



29 September 2026

Ms Ruth Owen CBE GAICD
Tax Ombudsman

Submission to the review: *ATO's administration of Director Penalty Notices*

**Submitted by:
UNSW Tax and Business Advisory Clinic**

Executive summary

The UNSW Tax and Business Advisory Clinic (the Clinic) welcomes the opportunity to provide a submission to your review of the ATO's administration of Director Penalty Notices (DPNs).

The Clinic recognises the importance of the Commissioner taking effective and timely action to recover company tax liabilities. However, this objective should be balanced with the need for the administration of the DPN regime to recognise and appropriately respond to vulnerable individuals, including people whose directorship has arisen through coercion or financial abuse.

Our submission makes recommendations to safeguard vulnerable directors by improving the ATO's administrative processes and communications. We also propose legislative reforms to address limitations in the current DPN regime. We make the following recommendations:

1. Establish a process for identifying vulnerable directors
2. Introduce pre-issuance safeguards for vulnerable directors
3. Improve the content of DPN issuance letters
4. Pause recovery action where a potential DPN defence has been raised
5. Provide practical guidance for coerced directors
6. Recommend legislative reform to address coerced directorships.

About us

The National Tax Clinic program is an Australian Government funded service which provides free tax advice to clients that would otherwise be unable to access such

advice due to financial hardship or other vulnerabilities. The UNSW Tax and Business Advisory Clinic was established as part of this program by the University of New South Wales in 2019.

The Clinic exclusively serves clients experiencing serious financial hardship who have been referred to the Clinic by community service partners including financial counsellors and pro bono legal clinics. This referral system is a unique feature of the UNSW Clinic and means that the Clinic is highly experienced in serving vulnerable clients.

Background

This submission focuses on the experience of clients who have been recorded as company directors despite having little or no meaningful control over, or involvement in, the relevant company. In some cases, the individual has been coerced into accepting a directorship. In others, documents appointing the individual as a director have been signed or lodged without their informed consent. We refer to these individuals as 'coerced directors'.

When taxation liabilities arise for companies with a coerced director, penalties and enforcement action may be directed against the victim-survivor. This enforcement action will sometimes involve the issuance of a DPN to the coerced director¹.

In our experience, coerced directors will typically react with alarm when receiving a DPN. In many cases the coerced director will be unaware of the underlying taxation debt of the company. Further, in some cases the receipt of a DPN will be the first time a victim-survivor becomes aware that they have been appointed as a company director.

We recognise that it is critical that the Commissioner takes steps to recover taxation debts in a timely manner, including through the issuance of DPNs. However, this important objective needs to be balanced against reasonable community expectations that the Commissioner identify and assist vulnerable individuals who may be adversely impacted by the DPN regime.

Our submission

We have focused our submission on ATO processes and communications for three phases of the DPN regime:

1. Before a DPN is issued
2. When a DPN is issued
3. After a DPN is issued

For each phase we will set out our observations regarding the effectiveness of ATO administration, with a particular focus on the impact on vulnerable persons. We will also outline our recommendations to improve ATO processes and communications and to mitigate the impact of DPNs on coerced directors.

¹ DPNs are only issued in respect of some taxation liability types including GST, PAYG withholding and superannuation guarantee charge. In this submission where we refer to taxation liabilities or taxation debts we are referring only to those amounts that are subject to the DPN regime.

Before a DPN is issued

Observations

The current ATO process for issuing DPNs is highly automated. While there may be some human involvement, this will generally be procedural and will not involve any 'process of reasoning' by the ATO officer involved.²

The automated nature of DPN issuance is also highlighted in the flow charts prepared by the ATO as part of the 2015 review by your office.³ These charts set out the process for issuing DPNs in 2015. These charts indicate that when certain legislative and operational pre-conditions are met (for example, whether a BAS has been lodged by the due date and whether a debt recovery letter has been issued) and the company takes no action in response to ATO contact, the DPN issues as a matter of course.

We are not aware of any circumstances where the ATO has taken the potential vulnerability of a director into account before issuing a DPN. This means that when a DPN is issued, a coerced director will receive the same communication and compliance action as that received by a director with full control and understanding of the relevant company.

Recommendations

1: Establish a process for identifying vulnerable directors

We recommend that it would be better practice for the ATO to seek to identify vulnerable directors/taxpayers and to identify these persons in their systems using a vulnerability flag⁴. This flag would then enable the ATO to tailor communications and compliance actions for such individuals to better focus on their circumstances.

To identify individuals who are at risk of vulnerability, we recommend that the ATO should enable victim-survivors to notify the ATO of their circumstances so that a vulnerability flag can be applied to their account. Intermediaries such as tax agents, financial counsellors and family law specialists should be permitted to do likewise.

