

REGULATION IMPACT STATEMENT FOR TAXATION CHANGES TO ADDRESS FRAUDULENT PHOENIX ACTIVITY

THE PROBLEM OR ISSUES THAT GIVE RISE TO THE NEED FOR ACTION

Introduction

During the election campaign, the Australian Labor Party (ALP) committed to address fraudulent phoenix activity¹. In particular, the ALP committed to:

- legislate to automate the current Director Penalty Regime (DPR) so that it automatically applies three months after remittance was due if the company does not report its outstanding liability;
- provide the ATO with the authority to stop directors and their associates accessing Pay As You Go (Withholding) (PAYG(W)) credits in their own tax returns where their company has not made the PAYG(W) payments to the ATO; and
- extend the DPR to include superannuation guarantee (SG) payments.

What is fraudulent phoenix activity

Fraudulent phoenix activity involves the accumulation of debts in a corporate structure and the liquidation of that company to avoid liability for those debts. It is important to distinguish such activity from honest behaviour.

Corporate law in Australia has traditionally reinforced the values of entrepreneurship and commercial risk taking, which are seen to be fundamental to wealth creation and a well-functioning market. Directors and shareholders are encouraged to engage in entrepreneurship and risk taking by limited liability, which can protect them from the costs associated with a company's failure.

A genuine business failure where the business has been managed responsibly and subsequently continues using another corporate entity is not of itself an illegitimate use of the corporate form. This use of the corporate form should be contrasted with dishonest practices that abuse the corporate form and the privilege of limited liability as a means of generating personal wealth or an unfair competitive advantage. Such arrangements may be used to avoid debts, including debts to other creditors, the Australian Taxation Office (ATO) and employees.

Fraudulent phoenix activity can take a variety of forms. In its most basic form, fraudulent phoenix activity may include accumulating debts without any intention of repaying those debts (for the purpose of wealth creation or to boost the cash flow of the business) and liquidating to avoid repaying the debt. The business then continues in another corporate entity, controlled by the same person or group of individuals.

However, fraudulent phoenix activity can often be more sophisticated, for example arrangements involving a number of companies controlled by the same person. One company will hold the assets and wealth for the group while another company provides services. The service company may be

¹ Election commitment 440.

liquidated and replaced with little disruption to the day-to-day operation of the overall business and the financial benefits from the unpaid liabilities are shared amongst the wider group. The services company has little or no assets to cover the company's debts (including employee entitlements).

Because of the variety of structures that phoenix activity can take and the need to protect entrepreneurialism, fraudulent phoenix activity is inherently difficult to define.² However, underlying the distinction between illegitimate, or fraudulent, phoenix activity and a legitimate use of the corporate form is the intention for which the activity is undertaken.

Impact of fraudulent phoenix activity

Phoenix activity has a significant impact on employee entitlements, government tax revenue collections and the economy more generally. Although it is difficult to measure precisely the cost of fraudulent phoenix activity, in 1996 the Australian Securities Commission (now ASIC) estimated the annual loss to the Australian economy due to phoenix activity as \$670 million to \$1.3 billion.³

This figure is likely to have grown as the ATO reports that, although fraudulent phoenix activity has historically been most prevalent with small business, that is, those businesses with a turnover below or around \$2 million, fraudulent phoenix activity is being undertaken by much larger businesses and by individuals who already have significant levels of wealth.

Concern over the spread of fraudulent phoenix activity to a wider range of businesses and across more industries is also heightened by the apparent increase in the numbers of individuals promoting the benefits of fraudulent phoenix activity. This was noted by the Joint Committee of Public Accounts and Audit in its report on tax administration tabled on 26 June 2008.⁴

The ATO estimates that the current stock of phoenix activity that it is monitoring poses a risk to revenue of around \$600 million.

In the past the biggest impact on the revenue has come from phoenix companies which fail to remit amounts withheld under the PAYG(W) system. These funds relate to the tax liability of a particular employee and it is as if the employer holds these funds 'on trust'. Such funds should never become part of the cash-flow of a business. However, the tax law does not make the employee liable for unremitted PAYG(W) amounts.⁵ In fact, under the existing law, the ATO cannot even pursue the outstanding PAYG(W) in relation to the salary and wages of the director of a phoenix company.

