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Analysis of the Bills

Introduction

2.1 The two key areas examined during the hearing were the legislative provisions relating to the petroleum resource rent tax, and the director penalty regime to make directors personally liable for their company's unpaid superannuation guarantee amounts.

2.2 Schedule 2 of the Bill amends the *Petroleum Resource Rent Tax Assessment Act 1987* to provide certainty regarding how the 'taxing point' is determined for the purpose of the Petroleum Resource Rent Tax (PRRT). The committee examined the need for the legislation and, at the same time, heard evidence from certain groups which were opposed to the legislative proposals. This Chapter discusses the policy intent and merits of the legislation.

2.3 Schedule 3 of the Bill strengthens directors' obligations to cause their company to comply with its existing pay as you go (PAYG) withholding and superannuation guarantee requirements. In particular, the Explanatory Memorandum states that 'these amendments reduce the scope for companies to engage in fraudulent phoenix activity or escape liabilities and payments of employee entitlements.' The second section of this Chapter examines this proposal in detail and, in particular, concerns by relevant industry bodies that the legislation could lead to more onerous requirements for company directors.

Petroleum Resource Rent Tax

The original policy intent

Background

2.4 The Explanatory Memorandum to the Bills states that they are confirming 'how the PRRT has applied since commencement'. It summarised the Court's decision earlier this year as:

> The Federal Court rejected this narrow interpretation [of ExxonMobil], instead affirming the long established application of the PRRT in relation to the taxing point consistent with the policy intent.[1]

2.5 The Explanatory Memorandum states that, if ExxonMobil's interpretation were applied, a number of unintended consequences would arise:

- it would be more in the nature of a tax on production, which is inconsistent with the aim of the PRRT being a tax on profit;
- in many cases, the taxing point would occur earlier than the point at which the products are sold, meaning that a derived market value would be used to calculate the tax, which would increase complexity; and
- the scope of eligible petroleum projects subject to the tax would be artificially limited.[2]

2.6 In evidence, Treasury quoted the Explanatory Memorandum to the Bill for the 1987 Act when it was first introduced into the Parliament. Treasury's point was that the tax was always intended to be a profits-based tax that was to be calculated by reference to the returns that a company was receiving for the product. The original Explanatory Memorandum stated:

> The PRRT contains rules for determining the petroleum projects that are subject to the PRRT and specifies the basis on which the PRRT liability of each participant is to be calculated. Broadly the tax will apply to be excess, if any, of receipts over expenditure. It provides for any excess of expenditure over receipts for a year to

1 Hon. Mr Wayne Swan MP, Deputy Prime Minister and Treasurer, *Explanatory Memorandum*, 2011, p. 16.

2 Hon. Mr Wayne Swan MP, Deputy Prime Minister and Treasurer, *Explanatory Memorandum*, 2011, pp. 16-17.

> be compounded forward and identifies the receipts or, in the case of certain petroleum projects that have not been sold by the point at which they leave an on-site storage facility, amounts deemed to be receipts that are to be assessable for PRRT purposes.[3]

2.7 The Explanatory Memorandum for the 1987 Act, when it was presented to the Senate following Government amendments in the House, also confirms the profits approach. It states, ‘The tax is to apply to profits from the recovery of petroleum in offshore areas’ and, ‘Unlike royalty and excise arrangements, the petroleum resource rent tax is profit-based, rather than being based on production’.[4]

Analysis

2.8 ExxonMobil did not dispute this high level policy intent, but they argued that the Tax Office initially had conflicting interpretations of the legislation. Further, ExxonMobil had raised this issue informally with the Tax Office shortly after entering the regime and formally raised it with the Tax Office in 1994 in relation to the 1991 year. ExxonMobil referred to a seminar paper presented by the Tax Office in 1992. The section on marketable petroleum commodities (MPCs) stated:

> Some of these products are further defined by reference to their gaseous mixture (eg sales gas – defined as a mixture that includes methane, where the methane comprises more than 50% by weight of the mixture). It is quite possible that some of these products, e.g. sales gas, could be produced on the platform in view of their definition. It has been suggested that an MPC does not become an excluded product until it is ‘in fact’, ‘from a practical point of view’ marketable. This is so, it has been suggested, even if the product has been further processed or treated, or has been moved beyond storage adjacent to the place of production (see ‘excluded commodity’, sec. 2). The Act does not ask when a commodity is in fact or from a practical point of view marketable. It defines an MPC and defines the point when that commodity becomes an excluded commodity. There is no room for the ATO to postpone the point at which an assessable petroleum receipt (or an exploration recovery receipt) is derived.[5]

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3 Mr James O’Toole, Treasury, *Committee Hansard*, Canberra, 27 October 2011, p. 2.

