The payment of tax debt during bankruptcy proceedings

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Abstract: This article explores the issues surrounding corporate insolvency, the non-remittance of PAYG withholding tax, and the non-remittance of superannuation guarantee charges and civil liability of directors for it. The director penalty regime may ultimately result in bankruptcy proceedings against directors and this article considers the interaction of bankruptcy law with the director penalty regime. Directors of a company will most likely face civil litigation for an unpaid tax debt should the alternative ATO enforcement procedures not succeed. The Commissioner, in order to enforce the judgment debt, will ultimately commence bankruptcy proceedings in the Federal Circuit Court of Australia by way of creditor's petition and after an act of bankruptcy has occurred. This article emphasises, with the recent authority of *Soong's* case, that it is vitally important for all directors to be vigilant to ensure that the company is meeting its tax obligations, and to take action if it appears that the company is having difficulty paying these amounts.

Director penalty regime

The director penalty regime (DPR)[1] imposes onerous penalties on directors for unpaid liabilities of the company.[2] Specifically, the DPR imposes rigorous penalties on directors whose companies breach their obligations to pay estimates of PAYG withholding liabilities to the Commissioner under Div 268 of the *Taxation Administration Act 1953* (Cth) (TAA), or who failed to remit amounts withheld, including from salaries and wages, dividends, interest and royalties.[3]

Since the enactment of amending legislation on 29 June 2012,[4] the relevant unpaid liabilities of group tax for the company will include both unpaid PAYG withholding tax and unpaid superannuation guarantee charges. The consequences for the Commissioner for the non-remittance of these taxes by companies include the following:

(1) having to refund employees the amount of tax which is due to them after the assessment of their individual income tax returns despite never having received any tax from those employees;

(2) acting as a de facto overdraft to the corporation as company directors have sought to continue incurring debts when there were reasonable grounds for suspecting the company is insolvent with the non-payment of group tax;[5] and

(3) the Commissioner not receiving the tax deducted from employees' wages by the corporation and thereby receiving reduced revenue for the Commonwealth Government.

Directors need to be vigilant more than ever to ensure the company is meeting its tax obligations and take action if it appears the company is having difficulty paying these amounts. The non-remittance of group tax has long been recognised as a practical indicator of insolvency for a company[6] and company directors have a duty to cease incurring debts when there are reasonable grounds for suspecting the company is insolvent.[7]

When a company commits a tax offence, that tax offence is deemed to have been committed by the directors of the company or any person who takes part in the management of the corporation.[8] Directors' liability for unpaid corporate income tax liability is enforced by other ways such as a reparation order under s 21B of the *Crimes Act 1914* (Cth). The effect of a reparation order is that directors are ordered to make reparation to the Commonwealth, by way of money payment or otherwise, in respect of any loss suffered, or any expense incurred, by the Commonwealth or the authority, as the case may be, by reason of the tax offence.[9]

The Commissioner will provide notice to a director that a penalty is being issued with the service of a document called a director penalty notice (DPN).[10] The Commissioner will issue a DPN in circumstances where the director has failed to discharge an obligation[11] and is therefore liable to pay the Commissioner, by way of penalty, an amount equal to the unpaid amount of each liability of the company[12] in respect of amounts withheld by the company.[13]

The Commissioner has an advantage in regards to service. The Commissioner is able to resort to the evidentiary presumption contained with the *Evidence Act 1995* (Cth) and the *Acts Interpretation Act 1901* (Cth)[14] to presume a time when the DPN has been served. DPNs are deemed to be served on a director when it is posted to,[15] or received by prepaid post at, the director's address[16] as shown in the current ASIC records.

Is there a tax exposure for a person who may be a director?

There are a number of persons that the Commissioner may issue a DPN to should a company not remit group withheld tax to the ATO. The DPN liabilities of relevant directors are parallel liabilities and the Commissioner may seek from any one or more of the directors for the sum up to a total amount of the company liabilities.

The Commissioner must give the director notice of the penalty[17] as DPN are notices before litigation[18] and the Commissioner may not commence legal proceedings to recover the penalty until a period of 21 days has passed (date is termed "the due date").[19] The DPN must inform the director of the four alternate courses of action that he or she has available to comply by the due date and these alternative actions include the following:

(1) for the company to pay the liability;[20]

(2) for the appointment of an administrator to the company on the proviso that

the unpaid group tax is not more than three months old, that is, the company is under administration within the meaning of s 436A, 436B or 436C of the *Corporations Act 2001* (Cth);[21]

(3) for the commencement of the winding-up of the company on the proviso that the unpaid group tax is not more than three months old (a director cannot discharge their personal liability within the DPN by having the company placed into administration or liquidation once a period of three months have passed);[22] or

