



**ASIC**

Australian Securities & Investments Commission

# **Senate inquiry into corporate tax avoidance and minimisation**

## **Submission by the Australian Securities and Investments Commission**

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## Executive summary

- 1 On 2 October 2014, the Senate referred an inquiry into corporate tax avoidance and minimisation to the Senate Economics References Committee for inquiry and report. The terms of reference are tax avoidance and aggressive minimisation by corporations registered in Australia and multinational corporations operating in Australia, with specific reference to:
  - (a) the adequacy of Australia's current laws;
  - (b) any need for greater transparency to deter tax avoidance and provide assurance that all companies are complying fully with Australia's laws;
  - (c) the opportunities to collaborate internationally to address the problem;
  - (d) the performance and capability of the Australian Taxation Office (ATO) to investigate and launch litigation in the wake of drastic budget cuts to staffing numbers;
  - (e) the role and performance of ASIC in working with corporations and supporting the ATO to protect public revenue;
  - (f) any relevant recommendations or issues arising from the Australian Government's white paper process on the reform of Australia's tax system; and
  - (g) any other related matters.
- 2 This submission focuses on the role and performance of ASIC in working with corporations and supporting the ATO to protect public revenue.

### ASIC's role and responsibilities

- 3 ASIC's fundamental objective is to allow markets to allocate capital efficiently to fund the real economy and, in turn, economic growth.
- 4 ASIC's strategic priorities are to:
  - (a) promote investor and financial consumer trust and confidence;
  - (b) ensure fair, orderly and transparent markets; and
  - (c) provide efficient and accessible registration.
- 5 These strategic priorities reflect our mandate under the *Australian Securities and Investments Commission Act 2001* (ASIC Act).
- 6 While it is not ASIC's role to directly deal with tax avoidance or minimisation, where permitted by law ASIC seeks to share information with the ATO to help identify tax avoidance and tax minimisation.

- 7 Public financial reports by entities required under the *Corporations Act 2001* (Corporations Act) may also provide an indication to the public that an entity is involved in tax avoidance or has adopted tax minimisation strategies.

## Assisting the ATO

- 8 ASIC assists the ATO in its role of collecting tax in a number of ways.
- 9 One way is through the exchange of information, including through the use of compulsory powers and under the terms of a Memorandum of Understanding (MOU) between the agencies.
- 10 The agencies also participate in joint working parties, such as the working party to combat illegal phoenix activity (the Inter-Agency Phoenix Forum).

## Financial reporting by companies

- 11 Chapter 2M of the Corporations Act contains the financial reporting and audit requirements for companies, disclosing entities and registered schemes in Australia.
- 12 Financial reports under Ch 2M provide information available to a wide range of users of financial reports, including the ATO and the general public. For a fee, anyone can obtain a copy of financial reports lodged with ASIC.
- 13 The information in financial reports may draw public attention to possible tax avoidance or tax minimisation by entities.
- 14 This submission outlines the financial reporting requirements of a range of companies, with a particular focus on those companies that have been discussed most recently in the media in connection with possible tax minimisation (i.e. certain foreign companies and small proprietary companies controlled by foreign companies).
- 15 ASIC may provide relief to companies from reporting requirements, either by class order or on a case-by-case basis, and relief can be granted subject to conditions. Some of the long-standing relief that ASIC has provided is relied on by proprietary companies through which foreign groups operate in Australia.
- 16 Concerns have been raised in the media about certain foreign groups operating through proprietary companies in Australia, particularly proprietary companies relying on ASIC class order relief to not lodge financial reports with ASIC. Concerns have also been raised in cases where

public financial reports lodged with ASIC appear to indicate that companies pay less income tax than might be suggested by their reported profits.

## **ASIC's compliance and surveillance programs for financial reports**

- 17 ASIC conducts proactive and reactive compliance and surveillance programs concerning both the lodgement and the content of financial reports.
- 18 If companies fail in their obligations to lodge financial reports, they are subject to enforcement action by ASIC in the courts.

## **Illegal phoenix activity**

- 19 Illegal phoenix activity has no universal definition, but it generally involves the deliberate use of company structures to avoid liabilities, including tax.
- 20 Illegal phoenix activity is relevant to this inquiry due to the significant amount of Government revenue lost through unpaid taxes. A recent report estimated the annual cost of this activity is up to \$610 million for Government revenue.<sup>1</sup>
- 21 ASIC and the ATO are undertaking a number of strategies to combat illegal phoenix activity.

## **Policy options**

- 22 This submission raises a number of policy options for issues related to:
- (a) the disclosure of related party information in financial reports;
  - (b) 'grandfathered' large proprietary companies;
  - (c) confirming whether a proprietary company is small;
  - (d) the limitations on information sharing with the ATO; and
  - (e) directors using false identities.
- 23 We also consider whether any amendment should be made to the legislative duty of directors to act in the best interests of the company.

