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Abstract
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Keywords
director, Division 269 TAA, obligations, ATO, defences, Phoenix activity

DIRECTOR PENALTY NOTICES – PROMOTING A CULTURE OF GOOD CORPORATE GOVERNANCE AND OF SUCCESSFUL CORPORATE RESCUE POST INSOLVENCY

SYLVIA VILLIOS*

The director penalty regime under Division 269 to Schedule 1 of the *Taxation Administration Act 1953* (Cth) empowers the Commissioner to take action against an insolvent company's directors to recover outstanding tax debts of a company. The director penalty regime was introduced as a substitute for the Commissioner's tax priority in a corporate insolvency and was aimed at encouraging directors to take early positive action to deal with insolvency. An analysis of Australia's director penalty regime, including the most recent reforms, reveals that the regime helps to foster a culture of good corporate governance which is fundamental to achieving successful corporate rescue post insolvency.

INTRODUCTION

This article considers the operation of the director penalty regime under Division 269 to the *Taxation Administration Act 1953* (Cth) (TAA) in the context of insolvency and bankruptcy. The provisions within this Division concern the obligation of directors to cause the company to meet its pay-as-you-go withholding (PAYG withholding) and superannuation guarantee charge (SGC) liabilities and the consequent duty imposed on directors to cause the corporation to take certain steps. Directors who fail to meet these obligations will face personal liability, subject to certain defences. Unlike many of the Commissioner's powers which predominantly serve a revenue purpose, the director penalty provisions of the *Corporations Act 2001* (Cth) (Corporations Act) have a much closer connection with corporation's law.

This article explores the legislative history of the director penalty regime, the operation of the current legislative scheme and the body of case law that has emerged in this area. The relevance of the connection between tax law and corporate insolvency law to the director penalty regime is that a core responsibility of a corporate board's oversight includes the wider statutory obligation to collect and account for corporate employee taxes. Accordingly, Australia's director penalty regime helps to foster a culture of good corporate governance which is fundamental to achieving successful corporate rescue post insolvency.

HISTORICAL BACKGROUND TO THE DIRECTOR PENALTY REGIME

Until 30 June 1993 the Commissioner had priority over all other unsecured creditors with respect to unremitted deductions for group tax under the former section 221P of the *Income Tax*

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Assessment Act 1936 (Cth) (ITAA 1936) and other taxes.[1] Section 221P gave the Commissioner priority in bankruptcy and in a winding up for Pay as You Earn (PAYE) deductions which had not been remitted to him or used to buy tax stamps. In 1993, the director penalty regime was introduced in Division 9 of the ITAA 1936 as a result of the enactment of the *Insolvency (Tax Priorities) Legislation Amendment Act 1993*. The director penalty regime was introduced as a substitute for the Commissioner's priority.[2] These reforms were based on recommendations by the Australian Law Reform Commission in the General Insolvency Inquiry, known as the Harmer Report. The Harmer Report recommended abolition of the priorities accorded to the Commissioner over all other unsecured creditors with respect to certain amounts deducted or withheld.[3] The 1993 Act also included measures to enable the Commissioner to recover the unremitted amounts more quickly through an estimation process and was aimed at encouraging directors "to face emerging problems as soon as possible".[4]

The regime that was set out in Division 9 of the ITAA 1936 was amended on 1 July 2010 by the *Tax Laws Amendment (Transfer of Provisions) Act 2010* (Cth). The 2010 amending Act repealed the parts of the ITAA 1936 that set out director obligations and added Division 269 to Schedule 1 of the TAA 1953. The Explanatory Memorandum expresses that the amending Act was intended to improve the legislation by rewriting it using plain English and modern drafting techniques and did not involve policy changes.[5]

In 2009, the Australian Government Treasury released a proposals paper entitled 'Action Against Fraudulent Phoenix Activity' (Proposals Paper).[6]The Proposals Paper reported that that losses caused by phoenix activity have been mounting in Australia with losses to the revenue authorities were estimated to run into the hundreds of millions of dollars.[7]The Proposals Paper described a newly-incorporated company taking over the business of a previously liquidated entity which has failed to pay its debts as the 'basic' form of phoenixing,[8]and phoenix activity within corporate groups as the 'sophisticated' form.[9] The sophisticated form of phoenixing was described as involving one entity with few assets within a corporate group incurring substantial liabilities by way of wages, superannuation contributions, PAYG withholding or sales tax, which is then liquidated.

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1 Priority was also given to withholding tax on dividends and interest (former section 221YU), for unremitted deductions from natural resource or royalty payments (former section221YHZD) and for unremitted deductions from prescribed payments tax (former section 221YHJ).

2 This statutory priority effectively lifted the Commissioner's claim, in a winding up process, to outstanding pay-as- you-earn (PAYE) liabilities ahead of some secured creditors and employee's claims for wages and other entitlements as well as unsecured creditors. It was removed in part on the basis that the Commissioner's priority was seen as unfair to employees and other unsecured creditors who had to wait until any outstanding PAYE liabilities were paid before their claims could be considered.

3 Australian Law Reform Commission, Report No 45, *General Insolvency Inquiry*, ALRC 45, (AGPS, Canberra, 1988), para 733-741.

4 Second Reading Speech, Hansard, Senate, 19 May 1993 at pp 879, 880.

5 Explanatory Memorandum, Tax Laws Amendment (Transfer of Provisions) Bill 2010, [1.8]-[1.9].

6 Treasury (Cth), 'Action against Fraudulent Phoenix Activity' (Proposals Paper, Treasury, Australian Government, November, 2009).

7 Treasury (Cth), 'Action against Fraudulent Phoenix Activity' (Proposals Paper, Treasury, Australian Government, November, 2009) 5–6; Bill Shorten, 'Protecting Employee Super and Strengthening the Obligations of Company Directors' (Media Release, No 138, 13 October 2011).

8 Treasury (Cth), 'Action against Fraudulent Phoenix Activity' (Proposals Paper, Treasury, Australian Government, November, 2009, 2.

9 Ibid, 1.1.

The need to deter fraudulent phoenix activities resulted in the most recent, significant changes to the director penalty regime which were introduced by the *Tax Laws Amendment (2012 Measures No. 2) Act 2012* (Cth) and the *Pay As You Go Withholding Non-compliance Tax Act 2012* (Cth) on 29 June 2012. These Acts made legislative amendments to the directors' penalty provisions in Division 269 of Schedule 1 to the TAA and associated measures were enacted. The changes generally apply from 30 June 2012. As a result of these changes, the Commissioner's powers regarding the director's penalty regime have broadened.[10] Whilst these changes were enacted so as to deter fraudulent phoenix activities, the auxiliary effect is that the scope of director's personal liability has expanded to encompass all directors who fail to meet PAYG withholding and SGC obligations.[11] Three principal changes were given effect by the 2012 amendments including a more limited ability to have director penalties remitted, director penalties in relation to unpaid SCG and the introduction of a PAYG withholding non-compliance tax for directors and certain associates.

