Revenue Law Journal

Volume 6 | Issue 1 Article 8

December 1996

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Abstract
The Income Tax Assessment Act 1936 (Cth) has recently been amended to include special provisions for the recovery of unremitted tax instalment deductions. These provisions replaced the priority provided to the Commissioner under former s221P. The new provisions provide the Commissioner with significant advantages and can operate in quite a draconian fashion as is illustrated by the recent decision in *Fitzgerald v DFC of T*. This article indicates that potential company directors should take heed of the warnings echoed in this case before blindly accepting their appointments.

Keywords
tax deductions, income tax, directors liability

DIRECTORS' LIABILITY AND THE NEW REGIME FOR COLLECTING UNREMITTED TAX INSTALMENTS

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Introduction

In 1993, a new regime for dealing with unremitted tax instalments was introduced.[2] The new regime, contained in Div 8 (s 222AFA - s 222AMB) and Div 9 (s 222ANA - s 222AQD) of Part VI of the Income Tax Assessment Act 1936 (Cth),[3] relates to amounts owing[4] under the Pay As You Earn System,[5] the Prescribed Payments

1 95 ATC 4587.

2 Proposals for the regime were announced in a joint statement by the Treasurer and the Attorney General on 2 December 1992.

3 Both Divisions were inserted by Act No 32 of 1993.

4 The amounts must have become payable after 30 June 1993.

5 Contained in Div 2 of Part VI of the Act (s 221A - s 221YAA). For a general overview of the "PAYE" system see: Woellner R, Vella T, Burns L and Barkoczy S, *Australian Taxation Law* (6th ed 1996 CCH Australia Ltd) 253-263.

System,[6] the Reportable Payments System,[7] the Withholding Tax System,[8] as well as certain other collection systems.[9] A common feature of all these collection systems is that they require tax instalments to be deducted from relevant payments at source and they require the payer to pay amounts equal to the instalments deducted to the Commissioner of Taxation within a specified time after the payments have been made.

At the time of its introduction, there was relatively little disquiet expressed concerning the new regime governing unremitted tax instalments.[10] This is perhaps surprising, given the seemingly draconian nature of the new provisions. This article outlines the new regime and focuses on the recent decision of *Fitzgerald v DFC of T*,[11] which concerned the operation of Div 9. This case highlights the extent of the Commissioner's powers and provides some important lessons for those contemplating taking on roles as directors of companies that have failed to meet their remittance obligations.

Outline of Division 8

Division 8 sets out a mechanism for the Commissioner to commence recovery proceedings in respect of unremitted amounts owing under the respective tax collection systems mentioned above. It is designed to enable the Commissioner to take "prompt and effective" recovery action[12] by empowering him to make an estimate of the amounts owing and to recover the amount of the estimate.[13] The new system

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6 Contained in Div 3A of Part VI of the Act (s 221YHA - s 221YHZ). See further, Woellner et al, above n 5 at 275-279.

7 Contained in Div 1AA of Part VI of the Act (s 220AA - s 220AZH). Again, see further, Woellner et al, above n 5 at 279-282.

8 Contained in Div 4 of Part VI (s 221YJ - s 221YY) relating to interest, dividends and royalties.

9 See Div 3B of Part VI (s 221YHZA - 221YHZZC) relating to natural resource payments and payments where Tax File Numbers have not been quoted.

10 Perhaps this was because, at the same time, the Commissioner's priority in respect of unpaid tax instalments under s 221P of the Act was removed and the introduction of the new regime was viewed as the "trade-off": see Doyle S, "The Fitzgerald Case, Div 9 Notices and the Personal Liability of a Director for Company Tax" (1995) 7 (5) CCH Journal of Australian Taxation 17 at 19. Or, perhaps, the more cynical view might be that this was because the sheer volume of tax legislation emanating at the time simply "flooded" the tax profession.

11 95 ATC 4587.

12 Section 222AFA(1).

13 Section 222AFA(2).

provides the Commissioner with a number of advantages[14] - the most crucial of which is that the Commissioner can now commence recovery proceedings sooner than in the past and without having to first establish the precise amount of an unpaid liability.[15]

The Commissioner's power to make an estimate is contained in s 222AGA(1).[16] Under that provision, if the Commissioner has reason to suspect that a "relevant person"[17] has become liable under a "remittance provision"[18] to make relevant payments and that liability is undischarged after the "due date",[19] he may make a "reasonable estimate"[20] of the unpaid amounts. The Commissioner is then required to notify the relevant person of his estimate in writing.[21] The notice is required to contain specified details.[22]

Under s 222AHA(1) a person who receives notice of an estimate is required to pay the Commissioner the amount of that estimate. This

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14 For a list of some of these advantages, see CCH Tax Editors, Australian Federal Tax Reporter (looseleaf service CCH Australia Ltd) para 759-000.