(4) an arrangement relating to such liability is in force under s 255-15, Sch 1 TAA.[23]

Understanding just who may be a person that is captured as a director for the purposes of a DPN is important. There is a presumption within the TAA that an officer or director of the company will be involved with management of the company. This presumption may be rebutted with evidence and this evidence must support the proposition that an officer (or director) did not aid, abet, counsel or procure the relevant act or omission to occur and cause the tax offence.[24]

A director, for the purposes of the DPN, will include:

(1) current serving directors of the company;[25]

(2) de facto directors and any persons who are appointed to the position of an alternate and are acting in that capacity;[25]

(3) previous directors of the company, especially if they were in office at the time when the tax liability arose. It will not matter if a director is no longer in that position of director at the expiration of the 21-day period[26] by the "due date" for the DPN;[27] and

(4) newly appointed directors — it is noted that should a newly appointed director be appointed to a company after the DPN's due date, and provided that the tax debt liability associated with the DPN is still outstanding to the ATO and the company has not been placed into administration or liquidation at the time of the director's appointment, then new directors will need to be aware that they will also be liable for the DPN after a period of 30 days of being a new director.[28]

New directors must be vigilant and ask crucial questions including, inter alia, questions regarding the historical tax compliance of the company. It will not matter that the tax debt arose prior to the appointment of the director once a 30-day period post appointment has elapsed. Accordingly, the new director must utilise the 30-day period and be clear in his or her mind about the tax compliance history of the company.

By way of completeness, the author notes that directors do a have a number of limited defences to an action commenced by the Commissioner for non-compliance with a DPN.[29]

These defences include, inter alia:

(1) whether or not the director undertook all possible and reasonable steps to ensure that other directors complied with their obligations;[30]

(2) whether or not the director was of good health during the period in office;[31] and

(3) whether or not the director was in the management of the company sufficiently long enough to affect the decision making of the company.[32]

DPN's interaction with bankruptcy law – Soong's case

The recent case of *DCT v Soong*,[33] (*Soong's* case) has emphasised the importance of directors complying with a DPN by taking one of the four alternate courses of action that he or she has available within the required time of 21 days. The facts in *Soong's* case were interesting as the Commissioner rejected an offer by the respondent director in bankruptcy proceedings to pay in full, via a bank cheque, the petitioned tax debt.

The statutory regime of s 8AAZL TAA permits the Commissioner to allocate funds paid to him among the various tax debts of a taxpayer at his discretion. The Commissioner is not required when doing this to take account of any instructions of the taxpayer.[34] One of the questions the court in *Soong's* case considered was whether or not the Commissioner is able to restrict the payment of the petitioned debt in bankruptcy proceedings and thereby attaching a condition to the tender of the bank cheque which would invalidate it as a tender.[35]

In *Soong's* case, the Commissioner had presented the respondent debtor with a creditor's petition on 10 April 2012 and, in response, the respondent debtor had filed a notice of opposition to the creditor's petition. The Commissioner's application by way of creditor's petition sought a sequestration order against the estate of the respondent debtor (Mr Steven Andrew Soong).

The key issue for determination in *Soong's* case was whether a bank cheque tendered by the respondent debtor, in the full sum of petitioned debt, should be tendered conditionally or unconditionally. That issue would settle the matter whether or not the court should make a sequestration order against the estate of the respondent debtor.

In the creditor's petition, the Commissioner claimed that the respondent debtor owed the applicant creditor the sum in the amount of $106,960.00, calculated as follows:

(1) the amount of $388,223.01 and costs of $21,847.90 due under a final judgment obtained in the Supreme Court of New South Wales on 28 May 2009, less credits in the sum of $192,288.50, plus $72,177.59 being interest on the balance of the judgment up to 27 February 2012; and

(2) minus a credit in the amount of $183,000.00 on 24 February 2012.

It is noted that as part of the process of making a person bankrupt, a creditor must prove the debtor has committed an "act of bankruptcy". These acts are set out in s 40 of the *Bankruptcy Act 1966* (Cth) and the most common act relied on by creditors is non-compliance with a bankruptcy notice.