4 Senator the Hon. Peter Walsh, Minister representing the Treasurer, *Explanatory Memorandum*, 28 April 1987, p. 4.

5 *Exhibit 1*, p. 9.

2.9 Following the hearing, Treasury noted that the views presented at these seminars are not formal Tax Office views, but that they are designed to assist industry by giving an indication of how the Tax Office is likely to approach new law:

> This paper was for information purposes only and a common practice to explain early thinking on new legislation. It is well known that such presentations at seminars are done in good faith but are not binding technical ATO views (such as a binding ruling). It was in no way a fully considered general view and definitely not a fully considered view for the Esso/BHP particular fact circumstances.[6]

2.10 ExxonMobil also noted that an opposite view was put to BHP by the Department of Primary Industries and Energy at the time.[7] Treasury provided evidence that ExxonMobil was itself not consistent in how it viewed the law during the early stages of the tax and that it favoured the later taxing point when this was to its benefit during a commercial dispute with the buyers of its products:

> At this time there was a commercial dispute between Esso/BHP and its buyers (including Victorian State Authorities) dealing with whether the PRRT imposed on Esso/BHP in respect of the gas sold to the buyers, could be passed on to the buyers (the 'pass-on' dispute).
>
> At the arbitration the State Government raised the taxing point issue in its submission, arguing that the amount of PRRT, if it could be passed on, was incorrectly calculated as the appropriate Taxing Point was at an earlier point than that contended for by Esso. Esso contended (in contrast to their position in the recent Federal Court case) that the appropriate taxing point was at the exit from Longford and had lodged its PRRT returns on that basis. This contention is consistent with the long-standing ATO view.[8]

2.11 The committee also questioned ExxonMobil on why it took 10 years for the company to commence its court case on this matter, because this delay could be interpreted as their agreement with the legislation. They replied:

> ... there were a number of issues around the application of PRRT to Bass Strait that had to be resolved, initially. And the first focus was on the most valuable product stream, which was crude oil and

6 Treasury, *Submission 17.1,* p. 4.

7 Mr Stuart Brown, ExxonMobil, *Committee Hansard*, Canberra, 27 October 2011, p. 10.

8 Treasury, *Submission 17.1,* p. 5.

> how you value crude oil. That was the biggest dollar-value dispute
> ...
>
> There were other issues around what costs were deductable and all this time the sales gas issue was going on. Especially in those early years, the value of sales gas was very low; the gas price was very low. So the revenue at stake, looking at the whole scheme of things, was not that big.[9]

2.12 In summary, ExxonMobil did not commence legal action until 2004 because they prioritised their tax issues on a commercial basis. They also stated that they filed conservatively because there were no precedents for how gas would be treated:

> At that stage there was no interpretation. Remember that the PRRT was introduced in 1987. The first taxpaying project was an oil project in 1989. There was no sales gas subject to tax until the Bass Strait project came in ... Right through that time there were differing views around the industry and in the ATO. In one office in the ATO there were clearly differing views, so we took the most conservative approach at that point and filed conservatively.[10]

2.13 The view of ExxonMobil is not necessarily representative of the general view of industry. In evidence, Treasury stated that, 'the small number of other taxpayers are operating in line with the current understanding of the law and the effect of the amendment'.[11]

Conclusion

2.14 The committee notes that ExxonMobil has disputed the Tax Office's interpretation of the law. The policy intent of the Act, that it is to implement a profits based tax, has always been clear. Further, this is how ExxonMobil filed its tax returns, this is how other taxpayers are operating, and it is how the Tax Office has administered the Act.

2.15 Under these circumstances, the committee believes that it is appropriate for the Parliament to affirm the policy intent of legislation as implemented in the Bills.

