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Directors Duties - the tax
perspective

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Directors and Tax Exposures

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1. General overview

1.1 A liquidator may recover from company directors in respect of:

1.1.1 uncommercial transactions pursuant to section 588FB of the *Corporations Act 2001* (Cth) (**'the Corporations Act'**); and

1.1.2 insolvent transactions pursuant to section 588FC of the Corporations Act.

1.2 The Commissioner is usually willing to fund a liquidator's actions, and promote a liquidator to use its formal powers of examination. An example of such actions taken by a revenue authority (although not the Commissioner) is found in *Mistmorn Pty Ltd (in liq) and Wily v Yasseen* (1996) 14 ACLC 1387.

1.3 In *Mistmorn v Yassen*, the liquidator (Wily) sought to recover funds from a shadow director (MrYasseen) on the basis that that person breached his duty of care to the company (Mistomorn). The company conducted a duty free store. The company purchased liquor and cigarets under bond on a sale tax, excise and duty free basis. Significant amounts of bonded goods were stolen on four separate occasions. Further, it was found that MrYasseen had caused the company to make purchases of stock which far exceeded historical purchases. The Court found that MrYasseen had breached his duty to the company on the basis that it '*... was irresponsible to build up large stocks of tobacco which were not needed and which were uninsured...'*

1.4 The principal creditor of the company was the Collector of Customs, who, acting under subsection 35A(1) of the *Customs Act 1901*(Cth) required the company to pay customs duty '*... which would have been payable had the goods been entered into for home consumption'*. The subsection provided that:

Whenever a person who has or has been entrusted with the possession, custody or control of dutiable goods which are subject to the control of customs,

(a) fails to keep those goods safely; or

(b) when so requested by a Collector, does not account for those goods to the satisfaction of a Collector;

that person shall on demand in writing made by a Collector, pay to the Commonwealth an amount equal to the amount of duty of Customs which would have been payable on those goods if they had been entered for home consumption on the day on which the demand was made.

- 1.5 The registered Directors of the company included a MrsHamad (at one time MrYasseen's de factor spouse) and at various times an employee and MrYasseen's sister. The Court found that MrYasseen acted as a director, and was liable under the then relevant *Corporations Law* provisions as a director. The Court held that the then *Corporations Law* was breached by MrYasseen, as he had failed to act with the care and diligence that a reasonable person in a like position would have exercised.

2. Overview of the director penalty provisions

- 2.1 The Commissioner has historically enjoyed a preference in relation to the tax installments deducted from the wages and salaries of employees. The provisions set out in section 221P of the *Income Tax Assessment Act 1936* (Cth) (the '**1936 Act**') became unworkable, were subject to much criticism, and were repealed in 1993. Those provisions were then replaced by the former Part VI of Division 9 of the 1936 Act, which clearly placed liability for default in remission of PAYG amounts to the Commissioner squarely on the directors of a company.
- 2.2 The former Division 9 of the 1936 Act was considered to be a 'code' (Santow JA at paragraph 132 in *DFC of T v Dick* [2007] NSWCA 190), whereby penalties were imposed on directors and companies that failed to pay installments deducted from (and amongst other things) wages, royalties, certain deductions from investment allowances, withholding taxes and a range of other PAYG amounts.
- 2.3 Justice Hayden in *DCF of T v Saurig* 2002 ATC 5135 at 5142 observed of the former director penalty provisions that:

There is a certain hardship in the speed of action which 222AOB(1) calls for because in the case of a company which cannot pay the deduction, the time allowed within which to arrive at an agreement with the Commissioner, appoint an administrator, or commence the winding up of the company is very short. The harshness was no doubt seen as appropriate, because the evils of taxpayers deducting taxation payments from employees' wages and not passing them to the authorities are considerable and perhaps

widespread. The evils are not limited to the tax avoided: they extend to the use made of the money, namely either theft or use as working capital, thereby permitting companies to continue to trade which in truth are not capable of continuing to trade lawfully ... An early sign of problems in a company is its living on the false reserves of non-remitted deductions from employees' wages. The harshness is to some extent ameliorated by the fact that the directors cannot be sued until a s222AOE notice is served, and by the time it has been served and a further fourteen days have passed, the director will have had a period sufficient to procure the company to take one of the four steps referred to in s222AOB(1). If one of the steps is taken, the director ceases to be liable. Harsh or not, however, the legislative scheme is in this respect clear.

- 2.4 The directors penalty regime contained in Part IV of Division 9 of the 1936 Act (containing sections 222ANA to 222AQD) was replaced as from 1 July 2010 by Division 1 of Schedule 1 to the *Taxation Administration Act 1953* (Cth) (**'the Administration Act'**) (containing sections 269-1 to 269-55). This was inserted by *Tax Laws Amendment (Transfer of Provisions) Bill 2010* (Cth).
- 2.5 The policy behind the director penalty provisions was explained at paragraph 2.12 of the Explanatory Memorandum (the **'Explanatory Memorandum'**) to *Tax Laws Amendment (Transfer of Provisions) Bill 2010*, by providing that:

Divisions 9 and 10 of Part IV of the ITAA 1936 introduced a new regime in 1993 to enable the Commissioner to recover certain tax debts earlier and more effectively. The new regime imposes a duty on directors to cause the company to forward amounts withheld from payments to employees and some other creditors to the Commissioner. The duty is enforced by penalties equal to unpaid amounts. The penalty is automatically remitted if the company meets its obligations, or promptly goes into voluntary administration or liquidation.

- 2.6 Further, it was observed at paragraph 2.12 of the Explanatory Memorandum provides that:

The penalty regime reflects the public duty on directors to ensure that amounts withheld from payments to third parties are promptly forwarded to the Commissioner. The public duty arises because withheld amounts are similar in nature to amounts held on trust. That is, the directors are in a position of trust and have a duty to protect those monies until they have been forwarded to the Commissioner.

2.7 Paragraph 2.14 of the Explanatory Memorandum provides that:

In addition, because the pay as you go (PAYG) withholding rules often give credit to the entity from which an amount has been withheld regardless of whether the withholder has paid the amount to the Commissioner, the Commonwealth is effectively guaranteeing such amounts. Such a guarantee necessitates the imposition of penalties on directors to ensure companies comply with their PAYG withholding obligations and to maintain the integrity of the tax system.

(a) *The types of obligations / payments which enliven the director penalty provisions*

2.8 Section 269-5 of Schedule 1 to the Administration Act provides for the object of the Division, by providing that:

The object of this Division is to ensure that a company either:

- (a) *meets its obligations under Subdivision 16-B (obligation to pay withheld amounts to the Commissioner) and Division 268; or*
- (b) *goes promptly into voluntary administration under the Corporations Act 2001 or into liquidation.*

Note: The directors' duties are enforced by penalties on the directors. A penalty recovered under this Division is applied towards meeting the company's obligation.

2.9 That is, the regime contained in Division 269 of Schedule 1 to the Administration Act provides that a director is under a duty to ensure that the company:

- 2.9.1 *meets its obligations under Subdivision 16-B (and Division 13) of the Administration Act, to remit withheld amounts to the Commissioner, and Division 268 of Schedule 1 to the Administration Act; or*
- 2.9.2 *goes promptly into voluntary liquidation under the Corporations Act 2001 (Cth) or into liquidation.*

2.10 If the company does not undertake one of the options on or before the due date for the remittance of the deduction or the amount to be withheld, then the directors of the corporation will be personally liable (by way of penalty) equal to the amount of the unpaid liability or the estimate.

(b) The Scope of the director penalty provisions

2.11 Section 269-10 of Schedule 1 to the Administration Act provides for the scope of the Division, by providing that:

269-10 Scope of Division

(1) *This Division applies as set out in the following table:*

Obligations that directors must cause company to comply with		
Item	<i>This Division applies if, on a particular day (the initial day), a company registered under the Corporations Act 2001 ...</i>	<i>and the company is obliged to pay to the Commissioner on or before a particular day (the due day) ...</i>
1	<i>withholds an amount under Division 12</i>	<i>that amount in accordance with Subdivision 16-B.</i>
2	<i>receives an * alienated personal services payment</i>	<i>an amount in respect of that alienated personal services payment in accordance with Division 13 and Subdivision 16-B.</i>
3	<i>provides a * non-cash benefit</i>	<i>an amount in respect of that benefit in accordance with Subdivision 16-B.</i>
4	<i>is given notice of an estimate under Division 268</i>	<i>the amount of the estimate.</i>

Note: In a case covered by item 2, 3 or 4 of the table, the due day is the same as the initial day.

(2) This Division applies in relation to an amount that the company purports to withhold under Division 12, but is not required to withhold, as if the company were required to withhold the amount.

