
Chapter 1

Companies' non-compliance with PAYG withholding and superannuation guarantee obligations

Outline of chapter

1.1 Schedule X to this Bill amends the *Taxation Administration Act 1953* (TAA 1953) by:

- extending the director penalty regime to make directors personally liable for their company's unpaid superannuation guarantee amounts;
- ensuring that directors cannot discharge their director penalties by placing their company into administration or liquidation when unpaid PAYG withholding or superannuation guarantee remains unpaid three months after its due date; and
- in some instances, making directors and their associates liable to pay as you go (PAYG) withholding non-compliance tax (effectively reducing credit entitlements) where the company has failed to pay amounts withheld to the Commissioner.

1.2 In this regard, the tax on directors and their associates is imposed by the Pay As You Go Withholding Non-compliance Tax Bill 2011.

Context of amendments

Director penalty provisions

1.3 In 1993 the director penalty regime was introduced to assist the Commissioner to recover certain company liabilities. The director penalty regime replaced the Commissioner's priority that previously existed under insolvency law for certain amounts withheld (particularly from salary or wages) but not paid to the Commissioner.

1.4 In 2010 the director penalty regime was re-written into Division 269 in Schedule 1 to the TAA 1953, with minimal policy change.

1.5 The policy objective of the director penalty regime is to ensure that directors cause their company to meet certain tax obligations or promptly put the company into liquidation or voluntary administration.

1.6 Under the tax laws companies have an obligation to withhold amounts from certain payments they make, such as wages to employees and fees to directors. There is a further obligation to pay those withheld amounts to the Commissioner (and to pay estimates of those amounts where applicable). These obligations exist under the PAYG withholding regime.

1.7 The director penalty regime makes directors of companies that fail to comply with their obligation to pay amounts withheld under the PAYG withholding regime to the Commissioner (or fail to pay an estimate of their PAYG withholding liability) personally liable for the amount that the company should have paid, through imposition of a penalty.

1.8 Where the company fails to pay such amounts, the existing director penalty regime makes directors liable to a penalty at the end of the day the company is due to meet its obligation.

1.9 The Commissioner must not commence proceedings to recover a director penalty until 21 days after he gives the director a written penalty notice.

1.10 The Commissioner uses these provisions to pursue directors of companies that fail to meet their PAYG withholding obligations, including directors of fraudulent phoenix companies who often fail to meet their PAYG withholding obligations.

1.11 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 debts and then is placed into voluntary administration or liquidation to avoid paying those debts. The business then 're-emerges' as another corporate entity, controlled by the same person or group, but free of debts. Phoenix companies gain a competitive advantage over compliant companies because their failure to pay employees' entitlements or tax liabilities, allows them to offer lower prices for goods and services. They can reinvest money that other compliant businesses allocate to tax and superannuation payments.

1.12 However, some aspects of the director penalty regime limit its efficacy in ensuring that directors cause their companies to comply with their obligations, including in phoenix cases. Most notably, as directors are provided 21 days notice of the penalty before the Commissioner is able to commence proceedings to recover the liability, some directors extinguish their personal liability by placing the company into voluntary administration or liquidation within that notice period and before the Commissioner can sue to recover their personal liability. This often means that the full amount of PAYG withholding liabilities is never recovered.

1.13 Compounding these problems is the ability of directors to continue to claim PAYG withholding credits (for amounts withheld from payments to them by the company) in their individual tax returns, even when the company has failed to pay some or all of its PAYG withholding liability to the Commissioner.

1.14 A further limitation of the director penalty regime is that its application is restricted to PAYG withholding obligations.

Summary of new law

1.15 These amendments protect workers' entitlements and strengthen directors' obligations by:

- expanding the application of the director penalty regime to unpaid superannuation guarantee charge;
- ensuring that directors cannot discharge their director penalties by placing their company into administration or liquidation when unpaid PAYG withholding or superannuation guarantee remains unpaid three months after its due date; and
- in some instances, making directors and their associates liable to PAYG withholding non-compliance tax (effectively reducing credit entitlements) where the company has failed to pay amounts withheld to the Commissioner.

1.16 In this regard, the tax on directors and their associates is imposed by the PAYG Withholding Non-compliance Tax Bill 2011.

1.17 These amendments, and the ATO's ability to target their application, act 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.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
In addition to liability for PAYG withholding amounts, directors are personally liable for their company's unpaid superannuation guarantee charge.	Directors are personally liable for their company's unpaid PAYG withholding amounts, including estimates of PAYG withholding liabilities.
A new director is not liable to a director penalty for company debts that existed when they became a director until 30 days after they became a director.	New directors can be liable for debts outstanding when they begin if they fail to arrange for the company to take necessary action within 14 days of become a director.
In addition to estimating unpaid PAYG withholding liabilities, the Commissioner can estimate unpaid superannuation guarantee charge.	An estimate can only be made in relation to a company's PAYG withholding liabilities.
The Commissioner may also serve a copy of a director penalty notice on the director at his or her tax agent's address.	The Commissioner may seek to recover a director penalty by issuing a director penalty notice and may commence proceedings to recover 21 days after the notice was issued.

<i>New law</i>	<i>Current law</i>
<p>Where 3 months has lapsed after the due day, the director penalty is not remitted by placing the company into administration or beginning to wind it up.</p> <p>New directors are not subject to these restricted remission options until 3 months after they become a director of a company, rather than 3 months after a debt arose.</p>	<p>A director can extinguish their personal liability by causing one of three things to happen before the notice is issued or within that 21 day notice period:</p> <ul style="list-style-type: none"> • payment of the debt; • appointment of an administrator under section 436A, 436B or 436C of the <i>Corporations Act 2001</i>; or • beginning the winding up of the company.
<p>In addition to these defences, a director that becomes liable to a director penalty for not causing its company to comply with its superannuation obligations is not liable to a director penalty if the company treated the SGA Act 1992 as applying to a matter in a way that was reasonably arguable and the company took reasonable care in applying the SGA Act 1992 to the matter.</p>	<p>A director has a defence in relation to a director penalty if the director had an illness that prevented him or her participating in the management of the company, or if the director took all reasonable steps to ensure compliance.</p>
<p>Where a company has failed to pay PAYG withholding amounts to the Commissioner, the Commissioner has a discretion to reduce a director's entitlement to PAYG withholding credits relating to withholding payments made by the company.</p>	<p>Regardless of whether a company has paid PAYG withholding amounts to the Commissioner, its directors are entitled to PAYG withholding credits withheld by the company from a withholding payment made to the director.</p>
<p>Company directors and their associates who are entitled to a credit attributable to a payment made by a company that has failed to pay amounts withheld under PAYG withholding to the Commissioner, can be liable to pay PAYG withholding non-compliance tax.</p>	<p>Company directors and their associates are entitled to PAYG withholding credits withheld by the company from a withholding payment made to them, such as salary, regardless of whether the company has paid the PAYG withholding amounts to the Commissioner.</p>

Detailed explanation of new law

Extending the director penalty regime to unpaid superannuation guarantee amounts

Collecting superannuation guarantee charge for the benefit of employees

1.18 Extending the director penalty regime to superannuation guarantee charge better secures workers' entitlements. The amount of the director penalty represents amounts of unpaid superannuation guarantee charge that should have been applied for the benefit of the employee, by providing it to a superannuation fund.

1.19 Amounts collected under the director penalty regime that represent superannuation guarantee charge are dealt with in the same way as superannuation guarantee charge amounts collected under the *Superannuation Guarantee (Administration) Act 1992* (SGA Act 1992). [Schedule X, item 35, subsections 63A(3) and (4) of the SGA Act 1992]

1.20 There may be cases where the Commissioner proceeds with a director penalty based on an estimate of a superannuation guarantee charge and is unable to identify immediately the relevant employee or employees who are entitled to the superannuation that is represented by amounts collected under the director penalty regime. In these cases, the collected amounts are held in consolidated revenue until the employee or employees and their entitlements are identified. During that time an employee may identify their claim to a superannuation entitlement. [Schedule X, item 35, subsections 63A(3) and (4) of the SGA Act 1992]

1.21 Once the employee or employees and their entitlements are identified, the money is applied for the benefit of the employee via an assessment in the same way as a collection of superannuation guarantee charge under the SGA Act 1992.