9 Mr Stuart Brown, ExxonMobil, *Committee Hansard*, Canberra, 27 October 2011, pp. 13-14.

10 Mr Stuart Brown, ExxonMobil, *Committee Hansard*, Canberra, 27 October 2011, p. 9.

11 Mr Paul McCullough, Treasury, *Committee Hansard*, Canberra, 27 October 2011, p. 6.

Retrospectivity

Background

2.16 The Bills apply the new definition of a marketable petroleum commodity back to 1990. Tax and business groups consistently made the point in submissions that the definition should only apply prospectively, either from the date of assent of the Bills or from the announcement in the 2011 Budget.[12]

2.17 Some of the more specific points made by business and tax groups were that:

- retrospective amendments are usually only made either to the benefit of taxpayers or to address tax evasion;[13]
- clarifying amendments usually operate prospectively;[14]
- retrospective amendments are permitted to resolve undue hardship, due to unintended applications to particular taxpayers; and
- retrospective amendments are permitted where a court's decision is totally unanticipated by all parties and it changes a common understanding of the law.[15]

Analysis

2.18 The committee's view is that legislation should be as fair as possible and that the extent to which it generates certainty for the community is also a tangible benefit. Legislating retrospectively should not be done lightly because it is very easy for it not to be fair and for it to create uncertainty. Decisions about retrospectivity must be made on a case by case basis.

2.19 As Treasury advised the committee, it is important to note that the legislation has been in place and has operated in line with the amendments back to the date at which they are deemed to commence. ExxonMobil and BHP and other companies have paid tax as if according to the amendments and the Tax Office has also administered the law as if

12 For example, the Law Council of Australia, *Submission 3*, p. 1; ICAA, *Submission 10*, p. 2; the Business Council of Australia, *Submission 2*, p. 1; the Australian Petroleum Production and Exploration Association, *Submission 1*, p. 3.

13 Mr Stuart Brown, ExxonMobil, *Committee Hansard*, Canberra, 27 October 2011, p. 12.

14 Mr Yasser El-Ansary, ICAA, *Committee Hansard*, Canberra, 27 October 2011, p. 20; Ms Teresa Dyson, Law Council of Australia, *Committee Hansard*, Canberra, 27 October 2011, p. 22.

15 Law Council of Australia, Submission 3, p. 2.

in accordance with the amendments. This is also consistent with the policy intent of the PRRT.[16]

2.20 In evidence, the Law Council of Australia stated that the Parliament should have enacted affirming legislation, 'many, many years ago'.[17] However, a similar argument could be put to ExxonMobil. It had the opportunity to litigate in the 1990s, but did not do so, with the result that the disputed tax amount grew over time. In fact, Treasury advised that ExxonMobil only started litigation when the Tax Office stated that it would determine the objections on the information at hand.[18]

Conclusion

2.21 The Bills do not create a new tax burden for ExxonMobil and BHP. Rather, they affirm the original legislative intent of the PRRT. Therefore, the Bills do not generate the type of uncertainty and unfairness that is the underlying concern behind retrospective legislation.

Sovereign risk

Background

2.22 During the inquiry, the Tax Institute, the ICAA and ExxonMobil argued that the Bills, through their retrospective application, increased sovereign risk and that Australia would be a less attractive place in the long term for international capital.[19]

2.23 At the hearing, ExxonMobil explained how the tax environment affects large scale investment decisions:

> ... resource projects in general tend to be so large that they take many years for the investment, the construction and the actual setting-up of the operation to take place. Once you hit the 'go' button, it takes that number of years before you have a producing entity. If you are a third of the way through that investment and someone changes the rules, someone changes the tax environment, you have two choices: you keep going, on the basis that going forward and actually starting the operation up is better than

16 Mr Paul McCullough, Treasury, *Committee Hansard*, Canberra, 27 October 2011, p. 2.

17 Ms Teresa Dyson, Law Council of Australia, *Committee Hansard*, Canberra, 27 October 2011, p. 22.

18 Treasury, *Submission 17.1*, p. 6.

19 Tax Institute, *Submission 4*, p. 2; ExxonMobil, *Submission 7*, p. [7]; ICAA, *Submission 10*, p. 2.

> stopping and writing off all the investment that you have made, or you stop. Once people have hit the 'go' button, you will find that these investments will keep getting made, but, just like in the tax return aspect of this, there is a lag in the investment confidence here. So the rule you make today will affect decision making about projects that may not start for another two or three years, which then have a four- or five-year investment ramp-up. So there is a substantial lag in this. I cannot sit here and tell you that, as a result of making one law change today, tomorrow doomsday will happen. It just does not work that way. But the setting in which people will view investments going forward will be different.[20]

Analysis

2.24 The committee acknowledges that tax laws are relevant to the investment decisions of multi-national corporations and that the Parliament needs to be mindful of how its legislation presents Australia in the global marketplace.

