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**Director Penalty Notices –
An Unfair Advantage?**


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**Introduction – The Abolition of the Priority
1992**

Subject to the costs and expenses of the winding up (that is, administration costs) the Commissioner of Taxation has priority over all other unsecured debts with respect to:


- unremitted tax instalment deductions (ITAA, s 221P1);
- unremitted prescribed payments deductions (ITAA, s 221YHJ);
- unremitted natural resource or royalty payment deductions (ITAA, s 221YH2D); and,
- unpaid withholding tax (ITAA, s 221YU) ALRC 45 at para 733



- The Commissioner's priority assures the Taxation Department of payment and it consequently is under no pressure to recover it in a normal commercial manner.*
- The Commissioner, by allowing taxation debts to accumulate without real risk to the Commissioner's position, may seriously disadvantage the interests of other unsecured creditors. The Commissioner may decide to let an employer continue trading even though group tax is owing. Other creditors will not be privy to this information and may be ultimately disadvantaged if the business later goes into liquidation.*
- Taxation debts of insolvents are insignificant in terms of total government receipts but the amount forgone by a private creditor may be the difference between the creditor surviving or failing.*



- The net loss to the Commissioner from the abolition of the priority would be insignificant. The Report of the Senate Standing Committee on Constitutional and Legal Affairs Priority of Crown Debts referred to estimates given by the Commission of Taxation for the 1976-7 financial year which showed that, while taxation receipts were \$15,884 million the amount of taxation debts to which Crown priority could have applied was estimated at \$10 million. Furthermore, the loss of revenue resulting from abolition of the priority would be partially offset by the Commissioner receiving a proportion of the general distribution of the insolvent estate.*
- The Commissioner should obtain no greater priority than would be obtained by a person claiming in respect of debts misappropriated by an agent.*
- There would be a significant reduction in litigation over the scope and operation of the Commissioner's priority. There have been a multitude of cases (both reported and unreported) on this priority and many of the reported cases contain judicial pleas for s 221P to be clarified."*



SENATOR McMULLAN

"The Bill will also make company directors liable for deductions made by their company and not remitted to the Commissioner. Currently, directors can be convicted in relation to their company's non payment of amounts deducted and can be ordered by a court to pay reparation equal to the deductions not remitted. This new measure will achieve this result more efficiently.

Consistent with the theme of the recent amendments to the Corporations Law, this measure will ensure solvency problems are confronted earlier and the escalation of debts will be prevented..."



Action Against Fraudulent Phoenix Activity

Under the guise of pursuing phoenix activity, the Commissioner sought amendments to the Income Tax Assessment Act 1936 ("ITAA") and associated legislation to strengthen his powers of recovery.

These amendments were introduced pursuant to the Tax Laws Amendment (Transfer of Provisions) Bill 2010 which received royal assent on 29 June 2010 and came into effect on 1 July 2010.

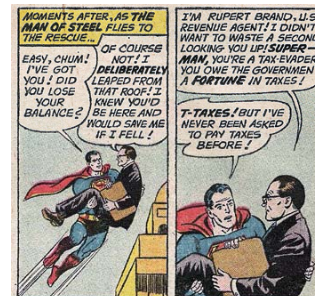
Interestingly, the bill was moved through parliament very quickly (even with a change in Prime Minister). It was passed by the lower house on 13 June 2010, and by the senate on 17 June 2010 without amendment.

222AOE Commissioner must give 14 days' notice before recovering penalty

The Commissioner is not entitled to recover from a person a penalty payable under this Subdivision until the end of 14 days after the Commissioner gives to the person a notice that:

- (a) sets out details of the unpaid amount of the liability referred to in subsection 222AOC(1), (1A) or (2) (whichever relates to the penalty); and
- (b) states that the person is liable to pay to the Commissioner, by way of penalty, an amount equal to that unpaid amount, but that the penalty will be remitted if, at the end of 14 days after the notice is given:
 - (i) the liability has been discharged; or
 - (ii) an agreement relating to the liability is in force under section 222ALA; or
 - (iii) the company is under administration within the meaning of the Corporations Act 2001; or
 - (iv) the company is being wound up." (emphasis added)

Giving Notice



Giving the Notice

222AOF How notice may be given

- (1) If it appears from ASIC documents that a person is, or has been within the last 7 days, a director of the company, the Commissioner may give the person a notice under section 222AOE by leaving it at, or sending it by post to, an address that appears from such documents to be, or to have been within the last 7 days, the person's place of residence or business.