Imposing and quantifying director penalties

1.22 Directors of companies that are registered under the *Corporations Act 2001* are personally liable for their company's failure to meet its superannuation guarantee obligations. This liability is imposed by a director penalty through an extension of the existing director penalty regime. [Schedule X, items 49 to 51, paragraph 269-5(a), subsection 269-10(1) and section 269-1 in Schedule 1 to the TAA 1953]

1.23 Where an employer fails to pay the appropriate amount of superannuation guarantee contributions to funds on behalf of their employees the outstanding amount is referred to as a superannuation

guarantee shortfall. Where an employer has a superannuation guarantee shortfall, a superannuation guarantee charge arises, once assessed.

1.24 The director penalty represents the amount of the company's superannuation guarantee charge either:

- as assessed by the employer through the lodgment of a superannuation guarantee statement;
- as assessed by the Commissioner through a default assessment; or
- as notified in a notice of an estimate issued by the Commissioner.

[Schedule X, items 41, 42 and 51, subsections 268-10(1) and (3) and items 4 and 5 in the table in subsection 269-10(1) in Schedule 1 to the TAA 1953]

Timing — when company directors become personally liable

1.25 Under subsections 269-20(1) and (2) in Schedule 1 to the TAA 1953 of the existing director penalty regime, company directors are liable to a director penalty at the end of the day that the company is obliged to pay to the Commissioner its PAYG withholding amounts if the company has not met that obligation. The penalty is due and payable at the end of the day the company is obliged to pay the Commissioner.

1.26 Where a director becomes a director after the company failed to meet its obligation to pay its liability by the due day, a different set of liability rules apply.

1.27 However, under the new rules new directors will be liable to a director penalty only where they become a director after the company has failed to meet its obligation by the due day and 30 days later the director is still a director and the obligation has not been met. The reason for the increase in the grace period from 14 days to 30 days is an acknowledgement of the fact that because the director penalty regime will now apply to both PAYG withholding and the superannuation guarantee, new directors need more time to ensure their corporate affairs are in order before being liable to a personal penalty. *[Schedule X, items 5 and 6, paragraph 269-20(3)(b) and subsection 269-20(4) in Schedule 1 to the TAA 1953]*

1.28 Unlike PAYG withholding, the superannuation guarantee charge is not due and payable under the SGA Act 1992 until the earlier of the employer self-assessing by lodging a superannuation guarantee statement or the Commissioner issuing an assessment.

1.29 This gave rise to the possibility that directors would escape or delay liability for director penalties by failing to lodge their superannuation guarantee statement as required, causing the superannuation guarantee charge to not become due and payable.

1.30 To avoid this outcome, and make a director personally liable for unpaid superannuation in a timely manner, the superannuation guarantee charge must be treated as payable even if it has not yet been assessed.

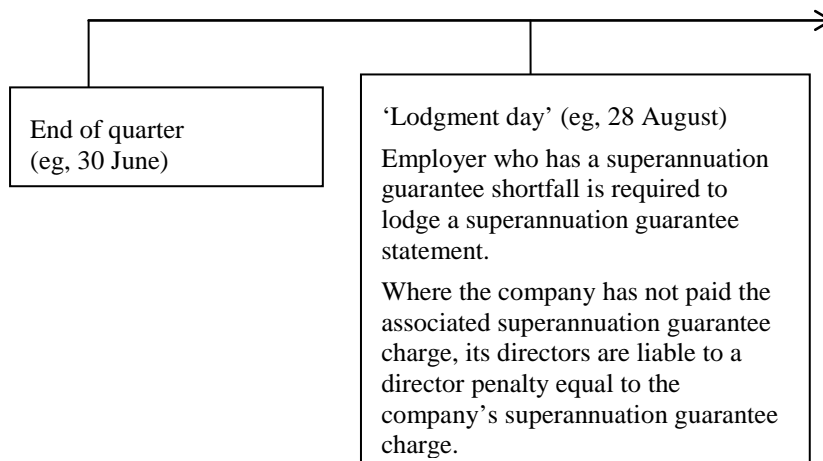
1.31 For the purpose of the director penalty regime, a company's superannuation guarantee charge is treated as payable on the day the employer is required to lodge their superannuation guarantee statement for the quarter to the Commissioner. This is either lodgment day, or a later day as allowed by the Commissioner (section 33 of the SGA Act 1992). *[Schedule X, item 52, subsection 269-10(3) in Schedule 1 to the TAA 1953]*

1.32 Accordingly, the existing directors are liable to a director penalty at the end of the lodgment day (or later day as allowed by the Commissioner under section 33 of the SGA Act 1992) if the company has not lodged its superannuation guarantee statement and paid the corresponding superannuation guarantee charge by the end of that day. *[Schedule X, items 51 and 52, subsections 269-10(1) and (3) in Schedule 1 to the TAA 1953]*

1.33 The lodgment day is a suitable day to treat the superannuation guarantee charge as falling due for the purpose of the director penalty regime as it is the day that the employer is required to lodge their superannuation guarantee statement (and where that happens, the day that the superannuation guarantee charge becomes due).

1.34 Diagram 3.1 demonstrates the timing of the liability arising, based on a quarter ending on 30 June.

Diagram 1.1: Due day of superannuation guarantee charge for the purpose of the director penalty regime



Example 1.1: Imposition of a director penalty for non-payment of superannuation guarantee amounts

Kevin and Ash are directors of Kash Pty Ltd. Aaron is employed by Kash Pty Ltd from 1 January 2013. During the January to March quarter of the 2012-13 income year, Kash Pty Ltd failed to pay any superannuation guarantee amounts to Aaron's superannuation fund.

As there is a superannuation guarantee shortfall, Kash Pty Ltd is required to report that shortfall in a superannuation guarantee statement to the Commissioner by 28 May 2013. However, Kash Pty Ltd does not report its shortfall by this date.

Therefore on 28 May 2013, Kevin and Ash are liable for director penalties for the value of the superannuation guarantee charge.

Expanding the estimates regime to cover unpaid superannuation guarantee

1.35 In addition to the Commissioner's power to issue an assessment to quantify an unreported superannuation guarantee shortfall, the estimates regime can also be used to quantify unpaid superannuation guarantee charge. The issue of an estimate notice creates a separate liability. A director penalty notice can also be issued for an estimate of superannuation guarantee charge (or PAYG withholding liability). [Schedule X, items 36 to 42 and 51, subsections 268-10(1), (1A) and (3), item 4 in the table in subsection 269-10(1) and sections 268-1 and 268-5 in Schedule 1 to the TAA 1953]

1.36 The ability to estimate a superannuation guarantee charge reduces the scope of phoenix operators to escape liabilities once they become aware that the Commissioner is pursuing them. For example, the issue of an estimate enables the Commissioner to take prompt action when an opportunity arises to secure recovery, without having to delay recovery by waiting for an assessment to be issued.

1.37 Like the director penalty regime, the estimates regime treats the superannuation guarantee charge as being payable even if it has not been assessed, to avoid problems with delaying or avoiding quantification. To enable the Commissioner to estimate the superannuation guarantee charge where it has not been assessed (and therefore is not due and payable under the SGA Act 1992), the estimates regime treats the superannuation guarantee charge as being payable on the day the superannuation guarantee shortfall for the quarter should have been reported to the Commissioner in a superannuation guarantee statement. This is the lodgment day or a later day if permitted by the Commissioner (section 33 of the SGA Act 1992). [*Schedule X, item 41, subsection 268-10(1A) in Schedule 1 to the TAA 1953*]

1.38 This timing is consistent with the application of the director penalty regime to unpaid superannuation guarantee charges.

Example 1.2: Director penalties for estimates of superannuation guarantee charge

Following on from Example 3.1, after 28 May Aaron and another employee, Graeme, make a complaint to the Commissioner about their unpaid superannuation.

Kash Pty Ltd has not lodged a superannuation guarantee shortfall statement and therefore has not reported the shortfall by lodgment day and the Commissioner has not permitted Kash Pty Ltd to lodge its superannuation guarantee statement at a later date.

Kevin and Ash are each liable to a director penalty relating to the superannuation guarantee charge from 28 May 2013, however the amount of the penalty is unknown.

The Commissioner, based on the information available, issues Kash Pty Ltd a notice of an estimate of the superannuation guarantee charge under Division 268 in Schedule 1 to the TAA 1953.

Kash Pty Ltd fails to pay the estimate by the end of the day it was issued, making Kevin and Ash each liable for a director penalty as a result of the estimate. (This is consistent with the operation of the existing director penalty regime.)

The director penalty liability is due and payable at the end of the day the estimate is issued to the company.