2.12 That is, the relevant 'obligations' for the purposes of the director penalty provisions include amounts that are required to be paid to the Commissioner pursuant to:

2.12.1 Subdivision 16-B of Schedule 1 to the Administration Act; or

2.12.2 Division 268 of Schedule 1 to the Administration Act.

2.13 Subdivision 16-B of Schedule 1 to the Administration Act itself deals with:

2.13.1 amounts that should be withheld pursuant to Division 12 of Schedule 1 to the Administration Act; and

2.13.2 amounts which should be paid to the Commissioner pursuant to Divisions 13 and 14 of Schedule 1 to the Administration Act.

2.14 Subsection 10-5(1) of Schedule 1 to the Administration Act provides that the following types of payments require withholding pursuant to Division 12 of Schedule 1 to the Administration Act:

Summary of withholding payments

<i>Item</i>	<i>Withholding payment</i>	<i>Section</i>
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<i>1</i>	<i>A payment of salary etc. to an employee</i>	<i>12-35</i>
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<i>2</i>	<i>A payment of remuneration to the director of a company</i>	<i>12-40</i>
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<i>3</i>	<i>A payment of salary etc. to an office holder (e.g. a member of the Defence Force)</i>	<i>12-45</i>
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<i>3A</i>	<i>a payment to a * religious practitioner</i>	<i>12-47</i>
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<i>4</i>	<i>A return to work payment to an individual</i>	<i>12-50</i>
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<i>5</i>	<i>A payment that is covered by a voluntary agreement</i>	<i>12-55</i>
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Summary of withholding payments

Item	Withholding payment	Section
6	<i>A payment under a labour hire arrangement or a payment specified by regulations</i>	12-60
7	<i>A * superannuation income stream or an annuity</i>	12-80
8	<i>A * superannuation lump sum or a payment for termination of employment</i>	12-85
9	<i>An unused leave payment</i>	12-90
10	<i>A social security or similar payment (e.g. old age pension)</i>	12-110
11	<i>A Commonwealth education or training payment</i>	12-115
12	<i>A compensation, sickness or accident payment</i>	12-120
13	<i>A payment arising from an investment where the recipient does not quote its tax file number, or in some cases, its ABN</i>	12-140
14	<i>Investor becoming presently entitled to income of a unit trust</i>	12-145
14A	<i>A trustee of a closely held trust distributing an amount from the trust income to a beneficiary, where the beneficiary does not quote its tax file number</i>	12-175
14B	<i>A beneficiary of a closely held trust becoming presently entitled to income of the trust, where the beneficiary does not quote its tax file number</i>	12-180

Summary of withholding payments

Item	Withholding payment	Section
15	<i>A payment for a supply where the recipient of the payment does not quote its ABN</i>	12-190
16	<i>A dividend payment to an overseas person</i>	12-210
17	<i>A dividend payment received for a foreign resident</i>	12-215
18	<i>An interest payment to an overseas person</i>	12-245
19	<i>An interest payment received for a foreign resident</i>	12-250
20	<i>An interest payment derived by a lender in carrying on business through overseas permanent establishment</i>	12-255
21	<i>A royalty payment to an overseas person</i>	12-280
22	<i>A royalty payment received for a foreign resident</i>	12-285
22A	<i>A departing Australia superannuation payment</i>	12-305
22AA	<i>An * excess untaxed roll-over amount</i>	12-312
22B	<i>A payment (of a kind set out in the regulations) to a foreign resident</i>	12-315
22C	<i>A payment (of a kind set out in the regulations) received for a foreign resident</i>	12-317
23	<i>A mining payment</i>	12-320
24	<i>A natural resource payment</i>	12-325
25	<i>A payment by a managed investment trust</i>	12-385

Summary of withholding payments

Item	Withholding payment	Section
26	A payment by a custodian or other entity	12-390

2.15 Further, alienated personal services payments (see Division 13 of Schedule 1 to the Administration Act) and non-cash benefits (see Division 14 of Schedule 1 of the Administration Act) may also be withheld.

2.16 Section 269-15 of the Administration Act deals with a director's obligations. Subsection 269-15(1) of the Administration Act provides that the '*... directors (within the meaning of the Corporations Act 2001) of the company (from time to time) on or after the initial day must cause the company to comply with its obligation.*' Subsection 269-15(2) of the Administration Act provides that:

The directors of the company (from time to time) continue to be under their obligation until:

- (a) the company complies with its obligation; or*
- (b) an administrator of the company is appointed under section 436A, 436B or 436C of the Corporations Act; or*
- (c) the company begins to be wound up (within the meaning of that Act).*

2.17 Subsection 269-15(3) of the Administration Act provides that:

The Commissioner must not commence, or take a procedural step as a party to, proceedings to enforce an obligation, or to recover a penalty, of a director under this Division if an arrangement that covers the company's obligations is in force under section 255-15 (Commissioner's power to permit payments by instalments).

2.18 Section 269-20 of the Administration Act deals with the amount of the penalty if a director is under an obligation pursuant to section 269-15 of the Administration Act. Subsection 269-20(1) of the Administration Act provides that:

You are liable to pay to the Commissioner a penalty if:

- (a) *at the end of the due date, the directors of the company are still under an obligation under section 269-15; and*
- (b) *you were under that obligation at or before that time (because you were a director).*

2.19 That is, subsection 269-15(1) of the Administration Act provides that a director on or after the 'initial day' must cause the company to comply with its obligations. If at the end of the 'due day' the company has not complied with its obligations, then subsection 269-20(1) of the Administration Act applies even if one stops being a director before the end of the 'due day'. That is, if one is a director as at the 'initial day', but resigns after the 'initial day' but before the 'due day', then the director will still be liable.

2.20 Further, subsection 269-20(1)(a) of the Administration Act provides that a director will be liable if the person is a director '*... at the end of the due day...*'. The person need not be a director as at the 'initial day', the only requirement of subsection 269-20(1) of the Administration Act is that the director holds that position as at the 'due day'. That is, if a person is not a director as at the 'initial day', but becomes a director by the end of the 'due day', then the penalty under subsection 269-20(1) of the Administration Act will apply.

2.21 In the event that subsection 269-20(1) of the Administration Act applies, then the '*... penalty is due and payable at the end of the due day*'. Subsection 296-20(5) of the Administration Act provides that the '*... amount of the penalty under this section is equal to the unpaid amount of the company's liability under its obligation*'.

2.22 It should be noted that section 269-25 of the Administration Act (see **paragraph 2.27** below) provides that notwithstanding that subsection 296-20(2) of the Administration Act provides that a penalty may be due and payable at the end of the 'due date', the Commissioner cannot commence proceedings to recover the penalty due under subsection 269-20(2) of the

Administration Act until the end of 21 days after the Commissioner has given notice of the penalty.

- 2.23 Whilst subsection 296-20(1) of the Administration Act imposes a penalty on persons who are directors at the '*...end of the due day ...*', subsection 269-20(3) of the Administration Act deals with penalties for new directors, being those that become a director **after** the 'due day'. Subsection 269-20(3) of the Administration Act provides that:

You are also liable to pay the Commissioner a penalty if:

- (a) after the due day, you become a director of the company and began to be under an obligation under section 269-15; and*
- (b) 14 days later, you are still under that obligation.*

- 2.24 That is, subsection 269-20(3) of the Administration Act provides that if a person becomes a director after the 'due day' and continues to be a director 14 days after becoming a director, then the person will be subject to a penalty. If a person becomes a director after the 'due day', but resigns within 14 days of becoming a director, then the penalty pursuant to subsection 269-20(3) of the Administration Act will not apply.

- 2.25 Subsection 269-20(4) of the Administration Act provides that the subsection 269-20(3) of the Administration Act penalty '*... is due and payable at the end of that 14th day*'. As with the penalty under subsection 269-20(2) of the Administration Act, section 269-25 of the Administration Act (see **paragraph 2.27** below) provides that notwithstanding that subsection 296-20(4) of the Administration Act provides that a penalty may be due and payable at the end of the 'due date', the Commissioner cannot commence proceedings to recover the penalty due under subsection 269-20(4) of the Administration Act until the end of 21 days after the Commissioner has given notice of the penalty.

- 2.26 As with the penalty under subsection 269-20(1), the amount of the penalty under subsection 269-20(5) of the Administration Act is '*... equal to the unpaid amount of the company's liability under its obligations*'.

2.27 Section 269-25 of the Administration Act deals with the notice requirement for director's penalties. As noted at **paragraphs 2.22** above, subsection 269-25(1) of the Administration Act provides that notwithstanding that a penalty may be 'due and payable' (see paragraphs 269-20(2) and (3) of the Administration Act), the Commissioner must not commence recovery proceedings until the end of 21 days after written notice is given to the person. Subsection 269-25(1) of the Administration Act provides that:

The Commissioner must not commence proceedings to recover from you a penalty payable under this Subdivision until the end of 21 days after the Commissioner gives you a written notice under this section.

