Phoenix Companies

What are they?
How to avoid the tag!

Phoenix Companies

What is a Phoenix Company?

The term “Phoenix Company” is one often used by Legislators, ASIC and the ATO and is often the focus of campaigns by regulators and law reform. What is not as clear, is what exactly is a Phoenix Company?

The general concept is that a Phoenix Company is a company that “rises from the ashes" of a failed company. The most common scenario painted is when:

- A new company, which we call “NewCo”, begins trading as an identical business from the same location, with a similar trading name as another company, which we call “OldCo”;
- The assets of OldCo are transferred to NewCo and no consideration is paid for those assets; and
- OldCo probably enters liquidation and leaves a number of creditors unpaid.

The situation as described is a bad things for two main reasons. Firstly, there is the financial loss suffered by the creditors of the OldCo when they go unpaid. Secondly, the situation is grossly unfair for the competitors of the Phoenix Company - if a company is not paying its tax debts or trade creditors then its cost base is lowered, usually to such an extent that a competitor can’t match its pricing.

But it can be confusing!

Whilst we can all agree that the Phoenix Company described above is a bad thing, there are situations that contain some of the elements described above but then vary in crucial aspects that may make it more difficult to describe the situation as a “Phoenix”. For example, what if the situation was as described above except that a full market price was paid from NewCo to OldCo for the purchase of the assets? In that situation the position is much less clear.

So there is a difficulty in deciding what is a Phoenix Company and what is not because of the failure of the Law to actually define a Phoenix Company. Nowhere in the Corporations Law or the Tax Act is a Phoenix company defined.

ASIC’s approach to Phoenix Companies

ASIC has a dedicated team dealing with Phoenix Companies. ASIC has taken a number of legal actions in recent years against directors and their advisers where ASIC considers there has been a Phoenix Company. Remembering that there is no definition of a Phoenix company in the Corporations Law, ASIC has taken action under a variety of sections of the Corporations Act including section 180 and section 181 which talk about a director’s responsibility to exercise due care and diligence and to act in good faith.

Of note, in the recent cases taken by ASIC, there is a common thread that assets were transferred from one company to another for no consideration. That is, the NewCo started using the assets of the OldCo but did not pay for those assets.

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ATO approach to Phoenix Companies

Similarly, the ATO also has a dedicated Phoenix Company team. The ATO has also taken action against directors for what the ATO considers Phoenix Company situations.

The main target of the ATO legal actions has been "payroll" companies. That is, where a company sets up a subsidiary that employs staff. That company will incur a large debt to the ATO for deducted PAYG deductions from staff wages. The holding company simply abandons the subsidiary and creates a new payroll company. The ATO approach is to issue default assessment against the Payroll company and to also seek to have a liquidator appointed to the payroll company. The ultimate objective is to have the liquidator then pursue a debt due from the Holding Company to the payroll company in liquidation.

Law reform on Phoenix companies

In 2011 and 2012, there were a number of Exposure Draft and new Laws passed that (supposedly) address Phoenix Companies. The main ones are detailed below.

Corporations Amendment (Phoenixing and Other Measures) Bill 2012

These new laws were passed in 2012 and affect ASIC's ability to wind-up abandoned companies and change advertising requirements in a liquidation. Notably, and strangely given the title of the legislation, these new laws have nothing to do with Phoenix Companies!

Corporations Amendment (Similar Names) Bill – Proposed

This proposed legislation is squarely aimed at Phoenix Companies. The new laws won't catch all Phoenix activity but it is a further move towards personal liability for company directors in this situation. Here are the main points from the proposed legislation:

- It tries to identify phoenix companies and make a director and the Newco liable for the debts of the Newco;
- The legislation focuses on the name of the OldCo and NewCo - if the name is the same or similar then the NewCo is caught by the legislation;
- If the NewCo has the same name as the OldCo then a director of the NewCo is personally liable for the debts of the NewCo for five years.

So, the legislation does not seek to help recover funds for the benefit of the OldCo, but instead squarely puts the director of the NewCo in the firing line for personal liability for all debts of the NewCo.

In essence, the proposed legislation is saying to directors that you might get away with a Phoenix Company once, but if you do, you'll be on-the-hook for all debts of the NewCo.

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Tax Laws Amendment (2012 Measures No.2) Bill 2012

As of 29 June 2012, these new laws became effective. These mew laws dramatically expand the scope for directors to be personally liable for a company's PAYG deductions and unpaid employee superannuation. If you were to read the preamble to the laws it would explain to you that the main thrust of these new laws was to attack Phoenix Company operations.

That may have been a driving force in the proposed legislation but there is:

- no attempt to define a Phoenix Company; and
- nothing in the new laws that restricts the personal liability to Phoenix Company situations.

So again, whilst these are laws worth noting, they have nothing to do with the specific situation of a Phoenix Company.

A Final Word

Providing clarity and advice around the issue of "Phoenix Companies" is difficult.

At the core of the issue is a simple concept that companies and directors should not be allowed to illegally walk away from the debts of a company and start a new company using the same assets and business model. But the problem is that the legislators have declined to define their view of a Phoenix Company.

For advisers, our advice is to be aware of the existing laws and, obviously, don't breach them! We have another Information Pack on the Sale of Assets Pre-Liquidation.

Contact us:

Dissolve Pty Limited
ATF Dissolve Unit Trust
Level 2 333 George Street Sydney NSW 2000
ABN 14 174 223 792

Phone 1300 724 957
Fax (02) 9290 2221
Email advice@dissolve.com.au