them on a watch list or taking of enforcement action. An equally important aim is to alert the would-be director to the fact that *ASIC has this information at its fingertips*. They, and their previous corporate histories, are not invisible. Directors would be required to supply any missing information, and if this is false, they may be prosecuted.³⁷ All of this director and incorporation information would add to the intelligence that ASIC could share with other government agencies.

The DIN would Reduce Regulatory Noise

While the main purpose of introducing the DIN would be to combat illegal phoenix activity, it would also provide significant benefit in terms of reducing regulatory noise. Our view is that implementation of a DIN would substantially reduce 'red tape' in the long run by enabling more efficient data matching. The additional uniformity of data produced by the DIN would also facilitate a whole-of-government approach to tackling the black economy. The Taskforce has identified that over 3.5 million director records are mismatched between the ABR and the ASIC registry.³⁸ This corresponds with our own research, which has identified, for example, that there are thousands of duplicate entries in ASIC's 'Banned and

³³ Ibid ch 2M.

³⁴ 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.'

³⁵ *Corporations Act* s 1308(2).

³⁶ 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

³⁷ *Corporations Act* s 1308(2), sch 3 item 335.

³⁸ Black Economy Taskforce, *Black Economy Taskforce: Interim Report* (March 2017) 18.

Disqualified Persons Dataset’ on *data.gov.au*,³⁹ resulting from misspelled and disordered names, fictional names, and different addresses. For example, according to this dataset, John Frederick Kennedy, seeming to allude to the late US President (John Fitzgerald Kennedy, or JFK), was permanently banned from providing financial services on 6 June 2011. In fact, an ASIC media release reveals that this was a company director by the name of Moshe Yair Mordechai,⁴⁰ but both Mr Mordechai and the fictional JFK are still recorded as banned individuals in ASIC’s registry. If identity manipulation and data matching errors as egregious as this one can slip through the cracks, this is an environment in which regulatory noise is bound to flourish.

Summary of Recommendation: 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.
- The process of incorporation should be online with the prospective directors quoting their DINs.
- The DIN should be quoted for changes of directorship within existing companies.
- While the DIN should enable the application form for registration as an Australian company to pre-populate with previous incorporation history, directors should be required to supply missing information.

Conclusion

We applaud the Black Economy Taskforce for investigating ways to reduce illegal phoenix activity. Our view is that the DIN would go a long way toward achieving this goal, and this view has the support of the Productivity Commission, three Senate Committees, ARITA, GIA, and many insolvency, credit and governance professionals. We urge the Australian Government to follow through on its commitment to consider implementation of a DIN as a matter of priority. We would be happy to assist Treasury further in relation to our recommendation to introduce the DIN to combat illegal phoenix activity and reduce regulatory noise.

³⁹ Australian Securities and Investments Commission, *Banned and Disqualified Persons Dataset* (5 May 2017) <<https://data.gov.au/dataset/asic-banned-disqualified-per>>.

⁴⁰ See Australian Securities and Investments Commission, ‘Convicted Company Director Permanently Banned from Credit and Financial Services’ (Media Release, 11-116AD, 10 June 2011).