
COMBATING ILLEGAL PHOENIX ACTIVITY

EXPOSURE DRAFT EXPLANATORY MATERIALS

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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
BAS	Business Activity Statement
Commissioner	Commissioner of Taxation
GIC	General Interest Charge
GST	Goods and Services Tax
GST Act	<i>A New Tax System (Goods and Services Tax) Act 1999</i>
LCT	Luxury Car Tax
PAYG	Pay-as-you-go
PRRT	Petroleum Resource Rent Tax
RBA	Running Balance Account
TAA 1953	<i>Taxation Administration Act 1953</i>
WET	Wine Equalisation Tax

Chapter 1

Combating illegal phoenix activity

Introduction

1.1 This Chapter outlines the issues associated with illegal phoenix activity and its impact on creditors, employees, government revenue and the broader economy. This Chapter also outlines the Government's response to illegal phoenix activity, including the amendments contained in the Exposure Draft.

Illegal phoenix activity

1.2 Phoenix activity is not defined in legislation and can encompass both legitimate business rescue activities and the use of serial deliberate insolvency as a business model to avoid paying company debts.

1.3 While the scale of illegal phoenix activity ranges from the opportunistic to the systemic, a common characteristic is the stripping and transfer of assets from a company to another entity. Such transactions are carried out by a company's directors or other controlling minds with the intention of defeating the interests of the first company's creditors in that company's assets. Such transactions are also facilitated by others, including unscrupulous pre-insolvency advisers, accountants, lawyers or other business advisers, who advise companies on how to engage in illegal phoenix activity.

1.4 Illegal phoenix activity was a significant issue explored in the Senate Economics Reference Committee's 2015 inquiry into *Insolvency in the Australian construction industry*. An April 2018 report by PricewaterhouseCoopers, prepared for the Phoenix Taskforce, estimated the direct cost to businesses, employees and government as a result of potential illegal phoenix activity to be between \$2.85 billion and \$5.13 billion in 2015-16.

1.5 Those affected by illegal phoenix activity include employees of the original failed company, other businesses and contractors who are owed money because they have supplied goods and services, and statutory bodies such as the ATO. It also gives phoenix companies an unfair advantage over their competitors, damaging the competitive process.

The Government response

1.6 The Australian Government has committed to ongoing reform of Australia's corporate insolvency regime. The Exposure Draft contains a package of measures aimed at countering illegal phoenix activity and marks the Government's third tranche of insolvency law reforms.

1.7 The first tranche, contained in the *Insolvency Law Reform Act 2016*, modernised the corporate reorganisation framework around the registration, remuneration and regulation of insolvency practitioners to improve confidence in the corporate insolvency regime and reduce associated costs.

1.8 The second tranche, introduced as part of the National Innovation and Science Agenda, focussed on supporting honest business restructuring. The *Treasury Laws Amendment (2017 Enterprise Incentives No. 2) 2017 Act* introduced a safe harbour for directors from personal liability for insolvent trading if the company is undertaking a restructure outside formal insolvency. From 1 July 2018, it also made *ipso facto* clauses (that allow contracting parties to immediately terminate agreements with a company when an insolvency event occurs) unenforceable if the company is undertaking a formal restructure.

1.9 The Exposure Draft implements four measures to combat illegal phoenix activity that were announced in the 2018 Budget:

- Schedule 1 introduces new phoenix offences to prohibit creditor-defeating dispositions of company property, penalise those who engage in or facilitate such dispositions, and allow liquidators and ASIC to recover such property (see Chapter 2);
- Schedule 2 ensures directors are held accountable for misconduct by preventing directors from improperly backdating resignations or ceasing to be a director when this would leave the company with no directors; (see Chapter 3);
- Schedule 3 allows the Commissioner to collect estimates of anticipated GST liabilities and make company directors personally liable for their company's GST liabilities in certain circumstances (see Chapter 4); and
- Schedule 4 authorises the Commissioner to retain tax refunds where a taxpayer has failed to lodge a return or provide other information that may affect the amount the Commissioner refunds. This ensures taxpayers satisfy their tax obligations and pay outstanding amounts of tax before being entitled to a tax refund (see Chapter 5).

1.10 The fifth and final element of the Budget package prevents related creditors facilitating illegal phoenix activity by unduly influencing the removal or replacement of external administrators. This is implemented through amendments to the *Insolvency Practice Rules (Corporations) 2016* in a separate Exposure Draft released on the Treasury website: www.treasury.gov.au.

1.11 The measures in the Exposure Draft build on other actions taken by the Government to combat crime and fraud occurring in the economy, including:

- instituting the Black Economy, Serious Financial Crime and Phoenix Taskforces;
- establishing a dedicated team to drive implementation of the extensive work program arising from the Government's response to the Black Economy Taskforce Final Report;
- establishing an Advisory Board made up of private and public sector members who will provide strategic advice on trends and risks in the black economy;
- reviewing and enhancing ASIC's powers and enforcement tools;
- initiatives to curb the excessive drain on the taxpayer funded Fair Entitlement Guarantee scheme, which covers employees' entitlements left outstanding as a result of failed business enterprises;
- the package of reforms in Schedule 5 to the Treasury Laws Amendment (2018 Measures No. 4) Bill 2018 that targets employers who fail to meet their superannuation guarantee obligations;
- legislating to enable information sharing between key regulatory agencies;
- improving the collection of GST on new residential premises and residential subdivision transactions and introducing a reverse charge to prevent GST fraud in the precious metals industries ;
- phasing in near real time reporting by employers of payroll and superannuation information to the ATO through the single touch payroll reporting framework;
- the prohibition of the manufacture, distribution, possession, use or sale of electronic point of sale sales suppression technology and software;

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- consulting on improving the transparency of beneficial ownership information of companies, and making the information available to key regulators for enforcement purposes; and
 - developing and improving legislation to encourage and protect whistleblowers.

Government taskforces

1.12 In order to develop an effective, whole-of-government response to the illegal phoenix problem, the Government established a number of taskforces to facilitate cross-agency co-operation and enforcement.

1.13 The Government established the Phoenix Taskforce in 2014, and the Serious Financial Crime and Black Economy Taskforces in 2015 and 2016 respectively. The Taskforces have each focussed on combating illegal phoenix activity and have provided extensive advice to Government.

Phoenix Taskforce

1.14 The Government's on-going Phoenix Taskforce comprises 30 Federal, State and Territory government agencies and provides a whole-of-government approach to combating illegal phoenix activity.

1.15 The Phoenix Taskforce is a crucial player in countering illegal phoenix activity, and has reported to the Government that the detection, deterrence and disruption activities undertaken by Phoenix Taskforce agencies are starting to have an impact on the problem. The Phoenix Taskforce has also contributed to the development of law reform proposals, including the reforms outlined in this Exposure Draft.

Serious Financial Crime Taskforce

1.16 The Serious Financial Crime Taskforce is part of the Australian Federal Police-led Fraud and Anti-Corruption Centre. The Taskforce, which includes ASIC, the Australian Transaction Reports and Analysis Centre, the ATO and other Commonwealth agencies, is responsible for investigations and prosecutions for serious and complex financial crimes including illegal phoenix activity.

Black Economy Taskforce

1.17 The Government established the Black Economy Taskforce to develop an innovative, forward-looking and whole-of-government policy response to combat the black economy in Australia.

1.18 The Government released the final report of the Black Economy Taskforce on 8 May 2018. The final report highlighted the harm the black economy causes to honest businesses and the community, penalising honest taxpayers, undermining the integrity of Australia's tax and welfare systems and creating an uneven playing field for the majority of compliant small businesses.

1.19 In the 2018 Budget, the Government announced a package of reforms to address the black economy, including:

- modernising and strengthening the Australian Business Number system;
- a comprehensive strategy to combat illicit tobacco;
- the introduction of an economy-wide \$10,000 cash payment limit;
- restricting government procurement to businesses that have acceptable tax records;
- \$315 million in additional funding to the ATO to increase its enforcement activity against black economy behaviour.
- a further expansion of the taxable payments reporting system and consultation about extending similar reporting to the sharing economy; and
- removing the tax deductibility of non-compliant payments;

Chapter 2

Phoenixing offences and property transfers to defeat creditors

Outline of chapter

2.1 Schedule 1 to the Exposure Draft introduces new phoenixing offences to prohibit creditor-defeating dispositions of company property, penalise those who engage in or facilitate such dispositions, and allow liquidators and ASIC to recover such property.

Context of amendments

2.2 Australia's corporate insolvency laws aim to balance the freedom of companies to engage in commercial risk-taking against the legitimate interests and expectations of creditors, including company employees. The Government has made a number of reforms to the law in recent years to ensure this balance is appropriate and to ensure that misconduct can be addressed quickly and efficiently.

2.3 The *Corporations Act 2001* imposes duties on directors and other officers to the company generally and specific duties that protect the interests of the company's creditors. The most serious breaches of these duties are subject to criminal offences in addition to civil remedies: for example, officers acting for an improper purpose (section 184) or failing to prevent the company from trading while insolvent (section 588G).

2.4 Part 5.7B of the *Corporations Act 2001* enables company liquidators to recover – on behalf of insolvent companies and their creditors – compensation from directors that fail to prevent insolvent trading (Division 4) and to seek court orders voiding certain transactions, including insolvent transactions and unfair preferences (Division 2). This allows liquidators and insolvent companies to better meet the legitimate demands of creditors affected by the insolvency.

2.5 The prohibition against insolvent trading (and associated compensation mechanisms) is subject to an important defence known as the safe harbour (section 588GA). Introduced as part of the Government's National Innovation and Science Agenda, the safe harbour encourages companies in legitimate financial difficulty to undertake a restructure in certain circumstances.

2.6 The safe harbour is intended to drive cultural change among company directors by encouraging them to engage early with financial hardship, keep control of their company and take reasonable risks to facilitate the company's recovery, rather than prematurely placing the company into voluntary administration or liquidation. The safe harbour is subject to a number of limitations that make it unattractive to dishonest directors who might want to illegally phoenix their company.

Summary of new law

2.7 Schedule 1 to the Exposure Draft amends the *Corporations Act 2001* to improve the mechanisms available to combat illegal phoenix activity, specifically creditor-defeating dispositions: transfers of company assets that prevent, hinder or significantly delay creditors' access to the company's assets in liquidation.

2.8 In particular, the amendments introduce new offences for:

- company officers that fail to prevent the company from making creditor-defeating dispositions; and
- other persons that facilitate a company making a creditor-defeating disposition.

2.9 These offences are subject to a number of important safe-guards to ensure the amendments do not affect legitimate businesses and commercial transactions. This includes maintaining the safe harbour for legitimate business restructures, respecting transactions made with creditor or court approval (as appropriate) under a deed of company arrangement or scheme of arrangement, and transfers at market value.