Fraudulent phoenix operators may also avoid other tax liabilities, such as the GST and the SG. The non-payment of SG is of particular concern as, unlike other liabilities imposed under Australia's taxation laws, it will result in a direct loss to the individual employee.

2 Parliamentary Joint Committee Report on Corporations and Financial Services 2004, Corporate Insolvency Laws: A Stocktake, The Commonwealth of Australia, Canberra, par 8.2.

³ Australian Securities Commission July 1996, Research Paper No 95/01-Phoenix Companies and Insolvent Trading, Canberra.

4 Joint Committee of Public Accounts and Audit July 2008, Report 410 into Tax Administration, Canberra, par 2.48.

5 See section 18-15 of Schedule 1 to the TAA 1953. Permitting credits to individuals even when amounts are not remitted ensures that an individual is not effectively taxed twice, once where amounts are withheld from their wages and again when the Commissioner seeks to collect unpaid amounts that have not been received.

In addition, fraudulent phoenix operators may fail to pay employees' redundancy entitlements, outstanding leave entitlements and voluntary superannuation contributions. The Government has committed to provide further protection for employees through the Fair Entitlements Guarantee.

Many fraudulent phoenix operators also leave debts to other creditors, such as suppliers of goods. These creditors receive some protection from the fact that, unlike the ATO and employees, they have the power to refuse credit or to require a personal guarantee from the directors.

Phoenix operators also impact on the efficient operation of the market because they can offer lower prices for their goods and services because they intend to avoid the tax and other liabilities associated with the project.

Problems with the existing law

The existing taxation law includes a number of features that can be used to address fraudulent phoenix activity. However, they have some limitations.

The Director Penalty Regime

The DPR (Division 269 of Schedule 1 to the *Taxation Administration Act 1953*) encourages a company director to cause the company to pay outstanding PAYG(W) amounts or enter into voluntary administration by making the director(s) personally and severally liable for those outstanding amounts if the ATO has given written notice to the director. The director can avoid liability by causing the company to do one of the following four things within 21 days of receiving the notice:

- comply with its obligations in relation to paying the PAYG(W) amounts;
- enter into a payment agreement with the Commissioner in relation to the amounts;
- appoint an administrator of the company;
- wind up the company.

The director will not be held personally liable for the debt if one of the defences in section 269-35 of Schedule 1 to the TAA 1953 is satisfied. These defences are:

- non-participation in the management of the company because of illness or some other good reason; and
- taking all reasonable steps to achieve compliance unless no such steps were available.

The ability of the DPR to address fraudulent phoenix activity is limited by a number of factors. Notably:

- issuing director penalty notices to crystallise a director's debt is highly resource intensive and, as a result, they are issued only to a small percentage of the directors who would otherwise be liable;
- director penalty notices may not be issued for 12 months or longer because the ATO must first identify that the company has an outstanding PAYG(W) liability (which is often hindered by the company failing to report its PAYG(W) liability) and then identify who the directors are

(in consultation with the ASIC), allowing the company to accumulate additional debts before taking action;

- as the regime focuses only on PAYG(W) liabilities, it does not provide any disincentive for fraudulent phoenix operators to accrue other liabilities, such as SG payments.

A company that fails to report is currently liable to a criminal penalty of 20, 40 or 50 penalty units (see sections 8C and 8E, and sections 16-150 and 16-153 of Schedule 1 to the TAA 1953).

Section 8Y of the TAA 1953 allows directors to be pursued personally for such penalties.

However, such criminal penalties are often negligible compared to the outstanding tax liabilities. In addition, section 8Y is currently being reviewed as part of a Council of Australian Governments review of provisions that make directors criminally liable for the conduct of companies. It is not feasible to enforce such a penalty against a phoenix company because they are likely to be in liquidation with limited funds to pay such penalties.

Denying PAYG(W) Credits

An individual who has had amounts withheld through the PAYG(W) system is entitled to a credit for those amounts, irrespective of whether they have been remitted. Indeed the usual practice of the Commissioner is to allow a taxpayer credit upon assessment for amounts withheld substantiated by a payment summary completed by the payer or a statutory declaration in lieu.

