



Dodgy directors under fire as Federal Government launches fresh crackdown on phoenix activity

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Federal Assistant Treasurer Nick Sherry has unveiled a raft of measures aimed at cracking down on so-called phoenix companies, claiming phoenix activity could be costing the Government \$600 million in tax revenue each year.

Phoenix activity refers to the process by which the owner of a failing business shuts down one corporate entity, only to take that entity's assets and start a new company. The process is used to avoid paying creditors and other debts such as taxes, wages and superannuation.

Earlier this year, the Government gave the Australian Tax Office more than \$70 million to fight phoenix activity, but the ATO has warned phoenix activity has increased during the downturn.

Warnings of some company directors becoming involved in repeated phoenix activity were given extra credence by Dun & Bradstreet research released last week that showed 43% of companies that went under in 2009 involved companies with directors who had been involved previously with firms that had been wound up.

"The latest estimates provided to me indicate that phoenix activity may be ripping up to \$600 million from the national revenue base - that is simply unacceptable and it's hurting the whole community and hitting the integrity of the system," Sherry said in a statement.

"As far as I am concerned, the people who engage in this practice deserve the full force of the law brought to bear against them - that is why we've commissioned a package of tough reform options that will use the tax and corporate legal systems to close them off at the pass."

Reforms suggested by Sherry, and now up for the public to comment on, include:

- Strengthening anti-avoidance provisions in the tax law to cancel any benefits derived through fraudulent phoenix activity.
- Making it an offence for an entity not to remit the required Pay-As-You-Go (Withholding) tax amounts.
- Making it an offence for directors to claim credits in relation to their own income for PAYG(W) amounts that have not been remitted by the company of which they are a director.
- Make directors personally liable for the debts of a liquidated company in circumstances where a 'new' company adopts the same or similar name as its previous incarnation.
- Changing the Corporations Act to "allow the corporate veil to be lifted where a company sets up a subsidiary with insufficient capital to meet the debts that could reasonably be expected to arise".

- Penalising those who promote fraudulent phoenix activity.
- Expanding the Australian Securities and Investment Commission's powers to disqualify directors.

One of the most controversial proposals from Treasury involves what is known in tax circles as the doctrine of inadequate capitalisation, a controversial idea from the US that allows authorities (such as the ATO) to pursue other companies within a group if that group is found to have set up a subsidiary that is undercapitalised and subsequently becomes insolvent.

But as Treasury says that while inadequate capitalisation rules would allow the authorities to target companies who set up subsidiaries with the express purpose of dodging their debts, officials have also acknowledged some big potential problems, particularly if capital constrained start-ups are exposed to the new rules.

"Limitations of this proposal are that it could reduce the level of start-up businesses through increased costs caused by the need to conduct due diligence on the capitalisation of subsidiary companies," the paper says.

Treasury also acknowledges that there are big difficulties in proving an intention to undercapitalise a company and with even defining the term "undercapitalised".

Sue Prestney, principal of MGI and the SME spokesperson for the Institute of Chartered Accountants, shares Treasury's concerns and says it would be extremely difficult for a company to even predict what level of capital was need to seed a new subsidiary.

"It's very subjective. One business can be totally unlike another and things change."

Indeed, Prestney for the possibility of any crackdown on phoenix activity to catch unsuspecting business owners who, for whatever reason, become involved in an insolvent company.

"People can find themselves with an insolvent company for all sorts of reasons and have it wound up. The danger is that if they try to go into business again, are they going to get caught up in these laws?"

"I'm very concerned innocent people are going to be targeted. Do we end up with a sledgehammer to crack a wall nut with these new proposals?"

Sherry says the Government remains "strongly committed to helping those businesses suffering from the global recession and will ensure that innocent directors and companies are not captured inadvertently by any features of new regime."

Sherry's proposals come just a few weeks after senior ATO official told a Parliamentary Committee that tougher penalties were needed to discourage the rising level of phoenix activity, which the ATO claims costs the economy between \$1 billion and \$2.4 billion a year.

Just 10 company directors have been prosecuted under phoenix trading laws since 2000 and those directors that have been convicted have typically received extremely light sentences. In

some cases, courts have imposed a sentence of home detention whereby the accused was even allowed to leave the home during daylight hours to conduct business.