1.39 Unlike estimates of PAYG withholding liabilities, the general interest charge (GIC) does not accrue on estimates of superannuation guarantee charge. The GIC does accrue on any assessment of the superannuation guarantee charge that is made after the estimate. *[Schedule X, item 42, subsection 268-75(1) in Schedule 1 to the TAA 1953]*

Director's ability to provide facts in relation to an estimate

1.40 Consistent with estimates of PAYG withholding liabilities, a director may submit a statutory declaration or affidavit to verify the amount of the underlying liability in relation to an estimate of liability for unpaid superannuation guarantee charges. The effect may be that the estimate is reduced or revoked. *[Schedule X, item 44, subsection 268-90(2) in Schedule 1 to the TAA 1953]*

1.41 The statutory declaration or affidavit must verify:

- the director's name and address;
- for each employee for which there is unpaid superannuation guarantee charge — their name and postal address, and if known, their tax file number; and
- the amount of the superannuation guarantee shortfall.

1.42 Additionally, as part of the statutory declaration or affidavit the director must verify what action has been taken to pay the superannuation guarantee charge to the Commissioner. *[Schedule X, item 45, subsection 268-90(2A) in Schedule 1 to the TAA 1953]*

Recovering director penalties

1.43 In order to recover a director penalty from a director, the Commissioner must issue a director penalty notice and wait until the end of 21 days after issuing that notice before commencing proceedings. *[Schedule X, items 4 and 53, subsection 269-25(1) in Schedule 1 to the TAA 1953]*

1.44 The Commissioner may also send a copy of a director penalty notice to a director's registered tax agent; this provides the Commissioner with an additional means of bringing the penalty to the director's attention. The tax agent has the professional knowledge to advise the director of the importance of the notice and the actions directors can take. However, whether the Commissioner chooses to avail himself of this right does not affect whether the Commissioner has given a director the actual

notice, or how the Commissioner may give a director the actual notice.
[Schedule X, item 3, subsection 269-52 in Schedule 1 to the TAA 1953]

1.45 During the 21-day notice period, the director can reduce or remit their penalty under the existing law by doing any of the following:

- paying the penalty;
- causing the company to comply with its obligation to pay the liability that the director penalty is based on;
- appointing an administrator of the company; or
- beginning to have the company wound up.

[Schedule X, item 8, subsection 269-30(1) in Schedule 1 to the TAA 1953]

1.46 However, where 3 months has lapsed after the due day, the director penalty is not remitted by placing the company into administration or beginning to wind it up. *[Schedule X, item 8, subsection 269-30(2) in Schedule 1 to the TAA 1953]*

Example 1.3: Actions that do not extinguish a director penalty

Kerry and Claire are directors of Tardy Co, which is required to pay amounts withheld under the PAYG withholding provisions to the Commissioner on a quarterly basis. During the January to March quarter in the 2013-14 income year, Tardy Co withholds \$4,000 from payments made to its employees and directors.

Tardy Co fails to pay or report any of the withheld amounts to the Commissioner by the due day (21 April 2014). From that day Kerry and Claire are liable to a director penalty for the value of the company's unpaid PAYG withholding liabilities.

By 21 July 2014, Kerrie and Claire have not remitted their director penalties. The only way that they can now discharge their penalties is by causing the company to pay the amounts withheld or personally paying those amounts.

New directors

1.47 The paragraphs above explain how the recovery process applies to directors who are directors on the day that the company fails to meet the particular obligation listed in section 269-10 in Schedule 1 to the TAA 1953.

1.48 New directors are liable for director penalties under the director penalty regime if an obligation giving rise to a director penalty exists, and

thirty days after the director started, the company or the company directors had not taken any of the actions that would discharge the obligation. *[Items 6 to 8, paragraph 269-20(3)(b) and subsection 269-20(4) in Schedule 1 to the TAA 1953]*

1.49 In addition, a new director will not be subject to the restricted remission options until three months after he or she became a director of the company regardless of how long the company has been liable for the debt. *[Schedule X, item 8, subsection 269-30(3) in Schedule 1 to the TAA 1953]*

Defences available to directors who are liable to director penalties for unpaid PAYG withholding liability or superannuation guarantee charge

1.50 Where the Commissioner seeks to collect a director penalty, the existing statutory defences are available to a director. *[Schedule X, item 2, subsections 269-35(1) to (4A) in Schedule 1 to the TAA 1953]*

1.51 Therefore, a director is not liable for a director penalty where they can establish that:

- because of illness or for some other good reason the director was not involved in the management of the company and it was reasonable for that director not to be involved; or
- the director took all reasonable steps to ensure the directors caused one of these three things to happen (or no such steps were available):
 - the company to meet its obligation to pay;
 - an administrator of the company to be appointed; or
 - the company to begin to be wound up.

[Schedule X, item 2, subsections 269-35(1) and (2) in Schedule 1 to the TAA 1953]

1.52 It is not sufficient for the director to state that no reasonable steps were available to cause one of those three things to happen. For example, it is not sufficient for a director to say that there were no reasonable steps available to cause the company to pay because the company had insufficient funds.

1.53 For the defence to apply there must be no reasonable steps available to ensure the directors caused the company to do any of those three things. Therefore, if there were insufficient funds to pay the PAYG withholding or superannuation guarantee charge amounts, the directors should have taken all reasonable steps to have an administrator appointed

or begin winding up the company. The defence only succeeds if there were no reasonable steps available to ensure the directors caused any of those things to happen. *[Schedule X, item 2, subsection 269-35(2) in Schedule 1 to the TAA 1953]*

1.54 Criteria replicating the existing criteria in subsection 269-35(4) in Schedule 1 to the TAA 1953 are provided to assist the Commissioner in determining what are ‘reasonable steps’. *[Schedule X, item 2, subsection 269-35(3) in Schedule 1 to the TAA 1953]*

1.55 The terms ‘good reason’ and ‘reasonable steps’ are included in the existing director penalty regime legislation and take their ordinary meaning. *[Schedule X, item 2, subsections 269-35(2) and (3) in Schedule 1 to the TAA 1953]*

1.56 In addition, a director is not liable to a director penalty relating to the superannuation guarantee charge, where they can establish that the penalty resulted from the company treating the SGA Act 1992 as applying to a matter or identical matters in a particular way that was reasonably arguable, if the company took reasonable care in connection with applying the SGA Act 1992 to the matter or matters.

1.57 There is no corresponding defence in relation to PAYG withholding obligations because they also arise if amounts are withheld but not remitted, meaning that it is more likely a company will be conscious of its unremitted PAYG withholding obligations than it will be of its superannuation guarantee obligations. Indeed, there can be some uncertainty about superannuation guarantee liabilities, especially about whether particular workers are employees and therefore entitled superannuation.

Reasonable care

1.58 Exercising reasonable care means making a reasonable attempt to comply with the relevant law. The effort required is one commensurate with all the taxpayer's circumstances, including the taxpayer's knowledge, education, experience and skill.

Example 1.4

Fantastic Fashions Pty Ltd is a medium-sized textiles company that has 43 people working for it to produce garments. Fantastic Fashions has 1 person employed on a fulltime basis, and another on a part-time basis, to work on human resources (HR) issues. Among other things, the small HR team is responsible for determining if workers are employees or contractors for superannuation purposes. In performing this task, the HR team considers various factors listed in a checklist

provided online by the ATO. This analysis would constitute the exercise of reasonable care.

Reasonably arguable

1.59 The term 'reasonably arguable' is defined in subsection 995-1(1) of the *Income Tax Assessment Act 1997* to have the meaning given by section 284-15 of Schedule 1 to the TAA 1953. A matter is reasonably arguable 'if it would be concluded in the circumstances, having regard to relevant authorities, that what is argued for is about as likely to be correct as incorrect, or is more likely to be correct than incorrect'. This definition provides a suitable standard for the purposes of the defence.

1.60 Generally, if a company has a reasonably arguable position, it will have also exercised reasonable care. However, there may be unusual cases where a company has failed to exercise reasonable care, but by chance has a reasonably arguable position.

Availability of defences for collection from third parties

1.61 If the Commissioner collects amounts from third parties in order to discharge a director penalty, the director can still avail themselves of the above defences. To do so, the director must provide information to the Commissioner within 60 days of receiving notice that the recovery has occurred or receiving a copy of a notice issued to a third party under section 260-5 in Schedule 1 to the TAA 1953. That information must satisfy the Commissioner of the matters relevant to make out one of the defences. *[Schedule X, item 2, subsections 269-35(4) and (4A) in Schedule 1 to the TAA 1953]*

1.62 The 60-day period to raise a defence applies to the recovery of all director penalties by methods other than court proceedings, regardless of the character of the underlying liability.