2.28 Subsection 269-25(4) of the Administration Act provides that despite '*... section 29 of the Acts Interpretation Act 1901, a notice under subsection (1) is taken to be given at the time the Commissioner leaves or posts it*'. Subsection 269-25(4) of the Administration Act was inserted as a result of an argument (which was not accepted) in *DC of T v Meredith* [2007] NSWCA 354. It should be noted that the New South Wales Court of Appeal in *Soong v DC of T* [2011] NSWCA 26 has subsequently held that the decision in *Meredith* was wrongly decided – which is no longer relevant as a result of the insertion of subsection 269-25(4).

2.29 Subsection 269-25(2) of the Administration Act provides for the contents of the notice:

The notice must:

- (a) *set out what the Commissioner thinks is the unpaid amount of the company's liability under its obligation; and*
- (b) *state that you are liable to pay the Commissioner, by way of penalty, an amount equal to that unpaid amount because of an obligation you have or had under this Division; and*
- (c) *explain the main circumstances in which the penalty will be remitted.*

2.30 That is, in order to be a valid notice, the notice must:

- 2.30.1 provide for what the Commissioner considers is the unpaid amount of the company's liability;

2.30.2 provide that the addressee is liable to pay to the Commissioner (as a penalty) an amount equal to the unpaid amount; and

2.30.3 explain the main circumstances in which a penalty may be remitted.

2.31 Section 269-30 of the Administration Act deals with the remission of penalties imposed pursuant to section 296-15 of the Administration Act, by providing that:

A penalty of yours under this Division is remitted if the directors of the company stop being under the relevant obligation under section 269-15:

(a) before the Commissioner gives you notice of the penalty under section 269-25;
or

(b) within 21 days after the Commissioner gives you notice of the penalty under that section.

2.32 That is, the director of a company that may be subject to a penalty pursuant to section 296-15 of the Administration Act will have the penalty remitted if the obligation under section 296-15 of the Administration Act no longer applies either before a notice of the penalty is given, or if a notice has been served, then within 21 days of service of the notice.

2.33 Section 269-35 of the Administration Act provides for defences:

269-35 Defences

Scope

(1) This section applies in relation to:

(a) proceedings to recover from you a penalty payable under this Division;
or

(b) proceedings against you in relation to a right referred to in paragraph 269-45(2)(b) (directors jointly and severally liable as guarantors).

Illness

- (2) *It is a defence in the proceedings if it is proved that, because of illness or for some other good reason, it would have been unreasonable to expect you to take part, and you did not take part, in the management of the company at any time when:*
- (a) *you were a director of the company; and*
 - (b) *the directors were under the relevant obligations under section 269-15.*

All reasonable steps

- (3) *It is a defence in the proceedings if it is proved that:*
- (a) *you took all reasonable steps to ensure that the directors complied with their relevant obligations under section 269-15; or*
 - (b) *there were no such steps that you could have taken.*
- (4) *In determining what are reasonable steps for the purposes of subsection (3), have regard to:*
- (a) *when, and for how long, you were a director and took part in the management of the company; and*
 - (b) *all other relevant circumstances.*

Power of courts to grant relief

- (5) *Section 1318 of the Corporations Act 2001 does not apply to an obligation or liability of a director under this Division.*

2.34 Subdivision 269-C of the Administration Act deals with discharging liabilities. Section 269-40 of the Administration Act deals with the effect of a director paying a penalty or the company discharging its liability:

269-40 Effect of director paying penalty or company discharging liability

Liabilities

- (1) *This section applies to the following liabilities:*
 - (a) *the liability of the company under its obligation referred to in section 269-10;*
 - (b) *the liability of each director (or former director) to pay a penalty under this Division in relation to the liability of the company referred to in paragraph (a);*
 - (c) *a liability under a judgment, to the extent that it is based on a liability referred to in paragraph (a) or (b).*

Discharging one liability discharges other liabilities

- (2) *If an amount is paid or applied at a particular time towards discharging one of the liabilities, each of the other liabilities in existence at that time is discharged to the extent of the same amount.*
- (3) *If, because of section 268-20 (Nature of liability to pay estimate), one of the liabilities is discharged at a particular time to the extent of a particular amount, each of the other liabilities in existence at that time is discharged to the extent of the same amount.*
- (4) *This section does not discharge a liability to a greater extent than the amount of the liability.*

2.35 Section 269-45 of the Administration Act deals with a director's right of indemnity and contribution, by providing that:

269-45 Directors' rights of indemnity and contribution

- (1) *This section applies if you pay a penalty under this Division in relation to a liability of the company under an obligation referred to in section 269-10.*

- (2) *You have the same rights (whether by way of indemnity, subrogation, contribution or otherwise) against the company or anyone else as if:*
- (a) *you made the payment under a guarantee of the liability of the company; and*
 - (b) *under the guarantee you and every other person who has paid, or from whom the Commissioner is entitled to recover, a penalty under this Division in relation to the company's obligation were jointly and severally liable as guarantors.*

2.36 Subdivision 269-D of the Administration Act deals with miscellaneous matters. Subsection 269-50 of the Administration Act provides how a notice may be given, by providing that:

269-50 How notice may be given

*The Commissioner may give you a notice under section 269-25 by leaving it at, or posting it to, an address that appears, from information held by the Australian Securities and Investments Commission, to be, or to have been within the last 7 days, your place of residence or * business.*

2.37 Further, section 269-55 of the Administration Act:

269-55 Division not to limit or exclude Corporations Act

To avoid doubt, this Division is not intended to limit or exclude the operation of Chapter 5 of the Corporations Act 2001 (External administration), to the extent that Chapter can operate concurrently with this Division.

3. The procedure and implications – directors penalty notices

3.1 The procedure to have the director penalty provisions apply are quite precise and follow this path:

- 3.1.1 a company has failed to remit an amount that it has withheld by the due date of payment;

3.1.2 the directors have failed to cause one of the following things to have happened:

- (a) pay the amount withheld to the Commissioner;
- (b) enter into a payment agreement with the Commissioner;
- (c) appoint an administrator under the Corporations Act;
- (d) begin to wind up the company under the Corporations Act;

3.1.3 the amount of the penalty imposed on the directors is equal to the unpaid remittance;

3.1.4 the Commissioner serves a notice on the Directors setting out the liability, and giving 14 days to effect one of the outcomes described in (2) above; and

3.1.5 if one of the four events happen within the 14 day period, the penalty will be remitted. If not, the Commissioner may recover the penalty from the Directors, but only 21 days after the notice is given to the directors.

3.2 Some important things to note are:

3.2.1 the penalty arises at the time that the remittance of the PAYG had not been made by the company, and the directors have not caused one of the things set out above to have occurred. In effect, there is a liability for penalty immediately when the company fails to pay the amount withheld to the Commissioner by the due date for payment. The other actions (i.e. entering into an agreement, appointing an administrator and beginning a wind-up of the company) must take place before the due date has passed.

3.2.2 causing one of the four things to happen before the Commissioner issues a notice will remove the grounds for the payment of the penalty.

3.2.3 if nothing is done before the notice is issued to the directors, then there is a 14 day period within which one of the four specified actions may be taken.

3.2.4 If none of the 4 actions are taken, the director is personally liable and the Commissioner can collect from them.

3.2.5 a director from whom a penalty is collected is entitled to be indemnified from the company and the other directors (section 269-45 of the Administration Act).

- 3.2.6 service of the notice is at the director's place of residence or business (either posting or leaving it there) as provided in the ASIC database (or as was provided in the last 7 days) (section 269-50).
- 3.2.7 the directors who are subject to the penalty are those who were directors at any time when the amount was withheld to the date that it was due and payable (section 269-20(1) of the Administration Act). Retirement before the due day will not relieve the director from penalty (see the note to subsection 269-20(1) of the Administration Act). If a person becomes a director during that period, then that person will be liable for the penalty (subsection 269-20(3) of the Administration Act). 'Shadow directors' may also be liable.
- 3.2.8 in the event that a payment arrangement is entered into and the company fails to comply, then the directors penalty springs back to life.
- 3.2.9 recourse to the company after the company has begun to be wound up, as a ground of relief, may be fraught with difficulty. In *Re Scobie; ex parte DFC of T 95 ATC 4525*, penalty notices were issued to husband and wife directors, and an application for a wind-up was made within the 14 day period in the relevant notice. Provisional liquidators were appointed. It was found by the Court that a company begins to be wound up when a Court makes an order for winding-up the company. It was argued by the directors that this was not possible within the 14 day time frame and therefore could not be the intention of the legislation. The Court did not accept that it was impossible to obtain a wind-up order within 14 days, and in any event the obligation arose from the date on which the tax was not paid (see also *Simpson v DFC of T 96 ATC 4661*, where the Directors argued that they could not do anything because a receiver was appointed). This stresses the importance of taking action before a notice is given.
- 3.2.10 in *Eaton v DC of T 2006 ATC 4708*, the entry into a Deed of Company Arrangement did not relieve the directors from penalty. It should be noted however, that the Deed of Company Arrangement did not specifically provide for payments to the Commissioner of Taxation (only to the creditors in a generic sense).
- 3.2.11 the Commissioner may estimate the liabilities (see below).

