AUSTRALIAN GOVERNMENT

TREASURY

**TRANSPARENCY OF BUSINESS TAX DEBTS**

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1. **INTRODUCTION**

I thank Treasury for the opportunity to comment on its ‘Transparency of Business Tax Debts’ exposure draft legislation. The Australian Research Council-funded project examining the regulation of illegal phoenix activity that I have led is in its concluding stages. Our aim has been to devise ways in which this damaging behaviour can be most efficiently and effectively prevented and deterred, without harming legitimate business activities to the detriment of the economy. We have now produced three major reports: [Defining and Profiling Phoenix Activity](http://law.unimelb.edu.au/__data/assets/pdf_file/0003/1730703/Defining-and-Profiling-Phoenix-Activity_Melbourne-Law-School.pdf); [Quantifying Phoenix Activity: Cost, Incidence, Enforcement](http://law.unimelb.edu.au/__data/assets/pdf_file/0004/2255350/Anderson,-Quantifying-Phoenix-Activity_Oct-2015.pdf); and [Phoenix Activity: Recommendations on Detection, Disruption and Enforcement](http://law.unimelb.edu.au/__data/assets/pdf_file/0020/2274131/Phoenix-Activity-Recommendations-on-Detection-Disruption-and-Enforcement.pdf). The views expressed in this submission come partly from our Recommendations report and partly are my own based on the 2018 exposure draft.

The concept of phoenix activity broadly centres on the idea of a corporate failure and a second company, 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.

Part II provides some background to the present enquiry, Part III contains some international comparators, and Part IV comments specifically on the draft provisions. In commenting on the government’s proposal, it is important to note that it is not explicitly addressing phoenix activity. The exposure draft explanatory materials state that:

1.2 This will allow tax debts to be placed on a similar footing as other debts, strengthening the incentives for businesses to pay their debts in a timely manner and effectively engage with the ATO to avoid having their tax debt information disclosed.

1.3 The amendments will reduce unfair financial advantage obtained by businesses that do not pay their tax on time and contributes to more informed decision making within the business community by enabling businesses to make a more complete assessment of the credit worthiness of other businesses.

The proposed tax disclosures are therefore intended to give lenders more information about the credit worthiness of existing, ongoing businesses, rather than allowing credit bureaus or others to prepare profiles about the individuals running those businesses and the credit worthiness of their future businesses. Transparency is vital in deterring misconduct. **However in my opinion, the presently proposed legislative instrument will encourage, rather than discourage, illegal phoenix activity.** I discuss this further below in Part V and suggest a small change to overcome this problem in Part VI.

**II BACKGROUND**

The significance of publicly available tax default information is that unpaid taxes are often an early sign of the precariousness of a company and its likelihood of defaulting on other debts.. In early 2016 we conducted a survey of members of the Australian Institute of Credit Management 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.’

While the ATO presently can use external debt collection agencies to pursue unpaid taxes,[[1]](#footnote-1) it has not been able to register tax defaults with credit reporting agencies, as a bank or trade creditor might. However, 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.[[2]](#footnote-2)

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. If credit reporting agencies could include tax default information in their advice to prospective lenders and trade creditors, one significant incentive to engage in illegal phoenix activity – its invisibility – would be undermined.

**III SOME INTERNATIONAL EXAMPLES**

This part examines how this issue has been dealt with in foreign jurisdictions. There are several international examples of tax debts being utilised publicly. As of 1 June 2014, the Estonian tax authority[[3]](#footnote-3) has published a ‘black list’ of tax debtors who owe at least EUR 1000 of taxes. The list is published on the tax authority’s webpage on a monthly basis, although there has been some controversy about the accuracy of debts published on the ‘black list’.[[4]](#footnote-4)

In Sweden, the Swedish Enforcement Authority (a subsidiary agency of the Tax Agency) is responsible for collecting both public debts (i.e. debts to central and local authorities, such as taxes) and private debts (based on titles of execution, judgments of general and administrative courts).[[5]](#footnote-5) The Enforcement Authority has direct access to a register of tax debtors kept by the Tax Agency. All public and private debts are recorded in the register. The register is searchable by name, as well as by personal identity number (for individuals) and company registration number (for companies). Information recorded on the register includes what kind of debt the individual or the company has and what action the Enforcement Authority has taken.[[6]](#footnote-6) A debtor’s details remain on the register for three years following payment of the relevant debt.[[7]](#footnote-7)

The public registration of tax debtor details in Sweden was the subject on an application before the European Commission of Human Rights, which considered whether the public registration of tax debtor information contravened Article 8 (Right to Privacy) of the European Convention for the Protection of Human Rights and Fundamental Freedoms. The Commission found that while the registration of the applicant’s debt interfered with his right to privacy, having regard to the margin of appreciation left to Swedish authorities, the registration in question ‘could reasonably be regarded as “necessary in a democratic society” within the meaning of Article 8 para. 2 (Art. 8-2) of the Convention.’[[8]](#footnote-8) Credit reporting agencies source tax debt information from the public register kept by the Swedish Enforcement Authority. For example, Soliditet, one of Sweden’s largest credit reporting agencies, sources tax debt information from the register on a weekly basis.[[9]](#footnote-9)

