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House of Representatives Standing Committee on Economics
c/o the Hon Julie Owens MP
Committee Chair
PO Box 6022
House of Representatives
Parliament House
Canberra ACT 2600

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Dear Standing Committee on Economics,

Tax Laws Amendment (2011 Measures No. 8) Bill 2011

We refer to the introduction of the Tax Laws Amendment (2011 Measures No. 8) Bill 2011 (the Bill) into the House of Representatives on 13 October 2011 and the inquiry into the Bill currently being conducted by the House of Representatives Standing Committee on Economics (Committee).

The Australian Institute of Company Directors is extremely concerned about the provisions in the Bill which extend the personal liability of directors to employees' unpaid superannuation guarantee entitlements. We are particularly concerned that the proposed legislation applies to all of Australia's 2.1 million[1] directors, not just directors of companies suspected of phoenix activity.

The Australian Institute of Company Directors is the second largest member-based director association worldwide, with over 30,000 individual members from a wide range of corporations: publicly-listed companies, private companies, not-for-profit organisations, charities, and government and semi-government bodies. As the principal professional body representing a diverse membership of directors, we offer world class education services and provide a broad-based director perspective to current director issues in the policy debate.

This submission provides a summary of our views and addresses the key areas of the Bill which have serious flaws that need to be addressed.

1. Summary

In summary, the Australian Institute of Company Directors is of the view that it is important for the Committee to note that:

(a) the Bill applies to *all* directors of Australian companies (registered under the Corporations Act 2001), not just to directors of companies suspected of phoenix activity;

[1] ASIC data, March 2011.

(b) the Bill make directors personally liable for the company's unpaid superannuation guarantee amounts regardless of the directors' culpability;

(c) the Bill make directors liable for actions of the company, regardless of the circumstances in which the company's breach occurred (i.e. even where the company's breach is inadvertent);

(d) the Bill assumes that identifying a company's employees and calculating the superannuation entitlement of every individual, is a straightforward exercise when in fact it is not;

(e) the Bill makes new directors, that is, directors who have joined a company after a breach has occurred, personally liable for the actions of others and for which they were in no way responsible;

(f) the provisions in the Bill effectively reverse the onus of proof so that directors are deemed to be liable unless they can prove otherwise;

(g) the defences provided in the Bill are limited and difficult to prove;

(h) the Bill assumes that directors will automatically know that there has been a shortfall in the superannuation guarantee charge, which is not necessarily the case;

(i) the Bill undermines the rule of law by automatically imposing liability on directors where they have not been notified that they are subject to a penalty;

(j) the Bill encourages the ATO to act slowly because three months after the superannuation guarantee charge should have been paid, the ATO does not need to provide advance notification to directors of a penalty and has access to a wider range of enforcement powers (including garnishee orders);

(k) director liability can be on the basis of an ATO estimate of the unpaid company liability prepared without the confidence and certainty as to correctness that would be necessary for an assessment, and with little time for the company to gather the information necessary to contest the accuracy of the estimate;

(l) the Bill is an over-extension of regulation and is more likely to create issues for directors intent on complying with the law than those involved in fraudulent phoenix activity; and

(m) if the Bill is not limited to companies suspected of phoenix activity and is to apply to all directors then it should also apply to all director equivalent positions such as employers, heads of government departments at a state and federal level (e.g. ministers and secretaries of departments), trustees, partnerships, trade union officials and all others who are responsible for making payments of superannuation.

These issues are discussed in more detail below.

2. The Bill applies to all directors not just directors of companies suspected of phoenix companies

The Australian Institute of Company Directors supports effective efforts to reduce fraudulent phoenix activity[2] and to protect workers superannuation entitlements from the fraudulent erosion of contributions. However, it is important to note that this Bill applies to all directors of Australian companies not just directors of companies suspected of fraudulent phoenix activity.

We note that the media release announcing the introduction of this Bill in the House of Representatives stated: "The ATO estimates that there are approximately 6,000 phoenix companies in Australia. This equates to approximately 7,500 – 9,000 company directors who will have personal liabilities under this legislation." This statement is entirely inaccurate and misleading. The Bill is not restricted to directors of companies suspected of phoenix activity, it applies to all of Australia's 2.1 million directors.

This means that any director of a company (from directors of small business and charities through to publicly listed companies) can be automatically liable, and subject to a penalty, for unpaid superannuation guarantee entitlements regardless of the circumstances in which the shortfall occurred and when they were not in any way involved in fraudulent phoenix activity.

