STANDING COMMITTEE ON LEGISLATION

TAXATION ADMINISTRATION BILL 2001
TAXATION ADMINISTRATION (CONSEQUENTIAL PROVISIONS) (TAXING) BILL 2001
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TRANSCRIPT OF EVIDENCE TAKEN
AT PERTH
ON WEDNESDAY, 15 MAY 2002

SESSION 3

Hon Jon Ford (Chairman)
Hon Giz Watson (Deputy Chairman)
Hon Kate Doust
Hon Peter Foss
Hon Bill Stretch (Substituted by Hon George Cash)

DE KERLOY, MR KONRAD
Partner, Freehills,
examined:

The CHAIRMAN: Welcome. Have you completed the witness form, and did you read the note at the foot of the form?

Mr de Kerloy: Yes, I have.

The CHAIRMAN: For your information, these proceedings are being recorded by Hansard. A transcript of your evidence will be provided to you. To assist the committee and Hansard, please quote the full title of any document you refer to during the course of this hearing, for the record. Please be aware of the microphones, and try to talk into them. Ensure that you do not cover them with papers or make noise near them. I remind you that your transcript will become a matter for the public record. If for some reason you wish to make a confidential statement during today's proceedings, you should request that the evidence be taken in closed session. If the committee grants your request, any public and media in attendance will be excluded from the hearing. Please note that until such time as the transcript of your public evidence is finalised, it should not be made public. I advise you that premature publication or disclosure of public evidence may constitute a contempt of Parliament, and may mean that the material published or disclosed is not subject to parliamentary privilege.

Mr de Kerloy: The Institute of Company Directors has asked me to make submissions in my opening statement, in particular about clauses 67 and 100. In relation to clause 67, the institute believes that Governments do have every right to be concerned about tax avoidance through the device of phoenix companies. The question is whether clause 67 is an appropriate or proportional response to that problem. Much has been said about clause 67 being an erosion of the protection afforded by the corporate veil. Put that way, it may imply that the corporate veil is something behind which dishonest directors may hide, and therefore that it serves illegitimate ends, or at least no legitimate ends. That view is not only simplistic, it is also quite wrong. The corporate veil does not protect, and has never protected, dishonest directors. Directors who divert the company's assets to establish new phoenix companies and to pay certain creditors while leaving others to lament - notably the federal and state commissioners of taxation - are not only in default of their fiduciary duties but are also in breach of their duties under the Corporations Act. The consequence of breaching duties imposed by that Act include a liability to pay compensation to the company, liability to pay a fine, disqualification and, where the breach is dishonest or reckless, a criminal conviction. A director who contravenes his duties recklessly or dishonestly will be guilty of an offence and may be fined up to $200 000, and/or be imprisoned for up to five years.

Similarly, the Corporations Act imposes severe penalties - both criminal and civil - for insolvent trading. There are thus more than adequate provisions in the Corporations Act to keep directors up to the mark, and to severely punish those who fall below it. The argument that clause 67 is necessary to prevent directors trading while insolvent or otherwise acting irresponsibly by setting up phoenix companies in order to jettison taxation obligation to the community is unsustainable. Clause 67 is nothing more than a rather heavy-handed and crude mechanism to assist in the

collection of tax. It enforces payment by providing, as the only alternative to payment, the corporate death of a company, either through administration or liquidation, or the imposition of personal liability on all directors of the company concerned, regardless of their innocence.

It must be remembered that, while an assessment is often described as an unpaid tax liability, it is in reality nothing more than the opinion of an assessment officer in the Office of State Revenue about a company's liability to pay tax. It is a tax liability, not because it is, as a matter of law and fact, a liability, but rather, once a tax assessor forms an opinion that there is a liability and issues an assessment, by the combined effect of clauses 31, 33 and 45, the assessment is deemed to be a liability which must be paid whether or not it is disputed upon proper ground, and notwithstanding that it is the subject of appeal or objection. The assessment is unchallengeable, except through the long process provided for under the Bill, even if the assessment officer acted unreasonably or with reckless indifference to the legal requirements of the particular taxing Act or the facts of the case, because, under clause 31, the citizen's common law rights to challenge the correctness or the validity of the assessor's opinion are abrogated. Thus the company may be destroyed or its directors made liable by an erroneous or reckless assessment, because the Bill requires payment before the correctness or validity of the assessment is ever tested. This is surely unfair.

