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Combating the Phoenix Phenomenon: An Analysis of International Approaches

Murray Roach*

Ab

emergence of the small single-director, single-shareholder company. In 2003, the Cole Royal Commission[2] highlighted the existence of a serious problem with phoenixing in the Australian building and construction industry. However, the literature confirms that the phoenixing syndrome is not unique to Australia.

Individual international jurisdictions have tended to tackle the issues in isolation as they have surfaced, careful not to over prescribe in the legislation for fear of stifling entrepreneurship. The result has been diverse legislative and compliance approaches across the international spectrum which operate with varying degrees of success. Some commonalties are emerging however, which hint at the possibility of a best practice approach to the problem. Cross jurisdictional conversations are beginning to take place in an effort to compare approaches and arrive at a comprehensive solution.[3]

2. A DEFINITION FOR PHOENIXING

The term 'phoenixing' was coined to describe the arising of a new business out of the 'ashes' of an expired former business – an analogy with the phoenix bird of Egyptian mythology.[4] However, arriving at an exact definition for phoenixing is problematic.[5] Although the term 'phoenixing' is increasingly being used in the pejorative sense, its definition is nebulous and difficult to pin down. A study conducted by the International Association of Insolvency Regulators (IAIR) revealed that no jurisdiction within the association was able to provide a categorical definition for phoenixing, although all acknowledged the phoenixing phenomenon as a problem to a greater or lesser extent.[6]

The difficulty in nailing down the term resides partly in the fact that phoenixing, of itself, is not inherently unlawful. To illustrate, it is not an offence for a business to fail once, or even on multiple occasions. If a company becomes insolvent and enters into liquidation, it is not improper for the directors of the insolvent company to form a new company involved in similar business activities. In the course of that new enterprise, it is not illegal for the management of the new company, to purchase assets out of the liquidation proceedings of the previous company for use in the new company.[7] There are good reasons for this.

History is replete with stories of innovators who have suffered bankruptcy somewhere along the path to success. The list includes such notables as: Henry Ford - who perfected the production line concept and the full application of specialisation; Walt Disney - entertainment entrepreneur; Charles Goodyear - inventor of the vulcanised rubber tyre; and Henry Heinz – founder of the eponymous American food conglomerate.[8] Experience shows that, on the whole, society benefits when entrepreneurs are not hindered from pursuing new entrepreneurial visions merely because of a previous failed business venture. The acquisition of business nous is, after all, an iterative process, with each business failure informing future business endeavours.

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[2] See Final Report of the Cole Royal Commission into the Building and Construction Industry tabled to

Phoenixing however, is ultimately an abuse of the limited liability concept and any analysis of phoenixing must necessarily consider the purpose of the corporate form and the theory underpinning company law. The rise in predominance of the limited liability company emanated from the period of rapid industrialisation in the UK during the 1700s.[9] It was a time when substantial amounts of venture capital were needed to exploit emergent technologies and embark on large-scale capital projects. Limited liability was originally designed to protect individual investors and encourage investment funding for major ventures that would benefit society. The limited liability concept has been vital to the aggregation of the vast sums of money necessary to implement the many large-scale infrastructure projects which have benefited society and appreciably improved first world living standards over the past two centuries.

The abuse of the corporate form however, is well documented, especially in the last half of the 20th century. The Costigan Royal Commission's revelation of the exploitation of 'bottom of the harbour' schemes to strip company assets, divert profits, and avoid tax was considered sufficiently repugnant as to trigger retrospective laws to prosecute culpable directors.[10]

Whilst such a strategy may fall under various definitions of phoenixing activity, it is not the type of phoenix activity that is of concern to governments around the world.[11]

The Australian Securities and Investments Commission (ASIC) categorises the phoenixing phenomenon in terms of '*innocent phoenixing*', '*occupational hazard*' and '*careerist offenders*'.[12] *Innocent phoenixing* occurs when a business comes under financial stress due to poor (as opposed to deliberately fraudulent) management decisions, inadequate record keeping and poor cash flow and financial management techniques. In some industries, such as building and construction, phoenixing is considered an *occupational hazard* in that once the business has collapsed, the operator's skill set drives them back into the same industry, where they are at high risk of failing again. They are affectively locked in to the industry by their skill-set. However, it is *careerist offenders* that pose the most serious concern for tax administrators. These operators intentionally structure their businesses to engage in cyclical phoenix activity, exploiting loopholes in insolvency laws and fractures in communication between government agencies and the insolvency profession.[13]

The Cole Royal Commission accepted ASIC's definition of phoenixing as the situation where an incorporated entity: [14]

- fails or is unable to pay its debts; and/or
- acts in a manner which intentionally denies unsecured creditors equal access to the entity's assets to meet outstanding debts; and
- within 12 months, another business commences which may use some or all of the assets of the former business, and is controlled by parties related to either the management or directors of the previous business

The Australian Tax Office (ATO) qualifies this definition somewhat to include only that behaviour which poses a significant risk to the tax revenue and retirement income systems. For the ATO phoenixing is defined as '(t)he evasion of tax and superannuation guarantee liabilities through the deliberate, systematic and sometimes cyclic liquidation of related trading corporate entities'.[15]

Some jurisdictions prefer the term '*strategic bankruptcy*' to describe phoenixing.[16] In many ways, this term helps to outline an important distinction between the motivations and intents in the minds of business owners engaged in fraudulent phoenix activity and those who have simply fallen foul of egregious economic conditions or disastrous but innocent business decisions.

It is important to keep in mind that there are many positive policy reasons for a government to foster an environment in which a failing enterprise is able to wipe the slate clean and start again. Innocent phoenix activity can preserve jobs and reduce the burden on the transfer payment system. It can encourage entrepreneurship and

[11] Appleby (2004)
[12] ASIC (2002)
[13] Ibid, p.4-5
[14] Cole (2003), pp.113-114
[15] ATO internal brief, "Strategically managing the risk posed by phoenix practices", p.4; Darmanin (2010), p.4
[16] Delaney (1992), Ch.6

rational risk taking and provide innovation, economic growth and new commodities for the community. Legitimate businesses do not always succeed on the first attempt. One UK source estimates that one in three businesses fails within their first three years of operation.[17] An innocent phoenix arrangement allows the profitable elements of a business to survive and start again, which provides some continuity for employees and suppliers. The critical factor is in deciding how to frame laws and policies to distinguish between harmful and beneficial phoenixing. For the purpose of this paper the use of the term "phoenixing", unless otherwise specifically stated, can be taken to refer to those business practices, which have a predominately undesirable effect on society.

3. PHOENIXING AND THE RATIONALE FOR LIMITED LIABILITY

The corporate form has two key facets; separate legal identity for the business and limited liability of the owners. Phoenixing allows the directors of closely held companies to take unfair advantage of these facets in tandem; firstly by isolating the directors' responsibility for their management decisions under the corporate veil and, secondly, by limiting their liability as investors to recompense the unpaid creditors of the business. The phoenix phenomenon is therefore fundamentally an abuse of the corporate form.

