

Part B The Collection of Taxation Debts

14 PERSONAL LIABILITIES OF COMPANY DIRECTORS

The policy in this chapter is to be followed by Tax Office staff. We have made every effort to ensure it is technically accurate, but in the interests of clarity it has been written in 'plain English' and should not be read or interpreted like legislation. If you feel that something in the chapter is wrong or misleading, please advise the Tax Office.

Date of effect: 4 July 2006 (This replaces the 2003 version.)

14.1 PURPOSE

14.1.1 This chapter deals with:

- the personal liabilities of company directors in relation to their company's liabilities under remittance provisions;
- other personal liabilities of company directors; and
- steps the Commissioner will take to recover these liabilities from directors.

14.2 LEGISLATION

14.2.1 Directors can incur a personal liability to pay certain amounts by virtue of:

- sections 222AOC or 222AOD *Income Tax Assessment Act 1936* (ITAA 1936) - if a company fails to remit deductions as required;
- sections 222APC or 222APD ITAA 1936 - if a company fails to pay an estimate as required; or
- section 222AQA ITAA 1936 - if a company contravenes a payment agreement under section 222ALA ITAA 1936.

14.2.2 Division 9 of Part VI of the ITAA 1936 seeks to ensure that a company either meets its obligations with respect to amounts deducted or withheld from payments, or goes promptly into voluntary administration or liquidation. It imposes a duty on the directors to cause the company to do so and enforces that duty by penalties.

14.2.3 **Prior to 1 July 2000**, these obligations arose under Division 1AAA (Reportable Payment System [RPS], Pay As You Earn [PAYE] and Prescribed Payment System [PPS] deductions), Division 3B (natural resource payments and unattributed income), Division 4 (dividend, interest, royalty withholding tax) and Division 8 (estimates and payment agreements).

14.2.4 **From 1 July 2000**, the pay as you go (PAYG) withholding system replaced the PPS and RPS and incorporated the main elements of the PAYE system. The remaining withholding systems also became part of the PAYG system. PAYG provisions are located in Part 2-5 of Schedule 1 to the *Taxation Administration Act 1953* (TAA).

14.2.5 Division 13 of that Schedule applies the PAYG withholding provisions to personal services income attributed to an individual under subsection 86-15(1) of ITAA 1997. These measures applied from 1 July 2000. However,

there were transitional arrangements for contractors who were in the PPS tax system. For these contractors, the measures did not apply until 1 July 2002.

- 14.2.6 Division 14 of that Schedule applies the PAYG withholding provisions to situations where non-cash benefits are provided.
- 14.2.7 Division 9 of Part VI of the ITAA 1936, which provides for penalties for directors of non-remitting companies, was amended to include Subdivision 16-B in Schedule 1 to the TAA in relation to amounts of PAYG withholding which were not remitted as required.
- Sections 220AAZA, 221YHZJ and 221R of the ITAA 1936, and Part 4-15 in Schedule 1 to the TAA provide for the recovery of amounts payable under Division 9 of Part VI of the ITAA 1936.
- 14.2.8 Pursuant to section 588FGA of the *Corporations Act 2001*, if a transaction is held to be a voidable transaction (subject to section 588FGB *Corporations Act 2001*), directors are liable to indemnify the Commissioner in respect of any loss or damage resulting from an order that the Commissioner repay to the company an amount previously paid in respect of a liability under a remittance provision or in respect of an estimate.
- 14.2.9 Through the operation of section 8Y of the TAA a person, such as a director, can be deemed liable for offences committed by a corporation. In some circumstances, a reparation order may be sought under section 21B of the *Crimes Act 1914*, seeking payment of losses incurred as a result of an offence.
- 14.2.10 In *Gould v. FC of T* (98 ATC 4946), the WA Supreme Court dismissed the taxpayer's appeal against a reparation order made pursuant to prosecution under section 8Y. The Court found that although the director's personal liability had been remitted pursuant to section 222AOG of the ITAA 1936, once the company had been placed into administration, the provisions of the ITAA 1936 did not implicitly limit the provisions of the *Crimes Act 1914*, and so the Court had been entitled to make the reparation order.
- 14.2.11 However, it should be noted that from 1 July 1999, the offence provisions relating to remittance of most withholding amounts were repealed in relation to most amounts withheld after that date.

