Personal Liability for Company Tax Debts Draft Legislation – Director Penalty Notices - What you don't know can hurt you!

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The Treasury has released draft legislation dealing with changes to the director penalty notice rules announced in the 2011/2012 Federal Budget.

Much of the government's publicity around the proposed changes has focused on fraudulent phoenix activity. The draft legislation, however, has relatively little to say about phoenix companies and a whole lot of detail about how the Australian Taxation Office (ATO) will have even greater powers to attack directors personally for company tax debts.

The key features of the proposed legislation are:

1. Unpaid superannuation guarantee amounts will be caught by the director penalty provisions
2. The ATO can avoid issuing a director penalty notice (and prevent directors having 21 days to relieve themselves of personal liability) where a company has unpaid liabilities that remain unreported for 3 months after the due date.
3. The Commissioner can prevent directors (or their associates) from receiving credit for PAYG withholding amounts where a company has failed to pay all those amounts to the ATO.

Requirement to issue a Notice

Under the existing DPN regime, the ATO must issue a director penalty notice prior to taking collection action. If the company is placed into liquidation within the prescribed time a director's personal exposure falls away.

A policy rationale for the 21 day notice period is to encourage the winding up of companies with escalating tax debts. This policy reflects criticism of the Tax Commissioner (going back many years) that he let tax debts escalate unchecked because he had a priority for tax claims, at the expense of other creditors who were unlikely to have known that tax liabilities were spiralling out of control.

The draft legislation removes the requirement for the Commissioner to give notice in some cases. This is a significant shift away from this original policy rationale and expands the net of personal liability.

Notices will not be required where the Commissioner takes administrative collection action (that is he does not formally sue to recover the claimed penalty) and also where a company has failed to attend to reporting requirements by the due date.

Administrative Collection

The Commissioner's armoury of administrative recovery powers include the ability to take tax credits that a director might otherwise be entitled to and to take money payable to a director by employers, banks and entities holding the proceeds of the sale of property amongst others. If the penalty notice rules do not need to be followed in these cases, the first a director may know about personal liability for company tax debts is when an EFTPOS transaction to pay for groceries is declined because there are insufficient funds left in the bank account.

The genesis of the proposed provision makes interesting reading. The original rule (Section 222AOE IITAA 1936) stated that the Commissioner was “not entitled **to recover** from a person a penalty… until the end of 14 days after the Commissioner gives the person a notice…” If “recover” means “collect” then a notice was required in every case, including administrative collection actions.

The rules were “re-written” with little fanfare, effective from 1 July 2010. The re-written provision (section 265-25 ITAA 1997) states that “the Commissioner must not commence **proceedings to recover** from you a penalty … until after the Commissioner gives you a written notice under this section.”

Proposed new Section 265-25 finally puts the Commissioner's cards on the table, and makes it clear that the penalty notice provisions only apply to “**proceedings before a court to recover**....a penalty”. A note to the new section now expressly acknowledges that the notice provisions will not apply to money collected under garnishee notices, amongst other things.

Lodging Late

The Commissioner will also be able to avoid the notice rules where a company overlooks lodgements for more than 3 months, and in some other circumstances. This will mean that there will no longer be an opportunity for a director to satisfy his or her obligations so that they are not personally liable for tax debts by putting the company into liquidation within the specified period. Removing the incentive for directors to liquidate a company is a significant shift away from the policy position that underpinned the DPN regime in the first place.

Defences

There are some very limited statutory defences that may be available to directors, such as where a person was too ill to participate in the management of the company. If the Commissioner can avoid the notice rules when he issues a garnishee notice on a bank (for example), what happens to these defences?

The new legislation will make these defences available where administrative action is taken, but will require any defence be raised within 60 days of notice of the administrative recovery steps.

What the draft legislation does not spell out is how a defence is to be raised where court proceedings are not on foot. If the Commissioner's existing policy on DPN debt recovery matters is any guide, the Commissioner himself may make the decision on the availability of any defences raised by a director.

Where to from here?

These are only some of the changes hidden in the detail of the draft legislation, however they make it clear that even though there is already significant personal risk for directors (and their families) things are about to get a whole lot worse.

In our experience, putting the tax detail in the too hard basket is a sure fire recipe for disaster. Given the new powers that the Commissioner is seeking, directors must be on top of company tax issues (such as superannuation contribution obligations in respect of contractors), and should review their personal asset protection arrangements.

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