THE CURRENT DIRECTOR PENALTY REGIME

Liability to Remit Taxes

The system of withholding PAYG deductions from the salary or wages of an employee, for the purpose of remitting those deductions to the Commissioner on behalf of the employee, is provided for in Division 12 of Schedule 1 to the TAA 1953. Section 12-35 provides:

> "An entity must withhold an amount from salary, wages, commission, bonuses or allowances it pays to an individual as an employee (whether of that or another entity)."

The requirement to remit those monies to the Commissioner is contained in Subdivision 16-B. Section 16-70(1) TAA 1953 provides:

> "An entity that withholds an amount under Division 12 must pay the amount to the Commissioner in accordance with this Subdivision."

Under Division 268 in schedule 1 of the TAA, the Commissioner may make an estimate of the unpaid and overdue amount of unremitted PAYG withholding and SGC amounts.[12] The amount of the estimate must be what the Commissioner thinks is reasonable.[13] The Commissioner must give to the employer written notice of the estimate[14], and the amount of the estimate becomes due and payable upon that notice being given.[15]

Part 3 of the *Superannuation Guarantee (Administration) Act 1992* provides an obligation on an employer to pay SGC.[16] Section 16 of the *Superannuation Guarantee (Administration) Act 1992* provides:

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10 The Tax Laws Amendment (2012 Measures No 2) Bill *2012* (Cth).

11 Explanatory Memorandum, Tax Laws Amendment (2012 Measures no. 2) Bill (2012) 3; Treasury (Cth), 'Action against Fraudulent Phoenix Activity' (Proposals Paper, Treasury, Australian Government, November, 2009.

12 Section 268-10(1) TAA.

13 Section 268-10(1) TAA.

14 Section 268-15 TAA.

15 Section 268-20(1) TAA.

16 Superannuation Guarantee (Administration) Act 1922 (Cth) Pt 3.

> "Superannuation guarantee charge imposed on an employer's superannuation guarantee shortfall for a quarter is payable by the employer."

These provisions create a liability upon the company to remit taxes to the Commissioner and are at the centre of the director penalty regime in Division 269.

The Object of Division 269

The relevant object of Division 269 is stated in section 269-5 of the TAA:

> The object of this Division is to ensure that a company either:
>
> (a) meets its obligations under:
>
> (i) Subdivision 16-B (obligation to pay withheld amounts to the Commissioner); and
>
> (ii) Division 268 (estimates of PAYG withholding liabilities and superannuation guarantee charge); and
>
> (iii) Part 3 of the Superannuation Guarantee (Administration) Act 1992 (obligation to pay superannuation guarantee charge); or
>
> (b) goes promptly into voluntary administration under the Corporations Act or into liquidation.

This objective is achieved by imposing personal liability on directors of companies that do not either meet their obligations or promptly go into administration or liquidation.[17]

Scope of Division 269

Division 269 applies if on a particular day (**the initial day**), a company withholds an amount under section 12-35, receives an alienated personal services payment, provides a non-cash benefit or is given a notice of an estimate under Division 268 and the company is obliged to pay that amount to the Commissioner on or before a particular day (**the due day**).[18] Division 269 also applies if on a particular day (the initial day), a quarter ends and the company is obliged to pay the SGC for the quarter in accordance with the *Superannuation Guarantee (Administration) Act 1992*, on or before a particular day (the due day).[19]

The due day for amounts withheld under section 12-35 is dependent upon the size of the withholder.[20] In relation to alienated personal services payments, non-cash benefits and estimates under Division 268, the due day is the same as the initial day.[21] The company's SGC for a quarter under the *Superannuation Guarantee (Administration) Act 1992* is treated as being payable on the day by which the company must lodge a superannuation guarantee statement for the quarter under section 33 of that Act, even if the charge is not assessed under that Act on or before that day.[22]

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17 Section 269-5 TAA; Practice Statement Law Administration (PS LA) 2011/18, para 47.
18 Section 269-10(1) TAA, Items 1-4.
19 Section 269-10(1) TAA, Item 5.
20 Section 16-75 TAA.
21 Section 269-10 TAA, Note.
22 Section 269-10(3) TAA.

Director's Obligations

Section 269-15 of Schedule 1 to the TAA provides that the directors (within the meaning of the Corporations Act)[23] of the company (from time to time) on or after the initial day (the day when the company 'withholds an amount') [24] must cause the company to comply with its obligation.[25] The director's obligation to cause the company to meet its obligation to pay a PAYG withholding or SGC liability commences from the time an amount is withheld or the end of the SGC quarter respectively.[26] The directors of the company (from time to time) continue to be under their obligation until:[27]

- the company complies with its obligation; or
- an administrator of the company is appointed under section 436A, 436B or 436C of the Corporations Act; or
- the company begins to be wound up.

Imposition of a Penalty

The effect of section 269-20 is that if, at the end of the due day, the directors of a company are still under an obligation imposed by section 269-15, a person who was under such an obligation at or before that time is liable to pay to the Commissioner a penalty equal to the unpaid amount of the company's liability.[28] The penalty is due and payable at the end of the due day.

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 if an arrangement that covers the company's obligation is in force under section 255-15 (Commissioner's power to permit payments by instalments).[29] However, if the company enters into a repayment agreement with the Commissioner, a director's obligation to cause the company to comply with its obligation, and subsequent penalty for failure to do so, is not removed or remitted. Rather, that obligation remains and the Commissioner is simply unable to collect the money or penalty while an instalment agreement is in place.[30]

There is clear authority that the legislation is intended to apply to retired directors of the company.[31] In the case of *Deputy Commissioner of Taxation v Power* [2012] NSWSC 995, Johnson J considered the operation of sections 269-15 and 269-20 and stated that a director will become

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23 The term "director" also includes defacto or shadow directors. *Deputy Commissioner of Taxation v Solomon; Deputy Commissioner of Taxation v Muriwai* (2003) 199 ALR 325; *DCT v Austin* (1998) 39 ATR 485; Markovic M, 'When Are You a Director When You're Not a Director? The Law of De Facto Directors' (2007) 25 *Company and Securities Law Journal* 101.

24 Section 269-10(1) TAA.

25 Section 269-15(1) TAA.

26 *Simpson v Deputy Federal Commissioner of Taxation* (1996) 132 FLR 459.