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<sup>1</sup> PricewaterhouseCoopers, *Phoenix activity: Sizing the problem and matching solutions*, report, Fair Work Ombudsman, July 2012, [www.fairwork.gov.au/About-us/news-and-media-releases/2012-media-releases/July-2012/20120704-phoenixing-report](http://www.fairwork.gov.au/About-us/news-and-media-releases/2012-media-releases/July-2012/20120704-phoenixing-report).

## A Assisting the ATO

### Key points

ASIC assists the ATO in its role of collecting tax in a number of ways.

One way is through the exchange of information, including the use of compulsory powers and under the terms of an MOU between the agencies.

The agencies also participate in joint working parties, such as the Inter-Agency Phoenix Forum.

### Ways ASIC assists the ATO

- 24 ASIC assists the ATO in its role of collecting tax in a number of ways:
- (a) We share the information each agency is permitted to share under our respective legislative arrangements.
  - (b) We cooperate in addressing issues that are of relevance to both agencies through, for example, working parties.
  - (c) Each agency has nominated relationship managers who are responsible for maintaining the relationship between the agencies and dealing with ad hoc issues and requests for information.

### Memorandum of Understanding

- 25 An MOU between ASIC and the ATO includes provisions for information sharing between the two agencies. The latest MOU was entered into in February 2013.
- 26 There are guidelines that underpin the MOU to help staff of both agencies navigate the legislative requirements on requesting and receiving information.
- 27 In general, information is sought from each agency in relation to particular matters of interest. Information is not generally provided proactively between the agencies.
- 28 The exchange of information between the ATO and ASIC is used relatively frequently. For example, in the period 1 January 2014 to 18 November 2014, there were 61 exchanges of information—32 from ASIC and 29 from the ATO.
- 29 Most of the requests to share information between the ATO and ASIC concern individual companies. Exchange of information can facilitate

meeting the regulatory mandates of each agency (e.g. investigations into particular alleged offences under the legislation administered by each agency).

- 30 Recently, at the request of the ATO, ASIC provided lists of:
- (a) all small proprietary companies controlled by foreign companies taking advantage of relief under ASIC Class Order [CO 98/98] *Small proprietary companies which are controlled by a foreign company but which are not part of a large group in Australia*; and
  - (b) all grandfathered large proprietary companies not required to lodge financial reports under the Corporations Act.
- 31 In particular, the ATO has been able to use tax data to determine where companies may be large and unable to rely on [CO 98/98].

## Limitations on providing information to the ATO

- 32 ASIC and the ATO have the ability to compel the other agency to provide confidential information.<sup>2</sup> From time to time these powers are used in addition to the general information sharing ability under the MOU.
- 33 However, there are restrictions on ASIC proactively providing confidential information to the ATO if the ATO has not sought that information under a notice or a request under the MOU.
- 34 If ASIC compulsorily acquires information for a particular purpose and subsequently attempts to disclose that information for another purpose, ASIC may be required to afford the subject of the confidential information procedural fairness and an opportunity to be heard and make submissions about the release.<sup>3</sup> This process has the potential to alert the person and may defeat the purpose of the release of the information.
- 35 We are not required to afford procedural fairness where this could alert a person and undermine an investigation. However, the party to be provided with the information must set out the case for why we should not afford procedural fairness. This can be problematic in cases where, for example, the taxpayer has no past history of acting to avoid an ATO investigation.

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<sup>2</sup> For example, s30 and 33 of the ASIC Act, s264 of the *Income Tax Assessment Act 1936*, and s353-10(1)(a)(i) of Sch 1 to the *Taxation Administration Act 1953*.

<sup>3</sup> See *Johns v Australian Securities Commission* (1993) 178 CLR 408, especially pp. 430–431 per Brennan J.

## Other support to the ATO

- 36            There are many ways that ASIC and the ATO work together—for example, working parties, liaison meetings, relationship managers, case-by-case assistance, joint projects, joint investigations, and compliance by self-managed superannuation fund (SMSF) auditors.
- 37            Of relevance to this inquiry is the joint working party between the agencies to combat phoenix activity: see Section D for further discussion.

## B Financial reporting by companies

### Key points

In this section, we provide an overview of:

- the financial reporting and audit requirements of Ch 2M;
- ASIC's discretion to grant relief from those requirements;
- who has access to the information contained in the lodged financial reports; and
- recent financial reporting by certain companies.