15 In his Second Reading Speech to the Insolvency (Tax Priorities) Legislation Amendment Bill 1993 (Cth), the Minister for the Arts and Administrative Services indicated that the new provisions "will ensure solvency problems are confronted earlier and the escalation of debts will be prevented."

16 During the period that an estimate is in force under this provision, the Commissioner may not make another estimate relating to the same underlying liability: s 222AGG(1).

17 As defined in s 222AFB.

18 That is the relevant provisions contained in the respective collection system Divisions prescribing the remittance of tax payments (s 220AG(1), s 221F, s 221G, s 221YHDC(2), s 221YHZD(1) and (1A), and s 221YN(1)): s 222AFB(1).

19 This is basically the date on which the person is required to pay an amount equal to the tax deducted under any of the respective collection systems to the Commissioner for a given period: s 222AFB(1).

20 In making the estimate, the Commissioner is specifically empowered to have regard to anything he thinks relevant including, for example, information about amounts deducted by the person during earlier periods: s 222AGA(2).

21 Section 222AGB(1).

22 The notice must identify the liability to which the estimate relates, specify the date on which the estimate is made, set out the amount of the estimate, state that the amount of the estimate is due and payable, state that if the person gives the Commissioner a statutory declaration substantiating the actual unpaid amount of the liability to which the estimate relates the estimate will be reduced accordingly or revoked and state the effect s 222AGF (see below): s 222AGB(2).

liability is distinct and separate from the liability to which the estimate relates, ie, the "underlying liability" to remit tax instalment deductions.[23] Nevertheless, the liability to pay the estimate and the liability to which the estimate relates are deemed to be "parallel liabilities".[24] This has the effect that, where an amount is paid in discharge of one of the parallel liabilities, the other parallel liability is deemed to be discharged to the same extent.[25] Where the amount applied in discharging a liability in respect of an estimate is greater than the amount of the underlying liability, the Commissioner is required to refund the excess (or apply it against any other tax liability of that person).[26]

Mechanisms exist for the reduction[27] of the amount of the estimate as well as the revocation[28] of the estimate. In order to effect a reduction or revocation, the person provided with the estimate must, within 7 days[29] after the notice of the estimate is sent, furnish the Commissioner with a statutory declaration,[30] indicating that the actual amount of tax owing is less than the amount of the Commissioner's estimate[31] or that the person did not make any deductions under the respective collection systems during the relevant period.[32] In cases where the relevant time limits have not been met, the Commissioner nevertheless has a discretion to reduce or revoke the estimate (although the Commissioner is not obliged to exercise this discretion).[33]

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23 See s 222AFA(3). The effect of this is that the Commissioner may institute recovery proceedings in respect of the unpaid amount of the estimate or the unpaid amount of the liability to which the estimate relates or both of these: s 222AHA(2).

24 Section 222AHA(3).

25 Section 222AHA(4).

26 Section 222AHB. This ensures that the relevant person is not required to pay any more tax than would be payable in respect of the underlying liability, ie, the estimate does not increase the person's liability to tax by effectively imposing double taxation.

27 Section 222AGC(1).

28 Section 222AGD(1).

29 Or such longer period as the Commissioner allows.

30 For details of the required form of the statutory declaration, see s 222AGF.

31 In which case, the estimate will be reduced by the amount by which the unpaid amount of the estimate (immediately before the reduction) exceeds the amount specified in the statutory declaration as the unpaid amount of tax owing.

32 In which case the estimate will be automatically revoked.

33 Sections 222AGC(2) and 222AGD(2). In considering whether to reduce or revoke an estimate, the Commissioner is required to have regard to the matters listed in s 222AGE.

