Treasury Laws Amendment (Combating Illegal Phoenixing) Bill 2019

Paula Pyburne
Law and Bills Digest Section

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Date introduced: 4 July 2019
House: House of Representatives
Portfolio: Treasury
Commencement: Sections 1–3 on Royal Assent; Schedules 1 and 2 on the day after Royal Assent; Schedules 3 and 4 on the first 1 January, 1 April, 1 July or 1 October after Royal Assent

Links: The links to the Bill, its Explanatory Memorandum and second reading speech can be found on the Bill’s home page, or through the Australian Parliament website.

When Bills have been passed and have received Royal Assent, they become Acts, which can be found at the Federal Register of Legislation website.

All hyperlinks in this Bills Digest are correct as at September 2019.
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History of the Bill
The Treasury Laws Amendment (Combating Illegal Phoenixing) Bill 2019 (the original Bill) was introduced into the House of Representatives on 13 February 2019. However, it lapsed when the 45th Parliament was prorogued on 11 April 2019.1

The Treasury Laws Amendment (Combating Illegal Phoenixing) Bill 2019 (the Bill) was introduced into the House of Representatives on 4 July 2019. The Bill is in near equivalent terms to the original Bill with necessary changes to commencement dates and omission of contingent amendments due to the passage of other legislation.

Purpose of the Bill
The purpose of the Bill is to amend various statutes to:

• introduce new phoenixing offences
• prohibit directors from improperly backdating resignations or ceasing to be director when this could leave a company with no director and
• allow the Commissioner of Taxation (the Commissioner) to collect estimates of anticipated goods and services tax (GST) liabilities and make company directors personally liable for their company's GST liabilities in certain circumstances.

Structure of the Bill
The Bill comprises four Schedules:

• Schedule 1 contains amendments to the Corporations Act 2001 to create phoenixing offences and other rules about property transfers to defeat creditors. It also contains consequential amendments to:
  – the Aged Care (Accommodation Payment Security) Act 2006
  – the Banking Act 1959
  – the Corporations (Aboriginal and Torres Strait Islander) Act 2006 (CATSI Act)
  – the Insurance Act 1973
  – the Life Insurance Act 1995
• Schedule 2 amends the Corporations Act to improve the accountability of resigning directors
• Schedule 3 amends the A New Tax System (Goods and Services Tax) Act 1999 (GST Act) and the Taxation Administration Act 1953 (TAA) in relation to GST estimates and director penalties and
• Schedule 4 amends the TAA to provide for the Commissioner of Taxation to retain tax refunds.

Background

Insolvency
Phoenixing takes place in the context of insolvency which is explained in broad terms below.

A company is classified as being solvent if, and only if, it is able to pay all of its debts as, and when, they become due and payable. Otherwise the company is insolvent.2

2. Corporations Act, section 95A.
Directors’ duties and liabilities

The decision about whether a corporation is insolvent is one which is made by its directors. Directors have a number of duties which are relevant to this decision. Importantly they must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they were a director of a corporation in the corporation’s circumstances and had the same responsibilities within the corporation as the director. A director of a corporation who makes a ‘business judgment’ is taken to meet the duty of care and diligence in respect of the judgment if they:

- make the judgment in good faith for a proper purpose
- do not have a material personal interest in the subject matter of the judgment
- inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate and
- rationally believe that the judgment is in the best interests of the corporation.

Under section 588G of the Corporations Act a company director may be liable under the insolvent trading provisions if:

- they are a director of a company at the time when the company incurs a debt
- the company is insolvent at that time, or becomes insolvent by incurring that debt and
- at that time, there are reasonable grounds for suspecting that the company is insolvent, or would become insolvent.

Importantly the duty to prevent insolvent trading is a duty not to incur debts when a company is insolvent.

Appointment of a liquidator

Once a liquidator is appointed, enforcement by creditors, other than secured creditors, is stayed. The liquidator takes control of the company’s property, carries on its business so far as is necessary for its beneficial winding up, and pays creditors in accordance with specified statutory priorities. The Personal Property Securities Act 2009 (the PPSA) sets out the rules for the order in which secured creditors are paid in the event of insolvency or bankruptcy.

The liquidation of a company generally terminates the employment of employees. Employees are considered to be a special type of unsecured creditors. As such, they have the right, if there are funds left over after payment of the fees and expenses of the liquidator, to be paid their outstanding entitlements in priority to other unsecured creditors. Priority employee entitlements are grouped into classes and paid in the following order:

- outstanding wages, superannuation contributions and superannuation guarantee charge (SGC)
- outstanding leave of absence (including annual leave and sick leave, where applicable, and long service leave)

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3. Corporations Act, subsection 180(1).
5. Corporations Act, sections 471B and 471C.
7. Corporations Act, paragraph 556(1)(e); Australian Taxation Office (ATO), Superannuation and insolvency, ATO website.
8. Corporations Act, paragraph 556(1)(g).
- retrenchment pay\(^9\) (sometimes referred to as redundancy pay).

Each class is paid in full before the next class is paid. If there are insufficient funds to pay a class in full, the available funds are paid on a pro rata basis (and the next class or classes will be paid nothing).

**About Phoenixing**

In July 2012, the Fair Work Ombudsman (FWO) released a report prepared by PriceWaterhouseCoopers (PwC) on phoenix activity in Australia.\(^10\) The PwC report defines phoenix activity as:

... the deliberate and systematic liquidation of a corporate trading entity which occurs with the fraudulent or illegal intention to:

- avoid tax and other liabilities, such as employee entitlements
- continue the operation and profit taking of the business through another trading entity.\(^11\)

According to the Treasury:

In its most basic form fraudulent phoenix activity involves one corporate entity carrying on a business, accumulating debts without any intention of repaying those debts (for the purpose of wealth creation or to boost the cash flow of the business) and liquidating to avoid repayment of the debt. The business then continues in another corporate entity, controlled by the same person or group of individuals.

Fraudulent phoenix arrangements are, however, often more sophisticated. In the ATO’s experience, a typical fraudulent phoenix arrangement would be structured as follows:

- a closely held private group is set up, consisting of several entities one of which has the role of hiring the labour force for the business
- the labour hire entity will usually have a single director who is not the ultimate ‘controller’ of the group
- the labour hire entity has few, if any, assets and little share capital
- the labour hire entity fails to meet its liabilities and is placed into administration or liquidation by the ATO
- a new labour hire entity is set up and the labour moved across to work under this new entity and
- the process is repeated, with little disruption to the day-to-day operation of the overall business and the financial benefits from the unpaid liabilities are shared amongst the wider group.\(^12\)

Fraudulent phoenix activity involves the liquidation of a company in order to avoid debts with the full intention of continuing the business after the liquidation. Fraudulent phoenix activity also usually involves the intentional structuring of a company in a way that allows directors to avoid

\(^9\) *Corporations Act*, paragraph 556(1)(h).


\(^11\) Ibid., p. ii.

meeting their obligations to pay taxes, employee entitlements and debts owed to other businesses.13

It is important to note that phoenix activity may 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, 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.14

Examples of circumstances where phoenixing is legal are:

• a viable business is prematurely liquidated by an overly cautious controller who fears insolvent trading liability during a period of poor liquidity—nevertheless the fundamental business is sound or
• a business fails due to factors beyond its control (such as a tourist operator whose first company is forced into liquidation or voluntary administration by an airline strike).

About the phoenix taskforce

In response to concerns about the growing problem of phoenixing—particularly in the building and construction industry—the Phoenix Taskforce was formed in 2015. The Taskforce comprises 34 federal, state and territory government agencies, including the Australian Taxation Office (ATO), ASIC, the Department of Jobs and Small Business, and the FWO. The Phoenix Taskforce provides a whole-of-government approach to combatting illegal phoenix activity.15 Since its inception the Phoenix Taskforce has achieved the following results:

• along with ASIC, prosecuted 25 illegal phoenix operators
• ASIC took action against 12 registered liquidators and 79 company directors
• a reduction in newly-created entities linked to confirmed phoenix activity
• identified businesses potentially at risk of illegal phoenix activity and
• the Serious Financial Crime Taskforce is taking action in relation to seven criminal phoenix matters.16

Cost of phoenixing to the Australian economy

The July 2018 report entitled The Economic Impacts of Potential illegal Phoenix Activity estimates the annual costs of phoenix activity are:

• the cost to business from unpaid trade creditors is between $1,162 million to $3,171 million
• the cost to employees, lost through unpaid entitlements is between $31 million to $298 million
• the cost to government from unpaid taxes and compliance costs is around $1,660 million.