### Requirement to report

- 38 Chapter 2M contains the financial reporting and audit requirements for companies, disclosing entities and registered schemes.
- 39 These provisions are directed at ensuring confident and informed markets and investors, and ensuring the accountability of management through the provision of timely and reliable financial information.
- 40 Financial reports under Ch 2M provide information available to a wide range of users of financial reports, including the ATO and the general public. The information in financial reports may draw public attention to possible tax avoidance or tax minimisation by entities.
- 41 Public financial reporting may reveal:
- (a) that an entity is paying a low effective tax rate compared to reported profit;
  - (b) related party relationships and transactions that may facilitate tax minimisation (e.g. non-arm's length transfer pricing arrangements); or
  - (c) that reported revenue is less than might be expected, given a company's operations in Australia or the operations of its larger multinational group.
- 42 Generally, Ch 2M requires the following entities to prepare financial reports:
- (a) disclosing entities (generally listed entities and entities with more than 100 members in a class of securities as a result of a public fundraising);
  - (b) public companies, except small companies limited by guarantee;
  - (c) large proprietary companies;
  - (d) registered schemes;
  - (e) small proprietary companies that are controlled by a foreign company;

- (f) small proprietary companies or small companies limited by guarantee that ASIC directs to prepare financial reports;
  - (g) small proprietary companies subject to a shareholder direction under s293 of the Corporations Act; and
  - (h) small companies limited by guarantee subject to a shareholder direction under s294A.
- 43 A proprietary company is ‘large’ (i.e. not ‘small’) for a particular year if it meets two or more of the following three criteria:
- (a) consolidated revenue of \$25 million or more for the year;
  - (b) consolidated gross assets of \$12.5 million or more at the end of the year; and
  - (c) 50 or more employees in the company and its controlled entities at the end of the year.
- 44 A company limited by guarantee is generally small if it has consolidated revenue of less than \$250,000.
- 45 Most entities that are required to report must do so annually. Certain disclosing entities must also prepare a half-year report. All entities that are required to prepare financial reports must also lodge them with ASIC unless they are a grandfathered large proprietary company. They must also comply with the requirements of the accounting standards and generally must have an audit or review by an auditor.
- 46 A grandfathered large proprietary company is exempted by the Corporations Act from lodging financial reports with ASIC. These companies were not required to lodge before 1995, when the test for lodgement was ownership based rather than the current economic significance size test.
- 47 A disclosing entity or registered scheme must lodge its full-year financial reports within three months after the end of the financial year. Except for grandfathered large proprietary companies, all other companies must lodge their financial reports within four months after the end of the financial year.

### **Foreign companies’ reporting requirements**

- 48 Foreign companies carrying on business in Australia are required to be registered with ASIC and to lodge financial reports annually. However, under the Corporations Act their financial reports are prepared and audited in accordance with the law of the place of origin of the company.
- 49 Depending on the accounting rules in the company’s place of origin, their financial reports may only concern the overall global operations of such companies. Accordingly, these financial reports are unlikely to provide the detailed information on Australian operations and internal cross-border

arrangements that would be necessary to obtain an indication of any possible tax minimisation strategies.

## ASIC relief

- 50 In addition to various financial reporting exemptions set out in the Corporations Act, ASIC can grant additional relief from all or some of the financial reporting and audit requirements of:
- (a) Pt 2M.2 (financial records);
  - (b) Pt 2M.3 (financial reporting); or
  - (c) Pt 2M.4 (appointment and removal of auditors), other than Div 4.
- 51 Relief can be granted by class order or on a case-by-case basis, and can be granted subject to conditions.
- 52 We can only grant relief if we are satisfied that at least one of three statutory preconditions in s342(1) is met. That is, requiring the entity to comply with the Corporations Act would:
- (a) render the financial report or other reports misleading;
  - (b) be inappropriate in the circumstances; or
  - (c) impose unreasonable burdens.
- 53 We are not obliged to grant relief even if one or more of the pre-conditions in s342(1) have been met. Decisions by ASIC to refuse relief can be appealed at the Administrative Appeals Tribunal (AAT).
- 54 Regulatory Guide 43 *Financial reports and audit relief* (RG 43) explains how ASIC may exercise its powers to grant relief from the relevant financial reporting and auditing requirements of Ch 2M.
- 55 RG 43 is supplemented by other regulatory guides that discuss the policy basis for certain class order relief and our general approach to granting relief in individual cases (e.g. Regulatory Guide 115 *Audit relief for proprietary companies* (RG 115)).
- 56 It is general ASIC practice to issue a consultation paper asking for comments as part of all policy projects, on the basis that policy development can be improved by seeking feedback from those who will use the policy. This includes significant proposed class order relief under Ch 2M and related regulatory guides. Any class order relief must consider:
- (a) the statutory preconditions to ASIC's ability to grant relief (see paragraph 52); and
  - (b) the objectives of the financial reporting and audit provisions (see paragraph 39).

