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## OBLIGATIONS AND CONSEQUENCES OF BEING A COMPANY DIRECTOR



***Individuals considering accepting an appointment as a director of a company should always ensure that they are aware of the full extent of the obligations of the appointment.***

Given the current uncertain economy, understanding your obligations as a company director have never been so relevant. In addition to the obligations imposed on directors under common law and the Corporations Act, the Australian Taxation Law imposes director duties and obligations for which there are significant consequences in the case of a breach.

Director obligations under these three branches of law are discussed below however it should be noted that directors also have obligations under other Acts of law such as the Occupational Health and Safety Act.

It should be noted that the term 'director' extends to a person who though not formally appointed as a director, acts as a director or whose instructions or wishes are customarily followed by the directors of a company (e.g. a shadow director).

## Director Obligations under Corporations Act

Under provisions of the Corporations Act, directors owe a number of duties to the company they direct for example:

1. *Duty to exercise care and diligence* – a director must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would use if that person were a director of a company in the same circumstances.
2. *Duty to act in good faith* – requires a director to exercise their powers in the company's interest, not misuse their powers, avoid conflicts of interest and not take advantage of their position for their own personal interest.
3. *Duty not to misuse position or information* – directors must not use their position to gain an advantage for themselves or for someone else, must not cause detriment to the company or otherwise improperly use their position.
4. *Duty to disclose* – a director must disclose any material interest in matters relating to the affairs of the company.
5. *Duty to avoid conflict of interests* – requires directors to avoid situations in which there is a 'real and sensible' possibility of conflict between the director's personal interest and that of the company.
6. *Duty to avoid trading while insolvent* – a director must prevent the company from incurring debts where reasonable grounds exist for suspecting that the company will be unable to meet those debts.

The ATO Receivables Policy dated 24 July 2008 states that the Commissioner will support a Liquidator or Administrator in actions against directors where the actions of the directors have adversely affected revenue, particularly in the case of insolvent trading.

7. *Duty to maintain certain records and reports* – directors must ensure the company keeps written financial reports which correctly record its transactions in order to prepare financial statements as required by law.

The Corporations Law provides a safe harbour in certain circumstances for directors where they have relied on expert advice. However, the Corporations law also requires directors to undertake their own investigations.

## Director Obligations under Common Law

A director owes fiduciary duties to the company which it directs on the basis that directors are appointed to act for the benefit of the company, however the position itself carries powers that could be used to the detriment of the company. Many of the fiduciary duties overlap with those imposed by the Corporations Law as described above.

Fiduciary duties owed by directors include:

- the duty of care and diligence;
- the duty to act honestly and in good faith for the benefit of the company;
- the duty not to act for an improper purpose;
- the duty to retain discretion; and
- the duty to avoid conflict of interests.

## Director Obligations under Australian Tax Law

While directors or potential directors may be aware of the above obligations, a lesser known risk is the significant scope under Australian Tax Law to impose personal liability on a company director for certain tax obligations or liabilities of the company. The following discussion outlines circumstances in which this may occur.

1. Division 9 of the 1936 *Income Tax Assessment Act*

The object of Division 9 is to guarantee that the directors of a company are liable to ensure that a company satisfies its tax liabilities or, where it cannot do so, be placed in voluntary administration or liquidation. Division 9 only applies to certain tax liabilities as follows:

- Withholding type payments (e.g. employee pay as go you ("PAYG") withholding remittance);
- Amounts payable in relation to alienated personal services income; and
- Amounts payable in relation to non-cash benefits.

In relation to the above tax obligations, Division 9 requires that where a company has made a deduction or withheld an amount that has a due date, the directors must ensure that the company either:

- Complies with its obligations in relation to paying the amount to the Commissioner by the due date;
- Enters into a payment agreement with the Commissioner;
- Appoints an administrator for the company; or
- Is wound up within the meaning of the Corporations Act.

Where the above has not been complied with, the Commissioner may impose a personal liability or penalty on a Director equal to the outstanding liability.

It should be noted that new directors can also be personally liable under Division 9, even where they were not involved with the company at the time the action or default arose. Accordingly, prospective directors should undertake comprehensive reviews of the company's tax position prior to accepting a directorship.

A lack of knowledge itself is not considered a valid defence against a Division 9 penalty however, where a director, due to

illness or another reason, did not take part in the management of the company at any time, he or she may have a defence against the imposition of a Division 9 penalty. An alternative acceptable defence is where a director takes all reasonable steps to comply with the relevant duties imposed.

## 2. Section 8Y of the *Tax Administration Act* (“TAA”)

Pursuant to section 8Y of the TAA, if a company commits an offence, for example, failure to lodge income tax returns or to remit PAYG withholding, a person who is concerned with or takes part in, the management of the company (e.g. a director or public officer) is deemed to have personally committed the tax offence and may be liable to pay a fine and any outstanding tax liability that has accrued as a result of the tax offence.

As with Division 9, there are possible defences against a section 8Y penalty. Where it can be proved that the director/officer did not aid, abet, counsel or procure the act or omission or if it can be proved that the director/officer was not in any way, by act or omission, directly or indirectly, knowingly concerned in, or party to, the act or omission of the company, Section 8Y penalties may not be imposed.

## 3. Criminal Code

Directors can also be prosecuted under the criminal code in the case where they have breached certain taxation offences such

as entering into an arrangement to avoid paying income tax. Penalties can include fines, preclusion from holding the position of director in any Australian companies and/or imprisonment.

## 4. Goods and Services Tax (“GST”)

While it is unlikely that directors will be held liable for GST debts of the company under the GST Act itself, directors should be mindful that Division 444 of Schedule 1 of the *Tax Administration Act* (“TAA”) imposes obligations on directors in respect of indirect taxes. Pursuant to Division 444, any notice or proceeding that may be given to or taken against a company under an indirect tax law can be given to or taken against a director of that company.

## Conclusion

Accordingly, individuals considering accepting an appointment as a director, particularly in the case of an established company, should be mindful of the full extent of the obligations they are undertaking in accepting the appointment, and also undertake a review of the company’s tax liabilities and outstanding tax obligations prior to accepting the position. Directors should also conduct appropriate enquiries at regular intervals into the tax affairs of their company to ensure the company’s compliance with the relevant obligations. Directors should consider these potential types of consequences and outcomes when reviewing any director indemnity policies and should understand the extent of such cover.

If you have any queries, or would like advice in relation to any matters relating to any of the above, please contact either Michelle Saunders or Marissa Bechta on (08) 6311 6900.

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