This Bill is yet another example of where legislation designed to target a few creates an overly burdensome liability risk for the majority of directors who are honest, diligent and comply with the law. The risk of liability (when culpability is not a pre-requisite) focuses director's attention unnecessarily on conformance, rather than performance issues, leading to economic and productivity inefficiencies.

3. The Bill makes directors personally liable regardless of the directors' culpability and regardless of the circumstances in which the company's breach occurred.

Pursuant to the Bill, directors will become personally liable to pay a penalty equal to the amount of the unpaid superannuation guarantee charge when the date the superannuation guarantee charge should have been paid passes. Generally, the superannuation guarantee charge should be paid by the 28th day of the second month after the end of each quarter. This is also the date that a superannuation guarantee charge statement disclosing any shortfall should ordinarily be lodged by the company.

The Bill renders directors liable for the company's breach:

- regardless of the directors culpability;
- in circumstances where they have not been involved in or responsible for the company's breach;
- in circumstances where they were not aware of, and did not have any knowledge of, the company's breach; and
- where the quantum of the company breach is estimated rather than determined more definitively by ATO assessment.

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[2] See for example: Submission to Treasury in response to *Options Paper: A Modernisation and Harmonisation of the Regulatory Framework Applying to Insolvency Practitioners (* 29 July 2011) and Submission to Treasury*: Treasury proposals paper, Action against fraudulent phoenix activity (*22 December 2009) available at www.companydirectors.com.au

Further, directors will be liable for the company's breach without consideration being given to the basis for the company's breach (for example, whether the breach was an inadvertent error, arose as a result of a technological issue or for some other good reason).

The issue of personal liability for corporate fault is a longstanding one and has been the subject of a number of reviews and inquiries.[3] In 2006, CAMAC was of the view that: "as a general principle, individuals should not be penalised for misconduct by a company except where it can be shown that they have personally assisted or been privy to that misconduct, that is, where they were accessories."[4] The Bill proposed, contrary to this analysis, means directors are liable simply because they are a director, even where they have not have had any personal involvement in a breach.

Recently, the issue of personal director liability for corporate fault was of such economic concern that it was included as a reform stream in the COAG *National Partnership to Deliver a Seamless National Economy*. The purpose of the director liability reform priority under this agreement was to substantially reduce the provisions imposing personal criminal liability on directors for acts of the company.

Contrary to the spirit of COAG's ongoing reforms, this Bill imposes further personal liability on directors for acts of the company. It is disappointing that at a time when COAG is working to remedy the economic issues caused by this type of legislation on one hand, the federal government is hindering these efforts by adding to the director liability burden, with the other.

We are of the view that imposing automatic personal liability on directors for acts of the company pursuant to this Bill (in circumstances where phoenix activity is not involved) is entirely inappropriate.

4. The liability applies to new directors who were not in any way involved in the previous breach

One of the most extraordinary provisions in this Bill relates to the treatment of new directors under the penalty regime. Pursuant to the Bill new directors will become liable for any superannuation guarantee charge that:

- should have been paid by the company; and
- which is overdue at the date of the director's appointment; and
- which the company does not pay within 14 days of the director's appointment.

It is unacceptable that new directors should become personally liable for previous breaches of the company (and/or other directors) when they were not in any way involved in any of the company's activities before their appointment. Making *anyone* liable to a penalty for the actions of another (whether it be a corporation or a natural person) when the person liable had no actual or legal ability to control the conduct is entirely contrary to the principles upon which our legal system is based. The effect of the Bill is akin to an employee starting a new job, only to find that they are now

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[3] See for example, *Senate Standing Committee on Legal and Constitutional Affairs Company Directors' Duties* (1989), Corporate Law Economic Reform Program Paper No 3 *Directors' Duties and Corporate Governance* (1997); Australian Law Reform Commission *Principled Regulation* (2002); Regulation Taskforce *Rethinking Regulation; Report of the Taskforce on Reducing Regulatory Burdens on Business* (2006); and CAMAC *Personal Liability for Corporate Fault* (2006).

[4] CAMAC Report *Personal Liability for Corporate Fault at* 9

personally liable for breaches of the law committed by the person who previously held the position prior to their appointment.

Directors, the same as any other citizen deserve to be fairly treated under the law. For this reason the provisions imposing personal liability on new directors (which are contrary to the rule of law) should be immediately deleted from the Bill.

It is also important to note that the Bill assumes that new directors will know within 14 days of being appointed that the company has an unpaid superannuation guarantee charge. For the reasons set out in section 5 below, this assumption is without foundation, further calling into question the utility of these provisions.

