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Tax Laws Amendment (2011 Measures No. 8) Bill 2011 and the Pay As You Go Withholding Non-compliance Tax Bill 2011

As you are aware, the IPA is the professional body of company liquidators and bankruptcy trustees, and for lawyers, financiers, academics and others concerned with insolvency law and practice. We welcome the opportunity to comment further on these proposed laws, which are an important aspect of Australia's insolvency regime.

Previous submissions

The IPA has already made these submissions on these laws:

- to Treasury on 15 January 2010 when these and other proposals were first raised in the November 2009 proposals paper;[1]
- to Treasury on 2 August 2011 in response to a request for comment;[2]
- to the House of Representatives Committee on 26 October 2011; and
- to Treasury on 11 November 2011.

It is not clear to us what, if any, of our previous submissions has been considered. We see that the government says it has "held further consultation with industry after withdrawing an earlier version of the legislation in November". The IPA was not contacted about this consultation. Given that background, we will be brief in our comments on this Bill and use your schedule of changes from the November 2011 version of the Bill to briefly state our views on the changes shown.

The director penalty regime and insolvency

We have explained that the policy decision to impose liability on directors for their company's withholding taxes dates back to 1993. The Commissioner's long standing priority in insolvencies was removed, that is, its right to claim against the insolvent's assets over and above all other creditors. This previously held priority had often meant the ATO was paid, but no other creditors received any dividend. As a quid pro quo, the right of the ATO was given to impose liabilities for certain company taxes on directors personally.

[1] Action against fraudulent phoenix activity

[2] Exposure Draft - Tax Law Amendments to Strengthen Company Director Obligations and Deter Fraudulent Phoenix Activity, 5 July 2011

Apart from assisting in tax recoveries, this had other important insolvency purposes. One was to give an 'incentive' to directors to properly attend to the payment of employees' tax payments, and to deter directors from misusing those funds by way of the threat of personal liability being imposed. One escape for directors was to put their company into insolvency which would generally absolve them from personal liability. This was an entirely legitimate response – if their company was insolvent, and non-payment of tax liabilities is often an indicator of that, then the company should be in insolvent administration.

As we continue to say, the EM is legally incorrect in saying that

"some aspects of the director penalty regime limit its efficacy [because] 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."

If the company is insolvent, the directors should put their company into voluntary administration or liquidation. Indeed, if the directors choose instead to have the company pay its tax liabilities over and above other creditors, while the company is insolvent, the directors are acting unlawfully: *Browne v DCT*.[3]

Phoenix activity in brief and ASIC's role

We do not see this law as being directed at unlawful phoenix misconduct, however that may be defined, although that misconduct by directors may be a reason for unpaid tax liabilities.

Defences

There is concern expressed about allowing what are referred to as an 'honest' director's proper defences to an ATO claim. The defences to a tax penalty notice are generally the same as those presently available under the Corporations Act for insolvent trading - s 588H, and for directors indemnity of the ATO - s 588FGB, and s 222AOJ of the Income Tax Assessment Act 1936. An 'honest' director, however that person may be defined, should be able to find a defence in these provisions.

The new law intends to impose this liability without a formal director penalty notice being served. We support the idea of service of a notice on a director as one way to cause the director to face the reality of their company's insolvency and for them to seek professional advice at the earliest opportunity. The serving of a penalty notice at a time when the company has an outstanding taxation/superannuation debt, and within the period in which personal liability has not become automatic, gives the 'honest' director the opportunity to take advice and make an informed decision regarding the company's future We do acknowledge and support what is a compromise, that this liability without service of a notice will only arise where some long period – 3 months – has expired and the company has not advised the ATO of its default. We feel strongly that directors should be given every opportunity to be aware of the personal liability that can attach through the non-payment of these tax liabilities because we are concerned that once directors become automatically personally liable, there is no incentive for them to take action to prevent incurring of further debt. If unchecked this may result in significant losses to creditors, including the ATO.

We did make a suggestion in our last submission and do not repeat it beyond saying that the law could provide that 'first time directors' must be served with a DPN. Thereafter, no notice is needed. As we said, there is some precedent for this approach under section 206D, whereby a director of an insolvent company can be disqualified as a director by ASIC but only if they have been responsible for 2 or more insolvent companies.

