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Director's liabilities and phoenix activity targeted

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Published by: Rohan Harris

The 2018 budget update for company directors.

On 8 May 2018, Treasurer Scott Morrison delivered the 2018 Budget, new measures to increase director liabilities and compliance were revealed, specifically targeting illegal company 'phoenix activity'.

The Treasurer has committed $40 million over four years to tackle illegal phoenix activity in response to reforms proposed in 2017. The measures will make changes to company and tax laws in relation to directors' personal liability for company debts.

The Australian Taxation Office (**ATO**) has also been given greater powers to retain tax refunds where there is outstanding debt.

The new measures include:

- Preventing directors from improperly backdating resignations to escape liability or prosecution
- Limiting the ability of directors to resign from a company which would otherwise be left with no directors
- Extending the Director Penalty Regime to include GST, luxury car tax and wine equalisation tax
- Introduction of director identification numbers which will interact with other identification numbers such as ABNs to track relationships between directors and companies.

These are discussed in more detail below.

Phoenix Activity

Phoenix activity is illegal and involves the creation of a new company to carry on the business of an insolvent company to avoid paying out creditors. This is often demonstrated by below market value transfers of the insolvent company's assets just prior to an administrator being appointed.

With no assets left in the business, creditors (including employees and the ATO) have no ability to recover unpaid monies.

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ATO), have no ability to recover unpaid monies.

Engaging in this type of conduct can result in criminal liability for a breach of director's duties under the *Corporations Act 2001*.

The statutory duties likely to be breached are the duties of care and diligence and good faith and duties not to make improper use of position and information. This is in addition to any common law fiduciary duties that may be breached. Breach of these duties may result in disqualification under the Corporations Act.

By limiting the ability of directors to resign and leave a company without a director, these new measures intend to ensure that there is always a responsible person who can be held accountable.

The Budget further proposed new offences to target those who facilitate phoenix activities, including 'friendly' advisors and liquidators who fail in their reporting duties to ASIC and the ATO, further resulting in financial and corporate misconduct.

You can identify these advisors through their tendency to cold-call with advice or provide unsolicited correspondence after public interaction with a creditor (for example, in the courts).

The government is considering increasing criminal penalties for financial and corporate misconduct as well, which would include creating accessorial liability offences.

Backdating Resignations

Preventing directors from backdating their resignations ensures that directors are liable for actions during their tenure. This will include under the Director Penalty Regime if necessary.

Australian Institute of Company Directors managing director Angus Armour has indicated that although this is a good measure in theory, it could result in directors becoming liable for GST payments under a broader range of innocent circumstances which have not been considered.

Director penalty regime extended

Under the current regime, unpaid company debts for PAYG withholding and superannuation guarantee charges may be recovered personally from company directors. With the new Budget changes, unpaid GST, luxury car taxes and wine equalisation taxes may also be personally recoverable.

Directors may avoid the penalty regime if they apply to liquidate the company within 21 days of reporting their liabilities to ASIC.

Individual director numbers

Similar to ACNs or ABNs, a director identification number will register the corporate activities of directors in order to record the interactions of directors with different and associated entities.

This will help monitor and prevent phoenix activities.

If directors and company officers remove themselves from one company and register a new and ostensibly identical company to engage in phoenix activities, it can be more easily tracked through the director identification number.

Key takeaways

With these measures, the Government is intending to implement further deterrent measures to prevent company directors avoiding their financial responsibilities to their companies, shareholders, employees and the ATO.

Therefore it is important for directors to always ensure that their companies are able to pay their debts as and when they fall due, or engage in pre-insolvency actions which prevent the directors becoming personally liable (for example, by engaging external administrators to deal with the

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(for example, by engaging external administrators to deal with the company's assets in a legitimate way).

Please contact Rohan Harris from our Corporate & Commercial team if you would like to learn more about the consequences for directors arising from the Budget.

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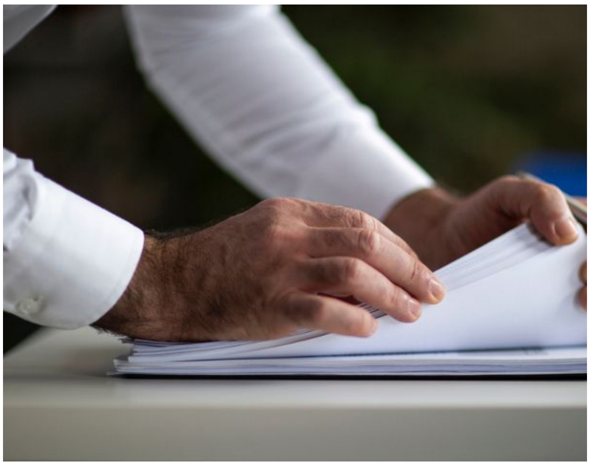

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