14.3 INTRODUCTION

A Director Penalty Notices (DPNs)

- 14.3.1 There is a continuing obligation on company directors, including new directors, to ensure that a company meets its remittance provision obligations or goes promptly into voluntary administration or liquidation. This duty is outlined at section 222AOB and is enforced by a penalty equal to the unpaid amount of the company's liability under the remittance provisions. Section 222AOE (and section 222APE in respect of estimates) requires the Commissioner to give a director 14 days notice before recovering this penalty. The notice sets out details of the unpaid amount and states that the penalty will be remitted if, at the end of 14 days after the notice is given:

- the liability has been discharged;

- an agreement relating to the liability is in force under section 222ALA; (see policy chapter entitled 'Payment agreements'); or
 - the company is under administration within the meaning of section 436A of the *Corporations Act 2001*; or
 - the company is being wound up (refer *Scobie v. DFC of T 95 ATC 4525*).
- 14.3.2 Directors of companies are automatically personally liable to pay, by way of penalty, amounts equal to any unremitted amounts their company has not paid by the due date. Their personal liability commences on the day after the due date for payment (section 222AOC). A comprehensive discussion of the obligations of directors under taxation legislation can be found in *Scobie supra* and in *Simpson v. DFC of T 96 ATC 4661*.
- 14.3.3 It should be noted that there is no provision in legislation for the Commissioner to extend the 14 day period for compliance with a director penalty notice.
- 14.3.4 From 1 July 2000, the insertion of section 222AOBA ITAA 1936 provided that these rules also apply to obligations relating to non-cash benefits.
- 14.3.5 It is preferable to have served a director penalty notice in situations where a director has become bankrupt or signed a section 188 authority, and where the Commissioner intends to prove in the estate.
- 14.3.6 Directors are not liable to pay penalties equal to the additional charges for late payment/General Interest Charge (GIC) incurred by their companies, and nor are additional charges/GIC payable on any of the penalties which the directors become liable to pay.
- 14.3.7 If a person becomes a director after the due date for payment of a particular unremitted amount, that person has by section 222AOD up until 14 days after the date of appointment to cause the company to comply with the legislative requirements, failing which that person also becomes liable to a penalty under section 222AOD. In *Fitzgerald v. DC of T 95 ATC 4587*, it was held that a director who held office for 17 days, and who did not make enquiries of the current financial position of the company, and who was not aware of moneys owing by the company to the Commissioner, was liable to pay an amount of penalties equal to the amounts not remitted by the company prior to his appointment.
- 14.3.8 Comparable provisions apply to directors of companies which fail to pay estimates (refer chapter entitled 'Estimating a liability').
- Section 222APB requires that, within 14 days after the day on which the Commissioner sends a notice of estimate to the company, the directors must cause the company to either:
- pay the estimate(s) as required;
 - enter into a section 222ALA payment agreement;
 - appoint an administrator of the company under the *Corporations Act 2001*; or
 - begin to be wound up (refer to *Scobie supra*).
- 14.3.9 If this obligation is not complied with, all directors who held office at any time during the 14 days after the day of service of the notice of estimate become liable to a penalty under section 222APC. The amount of the

penalty equals the unpaid amount of the estimate not paid, and the liability comes into existence on the 15th day after service of the estimate notice. A new director will receive a penalty under section 222APD if section 222APB has still not been complied with at the end of 14 days after the person became a director. The obligation to cause the company to do one of the above continues until compliance occurs.

- 14.3.10 Section 222APE requires that a penalty notice must be given to directors before the Commissioner can seek to recover a section 222APC or section 222APD penalty. Where the Commissioner has made an estimate and sent notice to the company, he can at any time after that, give penalty notices to the directors. However, the penalty is remitted if section 222APB is complied with before the 14th day after the director penalty notice was given.
- 14.3.11 If the directors fail to comply with the director penalty notice for either actual liabilities (222AOE) or estimates (222APE) within 14 days of service, legal action for recovery may proceed against each director to whom a notice was sent.
- 14.3.12 Once the 14 day period following the issue of the director penalty notice has elapsed, the recipient director continues to be liable for the penalty described on that notice until such time as it has been paid by the director or paid by another entity, such as the company or another director who shares a parallel liability in respect of that penalty. That is, after that 14 day period has elapsed, the recipient director continues to be liable for the penalty, even where another director later triggers remission of their parallel liability to that penalty by causing compliance with section 222AOB or section 222APB within the 14 days following receipt of their own director penalty notice.

B Contravention of Payment Agreements

- 14.3.13 If a company contravenes a section 222ALA payment agreement (refer to the chapter entitled 'Payment agreements'), any person who was a director at any time between the time of the making of the agreement and the time of its contravention becomes liable to pay a penalty equal to the balance payable under the agreement at the time it is contravened. A new director who is appointed after contravention is not liable to a penalty as a result of the contravened agreement, and nor is a director who resigned before the agreement was entered into.
- 14.3.14 There is no requirement for the Commissioner to send notice of a penalty for breach of a payment agreement prior to the institution of recovery proceedings. If the terms of the payment agreement are contravened, the legislation operates to impose a penalty automatically.