While a credit cannot be denied for unremitted amounts, the Commissioner does deny credits on the basis that an amount was not withheld in the first place. In the context of fraudulent phoenix activity the Commissioner's current practice is to deny the credit where the payee is a director of the paying entity and the Commissioner has evidence to support the view that moneys were not actually withheld.

However, the ability of the Commissioner to deny directors unpaid PAYG(W) credits is limited.

- It is relatively difficult for the Commissioner to obtain evidence that an amount was not withheld, particularly where the Commissioner is presented with a completed payment summary that suggests otherwise. It is relatively easy to prove that an amount was not remitted, which is readily apparent from the absence of a payment to the Commissioner.
- Conducting prosecutions for fraudulent conduct under the *Crimes Act 1914* and the *Criminal Code Act 1995* provides some disincentive to engage in such behaviour. However, such prosecutions generally require the involvement of the Australian Federal Police and the Commonwealth Director of Public Prosecutions, are highly resource intensive and can take several years to be finalised.

THE DESIRED OBJECTIVES

The objective of these reforms is to reduce fraudulent phoenix activity and its impact on the community. There should be sufficient deterrents in the tax law to discourage directors from undertaking fraudulent phoenix activity with the intention of the company avoiding its tax and superannuation obligations or avoiding the company's obligations to creditors more generally.

OPTIONS THAT MAY CONSTITUTE FEASIBLE MEANS FOR ACHIEVING THE DESIRED OBJECTIVES

The 'Action Against Fraudulent Phoenix Activity' proposals paper, which was released by the Government for public consultation on 14 November 2009 set out a number of taxation law and corporations law options for addressing fraudulent phoenix activity. Taxation law options include:

- automating the DPR;
- extending the DPR to other taxes;
- amending the promoter penalty regime;
- expanding the anti-avoidance provisions;
- re-instating the failure to remit offence;
- denying PAYG(W) credits to directors and their close associates;
- creating offences for claiming unremitted PAYG(W) credits; and
- extending the bond provision.

Corporations law options included:

- expanding the scope for disqualifying directors;
- restricting the use of similar names by successor companies; and
- adopting a doctrine of inadequate capitalisation.

As set out above, during the 2010 election campaign the Government committed to address fraudulent phoenix activity by:

- extending the DPR to include the SG;
- amending the current DPR so that it automatically applies after three months; and
- providing the ATO with the authority to stop directors and their associates accessing PAYG(W) credits in their own tax returns where their company has not made the PAYG(W) payments to the ATO.⁶

The Government also announced that it would restrict the use of similar names by successor companies and to further examine:

- extending the promoter penalty regime to include schemes to avoid payment of tax; and
- extending the DPR to indirect taxes.

⁶ Election commitment 440.

Details of the Government's tax election commitments in relation to phoenix companies and expected impacts are discussed below.

Expanding the DPR to apply to unpaid Superannuation Guarantee liabilities

Under the Government's election commitment, the existing DPR would be extended to include unpaid SG liabilities (that is, the SG Charge payable to the ATO because the company has not met their SG obligations to an employee).

The DPR is sometimes seen as draconian because it makes directors personally liable for the debts of the company. However, personal liability is considered appropriate in the case of the PAYG(W) because it represents employee entitlements.

Extending the DPR to the SG is appropriate because the SG is similar to PAYG(W) in that the amounts represent the entitlements of employees. In the case of PAYG(W) amounts, the Government will give the employee a credit regardless of the amount collected from the company. However, in the case of the SG, the Government will only credit an employee's superannuation fund when the amount is recovered from the company.

The Commonwealth Ombudsman estimates that 10 per cent of complaints about tax administration last year related to the ATO's inability to recover unpaid superannuation. Extending the DPR to the SG will discourage phoenix operators from using employee entitlements to disguise the company's cash flow issues and generally discourage fraudulent phoenix activity.

Automating the DPR

As set out above, the existing DPR makes a director personally liable for a company's outstanding PAYG(W) 21 days after being issued with a notice if the director has not caused the company to pay the debt or enter into a payment agreement, or placed the company into administration. The director's ability to put-off liability indefinitely until they receive a notice, and then to avoid liability absolutely by liquidating the company or making a payment arrangement, is a significant limitation on the effectiveness of the DPR.