We further suggest that the ATO should undertake reasonable steps to check relevant known data sets for indicators of vulnerability. This action will enable a vulnerability flag to be applied in circumstances where the victim-survivor or their intermediaries have not contacted the ATO but where data indicates an individual is at high risk of vulnerability. Data sets that may be relevant would include:

- apprehended violence orders
- Centrelink payments made to vulnerable persons (including Crisis Payments and Urgent Payments)
- parties to family law proceedings in the Federal Circuit and Family Court.⁵

² This was the finding by Greenwood J in *Guss v Commissioner of Taxation* (2006) 152 FCR 88 who noted at [69] that the issuance of the DPN in that case involved 'no process of reasoning, even a rudimentary process'

³ Inspector-General of Taxation's Debt Collection review July 2015 Appendix 2, Figures A2.2 and 2.3

⁴ It is noted that in the USA, the Internal Revenue Service identifies victims of domestic violence with a 'VODV' indicator in their systems

⁵ Further analysis would need to be undertaken to determine which data sets are already accessible to the ATO and whether the Commissioner should seek to gain access to other relevant data sets

We acknowledge that there may be reasonable concerns that a vulnerability flag could be exploited by non-vulnerable persons to obtain favourable treatment from the ATO. To mitigate this concern, we recommend that a vulnerability flag should be used only as an identification tool for the purposes of tailoring communications and compliance action for this cohort of individuals. Importantly, the flag should not be used to form any definitive conclusions regarding a defence to a DPN or in relation to other actions such as serious hardship relief.⁶

When a DPN is issued

Observations

In our experience, the first communication that a director receives from the ATO regarding a DPN is when the official notice is issued. Prior correspondence only consists of reminder letters regarding outstanding debts. In the circumstance of coerced directorships, the perpetrator of abuse will typically control the communication channels for the company, so the coerced director will often have no knowledge of the taxation debts of the company or have any warning that a DPN may be issued.

The receipt of a DPN is therefore particularly distressing for vulnerable DPN recipients as they will be unable to respond to the notice in a meaningful way given the limited understanding that they may have of the company and of its debts. These issues are compounded by the language of the notice, which is aggressive, legalistic and confusing. As a result, vulnerable recipients of DPNs will typically feel alarmed, overwhelmed and fearful when a DPN is received.

In addition, the content of the official director penalty notice has problematic features which negatively impact vulnerable and non-vulnerable recipients alike.

Significantly, the notice contains statements that may create a misleading impression regarding the effect of a DPN. For example, the first page of the notice asserts that:

You're receiving this notice because you are, or were, a director of this company. As the company failed to pay these amounts, you became personally liable to pay a penalty equal to the unpaid amounts.

However, this statement omits to mention that the director will not be personally liable if one of the DPN defences apply. It therefore implies that the director's liability is final.

We note that the letter briefly mentions DPN defences on the second page of the notice. In our view, this does not cure the misleading impression created by the statements on the first page. Further, the discussion of defences is wholly inadequate. The notice states:

You may not be liable for a director penalty if one of the defences under the relevant legislation is available to you. These are contained in section 269-35 of Schedule 1 to the *Taxation Administration Act 1953*.

⁶ To mount a defence to a DPN or to submit that serious hardship relief is warranted, further evidence should be submitted so that non-vulnerable persons cannot merely assert vulnerability to avoid compliance action and liabilities

This statement is couched in technical language and gives no detail about the types of defence available to directors. Recipients of DPNs should not be expected to have sufficient understanding of the tax law to be able to find and interpret legislative section references. The statement therefore does little to illuminate directors about the defences which may be available to them.

The notice also implies that if the director must take any action within 21 days to prevent personal liability. The notice states that:

Within 21 days of the issue date of this notice, you need to:

- pay the outstanding amounts, or
- cause the penalties to be remitted as described in the enclosed notice.

If you do not take one of these steps you will continue to be personally liable for the penalties and we may start action to recover the penalties from you without further notice.

While the statement accurately identifies the significance of the 21-day period, it does not explain that a director may nevertheless raise a substantive defence after this period has elapsed, including during debt recovery proceedings. The statement therefore gives the impression that a director cannot prevent their personal liability after the 21-day period. As a result, a significant number of our coerced director clients have not submitted DPN defences because of the mistaken belief that defences must be raised within 21 days.

Recommendations

2: Introduce pre-issuance safeguards for vulnerable directors

We recommend that the ATO should tailor communications to directors that have been identified with a vulnerability flag. Firstly, the ATO should use its best endeavours to separately contact such directors prior to the issuance of a DPN. The contact should be made through independently verified personal contact details rather than through the contact details of the company. This will mitigate the risk that the communications will be intercepted by the perpetrator.

