



The General Manager
Business Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

18 January 2010

Dear General Manager

**CONSUMER ACTION LAW CENTRE SUBMISSION:
"ACTION AGAINST FRAUDULENT PHOENIX ACTIVITY"
COMMONWEALTH GOVERNMENT PROPOSALS PAPER NOVEMBER 2009**

1. About the Consumer Action Law Centre

The Consumer Action Law Centre is a campaign-focused consumer advocacy, litigation and policy organisation.

Based in Melbourne, Australia, Consumer Action was formed in 2006 by the merger of the Consumer Law Centre Victoria and the Consumer Credit Legal Service and is funded jointly by Victoria Legal Aid and Consumer Affairs Victoria.

Consumer Action is the largest specialist consumer law legal practice in Australia.

2. Introduction: Consumers and Fraudulent Phoenix Activity

Consumer Action notes that the thrust of the "Action Against Fraudulent Phoenix Activity" Proposals Paper (the Proposals Paper), is to address fraudulent phoenix activity that impacts particularly on government revenue through the avoidance of taxation liabilities.

The Proposals Paper also notes that such activity also typically involves the non-payment employee entitlements - particularly superannuation.

To the twin detriments of negative revenue implications and the non-payment of employee entitlements, Consumer Action would add the impact that fraudulent, and indeed non-fraudulent, phoenix activity can have on consumers.

As a specialist consumer law centre, Consumer Action and its predecessor organisations have seen numerous cases in which phoenix activity has left consumers without recourse to resolve legitimate consumer law disputes. In cases where consumers are vulnerable or financially disadvantaged, such activity can have a significant and lasting negative impact on

the consumer's quality of life. In most cases it also has a negative impact on consumer confidence the marketplace.

Whilst Consumer Action generally agrees with the proposition in the Proposals Paper - that the underlying distinction between illegitimate, or phoenix activity and a legitimate use of the corporate form is the intention for which the activity is undertaken - we note our experience that there is a further category of activity that is neither legitimate nor fraudulent. That is the case of 'serial' phoenix activity - where the fraudulent intent may be absent, but the effect of multiple insolvencies and the reestablishment of a substantially similar business renders the activity illegitimate . Consumer Action and its predecessor organisations have noted individuals in the past who have repeatedly engaged in misleading and deceptive conduct, or sold defective goods, and then wound up their current corporate entity only to re-commence the same activity under the guise of another entity.

Consumer Action notes that this impact is somewhat distinct from the avoidance of debts (both taxation liabilities, and others), and may potentially be regarded as a secondary impact of phoenix activity rather than a motivating factor for it. Nevertheless, consumer impact does remain a problematic aspect of phoenix activity, and Consumer Action would urge Treasury to consider this aspect of phoenix activity in this consultative stage of the reform process.

To highlight the issue of consumer impact , Consumer Action provides the following case study for your consideration:

Case Study

An elderly pensioner ("Mr P") signed a contract with a company called Stilinox Sales Pty Ltd to purchase a massage chair at a value of \$3,990. Mr P paid an initial deposit of \$150 and arranged to pay the rest on lay-by.

Over the next fourteen months Mr P made regular repayments, until he had paid \$2995 of the total cost (plus the \$150 deposit). On receiving a windfall of \$1000, Mr P arranged to pay off the remaining amount cash on delivery.

After four months, and following repeated unsuccessful attempts to confirm delivery of the chair, Mr P contacted the Consumer Law Centre.

A solicitor from the Consumer Law Centre then acted on behalf of Mr P.

After another four months of negotiations with Stilinox, (during which the chair was not delivered), an application was lodged with VCAT naming Stilinox Australia Pty Ltd - the company listed on the lay-by agreement.

At that point, Stilinox Australia Pty Ltd went into liquidation and VCAT proceedings were withdrawn.

Approximately nine months later Mr P discovered that Stilinox was still in business and contacted the Centre.

Company searches revealed that two related companies - Stilinox Sales Pty Ltd and Stilinox International Pty Ltd, were still functioning. Further consideration revealed that the sales contract had actually been with Stilinox Sales Pty Ltd - and not Stilinox Australia Pty Ltd.