Under the Government's election commitment, the DPR will apply automatically three months after remittal was due if the company does not report its outstanding liability. As set out above, directors may already be subject to criminal penalties for failing to report their PAYG(W) liability, however, the criminal penalties may be negligible compared to the outstanding PAYG(W) and this provision is currently under review.

Limiting the application of the automated DPR to unreported amounts will help to ensure that honest taxpayers are not affected by the measure as it will encourage companies to report outstanding liabilities (even if they are not paid). The ATO will then have the opportunity to consider whether a director penalty notice should be issued.

Directors will still be able to avoid personal liability if they were not involved in the management of the company, took all reasonable steps to cause compliance (or no such steps were available), put the company into liquidation or caused the company to enter into a payment agreement with the ATO before the three month period expires. Directors also have a right of indemnity against the company for such debts.

The three-month time frame is considered appropriate as it prevents companies accruing large debts before going in to liquidation to avoid those debts. A longer period would, obviously, provide time for more debt to be accrued. Targeting the proposed measure at companies that do not report will

prevent phoenix operators using non-reporting as a tool to prolong the life of the phoenix company and accrue larger debts.

Denying PAYG(W) credits to directors and their associates if the company has not remitted

Under the Government's election commitment, PAYG(W) credits would be denied to directors and their associates if the company has not remitted PAYG(W). However, credits would not be denied if they did not participate in the management of the company, because of illness or some other good reason, or because the director took all reasonable steps to achieve compliance unless no such steps were available. The Commissioner will also have a general discretion to allow an associate to use PAYG(W) credits where it is reasonable given all the circumstances.

IMPACT ANALYSIS

The proposal is expected to result in a net benefit to the community. The potential compliance costs to businesses are small compared to the benefits associated with addressing fraudulent phoenix activity.

Benefits

Businesses

- These proposals benefit businesses that comply with their tax and superannuation obligations and put them on an even playing field with companies that might otherwise seek to engage in phoenix behavior to obtain a competitive price advantage for the provision of goods and services to customers.
- The automation of the DPR will encourage directors to address solvency issues earlier.

Employees

- Expanding the DPR to SG amounts will improve the likelihood that employees will be paid their superannuation entitlements. As the Government only provides credits for the amount actually collected, the possibility that directors will become personally liable for unremitted SG amounts provides an incentive for companies to comply with their superannuation obligations. The higher the level of compliance, the greater the amount of superannuation credits that employees will be able to access.

ATO

- These proposals are designed to strengthen the powers of the ATO to pursue phoenix activity by improving their ability to recover PAYG(W) and SG liabilities. The automation of the DPR will make the recovery process less resource intensive for the ATO and will encourage taxpayers to report their liabilities even if they remain unpaid.
- It is anticipated that the changes will also increase voluntary compliance.
- The ATO estimates that the current stock of phoenix activity that it is monitoring poses a risk to revenue of around \$600 million.

Creditors

- The automation of the DPR and extending it to SG liabilities is likely to encourage company directors to address their solvency issues in a more timely manner and will prevent them from using PAYG(W) and SG amounts to disguise cash flow problems.
- The proposed changes to the DPR and the potential financial impacts on directors personally should encourage them to treat their company's solvency issues more seriously and discourage directors from pursuing fraudulent phoenix activities.
- Removing incentives to undertake fraudulent phoenix activity would reduce the extent to which debt can be accumulated in a phoenix company. As such, not only will smaller debts be owed to creditors (including employees and the ATO) at the time of liquidation, but the nature of the company (and its successors) as a fraudulent phoenix company will become more readily apparent to creditors, who may then take action to protect themselves.
- The measures provide more incentive for directors to focus on the solvency of their company and therefore the company will be in a better position to manage potential debts to creditors.

Community

- Although it is difficult to measure precisely the cost of fraudulent phoenix activity, in 1996 the Australian Securities Commission (now ASIC) estimated the annual loss to the Australian economy due to phoenix activity as \$670 million to \$1.3 billion.⁷
- These proposals are expected to provide a revenue gain of \$126.7 million over the four year period 2011-12 to 2014-15.
- In addition to improving worker's access to entitlements, the community at large will benefit from the collection of tax debts and improved tax compliance. The proposals will improve market efficiency by reducing the amount of fraudulent phoenix activity.

