The Institute of
Chartered Accountants
in Australia

26 October 2011

Ms Julie Owens MP
Chair
House of Representatives
Standing Committee on Economics
PO Box 6021
Parliament House
CANBERRA ACT 2600

By email: economics.reps@aph.gov.au

Inquiry into legislation amending the petroleum resource rent tax and 'phoenixing' that avoids payment of employees' superannuation

Dear Ms Owens

We would like to thank the House of Representatives Standing Committee on Economics for the opportunity to put forward a submission in response to the above inquiry.

By way of background, the Institute of Chartered Accountants in Australia (the Institute) is the professional body representing Chartered Accountants in Australia. Our reach extends to around 70,000 of today's and tomorrow's business leaders, representing more than 57,000 Chartered Accountants and 13,000 of Australia's best accounting graduates currently enrolled in our world-class Chartered Accountants postgraduate program.

The Institute's members work in diverse roles across commerce and industry, academia, government and public practice throughout Australia and in 108 countries around the world. Relevantly, a significant proportion of our members are directly engaged in the specialist field of taxation and are highly experienced in the development, interpretation and application of revenue laws.

This submission sets out the views of the Institute in respect of specific components of the legislation being examined as part of the Committee's inquiry into:

1. proposed amendments to the Petroleum Resource Rent Tax Assessment Act 1987, and
2. extending the existing director penalty regime through various amendments to the Taxation Administration Act 1953 and other related legislation.

Proposed retrospective amendments to the PRRT Assessment Act 1987

The Tax Laws Amendment (2011 Measures No. 8) Bill 2011 includes amendments that are intended to retrospectively alter the operation of certain key provisions in the Petroleum Resource Rent Tax Assessment Act 1987 (PRRTAA) dating back to 1 July 1990.

It is our understanding that the motivation for seeking legislative change on a retrospective basis in this area is drawn from the current legal dispute between the Commissioner of Taxation and Esso Australia Resources Pty Limited. In effect, the proposed amendment seeks to codify the point at which tax is imposed under the PRRTAA, which is consistent with the findings of the Federal Court in their April 2011 judgement.

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Importantly, this legal dispute has been on-foot since 2004 and aspects of the Federal Court's most recent decision are currently the subject of an appeal by the taxpayer which is due to be heard in the Full Federal Court during November 2011.

It would not be appropriate for the Institute to comment on the veracity of the arguments put forward by either the Commissioner or the taxpayer in the current legal dispute. However, it is appropriate in the current situation to make some important remarks about the proposal to legislate retrospective tax laws.

It has been a long-standing practice of the legislature that retrospective tax laws will only be passed in exceptional circumstances where the integrity of the tax system would be fundamentally jeopardised if not for the introduction of back-dated taxation laws. Recent reviews into the policy-making processes surrounding the development of taxation law in Australia have supported the conclusion that tax measures introduced by the government should generally operate on a prospective basis only.

Where retrospective tax laws have been contemplated, it has been broadly accepted that such situations would be limited only to instances where taxpayers were either not adversely impacted (ie. neither worse off nor better off), or were in fact, favourably impacted.

Paragraph 3.21 of the 2008 report of the Tax Design Review Panel does acknowledge that in rare cases, retrospective tax laws may be appropriate where the changes 'rectify technical deficiencies from the date of the original legislation or where there is a serious risk to the revenue'.

A signal of the importance of freedom from retrospective laws has been held to be so critical to the basic rights of individuals and corporations that the constitutions of both the United States and Sweden have explicitly prohibited such a practice. Whilst Australia's constitution does not expressly prohibit the making of retrospective laws, the generally accepted practice of parliament has been to only exercise those powers sparingly, often only in extreme and exceptional circumstances.

It may be argued by the Government that the enactment of retrospective tax laws dealing with clarification of the 'taxing point' for PRRTAA purposes is both appropriate and justifiable. And whilst that argument could be readily challenged on any number of grounds, what absolutely cannot be justified is a complete usurping of the role of the judiciary in determining the outcome of a legal dispute currently on-foot between a taxpayer and the revenue.

The separation of powers as between the legislature and the judiciary is a fundamental doctrine embedded within the constitutional arrangements that underpins the integrity of Australia's governance arrangements. For the most part, this separation doctrine has been adhered to by parliaments, the judiciary, and the executive for many decades.

In order to protect the separation doctrine, it would be more appropriate for the Government to allow the current litigation to be concluded, and then to determine what course of action may be appropriate at that point in time. Not allowing the judicial process to reach its natural conclusion is seen by the Institute as an inappropriate interference in due process, which we believe would set a problematic and perilous precedent for further action of a similar nature in the future.