In 2012, a report of the United States Government Accountability Office considered reporting tax debts to credit bureaus.[[10]](#footnote-10) It drew no firm conclusions on whether tax debts should be reported but did note that important considerations in making such a decision include the accuracy and currency of the data, the size of the debt, the status of the debt, including whether it is disputed, and the expected costs and benefits of reporting.[[11]](#footnote-11)

**IV. COMMENTS ON THE EXPOSURE DRAFT**

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.[[12]](#footnote-12)

It is proposed that the measure will initially only apply to businesses with ABNs and tax debt of more than $10,000 that is at least 90 days overdue. The measure is estimated to provide a gain of $63 million in underlying cash balance terms over the forward estimates period.[[13]](#footnote-13)

There are a number of limitations built into the proposal to safeguard taxpayers. These are that

* the entity is not an excluded entity;
* the entity has not effectively engaged with the ATO in managing their tax debt; and
* the ATO has taken reasonable steps to confirm that there is no active complaint to the Inspector General of Taxation (IGT) relating to the proposed disclosure.

‘Effective engagement’ is further defined to mean that the taxpayer has done one of the following:

* entered into a payment arrangement;
* objected to a tax decision per Part IVC; or
* applied for AAT or Federal Court review of the Commissioner’s decision.

The exposure draft also proposes that the entity subject to the disclosure is given 21 days’ notice prior to the information being supplied to the credit reporting bureaus. The notice gives sufficient detail both of the information to be disclosed and how the entity may complain about, and therefore effectively stop, the disclosure.

All of these safeguards are important. It remains to be seen whether the line has been drawn in the correct place, and what percentage of the ‘tax defaulting’ population will be subject to credit bureau disclosures because they are 90 days overdue, owing $10,000 or more in tax, not an excluded entity, not disputing the debt, not effectively engaging with the ATO, and not complaining about the disclosure to the IGT. This is where illegal phoenix activity becomes relevant.

**V. THE PROPOSAL’S EFFECTIVENESS AGAINST ILLEGAL PHOENIX ACTIVITY**

It is not an offence to be the director of a company which has failed owing tax debts, nor does it indicate that the director or any company they manage will default in the future. Nonetheless, many of those companies which might be denied future credit because of an adverse credit report, based on a tax debt disclosure, will contemplate phoenix activity as the solution to their dilemma. **In my opinion, the proposed provisions will encourage, rather than discourage, phoenix activity.**

The proposed legislative instrument allows for disclosure under draft s 355-72 where:

(a) the entity is a \*taxation officer; and

(b) the record is made for, or the disclosure is to, a \*credit reporting bureau; and

(c) the record or disclosure is of information that relates to the \*tax debts of an entity (the ***primary entity***) that is included in a class of entities declared under subsection (5) of this section; and

**(d) the record or disclosure is for the purpose of enabling the credit reporting bureau to prepare, issue, update, correct or confirm credit worthiness reports in relation to the primary entity; and …**

Therefore, the information is only to be disclosed in relation to the ongoing, defaulting ‘primary entity’, not for the purpose of allowing the credit bureau to compile a profile of the individuals who are in control of the defaulting business. According to the Exposure Draft Explanatory Materials, the credit bureau is then expected to use the information for that same permitted purpose:

1.68 A credit reporting bureau will not be liable for an offence under section 355-155 (on-disclosure of protected information by other people) if they record or disclose the protected information for the original purpose, or in connection with the original purpose of the disclosure (see section 355-175). That is, the credit reporting bureau may use tax debt information concerning a particular entity for preparing, updating and issuing a credit worthiness report in relation to that entity.

Untrustworthy credit bureaus are likely to find themselves excluded from receiving the information:

1.35 As the Commissioner has discretion regarding whether or not to make a disclosure (once the conditions have been satisfied), the Commissioner has flexibility to establish appropriate administrative arrangements to ensure an entity which the Commissioner intends to disclose information to complies with any terms and conditions the Commissioner considers appropriate. **For example, the Commissioner may choose to only disclose to a credit reporting bureau that has agreed to maintain particular processes, safeguards and mechanisms to ensure taxpayer information is appropriately managed.**

1.36 The Commissioner also has flexibility to decide that a particular credit reporting bureau should no longer receive tax debt information from the Commissioner.

