The Australian Taxation Office – what role does it play in anti-phoenix activity?

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The prevention of fraudulent phoenix activity is an increasing issue for the Australian Government and the loss of taxation revenue that results from these arrangements can be significant. For this reason, the Australian Taxation Office (ATO) has played a major role in the development of anti-phoenix regulation and, in particular, the 2012 amendments to the director penalty regime seemed largely aimed at that issue. Typically however, the ATO will have two competing roles in the context of phoenix arrangements, being the primary collector of Australian taxation revenue and also a major creditor in the resulting corporate insolvency. Therefore, two key questions arise – how pervasive should the ATO’s collection powers be and to what extent should they be used to control fraudulent phoenix activity if the ATO is competing for funds against other creditors in the limited pool available. This article argues that there are several competing policy imperatives relevant to controlling fraudulent phoenix activity, and that legislative responses should consider the ATO’s role as both creditor in insolvency and collector of taxation revenue. Furthermore, the roles of the ATO and ASIC in relation to combatting phoenix activity need to be clarified. This article suggests that a framework based on decentred regulation might provide a better approach.

INTRODUCTION

The Australian Taxation Office (ATO) describes itself on its website as the “principal revenue collection agency” of the Australian Government.1 The Inspector General of Taxation has noted that the ATO “manages the revenue systems that sustain social and economic policy and funds services for Australians”.2 If collection is the major role that the ATO is to play then it should come as no surprise that the ATO will use the legislation that governs the taxation system in Australia to maximise collections. The full provisions within the legislation under which the ATO operates will, and should, be used to facilitate this collection. The ATO is also often caught up in discussion and commentary regarding phoenix activity which has been described as “the systematic act of transferring assets from an indebted company that has or will be wound up, into a new corporate structure that has the same directors, or company officers”.3 The wrongful behaviour associated with this activity arises where it is undertaken repeatedly and with the manipulation of assets to benefit operators of the company at the expense of creditors.4 That there is a potential loss of taxation revenue that results from this wrongful behaviour is clear.

What is less clear, though, is what the position of the ATO should be where a taxpayer is insolvent. Specifically, while the ATO has a valid claim to be paid as a creditor in insolvency, there are

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other creditors who also have a legitimate claim to the limited funds that are available. A question, therefore, arises as to whether creditors who have loaned funds or have made supplies to the insolvent debtor should receive less on a pro rata basis than the ATO on the basis that the ATO collections will be used for the maintenance of the social and economic policy of the country or fund services for other Australians. This is ultimately a policy question that needs to be considered through the legislation governing both taxation and insolvency law.

The various provisions that have been used by the ATO to collect its revenue in circumstances of insolvency have recently been discussed in several forums. This article does not seek to deal with all of those aspects but instead focuses on the specific role played by the ATO in the area of controlling fraudulent phoenix activity. The ATO’s attempts to curtail fraudulent phoenixing activity have blurred the lines between the ATO’s mandate to ensure taxpayers comply with their tax obligations and the ATO’s legislative ability to maximise taxation collections despite claims by other secured and unsecured creditors. This fundamental conflict sits at the heart of the considerations in this article.

In examining this conflict, the article suggests that legislative responses that attempt to deal with phoenixing activity ought not to provide opportunities for the ATO to improve its position vis-a-vis other creditors. It is argued here that there are several competing policy imperatives around the ATO’s attempts to combat phoenixing activity when considered against the broader insolvency policy of equal treatment for all creditors. Furthermore, it is argued that the role of the ATO and ASIC in addressing phoenix activities has become somewhat conflated which has resulted in the ATO playing a somewhat different role than it probably should. This article suggests that a decentred approach to regulating phoenixing activity would provide a better framework for resolving these conflicting policy objectives; one in which the ATO’s role with respect to taxation collection in insolvency is more clearly defined and less likely to result in the government competing with unsecured creditors for limited resources, whilst at the same time providing an effective means of combating undesirable phoenixing activity.

The first section of the article deals briefly with what is meant by fraudulent phoenixing activity. The second section provides some background to the current position in terms of the ATO and phoenixing. The most recent legislative changes are discussed in the third section which provides a critical analysis of the position of the ATO and ASIC with respect to phoenixing activity. The final part of the article considers an alternative to the current regulatory model, based on a decentred regulation framework, that assists in determining the roles that the ATO and ASIC have in relation to regulating fraudulent phoenixing activity.

**WHAT IS PHOENIXING AND SHOULD IT BE PROHIBITED?**

One of the difficulties with any discussion of steps taken against phoenixing activity is that there is no Australian legislation which clearly defines and prohibits phoenixing activity as such. This legislative gap is problematic as attempts to capture and regulate the behaviour can be misdirected. An extensive study of the issue of phoenix definition undertaken by Anderson et al in 2014 identified that “A key

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6 New Zealand legislation has attempted a definition: See ss 386A – 386E Companies Act 1993 (NZ), Section 386B(1) which defines a phoenix company as “in relation to a failed company, a company that, at any time before, or within five years after, the commencement of the liquidation of the failed company, is known by a name that is also (a) a pre-liquidation name of the failed company or (b) a similar name”. A pre-liquidation name refers to “any name (including any trading name) of a failed company in the 12 months before the commencement of that company’s liquidation” and similar names “means a name that is so similar to a pre-liquidation name of a failed company, as to suggest an association with that company”. Australia proposed a similar approach in 2012.
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Problem faced by regulators is the difficulty associated with identifying whether particular phoenix activity is illegal or not. Matthew also identified the lack of precision in respect of a definition of phoenix activity. Whilst there is a lack of precise legislative definitions, there are a number of documents that attempt to examine what form of phoenix activity should be regulated.

