AFFIRMATIVE
BUSINESS ADVISORY

DIRECTOR LIABILITIES / DUTIES

Directors are liable for a range of company debts and lodgements; and have a duty not to trade while insolvent.

Director penalty notices: How a director can be personally liable for certain company tax debts

If a company fails to comply with their obligations to pay certain debt/s, directors are held personally liable for the amount the company should have paid.

Overview

Company directors are legally responsible for ensuring that their company meets its pay as you go (PAYG) withholding, “net” GST (goods and services tax, wine equalisation tax and luxury car tax) and superannuation obligations. If a company fails to comply with their obligations to pay the debt by the due date for payment, company directors are held personally liable for the amount the company should have paid.

The laws governing the director penalty notice regime were strengthened significantly in June 2012 and recently changed again in 2019 and 2020. The net result is that it is now easier for directors to be pursued for these debts.

Under certain circumstances, the ATO can force directors of a company that is unwilling or unable to meet these obligations, to personally pay those debts. This is achieved with the issuance of a director penalty notice (DPN), for an amount equal to these amounts.

A director becomes liable for a penalty at the end of the day the company is due to meet its obligation. At this time, the penalty is created automatically. The ATO does not need to issue any notices or take any action to create the penalty. The Commissioner, however, must not commence proceedings to recover a director penalty until 21 days after a DPN is issued to a director.

There are two types of DPNs: a non-lockdown penalty notice, and a lockdown penalty notice.

Non-lockdown Director Penalty Notices

The first type is the “non-lockdown” DPN. Non-lockdown DPNs are issued to company directors that have lodged its business activity statements and instalment activity statements within three months of the due date for lodgement and superannuation guarantee charge statements within one month and 28 days after the end of the quarter that the superannuation contribution relates to, but the PAYG withholding, net GST and/or SGC debts remain unpaid. The notice gives directors 21 days to take certain actions, which results in the penalty being “remitted” i.e. cancelled.

Lockdown Director Penalty Notices

The second type is “lockdown” DPN. Lockdown DPNs are issued to company directors where a company has failed to lodge its business activity statements and instalment activity statements within three months of the due date for lodgement and superannuation guarantee charge statements within one month and 28 days after the end of the quarter that the superannuation contribution relates to. In this case, the penalty permanently locks down on the director and there is no ability to remit (i.e. cancel) the penalty, other than by paying the debt in full.

PAYG withholding non-compliance tax

PAYG withholding non-compliance tax (NCT) is imposed on directors and associates of directors under the Pay As You Go Withholding Non Compliance Tax Act 2012 (PAYG withholding NCT). The NCT is a 'tool of last resort' option for the Commissioner to pursue individual directors and their associates for an amount related to a company's unpaid PAYG withholding liabilities.

Payment by directors

Directors are liable to pay the NCT if they:

- were a director when the company failed to pay the withheld amounts on the date they were due
- became a director after the date the payment was due and they are still a director 30 days after the amount was due, but is still unpaid.

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

- the total amount withheld from payments made to the individuals by the company in the year
- the company's PAYG withholding liability for payments made during the year.

The same defences for director penalties can also be used for NCT.

Payment by associates

An individual who is an associate of a company director can also be liable to pay PAYG withholding NCT if the company has not paid the outstanding amount by the last day for remitting.
An associate of a director includes one of the following:

- the director's spouse
- the parent, grandparent, brother, sister, uncle, aunt, nephew, niece, lineal descendant or adopted child of the director, or of the director's spouse
- the spouse of a person referred to above
- a partner in a partnership with the director
- a trustee of a trust where the director or an associate of the director benefits from the trust.

However, the Commissioner must determine that the associate knew, or could reasonably be expected to have known, that the company failed to pay the withheld amounts. The Commissioner must also be satisfied that the associate:

- did not take reasonable steps to influence the director to make the company notify the Commissioner about the amount withheld
- did not take reasonable steps to influence the director to make the company pay the withheld amounts to the Commissioner
- did not take reasonable steps to influence the director to appoint an administrator/small business restructuring practitioner or have the company wound up
- did not report that the company had not paid the amount withheld to the Commissioner or other relevant authority.

Recovering withheld amounts

The Commissioner must not give an NCT notice to a director who has a director penalty liability. A director must also have an entitlement to a PAYG withholding credit for an extent to an amount withheld by the company from payments made by the company to the director (such as directors fees). The PAYG withholding NCT tax applies to amounts withheld during 2011-12 and later. A director or an associate can object to any decision the Commissioner makes.

Estimates and director penalty notices

Where the company has failed to meet its reporting requirements for PAYG withholding, net GST and SGC, the ATO may issue a DPN based upon the ATO's estimate. Directors can submit a statutory declaration or an affidavit to verify the amount of the estimated liability, which may reduce or revoke the liability.