1.63 Where the Commissioner has recovered any of the penalty by applying a credit against the director penalty, the 60 days runs from when the Commissioner notifies the director that recovery action has been taken. This notification could be provided in many different forms. For example:

- a note accompanying a notice of assessment;
- a running balance account statement which shows the offset has occurred; or
- a letter explaining that offsetting has occurred.

[Schedule X, item 2, subparagraph 269-35(4A)(a)(ii) in Schedule 1 to the TAA 1953]

Example 1.5: Applying credits against a director penalty

Hunter Co has failed to meet their obligation to pay amounts withheld under the PAYG withholding provisions to the Commissioner by the due date. A director penalty is raised against Kayleen as director of Hunter Co. To recover the penalty, the Commissioner applies credits that Kayleen is entitled to offset against her director penalty.

The Commissioner issues Kayleen with a notice of assessment. A note accompanying that notice explains that the credits have been applied against the director penalty.

Thirty days after the Commissioner issued Kayleen with her notice of assessment she provides the Commissioner with information she is relying on to satisfy the Commissioner that she was ill and therefore it was not reasonable for her to take part in the management of the company.

The Commissioner considers the information and is satisfied of the matters set out in the defence in subsection 269-35(1), meaning Kayleen is not liable to the director penalty. The Commissioner takes the necessary steps to return Kayleen to the position she would have been in if the credits had not been used to offset the director penalty liability.

1.64 Where the Commissioner has served a notice under section 260-5 in Schedule 1 to the TAA 1953 (the Commissioner may collect amounts from a third party) for the purpose of recovering the director penalty, the 60 days commences from when a copy of the notice is served on the director (as required by subsection 260-5(6) in Schedule 1 to the TAA 1953). [*Schedule X, item 2, subparagraph 269-35(4A)(a)(i) in Schedule 1 to the TAA 1953*]

Example 1.6: Period allowed to raise a defence to the recovery of a director penalty

Michael is a director of McGovern Co. McGovern Co has failed to pay its employees their superannuation guarantee entitlements and as a result Michael has a director penalty equal to the superannuation guarantee charge.

To recover the penalty, the Commissioner serves a notice under subsection 260-5(2) on the bank to recover money from Michael's bank account.

After serving the notice on the bank, a copy of the notice is served on Michael. The Commissioner is successful in recovering money from Michael's bank account.

Michael has 60 days from being served the copy of the notice under subsection 260-5(6) to raise a defence against the recovery of the penalty.

Where the Commissioner is satisfied that the defence is satisfied, the money recovered from the bank is returned to Michael.

1.65 Under the existing law, the Commissioner has considered the defences for all forms of recovery under the director penalty regime in section 269-35 in Schedule 1 to the TAA 1953. However, the setting of a distinct period is necessary to deal with the unique nature of the collection of penalties that reflect superannuation guarantee charge. Because superannuation guarantee charge is distributed to superannuation funds for the benefit of employees, and is ultimately paid out to that employee, there was a risk that if a director left it too long to raise a defence the money would be difficult to recover and repay to the director. This 60-day time frame provides certainty for directors, employees, and the ATO in dealing with recovery of superannuation guarantee charge.

1.66 The 60-day period is consistent with the standard objection period that applies under the taxation laws, unless another time period is specified.

PAYG withholding non-compliance tax

Background

1.67 Companies (and other entities) are required to withhold a portion of certain payments, such as the wages of their employees and payment of fees to directors, and pay the amounts withheld to the Commissioner (effectively as an instalment of tax). When the Commissioner assesses the payee for that income year, the payee is then entitled to a credit equal to the total of amounts withheld during the income year. The payment summary issued by the company to the payee shows, among other things, the amount the company withheld.

1.68 It is common for fraudulent phoenix operators to withhold amounts from payments but never pay the withheld amounts to the Commissioner. This may also occur when a company is facing financial difficulties. Instead of paying the withheld amount to the Commissioner, those amounts are used to improve their business' cash flow or for wealth creation while compliant businesses forward that money to the Commissioner as required under the law.

1.69 For the purpose of the discussion below, the term *PAYG withholding liability* refers to the amount that the company withholds but fails to pay to the Commissioner.

Overview

1.70 Company directors and their associates are liable to pay tax where their company has a PAYG withholding liability for an income year and the individual is entitled to a credit for amounts withheld by that company during the income year. *[Schedule X, item 14, sections 18-125 and 18-135]*

1.71 The PAYG withholding non-compliance tax is imposed by the Pay As You Go Withholding Non-compliance Tax Bill 2011. *[Schedule X, item 11, subsection 995-1(1) of the Income Tax Assessment Act 1997 (ITAA 1997) and Clauses 1 to 4 of the Pay As You Go Withholding Non-compliance Tax Bill 2011]*

1.72 The imposition of tax on directors and their associates where the company has failed to meet its PAYG withholding obligations provides a new strong incentive for company directors to ensure that their companies comply with existing obligations to pay withheld amounts to the Commissioner.

1.73 The circumstances that must exist before the liability to the PAYG withholding non-compliance tax arises are different for directors and associates. The amount of the tax is determined by the legislation. *[Schedule X, item 14, sections 18-125 and 18-135 in Schedule 1 to the TAA 1953]*

1.74 Although the tax is due and payable, the tax is not recoverable unless the Commissioner issues a notice to the individual director or associate. The Commissioner should only issue a notice after determining that it is fair and reasonable for the individual to pay the tax. The Commissioner cannot issue a notice where the relevant director has a director penalty liability because of the company's failure to pay PAYG withholding for the income year. *[Schedule X, item 14, section 18-140 in Schedule 1 to the TAA 1953]*

1.75 The exposure draft of the legislation achieved this policy outcome by way of reduction in the credits of the individual director or their associate. This Bill, together with the PAYG Withholding Non-compliance Tax Bill 2011, achieves the same policy outcome by way of a tax to safeguard the measure against constitutional challenge. The objective of this tax is to reverse the economic benefit of all or part of the credit to the extent to which the director (or associate) is entitled. Consequently, the measure achieves similar outcomes to the exposure draft, although the mechanics of achieving those outcomes have changed. *[Schedule X, items 13 and 14, sections 18-5 and 18-120 in Schedule 1 to the TAA 1953]*

Directors of companies that do not pay withheld amounts to the Commissioner

1.76 A company director can be liable to pay the PAYG withholding non-compliance tax where the company of which they are a director has withheld more amounts from withholding payments than it has paid to the Commissioner for the director's income year. This includes where the company has paid some, but not all, of the amounts withheld to the Commissioner. *[Schedule X, item 14, paragraphs 18-125(1)(a) to (c) in Schedule 1 to the TAA 1953]*

1.77 The directors can be liable to pay the tax where any amount of the company's PAYG withholding for the director's income year is still outstanding after its due date. *[Schedule X, item 14, paragraph 18-125(1)(c) in Schedule 1 to the TAA 1953]*

1.78 To be liable, the director must also have an entitlement to a PAYG withholding credit that is attributable to an extent to an amount withheld by the company from payments made by the company to the director (such as directors fees). *[Schedule X, item 14, paragraph 18-125(1)(d) in Schedule 1 to the TAA 1953]*

1.79 Liability to pay the PAYG withholding non-compliance tax arises for individuals that either:

- were a director when the company was due to pay the withheld amounts to the Commissioner but failed to do so (in full); or
- became a director after the payment of withheld amounts to the Commissioner was due (and not paid) and 30 days after they started as a director, they are still a director and the overdue withholding amount is still unpaid.

[Schedule X, item 14, subsection 18-125(2) in Schedule 1 to the TAA 1953]

1.80 The director penalty rules similarly apply to incoming directors (subsection 269-20(3) in Schedule 1 to the TAA 1953).

Example 1.7: The director is liable to pay PAYG withholding non-compliance tax

Service Co failed to pay to the Commissioner \$5,000 for amounts withheld from withholding payments (including employee wages and payments to directors) during the 2012-13 income year.

For the whole of the 2012-13 income year, including at all times when the withheld amounts were due to be paid to the Commissioner, Roxy was a director of Service Co.

During the income year Service Co withheld \$3,000 from wages paid to Roxy.