4. Defences – directors penalty notices

4.1 Subsection 269-35(1) of the Administration Act provides that:

This section applies in relation to:

- (a) proceedings to recover from you a penalty payable under this Division;*
- or*
- (b) proceedings against you in relation to a right referred to in paragraph 269-45(2)(b) (directors jointly and severally liable as guarantors).*

4.2 Subsection 296-35(2) of the Administration Act provides a defence for a director who because of illness or some other good reason, it would have been unreasonable to expect the director to, and the director did not in fact take part in the management of the company. Subsection 269-35(2) of the Administration Act provides that:

It is a defence in the proceedings if it is proved that, because of illness or for some other reason, it would have been unreasonable to expect you to take part, and you did not take part, in the management of the company at any time when:

- (a) you were director of the company; and*
- (b) the directors were under the relevant obligation under section 269-15.*

4.3 The defences are extremely limited, and the Courts have not widened them. It should be noted that what is 'reasonable' depends on when, and how long, the person was a Director and took part in the management in the company (and all other relevant circumstances). The following should be considered:

4.3.1 In *Fitzgerald v DFC of T 95 ATC 4587* and *Canty v DFC of T 2005 ATC 4470*, it was held that a director could have made an urgent application to the Court for a winding-up.

4.3.2 It was not enough that a former director was advised by, and relied upon a statement by a company that property of the company was to be sold and the proceeds would be used to pay the tax debt where the former director knew that the company was in financial difficulty (*Canty v DFC of T 2005 ATC 4470*).

4.3.3 A director caused a cash flow forecast to be prepared in which a payment arrangement with the Commissioner was based. The director expected that the repayment agreements would be complied with. The question was whether the director had reasonable grounds to so expect. The company received 2 demands for payment (one was a fine for an industrial accident, the other a claim for unpaid workers compensation premiums). The cash flows did not take these amounts into account. The Court held that the director ought to have known about these amounts (*DFC of T v Blaikie* 2006 ATC 4795).

4.3.4 In *DFC v T v Saurig* 2002 ATC 5135, Mr Saurig was one of three directors. His role was sales, and another director responsible for administration. He found out about the failure to remit, established the amount of the liability and tried to raise money to pay it. The other directors were unco-operative. He contacted the ATO of his own volition and attempted to resolve the matter. He tried to persuade the other Directors to put the company into liquidation, but was unsuccessful. It was not enough. The factor which weighed most against Mr Saurig was that he had '*... not taken professional, legal or accounting advice when he became aware of the difficulties that he faced*'.

5. Whether directors may argue estoppels in the context of directors penalty notices

5.1 *Deputy Commissioner of Taxation v Winters* was an application by the Commissioner for summary judgment with respect to a section 222AOE of the 1936 Act penalty notice. The decision illustrates the application of the principle of estoppel. It was held that on the evidence available, the defendants (e.g. Mr Winters) had made out the elements of estoppel. Further, it was held that the principle that estoppel does not apply to a statutory obligation did not necessarily extend to circumstances of the particular case, and that the directors could therefore raise limited estoppel on the basis that the relevant tax officer had created a 'legitimate expectation' in favour of the directors.

5.2 Evidence was led by both Mr Winters (a director who received a penalty notice) and a Mr Noble (the tax officer attending to the matter).

5.3 Mr Winters deposed that he attended a meeting with Mr Noble (after an earlier meeting was postponed, at Mr Noble's request), at which Mr Winters told Mr Noble of endeavours to sell the company. Mr Winter's deposed that various options were discussed at the meeting, including that:

- 5.3.1 the company enter into an arrangement with the Commissioner, and continue trading with a view to it being sold;
- 5.3.2 the company to cease trading immediately, which would mean that the Commissioner would receive nothing; and
- 5.3.3 the company go into voluntary liquidation.
- 5.4 Mr Winters deposed that '*... Noble said that the plaintiff ... [i.e. the Commissioner] ... wanted 100% of the amount due and to the effect that it would be in everybody's interest for the company to keep trading*'.
- 5.5 However, the evidence of Mr Noble differed from that of Mr Winters. Mr Noble contended that they did not discuss the directors penalty notice, but that he '*... agreed to postpone recovery action to allow the company's accountant to look at options for an arrangement with the plaintiff*'. Further, Mr Noble deposed that at the meeting, he '*... indicated that to be accepted any proposal would have to include an "upfront payment" of at least \$100,000. Inferentially, postponement of recovery action seems capable of including action founded on penalty notices given to the defendants*'. Further, Mr Noble put into issue allegations made by Mr Winters, including that Mr Noble had led Mr Winters to believe that a satisfactory arrangement could be entered into as between the company and the Commissioner, and that Mr Winters had a 'legitimate expectation' that the time for compliance with the penalty notice would be extended.
- 5.6 Justice Moynihan observed that:
- Estoppel of the kind the defendants seek to rely on here precludes a party who has induced another party to rely on a promise and thereby act to that second party's detriment from resiling from its promise unless the detriment is avoided.*
- 5.7 Further:
- The result is that it should be accepted that there is but one doctrine of estoppel, which provides that a court of common law or equity may do what is required, but no more, to prevent a person who has relied on an assumption as to a present, past or future state of affairs (including a legal state of affairs), which assumption the party estopped has induced him to hold, from suffering detriment in reliance upon the assumption as a*

result of the denial of its correctness. A central element of that doctrine is that there must be a proportionality between the remedy and the detriment which is its purpose to avoid.

5.8 Justice Moynihan held that: *'Here the defendants set up a case that they were induced not to appoint an administrator during the 14 day period by the plaintiff's conduct so that the plaintiff cannot now take advantage of that failure.'*

5.9 His Honour observed that:

It may be accepted as a matter of general principle that estoppels will not prevent the exercise of a statutory obligation It is however by no means clear that the principle extends to the circumstances here so as to prevent the defendants' favour they simply seek to preclude the plaintiff from relying on the consequences of their failure to take steps to avoid the effect of the penalty notices within 14 days of their receipt; that is in the light of an administrator being effectively appointed on 17 June. In the circumstances, the considerations being those that I have outlined, the applications for summary judgment should be dismissed and the defendants should have leave to defend.

5.10 That is, the Court accepted the director's argument that they had a 'legitimate expectation' that the time of compliance with the directors penalty notice would be extended. Further, if the Commissioner had not given them permission to continue trading, that they would have immediately appointed an administrator, thereby complying with the penalty notice. That is, the directors successfully argued that estoppel applied to prevent the Commissioner from obtaining summary judgment.

6. Preference payment

6.1 Whilst a payment by a company for its liability for PAYG may be recovered by a liquidator from the Commissioner as a preference under section 588FA of the Corporations Act, it may be recovered by the Commissioner pursuant to section 588FGA of the Corporations Act (although note the references to the former provisions). This approach does not require resort to the directors notice procedure (see *DFC of T v Austin* [1998] FCA 1034),

7. The Commissioner's power to estimate tax liabilities

- 7.1 As discussed at **paragraph 2** above, the director penalty provisions may be enlivened if a company does not meet its obligation under Division 268 of Schedule 1 to the Administration Act. That Division (which was introduced by the *Tax Laws Amendment (Transfer of Provisions) Act 2010* (Cth), and applies from the 2010/2011 and later income tax years) allows the Commissioner to quickly recover certain amounts which have not been remitted to the Commissioner (including amounts to be withheld under the PAYG regime).
- 7.2 Under Division 268, the Commissioner may make a reasonable estimate of a person's liability, having regard to matters which the Commissioner considers relevant, including previous amounts which may have been withheld. Upon the Commissioner making such an estimate, the person must be notified in writing of the estimate. The estimate may be reduced if (within 7 days or such further time allowed) the person provides a statutory declaration specifying the actual amount of the liability, or that no amounts were required to be withheld or paid.
- 7.3 Once an estimate is given, the Commissioner may commence recovery proceedings based on that estimate. The person liable may defend the proceedings by providing an affidavit deposing that the actual liability never existed, has been discharged, or is less than the estimate.

8. Section 8Y of the *Taxation Administration Act* (Cth)

- 8.1 Regard should always be given to section 8Y of the Administration Act. Subsection 8Y(1) of the Administration Act provides that:

Where a corporation does or omits to do an actor thing the doing or omission of which constitutes a taxation offence, a person (by whatever name called and whether or not the person is an officer of the corporation) who is concerned in, or takes part in, the management of the corporation shall be deemed to have committed the taxation offence and is punishable accordingly.

