



Tax Insights

Director penalty notice and ATO estimates regimes: Expansion to GST

Snapshot

The [Treasury Laws Amendment \(Combatting Illegal Phoenixing\) Bill 2019](#) is currently before the Federal Parliament awaiting debate. The Bill contains several measures announced in the 2018-19 Budget to counter illegal phoenixing activity.

The tax measures in the Bill are likely to take effect from 1 January 2020. They will provide the ATO with additional levers to improve Goods and Services Tax (GST) collections, and enable the ATO to act more promptly and with greater pressure applied to taxpayers.

While the Bill is broadly concerned with illegal phoenixing, it is important to note that the tax measures in particular, are not confined in their application to circumstances involving phoenixing activity. For this reason, all company directors should familiarise themselves with the scope and potential impact of the measures, both for their company and for themselves.

The Bill also come at a time when the ATO has been increasing its focus on assuring GST collections, including by means of its Justified Trust reviews of larger taxpayers. Justified Trust reviews include the evaluation of

evidence relevant to the ATO reaching a conclusion about whether the taxpayer is paying the correct amount of GST, and have involved an increased focus by the ATO on board level controls over tax governance.

Overview of the amendments before Parliament

The Bill proposes a range of amendments to the tax and corporations laws that will have significant implications for company directors. These include:

- In certain circumstances (outlined below), making a company's directors **personally liable** for outstanding payments of GST, Luxury Car Tax (LCT) and Wine Equalisation Tax (WET)
- Allowing the Commissioner of Taxation to **estimate** an entity's 'net amount' for a tax period (i.e. the sum of the entity's GST, LCT and WET liabilities, after necessary adjustments and available credits) and recover the estimated net amount from the entity. This measure applies to GST registered entities of all types, not just companies
- Authorising the Commissioner to **retain a tax refund** that is otherwise payable to an entity if the entity has any outstanding tax returns or has failed to provide other information that it is required to provide to the Commissioner. This discretion is in addition to the Commissioner's existing discretion to retain refunds where a return or other information required under the Single Touch Payroll, BAS or petroleum resource rent tax provisions is outstanding. While the explanatory material accompanying the Bill indicates that the Government "envisions" that the Commissioner will apply this new discretion in relation to entities identified as "a high risk", including those engaged in illegal phoenixing activity, the amending provisions do not expressly limit the exercise of the discretion in this way. This measure applies to entities of all types. The Commissioner is likely to release guidance material that will clarify the circumstances in which entities would be considered "a high risk".
- Preventing directors from improperly backdating resignations in breach of the rule requiring notification be given to the Australian Securities and Investment Commission (ASIC) within 28 days of the resignation date, and preventing directors ceasing to be a director when doing so would leave the company without any directors.
- Introducing new phoenixing offences to prohibit creditor-defeating dispositions of company property (i.e. transfers of company assets for less than market value [or the best price reasonably obtainable], that prevent, hinder or significantly delay creditors getting access to the company's assets in liquidation). This also includes introducing penalties for persons engaged in or facilitating creditor-defeating dispositions; allowing recovery of such property by liquidators and the ASIC; and allowing recovery of compensation from company officers and others responsible for creditor-defeating dispositions.

This Tax Insight considers the expanded director penalty and estimates regimes in more detail below.

Expansion of the director penalty regime

The director penalty regime in Division 269 in Schedule 1 to the Taxation Administration Act 1953 (TAA) currently applies in relation to pay as you go (PAYG) withholding and superannuation guarantee charge (SGC) payment obligations. It operates to enforce the duty of a company's directors to ensure that the company either meets its obligation to pay PAYG withholding and SGC amounts to the Commissioner or, recognising that the company may be insolvent, goes promptly into voluntary administration or liquidation (director's obligation).

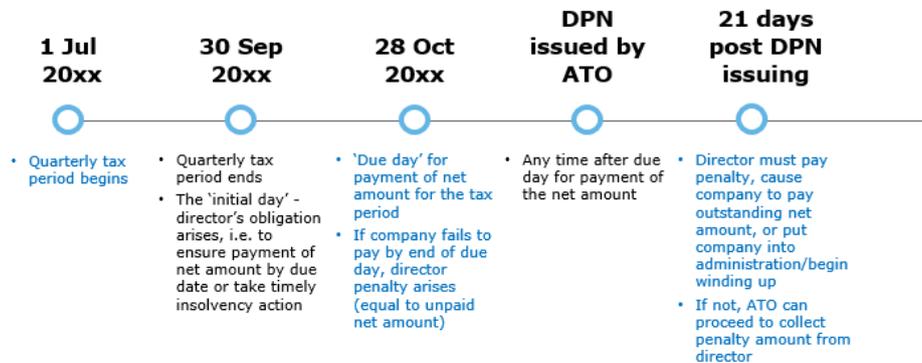
The Bill expands the regime to provide for penalties to apply to company directors when a company has an unsatisfied liability to pay an assessed net amount or, in relevant cases, a GST instalment amount. Under the GST self-assessment regime, an entity's net amount is deemed to be assessed when the entity lodges the GST return for the tax period.