2.10 To protect creditors, these amendments make a number of refinements to the corporations law to allow for the efficient recovery of assets and, where necessary, the provision of compensation. In particular, the amendments provide that:

- liquidators can seek to recover the assets or other consideration through the courts for the benefit of the company's creditors;
- ASIC can make orders to recover assets for the company's creditors; and
- liquidators – and in some cases creditors – can recover compensation from a company's officers and other persons responsible for a company making a creditor-defeating disposition.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<i>Creditor-defeating dispositions</i>	
A disposition of company property that has the effect of preventing, hindering or significantly delaying the property becoming available to meet the demands of the company's creditors in winding-up is a creditor-defeating disposition.	No equivalent.
<i>Recovery of voidable creditor-defeating dispositions</i>	
A transaction may be voidable if it is a creditor-defeating disposition and is made when the company is insolvent, or, because of the disposition, the company immediately becomes insolvent or enters external administration within the following 12 months. Exceptions apply.	No equivalent.
Liquidators may also apply to a court for an order in relation to a voidable creditor-defeating disposition.	Liquidators may apply to a court for an order in relation to a voidable transaction.
ASIC has specific powers to make orders to recover – for the benefit of a company's creditors – company property disposed of or benefits received under a voidable creditor-defeating disposition. Liquidators may apply to ASIC seeking an order.	No equivalent.
<i>Prohibitions on creditor-defeating dispositions</i>	
A creditor-defeating disposition is prohibited if it is made by a company at a time when the company is insolvent, or, because of the disposition, the company immediately becomes insolvent or enters external administration within the following 12 months. Exceptions apply.	No equivalent.

<i>New law</i>	<i>Current law</i>
It is a criminal offence for officers to engage in conduct that results in a company making a prohibited creditor-defeating disposition.	No equivalent.
A civil penalty provision applies to officers that engage in conduct that results in a company making a disposition where a reasonable person would have known the disposition was a prohibited creditor-defeating disposition.	No equivalent.
It is a criminal offence for a person to procure, incite, induce or encourage a company to make a prohibited creditor-defeating disposition.	No equivalent.
A civil penalty provision applies to a person that procures, incites, induces or encourages a company to enter into a disposition where a reasonable person would have known the disposition was a prohibited creditor-defeating disposition.	No equivalent.
The safe harbour is also available to officers and other persons as a defence against an alleged contravention of the creditor-defeating disposition prohibitions.	The safe harbour is available to directors as a defence against an alleged contravention of the insolvent trading prohibition.
<i>Compensation for contravention</i>	
Liquidators – and in some cases creditors – may also recover compensation from a person that breaches the creditor-defeating disposition prohibition.	Liquidators – and in some cases creditors – may recover compensation from a person that breaches the insolvent trading prohibition.

Detailed explanation of new law

Creditor-defeating dispositions

2.11 The concept of a creditor-defeating disposition is central to the amendments in Schedule 1 to the Exposure Draft. A creditor-defeating disposition may be a voidable transaction recoverable by the liquidator on application to ASIC or the Court. An officer or other person responsible for a company making a creditor-defeating disposition may be subject to criminal charges, civil penalties and compensation orders.

2.12 A creditor-defeating disposition is a disposition of company property that has the effect of preventing, hindering or significantly delaying the property becoming available to meet the demands of the company's creditors in winding-up. *[Exposure Draft, Schedule 1, items 1 and 11, subsection 588FDB(1) and section 9 (definition of 'creditor-defeating disposition') of the Corporations Act 2001]*

2.13 The creation by the company of a right or other interest in property in favour of another person is taken to be a disposition of the right or other interest in property and may constitute a creditor-defeating disposition. *[Exposure Draft, Schedule 1, item 11, subsection 588FDB(2) of the Corporations Act 2001]*

2.14 In some circumstances, there is an extension to the concept of a disposition to reflect the economic substance of a transaction. Where a company disposes of property to one person and that person pays some or all of the consideration to a third party, the company is taken to have made:

- a disposition of the property actually transferred; and
- a disposition of the consideration paid to the third party.

2.15 The extended concept of a disposition ensures the outcome is the same as if the company received all of the consideration itself and then provided that consideration to the third party. *[Exposure Draft, Schedule 1, item 11, subsection 588FDB(3) of the Corporations Act 2001]*

Example 2.1 Creditor-defeating disposition of a company

On 24 February 2020, LTV Commercial Pty Ltd sells a commercial property to Alexia who wants to set up a dancing studio. LTV Commercial and Alexia agreed that the purchase price for the property is \$500,000. The property was the company's major asset.

During the transaction, LTV Commercial instructed Alexia to pay the amount of \$500,000 to AUREA Dance Pty Ltd. Ronie is both the sole director and company secretary of LTV Commercial and AUREA Dance.

On 24 August 2020, a liquidator is appointed in the winding up of LTV Commercial. The company has insufficient assets to meet the demands of its creditors.

LTV Commercial has made two creditor-defeating dispositions. The first is of its commercial property to Alexia. The second is of \$500,000 to AUREA Dance.

Voiding the transaction

2.16 A transaction is voidable if it is a creditor-defeating disposition made by a company at a time when the company is insolvent, or, because of the disposition, the company immediately becomes insolvent or enters external administration within the following 12 months. [*Exposure Draft, Schedule 1, items 12 and 13, paragraphs 588FE(1)(c), (6B)(a) and (6B)(b) of the Corporations Act 2001*]

2.17 Describing a transaction as voidable allows a court, on the application of a company's liquidator, to make a range of orders to void the transaction and to restore the parties to the position they would have been in but for the transaction (section 588FF). A liquidator can apply to a court before the later of:

- 3 years after the relation-back day (see section 91); or
- 12 months after the liquidator was first appointed.

Where company is insolvent or becomes insolvent

2.18 Establishing that a company was insolvent (or became insolvent as a result of a disposition) is a critical step in voiding a creditor-defeating disposition. Dispositions made outside of this period and the 12 months prior to entering external administration are more likely to be undertaken for legitimate commercial reasons. Losses experienced outside this period may reflect the ordinary course of entrepreneurial risk-taking, which is not the target of these amendments.

2.19 Dispositions made while a company is insolvent or in the period before the company enters administration warrant a higher degree of scrutiny. This ensures the interests of creditors are protected and company officers are acting properly.

2.20 Section 588E applies a presumption of insolvency where a company has failed to keep or maintain financial records in accordance with section 286. This presumption is necessary to ensure that directors engaging in illegal phoenix activity cannot avoid the voiding of transactions by committing further breaches of the law to obscure a company's financial position. This presumption applies to voidable transactions generally.

2.21 However, the presumption does not affect a third party if the records were destroyed, concealed or removed by a person and the third party was not in any way responsible for the destruction, concealment or removal of the records (subsections 588E(4) and (6)).

Where company enters external administration after disposition

2.22 The extension of the period in which a creditor-defeating disposition may be voidable to the 12 months prior to the company entering external administration is an important amendment to ensure liquidators can effectively challenge illegal phoenix activity. However, it is necessary for liquidators to demonstrate that the disposition contributed – directly or indirectly – to the company entering external administration within the 12-month period. [*Exposure Draft, Schedule 1, item 13, subparagraph 588FE(6B)(b)(iii) of the Corporations Act 2001*]

2.23 A company enters external administration:

- on a day an administrator of the company is appointed under section 436A, 436B or 436C;
- on the day a deed of company arrangement is executed;
- on a day the winding up of the company is taken to have begun under section 513A or 513B; and
- on a day a provisional liquidator is appointed.

2.24 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 can make it impractical for liquidators to pursue many recovery actions, frustrating the intention of the law.

2.25 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.

Where a disposition is not voidable

2.26 A creditor-defeating disposition transaction is not voidable (or is not subject to court orders under section 588FF) if the disposition:

- was for market value consideration;
- was made under a deed of company arrangement or scheme of arrangement;
- was made by the company's liquidator; or
- was made in connection with a course of action that satisfies the safe harbour in the corporations law.

Market value consideration

2.27 A particular asset of the company not being available for division among creditors on winding up is not in and of itself evidence of a creditor-defeating disposition, provided the company received market value consideration for the disposition.

2.28 In response to a claim a particular disposition is voidable, it is a defence that the property disposed of was disposed of for market value consideration. In this context, market value means the price that would be paid in a hypothetical transaction between a knowledgeable and willing, but not anxious, seller to a knowledgeable and willing, but not anxious, buyer, who transact at arm's length. *[Exposure Draft, Schedule 1, item 17, subsection 588FG(9) of the Corporations Act 2001]*

2.29 The market value of the property is assessed on two occasions: when the relevant agreement for the disposition is entered into and when the property is transferred. In simple cases, these two occasions may happen at the same time. For the defence to be available, the consideration provided for the transfer must equal or exceed the market value at one or both of the times it is tested.

2.30 A person that has received property from a creditor-defeating disposition bears an evidential burden to adduce evidence that suggests a reasonable possibility that they paid at least market value for the disposition. *[Exposure Draft, Schedule 1, item 17, paragraph 588FG(9)(a) of the Corporations Act 2001]*

Example 2.2 Market value

Contrast Industries Pty Ltd is a building supply company. In June 2019, it enters into a contract with Respectable Homes Pty Ltd for the supply of building materials for \$50,000 with a delivery date of 1 December 2019. The contract is negotiated on an arms' length basis.

Also in June 2019, Contrast Industries enters into a second contract for the supply of a similar quantity of building supplies to Shady Retreats Pty Ltd. However, this contract is for \$25,000.

In late 2019, there is a housing construction boom, increasing the price of building materials. In December 2019, the value of the building materials that Contrast Industries delivers to each of its customers is \$60,000.

In January 2020, Contrast Industries goes into liquidation with insufficient funds to pay its employees or other creditors.

The liquidator may not seek to void the sale to Respectable Homes because the market value of the contract is assessed to be \$50,000 at the time it was made. It does not matter that the disposition of the building materials was for less than market value at the time the disposition was made.

The liquidator is able to seek a court order to void the sale to Shady Retreats because both the value of the contract and the value of the delivered goods were (at the relevant times) in excess of the \$25,000 paid in consideration.

Good faith

2.31 Subsections 588FG(1) and (2) prevent a court making an order in relation to a voidable transaction if the order is prejudicial to the rights of a good faith receiver, or purchaser for value, without notice of company's insolvency, or impending insolvency.

2.32 In relation to the initial recipient of a creditor-defeating disposition, subsection 588FG(1) and (2) do not apply in relation to an order based solely on the transaction being a creditor-defeating disposition. This generally reflects that it is unnecessary to establish the company is insolvent if the company enters administration within 12 months of the disposition. Rather, it is intended the broader defence available if the disposition was for market value consideration applies to the exclusion of other similar defences. *[Exposure Draft, Schedule 1, item 17, subsection 588FG(7) of the Corporations Act 2001]*

2.33 Subsections 588FG(1) and (2) will continue to apply if the order is also based on the transaction being voidable on some other ground.

2.34 A good faith test applies to subsequent purchasers for value. Where an initial creditor-defeating disposition is voidable, a subsequent transfer of the property is not protected merely because the subsequent transfer was for market value consideration. 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. *[Exposure Draft, Schedule 1, item 17, subsection 588FG(10) of the Corporations Act 2001]*

2.35 A subsequent purchaser's claim will continue to be voidable if it is also voidable under another category of voidable transaction.

Example 2.3 Good faith

Further to Example 2.2, Shady Retreats learns the liquidator of Contrast Industries is investigating its purchase of building materials. Shady Retreats transfers the building materials to Laundry Solutions Pty Ltd in January 2020 for market value: \$60,000.

The liquidator learns that Ian is the sole director of both Shady Retreats and Laundry Solutions. The liquidator can seek a court order to void Laundry Solutions' claim to the property because it is clear it had knowledge that the original transfer was voidable.

