

31 May 2012

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

Email: economics.reps@aph.gov.au

Dear Standing Committee on Economics,

Tax Laws Amendment (2012 Measures No. 2) Bill 2012

We refer to the introduction of the Tax Laws Amendment (2012 Measures No. 2) Bill 2012 into the House of Representatives on 24 May 2012 and the inquiry into the Bill currently being conducted by the House of Representatives Standing Committee on Economics (Committee). We hope these comments, which were provided to Federal Treasury in a written submission dated 2 May 2012, will be of assistance to the Committee.

The Australian Institute of Company Directors is the second largest member-based director association worldwide, with over 31,000 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.

1. Summary

The Australian Institute of Company Directors has significant reservations about the extension of directors' personal liability to employees' unpaid superannuation guarantee entitlements and in particular the application of these penalties to new directors. If these measures were confined to instances where fraudulent phoenix activity was suspected and the Bill contained an appropriate definition of fraudulent phoenix activity, we would be less concerned about the introduction of this Bill.

In summary, despite recent amendments to the proposed measures, the Australian Institute of Company Directors is of the view that:

- (a) the Bill still applies to *all* directors of Australian companies (registered under the Corporations Act 2001), not just to directors of companies suspected of phoenix activity;
- (b) the Bill makes directors personally liable for the company's unpaid superannuation guarantee amounts regardless of the directors' culpability;

- (c) the Bill makes new directors personally liable for the actions of the company even when the person was not a director at the time of the company's breach;
- (d) if directors who are ill or for some other good reason did not take part in the management of the company have a defence to liability, persons who were not directors at the time of the company's breach should not be liable or should have a similar defence;
- (e) the defences for directors in the Bill are still limited and difficult to prove;
- (f) the provisions in the Bill still reverse the onus of proof so that directors are deemed to be liable unless they can prove otherwise;
- (g) the Bill is an over-extension of regulation which is more likely to create issues for directors intent on complying with the law than those who deliberately avoid paying workers entitlements and engage in fraudulent phoenix activity; and
- (h) the Bill is contrary to the spirit of, and the Government's commitment to, the COAG reforms which are designed to reduce the burden of director liability in Australia to ensure we have a governance system that focuses more on performance than conformance.

These issues and others are discussed in more detail below.

2. The Bill increases the director liability burden for all of Australia's company directors not just directors suspected of phoenix activity

The Australian Institute of Company Directors supports effective measures to target fraudulent phoenix activity. Yet despite our calls to confine the proposed legislation to instances where fraudulent phoenix activity is suspected, the Bill does not do so and applies to all of Australia's 2.2 million directors. We note that the Government is now describing the measures as legislation designed to protect worker's entitlements rather than legislation solely designed to target phoenix activity.

It is important to note that the Regulatory Impact Statement prepared in June 2011 in respect of these measures focused solely on targeting phoenix activity. We are not aware of any rigorous analysis having been undertaken to assess the extent to which companies not involved in phoenix activity fail to pay their worker's entitlements. Further we are of the view that the Regulatory Impact Statement prepared in June 2011 dramatically underestimates the compliance costs of these measures on honest companies and the productivity losses that will occur as further director liability provisions are inserted into Australian law.

We are of the view that the overwhelming majority of Australian companies pay their tax liabilities and employees' entitlements in a timely fashion and in compliance with the law. Phoenix operators, on the other hand, may fail to remit PAYG withholding credits or avoid paying employee superannuation entitlements in order to direct the withheld amounts elsewhere. As stated in the explanatory memorandum, phoenix operators "gain a competitive advantage over compliant companies because their failure to pay employees' entitlements or tax liabilities, allows them to offer lower prices for goods and

services. They can reinvest money that other compliant businesses allocate to tax and superannuation payments.”²

The ATO has estimated that there are “approximately 6,000 phoenix companies in Australia” involving “approximately 7,500 – 9,000 company directors.”³ If phoenix company operators are the most likely to deliberately flout the law relating to PAYG withholding amounts or employee superannuation entitlements and these figures are accurate, less than 0.5% of Australia’s company directors are involved in this type of misconduct. Despite this, the Government has opted to address the misconduct of less than half a percent of directors by adopting a penalty regime which applies to all of Australia’s 2.2 million company directors.