After issuing Service Co with a director penalty notice (because the PAYG withholding liability had been reported before three months elapsed), Roxy caused Service Co to appoint an administrator within 21 days of the Commissioner issuing a director penalty notice and was therefore, liable to a director penalty.

Roxy is liable to pay the PAYG withholding non-compliance tax.

Amount of tax payable

1.81 The amount of tax payable by the director is the lesser of:

- the total amounts withheld from payments made to the individual by the company in the individual's income year (that is, the extent that the credit is attributable to amounts withheld from payments made by the company of which the individual was a director); and
- the company's PAYG withholding liability for payments made during the income year.

[Schedule X, item 14, subsection 18-125(3) in Schedule 1 to the TAA 1953]

Example 1.8: The amount of PAYG withholding non-compliance tax where the individual's credit is less than the company debt

Computer Co has an unpaid PAYG withholding liability for the 2014-15 income year totalling \$100,000.

Diego was a director of Computer Co throughout that income year and received director's fees for the income year. He is entitled to a credit of \$25,000 for amounts withheld from his director's fees.

Assume Diego is not liable to a director penalty. Diego must pay \$25,000 PAYG withholding non-compliance tax as the total of amounts withheld from payments to Diego is less than the value of the company's unpaid PAYG withholding liability.

Example 1.9: The amount of PAYG withholding non-compliance tax where the company debt is less than the individual's credit

Maverick Co failed to pay to the Commissioner \$4,000 of amounts withheld from withholding payments made during the 2013-14 income year.

Ciara is a director of Maverick Co and is entitled to a credit of \$30,000 for amounts withheld by Maverick Co from her director's fees.

Assume Ciara is not liable to a director penalty. Ciara is liable to pay \$4,000 PAYG withholding non-compliance tax as the company's PAYG withholding liability is less than the total amounts withheld from payments to Ciara.

When tax is payable

1.82 The PAYG withholding non-compliance tax is due and payable on the same date as the original income tax must be paid by the individuals for that financial year. As income tax is not due to be paid unless an assessment is made, and to account for cases where no income tax is payable by the individual, the individual is treated as being required to pay income tax for the income year. *[Schedule X, items 14 and 15, subsection 250-10(2) and section 18-145 in Schedule 1 to the TAA 1953]*

1.83 An individual that fails to pay some or all of an amount of PAYG withholding non-compliance tax on time must pay the GIC. The GIC accrues from the day by which the unpaid amount of tax was due to be paid and stops accruing on the later of the unpaid PAYG withholding non-compliance tax being paid or the GIC on the unpaid PAYG withholding non-compliance tax being paid. *[Schedule X, items 12 and 14, subsection 8AAB(4) of the TAA 1953 and section 18-150 in Schedule 1 to the TAA 1953]*

Reducing the amount of the director's PAYG withholding non-compliance tax

1.84 The director may attempt to satisfy the Commissioner that they had grounds for allowing the company not to meet its PAYG withholding obligations. Where the Commissioner is satisfied that the director met one of the specified grounds, the Commissioner is required to issue a notice to reduce the amount of tax payable by that director. *[Schedule X, item 14, section 18-130 in Schedule 1 to the TAA 1953]*

1.85 The director may attempt to satisfy the Commissioner of these grounds before or after the liability to pay the tax arises. Regardless of when the notice to reduce the amount of tax payable is issued, the reduction has effect as if the amount of tax payable was always the amount as reduced by the notice. *[Schedule X, item 14, subsections 18-130(2) and (6) in Schedule 1 to the TAA 1953]*

1.86 Where the Commissioner becomes aware of circumstances that may satisfy one of the grounds for reducing the tax, for example through an application by the director or because the director successfully raised a defence to a director penalty, the Commissioner must consider the circumstances. *[Schedule X, item 14, subsection 18-130(2) in Schedule 1 to the TAA 1953]*

1.87 Where the Commissioner is satisfied of the grounds after the liability to pay the tax arises, the notice to reduce the amount of tax payable may only be issued within four years after the original notice of assessment. This time limit is designed to provide finality in the taxpayer's affairs. *[Schedule X, item 14, section 18-130 and paragraph 18-185(c) in Schedule 1 to the TAA 1953]*

Grounds on which a director may rely

1.88 The first and second grounds on which the director may rely mirror the existing defences in the director penalty regime (section 269-35 in Schedule 1 to the TAA 1953). The content and considerations are the same under both regimes.

1.89 The first ground is that a director may not be responsible for the company's non-compliance because they were not involved in the management of the company and it was reasonable for the director not to be involved because of illness or some other good reason. This applies where the director had a reasonable basis not to be involved in the management of the company at any time during the period on or before a day that the company was required to pay any of its total PAYG withholding liability and ending when the Commissioner issues a reduction notice. *[Schedule X, item 14, paragraph 18-185(2)(a) in Schedule 1 to the TAA 1953]*

1.90 The second ground on which a director may rely to reduce their personal responsibility for the company's non-compliance is that the director took all reasonable steps to ensure that the directors caused:

- the company to pay the withholding liability;
- an administrator of the company to be appointed; or
- the company to begin to be wound up.

[Schedule X, item 14, paragraph 18-130(2)(b) in Schedule 1 to the TAA 1953]

1.91 Alternatively, the director may satisfy the Commissioner that there were no reasonable steps that could have been taken to ensure any of those things happened. *[Schedule X, item 14, paragraph 18-130(2)(b) in Schedule 1 to the TAA 1953]*

1.92 The director must cause the directors to take all reasonable steps to cause one of those three things to happen. A reduction in the amount of tax payable is not available where the director says that no reasonable steps were available to cause one of those three things to happen. For example, it is not sufficient for a director to say that there were no reasonable steps available to cause the company to pay because the company had insufficient funds.

1.93 To be successful in satisfying the Commissioner that there are grounds to reduce the tax payable, there must be no reasonable steps available to ensure the directors caused the company to do any of those three things. Therefore, if there were insufficient funds to pay the PAYG withholding, the directors should have taken all reasonable steps to have an administrator appointed or begin winding up the company.

1.94 In determining what would be reasonable steps for the director to have taken, the Commissioner must have regard to all of the relevant circumstances, including when, and for how long, the director was a director and took part in the management of the company. *[Schedule X, item 14, subsection 18-130(3) in Schedule 1 to the TAA 1953]*

Amount of the reduction in tax payable

1.95 The amount of the reduction in tax payable is determined by the Commissioner and is the amount stated in the notice issued by the Commissioner. *[Schedule X, item 14, subsection 18-130(4) in Schedule 1 to the TAA 1953]*

1.96 Where the director has satisfied the first ground, the Commissioner must have regard to:

- when, and for how long, the director did not take part in the management of the company;
- when, and for how long, the director could not have been expected to take part in the company; and
- what is fair and reasonable in the circumstances.

[Schedule X, item 14, paragraphs 18-130(5)(a) and (c) in Schedule 1 to the TAA 1953]

1.97 In determining the amount of a reduction based on the second ground, the Commissioner must have regard to:

- when the individual was a director of the company;
- how long the individual was a director of the company;

- how long the director took part in the management of the company; and
- what is fair and reasonable in the circumstances.

[Schedule X, item 14, paragraphs 18-130(5)(b) and (c) in Schedule 1 to the TAA 1953]

1.98 Where the Commissioner reduces the tax because the director has satisfied one of the grounds, the director will be entitled to interest. *[Schedule X, items 16 and 20 to 22, paragraph 3(1)(cab), subsection 10(2) and sections 3C and 10 of the Taxation (Interest on Overpayments and Early Payments) Act 1983]*

Associates of directors of companies that do not pay withheld amounts to the Commissioner

1.99 An individual who is an associate of a company director can be liable to pay PAYG withholding non-compliance tax for an income year if amounts withheld by the company (of which they are an associate of the director) have not been paid to the Commissioner by the last day for remitting any of the amounts withheld during the associate's income year. *[Schedule X, item 14, paragraphs 135(1)(a) to (c) in Schedule 1 to the TAA 1953]*

1.100 An *associate* is defined in section 995-1 of the *Income Tax Assessment Act 1997* as having the meaning given by section 318 of the *Income Tax Assessment Act 1936*. The latter section provides a very broad definition of 'associates of a natural person' which includes relatives, partners, a spouse and children of the natural person. *[Schedule X, item 14, paragraph 18-135(1)(a) in Schedule 1 to the TAA 1953]*

1.101 To be liable to pay the PAYG withholding non-compliance tax, the associate must be entitled to a credit which can be attributed to some extent to amounts withheld from payments such as salary or wages made to them by the company during the income year. *[Schedule X, item 14, paragraph 18-135(1)(c) in Schedule 1 to the TAA 1953]*

1.102 To be subject to the tax, the associate must also have been an associate of a director, and the director a director of the company, either:

- when that company was due to pay the withheld amounts to the Commissioner but failed to do so (in full); or
- after the unpaid withholding amount became due, and 30 days later the director was still a director and the overdue PAYG withholding remained unpaid.

