

**Combatting Illegal Phoenixing**

October 2017

Introduction

The Institute of Public Accountants (IPA) welcomes the opportunity to offer our **‘**Combatting illegal phoenixing’ submission and looks forward to working with the Government as it sets its economic agenda.

The IPA is one of the three professional accounting bodies in Australia, representing over 35,000 members and students in more than 80 countries The IPA prides itself in not only representing the interests of its members and but also Australia’s small business sector.

The IPA views **‘**Combatting illegal phoenixing’ as an essential activity to protect small bsuiensses that may be vulnerable and fall victim to illegal phoeninxing. The IPA has therefore made numerous recommendations that we believe will assist the Government in setting this new agenda.

The IPA’s submission has been prepared with the assistance of the IPA faculties including the faculties of taxation, accounting regulation, accounting education, financial services, corporate governance, public sector and small business. We are grateful for their contribution and guidance. The IPA submission has also benefited from consultation with IPA members who have expressed their views and concerns on a variety of matters. We are also grateful to all those who have taken the time to provide their input.

We look forward to discussing further and in more detail the IPA’s recommendations with the Government and Treasury. Please address any enquires to Tony Greco tony.greco&publicaccountants.org.au or Vicki Stylianou vicki.stylianou@publicaccountants.org.au

Yours sincerely

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## General Manager Technical Policy

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IPA Submission

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***Combatting illegal phoenixing***

This consultation paper covers an area of law that is of immense interest to IPA members who provide advice to small businesses on how best to deal with situations in which they have been the subject of a phoenix operator. The IPA also has members who are in commerce and will from time to time encounter business operators that fit the characteristics of phoenix operators. It is critical that the Government addresses, through legislative amendments, any weakness in the current regulatory system that permits individuals or groups of individuals to engage in phoenix activities.

Small businesses can fall victims in scenarios where directors of a failing business are able to find a way of exiting the enterprise without paying debts owed to suppliers, contractors and employees. This is an unfair and often an illegal activity impacting on those small businesses that have entered into a commercial relationship with an entity in good faith. A small business expects to be paid under their usual commercial terms on a timely basis for any work done or supplies sold to another business. Small businesses suffer economic losses as a result of phoenix activities and such losses may lead small businesses into financial crisis. It is hoped that these proposals assist in minimising the overall financial burden faced by ethical small businesses arising from dealings with unethical operators.

It should also be noted that it is possible for an unethical business operator to nominate an individual as a director simply by adding a name to a directors’ register online. An individual may find that they are a director of an entity without their consent when an entity has failed to pay its creditors or found to be trading while insolvent. The *Corporations Act 2001* does not distinguish between actions taken by a person that has properly consented to being a director or someone that has been added to a register online without their consent. An individual may be held liable for decisions made during their term as a director even though they had never given their formal consent. This needs to be at the forefront of the mind of government as it contemplates amendments to legislation dealing with phoenix operators.

Areas of reform for tax administration are briefly suggested in the consultation paper and these have qualified support.

***Establishing a hotline for phoenix activity***

A hotline using all available technologies to collect information about suspected phoenix conduct is supported. Such a hotline already exists in other areas of law enforcement. Crime Stoppers is one prominent example of such a hotline that is often cited in the media. It is used by the police in various States as a way of accessing information that might help solve a crime. Any hotline set up to handle complaints related to suspected phoenix behaviour could follow a similar awareness strategy so that individuals or businesses are made aware that they are able to complain to a central point managed by a dedicated team of experts in this area of the law.

The hotline should be housed and administered primarily within the Australian Securities and Investments Commission (ASIC) given that the mechanism primarily used to give effect to a suspected phoenix activity will be the relevant *Corporations Act* provisions. It is acknowledged that a phoenix taskforce may be multi-disciplined given that multiple offences covering different pieces of legislation may apply. We note that statistics on the number of calls received and whether they lead to successful investigations into suspected phoenix operatives must be maintained irrespective of whichever agency ultimately bears the portfolio responsibility. Such statistics however, should be used solely to monitor trends in usage rather than be seen as a justification to shut down the hotline after a short trial period, ie. when external pressures to meet efficiency dividends increase due to low usage rates. We are of the view that the establishment of a hotline facility as described in the proposal, is critical to the success of the overall package.

