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ATO Security Deposit Powers Become Law *Direct Solution for Phoenix Activity*

- **ATO granted wide powers to demand security deposits from businesses for existing and future tax liabilities**
- **Attempt to reduce phoenix schemes and tax avoidance**
- **Construction, labour hire, employment, security, road transport and cleaning industries likely to be hit hardest**
- **More reforms being considered including automatic director penalty notices**

Overview

While the new Resources Super Profit Tax has captured many media headlines, a potentially more far-reaching reform has easily and somewhat quietly passed through Federal Parliament endorsed by both sides. On Thursday 17 June 2010, the Senate passed new laws designed to combat the estimated \$600m lost annually by the ATO through fraudulent phoenix schemes.¹ Amongst other things, the new *Tax Laws Amendment (Transfer of Provisions) Act 2010* ('the Act') amends the *Commonwealth Tax Administration Act 1953*. The reforms attempt to reduce phoenix activity and tax avoidance by:

- Requiring businesses to provide a security deposit to the ATO as a means of offsetting future tax obligations
- Using many forms of security deposits including cash and charges over assets
- Targeting specific industries prone to phoenix schemes

Phoenix schemes are defined as activity to; "*avoid the payment of liabilities, often tax liabilities, through the liquidation of a company and the subsequent continuation of the business through a new company.*"²

Phoenix activity is extremely harmful to creditors and should be stamped out. Taylor Woodings welcomes these reforms and believes there is an opportunity to continue this reform agenda including automating Director Penalty Notices (DPN).

The broad powers contained in the Act may cause honest businesses in high-risk industries some anxiety. However, these fears will be considerably relieved if the ATO reserves its new powers to use security deposits only against suspected phoenix offenders, rather than broad industry groups.

¹ http://www.treasury.gov.au/documents/1647/PDF/Phoenix_Proposal_Paper.pdf

² <http://www.ipaa.com.au/default.asp?menuid=245&artid=757>

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Security Deposits – What are they? How much? What form?

The ATO may require a security by way of a bond or deposit or “any other means that the commissioner reasonably believes is appropriate.”³ The Act does not define the amount of the security, although presumably it will need to be sufficiently large to deter would-be operators of a phoenix scheme. This may mean an amount running into several thousands of dollars. It is clear that at a time when access to capital is limited and costly, small businesses required to pay security deposits will be burdened by having to either set aside resources or obtain finance.

Which businesses will be targeted?

The answer is, potentially any business, at any time. In Taylor Woodings’ view the ATO will use its considerable data-matching ability to focus on high-risk industries including those with high failure rates and high incidences of phoenix activity. A Treasury discussion paper notes phoenix activity is evident in the construction industry and industries, “where labour costs are high, such as labour hire, employment, security, road transport and the cleaning industry”⁴. In addition, Treasury specifically mention a rising prevalence of phoenix schemes in the property development sector. The relevant provision in the Act is provided below, and clearly demonstrates the wide net the ATO is now able to cast:

255-100 Commissioner may require security deposit

- (1) *The Commissioner may require you to give security for the due payment of an existing or future tax-related liability of yours if:*
- (a) *the Commissioner has reason to believe that:*
- (i) *you are establishing or *carrying on an *enterprise in Australia; and*
 - (ii) *you intend to carry on that enterprise for a limited time only; or*
- (b) *the Commissioner reasonably believes that the requirement is otherwise appropriate, having regard to all relevant circumstances.*

Other Proposed Reforms – Automating Director Penalty Notice

The security deposits represent the Government’s first step in their push to eliminate phoenix schemes and tax avoidance. In addition, the Government is reviewing and have sought comment from industry and key stakeholders, in relation to the Director Penalty Notice (DPN) regime with the potential to effectively automate these penalties. This would remove any requirement of the ATO to take formal steps before a penalty is issued, imposing a strict liability.

The current DPN laws allow the ATO to serve a penalty notice on a director and pursue them personally, after a period of time, for certain unpaid employee withholding tax liabilities. However, in addition to making reforms automatic,

³ Tax Laws Amendment (Transfer of Provisions) Act 2010

⁴ http://www.treasury.gov.au/documents/1647/PDF/Phoenix_Proposal_Paper.pdf



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directors may potentially also be personally liable for an additional range of payments, taxes and duties.

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Taylor Woodings suggests that boosting current powers will provide greater protection against phoenix schemes, and improve the behaviour and financial discipline of directors in general.

Taylor Woodings' View

- As phoenix operators are to be specifically targeted, financing businesses and individuals with a high propensity to engage in phoenix activity should be avoided.
- There may be some collateral damage to some innocent businesses receiving the additional burden of providing security deposits in targeted industries. How this will or can be resolved is still unclear, presenting a further issue to financiers.
- If the DPN laws are changed to apply automatically, then financiers will need to be vigilant in monitoring cash-flows and ensuring that companies meet ATO claims.
- Financiers and Directors should actively review customers with large ATO arrears. Workout proposals submitted by customers that are partly premised on the ability to informally “defer” the ATO may not be a viable alternative going forward.
- Firms with genuine cash flow issues should seek independent objective advice as soon as possible to minimise the impact of any ATO collection activity.