

CLIENT UPDATE

■■ CORPORATE INSOLVENCY

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Risks Facing Directors and Officers in Australia

In Australia today, there are more than 700 laws at federal, state and territory level that impose personal liability on company directors and officers for the actions of their companies. These are in addition to duties imposed by the *Corporations Act 2001*.

In South Australia, the *Statutes Amendment (Directors' Liability) Bill 2011* has sought to amend 25 pieces of legislation currently imposing liability on directors for corporate fault, and there appears to be an emerging trend to relieve director liability in other states as well.

Despite the raft of legal means to *pierce the corporate veil*, the significant risks faced by directors involved with companies trading at or near insolvency are limited to just a handful, and are as follows:

- Insolvent trading;
- Personal guarantees;
- Director penalty notices; and
- ATO indemnification claims.

With respect to insolvent trading, directors face prosecution from ASIC as well as liquidators. In the past year, ASIC has made it clear that it will increasingly focus attention on director prosecutions where debts are incurred when a company is insolvent, and liquidators have always been vigilant to review and seek commercial recoveries from directors for insolvent trading.

Recent ASIC guidelines emphasise the need for directors to keep themselves informed about the financial position of their companies, proactively investigate financial difficulties, obtain advice and, where the director suspects the company is insolvent, take active and timely steps to prevent further debts being incurred.

The *Corporations Act* provisions tend to be quite severe when compared to other legal jurisdictions and international insolvency practice generally, which emphasises the desirability of early intervention and workouts for companies under stress.

Directors and officers must be especially vigilant to comply with the *Corporations Act* and be aware of the steps that should be taken to avoid personal responsibility.

When to stop trading?

The particular wording of the *Corporations Act* requires a director to prevent trading whilst insolvent and this raises the question time and time again; when should an insolvency appointment occur?

A recent English case in *Roberts v Frohlich* [2011] EWHC 257 (Ch) provides some useful clarification of the thinking in this regard. In this matter, the Judge considered the directors were driven by 'willfully blind optimism' and the 'reckless belief' that in continuing with the project 'something might turn up' and found the directors were liable for wrongful trading (the *insolvent trading* equivalent) pursuant to the *UK Insolvency Act*.

We see many instances where directors delay taking the *hard decision* and this judgment serves as a useful reminder that a decision to continue to trade when the company is insolvent must be based upon a solid rationale and clear intention.

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Budget Update – ATO’s big stick for late returns

The 2011/12 Federal Budget contained significant *proposed* amendments that will impact upon the personal liabilities of directors.

With effect from 1 July 2011:

- the director penalty regime will be extended to superannuation guarantee amounts, making directors personally liable for their company’s failure to pay employee superannuation;
- the Australian Taxation Office (ATO) will be given the power to commence recovery action against directors under the director penalty regime, without providing a 21 day grace period, for certain unpaid company liabilities that remain unreported after three months of becoming due; and
- in certain circumstances, directors and associates of directors will be prevented from obtaining credits for withheld amounts in their individual tax returns where the company has failed to pay withheld amounts to the ATO.

It is clear these amendments are intended to help the Government stem the level of debt outstanding to it with respect to taxation arrears and to help curb fraudulent phoenix activity.

ATO’s use of Garnishee Orders – SMEs watch out!

It has been observed in our office that the ATO is becoming increasingly vigilant with its debt collection, and is bringing legal proceedings to wind up many more companies than it did during the GFC.

However, prior to issuing a winding up application, the ATO can use a large number of debt collection techniques to encourage debt repayment. One of the most effective is the Garnishee Order.

Under a Garnishee Order, the ATO communicates directly with a company’s bank and can require anything from all to a fixed percentage of the proceeds in the company’s bank account to be paid immediately to the ATO.

For most businesses that are struggling, such an Order spells the sudden death of the business.

Tips on dealing with the ATO

In our experience, Garnishee Orders remain a last choice procedure for the ATO, and tend to be used when a breach of trust or understanding has occurred.

Therefore, when dealing with the ATO and negotiating payment arrangements, we recommend the following:

- Be open and honest with the ATO debt recovery officer;
- Commit to achievable payment plans, not impractical plans;
- Be proactive and **contact the ATO first** if a payment plan default is to occur; and
- Make sure ongoing tax obligations are lodged and paid on time.

About us

Heard Phillips aims to be the first choice for critical SME insolvency, restructuring and forensic accounting matters in South Australia.

Our firm seeks to deliver superior quality outcomes for clients through our credible and reliable practitioners, who take pride in displaying the highest level of respect to all stakeholders.

