ABUSE OF THE CORPORATE FORM: REFLECTIONS FROM THE BOTTOM OF THE HARBOUR

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I. INTRODUCTION

1. *Crime and the Small Company*

> In all the experience of the law, there has never been a more prolific breeder of fraud than the one man corporation.[1]

It is now five years since the McCabe/La Franchi report[2] stirred the fiscal conscience of the nation. Followed not long after by the revelations of a number of the Costigan Royal Commission reports[3] and the Stewart Royal Commission into Drug Trafficking,[4] their combined effect was to reveal wrong-doing on a previously unimaginable scale and to destroy, perhaps forever, the myth of the separation between blue and white collar crime. In the years since, painstaking investigations by a number of agencies, including the Australian Federal Police, the Australian Taxation Office, the National Crime Authority and the Director of Public Prosecutions have exposed the intricate details of what is perhaps the largest series of frauds in Australian criminological history. Many of these investigations are still under way and the tortuous process of committal and trial of the major parties involved in what came to be known as the 'bottom of the harbour' tax evasion

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1 *Pepper* v. *Litton* 308 US 295, 313 (1939).
2 P.W. McCabe and D.J. Lafranchi, *Report of Inspectors Appointed to Investigate the Particular Affairs of Navillus Pty Ltd and 922 Other Companies* Melbourne, Government Printer, 1982.
3 F. Costigan, *Report of the Royal Commission on the Activities of the Federated Ships Painters and Dockers Union* AGPS, Interim Report No. 4, vol. 1, 1982; Final Report, 1984.
4 *Royal Commission of Inquiry into Drug Trafficking*, AGPS 1983.

conspiracies is underway. Nevertheless, it is already possible to discern some of the disturbing features common to many of the cases and to begin to draw some conclusions regarding the nature and form of one aspect of modern white collar crime in Australia. This can be done through a study of the reported and unreported cases which have touched upon various aspects of these matters, of court transcripts and documents and of the surprisingly sparse secondary materials.

This article focuses upon just one aspect of the bottom of the harbour phenomenon — the use or abuse of the corporate form and in particular that of the small, limited liability company. The research literature on white collar and corporate crime is overwhelmingly concerned with the behaviour of large corporations.[5] This is understandable; public companies are generally economically more significant and, more prosaically, the availability and diversity of data renders them more amenable to investigation.[6] Yet there is evidence that illegality by small companies[7] is widespread and endemic[8] and that the economic harm caused is considerable.

The phrase "crime and the small company" is perhaps misleading. Some of the abuses discussed in this paper do not necessarily involve illegality, either civil or criminal, but reveal how present, often inadequate, laws can be stretched or manipulated for anti-social purposes, how, by carefully operating in the grey areas of the law, regulation can be emasculated or avoided altogether. "The question is how is it possible for such manipulation, use and avoidance to be both possible and legitimate?"[9] It is, of course, the lawyers and accountants who are the most artful exploiters of the corporate form and who, not surprisingly, are now in the dock, involuntary cartographers of the boundaries between the legitimate and the illegitimate, between crime and non-crime and perhaps even between right and wrong.

2. *The Limited Liability Company*

A company is a "legal"[10] person. It can be conjured up by one person through "incantations by typewriter, the obtaining of two signatures,

5 A. Sutton and R. Wild, "Small Business: White Collar Villains or Victims?" (1985) 13 *Intl J Soc Law* 247.

6 D. Yum, *Control of Exempt Proprietary Companies — A Case for Change* Unpublished M.Ec. Thesis, University of New England, 1984.

7 A "small company" as used in this article means an exempt proprietary company [EPC], defined in s.5(1) of the Companies Code (1981) as a proprietary company no share in which is, by virtue of ss 5(5) and 5(6) deemed to be owned by a public company and no member of which is a public company; see also s.34 which describes a proprietary company as a company having a share capital but which restricts the right to transfer its shares, has no more than 50 members, prohibits any invitation to the public to subscribe for shares or debentures in the company and prohibits any invitation to the public to deposit money with the company.

8 New South Wales, Department of the Attorney-General and of Justice, Bureau of Crime Statistics and Research, *Research Report No. 4 Company Investigations 1975-1977* July 1978.

9 D. McBarnet, "Law and Capital: The Role of Legal Form and Legal Actors" (1984) 12 *Intl J Soc Law* 231, 234.

10 In contrast to a "natural".

payment of fees and compliance with formalities"[11] and like John Doe and William Roe of old, it plays a vital part in the construction of the complex web of fictions upon which our legal system is built. The modern limited liability company is a creature of the mid-nineteenth century[12] although of course the history of group enterprise and limited liability can be traced back to Greek and Roman law.[13] The prime object of the development of this corporate form was to facilitate fund raising, to "enable capitalists to carry on commercial speculations in numbers beyond what the ordinary machinery of the law could deal with."[14] For a number of reasons, the concept took hold only slowly[15] but, by the mid 1880's (which were years of economic depression) it gradually claimed the imagination of the business public. In 1897, the House of Lords enshrined the concept that a company's legal entity was separate and distinct from that of its members[16] and sanctioned the view that individual trading with limited liability was legitimate. Ireland comments:

> *Salomon* legitimated the adoption of the company legal form by individual proprietorships and small economic partnerships, validating their acquisition of the privilege of limited liability. It paved the way for the triumph of the company legal form.[17]

But even from the earliest days of the new Companies Act it became apparent that the primary motive of incorporation was not the raising of capital but the desire for emancipation from the "tyranny of unlimited liability".[18] More than a century later this remains truer than ever. Increasingly, companies are not created to facilitate the accumulation of capital for the purposes of private, productive enterprises, but for the purpose of protecting accumulated wealth by placing it out of reach of creditors, in particular, in the cases examined below, the Commonwealth. As well, in the last decade, the ancient device of the trust has been coupled with the limited liability company to create a "commercial monstrosity" whose scope for frustrating creditors has been considerable.[19]

The popularity of the company continues to grow unabated. Although it is difficult to obtain precise date as to the number and type of companies in Australia, a table compiled by Yum provides the following picture:[20]

11 *Peate* v. *Federal Commissioner of Taxation* [1965] ALR 352, 361 *per* Windeyer J.
12 P.W. Ireland, "The Rise of the Limited Liability Company" 12 *Intl J Soc Law* 239.
13 See note 8 *supra*, 4; L.C.B. Gower, *Principles of Modern Company Law* (4th ed. 1979), Chs 2 and 3; T. Hadden, *Company Law and Capitalism* (2nd ed. 1977) 9ff.
14 *Oakes* v. *Turquand* (1867) LR 2 HL 325, 365 *per* Lord Cranworth.
15 See generally note 12 *supra*.
16 *Salomon* v. *Salomon & Co Ltd* [1897] AC 22.
17 Note 12 *supra*, 255.
18 F.B. Palmer, *Private Companies* (11th ed. 1901) 6, cited in note 12 *supra*, 248.
19 H.A.J. Ford, "Trading Trusts and Creditors' Rights" (1981) 13 *MULR* 1.
20 Note 6 *supra*, 120.

TABLE I
Companies Registered as at 30 June 1983

	LIMITED BY SHARES PUBLIC	LIMITED BY SHARES PTY	LIMITED BY GUARANTEE	NO LIABILITY	UNLIMITED	TOTAL
ACT*	530	15 833	12	36	7	16 528
NSW	1 843	209 166	3 948	130	257	215 344
QLD	525	79 446	724	29	**	80 724
SA	439	39 340	50	22	116	39 967
TAS	103	8 665	210	16	4	8 998
VIC	2 169	161 737	751	93	257	165 007
WA*	991	48 566	48	160	12	49 777
	6 600	562 753	5 853	486	653	576 345

Source: NCSC Fourth Annual Report and Financial Statements, 1 July 1982 to 30 June 1983, 9.
* Estimated
** Included in total for proprietary companies.
Total public companies = 7 086

The Victorian Corporate Affairs Commission has provided the following data:[21]

TABLE II
Companies Registered in Victoria

DATE	PUBLIC (LIMITED BY SHARES AND GUARANTEE)	PUBLIC (NO LIABILITY)	PROPRIETARY (EXEMPT AND NON-EXEMPT)	TOTAL
30.6.83	2 920	93	161 994	165 007
30.6.84	3 203	92	170 064	173 359
30.6.85	3 169	76	180 480	183 725
30.6.86	3 333	80	190 313	193 726

The number of companies in existence, and being incorporated or de-registered yearly, places a great administrative burden upon Corporate Affairs Commissions. The number of companies registered and de-registered annually in Victoria is shown in Table III.

21 Personal communication, Commissioner for Corporate Affairs, 14 July 1986. As at 30 June 1984 there were 224 303 companies registered in New South Wales, 84 967 in Queensland, 41 036 in South Australia, 52 162 in Western Australia, 8 933 in Tasmania, 9 500 in the Northern Territory and 16 903 in the A.C.T.: see P. Grabosky and J. Braithwaite, "Of Manners Gentle: Enforcement Strategies of Australian Business Regulatory Agencies" Melbourne, O.U.P., 1986, 17. For United Kingdom data see Hadden, note 13 *supra*, 38-41. For statistics regarding the growth in the number of companies post-1895 see note 12 *supra*, 244. In England and Wales the number of private companies jumped from 189 575 in 1946 to 547 825 in 1975. In 1981 there were over 700 000 limited companies: G.R. Sullivan, "Company Controllers, Company Cheques and Thefts" [1983] *Crim L R* 512. Private companies made up 97% of all companies.

TABLE III

Companies Registered and De-registered in Victoria, 1975-1986

DATE	REGISTERED	DE-REGISTERED
30.6.75	4 840	Not available
30.6.76	9 694	Not available
30.6.77	14 122	Not available
30.6.78	10 647	Not available
30.6.79	11 138	2 677
30.6.80	12 024	2 738
30.6.81	18 370	2 535
30.6.82	19 578	2 850
30.6.83	10 550	1 879
30.6.84	12 169	4 288
30.6.85	14 589	4 024
30.6.86	15 658	5 657

Source: Personal communication, Commissioner for Corporate Affairs, 14 July 1986.

Although the small company has many legitimate uses[22] this article focuses upon two major aspects of the illegitimate use of the corporate form. The first is the use of the company in the perpetration of frauds and other offences and the second is the use of companies to shield individuals from personal, financial or other responsibility.[23]

3. Investigation of Corporate Abuse

Corporate crime has been resistant to investigation for a number of reasons. It shares with white collar crime in general the problems of legal and moral ambiguity and the difficulty of determining the borderline between acceptable and unacceptable conduct. These boundaries are often changeable, being the product of changes in legislation, judicial decisions and business practices. As Hadden observes, there is a continuum between legitimate and illegitimate conduct.[24] For example, when does remuneration

22 Apart from tax planning, such advantages include stability and permanency of the business structure, perpetual succession, flexibility of membership, limited liability and others: See Companies and Securities Law Review Committee, *Forms of Legal Organisation for Small Businesses* 1986, 4-5.

23 R. Baxt, "Commentary on The Use of the $2 Company for Family Planning and Related Activities" in *The Abuse of Limited Liability?* Monash University, Faculty of Law, (1983), 36.