- 8.2 That is, subsection 8Y(1) of the Administration Act provides that where a corporation does or omits to do an act which constitutes a 'taxation offence', a person (whether or not an officer of the company) who is '*... concerned in, or takes part in the management ...*' of the company, is deemed to have committed the taxation offence. The person is therefore '*...punishable accordingly...*'.

8.3 The term 'taxation offence' is defined in section 8A of the Administration Act as:

"taxation offence" means:

(a) an offence against a taxation law; or

(b) an offence against:

(i) section 6 of the Crimes Act 1914 ; or

(ii) section 11.1, 11.4 or 11.5 of the Criminal Code ;

being an offence that relates to an offence against a taxation law.

8.4 That is, a 'taxation offence' is an offence against a taxation law or an offence against certain provisions of the *Crimes Act 1914* (Cth) (the '**Crimes Act**').

8.5 Whenever dealing with section 8Y of the Administration Act, regard should also be given to section 21B of the Crimes Act, which allows a Court to make a reparation order requiring a person convicted of a federal offence to pay an amount to the Commonwealth in relation to any loss suffered as a direct result of the offence. This is in addition to any penalty which may be imposed for the offence (see **paragraph 9** below). The decision in *Hookham v R* 94 ATC 4789 is illustrative. There a company failed to remit group tax deductions to the Commissioner, and as a result committed nine offences under the then section 221F of the 1936 Act. Mr Hookham, being a director of the company, pleaded guilty to charges brought against him under section 8Y of the Administration Act. He was convicted and fined \$1,000 in respect of each offence, and ordered to pay reparations of \$198,224 under section 21B of the Crimes Act.

8.6 Subsection 8Y(1) of the Administration Act applies to a person who '*...is concerned in, or takes part in, the management of the corporation ...*'. The subsection also provides that it is irrelevant what the person is called, and it does not matter whether the person is an officer of the company. For the purposes of subsection 8Y(1) of the Administration Act, subsection 8Y(3) of the Administration Act deems an officer of a corporation to be concerned in, or to have taken part in the management of a corporation:

For the purposes of subsection (1), an officer of a corporation shall be presumed, unless the contrary is proved, to be concerned in, and to take part in, the management of the corporation.

8.7 Further, subsection 8Y(4) of the Administration Act defines who is an 'officer' for the purposes of subsection 8Y(1) of the Administration Act:

*In this section, **officer**, in relation to a corporation, means:*

- (a) a director or secretary of the corporation;*
- (b) a receiver and manager of property of the corporation;*
- (ba) an administrator, within the meaning of the Corporations Act 2001, of the corporation;*
- (bb) an administrator of a deed of company arrangement executed by the corporation under Part 5.3A of that Act;*
- (d) a liquidator of the corporation appointed in a voluntary winding up of the corporation; or*
- (e) a trustee or other person administering a compromise or arrangement made between the corporation and another person or other persons.*

8.8 Subsection 8Y(2) of the Administration Act provides a defence with respect to a charge under section 8Y(1) of the Administration Act, by providing that:

- (2) In a prosecution of a person for a taxation offence by virtue of subsection (1), it is a defence if the person proves that the person:*
 - (a) did not aid, abet, counsel or procure the act or omission of the corporation concerned; and*
 - (b) was not in any way, by act or omission, directly or indirectly, knowingly concerned in, or party to, the act or omission of the corporation.*

Note 1: A defendant bears a legal burden in relation to the matters in subsection (2), see section 13.4 of the Criminal Code .

Note 2: Subsection (2) does not apply in relation to a prosecution under Part 2.4 of the Criminal Code.

- 8.9 The decision of the Full Court of the Supreme Court of Queensland in *Buist v Federal Commissioner of Taxation* 88 ATC 4376 demonstrates the application of section 8Y of the Administration Act, and in particular the defence contained in paragraph 8Y(2)(b) of the Administration Act, being that the defendant ‘...was not in any way, by act or omission, directly or indirectly, knowingly concerned in, or party to, the act or omission of the corporation’.
- 8.10 The appellant was a director, and in some cases, the public officer of a number of companies. The companies had failed to lodge income tax returns for the 1974 to 1986 years. Notices to lodge the returns were served by the Commissioner on a firm of accountants who acted for both the appellant and the companies.
- 8.11 An employee of the firm of accountants brought the notices to the appellants attention. The accountant informed the appellant that the notices were being attended to. However, apart from asking if the situation was being addressed, the appellant did nothing to follow up the notices. The appellant assumed that all was in order and attended to by the firm of accountants and that the taxation liabilities of the companies were attended to, as the firm of accountants had not advised the appellant that they were not.
- 8.12 Kelly SPJ at 4377 observed that the ‘... defence upon which the appellant relied was that provided for by sec 8Y(2), the onus being upon him to establish on the balance of probabilities the matters set out in para (a) and (b) of that subsection.’
- 8.13 Kelly SPJ at 4378 observed that the defence contained in subsection 8Y(2) of the Administration Act was similar to the former section 75B of the Trade Practices Act 1974 (Cth) (repealed), which itself was considered in the High Court’s decision of *Yorke v Lucas* (1985) 158 CLR 661. It was observed that in *Yorke v Lucas* that:

... the word “knowingly” qualifies only the words “concerned in” and not also the words “party to” and it also held that before a person can be said to be a party to a contravention, which was the conduct with which the provision there in question dealt,

he must be an intentional participant the necessary intent being based upon knowledge of the essential elements of the contravention.

8.14 That is:

8.14.1 the word 'knowingly' qualifies the term 'concerned in' and not also the term 'party to';
and

8.14.2 before a person can be said to be a 'party to' a contravention, the person must be an intentional participant in the conduct. The intent must be based upon the knowledge of the essential element of the offence.

8.15 Kelly SPJ at 4378 then observed that: '*The onus is on the applicant to prove that he was not knowingly concerned in or was not a knowing participant in the omission of the corporation in each case to furnish the return required.*' Further, that knowledge may be either actual or constructive knowledge. Kelly SPJ then referred to *R v Glennan*(1970) 91 WN (NSW) 609, which itself was cited with approval by the High Court in *Yorke v Lucas*, and in particular the observation that:

Mere failure to make an inquiry which, if made, would yield knowledge of an essential fact, is not in itself enough to constitute knowledge of the fact, for it is accepted that to act negligently does not make a person an aider and abettor (Callow v. Tillstone(1900) 83 L.T. 411; see also Bowkerv. Premier Drug Co. (1928) 1 K.B. 217). But the circumstances of a given case may be such as to reveal not merely a failure to make an inquiry, but a failure to make an inquiry which is of such a kind as to suggest that the defendant has deliberately abstained from acquiring knowledge because he suspected the existence of a fact which would have been ascertained on inquiry, or that the defendant has acted recklessly in the sense that he did not care whether the facts existed or not (Carter v. Mace (1949) 2 All E.R. 714; cf. Davies, Turner & Co. Ltd. v. Brodie(1954) 3 All E.R. 283).

8.16 That is, the circumstances of a case may indicate that there is more than a mere failure to make an inquiry, but that there is a deliberate abstention, or that the person in question acted recklessly insofar as they did not care whether the facts existed.

8.17 Kelly SPJ observed that omitting to furnish a return, being the relevant charge which was imputed to the director pursuant to subsection 8Y(1) of the Administration Act, involves two

components ‘... one being omitting to make the required return and the other being omitting to take all steps necessary to ensure that the return is received by the Commissioner...’. It was observed that ‘... an omission to do either of these things constitutes the offence ...’. With respect to the defence, Kelly SPJ considered that ‘... the appellant would fail in his defence under s 8Y(2) unless he proved on the balance of probabilities that he was not knowingly concerned or was not a knowing participant in either of those omissions’.