[Schedule X, item 14, subsection 18-135(2) in Schedule 1 to the TAA 1953]

1.103 For the second scenario (new directors) the associate must have been an associate of the director for the full 30-day period. *[Schedule X, item 14, paragraph 18-135(2)(b) in Schedule 1 to the TAA 1953]*

1.104 Employees who are not associates of a company director are not liable to pay the PAYG withholding non-compliance tax.

1.105 Merely being an associate of the director does not mean that an individual is liable to pay the tax. The Commissioner must also be satisfied that due to the associate's relationship with the director or their relationship with the company, that the associate knew, or could reasonably be expected to have known, that the company had failed to pay amounts withheld to Commissioner. *[Schedule X, item 14, paragraphs 18-135(1)(d) and 3(a) in Schedule 1 to the TAA 1953]*

1.106 In addition to the knowledge or reasonable expectation of knowledge requirement, the Commissioner must also be satisfied that the associate did not:

- take reasonable steps to influence the director to cause the company to notify the Commissioner about the amount withheld;
- take reasonable steps to influence the director to cause the company to pay the withheld amounts to the Commissioner;
- take reasonable steps to influence the director to appoint an administrator or have the company wound up; or
- report to the Commissioner or another relevant authority that the company has not paid the amount withheld to the Commissioner.

[Schedule X, item 14, paragraph 18-135(3)(b) and subsection 18-135(4) in Schedule 1 to the TAA 1953]

1.107 In determining what are ‘reasonable steps’ the Commissioner may have regard to:

- the length and timing of the individual’s relationship with the director as an associate;
- the length and timing of the director being a director and taking part in the management of the company; and
- all other relevant circumstances.

[Schedule X, item 14, subsection 18-135(5) in Schedule 1 to the TAA 1953]

1.108 The other relevant authorities to whom the associate could report non-payment of PAYG withholding liabilities could include the Minister, the police, and regulatory bodies including the Australian Securities and Investments Commission and industry Commissioners. *[Schedule X, item 14, paragraph 18-135(3)(b) in Schedule 1 to the TAA 1953]*

1.109 An associate is not required to be actively involved in the company’s finances to be liable to pay the PAYG withholding non-compliance tax.

Example 1.10: An associate with reasonable knowledge of a company’s non-compliance

Jackson is a sole director of Onkey Pty Ltd which has not paid \$200,000 of amounts withheld to the Commissioner. Lisa is married to Jackson and is employed by the company to complete ad hoc administrative work but is constantly kept up to date about the operation of the company by Jackson. She received a payment summary from the company that indicated that the company had withheld \$5,000 of credits on her behalf.

The Commissioner is satisfied that Lisa knew that the amounts had not been paid to the Commissioner, and that she had not reported the debt to the Commissioner or another body. Also the Commissioner is satisfied that she had not taken any action to encourage the payment or the winding up of the company. Additionally, assume Jackson does not have a director penalty liability. Therefore, Lisa is liable to pay \$5,000 of PAYG withholding non-compliance tax.

Example 1.11: An associate without reasonable knowledge of a company’s non-compliance

Stephen was one of eight directors of Greenfield Pty Ltd for a period of two years. During this time his son, Riley, was employed by Greenfield for six months as a weekend courier. Greenfield has not paid \$500,000 of amounts withheld to the Commissioner. Riley

receives a payment summary from Greenfield Pty Ltd indicating that the company has withheld \$400 of tax from his salary.

Assume Stephen does not have a director penalty liability.

However, as Riley was not in a position to know of the withholding debt there was no possibility that he could report the liability or encourage his father to cause Greenfield to pay the Commissioner. Riley is not liable to pay the PAYG withholding non-compliance tax.

1.110 Alternatively, where the associate was an employee of the company, the associate is liable to pay PAYG withholding non-compliance tax if the Commissioner is satisfied that the associate was treated more favourably than other company employees. *[Schedule X, item 14, paragraph 18-135(1)(d) and subsection 18-135(6) in Schedule 1 to the TAA 1953]*

1.111 What constitutes more favourable treatment depends on the circumstances of each case. Where there is evidence of a difference in treatment it is most likely that the associate is being treated more favourably than other employees. For example, where the associate's wage is higher than other employees doing similar work or where the associate is receiving their entitlements whilst other employees are not. Alternatively, it may be that income is being split amongst associate employees to ensure lower tax rates or other entitlements. This list is not exhaustive of the instances of favourable treatment.

Example 1.12: Favourable treatment of an associate

Mustapha is the director of Multi Co. Mustapha's wife Mariam was employed by Multi Co.

During the 2012-13 income year, Multi Co failed to make superannuation guarantee payments and some wage payments for the employees other than Mariam.

Mariam has received all of her entitlements for the year and claimed \$500 of credits relating to payments made to her by Multi Co.

Multi Co has not paid \$10,000 of amounts withheld to the Commissioner.

Assume Mustapha does not have a director penalty liability.

Given that Mariam is an associate of Mustapha and the Commissioner is satisfied that Multi Co has treated Mariam more favourably than the other employees, Mariam is liable to pay \$500 of PAYG withholding non-compliance tax.

Amount of tax payable by an associate

1.112 Like with a director, the amount of tax payable by the associate is the lesser of:

- the total amounts withheld from payments made to the individual by the company in the individual's income year (that is, the extent that the credit is attributable to amounts withheld from payments made by the company of which the individual was an associate of a director); and
- the company's PAYG withholding liability for payments made during the income year.

[Schedule X, item 14, subsection 18-135(7) in Schedule 1 to the TAA 1953]

When tax is payable for an associate

1.113 The due and payable date for an associate's PAYG withholding non-compliance tax is the same as for directors (see paragraph 1.90).

[Schedule X, items 14 and 15, subsection 250-10(2) and section 18-145 in Schedule 1 to the TAA 1953]

1.114 The imposition of GIC on an associate's overdue PAYG withholding non-compliance tax is also the same as for directors (see paragraph 1.91). *[Schedule X, items 12 and 14, subsection 8AAB(4) of the TAA 1953 and section 18-150 in Schedule 1 to the TAA 1953]*

Recovering unpaid PAYG withholding non-compliance tax

1.115 If a company director or their associate is liable to pay PAYG withholding non-compliance tax, or GIC on that tax, and they have failed to do so, the Commissioner may only commence proceedings to recover the tax after issuing a notice to the individual. *[Schedule X, item 14, subsection 18-140(1) in Schedule 1 to the TAA 1953]*

1.116 The Commissioner must not issue a notice to enable recovery of PAYG withholding non-compliance tax from a director if that director has a director penalty liability that relates to the company's failure to meet its PAYG withholding obligations in item 1 in the table in subsection 269-10(1) in Schedule 1 to the TAA 1953. *[Schedule X, item 14, subsection 18-140(3) in Schedule 1 to the TAA 1953]*

1.117 The Commissioner must not issue a notice to enable recovery against an associate if the director who the individual is an associate of has a director penalty liability that relates to the company's failure to meet its PAYG withholding obligations in item 1 in the table in subsection 269-10(1) in Schedule 1 to the TAA 1953. *[Schedule X, item 14, subsection 18-140(3) in Schedule 1 to the TAA 1953]*

Notices

1.118 The notice must specify the company that the PAYG withholding non-compliance tax relates to, the income year of the individual and the amount of PAYG withholding non-compliance tax the individual is required to pay. *[Schedule X, item 14, subsection 18-140(4) in Schedule 1 to the TAA 1953]*

1.119 If, on the basis of the information available to the Commissioner, the Commissioner is satisfied that it is fair and reasonable for the individual to pay the PAYG withholding non-compliance tax, the Commissioner may issue a notice. *[Schedule X, item 14, subsection 18-140(2) in Schedule 1 to the TAA 1953]*