24 T. Hadden, "Fraud in the City: The Role of the Criminal Law" [1983] *Crim L R* 500, 501; see also G.R. Sullivan, "Fraud and the Efficacy of the Criminal Law: A Proposal for a Wide Residual Offence" [1985] *Crim L R* 616, 620.

become "excessive"? What is the "real" value of an asset for the purposes of sale? At what time does a business become insolvent? A cynical view of the under-enforcement of corporate law holds that the law is merely symbolic and that in fact there is no desire to detect, investigate and prosecute white collar criminals. There may be some truth in that, but, more likely, when it comes to major corporate crime;

> the complexity of corporate affairs and corporate structures, the number of interlocking companies that may be involved, the multiplicity of transactions in which many people may play a part, the vast documentation which may have existed but which may or may not now be in existence[25]

all act as formidable deterrents to potential corporate crime-busters. To give just one example, in one case presently before the courts on a preliminary examination, more than 50 000 documents were tendered by the prosecution. Only agreement between the parties ensured that the hearing would be concluded within a reasonable time.[26]

Corporate fraud is not high on the agenda of reformers of company law. Neither the recent report of the Companies and Securities Law Review Committee on *Forms of Legal Organisation for Small Businesses* [27] nor its antecedent Discussion Paper (1984), dealt in any detail with the problem of abuse of the corporate form other than dealing with the question of protection of creditors. The major company law texts deal almost grudgingly with the issue of piercing the corporate veil, but the general question of crime and the corporation is rarely addressed. Only gradually are the ramifications of the bottom of the harbour cases manifesting themselves in the legislative sphere, but even so, it is fair to say that:

> [a]gencies are ... left with a ragbag of weapons, some of which are akin to the blunderbuss and others to a toothpick, to deal with some of the most complex offences and sophisticated offenders that are likely to be encountered in the whole field of the criminal law.[28]

Corporate Affairs officers do not see themselves as being in the business of prosecuting criminals. The task of keeping tabs on the nearly 200 000 companies in Victoria alone is overwhelming. The McCabe/La Franchi and Costigan reports have revealed that enforcement mechanisms are hopelessly inadequate but especially so in relation to the bottom of the harbour companies. To this day companies directly or indirectly involved in the bottom of the harbour frauds have failed to lodge returns and remain unprosecuted. Shortages of staff, inadequate equipment and lack of funds

25 J.B. Goldrick, "Comment" in Sydney University, Institute of Criminology, *Corporate Crime* No. 19, 9 May 1974, 111.

26 *Currie* v. *Sheehan and Saunders* Melbourne Magistrates' Court 21 July 1986. The defendants in this case were involved in processing at least 700 to 800 companies through tax avoidance schemes. In a period of six years, just one liquidator, associated with the defendants, was professionally involved in the liquidation of about 2 000 companies, and about 1 100 of these were involved in tax avoidance schemes: see *Commonwealth* v. *O'Reilly* (1984) 8 ACLR 804, 807.

27 Note 22 *supra*.

28 *Id.*, (1983), 503.

have all been cited as reasons for inadequate enforcement.[29] Jurisdictional problems were also a contributory factor in that investigation and prosecution of breaches of corporate law are a State responsibility whereas the frauds were committed against the Commonwealth Government.[30] However, a major reason for the lack of rigorous enforcement may well be that the ideology of "regulation" which prevails in agencies such as the Corporate Affairs Commission is not consonant with an aggressive prosecution/deterrent orientation. This problem may be exacerbated by the fact that, faced with the massive task of regulating companies, the Government has, in the name of efficiency and "deregulation", degraded the prosecution process even further by introducing a penalty notice procedure into the Companies Codes[31] which equates offences such as failing to lodge returns with parking tickets and failing to obtain dog licences. This "dejudicialisation" of the procedure of adjudication and enforcement can only serve to encourage corporate deviance.

II. FORMS OF ABUSE

1. Abuse of Limited Liability

It has been argued that the major purpose of incorporation is the insulation of investors from the claims of creditors.[32] In *Commissioners of Inland Revenue* v. *Sansom*[33] the Master of the Rolls said that:

> the great reason why so many people form their businesses into limited companies and others invest their money in them is in order that they may be under no personal liability in respect of the transactions of those companies, and that is a perfectly legitimate object...[34]

The problem for creditors inherent in the principle of limited liability was obvious from the time this scheme was first proposed in the early nineteenth century. However the interests of creditors as a class were outweighed by the interests of entrepreneurs and promoters for whom limited liability was a boon.[35] The effect of limited liability is, of course, to shift the burden from

29 J. Telfer, "The Policing of Companies Including Some Comparisons of the Victoria and New South Wales Corporate Affairs Commissions" (1983) 1 *Coys & Sec L J* 243. See also Note, "Changes at Corporate Affairs" (1986) 60 *L Inst J* 1048. The Victorian Attorney-General, Jim Kennan attributed the poor performance of the Corporate Affairs Office to lack of computerisation and jurisdictional demarcation disputes between the Australian Taxation Office and the Corporate Affairs Office: *Ministerial Statement on the Operation of the Co-operative Companies and Securities Scheme* Victoria, Legislative Council Hansard, 16 October 1985, 316-325.

30 The secrecy provisions of the Income Tax Assessment Act 1936 (Cth) as it then stood was a barrier to the free flow of information between agencies. On the difficulties of the national co-operative scheme presently in force see Grabosky and Braithwaite, note 21 *supra*, 10-26.

31 S. 570A. This allows the National Companies and Securities Commission to serve a penalty notice upon anyone believed to have committed a prescribed offence against the Code. For a description of the penalty notice system in Victoria and proposals to apply the procedure to over 200 offences under the Companies Code see "Changes at Corporate Affairs" note 29 *supra*, 1049.

32 *Anderson* v. *Abbott* 321 US 349, 361 (1943) *per* Douglas J.

33 [1921] 2 KB 492, 500 *per* Lord Sterndale M.R.

34 *Ibid.*

35 See W.E. Paterson, H.H. Ednie, and H.A.J. Ford, *Australian Company Law* (3rd ed. 1981) para. 33/31.

investors to creditors. The extent of that burden can be gauged from the following data.

In 1984, in Victoria alone, some 700 companies went into liquidation leaving combined deficiencies of approximately $150 000 000.[36] Of course not all of these failures involved fraud or illegality, but in 1974, a survey of liquidators' reports relating to 2 587 companies wound up between 1962 and 1973 revealed that approximately 25% involved allegations of offences against the Companies Act or the Crimes Act.[37] Olsen noted (and these are in 1973 dollars) that in these windings up:

> [t]he total deficiencies of those companies are in the vicinity of $151,000,000. There were $116,000,000 which were estimated deficiencies in court windings up coupled with $22,000,000 in creditors' voluntary windings up taken from Statements of Affairs and when you consider that all of the companies which were wound up and which did not lodge Statements of Affairs it is conceivable that the figure is closer to between $160,000,000 and $170,000,000.[38]

The New South Wales Corporate Affairs Commission reported in 1977 that estimated deficiencies of assets to unsecured creditors, as disclosed in the Statements of Affairs lodged with the Commissioner, was $15 505 315 for 105 companies investigated during 1977.[39] Sutton's work for the New South Wales Bureau of Crime Statistics and Research showed that 46% of companies investigated had a paid-up capital of less than $1 000. He also found that companies who were suspected of trading offences or frauds generally had a low paid-up capital.[40]

A study by Yum[41] of failed companies revealed that 60% had less than $1 000 paid-up capital. Only three of 130 companies had more than $100 000 paid-up capital. In 49% of the cases examined, the deficit was greater than twenty-five times the amount of proprietor investment reflected in paid-up capital and director/shareholder deposits. Yum estimated the total annual deficit of exempt proprietary companies wound up in Australia in 1979 at approximately $327 000 000. For Victoria the amount was over $84 000 000. It is of interest to note from Yum's study that the Tax Commissioner was the petitioning creditor in 38% of the cases.[42]

(a) Limited Liability and the Bottom of the Harbour Frauds

The charge of conspiracy to defraud the Commonwealth[43] forms the basis for prosecutions in almost all of the cases so far brought before the courts.

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36 *Ministerial Statement* note 29 *supra*, 320.
37 P.T. Olsen, "Comment" in Sydney University, Institute of Criminology, *Corporate Crime* No. 19, 9 May 1974, 102.
38 *Ibid.*
39 See J. Dixon, "The Disclosure of Corporate Financial Standing — Can the Companies Act Protect the Community from Corporate Insolvency?" (1979) 7 *A Bus L Rev* 199, 200.
40 Note 8 *supra*, 28, 46.
41 Note 6 *supra*, 92.
42 *Id*, 101.
43 Crimes Act 1914 (Cth) s. 86.

The thrust of the charges is the allegation of an agreement between the parties to leave companies about to come under large tax liabilities with no assets with which to pay that liability. The major argument advanced on behalf of the defendants has been that the schemes were simply legitimate tax avoidance schemes and that they honestly believed, given the climate of judicial opinion at the time, that the scheme would be found to be lawful and that therefore no tax would be payable. However, the courts have held that the essence of the illegality, of the unlawful criminal conspiracy, lies in the intention to render the companies *absolutely unable to pay* in the event that the scheme would be challenged and fail. The companies remaining were, of course, mere empty shells, bereft of funds, except the $2.00 paid-up capital. In the case of *R* v. *Beames* [44] Fullager J. described one such conspiracy in more detail:

> [i]t was in essence perfectly simple. It was in essence to remove all its assets from the legal entity which was about to come under a large liability for income tax, and then to make that entity difficult, if not impossible, to trace and to put into control of the entity persons who had no assets. A promoter of the scheme would approach the director/shareholders of a substantial company, usually of the large family business kind, where the company had large current profits about to attract a large amount of income tax. The company, conveniently called the target company, would be caused by the director/shareholders to sell all its assets to a new company formed by the director/shareholders of the target company for the purpose of carrying on in the future all the business of the target company with all its assets. After the contract of sale and after transfer of the assets thereunder, but before payment of the price, the shareholders of the target company would sell their shares in the target company to the promoter of the scheme, or rather to a company of his, who thus came into control of a company, namely, the target company, the only substantial asset of which was its contractual right to recover a price in money from the new company of the vendor shareholders. A bank would advance for the promoter a sum which was then paid by him or by some company of his to the shareholders in the target company. The shareholders would lend the sum to the new company which would use the sum to pay to the target company the price of the latter's assets. The target company would have the sum stripped off it by dividend stripping out into the hands of the promoter's company or companies which would then pay off the bank. All the payments were done in one transaction by a "Round-Robin" of cheques but with a variation in the sums transferred which constituted in substance a high fee to the promoter from the vendor/shareholders ... These essentially simple transactions were done in a most complicated way through the medium of a screen of companies. With respect to the target company, and its assets, false trails were laid for future investigators by the use of false returns, falsified records, lost documents and changing of company names. Finally the target company, by now a taxpayer with a changed name and liable for a large amount of income tax, was "dumped", that is to say, persons of straw were paid money as consideration for executing masses of documents upon the lodging of which they became the only shareholders and directors of the target company, and more often of numerous target companies, of the existence of which they had then been completely ignorant. In many cases the "Dumpee" of a large number of target companies became such by "signing up" as director and transferee/shareholder of a holding company whose numerous subsidiaries were all thoroughly milked and worthless target companies.[45]

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44 Unreported, Supreme Court of Victoria, 23 September 1985.

