

ATO recovery action: how it works and how to avoid it

A GUIDE FOR ACCOUNTANTS AND ADVISORS

GET IN TOUCH



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1. INTRODUCTION

The Australian Tax Office (ATO) is currently owed about \$20 billion in unpaid tax.

While some of the debt owed to the ATO is uncollectable, a large amount is owed by businesses and individuals who have encountered temporary cash-flow shortages and subsequently fallen behind with required ATO payments. These taxpayers want to get up to date with their tax obligations but will face significant problems if the ATO takes recovery action against them.

We have been referred numerous clients by accountants who we have helped deal with their ATO debts. We believe that the best way to approach tax debts is to be proactive in obtaining professional assistance and in engaging with the ATO to negotiate a payment arrangement. However, taxpayers and their advisors need to be aware of the types of recovery action that the ATO can take if no payment arrangement is in place or able to be negotiated and the possible impact that this can have.

We have prepared this guide to help accountants and their clients understand:

- how to go about negotiating a successful payment arrangement with the ATO for large tax debts or in more complex circumstances
- the measures the ATO can take to recover tax debts if no payment arrangement is in place
- the impact ATO recovery action can have
- the steps that can be taken to avoid or minimise the effect of ATO recovery action.

If you would like to discuss any of the information contained in this publication or need advice on your own circumstances, please get in touch with us for a free initial consultation.



2. ATO PAYMENT ARRANGEMENTS

Payment arrangements are the most common step the ATO takes to recover tax debts, with over 950,000 arrangements entered into with taxpayers in the 2016 financial year.

The ATO will generally grant payment arrangements for small tax debts if a taxpayer or their accountant contacts them by phone. For larger tax debts, the ATO may request a written application for a payment arrangement, which should include:

- the taxpayer's proposal for a payment arrangement, including a proposal to deal with future interest or penalties that may be payable on the tax debt
- details of the reasons for the taxpayer failing to pay tax debts on time
- details of the taxpayer's current financial position, which should establish that the taxpayer can satisfy the debt to the ATO as well as debts to other creditors
- information and documents to satisfy the ATO that the taxpayer is able to meet instalments payable under the proposed payment arrangement, such as historical profit and loss statements evidencing a taxpayer's profitability and/or budgets or cash-flow forecasts.

Payment arrangements can take many forms, however, the ATO will usually:

- accept tax debts being paid by instalments
- require future tax lodgements and payments to be made on time
- consider writing off certain interest and penalties charged to a taxpayer
- require outstanding tax debts to be paid within 12 months (although they may agree to a longer payment period)
- consider applying payments made towards certain components of a tax debt, such as towards amounts that are the subject of a director penalty notice, although they are under no obligation to do so.

Security over assets

In circumstances where a taxpayer is unable to pay their debt to the ATO, the ATO may request, as part of a payment arrangement, that security is provided over the taxpayer's assets or the assets of a third-party guarantor. The most common type of security which the ATO will take is a mortgage over real property.

Additionally, if the ATO has refused a request for a payment arrangement by a taxpayer, the taxpayer may offer security over assets to the ATO, which may lead to the ATO reconsidering its position and granting the payment arrangement.

The ATO has standard security documents and it will add the costs associated with preparing and lodging these documents to the taxpayer's debt.

How we help secure ATO payment arrangements

We are often contacted by the accountants of companies or individuals who owe large amounts to the ATO. These taxpayers may have previously defaulted on ATO payment arrangements, or had payment arrangement proposals refused.

If the circumstances warrant it, we can assist a taxpayer to negotiate a payment arrangement with the ATO. While all of our clients have different financial circumstances and every proposal we put to the ATO is different, in most cases we:

- provide information to the ATO regarding the matters they require to be set out as part of a proposal for a payment arrangement
- advise the ATO of the estimated return they will receive by forcing the company into liquidation or the person into bankruptcy (based on our experience as insolvency practitioners) compared to accepting the proposed payment arrangement
- provide a comparison of the return to the ATO if a taxpayer's proposal for a payment arrangement is accepted (including, in most cases, on the basis that the ATO writes off some or all interest and penalties charged).