Deeds of company arrangement and schemes of arrangement

2.36 A deed of company arrangement is a binding arrangement between a company and its creditors governing how the company's affairs will be dealt with, which may be agreed to as a result of the company entering voluntary administration. It aims to maximise the chances of the company, or as much as possible of its business, continuing, or to provide a better return for creditors than an immediate winding up of the company, or both (see section 435A).

2.37 Similarly, schemes of arrangement under Part 5.1 may be used to affect a legitimate restructure. These schemes are subject to creditor or member approval, and ASIC and judicial oversight.

2.38 A creditor-defeating disposition does not form part of a voidable transaction if it is made under a deed of company arrangement or scheme of arrangement. Due to the oversight of creditors, ASIC and the Court (as appropriate), it is inappropriate to void a transaction entered into under the terms of these arrangements. *[Exposure Draft, Schedule 1, item 13, subparagraphs 588FE(6B)(c)(i) and (ii) of the Corporations Act 2001]*

Liquidator transactions

2.39 It is not intended that the amendments apply to transactions made by a liquidator (or provisional liquidator) exercising their duties to recover property for a company. The Government's 2016 reforms to the regulation of insolvency practitioners provide a sufficient safeguard against misconduct (see Schedule 2 to the *Corporations Act 2001*) and appropriate remedies if misconduct does occur. *[Exposure Draft, Schedule 1, item 13, subparagraphs 588FE(6B)(c)(iii) and (iv) of the Corporations Act 2001]*

The safe harbour

2.40 The safe harbour in section 588GA currently protects directors from liability for debts incurred by an insolvent company in connection with a course of action that is reasonably likely to lead to a better outcome for the company than the immediate appointment of an administrator or liquidator.

2.41 A court cannot make an order under section 588FF for a voidable creditor-defeating disposition if section 588GA would apply to an officer of the company in relation to the disposition (see paragraphs 2.82 to 2.86). This does not prevent the transaction being described as voidable in the law but does prevent a court from actually voiding the transaction. *[Exposure Draft, Schedule 1, item 17, subsection 588FG(8) of the Corporations Act 2001]*

Recovery by ASIC

2.42 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
- will 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.

2.43 The amendments grant ASIC specific powers to make administrative orders to recover property the subject of voidable creditor-defeating dispositions. ASIC may use these powers to recover property for a company in liquidation on its own initiative or on the application of a liquidator. *[Exposure Draft, Schedule 1, item 18, subsections 588FGAA (1) and (2) of the Corporations Act 2001]*

Making the administrative order

2.44 ASIC's powers are directed to the entities that receive the benefit of a voidable creditor-defeating disposition. This may include subsequent beneficiaries where the property has been transferred subsequent to the initial creditor-defeating disposition. ASIC may require a person to:

- return the property to the company for distribution to its creditors;
- pay an amount equal to the benefit the person received from the creditor-defeating disposition; or
- transfer property that was purchased with the proceeds of sale of a creditor-defeating disposition (or similar dealings).

[Exposure Draft, Schedule 1, item 18, subsection 588FGAA(3) of the Corporations Act 2001]

2.45 ASIC may not make an administrative order if the safe harbour would apply to the disposition or the initial disposition was for market value. Further, ASIC may not issue an administrative order against a subsequent good faith purchaser for value without notice. These requirements mirror the defences that apply to court orders discussed above. *[Exposure Draft, Schedule 1, item 18, subsection 588FGAA(4) of the Corporations Act 2001]*

2.46 Before ASIC may make an administrative order, it must consider the conduct of the company, its officers, any relationships between the company and the person who received the disposed property, and the circumstances, nature and terms of the disposition. *[Exposure Draft, Schedule 1, item 18, subsection 588FGAA(5) of the Corporations Act 2001]*

2.47 If ASIC is satisfied that an administrative order should be made, it must give copies of the order and the written reasons for the order to the person subject to the order and to the company's liquidator. If the administrative order requires the payment of an amount to the company, the order may set a time for the payment. *[Exposure Draft, Schedule 1, item 18, section 588FGAB of the Corporations Act 2001]*

2.48 ASIC may revoke an administrative order at any time. If it revokes an administrative order, ASIC must notify the person subject to the order. *[Exposure Draft, Schedule 1, item 18, subsection 588FGAA(6) of the Corporations Act 2001]*

Compliance with administrative orders

2.49 A person subject to an administrative order must comply with its terms. Conduct in contravention of an administrative order or a failure to do something required by the order is an offence. "Conduct" is defined in section 9 of the *Corporations Act 2001* as both acts and omissions. A contravention is subject to a penalty of up to 30 penalty units or imprisonment for up to six months, or both. *[Exposure Draft, Schedule 1, items 18 and 67, section 588FGAC and item 137A of the table in Schedule 3 to the Corporations Act 2001]*

2.50 If the administrative order relates to the payment of money, the company may recover the amount as a debt. If ASIC commences proceedings in relation to a person's failure to comply with an administrative order, the court may order the person to pay the amount to the company (in addition to paying the penalty to ASIC for non-compliance with the administrative order). *[Exposure Draft, Schedule 1, item 18, subsections 588FGAD(1) and (2) of the Corporations Act 2001]*

Example 2.4 Non-compliance with administrative orders

Super Lightspeed Pty Ltd disposes and sells its commercial unit to Nicholas in April 2019. Nicholas pays the purchase price of \$980,000 to Super Lightspeed. The commercial unit's market value is \$1,180,000. Super Lightspeed and Nicholas are unrelated parties.

On 1 September 2019, a liquidator is appointed for Super Lightspeed. Upon winding up of Super Lightspeed, the liquidator discovers that Nicholas has purchased the commercial unit below its market value. The liquidator makes an application to ASIC to make administrative orders against Nicholas for the amount of \$200,000.

On 28 September 2019, Nicholas receives an administrative order from ASIC ordering him to pay the amount of \$100,000 by 28 October 2019 and \$100,000 to Super Lightspeed by 28 January 2020. Nicholas fails to pay the amounts within the periods specified in the administrative order.

In February 2020, ASIC begins Court proceedings to enforce the order. The Court makes a judgment in ASIC's favour and orders Nicholas to transfer the \$200,000 to Super Lightspeed.

Nicholas may also face civil penalties or 6-months imprisonment, or both.

2.51 A person ordered to pay a company the present value of any property may instead transfer the property to the company. This applies where ASIC orders a person to return the benefit they obtained directly or indirectly from a voidable transaction, which may include property other than the property that was the subject of the initial creditor-defeating disposition. *[Exposure Draft, Schedule 1, item 18, subsection 588FGAD(3) of the Corporations Act 2001]*

Applications to set aside administrative orders

2.52 A person may apply to the Court to have an administrative order set aside if the person believes the order has been made in error. Applications must be made within 60 days of the applicant receiving the notice or becoming aware of the administrative order. *[Exposure Draft, Schedule 1, item 18, section 588FGAE of the Corporations Act 2001]*

2.53 A person may also apply to the Administrative Appeals Tribunal in relation to ASIC's decision to issue an administrative order (section 1317B).

Offences and civil penalty provisions

2.54 The amendments in Schedule 1 to the Exposure Draft make it an offence for a company officer or a facilitator such as a pre-insolvency adviser to cause a company to make a creditor-defeating disposition. The elements of the offences and the defences available largely mirror the elements and defences that apply to making a disposition voidable. Some additional specific elements and defences focus on the conduct of the officer or facilitator alleged to be responsible for the company making the disposition.

2.55 In addition, the amendments create civil penalty provisions equivalent to each of the offence provisions. This results in four provisions providing penalties for prohibited creditor-defeating dispositions:

- a criminal offence applies to officers that engage in conduct that results in the company making a prohibited creditor-defeating disposition;
- a civil penalty provision applies to officers that engage in conduct that results in a company making a disposition where a reasonable person would have known the disposition was a prohibited creditor-defeating disposition;
- a criminal offence applies to persons that procure, incite, induce or encourage a company to make a prohibited creditor-defeating disposition; and
- a civil penalty provision applies to a person that procures, incites, induces or encourages a company to enter into a disposition where a reasonable person would have known the disposition was a prohibited creditor-defeating disposition.

Officer’s duty to prevent prohibited creditor-defeating dispositions

Criminal offence

2.56 An officer’s culpability is assessed according to the conduct they intentionally engage in. This includes acts and omissions of the officer (section 9 of the *Corporations Act 2001*). [*Exposure Draft, Schedule 1, item 26, subsection 588GAA(1) of the Corporations Act 2001*]

Recklessness as to creditor harm

2.57 To be held criminally responsible, the officer must be reckless as to the result of their conduct: the result being the company making a creditor-defeating disposition. A person is reckless with respect to a result if they are aware of a substantial risk that the result will occur and, having regard to the circumstances known to them, it is unjustifiable to take the risk, or they know the result will occur (section 5.4 of the *Criminal Code*). The question whether taking a risk is unjustifiable is one of fact. [*Exposure Draft, Schedule 1, item 26, subsection 588GAA(1) of the Corporations Act 2001*]

2.58 A disposition is a creditor-defeating disposition if it prevents, hinders or significantly delays the disposed property becoming available to creditors (see paragraphs 2.11 to 2.15). [*Exposure Draft, Schedule 1, item 11, section 588FDB of the Corporations Act 2001*]

Disposition made at particular time

2.59 In addition, it is necessary to establish the creditor-defeating disposition was made at a particular time. Consistent with the voidable transaction amendments (see paragraph 2.16), a creditor-defeating disposition is prohibited if it is made:

- when the company is insolvent (or becomes insolvent because of the disposition); or
- within the 12 months prior to the company entering external administration (if the disposition contributed to the company entering external administration).

[Exposure Draft, Schedule 1, item 26, paragraphs 588GAA(1)(a), (b) and (c) of the Corporations Act 2001]

2.60 It is necessary to establish the defendant was reckless as to the existence of this circumstance (i.e. present insolvency) or the risk of the result (i.e. becoming insolvent or entering external administration), or had knowledge of it.

2.61 A person is reckless with respect to a circumstance if they are aware of a substantial risk that the circumstance exists or will exist and having regard to the circumstances known to him or her, it is unjustifiable to take the risk (section 5.4 of the *Criminal Code*; for reckless as to a result, see paragraph 2.57).

Civil penalty

2.62 The civil penalty provision applies in generally the same terms as the offence. However, the recklessness fault element that applies to the criminal offence is not required for the equivalent civil penalty provision.

2.63 To establish a contravention of a civil penalty provision, it is sufficient to establish a reasonable person would know the result of their conduct would be the company making a creditor-defeating disposition that prevents, hinders or significantly delays the disposed property becoming available to creditors. This is a negligence standard. *[Exposure Draft, Schedule 1, item 26, subsection 588GAA(2) of the Corporations Act 2001]*

2.64 In addition, the presumption of insolvency applies if the company failed to keep adequate financial records. However, this does not affect an officer if the records were destroyed, concealed or removed by another person and the officer was not in any way responsible (subsections 588E(4) and (6)). *[Exposure Draft, Schedule 1, item 4, paragraph 588E(1)(ea) of the Corporations Act 2001]*

2.65 If the presumption applies, the defendant will need to prove the solvency of the company to deny this element. The reversal of the onus of proof is appropriate because companies are under an obligation to maintain financial records and it is unreasonable for ASIC to be required to prove a fact that has been intentionally concealed by the defendant.