Note: Sections 28A and 29 of the Acts Interpretation Act 1901 are also relevant to giving a notice under section 222AOE.

ACTS INTERPRETATION ACT 1901 - SECT 28A

Service of documents

- (1) For the purposes of any Act that requires or permits a document to be served on a person, whether the expression "serve", "give" or "send" or any other expression is used, then, unless the contrary intention appears, the document may be served:
 - (a) on a natural person:
 - (i) by delivering it to the person personally; or
 - (ii) by leaving it at, or by sending it by pre-paid post to, the address of the place of residence or business of the person last known to the person serving the document; or



- (b) on a body corporate--by leaving it at, or sending it by pre-paid post to, the head office, a registered office or a principal office of the body corporate.
- (2) Nothing in subsection (1):
- (a) affects the operation of any other law of the Commonwealth, or any law of a State or Territory, that authorizes the service of a document otherwise than as provided in that subsection; or
 - (b) affects the power of a court to authorize service of a document otherwise than as provided in that subsection.



ACTS INTERPRETATION ACT 1901 - SECT 29

Meaning of service by post

- (1) Where an Act authorizes or requires any document to be served by post, whether the expression "serve" or the expression "give" or "send" or any other expression is used, then unless the contrary intention appears the service shall be deemed to be effected by properly addressing prepaying and posting the document as a letter, and unless the contrary is proved to have been effected at the time at which the letter would be delivered in the ordinary course of post.
- (2) This section does not affect the operation of section 160 of the *Evidence Act 1995*.



Deputy Commissioner of Taxation v Gruber (1997)

- Graham AJ of the New South Wales Supreme Court found that the Defendant did not receive the originals of two DPNs which had been posted to him at a property that he had not lived at for approximately 7 years, and which was vacant.
- His co-director did receive a copy of the Notice.
- Justice Graham also found that the Commissioner's staff had failed to comply with s.222AOF and that the reference to an ASIC search was not sufficient to constitute the place of residence or business of the Defendant last known to the Commissioner under s.28A of the *Acts Interpretation Act*.



Deputy Commissioner of Taxation v Nercessian [2006]

- In 2006, the New South Wales Court of Appeal found that it was sufficient for the Commissioner to search the ASIC records only and that the Commissioner was not bound to go beyond that. The Commissioner was not required to look at individual returns in particular.

Deputy Commissioner of Taxation v Meredith [2007]

- The NSW Court of Appeal held that a DPN sent to a director by ordinary prepaid post will be "given" to the intended recipient at the time the DPN is posted, such that the evidence of receipt or non-receipt by the director was irrelevant and the time would commence to run from the date of posting.




The Court of Appeal in *Meredith* was constituted by Giles, Ipp and Basten JJA. Giles JA gave a dissenting judgment, commenting particularly that s.29 of the *Acts Interpretation Act* applied not only to documents served under s.28 of that Act, but also the giving of a penalty notice in accordance with s.222AOF, and that therefore a director could seek to prove to the contrary that delivery was effected in the ordinary course of post.



Deputy Commissioner of Taxation v Soong [2009]

Schmidt JA followed *Meredith*, although making reference to the dissenting judgment of Giles JA and then stating:


"As I observed at the hearing, it would appear sensible for the Plaintiff (the Commissioner) to revisit the terms of the notices given under these provisions."



Soong v Deputy Commissioner of Taxation [2011]

- Five Member Court of Appeal

• *"It might be said that it would be strange if proof that a notice was delivered a year after posting would have the effect that service was not effected until a year after posting, but proof that it was not delivered at all would have the effect that service was effected at the time when the notice would have been delivered in the ordinary course of post. However, such a result is not necessarily unreasonable. It might be considered reasonable to place the risk of slow delivery on the giver of the notice, but the risk of complete failure of delivery on the recipient. In any event, as in Fancourt and Skalkos, I prefer to leave this question open."*




Postscript

"[73] By way of postscript, Div 9 has now become Div 269 in Sch 1 to the Taxation Administration Act 1953. Section 222AOE has now become s 269-25. Under a heading "When notice is given" s 269-25(4) states:

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.