- 57 ASIC may also make a declaration under s601CK(7) to provide financial reporting relief to a registered foreign company or a class of registered foreign companies. There are no pre-conditions for such declarations by ASIC. Our approach to granting declarations is outlined in Regulatory Guide 58 *Reporting requirements: Registered foreign companies and Australian companies* (RG 58). Our overall approach is to ensure consistency with the reporting requirements of equivalent Australian companies as far as appropriate.
- 58 ASIC is required to comply with the Australian Government Guide to Regulation, set out by the Office of Best Practice Regulation (OBPR), whenever we undertake a policy project that results in new or amended regulation. This includes a cost–benefit analysis of the impact of any proposed relief.
- 59 Class orders and declarations sunset ten years from the date they are originally made. Before a class order sunsets, ASIC assesses whether the relief is still necessary and appropriate, and, if so, commences the process to renew it. A regulatory impact statement is prepared for submission to OBPR. Subject to any initial concerns from OBPR, a consultation paper is prepared. After taking into consideration feedback from the consultation process and subject to OBPR views, ASIC will decide whether to reissue the class order and make any changes to the relief.
- 60 Entities are not obliged to take advantage of ASIC class order relief and can continue to comply with the full financial reporting and audit requirements of the Corporations Act.
- 61 An overview of relevant ASIC regulatory guides and class order relief is provided in Table 3 in Appendix 1. This is not an exhaustive list.
- 62 Table 4 in Appendix 2 summarises the numbers of entities subject to financial reporting and audit requirements of the Corporations Act and those relying on ASIC class order relief.

### **Relief for small proprietary companies controlled by foreign companies that are not part of a large group in Australia**

- 63 A relevant example of class order relief is [CO 98/98]. This class order gives small proprietary companies controlled by foreign companies that are not part of a large group in Australia relief from preparing and lodging financial reports.
- 64 The Corporations Act does not require small proprietary companies not controlled by foreign companies to prepare financial reports. However, the Corporations Act does require those small proprietary companies controlled by foreign companies to prepare financial reports. We understand that this is

to avoid foreign companies from operating in Australia through a series of small proprietary companies rather than a single large proprietary company. For that reason, [CO 98/98] does not apply where a small proprietary company is part of a large group in Australia.

65 [CO 98/98] defines a 'large group' as one in which the aggregated revenue, gross assets, and employees for the entity in question, its parents and any of their controlled entities formed or carrying on business in Australia (i.e. the 'group') would exceed two of more of the criteria in paragraph 43.

66 For financial years ending in the 12 months to 30 June 2011, 1,134 small proprietary companies controlled by foreign companies took advantage of [CO 98/98] and did not lodge financial reports with ASIC.

67 Given that a company must be a small proprietary company and not part of a large group in Australia to use [CO 98/98], it is less likely that a financial report would provide any significant information on tax minimisation arrangements.

68 Where such a company is part of a large international group, the group parent will typically have a public financial report in its place of origin. Such a report relates to the global operations and is unlikely to disclose any detailed information that would help in understanding arrangements affecting the payment of Australian tax (e.g. arrangements between group entities such as transfer pricing).

## Access to lodged financial reports

69 Under s1274(2), for a fee anyone can obtain a financial report lodged with ASIC. Financial reports lodged with ASIC can be located by conducting a free search of ASIC's registers on ASIC's online service (ASIC Connect). Financial reports can be obtained from ASIC Connect, by writing to ASIC, or from an approved ASIC information broker.

70 In addition, a number of federal and state regulators and law enforcement agencies, including the ATO, have direct access to ASIC's registers and can (and already do) obtain this information.

71 Chapter 7 requires Australian financial services (AFS) licensees to lodge financial reports with ASIC, but these financial reports are not publicly available unless they are also required to be lodged under Ch 2M.

## Digitally lodged financial reports

72 Entities may voluntarily lodge financial report information with ASIC in digital form. The information in digital financial reports is tagged using a

common set of identifiers that enable financial report users to readily extract and analyse the information. Digital reporting has the potential to make financial information more accessible to users and to facilitate comparisons across companies. For example, effective tax rates could be readily calculated and compared across companies.

## Recent reporting by certain companies

- 73 In the last two years, concerns have been raised in the media about certain foreign groups operating through proprietary companies in Australia, particularly where:
- (a) a proprietary company that relies on [CO 98/98] to not lodge a financial report with ASIC may be part of a group that minimises tax on business dealings with Australians; or
  - (b) public financial reports lodged with ASIC appear to indicate that companies pay less income tax than might be suggested by their reported profits or the operations of their group in Australia.
- 74 To the extent that proprietary companies controlled by foreign companies may not be reporting in Australia in reliance on [CO 98/98] and may also be parts of groups that minimise tax on their business dealings with Australians, we will review that relief.
- 75 The underlying basis for the relief afforded by [CO 98/98] is that the cost of preparing financial information significantly outweighs the benefit to the users of the financial report and imposes unreasonable burdens on the companies concerned. The ATO is a potential user of financial reports and is well placed to assess where, for individual companies, the costs of preparing such reports do not significantly outweigh the benefits of public disclosure of matters such as effective tax rates or related party arrangements.
- 76 Accordingly, subject to the OBPR requirements, we will consider changes such as amending [CO 98/98] so that relief is not available where the ATO notifies a company that the relief does not apply to that company. We will also consider similar limitations on relief available to small registered foreign companies under Class Order [CO 02/1432] *Registered foreign companies—financial reporting requirements*.
- 77 Cases where companies appear to pay less tax than might be suggested by their reported profits are not within ASIC's direct regulatory remit.