Secondly, the communication should be approached in a manner that minimises trauma that may be felt by the coerced director. The language used, whether in writing or otherwise, should be simple, compassionate and focused on helping the director understand:

- the nature of the underlying tax liabilities
- the possibility of the issuance of a DPN and the impact of that notice
- the defences to a DPN, including an express discussion regarding the defences that may apply to victim-survivors of coercion and financial abuse
- help that may be available.

The communication should also indicate that coerced directors will be afforded a period of grace so that the individual can contact the ATO to provide details of any defences prior to the issuance of a DPN⁷.

⁷ This period of grace should not be extended to non-coerced directors. Recovery action, including the issuance of DPNs, should proceed against non-coerced directors in parallel with pre-issuance communication with coerced directors

3. Improve the content of DPN issuance letters

In addition, the ATO should substantially rewrite its standard DPN issuance letter to clarify the potentially misleading statements set out in our observations above. The letter should prominently set out information about defences to DPNs including the types of defences that are available. The letter should also specifically explain potential defences for coerced directors and provide ATO contact details for directors that are experiencing financial abuse or other vulnerability.

After a DPN is issued

Observations

The main defence to a DPN is establishing that 'it would have been unreasonable to expect [the director] to take part, and [the director] did not take part, in the management of the company' due to 'illness or for some other good reason'⁸. While this defence may appear to have application to many coerced directors who have not participated in the management of the underlying company, it has been our experience that the majority of these individuals do not submit a defence.

There are two main reasons for the hesitancy in putting forward a defence.

Firstly, as noted in section 2 of this submission, many coerced directors do not submit a DPN defence because they mistakenly believe that no defence can be raised after 21 days has elapsed after the issuance of the DPN. In our view, this belief is often founded on the wording contained in the DPN which creates the impression that actions must be undertaken within the 21-day period.

Mounting a defence to a DPN within 21 days will present almost insurmountable hurdles for most victim-survivors. Many victim-survivors do not have access to financial and tax records of the associated company and will not have access to professional advice, which means that defending a DPN within 21 days is practically impossible. Further, because a significant number of coerced directors will have changed addresses as a result of escaping an abusive relationship, the DPN correspondence will often reach these directors after the 21-day period has elapsed.

A second reason for hesitancy in lodging a DPN defence is the perceived difficulty involved in making a defence submission.

Courts have found that the bar to proving a DPN defence is high, with the case of *Snell* providing a particularly sobering example of these issues.⁹ In this case, the NSW Court of Appeal observed that a DPN defence involves 'the backdrop that it is the obligation of a director to participate in management of the company, and a director is not entitled to choose not to participate.'¹⁰ Against that backdrop, 'the [DPN] defence is not easily established.'¹¹ Therefore if the director participates in the management of the company 'at any time', the defence is not available.¹² Notably, in

⁸ Subsection 269-35(1) of Schedule 1 to the *Taxation Administration Act 1953*

⁹ *Snell v Deputy Commissioner of Taxation ('Snell')* [2020] NSWCA 29, [49]

¹⁰ *Ibid*

¹¹ *Ibid*

¹² *Ibid*, [55]

this case it was held that the act of engaging with the Commissioner on behalf of the company was evidence of participation in the management of the company.¹³

This narrow reading of the DPN defence provisions means that any attempts by a director to engage with the ATO regarding taxation liabilities of the company is likely to compromise any later reliance on the defence by that director. This outcome is borne out in our first DPN defence case study set out below, which is based on de-personalised details of a client of the Clinic. We will also set out a second case study of a Clinic client who achieved a different outcome in relation to their DPN defence.

Case study 1: Erin

Erin was a victim-survivor of extensive intimate partner violence, coercive control and financial abuse. During the abusive relationship she was coerced by her partner into accepting an appointment as a company director for a restaurant business. Erin's partner controlled all financial aspects of the business including access to business records. However, during the period that Erin was a director, she contacted the ATO on multiple occasions to discuss payment arrangements for outstanding tax liabilities for the company.

In 2019, the abusive partner passed away and Erin resigned as a company director.

In 2024 the ATO issued a DPN to Erin. The DPN related to a \$20,000 unpaid PAYGW debt incurred by the company during the period that Erin was a director.

Erin lodged a DPN defence with the ATO, submitting that she did not take part in the management of the company due to coercive control and financial abuse perpetrated by her then-partner. The Commissioner rejected this defence.

In his written reasons for the decision, the Commissioner outlined two primary reasons for the rejection:

1. The failure of a director to participate in the management of a company, regardless of the reason, is inconsistent with the director's duty under the *Corporations Act 2001*. A director's failure to take part in the management of a company due to believing others were dealing with its financial affairs is not 'good reason' for lack of participation.
2. Erin's engagement with the ATO in relation to payment of company tax liabilities demonstrated her awareness of the financial affairs of the company and participated in the management of the company.