In its 1996 paper, the Australian Securities Commission sought to identify key features of phoenix activity. This included a failure or inability to pay debts as and when due, a transfer of assets to another business which is controlled or related to the original entity, and a level of intentionality. However, the Australian Securities Investment Commission’s (ASIC) submission to the Cole Royal Commission recognised that not all phoenix activity was unlawful per se, identifying “innocent phoenix operators” as those businesses who experience financial distress due to a combination of poor business practices, inadequate record keeping, cash flow management techniques, creditor management failure or overly rapid expansion. Where such companies are placed into external administration, especially where specialist equipment or the business itself are largely unsaleable, or such companies are the subject of a “pre-pack strategy”, there may be no improper conduct or contravention of the law in disposing of the assets of the failed company to directors of the phoenix company, who hope to resurrect the business. Indeed, corporations are in a sense set up to take advantage of this limited liability “failure”.

ASIC contrasted this non-fraudulent phoenix activity with that of “careerist offenders”, being those who purposely structure their operations in order to engage in improper phoenix activity which specifically targets certain creditors such as the ATO, State payroll taxes, workers compensation authorities and employee entitlements, including superannuation and long service leave. Thus, phoenix activity can be seen as “wrongful” where a new corporation is set up to avoid some or all of the debts of a previous corporation. For this reason, it is perhaps better to use the term Fraudulent Phoenix Activity.

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12 A pre-pack strategy is “the sale of a business (or part of a business) by a failing firm to a third party that may or may not be connected to the failing firm. The sale arrangements, including the property to be transferred, the identity of the buyer and the consideration, are agreed and documented while the failing firm continues to trade normally, and the sale is affected immediately after the initiation of insolvency proceedings in respect of the vendor failing firm. As a result, the target business continues to trade without any (or at least with only minimal) disruption to suppliers, customers and employees, and the proceeds of sale are used to satisfy (at least some of) the debts of the business that remain in the hands of the vendor failing firm.” See K Creighton-Selvay, “Pre-packed Administrations: An Empirical Social Rights Analysis” (2013) 42 2 Industrial Law Journal 85, 88. For a discussion of the perception of an association between “pre-pack insolvencies” and phoenixing see S Frisby, “The Second-chance Culture and Beyond: Some Observations on the Pre-pack Contribution” (2009) 3 Law and Financial Markets Review 242, 245 and S Frisby, “Insolvency Law and Insolvency Practice: Principles and Pragmatism Diverge?” (2011) 64 Current Legal Problems 349, 386-396; M Wellard and P Walton, “A Comparative Analysis of Anglo-Australian Pre-Packs: Can the Means be Made to Justify the Ends?” (2012) 21 International Insolvency Review 143.
14 According to the ATO experience, a typical fraudulent phoenix arrangement would be structured as: (i) 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; (ii) the labour hire entity will usually have a single director who is not the ultimate “controller” of the group; (iii) the labour hire entity has few, if any, assets and little share capital; (iv) the labour hire entity fails to meet its liability and is placed into administration or liquidation by the ATO; (v) a new labour hire entity is set up and the labour moved across to work under this new entity and (vi) the process is repeated, with little disruption to the day-to-day operation of the overall business and (vii) the financial benefits from the unpaid liabilities are shared amongst the wider group.
Fraudulent phoenixing activity is considered more likely to manifest itself in wholly owned, closely controlled and fully integrated corporate groups where shareholders and/or directors are subjected to a greater level of moral hazard\textsuperscript{15} to take advantage of the limited liability of corporate group members, at the expense of unsecured creditors. Within corporate groups, shareholders’ moral hazards are potentially compounded as each member company within the corporate group enjoys limited liability. Australian corporate law seeks to assist creditors in such situations, yet there is criticism of the impact of this law.\textsuperscript{16} Thus the fundamental difficulty with any policy response to fraudulent phoenix activity is to ensure that only the fraudulent behaviour is punished. However, while the key regulatory aspect seems to be focussed on the fraudulent intent associated with these arrangements,\textsuperscript{17} thus far no attempt to identify this fact appears in the legislation.\textsuperscript{18}

Furthermore, it can be argued that the intended “wrong” that should be addressed by any fraudulent phoenix regulation is largely informed by each government agency’s position. For example, ASIC considers the fraudulent conduct as being where “the directors or company officers avoid paying outstanding liabilities owed to creditors, employees and statutory bodies incurred by the company that has been wound up”. By contrast, ATO considers the fraudulent conduct to be “the evasion of tax and or superannuation guarantee liabilities through the deliberate, systematic and sometimes cyclic liquidation of related corporate trading entities”.\textsuperscript{19} This highlights the conflicting policy positions of the ATO and ASIC in relation to controlling fraudulent phoenix activity. As a result, this article suggests that the legislative reform to date has been agency specific, rather than holistically focussed on solving the phoenixing problem.