## C ASIC's compliance and surveillance programs for financial reports

### Key points

ASIC conducts proactive and reactive compliance and surveillance programs concerning both the lodgement and the content of financial reports.

If companies fail in their obligations to lodge financial reports, they may be subject to enforcement action by ASIC in the courts.

### Timely lodgement requirements

- 78 Companies that fail to lodge financial reports as required are identified and subject to ASIC's compliance and surveillance programs, which are outlined in the following paragraphs.
- 79 For listed entities, the relevant stock exchange monitors the timely provision of public financial reports. ASIC follows up with other entities that have not lodged financial statements and reports within the time required by the Corporations Act.
- 80 There are some practical difficulties with ASIC following up with large proprietary companies that have not lodged. This is because proprietary companies are not required to advise ASIC of their classification as a large proprietary company and their obligation to lodge a financial report.
- 81 However, ASIC makes inquiries of proprietary companies that we suspect may be large but have not lodged a financial report. During 2014 we made inquiries of 2,178 proprietary companies, resulting in 336 (large proprietary) companies lodging financial reports.
- 82 If an entity does not lodge a financial report after contact by ASIC, we may obtain an order to comply under s1274(11), requiring the entity to lodge the report within 10 business days, from the magistrates or local court in the relevant state or territory.
- 83 Non-lodgement is a strict liability offence under s319. The maximum penalty for a breach of s319 is \$10,200 or imprisonment for one year, or both. Companies that continue to fail to lodge can be prosecuted under s319.
- 84 The number of s1274 orders obtained and s319 prosecutions commenced in recent years is summarised in Table 1.

**Table 1: Orders obtained and prosecutions commenced**

	Six months to 31 December 2014	2013–14
s1274 orders obtained	28	35
s319 prosecutions commenced	10	8

## Content of financial reports

- 85 ASIC has a proactive program of reviewing the content of financial reports of 450 listed entities and other entities of public interest with many stakeholders. The purpose of these reviews is to ensure that investors and other stakeholders are receiving useful and meaningful information in accordance with the accounting standards and other financial reporting requirements of the Corporations Act.
- 86 Financial reports and focus areas in financial reports are selected on a risk basis. We issue six-monthly media releases before the December and June reporting seasons to inform preparers and auditors of focus areas for the upcoming season. These releases help improve compliance before the completion of financial reports. We also issue six-monthly media releases of our findings from proactive reviews of financial reports.
- 87 If, after contacting an entity with preliminary concerns from reviewing a financial report, we conclude that there were material deficiencies in the information provided in the financial report, we will ask the entity to inform the market through a revised financial report and, where relevant, a market announcement.
- 88 If an entity makes a material change to its financial information after our inquiries, we will issue an individual media release. This helps directors and auditors of other entities avoid similar issues.
- 89 In the three years to 30 June 2013, 4% of entities made material changes to their financial reports following ASIC inquiries.
- 90 We also reactively review the content of financial reports of other entities based on complaints and other intelligence, such as media reports.
- 91 Where an entity does not correct its financial report, we will consider enforcement action. This may include seeking a declaration from a court or other appropriate action. Since 30 June 2014, we will generally make a media announcement if a company materially restates its financial reports following concerns raised by ASIC.

## D Illegal phoenix activity and its role in tax avoidance

### Key points

Illegal phoenix activity has no universal definition, but it generally involves the deliberate use of company structures to avoid tax and other liabilities.

Illegal phoenix activity is relevant to this inquiry due to the significant amount of Government revenue lost through unpaid taxes.

ASIC and the ATO are undertaking a number of strategies to combat illegal phoenix activity.

### Illegal phoenix activity

- 92 It is central to the concept of limited liability that when a company fails the directors and the shareholders, as a general rule, are not held personally responsible for the debts of the company.
- 93 Genuine corporate failure, where the business has been responsibly managed and subsequently continues after liquidation using another corporate entity, is a legitimate use of the corporate form and of limited liability. These concepts are fundamental to the global commercial system. It follows that phoenix activity is not, therefore, inherently unlawful.
- 94 Illegal phoenix activity, on the other hand, involves using company structures to avoid tax and other liabilities, including employee superannuation and entitlements. It generally involves abuse of the corporate form by current or previous directors of the company who set out to deliberately and intentionally evade liabilities and deny creditors access to available company assets.
- 95 There is no single statutory definition or offence under the Acts we administer for 'illegal phoenix activity'. Illegal phoenix activity typically involves the winding up of a company and the subsequent continuation of that business in the form of a new company, often with a similar company name, structure and staff.
- 96 The original company is often in financial distress, so directors transfer the assets of the potentially insolvent company to a new company (controlled by the same directors), for negligible consideration, with the intention of denying access to the company's assets by the creditors.

- 97 This conduct is a concern for a number of regulatory agencies and each one has its own focus and, potentially, its own definition of what this activity means for them.
- 98 ASIC has identified three key characteristics that form the basis for our definition of illegal phoenix activity. They are:
- (a) the company failing and being unable to pay its debts;
  - (b) directors acting in a manner that intentionally denies unsecured creditors equal access to the available assets in order to meet and pay debts; and/or
  - (c) within some period of time soon after the failure of the initial company (usually 12 months), a new company commencing using some or all of the assets of the former business and being controlled by parties related to either the management or directors of the previous entity.