5. The provisions imposing liability reverse the onus of proof and provide limited defences

The liability provisions included in the Bill have limited defences. A defence is available under the Act if because of illness or for some other good reason the director did not take part in the management of the company at the relevant time. A second defence is available if a director can show that they took all reasonable steps to ensure that the company complied with its obligation, an administrator was appointed, the directors caused the company to be wound up or there were no reasonable steps that could have been taken to ensure that any of those things happened. However, these defences are only available if they are raised within 60 days of the Commissioner giving notice in relation to the recovery of the penalty.

In other words, directors will be liable for a penalty when the date for the payment of the superannuation guarantee charge passes unless the directors can prove otherwise. Not only do these provisions reverse the onus of proof, for the purpose of the Commissioner recovering a penalty, the defences must be raised within 60 days.

In *Deputy Commissioner of Taxation v Dick* (2007) 64 ACSR 61 at 74, the NSW Court of Appeal considered whether section 1318 of the Corporations Act 2001 (C'th) could apply to relieve a director from a corporation's tax liability. In doing so, Santow JA considered the legislative history of section 1318 and noted:

> "there is a consistent theme that the court should have the power to relieve, in order that penal provisions or quasi penal provisions should not operate unfairly or harshly. Relief so extended does not strictly speaking exonerate the person in question by removing the breach; rather it operates as a dispensing power excusing the contravenor... It does not mean that the breach is deemed never to have occurred. Rather the person concerned seeks to satisfy the court that "having regard to all the circumstances of the case" he or she "ought fairly be excused" so as to receive dispensation."

Unfortunately, there is no equivalent provision which applies to the penalties under the proposed tax amendments and instead only limited defences are provided. We are of the view that these provisions are contrary to the principles upon which our justice system is based and that directors should not be made liable for the acts of the company in circumstances where they have to prove their innocence and where limited defences (which are difficult to prove) are provided.

6. The Bill assumes that directors will automatically know that there has been a shortfall in the superannuation guarantee charge

The Bill appears to assume that all companies that have an unpaid superannuation guarantee charge are involved in fraudulent phoenix activity and that the directors will therefore know that a shortfall in the superannuation guarantee shortfall has occurred. We are of the view that basing the legislation on these foundations is flawed.

Assessing the quantum of superannuation payable to individuals that have worked for a company is not straight forward (unlike remitting PAYG amounts, which ordinarily ought to be clear). For example, the superannuation guarantee payable may be dependent upon whether:

- particular individuals are "employees" under the extended definition in the Superannuation Guarantee Act;
- remuneration is for ordinary time worked or for overtime not subject to the superannuation guarantee; and
- foreign based Australian employees remain within the scope of the superannuation guarantee.

If the ATO takes a different view from the company as to the application of these definitions, a shortfall may arise. In addition, a shortfall may occur if a company makes a contribution on behalf of an employee in failure of choice of fund requirements (even if the contravention is inadvertent). Given these complexities, it should not be assumed that directors will be aware that a shortfall has occurred or that the company has engaged in fraudulent phoenix activity.

In addition, it should not be assumed that directors will automatically be aware of a superannuation guarantee shortfall for the following reasons:

- in large companies non executive directors are not involved in the day to day management of the company and are not in a position to exercise operational responsibility for the company's compliance with tax and superannuation legislation;

- in large companies non executive directors will not be aware of issues relating to the calculation and payments of an individual's superannuation entitlements unless management specifically reports this information to the board; and

- in small businesses the burden of understanding and complying with complex tax and superannuation legislation, may lead to inadvertent and honest errors in compliance, particularly given that small businesses do not have the same ability to access professional advice as large companies.

In summary, allowing directors to be personally liable for the unpaid superannuation guarantee charge in circumstances where the amount payable is not always clear and when directors may not be in a position to identify a breach is inappropriate.

7. The notice requirements under the Bill are fundamentally flawed

Pursuant to the Bill the Commissioner has two processes for the recovery of the unpaid superannuation guarantee charge from directors. The Commissioner must issue a director penalty notice to provide advance notification before commencing proceedings where:

- the company's unpaid liability has been reported to the ATO within three months of when it was due to be paid; or
- the company's unpaid liability is not yet three months overdue.

A director will then have 21 days following the issuance of a director penalty notice to take all reasonable steps to ensure the company complies with the payment obligation or the company commences administration or winding up. The penalty cannot be recovered from a director who takes those steps within the notification period.

In circumstances where the unpaid superannuation guarantee charge remains unpaid three months after that due date, the Commissioner can commence proceedings without first issuing a penalty notice. This means that if the ATO does not detect an overdue amount quickly and respond quickly with a director penalty notice within the 3 month period, the directors are not provided with an opportunity to be informed about the breach and cannot ensure the company takes corrective action before personal recovery occurs.