In addition, a defence to the Commissioner's powers to recover the unpaid amount of an estimate also exists.[34] This defence requires the filing of an affidavit,[35] which verifies facts sufficient to prove that the underlying liability never existed, has been discharged in full,[36] or is less than the amount of the unpaid estimate.[37] Where the affidavit verifies that no underlying liability existed or that the underlying liability has been discharged, the Commissioner's estimate is respectively revoked or reduced to nil.[38] In cases where the affidavit verifies that the underlying liability is merely less than the amount of the unpaid estimate,[39] the estimate is reduced accordingly.[40] These adjustments are deemed to have effect from when the original estimate was issued (ie, they are retrospective adjustments[41]) but do not affect the Commissioner's rights to proceed with recovery action in relation to any underlying tax liability.[42]

Division 8 also contains a provision which imposes penalties for late payment of an estimate[43] as well as a provision for the remission of such penalties.[44]

Another important feature of Division 8 is that, by virtue of s 222ALA, it allows the Commissioner to enter into special payment arrangements with a person for the purposes of discharging that person's underlying liability arising under any of the remittance provisions as well as any liability resulting from an estimate made under the Division.

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34 Section 222AHC.

35 The affidavit must comply with the requirements of s 222AHE. That provision prescribes filing and service rules and sets out the facts that the affidavit must verify.

36 Section 222AHC(2).

37 Section 222AHC(3). Where the affidavit discloses that the liability is a specified amount which is less than the unpaid amount of the Commissioner's estimate, the Court is required to enter judgment in favour of the Commissioner in respect of the specified amount and the Commissioner is not entitled to recover the balance: s 222AHC(5).

38 Sections 222AHD(1) and (2).

39 But an underlying liability nevertheless still exists.

40 Section 222AHD(3).

41 Section 222AKA.

42 Section 222AKB.

43 Section 222AJA.

44 Section 222AJC.

Outline of Division 9

In contrast to Division 8, which is of general operation, Division 9 operates specifically in respect of companies and imposes a penalty regime that is targeted at company directors. The object of Division 9 is to ensure that a company meets its payment obligations under the various tax collection systems (including Division 8) or is promptly placed in voluntary administration or liquidation.[45]

By virtue of s 222AOB and s 222APB, duties are imposed on directors[46] to cause the company either to comply with its payment obligations under the respective collection systems, enter into a s 222ALA payment agreement,[47] appoint an administrator, or commence winding up proceedings. Where such duties have not been complied with, the directors are personally liable to pay a penalty under s 222AOC or s 222APC equal to the unpaid tax or estimate. The Commissioner is, however, only permitted to recover the penalty from a director where he has provided the director with written notice specifying details of the unpaid amounts of underlying tax or the unpaid amounts of the estimate and 14 days have passed since that notice was provided without s 222AOB or s 222APB having been complied with.[48] Where a person becomes a director at a time when s 222AOB or s 222APB have not been complied with and, if after 14 days since becoming a director either of those provisions have still not been complied with, that person is also deemed to be liable for the penalty.[49]

The penalty will be remitted if the company meets its payment obligations, goes into voluntary administration or begins to be wound up either before the relevant notice has been provided or within 14 days of the director being provided with the notice.[50] In cases where

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45 Section 222ANA(1).

46 "Director" is defined in s 222AFB as "someone who is a director of the company for the purposes of the Corporations Law": see further the wide inclusive definition of director in s 60 of the Corporations Law and the commentary in Ford HAJ and Austin RP, *Ford and Austin's Principles of Corporations Law* (7th ed 1995 Butterworths) at 255. The expression also includes (in the case of an unincorporated company) an office holder of that company.

47 See above.

48 Sections 222AOE and 222APE.

49 Sections 222AOD and 222APD. The harsh effect of these provisions on directors who have since resigned is illustrated below in the discussion of Fitzgerald's case.

50 Sections 222AOG and 222APF.

the penalty is paid, it is applied in discharging "parallel liabilities"[51] and the director is entitled to the same rights "whether by way of indemnity, subrogation contribution or otherwise" as if the payment had been made under a guarantee.[52] This gives the director a statutory right to recover the amount of the penalty paid against the company.[53]

Division 9 also contains "defence provisions". Sections 222AOJ and 222API provide that a director has a defence to the recovery of the penalty if it is proved that because of illness or some other good reason he or she did not take part in the management of the company at the relevant time, or the director took all steps (or there were no such steps that could have been taken) to ensure compliance with s 222AOB or s 222APB.

In addition, there is also a separate sub-regime in Division 9[54] that requires directors to ensure that a company meets its obligations under a s 222ALA payment agreement.[55] Where a company contravenes such an agreement (eg, by failing to meet its payment obligations on the due dates[56]), each person who was a director of the company between the time the agreement was made and the time the contravention took place[57] is deemed to be liable to a penalty of "an amount equal to the balance payable under the agreement". It would therefore seem that the penalty is not merely limited to the amount of any unpaid instalment but extends to the total amount outstanding under the payment agreement. As with the other provisions discussed above, the liability operates as a "parallel liability"[58] and similar rights of indemnity etc as those attaching to

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51 See s 222AOH and s 222APG. See also the discussion on parallel liabilities in the *Australian Federal Tax Reporter*, above n 14 at para 759-260 and, in particular, note that the parallel liability regime in Div 8 and Div 9 are "mutually exclusive".