45 For a description of a similar case see *Silbersher* v. *Gerkens* (1984) 13 A Crim R 1.

The effect of the impecuniosity of the companies was, as McCabe/La Franchi noted, to deter enforcement by the Australian Tax Office because that Office was of the view that further investigations into these companies would merely result in a throwing away of costs.[46]

2. Fraud

Whincup has observed:

> [i]n the company law context, as elsewhere, fraud is a most difficult expression to define. Certainly, fraudulent conduct goes far beyond deliberate attempts to deceive and extends to many transactions which are strictly speaking within the law but may none the less properly be condemned as 'sharp practice'. The task of definition is further complicated by our having to accept immediately that the whole point and purpose of incorporation is to enable individuals to evade trading liabilities which they would otherwise incur. That motive and that result cannot alone infringe the law.[47]

A company is not, of course, essential for the perpetration of fraud[48] but there are a number of reasons why companies may be used as vehicles for fraud.[49] First, a company is a common form of business organisation and shelf companies can be cheaply and conveniently acquired. The paid-up capital is minimal and the corporate entity provides a veneer of "respectability and prosperity".[50] Secondly, because the company has perpetual succession, then even though directors, shareholders and secretaries may change, those dealing with the company may believe that they are dealing with the same people. Thirdly, there is the advantage of limited liability. Fourthly, as will be seen below, companies are easy to manipulate and the rules and regulations regulating the small company are easy to flout. Finally, there is the ability to disguise asset and cash transfers under the guise of loans, remuneration and, where a company is trading, at least in part legitimately, there is the ability to legally and illegally obtain funds.

The bottom of the harbour cases are, in a sense, the mirror images of one of the oldest types of corporate abuse, the trading fraud. A trading fraud (or bankruptcy fraud or long-firm fraud) occurs when company directors or managers, sheltering behind the principle of limited liability, continue to incur debts knowing that the company will be unable to pay. In the process a wide range of creditors, including customers, suppliers, debenture holders and financial institutions, may be defrauded.[51]

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46 Note 2 *supra*, Vol. 1, 27.

47 M. Whincup, "'Inequitable Incorporation' — The Abuse of a Privilege" (1981) 2 *Coy Lawyer* 158, 164.

48 Other than for the offence of fraudulent trading.

49 See L.H. Leigh, *The Control of Commercial Fraud* (1982) 16-18.

50 *Id.*, 16.

51 See note 8 *supra*, 39; Hadden, note 13 *supra*, 284.

Meagher has described these "bankruptcy frauds" in the following terms:

> [a] company is established with some capital and commences operating a business. In the first few weeks of the business moderate orders are placed for goods, and payment is made promptly. The confidence of the supplier is established. Then more substantial orders are placed. The goods are diverted to another business conducted by the criminal organisation with no records being kept; or alternatively sold by the company with the profits being syphoned off prior to payment of the bill. At the same time the company purports to borrow heavily from other members of the criminal organisation and secures the borrowing with a debenture. The money "borrowed" is immediately applied towards some purpose that is to the benefit of the criminal organisation. A call is made under the debenture for the repayment of the money, it is not repaid and a "friendly" receiver appointed. The amount due under the debenture is by far the most substantial "debt" and the other creditors commence a write off of the monies due to them as a "bad debt". Occasionally a substantial legitimate creditor may complain and may embark upon liquidation proceedings but more often they are deterred by the cost of those proceedings where there is little likelihood of any financial recovery. In due course the receiver arranges the sale of the company as a "tax loss" and some composition is reached in which the creditors, grateful for the crumbs, accept a few cents in the dollar for their debts.[52]

The Cork Committee in the United Kingdom also noted general dissatisfaction with the law in this area. They were of the view that trading fraud of this kind was an urgent problem which demanded immediate attention before the law fell into even greater disrespect and contempt. Quoting from written evidence submitted by a divisional Consumer Protection officer of the South Yorkshire County Council they stated:

> [t]he doctrine of limited liability may have its good points, but it also leads to some indifference and lack of concern when company officials know that if the company goes down, they will not have any financial liability ... There are many fraudulent practices concerned with the formation and liquidation of companies. Companies are formed, debts run up, the assets milked and the company put into liquidation. Immediately a new company is formed and the process is repeated *ad infinitum.* Associated with the basic fraud is the practice of new companies buying the remaining stock of the old company [from the liquidator] at give-away prices, taking on the premises complete with fittings which are unpaid for, again at nominal prices.[53]

Another form of fraud has been identified as the management fraud, that is, the illegitimate exploitation of the assets of the company which is made possible by the close identity between the company and its officers.[54] Corporate officers may take advantage of the company in numerous ways. Amongst the most common methods which emerged from the bottom of the harbour cases and their aftermath were:

(a) Loans: the practice of making inter-company loans was central to the 'round robin' nature of the schemes, which required the same funds to be channelled through a series of companies within a short period of time to give the appearance of acquisition and disposal of assets.[55] Many

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52 D. Meagher, *Organised Crime* AGPS, (1983) 43.

53 *Report of the Review Committee into Insolvency Law and Practice* (Cork Committee) London, HMSO 1982, Cmnd 8558, para. 1741; see also note 49 *supra*, Ch.2; M. Levi, "Giving Creditors the Business: The Criminal Law in Inaction" 12 *Intl J Soc Law* 321.

54 See Sullivan, note 24 *supra*, 620.

55 Some of these loans may well have been in contravention of what used to be s. 67 of the Companies Act 1961 (Vic.) which prohibited a company from directly or indirectly purchasing its own shares.

of these 'loans' were quite clearly not in the interests of the companies concerned, being unsecured, interest-free and not supported by loan agreements or recorded in company minutes. The laundering of personal income through companies by means of loans and the making of loans to company controllers either without interest, or at low interest was common.

(b) Appropriation of company property: there are countless instances in the bottom of the harbour cases where the personal living expenses of directors and shareholders were met by the company, often by the use of credit cards in the name of the company as well as by the simple expedient of writing cheques on the company bank account for such expenses as children's school fees, swimming-pool maintenance and clothing.

(c) Transfer of assets: exorbitant fees, emoluments, retirement benefits, purchase options and incentive schemes were all used as vehicles for transferring the company's assets to those associated with it.

(d) Unrealistic asset valuations: perhaps the finest example of the transfer of assets at inflated prices is found in the Norfolk Island Public Art Gallery Scheme. The gallery was a gallery only in name and was established solely to function as part of a tax minimisation scheme which required 'donations' to be made to a public art gallery. Through a series of sales between associated entities the price of paintings originally purchased from a legitimate gallery for $5 400 was inflated to $60 000 000 for the purpose of the scheme.

3. Concealment of Wealth

The use of the corporate form to facilitate the perpetration of the conspiracies to defraud represents merely one aspect of the problem of abuse of the corporate form, namely the illegal acquisition of wealth. The second aspect relates to the proceeds of the schemes. Promoters charged from between 3% to 15% of the tax evaded as fees and in some cases the benefits have been estimated at up to $5 000 000. These funds were, in turn, channelled through a network of companies and trusts either directly or indirectly controlled by the defendants. Often these companies, themselves put through the tax minimisation schemes, would completely fail to lodge income tax returns or would lodge returns with nil incomes stating only that the company acted as trustee and derived no income for itself beneficially. The Australian Tax Office has had considerable difficulty in determining the persons or entities for whom or which these companies allegedly acted as trustees.

Both the Costigan Royal Commission[56] and the Stewart Royal

56 Note 3 *supra*, 1984, Vol. 2, para. 2.017.

Commission[57] have commented adversely on the phenomenon of criminals concealing their assets behind company facades, nominee proprietors and multiple trusts both within and without Australia.[58] The Stewart Royal Commission described how shareholders in one company were other companies with the holdings following a circular pattern and how the tracing of ownership of the shares was made difficult because the Declaration of Trust in relation to the ownership of shares was held in secret and was not on the public record. The Commission also noted that nominee companies acted as directors to provide confidentiality for directorships. The Commission noted:

> [t]he use of overseas trusts by criminals can create a hazard to the investigative accountant. Some firms of solicitors/accountants in Hong Kong operate a "mo meng" trust scheme. "Mo meng" essentially means "no life" or "no name" and is a facility for an individual to hide assets. The trust does not contain the name of the individual and so has "no life" or "no name". The name of the beneficiary of the trust is known only to that beneficiary and the persons who set up the trust. Information on the trust can only be accessed by reference to the "mo meng" name.[59]

The problem of determining the true ownership of property bedevils the task of recovery. In almost every case of taxation fraud, assets are held in the name of family trusts and companies. The issue is often brought to head when an attempt is made to freeze the assets of the defendant through the use of a Mareva injunction and it is here that the courts have shown a willingness to explore the reality behind the corporate facade.

(a) Mareva Injunctions

A Mareva injunction is an interlocutory injunction which restrains the defendant from removing from the jurisdiction or otherwise dealing with assets which the defendant has within the jurisdiction. Civil remedy action to recoup unpaid taxes and recover the proceeds of crime can be taken before, concurrently with or after prosecutions and often the injunction is called in aid to prevent the dissipation of these assets.

The basis of the jurisdiction for the granting of a Mareva injunction is that there must be a claim being a substantive cause of action against the defendant.[60] A question often arises whether a company, suspected of holding the defendant's assets, should be joined as a defendant, being in reality the defendant's alter ego, or should be joined as a third party, as an entity not ostensibly in dispute with the plaintiff but which should be given notice of the action. The Director of Public Prosecutions, exercising his civil remedies power,[61] has been directly or indirectly involved in a number of

57 Note 4 *supra*, 635.
58 See also note 52 *supra*, 26.
59 Note 4 *supra*, 636.
60 *The Siskina* [1977] 3 All ER 803.
61 See Director of Public Prosecutions Act 1983 (Cth) s. 6(1)(g)(h); see also M.C. Hines, "Mareva Injunctions; A New Weapon of the Commissioner" (1986) 15 *A T Rev* 80.

such cases. The case of *Deputy Federal Commissioner of Taxation* v. *Manners and Terrule Pty Ltd* [62] highlights the nature of the problem. In this case an injunction was sought against the first and second defendants to prevent the removal or dissipation of assets. The first defendant, Manners, a director of Metropolitan Taxation Services, a company involved in the Norfolk Island Public Art Gallery Scheme, asserted that he had no assets with which to satisfy a judgment against him and that assets held by the company Terrule were not beneficially owned by him. The amounts dealt with were considerable. Manners had been personally assessed for income tax at over $11 000 000 and Terrule at some $2 500 000. In granting the application for a Mareva injunction, Phillips J. stated:

> [a]lthough separate legal entities are involved ... I regard Terrule as being nothing more than Manners' instrument. I do not say that he would resort to unlawful conduct in this connection but I believe that he would have no compunction about the use of other entities, nor would subterfuge be beyond him. I am quite unimpressed by the assertion of inconvenience or unfairness to the defendants resulting from injunctive orders. Terrule is not a company in active trade.[63]

In subsequent proceedings to determine the beneficial ownership of the assets, the Commissioner of Taxation has claimed that, despite the registration of assets in the names of others, and the execution of numerous deeds, beneficiaries, the assets were paid for by Manners, and were treated and used by him for his own use and benefit and were to be ultimately disposed of as if they were his own. In *Federal Commissioner of Taxation* v. *Goldspink* [64] the total tax assessed amounted to over $3 000 000 and was assessed on income derived through participation as a vendor and promoter of tax avoidance schemes. The defendant claimed that the income was derived by companies and trusts, none of which had lodged returns. None of the companies and entities had separate bank accounts but all money went into the defendant's trust account. Various loans to other entities, including a defendant company of which he and his wife were directors, were used to purchase properties including the one in which he lived. Lusher J. held, on the principle of resulting trusts, that the assets were in fact those of the defendant and further, that there was a credible case that all of the transactions were shams.[65]

The Australian Law Reform Commission in its reference on insolvency

62 Unreported, Supreme Court of Victoria, 31 May 1985.

63 *Ibid.*

64 (1986) 17 ATR 290.