We have found this approach to be particularly effective when dealing with the ATO. One of the reasons for this is that the ATO is aware that in most formal insolvency appointments it receives little or no return.

3. DIRECTOR PENALTY NOTICES

A company is generally required to:

- lodge business activity statements (BAS) with the ATO each quarter (or lodge monthly instalment activity statements) reporting the amount of PAYG tax payable to the ATO
- pay required amounts of PAYG tax to the ATO by due dates
- pay superannuation contributions for its employees by due dates
- lodge a superannuation guarantee charge (SGC) statement with the ATO if it fails to pay superannuation contributions by due dates.

The ATO is able to recover a company's unpaid PAYG tax and superannuation from a company's directors by issuing any or all of the directors with a director penalty notice (DPN).

There are two types of DPN that the ATO can issue, depending on the circumstances:

21-day DPN (PAYG tax or superannuation unpaid but returns lodged within three months)

If a company fails to pay PAYG tax or superannuation, but it lodges its BAS and SGC statements within three months of due dates, the ATO is able to issue a DPN to the company's directors. The directors of the company will become liable to the ATO for the amount of PAYG tax and/or superannuation claimed in the DPN, unless:

- the PAYG tax or superannuation is paid; or
- the company is placed in liquidation or voluntary administration within 21 days of the date of the DPN.

"Lockdown" DPN (PAYG tax or superannuation unpaid and returns not lodged within three months)

If a company fails to pay PAYG tax or superannuation and it also fails to lodge its BAS and SGC statements within three months of due dates, the directors are automatically personally liable for unpaid PAYG tax and superannuation. In these circumstances, the ATO:

- can issue a DPN to recover unpaid PAYG tax or superannuation from the directors
- will hold the directors liable even if the company is placed in liquidation or voluntary administration
- can and will issue DPNs after a company is already in liquidation or voluntary administration
- can also estimate a company's liability for PAYG tax and superannuation and then issue a DPN based on these estimates of liability.

What happens if a director is liable under a DPN?

If a director becomes liable under a DPN, the ATO will treat the liability just as it would treat any ordinary tax debt payable. The ATO can and will:

- commence legal proceedings and obtain a judgment for the amount of the debt
- use the judgment to issue a bankruptcy notice and then subsequently make a director bankrupt
- garnish funds from a director's bank account or from their wages.

If a company has multiple directors, the ATO will often target its recovery action at the director or directors who it considers have the best ability to pay. The ATO will have certain information on a director's personal financial position based on their past income tax returns.



What can a director do to avoid DPN liabilities?

These tips will help directors avoid personal liability under DPNs:

- if a company is facing financial difficulty, get professional advice at an early stage – or immediately if a DPN is received. A professional advisor will be able to outline the risks associated with the continued trading of a company, including risks associated with DPNs
- seek to negotiate and then enter into a payment arrangement with the ATO. The ATO generally won't issue a DPN if they believe a payment arrangement is being negotiated in good faith, and they won't issue a DPN if a payment arrangement is in place and being complied with
- lodge BAS and SGC statements on time or, at worst, within three months of their due dates. If these lodgements are made but required amounts are not paid, directors will still have 21 days from the date of a DPN to place a company in liquidation or voluntary administration to avoid personal liability
- make sure directors' postal addresses are up to date in records maintained by the ASIC. DPNs are issued to directors' personal addresses as recorded with the ASIC. Non-receipt of a DPN due to a change of address is not a defence to a claim by the ATO
- if a liquidator or voluntary administrator is to be appointed to avoid liability, the time to make such an appointment is within 21 days of the DPN being issued – not 21 days from the date it was received
- before agreeing to be a director ensure a company has no PAYG tax or superannuation payable.

What can a director do if they are liable under a DPN?

If a director is liable under a DPN and the company involved is unable to pay the debt they should:

- promptly seek advice from a qualified professional
- if possible, negotiate a personal payment arrangement with the ATO for the amount of the director penalty debt – we have assisted numerous company directors with this
- if there are other directors of the company, seek that they make a contribution to the ATO to pay a proportionate part of the liability
- consider whether it may be possible to put forward a proposal for a personal insolvency agreement (a formal agreement under the Bankruptcy Act 1966 (Cth)) to avoid bankruptcy
- if there are no other alternatives, consider filing for bankruptcy.