Summary

2.66 The elements of the offence and civil penalty provision are summarised in Table 2.1.

Table 2.1 Officer’s duty to prevent creditor-defeating dispositions – elements

<i>Physical element</i>	<i>Fault element (offence)</i>	<i>Fault element (civil penalty)</i>
The defendant engages in conduct	Intent	Intent
The conduct results in a creditor-defeating disposition	Recklessness	Negligence (knowledge or reasonable knowledge)
The disposition is made when the company is insolvent, or, because of the disposition, immediately becomes insolvent or enters external administration within the following 12 months (the presumption of insolvency may apply in civil penalty proceedings)	Recklessness	Recklessness

2.67 Note that civil penalty provisions do not incorporate the equivalent fault elements from the *Criminal Code*. These fault elements apply according to the ordinary meaning of the elements of the provisions.

2.68 Table 2.1 makes it clear a different fault element applies to the physical element that the conduct results in a creditor defeating disposition. For a civil penalty, it is not necessary to demonstrate the defendant knew there was a substantial risk of the disposition being a creditor-defeating disposition. Rather, it is sufficient to demonstrate a reasonable person in the position of the defendant would have known that this was the case.

2.69 Defences to the offence and the civil penalty provision are discussed in paragraphs 2.75 to 2.95.

Facilitators procuring creditor-defeating disposition

2.70 The offence and civil penalty provisions for procuring a company to make a creditor-defeating disposition mirror the prohibition on conduct by officers. The difference is that a broader range of persons – both natural persons and legal persons – may be involved in a contravention. In addition, the basis for a person’s culpability is specific conduct to procure, incite, induce or encourage the company to make the disposition. [*Exposure Draft, Schedule 1, item 26, subsections 588GAB(1) and (2) of the Corporations Act 2001*]

2.71 The purpose of this prohibition is to address the actions of unscrupulous facilitators and pre-insolvency advisers, and other entities that, while not formally responsible for the management of a particular company, are responsible for designing and implementing illegal phoenix schemes.

2.72 A body corporate may engage in conduct that results in a contravention of the offence provision. This requires establishing that an individual procured, incited, induced or encouraged a company to make a prohibited creditor-defeating disposition and that individual did so within the actual or apparent scope of his or her employment, or within his or her actual or apparent authority of the body corporate (section 12.2 of the *Criminal Code*). Under section 12.3 of the *Criminal Code*, it is also necessary to establish:

- the board of the body corporate or a high managerial agent knowingly or recklessly carried out the relevant conduct, or expressly, tacitly or impliedly authorised or permitted the commission of the offence; or
- a corporate culture existed within the body corporate that directed, encouraged, tolerated or led to non-compliance.

2.73 The elements of the offence and civil penalty provision are summarised in Table 2.2.

Table 2.2 Facilitators procuring creditor-defeating dispositions – elements

<i>Physical element</i>	<i>Fault element (offence)</i>	<i>Fault element (civil penalty)</i>
The defendant procures a company to make a disposition	Intent	Intent
The disposition is made and is a creditor-defeating disposition	Recklessness	Negligence (knowledge or reasonable knowledge)
The disposition is made when the company is insolvent, or, because of the disposition, immediately becomes insolvent or enters external administration within the following 12 months (the presumption of insolvency may apply in civil penalty proceedings)	Recklessness	Recklessness

2.74 Note that civil penalty provisions do not incorporate the equivalent fault elements from the *Criminal Code*. These fault elements apply according to the ordinary meaning of the elements of the provisions.

Defences

2.75 The following defences apply uniformly to the criminal offence and the civil penalty provisions for both officers and other persons:

- the disposition was for market value consideration (see paragraphs 2.27 to 2.29); [*Exposure Draft, Schedule 1, item 26, paragraphs 588GAA(3)(b) and 588GAB(3)(b) of the Corporations Act 2001*]
- the disposition was made under a deed of company arrangement or scheme of arrangement (see paragraphs 2.36 to 2.38); [*Exposure Draft, Schedule 1, item 26, subparagraphs 588GAA(3)(a)(i) and (ii), and 588GAB(3)(a)(i) and (ii) of the Corporations Act 2001*]
- the disposition was made by the company liquidator (see paragraph 2.39); [*Exposure Draft, Schedule 1, item 26, subparagraphs 588GAA(3)(a)(iii) and (iv), and 588GAB(3)(a)(iii) and (iv) of the Corporations Act 2001*]
- the disposition was made in connection with a course of action and the safe harbour applies to the defendant.

2.76 In addition, it is a defence to a contravention of the new civil penalty provisions if:

- the defendant had reasonable grounds to expect the company was solvent at the time of the disposition (except where the company enters external administration because of the disposition within 12 months);
- the defendant took all reasonable steps to prevent the company making the disposition; or
- in the case of a defendant that is a director – because of illness of some other good reason, the defendant did not take part in the management of the company at the relevant time.

2.77 These lists do not exclude other defences of general application available under the *Criminal Code*.

2.78 The first three defences – market value consideration, liquidator transactions, and dispositions under a deed of company arrangement or schemes of arrangements – apply to the nature of the disposition and are discussed earlier in this Chapter. The other defences relate specifically to the conduct of the defendant and are discussed below.

2.79 Defendants bear an evidential burden in relation to each of the defences. An evidential burden means the burden of adducing or pointing to evidence that suggests a reasonable possibility that the matter exists or does not exist (subsection 13.3(6) of the *Criminal Code*). If a defendant satisfies an evidential burden, the prosecution in a criminal matter may disprove the existence of the defence by establishing its non-existence beyond reasonable doubt (subsections 13.1(2) and 13.2(1) of the *Criminal Code*).

2.80 This evidential burden is appropriate as these matters are peculiarly in the mind of a defendant. In the case of defendants that are company officers, these matters also relate to matters that the officer ought to have considered in fulfilling their duties to the company.

2.81 For example, a director bears an evidential burden in relation to the market value defence because the director responsible for a disposition should be aware of the pricing considerations that ought to have applied to the disposition if it were a legitimate transaction made by a director acting in good faith and in the interests of the company. For example, a director may satisfy an evidential burden by adducing evidence that the disposition was made on an arms' length basis, that a credible valuation supported the sale price or that a similar legitimate transaction was made for similar consideration.

The safe harbour

2.82 The safe harbour is an important defence available if the disposition is made in connection with a course of action that is reasonably likely to lead to a better outcome for the company than proceeding immediately to voluntary administration or winding up. The defence is a personal defence and depends on the actions the specific defendant took to develop the company's course of action, and their other conduct. *[Exposure Draft, Schedule 1, items 27 and 28, subsection 588GA(1) of the Corporations Act 2001]*

2.83 As with the other defences, a defendant bears an evidential burden in relation to the safe harbour. *[Exposure Draft, Schedule 1, item 29, subsection 588GA(3) of the Corporations Act 2001]*

2.84 There are circumstances that make the safe harbour unavailable. The first is where a company is failing to pay the entitlements of its employees by the time they fall due. The second is where a company has not complied or is not complying with its taxation reporting obligations. In both these cases, a person will not be eligible for the safe harbour protection. *[Exposure Draft, Schedule 1, items 30 and 31, subsection 588GA(4) of the Corporations Act 2001]*

2.85 The safe harbour is not available if the person fails to substantially comply with their obligations to assist an administrator, liquidator or controller in a formal insolvency. *[Exposure Draft, Schedule 1, items 32 and 33, subsection 588GA(5) of the Corporations Act 2001]*

2.86 Similarly, subsections 588GB(1) and (2) prevent a director from relying on books or information as evidence for the application of the safe harbour where these materials have not been provided to a liquidator, administrator or controller as required. *[Exposure Draft, Schedule 1, item 34, subsection 588GB(7) (paragraph (a) of the definition of "relevant proceeding") of the Corporations Act 2001]*

Expectation of solvency on reasonable grounds

2.87 A defence is available for a civil penalty contravention if a defendant had reasonable grounds to expect, and did expect, the company was solvent and would remain solvent despite making the disposition. *[Exposure Draft, Schedule 1, items 35, 36 and 37, subsections 588H(1) and (2) of the Corporations Act 2001]*

2.88 An expectation of solvency must be supported by facts that point to a high degree of certainty. A mere hope, possibility or suspicion that the company is solvent is insufficient. A person who is unaware whether the company is solvent – particularly a person who, because of their position, could not know – cannot rely on the defence.

2.89 A defendant may rely on a competent and reliable person responsible for providing information to the defendant about the company's solvency. The defendant must have reasonable grounds to believe the person is competent and reliable. *[Exposure Draft, Schedule 1, items 38 and 39, subsection 588H(3), of the Corporations Act 2001]*

2.90 The defence does not apply where the company entered external administration because of the disposition within 12 months of the disposition. *[Exposure Draft, Schedule 1, item 40, subsection 588H(3A) of the Corporations Act 2001]*

Reasonable steps defence

2.91 A defence is available for a civil penalty contravention to a person that takes all reasonable steps to prevent the company making the creditor-defeating disposition. This may include a non-executive director voting unsuccessfully against the disposition or, in the case of a company that is insolvent, attempting to place the company into administration or liquidation. *[Exposure Draft, Schedule 1, items 35 and 43, subsections 588H(1) and (5) of the Corporations Act 2001]*

2.92 The elaboration of this defence in subsection 588H(6) relates specifically to insolvent trading cases and does not necessarily apply to contraventions of the creditor-defeating disposition prohibitions. *[Exposure Draft, Schedule 1, item 44, subsection 588H(6) of the Corporations Act 2001]*

Illness or other good reason

2.93 A defence is available to a director for a civil penalty contravention if, for a good reason, the director did not take part in the management of the company at the relevant time. *[Exposure Draft, Schedule 1, items 35 and 41, subsections 588H(1) and (4) of the Corporations Act 2001]*

2.94 The primary scenario covered by this defence is illness where the director is temporarily absent from their duties to participate in the management of the company. Other examples are where an administrator or receiver has assumed control of the company's affairs.

2.95 The defence does not otherwise excuse the responsibility of a passive director to prevent the company making a creditor-defeating disposition. The defence does not displace the duty of every director to take an active part in the affairs of the company, and guide and monitor its management. This duty is implicit in the statutory duty of care and diligence.

Penalties

2.96 Penalties for a contravention of the new offence provisions are:

- 4,500 penalty units or three times the benefit gained, or imprisonment for 10 years, or both (for individuals); and
- 45,000 penalty units or three times the benefit gained or 10 per cent of the annual turnover of the entity (for corporations).

[Exposure Draft, Schedule 1, item 68, items 138A and 138B of the table in Schedule 3 to the Corporations Act 2001]

2.97 Once a declaration has been made that a person has breached a civil penalty provision, ASIC can seek a pecuniary penalty order (section 1317G) of up to \$200,000 or a disqualification order (section 206C). *[Exposure Draft, Schedule 1, item 66, items 6A and 6B of the table in section 1317E of the Corporations Act 2001]*

Compensation for breach of offence and civil penalty provisions

2.98 Amendments are made to Division 4 in Part 5.7B of the *Corporations Act 2001* to allow liquidators – and in some cases creditors – to recover compensation from officers and facilitators who have contravened a creditor-defeating disposition offence or civil penalty provision.