65 The task of establishing true ownership of property will become acute when litigation relating to the forfeiture of property under the proliferation of Confiscation of Profits of Crime Acts gets under way. At present the pecuniary penalties provisions of the Customs Act 1901 (Cth) allow the recovery of pecuniary penalties in relation to dealings in narcotic goods: ss 243A and following. An order freezing the assets of the defendant can be obtained prior to the making of a pecuniary penalty order, that property being put into the hands of the Official Trustee. The problem arises in determining what precisely is the "property of the defendant". See also Crimes (Confiscation of Profits) Act 1986 (Vic.); Crimes (Confiscation of Profits) Act 1985 (N.S.W.); Crimes (Confiscation of Profits) Act 1986 (S.A.).

has expressed its concern for difficulties encountered by trustees in bankruptcy when confronted by trusts and private companies:[66]

> [s]ometimes an insolvent will have arranged the setting up of a company or trust for the benefit of himself and his family. That facility may simply acquire assets or may operate an income producing business. It may engage in both. Yet the insolvent may have no direct ownership or proprietary interest in the company or trust, assets, business or income (that is invariably the case with the modern discretionary trust where the entitlement of beneficiaries to income or assets may be varied at will). Moreover the insolvent will have no apparent legal control of the entity.
>
> Nonetheless, the insolvent may exercise a real control of the company or trust and its business, even though that control may be less than apparent and disguised. Furthermore, benefits may come the way of the insolvent by use of assets the entity or by income distribution to members of the family of the insolvent.[67]

In the general commercial law field the problem of fraud and concealment has led to a more robust approach by the courts, best illustrated by the case of *Re A Company*.[68] In this case the defendant had set up a series of companies and trusts, both local and foreign, for the purpose of concealing the assets of the defendant and his relatives in anticipation of action being taken against him for deceit and breach of trust. An application was made to restrain the dispersal of the defendant's shares and interests in the companies and trusts and for the disclosure of information about the operation of foreign companies and trusts. The English Court of Appeal stated that evidence disclosed,

> an elaborate and most ingenious scheme brought into operation at the instance of the first defendant, whereby his personal assets were organised in such a way that they were held by foreign and English corporations and trusts in a manner that effectively concealed his true beneficial interest in English assets.[69]

The network of interlocking companies and trusts had been in place but were used after the fraud to place the assets out of the reach of the plaintiffs. The court granted the orders sought because there was massive evidence that the nominees and puppet directors danced to the defendant's tune. It was for the defendant to state that "one or more persons implicated in the silken skein of his spider's web had a genuine beneficial interest".[70]

(b) Complexity

It has often been noted that one of the difficulties in investigating crimes where companies are concerned and in tracing assets is the enormous

66 Australian Law Reform Commission, *General Insolvency Inquiry* Issues Paper No. 6, 1985.

67 *Id*, 25. This problem has, of course, arisen in other contexts, in particular in the family law arena where recalcitrant spouses have been known to place assets in the hands of family companies under their control in order to place those assets out of the reach of the Family Court when it came to make orders for the division of property: see *Ascot Investments Pty Ltd* v. *Harper* (1980) 33 ALR 631; D. Kovacs, "The Jurisdiction of the Family Court With Respect to Family Companies" (1982) 8 *Adel L Rev* 163.

68 [1985] BCLC 333.

69 *Id*, 335.

70 *Id*, 339.

complexity which can be intentionally generated by the multiplication of corporate or trust entities.[71] The use of overseas companies is a favourite ploy for the transfer or laundering of funds or movement of assets. There are many advantages in using overseas companies. First, investigators' powers are territorially limited. In the absence of reciprocal enforcement powers, the enforcement agency must rely on obtaining searches of public documents in other countries or upon the goodwill of enforcement agencies in those other jurisdictions. This usually means that investigations are delayed or made virtually impossible. In July 1986 the Attorney-General announced that the forty-nine Commonwealth countries had adopted a mutual assistance scheme for the tracing and confiscation of the proceeds of criminal activities.[72] Secondly, the cost of pursuing investigations overseas is prohibitive and, in times of fiscal stringency, it is unlikely that such investigations will be undertaken. Thirdly, if the foreign companies are not registered in Australia, they may choose not to enter an appearance in response to civil action and therefore are not amenable to the jurisdiction of the local courts. Accordingly, a plaintiff is unable to seek discovery or interrogatories. Fourthly, the relaxation of the banking and Foreign Exchange Regulations has rendered the removal of assets overseas much easier and made the flow of funds difficult to trace. Finally, the incorporation of companies around the world enables funds to be channelled overseas in the form of loans or by means of transfer pricing techniques. These funds can either be retained offshore for use by defendants there or returned to Australia in the form of loans by entities whose nature and origins, and relationship with the defendants, are almost impossible to determine.

The intentional creation of undue complexity to thwart investigation can be readily illustrated. In *Re A Company,* Cumming Bruce L.J. noted:

> [w]hen, after the fraud alleged in the Statement of Claim, the first defendant realised that insolvency of the plaintiffs was in sight, he either then arranged that his English assets should disappear into the network of inter-related English and foreign legal structures of such complexity that only he and/or his agents could disentangle his personal interests, or in the case of some English assets, he had already achieved this confusion against the contingency of a future judgment.[73]

A similar technique was employed in *Deputy Federal Commissioner of Taxation* v. *Manners.*[74] In this aspect of the litigation the defendant had applied for a stay of execution of judgment for taxation debts amounting to $11 019 659 against Manners and $2 542 423 against Terrule Pty Limited. One of the grounds for the application was the extraordinary delay on the part of the Commissioner of Taxation in dealing with objections and in the

71 Sullivan, note 21 *supra,* 522. Corporate raiders such as Industrial Equity Ltd have deployed chains of companies to conceal the fact that a takeover bid is under way: see *Re North Broken Hill Holdings Ltd* (1986) ACLC 131.

72 Attorney-General's Press Release 64/86, 31 July 1986. See also note 49 *supra,* Ch. 19.

73 Note 68 *supra,* 338.

74 [1985] ATC 4294.

investigation of the case generally. Senior counsel for the Commissioner asserted that Manners had boasted in 1981 that it would take at least five years to unravel his affairs.[75]

Manners was allegedly involved in the Norfolk Island Public Art Gallery Scheme in 1978. The suspected fraud was discovered in August 1979 and it was investigated from that date by some dozens of staff of the Director of Public Prosecutions Office, the Australian Taxation Office, the Special Prosecutor's Office, McCabe and La Franchi as special company investigators, and others. The committal proceedings alone have run to 121 sitting days and have produced over 16 000 pages of transcript.[76] The magnitude of the task of investigation is obvious. In answer to Manners' submission, Phillips J. stated:

> [m]y assessment of the factor of delay in this case is this — Geoffrey George Manners, both personally and as a director and effective controller of Terrule, engaged in transactions and arrangements to obstruct collection of tax over a protracted period of time; with the same intent an almost bewildering complexity of events and entities was injected into these transactions. The work of the plaintiff's officers, in endeavouring to unravel what has occured, was rendered correspondingly more difficult.[77]

4. *Trading Trusts*

It is appropriate at this point to examine the phenomenon of the corporate trading trust. The Companies and Securities Law Review Committee has described this entity as a "hybrid form of organisation", whose popularity "derives largely from a combination of taxation advantages not generally afforded to companies and a somewhat ill-defined species of limited liability".[78] Typically a proprietary company formed with the minimum capital, that is, $2.00, is appointed trustee of a trust which then carries on a business. Those with whom it deals do not know that the company is only acting in its capacity as trustee. Major problems have occured when a trading venture has failed and courts have taken different views as to the creditors' rights in relation to the trustee. The problem is that the property is beneficially owned by the beneficiaries and may not be available to meet the debts of the trustee, whose only assets are the $2.00 prescribed capital and a right of indemnity out of the trust property.[79]

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75 It should be noted that Phillips J. did not find that such a boast had in fact been made.

76 An application to review the Magistrate's finding that there was a case to answer was made to the Federal Court in October 1986 but as of this date (April 1987) a decision has not been handed down.

77 Note 74 *supra*, 4296.

78 Note 22 *supra*, para. 115.

79 See *Octavo Investments Pty Ltd* v. *Knight* (1979) 144 CLR 360. In this case Murphy J. commented: "It would be a curious perversion of the doctrines of trust evolved by Equity Courts if they can be used to implement a scheme in which a straw company is used as a trading trustee, and assets can be transferred preferentially to defeat ordinary creditors. A device to defeat creditors is not improved by using a straw company instead of a straw man. Trusts, including trading trusts, should not be allowed to become instruments to undermine the protection which the law otherwise confers on creditors", 372.

It is believed that the majority of companies presently formed are such companies. The Victorian Corporate Affairs Commissioner stated that at the end of 1978, approximately 12% of all companies on the Victorian register were trustee companies.[80] The growth in the number of such companies represents a process of intermediation of property relations; the interpolation of the corporate form between individuals and their assets to divorce ownership from control and, more importantly, reward from liability. Professor Yuri Grbich has observed acerbicly the transformation of the old-time "man of straw" to the modern "man of dry ice".[81] The purpose of this creature, the $2.00 nominee company, is to act as a "mobile, quixotic shield to protect both the trust assets and the humans who run the scheme against the stringent personal liabilities which equity has traditionally imposed on human trustees, and, occasionally, on beneficiaries."[82]

5. Self-Abuse?

Although theft from a company will rarely amount to simple appropriation of assets because of the availability of the techniques outlined above, there are jurisprudential barriers to concluding that a person can 'steal' from a company where that individual is effectively the sole shareholder and director of the company.[83] In *Roffel*[84] the following occurred:

> [t]he applicant and his wife were the sole shareholders and directors of a small proprietary company. The company had been established by the applicant in 1977. He had formerly conducted his clothing manufacturing business in partnership with his wife. Upon the formation of the company, it purchased the partnership assets. The purchase remained unpaid. In 1979 the premises occupied by the company were destroyed by fire and the insurance proceeds were paid into the company's bank account. The company had a number of trade creditors and the insurance proceeds were insufficient to meet all the claims by these creditors. The applicant drew five cheques upon the company's acount of which four were payable to cash and the fifth was payable to a travel agency. As managing director and secretary of the company he was entitled to draw cheques on the company's account. It was open to the jury to infer that he had used the proceeds of the cheques for his own purposes. He was subsequently charged with and convicted on five counts of

80 R. Viney, "Practical Problems Facing Directors and Officers of $2 Nominee Companies — Disclosure, Unlimited Liability and Other Matters" in *Problems of Administering $2 Nominee Trust Companies* Monash University, Faculty of Law, (1979).

81 Y. Grbich, "Can Liabilities Incurred By $2 Nominee Trust Companies be Recovered from the Trust Fund and Beneficiaries?" in *id.*, 5.1.

