1 May 2012

The General Manager
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Dear Treasury

Tax Laws Amendment (2012 Measures 3 No. 2) Bill 2012: Companies' non-compliance with PAYG withholding and superannuation guarantee obligations: Amendments to the director penalty regime

Chartered Secretaries Australia (CSA) is the independent leader in governance, risk and compliance. As the peak professional body delivering accredited education and the most practical and authoritative training and information in the field, we are focused on improving organisational performance and transparency.

Our Members are all involved in governance, corporate administration and compliance with the Corporations Act (the Act), with primary responsibility to develop and implement governance frameworks in public listed and public unlisted companies, as well as in private companies.

General comments

CSA welcomes the opportunity to comment on the proposed Tax Laws Amendment (2012 Measures 3 No. 2) Bill 2012: Companies' non-compliance with PAYG withholding and superannuation guarantee obligations (amendments to the director penalty regime).

However, CSA is disappointed that the legislation has not addressed in full the concerns we raised in our earlier submission on the Exposure Draft: Tax Law Amendments to Strengthen Company Director Obligations and Deter Fraudulent Phoenix Activity. Indeed, we note that the new bill, specifically by name and explanatory materials, proposes amendments that do not restrict the director penalty regime to cases of phoenix activity. Our key concern in the earlier consultation was that the amendments extended to all directors rather than being confined to phoenix activity, as set out in the title of and explanatory documents accompanying the original exposure draft.

We note that the original aim of the legislation has changed from one of protecting employee entitlements in cases of phoenix activity to one of extending the director penalty regime beyond phoenix activity. This deliberate change in policy[i] heralds a move beyond the intent of the original legislation, which was expressly to deal with phoenix activity. The policy intent now is to capture expressly all directors in the amendment to the director penalty regime, regardless of whether they are involved in phoenix activity, although the explanatory memorandum notes that the amendments should also deter company directors from engaging in fraudulent phoenix activities.

This extension, moreover, is in direct opposition to the government's own commitment to reform of derivative liability for corporate fault, as articulated in the Council of Australian Government (COAG) principles[ii] that aim to ensure that derivative liability is imposed on directors and other corporate officers in accordance with principles of good corporate governance and criminal justice, and is not imposed as a matter of course.

CSA is also extremely disappointed at the limited time granted to stakeholders to respond to the bill. CSA is of the view that providing only eight working days for consultation cannot be said to show any real desire to receive feedback on the bill. The process of earlier consultation has not resulted in stakeholder concerns being addressed — time to respond to this bill is even more necessary in such circumstances.

CSA notes that the short consultation time frame does not accord with the recommendations of the Banks Report[iii] and, in particular, the principle which requires effective consultations with stakeholders. Furthermore, it does not accord with the Australian Government's *Best Practice Regulation Handbook* (the Handbook), which sets out guidelines for consultation in Appendix C. These recommend a consultation period of between six and 12 weeks.

CSA's concerns with inadequate time for consultations reside with the problems which arise from insufficient or inappropriate consultation. In the first instance, CSA notes that a short time frame provides insufficient time to canvass views and generate discussion among stakeholders and potential respondents. When stakeholders do not have sufficient time to review the proposed reforms and consider their impact, it cannot be said that effective consultation is taking place.

The second issue is that of unintended consequences attached to drafting and insufficient time to provide input on the practical implications of the drafting. Consultation time frames need to be appropriately structured to allow ample time for stakeholders to provide the necessary insight into the direct and indirect consequences of proposed legislation or legislative amendment.

Concerns with the bill

The legislation extends the director penalty regime to apply to superannuation guarantee amounts such that directors can be personally liable for their company's unpaid superannuation guarantee amounts. We refer you to our earlier submission where we noted our support for these amendments in relation to phoenix activity due to the insolvency risks associated with such organisations, but where we also expressed strong concerns that there could be very undesirable unintended consequences in extending the amendments to all directors in all circumstances.

