



SMITH HANCOCK

INSOLVENCY NEWSLETTER

May 2009

ATO Director Penalty Notices

The Australian Taxation Office ("ATO") is commonly a creditor in all forms of external administrations, particularly liquidation. For many small businesses, the ATO can be seen to be a short term funding solution when there is a tightening of cashflow through the non-submission of activity statements and/or non-payment of a liability to the ATO.

Sections 222AOB and 222AOC of the Income Tax Assessment Act, 1936 ("ITAA36"), provides that the company directors are liable to pay an amount, by way of penalty, equal to the unpaid amount of the company's liability under a remittance provision (being, PAYG tax withheld) if the company's liability remains unpaid after the due date.

Further, in the event that a company does not lodge its activity statements as and when required, the Commissioner of Taxation ("Commissioner") may make an estimate of the taxation liability pursuant to Section 222AGA of the ITAA36. Sections 222APB and 222APC of the ITAA36 provide similar personal liability provisions, to that mentioned above, in the event the estimate remains unpaid.

However, Sections 222AOE and 222APE of the ITAA36 provide that the Commissioner must give 14 days notice to the director before recovering the unpaid amount of the company's PAYG liability. This notice is commonly known as a Director Penalty Notice ("DPN").

The DPN is sent by the Commissioner to the residential address of a director as recorded on the ASIC public register. To avoid personal liability a director must do one of the following four things within 14 days of the date of the DPN:

- (i) Discharge the debt stated in the DPN;
- (ii) Enter into a payment arrangement with the Commissioner to pay the outstanding debt;
- (iii) Appoint a Voluntary Administrator; or
- (iv) Appoint a Liquidator

A few tips for you and your clients to consider to avoid personal liability under a DPN:

- (i) Act quickly if a DPN is received or is anticipated to be received.
- (ii) Ensure that the company complies with a payment arrangement entered into with the Commissioner otherwise personal liability will still exist.
- (iii) Ensure that the company lodges with ASIC a notice of any change of personal details of a director or alternate director immediately after the changes occur. *(It is not a defence to a DPN that the address on the ASIC register is incorrect¹ and proof of receipt of the DPN does not have to be proven by the ATO²).*

Sections 222AOE and 222APE currently relate only to unpaid PAYG tax withheld. The potential exists for the ATO to amend the GST legislation to include a similar provision in respect to unpaid GST liabilities.

Smith Hancock can assist in reviewing the financial position of the company, providing advice on the options available and a recommendation on the best course of action where debts to the ATO exist.

Director's Duty to Prevent a Company from Trading whilst Insolvent

Section 588G of the *Corporations Act, 2001* ("the Act") imposes a duty upon a director to prevent a company from incurring debts whilst it is insolvent. Insolvent is defined in the Act as being unable to pay all of a company's debts as and when they become due and payable.

In these uncertain economic times, it is likely that insolvent trading will be brought increasingly into the spotlight in the case when a company has been placed into liquidation with significant liabilities.

A Liquidator, or a creditor with the Liquidator's consent, may bring proceedings against a director for insolvent trading pursuant to Part 5.7B of the

¹ Pursuant to Section 222AOF of the ITAA36

² See *Deputy Federal Commissioner of Taxation v Meredith* 2007 ATC 5353; (2007) NSWCA 354

Act. The insolvent trading claim is equal to the loss suffered by the company (or creditor) from the date the company was (or is deemed to be) insolvent. In such a case, the Court may order a director to be liable to compensate the company (or the creditor) for the loss suffered as a result of a breach of the insolvent trading provisions.

ASIC are also increasing their efforts to prosecute directors of companies who breach the insolvent trading provisions of the Act. ASIC's recent prosecutions relate to the criminal offence of insolvent trading (Section 588G(3) of the Act) where a director may be liable for a pecuniary penalty of up to \$220,000 or up to 5 years imprisonment.

Directors and their advisors should consider the financial position of a company on a regular basis in order to determine whether the company may be trading whilst insolvent. Some indicators of insolvency as highlighted in a leading case, (ASIC V Plymin (No 1) (2003) 46 ACSR 126) are:

- (i) Continuing trading losses;
- (ii) Overdue Commonwealth and State Taxes;
- (iii) No access to alternative finance;
- (iv) Creditors unpaid outside of trading terms;
- (v) Issuing of post dated cheques;
- (vi) Round lump sum payments/part payments to creditors;
- (vii) History of dishonoured cheques.

If any of your clients have indicated to you concerns that their company is experiencing cashflow difficulties or may possibly be trading whilst insolvent, please do not hesitate to contact us. Initial consultation will be without cost or obligation to your client.

Litigation Support Services

As announced in our February 2009 Newsletter, John Dickie recently joined the Firm and brought with him extensive experience in a number of specialist areas.

John expands the specialist services provided by Smith Hancock into areas of litigation support, forensic accounting, due diligence and business valuations. John's expertise will assist your clients in matters including:

- Providing expert reports in litigation proceedings.
- Shareholder/Partnership disputes;
- Family law proceedings;
- Valuations of businesses; and
- Assisting purchasers of businesses in the due diligence process.

John can be contacted directly on (02) 8844 8805.

Services Offered by Smith Hancock

Smith Hancock is a specialist Chartered Accounting practice, focusing on corporate reconstruction and insolvency.

In addition to the traditional formal insolvency appointments such as Voluntary Administrations, Receiverships and Liquidations, we undertake cost cutting reviews, business reconstruction advice, investigating accountants reports, partnership/ shareholder disputes, plus many other related services.

Please telephone or email us if you have a matter in which you consider we may be able to assist.

Electronic Newsletters

If you would prefer to receive our newsletters by e-mail, please do one of two things:-

- (a) Send an e-mail message to shs@smithhancock.com.au with the words "Newsletter" in the subject line, and provide your name and firm details in the message;
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