As this Committee will be aware, the Australian taxation system has suffered a number of significant policy and legislative 'shocks' in recent years. On each and every occasion, these 'shocks' have served to damage, to varying extents, the stability of Australia's taxation system. The stability and certainty of our tax system is a fundamental building block of Australia's reputation in both a domestic and international context. Given Australia's significant reliance on foreign investment capital in order to help fund the growth and expansion of the economy, we should resist any temptation to continue the pattern of disruptive 'shocks' and heightened concerns around Australia's sovereign risk profile in the eyes of investors. Avoiding the introduction of retrospective tax legislation would go some way to helping safeguard the stability of Australia's taxation system.

It is vitally important that the parliament hold the Government to account around ensuring that fiscal considerations, such as the well-publicised commitment to return the Federal Budget to surplus in 2012/13, do not contaminate the integrity of long-held principles surrounding the development and application of prospective taxation laws in Australia.

Proposed amendments to the Taxation Administration Act 1953

It is important to start by acknowledging that the Institute is fully supportive of the thrust of the proposed amendments in this area which seek to curtail the abusive practice of ‘phoenixing’ of corporations. Carefully calibrated measures which help to protect the entitlements of workers will always be supported by the Institute and its broad membership base.

That said, the Institute does have some points to make about the likely unintended consequences of certain aspects of the proposed amendments to the director penalty regime.

The key concern relates to the proposal to do away with the current 21-day notice period requirement that applies in circumstances where the Australian Taxation Office wish to commence proceedings to impose and recover director penalties in respect of corporation that has failed to meet its pay-as-you-go (PAYG) withholding obligations within three months of the due date.

Under the existing director penalty regime, the Commissioner is required to formally notify the directors of a company if they have PAYG debts outstanding for a period greater than three months. The formal notification, known as a director penalty notice, requires a minimum period of 21 days to elapse before the Commissioner is able to commence recovery proceedings against the company’s directors. This notice period is widely considered to be an effective and important ‘last chance’ step in the process of attempting to recover the unreported and/or unpaid employee entitlements owing to the ATO.

The Institute is concerned about the proposed amendment contained in Tax Laws Amendment (2011 Measures No. 8) Bill 2011 that would introduce a power for the Commissioner to commence legal proceedings to recover a director penalty without having to first issue a 21-day notice.

The implication of introducing such a unilateral power for the Commissioner is that company directors who are not engaged in any form of phoenix activity may find themselves caught by the director penalty regime for inadvertent reasons. It is not unreasonable to expect that from time-to-time, circumstances will arise that will result in a corporation not meeting its employee obligations in the timeframes expected under the law. Where this occurs, the law should not automatically assume that the directors of the relevant corporation are engaged in a fraudulent ‘phoenix’ type activity simply because a debt has remained outstanding for a period greater than three months.

While it is true that the director penalty regime contains provisions which would potentially allow directors who feel that they have inadvertently been impacted by the director penalty regime to put forward a case against the imposition of the penalty, our members inform us that in practice, the likelihood of the ATO not proceeding with the imposition of the penalty is small.

Furthermore, the introduction of this proposed expanded power for the Commissioner could have the inadvertent and perverse effect of encouraging the ATO to delay the chasing of unreported and unpaid employee obligations, in the knowledge that after the expiry of the three month period the ATO will be free to move straight to imposition of a director penalty.

The Institute cannot see any compelling basis for the introduction of legislation that would do away with essential statutory protections that exist to strike an appropriate balance between providing directors with a ‘last chance’ warning [as a precursor to the commencement of legal recovery action] and safeguarding the entitlements of millions of Australian workers.

The impact of this amendment is likely to be most pronounced amongst the small to medium-sized enterprise market, many of whom are already finding it difficult to navigate their way through an unpredictable economic environment and increasing regulatory burdens.

The Committee should consider the merits of recommending that the Government achieve its policy objectives through an alternative approach that would allow the Commissioner to by-pass the requirement to issue a director penalty notice in circumstances where:

1. an employee entitlement amount is unreported and unpaid for a period of three months or more, and
2. any of the relevant directors or the corporation have a history (over the course of the last five/ten years) of prior involvement in:
    a. fraudulent phoenix activities, or
    b. 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.

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If you would like to discuss any aspect of this submission further, please do not hesitate to contact me direct on 02 9290 5623.

Yours sincerely

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