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8 January 2010

The General Manager
Business Tax Division
Treasury
Langton Crescent
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By Email: phoenix@treasury.gov.au

Dear Sir

SUBMISSION INTO PROPOSALS PAPER ACTION AGAINST FRAUDULENT PHOENIX ACTIVITY

We refer to your proposals paper in relation to "Action Against Fraudulent Phoenix Activity" and are pleased to be provided with the opportunity to provide our submissions in relation to the various proposals as requested.

Pitcher Partners is an accounting and business advisory firm in the middle market, particularly small to medium public companies and privately owned businesses. Pitcher Partners is an association of independent Australian accounting firms located in Melbourne, Sydney, Perth, Brisbane and Adelaide. Nationally, this independent association has over 80 partners and more than 800 professional and support staff.

In Melbourne, Pitcher Partners is the fifth largest accounting firm in Victoria and it comprises 40 partners and over 500 professional and support staff. The firm also has an insolvency division that specialises in corporate and personal insolvencies and this division has 3 partners and 40 professional and support staff. Two of the divisions partners, are registered trustees in bankruptcy and all 3 partners are official liquidators of the Supreme Court of Victoria.

EXECUTIVE SUMMARY

We can summarise our submission as follows:

1. We agree that Phoenix Activity is prevalent within the Australian business community;
2. It is our observation and belief that the level of phoenix activity is increasing;
3. It is also our observation that the Australian Taxation Office ("ATO") is most usually the "target" of such phoenix activity and, consequently, bears the greatest cost burden of phoenix activity;

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4. We agree that the increase in prevalence of phoenix activity, and its impact on Government revenues (or indeed other creditors) warrants action by the Government;
5. We do not support the majority of the options outlined and consider that they, by and large, represent too broad or “blunt” an instrument to attempt to overcome phoenix activity. We are concerned that many of the proposed options would act as a material and serious disincentive to ordinary and honest company directors to engage in entrepreneurial activities necessary for the viability for the Australian economy.
6. We believe that the desired objective of reducing phoenix activities could be better achieved through the enforcement of existing legislation through currently existing legislative powers.

SPECIFIC SUBMISSIONS ON PROPOSED OPTIONS

We provide further comment in relation to the specific options outlined in the proposals paper.

For ease of reference, we have adopted the same numbering system as adopted in that paper.

4.2.1. Amend the Director Penalty Regime.

One of the proposed options outlined in the proposal paper is the broadening of the Director’s Penalty Regime to provide for automatic liability once certain taxation obligations have remained outstanding for a period of time. The discussion paper suggests a possible period of 3 months for the tax obligation to be outstanding in this regard.

It is submitted in the proposals paper that the adjustment of the Director’s Penalty Regime in this regard would have the effect of reducing the benefit available to directors of companies that engage in phoenix activity. The cited rationale is that the value of the taxes avoided in each instance should be reduced as a director concerned for their own personal financial position would ensure that tax obligations outstanding did not exceed that proposed three month period.

We do not agree with the proposed above option for the following reasons:

- The proposal for the adjustment of the Directors Penalty Regime should not be used as a substitute for the ATO’s debt collection activities. This is the effect that this proposal would have.
- The amendment of the Directors Penalty Regime in the manner proposed would have an effect on a broad category of directors, not just those engaged in phoenix activity. There is no automatic link between a company that has tax obligations outstanding for more than three months (or even insolvent companies), and directors of a company that may engage in phoenix activity. Only a small sub-set of companies that are wound up with three or more months outstanding tax obligations will have engaged in phoenix activities.

- If the Government wishes to make directors of companies automatically personally liable (albeit after a period of time when the tax obligations remain outstanding) for certain taxation obligations, then they should say so and not attempt to achieve the same result under the pretext that it is an amendment designed to overcome phoenix activity.
- We consider that the proposed option represents by far too broad an instrument to attempt to overcome phoenix activity. We believe that the consequential disincentive to “genuine” company directors is too great and provides too large a disincentive to entrepreneurialism. We believe that the loss to the Australian economy of such a disincentive by far outweighs the damage being suffered by phoenix activity.
- The increase of fraudulent phoenix activity in recent years is not necessarily an indication that the current legislative and administrative regimes do not provide a big enough disincentive to engage in such activity. Increased efforts can and should be made to enforce, more vigorously, the current legislative provisions. The recent decision in *Australian Securities and Investments Commission v Somerville*¹ is a clear example of how well publicised high profile cases can act as an effective deterrent to potential offenders. That case is also an illustration of the fact that the current provisions can be effective when enforced.

Estimate Regime.

We would support amendments to the estimate regime to assist the ATO in the collection process.

It is our observation that recalcitrant corporate tax payers, and their directors, will often fail to lodge returns over a prolonged period of time, thus frustrating the recovery process. We would welcome amendments to the Act to assist the ATO in its debt recovery practices in these instances.

4.2.2 Expansion of Director Penalty Regime.

One of the proposals to be considered is the expansion of the Director Penalty Regime to include other types of taxation liabilities including superannuation guarantee, GST, excise or company income tax.