- 8.18 In finding that the appellant did not have actual knowledge, and was not an actual knowing participant of the omissions, Kelly SPJ observed that:

*In respect of those companies of which the appellant was the public officer, it must have been within his actual knowledge whether a return containing his signature had in fact been made as the return of a company contains a declaration by the public officer. However, **what is not clear from the evidence is whether he was aware of the due date for the furnishing of each of the returns as set out in the final notices and there was no clear finding by the Stipendiary Magistrate on the matter.***

*I turn then to the appellant's knowledge of the omission to take all necessary steps to ensure that the various returns were received by the Commissioner. There is a finding that the final notices had been brought to the attention of the appellant and that, apart from asking if the situation was being addressed he did absolutely nothing to follow up the notices. In view of the evidence **this finding must be taken to mean only that the fact of the receipt of the final notices had been brought to the attention of the appellant, as the evidence does not show whether and if so to what extent he was made aware of the contents of those notices.** (emphasis added)*

- 8.19 However, Kelly SPJ found that the appellant acted recklessly in that the appellant did not care whether the companies would have complied with the Commissioner’s requirements, with the result that the appellant had constructive knowledge, and was constructively knowingly concerned in the omissions. Kelly SPJ found at 4379 that:

*I would be prepared to infer that the appellant did not have actual knowledge of the omission to take all steps necessary to ensure that the returns were received by the Commissioner. The position in relation to constructive knowledge is, however, somewhat different. **In my opinion this is not a case of the appellant merely failing to make an***

*inquiry which, had it been made, must have shown that the returns would not be prepared in sufficient time to comply with the Commissioner's requirements. On the contrary, it could be said that he acted recklessly in the sense referred to in R. v. Glennan (supra), that is that he did not care whether this would be done or not. He knew that final notices had been issued requiring the lodgment of returns for a number of companies for a number of years and he simply left the matter in the hands of his accountants without following it up. As the Stipendiary Magistrate properly points out the appellant's assumption that everything in relation to the taxation affairs of the companies concerned was done properly by Mr Baker had little foundation and the fact that it was necessary for the Commissioner to send final notices ought to have raised a doubt in his mind that this was so. In those circumstances simply to accept Mr Black's statement that he was attending to the notices without taking any steps to ensure that the notices would be complied with could be taken to indicate a lack of concern on his part as to whether this occurred. That being so, in my view **the appellant has failed to prove that he was not knowingly concerned or was not a knowing participant in the omission to take all steps necessary to ensure that the returns were received by the Commissioner** and the Stipendiary Magistrate was not in error in finding that the matters in para. (b) of sec. 8Y(2) had not been established on the balance of probabilities so that the defence as a whole had not been made out.[emphasis added]*

- 8.20 Justice Macrossan held that in deciding whether the defence under subsection 8Y(2) of the Administration Act was satisfied, the magistrate was involved in the task of examining the applicant's actions and behavior and gauging the genuineness, and weight of the applicant's assertions. That is, the judgment of the Magistrate was one for the Magistrate at first instance, after hearing the evidence. Justice Macrossan held at 4381 that:

The applicant knew that returns from the companies were demanded and that final notices to that end had been delivered. He did, it is true, engage accountants to act, but he did not ever check upon their rate of progress or the effectiveness of their efforts. He took no steps to ensure that any deadlines which might have been fixed for compliance were being met by those particular agents and he took no steps to engage others who might, in the circumstances, have been necessary either in addition or in lieu. The applicant knew that a duty lay upon the companies and the Magistrate has, in essence,

found that the applicant has given no reason to think that the duty was being effectively responded to. The result was that since he was the principal in control of the situation, it was not appropriate to hold that the applicant was not a party to or knowingly concerned in the failure that resulted. This, as I say, is the judgment of fact which was given and there is no reason to depart from it. The order should be as the presiding Judge proposes.

- 8.21 The implications of the decision in *Buist* are obvious. When put on notice that the taxation affairs of the company are not in order, a director must follow through. The defence under subsection 8Y(2) of the Administration Act is only available where the director has shown due diligence and proper enquiry and administration.
- 8.22 Indeed, as observed at **paragraph 8.19**, the Court held that both actual and constructive knowledge were sufficient to enliven section 8Y of the Administration Act. However, based on those comments, although there is seemingly no obligation to make an enquiry, once alerted to an act or omission on the part of the company, the director must follow through to ensure that the behavior is modified.
- 8.23 Further, it may be argued that based on the decision in *Buist*, it may be better for a director **not** to turn its mind to the company's taxation liabilities. If left to the company's accountants, and they do not come to the attention of the director, then a good defence may appear. However, if a prosecutable tax default of the company is drawn to the attention of the company, then the director cannot with impurity ignore that default or pass full responsibility to professional advisers.

9. 2011 Budget Announcement

- 9.1 The following changes were announced during the 2011 budget to counteract "phoenix company" activity included (with effect from 1 July 2011):
- 9.1.1 An extension of the director penalty regime to make directors personally liable for their company's failure to pay employee superannuation.
- 9.1.2 The Commissioner of Taxation will be able to commence recovery action against directors under the director penalty regime that remain unreported after three months of becoming due. Of concern is that the Commissioner need not provide a 21-day grace

period.

9.1.3 Directors and associates of directors may be prevented from obtaining credits for withheld amounts in their individual tax returns where the company has failed to pay withheld amounts to the ATO.

9.2 These changes mark a further step in the continuing expansion of remedies the Commissioner has available to him in pursuing directors of companies for tax debts.

10. Section 21C of the *Crimes Act 1914*(Cth)

10.1 As mentioned at **paragraph 8** above, section 21B of the Crimes Act allows a Court to make an order for reparation in the event that a person is convicted of an offence. Section 21B of the Crimes Act provides that:

(1) Where:

(a) a person is convicted of a federal offence; or

(b) an order is made under section 19B in relation to a federal offence committed by a person;

the court may, in addition to the penalty, if any, imposed upon the person, order the offender:

(c) to make reparation to the Commonwealth or to a public authority under the Commonwealth, by way of money payment or otherwise, in respect of any loss suffered, or any expense incurred, by the Commonwealth or the authority, as the case may be, by reason of the offence; or

(d) to make reparation to any person, by way of money payment or otherwise, in respect of any loss suffered by the person as a direct result of the offence.

(2) A person is not to be imprisoned for a failure to pay an amount required to be paid under an order made under subsection (1).

(3) Where:

(a) the court orders a federal offender to make reparation to the Commonwealth, to a public authority of the Commonwealth or to any other person by way of payment of an amount of money; and

(b) the clerk, or other appropriate officer, of the court signs a certificate specifying:

(i) the amount of money to be paid by way of reparation; and

(ii) the identity of the person to whom the amount of money is to be paid; and

(iii) the identity of the person by whom the amount is to be paid; and

(c) the certificate is filed in a court (which may be the first-mentioned court) having civil jurisdiction to the extent of the amount to be paid;

the certificate is enforceable in all respects as a final judgment of the court in which it is filed in favour of the Commonwealth, of that public authority or of that person.

10.2 It should be noted that section 21B of the Crimes Act is a reparation order. The nature of such orders were discussed in *Inwood v R* (1974) 60 Cr App R 70 at 73:

Compensation orders were not introduced into our law to enable the convicted to buy themselves out of the penalties for crime. Compensation orders were introduced into our law as a convenient and rapid means of avoiding the expense of resort to civil litigation when the criminal clearly has means which would enable compensation to be paid.

10.3 The means of the accused are relevant in determining whether a reparation order should be made (see for example *R v Oddt*[1974] 2 All ER 666 at 670).

10.4 As was observed in *Gould v Federal Commissioner of Taxation* 98 ATC 4946 at 4951 the ‘... preconditions to the exercise of the power are twofold. First, that there has been a conviction for an offence. Secondly, that by reason of the offence a loss has been suffered or expense incurred by the Commonwealth’.

- 10.5 The decision of the Supreme Court of Western Australia in *Vlahov v Federal Commissioner of Taxation* (1993) 26 ATR 49 illustrates the application of section 21B of the Crimes Act in the context of section 8Y of the Administration Act.
- 10.6 The appellant was a director of two companies which failed to pay certain amounts to the Commissioner, and purchase and affix certain stamps as required by the then tax legislation. The appellant was prosecuted pursuant to section 8Y of the Administration Act. Reparation orders pursuant to section 21B of the Crimes Act were also sought.
- 10.7 Justice White held that the conviction of an officer of a company pursuant to section 8Y of the Administration Act deems that officer to have committed an offence, being a precondition to the application of section 21B of the Crimes Act. Further, there is no limitation in both a penalty being imposed pursuant to section 8Y of the Administration Act, and a reparation order being made pursuant to section 21B of the Crimes Act. Justice White at 4505 held that:

There is nothing in the section which expressly limits the liability of a company officer to punishment alone, and it is not necessary to find any such term by way of implication. If such an officer is, in the particular circumstances of a case, deemed to have committed an offence, he may, of course, be convicted accordingly. Once that has been done, as it seems to me, the provisions of s 8Y(1) of the Taxation Administration Act will have taken effect and the court may punish the officer accordingly.

Section 21B of the Crimes Act operates where a person is convicted of an offence against the law of the Commonwealth, whether or not any penalty is imposed upon the person so convicted. Once an officer of a company is convicted by virtue of the provisions of s 8Y(1) of the Taxation Administration Act, he fulfils the condition prescribed in s 21B of the Crimes Act and the court may order him to make reparation in respect of any loss or expense referred to in that section.

- 10.8 However, the Court considered that although section 21B of the Crimes Act could apply, the Court has a discretion as to whether an order for reparation should be made. Further, in considering whether to exercise its discretion, White J at 4507 considered that in ‘... *the exercise of that discretion, the court may have regard to the personal circumstances and means of the offender*’. The Court also considered the remarks of Gibbs J in obiter in *Murphy, Minister of State for Customs and Excise for the Commonwealth of Australia v HF Trading Co Pty Ltd* (1973)

47 ALJR 198 that ‘...the Court has a discretion whether or not to make an order under s 21B of the Crimes Act and, in the exercise of that discretion, may have regard to matters personal to the offender ...’.