Costs

Business

- It is estimated that 6,000 companies may be directly affected by the proposals.
- The changes will also reduce the benefits associated with fraudulent phoenix activity, as they will reduce the ability of fraudulent phoenix companies to use their employees' PAYG(W) and SG as part of their cash flow and to accumulate large debts.
- These factors will reduce their ability to undercut legitimate business operators in the market place and will make it easier for creditors (including the ATO and employees) to identify fraudulent phoenix activity, potentially exposing the participants in phoenix activity to

⁷ Australian Securities Commission July 1996, Research Paper No 95/01-Phoenix Companies and Insolvent Trading, Canberra.

additional penalties and trading difficulties. These factors are designed to make fraudulent phoenix activity less attractive overall.

- The automation and expansion of the DPR is not expected to increase compliance or operating costs for businesses or directors of companies who are not engaging in phoenix activity.
- There is a small risk that the proposal to automate and expand the DPR will reduce entrepreneurial activity because of the changes to a director's potential personal liability. However, the fact that directors are already subject to potential penalties for the same conduct, and the targeting of the changes, will reduce the risk to honest and competent entrepreneurs

Employees

- The proposals may impact on 12,000 directors as employees (assuming that there are two directors per fraudulent phoenix company). These directors will face stronger penalties if they fail to report their PAYG(W) liabilities. In particular, they may become personally liable for company debts or be denied credits for PAYG(W) as a result of the proposals.
- Directors and the associates of directors may lose their PAYG(W) credits if they engage in fraudulent phoenix activity.
- These proposals are not expected to lead to increased costs or increased compliance burdens for other employees.

ATO

- The ATO may engage in activities to raise awareness about the new laws, through changes to the ATO websites and publications, and by contacting tax agents and insolvency specialists, particularly through consultative forums and seminars.
- These proposals will require additional funding for the ATO to cover increased operational costs. To obtain the benefits of these proposals, the ATO will spend \$18.41 million over the four year period 2010-11 to 2013-14.
- It is expected that the ATO will require additional staffing - full time equivalents (FTE) as follows: 26 FTE in 2011-12, 42 FTE in 2012-13; 26 FTE in 2013-14.

Creditors

- The proposals may encourage companies to pay their tax and superannuation obligations ahead of debts to other creditors and once the company goes into liquidation there is less money and assets available for distribution to these other creditors.

Community

- These proposals are not expected to lead to increased costs or increased compliance burdens for the community in general.

Conclusions

Although it is difficult to quantify the benefits and costs of these proposals, it is considered that on balance the proposals will provide a net benefit. The benefits will be based around improved tax compliance by companies and reduced incentives for companies to undertake fraudulent phoenix activity. The reduction of phoenix activity will provide benefits for employees, with regard to access to SG amounts and the community through improved collection of tax debts. The costs, for the most part, are for companies who would be actively seeking to avoid their tax and superannuation obligations to gain an unfair competitive advantage. The measures are expected to even the playing field for companies that comply with their tax and superannuation obligations; these companies are not expected to bear any additional costs from these proposals.

CONSULTATION STATEMENT

A range of options were set out for public consultation in the Action Against Fraudulent Phoenix proposals paper. The proposals that formed this election commitment were included in that proposals paper. The paper was open to submissions from the public from 14 November 2009 to 15 January 2010. There is also an intention to consult publicly on draft legislation.

Twenty-eight submissions were received in response to the proposals paper. The views set out in the public submissions in relation to the three proposals are set out below.

Automating the DPR

Fifteen submissions commented expressly on automation.

- Six submission supported automation after three months on the basis that it will reduce the incentive to engage in fraudulent phoenix activity and it will ease the administrative burden on the ATO, allowing the ATO to respond more effectively to a problem that is already unlawful and appears to be extensive.⁸
- Two submissions supported automation after a period of six months on the basis that PAYG(W) reflects amounts that are held on trust.
- The Commonwealth Ombudsman's submission gave general support for the automation of the DPR, but suggested that there should be a review mechanism to allow the ATO to release a director from liability and suggested that notices setting out the outstanding liability should be sent to directors.
 - Several defences will be available to directors, including the where the director was not involved in the management of the company, took all reasonable steps to achieve compliance or no such steps were available (section 269-35 of Schedule 1 to the TAA 1953). In addition, the Commissioner of Taxation has a general power to decide whether to enforce a tax debt.

