accountantsdaily BULLETIN

Why lockdown DPNs put accountants in jeopardy

TAX

Tax professionals could find themselves in the firing line if a director becomes personally liable for company debts.

By Trevor Withane•02 December 2022•6 minute read

With the increasing willingness of the ATO to pursue enforcement activity and the credit crunch from interest rate rises, inflation and falling property prices, it's unsurprising that more and more directors are finding themselves personally liable for their companies' debts through the receipt of a Director Penalty Notice (DPN).

Sometimes, the first time a director becomes aware that the ATO is pursuing or may pursue the director personally is when the DPN lands in his or her lap. The big shock comes when the director learns that the DPN is a so-called lockdown DPN, which essentially means that unless the company pays the ATO debt, the director will become personally liable. And that could eventually lead to his or her bankruptcy. Under a lockdown DPN, directors are unable to avoid personal liability by placing the company in the hands of an external administration, such as a voluntary administrator or liquidator.

The lowdown on lockdown DPNs

In contrast to a regular DPN, lockdown DPNs are issued in cases where not only has the director failed to cause the company to discharge its tax obligations, but he or she has also failed to cause the company to maintain its lodgment obligations (i.e. not lodging business activity statements, instalment activity statements or superannuation guarantee statements within three months of the lodgment due date).

As a result, the penalties under a lockdown DPN are more severe — there is no way for the director to cancel the penalty other than fully paying the debt (i.e. placing the company into voluntary administration or liquidation will not extinguish the director's personal liability for the ATO debt).

If the director does not pay the ATO debt under the DPN, it can be expected that the ATO will take enforcement action against the director which could, if not paid or settled, ultimately lead to his or her bankruptcy.

Companies, particularly SMEs, will often rely on their external tax professionals to provide them with the ATO's latest enforcement trends and take proactive steps to ensure that ATO returns are prepared and filed on time.

Given that tax professionals will be advising hundreds of companies, without robust systems in place proactive advice and warnings may simply slip through the net.

Could the accountant be liable?

In circumstances where a lockdown DPN is issued and the company cannot be placed into external administration to enable its directors to escape personal liability, the company and its directors may look to their accountant and or tax agent for compensation. The directors may be able to establish that if they were advised of the impact of a lockdown DPN and/or advised to lodge their returns in a timely fashion, they would not have incurred personal liability. Even if the debt is not paid, compliance with at least the filing obligations would mean that only a normal DPN would be issued and therefore the director could avoid personal liability by simply putting the company into external administration. Directors may also be attracted to the tax professional's professional indemnity insurance policy to provide recompense for any loss.

It is well established that an accountant's failure to warn the client of a particular result may render that accountant liable for professional negligence in the same way as if he or she had given incorrect advice if:

(1) the matter in relation to which advice is being sought is sufficiently serious (which is likely the case when dealing with potential tax liability), and

(2) the importance that the client would attach to the advice given by the accountant in relation to that matter (i.e. whether the client would consider the advice being of sufficient importance to impact his or her behaviour).

This test is likely made out in respect of DPN claims where, absent some break in the chain of causation, it is plain that the accountant's advice would have a major impact on a director's decision to act in a particular way — particularly with respect to the lodgment of tax returns.

This reasoning is likely to apply to other tax professionals, such as tax agents. In these cases, the court will likely find the accountant and or tax agent liable for the penalty imposed by the DPN.

Further, tax professionals may also find themselves liable in contract for breaching the express (or, in some cases, even implied) terms of their retainer agreement, which would frequently impose an obligation of due care and skill on the part of the tax professional in providing their clients with necessary updates and warnings.

How do tax professionals avoid liability?

Tax professionals should consider whether they have adequate systems in place to ensure that their clients are kept updated, warned and chased if returns have not been lodged. A good starting point would be following industry best practices, which include:

- Staying on top of ATO updates. The habit of regularly checking updates should decrease the chances of accidentally overlooking anything important. Anecdotal evidence reveals many instances where professionals thought they were exercising due care and skill, only to find out that they were following outdated standards.
- Staying up to date with professional obligations, applicable laws and regulations.
- Always including a disclaimer that the advice given is based upon the accountant's own view of how the law would operate in relation to the matter in hand, and that the ATO may take a different view.
- Keeping records of your communications with the client and carefully taking file notes of any calls and advice given. Given that the standard the tax profession should adhere to is one of due care and skill, being in possession of full records of communications with the client may prove to be critical in establishing a successful legal defence in this regard.

Trevor Withane is a partner at Ironbridge Legal.