The government has specifically noted that the amendments are not intended to capture only those directors who seek to avoid their responsibilities, but are being imposed on all directors, regardless of whether their behaviour is linked to the breach. That is, there is no consideration of any element of fault in the bill.

CSA supports the principle that, where companies contravene statutory requirements, liability should be imposed in the first instance on the company itself, and that personal criminal liability of a corporate officer for the misconduct of the corporation should be limited to situations where the officer knowingly encourages or assists the commission of the offence or is reckless in attending to their duties as a corporate officer, thus allowing the offence to occur (accessorial liability). This is a key principle agreed to by COAG — 'Principle 2: Directors should not be liable for corporate fault as a matter of course or by blanket imposition of liability across an entire Act'. The bill is also inconsistent with Principles 4, 5 and 6.

CSA does not support derivative liability, where directors who are diligently and responsibly undertaking their responsibilities and duties and who could not reasonably be expected to be aware of a breach are presumed to be guilty of an offence.

CSA is also very concerned that this bill misunderstands and so blurs the traditional boundaries between the role of non-executive directors and the role of management. The latter are typically the managers, with responsibility for day-to-day operations, including responsibility for ensuring that superannuation contributions are paid. Directors typically monitor management but are not usually directly involved in the day-to-day operations of the organisation.

There are already serious offences for people who fail to comply with their Pay As You Go (PAYG) withholding and superannuation guarantee contribution (SGC) withholding obligations, and appropriate penalties are in place. However, the measures contained in the amendments to the director penalty regime apply to directors of corporations that are not engaged in any fraudulent phoenix activity but who may be caught in the penalty regime as a direct result of inadvertent non-compliance that arises as a result of circumstances beyond the control of either the directors or the corporation's management.

As noted in our earlier submission, inadvertent non-compliance could arise in a large organisation with hundreds or thousands of employees which, due to a technical processing error in the payroll department, resulted in a small number of PAYG or superannuation contributions not being paid and remaining undetected for a period of time. As the bill is currently drafted, directors of such an organisation would face direct personal liability and penalties, despite having no knowledge of, or involvement in (or any reasonable prospect thereof), the contravention. CSA is strongly of the view that it would be inappropriate to attach derivative liability in such circumstances.

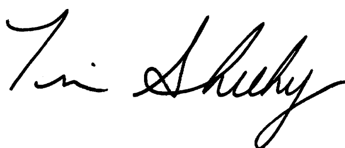
CSA continues to recommend that these extreme measures should be directly targeted at those who undertake fraudulent phoenix activity in order to avoid their obligations and not be applied to all directors. We are extremely concerned that the bill as currently drafted will have unintended undesirable consequences.

CSA notes that a board can direct a chief executive officer to pay employee superannuation entitlements as a condition of their employment contract. This would be a much more practical approach to ensuring employees receive their superannuation contributions than extending the director penalty regime in the manner outlined in the bill. The current approach is one of a ‘sledgehammer used to crack a walnut’.

CSA is pleased to see that the bill requires that the Commissioner of Taxation issue a notice to commence proceedings to recover unpaid superannuation guarantee amounts from directors personally. In situations where directors have no knowledge of, or involvement in (or any reasonable prospect thereof) the contravention, they are now granted the opportunity to direct management to make the SGC payments before being held personally liable.

CSA would be more than happy to discuss this issue further with you.

Yours sincerely



Tim Sheehy
CHIEF EXECUTIVE

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[i] Department of Treasury, *Explanatory Memorandum, Strengthening incentives for companies to comply with PAYG withholding and superannuation guarantee*, pp 3—4: 'These amendments protect workers' entitlements, strengthen directors' obligations by:

- expanding the application of the director penalty regime to unpaid superannuation guarantee charge;
- allowing the Commissioner to immediately commence recovery of all director penalties when the company's unpaid liability remains unpaid and unreported three months after the due day, regardless of the character of the company's underlying liability; and
- providing the Commissioner with the discretion to prevent directors and, in some instances their associates, from obtaining PAYG withholding credits where the company has failed to pay amounts withheld to the Commissioner.

