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# CREDIT ISSUES

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## WOODGATE & CO.

Chartered Accountant  
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### DIRECTOR PENALTY NOTICES

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#### History

On 1 July 1993 the *Insolvency (Tax Priorities) Legislation Amendment Act 1993* (Cth) introduced the Director Penalty Notice ("DPN") system, whereby the Australian Taxation Office ("ATO") could make a director personally liable for overdue taxes withheld from gross wages and salaries paid by a company. The reason for the introduction of the DPN system was because from 1 July 1993 the ATO no longer received priority in respect of pre-appointment debts under Section 221P of the *Income Tax Assessment Act 1936* (Cth) ("ITAA") over other unsecured creditors in respect of unpaid group tax.

#### Amendments to the law

On 1 July 2010 the *Tax Laws Amendments (Transfer of Provision) Act 2010* (Cth) ("the Act") commenced. The Act transferred the DPN provisions previously located at Part VI of the *ITAA* to the *Taxation Administration Act 1953* (Cth) ("TAA"). The legislative intention was to simplify the *ITAA*. As a consequence of the Act, the DPN provisions are now set out in Division 269 of Schedule 1 of the *TAA*.

The Act makes the following

amendments to the DPN regime:

- (a) the notice period of a DPN now commences on the date that it is posted, rather than when it is served on the director's last Australian Securities and Investments Commission ("ASIC") recorded address. This codifies the judgment of the New South Wales Court of Appeal in *Deputy Commissioner of Taxation v Meredith*;
- (b) the period of notice which the ATO is required to give directors before it can commence recovery proceedings against a director is extended from 14 days to 21 days. Further, the period of time within which the director has to ensure the company's compliance is also extended from 14 days to 21 days; and,
- (c) a director now has 21 days, from the date that the ATO posts the DPN, to ensure that the company does one of the following:
  - (i) complies with its obligation to pay the tax debt; or,
  - (ii) a Voluntary Administrator is appointed to the company

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under Part 5.3A of the *Corporations Act 2001* (Cth) ("*Corporations Act*"); or,

- (iii) that the company is wound up within the meaning of the *Corporations Act*.

If the director (or the company) does nothing and the debt is not paid, then he or she becomes personally liable for the amount set out in the DPN notice.

Importantly, if the company is in provisional liquidation or a Receiver and Manager or other Controller is appointed, the director is not relieved of his or her obligations.

### **Change of addresses**

Section 269-50 of the *TAA* states that the Commissioner of Taxation may serve a DPN by leaving it at or posting it to an address that appears, from information held by ASIC, to be, or to have been within the last seven days, the director's place of residence or business. An ASIC search will satisfy this requirement.

Section 205B(4) of the *Corporations Act* requires a company to lodge with ASIC notice of any change in the personal details of a director or secretary within 28 days after the change. The notice is lodged on a Form 484.

Whilst it is the company's obligation to ensure that the personal details of its directors are correctly maintained at ASIC, it is the director who is at risk of not receiving a DPN, if ASIC's records are incorrect. We are aware of several instances of DPNs being sent to directors' former addresses. Those DPNs were not brought to their attention until after the DPNs had expired. In one case, the DPN was for approximately \$199,000 and the

director subsequently filed for bankruptcy.

### **Tightening of defences**

Two loopholes in the DPN regime have now been closed, namely:

- (a) the company entering into a payment arrangement with the ATO will now not relieve the director of his or her obligations. The amendments merely preclude the ATO from commencing proceedings to enforce the obligation. As soon as there is a default by the company, the director's liability arises; and,
- (b) the illness or other good reason defence has been amended to make it more onerous. The defence may only be made out if it is proved that because of illness or some other good reason attributable to the director, it would have been unreasonable to expect the director to take part in the management of the company at that time; and the director did not take part in the management of the company.

It is likely that the illness or other good reason defence will be strictly limited by the Courts, having regard to a director's duty to participate in the management of the company as reiterated by the New South Wales Court of Appeal in *Deputy Commissioner of Taxation v Clarke*.

The amendments also state that Section 1318 of the *Corporations Act* does not provide relief to a director from his or her obligations or liabilities in respect of a DPN.

### **Further amendments**

The ATO is concerned about the risk to revenue from phoenix activities,

particularly as the ATO is often the only substantial creditor. Further, the ATO's annual report for the year ended 30 June 2010 noted that \$3.9B of total tax debt was classified as insolvency debt. This represented 14% of the ATO's total debt.

We can expect that the ATO will seek to further widen the scope of the DPN regime to include other withholding tax debts, such as superannuation and goods and services tax.

The ATO's website states that 5,200 DPNs were issued per year, under the previous DPN regime. In circumstances where there is Government pressure on the ATO to protect revenue, we can expect the number of DPNs issued by the ATO to increase.

### **Avoiding the potholes**

If after receiving a DPN, the director ensures that the company pays the debt to the ATO, then the director's risk has not been totally removed.

If the company goes into liquidation within six months of the payment to the ATO, the Liquidator may claim the payment is an unfair preference under

Section 588FA of the *Corporations Act* and sue the ATO to recover the payment. The ATO may then join the director as a cross defendant pursuant to Section 588FGA of the *Corporations Act*. Under Section 588FGA, if the ATO is ordered to repay the preference payment to the company in liquidation then, unless the director can sustain a defence, he or she indemnifies the ATO for its loss or damage. The loss or damage includes any costs or interest Ordered by a Court against the ATO.

### **Solution**

If a DPN is received by a director because PAYG withholdings were not paid as and when they fell due, the director should take immediate advice so that the appropriate remedial action can be taken.

Even if a director avoids personal liability arising from DPNs, he or she may still face personal liabilities under the provisions of the *Corporations Act* for trading whilst insolvent.

Woodgate & Co. can assist directors to determine the appropriate remedial action in the event of the receipt of a DPN.

**WOODGATE & CO.**

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