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For more information please contact: Ray Barrett on (03) 9428 1033

REFORMS TO ADDRESS CORPORATE MISUSE OF THE FAIR ENTITLEMENTS GUARANTEE SCHEME

The Federal Government has called for submissions from stakeholders for the purpose of undertaking a review of the Fair Entitlements Guarantee Scheme in the face of its growing cost to the taxpayer and perceived misuse of the scheme by corporations and advisors.

In the consultation paper, criticism is directed to phoenix activity and unregulated parts of the corporate insolvency advisory market.

We have made a submission in response to the consultation paper and we set out below a summary of the points we made:

Preliminary Points

Moral Hazard

The consultation paper makes reference to the moral hazard that the present FEG regime creates with particular reference to the actions of employers and their advisors in relation to the misuse of that regime. In our experience that point is well made.

The adverse outcome here is not just to the FEG scheme but also to ordinary unsecured creditors due to the subrogating effect of FEG standing in the shoes of employees in respect of the priority of claims

Generally speaking it is the unsecured creditors who have the least knowledge of the financial position of their customers. The economic effect of a company continuing to trade deeper into insolvency where all available assets are absorbed by priority creditors has an increasingly adverse impact on the returns to unsecured creditors. If those with the in-house knowledge, or at least an inkling of the adverse financial position of the company had taken steps to protect their own position the knock on effect to unsecured creditors is in our opinion likely to be reduced.

Accordingly, we suggest some measures be taken to place more of the risk of the adverse outcome of insolvent trading on those persons that have the greater access to knowledge. In relation to employees this could be done as follows:

1. Cap payment of annual leave at say 4 weeks. This will encourage employees to take annual leave during the course of employment and avoid an accruing liability,

2. Redundancy payments should be subject to a qualifying period of unemployment. For instance it is only payable say after 6 weeks of unemployment and evidence of job searching in the meantime. We note that s120 and 121 of the *Fair Work Act 2009* lends support to the policy position that redundancy payment be reduced where there are financial constraints.

NEW LEGISLATION

1. *Fair Work Act 2009* ('FWA")

   In light of our observations above perhaps s120(2) of the Fair Work Act ("FWA") could be amended to give FEG and the insolvency practitioner appointed to the employer standing to make application to Fair Work Commission ("FWC") for orders contemplated by s120.
   Perhaps the FWA could give some guidelines for the FWC to consider in relation to any such application such as the industry in which the employer operates its regional location

and the prospects of redundant employees being able to find work within the local area.

Such amendments may require an amendment to the priority provisions of the Corporations Act so that any determination of the FWC has its intended outcome.

OTHER REFORMS

Director Identification Number

We observe in court liquidations the inability to identify the director. In the result books and records and RATA are not obtained. A Director identification number and a Verification of Identity regime similar to that which is now established in respect of Land Titles Office transactions in Victoria should be introduced.

INCOME TAX ASSESSMENT ACT 1997

A company is not entitled to a deduction as against its taxable income provisions in respect of employee entitlements. In essence, they become a tax deduction when paid.

It is true that a company may make provision for these accruing expenses from an accounting perspective but even if this does occur inevitably those provisions are insufficient and cash trading losses soon absorb any working capital that may have supported the provisions.

We suggest that amendments to the ITAA 1997 be considered to allow employers to obtain a tax deduction in respect of some or all of those provisions.

An alternative is to amend the ITAA to allow employers to establish employee benefit trusts into which funds can be paid in respect of accruing entitlements, the tax deduction being allowed in the year of payment to the fund.

Presently the ATO attitude to such structures is restrictive with the costs of establishing the legal structure and the relative uncertainty of them being a significant disincentive to their use. We cannot see why such funds cannot be as popular and useful as SMSF as in a sense they are doing like jobs - that is providing support to employees through one of life's significant transitions.

We accept that there are approved worker entitlement funds but as these require ATO approval they are not and will not be common place for many employers. This is a disincentive for employers to establish low cost flexible arrangements.