Nevertheless, it is important to qualify from the outset that limited liability is not intrinsically inequitable in itself. The UK Insolvency Service highlights that a misconception exists amongst the general population in understanding company reconstructions. People intuitively feel that directors have a moral, if not legal, duty to discharge the debts of a failed company before undertaking a new venture.[18] However, this perception belies the underpinning rationale for the corporate form, which emanated in the industrial age during a period of rapid economic expansion.

Corporations under royal charter were a feature in English commerce from as early as the late sixteenth century. Although the concept of limited liability existed in theory at this early time, in reality it was illusory, with companies frequently calling on their members to meet outstanding debts.[19] Chartered corporations eventually began to wane principally due to the difficulties of obtaining a charter from the Crown and joint stock companies began to dominate the commercial world from about 1840.[20] Joint stock companies were in effect nothing more than vast partnerships with freely transferable shares, where members retained personal liability for company debts.

Limited liability as we know it today was formalised in 1855 with the enactment of the UK Limited Liability Act.[21] From a theoretical perspective, the case for limited liability was premised on the notion that, within a widely-held company, there was a separation of the ownership from the control of a business and this limited control justified a limited liability to accumulated debts.[22] Liberal economists countered this argument with the contention that limited liability was incompatible with free market behaviour and cautious investment and so limited liability resulted in economic

[17] See Insolvency Network at: http://www.insolvencynetwork.co.uk/page.php?id=56
[18] Appleby (2004), p31; Quainton (2008)
[19] Davies & Gower (2003), p.22
[20]

inefficiency.[23] An inherent tension exists between fostering the expedient gathering of large amounts of capital and assuring a well behaved marketplace. Too little regulation fosters volatility and corruption, while too much restrains innovation and flexibility.[24]

Early literature on the theoretical justification of the limited liability concept focused on the widely-held corporation and rarely considered the single-director, single-shareholder company. However, it has more recently been suggested that the extension of limited liability to the sole trader is justified on the grounds that the fixed 'special' assets of the business are said to represent the 'special capital' of the enterprise undertaken, rather than that of the individual.[25] Certainly, the 'separation of ownership and control' argument seems weak in the context of closely held companies, the predominant entity structure in phoenix operations.

Phoenixing represents a clear breach of a director's legal and ethical duty to act in the interests of all the investors (which includes the creditors) of the company. The resultant agency cost of the phoenixing director's breach of duty is ultimately borne by the creditors of the business. Nevertheless, it bears emphasising that the true nucleus of the phoenix problem is not so much located in theoretical flaws in the doctrines of limited liability and separate legal identity which underpin incorporation; rather, it resides in the transfer of assets from the failed company at undervalue.

4. COMMON PHOENIXING TECHNIQUES

Phoenixing essentially involves a director hiding behind the corporate veil which separates their actions and responsibilities. The basic premise of using a company to avoid responsibility for debt is common to all phoenixing, but the exact manner in which that outcome is achieved can vary from industry to industry and from jurisdiction to jurisdiction. Even so, the following common characteristics of harmful phoenixing tend to be observable across the international experience:[26]

- the failed entity is formed with only a nominal share capital
- the failed entity is under capitalised
- the directors/managers/controllers of the failed and successor company are the same
- the failed entity is trading whilst insolvent
- assets of the failed company are depleted shortly before the cessation of business
- the failed company makes preferential payments to key creditors to assure supply to the successor company
- the failed entity was operated to evade prior liabilities
- the successor company operates in the same industry

[23] Ibid, p.46
[24] Appleby (2004), p.70
[25] Orhnial, T. (1982), p.44
[26] Appleby (2004), p.6

- the successor company trades with the same or similar name
- the successor company commences trading immediately prior to, or within 12 months of, the cessation of the failed entity
- assets of the failed company are transferred at below market value to the successor company
- many of the employees of the failed company are re-employed by the successor company

The technique of phoenixing may vary somewhat between jurisdictions to accommodate legislative or other contextual differences. Within the Australian context, the following principle phoenixing scenarios predominate.[27]

4.1 One after the Other Method

In this scenario a closely held company is formed. The company trades for a short period, typically between six months and two years. During that time, the company accumulates large debts, most commonly in relation to unremitted tax, workers compensation and superannuation contributions. The management stalls creditors for as long as possible. Liquid assets that in a normal trading situation would be applied to payment of creditors are syphoned off the business for the personal use of the directors and their associates. When the pressure from creditors becomes intolerable, the company goes into liquidation and another company, frequently with a very similar name, purchases the productive assets and takes over the operations of the failing company. Often the new company operates out of the same premises, with the same suppliers, employees and customers. To all outward appearances, it is difficult to detect that there has been any change in the business at all. The directors of both companies may be identical or they may be related persons or associates who act as a puppet management for the phoenixing directors. The new company is usually able to continue to cash cheques from the former company because of the similarity in trading names. Liquidators generally conduct very limited investigations into the conduct of the directors, because there are insufficient funds left in the company to fund such activity.[28]

4.2 Management Company Method

Another strategy of phoenix operators is to quarantine the productive assets of the business in a management company. This primary company is kept solvent. A second labour supply company employs the workers and conducts the principal business operations. The management company hires the equipment to the labour supply company at exorbitant rates, thus stripping any profits out of the labour supply company. The labour hire company does not remit PAYG or GST withholding, these provisional amounts additionally being stripped by the management company. Eventually, the labour hire company will be liquidated, with little to no capital reserves, and a new one will rise in its stead. The real assets of the business are isolated and protected under the corporate veil of the management company for use in

[27] Cole (2003), pp.116-117
[28] Ibid, p.115-118

successive labour hire companies. The workforce is simply re-employed by the new labour hire company.[29]

4.3 Labour Hire Method

This strategy utilises a management company, a sales company and a labour hire company. The sales company receives all the income from the activities of the overarching business. The management company owns all the productive assets of the enterprise and hires them to the sales company. The sales company also hires employees from the labour hire company, but only to the extent of the net wages paid to the employees and other worker entitlements. Little, if any, provision is made for PAYG withholdings and workers compensation premiums. Often the labour hire company is a façade, merely issuing payment summaries, while the sales company pays the workers directly. The labour hire company is eventually forced into liquidation by the ATO or the workers compensation authority. The core assets of the overall enterprise are preserved in the management company.[30]

4.4 Shadow Directors Method

The control of phoenix activity is further complicated because of the ease with which former directors can control a company through spouses, relatives and associates.[31] There is little to prevent a disqualified director from giving advice as an employee of a successor company. An effective strategy to address the phoenix phenomenon must acknowledge the use of shadow directorships to circumvent disqualifications and find a way to counter them.

