Personal liability — expanding the director penalty regime

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- Directors are now personally liable for their company's unpaid superannuation guarantee amounts in addition to PAYG withholding amounts
- House of Representatives Committee recommended that the original proposal introduced in 2011 was too broad in that it transcended the purpose of targeting phoenix companies
- Although companies with adequate existing compliance arrangements are not burdened by the amendment, it does extend the responsibilities for directors who need to establish they took reasonable care regarding superannuation and tax obligations

The director penalty regime has been revised under recent reforms introduced by the Federal Government.

The Tax Laws Amendment (2012 Measures No 2) Bill 2012 was introduced into the House of Representatives on 24 May 2012 and was referred to the House of Representatives Standing Committee on Economics (Standing Committee) on that day. The bill was passed by the Senate and received royal assent on 29 June 2012 (Amending Act).

The Amending Act makes substantial amendments to federal legislation including the *Taxation Administration Act 1953* (TAA), *Superannuation Guarantee (Administration) Act 1992* (SGA), *Corporations Act 2001* (Corporations Act), *Income Tax Assessment Act 1997*, *Taxation (Interest on Overpayments and Early Payments) Act 1983* and the *Tax Laws Amendment (Taxation of Financial Arrangements) Act 2009*.

The key amendments as contained in Sch 1 of the Amending Act include:

- extending the director penalty regime (DPR) to make directors personally liable for their company's unpaid superannuation guarantee amounts (in addition to the existing obligation relating to PAYG withholding)
- allowing the Commissioner to pursue directors without issuing a director penalty notice in circumstances where a company's PAYG withholding obligations and superannuation guarantee obligations remain unpaid and unreported for a period of three months after the due day for the company's liability. The objective is to discourage directors from placing their companies into administration or liquidation
- extending the period of application in which the regime captures new directors from 14 days to 30 days from their appointment date
- allowing directors to raise a defence to a director penalty notice within 60 days of the notification. (It is also proposed that the Commissioner be given the power to send notices to a director's tax agent).

The Amending Act is the second attempt by the government to introduce reforms to the DPR. The first attempt had been in 2011 as part of the Tax Laws Amendment (2011 Measures No 8) Bill (first bill). However, the reforms to the DPR as contained in the first bill were removed before the first bill was passed on recommendation of the Standing Committee for being broader then the intended purpose of specifically targeting phoenix operators.

This article will briefly:

- explain the current DPR
- explain the key reforms under the Amending Act and
- consider whether the Amending Act adequately achieves the government's intention of protecting workers' entitlements and deterring phoenix activities.

A snapshot of the director penalty regime prior to the Amending Act

Company directors have duties under various Australian tax laws to withhold amounts from payments made to employees in the form of wages, or fees paid to directors (that is, the PAYG withholding regime) and to remit those amounts to the Commissioner within a prescribed period.

Under the DPR, directors have a duty to either cause their company to meet its tax obligations or otherwise put the company into liquidation or voluntary administration. The DPR makes directors of companies that fail to meet these statutory obligations personally liable, by way of a penalty, for an amount equal to what is owed by the company and that should have been paid on the due day.[1]

To recover the outstanding debt, the Commissioner must issue a director penalty notice (DPN). However, the Commissioner cannot commence proceedings to recover a penalty until the end of 21 days from the date the Commissioner issues the DPN.

What does a director penalty represent?

Where an employer does not pay the correct amount of superannuation guarantee contributions on behalf of its employees, this is referred to as the superannuation guarantee shortfall (SG shortfall). Where there is an SG shortfall, a superannuation guarantee charge (SGC) arises.

A director's penalty will represent the amount of SGC that the employee was entitled to and that the company should have paid to a superannuation fund. The SGC is assessed:

- by the employer through the lodgment of a SGC statement
- by the Commissioner through a default assessment or
- as estimated by the Commissioner and notified in a notice of an estimate issued by the Commissioner.

What has triggered the expansion of the director penalty regime?

