

Director Penalty Regime in 2011



Practical Advice - Commercial Outcomes

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**27 June 2011, Justice Middleton in the
Centro Property Case :**

*“A director is an essential component of corporate governance. Each director is placed at the **apex** of the structure of direction and management of the company. The higher the office, the greater the responsibility. The role of a director is significant as their actions may have a profound effect on the community and not just shareholders, employees and creditors”.*

Facts & Statistics

- In the past two years there was a 400% increase in uptake of debt arrangements SME entered into 85,000 interest-free payment arrangements and deferred 1,500 payments.
- 600 prosecutions have been made in recent months.
- 450 individuals and 140 companies in the 3 months to June in penalties of more than \$9.5 million.
- With a tally of 1,700 (approx) for the past financial year.



“How can it be tax evasion when they caught me?”

- Increased prosecutions facilitated by the sophisticated investigating techniques.
- 2010 legislative changes saw increased the ATO powers clamping down on unpaid taxes and increased focus on phoenix avoidance.
- The cost of to the Australian economy is estimated between \$1 billion to \$2.4 billion p.a.
- Forecasted ATO departmental expenses for the next 4 years totaling \$22.1 million and generating \$260 million in additional revenue.

- May 2011 Budget the Government declared its intention to bring Stricter Penalties.
- Directors will be personally liable from 1 July 2011 to pay debts of failed businesses including employee superannuation.

Primary Objective

- ATO's Guidelines and Strategy for recovery of personal liabilities Practice Statements PSLA2011/14&18 state the primary objective of the DPN regime 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 Commissioner also recognises that the prompt dispatch of DPNs can encourage directors to address a company's financial difficulties before they become insurmountable.”*

Changes since 1 July 2010

- On 1 July 2010 the Tax Laws Amendments Act 2010 commenced
- The Act transferred the DPN provisions to the Taxation Administration Act 1953 (“TAA”) and are now set out in Division 269 of schedule 1 of the TAA.

Removal of Installment Arrangement Protection

- Prior to July 2010 a Director was personally liable for remitted PAYG unless within 14 days of the date of the DPN:
 - (a) The debt was paid;
 - (b) The company entered into an installment together
 - (c) The company entered into a VA; or
 - (d) The company was being wound up.

Removal of Installment Arrangement Protection

After July 2010

- The option was removed.
- Directors will now be personally liable even if the company enters into a payment agreement.
- A Payment arrangement only precludes the ATO from commencing proceedings.
- Once the company defaults the Director's liability arises.
- If PAYG remains unpaid for more than 21 days after the DPN date the Director is personally liable.

Commencement Date of Notice

- If the company is in provisional liquidation or a Receiver or Manager or a Controller is appointed the Director is not relieved of their obligations.
- **21 days starts from the date that the ATO posts the DPN.**
- The DPN date is the date it was posted not served.
- Division 269-50 deems service to have occurred by the DPN being left at or posted to an address held by ASIC. An ASIC search will satisfy this requirement.

Case Examples

- Section 205B CA a company must lodge with ASIC notice of any change in the personal details of a Director within 28 days after the change.
- If the ASIC register is incorrect it is the Director who is at risk of not receiving a DPN.
- **This is all about to change....**

BEWARE – Increased Directors Reforms are Imminent

- In the May 2011 Budget tougher changes were announced.
- Draft exposure bill titled “*Tax amendments to strengthen company Director liabilities and deter fraudulent phoenix activity.*”

Main Changes expected to be enacted by Parliament before the end of year 2011.

BEWARE – Director Liability Set to Increase

- Director penalty regime extended to superannuation.
- The ATO power to be extended to commence recovery without providing a 21 day grace for certain unpaid company liabilities that remain unreported after 3 months of becoming due.
- This means that placing the company into VA liquidation after 3 months does not avoid personal liability.
- Certain circumstances, Directors and associates of Directors will be prevented from obtaining credits for withheld amounts in their individual tax returns, where the company has failed to pay withheld amounts.

Defence Options Narrowed

- Before commencing recovery action in respect of a DPN. Commissioner will evaluate any defence alleged pursuant to section 269-35 Schedule 1 TAA.
- After considering all documentation and evidence and it is apparent the Director could satisfy the court and they have a valid defence the Commissioner will not initiate (or continue) recovery proceedings.
- Personal liability applies to a Director appointed prior to the date of the DPN regardless of when they resign.

Defence Options Narrowed

Directors who are liable for penalties may seek to invoke the following defences;

- Because of illness or for some other good reason then it would be unreasonable to expect the Director to take part and the director did not take part in the management of the company.

or

- They took all reasonable steps to ensure the Directors complied with their relevant obligations or there were no such steps that the Director could have taken.