2.25 There are two aspects to sovereign risk in this inquiry. The first is in relation to retrospectivity, which has been discussed earlier. The second covers the rate at which changes are made, with more rapid changes increasing uncertainty for investors.

Conclusion

2.26 In this case, the committee is of the view that the Bills do not increase the sovereign risk of making long term investments in Australia. The Bills affirm the long term policy intent of the PRRT and do not impose any new tax burden.

2.27 Within this context, the Bills do not represent an unstable, or constantly changing tax framework that reduces the attractiveness of Australia as an investment destination.

20 Mr John Dashwood, ExxonMobil, *Committee Hansard*, Canberra, 27 October 2011, p. 15.

Phoenixing

Consensus against the practice

2.28 There was a very strong consensus amongst submissions and witnesses that fraudulent phoenix activity was abhorrent and that the non-payment of employee superannuation was inexcusable. It was also agreed that these had serious implications for the reputation of business, public confidence in the ability of the law to protect property rights and the ability of the current generation of Australian workers to provide themselves with a high income and high level of independence in retirement. As the Council of Small Business of Australia (COSBOA) stated at the public hearing, the behaviour of those company directors involved in fraudulent phoenix activity:

> ... is appalling and it makes it hard for everybody else in business. It is not just the fact they are doing it which is wrong—and it is wrong—but they are making it harder for everybody else, giving us a bad reputation and creating the opportunity for bad press. I think we need to spend more time chasing those people rather than chasing everybody and making life difficult for everybody.[21]

2.29 There was also much agreement that phoenixing was the result of deliberate moral choices and that it required a certain degree of malicious intent for any company to fail to pay an employee's superannuation.

Limiting the scope of the Bills to phoenix operators

Background

2.30 An issue that was raised by those who believed that the Bills affects all company directors, when in fact only a minority of company directors were responsible for either fraudulent phoenix activity or the non-payment of employee superannuation in the first place.

2.31 The Australian Institute of Company Directors put it to the committee at the public hearing:

> What we are very concerned about at the Australian Institute of Company Directors is that this legislation, which is apparently targeted at the phoenix company activity which is already subject

21 Mr Peter Strong, COSBOA, *Committee Hansard*, Canberra, 27 October 2011, p. 43.

> to ASIC overview in a very significant fashion, impacts on all directors of all companies throughout Australia—over two million, in fact, in relation to that.[22]

2.32 Similar concerns were raised by COSBOA, who stated: 'We are punishing innocent people for the behaviour of a few guilty people.' [23]

2.33 The ICAA shared this perspective, but proposed the following remedy; that the Committee should consider recommending to the Government that they allow the Commissioner of Taxation:

> ...to by-pass the requirement to issue a director penalty notice in circumstances where:
>
> - an employee entitlement amount is unreported and unpaid for a period of three months or more, and
> - any of the relevant directors or the corporation have a history (over the course of the last five/ten years) of prior involvement in:
>   - ⇒ fraudulent phoenix activities, or
>   - ⇒ a corporation that entered into external administration for reasons of insolvency.
>
> Where these conditions are not met, the legislation should continue to prescribe a requirement on the Commissioner to issue a 21-day notice prior to the commencement of director penalty recovery proceedings.[24]

Analysis

2.34 It is important to note up front that the Bills extend PAYG to those who do not meet the burdens of existing superannuation requirements. The committee rejects that it increases the burden. Rather, it more effectively enforces current obligations by extending the penalty regime for PAYG to superannuation.

2.35 The ATO has already identified likely targets under the Bills. The ATO explained that, according to their best estimate, at any given time there are around 6,000 phoenix companies operating in Australia and that between 7,500 and 9,000 company directors could be exposed to liabilities by the proposed legislation.[25]

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22 Professor Bob Baxt, AO, Australian Institute of Company Directors, *Committee Hansard*, Canberra, 27 October 2011, p. 32-34.