1.120 A notice given by the Commissioner to the individual director or their associate in order to recover an amount of unpaid PAYG withholding non-compliance tax is taken to be conclusive evidence of the making of the notice and that the amount and all particulars of the notice are correct. The only exception in regard to the amount and particulars is for objection and review proceedings under Part IVC of the TAA 1953. *[Schedule X, item 14, subsection 18-155(2) in Schedule 1 to the TAA 1953]*

1.121 A notice given by the Commissioner is valid even if the Commissioner has not complied with a provision of the Act, such as a procedural requirement under the Act. *[Schedule X, item 14, subsection 18-155(1) in Schedule 1 to the TAA 1953]*

1.122 These provisions are standard provisions in the tax law to facilitate the collection of tax. *[Schedule X, item 14, sections 18-145 to 18-155 in Schedule 1 to the TAA 1953]*

The company complies, or partially complies, before the notice day

1.123 If the company has paid some or all of their unpaid PAYG withholding liability after the day it was due but before the Commissioner issues a notice to enable recovery, the amount of the tax that is recoverable from the individual is reduced as a result. *[Schedule X, item 14, subsections 18-140(5) to (7) in Schedule 1 to the TAA 1953]*

1.124 If the company's discharge means that no tax would have been payable by the individual had the discharge occurred before the day the company was required to pay the amounts withheld to the Commissioner, the individual's amount of tax is reduced to nil and treated as always having been nil. *[Schedule X, item 14, subsection 18-140(5) and paragraph 18-140(6)(a) in Schedule 1 to the TAA 1953]*

1.125 However, if the company's discharge would have only reduced the amount of PAYG withholding non-compliance tax payable by the individual (had the discharge occurred before the company was required

to pay PAYG withholding to the Commissioner), the individual's tax is reduced.

1.126 The reduction is by the amount that the original of PAYG withholding non-compliance tax exceeds the amount that would have been payable, had the discharge occurred before the due day for the company paying its PAYG withholding to the Commissioner. *[Schedule X, item 14, subsection 18-140(5) and paragraph 18-140(6)(b) in Schedule 1 to the TAA 1953]*

1.127 Again, the reduced amount is treated as always having been the amount of PAYG withholding non-compliance tax payable by the individual. *[Schedule X, item 14, subsection 18-140(7) in Schedule 1 to the TAA 1953]*

The company complies after a recovery notice has been issued

1.128 A company may pay some or all of its PAYG withholding liability after the individual director or an individual associate of the director has become liable to pay an amount of PAYG withholding non-compliance tax.

1.129 If this occurs after the Commissioner issues a notice to enable recovery of the PAYG withholding non-compliance tax from the individual, the individual may be entitled to a credit. *[Schedule X, item 14, section 18-165 in Schedule 1 to the TAA 1953]*

1.130 To work out if the individual is entitled to a credit, the Commissioner must replace the amounts originally used to determine the amount of tax payable with amounts worked out taking into account the company's repayment. Where the new circumstances do not impact on the amount of tax payable by the individual, the Commissioner is not required to provide the individual a credit, although a discretion to do so exists. In determining whether to exercise that discretion the Commissioner must have regard to what is fair and reasonable in the circumstances.

1.131 If the Commissioner exercises that discretion, the amount of the credit entitlement must not exceed either the amount of PAYG withholding non-compliance tax payable by the individual, or the amount of the discharge. *[Schedule X, item 14, section 18-175 in Schedule 1 to the TAA 1953]*

Example 1.13: A later payment of the PAYG withholding liability with no impact on an entitlement to credits

Danielle is the sole director of Tucker Pty Ltd. Danielle was entitled to a credit of \$5,000 for amounts withheld from payments made to her by

Tucker Pty Ltd during the 2013-14 income year. Tucker Pty Ltd had an unpaid withholding liability of \$10,000 for amounts due in that income year.

Assume Danielle did not have a director penalty liability. Therefore, Danielle was liable to pay \$5,000 PAYG withholding non-compliance tax.

The Commissioner was satisfied that it was fair and reasonable for Danielle to pay the PAYG withholding non-compliance tax and issued a notice to enable recovery of the tax.

After this occurred, Tucker Pty Ltd made a payment of \$3,000 toward its withholding liability. As a result the Commissioner reconsidered Danielle's requirement to pay the tax.

Because the company debt after the partial repayment (\$7,000) still exceeds Danielle's original entitlement to credits (\$5,000), the Commissioner is not required to take any action.

1.132 If, under the new circumstances, the amount of PAYG withholding non-compliance tax payable by the individual is less than under the original circumstances (including if the amount payable would have been nil), the individual is entitled to a credit and the Commissioner must issue a notice. *[Schedule X, item 14, subsection 18-170(1) in Schedule 1 to the TAA 1953]*

1.133 An individual is entitled to a credit if the Commissioner issues a notice and becomes entitled to the credit on the day the notice is issued. *[Schedule X, item 14, subsections 18-170(2) and (3) in Schedule 1 to the TAA 1953]*

1.134 If, under the new circumstances, the individual would not have been required to pay the PAYG withholding non-compliance tax because the company debt no longer existed, the value of the entitlement must be equal to the original amount of PAYG withholding non-compliance tax. *[Schedule X, item 14, subsections 18-170(4) and (5) in Schedule 1 to the TAA 1953]*

1.135 Where the new circumstances lead only to a reduction in the amount of PAYG withholding non-compliance tax payable by the individual, the amount of the credit entitlement is determined by the Commissioner, having regard to what is fair and reasonable in the circumstances.

1.136 However, the credit entitlement must not be more than the original amount of PAYG withholding non-compliance tax or the amount of the company's discharge. The amount also must not be less than the amount by which the original PAYG withholding non-compliance tax exceeds the amount of tax that would have been payable had the

company's discharge occurred before the notice was issued. [*Schedule X, item 14, subsections 18-170(6) and (7) in Schedule 1 to the TAA 1953*]

1.137 The amount of the credit is the amount stated in a notice issued by the Commissioner. [*Schedule X, item 14, subsection 18-170(4) in Schedule 1 to the TAA 1953*]

Example 1.14: A later payment of a PAYG withholding liability resulting in an entitlement to credits

Fran is the sole director of Scott Pty Ltd. For the 2012-13 income year Fran is entitled to a credit of \$15,000 for amounts withheld from payments made to her by Scott Pty Ltd. As Scott Pty Ltd had a PAYG withholding liability of \$20,000, and assuming Fran does not have a director penalty liability, Fran is liable to pay \$15,000 PAYG withholding non-compliance tax.

After this occurred, Scott Pty Ltd pays \$18,000 of its PAYG withholding liability to the Commissioner.

Accordingly, the Commissioner must consider the impact on Fran's requirement to pay PAYG withholding non-compliance tax.

Because the original amount of tax (\$15,000) exceeds the revised company debt (\$2,000) Fran is entitled to a partial credit.

The Commissioner must provide Fran with a credit of at least \$13,000, which is the amount by which the original amount tax exceeds the company's revised debt.

The revised company withholding debt is used to calculate the credit entitlement because, had Scott Pty Ltd made the payment before Fran's credits were reduced, the amount of tax payable by Fran would have been equal to Scott Pty Ltd's debt (\$2,000) as it was less than Fran's credits.

1.138 The company may make numerous part-payments of its debt and, as a result, the individual may be entitled to a credit due to the Commissioner providing a notice. Where this has occurred, any reference to an amount of PAYG withholding non-compliance tax for the purpose of notices for later compliance, is treated as the amount of the tax, reduced by the total of credits which an individual is already entitled to due to earlier notices. Once the company has paid all of their withheld amounts to the Commissioner, all of the directors (and any associates that have been impacted) are entitled to a credit equal to the original amount of PAYG withholding non-compliance tax they were liable to pay. [*Schedule X, item 14, sections 18-170, 18-175 and 18-180 in Schedule 1 to the TAA 1953*]

1.139 In accordance with existing law, the credit or credits may be offset against existing debts, such as a PAYG withholding non-compliance tax debt, or, if there PAYG withholding non-compliance tax has been paid, it may entitle the individual to a refund.

1.140 The purpose of making a director or their associate entitled to a credit where the company has subsequently paid withheld amounts is to encourage company directors to cause their companies to comply.

1.141 Where a company has debts other than PAYG withholding liabilities, the Commissioner has a broad discretion (under Division 3 of Part IIB of the TAA 1953) as to how payments or credits are applied. The ATO's existing administrative practice statement explains the order in which payments by a company are applied against debts of various types.