Old and new directors

The ATO is able to issue a DPN to:

- someone who was a director at the time when unpaid PAYG tax or superannuation was incurred but who has subsequently resigned
- an incoming new director, after they have been in office for more than 30 days.

Defences to claims by the ATO under DPNs

A company's director will have a defence to a claim by the ATO under a DPN if they are able to establish that:

- due to illness or another acceptable reason, the director was not managing the company at the time the liability that gave rise to the DPN was incurred
- they took all reasonable steps to meet its obligations to pay PAYG tax
- they took all reasonable steps, where relevant, to place the company in liquidation or appoint a voluntary administrator to the company
- they took all reasonable steps to ensure that the company complied with its obligations to pay superannuation. This defence may be available, for example, in circumstances where directors reasonably thought they were engaging a subcontractor but the subcontractor was subsequently deemed to be an employee to whom superannuation provisions applied.

Defences to a claim under a DPN are often difficult to establish and legal advice and assistance will be required, which will be costly.

4. GARNISHEE NOTICES

The ATO can issue a garnishee notice to someone who holds money on behalf of a taxpayer or who may be liable to pay money to a taxpayer. A garnishee notice provides the ATO with a "charge" (a form of security) over the property against which the notice is issued, and it is an offence for the recipient of a garnishee notice not to comply with its terms.

Most commonly, garnishee notices are issued to:

- banks who hold money on behalf of a company or individual
- debtors who owe money to a company or individual
- an individual's employer to garnish a percentage of funds from their income.

A garnishee notice requires the recipient to pay funds to the ATO in lieu of a company's or an individual's taxation debts. For example, the ATO may issue a garnishee notice to a company's bank, requiring the bank to pay all or a percentage of funds held in the company's bank accounts to the ATO up to the amount of the company's taxation liability.

Impact of garnishee notices

A garnishee notice issued in respect of a trading company can have significant adverse effects on that company's financial position. This is because funds that may have been available to pay wages or outstanding trade creditors and other debts will instead be paid to the ATO.



Additionally, a garnishee notice issued in respect of an individual can result in significant funds being obtained by the ATO from their bank account, or the ATO taking a percentage of the person's wages until the amount of the ATO's debt is paid.

Given the potentially significant adverse effects of a garnishee notice, it is important for companies and individuals who fall behind in payment of their tax obligations to be proactive in their dealings with the ATO. Failing to initiate discussions with the ATO about how to repay tax debts makes the ATO more likely to take recovery action, including the issuing of a garnishee notice.

Garnishee notices issued to a person's employer

A garnishee notice can be issued for any type of personal tax debt, including income tax debts, GST or PAYG tax payable by a sole trader, or debts owed under DPNs. A garnishee notice in respect of an individual can be issued to various parties including the person's employer. If a garnishee notice is issued to a person's employer, it will require the employer to deduct a percentage of the person's pre-tax wages and pay the amount deducted to the ATO.

If this type of garnishee notice is issued and then a person goes bankrupt, the ATO can keep enforcing the notice generally until the person is discharged from bankruptcy, which is currently a minimum of three years from when they lodge their statement of affairs. That means the ATO can keep deducting money from a person's wages even while they are bankrupt.

How to avoid or minimise the impact of a garnishee notice

Individuals or companies with tax debts should obtain professional advice at an early stage on risks associated with the continued trading of the company, including risks associated with garnishee notices.

If a company genuinely wants to deal with its financial problems, including debts owed to the ATO, then it should:

- seek to negotiate a payment arrangement with the ATO. The ATO generally won't issue a garnishee notice if they believe a payment arrangement is being negotiated in good faith, and they won't issue a garnishee notice if a payment arrangement is in place and being complied with
- consider what information is being provided to the ATO in order to negotiate a payment arrangement. For example, if a list of a company's debtors is provided to the ATO and then the ATO refuses a payment arrangement, the ATO will then be able to issue garnishee notices to the company's known debtors
- be aware that if it is operating a bank account that holds credit funds in it, the ATO may issue a garnishee notice to the bank
- appoint a liquidator or voluntary administrator if it is ultimately unable to pay its debts including its debts to the ATO.