23 Mr Peter Strong, COSBOA, *Committee Hansard*, Canberra, 27 October 2011, p. 43.

24 ICAA, S*ubmission 10*, p. 4.

25 Mr Grant Darmanin, ATO, *Committee Hansard*, Canberra, 27 October 2011, pp. 32-34.

2.36 The effectiveness of the ATO's compliance model was supported in testimony from the small business sector who noted that:

> The tax office has its benchmarking. It is a very simple device that takes the honest ones of it, basically—you'd have to say they're honest—and identifies those who may be dishonest. Then the tax office sends them letters et cetera and chases them up. I think about 12 per cent of all businesses end up outside its benchmark. They have a fabulous system, and I think they could apply something similar around the phoenix companies and the other sorts of companies.[26]

2.37 On the other hand, the committee recognises that it can be prudent to limit legislation, rather than relying on administrative discretion, to ensure that there are no unintended consequences and that company directors who act in good faith are not caught by the provisions. Such an amendment, if possible, would provide confidence to compliant directors that they will not be inadvertently subject to these provisions.

Conclusion

2.38 The provisions in the Bills do not add to existing requirements, but instead apply a more effective penalty regime to phoenix operators who are abusing the law to obtain an unfair competitive advantage.

2.39 However, the committee notes concerns from the business community and its representatives that the Bills potentially apply to the broad range of directors whether engaged in phoenix activity or not. The committee recommends that the Government should investigate whether it is possible to tighten the provisions of the Bills to better target phoenix activity.

Recommendation 1

2.40 **The Government investigate whether it is possible to amend the Bills to better target phoenix activity.**

26 Mr Peter Strong, COSBOA, *Committee Hansard*, Canberra, 27 October, 2011, p. 45.

Penalties and defences

Background

2.41 Another objection to the bills was that in their present form they reverse the onus of proof and assume the guilt of company directors, rather than extend the presumption of innocence. This argument was made by Australian Institute of Company Directors in their submission.[27]

2.42 Witnesses from the Institute expanded on this point at the hearing. They noted that, although the Bills do not introduce a strict criminal liability, they make it more difficult to be a company director in a climate where strict criminal liability is becoming more accepted.

> Whilst the legislation does not introduce strict criminal liability...it very definitely impacts on a critical area that the federal government, through Senator Nick Sherry, is leading the charge on in relation to a review of all legislation, over 700 pieces of legislation, in Australia that create strict liability regimes, putting the onus of proof on directors to show that they are innocent rather than the Crown or the regulator having to prove that they are guilty. I firmly believe, despite the fact that I was chairman of a regulator for three and a bit years, that we should not depart from the principle that a person is innocent until proven guilty. But we seem to be absolutely abandoning that almost willy-nilly.[28]

Analysis

2.43 At the hearing, Treasury's response to these concerns about the onus of proof and the penalty regime was that the bills did not contain any innovation or novel development, but that they simply extended the scope of the existing system:

> ...it is not a whole new regime; it builds on an existing regime, the director penalty regime. In terms of wider exposure to directors, the only wider exposure in respect of an existing regime is that it also is proposed that it applies to super guarantee debts as well ... it is more an existing regime and an additional debt has been inserted into the director penalty regime—that is, the super guarantee.[29]

27 Australian Institute of Company Directors, *Submission 10*, p. 2.

28 Professor Bob Baxt, AO, Australian Institute of Company Directors, *Committee Hansard*, Canberra, 27 October 2011, p. 36.

29 Mr Haydn Daw, Treasury, *Committee Hansard*, Canberra, 27 October 2011, p. 27.

2.44 Furthermore, key changes to the director penalty regime in the bill were specifically designed to close loopholes in the existing system which enables fraudulent phoenix activity. For example, the removal of the 21 day notification period is essential to frustrate contrived insolvencies designed to allow directors to walk away from their obligations.

2.45 As the ATO advised about the directors of fraudulent phoenix directors:

> The way they currently operate...is to wait until they get a direct penalty notice and then put their company into administrational liquidation within 21 days, essentially wiping their hands of that formal liability. They start a new company and carry on the same business again. That is the reality.[30]

2.46 In the view of the Treasury, the current recovery rules concerning the 21 day notice actually impedes the collection of the liabilities, because unscrupulous directors can undermine the regime by going into liquidation soon after the notice is issued, thereby leaving a trail of debts behind them. These debts are difficult to recover. Furthermore, it is only after employees or ex-employees commence claiming their tax credit entitlements at year's end that any fraudulent activity by company directors comes to light. The bills seek to retrieve this situation.