[3] (1998) 82 FCR 1. In the event of the company's liquidation, the liquidator could sue the ATO to recover that money; the ATO could then sue the directors under s 588FGA.

Schedule

We otherwise provide our comments in the attached schedule.

Contact

We trust these comments are helpful. We would be pleased to discuss further if needed, in which case please contact the IPA's Legal Director, Michael Murray – 02 9080 5826 – mmurray@ipaa.com.au - as necessary.

Yours sincerely

Robyn Erskine
President
Insolvency Practitioners Association

Amendments to the director penalty regime [with IPA comments shown]

This paper outlines the Government's response to concerns expressed by stakeholders about what was Schedule 3 (Companies' non-compliance with PAYG withholding and superannuation guarantee obligations) to the *Tax Laws Amendment (2011 Measures No. 8) Bill 2011*, which was introduced to the House of Representatives in October 2011.

		IPA view or comment
Concern	Director penalties apply if a company makes an honest mistake about its superannuation liability; for example, when the company has an honest belief it is engaging a contractor who is actually an employee.	
Policy response	A director is not liable to pay a director penalty in relation to a company's failure to pay superannuation guarantee charge for a quarter to the extent that the failure is because the company: • took reasonable care in reaching that view; and • that view treated the *Superannuation Guarantee (Administration) Act 1992* as applying to a matter or identical matters in a particular way that was reasonably arguable.	**The defences available are consistent with other insolvency related defences – s 588H, s 588FGB – none of which has been found to be inadequate in giving directors adequate protection.**
Item / section	Item 58, subsection 269-35(3A) gives effect to this policy.	

Concern	Director penalty notices are served on directors personally and not their registered tax agent/s.	
Policy response	The Commissioner may give a copy of a director penalty notice to a director at the address of the director's registered tax agent, if that tax agent's address is the director's address for service for the purpose of any taxation law.	**The IPA supports whatever assists in bringing the directors' attention to their company's unpaid liabilities.**
Item / section	Item 4, section 269-52 gives effect to this policy.	

Concern	The Commissioner should have to issue a director penalty notice in all cases.	
Policy response	In all cases the Commissioner would have to issue a director penalty notice and wait 21 days before commencing recovery action, rather than being able to commence proceedings without issuing a notice. (However, note that 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).	**We think that a director penalty notice serves an important purpose of focusing the director's mind on the unpaid tax, and also on what is often their company's insolvency. However this relies upon the ATO serving a director penalty notice. We have commented in the past that the ATO should use director penalty notices more. If it cannot, because of resource or other reasons, then we think the 3 months delay is a reasonable approach.** **We do query what could be an unintended consequence, that where 3 months has lapsed after the due day, and the director knows the penalty is imposed whether or not he or she places the company into administration or winding up, then the director may trade on, and incur further liabilities, regardless, to the detriment of all creditors.**
Item / section	Item 5, subsection 269-25(1) of the original Bill has been deleted, which means that section 269-25 of the *Taxation Administration Act 1953* will continue to apply unaltered. Item 9, subsection 269-30(2) ensures that 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.	

Concern	New directors can be liable for debts outstanding when they begin, and have only 14 days to familiarise themselves with a company's affairs before being liable.	

Policy response 1	A new director should not be liable to a director penalty for company debts that existed at the time he or she assumed his or her directorship until 30 days after he or she became a director.	**30 days is a more reasonable period. We are aware of *Fitzgerald v DCT* (1995) 68 ATR 770 where a director was held liable within 14 days of his appointment.**
Item / section	This policy is effected by: • item 6, paragraph 269-20(3)(b); • item 7, subsection 269-20(4); and • item 16, paragraphs 18-125(2)(b) and 18-135(2)(b), and subparagraph 18-160(3)(b)(ii).	
Policy response 2	New directors should not be subject to the restricted remission options until 3 months after they become a director of a company, rather than 3 months after a debt arose.	**No IPA comment.**
Item / section	Items 9 and 55, section 269-30 gives effect to this policy.	

Concern	The law and/or amendments should be more specifically targeted at dealing with phoenix activity.	
Policy response	The Government is not proposing amendments to restrict the director penalty regime, or the proposed amendments to it, to cases of phoenix activity.	**We agree. The director penalty notice regime never had a policy focus of being directed at or restricted by unlawful phoenix activity; but such activity may be deterred or remedied by imposing personal liabilities on directors.**