After the three month period, the ATO can proceed by exercising existing ATO garnishee powers (for example deducting amounts straight from the director's personal bank account) or by offsetting the director liability against tax credits owed by the director personally. Where ATO notification is given after three months, steps taken by the director within 21 days following that notification will not prevent recovery from the director. However, any payment made by the company within this period will still reduce the amount of the superannuation guarantee charge that can be recovered from the director.

In the event that directors are not aware that the company has an unpaid and unreported superannuation guarantee charge (as discussed above) placing directors in a situation where the ATO does not even issue a penalty notice informing them of the issue before recovery is made, is in our view, contrary to the rule of law. We are of the view that the failure to issue advance notice after 3 months is particularly egregious, when the company or its directors are not in any way suspected of fraudulent phoenix activity and where errors in the calculation of the superannuation guarantee charge are not identified and brought to the company's attention until years after the issue has arisen or raised only on the basis of an estimate.

We are of the view that the Bill provides an incentive for the ATO to act slowly, given that three months after the superannuation guarantee charge should have been paid, the ATO does not need to notify directors of a penalty in advance and has access to a wider range of enforcement powers. We are of the view that if the Bill proceeds, these provisions should be amended so that only in circumstances where the ATO has sufficient evidence to suspect that the company and its directors of fraudulent phoenix activity, should the requirement to issue advance notice be dispensed with.

8. The process for challenging an estimate of the director penalty is unreasonable

Pursuant to the Bill, the recovery of a director penalty is not dependent upon a superannuation guarantee charge assessment being issued to the company (or a self-assessment by the company). If the actual unremitted PAYG or unpaid superannuation guarantee charge amount is unknown, the ATO may make an estimate against which there is only very limited time to contest.

In order to contest the estimate, a statutory declaration (or an affidavit if part of a legal proceeding) must be given containing specified information. This information includes details about the amount of the superannuation guarantee shortfall liability, what (if anything) has been done to comply, and proper identification of the employees to which the individual superannuation guarantee shortfall relates.

The Explanatory Memorandum does not itself explain the timeframe in which this declaration needs to be given, and it may be as little as 7 days. Nor does the Explanatory Memorandum make clear whether the declaration can be given by a director (in a personal capacity) or whether it can be given by the company (i.e. by a director only as agent for the company).

Clarification about who can make the declaration (the company or the director in a personal capacity) is required. Further, clarification is also required about the timeframe in which to make the declaration and why it differs from the 60 days for other defences.

We are of the view, that providing the company with only 7 days to determine these issues would be grossly inadequate. Our particular concern being the follow-on liability consequence for directors if the information necessary to contest the estimate is unable to be prepared within that timeframe. This is particularly the case, when the shortfall relates to an alleged non payment from years earlier and relates to individuals that no longer work for the company. In addition and as mentioned there may be some debate as to whether a person was in fact an "employee" for the purposes of superannuation guarantee legislation and therefore whether "employees" details can be provided under the proposed legislation to contest the estimate.

If the ATO provides the company with an estimate of the unpaid superannuation guarantee charge, a reasonable time (longer than 60 days) should be allowed for the company to contest the estimate.

9. Conclusion

In summary, we strongly oppose the introduction of this legislation, given that it offends the rule of law, largely imposes automatic liability on directors regardless of their culpability, provides insufficient notice requirements and gives the ATO wide ranging powers in circumstances where directors are not suspected of dishonesty. The Bill is an example of over-regulation of all directors to target the few who have acted improperly.

The Government states that one of its aims in respect of the legislation is to protect worker's superannuation guarantee entitlements. If the Bill is not limited to phoenix companies and the Government is of the view that these proposals are an entirely appropriate way to achieve the protection of workers superannuation entitlements, we see no reason why the penalty regime should be limited to directors. The legislation could easily extend to Ministers of government departments. Such an extension would make Ministers personally liable for any unpaid superannuation guarantee shortfall of a government employee within their department. If such an extension were made, new Ministers would also need to be made personally liable for any superannuation guarantee charge that was not paid under the previous Minister responsible for that department. Similarly, the Bill should also then apply to all director equivalent positions such as employers, heads of government departments at a state and federal level (e.g. ministers and secretaries of departments), trustees, partnerships, trade union officials and all others who are responsible for making payments of superannuation.

These amendments would make the application of the legislation consistent across the public and private sectors.

We are of the view that this Bill contains numerous issues which require thorough examination as a matter of priority. Until such a time as these issues have been resolved, the Bill should not proceed.

If you would like to discuss any aspect of our views please contact me

Yours sincerely,

John H C Colvin
CEO & Managing Director