5. THE SOCIO-ECONOMIC IMPLICATIONS

In developing a compliance strategy, it is important to understand the powerful socioeconomic drivers that underpin the phoenix phenomenon. Phoenixing helps to fund a lifestyle for directors that they otherwise could not afford. It provides the director a status of wealth that is extremely tempting. There appears to be varying degrees of acceptance of phoenixing amongst different ethnic, industry and socioeconomic cultures.[32] This may be due in part to a perception that the tax system is oppressive or unfair, or that phoenixing is essential to compete in an industry. Analyses of certain industries where phoenixing is prevalent indicates a general belief that phoenixing is ethical, or at least normal behaviour[33]. Generally, phoenix operators tend to be uncooperative with tax authorities and not particularly concerned with the consequences of being caught.[34] These data provide a reasonable heuristic of the relative ineffectiveness of present sanctions.

The insolvency process is designed to achieve a number of economic efficiency and equity policy objectives. Economic efficiency is achieved by promoting confidence in a credit system, where risks can be objectively quantified and high levels of trust exist that the insolvency process operates fairly and consistently.[35] Two efficiency aims

[29] Cole (2003), p.115-118
[30] Ibid
[31] Parliamentary Joint Committee on Corporations and Financial Services (2004), p.132
[32] ATO BISEP Analysis of Phoenix Practices
[33] Ibid
[34] Ibid
[35] Swain (2003), p.3

influence the development of policy on phoenixing. Firstly, there is pressure to deal with liquidations quickly and fairly to keep the transaction cost of bankruptcy and the cost of debt capital as low as possible. Importantly, the cost and availability of capital for all companies are directly influenced by what happens in the insolvency setting. Secondly, there is a social interest in expediting the transfer of the productive assets of the failed company to their new owners to mitigate the economic losses that come with the prolonged inactivity of these key assets.

Equity is achieved in the insolvency process by distributing the net assets of the failed business fairly, punishing fraudulent offenders and by reforming honest debtors by relieving them of financial liabilities and

Trade creditors possess the ability to diversify bad debt risk across a large number of

phoenixing problem. Accordingly, the ATO has attempted to distinguish and characterise *fraudulent* phoenix behaviour. Qualifying the types of behaviour that are considered fraudulent, illegal and abusive immediately excludes other less harmful, even positive, forms of business reconstruction. Moreover, it enables authorities to respond promptly to the worst aspects of phoenixing rather than causing them to remain distracted and bogged down in philosophical and legalistic debate.[74]

has been at least partly responsible for the failure of two or more corporations within seven years[81] or has repeatedly contravened the Act.[82]

ASIC is empowered (although not required) by the law to disqualify a person from managing corporations if the person has managed two or more failed corporations within a seven year period and providing the liquidator has reported to ASIC on those failed companies.[83]

6.2 Canada

Phoenixing is a recognised concern for Canadian authorities, chiefly in relation to small company bankruptcies.[92] Again, there is no formal definition of phoenix activity in Canadian law.

In the 1990s, strong consideration was given to addressing the phoenix problem by prohibiting the sale of the assets of a bankrupt company to its directors; a strategy known as 'asset rollovers'. Although this proposal aroused some interest amongst stakeholder groups, the prohibition was never implemented. Public consultations on various insolvency reform issues confirmed a consensus view that asset rollovers should not be prohibited, the rationale being that they often generate the best returns for creditors and produce the most efficient reallocation of assets.[93]

Phoenix activity in Canada is challenged through the use of civil and criminal remedies in the court system. Canada's approach to phoenixing closely parallels that of the US. If there is a formal insolvency, the trustee may pursue assets through fraudulent conveyance actions against the directors. Trustees are also empowered at a federal level to challenge arrangements which result in certain creditors receiving preferential treatment, including payment of outstanding liabilities in exchange for a promise to continue to supply the new company. Such remedies are also available outside of a formal insolvency through the use of provincial fraudulent conveyance and preferences legislation.[94]

Canadian law provides criminal sanctions for the fraudulent activities of directors, however it is difficult to determine the extent to which such sanctions are imposed in the context of phoenixing. In the normal course, if the Office of the Superintendent of Bankruptcy receives a complaint in relation to phoenix activity, a referral is made to the Royal Canadian Mounted Police for investigation. However, no reliable data is available regarding the frequency or effectiveness of such investigations.[95]

The liability of directors and officers of the company is not necessarily extinguished when a company ceases trading. Canadian law specifically assigns personal liability to directors for source deductions and GST, although directors may avoid personal liability if they can establish that they exercised a reasonable degree of care.[96]

Canadian company law does very little to protect creditors from repeated reckless behaviour and wrongful conduct of phoenix directors. There is currently no disqualification scheme in place and no public register of directors of failed companies exists. Although the concept of a register has been discussed, the idea is not widely supported.[97] Girgis (2009) urges incorporation of a disqualification scheme into the federal insolvency provisions, commenting that the director disqualification scheme in the UK has had more success in protecting creditors than any existing Canadian measures.[98]

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[92] Appleby (2004)
[93] Appleby (2004), p.29
[94] Girgis (2009)
[95] Appleby (2004), p.30
[96] Bomhof (2009), p.5
[97] Ibid, p.30
[98] Girgis (2009)

6.3 Ireland

The Office of the Director of Corporate Enforcement (ODCE) is responsible for developing legislative measures to counter phoenixing activity in Ireland. The Irish tax authority, Revenue, is generally the primary creditor of phoenix companies. Revenue manages this growing tax risk by monitoring a list of some 400 companies that exhibit certain common characteristics of the phoenix syndrome. However, the monitored segment is believed to represent only a small fraction of the annual incidences of phoenixing in Ireland.[99]

For two decades Ireland has been vigorously pursuing economic growth through corporate investment. A liberal corporate regime is designed to attract foreign direct investment and encourage individuals to take advantage of corporate entities to engage in business ventures.[100] At 12.5%, Ireland's corporate tax rate is amongst the lowest in the world. Company formation costs are low at around €500. In the ten year period up until 2005, Ireland's strategy enabled it to attract five times as much foreign direct investment as Australia.[101] This substantial influx of capital has enabled Ireland to achieve economic growth way in excess of the rest of the EU. Unfortunately, the policies that promoted growth in corporate investment have also realised an increase in the abuse of the privilege of limited liability. One report from Revenue estimated a tax gap of €140 million due to phoenixing.[102]

The ODCE believes that a rise in phoenixing is partly attributed to a recent decline in the stigma associated with insolvency.[103] Ireland employs a bond provision to help

company is capitalised to approximately €63,500 for a private company and €317,500 for a public company.

Authorities around the world are frequently frustrated by the resources expended, and the difficulties involved, in building cases against phoenix operators in order to have courts impose restrictions and interrupt the cycle of phoenixing. Ireland's unique approach reverses the burden of proof and frees up compliance resources. Honest directors who wish to pursue future ventures under a corporate structure are entitled to prove their case before a judge. Serial phoenix operators are thwarted because of the capitalisation rules that ensure substantial equity that creditors can access in a future liquidation.