Approximately twelve months after the initial application had been filed (and three years after the initial purchase date) a second application was lodged with VCAT, seeking rescission of the contract and repayment of \$2995.

The application was successful, and VCAT ordered that Mr P was entitled to rescission and a full refund.

Stilinox then failed to comply with the Order.

Following further action to enforce the judgement, Stilinox Sales Pty Ltd went into liquidation.

Mr P never got his money back.

It should be noted that following the events described above, the director of the various Stilinox companies was disqualified by ASIC from managing a corporation for four years.

Unfortunately this was too late to help Mr P, and his case highlights a common consumer experience of phoenix activity.

In addition to the above matter, Consumer Action has also encountered the Money For Living group of companies, which offer loans to retirees, similar to reverse mortgages.

In October 2009 Mr Stephen Mark O'Neill was convicted in Melbourne Magistrates Court of two charges of managing a corporation whilst disqualified - the companies were Money For Living (Australia) Pty Ltd, and MFL Property Holdings Pty Ltd. Both companies are currently in liquidation.

Finally, Consumer Action notes informal advice that some operators in the growing introduction agencies industry are operating multiple companies, with similar names and methods of operation. Given a recent rise in the number of consumer complaints in that industry, (often for significant sums of money), this is of serious concern, and it would not be surprising if a number of consumers in that industry were to be left "high and dry" by the strategic liquidation of corporate entities, only to find similar entities being established by the same operators, shortly thereafter.

Consumer Action notes that the options to address fraudulent phoenix activity identified in the Proposals Paper are for a large part targeted at the "typical" fraudulent phoenix activity outlined at page 2 of the Proposals paper.

Under this "typical" form, a string of phoenixed labour hire entities are used to support a broader over-all business which remains trading. Consumer Action understand that this "typical" form of fraudulent phoenix activity has particularly negative impacts on government revenue, and on the employees of phoenix operators.

Whilst Consumer Action understands the significance of that activity, Consumer Action's interest in phoenix activity is broader, as outlined above. Consumer Action's comments below, (which address the questions raised for consultation in the Proposals Paper), approach each question from the point of view of the potential impact that the proposal may have on phoenix activity more generally, rather than the "typical" form for which many of the proposals are directed.

As a result, some of the proposals which are possibly seen as secondary measures to deal with the particular type of fraudulent phoenix activity on which the Discussion Paper focuses, are given more emphasis, as they would in Consumer Action's view be effective for combating phoenix activity more generally. Similarly, some measures which are seen as primary methods of dealing with "typical" fraudulent phoenix activity, are less useful for the purpose of counteracting the basic form and are therefore given less focus. Further, Consumer Action has limited expertise in taxation law and is therefore unable to comment in

any detail on some of the proposals, beyond expressing an in principle view that if they will be effective then they should be adopted.

On balance, Consumer Action hopes that this submission may highlight an alternative rationale for introducing some of the proposals seen as less important to combat the "typical" form of fraudulent phoenix activity, and that Treasury may use this opportunity to address what is described as primarily a revenue matter, to implement reforms that may also have positive impacts for consumers by both reducing harm, and promoting confidence in the market.

For decades, a small, but nonetheless significant portion of operators have abused the corporate form to the detriment of the broader economy and the community which it serves. Reforms which can help address phoenix activity (without, of course, unduly restricting legitimate corporate activity) can only be beneficial.

Such reform should be pursued as vigorously as possible.

3. Questions for Consultation

3.1 - *Should director penalties be 'automated' and if so, is three months a reasonable period of time in which to require directors to meet liabilities, without unduly affecting directors facing adverse economic conditions?*

Consumer Action is inclined to support the automation of director penalties as a powerful tool to negate the tax avoidance incentive that reportedly drives much fraudulent phoenix activity.

We note, however, that it is not a reform without complication, given its general application to entities that have failed to lodge PAYG returns, as distinct from entities engaging in phoenix activity. For instance, we can see that the level of penalty on the one hand ought to be sufficiently large as to act as a deterrent to those who may be otherwise inclined to engage in phoenix activity. On another view, however, it could be seen as unfair or counterproductive to impose such a penalty on a business that is inadvertently and non-fraudulently fails to comply with these obligations.

