TAX TALKS

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Phoenix activity is a common phenomenon in the Australian tax ecosystem. It is something everybody has heard of in the insolvent space. But what is it?

Phoenix Activity

In this episode Ben Sewell of Sewell & Kettle will walk you through the ins and outs of a phoenix activity. Here is what we learned:

#1   Phoenix activity

Phoenix activity is when an existing ‘old’ company transfers its assets for no or inadequate consideration to another company (often newly incorporated) but leaves the liabilities behind. The creditors of the old company are now left without any assets for recourse. And the old company usually goes into liquidation after the transfer.

While it’s sometimes difficult to distinguish it from a legitimate business rescue, illegal phoenix activity occurs when the controllers intend to abuse the corporate form in order to defraud the company’s creditors. So the main point of distinction is the directors’ intent.

2 ATO

The Australian Taxation Office is often the greatest victim of phoenix activity in a small to medium insolvency. The old company usually doesn’t pay its GST, income tax or PAYG withheld in a phoenix scheme. And so the ATO is often the largest creditor at the time of insolvency, followed by other unsecured creditors.

3   Same name

Outsiders might never realise that a new company replaced the old company since the new company might have the same or a very similar name.

4 PAYG

PAYG that the employer withheld but didn’t pass on to the ATO becomes an unsecured debt in the liquidation. Once it has been withheld, the employee gets a credit on their tax return, even though the ATO never received the money. The employees don’t have to pay the PAYG again, even though it hadn’t been passed on to the ATO. Single Touch Payroll will help to reduce phoenix activity. But it won’t stop it.

5 Nobody knows how much

There is no official number of how much value is lost through phoenixing. A report by PWC released in April 2018 and commissioned by the Government’s Phoenix Taskforce estimates the direct cost of illegal phoenix activity in 2015/16 to be between $2.85 billion and $5.13 billion. So we know we have a problem, but we have no idea how big it is right now years later. And it is not only the actual dollar amount, it also harms competition by giving companies involved in phoenixing an unfair advantage.

 # 6 Outsourcing payroll is where the money is

The big money is in actively implementing schemes where businesses outsource their payroll function to a third-party operator. The business authorises the operator to manage their business' PAYG and taxes. The business gets a kick-back in cash, while the operator keeps the withheld taxes and transfer all its assets to a new company.

On paper a phoenix activity sounds easy, but it is actually quite complicated. Schemes are getting more sophisticated. That is why it is easier to outsource. Third party operators know how to do it.

 # 7 The government picks up the tab

The government pays out unpaid wages and leave entitlements (up to certain caps) through the Fair Entitlements Guarantee (FAG). It is to support employees who are victims of liquidation. So if a company goes into liquidation and it is an illegal phoenix activity, not only does the government lose out on taxes. It also has to pay the unpaid wages and leave.

 # 8   Phoenix activity might be legal

There might be a legitimate reason to move the assets from an old to a new company. And that is also called a phoenix activity. Which makes things really complicated. There is no clear line between legal and illegal phoenix activity.

 # 9   ABN fraud

ABN fraud is to use different ABNs and / or fake ABNSs to confuse the ATO and buy more time. It takes a while for the ATO's data matching algorithms to work out what is actually happening. By which time the fraudster is long gone. ABN fraud often goes hand in hand with a phoenix activity

 # 10 It is not the law that is missing

There is plenty of law already that would allow a liquidator to take action. And ASIC could step into the shoes of the liquidator. It is not the law that is missing. Yes, maybe we could have one more rule here or there.

 # 11   It is enforcement of these laws that is missing

But in the end it comes down to who enforces these laws. You can have all the laws in the world, if nobody enforces these, they are futile. ASIC has the jurisdiction but there is no policy direction.

 # 12   Long time

Phoenix activity goes back to the 1960s or even earlier. It has been going on for a long time. The ATO is trying to curtail it. There is the current Black Cconcomy Task Force. There is the Phoenix Activity Task Force. But our tax system is based on self-assessment and so we won't solve the problem until we put money into enforcement. There is no quick and easy solution.

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