2.99 Compensation may be sought against a person who has been found to have contravened a civil penalty provision or an offence in relation to a creditor-defeating disposition. Compensation is available for damage suffered by the company's creditors and may be awarded in the same proceedings that determined the offence or civil penalty. *[Exposure Draft, Schedule 1, items 45 to 49, sections 588J and 588K of the Corporations Act 2001]*

2.100 Compensation may also be sought against a person that has contravened an offence or civil penalty provision but has not been convicted or been subject to a civil penalty order. In these cases, proceedings must be brought within six years of the start of the company's winding up. *[Exposure Draft, Schedule 1, item 50, subsection 588M(1A) of the Corporations Act 2001]*

2.101 A declaration, conviction or finding made by a court in relation to a person's contravention of the offence of civil penalty provisions may be relied on in proceedings for compensation from the same person. *[Exposure Draft, Schedule 1, item 54, subparagraphs 588Q(b)(iv) to (vi) of the Corporations Act 2001]*

Preventing double recovery

2.102 Amendments are made to ensure creditors cannot obtain compensation to the extent compensation is obtained under another provision of the *Corporations Act 2001* such as Part 5.8A. Part 5.8A protects employee entitlements and allows for compensation to be paid by persons who enter agreements or transactions to avoid companies paying employee entitlements. *[Exposure Draft, Schedule 1, items 51 to 53, and 65, section 588N and paragraph 596AD(b) of the Corporations Act 2001]*

2.103 To the same end, contingent amendments are made to take into account the changes being progressed as part of the forthcoming Corporations Amendment (Strengthening Protections for Employee Entitlements) Bill 2018, a draft of which was released for public consultation on 12 June 2018. Contingent amendments commence differently (or not at all) depending on the sequence in which Bills pass the Parliament and commence.

2.104 Parallel amendments are intended to be made to the definition of the term ‘linked’. The Exposure Draft makes two amendments to the term, one that amends the existing definition for the purpose outlined in paragraph 2.102 and another amendment that incorporates both the first amendment and the amendment made by the other Bill. If the other Bill has commenced first, both amendments in the Exposure Draft apply simultaneously. If the Exposure Draft commences first, the second and final amendment in the Exposure Draft applies on the commencement of the other Bill, incorporating both amendments. *[Exposure Draft, Schedule 1, items 2 and 77, section 9 (definition of ‘linked’) of the Corporations Act 2001, and section 2 of the Exposure Draft]*

2.105 Amendments are made to subsection 596AI(1), which will be repealed under the other Bill. These amendments are unnecessary and do not commence at all if that Bill commences first. *[Exposure Draft, Schedule 1, items 75 and 76, subsection 596AI(1) of the Corporations Act 2001, and section 2 of the Exposure Draft]*

2.106 An amendment is made to insert a provision into section 596AB that becomes unnecessary when the other Bill commences. Another amendment is made repealing that provision when the other Bill commences. If the other Bill commences first, the provision is inserted and repealed instantly and does not operate. *[Exposure Draft, Schedule 1, items 64 and 78, subsection 596AB(5) of the Corporations Act 2001, and section 2 of the Exposure Draft]*

2.107 Other amendments are made to provisions inserted by the other Bill. These amendments are only necessary and only commence after both Bills have otherwise commenced. *[Exposure Draft, Schedule 1, items 79, 80 and 81, subsection 596AC(5), and paragraphs 596AG(1)(b), (ba), (bb) and (c) of the Corporations Act 2001, and section 2 of the Exposure Draft]*

Proceedings by creditors for compensation

2.108 Creditors generally require the consent of a liquidator to bring their own proceedings for compensation. *[Exposure Draft, Schedule 1, items 55 and 56, section 588R of the Corporations Act 2001]*

2.109 A creditor may give a liquidator notice of their intention to bring proceedings and seek the liquidator's consent. This must be done at least six months after the winding up began. *[Exposure Draft, Schedule 1, items 57 and 58, section 588S of the Corporations Act 2001]*

2.110 The liquidator may refuse to grant the consent within three months of receiving the creditor's notice. The liquidator must provide a written statement of their reasons for the refusal.

2.111 After the end of the three-month period, the creditor may seek leave of the court to commence proceedings without the liquidator's consent. If the liquidator has provided a statement of reasons, the creditor must file the reasons with the court. *[Exposure Draft, Schedule 1, item 59, subsection 588T(2) of the Corporations Act 2001]*

2.112 In any event, a creditor cannot commence proceedings for compensation for a creditor-defeating disposition if:

- the liquidator has sought a court order under section 588FF for the disposition;
- ASIC has issued an order for the disposition;
- the liquidator has applied to ASIC for an order in relation to the disposition; or
- the liquidator has intervened in an application for a civil penalty order against a person for the disposition.

[Exposure Draft, Schedule 1, items 60 to 63, subsection 588U(1) of the Corporations Act 2001]

Consequential amendments

2.113 An amendment is made to allow a set of general presumptions to apply when ASIC considers making an order to recover property, and in court proceedings to set aside an ASIC order. This includes the presumption of insolvency where adequate financial records have not been maintained. *[Exposure Draft, Schedule 1, item 3, paragraphs 588E(1)(aa) and (ab) of the Corporations Act 2001]*

2.114 Amendments are made to ensure findings made in one civil proceeding can be relied on in another civil proceeding where appropriate, including in relation to the new types of proceedings created in these amendments. These presumptions do not apply to criminal proceedings. *[Exposure Draft, Schedule 1, items 5 to 9, paragraphs 588E(8)(a), (aa), (b) and (da), and (8A)(a) of the Corporations Act 2001]*

2.115 Section 588FGA grants the Commissioner of Taxation an indemnity against the directors of a company if a court makes an order under section 588FF against the Commissioner for the payment of certain tax liabilities by the company. An amendment is made to grant the same indemnity if an equivalent order is made by ASIC. *[Exposure Draft, Schedule 1, items 19, subsection 588FGA(1) of the Corporations Act 2001]*

2.116 Section 588FGB provides defences against an indemnity granted under section 588FGA. An amendment is made to align the expectation of solvency defence with the same defence that applies to contraventions of the creditor-defeating disposition civil penalty provision (see paragraph 2.87) in cases where the indemnity relates to a creditor-defeating disposition. *[Exposure Draft, Schedule 1, items 20, subsection 588FGB(4A) of the Corporations Act 2001]*

2.117 Section 588FH allows a liquidator to recover from a related entity of a company a debt that the entity owed that is discharged because of certain voidable transactions of the company. A court must take any amount recovered under this section into account when making orders under section 588FF. An amendment is made to require ASIC to also take any recovery into account when making its orders. *[Exposure Draft, Schedule 1, item 21 and 22, subsection 588FH(3) of the Corporations Act 2001]*

2.118 Section 588FI prevents the double recovery of an unfair preference where the preferred creditor has put the company in the same position as if the unfair preference had not been entered into. Subsection 588FI(2) prevents a court from making an order under section 588FF prejudicing the right or interest of the creditor. An amendment is made to prevent ASIC from making a similar order. *[Exposure Draft, Schedule 1, items 23 and 24, paragraph 588FI(1)(b) and subsection 588FI(2A) of the Corporations Act 2001]*

2.119 The amendments in Schedule 1 add a number of new provisions to the existing insolvency law. To assist users of the law, a number of new headings are inserted for both the new provisions and for existing provisions. *[Exposure Draft, Schedule 1, items 10, 11, 14 to 18, 25, 26, 35, 40 and 42, headings to Division 3, Subdivisions A, B, C, D and E in Division 2, and Subdivisions A, B and C in Division 3 of Part 5.7B, and the headings to subsections 588FG(1), (2) and (7), and 588H(1), (2), (4) and (5) of the Corporations Act 2001]*

2.120 Amendments are made to other legislation to ensure that statutory and judicial managers appointed to a prudentially regulated entity are not subject to the new offences and their transactions are not voidable. This is consistent with the exemption these managers have from the insolvent trading prohibition and existing categories of voidable transactions. *[Exposure Draft, Schedule 1, items 69 to 74, subparagraph 14CA(b)(iv) and subsection 14C(3) of the Banking Act 1959, subparagraph 62ZOL(b)(iv) and subsections 62ZM(3) and 62ZOK(3) of the Insurance Act 1973, and paragraph 179AL(b)(iv) and subsections 179(3) and 179AK(3) of the Life Insurance Act 1995]*

Application provisions

2.121 The amendments in Schedule 1 to the Exposure Draft generally commence and apply from the day after Royal Assent. Some contingent amendments designed to prevent the double recovery of compensation may commence at a later time or not at all (see paragraphs 2.103 to 2.107). *[Exposure Draft, section 2]*

2.122 The amendments to section 588H notionally affect the defences to the insolvent trading civil penalty provision. These amendments apply to debts incurred, and dispositions made, after commencement. *[Exposure Draft, Schedule 2, item 5, subsection 1650(1) of the Corporations Act 2001]*

Chapter 3

Improving the accountability of resigning directors

Outline of chapter

3.1 Schedule 2 to the Exposure Draft ensures directors are held accountable for misconduct by preventing directors from improperly backdating resignations or ceasing to be a director when this would leave the company with no directors. This will reduce the incidence of illegal phoenix activity and its effect on employees, creditors and government revenue.

Context of amendments

3.2 Divisions 1 and 3 of Part 2D.3 of the *Corporations Act 2001* regulate the appointment and removal of directors. These provisions also contain replaceable rules that may be replaced by provisions of a company's constitution (section 135).

3.3 A proprietary company must have one Australian-resident director over the age of 18 (sections 201A and 201B). A company may generally appoint a person as a director by a resolution passed in a general meeting (replaceable rule section 201G).

3.4 A director may unilaterally resign in writing (replaceable rule section 203A). A company may also remove a director through a resolution (replaceable rule section 203C for proprietary companies).

3.5 A director may also be removed by a resolution of members (section 203D in the case of public companies and replaceable rule section 203C in the case of proprietary companies).

3.6 Under subsection 205B(5), a company must notify ASIC within 28 days if a person is appointed as a director or stops being a director. The company's obligation to notify ASIC of a director's resignation may be satisfied by the resigning director notifying ASIC themselves (section 205A and paragraph 205B(6)(b)).

3.7 Contraventions of the reporting obligation in subsection 205B(5) are governed by the general penalty provisions in Division 2 of Part 9.4, the penalties in Schedule 3 (relevantly 60 penalty units or imprisonment for 1 year, or both) and Chapter 2 of the *Criminal Code*.

3.8 Although the company is under the obligation to comply with subsection 205B(5), directors or a company secretary (as appropriate) are vicariously liable for a contravention (section 188). Contravention of section 188 is a civil penalty provision under section 1317E and is subject to penalties of up to \$3,000.

3.9 In addition, subsection 1308(2) makes it an offence to supply false or misleading information to ASIC.

Implications for illegal phoenix activity

3.10 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.

3.11 The lodgement of a notice with ASIC that a director has resigned by necessity occurs after the fact, and a discrepancy can arise where a director alleges that a resignation notice was provided to the company, but the company has not communicated this to ASIC.

3.12 A former director may also cause the company to backdate the effective date of their resignation to implicate a new director in offending conduct.

