

AUSTRALIAN GOVERNMENT
SENATE ECONOMICS STANDING COMMITTEE
IMPACT OF THE NON-PAYMENT OF THE SUPERANNUATION GUARANTEE

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I INTRODUCTION

I thank the Senate for the opportunity to make this submission. I lead a group of academics currently undertaking an Australian Research Council-funded project examining the regulation of illegal phoenix activity. Our aim is to devise ways in which this damaging behaviour can be most efficiently and effectively prevented and deterred, without damaging legitimate business activities to the detriment of the economy. We have now produced two major reports on the subject: *Defining and Profiling Phoenix Activity* and *Quantifying Phoenix Activity: Cost, Incidence, Enforcement*. Both are available from <http://law.unimelb.edu.au/centres/cclsr/research/major-research-projects/regulating-fraudulent-phoenix-activity>. Our third report containing recommendations to detect, disrupt and bring enforcement actions against harmful phoenix activity will be released at the end of February 2017. I am also the author of a book entitled *The Protection of Employee Entitlements in Insolvency: An Australian Perspective* (MUP, 2014).

II COMMENTS TO ADDRESS TERMS OF REFERENCE

While our research has not focused specifically on the recovery of the superannuation guarantee, I make the following comments which relate to the terms of reference dealing with **the economic impact on workers and the impact upon government revenue, and remedies to recoup SG in the event of company insolvency and collapse, including last resort employee entitlement schemes.**

- While the exact quantification of amounts of superannuation lost through insolvency is difficult to achieve, external administrator reports to ASIC for 2015-2016 indicate that there were 19 instances where over \$1,000,000 of superannuation was lost; there were also 171 instances of unpaid superannuation between \$250,001 and \$1,000,000.¹
- Phoenix activity broadly centres on the idea of a corporate failure and a second company, often newly incorporated, arising from the ashes of its failed predecessor where the second company's controllers and business are essentially the same. It becomes illegal, as a breach of directors' duties, where the intention of the company's controllers are to shed debts while continuing the business through a new entity.
- The non-payment of taxes and employee entitlements, including superannuation, is often the main objective of illegal phoenix activity. Estimates of the amounts lost are imprecise but are believed to be in the billions of dollars.²

¹ ASIC, *Report 507 Insolvency Statistics: External Administrators' Reports (July 2015 to June 2016)* (December 2016), Table 37.

² PriceWaterhouseCoopers and Fair Work Ombudsman, *Phoenix Activity - Sizing the Problem and Matching Solutions* (June 2012), 15. The PWC Report estimated that the cost to business generally from illegal phoenix activity fell somewhere between the \$1,784,338,743 and \$3,191,142,300 range annually. It also estimated that illegal phoenix activity resulted in lost employee entitlements between \$191,253,476 and \$655,202,019 annually.

- Illegal phoenix activity often involves the failed company being wound up with few or no assets. This means that employees will receive little from their status as secured creditors in the liquidation.³ Instead, they must rely on the Fair Entitlements Guarantee (FEG), which does *not* cover superannuation as the statutory priority does.
- While about 8,000 companies enter liquidation each year, and their employees can claim on FEG, five times as many companies each year are abandoned and eventually deregistered by ASIC for failure to pay annual fees and submit returns.⁴ The employees of abandoned companies receive nothing from the company and do not qualify for FEG.⁵ Their access to FEG should be addressed. The amounts of lost superannuation of employees of abandoned companies are unknown and unknowable.
- Companies which are created with the intention that they be closed down without paying taxes and employee entitlements outcompete law abiding competitors who may be forced into similar behaviour to stay in business, albeit through a new company.
- Our recommendations to tackle harmful phoenix activity, whether technically illegal or else engaged in by repeatedly unsuccessful business owners, involve a wide range of measures to detect, disrupt and bring enforcement actions. In the superannuation context, a similar emphasis on prevention rather than cure might be warranted.

I make the following comments about the **effectiveness of legislation to ensure timely payment of the SG, and measure to improve compliance with the payment of SG.**

- It is difficult for employees to monitor their employer's compliance with SG obligations, notwithstanding payslip reporting of SG payments.⁶ Those most vulnerable to non-payment of superannuation – casual, NESB, or poorly educated – are the least likely to monitor employer compliance, quite apart from timing issues that make the matching of entitlement and payment hard to achieve.
- Even where non-compliance is detected, the employee cannot force the employer to comply, nor can it force the ATO to take action on their behalf: *Kronen v FCT* [2012] FCA 1463; *Kronen v Commissioner of Taxation* [2013] FCA 416.