C Provisions of the Corporations Act 2001

- 14.3.15 If a liquidator recovers amounts remitted to the Commissioner in payment of a liability under a remittance provision or an estimate because a transaction is void (because, for example, it was an unfair preference), any person who was a director when that payment was made is liable to indemnify the Commissioner for any loss or damage resulting from the court order. The Full Federal Court has given consideration to these indemnity provisions (*Browne & Ors v. DC of T*, and *DC of T v. Smith & Ors* 16 ACLC 559, 153 ALR 10).

- 14.3.16 The directors of a company owe a duty of care to the company not to prejudice the interests of creditors in the exercise of their powers. If the interests of creditors are adversely affected by the actions of directors and it can be shown the directors have acted inappropriately, the directors may be liable to either a civil or criminal penalty order for payment of compensation to the company or to creditors.
- 14.3.17 The directors are also under a duty to prevent the company incurring debts while it is insolvent. This is referred to as insolvent trading (section 588G *Corporations Act 2001*). Liquidators have the right to recover unpayable debts from directors who breach that duty (sections 588J and 588M *Corporations Act 2001*). The Commissioner may, with the written consent of the company's liquidator, begin proceedings under section 588M to seek to recover from the director an amount equal to the loss or damage that the Commissioner suffered as a result of the director's contravention of section 588G (ie the portion of the tax liabilities that the company accrued while it was trading insolvently and which the Commissioner was not able to recover in the liquidation).

D Other remedies

- 14.3.18 Where the company has committed an offence, a director or other officers of a company may also be liable for prosecution under section 8Y of the TAA for that offence. For instance, where a company fails to comply with its obligations to furnish a return or other information, the directors may be prosecuted. In certain extreme circumstances, where there is a loss to the Commonwealth, a person convicted of an offence could be ordered to make reparation under section 21B *Crimes Act 1914*.
- 14.3.19 In some cases, there may also be circumstances suggesting fraud against the Commonwealth under the *Crimes Act 1914*. Where this is suspected, it should immediately be brought to the attention of supervisors.

14.4 POLICY

- 14.4.1 Consistent with the primary object of these provisions, and rather than allowing a company to continue to accumulate unpaid liabilities, the Commissioner will employ these measures to induce those who control the company to bring its affairs under some form of administration so as to protect the interests of all creditors.
- 14.4.2 Debtors can expect that in most cases, director penalty notices will issue as a matter of course in order to maximise both the compliance effects and the revenue collection potential of the legislation. The notices will issue as soon as practicable after the due date for payment (or after service of a notice of estimate) if the company has not taken one of the necessary steps.
- 14.4.3 The amounts owing by companies pursuant to remittance provisions (including estimates), and the amounts owing by each director pursuant to various director penalty provisions are parallel liabilities. This means that, although amounts owing by the company (including estimates) and penalties equal to the amounts owing by each director are separate and distinct liabilities, any reduction in one liability results in the discharge of the other parallel liability(s) for the same period, to the same extent.

- 14.4.4 Payments of the company's tax liabilities which have been made from the personal resources of the directors, should be allocated firstly to the director penalty liability. A person who pays an amount as a result of director penalty provisions has rights of indemnity and contribution against the company and other directors.
- 14.4.5 Before continuing action against directors personally, the Commissioner will:
- (i) evaluate the alleged defences of those directors, taking into consideration all relevant documentation and evidence provided by the directors. It would be inappropriate to proceed against a director if it is decided that the director has a valid defence under section 222AOJ, 222API and/or 222AQD and it would be highly unlikely that a court would make an order in the Commissioner's favour; and/or
 - (ii) determine which director(s) to pursue. There would be a number of factors to consider including the ability of the director to pay, the director's right to be indemnified by the company and other directors, the cost effectiveness of the action and similar issues.
- 14.4.6 It should be noted that any insolvency administration under the *Corporations Act 2001* which affects the company's liability can not operate to release a director from their (separate but parallel) liability to pay a director penalty amount. There is no statutory authority which permits this release. It therefore follows that a Deed of Company Arrangement which operates to compromise a debt owed by the company can not affect the personal liability of the director.
- 14.4.7 The Commissioner may issue a director penalty notice at the same time as recovery action is being taken against the company. However, because the penalty which is the subject of that notice will be automatically remitted if the company is wound up within 14 days after the notice is given, a notice can only issue 'before the company begins to be wound up' (ie before a wind up order is made) — see sections 222AOB, 222AOE and 222APE ITAA 1936.
- 14.4.8 In cases where a court orders the Commissioner to pay an amount received from a company to the liquidator of the company because the court deemed the amount the Commissioner received to be a voidable transaction, the Commissioner may take action to recover from the directors. This will often involve joining the directors in any court proceedings taken by a liquidator against the Commissioner. The case of *Browne & Ors v. DC of T*, and *DC of T v. Smith & Ors*, supra, uphold the right of the Commissioner to take such action.
- 14.4.9 The Commissioner will also look to support the activities of a liquidator or administrator in appropriate actions against directors where there is a view that the action of directors has adversely affected the revenue. In particular, the Commissioner will encourage a liquidator to pursue directors in appropriate cases of insolvent trading where there is a significant amount of tax involved, and there is potential for recovering that amount by initiating action against a third party.
- 14.4.10 From time to time, the Commissioner may be approached by a former director of a company with a request to provide information about the Commissioner's negotiations with, or actions against, the company or against other directors or former directors who share a parallel liability.