Of course, once the information has been disclosed by the ATO in relation to a defaulting business and supplied by the credit bureau to a customer, there is nothing stopping the customer – another information bureau perhaps - from using that information to compile a profile of the individuals who are in control of the defaulting business.[[14]](#footnote-14) An ASIC search will reveal the directors of the defaulting company. This profile could be very effective in discouraging illegal phoenix activity by those individuals in their future businesses. **However, if the defaulting company is liquidated within 21 days of the ATO sending the tax debt disclosure notice, it appears the ATO has no legal basis for supplying the information to the credit bureaus in the first place.**

As an aside, it should also be remembered that liquidation of a defaulting company within 21 days after a director receives a director penalty notice (DPN) will also defeat the ATO’s ability to recover unremitted PAYG(W) and superannuation from the director, where those liabilities are reported but unpaid. Only ‘lockdown’ DPNs, where the liabilities are both unreported and unpaid, are not defeated by the company’s liquidation. However, the ATO’s ability to quantify the liability and issue the lockdown DPN is made more difficult by the taxpayer’s failure to report the liabilities.

**VI CONCLUSION**

In relation to the present exposure draft, it is therefore suggested that Treasury consider whether the provision above

**(d) the record or disclosure is for the purpose of enabling the credit reporting bureau to prepare, issue, update, correct or confirm credit worthiness reports in relation to the primary entity; and …**

be expanded to ‘credit worthiness reports in relation to the primary entity, *its directors and officers, and any other entity that they presently are associated with or are associated with in the future.*’

I recognise that this is a significant expansion of the proposed scope of the provision. However, the government and Treasury have shown that they are committed to combatting illegal phoenix activity. It would be a pity if this well-motivated initiative to improve transparency of tax debt were to lead to a greater incidence of illegal phoenix activity rather than the opposite.

1. 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*’). [↑](#footnote-ref-1)
2. Evidence to Standing Committee on Tax and Revenue, Parliament of Australia, Canberra, 28 February 2014, 24 (Geoff Leeper). [↑](#footnote-ref-2)
3. Tax and Customs Board, Republic of Estonia, *Public Databases for Conducting Background Research on Counterparties: Inquiries Available from the Website of the Estonian Tax and Customs Board* – *Taxes Paid* <<https://www.emta.ee/eng/business-client/taxation-payment-taxes/public-databases-conducting-background-research>>: ‘The Excel spreadsheets that can be opened at the bottom of the page allow you to verify if a person such as your counterparty has paid taxes and in what amount. The tables provide the total amounts of state taxes paid on a quarterly basis by taxable persons (except private individuals) and separate amounts of total employment taxes, contributions to mandatory funded pension and unemployment insurance premiums paid.’ See Ants Karu, *Amendments on Estonian Tax Legislation* (20 August 2014) Legal Knowledge Portal <<http://legalknowledgeportal.com/2014/08/20/amendments-on-estonian-tax-legislation/>>. [↑](#footnote-ref-3)
4. Toomas Hõbemägi, *Companies Become Tax Debtors because of Problems in e-Tax Board* (12 March 2015) Baltic Business News <<http://www.balticbusinessnews.com/article/2015/3/12/companies-become-tax-debtors-because-of-problems-in-e-tax-board>>. [↑](#footnote-ref-4)
5. See Swedish Tax Agency, *Taxes in Sweden: An English Summary of Tax Statistical Yearbook of Sweden* (2012) 17 n 3; Swedish Enforcement Authority, *Information about the Activities of the Swedish Enforcement Authority*, [4.1]–[4.2] <<https://www.kronofogden.se/InEnglish.html>>. [↑](#footnote-ref-5)
6. Swedish Enforcement Authority, ibid [4.4]. [↑](#footnote-ref-6)
7. International Business Publications Inc, *Sweden Insolvency (Bankruptcy) Laws and Regulations Handbook: Strategic Information and Basic Laws* (International Business Publications, 2015) 62. [↑](#footnote-ref-7)
8. *Gedin v Sweden* (1996) 29189/95 <<http://echr.ketse.com/doc/29189.95-en-19961127/view/>>. [↑](#footnote-ref-8)
9. See Solidtet, *Our Sources* <<http://www.soliditet.se/cms/lang/en_GB/soliditet/AboutSoliditet/Sources>>. [↑](#footnote-ref-9)
10. US Government Accountability Office, *Report to Congressional Requesters: Federal Tax Debts – Factors for Considering a Proposal to Report Tax Debts to Credit Bureaus* (September 2012). [↑](#footnote-ref-10)
11. Ibid. [↑](#footnote-ref-11)
12. Australian Government, *Mid-Year Economic and Fiscal Outlook* (December 2016) 113. [↑](#footnote-ref-12)
13. Ibid. [↑](#footnote-ref-13)
14. This is confirmed in the Exposure Draft Explanatory Materials: ‘[1.71] For the avoidance of doubt, these amendments ensure that the customers of a credit reporting bureau and any other third parties subsequently dealing with tax debt information are not exposed to criminal sanctions for recording or on-disclosing the information.’ [↑](#footnote-ref-14)