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Legal Alert

July 2011.

Director Penalty Notices – increasing directors' personal liability

Key Summary

Twelve months ago, the Government made a number of amendments to the Director Penalty Notice (DPN) regime, designed to streamline the processes associated with the issue and enforcement of DPNs. In so doing, the Government has given notice of its intentions regarding the DPN regime and all directors should ensure that they are familiar with the effects of the proposed changes.

Current DPN regime

Given the proposed changes, it is important that directors re-familiarise themselves with the DPN current regime. This will allow them to promptly take steps to put in place adequate arrangements to ensure that a DPN is dealt with as quickly as possible, given the potential for a DPN to trigger significant personal liability on the part of company directors.

Currently, the DPN regime imposes a duty on directors to cause the company to remit all withholding amounts (e.g. PAYG) payable to the ATO.

Enforcement of that duty is effected by the imposition of a penalty on directors of the company at the time the taxation liability falls due. The penalty is equal to the amount of the taxation liability payable by the company. When the company has paid the outstanding amount to the Commissioner, the penalty is reduced to zero. Alternatively, should the company be unable to pay the outstanding amount, the penalty can be reduced to zero by way of the director(s) promptly acting to appoint an administrator or a liquidator to the company. Should neither of these measures be undertaken, the ATO is able to take measures to enforce the penalty personally against the directors.

Before doing so, the current DPN regime requires that the directors of the company be given a "polite final reminder" of their duty to cause the company to remit withholding amounts. That reminder takes the form of a DPN served on the director identifying the relevant outstanding taxation amount.

A recipient of a DPN has only 21 days from the date of posting of the DPN within which to cause the company to:

- pay the outstanding taxation liability in full;
- enter into a payment arrangement with the ATO for payment of the whole of the outstanding liability; or
- appoint an administrator or a liquidator to the company.

Once the proposed DPN regime changes are enacted, the regime will also impose automatic personal liability on directors in respect of unreported withholding amounts associated with employees. It is recommended that directors act now and review their company's relevant reporting and payment processes associated with withholding amounts, to avoid the substantial personal risks that are currently in place, as well as those wider risks that will soon be enacted.

Should a DPN not be complied with, the ATO is entitled to enforce the penalty against the recipient director personally. The narrow range of defences available under the DPN regime (DPN Defences) requires that a director:

- was not involved in the management of the company; or
- took all reasonable steps to achieve compliance, or otherwise no such steps were available.

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DPN Policy Changes: 2011 – 2012 Budget

The Budget announcement set out three areas of DPN policy change, which are aimed at countering 'fraudulent phoenix activity' – categorised by the Government as being the intentional accumulation of debts to improve cash flow or wealth followed by liquidation of the company in order to avoid paying the debt(s), as a result of which the business is continued, free from its previous debts and liabilities, via another corporate entity controlled by the same person or group.

These policy changes, and the associated Government rationale for each, are summarized below.

Personal liability of a director able to be enforced without a DPN being issued in respect of unpaid company liabilities falling within the DPN regime which are unreported for more than three months after falling due.

Withholding amounts caught by the current DPN regime are effectively held on trust by a company for the Commissioner, and should therefore at no stage be included in a company's cash flow.

The proposed change will only affect companies which do not report their outstanding liabilities, and directors who become personally liable as a consequence will maintain a right of indemnity against the company for such amounts.

Companies that report their outstanding liabilities in the ordinary course will still be subject to the current regime, which requires the issue of a DPN to a director before personal liability can be enforced.

Extension of the DPN regime to include superannuation guarantee amounts.

While superannuation guarantee amounts are not strictly held 'on trust' by a company for the Commissioner, they are amounts which a company is required to pay for the benefit of its employees.

Personal liability for these amounts is to accrue as superannuation guarantee amounts represent a form of employee entitlement withheld by the employer and if these amounts are not recovered from the employer, their benefit to the employee is lost completely.

Preventing directors and associates of directors from obtaining personal tax credits for withheld amounts in circumstances where the company has failed to pay those withheld amounts to the Commissioner.

Unlike superannuation guarantee amounts, an employee is entitled to a credit for PAYG amounts even if they have not been remitted to the Commissioner.

This change will allow the ATO to deny PAYG credits to directors of companies and their families which have not remitted, rather than not withheld, PAYG amounts.

Given the lack of any legislation, at this stage there remain a number of unanswered questions about:

- when these changes will be enacted, and what will be their final terms; and
- whether the changes operate retrospectively from 1 July 2011 (or some other date as set by the amendments).

Nevertheless, it is strongly recommended that directors be diligent in ensuring that they have a clear picture of the financial circumstances of their company, particularly in the reporting of taxation liabilities and superannuation guarantee amounts associated with employees.

Conclusion

In announcing the proposed policy changes to the DPN regime, the Government's stated aim is to ensure that the DPN regime focuses directors' attention on all withholding amounts associated with employees being paid to the ATO or, in the case of superannuation guarantee amounts, to the benefit of the employees, rather than being used to support the cash flow of the company. For directors who neglect to undertake such measures, the DPN regime imposes significant personal financial consequences.

This article was prepared by Colin Brown, a partner in our insolvency and reconstruction team. We invite you to contact Colin or Michael O'Neill, should you have any questions or require any further information about the matters discussed in this article.

The contents of this article are intended to provide only a general summary on matters of interest and are not comprehensive, nor does this article constitute legal advice. You should seek legal or other professional advice before acting or relying on any of the contents of this article.

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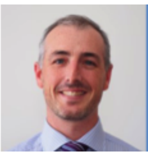

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