

New penalties for avoiding employee entitlements

The Commonwealth Government has introduced legislation targeting the misuse of the taxpayer-funded Fair Entitlements Guarantee (FEG) scheme by directors, officers and related entities of insolvent companies.

FEG is a government-run, taxpayer-funded scheme under which employees of companies which are in liquidation can apply to have certain unpaid entitlements paid out.

The FEG scheme is vulnerable to misuse by persons who seek to structure their business affairs so as to avoid paying employee entitlements, including by way of phoenix activity. Phoenix activity occurs where the assets of an insolvent company are transferred to a new corporate entity, allowing the new company to recommence the same business activities while leaving liabilities, including unpaid employee entitlements, in the insolvent company. In this way, phoenix activity results in more employees accessing the taxpayer-funded FEG scheme to recover their unpaid entitlements.

The reforms which are contained in the *Corporations Amendment (Strengthening Protections for Employee Entitlements) Act 2019 (Act)* include new penalties for directors and related entities who deliberately structure their business affairs to avoid paying employee entitlements.

The amendments to the *Corporations Act 2001* include:

- new and stronger penalties and compensation options against company directors who avoid their obligations to pay employee entitlements;
- new powers to disqualify directors who have been involved in multiple insolvencies where employees have resorted to the FEG scheme for payment of their unpaid entitlements; and
- new options to seek contributions from related entities to recover unpaid employee entitlements.

The new provisions are summarised below.

Criminal offence

It is an offence to intentionally or recklessly enter into agreements or transactions which avoid, prevent or significantly reduce the recovery or amount of employee entitlements (**Arrangement**).

Individual penalties

- 10 years' imprisonment; and/or
- A fine the greater of:
 - 4,500 penalty units (currently \$945,000); or
 - where the Court can determine the total value of the benefit obtained by committing the offence - 3 times that value.

Body corporate penalties

- A fine the greater of:
 - 45,000 penalty units (currently \$9,450,000);
 - where the court can determine the total value of the benefit obtained by committing the offence - 3 times that value; or
 - 10% of the body corporate's annual turnover during the 12-month period ending at the end of the month in which the body corporate committed or began committing the offence.

Compensation orders

If:

- a person (including a company) enters into an Arrangement; or
- an officer of a company causes the company to enter into an Arrangement, and

that person or officer knew, or a reasonable person in their position would know, that it was likely to avoid, prevent or significantly reduce the recovery or amount of employee entitlements, that person will be liable.

Compensation

- Such a person is liable to compensate the company (by its liquidator) or the affected employees (or FEG).

Civil penalties

- The Court can order penalties of up to \$200,000.

Contribution orders

New type of order:

- Related entities of companies in liquidation can be ordered to make contributions for the payment of outstanding employee entitlements of the insolvent company in certain circumstances (**Related Entity**).



Contribution order groups:

- The new orders only affect companies in 'contribution order groups'.
- Contribution order groups are groups of companies based on corporate control, and tax and financial reporting obligations.



When orders may be made

- Orders may be made on the application of a liquidator - and with leave of the Court, the Australian Taxation Office, Fair Work Ombudsman and the Secretary of the Department administering the FEG scheme.
- The Related Entity must have benefitted, whether directly or indirectly, from the labour of the employees of the related insolvent company (other than on arms-length terms).

Director disqualification

A person may be disqualified from managing corporations where, within the past seven years, the person has been an officer of two or more corporations which have had employees rely on the FEG scheme and there has been a history of involvement in:

- corporate contraventions, such as insolvent trading;
- insolvencies, such as liquidation and voluntary administration; and
- inappropriate reliance on the FEG scheme where the Commonwealth has received less than a 10% return on the advance.



ASIC disqualification

- ASIC may disqualify persons for up to 5 years.



Court disqualification

- The Court may disqualify persons for a period it considers appropriate.



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