CREDIT ISSUES

WOODGATE & CO.

Chartered Accountant

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ASIC TARGETS PHOENIX ACTIVITIES

The Australian Securities and Investments Commission ("ASIC") is targeting directors with a history of failed companies. As part of a programme to deter fraudulent phoenix activities, ASIC advised that it has identified 2,500 individuals, who were directors at the time that 1,400 companies were wound up, or ceased being directors shortly before those companies went into liquidation.

What is phoenix activity?

A report prepared for the Fair Work Ombudsman ("FWO"), by PricewaterhouseCoopers ("PWC"), and posted on the ASIC website in September 2013, defined phoenix activity as the deliberate and systematic liquidation of a corporate trading entity, which occurs with the illegal or fraudulent intention to:

(a) avoid paying tax and other liabilities, such as employees' entitlements; and,

(b) continue the operation of the business, through another trading entity.

There is a distinction between fraudulent phoenix activity and honest behaviour. For example, a company may be managed responsibly and then fail. The company then goes into liquidation and the Liquidator sells the assets of the business to the directors of the failed company, who hope to resurrect the business. This is not necessarily an abuse of the corporate structure. Fraudulent phoenix activity involves the liquidation of a company in order to avoid debts, with the intention of continuing the company's business after the liquidation. Fraudulent phoenix activity often involves the deliberate structuring of the affairs of a company in a way that allows the company and its directors, to avoid their obligations to pay tax, employees' entitlements and other creditors. The major creditors of a phoenixed company are often the Australian Taxation Office ("ATO"), state revenue authorities and workers' compensation insurers.

In the late 1980s and early 1990s phoenix activity would typically occur when the directors would incorporate a new company, often using the same or a very similar company name to the old company, and then commence trading using some or all of the assets of the old company. The old company would then go into liquidation, leaving it

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with few assets to pay its creditors. This form of corporate restructuring was particularly popular in the building and construction industries.

However, phoenix activity has evolved. More sophisticated phoenix activity involves planning for failure via the use of a group of companies.

In a simple example, one company owns the plant and equipment, another company is the trading entity and a third company is a labour hire company, which employs the staff. The labour hire company will typically own little or no assets. The labour hire company can incur debts, particularly taxation debts, and then be wound up without disrupting other group companies. A new labour hire company is then incorporated and the staff are transferred to this entity.

Costs of phoenix activities

The PWC report estimated that the annual costs of phoenix activities to the Australian economy were between $1.8 billion and $3.2 billion, including costs to employees, business and government. Costs to employees were estimated at between $200 million and $700 million. Costs to business were estimated to be between $1 billion and $1.9 billion. Costs to government were thought to be approximately $600 million.

Indicators of phoenix activities

Some indicators of phoenix activities include:

(a) failing to lodge business activity statements and/or income tax returns;

(b) understating debts owed in the company's books and records, particularly taxation debts;

(c) failing to remit PAYG withholdings, superannuation and child support payments, as those payments become due and payable;

(d) underpaying workers;

(e) changing employment conditions;

(f) the directors of the new entity are the same as the directors of the failed company, or family members or other close associates;

(g) the same or a very similar trading name as used by the old company is used by the new entity; and,

(h) the same business premises, telephone number, mobile phone numbers and other contact details are used by the new entity.

This is not an exhaustive list.

Industries at risk

Historically, the building and construction industries were particularly susceptible to phoenix activities. However, the PWC report stated that the private security, cleaning, road transport, textiles, clothing and footwear manufacturing industries were also at risk of phoenix activities. A common feature of those industries is intense price competition and low barriers to entry.

As part of its surveillance programme, ASIC will be focusing on the building and construction, labour hire, transport, security and cleaning industries.

Other enforcement activities

ASIC is a member of the Inter-Agency Phoenix Forum, which comprises 13 government agencies, including the ATO, FWO, the Australian Crime Commission and the various State and Territory revenue authorities.

ASIC may also provide funding to Liquidators, from the Assetless Administration Fund, to investigate the affairs of failed companies and the conduct of directors.

Given the pressure from government for revenue, we can expect to see further efforts to reduce losses of tax revenue from phoenix activities.

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