3.13 Finally, in some instances, a company director may abandon a company by resigning without another director in place to provide oversight of the company. The abandoned company is unable to notify ASIC of the resignation or appoint a replacement director, and may continue to be registered for some time with unpaid debts before creditors or ASIC take steps to wind it up.

Summary of new law

3.14 Schedule 2 to the Exposure Draft prevents the backdating of resignation in breach of the 28-day rule in section 205B unless ASIC or the Court is satisfied the change took place on the purported date.

3.15 Abandonment of companies by a resigning director or directors, leaving the company without a natural person’s oversight, is also prevented.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<p>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.</p> <p>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.</p>	<p>Directors may resign at any time in writing, subject to the company's constitution.</p> <p>The company (or the former director) must notify ASIC within 28 days of the resignation.</p>
<p>A director may not resign from a company if doing so would leave the company without a director (unless the company is being wound up).</p>	
<p>A director may not be removed by a resolution of members of a proprietary company if doing so would leave the company without a director (unless the company is being wound up).</p>	<p>A director may be removed by a resolution of company members, subject to a proprietary company's constitution.</p>

Detailed explanation of new law

Preventing inappropriate backdating of director resignations

3.16 If a 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. [*Exposure Draft, Schedule 2, item 2, subsection 203AA(1) of the Corporations Act 2001*]

3.17 This amendment also applies to alternative directors who resign prior to the end of their term of appointment. [*Exposure Draft, Schedule 2, item 2, note to subsection 203AA(1) of the Corporations Act 2001*]

Example 3.1 Inappropriate backdating of director resignations

Bill is the sole director of Artificial Constructions Pty Ltd, a building company that is insolvent. On 10 July 2019, Artificial Constructions borrows \$50,000 it claims is for the purpose of finalising the construction of a small apartment complex.

On 15 July, Artificial Constructions transfers the \$50,000 and other assets to another company, Artificial Constructions (No. 2) Pty Ltd, of which Bill is also a director.

On 20 October 2019, the creditors of Artificial Constructions commence proceedings to have a liquidator appointed to the company.

On 1 November 2019, Artificial Constructions lodges a notice with ASIC that Bill resigned from the company and was replaced by Theo on 1 July 2019. Bill claims that he should not be held accountable for the misconduct that occurred in July 2019 as he was not a director.

However, Bill's resignation is taken to be effective from 1 November 2019. Bill can be prosecuted for breaching his duty as a director to prevent the company from trading while insolvent and for causing the company to make a creditor-defeating disposition.

Applications to ASIC and the Court

3.18 Either the former director or the company may apply to ASIC or the Court to backdate a resignation that is lodged after the 28-day period. The applicant must satisfy ASIC or the Court (as appropriate) that the director did in fact resign on the purported date. *[Exposure Draft, Schedule 2, item 2, subsection 203AA(2) of the Corporations Act 2001]*

3.19 If the application is made to the Court, the applicant must satisfy the Court that it is just and equitable to make the order to backdate the resignation. *[Exposure Draft, Schedule 2, item 2, subsection 203AA(3) of the Corporations Act 2001]*

3.20 If the application is made to ASIC, ASIC must take into account the conduct and representations of the applicant, including the reasons for the delayed notification, when determining whether to allow the resignation to be backdated. *[Exposure Draft, Schedule 2, item 2, subsection 203AA(4) of the Corporations Act 2001]*

3.21 If the application is made to ASIC, it must be made within 56 days of the purported date of the director's resignation. Applications to the Court can be made within 12 months of that date. *[Exposure Draft, Schedule 2, item 1, subsection 203AA(5) of the Corporations Act 2001]*

Example 3.2 Application to Court

Further to Example 3.1, Bill cannot apply to ASIC to backdate the effective date of his resignation because the company provided the notification to ASIC after the end of the 56-day period.

Bill applies to the Court to have the effective date of his resignation backdated. Bill cannot adduce clear evidence to substantiate his position that he resigned on 1 July 2019. ASIC responds to the application and adduces evidence that Bill was still involved in the management of the company during July 2019.

The Court refuses the application.

3.22 If the Court makes an order to backdate the effective date of a director's resignation, the applicant must provide a copy of the order to ASIC within two business days. Non-compliance is a strict liability offence subject to 60 penalty units or imprisonment for 1 year, or both. This is consistent with the strict liability offence for failing to notify ASIC of the resignation on time under subsection 205B(5). *[Exposure Draft, Schedule 2, items 2 and 4, subsections 203AA(6) and (7), and item 40A of the table in Schedule 3 to the Corporations Act 2001]*

3.23 If the applicant is a company, its secretary or directors may be subject to a civil penalty for a failure of the company to provide a copy of a Court order to ASIC. It is a defence if the secretary or director (as appropriate) took all reasonable steps to ensure the company provided the copy of the Court order to ASIC. *[Exposure Draft, Schedule 2, item 1, paragraph 188(1)(ea) of the Corporations Act 2001]*

Preventing the abandonment of companies

3.24 A director may not resign if the resignation would leave the company without a director. *[Exposure Draft, Schedule 2, item 2, subsections 203AA(8) and 203AB(1) of the Corporations Act 2001]*

3.25 There are often circumstances where there will be a legal impediment under a company constitution to appointing a replacement director before the outgoing director can leave office. To accommodate temporary absences of a director, the amendment applies at the end of the day on which the director purports to resign. If another director is appointed the same day as the resignation, the resignation is effective.

3.26 The end of day test also applies in situations where multiple directors resign on the same day. In this case, all the resignations will be ineffective unless at least one director is appointed to the company at the end of the day.

3.27 Similar restrictions apply to the power of a proprietary company's members to remove a director by resolution. This is necessary to address the potential for a single member proprietary company to resolve to remove the director. *[Exposure Draft, Schedule 2, item 3, subsection 203CA(1) of the Corporations Act 2001]*

3.28 A single director may resign or be removed if the company is being wound up at the time. Division 1A in Part 5.6 of the *Corporations Act 2001* outlines the times when a winding up is taken to have begun. *[Exposure Draft, Schedule 2, items 2 and 3, subsections 203AB(2) and 203CA(2) of the Corporations Act 2001]*

3.29 These amendments do not prevent a sole director being removed because they are disqualified from being a director.

Application provisions

3.30 The amendments commence on the day following Royal Assent. *[Exposure Draft, section 2]*

3.31 The amendments apply to director resignations and resolutions to remove directors taking effect on or after commencement. *[Exposure Draft, Schedule 2, item 5, subsections 1650(2) and (3) of the Corporations Act 2001]*

Chapter 4

GST estimates and director penalties

Outline of chapter

4.1 Schedule 3 to the Exposure Draft allows the Commissioner to collect estimates of anticipated GST liabilities and make company directors personally liable for their company's GST liabilities in certain circumstances.

4.2 Schedule 3 also applies to LCT and WET as these taxes are jointly administered with the GST.

Context of amendments

The estimates regime

4.3 The estimates regime (Division 268 in Schedule 1 to the TAA 1953) enables the Commissioner to estimate unpaid amounts of PAYG withholding and superannuation guarantee charge, and to recover the amount of those estimates from taxpayers.

4.4 The estimates regime is a valuable compliance tool available to the Commissioner where a taxpayer has failed to report information. A taxpayer becomes liable to pay an estimate when the Commissioner provides a notice of the estimate (section 268-20).

4.5 The estimate liability is distinct from the underlying liability of the taxpayer to pay the withholding amount or superannuation guarantee charge. However, the discharge of one liability discharges the other.

4.6 The Commissioner may reduce or revoke an estimate (section 268-35) or the taxpayer may cause the estimate to be reduced or revoked by providing a sworn statement – a statutory declaration or an affidavit – that the underlying liability (if any) is lower than estimated (section 268-40). Reductions (and revocations) take effect as if the estimate was always of the reduced amount (or did not exist) (section 268-55).

4.7 The GIC applies to PAYG estimates that remain unpaid after 7 days of the notice being provided (section 268-75). This liability is also distinct from the GIC applying to the underlying liability under section 16-80, although discharging one liability discharges the other (and similar interest liabilities) (section 268-80).

4.8 The GIC does not accrue on superannuation guarantee charge estimates (paragraph 268-75(1)(b)), although it does accrue on the underlying charge under section 49 of the *Superannuation Guarantee (Administration) Act 1992*.

Director penalties

4.9 The director penalty regime (Division 269 in Schedule 1 to the TAA 1953) allows the Commissioner to make directors of a company personally liable for specified taxation liabilities of the company in certain circumstances of non-payment by the company.

4.10 Under section 269-10, the director penalty regime applies to a company's liabilities to pay to the Commissioner:

- PAYG withholding amounts;
- superannuation guarantee charges; and
- estimates of PAYG withholding liabilities and superannuation guarantee charges.

4.11 Directors are under a general obligation to ensure the company either satisfies the above liabilities, or recognising the company may be insolvent, goes into administration or is wound up (section 269-15). The obligation begins on an initial day specified in relation to each category of underlying company liability. The obligation continues to apply to directors that cease to be directors after the initial day.

4.12 Directors are subject to a penalty if their obligation is unfulfilled by the due date. New directors that are appointed after the due date, become subject to the penalty if the obligation remains unsatisfied for a further 30 days (section 269-20).

4.13 Directors are subject to a penalty equal to the amount of the company's unpaid obligations but the penalty may not be collected before the Commissioner issues a director penalty notice and a further 21 days elapse (section 269-25). Payment of either the penalty or the company's underlying liability satisfies both obligations (section 269-40). Directors may also seek to recover any penalty they have paid under a right of indemnity (section 269-40).

Remission of penalties

4.14 A penalty is generally remitted if the director complies with their obligation by placing the company into administration or beginning to wind it up before or within the 21-day notice period (section 269-30). This remission is subject to a number of different conditions in subsection 269-30(2). Where the conditions are not satisfied, the penalty is said to be 'locked down'.

4.15 The table in subsection 269-30(2) specifies a date (the lockdown date in column 2) before which the director may avoid the full penalty. If the company enters administration or begins to be wound up after this date, the extent to which the director's penalty is remitted is limited or abolished. The extent to which the penalty is locked down in this way is specified in column 3 of the table.

4.16 For example, where the director's obligation in respect of a PAYG withholding estimate is satisfied because the company is placed into administration or wound up (rather than the company paying the liability), the director will still be subject to a penalty if the administration or winding up commenced more than three months after the due date for the payment of the company's underlying liability.

Defences

4.17 A number of defences against the penalty exist in section 269-35 and are based on the reasonableness of the conduct of the director and, in some cases, the company.

Other changes to the director penalty regime

4.18 The Government is progressing two amendments to the director penalty regime through the Parliament. The amendments in Schedule 5 to the Treasury Laws Amendment (2018 Measures No. 4) Bill 2018 would provide:

- that a director's obligations in relation to ensuring their company pays an estimate of superannuation guarantee charge or withholding liability commences at the same time as their obligations in relation to ensuring the company pays the underlying liability to which the estimate relates (rather than the date the company is given notice of the estimate); and
- for the removal of the three-month rule which applies before director penalties with respect to unpaid superannuation guarantee charge liabilities (and estimates of these liabilities) become 'locked down' and can no longer be remitted (subsection 269-30(2)). The three-month rule will be retained for PAYG withholding liabilities and associated estimates.