An individual with a significant ATO debt can:

- negotiate a payment arrangement with the ATO, if possible
- put forward a proposal for a personal insolvency agreement
- file for bankruptcy if they cannot pay their debts over time. Once a person is bankrupt, the ATO generally won't issue garnishee notices to their employer or any other party for pre-bankruptcy tax debts.

If the ATO has issued a garnishee notice to a person's employer, they can:

- resign their employment and obtain a new job. A garnishee notice will not follow a person to their next employer, however, there is a chance that the ATO may issue a new garnishee notice to a new employer even after bankruptcy
- make submissions to the ATO and ask it to reduce the amount it takes each pay period. Taking various factors into account, the ATO will then decide whether or not to do this.

5. ATO WINDING UP PROCEEDINGS AND COMPANY LIQUIDATION

The ATO is the most common creditor to pursue winding up applications against companies – it pursued over 1,500 in the 2017 financial year. The ATO is generally only able to file a winding up application against a company in court if it has issued the company with a statutory demand and the company has failed to pay the amount of the demand within 21 days of service.

If the ATO files a winding up application against a company then the company will be placed in liquidation by the court unless the debt to the ATO is paid in full or a suitable payment arrangement is negotiated.

A company that receives a winding up application cannot be voluntarily placed in liquidation. However, the directors can still appoint a voluntary administrator with a view to putting forward a proposal for a deed of company arrangement in order to compromise debts owed to creditors including debts to the ATO.

It is best for company directors to be proactive in their dealings with the ATO and to negotiate a payment arrangement to pay a company's tax debts prior to a company receiving a statutory demand or a winding up application being filed. However, even if the ATO does issue a statutory demand or file a winding up application there are still options available to the company rather than merely letting the ATO put it into liquidation.

How we negotiate successful payment arrangements for companies facing liquidation

We have succeeded on a number of occasions in negotiating payment arrangements with the ATO on behalf of companies, even after the ATO has issued a statutory demand or filed a winding up application.

The negotiation of a payment arrangement is more difficult after a winding up application has been filed. Generally, the ATO will require a significant amount of its debt to be paid up front and/or some form of guarantee from the company's directors, possibly including the directors providing security to the ATO over assets that they own.

Here are some of the arrangements we have helped put in place:

- A large transport company owed several hundred thousand dollars to the ATO and had defaulted on eight previous payment arrangements, so the ATO was taking steps to wind up the company. After reviewing the company's circumstances with its directors and accountants, we advised the ATO that placing the company in liquidation would likely result in the directors' bankruptcy, due to the numerous guarantees they had given to financiers and other parties. The directors then engaged us to put another proposal to the ATO, arranging to pay the company's tax debt over two years providing the ATO agreed to write off the interest and penalties it had charged. After some negotiation, the payment arrangement was accepted and the company avoided liquidation.

- The director of a company approached us about a retail business it traded. The business owed several hundred thousand dollars to the ATO. The ATO had issued the company with a statutory demand and refused a payment arrangement request to pay its outstanding debt by monthly instalments. We put a similar payment arrangement proposal to the ATO, however, as part of the proposal we pointed out the ATO's likely return in liquidation, along with details of the steps the company had taken to improve its profitability. The ATO accepted this payment arrangement and agreed to withdraw the statutory demand it had issued.

6. ATO BANKRUPTCY PROCEEDINGS

The ATO can and will commence legal proceedings against a person who owes unpaid tax debts. This can include tax debts owed as a result of a DPN. If the legal proceedings are not defended, or any defence is unsuccessful, the ATO will obtain a court judgment for the amount of tax owed plus interest and costs.

If the ATO obtains a judgment of more than \$5,000 against a person, it can use that judgment to arrange for a bankruptcy notice to be issued. The bankruptcy notice is required to be served on a person, either personally or by way of substituted service pursuant to a court order.