**BACKGROUND TO THE 2012 AMENDMENTS**

Concerns about utilising a corporate form to facilitate tax evasion or avoidance are long standing in Australia. For example, during the 1970s the so called “bottom of the harbour” arrangements involved fraudulent activity utilising the corporate structure and leading to the evasion of taxation debts. The bottom of the harbour schemes have been described as:

> the purchase of companies with large current year tax liabilities for near asset value. The assets of the companies were thus split between the vendor shareholders and the scheme’s promoter. Control was then assigned to persons of straw and the records lost or destroyed.\textsuperscript{20}

These types of arrangements were finally attacked for being fraudulent activities largely through the long standing criminal law,\textsuperscript{21} although the income tax legislation was amended ostensibly on the basis of such types of arrangements.\textsuperscript{22} Whilst the social circumstances may have been somewhat different, it is suggested that some parallels can be drawn with the complaints concerning the current

\textsuperscript{15}The principle economic advantage of limited liability, although more pertinent to a public limited liability company, is generally considered to be the encouragement of investment by passive investors in risky enterprises. The economic argument is that limited liability ensures that company creditors can seek recourse only against the assets of the company for payment of their outstanding debts. If such assets are insufficient then the deficiency/loss is to be borne by the creditor. The disadvantage of limited liability is that it increases the probability that the company will have insufficient assets to pay creditors’ claims, creating a moral hazard for shareholders/directors. Shareholders/directors have an incentive, to enter into transactions, to strip assets or to increase indebtedness, especially when the company is approaching insolvency. See M C Jensen and W H Meckling, “Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure” (1976) 3 Journal of Financial Economics 305.

\textsuperscript{16}Matthew, n 8, 125-133.


\textsuperscript{18}See eg, Matthew, n 8, 119.


\textsuperscript{21}See what was then s 86(1)(e) of the Crimes Act 1914 (Cth) and also J Popple, “The Right to Protection from Retroactive Criminal Law” (1989) 13 Crim LJ 251, 259.

\textsuperscript{22}See now Income Tax Assessment Act 1936 (Cth) Pt IVA. There were other amendments that more directly related to the fraudulent activity however: Crimes (Taxation Offences) Act 1980 (Cth) and Taxation (Unpaid Company Tax) Act 1982 (Cth).
phoenixing situation. In particular, it is now recognised that the failure to pursue the wrongdoers in the bottom of the harbour schemes was largely due to lack of resources, or perhaps even lack of desire to do so, rather than one of a lack of legislative power as such. There is no doubt that combating fraudulent activity of any type is likely to require intensive resources. That is because it is necessary to investigate a situation which has the appearance of one form but in reality is something else. Fraud and avoidance involving the phoenixing process is unlikely to be any different. In the circumstances of phoenixing it is necessary to identify the persons and/or the entity that has taken the assets of the company that has been “phoenixed” and recover them for the creditors of that entity, including the ATO. The issue that arises is how much is this process enhanced by changing legislation rather than simply investing more resources into the identification and recovery exercise. If it is a question of resources and not necessarily one of inadequate legislative power, then it is suggested a different response is needed.

The efforts to specifically target phoenix activity in the context of taxation appear to be of fairly recent origin. Anderson notes the ATO created the “Phoenix Project” in 1998 which “allocated more staff to work with other agencies to address the phoenix problem”. At the Cole Royal Commission, it was recognised that phoenix activity was a problem in the construction industry. The ATO was amongst those who raised concerns, whose submissions referred to “millions of dollars of lost revenue to ATO” and that the fraudulent phoenix activity had become more prevalent. A number of recommendations were made in terms of sharing information and strengthening corporate laws in respect of disqualification. However, for the purposes of this article it is notable that no recommendations were made to strengthen the ATO’s powers in respect of claims against company directors for company debts.

Following on from the Cole Royal Commission was the Parliamentary Joint Committee (PIC) on Corporations and Financial Services report on insolvency laws which devoted a chapter to covering the issue of phoenix companies. The PIC report highlighted the longstanding concern of regulatory bodies; however the report did not refer to any examples pre-1992-1993. The PIC report noted that the ATO was targeted by the “careerist offenders”. It also contained a lengthy discussion of the disqualification provisions under the Corporations Act 2001 (Cth) for directors, recommended some changes and supported the recommendations of the Cole Royal Commission. Specific support was given for the identification of the directors involved in the fraudulent activities and clarification of the separate responsibilities of government agencies, particularly the ATO and ASIC. The PIC made a

25 Anderson, n 24, 414.
28 In the recent Productivity Commission’s Business Set-Up, Transfer and Closure Report, it was acknowledged that a precise estimate of the prevalence and impact of fraudulent phoenix activity is difficult to determine. However, it was estimated that 2,000 to 3,000 business per year are involved in phoenix activity, with an overall cost to employees, business and governments being in the range of $1.8 to $3.2 billion per year. Of this, the loss to government revenue was estimated to be in the range of $601-611 million. Productivity Commission, Business Set-up, Transfer and Closure, n 17, 423-424.
29 Productivity Commission, Business Set-up, Transfer and Closure, n 17, 161-166.
30 Parliamentary Joint Committee on Corporations and Financial Services Corporate Insolvency Laws: A Stocktake, n 11, Ch 8.
31 Parliamentary Joint Committee on Corporations and Financial Services Corporate Insolvency Laws: A Stocktake, n 11, 132 [8.7].

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recommendation\textsuperscript{32} that a statutory Mareva injunction be created in order to freeze director’s assets where there are potential claims by a corporation. It also sought to extend liability within corporate groups as well as improving controls over who is allowed to register a company. Whilst this report was prepared by a committee on corporations and financial services, it is again notable, for this article, that there were no detailed recommendations about the powers of the ATO in terms of tax collection. Specifically, it was not recommended that directors should be held liable on a broader basis for taxation debts of the company.

In 2009, the government issued a Treasury Proposals Paper\textsuperscript{33} which expressed a major concern with respect to phoenix activity: the loss of taxation revenue.\textsuperscript{34} Although the initial chapter is couched in general terms about what constitutes fraudulent phoenix activity, it is clear that the proposals paper was concerned fundamentally with the collection of taxation, as the ATO was the only creditor discussed. The provisions being utilised to attack phoenix activity under the corporate law were reviewed along with provisions in taxation law that relate to the collection of tax and reducing tax avoidance and evasion. However, the conclusion reached was that fraudulent phoenix activity had “increased” in recent years.\textsuperscript{35} The proposals paper suggested\textsuperscript{36} there needed to be three principles in terms of any reforms, being:

• to ensure that fraudulent phoenix activity is identified and that innocent directors are not captured inadvertently;
• incentives for fraudulent activity are removed; and
• company directors needed to be forced to take greater responsibility for the tax debts and be forced to deal with the insolvency sooner.