27 Section 269-15(2) TAA.

28 Sections 269-20(1) and 269-20(2) TAA.

29 Section 269-15(3) TAA. Prior to 1 July 2010, the Commissioner had specific powers to enter into payment agreements with companies under section 222ALA in Division 8 of the ITAA 1936. That section (along with the rest of Division 8) has been repealed. From 1 July 2010, any payment arrangements must be made under section 255-15 of Schedule 1 to the TAA.

30 Sections 269-25(1) and 269-15(3) TAA.

31 For example, see *DCT v Solomon* (2003) 52 ATR 279 at [9-11]; *Fitzgerald v DCT* (1995) 68 ATR 770; *Canty v Deputy Commissioner of Taxation* [2005] NSWCA 84.

liable to a penalty if, at the end of the due day, the company has not complied with its obligations, and that person was under an obligation to cause the company to comply by reason of having the status of director *"at any time prior to the due day"*.[32] He went on to say that "*Accordingly, a proper construction of the legislation indicates that the obligation is indeed a continuing one, and that it survives any renunciation of directorial duty*."[33] One commentator suggests that personal liability may linger for some time for retired directors as the state and territory limitation actions may not apply to a penalty recoverable under a director penalty notice (DPN).[34]

There is also clear authority that the provisions apply to directors that are appointed for a short time and to new directors appointed after the due date for remission has passed.[35] In *Fitzgerald v DCT* (1995) 68 ATR 770, a director was held to be liable even though he was only appointed for a period of 17 days, and at a time after amounts for unremitted prescribed payment deductions were due and payable by the company. French J made the following comments in relation to the liability of a new director:

> "The provisions providing for penalties for directors pursuant to Division 9 have been in force since July 1993 so that 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 were any moneys owing by the company to the respondent. If there was evidence to suggest that upon such inquiry a director was not given the correct information then it may be that he would be able to establish a defence to the respondent's claim for penalty. However there is nothing in the affidavit material before me that suggests that this has occurred in this case."[36]

As a result of the 2012 amendments new directors are given a 30 day period in which to comply with their obligation under section 269-15.[37] In the case of new directors, the penalty is due and payable at the end of that 30th day.[38] This provides new directors with a slightly longer period (prior to the 2012 amendments the period was 14 days) in which to make the relevant inquiries in relation to the tax affairs of the company and to act accordingly.

Formal Notice Requirements

The Commissioner must not commence proceedings to recover the penalty until the end of 21 days after the Commissioner gives notice of the penalty.[39] The notice must set out what the Commissioner thinks is the unpaid amount of the company's liability, state that the director is liable to pay to the Commissioner, by way of penalty, an amount equal to that unpaid amount because of an obligation that the director has or had under Division 269 and explain the main circumstances in which the penalty will be remitted.[40] A single notice may relate to two or more penalties.[41] A notice is taken to be given at the time the Commissioner leaves or posts it.[42]

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32 *Deputy Commissioner of Taxation v Power* [2012] NSWSC 995 at 364.

33 Ibid.

34 Matthew Broderick, 'Company Directors: Federal Taxation Liabilities and Obligations When Nearing Insolvency – Part 1' (2009) 38 *Australian Tax Review* 12.

35 *Deputy Commissioner of Taxation v George* [2002] NSWCA 336.

36 *Fitzgerald v DCT* (1995) 68 ATR 770 at 359.

37 Section 269-20(3) TAA; *Fitzgerald v DCT* 68 ATR 770 at 772.

38 Section 269-20(4) TAA.

39 Section 269-25(1) TAA.

40 Section 269-25(2) TAA.

41 Section 269-25(3) TAA.

42 Section 269-25(4) TAA. This is despite section 29 of the *Acts Interpretation Act 1901*.

The Commissioner may give notice under section 269-25 by leaving the DPN 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, the director's place of residence or business.[43] The Commissioner may also give a copy of a DPN to a director's registered tax agent by leaving the copy at or posting the copy to the address of the registered tax agent.[44] It is considered that a tax agent would have the professional knowledge to advise the director of the importance of the notice and the actions the director can take.[45]

A considerable amount of litigation in relation to the director penalty regime has concerned the validity of notices served by the Commissioner, particularly in relation to the former regime in the ITAA 1936. In the majority of these cases the Commissioner has been successful and the notices have been held to be valid. In the recent case of *Power v Deputy Commissioner of Taxation* [2013] NSWCA 428, a DPN did not state, in express terms, that the director's liability was because of an obligation that he had under Division 269. The question was whether that is a critical element of the requirement of section 269-25(2)(b). In the New South Wales Court of Appeal, Emmet JA referred to *Deputy Commissioner of Taxation v Woodhams* [2000] HCA 10 where the High Court identified two purposes of a section 222AOE notice (predecessor to section 269-25).[46] The first was to inform the recipient of the unpaid amount of a company's liability and of the recipient's liability to a penalty in the same amount. The second was to inform the recipient of the alternative courses available which would result in remission of the penalty.[47] The New South Wales Court of Appeal held that the giving of the notice to the director fulfilled the legislative purpose of section 269-25 and accordingly, the fact that the notice did not expressly state the source of the obligation did not render the notice invalid.[48]

Prior to the introduction of Division 269, there was considerable ambiguity in relation to the issue of when the notice was "given" under the former section 222AOE and upon non-delivery of a notice.[49] Section 269-25(4) provides that the notice is 'taken to be given' upon the Commissioner leaving it at or posting it to the address of the director. The operation of this provision was recently considered in *Roche v Deputy Commissioner of Taxation* [2014] WASCA 194 where Newnes JA stated that:

> "Section 269-25(4) provides that the notice is 'taken to be given' upon the Commissioner leaving it at or posting it to the address of the director. The clear intention is that the act of leaving or posting the notice constitutes the giving of the notice to the intended recipient

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43 Section 269-50 TAA.

44 Section 269-52(2) TAA.

45 Australian Taxation Office, PS LA 2011/18, para 49.

46 *Deputy Commissioner of Taxation v Woodhams* [2000] HCA 10 at 34.

47 *Power v Deputy Commissioner of Taxation* [2013] NSWCA 428 at 48.

48 *Power v Deputy Commissioner of Taxation* [2014] HCA 198; The decision of the Court of Appeal is plainly right.