The report puts the annual total cost of illegal phoenix activity at between $2.85 billion and $5.13 billion.17

Consultation
In September 2017, the Turnbull Government announced its intention to introduce a comprehensive package of reforms both to deter and to penalise phoenix activity. The package would include:

... the introduction of a Director Identification Number (DIN) and a range of other measures to both deter and penalise phoenix activity.

The DIN will identify directors with a unique number, but it will be much more than just a number. The DIN will interface with other government agencies and databases to allow regulators to map the relationships between individuals and entities and individuals and other people.

In addition to the DIN, the Government will consult on implementing a range of other measures to deter and disrupt the core behaviours of phoenix operators, including non-directors such as facilitators and advisers.

Accordingly, Treasury circulated an exposure draft of the Bill for public comment. 37 submissions were subsequently received. A comparison of the exposure draft and the final form of the Bill reveals significant changes to clarify the amendments.

Committee consideration
Senate Economics Committee
The original Bill was referred to the Senate Standing Committees on Economics (Senate Economics Committee) for inquiry and report by 26 March 2019. The Senate Economics Committee recommended that the Bill be passed stating:

The committee understands that illegal phoenix activity is becoming increasingly sophisticated and difficult to detect and prosecute under existing legal frameworks. The committee believes the package of reforms contained in the Bill will give regulators additional enforcement and regulatory tools to better detect and disrupt illegal phoenix activity and to prosecute or penalise directors and others who engage in or facilitate this illegal activity. Though the committee cautions that the regulators’ ability to pursue and prosecute effectively is closely linked to the right amount of resourcing being made available to the regulator to effectively perform its work.

... the committee is concerned that, as drafted, the scope of a ‘creditor defeating disposition’ and the circumstances under which such transactions are voidable may not capture the entire range of dispositions that are not legitimate commercial transactions. Consequently, this may have an unintended consequence of limiting the ability of regulators and liquidators to fully combat some illegal phoenixing activities.

18. K O’Dwyer (Minister for Revenue and Financial Services), A comprehensive package of reforms to address illegal phoenixing, media release, 12 September 2017.
19. Ibid.
21. Ibid.
22. The terms of reference for the inquiry, submissions to the Senate Economics Committee and the Committee’s final report are available on the inquiry homepage.
**Senate Standing Committee for the Scrutiny of Bills**

The Senate Standing Committee for the Scrutiny of Bills (the Scrutiny of Bills Committee) considered the Bill and noted that it introduces new strict liability offences. However the Explanatory Memorandum to the Bill does not explain why the application of strict liability is necessary or appropriate in the circumstances. According, the Scrutiny of Bills Committee asked the Assistant Treasurer for a 'more detailed justification for the application of strict liability to an offence attracting a penalty of 120 penalty units'.

Assistant Minister for Superannuation, Financial Services and Financial Technology, Senator Hume responded to the Scrutiny of Bills Committee on 8 August 2019. Her comments are canvassed under the heading ‘Key issues and provisions’ below.

Whilst the Scrutiny of Bills Committee noted her explanation:

> … from a scrutiny perspective, the Committee remains concerned about the application of strict liability to an offence carrying a penalty of 120 penalty units. In this regard, the Committee reiterates that the Guide to Framing Commonwealth Offences states that the application of strict liability is only considered appropriate where the relevant offence is only punishable by up to 60 penalty units.

**Policy position of non-government parties**

The Australian Labor Party (Labor) members of the Senate Economics Committee, while not opposing the legislation, made additional comments in relation to the Bill expressing their concerns as follows:

> The primary concern is that the Government is focusing on new legislative amendments and offences when the primary focus should be on amending and enforcing existing legislation.

> The second concern is that this legislation does not seem to anticipate logical manoeuvrings from unscrupulous actors that could be reasonably expected if this legislation were to pass.

An example cited by the Labor members of a potential response to the legislation is where a business is structured so that debts accrue in an assetless company, and assets are held in another.

**Position of major interest groups**

The Senate Economics Committee which inquired into the original Bill received 21 submissions. Submitters generally supported the legislation—although some expressed concern that it did not go far enough.
Others expressed the view that, even though there is merit in a Bill to deter and disrupt illegal phoenix activity, more proactive policy and enforcement of existing law is needed.32

More detailed comments by the submitters to the Senate Economics Committee are canvassed below under the heading ‘Key issues and provisions’.

**Statement of Compatibility with Human Rights**

As required under Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* (Cth), the Government has assessed the Bill’s compatibility with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of that Act. The Government considers that the Bill is compatible.33

**Parliamentary Joint Committee on Human Rights**

The Parliamentary Joint Committee on Human Rights has determined that the Bill does not raise human rights concerns.34

**Key issues and provisions—Schedule 1**

<table>
<thead>
<tr>
<th>Quick guide to Schedule 1</th>
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<tbody>
<tr>
<td>The amendments in <strong>Part 1</strong> of Schedule 1 to the Bill:</td>
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<tr>
<td>• introduce new offences which prohibit <strong>creditor-defeating dispositions</strong> of company property</td>
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<td>• penalise those persons who either engage in or facilitate creditor-defeating dispositions and</td>
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<tr>
<td>• allow liquidators and ASIC to recover the relevant company property.</td>
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<tr>
<td>Importantly the Bill does not contain a formal definition of ‘phoenixing’.</td>
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<tr>
<td>The provisions in <strong>Part 2</strong> of Schedule 1 to the Bill amend various statutes to insert references to <strong>creditor-defeating dispositions</strong> or to relevant section numbers of the <em>Corporations Act</em>.</td>
</tr>
<tr>
<td>The amendments in <strong>Part 3</strong> of Schedule 1 to the Bill amend the <em>Corporations Act</em> to introduce the concept of <strong>linked</strong> dispositions.</td>
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**Financial implications**

According to the Explanatory Memorandum to the Bill the measures in Schedule 1 will have nil financial impact on the Commonwealth.35

33. The Statement of Compatibility with Human Rights can be found at pages 65–72 of the *Explanatory Memorandum* to the Bill.
Creditor-defeating dispositions

Part 5.7B in Chapter 5 of the Corporations Act is about recovering property or compensation for the benefit of the creditors of an insolvent company. Items 7–73 of Part 1 of Schedule 1 to the Bill amend Part 5.7B of the Corporations Act to insert the new phoenixing offences.

The amendments do not specifically define the term ‘phoenixing’. Rather, item 18 of Part 1 in Schedule 1 to the Bill inserts proposed section 588FDB into the Corporations Act to introduce the term creditor-defeating disposition in relation to company property.

**Meaning of property for the purpose of the Bill**

Section 9 of the Corporations Act defines property as any legal or equitable estate or interest (whether present or future and whether vested or contingent) in real or personal property of any description and includes a thing in action, and in Part 5.7B (which is relevant to this Bill) has a meaning affected by section 588C.

Section 588C of the Corporations Act provides that the property of a company includes Personal Property Securities Act 2009 (PPSA) retention of title property, if the security interest in the property is vested in the company because of the operation of any of the following provisions:

- section 267 or 267A of the PPSA (property subject to unperfected security interests) and
- section 588FL of the Corporations Act (collateral not registered within time).

Proposed subsection 588FDB(1) of the Corporations Act provides that a disposition of company property is a creditor-defeating disposition if both of the following conditions are satisfied:

- the consideration paid to the company for the relevant property was less than the lesser of:
  - the market value of the property or
  - the best price that was reasonably obtainable for the property, having regard to the circumstances existing at that time and
- the disposition has the effect of preventing the property from becoming available for the benefit of the company’s creditors in the winding-up of the company; or hindering, or significantly delaying that process.

The test is applied at the time that the relevant agreement for the disposition was made or, if there was no such agreement, at the time of the disposition. Importantly, there is no requirement for intention. The test for whether there has been a creditor-defeating disposition is an effects test.

Proposed subsections 588FDB(2) and 588FDB(3) of the Corporations Act respectively extend the concept of disposition to:

- the conduct of a company that results in another person becoming the owner of property that did not previously exist and
- the conduct of a company which makes a disposition of property to another person who then gives some or all of the consideration for the disposition to a third party other than the

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36. A ‘thing in action’ is often referred to as a ‘chose in action’. It is an intangible personal property right which is incapable of physical possession and can only be claimed or enforced by a legal or equitable action—for example, a right to enforce and receive payment for a debt, obtain money by way of damages for breach of contract, or receive recompense for a wrong. **Source:** Butterworths concise Australian legal dictionary, 3rd edn, LexisNexis Butterworths, Australia, 2004, p. 69.

