

Practice Alert

Director Penalty Notices

OCTOBER 2009

Introduction

Personal Liability notices are an extremely powerful and effective debt collection tool available only to the **Australian Taxation Office**. They allow the ATO to impose personal liability on company directors without the delay or expense of taking legal action. For this reason, it is essential that company directors act promptly if they receive a **Director Penalty Notice**. However, while it is easy to conclude that company directors must act quickly if they receive a notice, they must choose their course of action carefully. Although paying the amount of the notice may appear to be the simplest and most direct response, as we will explain below it may actually result in a significantly larger personal liability in the future.

How the Notices work?

If a company falls behind in its payment of tax liabilities, the ATO can issue a Director Penalty Notice to any or all of the directors. The notice take the form of a letter from the ATO.

Once they are received, company directors have fourteen (14) days to implement one of four alternatives:

- < Pay the debt in full; or
- < Agree and implement an instalment payment with the ATO; or
- < Ensure that the company is being wound up; or
- < Place the company in voluntary administration.

If one of these four outcomes is not achieved within the fourteen day period, then the Income Tax Assessment Act imposes personal liability on directors for the amount as set out in the notice.

Pay the debt in full

Ensuring that the company pays the debt is the most obvious way of dealing with a Director Penalty Notice - but depending on the circumstances it may not be the best alternative.

If the company is later wound up - despite the best endeavours of directors - then the liquidator will scrutinise any payments to creditors, and attempt to clawback any potential 'unfair preferences.'

Unfair preferences are governed by specific provisions of the Corporations Act - but briefly, they are transactions that provide a creditor with part or full payment that is not available to all creditors, and they can be recovered or 'clawed-back' by a liquidator in specific circumstances. If the liquidator is able to

recover unfair preferences paid to the ATO, then section 588FGA of the Corporations Act allows the ATO to seek reimbursement from the directors of the company, unless the directors can establish one of the statutory defences.

The statutory defences are similar to those available against insolvent trading claims, if a director:

- < Had reason to believe that the company was solvent; or
- < Had taken 'all reasonable steps' to stop the transaction; or
- < Was not involved in the management of the company for 'good reason'; or
- < Had believed that the company was solvent because of the advice of a 'competent and reliable person.'

CASE STUDIES

Gibbons & Anor v Deputy Commissioner Taxation illustrates how the clawback indemnification works.

The liquidators of a company took action to recover unfair preferences totalling more than \$821,000 from the ATO.

The ATO admitted receiving the payments, but argued that the company was not insolvent at the time the payments were made. In addition, the ATO cross-claimed against the director, so that if the liquidators were successful, it could seek an indemnification order from the director.

The director likewise argued that the company was solvent when the payments were made, and also argued that he was entitled to various statutory defences - namely that he had reasonable grounds to believe that the company was in fact solvent, that he

Contact details:

Anthony Warner T 8243 5220 M 0402 879 830
Steven Kugel T 8243 5252 M 0411 559 111