The Companies Act provides an automatic five-year director disqualification where a person (director or otherwise) is convicted on an indictable offence in relation to a company or involving fraud or dishonesty.[108]

Phoenix activity in Ireland is primarily detected and reported by creditors.[109] However, as with other jurisdictions, phoenix companies tend to arrange to discharge their key trade creditors prior to falling under administration. Trade creditors in Ireland seem prepared to continue to deal with phoenix companies if their losses have not been substantial. Legal action against fraudulent preferential payments is available, however ODCE believes the prevailing feeling amongst creditors to be that there is little point in pursuing such action.

There is no mandatory requirement for insolvent companies to undergo liquidation in Irish company law. Until the introduction of the ODCE, there was a distinct lack of resources available to investigate corporate failures and the risk of phoenixing being detected and prosecuted was insignificant. The ODCE is entitled under the Companies Act, to conduct its own investigations and seek sanctions against phoenix activity by applying insolvency and winding up provisions relating to:

- criminal and civil liability for fraudulent trading (s297)
- civil liability for fraudulent preference (s286)
- civil liability for director malfeasance (s298)
- criminal liability for transfer of assets with intent to defraud creditors (s295)

However, obtaining proof of fraud is extremely difficult and as a result, there have been few instances of personal liability being imposed on directors of phoenix companies in Ireland. Revenue has instigated a number of initiatives to counter phoenixing in problem industries. For instance, public bar licence renewals require a tax clearance certificate, which will not issue if there is an outstanding tax obligation.[110]

Revenue's approach to the phoenix problem is proactive. Strategy is integrated across organisational departments and utilises cross functional and external intelligence.

[108] Ibid, s.160
[109] Appleby (2004), p.40
[110] Taxes Consolidation Act (Ireland) 1997, s.1064

Phoenix activity is identified at the earliest possible stage. Rapid follow-up action is instigated to prevent the build up of tax arrears, fraudulent and reckless trading is aggressively pursued in the courts, and a rigorous monitoring program of identified high-risk directors is implemented.[111] A 'commonality check' uses data matching techniques to compare companies with current tax arrears with companies that have been liquidated to detect the presence of common directors.[112]

6.4 New Zealand

New Zealand's corporate regulatory system recognises the national need to encourage entrepreneurship. The incorporation processes is inexpensive and simple, which enables the swift establishment of new companies in the event of the failure of an antecedent company.[113] New Zealand poses few restrictions on the incorporation of new companies. There is no minimum capital requirement and few limitations on who may become a director.[114] There are no mandatory qualifications or training requirements for a company director.[115] A company can be established over the Internet, across borders, for a fee of $NZ160. The comparative ease of incorporating in New Zealand [116] is beginning to cause concern for other jurisdictions, who are detecting an increase in use of New Zealand registered labour supply companies[117] to facilitate phoenixing in Australia.[118]

The Official Assignee acknowledges a lack of definitive data on the extent of the phoenixing phenomenon in New Zealand. [119] Anecdotal evidence suggests that suppliers and Inland Revenue (IR) are th

of insolvent companies, along the lines of the United Kingdom *Insolvency Act 1986.*[123] A contemporary report on the effectiveness of UK Company Law had concluded that incidence of phoenixing had been reduced by the changes introduced in 1986.[124] The Cabinet Paper accepted that the proposed provisions could not create a widespread restriction on the re-use of the name of insolvent companies; neither would they eliminate the abuse of phoenix companies.[125] Regardless, the decision was taken to implement the provisions in New Zealand corporate law.

New Zealand law prohibits a person from being a director of a phoenix company within a certain period of being a director of a failed company, unless that director has been granted leave of the court.[126] The prohibition is not calculated to prevent the re-use of a company or business name as such, simply the recycling of a company name by a director of the failed company. It does not attempt to restrict transactions by delinquent directors with new companies which have no relationship with the failed company. However, the sale of any asset, including goodwill, by a director at undervalue to another company, with which that director is associated, if done in bad faith will contravene the Act.[127] The offence is not circumvented by adopting a non-corporate form for the new business. The prohibition extends to involvement in any business that has an identical or similar name to a failed company.[128] This prevents the exploitation of any goodwill of the failed company that is attached to its name.

If a director has been involved in one or more failed companies, the Act empowers the Registrar of Companies to disqualify that person from acting as a director, if the Registrar is satisfied that there has been

While the proposal to create a new criminal provision was widely supported in submissions to the Insolvency Law Review, concerns have been raised about the potential for prosecution successes given the required 2.0 ndardf I

At an administrative level, HMRC readily acknowledges that phoenix companies pose a higher than normal risk to revenue. To mitigate this risk procedures are employed to flag 'successor' (phoenix) companies, in circumstances where the liquidated company has avoided a revenue debt of £10,000 or more and the successor company is engaged in the same industry.[152] The flag promotes the full use of available intelligence to highlight issues at a very early stage and manage compliance of the phoenix company. The flag ensures a PAYE scheme is initiated for the new company. It also ensures an escalated tax debt recovery process is implemented. The PAYE regulations provide for HRMC on the basis of previous payment history to insist on payment of an unremitted PAYE withholding within seven days.[153] These measures proactively monitor the activity of high-risk 'successor' companies and prevent a subsequent excessive buildup of unremitted tax before HMRC initiates insolvency proceedings.

The Higgs Review in 2003 examined the role and effectiveness of non-executive directors in the UK. One of its key recommendations was the developmw(153)T/..7(lTw[(4r3D. on t

approach is required which clearly enunciates the issues, coordinates compliance efforts, reduces opportunity, eradicates phoenixing benefits, enhances lead-time detection and mitigates any residual negative effects of phoenixing.

7.1 Legal definition, legislative change and agency responsibilities

It is clear from the international experience that the development of anti-phoenixing measures is heavily influenced and constrained by concerns about stifling entrepreneurship. The term "phoenixing" is seldom mentioned across the spectrum of international taxation and corporations' legislation. Definitions are rarer still.[167] The legislation dealing with the phoenixing phenomenon tends to be disjoint, split between tax authorities and corporation watchdogs, which makes detection and enforcement problematic.

Defining phoenixing at law is an essential precursor to combating the syndrome. A legal definition might reasonably include indicia of both acceptable and unacceptable business reconstructions to reaffirm the validity of genuine reorganisations. However, legislative design needs to follow a coherent principles approach rather than a black letter drafting style. Clear articulation of the legislative intent in the drafting of the law will reduce complexity and prevent the development and exploitation of technical loopholes by enabling judicial decisions to adapt to changing circumstances.[168] Equally, legislation must provide certainty for those directors of failed companies who wish to engage in legitimate business reconstructions. In particular, the legislation should recognise illicit phoenixing as a criminal offence of fraud on the creditors of a company and provide a penalty regime on par with fraud offences of comparable magnitude.

It is important that individual government agency responsibilities in relation to the monitoring and prosecution of phoenixing be clearly articulated in the legislation and the interfaces between agencies outlined in memoranda of understanding. Where appropriate, jurisdictions should look at implementing an inter-agency/cross-functional phoenix task force to synergise agency technical capabilities, intelligence resources and enforcement powers. This is likely to result in more efficient and effective application of resources.

