

ATO DIRECTOR PENALTY NOTICES DON'T DELAY, ACT QUICKLY!!

There are many ways that a company director can become personally liable for a debt. The most common way is through the provision by a director of a personal guarantee to a creditor.

When a company is placed into liquidation, a director can become liable to a liquidator for insolvent trading or as a consequence of some uncommercial transaction.

Under Section 588FGA of the Corporations Act 2001 (Act), a director may also become liable to the Commissioner for Taxation if an order is made requiring the Commissioner to pay monies to the liquidator which are determined to be a voidable transaction.

Directors can also become automatically liable to the Commissioner for Taxation if a director fails to comply with a Director Penalty Notice (**DPN**) under S222AOE of the Income Tax Assessment Act.

Personal Liability to Australian Taxation Office

Up until 1993, when a company was placed into liquidation, directors had little or no personal exposure to the Commissioner for Taxation for outstanding tax debts of the company because the Commissioner had a priority over other creditors in a liquidation.

The Commissioner lost that priority in 1993, as a consequence of reforms to the then Corporations Law.

The trade off for that loss of priority ranking however, was that the Commissioner could make directors personally liable for penalties for outstanding tax debts.

As a result of those changes, company directors are now personally liable for an automatic penalty equal to their companies unpaid remittance liabilities.

The penalty is imposed by the operation of Section 222AOC of the Income Tax Assessment Act 1936 (**ITAA**) which relevantly states as follows:

"If Section 222AOB is not complied with on or before the due date, each person who was a director of the company at any time during the period beginning on the first deduction day and ending on the due date is liable to pay the Commissioner by way of penalty, an amount equal to the unpaid amount of the company's liability under a remittance provision in respect of deductions for amounts withheld..."

This provision applies to anyone who falls under the definition of a director any time from when the tax was deducted to when it was payable.

Director Penalty Notice

Before the Commissioner can collect the penalty, however, the Commissioner must issue a DPN to the director under Section 222AOE of the ITAA.

The DPN provides that a director who receives such a notice has 14 days to do any one of the following:

- pay the amount stated in the DPN;
- enter into an Agreement in writing with the Commissioner to pay the amounts stated in the notice;
- cause the company to enter into administration; or
- cause the company to be wound up.

If the director complies with one of the four above options, the penalty will be remitted.

If the director does not comply with the DPN within the 14 day period, then the director will become personally liable for the amount stated in the Notice.

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ATO Policy on DPN's

According to the Chapter 14 of Receivables Policy published by the Australian Taxation Office, "Personal Liabilities of Company Directors" effective 24 July 2008, the Commissioner will endeavour to issue the DPN as soon as practicable after the penalty is incurred.

As stated in the Policy:

"This is consistent with the primary object of the Director Penalty Provisions which is to induce directors to either cause the company to pay the outstanding liabilities or to have the company quickly brought under some form of external administration so as to protect the interests of all creditors.."

The Policy adds that:

"the Commissioner also recognises that the prompt dispatch of DPNs can encourage directors to address a company's financial difficulties before they become insurmountable..."

Notice can be Served Even if Not Received by a Director

Receipt by a director of a DPN requires immediate action.

A serious and unfair problem facing Directors however, is that as a result of a recent decision of the Court of Appeal, the 14 day period does not commence from the date of receipt of the DPN but from the date of posting by the Commissioner.

Provided the Commissioner posted the DPN, the director can still become personally liable if the director fails to act within the 14 day period even if the director has not received the DPN.

In the decision of the Court of Appeal of *Deputy Commissioner of Taxation v Meredith [2007] NSWSCA 354*, the Court of Appeal made it clear that a director did not need to have received the DPN for the Notice to have its effect.

In that case, the director argued that there was "non receipt" of the Director Penalty Notice.

The Court of Appeal said:

"..Section 222AOF reveals a clear intention that the Commissioner will satisfy the precondition to the entitlement to recover the penalty if a notice is sent by post to the director's address as found in ASIC records." "...the precondition may be satisfied merely by posting a notice to the required address..."

The practical effect of the decision is that the 14 day period commences from the time that the DPN is posted to the director, not the time that the DPN would have been delivered by ordinary post.

According to the Decision Impact Statement issued by the ATO on 9 May 2008 in response to the Meredith decision:

"Before the Court of Appeal's decision in the Meredith matter, the Commissioner accepted that a DPN sent under s222AOE or s222APE sent to a director by ordinary pre-paid post was 'given' to the intended recipient at the time the DPN would have been delivered in the ordinary course of post and the director had 14 days after the day of delivery in the ordinary course of post to cause the company to comply with s222AOB and achieve remission of the penalties."

The Commissioner now accepts the decision of the Court of Appeal that a DPN...sent to a director by ordinary pre-paid post will be 'given' to the intended recipient at the time the DPN is posted..."

The Commissioner will calculate the time for compliance with the DPN from the date on which the DPN was posted, irrespective of whether or when the DPN was received or delivered."

If a director does not comply with the DPN within 14 days after the notice is posted to the director the Commissioner will be able to recover the penalties from the director personally.

If the penalty notice is not paid and no other action is taken by the director, the Commissioner can commence recovery proceedings against the director.

It Can Get Worse!

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The problems of the director however do not end if after receiving a DPN the director causes the company to pay the unremitted tax.

Even if the unremitted amount is paid in satisfaction of the DPN, the director can still be personally liable to pay the same amount to the Commissioner if the company is subsequently placed into liquidation.

This is because Section 588FGA of the Act entitles the Commissioner to recover from the director any sum which the Commissioner may be ordered to pay to the liquidator under Section 588FF.

This means that directors who cause the company to pay a tax debt to avoid personal liability after receiving a DPN may still become personally liable to the Commissioner under Section 588FGA for any amount that the Commissioner may order to pay to the liquidator.

If there is a risk that a company may become insolvent, a director who is served with a DPN faces a dilemma to either pay the debt and continue trading or alternatively place the company into administration or liquidation.

If the Director decides to pay the debt and continue trading the company, the director can still become liable to the Commissioner for amounts paid to the Commissioner if the company subsequently goes into liquidation.

Conclusion

A DPN is a powerful and effective collection tool for the Commissioner of Taxation.

Even though paying the outstanding amount may appear to be the simplest and most effective response, it is still possible for a director to become personally liable to the Commissioner under Section 588FGA of the Act.

The key for directors served with a DPN is to not delay and act quickly particularly as they may have less time than what they think to act before incurring an automatic penalty and personal liability exposure.

On receipt of a DPN a director should urgently obtain legal advice as well as advice from an insolvency practitioner.

If you would like any further information on this topic, please contact Irena Reiss on 8239 6505 or irena.reiss@kreissonlegal.com.au

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