49 *Deputy Commissioner of Taxation v Meredith* [2007] NSWCA 354 held that the date upon which a DPN was "*given*" for the purpose of section 222AOE on the date it was posted. The decision in *Meredith* was overruled in *Soong v Deputy Commissioner of Taxation* [2011] NSWCA 26. The Court unanimously held that a DPN was "*given*" under section 222AOF for the purposes of section 222AOE when it was delivered rather than, as held in *Meredith*, when it was posted. Special leave to appeal to the High Court from the decision in *Soong* was refused on 12 August 2011. In response to the decision in *Soong*, on 29 November 2011 the Commonwealth Parliament enacted the *Tax Laws Amendment (2011 Measures No. 7) Act 2011* (Cth) (the *2011 Act*) which inserted Schedule 7 into the *1953 Act* to overcome the decision in *Soong* and to reinstate the *Meredith* decision.

> for the purposes of section 269-25(1). Upon the leaving or posting of the notice the requirements of section 269-25(1) have been met. The obvious purpose is to avoid any question as to the time of delivery or any issue of non-delivery of the kind now sought to be raised by the appellant and which might otherwise be open under section 29(1) of the Acts Interpretation Act."[50]

Accordingly, a DPN is effective at the time that the Commissioner posts the notice, regardless of whether delivery actually occurs or how long the notice takes to get delivered. The risk that the DPN may be lost in the postal system is placed upon the director.

Remittance of a Penalty

Where a PAYG withholding or SGC liability is reported within three months of the liability's due date for lodging a return,[51] remission of the relevant penalty will occur if payment is made or if the company is placed into administration or liquidation before a DPN is issued or within 21 days of the DPN being given. However, if the PAYG withholding or SGC liability is not reported within three months of the due date for lodging a return then remission of the penalty relating to the unreported amount will not occur after that three month period if the company is placed into administration or liquidation before a DPN is issued or during the 21 day period following the DPN being given.[52] The only manner in which remission can occur in this case is if payment is made.

Prior to 29 June 2012 legislative amendments directors were able to avoid the penalty provisions by seeking to appoint a liquidator or administrator within 21 days of the DPN being given, leaving the Commissioner unable to recover against directors personally. However, the defence provided by section 269-30 in schedule 1 of the TAA has been qualified by section 269-30(2).[53] The recent case of *Deputy Commissioner of Taxation v Roche* [2014] WASC 222 held that if the company had debt outstanding on 29 June 2012, and that debt had not been reported to the Australian Taxation Office (ATO) within 3 months of the due date, then as at 29 June 2012, the remittance options available to directors in respect of the director penalty are reduced to one (being payment).[54] Sanderson J stated that "*the removal of the remission provision simply means a process which could have led to the termination of the obligation is no longer available. The obligation remains. There has been no change to the status of the director because an obligation which existed continues to exist.*" Accordingly, a director who could have secured the remission of a penalty by causing one of the things specified in section 269-15(2) to occur before being served, or within 21 days of being served with a DPN would cease to be able to do so. This is a considerable increase in the personal liability of directors for past events.

As a result of the 2012 amendments, the provisions concerning remittance of a penalty for new directors have changed. For a director appointed after the due date for lodging a return of the company's PAYG withholding or SGC liability any penalty relating to an unreported liability will be remitted if the company is placed into liquidation or administration within three months after

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50 *Roche v Deputy Commissioner of Taxation* [2014] WASCA194 at 279.

51 For the purposes of Division 269 of Schedule 1 to the TAA the company's SGC for a quarter is treated as being payable on the day by which the company must lodge a superannuation guarantee statement for the quarter under section 33 of the SGAA.

52 Section 269-30(2) TAA.

53 Section 2 and Division 3 of Part 1 in Schedule 1 of the *Tax Laws Amendment (2012 Measures No 2) Act 2012* (Cth).

54 *Deputy Commissioner of Taxation v Roche* [2014] WASC 222 at 38.

the day the person became a director, regardless of how long the company has been liable for the debt. After this three month period the penalty will not be remitted should the company go into liquidation or administration. However, if the liability was reported within the three month period starting after the day the person was appointed director, the penalty would be remitted if liquidation or administration commenced before a DPN is issued or within 21 days of such a notice being given.[55]

Defences

There are three defences to a DPN which are discussed below.[56] The current legislation allows defences to be raised within 60 days from notification.[57] The penalty will not be payable if the information is provided in the time required and the Commissioner is satisfied that the director's circumstances meet one of the statutory defences.[58] Whether a director is able to satisfy the requirements to make out a statutory defence will depend on the facts of each case.[59] A director who is dissatisfied with the Commissioner's decision to reject the defence on the basis that the statutory defence has not been made out may request a statement of reasons relating to that decision under section 13 of the *Administrative Decisions (Judicial Review) Act 1977* (ADJR Act).[60] They may also elect pursuant to section 5 of the ADJR Act to make an application to the Federal Court or Federal Magistrates Court to seek a review of the decision.

Illness

Firstly, section 269-35(1) provides a defence in the proceedings against a director if it is proved that, because of illness or for some other good reason, it would have been unreasonable to expect the director to take part, and the director did not take part, in the management of the company "at any time" when they were a director of the company and the directors were under the relevant obligations under section 269-15.[61] As a result of the 2012 amendments this defence is now more difficult to establish as it now includes an objective element.[62]

The case of *Deputy Commissioner of Taxation v George* (2002) 55 NSWLR 511 considered the operation of this defence under the predecessor provisions in the ITAA 1936. In that case, a company failed to comply with its obligations to remit PAYE deductions to the Commissioner. The director did not participate in the management of the company between September 1996 and June 1999 as during the time he was an acting judge. The director argued that he fell within this defence as there was a good reason for him not to take part in the management of the company during the period due to the perception that the role as an acting judge required of him. The trial judge found the director had not taken part in the management of the company for a period from September 1996 to June 1999 for "good reason" pursuant section 222AOJ(2) (former section 269-35(1)), and was therefore liable to a penalty only in respect of the period after June 1999. The Deputy Commissioner appealed the trial judge's decision. The New South Wales Court of Appeal

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55 Section 269-30(3) TAA.
56 Div 269-35 TAA.
57 Section 269-35(4A) TAA.
58 Australian Taxation Office, PS LA 2011/18, para 57.
59 Ibid, para 61.
60 *Ruddy v DCT* (1998) 82 FCR 337.
61 Section 269-35(1) TAA.
62 Section 269-35(2) TAA; Matthew Broderick, 'Legislative Change to Director Penalty Notices and Security for Tax Payments' (2011) 40 *Australian Tax Review* 63.

held, allowing the appeal, that this defence can only succeed if the illness or other good reason continues for the whole of the time the director is in office and the obligation to comply with section 269-15 continues. Gzell J considered the meaning of the words “at any time” in the predecessor to s269-35(1):[63]

> “The words "at any time" in section 222AOJ(2) related to the period when a person was a director and the directors were under an obligation to comply with section 222AOB(1). That means, in my view, that the director had to establish good reason for non-participation in the management of the company throughout the period the person was a director and the directors were under a section 222AOB(1) obligation. The defence was not enlivened merely because on one or more discrete occasions during that entire period the director had good reason not to participate in the management of the company. The requirement was that a director did not take part in management at any time. That requirement was not satisfied if there was participation on one or more occasions. No participation at any time meant non-participation at all times. The submission of the respondent does not give weight to the negative requirement. In my view, a director who established that at some time during the directorship when under a section 222AOB(1) obligation, there was good reason for non-participation in the management of the company, did not gain a defence to a penalty under section 222AOC or section 222AOD based on an obligation continued by section 222AOB(3) at a time when there was no continuing defence.”