7.2 Protecting legitimate reconstructions

The literature demonstrates a universal recognition that the legitimate reconstruction of ailing businesses often maximizes stakeholder outcomes. The difficulty lies in determining when a reconstruction is in the public interest and when it is a mere sham to facilitate fraud.[169] Legitimate reconstructions should be supported. Bogus reconstructions should be quashed. The government should consider the benefits that would result from a formal legal process for reviewing and sanctioning bona fide company reconstructions. Such a mechanism could be expected to include legislation, policy and guidelines and a formal independent review panel to examine and approve corporate reconstructions. The mechanism would assure the probity of insolvency transactions and provide certainty to directors wishing to engage in honest business

management specialists, rather than judges, who may not have the business expertise necessary to distinguish between a legitimate and fraudulent reconstruction.

7.3 Detection and response

The compliance approach adopted to combat phoenixing must be comprehensive - strategic and tactical, proactive and reactive. From a top-down perspective the strategy must target known high-risk industries, regions and individuals. Processes must support early detection and rapid reaction. Where possible, compliance responses, such as the early issue of director penalty notices, should be automated to tighten the compliance net and reduce the burden on limited resources. At the same time, from the bottom-up, lead-time data needs to be collected and synthesised into intelligence, which in turn will inform the strategy as to emerging risks.

Importantly, compliance strategies should adhere to regional compliance models and support the political objectives of encouraging legitimate entrepreneurial risk taking under the protection of corporate limited liability. Processes and systems must support and encourage those directors generally willing to comply and strong enforcement action taken against the worst serial phoenix offenders.[170]

Phoenix compliance teams need to make the best use of the full ambit of available intelligence. To the end government agencies need to foster partnerships with other government and non-government organisations, such as credit reference associations and industry associations. This approach offers the opportunity of real-time intelligence and the development of prospective indicia of emergent phoenixing risks. Information from these sources will prove invaluable for data matching and profiling of phoenix operators. Several jurisdictions have shown benefits from monitoring acknowledged indicators of phoenix preparation.[171] The strategic sharing of data related to non-lodgment and unpaid tax liabilities between tax and corporate enforcement authorities would help trigger compliance activity across both spheres. The adoption of a tax clearance certificate, such as that employed in Ireland, could be made a condition of continued annual company registration. However, this policy may be less effective than a simple program of expeditious debt enforcement action from within the tax authority. Currently, a raft of Australian legislative restrictions thwarts interagency communication, hindering the detection and prosecution of phoenixing offences. There is a need to revisit secrecy and exchange of information laws with a view to removing this blocker to effective enforcement against phoenixing.[172]

Tax and corporate authorities need to cooperate to ensure that robust automated data matching occurs against the restricted/disqualification register to ensure that disqualified directors cannot register a company. Suspected phoenix operators must be identified at an early stage and flagged on tax administration systems.[173] The flag should trigger a high-risk response to non-lodgment and/or unpaid tax liabilities by way of high-level monitoring, early intervention and escalated debt recovery. The production of directors' penalty notices, holding the director personally liable if tax

[170] See ATO Compliance Model at http://www.ato.gov.au/corporate/content.asp?doc=/content/5704.htm
[171] the UK's flags identified successor companies
[172] Cole (2003), p.165
[173] HMRC, Insolvency Manual, INS1121 – Insolvency and Insolvency Practitioners

debt is not cleared within a prescribed period, should be automated and issued at an early stage where phoenixing is suspected and/or flagged.

7.4 Directors' liability for non-remission of collected tax

At a legislative level, there is a credible argument that directors' should be held personally liable for non-remission of taxes as per the Canadian approach.[174] The basis of this view is that GST collections and tax withholdings are not liabilities in the same manner as trade creditors are. These moneys are collected in good faith from customers and employees who have the expectation that they will be remitted to the government as tax. The non-remission of these funds, either because they have been allocated for business or for personal use, is effectively a misappropriation of funds for which the director arguably should be held personally accountable.

The international experience reveals that tax administrations are overwhelmingly the foremost victim of phoenixing. Holding directors personally accountable for the taxes that they collect would eliminate a substantial benefit of phoenixing and thus should significantly reduce the extent of the phenomenon. It must be acknowledged however, that this measure would also no doubt act as a significant disincentive to entrepreneurs who currently enjoy the option of utilising tax withholdings to overcome periodic cash flow problems or as initial capital funding of the business. Further analysis is required before the efficacy of such a policy can be accurately assessed.

7.5 Double-dipping of withholding taxes

Legislation should include a provision to ensure that PAYG withholding credits are denied to directors to the extent that they are not remitted. This prevents 'double dipping' of phoenixing directors who misuse the PAYG withholding system to dishonestly allot themselves large income tax credits. Similarly, GST credits should be denied between companies in business groups where a former company has phoenixed to prevent abuse of the GST system. Grouping provisions should look through the corporate veil into the successor company for misappropriated assets where phoenixing is proven.

7.6 Investigation of assetless companies

Publicly funded investigations have proved effective in overcoming the issue of phoenix directors stripping company funds to prevent detection of their malfeasance. Conceptually, a liquidator is expected not to engage in a course of action if it is unlikely to produce a worthwhile benefit for the creditors.[175] Moreover, liquidators, being commercial operators, are reluctant to conduct any activity, such as an investigation or legal action, for which they are unlikely to be paid. The Assetless

Alternatively, the responsibility for investigating director misconduct could be allocated to a specialist government agency with appropriate investigative and forensic accounting capabilities and the power to prosecute misconduct. Interestingly, the UK has established the Companies Investigation Branch (CIB), which has wide investigatory powers and the statutory authority to request the court to wind-up rogue companies in the public interest without having to establish insolvency or breach of the law.[176] Having a dedicated corporate investigative department to look into director misconduct enables the robust and vigorous pursuit of phoenixing operators and also mitigates the risk of collusion between liquidator and director that exists under the current investigation scheme.

The self-sufficiency and longevity of any investigations program, whether performed by liquidators through the Assetless Administration Fund or by a new government agency, could be underwritten by imposition of a levy on corporate registration fees and by channelling the proceeds of directors' fines back into investigations.

7.7 Strengthening the penalty regime

Overall, it is readily apparent that the current penalty regime needs strengthening. The penalties administered by the courts in recent phoenixing cases seem incongruous with the nature of the offence, which is in reality a fraud. The absence of a strong deterrent effect is undoubtedly contributing to the growth of the phenomenon.[177] Low conviction rates and light penalties reinforce the belief amongst directors that phoenixing is a low-risk activity with big rewards.[178] The clear articulation in the legislation that phoenixing is a fraud, with penalty provisions that correspond with the seriousness of the offence, is therefore essential to provide a disincentive for directors

and implementation of a mandatory qualification for people wanting to use the corporate form to run their businesses could also help to lift the skill levels and competence of directorship, promote an ethical approach to management and institute more robust corporate governance.