³ External administrators' reports to ASIC for the period 2015-2016 show that in 3,051 administrations out of a total of 9,465 (or 32.2%), employees' superannuation between \$1 and \$100,000 was unpaid: ASIC, *Report 507*, above n 1, Table 37. Because the report prepared by external administrators for ASIC does not separate out instances of suspected phoenix activity, there is no separate figure for that.

⁴ *Corporations Act* s 601AB. In 2014-15, 7,044 companies entered liquidation, 6.2% of the 112,714 companies that were deregistered in that year. ASIC has informed us that of the remaining companies, 42,059 were deregistered at ASIC's instigation. Of these, about 89.4%, or 37,600 companies, are believed to have been wound up for failure to pay fees.

⁵ The 'catch-22' here is that liquidators need to be paid for their work. If the company has no assets to pay the liquidator, and the employees are not willing to put money towards the liquidator's costs to pay for the company to be liquidated or for the liquidator to investigate possible recovery actions against the directors personally, then the company does not enter liquidation at all. There is limited money available from ASIC to fund 'assetless' administrations, but access to this funding depends upon a liquidator undertaking preliminary investigation work and making a case for the funding – another catch-22.

⁶ See further Helen Anderson and Tess Hardy, 'Who Should be the Super Police? Recovery of Unremitted Superannuation in Insolvency', (2014) 37(1) *University of New South Wales Law Journal* 162, 168, 182.

- Even where the ATO does act by sending a director penalty notice to the director of the insolvent company, the ability of the director to escape personal liability by promptly liquidating the defaulting company within 21 days of receiving the notice means that the unpaid PAYG(W) and superannuation amounts are not recovered.
- In the context of illegal phoenix activity, *the whole point* of the exercise is to close down a debt-laden company and continue the business with a clean slate. Avoiding the DPN is a happy consequence (for the director) of this strategy.
- Single touch payroll will address this issue, but *only* if it involves both payment and reporting. If, as at present, it only requires reporting, it undermines the usefulness of the lockdown DPN, introduced in 2012,⁷ and puts the onus back on the ATO to send DPNs on all unpaid, reported liabilities. But the problem with this is that the director can *still* avoid the DPN in relation to the reported amount by liquidating the company within 21 days. The business can continue through a new company, which as a separate legal entity, is not liable for the old company's debts. Therefore in my opinion, single touch payroll must involve payment as well as reporting.

I make the following comments about **information barriers**.

- While relevant regulators are members of the Interagency Phoenix Forum and prescribed taskforce which facilitates information sharing, there needs to be much better procedures for data sharing between them. However, the first step is much better data *gathering* on directors and their companies – existing, liquidated or abandoned.⁸ An ounce of prevention is worth a pound of cure, and at least some of those avoiding obligations to pay taxes and employee entitlements will think twice if they have a greater expectation of being caught.
- There should be better avenues for information sharing between unions, superannuation funds and relevant regulators. 'Privacy' is a shield behind which wrongdoers act with impunity.
- Credit reporting agencies can act as market-based regulators. If they are given information about unremitted superannuation and those responsible for it, those persons are likely to find it hard to get finance for their next companies.

I make the following comments about **reporting of complaints about SG non-payment**.

- The ATO is not the most logical place for people to go to complain about unpaid superannuation. It makes sense for the FWO or Department of Employment to be given a greater role in detecting unpaid superannuation (through the FWO inspectorate) and in receiving complaints from the public.
- All regulator websites should display accurate, detailed and consistent information, so that complainants are not sent from one place to another to find the appropriate place to complain. Links should be updated. The current link on the ASIC webpage for the ATO's superannuation complaint area comes up with a 'page not found'.

⁷ In simple terms, the lockdown DPN takes away the directors' ability to escape the DPN through speedy liquidation where the amount of liability is not reported.

⁸ See further Helen Anderson, 'Sunlight As The Disinfectant For Phoenix Activity' (2016) 34 *Company and Securities Law Journal* 257.