1.142 An individual's entitlement to a credit as a result of the company making late payments of withheld amounts to the Commissioner does not entitle the individual to interest on the credit. This avoids providing an incentive for companies to pay withheld amounts after they are required to by the law. *[Schedule X, items 17 to 19, subsections 3(1) and (3) of the Taxation (Interest on Overpayments and Early Payments) Act 1983]*

Timing of notices

1.143 Notices issued for the purpose of enabling the Commission to collect the PAYG withholding non-compliance tax can be issued no later than two years after the notice of assessment for the individual's income tax for that income year is issued. *[Schedule X, item 14, paragraph 18-185(b) in Schedule 1 to the TAA 1953]*

1.144 Notices that result in an increase in the amount of PAYG withholding non-compliance tax payable (for example, through an amendment to a notice that reduces tax) or a notice that decreases or disentitles an individual's credit entitlement (for example, through an amendment to a credit entitlement notice) can be issued no later than two years after a notice of assessment is given. *[Schedule X, item 14, paragraph 18-185(6) in Schedule 1 to the TAA 1953]*

1.145 Notices that result in a reduction in the amount of PAYG withholding non-compliance tax payable, or that entitle an individual to a credit (or increase a credit entitlement) can be issued no later than four years after the notice of assessment for the individual's income tax for that income year is issued. *[Schedule X, item 14, paragraph 18-185(c) in Schedule 1 to the TAA 1953]*

1.146 If no notice of assessment for the individual's income tax for that income year has been issued, or if the notice is to give effect to a decision on a review or appeal or because of an objection made by the

individual or pending a review or appeal, there is no time limit of the Commissioner issuing a notice of any sort. *[Schedule X, item 14, paragraphs 18-185(a) and (d) in Schedule 1 to the TAA 1953]*

1.147 The longer period for notices that reduce the tax payable or entitle an individual to a credit (or a greater credit) also allows a greater period for individuals to benefit from the company later meeting its obligation to pay its PAYG withholding liability to the Commissioner.

Review of decisions

1.148 A director or an associate who receives a notice enabling the Commissioner to recover an amount of PAYG withholding non-compliance tax may object against any decision the Commissioner has made under section 18-51, 18-52AA, 18-54A or 18-55. This includes decisions in relation to:

- reducing the amount of tax payable by a director;
- issuing a notice to enable recovery of the tax; or
- entitling the individual to a credit (and the amount of the credit).

[Schedule X, item 14, section 18-190 in Schedule 1 to the TAA 1953]

1.149 Where a director or associate succeeds in a review of a Commissioner's decision to reduce (or not reduce) the tax or a Commissioner's decision to issue a notice to enable recovery, the taxpayer is entitled to interest.

Right of indemnity and contribution

1.150 The treatment of directors under the PAYG withholding non-compliance tax provisions is consistent with that under the director penalty regime — directors effectively have joint and several liability.

1.151 To deal with the potential unfairness associated with recovering different amounts from company directors (as a consequence of their original credit entitlement being lower than other directors and therefore the amount of PAYG withholding non-compliance tax payable also being lower), a right of indemnity and contribution allows directors to recover the amounts they have been responsible for contributing on behalf of the company against the company or other directors. *[Schedule X, item 14, section 18-160 in Schedule 1 to the TAA 1953]*

1.152 A director whose PAYG withholding non-compliance tax was reduced by the Commissioner because the Commissioner was satisfied

that the director was not, to some extent, responsible for the company's non-compliance, has their responsibility to contribute to other directors reduced to the same extent. [*Schedule X, item 14, section 18-51 and subsection 18-160(4) in Schedule 1 to the TAA 1953*]

Example 1.15: Directors seeking contributions from each other

Wilhelm and Aislinn are the directors of Rainbow Co. In the 2013-14 income year, Rainbow Co had a PAYG withholding liability of \$50,000. (Assume neither Wilhelm nor Aislinn have director penalty liabilities.) Wilhelm's credit entitlement attributable to amounts withheld by Rainbow Co was \$15,000, making Wilhelm liable to pay \$15,000 PAYG withholding non-compliance tax. Aislinn's credits attributable to amounts withheld by Rainbow Co was \$20,000, making her liable to pay \$20,000 PAYG withholding non-compliance tax.

Wilhelm and Aislinn are both able to claim their contributions back from Rainbow Co.

Alternatively, they both may seek a contribution from each other.

1.153 Because associates may also have to pay PAYG withholding non-compliance tax, the right of contribution allows them to claim back the tax they have paid from the company or the company's directors.

1.154 However, no individual may recover their contribution from an associate.

Example 1.16: An associate seeking a contribution from a director

Matt is a director of Kingsgate Pty Ltd. In the 2013-14 income year, Kingsgate Pty Ltd had a PAYG withholding liability of \$10,000 (assume Matt does not have a director penalty liability). Matt was liable to pay \$8,000 PAYG withholding non-compliance tax. The Commissioner was also satisfied that Matt's associate Pam, was liable to pay \$2,000 PAYG withholding non-compliance tax.

Matt and Pam are both able to claim payments of \$8,000 and \$2,000 back from the company.

Pam is also entitled to claim her payment of \$2,000 back from Matt directly.

However, Matt is not entitled to claim his payment of \$8,000 back from Pam as she is his associate, not a director of Kingsgate Pty Ltd.

1.155 The right of indemnity and contribution is an important aspect of ensuring that any one individual, particularly an associate, is not solely

responsible for the financial burden caused by the company's failure to comply with their obligations.

Application and transitional provisions

1.156 The amendments to extend the director penalty regime and the estimates regime to superannuation guarantee charges, apply if the company is originally required to lodge a quarterly superannuation guarantee statement to report unpaid and overdue superannuation guarantee shortfall on or after the day on which the amendments formally commence. The amendments do not apply where the original requirements to report a superannuation guarantee shortfall arose before the amendments commenced. The amendments commence on the day after Royal Assent. *[Schedule X, item 47]*

1.157 The amendments to the director penalty defences and notice requirements apply to penalties due at or after this Bill receives Royal Assent *[Schedule X, item 4]*. The additional defence that arises in relation to a superannuation guarantee charge related director penalty if the penalty accrued after Royal Assent *[Schedule X, item 57]*.

1.158 The rules particular to new directors apply if a director becomes a director and begins to be under an obligation on or after the day this Bill receives Royal Assent. *[Schedule X, item 7]*

1.159 The rules regarding the effect of a directors' obligation ending before the end of the notice period, and restricting the remission options available to directors after a director penalty has been outstanding for three months apply if the directors of the relevant company stop being under the relevant obligation on or after the day this Bill receives Royal Assent. *[Schedule X, item 9]*

1.160 The amendments for reduction of credits to directors and associates apply to amounts withheld during the 2011-12 income year and later income years, if the company withholding the amounts is required to pay them to the Commissioner on or after the day after this Bill receives Royal Assent. *[Schedule X, item 23]*

Consequential amendments

1.161 The consequential amendments to the *Corporations Act 2001* reflect changes associated with the extension of the estimates regime and director penalty regime to the superannuation guarantee charge to ensure consistent treatment of superannuation guarantee charge amounts

regardless of how they are quantified or collected. *[Schedule X, items 24 to 34]*

1.162 A consequential amendment to the ITAA 1997 instructs taxpayers on how to treat the PAYG withholding tax for the purpose of the alienation of personal services income. *[Schedule X, item 10, subsection 86-40(2) of the ITAA 1997]*

Applying payments and credits against unquantified director penalties

1.163 Under the existing payment and crediting rules in Division 3 of Part IIB of the TAA 1953 the Commissioner must treat a payment or credit using one of two methods (allocating the amount first to a running balance account or applying the amount first against a non-running balance account). Although this gives the Commissioner considerable discretion as to how a payment or credit is applied, prima facie there is no discretion not to apply a payment or credit (except in three specified cases).

1.164 Amendments to the payment and crediting rules give the Commissioner a discretion not to treat the amount of a payment or credit using either of the stipulated methods if doing so would require him to apply that amount against a director penalty. A discretion is being included for director penalties because of their unusual nature of being 'parallel liabilities'. That is, the relevant company has an underlying liability for an equivalent amount (and other directors also have a liability for an equivalent amount). Consequently, where an individual has a director penalty liability and is entitled to a credit, the Commissioner is not compelled to apply that credit against the director penalty liability, although the credit can be applied under the rules in Division 3 of Part IIB in the TAA 1953. *[Schedule X, item 1, subsection 8AAZL(4) of the TAA 1953]*