The Tax Office is responsible for ensuring that the release of taxpayer information is in accordance with the disclosure provisions of the ITAA 1936. Section 16 of that Act allows disclosure by an officer if it is in the performance of the officer's duties. In this situation, information may be disclosed if it ensures or encourages compliance with the Act (for example, where provision of the information promotes payment of a director penalty). The officer must be satisfied that the former director is *not* seeking information for a purpose which is wholly unrelated to the recovery of the amounts.

14.4.11 It is accepted that it is possible that the disclosure of information to a former director can facilitate collection of unremitted amounts. The sort of information that might be disclosed could include:

- the amount of the outstanding liability
- the action the Tax Office is taking against particular persons to recover all or part of that liability
- the identity of the persons who have already paid part of the liability.

14.4.12 For example, a former director may be encouraged to pay an outstanding amount of penalty when they see that other parallel debtors have paid amounts towards the penalty and have rights of indemnity against the former director.

14.4.13 Even where a penalty has been paid in full, disclosure to a former director that specifically identified persons have a right of indemnity against them could also be made, where the disclosure makes it clear to the former director that they have not escaped liability by failing to make a payment directly to the Commissioner.

14.4.14 It should be noted, however, that the Commissioner is not obliged to disclose information in the situations outlined above, and would only do so when satisfied that the disclosure would aid in the recovery of unremitted amounts or assist the former director to understanding their rights and liabilities.

14.5 TERMS USED

14.5.1 'Estimate' refers to the Commissioner's power under section 222AGA to establish a liability by making a reasonable estimate of an unpaid liability made by the Commissioner where there is reason to suspect a person has become liable under a remittance provision, and the liability to pay those amounts remains undischarged after the due date of the deductions.

14.5.2 'Non-cash benefit' is property or services in any form except money. If a non-cash benefit is dealt with on behalf of an entity, or is provided or dealt with as an entity directs, the benefit is taken to be provided to the entity.

14.5.3 'Personal services income' is income that is mainly a reward for the personal effort or skills of an individual.

Alienation of personal services income occurs when the services of an individual are provided through an interposed entity rather than directly by the individual who performs the services. As a result of measures introduced from 1 July 2000, there are limitations to deductions that can

be claimed and PAYG obligations arise in respect of the personal services income that is to be included in an individual's personal assessable income.

14.5.4 'Remittance provisions' were various provisions of the ITAA 1936 that required a debtor to remit:

prior to 1 July 2000,

- deductions made from reportable payments;
- tax instalment deductions made from payments of salary and wages;
- deductions from prescribed payments;
- deductions made from natural resource payments or unattributed payments; and
- dividend, interest and royalty withholding taxes.

on or after 1 July 2000 –

A payer's obligations to pay withheld amounts to the Commissioner are set out at Subdivision 16-B TAA, specifically

- amounts withheld under the PAYG withholding system.

14.5.5 'Withholding payment' means:

- (a) a payment from which an amount must be withheld under Division 12 in Schedule 1 to the TAA; or
- (b) an alienated personal services payment in respect of which Division 13 in that Schedule requires an amount to be paid to the Commissioner; or
- (c) a non-cash benefit in respect of which Division 14 in that Schedule requires an amount to be paid to the Commissioner.

14.5.6 'Voidable transactions' are transactions that may be regarded as void if it is determined that they are insolvent transactions within the meaning of section 588FE *Corporations Act 2001*.