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comment and opinion

PHOENIX ACTIVITY – A CONTEXT NOT A CRIME

Regulators have several legislative measures available to combat illegal behaviours that arise in the phoenix context.

There are three things that everyone knows about phoenix activity. The first is that there is no accepted definition of phoenix activity. The second is that there is no express phoenix offence. The third is that the law allows people to fail at one business and start another one, minus the debts of the first.

All of these provide enough legitimate opportunities, or legislative loopholes depending on your perspective, to advise clients that phoenix activity is okay. Right? Wrong.

It's certainly true that the separate legal entity of a company and the limited liability of its shareholders protects the investors of a failed business from its debts. However, the corporate veil does nothing to protect the failed company's directors from the consequences of their own improper behaviour.

Any actions of the failed company's' directors that are not in the best interests of that company, or are for an improper purpose, or cause detriment to that company, are a breach of their directors' duties. An example is the deliberate undervaluing of assets transferred between companies. Breaches of directors' duties are actionable by the liquidator or ASIC, either as a civil penalty or a criminal prosecution. The maximum criminal penalty is five years in jail and a $340,000 fine.

But wait, there's more – much more. Unremitted taxes are recoverable by the ATO via director penalty notices (DPNs). Since 2012, directors who fail to report and pay withholding taxes are not able to take advantage of a quick liquidation or voluntary administration to escape personal liability. This 'lockdown DPN' mechanism makes it a risky proposition not to report the amounts the company owes.

Where these liabilities are reported but not paid, the ATO can more easily impose the DPN, overcoming the detection problem. Unmet payroll tax obligations are also payable by directors in NSW via a similar DPN mechanism. Directors can also find themselves liable for penalties as accessories to breaches of the Fair Work Act where their company, solvent or not, fails to pay wages to employees.

In none of these instances does the liability of the directors rely on a finding that they engaged in illegal phoenix activity. These are just a small sample of the legislative measures open to regulators to combat the types of illegal behaviours that arise in the phoenix context. A fuller list of the federal provisions are available in a recent report I co-authored: *Defining and Profiling Phoenix Activity* (available on the University of Melbourne Website). There are also numerous relevant state laws.

All of these provisions have now been around for at least several years. What should be causing concern to advisors who recommend phoenix activity to clients is the increased focus and co-ordination of regulators. The main business regulators in Australia are members of the Interagency Phoenix Forum which has recently been declared a prescribed taskforce. This allows for much greater information sharing between the agencies.

The ATO is also the host of the Cross Agency Phoenix Watchlist, which collates information from regulators and makes it available to each of them in their own prosecutions. This watchlist began its operations in January 2015 and will go from strength to strength as more information is gathered. And while the ATO struggles to attract much sympathy as a creditor, let's remember that those who obey the law and pay their fair share of taxes have to subsidise those who don't.

So let's forget the perennial and frustrating question 'is it a phoenix or not?' It doesn't matter. The regulators are armed and motivated with enough tools to target the sort of wrongful behaviour that causes loss to creditors.