The reforms contained within the Amending Act originated from the *Action Against Fraudulent Activity* proposals released by the government in 2009 and the 2010 *Review into the ATO's Administration of the Superannuation Guarantee Charge* (SGC review). The proposals and the SGC review were particularly concerned with addressing phoenix activities. The SGC review resulted in a number of recommendations designed to improve the superannuation guarantee system. The recommendations included seeking a deterrence or penalty effect on those who do not lodge SGC statements on time or who delay payment of SG entitlements.[2] The recommendations placed an emphasis on protecting employee entitlements especially for those most at risk.

The new director penalty regime following introduction of the Amending Act

The explanatory memorandum to the Amending Act states that:

> Phoenix activity poses a significant threat to employee entitlements, government revenue, and the economy as a whole. In its most basic form, a fraudulent phoenix company is used to intentionally accumulate debt and then is placed into voluntary administration or liquidation to avoid paying those debts.[3]

The old DPR was limited to PAYG withholding. However, under the Amending Act, the DPR is expanded to capture unpaid SGC. Therefore, directors of companies will be personally liable for the superannuation guarantee obligations of those companies.

The amendments are designed to:

> deter company directors from engaging in phoenix activities or using amounts for company or other purposes that should be paid to the Commissioner or superannuation funds.[4]

Liability of directors

Liability of existing company directors

Under the old DPR, company directors were liable for a director penalty at the end of the due date, being the day that the company was obliged to pay to the Commissioner its PAYG withholding amounts and had not done so. A SGC was not due and payable until either it is assessed by the employer lodging a superannuation guarantee statement or the Commissioner issuing an assessment.

Under the Amending Act, a company's SGC is treated as payable on the day that an employer is required to lodge a superannuation guarantee statement for a quarter or a later day as may be permitted by the Commissioner. In the event that a company does not meet this obligation, the current directors will become liable to a director penalty.

Does liability extend to new directors?

Under the old DPR, new directors were liable if, within 14 days of becoming a director, they do not arrange for the company to take the appropriate action to pay an outstanding debt. However, under the Amending Act, new directors will only be liable where the company fails to meet its obligation by the due date and 30 days after the new director's appointment.

Extinguishing liability

Under the old regime, a director could extinguish their personal liability in one of three ways, (either before a director penalty is issued, or within 21 days[5] of the notice period), by:

(a) by paying the outstanding debt

(b) appointing an administrator under the Corporations Act or

(c) commencing to wind up the company.

Under the Amending Act, directors will not be able to extinguish their personal liability by relying on items (b) and (c) above where three months have passed from the due day for the outstanding liability and the liability remains unpaid and unreported (three-month rule). These remission options do not apply to new directors until a period of three months from the day of their appointment. This proposal is said to be designed to prevent phoenix activity, that is, where a company on receipt of a DPN from the Commissioner places the company into liquidation or starts to wind up the company.

Defences for directors

Under the old regime, there were two defences available to directors. These were:

- illness — where a director had an illness that prevented that director from involvement in the management of the company or
- reasonable steps — where a director took all reasonable steps to ensure compliance with one of the following:
  (a) paying the outstanding liability
  (b) appointing an administrator or
  (c) commencing wind up of the company.

The steps in (b) and (c) above are somewhat limited under the introduction of the new three-month rule.

However, in addition to these defences, under the Amending Act a director is not liable where the director can establish that the director penalty resulted from the company's reasonable interpretation of the SGA; that is, where the company took the view that the SGA applied to facts in a certain way that was reasonably arguable. The company must demonstrate that it took reasonable care (tested against all the company's circumstances, including knowledge, experience and skills) in establishing the application of the SGA to such facts. PAYG withholding obligations do not have a similar defence.

Recovery of liability from third parties

The Amending Act extends the Commissioner's powers of collection. The Commissioner may collect amounts from third parties to discharge a director penalty. If this occurs, a director may raise a defence within 60 days from the date a notice is received that a recovery has occurred or from receiving a copy of a notice issued to a third party. This period does not apply where the Commissioner has recovered the amount under court proceedings.