We are firmly of the view that if new legislation is being introduced to target a specific problem, then the legislation must clearly define the issue sought to be addressed and specifically regulate that problem. Unfortunately, the breadth of this Bill provides 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.

We re-iterate that the issue of personal liability for corporate fault is a longstanding one and has been the subject of a number of reviews and inquiries.⁴ 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.”⁵ Contrary to these recommendations, the Bill proposed makes directors personally liable for corporate fault simply because they are a director and in circumstances where a director has not had any personal involvement in the corporation’s 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.

² Explanatory Memorandum to the Exposure Draft at page 2.

³ Media Release, *Protecting Employee Super and Strengthening the Obligations of Company Directors*, the Hon Bill Shorten MP, 13 October 2011.

⁴ 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).

⁵ CAMAC Report *Personal Liability for Corporate Fault* at 9

In addition, the Bill also fails to appreciate the difference in larger companies, between non-executive directors and management and the fact that non-executive directors are generally not involved in the day to day management of the company (including such functions as human resources and payroll).

3. The penalty regime should not apply to new directors, who were not directors of the company at the time of the company's breach

The Australian Institute of Company Directors is particularly concerned about the application of the proposed measures to new directors. In summary, the Bill makes new directors 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 30 days of the director's appointment.

We are of the view that new directors should not be made personally liable for breaches of the company's PAYG withholding amount or superannuation guarantee entitlement obligations, where the company's breach occurred prior to the director's appointment. This offends a fundamental tenet of the rule of law. In these circumstances, regardless of whether the amount remains outstanding when a new director is appointed, the fact is, the breach occurred at a time when the new director had no actual or legal ability to influence the conduct of the corporation. Making *anyone* liable to a penalty for the actions of another (whether it be a corporation or a natural person) in circumstances where the person was not involved in the breach and had no ability to influence the conduct leading to the breach is entirely contrary to the principles upon which our legal system is based.

Pursuant to the Bill section 269-35 of Schedule 1 to the Taxation Administration Act 1953 will be amended to include the following defence:

"You are not liable to a penalty under this Division if, because of illness or for some other good reason, it would have been unreasonable to expect you to take part in the management of the company at any time when:

- (a) you were a director of the company; and
- (b) the directors were under the relevant obligations under sub-section 269-15(1)."⁶

The 'illness' defence recognises that there will be circumstances when a director is not involved in the management of the company and should therefore not be liable for conduct that has occurred during that period. Incredulously, this same reasoning is not applied to new directors, who have *no capacity* whatsoever to be involved in being a director, let alone to participate in the management of the company at a time prior to their appointment.

If it is unreasonable to expect a director to take part in the management of the company at a time when they are ill or have some other good reason, surely it is unreasonable to expect a person to take part in the management of a company when they are not even appointed as a director? Aside from the issue of whether a new director should be liable at all for a corporation's breach which occurred prior to their appointment, it seems illogical to have a defence for when a person *is a director* and *did not take part in the management of a company* but not to have a defence for a person who *was not a*

⁶ See Exposure Draft, item 2, subsection 269-35(1)

*director and could not have taken part in the management of a company at the time of the company's breach.*⁷

Although it has been argued that the penalties for new directors are just an extension of existing law, we are strongly of the view that new directors should be removed from the scope of the new (and existing) penalty regime as a matter of priority. If the Government is intent on imposing personal liability on directors for acts of the company (which we regard as unnecessary in this instance), at the very least liability should be confined to persons who were directors at the time of the company's breach.

It is on this issue in particular, that we most strongly disagree with the Assistant Treasurer's comments that "the measures strike an appropriate balance between protecting workers' entitlements while not discouraging people from becoming company directors."⁸ Our survey evidence of directors already indicates that in addition to the willingness of persons to become or remain directors, there is a larger economic problem here which will be compounded if these measures are introduced.

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

In our submission to the House of Representatives Standing Committee on Economics dated 26 October 2011⁹, we noted that unlike the calculation of PAYG withholding amounts, assessing the quantum of superannuation payable to individuals is not straight forward. The amount of superannuation payable may be dependent upon, for example, whether particular individuals are employees or whether remuneration is for ordinary time worked or for overtime.