It is difficult to see within the subsequent proposals that the first of these principles is maintained. Some of the proposals put forward were aimed at automating the liability of the directors for the PAYG withholding liabilities, where the amounts remained unpaid for a period of time and there had been no action to place the company in an insolvency procedure. It was also suggested that this liability be extended to other types of taxes collected regularly, such as superannuation, GST and excise. Other options canvassed included the creation of an offence in respect of a failure to remit deductions, denying PAYG withholding credits for directors and their close relatives who fail to remit, and creating an offence for directors to claim credits for PAYG where they know the amounts were not remitted. Non-tax options included restricting similar name trading, requiring bonds beyond income tax liabilities and applying a doctrine of inadequate capitalisation in corporate groups. The reaction to the proposals paper saw some retreat from the automatic liability of directors, though the legislation that was ultimately passed in respect of attacking phoenixing did contain much of the sentiment evident in the proposals paper.

The centre piece of the government’s ultimate response to the Treasury Proposals Paper was the much discussed amendments to the director penalty provisions in the Taxation Administration Act.\textsuperscript{37} The relevant provisions are mostly contained in the Taxation Administration Act 1953 Sch 1 and the major elements of this legislation have been well documented.\textsuperscript{38} The first major change was that the

\textsuperscript{32} See Recommendation 33: Parliamentary Joint Committee on Corporations and Financial Services, Corporate Insolvency Laws: A Stocktake, n 11, 149 [8.81].


\textsuperscript{34} This is discussed in more detail below under the heading “General Insolvency Principles, The Position of the ATO and ASIC’s Regulatory Powers”.

\textsuperscript{35} Australian Government, Treasury, Action against Fraudulent Phoenix Activity, n 33, 12. It might be noted that there was no evidence presented to justify this conclusion.

\textsuperscript{36} Australian Government, Treasury, Action against Fraudulent Phoenix Activity, n 33, 12.


\textsuperscript{38} See eg, A Athanasiou and M Gioskos, “Ashes to Ashes … the Phoenix No Longer Rises” (2012) 47 (3) Taxation in Australia 136; S Mullette, “Penalty Shootout” (2012) 24(3) Australian Insolvency Journal 8 where some details of the provisions are covered.
director penalty regime was to operate to include any unpaid superannuation guarantee charge. Prior to 1 July 2012, there was no personal obligation on the directors where superannuation contributions were not made. A superannuation guarantee charge (tax) is payable when an employer self-assesses or the ATO issues an assessment in circumstances where the employer has failed to provide for the amount of compulsory superannuation. The legislation enables the ATO to recover even if an assessment has not been made, where an estimate is made.

The second major change was the circumstance under which relief is granted to directors, who would otherwise be liable for the company’s PAYG withholding amounts. Prior to the 2012 changes, it was possible for the directors to have the penalty obligation remitted, if following a notice the directors caused the company to enter into liquidation or administration within 21 days. The new provisions made it more onerous for the directors to have the penalty remitted; however the government withdrew the earlier proposal, promoted by the ATO, under which the directors would be liable if a debt remained unpaid after three months. The arrangements are now very technical in that the placement of the company in liquidation or administration does not cause the penalty to be remitted, if within a three-month period from when it is due, the unpaid PAYG withholding amount or the superannuation guarantee obligation is not notified to the ATO in accordance with obligations elsewhere in the relevant legislation. If there has been an estimate provided under Div 268, then there is no remittance of the penalty, so that in that circumstance, after three months, the entering into liquidation or administration does not alter the penalty. The ATO still needs to provide the director with a notice prior to the collection of any penalty by way of proceedings; however other means of collection do not require any notice under the new system. There are also some changes to the position of persons who become directors where there might be amounts already owing in respect of PAYG withholding or superannuation guarantee obligations.

A final change, designed to encourage compliance with the obligations by the directors, was the imposition of a new tax known as the PAYG Withholding Non Compliance tax. This tax is aimed at preventing the directors and their associates from claiming credit for PAYG amounts that were not paid over to the ATO. The tax means that credits are effectively withheld until the amounts owing are paid. Controversially, the tax can extend to associates of the directors, where they have actual knowledge of the non-payment by the company or where the associate was reckless as to that knowledge and they did not take reasonable steps to influence the director or report the matter. It also applies where the associate was an employee and the Commissioner is satisfied that the company treated the individual more favourably than it treated other employees of the company. There are a