The institute submits that clause 67 should be withdrawn from the Bill in its entirety. If, however, the commissioner has the right to issue a notice under clause 67, there must be some reasonable check on his power to do so. The institute submits that the right to issue a notice should only arise after a court of first instance has upheld the assessment in whole or in part, or there is at least a means by which the company can seek judicial review of the assessment on a preliminary basis within a specified number of days of the commissioner giving notice that he intends to issue a notice to the company's directors under clause 67.

I now turn to clause 100. It is a fundamental principle of criminal law that the law punishes criminality only where there is a guilty mind. Indeed, that principle is embodied in section 24 of the Western Australian Criminal Code, which reads -

> A person who does or omits to do an act under an honest and reasonable, but mistaken, belief in the existence of any state of things is not criminally responsible for the act or omission to any greater extent than if the real state of things had been such as he believed to exist.
>
> The operation of this rule may be excluded by the express or implied provisions of the law relating to the subject.

Chief Justice Dixon of the High Court described this principle as the most fundamental element in a rational and humane Criminal Code. However, the principle is abrogated by clause 100. It is part of a regrettable trend in Australian legislation, which is indicative of the general attitude amongst state and federal Governments, that fundamental common law rights and privileges against incrimination are no longer a concomitant of Australian citizenship, but a gift of the state. The defences under clause 100(2), and to the limited extent that it may apply, under clause 104, while giving the appearance that it has alleviated the director from the draconian consequences of clause 100(1), do not, upon proper analysis, do any such thing.

[11.30 am]

A body corporate can commit an offence only through the agency of its individual officers and employees. Generally, whether a body corporate commits an offence depends on whether its officers or employees are charged with such a high degree of responsibility for the management of the company that they can be seen to be acting as the company rather than for the company. Under the Western Australian Interpretation Act a person is defined to include a company. That definition extends to every written law. It follows that the offences contained in sections 96 to 99 and elsewhere in the Act are to be read as extending to both the individual offenders and, if the individual offenders have the requisite degree of responsibility, usually executive directors and other senior executives, to the companies on whose behalf they act. Contravention of those sections renders the individuals and their companies guilty of an offence and liable to a fine of $20 000 or more. The burden of the fine falls directly upon the individuals actually concerned with the contravention and their companies and, indirectly, upon innocent shareholders. The institute submits that that mechanism is sufficient to ensure - and has historically been regarded as sufficient to ensure - compliance by the individuals concerned with the law, and compliance by the company to take reasonable responsibility for appointing executives who may be expected to act within the confines of the law. However, there is no justification for making - indeed it is wholly unreasonable to do so - fellow directors criminally responsible for the criminal acts of recalcitrant directors when they themselves were not involved in, or not even aware of, the commission of the offence.

The unreasonableness may be demonstrated quite simply: if the Premier of Western Australia were to commit a criminal offence whilst in office, would it be reasonable for every member of Cabinet, or indeed every member of Parliament, prima facie to be held criminally responsible for that offence? How comforted would the members of Cabinet or Parliament be by the availability of a defence that required them to prove that they could not reasonably have been expected to have prevented the commission of the offence by the Premier?

Hon PETER FOSS: I should have asked the officers, but I think the Office of State Revenue is never quite sure who commits an offence on behalf of the company. Some offences are offences of failure to do things and the OSR is never quite sure who failed to do something. Is there an alternative process by which state revenue can require people to name the person who did something or should have done something? You can see what state revenue's problem is; it has the difficulty of dealing with an amorphous group and of deciding whom to prosecute. We know it is the company but the company did not do it. Who would have done it? I agree that this legislation goes too far. I am asking if you have thought of a way of dealing with that.

Mr de Kerloy: Other than proper evidence gathering, there is probably not. Sometimes if legislation indicates that the company is strictly liable, the mechanisms that protect the State are a large fine against the company, then the directors of that company being brought to account by innocent shareholders by asking on what basis they fiddled the tax books to provoke the Commissioner of State Revenue to prosecute the company. It is going far too far to bring home criminal responsibility to entirely innocent directors.

Hon PETER FOSS: I agree with your proposition. I am looking at the Office of State Revenue's problem when it can prove that the company is guilty. It is faced with the practical problem of having to prove something, but only the people in the company can provide that information.