Coming on top of existing measures in respect of unpaid PAYG withholding and SGC liabilities, these changes have the potential to increase substantially the level of financial exposure for individual directors. They are clearly intended to sharpen the focus of directors on whether their company is meeting its GST, LCT and WET obligations in a timely way, and if not, to take speedy and appropriate action to address the situation.

An example of a possible timeline for a Director Penalty Notice (DPN) issuing is as follows:

Example DPN timeline

GST annual turnover <\$20M (quarterly GST taxpayer)



In particular:

- A director will have an obligation to ensure that the company either pays an assessed net amount or GST instalment, or is put into voluntary administration/wound up. The director's obligation will arise on the last day of the tax period (the 'initial day').
- The director will become liable to a director penalty at the end of the day that payment of the net amount or GST instalment is due (the 'due day') if the director has not met their obligation by the due day¹.
- At any time after the due day, the Commissioner will be able to issue a Director Penalty Notice (DPN) for the penalty, if the director's obligation remains unsatisfied.
- The amount of the penalty will be equal to the company's unpaid net amount or GST instalment. The general interest charge (GIC) may be applicable.
- The director will have 21 days, beginning when the Commissioner issues the DPN, to satisfy the liability.
- A director that ceases to be a director after the initial day remains subject to the obligation, even if their directorship ceases before the due day.

The expanded DPN regime also applies to companies for whom the Commissioner has estimated net amounts under the expanded estimates regime (see below). That is, directors may also be liable should the Commissioner estimate the company's net amount – for example, in circumstances where the company has not lodged its GST return for the tax period.

Remittance of director penalties

A director penalty is generally remitted if the director complies with their obligation, either before the DPN is issued or within 21 days of it being issued, by:

- The outstanding liability being paid; or
- The company being put into voluntary administration or winding up begins.

However, a lockdown rule applies to director penalties. This effectively prevents their remission (in full or in certain cases in part) if:

¹ In general, the due day is: For GST taxpayers with monthly tax periods, the 21st day of the following month; for GST taxpayers with quarterly tax periods (including GST instalment taxpayers), the 28th day of the month following the end of the quarter.

- Compliance is by means of the company being put into administration or beginning to be wound up; and
- This action occurs **more than three months** after the due day for payment of the assessed net amount or GST instalment.

That is, if the director is too slow to initiate insolvency action, they will continue to be liable for payment of the director penalty.

The director penalty rules also apply to new directors appointed to companies, even when appointment occurs after the due day for payment of a net amount or GST instalment. New directors appointed after the due day have 30 days, starting on the day of their appointment, before they become liable to a director penalty.

Defences

Several defences are available to a director in respect of a director penalty issued by the Commissioner:

- Inability to comply with the director's obligation due to illness or other good reason;
- The director having taken all reasonable steps to comply with the obligation, or there were no reasonable steps the director could have taken to ensure compliance with the obligation;
- The penalty was due to the company adopting a reasonably arguable position (RAP) and it took reasonable care in applying the GST law.

In relation to these defences, it is worth noting the importance of having contemporaneous documentation that evidences relevant circumstances or actions. This would include, for example, a RAP paper is prepared whenever a potentially contentious GST position is taken by a company.

Expansion of the estimates regime

The estimates regime in Division 268 in Schedule 1 to the TAA currently allows the Commissioner to make and collect estimates of PAYG withholding and SGC liabilities. This regime targets taxpayers who fail to report and pay these liabilities.

The Bill expands the regime to allow the Commissioner also to collect estimated 'net amounts'. This measure will enable the Commissioner to collect GST, LCT and WET liabilities in a more timely way from taxpayers who fail to lodge GST returns.

Where a net amount is estimated by the Commissioner:

- The estimated net amount is deemed to arise and be payable on the day the taxpayer was required to lodge its GST return for the tax period;
- The GIC applies to an estimate of a net amount if the liability remains unpaid after seven days following the entity's receipt of the estimate notice. Where applied, GIC accrues from the day the GST return was due.

A taxpayer may reduce the amount of an estimated net amount by making a sworn statement that its actual net amount for the tax period was less than the estimate, and providing relevant information including details of its taxable supplies (including taxable supplies of luxury cars), creditable acquisitions, and assessable dealings and wine tax credits for WET purposes.