37. Corporations Act, section 9 defines the term relevant agreement as an agreement, arrangement or understanding: (a) whether formal or informal or partly formal and partly informal; and (b) whether written or oral or partly written and partly oral; and (c) whether or not having legal or equitable force and whether or not based on legal or equitable rights.
company—so that the amount of the disposition is equal to the consideration that was given to the third party.

**Key issue—best price reasonably obtainable**

Professor of Corporate Law at the Sydney Law School, Jason Harris, opines:

> The reforms have the potential to stifle good faith restructuring as companies will often transfer assets from an insolvent company (Oldco) to a new company (Newco) as part of a debt for equity swap. In such a case it could be said that the transfer would prevent the property being available for creditors in Oldco's liquidation. Of course, if market consideration is paid in the debt for equity swap then this would not be a creditor-defeating disposition, but the proposed laws would open up new grounds for fights over valuations and questions over the process followed to obtain the valuation or at least the “best price that was reasonably obtainable”. 38

**Presumption of creditor-defeating disposition**

Requirements to keep and retain financial records are set out in subsections 286(1) and (2) of the Corporations Act. The subsections operate so that a company which fails to comply with these requirements is presumed to be insolvent.39

**Item 9** of Schedule 1 to the Bill inserts **proposed subsection 588E(4A)** into the Corporations Act to create a presumption that the consideration paid for a disposition is less than both the market value of the property and the best price reasonably obtainable for the property (that is—the first condition of a creditor-defeating disposition is satisfied), if it is proved that the company failed to keep financial records relating to the disposition or failed to retain financial records about the disposition for seven years after it occurred.

The presumption created by **proposed subsection 588E(4A)** is subject to an exception. **Item 11** of Schedule 1 to the Bill amends existing subsection 588E(6) of the Corporations Act to negate the presumption if it would prejudice a right or interest of a person where the company is presumed insolvent because of a contravention of subsection 286(2). The exception will operate where it is proved that:

- the contravention was due solely to someone destroying, concealing or removing financial records of the company
- none of those financial records was destroyed, concealed or removed by the first-mentioned person and
- the person was not in any way, by act or omission, directly or indirectly, knowingly or recklessly, concerned in, or party to, destroying, concealing or removing any of those financial records.


**Voidable transactions**

**Meaning of relation-back day for the purpose of the Bill**

Section 588FE of the *Corporations Act* permits the liquidator of an insolvent company to avoid various antecedent transactions—provided that they occurred within certain time frames. For instance, insolvent transactions and unfair loans entered into during specified periods prior to the *relation-back day* are voidable transactions. Section 91 of the *Corporations Act* sets out in table form the point at which a relation-back day arises. Generally speaking the relation-back day is the date of the application for winding up the company. An ‘unfair preference’\(^{40}\) is voidable if it is entered into during or after the six months ending on the relation-back day.\(^{41}\) An uncommercial transaction is voidable if it was entered into during the two years ending on the relation-back day.\(^{42}\)

**Item 20** of Part 1 in Schedule 1 to the Bill inserts *proposed subsection 588FE(6B)* which sets out the additional set of circumstances which must be satisfied for a transaction to be **voidable**.

**First** the transaction is a **creditor-defeating disposition** of property.\(^{43}\)

**Second**, at least one of the following applies:

- the transaction was entered into **when the company was insolvent**, during the 12 months ending on the relation-back day, or both after that day and on or before the day when the winding up began

- the company **became insolvent** because of the transaction or an act done to give effect to the transaction during the 12 months ending on the relation-back day, or both after that day and on or before the day when the winding up began

- **less than 12 months after the transaction**, the start of an external administration of the company occurs as a direct or indirect result of the transaction.\(^{44}\)

**Third**, the transaction was not done under a compromise or arrangement approved by a Court,\(^{45}\) under a deed of company arrangement\(^ {46}\) or by an administrator,\(^ {47}\) liquidator or a provisional liquidator\(^ {48}\) of the company.\(^ {49}\)

According to the Explanatory Memorandum to the Bill:

Placing a company into administration shortly after it makes a voidable transaction is a common illegal phoenix activity. A persistent issue in the practical operation of the corporate insolvency law is the cost and uncertainty associated with establishing that a company was insolvent at a particular time. This cost

\(^{40}\) An ‘unfair preference’ is a payment or transfer of property made by a company, when insolvency is imminent, to a particular creditor where the creditor receives more for an unsecured debt than would have been received if the creditor had had to prove for it in the winding up. *Source: Butterworths Concise Australian Legal Dictionary, 3rd ed., LexisNexis Butterworths, Australia, 2004, p. 439.*

\(^{41}\) *Corporations Act*, subsection 588FE(2).

\(^{42}\) *Corporations Act*, subsection 588FE(3).

\(^{43}\) *Corporations Act*, proposed paragraph 588FE(6B)(a).

\(^{44}\) *Corporations Act*, proposed paragraph 588FE(6B)(b).

\(^{45}\) *Corporations Act*, section 411.

\(^{46}\) *Corporations Act*, Part 5.3A, Division 10 sets out the effects of a deed of company arrangement.

\(^{47}\) *Corporations Act*, section 436A provides that a company may appoint an administrator if the board thinks it is or will become insolvent and section 437A sets out the role of an administrator.

\(^{48}\) *Corporations Act*, Part 5.6, Division 3 sets out the responsibilities of a liquidator.

\(^{49}\) *Corporations Act*, proposed paragraph 588FE(6B)(c).
can make it impractical for liquidators to pursue many recovery actions, frustrating the intention of the law.

Together with the presumption of insolvency where financial records are not maintained, this amendment is intended to significantly ease the burden on liquidators pursuing illegal phoenix activity and recovering assets for the benefit of company creditors. 50

**Court orders**

**Current law**

Currently section 588FF of the *Corporations Act* allows a court to make orders about voidable transactions on the application of a liquidator. However, the court is prevented from making an order in relation to a voidable transaction in a range of circumstances including where:

- the order is prejudicial to the rights of a person who is not a party to the transaction and who has acquired the property in good faith without notice of the company’s insolvency: existing subsection 588FG(1) or
- the order is prejudicial to the rights of a party to the transaction who became a party to the transaction in good faith and is a purchaser for value, without notice of company’s insolvency: existing subsection 588FG(2).

The Explanatory Memorandum to the Bill sets out the nature of the ‘good faith’ test:

> A general good faith test applies to subsequent purchasers of property that was the subject of a creditor-defeating disposition (regardless of whether the initial company was insolvent at the time). Where an initial creditor-defeating disposition is voidable, a subsequent purchaser’s title to property is protected provided the subsequent purchaser acquired the property in good faith. The subsequent purchaser’s claim to the property will be voidable if that person acted in bad faith, for example because they knew the initial transfer was voidable or were wilfully blind to the likelihood that the initial transfer was voidable. 51

**What the Bill does**

*Item 24* of Schedule 1 to the Bill inserts proposed subsections 588FG(7)–(9) into the *Corporations Act*. The provisions will apply to those voidable transactions which are the result of a creditor-defeating disposition as follows:

- subsections 588FG(1) and (2) do not apply to an order based solely on the transaction being a creditor-defeating disposition because the disposition caused the company to enter external administration: *proposed subsection 588FG(7)*
- the court may not make an order in relation to a creditor-defeating disposition where the disposition was based on a course of action which was reasonably likely to lead to a better outcome for the company—that is, based on the safe harbour provisions in paragraphs 588GA(1)(a) and (b) (see the discussion about the safe harbour provisions below): *proposed subsection 588FG(8)* and
- the court may not make an order in relation to a creditor-defeating disposition where the disposition was made to a third party who acquired the property in good faith: *proposed subsection 588FG(9).*

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**ASIC orders**

The Bill gives ASIC a suite of new powers. According to the Explanatory Memorandum to the Bill:

> The amendments ensure ASIC has power to take effective action against illegal phoenix activity and protect the interests of legitimate creditors. This will:

- overcome difficulties faced by liquidators where the company has insufficient funds to cover the cost of court action; and
- allow ASIC to intervene where a liquidator is not fulfilling its obligations to recover company property, for example because the liquidator is complicit in the illegal phoenix activity of a company director.  