***Creating a phoenix offence***

The creation of a specific phoenix offence is supported with qualification. Any investigation examining a case where a phoenix offence is suspected, must be able to prove to a court of law that the assets had actually moved from the phoenix operator to a transferee, with the intent of hiding the assets from being available for distribution to an entity’s creditors. It is noted that the consultation paper refers to the notion of assets being transferred in order to prevent, hinder or delay any property being available for distribution to creditors. These words are appropriate and would capture any attempts by an individual to structure a situation in which assets and funds are beyond the reach of creditors.

Under the proposals outlined in the consultation paper, ASIC would issue a notice to the transferee entity that would require that entity to return assets or funds to the regulator as a result of suspicious phoenix activity. A recipient of such a notice would be able to apply to have a court to set aside the notice. While this regime is similar to that operating under the Bankruptcy Act, there may be a further principle that is in need of consideration here, so that directors who are under investigation are afforded natural justice. In this sense, clarification is needed in terms of whether ASIC will need to apply to a court to secure assets on behalf of the Commission’s investigators or on behalf of a liquidator. If not required to seek court approval, this may be a contentious issue given that the suspicious phoenix activity will still need to be tested within the court. In this respect, it may be prudent to give further consideration to the concept of bringing the approach in alignment with the *Proceeds of Crime Act 2002* (POCA) in which court applications must be made to freeze bank accounts and restrain assets in the circumstances outlined in that legislation.

***Remedies***

We agree that changes need to be made to the law so that an operator of a phoenix company is unable to hide behind the transferee. The *Proceeds of Crime Act 2002* (POCA) is an ideal model for seeking remedies given that POCA provides for court orders to be issued in order to restrain assets that are suspected of being the proceeds of crime. Applying similar provisions to suspected phoenix activities, the transferee would be prohibited from the disposal of or dealing with property that is suspected to be the proceeds of a phoenix activity. This would similarly be the case for any funds that were found to have been transferred from a bank account of the transferor to a transferee. We argue that forensic accountants or experienced corporate fraud investigators should be able to follow the movements of financial and other assets from the hands of a transferor to the transferee.

The POCA is more closely aligned with the objectives of the current consultation paper given that assets are typically stripped from an entity and/or siphoned off to another business that is either owned or has the involvement of the phoenix operator. While the link between insolvency and bankruptcy is acknowledged given that they are drawn from the same discipline, what is being dealt with here, in essence, amounts to an act of theft or conversion of assets from one entity into another.

***Directors and their appointment***

With respect to provisions relating to directors, amendments to the *Corporations Act 2001* must ensure that directors are unable to backdate resignations of directors which can effectively shield phoenix operators from the consequences of their actions. It would seem, that the consequences of backdating resignations can make it difficult for regulators to hold individuals accountable for offences after the date of resignation. We see this as a potential loophole that must be closed in order to tighten the practices related to the maintenance of a company’s register online. As discussed in the consultation paper, the use of ‘dummy’ directors, as a means of covering up the presence of shadow/defacto directors is also problematic, ie given that these directors may not actually exist or are persons unable to be found at the addresses or contact details that have been put on their *‘directors’* record online. This presents an obstacle for investigators trying to determine precisely where the liability for insolvency that results from the phoenix activities ought to lay. There is a further significant question that must be asked: should ASIC be given the power to reinstate a director or a person found to have been involved in phoenix activities in order to ‘remedy the wrong’? Such a reinstatement would need to be made in circumstances where ASIC investigators or insolvency practitioners are able to demonstrate that a phoenix operator was a director previously, and there are reasons to suspect that asset transfers from the insolvent entity had taken place under the instruction of the phoenix operator. A successful request should result in the reinstatement of the phoenix operator as a director with an accompanying signifier/identifier which effectively informs persons accessing the company’s extracts that the individual has been reinstated and is under active investigation. This would be one means of refocusing attention on the phoenix operator rather than an individual that may have either in full knowledge, or unwittingly, become a director of an entity that had been the subject of an asset stripping exercise.