Given the importance of PAYG obligations, however, and the serious negative consequences for revenue if they are not complied with generally (in addition to the consequences of the more specific case of fraudulent phoenix activity), we are inclined to support the proposed reform.

We note also that there are likely to be efficiency gains when compared with the current director penalty notice system, which is inefficient and administratively onerous.

3.2 - *If the 'automated' approach were taken, would there be a continuing role for the director penalty notice?*

Consumer Action concurs with the view expressed in the Proposals Paper, that an automated penalty regime does not negate the role of the director penalty notice.

In practice, an automated penalty regime may well mean that the director penalty notice is seldom used, but the option should remain for instances where the ATO has identified a 'serial' phoenix operator.

In Consumer Action's experience, it is not difficult to identify individuals who habitually engage in fraudulent phoenix activity, and there is no reason why the director penalty notice system should not be retained to crystallise the liabilities of those individuals prior to the time-frame of the proposed automated penalties. Although an automated penalty regime will be a welcome reform, the director penalty notice system should be retained as an option for combating known phoenix operators.

3.3 - *If the 'automated' approach were to be taken should any additional limitations on the regime be imposed? Is three months the right time-frame? Is there a need for additional defences? Should there be a limitation period for the ATO to recover the penalty?*

In view of the views expressed in section 3.1, we are inclined to the view that additional defences to the penalty ought to be considered. In particular a defence of honest and reasonable mistake may be appropriate. A limitation period to recover the penalty is also appropriate. A limitation period appears to be an appropriate counter-balance to the need to cast the automatic penalty framework wider to capture the activity of concern and ought to act as an appropriate discipline in enforcing the regime.

3.4 - *Should the director penalty notice regime be expanded to include an additional range of payments, taxes and duties?*

Consumer Action supports a targeted expansion of the above proposal as a logical extension to anti-phoenix measures.

On the one hand, it would seem illogical to take action against one form of incentive, but to fail to deal with others which may also contribute to undesirable activity. On the other hand, given a broader (albeit in itself concerning) sphere of conduct will be captured, some caution is warranted.

Certainly, the public interest grounds identified in relation to superannuation guarantee payments provide a powerful additional argument for at least including those liabilities in an expanded penalty regime. The consideration of inclusion of other payments, taxes and duties should occur on a case by case basis where it can be established that either the absence of a penalty for non-payment provides a strong incentive for phoenix activity or the inclusion is appropriate on other public interest grounds.

3.5 - *If the director penalty regime is expanded, should the estimation regime be similarly amended?*

Yes - this proposal is a logical and consequential extension of expanding the penalty regime.

3.6 - *Should the promotion of fraudulent phoenix behaviour be made subject to the promoter penalty regime?*

Consumer Action strongly supports this measure.

In cases where knowledge exists or can be imputed, it would be remiss to fail to deal with those who derive income through promoting fraudulent phoenix activity to others, as such conduct arguably contributes as much to the spread of fraudulent phoenix activity as any other factor. At a fundamental level, there is a logical inconsistency in allowing individuals to benefit from promoting phoenix activity, whilst at the same time identifying phoenix activity as harmful and taking steps to prevent it. If phoenix activity is to be opposed, then so should those who seek to benefit by promoting it to others.

3.7 - *Should the taxation law include anti-avoidance provisions that give the Commissioner the ability to trace the benefit derived from fraudulent phoenix activity to individuals and entities other than the liquidated company?*

Consumer Action strongly supports this proposal.

Ultimately - the power to recover a phoenixes entity's outstanding liabilities from a related entity goes to the heart of phoenix activity, and should have powerful benefits government revenue. Further, this power would provide a strong deterrent, to prevent operators from engaging in phoenixing in the first place.

Crucially - and as identified in the Proposals Paper - taking an anti-avoidance approach to applying this measure ensures that it will not hinder legitimate corporate activity, which in turn removes any major objection to implementing the proposal.