52 Sections 222AOI and 222APH.

53 It would also apparently give the director a right to seek contribution from the other directors of the company.

54 Contained in Subdivision D (s 222AQA - s 222AQD).

55 Section 222AQA(1).

56 The company might also contravene the agreement by not complying with a special condition such as not providing the Commissioner with a cash flow projection as agreed: see S Doyle, above n 10 at 18.

57 Including a person who was a director at either of those times (but not between such times). Note that the person need not be a director at both the time the agreement was made and the time the contravention took place.

58 Section 222AQA(2).

directors (outlined above) also arise.[59] Likewise, a defence similar to the s 222AOJ and s 222API defences is also available - although the director (if he or she was a director at the time the agreement was made) is also required to establish that he or she had reasonable grounds to expect, and did expect, that the company would comply with the agreement.[60]

As the provisions in Div 9 specifically impose "penalties",[61] s 51(4) will prevent directors from being able to claim deductions under s 51(1) for any amounts paid under the Division.

Fitzgerald's Case

The short but significant decision in *Fitzgerald v DFC of T*[62] illustrates the far-reaching impact of the penalty provisions in Div 9. The facts of the case are relatively straightforward. Fitzgerald had appealed against an order for summary judgment which required him to pay a Division 9 penalty. The penalty related to prescribed payment deductions owing by a company in which he was formerly a director. The prescribed payment deductions were due and payable by the company on or before 14 January 1994. Fitzgerald, however, had only been a director of the company for 17 days (between 11 March and 28 March 1994) and was served with the notice under Division 9 around 10 June 1994. It was common ground that, for the period that he had been a director, s 222AOB had not been complied with.

According to the Deputy Commissioner, Fitzgerald was liable to pay the penalty from 25 March 1994 (14 days after he became a director) and it was irrelevant that he was no longer a director when served with the relevant notice.

Fitzgerald submitted that the purpose of Div 9 was to ensure that a company met its payment liabilities, entered into a payment arrangement, or took steps to go into voluntary liquidation or administration and that the Division would be frustrated if the person served with the notice was not in a position to ensure that the company complied with one of these obligations. He argued that, since he was no longer a director at the time the notice was sent, he

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59 Section 222AQC.

60 Section 222AQD(5).

61 The relevant provisions being s 222AOC, s 222AOD, s 222APC, s 222APD and s 222AQA.

62 95 ATC 4587.

was not in a position to take any steps to ensure compliance with s 222AOB and should therefore not be liable for the penalty.

In the alternative, Fitzgerald sought to raise a defence under s 222AOJ. He pointed to the fact that he was only a director for 17 days and submitted that he did not take part in the management of the company and was unaware of the company's tax liability at the time that he was a director.

The appeal came before French DCJ of the District Court of Western Australia, who rejected Fitzgerald's appeal and found in favour of the Deputy Commissioner. Her Honour adopted a strict literal approach in applying the Div 9 provisions. This was so, despite the fact that she clearly acknowledged the harsh consequences that would flow from this approach in the case before her. In this respect, she stated:

> Although [Fitzgerald's] arguments have some force in as much as it seems a harsh result to require payment of a penalty for unpaid tax to be made by a person who is no longer a director of the company and was only a director for a period of 17 days the legislation does appear to be clear. The liability of a new director arises after the expiration of 14 days after his appointment pursuant to the provisions of s 222AOD. Although the Commissioner must give 14 days notice before recovering that penalty there is nothing in the legislation that suggests that the liability arises as a result of the notice. There is nothing in the provisions of s 222AOE that indicates that the person to whom a notice is sent must currently be a director of the company. Although that section states that the amount of the penalty to be recovered will be remitted if the liability has been discharged or the company is under administration or liquidation there is nothing to indicate that these steps have to be taken by the person to whom the notice is sent.[63]

Furthermore, French DCJ dismissed the taxpayer's claim for a defence on the basis that she found no evidence to suggest that Fitzgerald did not take part in the management of the company (despite the fact that he was only a director for 17 days). In any case, she found that the fact that he merely did not have knowledge of the company's liability was insufficient grounds to establish a defence. In this respect she clearly placed the onus on those contemplating taking on roles as directors to carefully consider the tax liabilities of their companies before taking on such roles. In this respect she cautioned:

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63 95 ATC 4587 at 4589.