Importantly, the liability to pay the estimated net amount is distinct from the taxpayer's underlying liability to pay its actual net amount for the tax period (whether the latter has been assessed or not). What this means is that the liabilities exist in parallel. An estimate together with an assessment for the same underlying net amount can both be payable. However, an entity discharging one of these net amount liabilities, by payment or via a credit arising under the tax law, discharges the other liability to the same extent.

When this expansion of the estimates regime is layered with the expanded director penalty regime, the expanded powers of the ATO become much more impactful. In the case of a company with an estimated net amount outstanding, the directors of the company will also be subject to the expanded DPN regime.

Timing

Provided that Parliament passes the Bill by the last sitting day of 2019 (i.e. 5 December 2019), the tax measures should become operative from 1 January 2020.

Deloitte observations

The expansion of the estimates and director penalty regimes should facilitate faster and more effective recovery of GST, LCT and WET from non-complying taxpayers. The new measures, in conjunction with other recent changes to the GST law, including those targeted at the residential property and precious metals sectors, are likely to make a sizeable contribution to reducing the GST gap.

The ATO's most recent estimate of the GST tax gap was a figure in excess of AU\$5.3 Billion² (i.e. the difference between the ATO's view of the amount of GST payable under the law and the amount actually collected).

The fact of the large GST gap is influencing changes to the ATO's administration of GST. There are several indicators that the ATO has been sharpening its focus on assuring accurate and timely GST collections from large corporate taxpayers. Recent changes to the ATO's organisational structure and to its conduct of Justified Trust/Top 100/Top 1000 assurance reviews indicates that the ATO is moving away from dealing with GST compliance in isolation, and has moved to a whole of tax approach with taxpayers. GST assurance reviews will increasingly be run in parallel with Top 100/Top 1000 reviews and, from July 2020, GST will become part of fully integrated tax reviews. Further, the makeup of the Top 100/Top 1000 taxpayer lists is being modified to take account of taxpayers of GST-consequence that have previously not been included.

While driven by the Government's reform agenda around illegal phoenixing activity, the tax measures are not worded in a way that limits their application to taxpayers engaged in such activity. The expanded estimates regime will enable the Commissioner to identify and seek to collect outstanding GST, LCT and WET liabilities, with much greater speed than previously, in any case where a company (or other type of entity) has failed to lodge its GST return by the due date for the tax period. In the case of company taxpayers, the expanded director penalty regime will also serve to increase the pressure with which the Commissioner can collect or otherwise pursue outstanding net amount liabilities.

[Draft guidance](#) issued by the Commissioner on 6 September 2019 indicates that he intends to use the power to make estimates of unpaid net amounts only in cases where there are reasonable grounds to believe that the taxpayer or related entities are involved in phoenix activity or they are taking action to defeat creditors. The draft guidance also indicates that estimates of unpaid net amounts will generally not be made unless multiple attempts have been made to contact the taxpayer and the taxpayer either fails to engage or refuses to co-operate.

There has been some alarmist reporting in the media, suggesting that the Commissioner will be able to "dream up" any estimated net amount figure he chooses, with no requirement for it to reflect the taxpayer's actual trading activity. The law does require however that an estimate be one that the Commissioner considers reasonable. Further, as has been judicially noted, while the Commissioner has the scope to take a broad-brush liberal approach to making an estimate, the recipient of an estimate – being the one who has all the relevant information – is immediately able to cause the estimate to be reduced by giving a sworn statement to the Commissioner. The requirement of reasonableness is addressed in the draft guidance, together with examples of information that the Commissioner anticipates may be relevant to making estimates of unpaid net amounts.

² 2016-17 GST tax gap. The estimated tax gap (2015-16) for PAYG withholding payments is \$3.4 Billion, and \$2.8 Billion for SGC payments.

In practical terms, the expansion of the estimates and director penalty regimes will add an extra overlay of responsibility for all company directors, and an extra layer of potential personal financial exposure. It is essential for directors of all companies, regardless of size, listing status or business sector, to:

- Familiarise themselves with the scope and potential impact of the measures, both for their company and for themselves personally;
- Understand the key timing aspects of the measures. This will be critical, particularly in relation to taking appropriate action promptly, in order to avoid director penalties becoming locked down (i.e. unable to be remitted);
- Understand the potential implications of these measures in circumstances of accepting appointment as a new director of an existing company and/or retiring as a director;
- Reflect on their level of comfort that their company is fully compliant with its GST reporting and payment obligations (and any LCT and/or WET obligations). If the company has not already reviewed its GST risk management and governance framework, and the efficacy of its GST compliance systems and processes, this is a timely point to do so; and
- Be aware of the importance of producing and retaining contemporaneous documentation that can be relied on as evidence of compliance in the event of a DPN being issued.

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