

The following technical update covers amendments to the debt collection procedures of the Australian Taxation Office, guidance for directors on avoiding insolvent trading and a case which summarises what action directors should take to avoid liability for insolvent trading.

Changes to ATO Director Penalty Notices

The Tax Laws Amendment (Transfer of Provisions) Act 2010 applies to taxation amounts payable by a company on or after 1 July 2010. Among other measures, the amendments make changes to the collection and recovery of taxation liabilities, including the use of Director Penalty Notices ("DPN") by the ATO. A DPN is a formal notice or letter requesting payment of outstanding taxation liabilities of a company and sets out prescribed actions that a director may take, failing which the director becomes personally liable for the company's taxation liability. The timeframe for a director to act on a DPN has been extended from fourteen (14) days to twenty-one (21) days.

The new law confirms that a DPN takes effect from the date it is posted rather than the date it is received by the director and the DPN need only be sent to the director's address as per the ASIC database. This emphasises the importance of notifying ASIC of a change of address.

Arguably the most important change is that upon receipt of a DPN, a director can no longer avoid personal liability by entering into an instalment arrangement with the ATO. However, the ATO will be precluded from commencing proceedings to enforce the DPN while the arrangement is maintained. A director will avoid personal liability if they appoint a Liquidator or Voluntary Administrator within twenty-one (21) days of the date of the DPN.

Previously a director could possibly rely on the "illness or other good reason" defence to avoid personal liability imposed by the DPN. However, a director must now also show that in addition to there being an "illness or other good reason", that it would have been unreasonable for that person to have taken part in the management of the company at the time the tax liability was due.

A further change removes the discretion of the Court to relieve a director from liability under the general relief provisions of Section 1318 of the Corporations Act 2001 ("the Act").

ATO Modifies the Security Deposit Rules

Effective from 1 July 2010, the security deposit rules have been amended. Previously the ATO could only seek security deposits for present or future income tax liabilities. The security deposit was introduced as a measure to reduce the instance of phoenix activity. If the ATO suspects a taxpayer of phoenix activity, for example where the directors of a corporate taxpayer have a history of non-compliance, it may request the taxpayer to pay a security deposit or bond for an amount equal to its estimated taxation liabilities. This is intended to prevent the taxpayer from transferring its assets to a new company, usually with the same directors, and leaving the existing company with minimal assets and an unpaid tax liability.

A security deposit can now be sought in respect of all present and future taxation liabilities including PAYG, GST and FBT. Failure to give the security required by the ATO is an offence and the penalty has increased five (5) fold to \$11,000 for individuals and \$55,000 for corporations.

New ASIC Regulatory Guide for Directors on Insolvent Trading

On 29 July 2010, the Australian Securities and Investments Commission issued Regulatory Guide 217 "Duty to Prevent Insolvent Trading: Guide for Directors". A straightforward interpretation of the duty is that a director is required to prevent a company from incurring a debt at a time when the company is insolvent.

The guide discusses the consequences of a breach of the duty such as;

- Compensation Order; the Court orders a director to pay an amount equal to the loss suffered by the company,
- Pecuniary Penalty Order; up to \$200,000 for serious breaches,
- Disqualification from managing a corporation, and
- Criminal Offence: for dishonest actions up to five (5) years prison and \$220,000 fine.

The defences to an insolvent trading action are also set out in the guide, including;

- Reasonable grounds to suspect solvency,
- Reliance on third parties,
- Illness,
- Reasonable steps to avoid incurring the debt.

We note that any action the directors took to seek specialist insolvency advice, including appointing a Voluntary Administrator, is taken as a factor in determining whether the defences are available.

The guide goes on to explain the complex concept of solvency. ASIC then sets out four (4) key principles that directors should abide by to discharge their duty;

- Directors must remain informed,
- Directors should investigate financial difficulties,
- Directors should obtain advice, and
- Directors should act in a timely manner.

The action that a director should take is summarised in paragraph RG 217.39, which states;

“As soon as there are reasonable grounds to suspect that the company is in financial difficulty, a director should consider obtaining appropriate advice from a suitably qualified, competent and reliable person about the financial position of the company and how the financial difficulties can be addressed. A director is potentially able to rely on appropriate advice in circumstances where the adviser is given full, complete, accurate and up-to-date instructions by, or on behalf of, the director to enable the adviser to properly and adequately provide competent advice.”

The final section of the guide discusses the approach of ASIC to insolvent trading and presents a table of factors it takes into account. There is also an annexure listing indicators of potential insolvency.

The guide is available on the ASIC website at <http://www.asic.gov.au/asic/asic.nsf/byheadline/Regulatory+guides?openDocument#201>

An insolvent trading action can be brought by the company’s Liquidator, one of its creditors or ASIC. We note that prima facie compliance with Regulatory Guide 217 may not necessarily prevent insolvent trading action being brought by an eligible applicant, as each case will depend upon its particular facts, matters and circumstances.

Recent Decision

McLellan, in the matter of The Stake Man Pty Ltd v Carroll [2009] FCA 1415

This case concerns insolvent trading proceedings brought against the company’s director by its Liquidator. Whilst the Court found the director breached his duty to prevent insolvent trading, pursuant to Section 1317S & 1318 of the Act he was excused from any liability as he was found to have acted honestly. However, the Court ordered the Director to pay the Liquidator’s legal costs.

The actions of the director included taking active steps to expand sales, monitoring stock levels and to seek out investors and additional debt financing. The director changed from his regular accountant to one with specialised experience in the timber industry. The director argued that he relied on the accountant’s advice but was unable to establish any of the statutory defences in Section 588H of the Act such as reliance on other persons. The director did not receive any personal benefit from the insolvent trading. The director also met with an insolvency practitioner approximately three (3) months before he resolved to appoint a Voluntary Administrator, albeit a different insolvency practitioner.

The case confirms that Courts are likely to view favourably directors who take active steps to attempt to resolve the company’s solvency concerns. The case also demonstrates that relief from liability for insolvent trading is available for directors who seek out expert advice and rely upon the advice to try to improve the company’s circumstances until the appointment of an administrator becomes unavoidable.

Conclusion

The team at O’Brien Palmer is committed to assisting our contacts help their clients understand and navigate the complex realms of insolvency. As part of that commitment, we would be pleased to answer any of your questions regarding our services. We also offer a complimentary and obligation free initial consultation to establish the nature of the problem and the manner in which we can be of service.

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