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39 See Taxation Administration Act 1953 (Cth) Sch 1 s 269-10, item 5.
41 The difficult section is Taxation Administration Act 1953 (Cth) Sch 1 s 269-30. Mulette describes the table as “complicated”: Mulette, n 38, 9. This is probably a generous view of the drafting effort.
42 See Taxation Administration Act 1953 (Cth) Sch 1 s 269-30.
43 Taxation Administration Act 1953 (Cth) Sch 1 s 269-30.
44 See Taxation Administration Act 1953 (Cth) Sch 1 s 269-25.
45 Under Taxation Administration Act 1953 (Cth) Sch 1 s 269-20(3), a new director has 30 days to ensure that the company complies with the withholding or superannuation guarantee obligations before becoming personally liable. It can be noted that simply resigning as a director within that time does not relieve the incoming director of this liability. Under s 269-30(3), an incoming director has three months from the date of their appointment to have the obligation remitted by placing the company in administration or liquidation.
46 See Taxation Administration Act 1953 (Cth) Sch 1 s 269-35.
47 See Pay As You Go Withholding Non-compliance Tax Act 2012 (Cth) s 3 which imposes the tax as per Subdiv 18-D in Sch 1 of the Taxation Administration Act 1953.
48 See Taxation Administration Act 1953 (Cth) Sch 1 s 18-120.
49 See Taxation Administration Act 1953 (Cth) Sch 1 s 18-135.
number of fairly wide discretions in the hands of the Commissioner, with respect to the imposition of this tax, including that it is “fair and reasonable” for the individual to pay in respect of that year.50

More recently, the Productivity Commission has recommended51 that, in addition to existing requirements for directors, amendments should be made to s 117 of the Corporations Act 2001 (Cth) to require directors to provide a Director Identity Number at the time of the registration. It has also been recommended that ASIC be provided additional enforcement powers with respect to this requirement. However, no recommendations have been made in relation to the current taxation provisions.

GENERAL INSOLVENCY PRINCIPLES, THE POSITION OF THE ATO AND ASIC’S REGULATORY POWERS

The Australian Government’s policy in relation to previous insolvency law reform has been that the ATO is an ordinary unsecured creditor in insolvency; one who is afforded no greater priority simply because the ATO plays a greater society role in collection of taxation revenue.52 Unfortunately whilst there was a broad policy acknowledging the ATO as an ordinary unsecured creditor, the legislative reality is much more complex. This complexity arises from a seemingly endless array of provisions in various taxation legislation and the Corporations Act that can be interpreted or used to provide a way of either improving the priority position of the ATO, or at least creating a doubt as to whether the ATO should be in a preferred position. There seems little inclination on the part of the government to provide a legislative solution or clear guidance as to the position of the ATO with respect to the insolvent debtor.

It has been clear since the publication of the Treasury Proposals Paper53 that a major concern with respect to phoenix activity from the Commonwealth Government’s perspective is the loss of taxation revenue. This is understandable given the obligation upon all parties to pay taxation in accordance with the valid obligations under the law. When a corporation is insolvent, there are likely to be more unpaid creditors than just the ATO. Therefore does an approach that specifically benefits a particular creditor deliver consistency with fundamental principles of insolvency law? Insolvency procedures are collective in nature.54 Insolvency is often a zero sum game in that if funds are provided to one creditor, there will be less for other creditors. Hence in order for any party to have faith in an insolvency procedure, creditors need to be certain that they are going to be treated fairly in the insolvency. If there is this lack of faith in the procedure, creditors will act to protect their position by,

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50 This fact may raise some question as to whether this obligation might fall outside of the meaning of a “tax” as to be such, it must not be arbitrary: Roy Morgan Research Pty Ltd v Federal Commissioner of Taxation (2011) 244 CLR 97; [2011] HCA 35 [38]. In MacCormick v Federal Commissioner of Taxation (1984) 158 CLR 622; [1984] HCA 20 [32], Gibbs CJ, Wilson, Deane and Dawson JJ stated that “For an impost to satisfy the description of a tax it must be possible to differentiate it from an arbitrary exaction and this can only be done by reference to the criteria by which liability to pay the tax is imposed. Not only must it be possible to point to the criteria themselves, but it must be possible to show that the way in which they are applied does not involve the imposition of liability in an arbitrary or capricious manner.” It has been suggested that a number of the criteria in s 18-135 leave too much discretion in the hands of the Commissioner.

51 Australian Law Reform Commission, Business Set-up, Transfer and Closure, n 17, 38, 409.

52 Australian Law Reform Commission (ALRC), General Insolvency Inquiry, Report No 45 (Canberra, 1988) [713], [737]. See also: Senate Standing Committee on Constitutional and Legal Affairs Priority of Crown Debts (Australian Government Publishing Service, Canberra, 1978); Taxation Debts (Abolition of Crown Priority) Bill 1980 Explanatory Memorandum which in dealing with the amendment of then s 215 of the Income Tax Assessment Act 1936 [subsequently now in Taxation Administration Act 1953 (Cth) Pt 4.15] noted “Specifically, the section as amended will acknowledge the rights of secured and preferred creditors to be paid first. Out of any assets of the company remaining for ordinary creditors only a pro rata share will be required to be set aside for income tax”; Insolvency (Tax Priorities) Legislation Amendment Act 1993 (Cth).

53 Australian Government, Treasury, Action against Fraudulent Phoenix Activity, n 33.

54 This conceptual notion is perhaps regarded as so fundamental, it is rarely explained fully. Jackson notes that “A collective system that treats all claimants standing in the same relationship to the debtor alike has the virtue of substituting a sum ‘certain’ for the uncertain amount that might be realized under an individualistic creditors’ remedy system.” T Jackson, “Bankruptcy, Nonbankruptcy Entitlements and the Creditors Bargain” (1982) 91 Yale Law Journal 857, 861. He goes on to note also the advantage of potential increases in the pool of assets available because of a more synergistic approach to the debtor’s assets and the reduction in costs from having only one central approach instead of each creditor having to incur costs of recovery.
for example, charging more for credit or undertake excessive monitoring. The collective nature of an insolvency procedure thus provides benefits to all creditors, because each creditor charges less to all purchasers of credit safe in the knowledge that if any debtor fails to repay, they will get at least as much as other creditors. There are variations within the collective nature in the sense that some creditors have been allocated priority. In Australia, it was recognised by the Harmer Report\textsuperscript{55} that the priority then afforded to the ATO in respect of unremitted tax deductions was not, on balance, justifiable. The Harmer Report noted “the failure by the Crown to take steps to see the money paid over is damaging and has a prejudicial effect on all creditors.”\textsuperscript{56} In other words, the priority that was then afforded to the ATO resulted in the ATO not being proactive in pursuing debts at an early stage. The ATO’s passive pursuit of debt meant that other creditors, without the priority, were left unpaid to an extent greater than might otherwise be expected.