## The relevance of illegal phoenix activity to tax avoidance

- 99 The relevance to this issue is the significant amount of Government revenue lost through unpaid taxes.
- 100 A 2012 PricewaterhouseCoopers report commissioned by the Fair Work Ombudsman<sup>4</sup> estimated the total cost of illegal phoenix activity to the Australian economy to be between \$1.8 billion and \$3.2 billion per year.
- 101 The report estimates that the annual cost of this activity is up to \$610 million for Government revenue—mainly as a result of unpaid tax—but also due to payments made to employees under the Fair Entitlements Guarantee (FEG).
- 102 While not all insolvencies can or should be classified as relevant to tax avoidance, a significant amount of Government revenue is lost each year through unpaid taxes and Government payouts via FEG and, previously, under the General Employee Entitlements and Redundancy Scheme (GEERS).
- 103 ASIC is undertaking a number of strategies to combat phoenix activities, including:
- (a) administering the Assetless Administration Fund (AA Fund), which provides funding for preliminary investigations and reports by liquidators into the failure of companies with few or no assets, with a particular focus on phoenix activity;

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<sup>4</sup> PricewaterhouseCoopers, *Phoenix activity: Sizing the problem and matching solutions*, report, Fair Work Ombudsman, July 2012, [www.fairwork.gov.au/About-us/news-and-media-releases/2012-media-releases/July-2012/20120704-phoenixing-report](http://www.fairwork.gov.au/About-us/news-and-media-releases/2012-media-releases/July-2012/20120704-phoenixing-report).

- (b) disqualifying directors who have been the directors of two or more failed companies within seven years, with a particular focus on phoenix activity. In the 2013–14 financial year, ASIC disqualified 60 company directors from managing corporations; 47 of those were as a result of investigations funded by the AA Fund;
- (c) operating the Liquidator Assistance Program, which aims to ensure directors of companies in external administration comply with their obligations to provide information to the liquidator or ASIC about the companies they managed. Directors who fail in these obligations may be the subject of ASIC-initiated court action;
- (d) taking enforcement action against directors where ASIC becomes aware of serious allegations of illegal phoenix activity for offences such as breaches of directors' duties and insolvent trading;
- (e) carrying out a proactive surveillance campaign that focuses on the future conduct of directors, rather than conduct that has already occurred, with the aim of preventing illegal phoenix activity; and
- (f) membership and participation in the whole-of-government Inter-Agency Phoenix Forum, which comprises a number of federal regulatory and enforcement agencies, such as ASIC, the ATO and the Australian Crime Commission.

## E Policy considerations

### Key points

This section outlines some aspects of corporations and securities legislation that might be further considered by the Australian Government in connection with tax avoidance and tax minimisation.

This section also discusses whether any amendment should be made to directors' duties.

### Possible areas for further consideration

- 104 The Australian Government could consider the following legislative amendments to provide more public transparency of information that may be relevant in identifying possible tax avoidance and tax minimisation, and to facilitate information sharing by ASIC to the ATO: see Table 2.

**Table 2: Possible amendments**

	Current situation	Possible amendment
<b>Disclosure of related party information in financial reports</b>	The accounting standards contain disclosure requirements for related party relationships and transactions. These disclosures could help the public identify non-arm's length arrangements that might be used to minimise tax payments in Australia. However, the requirements do not apply to non-reporting entities.	Taxation legislation could be amended so that non-reporting entities would be required to make these disclosures in financial reports under the Corporations Act if notified to do so by the ATO.
<b>Grandfathered large proprietary companies</b>	Grandfathered large proprietary companies are exempt from lodging financial reports with ASIC. The lack of availability of public financial reports reduces transparency about possible indicators of tax avoidance or tax minimisation.	The concept of 'grandfathered large proprietary companies' could be removed from the Corporations Act and these companies required to lodge financial reports with ASIC. This would remove any inequity with similar companies that are required to lodge financial reports. Consideration may need to be given to privacy concerns that may have contributed to the original decision to provide the grandfathering exemption.