**Pre-conditions for making an order**

Item 25 of Schedule 1 to the Bill inserts proposed Subdivision D—ASIC orders about certain voidable transactions. Within new Subdivision D of Part 5.7B, proposed section 588FGAA of the *Corporations Act* applies only if three pre-conditions are satisfied:

- a company for which a liquidator has been appointed has made a **creditor-defeating disposition** of property
- the disposition is voidable because of subsection 588FE(6B) and
- a person has received money or property as a direct or indirect result of the disposition or the person’s acquisition of the property after the disposition.

In that case a liquidator may request ASIC to make an order—provided that the request is made during the period beginning on the **relation-back day** and ending on the later of either three years after that day or 12 months after the first appointment of a liquidator to the company.

**Nature of the orders**

ASIC may make orders either in response to a request by a liquidator (as above) or on its own initiative. These are administrative orders. They may:

- direct a person to transfer to the company property that was the subject of the disposition
- require a person to pay to the company an amount that, in ASIC’s opinion, fairly represents some, or all, of the benefits that the person has received (directly or indirectly) because of the disposition
- require the person to transfer to the company property that, in ASIC’s opinion, fairly represents the application of proceeds of property that was the subject of the disposition.

However, the power for ASIC to make an order is limited so that ASIC must not make such an order if it has reason to believe that, if it were a court, section 588FG would prevent it from making a corresponding order under section 588FF. (See the information under the heading ‘Court orders’, above).

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52. Ibid., p. 23.
55. *Corporations Act*, proposed paragraph 588FGAB(3)(b).
An order must include written reasons for the making of the order.\(^{58}\) At any time, ASIC may, in writing given to the person, revoke or amend the order.\(^{59}\) In deciding whether to make an order, ASIC must take into account:

- the conduct of the company and its officers
- the conduct of the person who received the money or property
- the circumstances, nature and terms of the disposition
- the relationship (if any) between the company and the person and
- any other matter ASIC considers relevant.\(^{60}\)

A court may, upon application from a person who has been given an order by ASIC, or any other person interested in such an order, set aside the order if the court is satisfied that the three pre-conditions for the making of the order (as set out above) are not met.\(^{61}\)

**Key issue—breadth of the power**

Whilst the Law Council of Australia (LCA) supports the Government’s proposal to make liquidator recoveries for creditors easier, it does not support the proposed power for ASIC on the grounds that ‘it raises multiple rule of law concerns by being too broad and arguably seeks to confer judicial power of the Commonwealth on ASIC’.\(^{62}\) The LCA explains its concerns as follows:

> The proposed new section 588FGAA confers a broad discretion on ASIC as to whether to issue a notice (subsection 588FGAA(5)), and specifically limits ASIC’s discretion if it believes that the court would not make an order ...

> These are powers that are far beyond the powers conferred on the Official Receiver under the equivalent Bankruptcy Act provision. Furthermore, the Court may only overturn the notice if it determines that section 588FGAA does not apply (subsection 588FGAE(3)). In the Committee’s view, these elements not only make the proposed new power inappropriate as being too broad, but render it open to a constitutional challenge for improperly conferring judicial power on ASIC.\(^{63}\) (emphasis added)

Professor Harris also raised concern about the new power:

> Directing ASIC to place itself in the position of a court is objectionable on policy grounds as well as on constitutional grounds. ASIC should not be assuming the role of the court, nor should it be punishing persons for receiving property subject to a voidable transaction, particularly where no court determination has yet been made. The order is made based purely on "ASIC believing that the disposition is voidable".\(^{64}\) (emphasis added)

The Australian Institute of Company Directors (AICD) noted that ‘the nature of the power is very significant as it enables ASIC to compel the transfer of property to the company under its own

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58. *Corporations Act*, proposed subsection 588FGAB(1).
60. *Corporations Act*, proposed subsection 588FGAA(5).
61. *Corporations Act*, proposed section 588FGAE.
63. Ibid., p. 2.
64. Harris, ‘*Will combating phoenix activity stifle genuine restructuring activity?*’, op. cit., p. 49.
initiative’. Accordingly, the AICD recommends that ‘ASIC be required to seek a Court order to unwind the effect of a voidable’ creditor-defeating disposition. 65

The concerns raised by the LCA and Professor Harris are that the Bill would confer judicial power of the Commonwealth on ASIC in violation of section 71 of the Constitution. Given that phoenixing often involves substantial sums of money, if this is correct – or even arguable – it may be that the Bill, as drafted, will invite a constitutional challenge by a person or entity subject to such an order from ASIC. If this were to occur, such litigation may result in a degree of uncertainty regarding the operation of the ASIC order regime until such litigation was resolved.

Criminal offences and pecuniary penalties in the Corporations Act
Subsection 1311(1) of the Corporations Act, states that a person who does an act or thing that the person is forbidden to do under a provision of the Act or does not do an act or thing that the person is required or directed to do by a provision of the Act is guilty of an offence. An offence is punishable by the criminal sanctions of imprisonment or fine (pecuniary penalty).

Where the Criminal Code fits in
The Criminal Code Act 1995 contains the Criminal Code (the Code). Chapter 2 of the Code entitled ‘General Principles of Criminal Responsibility’ contains a comprehensive statement of principles of criminal responsibility for Commonwealth offences. Section 1308A of the Corporations Act provides that, subject to that Act, Chapter 2 of the Code applies to all Corporations Act offences. Chapter 2 of the Code provides that offences have physical elements, for example, doing or not doing an action, and fault elements, such as intention, knowledge, recklessness or negligence. Under the Code if the legislation creating an offence does not specify a fault element for a physical element consisting of conduct, the automatic fault element is intention. 66

The standard of proof for a criminal offence is ‘beyond reasonable doubt’. 67
The maximum penalty for each offence is set out in Schedule 3 to the Corporations Act, which details in table form pecuniary penalties and/or terms of imprisonment for contraventions of specified provisions.
Section 1311C of the Corporations Act sets out the method of calculating the fine payable where a body corporate (rather than a person) is convicted of an offence.
Section 1314 provides that offences under the Corporations Act are continuing offences. 68 This means that a person is guilty of a separate offence for each day of non-compliance, where an act or thing must be done within a particular period or before a particular time, and failure to comply is an offence.

65. Australian Institute of Company Directors, Submission to the Senate Economics Legislation Committee, op. cit., p. 3.
66. Criminal Code, subsection 5.6(1).
68. Under subsection 4K(2) of the Crimes Act 1914, a person is guilty of a separate offence for each day of non-compliance, where an act or thing must be done within a particular period or before a particular time, and failure to comply is an offence. This is referred to as a continuing offence. Continuing offences provide a strong incentive for compliance with a continuing obligation following an initial contravention.
Civil penalty provisions in the Corporations Act

In addition to criminal offences, the Corporations Act contains civil penalty provisions. A civil penalty is generally assessed by reference to the seriousness of the contravention rather than by reference to the quantum of loss or profits flowing from the contravention. In civil penalty proceedings the court may relieve a person either wholly, or partly, from a liability if the person has acted honestly and having regard to all the circumstances of the case.\(^{69}\)

A civil penalty is an amount owing to the Commonwealth and payable to ASIC on the Commonwealth’s behalf. It is treated as a civil judgment debt.\(^{70}\) The debt becomes payable as a result of proceedings brought by ASIC in a civil court.

Civil penalties provide an additional or alternative enforcement option, especially where there may be difficulty in proving the necessary fault element to establish a criminal offence.

Offence—failing to comply with orders

Proposed section 588FGAC of the Corporations Act provides that it is a criminal offence to engage in conduct which contravenes an order by ASIC (as set out above). In the absence of any specific fault element, the automatic fault element is intention. This means that a person who negligently breaches an ASIC order will not be liable for a criminal offence under the Bill. Item 101 of Part 3 in Schedule 1 to the Bill sets the maximum pecuniary penalty for the offence at 60 penalty units for an individual.\(^{71}\)

Where ASIC makes an order requiring a person to pay to a company an amount that represents all or part of the benefits that the person has received as a result of the disposition:

- the amount payable under the order is recoverable as a debt in a court of competent jurisdiction\(^ {72}\) and
- the order may be complied with by transferring the property to the company.\(^ {73}\)

Where a court convicts a person of failing to comply with an order, the court may order the person to pay the company an amount not exceeding the amount involved in the contravention.\(^ {74}\) This amount is in addition to the pecuniary penalty imposed for the offence.