A person served with a bankruptcy notice has 21 days from the date of service to pay the debt claimed. If payment is not made within this timeframe the person will have committed an act of bankruptcy and the ATO can and will apply to court to make the person bankrupt. The hearing date for the court application will be about one month after the application is filed.

How we help negotiate payment arrangements for people facing bankruptcy

It is best for individuals to be proactive in their dealings with the ATO and negotiate a payment arrangement prior to the ATO taking recovery action. However, if the ATO has already issued a bankruptcy notice, or even if it has commenced legal proceedings to make a person bankrupt, it is still possible to negotiate a successful payment arrangement with them.

We recently negotiated a payment arrangement for a client who had failed to pay an amount claimed in a bankruptcy notice issued on behalf of the ATO, resulting in the ATO commencing legal proceedings to bankrupt him. We put a proposal to the ATO to pay the debt owed by way of instalments over two years. The proposal was initially rejected but we subsequently made an offer to the ATO to take security over the debtor's property as part of the payment arrangement. The ATO agreed and arranged for security documents to be prepared, withdrawing the legal proceedings it had commenced to make the debtor bankrupt.



7. OTHER ATO RECOVERY TOOLS AND TYPES OF ATO RECOVERY ACTION

Disallowing PAYG withholding credits

The ATO may “disallow” PAYG tax credits available to a director or a close associate of a director in their personal income tax returns in circumstances where the employer company has failed to pay PAYG tax in respect of amounts paid to them.

Engagement of third-party debt collectors

The ATO commonly engages external debt collection agencies and lawyers to collect unpaid tax debts on its behalf.

Security bond deposits

In some circumstances the ATO will ask a company to provide a security bond deposit against projected future tax liabilities. The ATO may ask for a security bond deposit prior to registering a company for an ABN if they consider that a company's director has a history of being associated with companies that have failed to report and/or pay required tax amounts.

Indemnities from directors for unfair preference claims

If a company is placed in liquidation, a liquidator may be able to recover amounts that the company paid to the ATO in the six months prior to the relation-back day for the liquidation. This type of claim by a liquidator is known as an unfair preference claim.

If a liquidator pursues the ATO for an unfair preference claim, then the ATO is entitled to seek recovery from the company's director of any PAYG tax that it is required to pay to the liquidator. In order to recover PAYG tax in this manner, the ATO will require a company's liquidator to commence legal proceedings against it to recover unfair preference payments, and the ATO will then join the company's director as a party to the legal proceedings.

Referring tax debts to credit reporting agencies

The Federal Government proposed in its 2016 Mid-Year Economic and Fiscal Outlook that the ATO be authorised to disclose unpaid tax information to credit reporting agencies. Legislation implementing this proposal has been drafted, but not yet been passed, however, if it is implemented the ATO will be able to disclose unpaid tax information for taxpayers with an ABN where:

- the taxpayer owes more than \$10,000 in unpaid tax
- the tax is at least 90 days overdue (with this period possibly to be increased to 180 days)
- the tax debt is not subject to a payment arrangement
- the tax debt is not subject to dispute
- the ATO has notified a business it intends to do so.

8. TESTIMONIALS

We have provided advice and assistance to numerous companies and individuals who have encountered problems in paying debts owed to the ATO. Here are some of their experiences:

" In an unfortunate series of events, our directors were faced with director penalty notices issued by the ATO. We sought advice with and subsequently engaged Pearce & Heers to assist us with the negotiation with the ATO to obtain a solution. This resulted in a good outcome, with a manageable payment plan to alleviate the debt without any further measures needing to be taken by the ATO. I would happily recommend their services.

Julie, company director

" Pearce & Heers have helped three of our clients deal with tax debts which they owed in 2017, including negotiating two successful payment arrangements with the ATO."

LC, accountant

" Losing your business and financial security is a very stressful time for anyone but dealing with the team at Pearce & Heers made a very difficult time that little bit easier. I would definitely recommend you talk to Pearce & Heers if you find yourself in a difficult situation such as ours.

Kate, business owner

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