⁸ The Australian Manufacturing Workers' Union, the Construction, Forestry, Mining and Energy Union, Consumer Action, the Department of Education, Employment and Workplace relations, Insolvency Practitioners Australia, the Institute of Chartered Accountants and Printing Industries.

- Another two submissions,⁹ while not rejecting the proposal, expressed concern that the proposal was not sufficiently targeted at fraudulent phoenix activity and that the automatic period should be long enough to allow for seasonal fluctuations in cash flow and give directors time to become familiar with the business's financial situation.
 - The current proposal has been targeted at fraudulent phoenix activity by limiting it to companies that do not report their outstanding liabilities. As a result, most honest and competent directors will not be impacted by the change.
 - PAYG(W) amounts that have been withheld should be held on trust and therefore should not be included in business cash flow.
 - Directors will have a right of indemnity against the company (section 269-45 of Schedule 1 to the TAA 1953). Directors will also be able to access defences, such as where the director was not involved in the management of the company or took all reasonable steps to achieve compliance (section 269-35 of Schedule 1 to the TAA 1953).

Four submissions did not support automating the DPR. Three of these submissions were made by committees of the Law Council's Business Law Section (the Corporations Law Committee, the Reconstruction Law Committee and the Taxation Law Committee) and one was made by the law firm Pitcher and Partners. They were concerned that:

- Automation effectively reinstates the ATO's priority in company liquidations because companies will pay tax debts before private debts;
- Automation is unnecessary - the ATO should utilise its existing powers more effectively; and
- The proposal should be more targeted.
 - It is important to remember that these amounts are essentially held on trust and should not be included in the company's everyday cash flow.
 - As set out above, the existing DPR is undermined by the large administrative burden that it imposes on the ATO and because directors can easily escape liability by putting the company into liquidation during the notice period.
 - The current proposal has been targeted more directly at fraudulent phoenix activity by only applying automatic liability where the company has not reported its outstanding liability. As such, dishonest directors will not be able to prolong the life of a phoenix company by failing to report outstanding liabilities.

Extending the DPR to SG amounts

Fourteen submissions commented on the proposal to extend the DPR to SG liabilities.

- Nine out of 14 submissions supported extending the DPR beyond PAYG.

⁹ Accounting firm Barrett Walker and the Housing Industry Association.

- All of those nine submissions supported extending the DPR to a range of taxes, such as company income tax and GST, not just SG liabilities.
 - Three submissions supported extending the DPR beyond tax liabilities to include other worker entitlements.
 - These submissions noted that extending the DPR would discourage fraudulent phoenix activity and remove distortions in the tax system (where one type of tax is paid in preference to another).
 - These submissions considered that other creditors would not be prejudiced and that honest directors would have nothing to fear.
 - The submissions noted the importance on SG liabilities to retirement incomes and their relationship with other entitlements, such as insurance and workers compensation.
 - The Commonwealth Ombudsman noted that 10% of complaints it received about taxation administration were about the ATO's inability to recover SG liabilities.
 - Overall, they considered that extending the DPR to SG liabilities was justified on public interest grounds.
- The Institute of Chartered Accountants stated that they do not support extending the DPR beyond PAYG(W) on the basis that attaching personal liability to directors is only appropriate for PAYG(W) because it represents amounts that are essentially held on trust.
 - Although SG is not held on trust per se, it does represent an amount that the company is obliged to pay for the benefit of the employee. Employees receive the benefit of PAYG(W) credits regardless of whether the amount is recovered from the employer. In contrast, employees do not receive SG amounts that are not recovered from the employer.
- Pitcher Partners did not object to the extension of the DPR but did not believe that it would help to curb fraudulent phoenix activity.
 - There is evidence to suggest that fraudulent phoenix operators often use their employees SG entitlements as part of the businesses cash flow to generate profits for themselves and to prolong the life of the phoenix company. Making directors potentially liable for such amounts will discourage this behaviour.
- The Australian Institute of Company Directors and the three committees of the Business Law Section of the Law Council of Australia opposed the expansion of the DPR on the basis that it would effectively make the Crown a priority creditor.
 - Providing an incentive to pay a particular debt will encourage that debt to be paid in preference to other debts, in the same way that the other debts might be preferred in the absence of that debt. Unlike other creditors, the ATO cannot protect itself by refusing to provide credit.