7.9 Arms-length asset transfers

A recurring theme in this paper is that the crux of the phoenixing problem is the undervalue transfer of assets from the failed company to the successor company. Because of the economic imperatives of insolvency, which include achieving the fastest possible reallocation of economic resources, given the highly specialised nature of assets under liquidation and the fact that the break-up of the assets during sale usually diminishes their overall value, liquidators will often have little alternative but to dispose of the business assets to the successor company.[180] An absolute prohibition on transfer of tangible assets to the original directors is almost universally seen as undesirable policy because it restricts the opportunity of achieving the highest price.

reporting to authorities. Pre-packing preserves the value of the goodwill of the failed company that would otherwise be eroded in a formal liquidation process.[185]

Whatever disposition strategy is adopted it must ensure the integrity of transactions

7.12 Reliance on creditors to initiate action

Most enforcement systems around the world place an unrealistic expectation on creditors to identify and report incidences of phoenix. While creditors are certainly in an ideal position to recognise a phoenixing situation, there are serious doubts as to whether this strategy is effective in detecting phoenixing. Directors often diffuse this risk by conferring preferential payments to placate angry creditors. Many creditors

directors to cover up fraud and facilitate phoenixing activity.[209] The UK Insolvency Service recently highlighted a lack of disclosure and transparency by the insolvency profession in the administration of pre-packs, with more than one-third of liquidators failing to meet basic guidelines protecting creditor interests.[210] A New Zealand Insolvency Law Reform discussion paper highlighted concerns about the supervision of the insolvency profession, and concluded up to 40% of New Zealand's insolvency practitioners might not meet adequate standards.[211]

The Corporations Law seeks to assure the independence of insolvency practitioners by a system which includes mandatory registration, qualification and skilling requirements, detailed legal responsibilities and established criteria for independence.[212] Insolvency professionals are prohibited from issuing inducements to members or creditors to obtain appointments.[213] However, because the vast majority of directors entering into voluntary administ

that adopted in the UK, greatly improves the likelihood of identifying incompetence, misbehavior and complicity amongst liquidators in respect of phoenixing.[220] Regardless of the approach adopted, comprehensive monitoring of the insolvency industry is required to ensure liquidators are fulfilling their responsibilities in preventing the under-value transfer of assets which characterises and underpins all phoenixing activity.

The establishment of specialised insolvency regulatory authorities, distinct from the corporate regulatory authorities, which are frequently overstretched,[221] will enhance supervision of the insolvency profession and reduce the risks of under-value transfer of assets, excessive liquidator fees and liquidator collusion in phoenixing. The insolvency regulatory authority should have statutory powers to manage industry licensing, set ethical standards, policy and guidelines and monitor compliance across the profession. It would investigate complaints of misconduct, fix remuneration scales and review liquidators' fees. It could also review and sanction reconstructions to assure their integrity and provide certainty for successor businesses.

In Australia, the Institute of Chartered Accountants has recommended ASIC

8. CONCLUSION

Phoenixing remains a significant global problem for taxation authorities and corporate watchdogs. With a few exceptions here and there, jurisdictions have attempted to tackle the phenomenon in isolation, shaping strategies that fit their unique legal frameworks and regional factors. Although there have been some recent attempts to network and share experiences,[225] jurisdictions have not yet grasped the opportunity to synthesise and benchmark approaches across the wider international spectrum in order to develop an international best practice approach to combating phoenixing.

Ultimately, political and institutional dimensions are going to influence the choices taken by policy makers. The recent global financial crisis has heightened community fears that honest businessmen, suffering at the hands of worsening economic conditions, will be unfairly caught up in a tightening compliance net. Consequently, pragmatic governments may well be resigned to tolerating the present level of socio-economic costs associated with phoenixing in order to foster enterprise, encourage growth and prevent alienating the wider business community.

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ribute income from those who are rewarded by free markets to

TABLE 2.

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[10] *Taxing the Working Poor: The Political Origins and Economic Consequences of Taxing Low Wages*, *Comparative Labor Law and Policy Journal*, *Minimum Wages, Minimum Labour Costs and the Tax Treatment of Low-Wage Employment*, , *OECD Factbook 2009: Economic, Environmental and Social Statistics*, *Taxing Working Families: A Distributional Analysis*,

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TABLE 3. COUNTRY COMPARISONS OF TAX-TO-GDP, 2007

Country	*Income Taxes*	*Payroll taxes*	*Consumption Taxes*	*Total Taxes*
[illegible]	[illegible]	[illegible]	[illegible]	308
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	333
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

2.1 Taxes

TABLE 4. STANDARD DEDUCTIONS, PERSONAL EXEMPTIONS, SIMPLE INCOME TAX THRESHOLDS, AND TAX RATE SCHEDULES FOR VARIOUS TAXPAYERS, 2010

	Unmarried individuals	*Heads of household with one child*	*Married couples filing joint returns with two children*
Standard deduction	$5,700	$8,400	$11,400
Personal exemption	$3,650	$7,300 (2 × $3,650)	$14,600 (4 × $3,650)
Simple income tax threshold	$9,350	$15,700	$26,000
Tax rate (imposed on taxable income)	*Rate bracket*		
10	$0 to $8,375	$0 to $11,950	$0 to $16,750
15	$8,375 to $34,000	$11,950 to $45,500	$16,750 to $68,000
25	$34,000 to $82,400	$45,500 to $117,450	$68,000 to $137,300
28	$82,400 to $171,850	$117,450 to $190,200	$137,300 to $209,250
33	$171,850 to $373,650	$190,200 to $416,700	$209,250 to $373,650
35	over $373,650	over $416,700	over $373,650

The child tax credit

The making work pay tax credit

The dependent care credit

[illegible]

[illegible]

[illegible]

2.2 Welfare

TABLE 7. OUTLAYS FOR THE PRINCIPAL FEDERAL BENEFIT PROGRAMS IN THE UNITED STATES (BILLIONS OF DOLLARS)

	2009 actual	*2015 estimate*
	$	$
		65
		336

TABLE 8. SHARE OF AGGREGATE HOUSEHOLD INCOME IN THE UNITED STATES, BY QUINTILES AND THE GINI INDEX, 2005

	Market income	*Disposable income*
Quintiles		

3.3 Australia

TABLE 9. FAMILY TAX BENEFIT PART A, AS OF JULY 1, 2010

Maximum rates		
For each child	*Per fortnight*	*Per year*
Aged 13 years	$160.30	$4,167.80
Aged 13-15 years	$206.48	$5,368.48
Aged 16-17 years	$257.12	$6,685.12
Aged 18-24 years	$257.12	$6,685.12
Independent 0-24 years	$257.12	$6,685.12
Base		
For each child	*Per fortnight*	*Per year*
Aged 18 years	$52.74	$1,371.24
Aged 18-24 years	$52.74	$1,371.24

Source: [illegible] 2010,

4.1 Providing benefits through social welfare or tax systems

[illegible]

[illegible]

[illegible]

4.2 High Marginal Tax Rates

tax system's

[102]

4.3 Marriage penalties

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[102] *See, e.g.*, *Journal of the National Association of Administrative Law Judges*,

[103] *See, e.g.*, *Family Law Quarterly*,

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4.4 Administrative problems

4.4.1 Participation, noncompliance, and simplification

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[107] *See, e.g.*,

Poverty, the Distribution of Income, and Public Policy,

[108]

Earned Income Tax Credit Eligibility and Participation,

[109]

The Earned Income Tax Credit Program Has Made Advances; However, Alternatives to Traditional Compliance Methods Are Needed to Stop Billions of Dollars in Erroneous Payments,

Oregon Law Review,

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4.4.2

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4.4.3 [illegible]

eJournal of Tax Research (2010) vol. 8, no. 2, pp. 162-174

The Hardship Discretion – Building Bridges

1936 (ITAA 1936) which had provided a discretion for the Tax Relief Board to release taxpayers from a tax liability in the case of hardship. The new provisions in Div 340 TAA granted the discretion to release taxpayers in cases of hardship directly to the Commissioner.

