



Tax Alert November 2008

Director Penalty Notices

Recently, we have seen an increase in the use of Director Penalty Notices by the Australian Taxation Office (ATO). These notices are very important documents, and it is critical that directors respond immediately in order to avoid the potentially significant consequences which may arise.

Circumstances in which a Director Penalty Notice may be issued

The Income Tax Assessment Act 1936 (Cth) (Act) requires companies to remit group tax which has been withheld or deducted. If group tax is not remitted by the required date, the company must:

- > make an agreement with the Commissioner to pay the outstanding amount
- > appoint an administrator, or
- > begin winding up the company.

If one of these things does not occur by the required date, directors of the company automatically become personally liable to pay the outstanding amount as a penalty. However, before the Commissioner can commence proceedings to recover the debt, the director must have failed to comply with a Director's Penalty Notice.

What is a Director Penalty Notice (DPN)?

A DPN is a notice prepared by the ATO setting out the obligations of the director in respect of the group tax owed by the company. After receiving a DPN the director must:

- > pay the amount specified in the notice
- > cause the company to enter into a payment arrangement with the Commissioner
- > cause the company to enter into administration, or

- > cause the company to be wound up.

If the director complies with the DPN within 14 days of service, the outstanding amount is considered to have been remitted by the director, who has no further liability to pay the penalty.

What is the amount of the liability under a DPN?

Directors who are served with a DPN are liable to pay an amount equal to the company's liability for the withheld/deducted amount.

How must a DPN be served?

A DPN is deemed to have been validly served once the ATO posts it in a stamped envelope addressed to the director at the address noted on ASIC's records. This is so even if the recipient of the DPN is no longer a director of the company. There is no time limit in which the ATO may serve a DPN, meaning that directors who have had no involvement in the affairs of a company for many years may still be liable for unremitted group tax.

What is the due date for compliance?

Directors have 14 days after service of the notice in which to comply with its terms. It is not relevant whether or not the director receives the notice; only that it was properly served. Since the decision in *DCT v Meredith* [2007] NSWCA 354, the ATO has regarded the time for compliance as being 14 days from the date that the DPN is posted. There is no legislative provision which allows the Commissioner to extend the 14 day period.



If the director complies with the DPN within time, the penalty is considered to have been remitted by the director and no further liability arises.

What is the consequence if a director fails to comply with a DPN?

The Commissioner may commence legal action against a director personally who fails to comply with a DPN. This means that a Director cannot hide behind a company structure to avoid liability. It appears to us that the ATO is choosing to take this course of action more often than in previous years.

When can a Director avoid the consequences of failure to comply with a DPN?

Thomson Playford Cutlers has advised clients in circumstances where they have failed to comply with a DPN. There are limited circumstances in which a director will **not** be liable. For example:

- > Does the DPN contain accurate details of the amount which is due? If not, the notice is misleading and may be invalid.
- > Have other directors paid all or part of the penalty? If so, the liability of the remaining directors will be reduced by that amount (although the director who did pay the outstanding amount has a right of indemnity and contribution from the company and other directors).

> Is the director able to prove that due to illness or some other good reason he or she did not take part in the management of the company for the whole time that the company was obliged to remit deductions? If so, the director may avoid liability pursuant to the DPN. However, practically this is an extremely difficult thing to prove.

> Is the director able to prove that they took all reasonable steps to ensure that the directors complied with the obligation to remit tax? If so, the director will no longer be liable. For example, if a director can show that a receiver took control of assets and an application to wind up the company had been adjourned, this may be sufficient to satisfy the 'all reasonable steps' requirement.

> Is the director able to prove that there were no steps they could have taken to ensure the directors complied with the obligation to remit tax? If so, the director will no longer be liable.

> Is the director able to establish that he or she relied upon advice from the ATO that an extension of time would be granted in circumstances when, in fact, an extension was not granted? If so, this may create an estoppel whereby the ATO cannot act before the expiry of the time for which the extension was promised.

Thomson Playford Cutlers can assist to advise on whether or not a director may avoid liability after failing to comply with a DPN.

Final comment on Director Penalty Notices

The consequences for failing to comply with a DPN are so grave that directors must act quickly and decisively if they receive one. Importantly, both current directors (even those who are newly appointed) and former directors may be liable pursuant to a DPN. This means that ingoing and outgoing directors should consider the company's liability for unremitted group tax very carefully before agreeing to become a director or when negotiating an exit strategy.

Directors and their advisers must remember that the 14 day timeframe to comply with a DPN is based on when the DPN was served not received, so directors must ensure that ASIC always has their current address details. This will make it less likely that they will become liable for non-compliance before they become aware of the notice.

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