- The Taxation Law Committee of the Business Law Section of the Law Council of Australia suggested that it is not always clear whether a person is an employee (and, therefore it may not be clear that there is an SG liability).
 - The term ‘employee’ for SG purposes is defined under section 12 of the *Superannuation Guarantee (Administration) Act 1992* to include common law employees and an expanded definition of employees including individuals working under a contract wholly or principally for labour, members of the board of directors or executive body of a company and artists, musicians and sportspersons who are paid to perform or present.
 - Whether a person is an employee or an independent contractor for the purposes of the SG is a question of fact to be determined by examining the terms and circumstances of the arrangement between the payer and the person performing the work. The ATO superannuation guarantee ruling *SGR 2005/1* provides guidance on how to determine whether an individual is an employee. The ATO also has an online decision tool to assist businesses to determine whether a worker is engaged under an employment relationship.
 - In the circumstances where the company or director was not aware, and could not reasonably have known, that a person was an employee, then the director would be able to utilise the defence that they took all reasonable steps to comply or that no such steps were available (subsection 269-35(3) of Schedule 1 to the TAA 1953).
 - Directors will also have a right of indemnity against the company (section 269-45 of Schedule 1 to the TAA 1953).
- The Corporations Committee of the Business Law Section of the Law Council of Australia commented that extending the DPR to SG liabilities would exacerbate the existing administrative problems with the DPR.
 - Most fraudulent phoenix operators avoid paying more than one type of tax. As such, certain efficiencies would be achieved by expanding the DPR. For example, after contacting ASIC to identify the directors of a company, the ATO could issue director penalty notices in relation to more than one tax liability without contacting ASIC again.
 - The administrative problems associated with the DPR will be eased through the automation of the regime as set out in this proposal.

Denying PAYG(W) credits to directors and their associates

Nine submissions commented on the proposal to deny PAYG(W) credits to directors and their associates for unremitted PAYG(W).

- Five submissions supported the proposal on the basis that it would discourage fraudulent phoenix activity.
 - The submissions generally supported denying PAYG(W) credits to directors and their families on the basis that this would provide an additional incentive not to engage in fraudulent phoenix activity.

- Barrett Walker suggested that denying credits to other employees who knew of, or were involved in, the non-remittal of PAYG(W) would encourage reporting of fraudulent phoenix behaviour.
- Pitcher and Partners submitted that the proposal had merit but would not directly address fraudulent phoenix activity.
 - There is evidence that fraudulent phoenix company operators routinely fail to remit PAYG(W) and then benefit from the non-remittal by claiming those credits.
- Three submissions did not support the proposal.
 - The Housing Industry Association rejected the proposal on the basis that an error on the part of the ATO would adversely affect taxpayers. However, it was not clear why the Housing Industry Association considered this a bigger risk than the ATO making errors generally.
 - The Taxation Committee of the Law Council of Australia considered that denying such credits would require allocating unremitted PAYG(W) amounts between directors and employees and that the benefit achieved would not be worth the effort required.
 - The election costing of this proposal suggests that there will be a positive gain to the revenue from these proposals even after an allowance has been made for the administrative costs of the ATO.

A CONCLUSION AND RECOMMENDED OPTION

This proposal is an election commitment.

A STRATEGY TO IMPLEMENT AND REVIEW THE PREFERRED OPTION

These proposals would be pursued by amending the relevant tax legislation. To review the effectiveness of the changes and the additional funding provide to the ATO it is proposed that the Treasury and ATO undertake a review four years after implementation. The review would assess the impact of the proposal, the effectiveness of the proposal in meeting its objectives, considering the cost of implementing and administering the proposals.