The operative provision in the new regime provided for individuals to be released from a taxation liability if meeting the liability would cause serious hardship, and for trustees of deceased estates to be released from a liability if dependants of the deceased would suffer serious hardship if required to satisfy the liability.[2] Application must be made for release from the taxation liability,[3] with the taxes from which release may be sought including:

- income tax;
- fringe benefits tax or a Fringe Benefit Tax (FBT) instalment;
- Medicare levy including the surcharge;
- Pay As You Go (PAYG) instalments; and
- additional taxes, penalties and interest charges associated with these taxes.[4]

The new provisions also allowed for review of the Commissioner's discretion decision through the objection and review procedures in Part IVC TAA.[5]

The Explanatory Memorandum (EM) accompanying the new measures explained that the purpose of the amendment was to streamline the decision process, as the previous requirement for a three-member Tax Relief Board to convene to consider hardship cases had become resource intensive and inflexible, leading to backlogs and delays in

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The Commissioner may release you, in whole or in part, from the liability if you are an entity specified in the column headed "Entity" of the following table and the condition specified in the column headed "Condition" of the table is satisfied.

Entity and condition		
Item	Entity	Condition
1	an individual	you would suffer serious hardship if you were required to satisfy the liability
2	a trustee of the estate of a deceased individual	the dependants of the deceased individual would suffer serious hardship if you were required to satisfy the liability
Person and condition		
Item	Person	Condition
1	an *individual	you would suffer serious hardship if you were required to satisfy the liability
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[3] Section 340-5(1)&(2) Sch 1 TAA.
[4] Section 340-10(1)&(2) Sch 1 TAA.
[5] Section 340-5(7) Sch 1 TAA.

considering applications.[6] The sole criteria for release from a taxation liability remained serious hardship, with the EM suggesting that release from a liability would not normally be granted where the release would not relieve the hardship, an example being where the existence of other creditors made bankruptcy inevitable, and a release would advantage other creditors at the expense of the Australian Taxation Office (ATO).[7]

While the EM provides no guidance as to the circumstances which may be sufficient to establish serious hardship, it does specify that the onus is on the applicant to furnish sufficient information to satisfy the Commissioner that a release on the basis of serious hardship would be appropriate.[8]

3. APPLYING THE LEGISLATION

> the High Court in *Rex v Trebilco; ex parte F.S. Falkiner & Sons Ltd* (1936) 56 CLR 20.

The discussion in this paper follows this two step process, initially examining the factors in establishing serious hardship, before analysing the exercise of the Commissioner's discretion as to whether to release the taxpayer from the taxation liability.

4. ESTABLISHING SERIOUS HARDSHIP

No legislation formulation is provided as to the establishing of serious hardship, and no guidance is available from the EM. As noted by Hill J in *Powell v Evreniades*:

> There is no definition in s.265 of what is meant by "serious hardship" nor would one expect there to be. Each of the words in the phrase is an ordinary English word having a well understood meaning. The context in which the words appear makes it clear that the Relief Board is to consider whether the exaction of the full amount of tax would involve the dependants of a deceased taxpayer in financial difficulty which in all the circumstances can be said to be serious. The financial difficulty will be such that the

A further issue for judicial consideration has been whether the existence of an unresolved objection or appeal against an assessment may be used to find serious hardship by the payment of the disputed amount. The courts have displayed a marked reluctance to prevent collection of taxes pending resolution of a dispute as to the assessment.

Asprey J in *DCT v Niblett*[30] observed that:

> It may be thought to be a hardship that a taxpayer should have to pay the tax assessed

exercised. In the decision in *Powell*, Hill J took the view that the factors considered in relation to exercising the discretion to rel

> exercised, there will be a threshold beyond which it would defeat the primary object of the legislation.[45]

While the discretion provided to the Commissioner would appear to be at large, there are broadly stated limits on the discretion to be exercised by the Commissioner. Windeyer J in *Giris Pty Ltd v FCT*[46] spoke of the need, when exercising a discretion, " … to be guided and controlled by the policy and purpose of the enactment, so far as that is manifest in it [and to] exclude from … consideration any matter which it would be unlawful … to take as a criterion."[47]

There have been attempts to outline the types of factors which would be expected to be considered. In *Re Wilson v Minister for Territories*,[48] Deputy President Hall said:

> The considerations that will be relevant to the proper exercise of the discretion whether or not to grant remission when undue hardship is established will vary from case to case. However, in my view, relevant considerations are likely to include the circumstances out of which the hardship arose; whether those circumstances were within the capacity of the applicant to have foreseen and controlled; whether the applicant has over-committed himself financially; whether the applicant or any of his dependants has suffered serious illness or accident involving irrevocable financial loss to the applicant; whether the applicant has been in regular employment; whether the circumstances of the hardship are likely to be of a temporary or recurring nature; and whether a decision to remit the rates would, as a matter of administrative justice and fairness be appropriate having regard to the fact that ratepayers, other than pensioners, are normally obliged to pay their rates in full ...[49]

The matter highlighted by this passage, and a matter which has proven significant in a number of decisions, is the degree of culpability by the taxpayer in contributing to the 'severe hardship' in which they find themselves. As stated by Wilcox J in *Corlette v Mackenzie & Ors*,[50] "It would be extremely odd if a taxpayer who was the author of his or her misfortunes, through imprudent or extravagant expenditure, was entitled, as a matter of right, to a release of unpaid income tax."[51]

The significance of this factor was highlighted by Deputy President Block in *Rollason v FCT*

a guide to the types of factors which may result in the exercise of the discretion to grant relief against a taxpayer suffering hardship, the examples provided by the ruling encompass such factors as:

- whether the taxpayer has disposed of funds without making provision for tax liabilities;
- whether granting relief would not reduce hardship, such as where there was a prospect of bankruptcy, and relief would only serve to advantage other creditors;
- whether the taxpayer has failed to pursue debts,;
- whether the hardship is associated with a single event or short term outcome.

While three of these factors relate to the taxpayer personally, the second factor is arguably wider, and takes into account the greater public interest in the collection of revenue, and not serve to advantage creditors to the detriment of the revenue if the taxpayer is declared bankrupt.