2.47 The ATO also pointed out that the existing regime has defences for directors so that they are not inadvertently swept up. These defences remain available to directors under the Bills. For example, the defences for director penalties include illness or some other reason such that it would be unreasonable to expect a director to take part in the management of a company at the relevant time, or if the director took all reasonable steps to ensure that a company complied with its obligations.[31]

2.48 Although these defences appear reasonable in the first instance, the Australian Institute of Company Directors gave an example of how they might not protect directors:

> Let’s assume you have a difficult issue in accounting principles or some difficult question where the director, not being an expert, feels, ‘I have to go and get expert advice.’ They get expert advice which turns out to be wrong. They have relied on it, and we have just been told by Justice Middleton in the Centro case that there are some areas where, despite the fact that you go and get that advice, you are still going to be liable. In that situation what more

30 Mr Grant Darmanin, ATO, *Committee Hansard*, Canberra, 27 October 2011, p. 31.

31 See item 6 in the Tax Laws Amendment (2011 Measures No. 8) Bill 2011.

> could the director have done? Yet that director is going to be the person that is going to have to carry the onus of the penalty.[32]

2.49 Given the concerns expressed by industry, the committee believes that it would be appropriate for the Government to investigate whether it is possible to expand the definitions in the Bills. It may also be possible to work through some more factual scenarios to determine how the proposed defences would work in practice.

Conclusion

2.50 The committee is not convinced that the bills reverse the onus of proof or undermine established principles of natural justice. They simply extend the penalty provisions that already apply to PAYG to superannuation.

2.51 However, given the concerns expressed by industry at the hearings in relation to how the defences would operate in practice, the committee believes that it would be worthwhile for the Government to investigate this matter further and determine whether it would be possible to expand and strengthen the defences for company directors.

Recommendation 2

2.52 **The Government explore whether to expand and strengthen the defences for company directors available in the Bills.**

Small business

Background

2.53 The special needs of small business figured prominently in the responses to the proposed bill, in particular the limited capacity of small businesses to cope with the growing complexity of what is already a very complex taxation system. The ICAA made this point as follows:

> ...the small- to medium-sized enterprise market is typically the component of the taxpaying community that often struggles with the challenges of complying with what is fundamentally a very complex tax system and significant complexity around the administration of the tax system as well, quite aside from the

32 Professor Bob Baxt AO, Australian Institute of Company Directors, *Committee Hansard*, Canberra, 27 October 2011, p. 40.

> application of the revenue law itself. This is mostly because SME market businesses often find themselves in a position where, if they are fortunate enough to be in a growth market they may well be expanding at quite a significant rate of growth, but at the same time their processes, their level of sophistication in terms of their capacity to interpret and apply the complexities of the tax system as it begins to become more clunky and more cumbersome the bigger they are do not necessarily correlate together very well.[33]

2.54 COSBOA argued that the bill imposed a degree of complexity that a great many small business directors would not be able to manage effectively.[34]

Analysis

2.55 The committee reiterates its earlier comments. Firstly, the Bills do not impose new obligations on companies and their directors. Obligations in relation to superannuation remain the same. What the Bills do is to impose more effective penalties on company directors that do not meet their obligations and seek to avoid their superannuation responsibilities.

2.56 The ATO advised the committee at the hearing that the current system operates in order to encourage the engagement of the business community. Companies that are concerned about creating a liability for themselves only have to contact the ATO to receive assistance:

> The super guarantee system is a self-assessment system, so employers do not need to report to us that they have made payments. This encourages engagement because if a director ensures that the company reports its obligation within three months after the due date, the director avoids being personally liable. It encourages that engagement and lets us know what the liability is. Then we can pursue the company or pursue the director via the 21-day director penalty notice.[35]

2.57 The accessibility of the ATO and its success in working with small business and communicating with clients was substantiated by testimony from COSBOA. At the hearing COSBOA testified that in their experience the ATO:

> ...do not want to make it too complicated for small business, and that is what we are talking about, and many small businesses are

33 Mr Yasser El-Ansary, ICAA, *Committee Hansard*, Canberra, 27 October 2011, p. 24.

34 Mr Peter Strong, COSBOA, *Committee Hansard*, Canberra, 27 October 2011, pp. 43-44.

35 Mrs Geraldine Panfilo, ATO, *Committee Hansard*, Canberra, 27 October 2011, p. 28. Mrs Panfilo's testimony on this point is further elaborated on pp. 30 -31.