Ultimately the government did not implement the clear recommendation of the Harmer Report but compromised, with the ATO losing the outright priority but being able to claw back the amounts directly from the directors in certain circumstances. It was clear that the ATO was never quite removed to the status of an ordinary creditor in respect of these types of claims, but the 2012 law changes promote the ATO’s position as a creditor somewhat further. The important considerations raised by the Harmer Report were not apparent in the more recent discussion. In the more recent discussion and subsequent amendments, it has been assumed that somehow the issue of director liability is essentially a matter of ensuring compliance with the tax legislation and is not an issue of priority in an insolvency situation. This argument is plausible, if it were possible to ignore the insolvent trading provisions of the Corporations Act or other alleged claims against directors in the phoenixing situation.\textsuperscript{57} For example, if there is a phoenixing operation in which a company has incurred debts and failed to remit obligations in respect of tax deductions from wages, there will be inadequate assets left within the company that has been abandoned. In such circumstances a company liquidator may pursue the directors for insolvent trading or a claim against directors for breach of fiduciary duty or statutory duty under Pt 5.7B.\textsuperscript{58} The ATO can also pursue the directors in respect of the unremitted tax obligations by virtue of the taxation legislation. It may be that the directors will have sufficient funds to meet all of these claims. There is a possibility, however, that the directors themselves will lack the funds to pay all of these claims. If that is the case, there is the matter of which of these claimants should have priority. The legislation does not consider this issue and provides no solution. It is submitted that the same considerations as were applied in the Harmer Report are relevant here. Namely, that the ATO needs to be similarly treated to other creditors, once insolvency occurs and if the ATO is to be given a greater claim vis a vis other creditors, it ought to be fully justified. Unfortunately no such argument has been made and the arguments raised by the Harmer Report remain persuasive. It might be thought that the legislation relating to the recovery of these taxation claims is entirely consistent with broader insolvency principles. Section 269-5 of Sch 1 of the Taxation Administration Act 1953 states that the subdivision has the objective to “ensure that a company either: (a) meets its obligations … or (b) goes promptly into voluntary administration under the Corporations Act 2001 or into liquidation”. These alternative objectives suggest that the legislation is designed to push the directors towards implementing a collective insolvency process. However, in examining the substance of the 2012 changes it would seem the objective is abandoned. The flavour of these amendments can be found in the Explanatory Memorandum where it is stated:

\textit{some aspects of the director penalty regime limit its efficacy in ensuring that directors cause their companies to comply with their obligations, including in phoenix cases. Most notably, as directors are}

\textsuperscript{55}Australian Law Reform Commission, Report No 45, n 52, [733]-[741].

\textsuperscript{56}Australian Law Reform Commission, Report No 45, n 52, [737].

\textsuperscript{57}This may include claims in respect of a breach of director’s duties such as the obligation to act in the best interest of the corporation (also in s 181 of the Corporations Act 2001 (Cth)) or perhaps for undertaking uncommercial transactions or other claims in Pt 5.7B of the Corporations Act 2001 (Cth).

\textsuperscript{58}In practical terms it may be that liquidators of a company that has been phoenixed will have few funds to pursue claims against directors. If that is the case then it reinforces somewhat the argument made here that the current approach allows the ATO to be favoured at the expense of creditors who must rely upon a liquidator to take action against the directors.
provided 21 days’ notice of the penalty before the Commissioner is able to commence proceedings to recover the liability, some directors extinguish their personal liability by placing the company into voluntary administration or liquidation within that notice period and before the Commissioner has an opportunity to commence proceedings to recover the debt. This often means that the full amount of PAYG withholding liabilities is never recovered.59

The argument for the changes was thus the belief that directors were avoiding personal liability by placing the company in liquidation or administration in the period following the serving of the Director Penalty Notice. It is no doubt desirable that if directors are in a position to cause the company to comply with the tax obligations, they should cause it to do so. On the other hand, the stated objectives of the Tax Administration Act are clear. The Explanatory Memorandum seems to be complaining that once the company enters into the relevant insolvency procedure, the ATO will be treated like any other creditor and it stands a chance of losing what might be termed a preferred position of being able to claim directly from the directors. The question becomes in the case of these particular taxation debts, should the notion of the separate legal entity of the corporation be abrogated and should the directors effectively provide a personal guarantee for these debts?

There is some force in the argument that of all creditors, the ATO suffers most in fraudulent phoenix activity. The argument that can be made is that a fraudulent phoenixing operation requires the support of trade creditors and employees but does not require anything from the ATO. Accordingly a fraudulent operator will tend to pay the suppliers and employees of the business but leave the ATO unpaid when a new entity is established. Whilst that much is plausible, the difficulty is we do not have data to prove this is the case. Further even if that can be accepted it does not automatically follow that the current provisions where the ATO is provided with a direct line to the directors’ funds is the best way to proceed.