> Although he was not aware of the company's financial position or the moneys due to the [Commissioner] this is not sufficient to provide a defence ... it is the responsibility of a new director at or prior to taking up his appointment to make inquiries of the relevant officers of the company as to whether there are any moneys owing by the company to the [Commissioner].[64]

What French DCJ was indicating in the passage above is that directors will need to investigate whether a company has met its relevant payment obligations or else, like Fitzgerald, suffer the consequences that may arise where it has breached these obligations. It is clear from her Honour's words that a director cannot simply hide behind a "cloak of ignorance".[65]

Notwithstanding these strict views, French DCJ did go on to indicate that, where a director did make inquiries of the relevant officers of the company and he or she was not given correct information, then it may be that the director would be able to establish a defence.[66] Even if this obiter dicta is accepted in later cases to establish a specific ground of defence, it may be viewed restrictively and may only be available in a limited number of situations.[67] In this respect, it is submitted that French DCJ would probably place an onus on potential directors to make those kinds of inquiries that a "prudent" person contemplating taking on the responsibilities of a director would make, taking into account the consequences that might flow if such inquiries were not made.[68] Furthermore, it is considered highly

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64 95 ATC 4587 at 4590.

65 French DCJ's approach is not inconsistent with the principles of corporate governance which have developed over recent years and which make it clear that directors should not presume they can hide behind the paper shield of a company.

66 95 ATC 4587 at 4590.

67 For example, where a new director has been misled by the other officers of the company, despite having made prudent inquiries which would have otherwise revealed the company's true position.

68 By way of contrast, compare the recent reforms in the corporate governance area which have introduced the concept of due diligence as the foundation of defences under several provisions of the Corporations Law, eg: s 588H(3), s 996(2), s 1008A(2) and s 1011. Generally, these provisions allow an officer a defence in circumstances where the officer had either made adequate inquiries and/or relied on the advice of a competent and reliable person. But note that there is also authority that suggests that, in certain cases, it is not acceptable for an officer to rely on the assurances of other officers: Statewide Tobacco Services Ltd v Morley (1990) 2 ACSR 405 and Commonwealth Bank of Australia v Friedrich (1991) 5 ACSR 115. See also, generally, Sievers AS, "Farewell to the Sleeping Director - the Modern Judicial and Legislative Approach to

doubtful that a director would be permitted to rely on such a defence where he or she later discovers the true position of the company but then does not take any steps to comply with the relevant obligations of Div 9. This is because the policy behind Div 9 would appear to be to place a continuing obligation on directors to ensure that the company complies with the duties listed in the relevant provisions.[69]

Caveat Director

It is abundantly clear from the warnings echoed by French DCJ that those contemplating taking on roles as company directors should exercise due caution and make appropriate inquiries concerning a company's tax liabilities under the myriad of collection systems before accepting their appointments. In addition such persons should also make appropriate inquiries concerning any payment agreements that have been entered into by the company with the Commissioner.[70] As *Fitzgerald's* case illustrates, the provisions in Div 9 appear to be "appropriately" drafted to operate in such a way that they may come to "haunt" directors of companies.[71] These directors may have long since resigned from their appointments but find that they are liable for their companies' tax debts (which may have been incurred even before they commenced their duties as directors). In this respect, it has been noted elsewhere that:

> These former directors are in an invidious position bearing in mind that they are no longer in a position to cause the company to comply with s 222AOB or s 222APB. Furthermore, the mere fact that a director may have a statutory right to recover the amount paid from the company may be cold comfort in many cases.[72]

Whilst it is not difficult to find some sympathy for Fitzgerald and directors in similar positions to him, it is apparent that the law is clearly moving towards a new age in which the maxim "caveat director" is not inappropriate.

Directors' Duties of Care, Skill and Diligence" (1993) 21 Australian Business Law Review 111 and Ford and Austin, above n 46 at 282.

69 See, eg, s 222AOB which makes reference to persons who are directors of the company *"from time to time"*. (Emphasis added)

70 See Doyle, above n 10 at 18-19.

71 See Barkoczy S, "Directors Beware: A Review of the Decision in Fitzgerald's Case" (1995) 42 *CCH Tax Week* 785 at 787.

72 Barkoczy, ibid.