Defence Options Narrowed

- In determining reasonable steps it is relevant when and for how long the person was a Director and took part in the company's management and "all other circumstances."

Tip : Keep Minutes of Meetings if you want to do the right thing and the others don't

Payment of the Debt May Still Not Be Enough

- If the company goes into liquidation within 6 months of the payment to the ATO, the liquidator may claw back the payment as an unfair preference from the ATO Section 588FA of the Corporations Act.
- Section 588FGA. If a remittance liability is held to be a void transaction, Directors are liable to indemnify the Commissioner to return that payment to the liquidated company.

Security Deposits

- The ATO has a discretion to require a company to provide security where reasonable to expect the company would be unable to meet its tax obligations.

Security may be sought where:

- a taxpayer requests the Commissioner defer the time for payment of a debt;
- a taxpayer is seeking to pay a debt by installments;
- The Commissioner has reason to believe the taxpayer intends to carry on business for a limited period only;
- the taxpayer admits they are temporarily unable to pay the taxation debts;

Security Deposits

- A debt is subject to dispute and an arrangement has been made with the Commissioner.
- The taxpayer appears to be dissipating assets.
- The taxpayer wishes to leave Australia but is not in a position to pay the debt before leaving;
- The taxpayer is seeking a departure authorisation certificate from the Commissioner
- There is any other indication that the revenue may be at risk.

Security Deposits Requirement to Give More Notice

- The security notice must be served on the taxpayer and must;
- explain why the Commissioner requires the security.
- set out the amount of the security;
- describe the means by which the taxpayer is required to give the security.
- specify the time by which the taxpayer is required to give the security; and explain how the taxpayer may have the Commissioner's decision to require security reviewed.
- A taxpayer from whom security is requested has right of review under the Administrative Decisions (Judicial Review) Act 1977.

Types of Security

The preferred securities are;

- Registered first mortgage from the taxpayer or a third party, over freehold property;
- a registered second or subsequent mortgage from the taxpayer or a third party, over freehold property where there is sufficient equity in the property to secure the tax debt whilst ceding priority to the first or prior;
- an unconditional bank guarantee from an Australian bank where the bank pays the Commissioner upon demand;

Firmer Action Approach

- The ATOs firmer action approach is outlined in the fact sheet current as at December 2010 and is a useful guide for what to look out for to avoid being caught out.

Firmer Action Approach

- a) of course paying the right amount of tax, on time, has to be top of the list.
- b) Keep adequate and accurate records.
- c) Stick to proven, genuine tax deductions.
- d) Use legitimate business structures.
- e) Make sure your business is registered for all the appropriate taxes.

Firmer Action Approach

- a) Keep your contact details up to date (so you don't miss important information from relevant organisations or branches of government);
- b) Never 'back date' your documents;
- c) If you receive DPN must act immediately;
- d) Keep ASIC informed of your address. It is your responsibility and if not brought to your attention bad luck and you may consequently lose opportunity to avoid personal liability;
- e) Keep minutes of meetings if want to do right thing and others don't as past directors can be held liable as well.

The stated approach is to:

- *“take into account individual circumstances to determine the best way to clear your debt. For businesses, we may also review viability to determine the appropriate firmer action to take”.*
- Firmer action will not be taken if you are complying with an agreed payment arrangement, including lodging and paying current obligations on time.

When is Firmer Action Taken

- You choose not to work with us despite multiple attempts by us to contact you.
- You repeatedly default on your payment arrangements.
- Your debt is escalating and there is no evidence that you will be able to meet your ongoing tax obligations.
- You have been subject to an audit where deliberate avoidance was detected and payment avoidance is continuing.
- For business operators, where there is evidence that liquidation is being used to avoid financial obligations, risking assets.

What Can You Do If Firmer Action is Being Taken?

- Pay in full.
- Consider deferring firmer action if you make an agreed lump sum payment towards your outstanding tax debt and enter into a direct debit payment arrangement for the balance of the debt.
- For businesses with a debt greater than \$100,000, you will need to demonstrate that your business is viable before firmer action is deferred.

Risk Management

- Simple steps that can be taken to prepare for the anticipated changes and avoid personal liability:
- Make sure your BAS are up to date.
- make sure BAS are lodged within 3 months of the due date .
- Even if the company cannot pay a debt arising from a return, make sure you lodge it anyway to avoid personal liability;
- This also signals the need to address the solvency of the company and seek immediate assistance from a insolvency practitioner

Risk Management

- Remember even if a director avoids personal liability arising from DPNs, he or she may still face personal liabilities under the Corporations Act trading for whilst insolvent. Therefore seek advice early.