Note 1: Section 28A of the Acts Interpretation Act 1901 may be relevant to giving a notice under subsection (1).

Note 2: Section 269-50 of this Act is also relevant to giving a notice under subsection (1).




[74] Section 269-50 is the replacement for s.222AOF. It provides:

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.


[75] The Explanatory Memorandum which accompanied the Bill effecting these changes contains the following paras 2.78–2.80:

The rewrite has been drafted taking account of a number of court decisions on the application of Division 9. Where appropriate, the outcome of those decisions has been reflected in the rewrite.




For example, the Meredith case concerned when the Commissioner has given a director penalty notice. The court decided that section 29 of the Acts Interpretation Act 1901 did not apply, so that a notice was given when it is posted (rather than when it is received).

That result was the intended result under the current law but, to remove any possibility of a future misunderstanding, the rewrite clearly excludes the operation of section 29 of the Acts Interpretation Act 1901. This has not resulted in a policy change as it simply reflected the current state of the law as set out in the Meredith decision.



[76] It is, of course, a matter for the Legislature as to whether, as a consequence of a decision of this court not to follow the majority judgment in Meredith, that decision should be reflected in any amendments to the statutory provisions referred to in the preceding paragraphs of this postscript."







PRESENTLY, AS BRAND COMPUTES SUPERMAN'S TAXES...

ONE BILLION DOLLARS? GOSH, BRAND, I NEVER KEEP ANY OF THE WEALTH I EARN! I GIVE EVERYTHING AWAY TO WORTHY CAUSES!

WELL, EVEN IF YOU GAVE AWAY ALL THE MONEY YOU EARNED, YOU'RE NOT EXCUSED! MANY MILLIONAIRES GIVE MONEY TO CHARITY, TOO. YET THEY PAY TAXES!

NOON TOMORROW IS THE TAX DEADLINE! IF YOU DON'T DELIVER \$1,000,000, WHICH INCLUDES YOUR BACK TAXES, I'LL ORDER THE F.B.I. TO ARREST YOU!

THAT ISN'T MUCH TIME, BRAND! BUT OKAY, I'LL SEE WHAT I CAN DO!



The New Regime

Division 269 of Schedule 1 of the *Taxation Administration Act 1953* ("TAA")

Section 269-15 of the TAA is the section that now sets out the liability of a director to cause a company to comply with its obligations and refers to them in generic terms.

The obligations that the directors must cause the company to comply with are set out in a table in s.269-10. The table can be added to quite simply to expand the nature of the obligations.



Section 269-15(2) provides that the directors of a company continue to be "under their obligation" until the company complies with its obligation, an administrator is appointed or the company begins to be wound up under the *Corporations Act*.



The option of an instalment arrangement has been removed as being an action that will discharge the concurrent liability. But it is still contained in s.269-15(3) as a "brake" on the commencement or taking of any step in recovery proceedings, whilst ever an instalment arrangement is in force under s.255-15.

The penalty provisions appear in s.269-20 of the TAA and provide that a director is liable to pay to the Commissioner a penalty if they are still under an obligation "at the end of the due day", invoking the colloquial expression "at the end of the day".



The period of notice begins on the day the notice is posted, not receipt of the notice. Section 269-25(4) provides:

"Despite s.29 of the Acts Interpretation Act 1901, a notice under subsection 1(1) is taken to be given at the time that the Commissioner leaves or posts it."

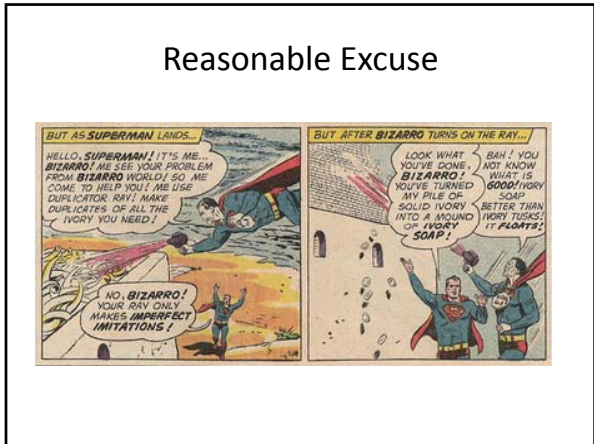
Gathering Funds



Defences

The defence now requires that the director prove that, because of illness or for some other good reason, it would have been unreasonable to expect them to take part, and they did not take part, in the management of the company. s.268-35(2) of TAA.





