MARSH

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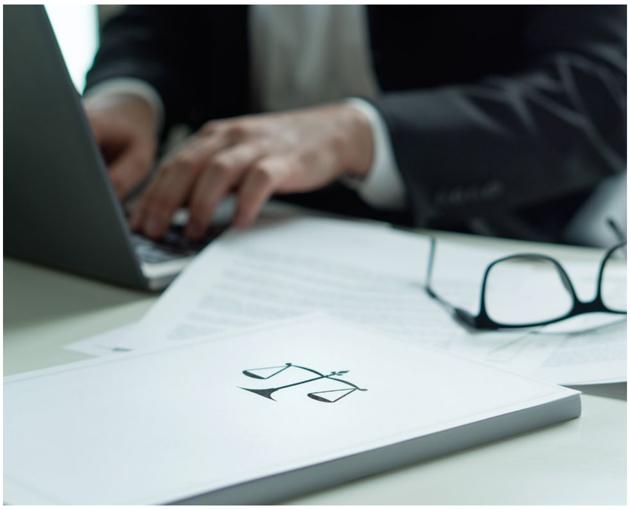
Combating Illegal Phoenixing

The Impact of the Treasury Laws Amendment Act 2020 on Directors and Officers and Professional Indemnity Insurance

The Treasury Laws Amendment (Combating Illegal Phoenixing) Act 2020 (Cth) (the Act) enacted on 17 February 2020 imposes a number of new criminal offences and civil penalties upon directors and officers and professional advisors who engage in illegal phoenix activity in order to avoid tax and other liabilities.



The Act amends the *Corporations Act 2001 (Cth)* by (amongst other things) introducing the concept of a 'creditor-defeating disposition',[1] being:

"A disposition of company property for less than its market value (or the best price reasonably obtainable) that has the effect of preventing, hindering or significantly delaying the property becoming available to meet the demands of the company's creditors in winding-up." [2]

New criminal offences apply to, for example:

- An officer of a company engaging in conduct that results in the company making a creditor-defeating disposition of property of the company, if
  a. the company is insolvent; or
  b. the company becomes insolvent because of the disposition or a number of dispositions made at the time of the disposition; or
  c. less than 12 months after the disposition, the start of an external administration of the company occurs as a direct or indirect result of the disposition; or
  d. less than 12 months after the disposition, the company ceases to carry on business altogether as a direct or indirect result of the disposition.[3]
- A person engaging in conduct of procuring, inciting, inducing or encouraging the making by a company of a disposition of property that results in the company making the disposition of the property, if:
  a. one or more of the following applies:
     i. the company is insolvent;
     ii. the company becomes insolvent because of the disposition or a number of dispositions made at the time of the disposition;
     iii. less than 12 months after the disposition, the start of an external administration (as defined in Schedule 2) of the company occurs as a direct or indirect result of the disposition;
     iv. less than 12 months after the disposition, the company ceases to carry on business altogether as a direct or indirect result of the disposition; and
  b. the disposition is a creditor-defeating disposition.[4]

1 Section 558FDB of the Corporations Act 2001 (Cth).
2 Treasury Laws Amendment (Combating Illegal Phoenixing Bill 2019 (Cth), Explanatory Memorandum p 13.
3 Section 588GAB(1) of the Corporations Act 2001 (Cth).
4 Section 588GAC(1) of the Corporations Act 2001 (Cth).

However, these offences will not apply if the disposition:

a. is made under a compromise or arrangement approved by a Court under section 411; or
b. is made under a deed of company arrangement executed by the company; or
c. is made by the company's liquidator; or
d. is made by a provisional liquidator of the company.[5]; or
e. as connected with a course of action likely to lead to a better outcome for the company .[6]

The threshold for criminality is **recklessness** as to harm.

The criminal penalties for contravention of the above include significant fines[7] for both the company and individuals and in the case of the latter also include up to ten years imprisonment.

Civil penalties are also available for conduct that falls short of the recklessness threshold. These are section1317E penalties.[8]

ASIC may make the following orders against a person who has received any money or property as a direct or indirect result of a credit- defeating disposition or the person's acquisition of the property after such disposition:

- an order directing the person to transfer to the company property that was the subject of the disposition;
- an order requiring the person to pay to the company an amount that, in ASIC's opinion, fairly represents some or all of the benefits that the person has received (directly or indirectly) because of the disposition;
- an order requiring the person to transfer to the company property that, in ASIC's opinion, fairly represents the application of proceeds of property that was the subject of the disposition.[9]

A person engaging in conduct that contravenes such an order is guilty of an offence.[10]

In addition, liquidators and in some cases creditors can recover compensation from a company's officers and other persons responsible for a company making a creditor-defeating disposition.[11]

Treasury Laws Amendment (Combating Illegal Phoenixing) Act 2020 (Cth) also introduces additional measures that are designed to improve the accountability of culpable directors and increase the prospect of the ATO recovering unpaid tax liabilities, including amending the *Taxation Administration Act 1953 (Cth)*, to extend existing director liability provisions for unpaid PAYG withholding amounts and superannuation guarantee charges to GST[12]

5 Section 588GAC(3) of the Corporations Act 2001 (Cth)
6 Section 588GA of the Corporations Act 2001 (Cth)
7 If an individual, the greater of $945,000 or 3 times the benefit obtained. If a company the greater of $9,450,000 or 3 times the benefit obtained (or detriment avoided) by one or more persons reasonably attributable to the 'creditor-defeating disposition' or 10% of its annual turnover.
8 Section 588GAB(2) and 588GAC(2) of the Corporations Act 2001 (Cth), for officers and other persons respectively.
9 Section 588FGAA(3) of the Corporations Act 2001 (Cth)
10 Section 588FGAC of the Corporations Act 2001 (Cth)
11 Sections 55J(1A),558K(2) and 588M(1A)of theCorporations Act 2001 (Cth)
12 Section 268-1 in Schedule 1 of the Taxation Administration Act 1953 (Cth)

Implications for Directors' and Officers' Liability Insurance

Criminal penalties imposed pursuant to the Act are likely to be uninsurable, although defence costs may still be payable provided the definition of Claim in the policy includes criminal proceedings or the like.

Civil penalties imposed pursuant to the Act are generally insurable at present, and cover should be available as long as the policy provides cover for such penalties.

While some policies will cover a director's personal liability for corporate taxes or superannuation contributions to the extent the company cannot pay these amounts, for example, due to insolvency, many policies have broad form exclusions for tax liabilities and/or superannuation liabilities.

Implications for Professional Indemnity Insurance

As noted above both criminal and civil penalties may be imposed on those persons engaging in conduct of procuring, inciting, inducing or encouraging the making of a creditor-defeating disposition. This could apply to a number of professionals, including lawyers and accountants.

Similarly, criminal penalties imposed pursuant to the Act are likely to be uninsurable. In addition, many Professional Indemnity polices do not include criminal proceedings or the like in the definition of Claim, and as a result, will not cover defence costs incurred because of such proceedings.

With respect to civil penalties, many Professional Indemnity policies either expressly exclude fines and penalties cover or only provide express cover for compensatory civil penalties. The civil penalties imposed as a result of the Act are unlikely to be considered compensatory, and therefore Professional Indemnity polices which use this type of language may not afford cover.

As a result, insureds should consider obtaining Professional Indemnity cover with insurers that:

- Include criminal proceedings or the like in the definition of claim; and
- Provide express cover for insurable civil penalties.

For further information, please contact your local Marsh office or visit our website at marsh.com.

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