Recovering director penalties

Director penalties are automatically imposed by the ATO. However, the Commissioner must follow a specific procedure before starting proceedings to recover that debt, as set out in the note to 269-20(2) of the Taxation Administration Act 1953 (TAA). If the Commissioner determines it is 'fair and reasonable' for a director to pay the outstanding tax, a DPN will be issued. The Commissioner will not start proceedings to recover the debt until 21 days after the DPN is issued.

DPNs must be issued to an individual director. Directors are jointly and severally liable for the debt and will each owe the same amount of money under the DPN. The ATO considers that a DPN notice is issued on the day it is posted to the director's address listed in the company records maintained by the Australian Securities and Investments Commission (ASIC). If a DPN is delivered to an old address, it is still considered to be validly issued. The ATO may also send a copy of the DPN to the director's registered tax agent as an additional way of bringing the penalty to the director's attention; however, if the tax agent does not bring the notice to the director's attention, the notice is also still considered to be validly issued.

The ATO can also collect the tax in other ways, for example by withholding a tax refund or issuing a garnishee notice. The ATO has the power under section 260-5 TAA to issue a garnishee notice to any third party that owes or holds (e.g. the company's bank) any money on behalf of the company. A garnishee notice requires the third party to pay money directly to the ATO.

A garnishee notice can require payment of a percentage of the debt, or funds held, or may seek payment of a lump sum amount i.e. the full amount up to the ATO's debt. For individuals, this means that the ATO can issue a garnishee notice to an employer or contractor. For businesses, the ATO can issue a garnishee notice to a financial institution, or any trade debtor.

Remitting director penalties

Director penalties will be remitted if the company pays the outstanding tax at any time. Director penalties will also be remitted if, within 21 days of a DPN being issued:

- The company reported its PAYG withholding and net GST within three months of the due date for lodgment and lodged its superannuation guarantee charge statements within one month and 28 days after the end of the quarter that the superannuation contribution relates to (i.e. it is a non-lockdown DPN); and
- The company goes into voluntary administration, appoints a small business restructuring practitioner, or goes into liquidation.

However, if the company fails to report its PAYG withholding, net GST or SGC liabilities within the above time periods, the director penalties cannot be remitted even if an administrator, small business restructuring practitioner, or a liquidator is appointed. The DPN regime imposes a lockdown on a director for liabilities that are unpaid and unreported within their required lodgment periods.

Defences for director penalties

A director is not liable for a director penalty if they can establish that one of the defences under the legislation is available to them.

A defence can be that due to illness or another acceptable reason, a director was not managing the company at the time the liability was incurred. This defence can be used if it is "unreasonable to expect (the director) to take part due to illness (theirs or someone else's) or some other good reason".

A director is also not liable for a director penalty if they can establish that they took all reasonable steps to:

- make the company meet its obligation to pay
- appoint an administrator
- appoint a small business restructuring practitioner
- wind up the company.

Or, if it can be established that no reasonable steps were available. Unacceptable defences would include:

- the company had insufficient funds to pay the tax
- a consensus to appoint an administrator/small business practitioner/liquidator could not be reached.

A director may also be able to claim a defence in relation to penalties relating to net GST or Superannuation debts, to the extent the penalty was due to the company adopting a reasonably arguable position and the company took reasonable care in connection with applying the GST Act or the Superannuation Guarantee (Administration) Act 1992 as relevant.

There is no corresponding defence for PAYG withholding obligations.

Directors cannot use a defence that a DPN was sent to the wrong address. The ATO use the address listed on the public record of the company with ASIC. The ATO considers directors are responsible to keep this information current.

Previous Directors

The ATO is able to issue a DPN to a director who has resigned before issuance of any notices.

New Directors

New directors appointed to a company become personally liable for any historic unpaid PAYG, net GST and superannuation (GST only from 1 April 2020 and superannuation only from 1 April 2012) 30 days after they commence as a director. Avoiding personal liability is limited to either paying the debt or causing the company to be placed into voluntary administration or liquidation within 30 days of appointment as a new director.

Adopting the view that resigning your directorship within the 30-day period will result in avoiding personal liability is flawed, as it is imposed regardless of whether the person remains as a director at the expiry of 30 days, or not. In fact, a director who resigns would be in a more difficult position, as they cannot then cause the company to pay the debt or influence a voluntary administrator, small business restructuring practitioner, or liquidator being appointed.

Right of indemnity and contribution

The legislation outlines the rights of a director who pays a company liability as against the other directors who were also liable to pay the penalties. To deal with the potential unfairness associated with recovering different amounts from company directors, a right of indemnity and contribution allows directors to recover amounts they have paid on the company's behalf against the company or its other directors.

Associates who have been levied with a PAYG withholding non-compliance tax also have right of indemnity and contribution, to claim back tax they have paid. However, no individual may recover their contribution from an associate.

The right of indemnity and contribution seeks to ensure that any one individual, particularly an associate, is not solely responsible for the financial burden caused by the company's failure to comply with its obligations.

Disclaimer