82 *Ibid.*

83 See P. Von Nessen, "My Body, Myself: Problems of Identity in Corporate Crime" (1985) 3 *Coys & Sec L J* 235; P. Von Nessen, "Company Controllers, Company Cheques and Theft — An Australian Perspective" [1986] *Crim L R* 154. However, this does not necessarily mean that a person may not be guilty of *misapplying* the property of a company. Both New South Wales (Crimes Act 1900 (N.S.W.) s. 173) and South Australia (Criminal Law Consolidation Act 1935 (S.A.) s. 189) have provisions which make it an offence for an officer of a company to fraudulently take or apply a company's property. In *Attorney-General's Reference No. 1 of 1985* (1985) 19 A Crim R 436, 437, 442 the South Australian Court of Criminal Appeal held that the word "applies" in s. 189 cannot be equated with the word "appropriates" in s. 72 of the Crimes Act 1958 (Vic.) and distinguished *Roffel's* case (below) on that basis. See also *R.* v. *Glenister* [1980] 2 NSWLR 597.

84 [1985] VR 511.

> theft. He sought leave to appeal against his convictions on the ground that the Crown had not established the element of appropriation in any of the five counts of theft.[85]

The majority of the Court, Young C.J. and Crockett J., held that no theft had occurred in these circumstances. Although in theory a natural person can steal from a company, even one in which he is the dominant shareholder and director, there were difficulties of proof. In this case, there was no appropriation of property as required by section 72 of the Crimes Act 1958 (Vic.), there being no adverse interference or usurpation of the owner's rights because the company, through Mr Roffel, had consented. As Crockett J. noted: "by the instrumentality of the only person through which it could effectively act it consented to entering into the impugned transactions."[86]

Questions of company law such as the doctrine of ultra vires[87] and whether the transaction was void or voidable on the ground of mistake or fraud were held not to be relevant to the question of whether consent had been given for the purposes of the criminal law. Brooking J., dissenting, was of the view that company law considerations were relevant. He said:

> [s]o far as the company law at all events is concerned, it is not correct to say that a company may dispose of its own property as it wishes. For the creditors of a company are entitled to look to its subscribed capital ... Although, as in the present case, only two dollars may have been subscribed, the protection given to creditors extends to the whole of the assets of the company, in the sense that it can make no payment to its shareholders except by way either of division of profits or of authorised reduction of capital: *Hill v Permanent Trustee Co. of New South Wales* [1930] AC 720, at p 731. The basic principle has the result that every transaction between a company and any of its members, by means of which any capital is repaid to him, is prohibited, unless the court has sanctioned the transaction; moreover, since the transaction is prohibited and void, it cannot be ratified even by unanimous decision of the shareholders.[88]

The schizophrenia engendered by *Salomon's* case[89] appears to have been a stumbling block to charging some of the bottom of the harbour defendants with theft, as they had control of the company at the time they appropriated the assets. However, the Queensland Court of Criminal Appeal in *Maher*,[90] suggested that directors in such circumstances may be guilty of conspiracy to defraud the company, provided, of course, that more than one director was involved. The Court held that it was not inconsistent with the notion of a criminal conspiracy that it may involve an agreement to do acts which are of themselves quite lawful. The criminal component of the conspiracy is constituted by the element of defrauding the company of that to which it would otherwise have had the benefit, that is, the funds appropriated and available to meet its tax liability. Thus *Roffel* was considered irrelevant.

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85 These facts are taken from the headnote.
86 Note 84 *supra*, 522.
87 Now abolished — see Companies Code (1981) s. 66C.
88 Note 84 *supra*, 525.
89 Note 16 *supra*.
90 Unreported, 20 June 1986.

6. Manipulability

The ability to manage totally the affairs of a company, to appoint and remove directors and liquidators, to dispose of its assets and of the company itself was the sine qua non of the bottom of the harbour offences. Although the proprietary company is subject to a number of regulations under the Companies Code relating to notification of changes in directors, shareholders, place of business and others, the task of enforcement of such provisions has meant that any irregularities in company procedures would not be detected or dealt with until long after the event. Some of the salient features of the schemes are detailed below.

(a) Ease of Sale

The bottom of the harbour cases and litigation have revealed the ease with which one company can be sold and re-sold, transformed in structure and have its name changed within a very short period of time. In these schemes, company trafficking was raised to an art form, an art made possible by the development of modern technology such as word processors which enables pro- forma documents to be created, tailored and produced for the individual case and processed by the thousand. According to the McCabe/La Franchi Report,[91] one promoter was said to have stripped some 2 086 companies. In 733 of those companies, the Commissioner had been unable to collect on incomes aggregating more than $128 000 000.

(b) Compliant and Sham Directors

> The public policy upon which the privilege of limited liability is given to companies, private as well as public, is that the directors shall observe the trust which Parliament has reposed in them. It is the chief protection of the creditors.[92]

Just how far this privilege has been abused is once again illustrated by the bottom of the harbour cases. The appointment of directors of companies is subject to few restrictions such as age, disqualification for bankruptcy or certain offences.[93] McCabe and La Franchi[94] described sham or straw directors or purchasers as persons who — (1) were able to disappear totally if need be; (2) would be hard to find; (3) could move around the country at will; (4) were leaving for overseas; (5) were of little or no substance; and (6) had little or no assets which could be attacked by the Taxation Commissioner.

Sham directors were often found to be members of the Painters and Dockers Union and people with no commercial experience who signed and executed documents the contents of which they had no knowledge. In the case of *Beames* [95] Fullager J. noted that straw directors became the only

91 Note 2 *supra*, Vol. 1, 27.
92 *Cooper* v. *Luxor (Eastbourne) Ltd* [1939] 4 All ER 411, 418-419, *per* Scott L.J.
93 Companies Code (1981) ss 219, 226, 227.
94 Note 2 *supra*, Vol. 1, 10.
95 Note 44 *supra*.

shareholders and directors of numerous target companies the existence of which they had been until that time completely ignorant. In one case, which was regarded as typical, the dumpee was a temporarily unemployed sailor with no fixed place of abode and virtually no assets.[96] In *R* v. *Freedman and Young*[97] McGuire J. made this observation as to the appointment of one man as public officer, secretary and director of seventy-six acquired companies:

> [h]e was a cleaner by occupation. He signed company minutes without ever having attended one. He signed the all important section 52 declarations without reading them or understanding their importance. In short, he said he signed numerous company and taxation documents blindly, that is, without enquiring or without being informed as to their purpose or significance. [He was], it seems, but a dummy.[98]

The ability to appoint nominee directors and shareholders increases the capacity of persons involved in such schemes to mask their involvement, especially when those companies hold assets on behalf of that person. Investigation is made even more difficult when those nominee directors and shareholders are located overseas. In one case, the defendant had made use of a company registered in Hong Kong but for whom nominee directors and shareholders were provided by a Singapore company which charged $S200 per nominee shareholder per annum and $S1 200 per nominee director per annum.[99] The nominee director had deposed that she was authorised to sign numerous documents including liquidation papers for a number of Australian companies the state of affairs of which she knew nothing about. An extra fee was paid for signing the liquidation documents. Such activities make a mockery of the laws relating to directors' responsibilities and duties.

(c) Compliant Liquidators

> Creditors are entitled to look for their security to ... the business of the company as a going concern: for in reliance upon the assumption that it continue to pursue the objects for which it was incorporated and thereby derive income, they might have given credit to the company.[100]

An exempt proprietary company need not appoint a registered liquidator. One of the consequences of a company being processed through a tax avoidance scheme was that the company was left with no assets except a written loan to another company which was a member of the scheme. The company would then go into voluntary liquidation and a liquidator would be appointed, that liquidator of course being a person associated with the scheme. In *Commonwealth* v. *Brown* [101] the Commissioner of Taxation applied to the Court for an order that the liquidator be removed and certain proceedings under the liquidation be set aside. The defendant in this case was subsequently charged with conspiracy to defraud the Commonwealth in

96 See also *R* v. *Lee Gabriel Hurley* Unreported, Supreme Court of Queensland, 13 February 1984.
97 Unreported, Brisbane District Court, 5 December 1985.
98 *Ibid.*
99 At $S1.3 per $A1 at current rates.
100 Note 35 *supra*, para. 33/22.
101 (1982) 13 ATR 1.

relation to the Norfolk Island Public Art Gallery case. The purpose of the winding up was to ensure that there would be no person against whom the Commissioner of Taxation could proceed and the aim of having a friendly liquidator, as explained in this case, was to prevent the acknowledgement of the Commissioner of Taxation as a creditor, to fail to call a meeting of creditors as required under the Companies Code, to fail to pay income and other taxes, to fail to recover assets of the company and to fail to investigate certain payments by the company to other entities. In this case the liquidator was also faced with a conflict of interest in that he had an interest in the successful avoidance of tax, that avoidance being rendered more probable by the dissolution of the company. Further, the liquidator had failed to investigate possible breaches of section 67 of the Companies Act 1961 (Vic.) and had failed to keep sufficient records: in fact he had destroyed certain documents, an act which Crockett J. described as action "bordering on the contumacious".[102] The Court agreed to appoint a new liquidator and drew the reasons for judgment to the attention of a number of bodies and persons including the Commonwealth and State Attorneys-General, the Commissioner for Corporate Affairs and others.

Similarly, in *Commonwealth* v. *O'Reilly* [103] the Court set aside the dissolution of a number of companies and directed that the liquidator appointed by the scheme promoters should be removed and another appointed. The liquidator was not impartial because his duty as a liquidator to investigate the affairs of the company conflicted with his personal interests as the 'in house liquidator' for the promoters of the scheme. Most pointedly, from an investigating point of view, the liquidator was unable to distinguish the interests of the company itself from the interests of those who controlled it or held a beneficial interest in it or the interests of some other companies or group of companies. He was unable to pursue investigation into the possible misfeasance by the company's controllers who, it appeared, carried on the business of the company otherwise than for the benefit of the company or its creditors, including creditors such as the Commissioner of Taxation.[104]

7. *Abuse of Notification Procedures*

A quid pro quo for the creation of limited liability companies is the requirement that a minimal level of information about the current membership and financial status of the organisation be publicly available in order to protect the investing public or creditors. Access is made easy by the ready availability of microfiche copies of company documents at a comparatively low price. However, the protections afforded by such notification requirements have proved illusory. McCabe/La Franchi observed:

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102 *Id*, 9.

103 (1984) 8 ACLR 804. See also *Commonwealth* v. *Duncan* [1981] ATC 4228.

104 See *Walker* v. *Wimborne* (1976) 137 CLR 1. On the question of directors' duties towards creditors see also *Nicholson* v. *Permakraft (N.Z.) Ltd (in liq.)* (1985) 3 ACLC 453; *Kinsela* v. *Russell Kinsela Pty Ltd (in liq.)* (1986) 10 ACLR 395; noted by J. Hill, (1986) 60 ALJ 525.