Consumer Action does not have expertise in taxation law and is therefore unable to comment on this proposal beyond expressing in principle support.

3.8 - *Would it be appropriate to remove the requirement that a director has managed two or more failed corporations before ASIC can disqualify a director?*

Consumer Action supports this proposal on the basis that if a director can be shown to have been engaged in phoenixing - even if it has only been on one occasion - then that should, by definition, be enough to mark them as unfit to be concerned in the management of a company.

Effectively done, the removal of this requirement would provide ASIC with a powerful deterrent against phoenix activity, and would hopefully operate to significantly reduce the activity and therefore its negative impact on consumers, and the economy generally.

Finally, this measure acknowledges the reality that phoenix activity is engaged in purposefully and deceitfully by individuals, who will often go on to repeat the behaviour in a systematic manner. The most effective way to counter those individuals, is to deny their access to the corporate form.

In the event the requirement is removed, we suggest that it be explicit that it is done to allow disqualification at an earlier stage in appropriate cases. In our view this will be important to avoid uncertainty about whether 'the bar has been raised or lowered' in the absence of a clear numeric threshold.

In relation to the potential objections to this proposal raised in the Proposals paper, Consumer Action makes the following comments:

(a) *Objection: That the reform may be too broad to combat fraudulent phoenix activity.*

Consumer Action acknowledges that the reform is broad, and has the potential to apply beyond phoenix activity - it is for this reason that we also support some expansion of the defences available to a director's penalty and other measures noted above. We do not consider however that the proposed reform is so broad that it ought not be able to go ahead, given there are options available to address the reach of the regulation.

We note also that in practice, the breadth of the measure depends significantly on the relevant regulators' and ultimately the courts' application of it. For all the rhetoric that tends to surround this issue, numerical analysis shows that over-enforcement of regulation has not been the typical problem.

It would seem unnecessarily cautious to deny the relevant regulators a powerful tool for dealing with a known form of corporate misconduct, on the basis that they may - despite their clear mandate to do otherwise - utilise that tool to prevent positive corporate behaviour.

(b) *Objection: The reform could act as a disincentive for directors to take entrepreneurial risks.*

Consumer Action agrees with the view expressed in the Proposals Paper - namely, that this objection is negated by restricting the power to disqualify to cases where the conduct of an individual has made them unfit to be involved in the management of a business.

(c) *Objection: The reform could be avoided by the use of shadow directors.*

Consumer Action notes that this is a legitimate concern, and, as is noted in the Proposals Paper, the use of shadow directors is already a common phenomenon in fraudulent phoenix activity.

That being said, the fact that some phoenix operators may avoid a reform is not a strong argument to oppose its implementation. Very few reforms are one hundred percent effective in their implementation. The real measure is - will the reform prevent at least some of the activity it is designed to prevent? And further, will the reform introduce negative consequences that outweigh its benefits?

In Consumer Action's view, enhancing ASIC power to disqualify directors could have a strongly positive impact on preventing fraudulent phoenix activity, and could only have negative consequences if ASIC were to grossly and inappropriately misapply the power. This would seem highly unlikely, and if it were to occur, then it is always possible to remove the power again.

The use of shadow directors is likely to be an ongoing problem associated with fraudulent phoenix activity, but should not be a reason in and of itself to prevent what could be a very significant and powerful reform.

3.9 - Should an offence for the non-remittance of PAYG(W) amounts be reintroduced into the taxation law?

Consumer Action has insufficient expertise to comment on this proposal in any detail, but does express in principle approval for the bolstering of any measure that may act as a disincentive and deterrent to fraudulent phoenix activity.

Consumer Action notes that the above measure would 'raise the stakes' somewhat for those engaging in fraudulent phoenix activity, and provide a more accurate indication of the seriousness with which phoenix activity and associated taxation avoidance is regarded by both the government, and the community generally.

3.10 - *Should a similar offence provision be created in relation to non-compliance with superannuation guarantee obligations?*

Certainly, Consumer Action strongly believes that the failure to pay superannuation payments on behalf of employees is one of the more odious outcomes of fraudulent phoenix activity.