These amendments and the ATO's ability to target their application deter company directors from engaging in fraudulent phoenix activities or using amounts that should be paid to the Commissioner or superannuation funds for company purposes.'

[ii] On 7 December 2010, COAG agreed to a set of six principles for the imposition of personal criminal liability for directors and other corporate officers in circumstances of corporate fault (COAG Principles). The Principles are that:

1. Where a corporation contravenes a statutory requirement, the corporation should be held liable in the first instance.
2. Directors should not be liable for corporate fault as a matter of course or by blanket imposition of liability across an entire Act.
3. A 'designated officer' approach to liability is not suitable for general application.
4. The imposition of personal criminal liability on a director for the misconduct of a corporation should be confined to situations where:
    a. there are compelling public policy reasons for doing so (for example, in terms of the potential for significant public harm that might be caused by the particular corporate offending);
    b. liability of the corporation is not likely on its own to sufficiently promote compliance; and
    c. it is reasonable in all the circumstances for the director to be liable having regard to factors including:
        i. the obligation on the corporation, and in turn the director, is clear;
        ii. the director has the capacity to influence the conduct of the corporation in relation to the offending; and
        iii. there are steps that a reasonable director might take to ensure a corporation's compliance with the legislative obligation.
5. Where principle 4 is satisfied and directors' liability is appropriate, directors could be liable where they:
    a. have encouraged or assisted in the commission of the offence; or
    b. have been negligent or reckless in relation to the corporation's offending.
6. In addition, in some instances, it may be appropriate to put directors to proof that they have taken reasonable steps to prevent the corporation's offending if they are not to be personally liable.

The COAG principles were agreed following the report to the government by the Corporations and Markets Advisory Committee (CAMAC) in 2006, *Personal liability for corporate fault*, September 2006. The report was prepared in response to the reference to the Advisory Committee in July 2002 by the then Parliamentary Secretary to the Treasurer of issues relating to directors' duties and personal liability. The Report states on pp 33-35: 'The Committee is of the view that, as a general principle, individuals should not be made criminally liable for misconduct by a company except where it can be shown that they have personally helped in or been privy to that misconduct, that is, where they were accessories. There was strong support for this position in submissions. The Committee is concerned about the trend in various pieces of legislation to treat directors or other corporate officers as criminally liable for misconduct by their company unless they can make out a relevant defence. Provisions of this kind are

objectionable in principle and unfairly discriminate against corporate personnel compared with the way in which other people are treated under the criminal law:

- the deeming of individuals to be guilty of an offence, by reason of an office they hold or a role they play, unless they can establish a defence, offends ordinary notions of fairness
- the reversal of the onus of proof inherent in such provisions is contrary to the general presumption of innocence in criminal law
- the fact that someone is a corporate officer should not subject that person to criminal liability in a way that an individual in other circumstances, or an individual in a responsible position in a non-corporate organisation, would not be so subject
- the fact that a corporate officer may be able, in the circumstances of a particular case, to make out a relevant defence and thereby avoid conviction does not remove the seriousness of the risk to reputation and the apprehension, effort and expense to which he or she is subject by being exposed to criminal liability on a prima facie basis
- as a practical matter, whatever justification there may be, in the context of a small or closely-held company, for treating the individuals who run the company as personally responsible for its conduct, this approach becomes increasingly problematic in the case of larger corporate organisations. It does not fit at all well with the current Australian preferred governance model of boards constituted by a majority of non-executives
- an undue skewing of personal liability provisions, towards the interests of corporate compliance at the expense of individual fairness, will discourage people from accepting board or managerial positions in corporate enterprises.

Apart from objections in principle to this extended form of personal liability, the range and disparity in the form of the deeming provisions found in various pieces of legislation create complexity and work against clear understanding and effective compliance.'

[iii] Treasurer of Australia, *Report of the Taskforce on Reducing Regulatory Burdens on Business – Final Government Response,* Media Release, 15 August 2006