> [t]he Companies Act extends a privilege to persons to be appointed as directors of companies. The Act provides, once a person has been appointed a director of a company, that notice of such appointment shall be lodged with the Commissioner for Corporate Affairs. The Act further provides a company shall have a registered office address and that address or any change of address shall be notified and lodged with the Commissioner.
>
> The philosphy behind the notification provisions is to ensure that persons appointed may be contacted and that the office of the company is open and accessible to the public. The Act requires that a secretary be in daily attendance at the registered office address of the company and certain statutory records be available for inspection. In other words, the provisions are basic to the concept that a legal person with limited liability has identifiable officers and an established address.
>
> The matters which are the subject of this report reveal an abuse of the philosophy of the notification provisions of the Act on an Australia-wide scale ... All told upwards of 3,000 companies are involved.[105]

The lack of vigorous enforcement by Corporate Affairs Officers allowed, if it did not encourage, sloppy company practice. According to the Victorian Attorney-General, Mr Kennan, in the years 1984 and 1985 the Corporate Affairs Commission prosecuted more than 20 000 companies and individuals in the Magistrates' Court for minor regulatory offences. He stated "[w]hilst the individual offences may be minor, the widespread disregard for these requirements is disquieting."[106] A senior Corporate Affairs Officer has stated:

> [t]hese bottom of the harbour frauds, they absolutely blossomed because compliance with straight out simple statutory obligations — strict liability offences — were not enforced. There was not proper enforcement to ensure that returns of directors were promptly put in, returns as to allotments to shareholders, returns as to registered offices, and it's absolutely certain that that provided the environment in which these guys operated to send the companies to the bottom of the harbour.[107]

Yum's study showed that in Victoria, in 1981, there was a submission rate of only 75% in respect of annual returns.[108] The statistics regarding the disclosure of financial information were even more depressing. Only 36% of exempt proprietary companies sampled by him had lodged their accounts within the prescribed period. In any event, lodgement of returns does not guarantee their accuracy. False and misleading returns, especially in relation to the value of assets, where those assets are inter-company loans, were commonplace and there is little that the Corporate Affairs Commission could do to check the content of such returns. In this respect, Gower's comment upon the importance of disclosure of financial information seems, if anything, understated:

> [o]n the basis that 'forewarned is forearmed' the fundamental principle underlying the *Companies* Acts has been that of disclosure. If the public and the members were enabled to find out all relevant information about the company, this, thought the founding fathers of our company law, would be a sure shield. The shield may not have proved quite so strong as they had expected, and in more recent times it has been supported by offensive weapons ... [b]ut basically, disclosure still remains the principal safeguard upon which the *Companies Acts* pin their faith.[109]

105 Note 2 *supra*, Vol. 1, 1.
106 *Ministerial Statement* note 29 *supra*, 321.
107 Cited in Grabosky and Braithwaite, note 21 *supra*, 15.
108 Note 6 *supra*, 74.
109 Gower, note 13 *supra*, 497.

III. REFORMING THE CORPORATE FORM

This relatively brief examination of the role of small companies in the bottom of the harbour conspiracies compels an indorsement of the comments made by investigators into the affairs of an English company in another context:

> [i]n conducting an enquiry of this kind[110] one cannot fail to be struck by the ridiculous proliferation of worthless, one might even say deceitful limited liability companies ... We wonder whether the time has not come to put some sensible limit on their procreation. It would at least clear some of the dross away if incorporation were to be limited to companies with a paid-up share capital of, say, 10,000 [pounds]. The abuses to which the great majority of these companies lend themselves so outweigh their usefulness as to make a farce of the *Companies Acts* and of the very concept of limited liability.[111]

These abuses are not, in my view, merely the product of a few spectacular cases.[112] The evidence relating to the number of company collapses and liquidations, the magnitude of the losses and the general disobedience of the law indicate that the problem is structural rather than pathological. Fraud is, of course, not confined to companies, but the abuse of the concept of limited liability is a particular form of fraud which should be amenable to control. Remedies against abuse are available and are being constantly refined and developed, but experience to date has been that enforcement has been sporadic, unenthusiastic and often belated.

The nature of the problem lies more deeply than inadequate enforcement of present laws. The problem lies in the perversion of the corporate form itself. When the modern company forms were first established in the mid-nineteenth century, their primary purpose was, as has been discussed, to encourage enterprise by enabling the accumulation of capital with limited risk. The entrepreneur was to be the engine of economic growth and thereby the economy as a whole would benefit. What is clear today is that many, if not most of the companies formed, and certainly the subject of investigation, are not entrepreneurial, do not trade, do not produce and perform no functions other than to frustrate creditors, avoid tax and impede investigation. As Young J. commented acerbicly:

> [t]he law as to corporate personality and limited liability was created for the public interest to promote trade and responsible development of our nation and not for the benefit of professional company directors or persons who euphemistically call themselves merchant bankers, to grow rich on other people's moneys[113]

Absent the basic rationale of the company, there seems to be no reason for non-trading companies to exist. The entrenchment of legal formalism ought

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110 Inter alia, into the provenance and ultimate destination of various monies.

111 *Investigation into the affairs of Norwest Holst Ltd,* HMSO (1982), para. 292; cited in Sullivan, note 21 *supra,* 512.

112 *Cf.* G. Fewster, "The Use of the $2 Company for Family Planning and Related Activities" in note 23 *supra,* 25.

113 *Ausbro Forex Pty Ltd* v. *Mare* [1986] 4 NSWLR 419, 424 in the context of an application for a Mareva injunction.

not to blind us to the reality of corporate activity. As Windeyer J. noted, "a company like Casuarina may be prestigious in the proper sense of the word, and the accountants called prestigiators."[114] It was the philosophy of formalism, dominant in the High Court of Australia during the 1970s, which spawned the tax avoidance industry which in turn engendered contortions of the corporate form to enable some of the far reaches of some of the more bizarre decisions of the court to be explored by professional prestigiators. In the following discussion, some present remedies and possible reforms relating to the problem of abuse of the corporate form are briefly examined.

1. *Abolition of Limited Liability*

> If one-half of mankind were creditors, and the other half members of companies (limited), opinions would perhaps be equally divided on the question whether limited liability ought to be favoured.[115]

It is quite clear that some form of limited liability is essential if the maintenance and continuation of the system of private enterprise as is practised in advanced industrial capitalist societies is to continue. The history of limited liability prior to the Limited Liability Act 1855 (U.K.) provides sufficient evidence of the economic need for some form of legal entity to fulfill this function and its existence in some form in almost all developed legal systems attests to its usefulness, if not indispensability.[116] However it is also true to say that the gloomy predictions of commentators contemporary to the introduction of limited liability who were of a view that the new laws would "encourage recklessness and fraud on the part of company promoters and directors"[117] may have proved to be more correct than supporters of limited liability would care to admit.

It may well be that the availability of limited liability itself should be limited, the task being "to seek to define modern conditions appropriate in our society in which private capital can be allowed the privilege of incorporation with limited liability."[118] Perhaps incorporation should be confined to trading companies or incorporation itself be made more difficult or expensive. Wright[119] has lamented the fact that there are no checks by Corporate Affairs Officers of the criminal or other background of incorporators or directors, that there are no checks of the financial capacity of incorporators, that there is no advertising of the fact of incorporation, no chance for people to object to incorporation and no guarantee fund to protect investors from failed corporations.

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114 *Federal Commissioner of Taxation* v. *Casuarina Pty Ltd* (1970-71) 127 CLR 62, 77; "Prestigious": practising juggling or legerdemain; cheating, deceptive, illusory; "Prestigiator": a juggler, a conjuror, a cheat: Oxford English Dictionary.

115 Cockle C.J. in *Walsh* v. *Stephens* (1873) 3 QSCR 98, 107.

116 See note 35 *supra*, para. 33/29.

117 Hadden, note 13 *supra*, 23.

118 K.W. Wedderburn, *Company Law Reform*, Fabian Tract 363, 19, cited in note 35 *supra*, para. 33/28.

119 K. Wright, "Corporate Crime and the $2 Company" (1978) 3 *Credit Rev* 24.

2. Modification of Limited Liability: Minimum Paid-up Capital

It has been suggested that the prescription of a minimum paid-up capital for small corporations may obviate some of the abuses outlined above. Most relevantly, in the present context, a substantial minimum paid-up capital might discourage frivolous incorporation.[120] This appears to be the main purpose of such requirements in those jurisdictions which require a minimum paid-up capital, rather than ensuring a substantial capital base which could provide a source of relief for creditors. The Companies and Securities Law Review Committee has come out against such a proposal, arguing that this would not ensure against loss, that any such figure would be arbitrary and usually inappropriate and that the administrative burden was not warranted.

3. A New Form of Corporate Entity

As Sutton and others have shown, many, if not most, offences concern proprietary companies, sole traders or partnerships which have availed themselves of incorporation. Sutton argues that limited liability in this area is inconsistent with the original idea behind the law which was to protect investors in large companies who played no part in running them.[121] Hadden, and others have argued that a new form of incorporation for small business should be developed, much like organisations in France or Germany. This idea has now been taken up and developed by the Companies and Securities Law Review Committee which, in its Report of 1985, has recommended a new corporate entity to be known as a "close corporation" which would be established by separate legislation. The Committee states:

> [t]his entity would be designed primarily for owner operated and other forms of small business. The close corporation would be a full juristic person offering to its members all the advantages of separate legal personality including:
>
> *Perpetual succession and consequent ability to:
>
> **purchase, hold, convey or otherwise deal with the property in its own name;
>
> **employ members, and thereby provide them with certain benefit, including superannuation entitlements; and
>
> **continue in existence, subject to liquidation irrespective of changes in its members;
>
> *the right to sue and be sued in the corporate name;
>
> *the ability to create floating charges.[122]

The proposed legislation would eliminate the formal director/shareholder distinction, regulate the internal affairs of the corporation by rules appropriate to a partnership rather than those of a company and thirdly, have minimal reporting requirements with civil rather than criminal consequences for non-compliance. The Committee recommended the adoption of the principle of limited liability for close corporations though in certain circumstances unlimited personal liability would occur.

120 Note 22 *supra*, 50-51.
121 Note 5 *supra*, 62.
122 Note 22 *supra*.

The Committee recommended three legislative grounds of recourse against members personally in the event of the insolvency of a close corporation. These are:

(a) Where debts are incurred recklessly. This is similar to the provisions of sections 556(1) and 557 of the Companies Code.
(b) Compensation for assets improperly disposed of. This is similar to section 453 of the Companies Code.
(c) Where there has been undue delay in bringing the corporation's activities to an end. Members of such a corporation would be liable without limit where they had either failed within a reasonable time to cause the cessation of the corporation's business, to call a meeting of members and creditors, or to arrange for adequate capital to be put into the corporation.

There are a number of advantages to this model. The Committee has recommended that membership be confined to natural persons and that no juristic person can indirectly hold an interest, whether through the instrumentality of a natural person as its nominee, trustee or otherwise.[123] This may assist in determining true ownership of assets. As well, no such corporation can be a holding company. A close corporation could not act as trustee under an express trust and personal liability would attach to any purported trustee.[124] This appears to be aimed at destroying the $2.00 trustee company and is to be welcomed.

On the other hand, the Committee recommends that close corporations not have a minimum paid-up capital nor be required to file an annual return, but it did recommend the establishment of a liquidator's recovery fund to assist liquidators to defray the cost of investigation arising from the insolvency of close corporations.

There are, however, less drastic means for controlling corporate abuse than completely changing the corporate form. Both legislatures and courts have addressed these problems in various ways.