In *Soong's case*, the creditor's petition claimed that the respondent debtor owed the applicant creditor (the Commissioner) the total sum of $106,960.00. It is noted that a creditor's petition shall not be presented against a debtor unless the amount claimed exceeds the sum of $5,000[36] and the claim cannot be more than six years old.[37]

The relevant facts in *Soong's* case were as follows:

(1) the respondent debtor had committed an act of bankruptcy due to failure to comply with the requirements of a bankruptcy notice served on him on 22 November 2011;

(2) the act of bankruptcy on which the petition was found occurred within six months before the presentation of the petition on April 2012;[38]

(3) the bankruptcy noticed exhibited a judgment dated 28 May 2009 in the sum of $388,223.01 plus $21,847.90 costs;

(4) the amount of the judgment debt has been reduced as indicated in the petition. This was done by an instalment regime initially of $10,000.00 per month, later of $2,500.00 per month.

(5) (4) it appeared, as noted by the court in the judgment, that these repayments ceased in January 2011;

(6) the respondent debtor was a director of the following companies, Lafari Pty Ltd and Linsari Pty Ltd;

(7) the matter had been adjourned on several occasions during which time DPNs were sent to Mr Soong in respect of the liabilities[39] of two companies of which he was a director, Lafari Pty Ltd and Linsari Pty Ltd;

(8) no payments were made in response to the DPNs by the respondent debtor (Mr Steven Andrew Soong); and

(9) the Commissioner had, after the filing of the creditor's petition in the Federal Circuit Court of Australia, issued DPNs to Mr Steven Andrew Soong on the following dates: 26 September 2012, 14 January 2013, 17 January 2013, 8 March 2013, 24 June 2013, 29 July 2013, 9 July 2013, 9 July 2013, 15 August 2013 and 27 September 2013.

Accordingly, the DPNs were notices that had been issued under s 269-25 of Sch 1 TAA and were prima facie evidence that:[40]

(1) Mr Steven Andrew Soong had a tax-related liability, namely, penalties arising under s 269-20 of Sch 1 TAA; and

(2) the sum of $443,076.00 was owed by Mr Steven Andrew Soong as at 5 November 2013, and this sum was a debt that was due and payable by Mr Steven Andrew Soong to the Commonwealth of Australia in respect of the tax-related liability referred to in the certificate issued under s 255-45 of Sch 1 TAA.

Interestingly in *Soong's* case, the matter came before the court on seven occasions and on the penultimate occasion on 18 November 2013, counsel for the respondent debtor sought to tender a bank cheque in the sum of $106,960.00. The bank cheque was tendered in an envelope to purportedly pay in full the petitioned debt. It is important to remember that the Commissioner's petitioned sum of $106,960.00 was a significantly smaller sum than was owed by way of penalty in the DPNs, the sum of $443,076.00.

The court was informed on 18 November 2013 that the said bank cheque was said to be a "gift" from the debtor's brother to him. As a matter of practicality, the bank cheque was placed in an envelope and kept with the court file while the matter was adjourned for further hearing to 2 December 2013. Counsel for the respondent attempted to tender the bank cheque. The Commissioner objected to the tender of the bank cheque.

It has been a long-established principle in bankruptcy law that a sequestration order is not appropriate in the circumstances when a debtor is able to pay his debts, but has not done so, simply because the debtor refuses to pay the debt.[41] For this reason, a creditor's petition may be dismissed by the Federal Circuit Court of Australia in the circumstances that it is satisfied that the debtor is able to pay his or her debts[42] or for other sufficient cause a sequestration order ought not to be made.[43]

As a general proposition, bankruptcy law will distinguish between the unwillingness to pay one's debts as opposed and distinct from inability to pay those debts as and when they fall due.[44] Put simply, a creditor will not be entitled to make a recalcitrant debtor bankrupt, even though the debtor satisfies the court that he is plainly solvent and able to pay his debts.

The legislative intent of the *Bankruptcy Act 1966*[45] is to leave a creditor, in those circumstances of a recalcitrant debtor, to ordinary remedies by way of execution and garnishee.[46] The recent decision of *Soong's* case has challenged that principle in the context of the DPN.

The Commissioner in *Soong's* case indicated that he would be inclined to reject the tender of the bank cheque in the circumstances that the bank cheque represented payment of the petitioned tax debt. For this reason, the Commissioner submitted to the court that the tender of the bank cheque was conditional and unless the respondent director debtor had accepted that the bank cheque was a partial payment of the monies owed in DPNs, and only in those circumstances, would the bank cheque be accepted. The Commissioner had put to the court that the bank cheque would not be evidence of the respondent debtor's solvency.[41]

The court in *Soong's* case had regard to the Commissioner's concern about the solvency of the debtor. It was not a disputed fact that the respondent debtor's brother had paid the bank cheque and thereby the tender of the bank cheque did not evidence the respondent's debtor's solvency — the bank cheque had not come from the respondent debtor's own funds but from his brother. Furthermore, the court in *Soong's* case had regard to the fact that the taxation liability sought in the creditor's petition was an old debt as the original judgment had been entered into on 28 May 2009.