Mr de Kerloy: Perhaps. It may be resolved by giving the commissioner the ability to interview individual people within the company to see who was responsible for the act. That device is used by the Australian Securities and Investments Commission, which has in-camera hearings and can effectively subpoena people to appear to provide the information they want, which they then may use to advance a prosecution of the case. There are ways in which the commissioner could, whether under this Bill or with amendments to it, get to the people who are guilty. It is unreasonable and unfair for the commissioner to have a blanket right to hold everyone responsible. It will have a real impact on the willingness of honest people to serve. The reality is that dishonest people generally do not give a damn. Phoenix company directors should have been prosecuted and jailed. It was a lack of willingness on the part of the federal Commissioner of Taxation to apply its provisions that allowed phoenix companies to get away with their actions. There was plenty of provision within the Corporations Law and elsewhere that could have made those directors liable.

Hon PETER FOSS: Another concern raised by the taxation officer was ASIC's doing too little to prosecute directors so that the insolvency provisions could be used. Assuming there was some justification in the priority - I am not convinced of that - rather than making directors liable, we copied the ASIC provisions without requiring a prosecution as a precursor. In other words, directors would have had to knowingly continue to trade whilst insolvent. They could be charged retrospectively rather than prospectively. Prosecution would not depend on a federal process.

Mr de Kerloy: I can understand the state commissioner's point of view. He said that the Corporations Law contains very heavy penalty provisions but, effectively, the regulator does not take sufficient action because he is underfunded or whatever.

Hon PETER FOSS: It never has taken sufficient action as far as I know.

Mr de Kerloy: The regulator is much more active than it was. The present budget has given it an increase in regulatory capacity. It has been a problem. A provision could be included in this Bill, which would entitle the commissioner to chase the dishonest people. We would not have difficulty with that.

Hon GEORGE CASH: In your letter to this committee, you suggested that written submissions would be available by lunchtime today. Are you proposing to recommend any amendments? If so, we would be pleased to receive them in due course, especially having regard to what you said.

How does clause 100 - individual directors liability - compare with Corporations Law?

Mr de Kerloy: We would take the opportunity, if it were open to us, to make a suggestion that would, I think, give some check and balance to the exercise of the section 67 notice. I am suggesting that if it is not to be abrogated altogether, when the commissioner is about to issue the notice there must be some ability for the taxpayer to say, "Hang on a minute, we have a genuinely disputed assessment and before you issue your notice, which might have the effect of destroying the company or making a person liable, we want an independent person, even on a preliminary basis, to say whether the notice can be issued." That would quickly weed out the frivolous objections used as an attempt to delay the inevitable, and leave time for the genuine objections. A current, relevant example is the $67 million tax assessment issued to the Westralia Airports Corporation, which case is now in the public domain. That was done based on very poor information and it is being heavily contested. The first aspect of that can be tested insofar as an objection was lodged at the end of January.

Four months later, the commissioner is not even close to making a determination about the objection; yet under these provisions he could issue a notice and either force the company into administration or require it to pay. A company in that position would like to go to an independent tribunal, a judge or the taxation appeal board on the basis that it is not a frivolous objection but a genuine objection and it wants the notice held off until at least the objection is heard or the final determination is made.

Hon GEORGE CASH: Thank you for those comments. You will be pleased to know that this morning the Commissioner for State Revenue acknowledged that if there were an opportunity to improve the legislation he would be happy to listen and no doubt make recommendations to the Government. In that regard it would be very helpful if you could provide in due course any amendment you believe would improve any of the clauses, particularly clauses 67 and 100. We will take them up with the commissioner and the Government.

Mr de Kerloy: On your second point, I am not aware of any provision in the Corporations Law that deems fellow directors guilty of the acts of their fellow directors. There is a general duty on all directors to prevent insolvent trading. However, they have reasonably adequate defences insofar as they are able to establish that they relied on reasonable information to make decisions to cause the company to continue to trade. The current legislation does not have these checks and balances.

Hon GEORGE CASH: You referred to the removal of judicial review in regard to a number of issues. Will you expand on that area? Do you have any recommendations on providing judiciary review?