	Current situation	Possible amendment
<b>Confirmation whether a proprietary company is small</b>	Most of the more than 1.7 million Australian proprietary companies are not required by the Corporations Act to lodge financial reports with ASIC. Some of these companies may become large but fail to prepare and lodge financial reports. There is no requirement for these companies to confirm to ASIC that they are small for each financial year, which would act as a trigger for the companies and their directors to review the company's status.	Proprietary companies could be required by the Corporations Act to confirm to ASIC whether they remain small. However, this would need to be balanced against the administrative cost and red tape imposed on the vast majority of proprietary companies that are small for any given year. There is also likely to be a cost to ASIC in following up companies that do not confirm their status for any given year.
<b>Limitations on information sharing with the ATO</b>	Before providing confidential information to the ATO that may help identify and address tax avoidance, there are circumstances that sometimes require ASIC to provide procedural fairness to the person affected by the provision of that information. This process has the potential to alert the person and defeats the purpose of the release of the information.	The confidentiality provisions in s127 of the ASIC Act could be amended to put beyond doubt that ASIC is able to freely share information with the ATO without the need to provide procedural fairness to the affected person.
<b>False identities of directors</b>	Currently, ASIC has no authority to check the identity of individuals who are notified as being the directors of a company to be registered with ASIC. Such individuals could use false identities to form companies that are used in tax avoidance activities.	ASIC could be allowed to require evidence of the identities of proposed directors of companies. The recommendation of the Financial System Inquiry to develop a national strategy for a federated-style model of trusted digital identities will assist with this. <sup>5</sup>

## Directors' duties

- 105 Directors have a legislative duty under s181 of the Corporations Act to act in the best interests of the corporation, which is generally thought to coincide with the best interests of shareholders. While this general duty would not override specific requirements of tax legislation, tax minimisation in some circumstance may be consistent with this general duty.
- 106 The duty is important to protect shareholder interests and is not directed at taxation. We believe that it would be impractical and inappropriate to attempt to address tax minimisation by modifying this general duty in the Corporations Act.

<sup>5</sup> Financial System Inquiry, *Financial System Inquiry final report*, November 2014, Recommendation 15, <http://fsi.gov.au/publications/final-report/>.

## Appendix 1: Summary of key ASIC class orders and guidance concerning financial reporting

Table 3: ASIC class orders and guidance concerning financial reporting

<p><b>Disclosing entities</b></p>	<p>Class Order [CO 08/15] <i>Disclosing entities—half-year financial reporting relief</i> relieves a disclosing entity from the requirement to prepare and lodge a half-year financial report and directors' report during the first financial year of the entity, where that first financial year lasts for eight months or less.</p> <p>Regulatory Guide 95 <i>Disclosing entity provision relief</i> (RG 95) discusses relief from the disclosing entity provisions as defined in s111AR.</p>
<p><b>Externally administered companies</b></p>	<p>Class Order [CO 03/392] <i>Externally administered companies: Financial reporting relief</i> provides relief from the financial reporting obligations for companies subject to certain forms of external administration.</p> <p>Regulatory Guide 174 <i>Externally administered companies: Financial reporting and AGMs</i> (RG 174) outlines our approach to financial relief for externally administered companies from the financial reporting requirements of the Corporations Act.</p>
<p><b>Foreign companies</b></p>	<p>RG 58 describes the relief from the financial reporting requirements of the Corporations Act that may be granted to registered foreign companies and Australian companies with foreign shareholders.</p> <p>[CO 02/1432] provides lodgement relief to certain registered foreign companies—that are equivalent to small proprietary companies that are not part of a large group in Australia—from the requirement to lodge a financial report if the company is not required by the law of its place of origin to prepare a financial report.</p>
<p><b>Proprietary companies</b></p>	<p>Class Order [CO 98/1417] <i>Audit relief for proprietary companies</i> provides relief from the requirement for an audit of the financial report of a proprietary company if the conditions in the order (e.g. a resolution of shareholders and directors to apply the relief, the existence of particular financial conditions and the financial report being compiled by a professional accountant with particular qualifications) are met. The relief is only available to companies that have not had an audit in the past three years.</p> <p>RG 115 discusses the class order relief and indicates when we may give individual audit relief to proprietary companies.</p> <p>[CO 98/98] provides lodgement relief to certain small proprietary companies that are controlled by foreign companies. For further information, see paragraphs 63–68.</p>
<p><b>Wholly owned entities</b></p>	<p>Class Order [CO 98/1418] <i>Wholly-owned entities</i> provides a process by which the wholly owned subsidiaries of a parent company may be granted relief from their reporting and audit requirements. [CO 98/1418] contains a number of conditions that the company group must satisfy.</p> <p>In particular, the parent and wholly owned subsidiaries must have entered into a deed of cross-guarantee and the parent company must lodge consolidated financial statements covering all of the entities subject to the relief.</p>

## Appendix 2: Corporations Act entities with financial reporting obligations

Based on information lodged with ASIC in the 12 months to 30 June 2011, there were 1,749,561 companies, registered schemes and disclosing entities in Australia. Of these, 28,880 have financial reporting obligations under the current requirements in Ch 2M. These companies are divided as set out in Table 4.