The director was therefore liable to pay the penalty as calculated over the entire period of the company's breach. Accordingly, the non-participation defence is only available if a director establishes good reason for failing to take part in the management of the company for the entire period when they are under an obligation under section 269-15. This makes it extremely difficult for a director to rely upon this defence.

All Reasonable Steps

Secondly, section 269-35(2) provides a defence in the proceedings against a director if it is proved that the director took all reasonable steps to ensure that the directors complied with their relevant obligations under section 269-15 or there were no such steps that they could have taken.[64] That is, the director took all reasonable steps to ensure that:

- payment was made; or
- an administrator of the company was appointed under section 436A, 436B or 436C of the Corporations Act; or
- the company began to be wound up.

The defence requires demonstration, in respect of all of the options in section 269-15, that all reasonable steps have been taken or that there are no steps that the director could have taken.[65] In determining what reasonable steps could have been taken, regard must be had to when, and for how long, the director took part in the management of the company as well as all other relevant circumstances.[66] In the case of a director who was a director at the time when the tax liability was incurred by the company, it is necessary to consider whether the defences are

63 *Deputy Commissioner of Taxation v George* (2002) 55 NSWLR 511 at 517 at 21-26.

64 Section 269-35(2) TAA.

65 *Miller v Deputy Commissioner of Taxation* (1997) 26 ACSR 533, 538; (1998) 98 ATC 4059; *Canty v Deputy Commissioner of Taxation* [2005] NSWCA 84 [33] (Handley JA; Beazley JA agreeing).

66 Section 269-35(3) TAA.

established for the whole of the period between the due date and the expiry of the notice.[67] In *Canty v Deputy Commissioner of Taxation* [2005] NSWCA 84 Handley JA addressed this issue and said:[68]

> "Proof that nothing could have been done at various times during this period would not establish that nothing could have been done at other times. Proof that the person took all reasonable steps at various times would not establish that he or she took all reasonable steps."

The length of the action period will, however, also be a relevant consideration.[69]

The case of *DCT v Saunig* [2002] NSWCA 390, demonstrates the difficulty in establishing this defence. In this case, a director was served a notice of penalty pursuant to the predecessor of section 269-25 for failure to remit PAYG withholding amounts. The director argued that he fell within this defence as when he had learnt that management had failed to remit PAYG withholding amounts to the ATO, he acted to make payments of these unremitted amounts to the Commissioner and contacted the ATO in an attempt to reach an agreement as to payment. The trial judge found that the director had taken all reasonable steps to ensure that the company complied with its obligations. The Commissioner appealed the decision of the trail judge and the New South Wales Court of Appeal overturned this decision and held that the appellant's "*conduct must be judged not only by reference to what he knew but also by reference to what he ought to have known. He ought to have known ... that the ... deduction payments ... were not being passed on to the Taxation Office*".[70] The Court of Appeal held that a reasonable director would have sought legal advice from a lawyer or practical advice from an accountant at an earlier point in time, which may have encouraged the other directors to comply or alternatively would have resulted in the director winding up the company in his capacity as a director.[71] The court held that it was open to the director acting alone to cause the company to take the third step contemplated by the predecessor to section 269-15(2)(c), namely to cause the company to "begin to be wound up" within the meaning of the Corporations Act.[72] Accordingly, the director did not make out the defence and was found liable for his failure to remit PAYG withholding amounts.

In *Deputy Commissioner of Taxation v Roche* [2014] WASC 222, a director was prosecuted for failure to remit PAYG withholding amounts. The case involved a director who was attending university and did not attend the company's premises or review its affairs 'on a day to day basis'. The director said that he had regular discussions with his father concerning the company's affairs and periodic meetings with his father and the company's financial controller. From time to time he was shown cash flow projections for the company and provided with an explanation of the company's outstanding liabilities, its expected expenses and expected revenue. He also saw some cash flow projections but appeared not to have considered these in detail. The Western Australia Supreme Court held that the director was liable for unpaid PAYG withholding amounts despite the fact that he had limited involvement in the company's activities. The Court made the following comments regarding the director's involvement with the company:

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67 *Canty v Deputy Commissioner of Taxation* [2005] NSWCA 84 at 42, 45.

68 Ibid at 46.

69 *Canty v Deputy Commissioner of Taxation* [2005] NSWCA 84 at 42, 45.

70 *DCT v Saunig* [2002] NSWCA 390 at 28 per Heydon JA; also see *D C of T v Solomon* (2003) 199 ALR 325, 335 per Gzell J.

71 *DCT v Saunig* [2002] NSWCA 390 at 37. Also see, *Deputy Commissioner of Taxation v Roget* [No 2] [2014] WADC 25.

72 *DCT v Saunig* [2002] NSWCA 390 at 32.

> "What is striking about the evidence of the defendant is its lack of detail. Presumably it reflects the level of his involvement with the day to day operations of the company. Clearly then he knew little of what was happening and how the company was placed financially. He appears to have been what is sometimes called a 'sleeping director'. Being a sleeping director is a very dangerous pastime."

The Court ruled that the non-involvement in the company's affairs did not reduce the director's liability. Therefore, he was found liable for his failure to remit PAYG withholding amounts. Further, there was no evidence of steps that he had taken to cause the company to pay its obligations, meaning that he did not satisfy any of the defences from personal liability under the director penalty regime.