Section 1318 of the Corporations Act

In *DCT v Dick*:

"The maxim generalia specialibus non derogant thus operates in a context where, if the general provision (s 1318), were to apply, it would neutralize the specific provisions of Divs 8 and 9 of the ITAA. Compare O'Connor J in Goodwin v Phillips (1908) 7 CLR 1 at 14:

Where there is a general provision which, if applied in its entirety, would neutralize a special provision dealing with the same subject matter, the special provision must be read as a proviso to the general provision, and the general provision, in so far as it is inconsistent with the special provision, must be deemed not to apply."

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

Expansion of the New Regime

- The director penalty regime will be extended to superannuation guarantee amounts, making directors personally liable for their company's failure to pay employee superannuation;
- The Australian Taxation Office ("ATO") will be given the power to commence recovery against directors under the director penalty regime, without providing a 21 day grace period, for certain unpaid company liabilities that remain unreported after 3 months of becoming due; and
- In certain circumstances, directors and associates of directors will 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.

"[33] It is incumbent upon the Commissioner to exercise his powers under Division 9 expeditiously for otherwise their exercise after the escalation of debts can have Draconian consequences. An early sign of problems in a company is its living on the false reserves of non-remitted PAYG withholdings. The Commissioner is in the position that he will have notice of a failure to remit. He should act then, when PAYG withholdings are relatively low and the directors' liabilities are correspondingly so."



Limitation Defences – A Further Advantage?

Section 14 of the *Limitation Act 1969 (NSW)* reads:

"14. *General*

- (1) *An action on any of the following causes of action is not maintainable if brought after the expiration of a limitation period of six years running from the date on which the cause of action first accrues to the plaintiff or to a person through whom the plaintiff claims:*



- (a) *a cause of action founded on contract (including quasi contract) not being a cause of action founded on a deed,*
- (b) *a cause of action founded on tort, including a cause of action for damages for breach of statutory duty,*
- (c) *a cause of action to enforce a recognizance,*
- (d) *a cause of action to recover money recoverable by virtue of an enactment, other than a penalty or forfeiture or sum by way of penalty or forfeiture.*



- (2) *This section does not apply to:*

- (a) *a cause of action to which section 19 applies, or*
 (b) *a cause of action for contribution to which section 26 applies.*

- (3) *For the purposes of paragraph (d) of subsection (1), "enactment" includes not only an enactment of New South Wales but also an enactment of the Imperial Parliament, an enactment of another State of the Commonwealth, an enactment of the Commonwealth, an enactment of a Territory of the Commonwealth and an enactment of any other country."*



Section 18 of the *Limitation Act* reads:

"18. *Penalty and forfeiture*

- (1) *An action on a cause of action to recover a penalty or forfeiture, or sum by way of penalty or forfeiture, recoverable by virtue of an enactment, is not maintainable if brought after the expiration of a limitation period of two years running from the date on which the cause of action first accrues to the plaintiff or to a person through whom the plaintiff claims.*
- (2) *In this section "penalty" does not include a fine to which a person is liable on conviction for a criminal offence."*



The High Court, in the case of *Deputy Commissioner of Taxation v DTR Securities Pty Ltd* (1988) 165 CLR 56, and the related case of *Deputy Commissioner of Taxation v Moorebank Pty Ltd* (1988) 165 CLR 55 held that the *Limitation Act 1969 (NSW)* did not apply to tax related liabilities.

That has also been confirmed by the NSW Court of Appeal in the case of *Muc v Deputy Commissioner of Taxation* [2008] NSWCA 96.

In that case, the Court of Appeal considered Schedule 1 to the *Tax Administration Act* and held unanimously that it was intended to cover the field and that therefore s.109 of the Federal Constitution applied, precluding the operation of the *Limitation Act 1969 (NSW)*.



Section 588FGA – The Sting in the Tail

- 2) Each person who was a director of the company when the payment was made is liable to indemnify the Commissioner in respect of any loss or damage resulting from the order.