Duty to prevent creditor-defeating dispositions

Current duties

Currently Division 3 of Part 5.7B of the Corporations Act sets out a director’s duties to prevent insolvent trading. In particular, section 588G applies where:

- a person is a director of a company at the time when the company incurs a debt
- the company is insolvent at that time, or becomes insolvent by incurring that debt and
- at that time, there are reasonable grounds for suspecting that the company is insolvent, or would become insolvent.

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69. Corporations Act, section 1317S.
70. Corporations Act, subsection 1317GAA(2).
71. Under section 4AA of the Crimes Act 1914 a penalty unit is equivalent to $210 so the penalty is $12,600.
72. Corporations Act, proposed subsection 588FGAD(1).
73. Corporations Act, proposed subsection 588FGAD(3).
74. Corporations Act, proposed subsection 588FGAD(2).
In that case, the person commits an offence if:

- when the company incurred the debt the person is a director of the company
- the company is insolvent at that time, or became insolvent by incurring the debt
- the person suspected at that time that the company was insolvent or would become insolvent as a result of incurring the debt and
- the person’s failure to prevent the company incurring the debt was dishonest.  

A person who fails to prevent the company from incurring the debt (but not dishonestly) contravenes subsection 588G(2) of the *Corporations Act* if:

- the person is aware at that time that there are such grounds for suspecting that the company is insolvent, or would become insolvent or
- a reasonable person in a like position in a company in the company’s circumstances would be so aware.

This is a civil penalty provision. The maximum penalty payable by an individual is the greater of:

- 5,000 penalty units ($1,050,000) and
- if the Court can determine the benefit derived and detriment avoided because of the contravention—that amount multiplied by three.

The maximum penalty payable by a body corporate is the greatest of:

- 50,000 penalty units ($10.5 million) or
- if the Court can determine the benefit derived and detriment avoided because of the contravention—that amount multiplied by three and
- either:
  - 10 per cent of the annual turnover of the body corporate for the 12-month period ending at the end of the month in which the body corporate contravened, or began to contravene, the civil penalty provision or
  - if that amount is greater than an amount equal to 2.5 million penalty units—2.5 million penalty units ($525 million).

**What the Bill does**

The Bill expands the director’s duties to include a duty to prevent creditor-defeating dispositions. To that end, **proposed Subdivision B—Duties to prevent creditor-defeating dispositions** is inserted into Division 3 of Part 5.7B of the *Corporations Act* by *item 33* of Part 1 in Schedule 1 to the Bill.

The duty is directed towards an officer of a corporation.

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75. *Corporations Act*, subsection 588G(3).
76. *Corporations Act*, section 1317E.
77. *Corporations Act*, subsection 1317G(3).
Who is an officer of a corporation?

- a director or secretary of the corporation
- a person:
  - who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation
  - who has the capacity to affect significantly the corporation’s financial standing or
  - in accordance with whose instructions or wishes the directors of the corporation are accustomed to act (excluding advice given by the person in the proper performance of functions attaching to the person’s professional capacity or their business relationship with the directors or the corporation)
- a receiver, or receiver and manager, of the property of the corporation
- an administrator of the corporation
- an administrator of a deed of company arrangement executed by the corporation
- a liquidator of the corporation or
- a trustee or other person administering a compromise or arrangement made between the corporation and someone else.  

Criminal offence of an officer

Within new Subdivision B, proposed subsection 588GAB(1) prohibits an officer of a company from engaging in conduct that results in the company making a creditor-defeating disposition of property of the company, if:

- the company is insolvent
- the company becomes insolvent because of the disposition or a number of dispositions made at the time of the disposition or
- the company enters external administration, or ceases to carry on business altogether, less than 12 months after the disposition as a direct or indirect result of the disposition.

Criminal offence of a person

Illegal phoenix activity may occur as a result of advice from a solicitor, barrister, accountant, insolvency practitioner or business advisory/turnaround specialist. Where an old company is placed in liquidation, the liquidator takes on the same duties as a director of the company and this operates as a disincentive for any improper conduct. However, problems arise where lawyers and accountants who formulate, advocate and even carry out a fraudulent phoenix scheme are likely to escape being characterised as an officer of the corporation.

The Bill inserts proposed subsection 588GAC(1) into the Corporations Act to address this issue. It prohibits a person from engaging in the conduct of procuring, inciting, inducing or encouraging the making by a company of a disposition of property in equivalent circumstances to proposed subsection 588GAB(1), where the disposition is a creditor-defeating disposition. This ensures that such persons providing advice that facilitates illegal phoenixing are captured.

80. Corporations Act, section 477.
A failure to comply with either of those provisions is a criminal offence. **Item 102** of Part 3 in Schedule 1 to the Bill sets the maximum penalty for the offences at 10 years imprisonment.

**Civil penalties**

**Proposed subsections 588GAB(2) and 588GAC(2)** of the *Corporations Act* establish civil penalty provisions in equivalent terms to the criminal offence if, in addition, the officer or the person (as the case may be) knows, or a reasonable person in that position would know, that the disposition is a creditor-defeating disposition.  

Exceptions to the application of the offences and civil penalty provisions may apply.  

**Expanding the safe harbour**

As stated above, section 588GA of the *Corporations Act* sets out the safe harbour provisions. The rationale for these provisions is:

The threat of Australia’s insolvent trading laws, combined with uncertainty over the precise moment a company becomes insolvent have long been criticised as driving directors to seek voluntary administration even in circumstances where the company may be viable in the longer term. Concerns over inadvertent breaches of insolvent trading laws are frequently cited as a reason that early stage (angel) investors and professional directors are reluctant to become involved in a start-up.

The provisions create a safe harbour for company directors from personal liability for insolvent trading if the company is undertaking a restructure outside formal insolvency. This will drive cultural change amongst company directors by encouraging them to keep control of their company, engage early with possible insolvency and take reasonable risks to facilitate the company’s recovery instead of simply placing the company prematurely into voluntary administration or liquidation.

**Items 34–41** of Part 1 in Schedule 1 to the Bill amend section 588GA of the *Corporations Act* to extend the operation of the safe harbour so it applies to dispositions of property as well as to a company incurring a debt, where the company is undertaking a restructure that is reasonably likely to lead to a ‘better outcome’ for the company than entering a formal insolvency process.

**Extending the defences**

**Existing defences**

Currently section 588H of the *Corporations Act* provides three defences for a person who fails to prevent a company from incurring a debt and thereby contravenes subsection 588G(2).

The **first defence** arises if it is proved that at the time when the debt was incurred, the person had reasonable grounds to expect, and did expect, that the company was solvent and would remain solvent even if it incurred the debt.

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82. **Item 100** of Part 3 in Schedule 1 to the Bill amends section 1317E of the *Corporations Act* to provide that **proposed subsections 588GAB(2) and 588GAC(2)** are civil penalty provisions.

83. *Corporations Act*, **proposed subsections 588GAB(3) and 588GAC(3)** provide that exceptions apply where the transaction was done under a compromise or arrangement approved by a Court, under a deed of company arrangement or by a liquidator or a provisional liquidator of the company.

84. The safe harbour provisions were inserted into the *Corporations Act* by the **Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act 2017**.


86. **Corporations Act**, subsections 588H(2) and (3).
The second defence arises for the director of a company where, because of illness or for some other good reason, he or she did not take part in the management of the company at the time the relevant debt was incurred.87

The third defence arises where the person took all reasonable steps to prevent the company from incurring the debt.88 The matters to be taken into account in deciding whether the person took reasonable steps include any action the person took with a view to appointing an administrator of the company; when that action was taken; and the results of that action.89

What the Bill does

Item 45 of Part 1 in Schedule 1 to the Bill repeals and replaces subsection 588H(1) of the Corporations Act so that the defences not only apply to civil penalty proceedings for a contravention of subsection 588G(2) but also to civil penalty proceedings under proposed subsections 588GAB(2) and 588GAC(2).

To facilitate the expanded application of the defences proposed subsection 588H(1) introduces the concept of the key time. For the purposes of the amendments in this Bill, the key time is the time of the disposition of a company’s property.

