CONSTRUCTION INDUSTRY IN THE FIRING LINE AS ATO FLEXES ITS NEW(ISH) MUSCLES

The high level of insolvencies in the construction industry continues with ASIC reporting 1,051 insolvencies in the industry for New South Wales over the year to 30 June 2013. This represents almost half of the insolvencies in the construction industry nationally.

These worrying statistics are compounded by the fact that approximately 85% of the construction industry insolvencies (a statistic replicated both nationally and in New South Wales) reported that they had unpaid ATO debts owing at the time the insolvency practitioner was called in.

Company directors need to beware that non-payment of ATO debts now carry significant personal consequences, with the June 2012 amendments to the Director Penalty Notice **(DPN)** regime.

Previous DPN regime

Company directors could only become personally liable for unpaid PAYG tax liabilities once the ATO commenced recovery proceedings and served a DPN on the director. In order to avoid personal liability, company directors had to take one of the following courses of action within 21 days of service of a DPN being issued:

- Payment of the liability; or
- Appointing an administrator to the company; or
- Appointing a liquidator to the company.

Assuming a company director acted with one of the above courses of action, they would avoid personal liability under the protection of the corporate structure, i.e. this would be a debt of the company only.

New DPN regime

The ATO will still be prevented from commencing recovery proceedings against a company director until it has served a DPN. However, where PAYG (and now also superannuation) remain unreported and unpaid within three months after the due date, company directors are subject to personal liability even if they place the company into administration or liquidation, i.e. this is no longer a defensive action available.

Furthermore, a new director can also become liable for unpaid ATO debts preceding their appointment. If a company has not paid or reported its PAYG or SGC liability to the ATO within three months after the payments became due, then the new director will become personally liable for those debts 30 days after their appointment.

Company directors will only have a 30 day period to understand the company's liability position and resign to avoid any personal liability.

12 months and counting with the new DPN regime

For the first year of operation of the new regime we observed an increasing number of DPNs being issued by the ATO for unpaid PAYG and SGC liability, even after the company was placed into liquidation. We expect this trend to continue as the ATO ramps up training of its staff and automates the DPN process.

In some instances, the ATO has issued garnishee notices to third parties (e.g., a bank, or someone owing money to the director's company) requiring them to pay all or part of that money to the ATO.

What should company directors do?

Here are our tips to avoid personal liability:

1. **Report on time** – even if the debts cannot be paid, company directors need to ensure they report PAYG tax and SGC liability within three months of them becoming due. This reserves the rights and options available to directors to avoid personal liability;
2. **Consider a payment plan** – if you cannot pay, then consider negotiating a realistic payment proposal with the ATO if the liabilities are unpaid and unreported beyond three months after the due date;
3. **Reconsider the priority of creditor payments** – directors need to ensure that PAYG and superannuation debts are paid as promptly as possible;
4. **New directors should undertake due diligence** – to ascertain the PAYG and superannuation liability position before accepting appointment as Director. New directors can be deemed liable for debts incurred before their appointment after 30 days;
5. **Ensure your company's registered address details are up to date on ASIC record** – DPNs will be validly served and enforceable 21 days from the date the ATO posts it to the registered address as listed with ASIC, failure to update address with ASIC is not an acceptable defence; and

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6. **Consult with an insolvency specialist** – If the company has cash flow issues, there are provisions in the Corporations Act which can be utilised to restructure your company by implementing arrangements with creditors. There are options other than liquidation.

Case Study

Alex and Jess are directors of Build Co, which is required to pay amounts withheld under the PAYG withholding provisions to the ATO on a quarterly basis. During the March quarter, Build Co withholds $6,000 from payments made to its employees. Build Co fails to report and pay any of the withheld amounts to the ATO by the due date (i.e., 28 April). From that day the ATO is entitled to serve a DPN, making Alex and Jess personal liable to the penalty but can be avoided by either paying the liability, appointing an administrator, or appointing a liquidator.
If Build Co fails to report and pay any of the withheld amounts to the ATO within three months after the due date (i.e., by 28 July), the ATO is entitled to serve a DPN, making them personally liable.

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