4.19 For the purposes of this Exposure Draft, it is assumed the amendments in Schedule 5 to that Bill will commence before the amendments in Schedule 3 to the Exposure Draft. While this is relevant to the technical interaction of the provisions, the policy outcomes achieved under Schedule 5 to that Bill are independent of the policy outcomes achieved by this Exposure Draft.

Collection of GST and other liabilities

4.20 An entity's liability to pay GST (or entitlement to a refund) is linked to the entity's assessed net amount for a tax period (Divisions 33 and 35 of the GST Act). An entity's net amount for a tax period is the amount of GST imposed on the entity's taxable supplies less the entity's input tax credits, taking into account any adjustments (sections 17-5 and 17-10 of the GST Act).

4.21 A net amount includes any applicable LCT and WET (section 17-5(2) of the GST Act). The provisions under Subdivision 21-A of the *A New Tax System (Wine Equalisation Tax) Act 1999* and Subdivision 13-A of the *A New Tax System (Luxury Car Tax) Act 1999* allow for those taxes (and associated credits and adjustments) to be administered by the GST system.

4.22 An entity is only liable to pay a net amount to the Commissioner when the net amount is assessed (becoming an 'assessed net amount'). GST operates under a full self-assessment system – an entity is deemed to have received an assessment when it lodges its return for a tax period (section 115-15 in Schedule 1 to the TAA 1953). Entities must lodge returns in accordance with Division 31 of the GST Act.

4.23 Non-compliant entities are able to undercut prices knowing that they do not intend to pay the GST collected, giving them a competitive advantage over compliant companies. Ensuring GST liabilities are collected is necessary to level the playing-field in the market and to help build confidence in the competitive process.

4.24 Illegal phoenix activity poses a particular risk to the integrity of the GST's input tax credit system through claiming excess input tax credits, resulting in an excessive refund. When the excess is discovered, the Commissioner must amend the relevant GST assessment and pursue the excess as a debt (see subsection 35-5(2) of the GST Act). The collection of this debt – as with GST debts more generally – may be obstructed by illegal phoenix activity.

Summary of new law

4.25 Schedule 3 to the Exposure Draft extends the estimates and director penalty regimes to GST liabilities, including LCT and WET. This will address illegal phoenix behaviour, including the non-payment of GST liabilities.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
The Commissioner can also collect estimates of anticipated GST liabilities, including LCT and WET liabilities.	The Commissioner can collect estimates of PAYG withholding and superannuation guarantee charge liabilities.
The Commissioner can also impose director penalties on company directors to collect outstanding GST liabilities, including LCT and WET liabilities, and estimates of those liabilities.	The Commissioner can impose director penalties on company directors to collect outstanding PAYG withholding and superannuation guarantee liabilities, and estimates of those liabilities.

Detailed explanation of new law

Estimates

4.26 The scope of the estimates regime in Division 268 in Schedule 1 to the TAA 1953 is expanded to allow the Commissioner to make estimates of an entity's net amount under the GST Act. *[Exposure Draft, Schedule 3, item 5, paragraph 268-10(1)(c) in Schedule 1 to the TAA 1953]*

4.27 Any estimate of a net amount will necessarily include any applicable LCT and WET (see paragraph 4.21).

4.28 If the Commissioner makes an estimate of an entity's net amount, the entity is liable to pay the amount of the estimate to the Commissioner.

4.29 Because an entity is not under an obligation to pay a net amount until it has been assessed, an amendment is made to Division 268 to deem net amounts to be payable. This deeming rule only applies for the purposes of Division 268 and does not otherwise allow the Commissioner to collect the amount without a valid assessment being issued.

4.30 The deeming rule allows the provisions of the estimates regime that operate with respect to an underlying liability – PAYG withholding and superannuation guarantee charge liabilities in the current law – to apply to net amounts in a similar way. *[Exposure Draft, Schedule 3, item 6, paragraphs 268-10(1B)(a) and (d) in Schedule 1 to the TAA 1953]*

4.31 For example, subsections 268-30(1) and (2) provide that a liability to pay an estimate is provable in bankruptcy if the relevant underlying liability is also provable. By deeming the net amount to have arisen and to be payable on the GST lodgement due date, the estimate will be provable in bankruptcy if that date is prior to the date of bankruptcy (see subsection 82(1) of the *Bankruptcy Act 1966*).

4.32 The net amount is deemed to arise and be payable on the day the entity was required to lodge its GST return. [*Exposure Draft, Schedule 3, item 6, paragraphs 268-10(1B)(b) and (c) in Schedule 1 to the TAA 1953*]

Paying an estimate (or an assessed net amount)

4.33 The nature of the net amount is also relevant for the purposes of section 268-20, which provides that discharging a liability to pay an estimate discharges the underlying liability to the same extent, and vice versa.

4.34 The amendments ensure that a payment towards an estimate of a net amount is also applied to a liability to pay an assessed net amount, whether that assessment has been made or not. Similarly, if an assessment has been made of a net amount and a liability arises, a payment towards that liability (including a payment of a director penalty) is also applied to the estimate liability. [*Exposure Draft, Schedule 3, item 8, subsection 268-20(4A) in Schedule 1 to the TAA 1953*]

Example 4.1 Estimate liability paid – no assessed net amount

Peter has failed to lodge his GST return in relation to a tax period. The Commissioner makes an estimate of Peter's net amount in the amount of \$20,000.

Peter pays \$10,000 to partially discharge the estimate liability. The estimate liability is reduced to \$10,000. Peter does not have a liability to pay an assessed net amount. The \$10,000 is held-over until Peter lodges his GST return.

After making the initial \$10,000 payment Peter lodges his outstanding GST return. Based on the information in the return, Peter is assessed as having an assessed net amount of \$25,000 owing to the Commissioner. The held-over \$10,000 is applied to the liability to pay the assessed net amount, the balance of which is reduced to \$15,000.

Example 4.2 Estimate liability paid – assessment issued

Further to Example 4.1, Peter makes an additional payment of \$5,000 towards the estimate liability. The estimate liability is reduced to \$5,000. The balance of the liability to pay the assessed net amount is reduced to \$10,000.

Example 4.3 Assessed net amount liability paid

Further to Example 4.2, Peter pays \$10,000 to fully discharge the liability to pay the assessed net amount.

This amount is applied to Peter's estimate liability but, because the amount is greater than that liability, only the amount of outstanding estimate liability (\$5,000) is applied (subsection 268-20(5)), reducing the balance of liability to nil. Peter has now satisfied his obligations.

4.35 The examples above do not take into account the impact of the GIC on either liability. GIC applies to an estimate of a net amount if it remains undischarged after seven days following the entity's receipt of the estimate notice. Where GIC applies, it accrues from the day the GST return was due (section 268-75). Payments of GIC follow the same principle in that they are also applied against any GIC attached to an underlying assessed net amount liability. *[Exposure Draft, Schedule 3, item 10, subsection 268-80(1A) in Schedule 1 to the TAA 1953]*

Reducing an estimate

4.36 An entity may reduce the amount of an estimate by making a sworn statement that the entity's net amount for the tax period is less than the estimate (or that it did not have a net amount) (section 268-40).

4.37 The sworn statement must set out the following facts in relation to the tax period:

- the entity's net amount;
- the entity's taxable supplies and creditable acquisitions (within the meaning of the GST Act);
- the entity's assessable dealings and wine tax credit entitlements (if any, within the meaning of the *A New Tax System (Wine Equalisation Tax) Act 1999*);
- the steps the entity took to comply with its obligations under Division 31 and 33 of the GST Act.

[Exposure Draft, Schedule 3, item 11, subsection 268-90(2B) in Schedule 1 to the TAA 1953]

Director penalties

4.38 The scope of the director penalty regime in Division 269 in Schedule 1 to the TAA 1953 is expanded to allow the Commissioner to impose director penalties in relation to companies' unsatisfied liabilities to pay assessed net amounts under the GST Act. *[Exposure Draft, Schedule 3, item 14, item 6 of the table in subsection 269 10(1) in Schedule 1 to the TAA 1953]*

4.39 Any assessed net amount will necessarily include any applicable LCT and WET (see paragraph 4.21).

4.40 Company directors are under an obligation to ensure their company complies with its obligation to pay an assessed net amount liability (or, recognising the company may be insolvent, goes into administration or begins to be wound up) (section 269-15). The obligation on the directors begins on the day the relevant tax period ends (the initial day). Directors that cease to be directors after this date are subject to the obligation, even if they cease to be directors before the due date.

4.41 As with the other categories of director penalties, the penalty arises when the director's obligation is unsatisfied on the due date, in this case, the day the company is required to pay the assessed net amount (or 30 days after the appointment of a director appointed after that day) (section 269-20).

4.42 However, the penalty is only recoverable following a period of 21 days beginning when the Commissioner issues a director penalty notice to a director (section 269-25).

4.43 The amount of the penalty is the company's unpaid liability to pay the assessed net amount (subsection 269-20(5)).

Example 4.4 Director penalties

Emma and Julie are directors of Swift Supply Pty Ltd.

Swift Supply is required to pay and report GST on a quarterly basis under section 27-5 of the GST Act. Swift Supply is required to lodge its return for the quarter ending 30 June 2019 by the due date of 28 July 2019 (section 31-8 of the GST Act).

Swift Supply lodges its return more than three months late on 1 November 2019. The return gives rise to a liability for Swift Supply to pay an assessed net amount of \$100,000. The due date for the payment is 28 July 2019 (section 33-3 of the GST Act).

Emma and Julie are under an obligation to ensure Swift Supply pays the liability, enters administration or begins to be wound up. The obligation begins on the initial day, the day the tax period ended (30 June 2019).

Julie resigns from Swift Supply on 20 July 2019. This does not affect her obligation in relation to the company's liability.

Swift Supply is never in a position to pay the liability. As such, both Emma and Julie were required to place the company into administration or begin winding it up. This does not happen on or before the due date of 28 July 2019 and the director penalties begin to apply from this date.

The Commissioner issues director penalty notices to Emma and Julie on 1 February 2020. The Commissioner may begin recovery proceedings on or after 23 February 2020.

Remission of penalty

4.44 The penalty may be remitted if the director complies with the obligation before the director penalty notice is issued or within 21 days of the day the notice is issued (subsection 269-30(1)).

4.45 However, if the director complies with the obligation by placing the company into administration or beginning to wind up the company, the full amount of the penalty is only remitted if this is done within three months of the relevant due date. The end of the three-month period is the lockdown date for the penalty.

4.46 Where the company enters administration or begins to be wound up after the lockdown date, only the amount of the company's liability that was reported to the Commissioner within the three months before the due date is remitted. If the assessed net amount is based on a return lodged after the lockdown date, a default assessment or an amended assessment issued by the Commissioner, this may result in the penalty being locked down in whole or in part and not being remitted. *[Exposure Draft, Schedule 3, item 16, item 5 of the table in subsection 269-30(2) in Schedule 1 to the TAA 1953]*

4.47 If a director is appointed to the company during or after the three-month period, the full amount of the director's penalty can be remitted within three months of their appointment. *[Exposure Draft, Schedule 3, item 17, subsection 269-30(3) in Schedule 1 to the TAA 1953]*

Example 4.5 Remission of penalties

Further to Example 4.4, Kerrie is appointed as a director of Swift Supply on 15 November 2019 and is immediately under the obligation to ensure Swift Supply pays the liability, enters administration or is wound-up. The penalty arises for Kerrie after 30 days on 15 December 2019.