The ability of the ATO to issue Directors Penalty Notices in respect to unpaid PAYG withholding tax (and certain other taxes) was received as a “trade-off” under amendments which took effect in June 1993 whereby the ATO gave up its statutory priority for certain unpaid taxes in a liquidation. That position has remained for the last 16 years.

Whilst we would not necessarily oppose the ability of the ATO to issue Directors Penalty Notices in respect to other taxes, we do not see it as an effective mechanism in attempting to curb phoenix activity.

¹ [2009] NSWSC 934

For the reasons set out in 4.2.1 above, we consider this to be too blunt an amendment to be supported.

If the Government wishes to propose an expansion of the Directors Penalty Regime, then it should do so without seeking to justify as a means of reducing phoenix activity.

4.2.3 Amend the promoter penalty regime.

We would, broadly speaking, support amendments to this regime aimed at focussing on the promoters or “architects” of such phoenix activity. We do note however that there are a number of uncertainties with the application of the current regime which would need to be resolved before it could be expanded as contemplated.

4.2.4 Anti Avoidance Provisions

The GAAR would need to be extended to allow for the ability to pursue the entity receiving the benefit of the phoenix activity.

Whilst we would support the possibility of amendments to the GAAR that would allow the pursuit of the recipient entity in cases of phoenix activity, we do note that the ability to seek recovery from the entities who receive the benefit of such phoenix transactions will often be available to the liquidator of the failed entity. In the vast majority of occasions those actions are not pursued for lack of funding. The ATO will generally be the largest creditor in such liquidations and whilst the ATO does fund liquidators in some circumstances, an expansion of this program would achieve the same result at a fraction of the cost, and with far less uncertainty than exists under the current law.

4.2.5 Reinstatement of “Failure to Remit” Offence

For the reasons set out in 4.2.1 above we consider the reinstatement of the “failure to remit” offence as being an inappropriate and blunt instrument in an effort to overcome phoenix activity.

4.2.6 Denying PAYG Withholding Credits

Whilst we believe that the proposal has merit, we believe that this option would have little or no effect in reducing the prevalence of phoenix activity.

4.2.8 Expand the Scope for Disqualification of Directors

Whilst we believe that the expansion of the scope for the disqualification of directors would be useful in some circumstances, as identified in the proposals paper we would agree that the approach is too broad to attempt to combat phoenix activity and may be too readily circumvented through the use of “shadow directors.”

4.2.9 Restriction of use of similar name by successor company.

Whilst we would not oppose the introduction of such provisions, for the reasons set out in the proposals paper we would agree that such provisions could, too easily, be circumvented. For this reason we do not believe that it would be successful in materially reducing the occurrence of phoenix activity.

4.3.1 Provision of Bonds.

Subject to further clarification as to when the provision of these bonds would be required, we broadly support this proposed amendment. We would expect bonds to be only required in very specific circumstances, and only in cases of clear previous phoenix activity by the company promoters.

4.3.2 Doctrine of Inadequate Capitalisation

Whilst the proposal for the introduction of a doctrine of inadequate capitalisation has some merit, we are concerned that its practical implementation would be far too complex, unwieldy, and fraught with problems associated with its practical implementation.

We believe that other legislative weapons to combat phoenix activity would be more appropriate.

Other Legislative Powers

We believe that the Crimes (Taxation Offences) Act 1980 is an ideal 'vehicle' (so to speak) for taking action to address fraudulent phoenix activity. We are puzzled therefore, as to why there is no mention of this Act in the Proposals Paper, especially as in Taxpayer Alert TA 2008/16 Liquidation of entities to avoid the payment of tax liability the ATO states that:

*[I]iquidating an entity to secure an inability to pay future income tax liability may attract criminal sanctions under the Criminal Code including defraud contrary to s135.1 of the Criminal Code or conspiracy to defraud under s135.4 of the Criminal Code, or alternatively the Crimes (Taxation Offences) Act 1980, including penalties of 1000 penalty units and/or 10 years imprisonment.
[Emphasis added]*

In short, we do not think that the explanation in the last sentences of section 3.1.4 that new legislation is required because:

fraud investigations typically involve the resources of the Australian Federal Police (AFP) and the Commonwealth Director of Public Prosecutions (CDPP) which can be problematic due to competing priorities for the same resources. Notably, in the ATO's experience phoenix prosecutions, based as they are on fraud, are usually highly resource intensive, very costly and may take some years to be finalised.

is a compelling argument.

To the extent however, that (notwithstanding our view to the contrary) the Government believes that new taxation legislation is required to support the Crimes (Taxation Offences) Act 1980 we suggest that consideration should be given to 're-introducing' the Taxation (Unpaid Company Tax) Assessment Act - which was specifically designed to recover tax evaded under the Crimes (Taxation Offences) Act 1980 - in a form that specifically allows recovery of the amounts/types of tax in question.

This concludes our submission. We would be pleased to answer any queries you may have and in this regard, our contact details are set out below:

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Yours faithfully
PITCHER PARTNERS



A R YEO
Partner