In *Fitzgerald v DCT* (1995) 68 ATR 770, the appellant was a director for only 17 days, and at a time after amounts for unremitted prescribed payment deductions were due and payable by the company. The Commissioner served a notice of penalty on the director pursuant to the predecessor to section 269-25 and subsequently obtained summary judgment for payment of the penalty. On appeal the director argued that he could satisfy this defence as he did not take part in the management of the company, was not aware of the tax debt until he ceased being a director and he was not in a position to take reasonable steps to ensure payment. It was held that, even though it seemed harsh, the legislation clearly provided that the liability of a new director arose after the expiration of 14 days after the director's appointment (this has been extended to 30 days under section 269-20(3)). The fact that the appellant was not aware of the existence of the tax debt did not suggest that there were no reasonable steps that could have been taken to ensure compliance with the relevant provisions. French DJC explained:

> "Although it is clear that the appellant was not aware of the company's failure to comply with the provisions of section 222AQOB there is nothing in the affidavit material before me that would suggest that he may have a defence to the respondent's claim. Although he was only a director for a period of 17 days there is nothing to suggest that he did not take part in the management of the company. Although he was not aware of the company's financial position or the moneys due to the respondent this is not sufficient to provide a defence."

In *Canty v Deputy Commissioner of Taxation* [2005] NSWCA 84 the New South Wales Court of Appeal suggested that in order to fall within this defence, a former director would have to make an urgent application to the Court for a winding up in the capacity of a shareholder or creditor. The Court explained that:

> "the former director will be a contingent or future creditor because of the right of indemnity against the company for the penalty the Commissioner is seeking to recover. In that capacity he or she is entitled to make an urgent application for a winding up order (See now Corporations Act s 462(1)(b), (4)). A company which cannot pay its group tax over many weeks is prima facie insolvent."

Accordingly, from the time new and former directors of a company become under a relevant obligation under section 269-15, they will need to take active steps to ensure that the company is placed into voluntary administration or wound up in order to escape liability.

Defence specific to penalty related to SGC

Thirdly, section 269-35(3A) provides a defence in the proceedings against a director if the company applied the relevant legislation in a particular way that was "reasonably arguable" in regards to a SGC.[73] The term 'reasonably arguable' is defined in section 995-1(1) of the *Income Tax Assessment Act 1936* (Cth) to have the meaning given by section 284-15 of Schedule 1 to the TAA. A matter is reasonably arguable 'if it would be concluded in the circumstances, having regard to relevant authorities, that what is argued for is about as likely to be correct as incorrect, or is more likely to be correct than incorrect'. The Commissioner's practice statement provides that this definition provides a suitable standard for the purposes of the defence.[74] Exercising reasonable care means making a reasonable attempt to comply with the relevant law. The effort required is one commensurate with all the taxpayer's circumstances, including the taxpayer's knowledge, education, experience and skill.[75] Accordingly, this defence is most likely to be relied upon in those cases where there may uncertainty about superannuation guarantee liabilities, in respect of whether particular workers are entitled to superannuation.[76]

Section 1318

Section 1318 of the Corporations Act does not apply to an obligation or liability of a director.[77] Accordingly, a director cannot be relieved from an obligation or liability under Division 269 on the grounds of honest and reasonable conduct.

Estoppel

It is possible for a director to raise a defence of estoppel. In *Federal Commissioner of Taxation v Winters* (1997) 97 ATC 4967 two directors successfully argued that summary judgement should not be made against them on the basis that during negotiations with the ATO after receiving the DPN, they had been given reason to believe that time for compliance with the DPN would be extended. They argued that they had therefore been induced not to appoint an administrator within the 14 day period of the notice (under the former director penalty provisions) and that the Commissioner should be prevented from taking advantage of that failure. In giving leave to the directors to defend, Moynihan J took the view that, if the factual issues were resolved in the defendant's favour, they were capable of making out the elements founding an estoppel.[78] This can be contrasted with the recent case of *Deputy Commissioner of Taxation v Roche* [2013] WASC 302 where the court held that the elements of an estoppel by representation could not be made out because the Deputy Commissioner had expressly rejected the director's payment proposal relating to the DPN.

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73 Div 978-025 TAA.

74 Australian Taxation Office, PS LA 2011/18, para 64. For further discussion on the meaning of reasonably arguable refer to Miscellaneous Taxation Ruling MT 2008/2 *Shortfall penalties: administrative penalty for taking a position that is not reasonably arguable*.

75 Australian Taxation Office, PS LA 2011/18, para 65; For further discussion on the meaning of reasonable care refer to Miscellaneous Taxation Ruling MT 2008/1 *Penalty relating to statements* : *meaning of reasonable care, recklessness and intentional disregard* .

76 Australian Taxation Office, PS LA 2011/18, para 63.

77 Section 269-35(5) TAA; *DCT v Dick* (2007) 67 ATR 762 has been legislated.

78 Also see the recent case of *Deputy Commissioner of Taxation V Roget* [No 2] [2014] WADC 25 (27 February 2014) the Court held that the defence of estoppel raised by the defendant was a matter which the Court considered should proceed to trial.

Effect of Director Paying Penalty or Company Discharging Liability and Director's Rights of Indemnity and Contribution

The DPN liabilities of directors are parallel liabilities and the Commissioner may seek from any one or more of the directors for the sum up to a total amount of the company liabilities.[79] Before determining which director or directors to pursue, the Commissioner will have regard to a number of factors, including each director's capacity to pay and the relative merits of any defences that may be available to them.[80] Under section 269-40(2), if an amount is paid or applied at a particular time towards discharging a company's liability under its obligation to pay an amount to the Commissioner on the due day, each director's liability to pay a penalty under Division 269 in relation to the company's liability, if still in existence at that time, is discharged to the extent of the amount so paid or applied. Further, section 269-45 confers on a director who pays a penalty the same rights, by way of indemnity, subrogation, contribution or otherwise, against the company or anyone else, as if the director made the payment under a guarantee of the company's liability.

Non-compliance tax

As a result of the 2012 amendments to the director penalty regime, directors (and their associates) who are entitled to a credit attributable to a payment made by a company that has failed to pay amounts withheld under PAYG withholding to the Commissioner, can be liable to pay a new PAYG withholding non-compliance tax.[81] This tax effectively reverses any PAYG credit to which the director was entitled. The Commissioner must not commence proceedings to recover the PAYG withholding non-compliance tax (or any related GIC) until a written notice is given to the individual.[82] The Commissioner must not give a notice if, at that time, the individual (or the director to which a non-director individual is associated) is liable to pay a director penalty under Division 269 of Schedule 1 to the TAA because of the company's failure to pay PAYG withholding for the income year to which the PAYG withholding non-compliance tax relates.[83]

Further, a notice may only be given if the Commissioner is satisfied, on the basis of information available to the Commissioner, that it is fair and reasonable for the individual to pay PAYG withholding non-compliance tax in relation to the company for the income year.[84] When considering whether it is fair and reasonable for the individual to pay PAYG withholding non-compliance tax, regard will be given to the object of the tax which is to reverse the economic benefit of a PAYG withholding credit that an individual is entitled to where the credit relates to unpaid PAYG withholding of the company.[85] The Commissioner's practice statement discusses other factors that may be relevant in determining whether it is fair and reasonable to issue a notice as well as when liability will extend to an associate.[86]

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79 Australian Taxation Office, PS LA 2011/18, para 67.
80 Australian Taxation Office, PS LA 2011/18, para 67.
81 TAA, Schedule 1, Subdivision 18-D, Part 2-5.
82 TAA, Schedule 1, s 18-140(1).
83 TAA, Schedule 1, s 18-140(3).
84 TAA, Schedule 1, s 18-140(2).
85 Australian Taxation Office, PS LA 2011/18, para 79.
86 Ibid, para 79.