> on boards. They are our agency of choice. They are very good at communicating with small business and they are very good at trying to make their processes simpler.[36]

2.58 Further, the committee notes that it has already made recommendations that the Government should investigate whether the Bills should be tightened to focus only on phoenix operators and to explore whether the defences should be expanded.

Conclusion

2.59 The burdens in relation to small business are overstated. The administrative demands of superannuation are contained in existing law which SMEs can manage, especially given the focus of the ATO in engaging with small business. Finally, the committee expects that the Government will further explore whether it is possible to amend the Bills to better target phoenix operators and widen the defences for directors.

Volunteer and non-profit sector

Background

2.60 The possibility that the bills might inadvertently have a negative impact on the directors of the volunteer and non-profit sector was also raised during the committee's hearings. The assumption underlying such concerns was a significant proportion of the sector's directors lacked the capacity to cope effectively with the responsibilities imposed by the bill. COSBOA, in particular, stated this at the hearing.[37]

Analysis

2.61 Following the hearing the Treasury provided a submission clarifying the situation regarding volunteer organisations and the non-profit sector and the claims about their alleged vulnerability under the Bills. Treasury have advised the committee that the existing director penalty provisions only apply to the directors of companies registered under the *Corporations Act 2001*. The amendments in the Bills would not change that application.

2.62 Clubs and associations are mostly incorporated under the incorporated associations legislation in the various states and territories. Since clubs, sporting associations and not-for profits are generally not run as

36 Mr Peter Strong, COSBOA, *Committee Hansard*, Canberra, 27 October 2011, pp. 45-46.

37 Mr Peter Strong, COSBOA, *Committee Hansard*, Canberra, 27 October 2011, pp. 43-44.

companies under the *Corporation Act 2001*, the director penalty provisions and proposed changes will not alter their status, obligations and potential implications.[38]

Conclusion

2.63 It is clear to the committee that there is considerable confusion about the status and responsibility of directors in the voluntary and not for profit sectors. This is a very serious concern, given the implications for the individuals involved and the wider community that so selflessly serve. However, given the advice of Treasury on the matter, there is no reason to believe the bill has any negative implications for the sector. The committee welcomes this advice.

Summary

2.64 The committee notes the concerns expressed by business about the impact of the Bills on company directors. However, the committee also notes the severity of the conduct that causes employees to lose millions of dollars in superannuation annually. The Textile Clothing and Footwear Union of Australia gave the example of a company that was placed in liquidation, owing $500,000 in employees' entitlements, of which $135,000 was superannuation. Its only secured creditor was a company whose directors were the same directors as the insolvent company. A further company, controlled by a relative of the first company, started up operations on the same premises and employed some of the original employees, all of whom were unable to recover a significant proportion of the superannuation, including voluntary contributions.[39]

2.65 In evidence, Treasury noted that there are companies that offer a speedy voluntary liquidation service if you are a company director and have received a penalty notice.[40]

2.66 The committee asked the Tax Office in evidence what a business would have to do in order to not meet their legal obligations in relation to superannuation:

> The corporate employer is required to pay nine per cent of the salary and wages into the employee's superannuation fund by the 28th day after the end of a quarter. If they fail to do so or if they

38 Treasury, *Submission 17*, p. 1.

39 Textile Clothing and Footwear Union of Australia, *Submission 16,* pp. 3-4.

40 Mr Michael Bradshaw, Treasury, *Committee Hansard*, Canberra, 27 October 2011, p. 31.

underpay then they need to lodge a super guarantee statement with the tax office by the 28th day of the second month at the end of the quarter. That is the current law. That is the obligation as it stands. If they then do not lodge that statement and for us to penalise the director personally that statement has not been lodged for a further three months—so we have not received notification of the liability and they have not reported their obligation to the tax office. In effect, it is five months from the end of the quarter.[41]