We note with interest, that unethical individuals may be able to appoint or remove individuals from a regulatory register without the knowledge of the people concerned. In a case reported earlier this year on an online news service, we understand that an individual altered the structure of a proprietary company’s board of directors and changed a company register 12 times within the space of 24 hours. The changes made to this register involved the removal of a director, the alteration of shares belonging to that director, and the appointment of two new directors. All of these changes were then mysteriously reversed the very next day. We argue that the removal of a director should be done online only when their electronic signature or other key identification number/unique identifier not known to a company secretary or another director, is quoted.

***Timelines for changes to director information***

Other potentially contentious areas in business regulation for small business and businesses more generally, are the timelines set down for notifying a regulator of changes in status. The consultation paper notes that the current law has a time limit of 28 days for persons to notify the Commission via a change to company details reporting process indicating that a change in governance personnel has occurred. We are of the view that the 28-day deadline was no doubt a suitable time-frame for many years prior to the advent of the internet and the ability to lodge changes in any details online. With current technology however, Form 484 can be lodged and details changed within hours of a decision being known. Accordingly there appears to be no further rationale for retaining a 28-day lodgement period in the era of electronic lodgement. It is difficult to imagine what circumstances in the ordinary course of business, would prevent an individual from lodging changes to directors particulars within a 14 day period. We also suggest that directors’ resignations that occur during a period when a company secretary is on leave or unwell may be dealt with as an exception with special consideration for late lodgement. It is somewhat anomalous that changes to a company constitution must be lodged within 14 days of members voting on the changes to company rules, and yet there is a longer period for the change of director’s details on an online register. The finalisation of constitutional amendments based on the result of a member vote can be a more complex task than the updating of corporate address details or general director details on the online register accessible on the ASIC web site. At the very least, an alignment of dates for changes should be considered. There is merit in considering the consultation paper’s suggestion that a director be responsible for reporting their resignation to the corporate regulator rather than leaving it to the company. This should also apply to appointments to the role as a director of an entity that has two or more directors. It would at the very least, place checks and balances on the update of details, the appointment and resignation processes.

There may be circumstances in which a phoenix operator attempts to move assets into an entity where the ownership structure is opaque and may be more complicated than the entity from which assets and funds have been removed. Ensuring that owners of beneficial interests are identified on ASIC’s database and elsewhere is critical to limiting the options a phoenix operator may have to shuffle assets from one place to another.

***Abandoning a company***

The government proposal to prohibit a sole director from resigning the post of director without winding up the entity or placing it in the hands of an administrator or liquidator is supported. This would assist in ensuring that the regulator is given an alert during the resignation process and thus forces the sole director to ensure that they comply with all relevant processes to wind a company down without leaving a dormant shell. The register should not permit a sole director to resign unless there is evidence of another director having been appointed or that the business is being wound up. Given advances in algorithms and technology generally, particularly in respect of web sites and databases at the present time, it would be a relatively simple task for the corporate regulator to link the resignation of a sole director with the appointment of a replacement director or a concomitant application to windup the company.

***Restricting voting rights***

Restricting the voting rights of related creditors of a phoenix operator is supported given that such relationships pose a conflict of interest in the context of a meeting of creditors. Permitting equal voting rights to related creditors in circumstances where a motion to remove an administrator has been put, does not serve the interests of other creditors. The suggested reform that would allow the external administrator to ignore or disregard related creditor votes when a motion to remove an administrator is in question, is thus supported. There is merit also in further reflecting on this proposal and what such a measure might mean in circumstances where an external administrator should be removed.

***Extension of penalty notices to the goods and services tax regime***

We agree with the proposal that the penalty notice regime should extend to all tax matters and not just ‘pay as you go’ payments. This gives the tax regime a more holistic approach to collections and means that the revenue authority is able to send notices to directors on an additional matter that relates to an entity’s tax obligations. It brings uniformity to the tax regime in this area and acts as a warning to directors in circumstances where a phoenix operator sees an incentive in attempting to game the system.

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