Given the wider scope of this second factor, it may appear somewhat surprising that in A Taxpayer the Commissioner had argued that the discretion in s 340-5(3) allowed the Commissioner to take into account only matters relating to the particular taxpayer. The argument of the Commissioner suggested that by taking into account the public interest in the taxpayer continuing in a highly paid position and paying tax at the top marginal rate, the AAT had erred in law by considering an irrelevant consideration.

Stone J agreed that the 'public interest' would be an irrelevant consideration in determining the first issue of whether the taxpayer faced severe hardship, but her Honour was satisfied it was not irrelevant to the exercise of the discretion as to where to provide relief.[55]

If the greater public interest is an element for consideration in exercising the discretion as to the granting of relief, a further aspect of this is arguably the impact the exercise of the discretion may have on taxpayer perceptions, and the potential for impact on future taxpayer compliance.

That such is the case has been recognised by the current Commissioner in noting that:

> In the foreseeable future, tax administrators will need to be even more careful in balancing the need to be fair, efficient and effective. On the one hand, they must be vigilant for abusive tax practices so as to provide a level playing field, but at the same time empathetic to taxpayers facing real hardship.[56]

The final part of this paper considers the potential for an overly-restrictive exercise of the relief discretion to impact on taxpayer perceptions and resultant compliance behaviour.

[55] Above, note 23 at para 63.
[56] D'Ascenzo M, "Sustaining good practice tax administration," (2009) 38 AT Rev 76 at 85.

> exercised, there will be a threshold beyond which it would defeat the primary object of the legislation.[45]

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eJournal of Tax Research (2010) vol. 8, no. 2, pp. 162-174

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[3] Section 340-5(1)&(2) Sch 1 TAA.
[4] Section 340-10(1)&(2) Sch 1 TAA.
[5] Section 340-5(7) Sch 1 TAA.

considering applications.[6] The sole criteria for release from a taxation liability remained serious hardship, with the EM suggesting that release from a liability would not normally be granted where the release would not relieve the hardship, an example being where the existence of other creditors made bankruptcy inevitable, and a release would advantage other creditors at the expense of the Australian Taxation Office (ATO).[7]

While the EM provides no guidance as to the circumstances which may be sufficient to establish serious hardship, it does specify that the onus is on the applicant to furnish sufficient information to satisfy the Commissioner that a release on the basis of serious hardship would be appropriate.[8]

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A further issue for judicial consideration has been whether the existence of an unresolved objection or appeal against an assessment may be used to find serious hardship by the payment of the disputed amount. The courts have displayed a marked reluctance to prevent collection of taxes pending resolution of a dispute as to the assessment.

Asprey J in *DCT v Niblett*[30] observed that:

> It may be thought to be a hardship that a taxpayer should have to pay the tax assessed

exercised. In the decision in *Powell*, Hill J took the view that the factors considered in relation to exercising the discretion to rel

> exercised, there will be a threshold beyond which it would defeat the primary object of the legislation.[45]

While the discretion provided to the Commissioner would appear to be at large, there are broadly stated limits on the discretion to be exercised by the Commissioner. Windeyer J in *Giris Pty Ltd v FCT*[46] spoke of the need, when exercising a discretion, " … to be guided and controlled by the policy and purpose of the enactment, so far as that is manifest in it [and to] exclude from … consideration any matter which it would be unlawful … to take as a criterion."[47]

There have been attempts to outline the types of factors which would be expected to be considered. In *Re Wilson v Minister for Territories*,[48] Deputy President Hall said:

> The considerations that will be relevant to the proper exercise of the discretion whether or not to grant remission when undue hardship is established will vary from case to case. However, in my view, relevant considerations are likely to include the circumstances out of which the hardship arose; whether those circumstances were within the capacity of the applicant to have foreseen and controlled; whether the applicant has over-committed himself financially; whether the applicant or any of his dependants has suffered serious illness or accident involving irrevocable financial loss to the applicant; whether the applicant has been in regular employment; whether the circumstances of the hardship are likely to be of a temporary or recurring nature; and whether a decision to remit the rates would, as a matter of administrative justice and fairness be appropriate having regard to the fact that ratepayers, other than pensioners, are normally obliged to pay their rates in full ...[49]

The matter highlighted by this passage, and a matter which has proven significant in a number of decisions, is the degree of culpability by the taxpayer in contributing to the 'severe hardship' in which they find themselves. As stated by Wilcox J in *Corlette v Mackenzie & Ors*,[50] "It would be extremely odd if a taxpayer who was the author of his or her misfortunes, through imprudent or extravagant expenditure, was entitled, as a matter of right, to a release of unpaid income tax."[51]

The significance of this factor was highlighted by Deputy President Block in *Rollason v FCT*

a guide to the types of factors which may result in the exercise of the discretion to grant relief against a taxpayer suffering hardship, the examples provided by the ruling encompass such factors as:

- whether the taxpayer has disposed of funds without making provision for tax liabilities;
- whether granting relief would not reduce hardship, such as where there was a prospect of bankruptcy, and relief would only serve to advantage other creditors;
- whether the taxpayer has failed to pursue debts,;
- whether the hardship is associated with a single event or short term outcome.

While three of these factors relate to the taxpayer personally, the second factor is arguably wider, and takes into account the greater public interest in the collection of revenue, and not serve to advantage creditors to the detriment of the revenue if the taxpayer is declared bankrupt.

Given the wider scope of this second factor, it may appear somewhat surprising that in *A Taxpayer* the Commissioner had argued that the discretion in s 340-5(3) allowed the Commissioner to take into account only matters relating to the particular taxpayer. The argument of the Commissioner suggested that by taking into account the public interest in the taxpayer continuing in a highly paid position and paying tax at the top marginal rate, the AAT had erred in law by considering an irrelevant consideration.

Stone J agreed that the 'public interest' would be an irrelevant consideration in determining the first issue of whether the taxpayer faced severe hardship, but her Honour was satisfied it was not irrelevant to the exercise of the discretion as to where to provide relief.[55]

If the greater public interest is an element for consideration in exercising the discretion as to the granting of relief, a further aspect of this is arguably the impact the exercise of the discretion may have on taxpayer perceptions, and the potential for impact on future taxpayer compliance.

That such is the case has been recognised by the current Commissioner in noting that:

> In the foreseeable future, tax administrators will need to be even more careful in balancing the need to be fair, efficient and effective. On the one hand, they must be vigilant for abusive tax practices so as to provide a level playing field, but at the same time empathetic to taxpayers facing real hardship.[56]

The final part of this paper considers the potential for an overly-restrictive exercise of the relief discretion to impact on taxpayer perceptions and resultant compliance behaviour.

[55] Above, note 23 at para 63.
[56] D'Ascenzo M, "Sustaining good practice tax administration," (2009) 38 *AT Rev* 76 at 85.

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- [illegible]
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A Taxpayer [illegible]

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[illegible][6]

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[5] [illegible]

[6] [illegible] *AT Rev* [illegible]