Items 46–49 and items 51–54 amend section 588H to apply each of the defences to a disposition of property. The only exception is set out in item 50 of Part 1 in Schedule 1 to the Bill which inserts proposed subsection 588H(3A) into the Corporations Act. It operates so that the reasonable grounds defence (the first defence mentioned above) will not be available in relation to a disposition of the company’s property if the key time was less than 12 months before either:

• the start of an external administration that was brought about by the disposition or
• the company ceased to carry on business as a result of the disposition.

Liability to compensate the company

Current rules

Subsection 588J(1) of the Corporations Act provides that where, on an application for a civil penalty order against a person in relation to a contravention of subsection 588G(2)—that is a breach of the directors’ duty to prevent incurring a debt leading to insolvency—the Court is satisfied that:

• the person committed the contravention in relation to the incurring of a debt by a company
• the debt is wholly or partly unsecured and
• the person to whom the debt is owed has suffered loss or damage in relation to the debt because of the company’s insolvency

then the Court may order the first-mentioned person to pay to the company compensation equal to the amount of that loss or damage.

88. Corporations Act, subsection 588H(5).
89. Corporations Act, subsection 588H(6).
What the Bill does

**Items 55–57** of Part 1 in Schedule 1 to the Bill amend section 588J of the *Corporations Act* so that the liability to compensate the company is expanded to include circumstances where there have been proven contraventions of proposed subsections 588GAB(2) and 588GAC(2) relating to a disposition of property of a company.

**Items 58 and 59** of Part 1 in Schedule 1 to the Bill amend section 588K of the *Corporations Act* so that compensation may be awarded in the same proceedings that determined the offence or civil penalty. This means that a person may also be ordered to pay compensation when found guilty of an offence under proposed subsections 588GAB(1) or 588GAC(1).

Compensation may also be sought against a person who has contravened proposed sections 588GAB or 588GAC but has not been convicted or been subject to a civil penalty order. In that case a creditor may sue to recover the compensation with the written consent of the company’s liquidator.

**Items 97–99** in Part 3 of Schedule 1 to the Bill ensure that creditors cannot obtain compensation to the extent that compensation is obtained under the provisions of the *Corporations Act* in Part 5.8A that deal with employee entitlements.

Key issues and provisions—Schedule 2

**Quick guide to Schedule 2**

The amendments to the *Corporations Act* in Schedule 2 to the Bill are intended to ensure that directors:

- cannot backdate resignations or
- cease to be a director if this would leave the company with no directors.

**Financial implications**

According to the Explanatory Memorandum, the measure in Schedule 2 to the Bill will have nil financial impact on the Commonwealth.

**Resignation of directors**

Part 2D.3 of the *Corporations Act* deals with the appointment, remuneration and cessation of appointment of directors. Within Part 2D.3, section 203A states that a director of a company may resign as a director by giving a written notice of resignation to the company at its registered office.

**Item 2** in Schedule 2 to the Bill inserts proposed sections 203AA and 203AB into the *Corporations Act*.

**Proposed section 203AA** of the *Corporations Act* sets out the day that the resignation of a director takes effect. The general rule, in proposed subsection 203AA(1) is that a person’s resignation as a director of a company takes effect:

- on the day the person stopped being a director—provided that ASIC is notified in the prescribed manner and form within 28 days after the day the person stopped being a director

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90. *Corporations Act*, proposed subsection 588M(1A) inserted by item 60 of Part 1 in Schedule 1 to the Bill.
91. *Corporations Act*, proposed subsection 588R(1A) inserted by item 65 of Part 1 in Schedule 1 to the Bill.
otherwise—on the day that written notice of the resignation is lodged with ASIC.

There is an exception to this general rule. The person may apply to either ASIC or the Court for it to fix the resignation day. In either case, the person must satisfy either ASIC or the Court that he, or she, stopped being a director of the company on the resignation day.93

The Explanatory Memorandum to the Bill provides the rationale for these changes:

Company directors engaging in illegal phoenix activity have opportunities to exploit deficiencies in these laws to obscure their role in company decisions and to shift accountability to other directors. In egregious cases, a phoenix operator may seek to shift accountability to a ‘straw director’ who has no real involvement in the company, may have little or no knowledge of their appointment and is often of limited financial means, frustrating recovery and enforcement efforts. ‘Straw directors’ may also be deceased persons or entirely fictitious.94

However the Governance Institute of Australia expressed concern that the amendments might ’give rise to unintended consequences’ providing the example of the sale of a company with a settlement date of 30 June:

After settlement, control of the company transfers to the new owners. The outgoing company secretary or solicitor would be responsible for undertaking certain administrative tasks arising from the transfer, including notification of resignation of the outgoing directors, effective as at 30 June.

If for some unforeseen circumstance (such as human error, illness etc), the notification of resignation is lodged more than 28 days after the effective date, (say on 1 August) under the current law, the late lodgement will attract a late fee and the effective date of the outgoing director’s resignation will then be recorded in the ASIC register as 30 June, which reflects the reality of the transaction.

Under the new provisions, the late lodgement will result in the effective date of the outgoing directors’ resignations being recorded as 1 August. This does not accurately reflect the reality of the transaction or who controls the company at the record date and will result in the outgoing directors being liable for the acts of the company’s new directors until their effective resignation date.95

However, it would appear that such circumstances would potentially be captured by the exception provided by proposed subsection 203AA(2), as that allows ASIC or the Court to fix the resignation date when the relevant notification date is otherwise missed. This is discussed below.

Application to ASIC

Where the person makes an application to ASIC:

• the application must be lodged, in the prescribed form, with ASIC within 56 days of the day the person stopped being a director of the company96
• ASIC must not fix the resignation day unless it has considered any conduct, act, omission or representation of the applicant relevant to notifying ASIC of the resignation and the reasons for any delay.97

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93. Corporations Act, proposed subsection 203AA(2).
96. Corporations Act, proposed paragraph 203AA(5)(a).
Application to the Court

Where the person makes an application to the Court:

- the application must be lodged with the Court within 12 months after the day the person stopped being a director or such later time as the Court allows\(^\text{98}\)
- the Court must not fix the resignation day as the day the person’s resignation takes effect unless it is satisfied that it is just and equitable to do so\(^\text{99}\)
- if the Court fixes the resignation day as the day the person’s resignation takes effect, the applicant must, within two business days, lodge with ASIC a copy of the order made by the Court that fixes the day. A failure to do so gives rise to an offence of strict liability.\(^\text{100}\) The maximum penalty for the offence is 120 penalty units.\(^\text{101}\)

Scrutiny of Bills Committee comments

As stated above, the Scrutiny of Bills Committee questioned the penalty for the offence. The response from the Assistant Minister for Superannuation, Financial Services and Financial Technology, Senator Hume, states:

Proposed section 203AA ensures directors are held accountable for misconduct by preventing company directors from improperly backdating resignations. If the resignation of a director is reported to ASIC more than 28 days after the purported resignation, the resignation takes effect from the day it is reported to ASIC. However, a company or a director may apply to ASIC, or the Court, to give effect to the resignation notwithstanding the delay in reporting the change to ASIC. If the Court makes an order to backdate the effective date of a director’s resignation, proposed subsection 203AA(6) provides that the applicant must provide a copy of the order to ASIC within two business days.

The obligation to inform ASIC of a Court order is necessary to ensure the company register maintained by ASIC is accurate. A failure by an applicant to inform ASIC of an order fixing a director’s date of resignation would cause the company register to be inaccurate and the register could not then be relied on by consumers and other members of the community dealing with the relevant company or director.

An offence of strict liability is necessary to ensure compliance with this simple but important obligation ... While the amendments depart from the Guide [to Framing Commonwealth Offences], the fine imposed is justified by the important nature of the obligation, the significant consequences on the community of non-compliance and the need for a strong and appropriate deterrent.\(^\text{102}\)

Abandoning the company

Proposed section 203AB of the Corporations Act operates so that the resignation of a director has no effect if it would leave the company without at least one director. Importantly though this will not prevent the resignation of a director from taking effect on or after the day that the winding up of the company has begun.

Similarly, a resolution by members of a proprietary company is void if the resolution would have the effect that the company does not have at least one director. However, the resolution will not

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\(^{98}\) Corporations Act, proposed paragraph 203AA(5)(b).

\(^{99}\) Corporations Act, proposed subsection 203AA(3).

\(^{100}\) The imposition of strict liability means that a fault element does not need to be satisfied, but the offence will not criminalise honest errors and a person cannot be held liable if he, or she, had an honest and reasonable belief that they were complying with relevant obligations.

\(^{101}\) Item 5 in Schedule 2 to the Bill amends the table in Schedule 3 of the Corporations Act.

