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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

The Director Penalty Notice (“DPN”) system, was introduced on 1 July 1993, following amendments to the *Corporations Law* (as it was then) in response to the Harmer Report. The DPN system imposed obligations on a director and if those obligations were not met, made a director personally liable for a penalty equivalent to overdue taxes withheld from gross wages and salaries paid by a company. The Australia Taxation Office (“ATO”) could not collect the penalty until a notice was served on the director. The DPN system also provided limited defences.

The DPN system was amended from 1 July 2010. The four obligations on the director in the original system were replaced by the single obligation to ensure the company complied with its payment obligation. The director’s obligation to ensure payment by the company also ceased if an Administrator or Liquidator was appointed to the company. Effectively this meant that a director’s penalty was remitted, if 21 days from the date that the ATO posted the DPN to the director, one of the following had been achieved:

(a) the company complied with its

obligation to pay the tax debt; or

- (b) an Administrator had been appointed to the company under Part 5.3A of the *Corporations Act* 2001 (Cth) (“*Corporations Act*”); or
- (c) the company was wound up within the meaning of the *Corporations Act*.

If the director did nothing and the debt was not paid by the company, then the ATO was entitled to commence proceedings to recover from the director the amount set out in the DPN. If an Administrator or Liquidator was appointed within 21 days of the DPN being posted, then the director’s personal liability was remitted.

#### Intention of the 2012 Amendments

On 29 June 2012 the DPN regime was further amended when the *Tax Laws Amendment (2012 Measures No. 2 Act) 2012 (Cth)* (“*Amendment Act*”) received royal assent. The revised explanatory memorandum to the *Amendment Act* stated that the intention of the DPN regime is to ensure that directors cause their company to meet certain taxation obligations or promptly put the company into liquidation or voluntary

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administration. The June 2012 amendments made significant changes to the defences available to directors and to remission of penalties.

The amendments also aim to deter company directors from engaging in phoenix activities or using company funds that should be paid to the ATO or superannuation funds.

The ATO expects, over five years, to collect a further \$300M as a consequence of the amendments to the DPN regime.

### **Amendments to the law**

The DPN system has always provided that directors were personally liable for PAYG withholdings withheld from wages and salaries. The DPN regime has now been extended to include the unpaid superannuation guarantee charge ("SGC"). Further, in addition to estimating unpaid PAYG withholding liabilities for the purposes of issuing a DPN, the ATO may also estimate unpaid SGC.

As a consequence of the 2012 amendments, the extent to which a director's liability for PAYG withholdings or SGC is remitted by the appointment of an Administrator or Liquidator is as follows:

- (a) any amounts overdue for up to three months which have not been reported; and,
- (b) any amounts overdue which have been reported to the ATO.

Directors will not be able to remit their personal liability by placing the company into voluntary administration or liquidation when PAYG withholdings or SGC are

unreported and unpaid three months after the due date.

Other amendments to the DPN regime are as follows:

- (a) there is an element of retrospectivity in that liabilities incurred prior to 29 June 2012 but which became due for payment either before or after that date, are subject to the new DPN regime;
- (b) the ATO may now serve a DPN on the company's tax agent; and,
- (c) a new director is not liable under the DPN system, until 30 days after becoming a director.

Even if three months has lapsed from the due date of an unreported PAYG withholding or SGC debt, in order to recover the debt from a director, the ATO must still issue a DPN and wait for 21 days after issuing the DPN, before commencing legal proceedings against the director.

As a consequence of the *Pay As You Go Withholding Non-Compliance Tax Act 2012* (Cth) which became effective on 29 June 2012, directors and their associates are denied credits for PAYG withholdings deducted by a company which has failed to remit the PAYG to the ATO.

### **Defences**

The defences to a DPN issued for PAYG withholdings are limited to:

- (a) because of illness or for some other good reason, it would have been unreasonable to expect the director to take part in the management of the company and the director did not take part

in the management of the company; or,

- (b) the director took all reasonable steps to ensure that the company complied with its obligations, caused an Administrator to be appointed or the company to be wound up, or there were no such reasonable steps that could have been taken.

In addition to the above, there is a further defence in regard to SGC, if the company treated the *Superannuation Guarantee (Administration) Act* ("SGAA") 1992 (Cth) as applying in a way that was reasonably arguable and the company took reasonable care in applying the SGAA to the matter.

### **Change of addresses**

Section 269-50 of Schedule 1 of the *Taxation Administration Act* (1953) (Cth) states that the ATO 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 satisfies this requirement.

Section 205B(4) of the *Corporations Act* requires a company to lodge with ASIC details of any change in the personal details of a director within 28 days after the change.

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. This is a particular risk for a director whose term is short or the conduct of secretarial matters is unreliable.

### **Possible consequences of the amendments**

It is not unusual for insolvent companies to have unreported and unpaid PAYG withholding and SGC liabilities. Therefore, it is likely that the 2012 amendments to the DPN regime may have the following consequences:

- (a) as directors became more concerned about personal liability issues the numbers of companies that are placed into either voluntary administration or liquidation may increase;
- (b) for those directors unaware of the amendments to the DPN regime, there will be an increase in personal liability and may be an increase in the number of personal bankruptcies;
- (c) a restructuring of corporate groups so that staff are employed by labour hire companies. A labour hire company can then be placed into liquidation with a minimum of disruption to the other members of the corporate group;
- (d) directors may prefer payments to the ATO over other creditors. This may then result in an increase in unfair preference recovery proceedings commenced by Liquidators, when the companies are subsequently wound up. However, directors will be vulnerable to the statutory indemnity under the *Corporations Act*, as discussed below; and,
- (e) more directors of companies in the small and medium enterprise sector will restructure their personal financial affairs so that they are men of straw.

## Further amendments

We understand that the ATO was considering a proposal for automating the process for the issuing of the DPNs. The aim would be to increase the number of DPNs issued per year and to reduce the cost of issuing those DPNs. However, this was not approved by parliament. In current circumstances where there is pressure on the ATO to increase revenue to the government, we can expect this issue to be revised.

## Paying a DPN is not always the answer

If a company pays a debt to the ATO either after the director receives a DPN or three months after an unreported debt is due to the ATO, the risk to directors is not totally removed.

If the company subsequently goes into liquidation within six months after the payment is due to the ATO, the Liquidator may claim the payment as 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. Under Section 588FGA of the *Corporations Act*, if the ATO is ordered to pay the preference

payment to the company in liquidation then, unless the director can sustain the 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. Those costs can be considerable.

## Solution

If a DPN is received by a director because PAYG withholdings or SGC were not paid as and when they fell due, the director should immediately take appropriate advice.

Further, directors should not allow a company to incur PAYG withholdings or SGC debts which are unlikely to be reported and not paid, otherwise they will not be able to avoid personal liability for those debts overdue by more than three months. There is no possibility of the liability for those debts to be remitted. If the debt is reported on time but unpaid, the debt may be remitted by appointing an Administrator or having the company wound up.

Woodgate & Co. can assist directors to determine the appropriate action in the event of the receipt of a DPN or where there are outstanding taxation lodgements.

## WOODGATE & CO.

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