- 10.9 As a result, it was held that a reparation order pursuant to section 21B of the Crimes Act should not be made, given the financial position of the appellant. Justice White at 4507 held that:

It is clear that the amount of the reparation orders (namely \$20,136.33 in the case of Chertsey Pty Ltd and \$111,802.73 in the case of Timeworth Pty Ltd) far exceeded what the appellant could reasonably be expected to pay. Notwithstanding the comment in Mark Bradburn which I have set out above, each case must be dealt with on its merits and the financial position of the appellant, which I have described above, precludes any reasonable prospect of his being able to pay any part of the reparation ordered within a reasonable period. Even fixing a much-reduced figure of reparation would not result in achieving payment within a reasonable period.

- 10.10 The decision of the Full Court of the Supreme Court of Western Australia in *Gould v Federal Commissioner of Taxation* 98 ATC 4946 illustrates the application of section 21B of the Crimes Act and section 8Y of the Administration Act in the context of directors penalties.

- 10.11 The Commissioner issued notices pursuant to the (former) section 222AOE of Division 9 of Part VI of the 1936 Act to the taxpayer, advising that unless the outstanding amounts (of a company) were paid, or the company placed into voluntary liquidation or administration within 14 days (as required by the former section 222AOB of the 1936 Act), then a reparation order would be sought.

- 10.12 The crux of the taxpayer’s argument was that a reparation order, such as that pursuant to section 21B of the Crimes Act, should not allow the Commissioner to achieve what it could have achieved by civil action (e.g. pursuant to the director’s penalty provisions – being the former Division 9 of Part IV of the 1936 Act). The Court disagreed with this analysis. The Court at 4951 observed that ‘... I think it would be wrong to view reparation orders solely and entirely as an alternative to civil remedies...’. Further, it was observed that in *Vlahov* ‘... the Court also held that a reparation order could be made irrespective of whether there was a prior civil liability to make reparations’. Further, it was held at 4952 that:

The position of directors who have complied with the notice is different. They still remain liable to prosecution if a taxation offence has been committed. What has changed is that they are not immediately liable to the fixed penalty provided for in the legislation. The process of administering the affairs of the company will continue in accordance with the Corporations Law. During the process of administration the liability of the company for unremitted deductions might be discharged wholly or in part. But if, as events turn out, a taxation offence has been committed a prosecution may be launched. It is only after there has been a conviction for an offence, accompanied by a finding that the Commonwealth has suffered a loss as a result of the offence, that the power to make a reparation order is triggered.

10.13 The Court further observed at 4952 that:

A director opposing the making of a reparation order is in a different situation to one who is defending civil proceedings for recovery of a penalty. In terms of the remedy there are discretionary considerations ... that apply in the former but which would not in the latter.

10.14 The Court discussed the interaction of the director's penalty provisions and the reparation order regime at 4952:

It seems to me that there remains an incentive for directors to act in accordance with a notice. If they do not they are immediately liable to a fixed sum which is then due and owing and which can be recovered by civil action at any time. They may be at risk if they pay the penalty and seek recovery from the company. If they do comply with the notice they have a potential temporal advantage in that they have no present liability to pay any amount unless and until there has been a prosecution and a conviction. In addition they have an opportunity to put to the Magistrate matters that are relevant to the exercise of the discretion in relation to the making of a reparation order but which might not be relevant to the remedy in the civil proceedings. The amount of a reparation order would be reduced by any distributions or other payments made during the administration of the company's affairs. It is open to doubt whether a director who had paid a penalty would be able to claim the benefit of those payments in the administration.

10.15 Further, the Court found that a reparation order could be made (i.e. it was not an inappropriate exercise of a Court's discretion), notwithstanding that it would allow the Commissioner to recover amounts which could not be recovered under the director penalty provisions.

11. Application of the Crimes (Taxation Offences) Act 1980 (Cth)

11.1 The provisions of the *Crimes (Taxation Offences) Act 1980*(Cth) (**'Taxation Offences Act'**) are often overlooked by advisers, particularly those who are asked to remedy tax exposures by shifting assets away from exposed entities. The provisions need to be carefully considered, particularly as they are one of few instances where advisers can be jailed for merely advising. However, there are few recorded instances where the Commissioner has sought to apply them (see *R v Ditford* 87 ATC 4678 and 91 ATC 4423).

11.2 The Taxation Offences Act is directed to the evasion of taxation by rendering a company or a trust unable to pay the tax. The Taxation Offences Act imposes criminal penalties on both taxpayers and their advisers.

11.3 Broadly speaking, the Taxation Offences Act is concerned with:

11.3.1 the stripping of assets of companies and trusts before tax due or pending on past income can be collected; and

11.3.2 schemes under which a tax liability falls on a trust or company that is never intended to have sufficient assets to meet its proper tax liability.

11.4 Subsection 5(1) of the Taxation Offences Act provides that a '*... person is guilty of an offence ...*' if the person enters into an arrangement or transaction, the purpose of which includes the:

... intention of securing, either generally or for a limited period, that a company or trustee (whether or not a party to the arrangement or transaction) will be unable, or will be likely to be unable, having regard to the other debts of the company or trustee, to pay income tax payable by the company or trustee ...

11.5 Subsection 5(2) of the Taxation Offences Act creates a similar offence to subsection 5(1) of the Taxation Offences Act in relation to 'future income tax', provided that the tax does ultimately become due and payable.

11.6 Subsection 6(1) of the Taxation Offences Act provides that a ‘... person is guilty of an offence ...’ if the person directly or indirectly ‘... *aids, abets, counsels or procures another person (including a company)* ...’ or being concerned in, or a party to, the entry by another person, into an arrangement or transaction ‘knowing or believing’ that the arrangement or transaction is being entered into for the purpose referred to in subsection 5(1) of the Taxation Offences Act. Subsection 6(2) of the Taxation Offences Act creates a similar offence to subsection 6(1) of the Taxation Offences Act in relation to ‘future income tax’, provided that the tax does ultimately become due and payable.

11.7 Subsection 7(1) of the Taxation Offences Act provides that:

(1) *Where a person:*

(a) *enters into an arrangement or transaction;*

(b) *directly or indirectly, aids, abets, counsels or procures another person (including a company) to enter into an arrangement or transaction; or*

(c) *is, in any way, by act or omission, directly or indirectly concerned in, or party to, the entry by another person (including a company) into an arrangement or transaction;*

knowing or believing that the arrangement or transaction will secure, or will be likely to secure, either generally or for a limited period, that a company or trustee (whether or not a party to the arrangement or transaction) will be unable, or will be likely to be unable, having regard to other debts of the company or trustee, to pay income tax payable by the company or trustee, the first-mentioned person is guilty of an offence.

11.8 Subsection 7(2) of the Taxation Offences Act creates a similar offence to subsection 7(1) of the Taxation Offences Act in relation to ‘future income tax’, provided that the tax does ultimately become due and payable.

11.9 Subsection 7(3) of the Taxation Offences Act provides defences to offences under subsections 7(1) and 7(2) of the Taxation Offences Act:

(3) *Where:*

- (a) *a company or trustee:*
 - (i) *enters into an arrangement with a creditor for payments to be made, during a limited period, to the creditor by the company or trustee or by a person (including a company) at the direction of the company or trustee; or*
 - (ii) *enters into a transaction that involves the company or trustee making a payment to, or directing a person (including a company) to make a payment to, a creditor of the company or trustee; and*
- (b) *the company or trustee enters into the arrangement or transaction with the intention:*
 - (i) *of securing, or attempting to secure, that the company or trustee will be able to continue to carry on business; or*
 - (ii) *of obtaining a financial benefit for the company or trustee;*

neither subsection (1) nor subsection (2) applies to or in relation to that arrangement or transaction.

- 11.10 It should be noted that sections 5, 6 and 7 of the Taxation Offences Act put advisers at risk. Further, the penalty for an offence (i.e. a charge under any of the provisions mentioned above) is up to 10 years' imprisonment and / or a fine of up to \$110,000 (refer to the notes in those sections).
- 11.11 It should be observed that the difference between sections 5 and 6 of the Taxation Offences Act on one hand, and section 7 of the Taxation Offences Act on the other, is that section 7 of the Taxation Offences Act does not require a specific purpose for entering into the scheme. Rather, section 7 of the Taxation Offences Act requires a knowledge or belief as to the outcome of the arrangement (i.e. it is the subjective intention).
- 11.12 Subsection 9(2) of the Taxation Offences Act provides that a '*... prosecution for an offence against this Act may be commenced at any time*'. Further, as the offences under the Taxation Offences are criminal offences, the defendant's guilt must be proved beyond reasonable doubt.
- 11.13 It should also be noted that subsection 12(1) of the Taxation Offences Act provides that the Court may order a person to pay to the Commonwealth '*... such amounts as the Court thinks fit*

but not exceeding the amount of the ... tax moneys due and payable by the company ...on the day of the conviction ...'.