Mr de Kerloy: To answer that question, we must understand that there are two stages in which an assessment previously was capable of review. The first was the decision to issue the making of the assessment. That could often be done by a junior person in the Office of State Revenue. A preliminary question has always been whether the commissioner and his delegate, the junior assessor, had cast their minds to the fundamental elements of the particular taxing statute and whether there was a fundamental amount of information on which they could marry the two and make at least a preliminary assessment. That dealt with the validity of the process by which an assessment was made. It did not deal with the merits. The second stage, the merit stage, was often then dealt with at objection and appeal stages. On an objection, the commission would listen to all the objections and make a much more detailed review of what the taxpayer was saying and decide whether to allow the objection. In that process he also had discretion for whether he should, as a matter of the exercise of his discretion, extend the time for payment. The objection-determination stage was always the one that would be subject to proper appeal to the Supreme Court. Other mechanisms existed by which his decision to make the assessment in the first place or to extend time, even if only for a short time, or whatever, could be challenged. It was typically with the rather old-fashioned mechanism of prerogative writs.

In the federal arena we have the federal Administrative Appeals Tribunal, which has blown away all the technicalities about prerogative writs. It has simply said that if anyone has a problem with the exercise of a discretion or making a decision he can come to the tribunal on a fairly straightforward basis and explain those problems, and as a second check the tribunal will decide whether it was properly done.

The abrogation of every right to challenge every one of the decisions of the commission without any recourse at all will put the taxpayer at the mercy of the executive power of the State.

[11.45 am]

I cannot put it any more highly than that. We are not saying that there are malicious intentions or that the commission is out to get anyone. We are saying that people, quite genuinely, make mistakes. At that level the commissioner's decision ought to be reviewed and the simpler the process, the better. No-one is advocating a lengthy process in which a person goes through the Supreme Court. We would advocate a simpler tribunal process in which the decision can be reviewed at a preliminary level and a decision made quickly and cheaply as a preliminary check on the exercise of that power. That would be a great improvement in the legislation.

Hon PETER FOSS: You heard the suggestion of the Small Claims Tribunal. Non-reviewable decisions are dealt with fairly quickly. What about the Small Claims Tribunal, constituted by a magistrate, as a quick process for getting the non-reviewable decisions through?

Mr de Kerloy: It would assist the process if it were run by someone who was skilled in the Act. A magistrate could bring himself up to speed in that area, but a dedicated or competent person, whether he is from the magistracy or the District Court, should be appointed to deal with these matters quickly. We understand the commissioner's desire to get on and get paid and not be put off by spurious and specious arguments. However, as taxpayers and directors, we want to have the ability to go before someone quickly and cheaply and to even get the matter reviewed on the papers.

Hon PETER FOSS: The only reason I suggest that is that we do not want to set up a totally new process with reams of legislation. There is only one process that I know of where it could be done on the papers quickly and cheaply; that is, the Small Claims Tribunal that is constituted by a magistrate. Internally it would have to make sure it had somebody who became skilled in that area - there would be some people would not want that - but it is a pigeonhole that is already available and could be utilised.

Mr de Kerloy: Anything would be better than what is proposed at the moment, which is just a closed door.

Hon PETER FOSS: We may find the commissioner less keen on non-reviewable decisions if they all go off to the Small Claims Tribunal.

Hon GEORGE CASH: If you have any amendments in that area we would be interested to know of them. As Hon Peter Foss said, we use the Small Claims Tribunal only because it exists. It is more convenient for the Government to resort to what it has rather than establish a new structure. Perhaps, if the matter went to the Small Claims Tribunal in the first instance and it was found that it was not appropriate, something else might flow from that.

We seem to have covered clauses 67 and 100. I would be interested to know if Mr de Kerloy has any comment to make about clause 94 that deals generally with legal professional privilege.

Mr de Kerloy: That area will be covered by one of my partners who is a representative of the Law Society of WA and will be before the committee at 1.00 pm. He has spent more time on that issue and will be able to help you more rather than having me provide some half-baked view off the cuff.

Hon GEORGE CASH: No doubt you heard the Institute of Chartered Accountants say that it would be delighted if the same privilege was conferred upon it. I say no more.

Mr de Kerloy: We are struggling to maintain it in one group of professionals. To not only get it to remain in the legal profession, but also to extend it to the accounting profession is one step too far at this stage.

Hon GEORGE CASH: I am sure it was no more than a passing comment.

The CHAIRMAN: Thank you very much.