It seems that the most recent amendments take a fairly broad-brush approach without too much consideration as to whether any particular director is engaged in fraudulent phoenix activity or whether it is simply that the company is insolvent. It is doubtful if the changes promoted in the 2012 amendments will assist in achieving the second objective in s 269-5. If this objective has been abandoned, as the effect of the legislation now seems to make clear, it should be removed to make it clear that the legislation is concerned with collection of tax by the ATO and not a more worthy goal (at least in the insolvency law sense) of having the company enter voluntary administration promptly. In addition, it is difficult to see how the extension of the PAYG Withholding tax liability to associates of the directors represents a step in dealing with phoenix activity. The legislative extension provides for no distinction between a genuine case of fraudulent phoenix activity and those of directors who may be conducting small businesses at the margin of solvency with little financial sophistication. Indeed it may well be that the effect of the changes will be that the ATO is less active in chasing its debts, knowing it has recourse to the directors (and in some cases the directors’ associates) personally. In turn, a director may be less inclined to deal quickly with the company’s insolvency as it is recognised that in certain situations personal liability cannot be avoided, even with the company’s entry into the insolvency procedure.

**THE ATO IN A DECENTRED REGULATION ENVIRONMENT**

Assuming that one of the aims of the ATO’s collection powers continues to be that of encouraging insolvent companies to enter into an insolvency procedure promptly, it is arguable that the ATO plays some form of regulatory role in dealing with insolvent companies. There is, however, some confusion perhaps around the delineation of roles being played by the two major regulators here: the ATO and ASIC. If the ATO sees itself, or is seen by others as a potential regulator in this sense, it seems that the ATO has a conflicted position in that it is both creditor and regulator. It has become clear in other

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areas that the ATO has used its legislative powers to improve its position vis-à-vis other creditors. Whilst this is an area of study in itself, the clear message from the ATO’s actions is that it is concerned to ensure it collects its debt and does not defer to other creditors by adopting a pari passu approach. Therefore the question needs to be asked as to whether the ATO is a proper authority to police phoenix activity? This blurring of the position of the ATO and ASIC may have resulted in a set of provisions that confuses the need for the ATO to preserve its position as creditor and its power as enforcer of the taxation legislation. The ATO pursues its own agenda in terms of ensuring compliance and collecting the debts it is owed. Whether that will result in a benefit to any other creditors is at best coincidental and can never be guaranteed. It may be that a more holistic approach needs to be adopted at an administrative level. Whilst ASIC has shown itself to be overburdened with functions and is perhaps underfunded as a result, it remains within our system the appropriate administrative body to deal effectively with fraudulent phoenix activity.

The conclusion drawn from the current approach is that ASIC fails to adequately police fraudulent phoenix activity because it lacks the incentive that the ATO has to pursue the matter. Furthermore, there is general consensus that ASIC has limited resources in relation to fraudulent phoenix activity. Our corporate law system deserves better. We need to examine the underlying principles that belie phoenixing, as well as objective data supporting the extent of the phoenixing problem. A fundamental re-examination of the legislative approach to prevent phoenixing should be undertaken, part of which includes a need to examine the regulation of phoenixing activities in similar jurisdictions. Only by doing so can the position of the ATO be considered in a more objective way.

As fraudulent phoenix activity offends both general insolvency principles and the ATO’s tax compliance mandate, then the optimal regulatory approach is one that, at the very least, takes into consideration both these purposes. ASIC is still the corporate regulator, having the powers to deal with directors who engage in fraudulent phoenix activity and, therefore, is the proper party to proceed with enforcement. However, to position the ATO as a regulator would leave a confused and lopsided public policy position in which one creditor can protect itself in insolvency, but other unsecured creditors lack the same opportunity.

An alternative approach may be to develop a framework based on decentred regulation principles. Black argues that the advantage of adopting a decentred approach to understanding regulation is that it “emphasises both causal complexity and the complexity of interactions between actors in society (or systems)”.

By exploring further the notions of regulatory functions, regulatory capacity and regulatory enrolment an analytical framework for decentred regulation can be developed which facilitates a detailed description of a complex regulatory system, and which provides a critical frame for assessing its effectiveness and legitimacy.

This recognises that there can exist a “multitude of regulatory actors”, both government and non-government and allows for specific consideration of inter-agency collaboration. While it is acknowledged that decentred regulation is premised on enrolment of non-government actors in the regulation framework, from a practical perspective it is argued that government continues to maintain a substantial role in the regulation of phoenix activity. Further, as Black notes in the context of the role that credit ratings played in the global financial crisis, enrolment itself brings significant

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60 See for example the use of s 260-5 notices attempting to garnishee debts owing to the insolvent as evidenced in cases such as Bruton Holdings Pty Ltd (in liq) v Federal Commissioner of Taxation (2009) 239 CLR 346; [2009] HCA 32 and Federal Commissioner of Taxation v Park (2012) 205 FCR 1; 90 A TR 519; [2012] FCAFC 122, which show the ATO is willing to ensure that legislative advantage will be taken.


63 In analysing the development of consumer credit regulation in the United Kingdom through the lens of a decentred model, Iain Ramsey noted the significant role played by the government given that consumer protection rules are based in the law, and that many of the UK initiatives which involved of non-government actors in the process would not have occurred if not driven by the government: I Ramsey, “Consumer Law, Regulatory Capitalism and the ‘New Learning’ in Regulation” (2006) 28(9) Sydney Insolv LJ 127.
dependencies and vulnerabilities. However, the value of adopting a decentred analysis of the fraudulent phoenix activity regulation is that it provides a framework in which regulatory functions could be distributed across multiple agencies, in particular ASIC and the ATO. This framework provides a means by which weaknesses of the current regulation can be examined in order to identify specific regulatory needs, the capacity of each agency to address those needs and the relationship of each agency to specific functions within the regulation process can be identified.