4. *Fraying the Corporate Veil: Statutory Provisions Creating Personal Liability*

The phrase 'piercing the corporate veil' is evocative but tends to lack a precise meaning. Generally, it can be said that when one pierces the corporate veil one goes behind the corporate personality to lay responsibility at the feet of the individual member or members. As has been seen above, the problem arises in many contexts, income tax law, Mareva injunctions, fraud and over a wide range of commercial transactions. Each area of law has tended to fashion its own responses, usually ad hoc. As Gower has commented:

> Until very recently, the court and the legal profession have failed to see the interconnection between the various situations in which the problem arises, with the result that relevant decisions taken in one context have not been cited in litigation in another context.[125]

123 *Id*, recommendation 6.
124 *Id*, recommendation 16.
125 Gower, note 13 *supra*, 138.

(a) Companies Code

Although the Companies Codes contains a number of provisions which render an officer personally liable for improper or dishonest conduct, these provisions have been little used in the bottom of the harbour context. Among the most relevant are section 229 which requires company officers to act honestly, carefully and diligently in the discharge of their duties;[126] section 229A, introduced in 1986, which renders a director of a trustee company liable for any liability incurred while the company was acting as trustee where the trustee is not entitled to be fully indemnified out of trust assets[127] and section 556 which prohibits fraudulent trading.[128] The offence is designed to counter the "trading offences" or bankruptcy frauds described above[129] but is probably inapplicable to the bottom of the harbour cases as it could not be said that the tax liability was a debt which was "incurred" by the company. The significant aspect, in terms of corporate liability, of the provisions relating to fraudulent trading, is that by section 557, when a person has been convicted of the offence, that person is personally responsible "without any limitation of liability for the payment to the person to whom the debt is payable of an amount equal to the whole of the debt or such part of it as the court thinks proper."[130]

Section 542 is a procedural section which enables the National Companies and Securities Commission or a manager or liquidator to apply to the court for an order which, inter alia, may include a direction that a person who has been guilty of fraud, negligence, default, breach of trust or breach of duty to a corporation and who, as a result, has caused the corporation loss or damage, to pay money or transfer property to the corporation or pay to the corporation the amount of loss or damage. These misfeasance provisions are potentially powerful weapons against defaulting officers where they have prejudiced the company by creating an inability to pay its creditor, namely the Commissioner of Taxation but have been little used in this context.[131]

(b) Taxation Laws

The most severe reaction to the discovery of large scale tax evasion and the consequent loss of both revenue and respect for taxation laws in general

126 On pain of fine or imprisonment, in the latter case where the offence is committed with an intent to cheat or defraud. If a director's powers are exercised for an improper purpose "the director will be liable personally to compensate the company on the same basis that a trustee is liable personally to restore trust property lost in breach of trust." H.A.J. Ford, *Principles of Company Law* (4th ed. 1986) 394.

127 Either because the trust deed expressly denies the right of indemnity or the trustee committed a breach of trust.

128 This offence can be briefly described as the incurring of a debt when a company is insolvent or the entering into transactions with intent to defraud creditors. These offences only apply to companies which are, or have been wound up or have ceased to trade or are in receivership or under investigation: s. 553; see generally R.C. Williams, "Fraudulent Trading" (1986) 4 *Coys & Sec L J* 14.

129 Note 49 *supra* Ch. 10.

130 S. 557(1).

131 For a scathing criticism of the non-use of misfeasance proceedings against the bottom of the harbour schemes see note 3 *supra*, Interim Report No. 4, Vol. 1, 71-96.

came in the form of wholesale legislative reform of laws governing taxation administration, recovery and enforcement. The first was the Crimes (Taxation Offences) Act 1980 (Cth) which was credited with stopping the bottom of the harbour industry in its tracks.[132] Among other things, the Act makes it a criminal offence to aid and abet, counsel or procure another person (including a company) or to directly or indirectly be concerned in the entry by another person (including a company) into an arrangement or transaction with the object of rendering the company or trustee unable to pay income tax or sales tax due and payable or which may become due and payable.[133] Under this Act a *person* convicted of an offence against the Act may be ordered to pay to the Commonwealth, in addition to the penalty under the Act, an amount not exceeding the income tax or sales tax monies due and payable *by the company or trustee* on the date of the conviction other than amounts in respect of which liability to pay has not been finally determined.

The second and more controversial piece of legislation because of its purported retrospective effect was the Taxation (Unpaid Company Tax) Assessment Act 1982 (Cth). This and associated Acts provide for the assessment and collection of taxes intended to recoup the revenue for company tax which was lost as a result of the adoption of schemes which left the companies without assets to pay the taxes for which they were liable.[134] This Act in effect makes vendor shareholders liable for the tax of companies which were defunct or insolvent. Liability in effect attached to shareholders who had already sold their shares.

The third and probably most important piece of legislation because it is directed at all tax offences is the legislation introduced in 1984 which made changes to the Taxation Administration Act 1953 (Cth). The most relevant section is section 8Y(1) which states:

> Where a corporation does or omits to do an act or thing the doing or omission of which constitutes a taxation offence, a person (by whatever name called and whether or not the person is an officer of the corporation) who is concerned in, or takes part in, the management of the corporation shall be deemed to have committed the taxation offence and is punishable accordingly.

Section 8Y(2) provides that it is a defence if a person proves that he or she:

> (a) did not aid, abet, counsel or procure the act or omission of the corporation concerned; and
>
> (b) was not in any way, by act or omission, directly or indirectly, knowingly concerned in, or party to, the act or omission of the corporation.[135]

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132 There has only been one conviction under this Act and that was recorded in 1986; see *R.* v. *Rumpf* 24 September 1986, Supreme Court of Victoria.

133 S. 6(1); see also CCH, *Australian Federal Tax Reporter,* para. 944-150.

134 See *Deputy Federal Commissioner of Taxation* v. *Truhold Benefits Pty. Ltd.* (No. 3) ATC 4298.

135 In his second reading speech, the Minister assisting the Treasurer said of s. 8Y: "In tax matters up to now, such individuals have been able to escape responsibility for their actions or omissions by shielding behind the corporate veil, with the result that prosecutions against corporations have often proven fruitless — usually because there are litte or no funds left in the company. In many such cases the persons who would suffer if a fine was imposed on the company are innocent creditors of the company." See CCH, *Australian Federal Taxation: Penalties and Offences* (1985) 239.

Where this provision is combined with the power in the court to make a reparation order (for example, section 21B of the Crimes Act 1914 (Cth)) in respect of a loss suffered by the Commonwealth by reason of non-payment of evaded taxes,[136] the corporate veil is left in tatters.

5. Fraying the Veil: The Common Law

English and Australian courts have generally been reluctant to pierce the corporate veil, enshrining *Salomon's* case as a form of holy writ. Kahn-Freund[137] described the case as calamitous and Windeyer J. was of the view that it led the law into "unreality and formalism."[138] Gower observes that the English cases on lifting the corporate veil show no consistent principle beyond a refusal by the legislature and the judiciary to apply the logic of the principle laid down in *Salomon's* case where it is too flagrantly opposed to justice, convenience and the interests of the revenue.[139] Courts in the United States have adopted a more flexible approach, regarding the corporate entity as being a theory of commercial convenience only.[140] The most general statement of principle is found in *United States* v. *Milwaukee Refrigerator Transit Co.:*

> If any general rule can be laid down ... it is that a corporation will be looked upon as a legal entity as a general rule, and until sufficient reason to the contrary appears; but, when the notion of legal entity is used to defeat public convenience, justify a wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons.[141]

The various rationales developed or adopted by the courts can be crystallised under three main headings.

(a) Fraud, Injustice or Illegal Purpose

There is little English or Australian case law relating to this head of corporate veil shredding but there appears to be a principle, little used, that if a company is formed for the express purpose of doing a wrongful act or if, when formed, those persons directly in control expressly direct that a wrongful act be done, those persons, as well as the company, are responsible for the consequences.[142] In the United States it has been said that the existence and use of a separate subsidiary corporation to shield appearance from potential liability is not fraudulent in and of itself. Nor is it sufficient that the plaintiff is unable to satisfy his judgment against the subsidiary corporation.[143]

136 See *Murphy* v. *H.F. Trading Co. Ltd* (1973) 47 ALJR 198.
137 O. Kahn-Freund, "Some Reflections on Company Law Reform" (1944) 7 *Mod L Rev* 54.
138 *Gorton* v. *Federal Commissioner of Taxation* (1965) 113 CLR 604, 627; see also note 126 *supra*, 136.
139 Gower note 13 *supra*, 112.
140 Note 47 *supra*, 160.
141 142 Fed Rep 247, 255 (1905); see also D.H. Barber, "Piercing the Corporate Veil" (1980-1981) 17 *Will L J* 371.
142 *Johnson* v. *Bucko Enterprises* [1975] 1 NZLR 311; *Rainham Chemical Works* v. *Belvedere* [1921] 2 AC 465, 476.
143 R.C. Downs, "Piercing the Corporate Veil — Do Corporations Provide Limited Personal Liability?" (1985) 53 *U Mo K C L Rev* 174, 194.

(b) Shams

Many of the bottom of the harbour cases featured 'round robin' transactions whereby vast amounts of money were transferred, often on the same day, from company to company only to end up in the hands of the original company or its immediate successor. Attempts to characterise such transactions as shams have usually been unsuccessful. Diplock L.J. is the author of the most widely quoted statement:

> I apprehend that, if it has any meaning in law, it means acts done or documents executed by the parties to the 'sham' which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create.[144]

English, Australian and Canadian courts[145] have adopted a restrictive approach to the concept of sham, tending to hold that a transaction may be valid even though the ultimate result leaves the parties in no different position than when they commenced the transaction. In *Currie* v. *Sheehan and Saunders,*[146] the Magistrate ruled that although the transactions which were part of the complex schemes were artificial or contrived, and even though they lacked commercial sense or reality, they were not shams because they were effective to serve their intended result and created the legal rights and obligations they gave the appearance of creating. However, there are indications of a change in judicial attitude, at least in Victoria, toward the bottom of the harbour cases.

In *Deputy Commissioner of Taxation* v. *Vereker*[147] the plaintiff Commissioner, who had obtained judgment against the defendant Vereker for $5 120 075, comprising income tax and interest, sought declarations that assets in the name of a number of the defendant companies were in fact the assets of the first defendant. It was contended that the assets had been alienated to put them beyond the reach of the plaintiff. The plaintiff contended that the transactions were shams and could be disregarded and this contention was accepted by Marks J., who adopted Lord Diplock's test in *Snook's* case but drew also upon the English taxation case law which had moved away from 'step by step' analyses of transactions to a 'global' analysis employing the concept of "fiscal nullity".[148] The essential indicia of sham in *Vereker's* case were that most if not all the legal entities involved were trustee companies which had been cynically used,[149] that the transactions involving

144 *Snook* v. *London & West Riding Investments Ltd* [1967] 2 QB 786, 802.

145 See Durnford, J.W. "The Corporate Veil in Tax Law" (1979) 27 *Canadian Tax J* 282, 304.

146 Melbourne Magistrates' Court, 21 July 1986. This was another of the bottom of the harbour cases of the type described above.

147 Unreported, Supreme Court of Victoria, 18 December 1986.

148 Marks J. drew particularly on *W.T. Ramsay Ltd* v. *Inland Revenue Commissioners* [1982] AC 300 and *Furniss* v. *Dawson* [1984] AC 474, decisions which have not generally found favour in Australia: see I.C.F. Spry, "Fiscal Nullity in Australia" (1984) 13 *A T Rev* 150.