\(^{102}\) Senate Standing Committee for the Scrutiny of Bills, Scrutiny Digest, 5, op. cit., pp. 77–78.
be void provided that it is to take effect in or after the day that the winding up of the company has begun.  

Stakeholder comments

The AICD acknowledged the challenges ‘relating to abandonment of companies by directors engaged in illegal phoenix activity’. However, it expressed concern:

... this change could perversely incentivise directors of troubled companies to resign early to ensure that they do not become the sole director on the board, and therefore be precluded from resigning. This could drain a company of directors at a time when they are most needed to guide the company through difficult circumstances ...

the AICD considers the best option to address the issue of abandonment is stronger enforcement action against directors who abandon companies through use of existing laws, and particularly the directors’ duties provisions of the Corporations Act.

According to the submission by Professor Helen Anderson of the Melbourne School of Law:

The two issues here are volume and enforcement. Our research indicated that there were about 37,600 companies deregistered by ASIC each year for failure to return forms and pay fees. This is nearly five times the amount of companies liquidated. The point of the government’s suggestion is that by deeming the resignation to be ineffective, the director remains accountable as a director. However, this does nothing to ensuring that the affairs of those abandoned, deregistered companies are investigated ... or that action will be brought against those directors.

Key issues and provisions—Schedule 3

Quick guide to Schedule 3

The amendments in Schedule 3 to the Bill:

- allow the Commissioner of Taxation to collect estimates of anticipated GST liabilities and
- make company directors personally liable for their company’s GST liabilities in certain circumstances.

Financial implications

According to the Explanatory Memorandum, as at the 2018–19 Budget the measure is estimated to make the following saving to budget over the forward estimates:

- financial year 2018–19: nil
- financial year 2019–20: $5 million
- financial year 2020–21: $15 million

103. Corporations Act, proposed subsection 203CA inserted by item 3 of Schedule 2 to the Bill.
104. Australian Institute of Company Directors, Submission to the Senate Economics Legislation Committee, op. cit., p. 5.
105. Ibid.
Commissioner to estimate liabilities

As noted previously, fraudulent phoenix activity often involves the intentional structuring of a company in a way that allows directors to avoid meeting their obligations to pay taxes, employee entitlements and debts owed to other businesses.\(^\text{108}\) The amendments in Schedule 3 of the Bill are aimed at such conduct with respect to GST liabilities.

Current law

Currently, Division 268 in Schedule 1 of the TAA empowers the Commissioner to make estimates of an entity’s liability in relation to pay as you go (PAYG) withholding under Part 2-5 of the TAA or any unpaid SGC and to recover the amount of the estimate.

Section 268-15 of the TAA requires the Commissioner to give a written notice of the estimate which:

- identifies the underlying liability
- specifies the date of the estimate
- sets out the amount of the estimate
- states that the amount of the estimate is due and payable and
- explains how the amount of the estimate may be reduced or the estimate revoked.

Once a notice of estimate has been given by the Commissioner to a taxpayer, the amount is due and payable.\(^\text{109}\) The amount of the estimate is distinct from the underlying liability of the taxpayer to pay the estimated amount.\(^\text{110}\) This ensures that the accuracy of the estimate is irrelevant to the legal liability to pay.\(^\text{111}\)

Director penalty notice regime

The director penalty notice (DPN) regime reinforces the obligations of companies to pay their estimated or actual tax liabilities. It does this by providing that directors have an obligation to ensure that the company complies with its obligation to pay its tax liability.\(^\text{112}\) The obligation imposed on the directors continues until the company:

- has paid the outstanding tax or
- is wound up or placed in voluntary administration.\(^\text{113}\)

Where this does not occur, the ATO may issue a director penalty notice if the directors do not pay the relevant liabilities by the due date.\(^\text{114}\)

There are two defences available. First, a company’s director will have a defence to a director penalty notice if they are able to establish that, due to illness or for ‘some other good reason’ it

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\(^{109}\) TAA, Schedule 1, subsection 268-20(1).

\(^{110}\) TAA, Schedule 1, subsection 268-20(2).

\(^{111}\) TAA, Schedule 1, section 268-25.

\(^{112}\) TAA, Schedule 1, subsection 269-15(1).

\(^{113}\) TAA, Schedule 1, subsection 269-15(2).

\(^{114}\) TAA, Schedule 1, sections 269-20 and 269-25.
would have been unreasonable to expect the director to take part in managing the company, and they did not take part in managing the company when they were appointed to that role.\(^{115}\)

**Second** it will be a defence if a company director:

- took all reasonable steps to ensure that the directors caused the company to comply with its obligation; or the directors caused an administrator of the company to be appointed under the *Corporations Act*; or the directors caused the company to begin to be wound up or
- there were no reasonable steps that the company director could have taken to ensure that any of those things happened.\(^{116}\)

**What the Bill does**

Under the *GST Act* a ‘net amount’ is defined broadly to be an entity’s total GST payable less any input credit entitlements, subject to any adjustments.\(^{117}\) Where an entity has failed to lodge a return, the Commissioner may make an assessment of net amount based on the information available to him or her – that is, an estimate.\(^{118}\)

**Items 3** and **6** of Schedule 3 to the Bill amend section 268-1 and subsection 268-10(1) respectively to expand the matters about which the Commissioner may make estimates to include net amounts in respect of GST, wine equalisation tax and luxury car tax and to recover those amounts.

**Item 7** of Schedule 3 to the Bill inserts proposed subsection 268-10(1B) into the TAA. It provides that where a person has a net amount\(^{119}\) for a tax period\(^{120}\):

- the person is treated as being liable to pay that net amount
- that liability is treated as having arisen on the day by which the person must give their GST return for the tax period to the Commissioner
- that liability is treated as being payable on that day and
- the entire amount of that liability is treated as being unpaid.

The effect of the Bill is to extend the Commissioner’s reach to include estimates of an entity’s net amount under the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act). When an entity has failed to lodge a GST return on its due date, the Commissioner can issue a notice of an entity’s estimated net amount to the taxpayer. The taxpayer will then be deemed to owe this estimated net amount of GST to the Commissioner, despite an actual assessment not having been made.

**Stakeholder comments**

The Housing Industry Association (HIA) opposes Schedule 3 of the Bill on the grounds that the rule ‘can have a harsh application’ as the time allowed within which to arrive at an agreement with the Commissioner, appoint an administrator, or commence the winding up of the company is very short.\(^{121}\)

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115. TAA, Schedule 1, subsection 269-35(1).
116. TAA, Schedule 1, subsection 269-35(2).
118. TAA, Schedule 1, section 155-5.
According to Professor Helen Anderson:

In terms of including GST in the [director penalty notice] DPN regime, it is important to recognise the fundamental difficulty with using DPNs to recover any losses caused by illegal phoenix activity. The whole modus operandi of illegal phoenix activity is to liquidate a company and transfer the business to a new one. There is no liability on a director under a DPN where there is a prompt liquidation within 21 days of receiving the notice, provided liabilities are reported.

A savvy, deliberate phoenix operator therefore does not fear a DPN, regardless of what it includes. The cost of incorporating a new company – currently $463 – is worth incurring to avoid tens of thousands in tax debts.122

**Directors duties**

**Who is a director**

The term *director* of a company or other body means:

- a person who:
  - is appointed to the position of a director; or
  - is appointed to the position of an alternate director and is acting in that capacity regardless of the name that is given to their position; and
- unless the contrary intention appears, a person who is not validly appointed as a director if:
  - they act in the position of a director; or
  - the directors of the company or body are accustomed to act in accordance with the person’s instructions or wishes.123

**Current law**

An entity has an obligation to pay an estimate or other tax liability set out in a notice by the Commissioner. In addition, section 269-1 in Schedule 1 of the TAA provides that the directors of a company have a duty to ensure that the company meets its obligations including, but not limited to, those under Division 268 (as set out above) and under Part 3 of the *Superannuation Guarantee (Administration) Act 1992* (SGAA) (obligation to pay SGC). If it is unable to meet those obligations, the directors must ensure that the company promptly goes into voluntary administration under the *Corporations Act* or into liquidation.