The Commissioner also issues a director penalty notice to Kerrie on 1 February 2020.

Emma and Kerrie place Swift Supply into administration on 10 February 2020.

The original directors, Emma and Julie, may seek to have their penalties remitted because their obligation is satisfied on 10 February 2020, before the end of the 21-day period on 22 February. However, because Swift Supply entered administration more than three months after the company's due date of 28 July, the penalty is locked down. The entire amount of the penalty is locked down because the company's GST return for the June quarter was more than three months late.

As a new director, Kerrie is entitled to a full remission of the penalty because Swift Supply entered administration:

- within 21 days of the director penalty notice being issued to Kerrie; and
- within three months of Kerrie being appointed a director.

4.48 If a director complies with their obligation because the company pays the outstanding assessed net amount liability, the full penalty is remitted, regardless of when this occurs.

Defences

4.49 The defences currently in Division 269 apply in relation to penalties for unpaid assessed net amounts (section 269-35). These include the defences that the director was unable to comply with the obligation due to illness or other good reason, or that the director took all reasonable steps to comply with the obligation.

4.50 An amendment is made to allow a director to claim a defence to the extent the penalty was due to the company adopting a reasonably arguable position and the company took reasonable care in connection with applying the GST Act. *[Exposure Draft Schedule 3, items 18 and 19, subsection 269-35(3A) in Schedule 1 to the TAA 1953]*

Application to estimates of net amounts

4.51 Because of the amendments to the Division 268, Division 269 applies to estimates of net amounts.

4.52 The initial day for the directors' obligation in relation to the company's liability to pay an estimate of a net amount is the day the relevant tax period ended. This aligns with the initial day for assessed net amounts. *[Exposure Draft, Schedule 3, item 15, paragraph 269-10(5)(ba) in Schedule 1 to the TAA 1953]*

4.53 The entire amount of a penalty associated with an estimate of a net amount is locked down and cannot be remitted if the obligation is satisfied by the company entering administration or beginning to be wound up more than three months after the day the company was required to lodge its GST return. *[Exposure Draft, Schedule 3, item 16, item 6 of the table in subsection 269-30(2) in Schedule 1 to the TAA 1953]*

4.54 Other than the features described above, Division 269 applies to these estimates in the same way it applies to other company liabilities that are subject to the director penalty regime.

Consequential amendments

4.55 Consequential amendments are made to update the simplified outlines and objects provisions for Divisions 268 and 269. *[Exposure Draft, Schedule 3, items 2, 3, 4, 12 and 13, sections 268-1 and 269-1, paragraph 268-5(c), and subparagraphs 269-5(a)(iii) and (iv) in Schedule 1 to the TAA 1953]*

4.56 An amendment is made to an example in Division 268 to reflect the fact the Commissioner cannot initiate proceedings to recover a net amount (only an assessed net amount or an estimate of a net amount). *[Exposure Draft, Schedule 3, item 7, example to subsection 268-20(2) in Schedule 1 to the TAA 1953]*

4.57 An amendment is made to section 268-30 to ensure that the liabilities admitted as proof in bankruptcy cannot be duplicated. In particular:

- a liability to pay an estimate of a net amount cannot be admitted as proof if a liability to pay an assessed net amount for the same tax period has already been admitted as proof; and
- if an estimate liability has been admitted as proof, the liability to pay an assessed net amount can only be admitted if it exceeds the outstanding estimate liability.

[Exposure Draft, Schedule 3, item 9, subsection 268-30(4A) in Schedule 1 to the TAA 1953]

4.58 An amendment is made to a note in the GST Act to highlight that a deemed assessed net amount that arises because an excessive GST refund is reduced (see paragraph 4.24) is subject to the amended estimates and director penalty regimes. *[Exposure Draft, Schedule 3, item 1, the note to subsection 35-5(2) of the GST Act]*

Application provisions

4.59 The amendments in Schedule 3 commence on the first day of the quarter following Royal Assent. *[Exposure Draft, section 2]*

4.60 The amendments apply to tax periods that start on or after commencement. *[Exposure Draft, Schedule 3, item 20]*

Chapter 5

Retention of tax refunds

Outline of chapter

5.1 Schedule 4 to the Exposure Draft authorises the Commissioner to retain tax refunds where a taxpayer has failed to lodge a return or provide other information to the Commissioner that may affect the amount the Commissioner refunds. This ensures taxpayers satisfy their tax obligations and pay outstanding amounts of tax before being entitled to a tax refund.

Context of amendments

5.2 Part IIB of the TAA 1953 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.

5.3 Subsection 8AAZC(1) provides the Commissioner with a broad discretion to establish 'one or more systems of accounts for primary tax debts', which are known as Running Balance Accounts (RBAs).

5.4 Under the definition of a 'primary tax debt' (section 8AAZA), an RBA may include tax debts that are due but not yet payable to the Commonwealth, as well as debts that are due and payable to the Commonwealth.

5.5 The Commissioner may also maintain other systems of account such as income tax accounts, which are not RBAs.

Application of payments and credits

5.6 Division 3 of Part IIB contains two methods for the application of payments received by the Commissioner and credits arising under the tax laws. Method One (section 8AAZLA) allows the Commissioner to apply the amount to an RBA. Method Two (section 8AAZLB) applies in a similar way to non-RBA tax debts.

5.7 Both methods apply the payment or credit to a particular debt or RBA. If the payment or credit is not exhausted after being applied to the particular debt or RBA, it gives rise to an ‘excess non-RBA credit’ (subsections 8AAZLA(3) and 8AAZLB(3)) and, in the case of an RBA, an equivalent RBA surplus (section 8AAZA).

5.8 An excess non-RBA credit or RBA surplus is a credit the Commissioner must apply in accordance with the provisions in Division 3 (paragraphs 8AAZL(1)(b) and (c)). That is, the provisions may apply multiple times in relation to a particular credit amount until it is exhausted.

Payment of refunds

5.9 Only when a credit (including an excess non-RBA credit or RBA surplus) is not able to be applied under Division 3 (because there are no remaining debts), is the Commissioner required to refund the amount to the taxpayer (section 8AAZLF). Following the Full Federal Court decision in *Commissioner of Taxation v Multiflex Pty Ltd* (2011) 82 ATR 153, this obligation must be performed 'within a time fixed by what is reasonably necessary to make that refund'. Of itself, this period does not allow the Commissioner to verify information or undertake other actions.

5.10 This obligation to pay refunds is subject to the Commissioner’s discretion to retain refunds in certain circumstances, including where the taxpayer has failed to provide certain information – including a BAS or PRRT notice (section 8AAZLG), or a Single Touch Payroll notification under Division 389 in Schedule 1 to the TAA 1953 (section 8AAZLGB), or where the Commissioner is verifying information provided by the taxpayer (section 8AAZLGA).

5.11 Under section 8AAZLG, 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. Under section 8AAZLGB, the Commissioner may retain the refund until they become reasonably satisfied that the taxpayer does not have to give the relevant notification under the Single Touch Payroll provisions in Division 389 in Schedule 1 to the TAA 1953 or does not have a PAYG withholding liability. 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.

5.12 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.

Summary of new law

5.13 The Commissioner may retain tax refunds where a taxpayer has failed to lodge a return or provide other information that may affect the amount the Commissioner refunds. This ensures taxpayers satisfy their tax obligations and pay outstanding amounts of tax before being entitled to a tax refund.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
The Commissioner may also retain a refund to a taxpayer that has other outstanding lodgements or information that needs to be provided to the Commissioner.	The Commissioner may retain a tax refund to a taxpayer that has an outstanding notification under the BAS or PRRT provisions.

Detailed explanation of new law

5.14 Schedule 4 to the Exposure Draft extends the operation of section 8AAZLG to authorise the Commissioner to retain refunds from a taxpayer that has failed to lodge a return or provide other information that may affect the amount the Commissioner refunds. [*Exposure Draft, Schedule 4, item 1, subparagraph 8AAZLG(1)(b)(iii) of the TAA 1953*]

5.15 The Commissioner may retain the refund until the return or other information is provided, or the Commissioner makes an assessment of the underlying amount. The Commissioner must then refund the amount or apply a separate discretion to further retain the amount (for example, section 8AAZLGA).

5.16 Where a new tax liability arises before the date the Commissioner must pay a refund, the Commissioner is able to apply the amount that would otherwise have been refunded against the new liability. This ensures taxpayers satisfy their tax obligations and pay outstanding amounts of tax before being entitled to a tax refund.

5.17 If the taxpayer is a full self-assessment taxpayer, the lodgement of an outstanding income tax return causes the taxpayer to be taken to have received an assessment, crystallising the taxpayer's income tax liability (see section 166A of the *Income Tax Assessment Act 1936* and section 5-5 of the *Income Tax Assessment Act 1997*).

5.18 The introduction of this discretion does not affect the existing discretion the Commissioner has to retain refunds where a notification under the Single Touch Payroll, BAS or PRRT provisions is outstanding. The Commissioner's existing administrative arrangements (see *Practice Statement Law Administration 2011/22*) in relation to this discretion are unaffected by these amendments.

5.19 The Commissioner will release guidance to support the administration of the discretion in the amendments. The Government envisages the Commissioner will apply the new discretion in relation to taxpayers identified as a high-risk, including those engaging in illegal phoenix activity.

Example 5.1 Retention of refunds

Fred is the sole shareholder and director of Super Express Deliveries Pty Ltd, which carries on a business as a courier. It lodges its BAS for the quarter ending 30 June 2019. The lodgement triggers an assessment of the entity's GST liability for the quarter, which reveals the entity is entitled to a credit of \$200,000.

At the time, Super Express Deliveries Pty Ltd does not have any outstanding tax debts and would ordinarily be entitled to have the credit paid out as a refund. However, Super Express Deliveries Pty Ltd has not lodged its income tax return for the 2017-18 income year.

The Commissioner reviews the affairs of the Super Express Deliveries Pty Ltd and Fred. The Commissioner identifies that, over the past five years, Fred has owned and operated three other courier companies, each of which has entered into liquidation owing significant debts to its employees, the Commissioner and other creditors. The Commissioner learns ASIC is investigating Fred for engaging in illegal phoenix activity.

The Commissioner exercises his discretion to retain the \$200,000 refund until Super Express Deliveries Pty Ltd lodges its outstanding income tax return.

On learning that the refund will not be paid, Fred lodges the outstanding income tax return on behalf of Super Express Deliveries Pty Ltd. The return results in the company being taken to have received an assessment and the crystallisation of a liability of \$150,000.

The Commissioner applies the \$200,000 credit against the income tax liability, reducing it to nil. The Commissioner pays a refund of \$50,000 to Super Express Deliveries Pty Ltd.

The Commissioner continues to explore other avenues to recover the unpaid tax liabilities from Fred's other companies.

Application provisions

5.20 The amendments in Schedule 4 commence on the first day of the quarter following Royal Assent. *[Exposure Draft, section 2]*

5.21 The amendments apply to refunds the Commissioner is otherwise required to pay on or after commencement. *[Exposure Draft, Schedule 4, item 2]*