149 There were some 36 companies and 20 trusts. Although legal form was followed in that there were trust deeds and settlors and beneficiaries nominated, it was a cynical exercise because many of the beneficiaries had no knowledge of the use to which their names were put. Frequent changes of name were employed to put investigators off the scent.

the flow of money were "pre-ordained" and had no commercial purpose, that all the legal entities were part of a network controlled by the first defendant, that the defendant retained a strong nexus between himself and the purportedly alienated assets and that ultimately, while legal forms were used, the substance was disregarded.

(c) Facade

The argument that a company, especially a one-person company, is an agent of the controller received short shrift in *Salomon's* case and has been unproductive since.[150] As Windeyer J. noted, a "company which speaks with the voice of the person who controls and which acts as he directs is not necessarily to be called a facade, nor its acts in the law called shams."[151] However, in *Wallersteiner* v. *Moir,*[152] Lord Denning was characteristically bold and was prepared to hold that a series of English and international companies controlled by the one person was a mere facade for the activities of the defendant:

> I am quite clear that they were just the puppets of Dr. Wallersteiner. He controlled their every movement. Each danced to his bidding. He pulled the strings. No one else got within reach of them. Transformed into legal language, they were his agents to do as he commanded. He was the principal behind him. I am of the opinion that the court should pull aside the corporate veil and treat these concerns as being his creatures — for whose doings he should be, and is, responsible.[153]

6. Controlling Corporate Controllers

There exist a number of provisions in the Companies Code which address the problems of incompetent or dishonest company officers and the problem of unauthorised use of or disposition of company property. Although these are not 'counter-veiling' measures in the strict sense they are, however, relevant to the question of corporate abuse.

(a) Unauthorised Loans

Section 230 of the Companies Code prohibits a company from directly or indirectly making loans to directors of the company, a spouse of such a director or relative of such a director or spouse, director of related corporations, various trustees of trusts and various other related corporations. However it should be noted that section 230(3) provides that section 230(1) does not apply to an exempt proprietary company. In other cases where the section applies (and there are many exemptions) the defaulting directors or officers may be jointly liable to indemnify the company against any losses and where the offence was committed with intent to deceive or defraud the company, or members or creditors of the company,

150 See note 126 *supra*, 137.
151 *Casuarina*, note 114 *supra*, 77.
152 [1974] 3 All ER 217.
153 *Id*, 238.

the penalty is $20 000 or imprisonment for five years or both: section 230(5)(e).

The Companies and Securities Law Review Committee, while not recommending the prohibition of loans to and from close corporations, recommended that amounts owing to members by way of loans to the corporation should rank for payment after all external creditors had been paid in full and before other amounts owing to members in their capacity as members.[154]

(b) Undue Preference

A preference is a transaction whereby one or some creditors are paid or satisfied in some way and others in the same category are not.[155] Section 451(1) of the Companies Code provides:

> A settlement, a conveyance or transfer of property, a charge on property, a payment made, or an obligation incurred, by a company that, if it had been made or incurred by a natural person, would, in the event of his becoming a bankrupt, be void as against the trustee in the bankruptcy, is, in the event of the company being wound up, void as against the liquidator.

The bankruptcy law referred to is section 122 of the Bankruptcy Act which provides that recovery of the benefit of such transactions is limited to transactions made within six months before the bankruptcy, but that rights of purchasers in good faith and for value are unaffected. An analogy can also be drawn with section 172 of the Property Law Act 1958 (Vic.) which is aimed at avoiding dispositions of property with intent to defraud creditors. The Australian Law Reform Commission notes that some overseas countries

> have introduced a special category of preference to take account of those who, by reason of their connection with or special relationship with the insolvent, might be expected to have known or should have known of the financial circumstances of the insolvent. If a transaction is made between the insolvent and a member of this special category of person of a preferential nature, a preference is deemed or presumed and the onus lies upon the 'insider' to prove otherwise.[156]

(c) Sales and Purchases at Under or Over-Value

Section 453 of the Companies Code provides that where any property, business or undertaking has been acquired or sold within a period of four years before the commencement of the winding up of the company from or to promoters', spouses or relatives of promoters, directors, spouses or relatives of directors, related corporations or directors or spouses or relatives of related corporations, the liquidator may recover the amount which represents the amount by which the acquisition exceeded the value of the property sold or acquired.

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154 Note 22 *supra*, recommendation 40.
155 Note 66 *supra*, 25.
156 *Id*, 26.

(d) Disqualifying Directors

The ease with which directors of failed companies could set up new companies and become directors of those companies only to repeat the process of fraudulent liquidation has been the subject of widespread dissatisfaction.[157] The National Companies and Securities Commission may prohibit a person from being a director or promoter of a company for a period not exceeding five years where the company has been wound up or is in the course of being wound up or has been or is under official management or whose property is in the hands of a receiver or a receiver and manager.[158] An order can only be made under this section if the person was, within the period of seven years before the Notice of Application, a director of, or was concerned in, the management of two or more companies to which the section applies and, the person was wholly or partly responsible for the company being wound up, being under official management, ceasing to carry on business, being unable to satisfy a levy of execution or being subject to the appointment of a receiver or manager or entering into a compromise arrangement with its creditors.[159] A contravention of this section is punishable by a fine of $5 000 or imprisonment or both.

In 1985, section 562A was enacted which enables the NCSC to disqualify a person who is a director of any company at any time in the twelve months immediately before the commencement of winding up proceedings.[160] Under section 418, a liquidator is required to report the fact that an officer or member of a company may have been guilty of an offence in relation to the company or that a participant in management has misapplied company property or has been guilty of a breach of duty or trust.[161]

The English have gone some distance further by prohibiting a person who is a director of a company within that period of twelve months before the company went into liquidation, for a period of five years, from being a director of or being directly or indirectly concerned in any company with the same or similar name as the liquidated company.[162] As well, a disqualified, prohibited or bankrupt person, or a person who is involved in the management of a company by acting on the instructions of such a person is made personally liable for certain debts of the company.[163]

IV. CONCLUSION

There can be no doubt that the corporate form is in transition. The reasons for these changes are various. The Companies and Securities Law Review

157 Cork Committee, note 53 *supra*, para. 1813.
158 S. 562(1) and (2).
159 S. 562(3).
160 The Victorian Corporate Affairs Commission has pledged to conduct a major offensive utilising the new s. 562A: see "Changes at Corporate Affairs" note 29 *supra*, 1051.
161 See note 126 *supra*, 373.
162 Insolvency Act (1985), s. 17. See also discussion in Note, "Insolvent Abuse" (1986) 136 *New L J* 324.
163 Insolvency Act (1985), s. 18.

Committee, in recommending a new form of corporate entity, the close corporation, is concerned with deregulating the environment within which entrepreneurs operate but at the same time to protect the interests of creditors. The Australian Law Reform Commission is examining both individual and corporate insolvency because of the belief that present insolvency laws are probably out of date and unsatisfactory, a conclusion reached by the Cork Committee in England after five years of enquiry.

The criminogenic consequences of the present corporate forms or future forms have not been uppermost in the mind of company law reformers. The bottom of the harbour cases developed into a new art form the potentialities for abuse which were inherent in the present legal structures of our corporate law. One result of these cases has been the greater willingness for courts and legislators to pierce the veil. A great deal more can be done.

First, by whatever means, 'frivolous' incorporation should be discouraged. This can be done by requiring that only genuine trading concerns be allowed to incorporate or by mandating a minimum paid-up capital. Either method may have inhibited the proliferation of companies which were a necessary part of the bottom of the harbour schemes. Secondly, the process of intermediating property relations should be curtailed. The use of trusts and nominees has made the task of tracing assets illegally obtained extremely difficult but, short of abolishing the concept of the trust itself, the recommendations of the Companies and Securities Law Review Committee, that membership of close corporations be limited to natural persons and that natural persons be prohibited from holding any interest in a close corporation as nominee or trustee of a body corporate, has much to commend it.

Gates has argued, correctly in my view, that the "deliberate interposition of a company for the dominant purpose of circumventing the intended operation of a statute ... calls for a response that is positive, direct and comrehensive".[164] In his view the answer to abuse of the corporate form lies in the development of a "comprehensive, routine method of identifying beneficial owners and controllers".[165] This would be allied with a 'purpose' test to determine whether the corporate entity was established to circumvent the object of a statute and, as well, by a 'business activity' test whereby, if the corporate entity "engaged in no business or commercial dealings or performed no justifiable commercial functions, that could be a factor relevant to the overall determination to disregard the corporate entity."[166]

Thirdly, the relaxation of reporting requirements must be resisted. The Companies and Securities Law Review Committee has recommended that

164 S. Gates, "Disregarding the Corporate Entity in Favour of Beneficial Ownership and Control" (1984) 12 *A Bus L Rev* 162, 192.

165 *Id*, 194.

166 In the family law arena, the courts have attempted to circumvent the High Court's refusal to allow injunctions to be made against family companies, by developing a doctrine of "factual control" of property. Thus, although assets may be technically owned by a company, a party to the marriage may have factual control of those assets. That factual control may be used for the purpose of determining that party's financial resources: see D. Kovacs, note 67 *supra*, 175.

the new "close corporation" not be required to file annual financial returns but merely keep its record in such a way as would enable profit and loss statements and balance sheets to be readily audited. The experience of the bottom of the harbour cases shows that the existence of a public historical record of a company is an important part of the investigatory process and maintenance of such information on the public record obviates the need to obtain access to private premises as part of the investigation.

Fourthly, the intimate connection between taxation frauds and breaches of corporate law indicates the need for closer co-operation between state and federal prosecuting authorities. Ideally, the responsibility for corporations should be in the hands of one government agency, the Commonwealth. The present co-operative scheme has proved cumbersome and slow to change. The failure of state Corporate Affairs Offices to pursue investigations has in part been due to inadequate resources and in part to the fact that they are not seen as prosecuting agencies. The first defect is slowly being remedied by an injection of much needed funds.[167] The second could be overcome by transferring major prosecutions to the Director of Public Prosecutions in much the same way as taxation prosecutions are shared between that Office and the Australian Taxation Office.

Fifthly, curbs need to be placed on the widespread practice of making inter-company loans for purposes which are not remotely connected with the business of the company. This was a feature of the bottom of the harbour cases. Present legislation which prohibits the making of loans to related persons or companies does not include exempt proprietary companies and the proposed provisions of the close corporations legislation do not go far enough in controlling such activities. What clearly emerged from the tax conspiracies was that the interests of the companies, their directors and shareholders were rarely distinguished.

Finally, the extent of fraud and the use of new companies to replace the old failed ones, indicates the need for vigorous enforcement of the provisions in the Companies Codes relating to the disqualification of directors. There appears to be a need for legislation along the English lines which prevent the use of the same or similar names of failed companies and the provisions for personal liability upon disqualified directors who are involved with companies.[168]

The introduction of some or all of these reforms, together with a judicial attitude which regards substance rather than form as important,[169] will go some way to ensuring that the corporate veil, if not pierced, becomes at least a little more diaphanous.

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167 See statement by Ministerial Council in March 1987 stating that some $4 m are to be given to state offices to increase resources.

168 The Victorian Corporate Affairs Commission, following the recommendations of an Insolvency and Investigations Task Force established by the Attorney-General, intends to issue show cause notices to persons who were directors of two or more failed companies with a view to prohibiting them from taking part in the management of any other company for a period of up to five years: see "Changes at Corporate Affairs" note 29 *supra*.

169 See *e.g.* the judgment of Marks J. in *Vereker*, note 147, *supra*.