**Table 4: Types of companies with financial reporting obligations**

	Description	Financial reporting obligations	Number reporting
<b>Listed public companies</b>	Public companies that are listed on a stock exchange.	Prepare and lodge an annual audited financial report and an annual directors' report and an audited remuneration report and financial report. Prepare and lodge a half-year financial report that has been reviewed or audited by an auditor and a half-year directors' report.	1,951
<b>Unlisted public companies other than those limited only by guarantee</b>	Public companies that are not listed on a stock exchange other than those only limited by guarantee (discussed below). They include companies limited only by shares, a small number of 'no-liability' public companies and public companies limited by both shares and guarantee.	Prepare and lodge an annual audited financial report and annual directors' report. Some companies will have more reporting obligations as unlisted disclosing entities (see below).	5,476
<b>Public companies limited by guarantee</b>	Public companies limited by guarantee. These companies predominantly have a not-for-profit focus.	Prepare and lodge an annual audited or reviewed financial report and an annual directors' report. Companies that are registered with the Australian Charities and Not-for-profits Commission do not presently need to lodge financial reports with ASIC for years commencing on or after 1 July 2013.	8,360
<b>Registered schemes—Listed</b>	A scheme registered under the Corporations Act that is also listed on a stock exchange.	Prepare and lodge an annual audited financial report and an annual directors' report. Prepare and lodge a half-year financial report that has been reviewed or audited by an auditor and a half-year directors' report.	83

	Description	Financial reporting obligations	Number reporting
<b>Registered schemes—Unlisted</b>	A scheme registered under the Corporations Act that is not listed on a stock exchange.	Prepare and lodge an annual audited financial report, an annual directors' report and an annual auditor's report. Some schemes will have more reporting obligations as unlisted disclosing entities (see below).	3,738
<b>Unlisted disclosing entities</b>	Includes unlisted registered schemes that have issued a managed investment product to 100 or more people, unlisted public companies that have issued securities to 100 or more people using a disclosure document, and unlisted companies that have issued a debenture.	Prepare and lodge an annual audited financial report and an annual directors' report. Prepare and lodge a half-year financial report that has been reviewed or audited by an auditor and a half-year directors' report.	2,102 (being 1,679 unlisted registered schemes and 423 unlisted companies included as reporting elsewhere in this table)
<b>Wholly owned subsidiaries with ASIC relief</b>	7,175 proprietary companies and 625 unlisted public companies that are wholly owned by another company and meet the conditions for financial reporting relief under [CO 98/1418].	ASIC provides class order relief from financial reporting for wholly owned subsidiaries that are party to a deed with cross-guarantee with their parent and meet certain other conditions.	None.
<b>Large proprietary companies</b>	Proprietary companies that meet two or more of the following three criteria: <ul style="list-style-type: none"> <li>• consolidated revenue of \$25m or more for the year;</li> <li>• consolidated gross assets of \$12.5m or more at the end of the year; and</li> <li>• 50 or more employees in the company and its controlled entities at the end of the year.</li> </ul>	Prepare and lodge an annual audited financial report and an annual directors' report.	5,359, including 224 with ASIC audit relief (excludes grandfathered large proprietary companies, discussed below)
<b>Small proprietary companies—Not controlled by a foreign company</b>	Proprietary companies below the size thresholds that are not controlled by a foreign company.	Maintain written financial records that would enable true and fair financial statements to be prepared and audited. Can also be directed by ASIC or shareholders with 5% of voting capital to prepare an audited financial report.	114 (1,712,865 were not required to report)

	Description	Financial reporting obligations	Number reporting
<b>Small proprietary companies—Controlled by a foreign company</b>	Proprietary companies below the size thresholds that are controlled by a foreign company.	Report in the same manner as large proprietary companies. However, ASIC provides class order relief ([CO 98/98]) so they are treated the same as other small proprietary companies if they are not part of a large group in Australia.	2,309 (1,134 have ASIC relief and were not required to report)
<b>Grandfathered large proprietary companies</b>	Proprietary companies incorporated before 1995 (when the obligation for large proprietary companies to report was introduced) that were previously exempt proprietary companies, had their financial reports audited and met certain other requirements.	Prepare an annual audited financial report and an annual directors' report, but no requirement to lodge with ASIC.	1,490

## Key terms

Term	Meaning in this document
AA Fund	Assetless Administration Fund
AAT	Administrative Appeals Tribunal
accounting standards	As defined in s9 of the Corporations Act
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services  Note: This is a definition contained in s761A.
AFS licensee	A person who holds an AFS licence under s913B of the Corporations Act  Note: This is a definition contained in s761A.
ASIC	Australian Securities and Investments Commission
ASIC Act	<i>Australian Securities and Investments Commission Act 2001</i>
ATO	Australian Taxation Office
Ch 2M (for example)	A chapter of the Corporations Act (in this example numbered 2M), unless otherwise specified
[CO 98/98] (for example)	An ASIC class order (in this example numbered 98/98)
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
grandfathered large proprietary companies	Large proprietary companies exempted by the Corporations Act from lodging financial reports with ASIC. These companies were not required to lodge before 1995, when the test for lodgement was ownership based rather than the current economic significance size test.
MOU	Memorandum of Understanding
OBPR	Office of Best Practice Regulation
RG 43 (for example)	An ASIC regulatory guide (in this example numbered 43)
s293 (for example)	A section of the Corporations Act (in this example numbered 293), unless otherwise specified