Commissioner's expanded powers

Under the Amending Act, the Tax Commissioner's powers will be expanded to permit the Commissioner to:

- estimate unpaid SGC in addition to the power to issue an assessment to quantify an unreported SG shortfall and
- serve a notice on a director or a copy of a director penalty notice at the directors' tax agents' address.

The power given under the Amending Act to the Commissioner with respect to estimating unpaid SGC is also designed to deter phoenix operators. This is because the ability to issue an estimate gives the Commissioner power to take prompt action to recover outstanding liability without having to wait for an assessment to be issued. The estimate treats the SGC as due for payment on the day the SG shortfall should have been lodged in a statement to the Commissioner. General interest charges do not accrue until an assessment of SGC is made.

Directors can respond to the estimate given by the Commissioner in a statutory declaration or affidavit that includes the director's details, the details of the employees for which the unpaid SG shortfall applies, the amount of the SG shortfall, and the action taken by that director to comply with the SGC obligations. The submission may result in the Commissioner reducing or revoking the estimate.

Has the Amending Act gone too far?

Broadly, the proposals contained in the Amending Act do not introduce new practices. The Amending Act merely expands current practices with respect to PAYG withholding obligations to capture those phoenix operators who are misusing the current DPR.

The concern that was raised to the first bill, and alluded to by the Standing Committee in its report[6], was that the reforms were intended to deter phoenix activities. They were not intended to capture all directors including those who were honest but for reason of oversight fell foul of the DPR. The Standing Committee recognised these concerns under the first bill and recommended that the government 'investigate whether the [tax legislation] should specially target phoenix operators and whether the defences in the [tax legislation] should be expanded'.[7]

In our view, directors of companies who have established compliance arrangements should not be alarmed with the revised DPR under the Amending Act. Assuming that a company has compliance arrangements that are adequate, they should be sufficient to raise awareness of tax obligations. However, even in cases of mere oversight, directors are given a reasonable period of notice which should provide sufficient time for an honest director to arrange for the company to make good a delay in payment or an error in payment due to oversight.

The new DPR raises the bar for directors. As a consequence, company directors (whether executive or non-executive) should be actively involved in the review and oversight of the company's tax obligations. A mere reliance on a company accountant or bookkeeper's report to the board alone may not be sufficient support enlivening a defence. Directors will need to be able to establish that they took 'reasonable care' with respect to the company's tax obligations and their duties as directors generally.

Getting ready

In responding to the new DPR, directors should take the following steps.

Review and implement

Undertake a review of existing procedures or implement procedures (covering tax governance and compliance) to ensure adequate compliance with the expanded DPR. Where existing compliance procedures are in place, directors could merely tweak these to capture superannuation guarantee obligations.

Establish policy

Establish a DPR policy. This policy could summarise the duties of directors under the DPR and could be given to each new director. Existing directors could review this policy to ensure ongoing compliance.

Review insurance

Consider whether the company has sufficient directors' and officers' insurance protection or whether such insurance should be taken out.

Seek professional advice

Ensure that the company and its directors obtain appropriate professional advice to ensure the company's compliance with its legal obligations so as to prevent penalties being made against directors personally.

Small business owners, family business operators and sole directors are particularly encouraged to seek professional advice to ensure that they understand their tax obligations.

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Notes

1 The duty extends to a person who was a director for at least some of the period before the date the company became liable to pay the tax obligation
2 Noroozi A (Inspector General of Taxation), 2010, *Review into the Australian Taxation Office's Administration of the Superannuation Guarantee Charge*, Australian Government
3 p 10, para 1.11
4 p 11, para 1.16
5 It had been proposed in the Tax Law Amendment (2011 Measures No 8) Bill that the 21-day period be removed. This proposal has not been carried through in the Amending Act
6 House of Representatives — Standing Committee on Economics, 2011, *Advisory report on the Tax Laws Amendment (2011 Measures No 8) Bill and the Pay As You Go Withholding Non-Compliance Tax Bill 2011*
7 ibid, p iv ■