Where the company does not meet its obligation the DPN regime in the TAA operates so that a person who is a director of a company on or after the initial day must cause the company to comply with its obligation.124 Where the obligation still exists on the due day the directors are subject to a penalty.125

The penalty is issued by the Commissioner providing a notice under the DPN regime. However the Commissioner must not commence proceedings to recover any such penalty from a director until the end of 21 days after the Commissioner has given a written notice under the DPN regime to that effect.126

124. TAA, Schedule 1, subsection 269-15(1).
125. TAA, Schedule 1, subsections 269-20(1) and (2).
126. TAA, Schedule 1, subsection 269-25(1).
What the Bill does—creating director penalty

Items 13 and 14 of Schedule 3 to the Bill amend sections 269-1 and 269-5 of Schedule 1 of the TAA to broaden the obligations which the directors of a company have a duty to meet to include an entity’s unsatisfied liabilities to pay assessed *net amounts* and GST instalments under the *GST Act*. The obligation on the directors begins on the initial day. Item 16 inserts *proposed paragraph 269-10(5)(ba)* into the TAA so that the *initial day* for assessed or estimated net amounts is the day the relevant tax period ends.

The penalty arises on the *due day*. Item 15 amends the existing table in subsection 269-10(1) of the TAA to provide the *due day* is:

- for assessed net amounts—the day the company is required to pay the assessed net amounts
- for GST instalments—the day the company is required to pay the GST instalments.

What the Bill does—remission of director penalty

If the director complies with the obligation (to pay assessed or estimated net amounts or GST instalments) before the director penalty notice is issued or within 21 days of the day the notice was issued, the penalty may be remitted. Alternatively, if the director complies with their obligation by placing the company into administration or by commencing the wind up of the company within three months of the due date the full amount of the penalty is remitted. After the three months has elapsed the penalty is said to be ‘locked down’ and the director is under an obligation to pay the penalty amount.

Where the company enters administration or begins to be wound up after the lockdown date, only the amount of the company’s assessed net amount liability that was calculated by reference to information reported to the Commissioner before that date is remitted. Item 17 of Schedule 3 to the Bill inserts *proposed table items 5 and 6* into the table in subsection 269-30(2) of the TAA to reflect this.

Key issues and provisions—Schedule 4

**Quick guide to Schedule 4**

The amendments in Schedule 4 to the Bill authorise the Commissioner to retain tax refunds where a taxpayer has failed to lodge a return or failed to provide other information to the Commissioner that might affect the amount of a refund.

**Financial implications**

According to the Explanatory Memorandum to the Bill, ‘as at the 2018–19 Budget, the measure is estimated [to] result in a small but unquantifiable gain to revenue over the forward estimates period’.

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127. TAA, Schedule 1, subsection 269-15(1).
128. TAA, Schedule 1, subsection 269-30(1).
129. TAA, Schedule 1, column 2 in the table in subsection 269-30(2).
Current law
Part IIB of the TAA provides for the treatment of money that is paid to the Commissioner, or is held by, or is owing to the Commissioner, in relation to taxpayers’ tax affairs. The provisions allow the Commissioner to apply money received against a taxpayer’s tax debts and require the Commissioner to pay refunds in certain circumstances.

The obligation to pay refunds is subject to the Commissioner’s discretion to retain refunds in certain circumstances, including for example:

- where the taxpayer has failed to provide certain information such as a Business Activity Statement (BAS) or a Petroleum Resource Rent Tax (PRRT) notice131 or
- where the Commissioner is verifying information provided by the taxpayer. 132

The Commissioner may retain the refund until the taxpayer provides the relevant notification to the Commissioner, or the Commissioner makes or amends an assessment of the amount.133 However, the Commissioner must pay interest on the amount under the Taxation (Interest on Overpayments and Early Payments) Act 1983 if the refund is further delayed.

What the Bill does
Item 1 in Schedule 4 to the Bill inserts proposed subparagraph 8AAZLG(1)(b)(iii) into the TAA to expand the circumstances under which the Commissioner may retain a tax refund to include where the entity has not given the Commissioner a notification required under any provision of a taxation law, which may affect the amount the Commissioner refunds to the entity.

The Explanatory Memorandum to the Bill sets out the rationale for the amendment:

Taxpayers engaged in illegal phoenix activity will often not lodge or will delay lodging returns that will result in a tax liability becoming due. However, these taxpayers may lodge a return (often a BAS) where it will result in a credit arising. Operators may use the delay in the tax liability arising to obtain a refund they would otherwise not be entitled to, strip assets from the company or otherwise frustrate the collection of the liability.134

Stakeholder comments
Although the CFMEU was broadly supportive of the amendments in the Bill, it expressed some concern about the proposal to expand the ATO’s existing power to retain tax refunds:

The proposal … must not have the unintended consequence of:

a. reducing the total pool of funds available to creditors (which would have a negative effect on workers affected); or

b. locking up outstanding entitlements for creditors (including affected workers).

The proposal should not interrupt the priority set up pursuant to s.556 of the Corporations Act 2001, or otherwise privilege the ATO as a creditor (in relation to all its liabilities) over other creditors, including employees, so as to subvert the current order of priority. 135

131. TAA, section 8AAZLG.
132. TAA, section 8AAZLGA.
133. TAA, section 8AAZLG.
Concluding comments

According to a Treasury proposals paper circulated in November 2009 entitled *Action Against Fraudulent Phoenix Activity*:

Defining precisely what constitutes fraudulent phoenix activity is inherently difficult ... However, underlying the distinction between illegitimate, or fraudulent, phoenix activity and a legitimate use of the corporate form, is the intention for which the activity is undertaken. Relevantly, ASIC draws a distinction between businesses that get into a position of doubtful solvency or actual insolvency as a result of poor business practices ... and those operators who deliberately structure their operations in order to engage in phoenix activity to avoid meeting obligations. ¹³⁶ (emphasis added)

The Melbourne Law School report entitled *Quantifying Phoenix Activity: Incidence, Cost, Enforcement* contains a detailed study of publicly available statistics in an effort to determine the cost of phoenix activity. ¹³⁷ The report includes the results of a search of ASIC media releases for the period 1 January 2004 to 30 June 2014. That search identified that 51 directors were disqualified in circumstances involving problematic or illegal phoenix activity. There were 165 companies involved in these 51 disqualifications. Within those media releases, nine provided the details of the loss suffered. ¹³⁸ These are set out in table 1 below.

**Table 1: Cases where the loss was caused by problematic or illegal phoenixing**

<table>
<thead>
<tr>
<th>Case no.</th>
<th>Amount of loss per group</th>
<th>No. of companies in the group</th>
<th>No. of directors disqualified</th>
<th>Average loss per company</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$23 mill</td>
<td>6</td>
<td>4</td>
<td>$3.38 mill</td>
</tr>
<tr>
<td>2</td>
<td>$13 mill</td>
<td>6</td>
<td>1</td>
<td>$2.17 mill</td>
</tr>
<tr>
<td>3</td>
<td>&gt;$5 mill</td>
<td>4</td>
<td>1</td>
<td>$1.25 mill</td>
</tr>
<tr>
<td>4</td>
<td>$4.96 mill</td>
<td>6</td>
<td>2</td>
<td>$1.67 mill</td>
</tr>
<tr>
<td>5</td>
<td>$4.7 mill</td>
<td>3</td>
<td>1</td>
<td>$1.57 mill</td>
</tr>
<tr>
<td>6</td>
<td>$4.02 mill</td>
<td>5</td>
<td>1</td>
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<td>4</td>
<td>1</td>
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<tr>
<td>8</td>
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<td>2</td>
<td>1</td>
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</tr>
<tr>
<td>9</td>
<td>$0.53 mill</td>
<td>3</td>
<td>1</td>
<td>$0.18 mill</td>
</tr>
<tr>
<td>Total</td>
<td>&gt;$57.74 mill</td>
<td>33</td>
<td>13</td>
<td>&gt;$1.75 mill per company</td>
</tr>
</tbody>
</table>


¹³⁸ Ibid., p. 46.
Clearly the problems which the Bill seeks to address are costly to the community and have been evident for some time.\textsuperscript{139}

The Bill contains four measures to combat illegal phoenixing activity—without actually defining phoenixing \textit{per se}. These are:

- the introduction of new phoenixing offences
- a prohibition on company directors from improperly backdating resignations or ceasing to be a director when this will lead to the abandonment of the company
- allowing the Commissioner to estimate GST liabilities and making company directors personally liable for their company's GST liabilities in certain circumstances and
- expanding the circumstances in which the ATO may retain a tax refund.

Each of these is expected to confront instances of corporate conduct which may be relevant to phoenixing.