12. Liability of directors for goods and services tax

12.1 The *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (the '**GST Act**') does not generally provide for recovery of goods and services tax from Directors. However, section 444-15 of the First Schedule to the Taxation Administration Act would appear to allow the Commissioner to proceed against a Director for a company's goods and services tax liability.

12.2 Subsection 444-15(1) of the First Schedule to the Administration Act provides that:

*Any notice, process or proceeding that may be given to, served on or taken against a company or its public officer under an * indirect tax law may, if the Commissioner considers it appropriate, be given to, served on, or taken against an entity (the **representative**) who is:*

(a) a director, secretary or other officer of the company; or

(b) an attorney or agent of the company.

12.3 Further, subsection 444-15(2) to the First Schedule of the Administration Act provides that:

The representative has the same liability in respect of the notice, process or proceeding as the company or public officer would have had if it had been given to, served on or taken against the company or public officer.

12.4 Further, subsection 444-15(3) of the First Schedule to the Administration Act provides that section 44-15 '*...does not, by implication, reduce any of the obligations or liabilities of the company or public officer.*'

12.5 Whilst the provision appears to allow the Commissioner to access Directors for corporate goods and services tax debts because the provisions extend to public officers, attorneys and agents, the provisions are more likely to relate to business activity statement filing obligations, rather than tax payment obligations. Further, in practice the Commissioner does not apply the provision to attack directors.

13. Liability of Directors and former Directors for New South Wales State taxes

13.1 Division 2 of Part 7 of the *Taxation Administration Act 1996*(NSW) (the‘**NSW Administration Act**’) allows the Chief Commissioner of State Revenue (NSW) (the‘**Chief Commissioner**’) to recover a NSW State tax from a director, or former director of a corporation.

13.2 Section 47B of the NSW Administration Act provides that:

47B Liability of directors and former directors of corporation for failure to pay tax

(1) *If a corporation fails to pay an assessment amount in accordance with a notice of assessment issued by the Chief Commissioner, the Chief Commissioner may serve a compliance notice on one or more of the following persons:*

(a) *a person who is a director of the corporation,*

(b) *a person who was a director of the corporation at the time the corporation first became liable to pay the tax, or any part of the tax, that is included in the assessment amount or at any time afterwards (referred to in this Division as a "former director"), subject to subsection (5).*

13.3 That is, subsection 47B(1) of the NSW Administration Act provides that ‘directors’ and ‘former directors’ of a corporation may be liable for the tax if the ‘director’ or ‘former director’ is served with a ‘compliance notice’.

13.4 It should be noted that paragraph 47B(1)(b) of the NSW Administration Act provides that a ‘former director’ is liable, subject to subsection 47B(5) of the NSW Administration Act, which itself provides that:

A person does not cease to be liable to pay an assessment amount because the person ceases to be a director of the corporation, but a former director of a corporation is not liable for any tax for which the corporation first became liable after the director ceased to be a director of the corporation.

13.5 That is, a former director may be liable with respect to a State tax if the corporation was liable at the time that the liability arose. If a corporation becomes liable after the former director ceased

to hold that position, then the former director will not fall within the scope of section 47B of the Administration Act.

13.6 It should be noted that the inverse limitation (i.e. corporation tax liabilities which arise before a director becomes a director) does not apply. As a result, a director of a corporation may become liable for a NSW State tax notwithstanding that the corporations liability arose before the director became a director. As a result, an in-coming director should ensure that it has conducted appropriate due diligence into the matter.

13.7 Whilst subsection 487B(1) of the NSW Administration Act provides that a director or former director may be liable if served with a 'compliance notice', that term is defined in subsection 47B(2) of the NSW Administration Act as:

A "compliance notice" is a notice that advises the director or former director on whom it is served that if the failure to pay the assessment amount is not rectified within the period specified in the notice, being a period of not less than 21 days, the director or former director will be liable to pay the assessment amount.

13.8 That is, the 'compliance notice' must:

13.8.1 be served;

13.8.2 advise the 'assessment amount';

13.8.3 advise that if the 'assessment amount' is not rectified within a period (which must be specified in the notice), with the period being not less than 21 days; and

13.8.4 advise that a failure to rectify, will cause the director (or former director) to be liable for the amount.

13.9 Further, subsection 47B(4) of the NSW Administration Act provides that a failure to have the 'assessment amount' rectified within the period specified, then the director or former director will be jointly and severally liable to pay the assessment amount:

If the failure to pay the assessment amount is not rectified within the period specified in the compliance notice, the director or former director on whom the compliance notice was served is jointly and severally liable with the corporation to pay the assessment amount.

13.10 Subsection 47B(3) of the NSW Administration Act provides for when an assessment amount is 'rectified' for the purposes of subsection 47B(2) of the NSW Administration Act:

- (3) *For the purposes of this Division, a failure to pay an assessment amount is rectified if:*
- (a) *the assessment amount is paid, or*
 - (b) *the Chief Commissioner makes a special arrangement with the corporation for the payment of the assessment amount, or*
 - (c) *the Board of Review waives or defers payment of some or all of the assessment amount, or*
 - (d) *an administrator of the corporation is appointed under Part 5.3A of the Corporations Act 2001 of the Commonwealth, or*
 - (e) *the corporation begins to be wound up within the meaning of the Corporations Act 2001 of the Commonwealth.*

13.11 Whilst paragraph 47B(2)(b) of the NSW Administration Act provides that an assessment amount may be 'rectified' if a special arrangement is made, section 47C of the NSW Administration Act provides that the failure to comply with a special arrangement may cause the machinery of Division 2 of Part 7 of the NSW Administration Act to apply.

13.12 Subsection 47D of the NSW Administration Act provides that a director / former director has a right of contribution and indemnity as against both the corporation and the other directors / former directors upon payment of an amount:

If a director or former director of a corporation is liable to pay an assessment amount under this Division and an amount is paid by the director or former director in discharge of that liability, the director or former director is entitled:

- (a) *to be indemnified for payment of that amount by the corporation, and*
- (b) *to recover a contribution from any other director or former director of the corporation who is liable to pay the assessment amount under this Division, as if the directors and former directors who are liable to pay*

the assessment amount had jointly guaranteed payment of the assessment amount.

13.13 Section 47E of the NSW Administration Act provides for defences available to directors and former directors that may be liable under the Division. Section 47E of the NSW Administration Act provides that:

In proceedings for the recovery of an assessment amount from a director or former director of a corporation under this Division, it is a defence to the recovery of that amount if the director or former director establishes that:

- (a) the director or former director took all reasonable steps that were possible in the circumstances to ensure that the corporation rectified the failure to pay the assessment amount, or*
- (b) the director or former director was unable, because of illness or for some other similar good reason, to take steps to ensure that the corporation rectified the failure to pay the assessment amount.*

13.14 That is, a director / former director may have a defence if:

13.14.1 the director / former director took all reasonable steps to ensure that the corporation rectified the failure to pay the assessment amount; and

13.4.2 the director / former director was unable, due to illness or some other 'similar good reason' to take steps that the assessment amount was rectified.

14. Foreign tax debts

14.1 This topic is included because it is relatively new, although it does not encompass director's liabilities.

14.2 The general law position is that Courts will not assist in the collection of foreign tax debts 9and likewise, a foreign jurisdiction's Court will not assist in collecting an Australian tax debt). For example, it was observed by Sankey J in *Indian and General Investment Trust Ld v Borax Consolidated Ld* that: '*Whilst it is the duty of an English court to enforce an English taxing Act, it is no part of its duty to enforce the taxing Act of another country.*'

14.3 However, this general principal has been amended in Australia as a result of the introduction of Division 263 of Schedule 1 of the Administration Act. Indeed, section 263-5 of Schedule 1 of the Administration Act provides that:

This Subdivision can be activated if there is in force an agreement between Australia and a foreign country or territory that contains an article relating to assistance in collection of foreign tax debts.

The Commissioner can collect from an entity an amount in respect of a tax debt that the person owes to such a country or territory or take action to conserve assets of the entity.

The Commissioner is required to remit amounts collected to the foreign country or territory concerned.

14.4 A foreign government may now make a claim which will be enforced by the Commissioner. However, there must be a provision in the relevant International Tax Agreement (such as in the New Zealand / Australia Double Tax Agreement).

14.5 The Commissioner must enter the claim into a register, and once entered it becomes an amount owed by the debtor to the Commonwealth (section 263-30 of the Administration Act). General interest charge then accrues on the debt, and the Commissioner enforces it in the usual way.

14.6 Questions such as challenges on the validity of the debt, and what the impact of successful challengers are will need to be considered.

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