If a taxation law offence provision would be effective in curbing such conduct, and could appropriately balance the sorts of factors we have outlined above, then Consumer Action expresses its strong in-principle support for such a provision. Again, Consumer Action has insufficient taxation law expertise to express anything beyond in principle support for this proposal.

3.11 - *Is the denial of PAYG withholding credits to directors by the ATO an appropriate mechanism to deal with fraudulent phoenix behaviour? Should it extend to all directors and close relatives of the director (provided that the Commissioner is given a discretion to allow PAYG(W) credits where it is appropriate to do so)?*

Consumer Action has insufficient taxation law expertise to comment further on the proposal, or the practicality of its implementation.

3.12 - *Would a restriction on the use of a similar name or trading style be an effective mechanism in curbing fraudulent phoenix activity?*

Consumer Action strongly supports this proposal and sees it as a key mechanism to counter the more "basic" form of fraudulent phoenix activity discussed at point 2. above.

In the experience of Consumer Action and its predecessor organisations, serial phoenix operators often use phoenixing as a convenient means of "rolling" their business over into a new entity, shedding debts and outstanding obligations to government, consumers and employees in the process. The successor company then operates along as similar lines as possible to the previous entity, to minimise disruption of the business, and smooth the "rollover".

Preventing successor entities from adopting a similar name to the phoenixed entities (and making directors liable for the debts of the liquidated company if they do) would be a simple and highly effective means of disrupting the "rollover" mentality common amongst phoenix operators. The practical difficulty of establishing a new business under a dissimilar name, and then attempting to re-establish the business should not be under-estimated - particularly for a small business operator. Further, and as the Proposal Paper states, this measure would impose additional, and often substantial costs on the new entity.

In Consumer Action's view this simple measure would create a significant disincentive to fraudulent phoenix activity - particularly "basic" fraudulent phoenix activity - and therefore presents significant benefits for consumers. Further, this proposal would send a clear message to the market that fraudulent phoenix activity is not to be tolerated, by targeting one of the key - and publicly visible - indicators of fraudulent phoenix activity.

On that basis, this measure may provide a powerful deterrent effect to operators who may otherwise regard phoenix activity as a quasi-legitimate practice. Without a clear prohibition on successor company's using similar names and trading styles to their phoenixed predecessors, the issue of whether phoenixing is a legitimate use, or a flagrant abuse, of the corporate form is easily blurred in the minds of some business operators.

3.13 - *Should it be an offence for directors to claim non-remitted PAYG(W) when the company has not remitted PAYG(W)? As this approach would target both fraudulent phoenix directors as well as legitimate directors, would it achieve the right balance between protecting revenue and protecting the interests of legitimate directors?*

Consumer Action does not have sufficient expertise in taxation law to comment on this proposal.

3.14 - *Is it appropriate for the ATO to require a bond to be paid in relation to an expanded range of liabilities if fraudulent phoenix activity is suspected or expected? What would be an appropriate amount? Should it be referable to three months of anticipated tax liabilities? Six months?*

Consumer Action expresses in-principle support for this proposal, as it would provide a strong disincentive to would-be phoenix operators provided it is subject to the proviso that the suspicion or expectation must be reasonable. The suggested proviso, that the Commissioner have a degree of discretion in requiring the bond, is also important and should be implemented so as not to unnecessarily impede smaller, honest entities from operating.

In relation to the bond period, Consumer Action is of the view that the bond should cover the period of time permitted under an automated director penalty regime, (as described at 3.1). If directors are permitted three months to meet their liabilities before being subject to automated penalties, then a three month bond should apply. If the automated penalty period is six months, then the bond period should be also.

3.15 - *Do you have any other suggestions that would assist to deter entities from engaging in fraudulent phoenix activity?*

No. Consumer Action believes that many of the above proposals, working together, would provide a far stronger frame-work to counter fraudulent phoenix activity than that which currently exists in Australia, and would be pleased to see those proposals put into practice.

Consumer Action has not further suggestions to add to those proposals.

Yours sincerely,

Zac Gillam
Senior Policy Officer