INTERACTION WITH THE *BANKRUPTCY ACT 1966* (CTH)

The director penalty regime can ultimately lead to bankruptcy proceedings by directors. In order to enforce the judgement debt, after an act of bankruptcy has occurred, the Commissioner will commence bankruptcy proceedings against the director in the Federal Court of Australia by way of creditor's petition. At the hearing of a creditor's petition the Court shall require proof of the matters stated in the petition, service of the petition and the debt on which the petitioning creditor relies is still owing.[87] If the Court is not satisfied with the proof of any of those matters, or is satisfied by the debtor that he or she is able to pay his or her debts or that for other sufficient cause a sequestration order ought not to be made, it may dismiss the petition.[88]

In the case of *DCT v Soong* [2013] FCCA 2106, the Deputy Commissioner presented a petition in April 2012 seeking a sequestration order against the estate of Mr. Soong. In the petition the Commissioner claimed that Mr. Soong owed the Commissioner the amount of $106,960.00. The act of bankruptcy claimed by the Commissioner was the debtor's failure to comply with the requirements of a bankruptcy notice.

The matter was adjourned on several occasions during which time DPNs were sent to Mr Soong in respect of the PAYG withholding liabilities of two companies of which he was a director. Post presentation of the petition, the Commissioner issued a further ten DPNs to Mr Soong on separate occasions. The sum of $443,076.00 was owing to the Commissioner under the DPNs at 5 November 2013. On the seventh occasion the matter came to court, a bank cheque, said to be a gift from the debtor's brother to him in the amount claimed in the petition, was produced to the court. It was intended that the bank cheque be tendered in full payment of the amount due under the petition. However, the Commissioner indicated that he would be inclined to reject the tender unless it was accepted by Mr Soong that the moneys represented by the bank cheque could be utilised pursuant to the sections 8AAZL, 8AAZLB and 8AAZLE of the TAA against the debts of Mr Soong to pay the director penalties first. The statutory regime of section 8AAZL of the TAA permits the Commissioner to allocate funds paid to him amongst the various tax debts of a taxpayer at his discretion. The Commissioner is not required when doing this to take account of any instructions of the taxpayer.[89]

Mr Soong argued that upon the tender being made the court should exercise its discretion under section 52(2) of the *Bankruptcy Act 1966* (Cth) to dismiss the petition on the grounds that the court should be satisfied that for 'other sufficient cause' a sequestration order ought not be made. One of the questions the court considered was whether by restricting the payment to the debt contained in the petition Mr Soong was attaching a condition to the tender, which would invalidate it as a tender. The court determined that in the context of the statutory rights of the Commissioner to apply the money that the Mr Soong was providing an instruction to the Commissioner that would have the same effect as a condition. Accordingly, as a conditional tender is no tender Mr Soong's claim that the debt would be extinguished by it could not be maintained.

The court referred to a number of authorities in the Federal Court of Australia indicating that a refusal to accept a tender of the full amount of the debt in a creditor's petition does not constitute "other sufficient cause" within the meaning of section 52(2)(b) of the Bankruptcy Act

87 Section 52(1) *Bankruptcy Act 1966* (Cth).
88 Section 52(2) *Bankruptcy Act 1966* (Cth).
89 Section 8AAZLE TAA.

1966. Further, the court held that there was no extortion by the Commissioner in these circumstances that could be considered "other sufficient cause" as the petition was not issued for any collateral purpose or to obtain the payment of any moneys not otherwise payable from the Commissioner. In making this determination, the court considered the Commissioner's legitimate concerns about Mr Soong's solvency and that the taxation liability sought in the creditor's petition was an old debt. Accordingly, the court did not exercise a discretion under s52(2) of the Bankruptcy Act 1966 to dismiss the petition, even though a bank cheque was tendered in the full sum of the petitioned debt. The court dismissed the notice of opposition and Mr Soong applied the decision in the Federal Court of Australia where Jacobson J refused to grant leave to appeal. Ultimately, the matter came back to the Federal Circuit Court of Australia where the sequestration order was made against Mr Soong's estate.

COMBATTING PHOENIX ACTIVITY

The 2012 amendments to the director penalty provisions were aimed at addressing the mounting revenue losses caused by phoenix activity in Australia.[90] The Proposals Paper estimated losses to taxation authorities due to phoenix activities to run into the hundreds of millions of dollars.[91] Pheonix activity significantly impacts on employees who are not paid their entitlements and creates deficiencies in retirement, thereby threatening the wider economy.[92] A press release in 2011, accompanying the draft legislation, estimated that there were 6000 phoenix companies in Australia.[93] Accordingly, it is clear that phoenix activities present a significant risk to the revenue. Further, if phoenix activities are not dealt with by the imposition of harsh penalties, this can have a broader impact on tax compliance. The literature suggests that the perceived level of tax evasion by other taxpayers is one of the factors that can cause taxpayers to be less likely to comply with their tax obligations.[94] This may lead to decreased tax collections due to impacts on taxpayer morale and propensity to comply which could potentially undermine the integrity of Australia's tax system.

The ATO's most recent Annual Report states that "we continued to target fraudulent phoenix activity as part of a whole-of-government strategy. We aim to maintain a level playing field for honest businesses, prevent ongoing revenue loss and support our law enforcement partners". In 2013–14, the ATO conducted over 270 reviews and audits resulting in $76.7 million in liabilities and cash collections of $12.3 million. In addition, the ATO undertook over 1,500 reviews and audits of property developers, with many also showing signs of fraudulent phoenix behaviour.[95] The expansion of the director penalty regime makes it easier for the Commissioner to pursue directors who fail to cause the company to meet its PAYG withholding and SGC liabilities, which is likely to lead to an increase in collections, thereby mitigating some of the Commissioner's exposure to insolvency risk.

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[90] Treasury (Cth), 'Action against Fraudulent Phoenix Activity' (Proposals Paper, Treasury, Australian Government, November, 2009) 5–6.