2.67 Their obligations for the next quarter would have already arisen by this time as well.

2.68 Compared against the severity of this conduct, there are many different ways in which compliant directors can manage their superannuation obligations. In evidence, the Tax Office explained that directors could simply get the company to pay the required amounts and that would thereby extinguish their liability. If a company had cash-flow problems and could not pay the whole amount up-front, they could still extinguish the director's personal liability by entering into a payment arrangement.[42]

2.69 In their testimony at the hearing, the Tax Office stated that the system is designed to encourage business to approach them if problems arise:

2.70 The super guarantee system is a self-assessment system, so employers do not need to report to us that they have made payments. This encourages engagement because if a director ensures that the company reports its obligation within three months after the due date, the director avoids being personally liable. It encourages that engagement and lets us know what the liability is. Then we can pursue the company or pursue the director via the 21-day director penalty notice.[43]

2.71 On the other hand, almost all phoenix operators do not report, do not lodge, and do not pay.[44]

2.72 Given the severity of phoenixing, the fact that the Tax Office has a track record of working with compliant taxpayers and encourages engagement with taxpayers, the committee is of the view that the Bills show great potential in striking a reasonable balance between the interests of the victims of phoenixing, many of whom are low income earners, and

41 Mrs Geraldine Panfilo, ATO, *Committee Hansard,* Canberra, 27 October 2011, p. 34.

42 Mrs Geraldine Panfilo, ATO, *Committee Hansard*, Canberra, 27 October 2011, p. 28.

43 Mrs Geraldine Panfilo, ATO, *Committee Hansard*, Canberra, 27 October 2011, p. 28.

44 Mr Grant Darmanin, ATO, *Committee Hansard,* Canberra, 27 October 2011, p. 31.

compliant company directors. The committee has recommended that the Government investigate two refinements to the Bills, but the committee remains of the view that stronger legislation in dealing with phoenix operators will be required. The sooner this occurs, there will be more employees that receive their full superannuation amounts.

Overall conclusion

2.73 The committee supports the passage of the Bills. In relation to the Petroleum Resource Rent Tax (PRRT), the legislation provides certainty for how the taxing point is determined.

2.74 The committee notes that ExxonMobil disputes the Tax Office's application of the law from the start of the tax's application to Bass Strait in 1990-91 and that the Bill should not apply retrospectively back to that date. The committee received recommendations that it should apply prospectively from the date of announcement or the date of Royal Assent.

2.75 However, the committee rejects this position and concludes that the PRRT was always meant to be a profits based tax and that the Bill is not imposing a new tax burden, but that it is affirming the original policy intent of the legislation and the tax paid under it.

2.76 Schedule 3 of the Bill strengthens director's obligations to cause their company to comply with its existing pay as you go withholding and superannuation guarantee requirements. The committee supports measures in principle to deter companies from engaging in fraudulent phoenix activities.

2.77 The committee also notes that, for an employer not to comply with their employees' superannuation obligations under this Bill they must fail to carry out a number of legally required steps over a number of months. This goes beyond forgetfulness or oversight. Further, the Bills include a number of defences to protect company directors who act in good faith.

2.78 The committee received evidence that the provisions placed an increased burden on company directors. However, the provisions do not impose a greater burden because they already exist in relation to Pay As You Go within the tax system, where they operate successfully, and are being transferred across to superannuation. Business groups suggested to the committee that the Bills should be tightened to only focus on phoenix operators and the committee agrees that it would be worthwhile to investigate this possible refinement to give honest directors comfort they will not be inadvertently targeted by the ATO. Similarly, the committee has recommended that the Government should investigate whether to expand the defences in the Bills.

2.79 To allow this to occur, the committee is of the view that the remainder of Tax Laws Amendment (2011 Measures No. 8) Bill 2011 should proceed and that Schedule 3 should be deleted from it. The Pay As You Go Non-compliance Tax Bill 2011 deals solely with phoenixing, so it should remain pending while the Government completes its investigations.

Recommendation 3

2.80 **The House of Representatives pass the Tax Laws Amendment (2011 Measures No. 8) Bill 2011 after deleting its Schedule 3 and associated provisions. The Pay As You Go Non-compliance Tax Bill 2011 should remain pending the Government's investigations detailed in recommendations 1 and 2.**

Julie Owens, MP
Chair
2 November 2011