Black states that development of such a framework requires considerations of certain analytical tasks, being:

- the disaggregation of what regulation entails in functional terms, the identification of actors who are or might be involved in the regulatory system, an analysis of their regulatory capacity, relating that capacity to different regulatory functions, and an analysis of the interrelationships that arise between the actors in the regulatory system.

The components of this framework can be seen as “tasks”, though not necessarily linear in application, which provide some indication on how a decentred model might work. The first task involves identifying and extracting the functions, or objectives, of anti-phoenix regulation. Black suggests that there are three core regulatory functions, being standard setting, information gathering and behaviour modification, which are performed in order to “regulate” in a traditional sense. However, as Black notes, a narrow interpretation of these functions may reduce the analysis to the “command and control” regulatory framework that a decentred understanding seeks to avoid.

In addition to identifying regulatory functions, it is also necessary to identify the range of actors that may be involved in anti-phoenix regulation and determine their respective regulatory capacity. As stated above, for the purpose of this article, the “actors” are confined to discussion of ASIC and the ATO. However, other potential actors include insolvency practitioners, professional bodies such as the Australian Restructuring Insolvency and Turnaround Association (ARITA) and Australian Institute of Company Directors, as well as creditors who have suffered loss at the hands of phoenixin operators. It has been previously identified that ASIC is considered to be resource scarce. However, regulatory capacity is not confined to actual capacity, but rather extends to potential possession of resources, such as expertise, financial and economic resources, authority, and organisational capacity. In addition, there must also be a willingness to use resources to further identify goals and objectives. This may be problematic when funding issues arise.

The more critical task is to evaluate how the actors interrelate, and how the regulatory capacity of each actor relates to the regulatory functions associated with fraudulent phoenix activity. This facilitates a deeper understanding of complexities involved in regulating fraudulent phoenix activity and possible inter-agency relationships. We are not suggesting in this article all of the potential actors

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69 The net may even be cast wider in the case of something such as phoenixin where customers for example may be capable of alerting ASIC of phoenix type activity. See generally Price Waterhouse Coopers, n 13, 4-5.
70 For discussion of funding issues and impact on performance, see generally Australian Government, Senate Economic References Committee, Performance of the Australian Securities and Investments Commission, Final Report, n 23.
and how they may play a role in anti-phoenixing activity – we focus largely on the ATO and its role. However, we do provide some preliminary examples of how this might occur.

This standard setting function recognises that each actor will have differing and, possibly, competing objectives as to the aims of the anti-phoenix regulation, and there will generally be more than one actor involved in the drafting of the applicable “rules”. Therefore, Black argues that the process of defining objectives through a process of negotiation and bargaining is crucial.71 In the context of ASIC and the ATO, it is with respect to this function that rethinking needs to occur. That is, the ATO’s conflicting role as creditor in insolvency needs to be explicitly recognised in the process of determining relevant standards and policy positions.

A decentred analysis of the information gathering function of regulation also recognises that information is diffused among various actors, so that no one actor has all the information necessary to ensure that the regulation operates effectively. In this context, it is clear that the ATO has access to a wide range of information by virtue of its administration powers and, therefore, has the potential to reduce the information asymmetry that is considered a significant cause of regulatory failure.72 Therefore, one way forward may be that information from the ATO be shared with ASIC in a more formal manner, with further funding provided by the government to enable such cooperative sharing.73

Similarly, the ATO has a wide range of legislative powers that both assists collection of taxation revenue and has the potential to moderate behaviour. For example, as indicated above, the objectives of the director penalty provisions are aimed at modifying the behaviour of directors towards entering into a collective insolvency process. However, Black argues that behaviour modification goes beyond mere compliance objectives and that methods of information gathering can also impact behaviour.74 By way of example, in its 2013-2014 Annual Report, the ATO stated:

behavioural insights helped us refine a debt collection warning letter prompting taxpayers to take immediate action to address their debt. Results indicate a 12.6% increase in payments in full for activity statement debts, and a 12.1% increase in payments in full for income tax debts.75

A final aspect which needs to be considered is the enrolment of various actors.76 That is, will the actors buy in to the role of assisting with the overall aims? In this context, the ATO has clearly bought in to the process of regulating anti-phoenix activity, given its formal pronouncements discussed earlier in the article. Thus this issue may not be a difficulty in the case of the ATO, but it would be necessary to identify the role in the regulatory capacity rather than the debt collection aspect.

CONCLUSIONS

The real matter of concern in the area of fraudulent phoenixing is with respect to enforcement of current obligations against directors in such circumstances and this requires dedicated funding for ASIC to enforce, as well as perhaps, a greater exchange of information with the ATO. The new powers granted to the ATO with respect to director liability are likely to benefit only the ATO. Again, they fail to adequately identify fraudulent phoenix activity and as a result are likely to catch genuine insolvencies in a way that will result in the ATO gaining a preferential position. In addition, the potential liability of associates of directors raises a number of equity issues which makes the approach seem very heavy handed. Whether such legislation is beneficial to our commercial activity is doubtful. It certainly raises questions as to whether the intent of the legislation: to place the ATO in the position
of any other creditor, in terms of priority, and to encourage early placement into insolvency, is still a working principle of the current legislation. A much more principled approach is needed whereby consideration is given within tax legislation to the situation in insolvency. In this article, we argue that a decentred analysis of the regulation can inform the roles that the ATO and ASIC have in relation to fraudulent phoenix activity. A framework built on this analysis could provide a new way of thinking on the current regulation which would enable a more practical discussion of how the two agencies interrelate, and how the anti-phoenix regulation could be improved. However, it would require a whole of government approach and the recognition that new procedures may not result in the ATO advancing its position vis a vis other creditors.