The tax law affords the Commissioner discretion to allocate tax funds collected among the various tax debts owed by a taxpayer. The case of *Soong* is an example of the Commissioner exercising his discretion pursuant to ss 8AAZL, 8AAZLB and 8AAZLE TAA. The Commissioner argued in *Soong's* case that the Commissioner's preferred application of the bank cheque was to pay the tax penalty in the DPN first. In those circumstances, it was submitted that the Commissioner would not object to the tender of the bank cheque. The creditor's petition would thereby remain unpaid and the court should not exercise the discretion under s 52(2) of the *Bankruptcy Act 1966* to dismiss the petition — the debt due in the creditor's petition thereunder had not been paid.

In *Soong's* case, the Federal Circuit Court of Australia dismissed the notice of opposition and this decision was taken on appeal to the Federal Court of Australia, where Jacobson J refused leave to appeal (the decision being an interlocutory one) on 12 February 2014. The matter came back before the Federal Circuit Court of Australia where the sequestration order was made against the estate of the respondent debtor, Mr Steven Andrew Soong.

In conclusion, *Soong's* case is an example of when the Federal Circuit Court of Australia will not exercise a discretion under s 52(2) of the *Bankruptcy Act 1966* to dismiss the petition when a bank cheque is tendered in full sum of the petitioned debt.

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References

1 Div 269, Sch 1 to the *Taxation Administration Act 1953* (Cth) (TAA).

2 See, for example, *DCT v Saunig* [2002] NSWCA 390.

3 S 269-10 TAA.

4 On 27 January 2012, Treasury released an exposure draft of the Personal Liability for Corporate Fault Reform Bill 2012.

5 S 588G of the *Corporations Act 2001* (Cth).

6 S 95A of the *Corporations Act 2001*.

7 S 588G of the *Corporations Act 2001*.

8 S 8Y TAA.
9 See *Hookham v R* (1994) HCA 52, as an example.
10 S 269-25, Sch 1 TAA.
11 S 269-15, Sch 1 TAA.
12 S 16-70(1), Sch 1 TAA.
13 Div 12, Sch 1 TAA.
14 S 29 of the *Acts Interpretation Act 1901*.
15 S 163(1) of the *Evidence Act 1995*.
16 S 160(1) of the *Evidence Act 1995*.
17 S 269-25, Sch 1 TAA.
18 *DCT v Woodhams* [2000] HCA 10 at [19] and [21].
19 Ss 269-25 and 269-30(1)(b), Sch 1 TAA.
20 S 269-15(2)(a), Sch 1 TAA.
21 S 269-15(2)(b), Sch 1 TAA.
22 S 269-15(2)(c), Sch 1 TAA.
23 S 269-15(3), Sch 1 TAA.
24 S 8Y(2) TAA.
25 S 9 of the *Corporations Act 2001*.
26 S 269-20, Sch 1 TAA.
27 See *Canty v DCT* [2005] NSWCA 84.
28 S 269-20(4), Sch 1 TAA.
29 *Fitzgerald v DCT* 95 ATC 4587, cited with approval in *DCT v Gray* [2007] QDC 261.
30 S 269-35(2)(i), Sch 1 TAA.
31 S 269-35(3)(b), Sch 1 TAA.
32 S 269-35(3)(a), Sch 1 TAA.
33 [2013] FCCA 2106.
34 S 8AAZLE TAA.
35 *Australian Mid-Eastern Club Ltd v Yassim* (1989) 1 ACSR 399, cited with approval in *Re Simionato Holdings Pty Ltd (ACN 065 117 259); FCT v Simionato Holdings Pty Ltd* [1997] FCA 125.
36 S 44(1) of the *Bankruptcy Act 1966*.
37 S 41(3)(b) of the *Bankruptcy Act 1966*.
38 S 44(1)(c) of the *Bankruptcy Act 1966*.
39 In respect of amounts withheld under Div 12 and Sch 1 TAA.
40 S 255-45, Sch 1 TAA.
41 *Re Ronald Grafton Sarina v The Council of the Shire of Wollondilly* [1980] FCA 138.
42 S 52(2)(a) of the *Bankruptcy Act 1966*.
43 S 52(2)(b) of the *Bankruptcy Act 1966*.
44 *Francis v Eggleston Mitchell Lawyers Pty Ltd* [2014] FCAFC 18 at [50] per Rares, Flick and Bromberg JJ.
45 S 52(2) of the *Bankruptcy Act 1966*.
46 *Re Ronald Grafton Sarina v The Council of the Shire of Wollondilly* [1980] FCA 138 per Deane J.

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