[91] Ibid 5; Bill Shorten, 'Protecting Employee Super and Strengthening the Obligations of Company Directors' (Media Release, No 138, 13 October 2011).

[92] Treasury (Cth), 'Action against Fraudulent Phoenix Activity' (Proposals Paper, Treasury, Australian Government, November, 2009).

[93] Bill Shorten, 'Protecting Employee Super and Strengthening the Obligations of Company Directors' (Media Release, No 138, 13 October 2011).

[94] Ibid.

[95] Australian Taxation Office, ATO Annual Report 2013-14, 62.

FOSTERING A GOOD CORPORATE GOVERNANCE CULTURE

Unlike the Commissioner's former statutory priority, the director penalty regime does not rely on a company being placed into some form of external administration before the Commissioner can collect unremitted amounts. An early sign of insolvency in a company is that the company is living on the false reserves of non-remitted PAYG withholdings.[96] The Commissioner is in the position where he will have notice of a failure to remit and can act then, when PAYG withholdings are relatively low and the directors' liabilities are correspondingly so. Accordingly, the director penalty regime allows for early intervention by the Commissioner and is likely to result in the directors of a company acting promptly to place the company into external administration. Further, as a result of the 2012 amendments, if the PAYG withholding or SGC liabilities are not reported within three months of the due date for lodging a return then remission of the penalty can only occur if payment is made.[97] These provisions clearly serve a revenue purpose.

Unlike many of the Commissioner's powers which predominantly serve a revenue purpose, the director penalty provisions of the Corporations Act have a much closer connection with corporate law. The connection between tax and corporate law in relation to the provisions considered in this article was considered in *DCT v Dick* (2007) 67 ATR 762. In that case, Spigelman CJ said that the former Divisions 8 and 9 contained in the ITAA 1936 (now legislated in Divisions 268 (Estimates and recovery of PAYG withholding liabilities) and 269) are "*one part of a set of interrelated provisions which could be said to simultaneously serve both revenue and corporations law purposes*." Spigelman CJ discussed the connection between these Divisions and corporate law and described the connection starting with the removal of the Commissioner's priority for tax. Substituted were the two sets of provisions, one contained in Pt 5.7B of the *Corporations Law* and the other Divisions 8 and 9 contained in the ITAA 1936. Santow JA said that these two sets of provisions "*reach into a core area concerned with corporations, namely their liquidation or administration*". He went on to say that:

> "Though these matters are directed to discharging fiscal obligations they:
>
> (a) are imposed on directors as such;
> (b) replace the Tax Commissioner's historical priority for tax; and
> (c) substitute a scheme for accelerated collection of PAYG amounts, which, though it is found in income tax legislation, has a direct connection with the liquidation or administration of companies."

The New South Wales Court of Appeal considered the relevance of this connection between tax law and corporate law and determined that a core responsibility of a corporate board's oversight included the wider statutory obligation to collect and account for corporate employee taxes. This is achieved by imposing strict obligations on directors to cause their company to comply with these tax obligations or face personal penalty. In doing this, Santow JA said that:

> "tax legislation reaches into core corporate areas of liquidation and the related status of administration. Thus neglect of that statutory obligation can put the corporation at risk of its demise. These PAYG obligations of directors are no less obligations of a director qua director in both an individual and collective board sense and no less capable of giving rise to

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[96] Gzell J in *Deputy Commissioner of Taxation v George* (2002) 55 NSWLR 511 at 520, an "early sign of problems in a company is its living on the false reserves of non-remitted" deductions from employees' wages.

[97] Section 269-30(2) TAA.44

> default or breach of duty than other corporate statutory obligations. They arise directly under the ITAA and indirectly in avoiding endangering the company by their breach. A breach of the tax obligation is capable of giving rise to a parallel breach of the core duty of care and diligence if directors expose their company carelessly to liquidation or administration by reason of their permitting neglect of the company's PAYG obligations."

If directors neglect their tax obligations, they are putting the company at risk. Accordingly, the director penalty regime fosters good corporate governance which is fundamental to be able to achieve successful corporate rescue.

By making directors personally liable for PAYG withholding and SGC liabilities under the director penalty provisions, it encourages directors to confront solvency problems earlier, to prevent the mounting up of debts and to ensure that steps are taken expeditiously to prevent a company continuing to incur debts when in financial difficulties. The Harmer Report said at [53]:

> "An ordered form of administration of the affairs of an insolvent person is at the centre of insolvency law — whether, in the case of an insolvent company, that law offers the prospect of a winding up or continuation of the corporate business. This approach is similar to that taken by insolvency law inquiry bodies in many overseas countries, such as USA, Canada, UK and some of the European nations. It also requires legislation to encourage directors to take early and orderly steps to deal with an existing or impending state of insolvency. The Commission's recommendations in respect of potential director liability for the debts of an insolvent company may provide such encouragement... [T]he aim is to encourage early positive action to deal with insolvency."

In encouraging early intervention, Australia's current director penalty regime discourages directors against continuing to trade on false reserves, leading to the demise of the company to a point where it has no prospects of achieving corporate rescue post insolvency.

CONCLUSION

By examining the legislative history of the director penalty regime, the operation of the current legislative scheme and the body of case law that has emerged in this area, it is evident that the director penalty regime has increased considerably in its scope since its introduction in 1993. The director penalty regime was introduced as a substitute for the Commissioner's priority in insolvency, however the most recent reforms have broadened the regime, extending the policy beyond the revenue function to mandate good corporate governance practices. In particular, the current regime ensures that one of the core responsibilities of a corporate board's oversight must be to collect and account for corporate employee taxes, otherwise director's risk facing personal liability. While these provisions operate harshly, it is reasonable to expect that individuals who take on director roles in companies are responsible and assume their roles appropriately ensuring that they have done their due diligence and are financially literate and aware of their tax and corporate law obligations. This is particularly so given the considerable impact upon individual employees who are not paid their entitlements and the broader implications for the community that result.

Further action in this area may involve extending the director penalty regime to cover liabilities such as indirect taxes (for instance GST and excise) and even the company's own income tax. This was one of the options discussed in the Proposals Paper.[98] Given the arguments raised in

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98 Treasury (Cth), 'Action against Fraudulent Phoenix Activity' (Proposals Paper, Treasury, Australian Government, November, 2009) 14.

this paper, it appears as though there may be justification in doing so. In that regard, while these taxes do not relate to the liability of another entity, their inclusion in an expanded director penalty regime would act as a further incentive for directors to ensure that the company is meeting its tax obligations, thereby promoting good corporate governance and accountability and improving the company's prospects of achieving successful corporate rescue post insolvency.