For this reason, we are pleased to see that the revised draft includes a defence which provides that a person will not be liable for a penalty to the extent that "the penalty resulted from the company treating the Superannuation Guarantee (Administration) Act 1992 as applying to a matter or identical matters in a particular way that was reasonably arguable, if the company took reasonable care in connection with applying that Act to the matter or matters."¹⁰

While the insertion of this defence is a small improvement, it is still important to note that the liability provisions included in the Bill are generally subject to limited defences. As set out above, 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 when the directors were under the relevant obligations. A further 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, outside of court proceedings these defences are only available if they are raised within 60 days of the Commissioner giving the director notice in relation to the penalty or giving notice that a penalty has been recovered.¹¹

⁷ In addition, we refer to our comments in section 2 above relating to the difference between the role of non-executive directors and management in larger companies.

⁸ Media Release, *Protecting Worker's Entitlements and strengthening director obligations*, the Hon David Bradbury MP, 18 April 2012.

⁹ Available at www.companydirectors.com.au

¹⁰ Exposure Draft, item 56, subsection 269-35(3A)

¹¹ Exposure Draft, item 2, subsections 269-35 (4A)

In other words, directors will be liable for a penalty when the date for the payment of the superannuation guarantee charge (or PAYG withholding amount) 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.¹²

It is also important to note that section 1318 of the Corporations Act 2001 (C'th) does not apply to an obligation or liability of a director under the relevant Division of the Taxation Administration Act 1953.¹³ Section 1318 of the Corporations Act allows a person to be wholly or partially relieved from liability in circumstances where the court is of the view that the person has acted honestly and having regard to all the circumstances, ought fairly be excused. We agree with the comments of Santow JA in *Deputy Commissioner of Taxation v Dick* (2007) 64 ACSR 61 at 74, that: "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."

Unfortunately, no equivalent provision to section 1318 applies to penalties under the proposed tax amendments and therefore these provisions have the potential to operate harshly. The Australian Institute of Company Directors will not support liability provisions that make the directors liable for acts of the company in circumstances where such limited defences are provided, the defences that are provided are difficult to prove and where the onus is on the director to prove why they should not be liable.

5. The time frames for directors to respond to notices and estimates relating to a super guarantee shortfall are insufficient

5.1 *The 21 day notice period only applies to the commencement of recovery proceedings*

In our previous submissions we raised concerns about the Commissioner being able to commence proceedings without first issuing a penalty notice on a director. We stated that without the receipt of a notice, directors "are not provided with an opportunity to be informed about the breach and cannot ensure that the company takes corrective action before personal recovery occurs."¹⁴ We therefore note that the revised draft now leaves the existing law as is and provides that "the Commissioner must not commence proceedings to recover from you a penalty payable under this Subdivision until the end of 21 days after the Commissioner gives you written notice under this section."¹⁵

Despite this revision, it is important to note that the issuing of a notice must only occur before the Commissioner *commences proceedings* to recover a penalty. Under the proposed amendments, it appears that the Commissioner will still be able to directly recover a penalty from a third party (i.e. offsetting the directors' tax credits against the penalty or by recovering the amount from a bank which

¹² The defences must be raised within 60 days from the Commissioner giving the director notice in relation to the penalty or giving notice that a penalty has been recovered.

¹³ Schedule 1, *Taxation Administration Act* 1953, subsection 260-35(5) provides "section 1318 of the Corporations Act does not apply to an obligation or liability of a director under this Division."

¹⁴ Australian Institute of Company Directors' submission to the House of Representatives Standing Committee on Economics dated 26 October 2011 available at www.companydirectors.com.au.

¹⁵ See Schedule 1, *Taxation Administration Act* 1953, subsection 269-25(1).

holds an account for the director) without having to issue a notice beforehand.¹⁶ Given that the Commissioner cannot commence proceedings to recover a penalty until 21 days after a written notice is provided, we are of the view that the Commissioner should also not be able to *recover a penalty* from a director (where fraudulent phoenix activity is not suspected) until at least 21 days after a written notice is provided.

5.2 *The 21 day notice period is only useful to remit a penalty by way of administration or winding up if the notice is issued within 3 months from the company's due date*

If the director receives a notice from the Commissioner alerting them to the fact that the Commissioner will shortly commence proceedings to recover a penalty from the director, the director has 21 days to take corrective action. Corrective action by the director would be causing the company to comply with its obligation; appointing an administrator; or commencing the winding up of the company. If any of these options occurs within 21 days the penalty will not be recoverable by the ATO from the director. However, the latter two of these options to remit the penalty will only be available *within 3 months of the original due date for the company's obligation*.

Once three months passes from the company's due date, the director's actions in placing the company into administration or in winding up the company (even if this occurs following the receipt of an ATO notice and during the 21 day notice period) will not be sufficient to remit the director's penalty.

If significant delays are taken by the ATO in actioning employee complaints about unpaid superannuation guarantee entitlements, it is almost inevitable that 3 months will have elapsed before the ATO raises the issue with the company or provides a notice to directors. If a director receives a notice after the 3 month period has expired, the options available to the director to remit the penalty are to cause the company to pay the amount or personally pay the penalty.

On this basis, it may be that for the purpose of the superannuation guarantee charge, Australian directors will need to assume that the 21 day notice period to put the company into administration or to commence winding up will generally be unavailable. While this may be appropriate where phoenix activity is occurring, limiting the options of honest directors to take corrective action simply because the issue was identified 3 months after the company's due date or because the ATO failed to send a notice within 3 months of due date, is a serious flaw of this regime.

5.3 *The directors only have 7 days to lodge a statutory declaration or affidavit to dispute an estimate of the superannuation charge*

The Bill provides that the recovery of a penalty is not dependent on an assessment of the superannuation guarantee charge and allows the Commissioner to issue an estimate. In the event a director wishes to contest the estimate (and the penalty arising from the estimate) the director must make a statutory declaration (or affidavit) on behalf of the company. The statutory declaration or affidavit must include details such as; each employee for whom there is an individual guarantee shortfall, the employee's name, postal address, the amount of the shortfall and

¹⁶ See for example, Exposure Draft, item 2, subsection 269-35(4A)(a)(ii) and Explanatory memorandum at pages 15 and 16.

what has been done to comply with the obligation to pay the relevant superannuation charge for the quarter.¹⁷

We are of the view that a 7 day time frame to provide this information is completely unreasonable. Given that a superannuation shortfall may be identified years after it occurred, it may take some time for the company to search its records and gather the necessary information. Allowing directors only 7 days to find the relevant information and prepare a declaration or affidavit is unacceptable. We are of the view that a minimum of 60 days would be a more appropriate period. We are concerned that the ATO may ease its administrative burden by passing on an employee complaint to the employer in the form of an estimate and leave the employer with only 7 days to address and resolve the issue. We recommend that a 60 day period be allowed for the preparation of an affidavit or declaration to contest the estimate.

6. Conclusion

In summary, despite recent revisions to the proposed measures 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, and gives the ATO wide ranging powers in circumstances where directors are not suspected of dishonesty.

The Government continues to stress that these amendments are an “extension” of existing law. We are of the view that extending existing law, where the existing law suffers from the same or similar defects set out above, does not justify the introduction of these measures. Even on important issues such as the protection of workers entitlements, harshly over-regulating the overwhelming majority to target the very few who have acted improperly is inappropriate.

We continue to be concerned about the number of Government proposals that continue to increase the compliance burden on companies at a time when many sectors of the economy and many small businesses are finding conditions tough. The Government’s approach in continuing to increase the regulatory burden on business, business owners and directors generally is in stark contrast to the approach being taken by governments worldwide that are working hard to find ways to stimulate, rather than stifle entrepreneurialism, productivity and innovation post the GFC.

Continuing to over-regulate companies, directors and small business owners, at a time when these businesses are working hard to survive and to keep their staff employed, highlights the widening gap between the understanding by the Government of business and the reality faced by business.

If these measures were confined to instances where fraudulent phoenix activity was suspected and the Bill contained an appropriate definition of fraudulent phoenix activity, we would be less concerned about the introduction of this Bill. We have put this proposition forward on many previous occasions. However, the Bill is not so confined and will apply harshly to directors who make every effort to ensure their companies comply with the law relating to the payment of superannuation guarantee entitlements and PAYG withholding credits.

¹⁷ Exposure Draft Item 45, subsection 268-90(2A).

AUSTRALIAN INSTITUTE
of **COMPANY DIRECTORS**

We anticipate that the continual increase in liability provisions and penalties such as these will continue to seriously impact upon the willingness of talented and honest people to take up directorships and impede the prosperity of this country.

If you would like to discuss any aspect of our views please contact me on (02) 8248 6600.

Yours sincerely,

 John H C Colvin
CEO & Managing Director