Case study 2: Donna

Donna was a victim-survivor of extensive intimate partner violence, coercive control and financial abuse. During the period of the abusive relationship, Donna became completely financially dependent on her abusive partner who controlled her finances including accessing her myGov account. Donna's partner also coerced her into signing various legal documents. Later, Donna became aware that one of those documents appointed her as a director of a company. Donna undertook some administrative tasks for the business of the company but otherwise was not involved in the management of the company.

¹³ Ibid, [63]. See also *Deputy Commissioner of Taxation v Lister* [2002] QCA 270, [14]

Donna separated from her abusive partner in 2023 and resigned as a director of the company.

Later in 2023, Donna was issued a DPN for \$175,000 for various taxation and superannuation liabilities of the company of which she was previously a director.

Donna lodged a DPN defence with the ATO, submitting that she did not take part in the management of the company due to coercive control and financial abuse perpetrated by her then-partner.

It appears that the Commissioner accepted the DPN defence put forward by Donna because the penalty was removed from her ATO client account. However, Donna received no correspondence from the ATO confirming this decision.

As is demonstrated by the above case studies, different outcomes may arise in relation to DPN defences raised by victim-survivors in similar circumstances. Erin and Donna were both subject to intimate partner violence and had been coerced into signing director appointments. Both women were also minimally involved in the business of the indebted company, except for the efforts of Erin to make arrangements for payments of the taxation debts of the company.

The regime should not place a coerced director in a position where seeking assistance from the ATO to address a company's taxation liabilities may itself prejudice the director's ability to establish a defence. This approach has the perverse effect of discouraging a coerced director from trying to do the right thing by engaging with the ATO regarding the company's debts.

The outcome in Erin's case illustrates the difficulty of applying the existing defence to circumstances involving coercive control and financial abuse. The Commissioner's reasoning appears consistent with the approach taken in *Snell*. The significance of Erin's case, therefore, is not that the Commissioner applied the existing law incorrectly, but that the existing law may produce an inappropriate outcome in circumstances of coercion and financial abuse.

We would welcome an administrative approach from the ATO that would allow directors to contact the ATO about company liabilities without prejudice to a future DPN defence. However, we accept the Commissioner may consider that any such approach might conflict with court decisions on this issue. We therefore submit that legislative reform should be considered to ensure that the DPN law appropriately deals with coerced directorships.

While we acknowledge that it is not the role of the Commissioner to make tax policy, we do suggest that the Commissioner plays an important part in recommending tax changes to Government where he has identified that the current law is deficient. In this regard, we note that the ATO has previously acknowledged on the record that the DPN law does not appropriately deal with coerced directors. At the Parliamentary Joint Committee on Corporations and Financial Services, ATO Assistant Commissioner Ms Anita Challen relevantly made the following comments:

[The DPN defence legislation] doesn't provide for all instances of financial abuse or coercive control. There would definitely be an opportunity to consider whether those defences should be expanded more broadly. What we have seen through the courts is that the bar is quite high with regards to the

test of evidence required to support that test of whether or not it was reasonable.¹⁴

Recommendations

4. Pause recovery action where a potential DPN defence has been raised

Where a director contacts the ATO and indicates that their circumstances may support a DPN defence, we recommend that the Commissioner should pause debt recovery action for a reasonable period to allow the director an opportunity to obtain advice and prepare their defence.

5. Provide practical guidance for coerced directors

We recommend that DPN information on the ATO website be expanded to specifically deal with coerced directors. The information should include guidance on the factors and evidence that the Commissioner takes into account in making a DPN decision in respect of a coerced director. Ideally, the guidance should be sufficiently extensive and practical to enable a victim-survivor to prepare a DPN defence without the need to seek professional advice.

6. Recommend legislative reform to address coerced directorships

We respectfully submit that Commissioner should recommend to Government that the DPN legislation be amended to better accommodate circumstances involving coercion and financial abuse. In particular, consideration should be given to amending the ‘some other good reason’ defence so that circumstances involving coercion, financial abuse or other forms of vulnerability are expressly capable of constituting a sufficient reason for a director’s non-participation in management. In addition, we submit that amendments should be considered to ensure that a director’s reasonable engagement with the ATO concerning company tax liabilities does not, of itself, prevent the director from relying on a DPN defence.

Conclusion

The DPN regime serves an important role in ensuring that taxation liabilities are addressed and that directors cannot simply disregard their obligations. However, the experience of the Clinic’s clients demonstrates that the operation of the regime can have particularly severe consequences where an individual has become a director as a result of coercion or financial abuse.

For these individuals, the formal status of being a director may bear little relationship to their actual involvement in, or control over, the affairs of the company. Current ATO administrative processes do not sufficiently account for these circumstances. In particular, the highly automated nature of DPN issuance, the content and presentation of DPN communications and the practical difficulties associated with establishing a defence can combine to make the regime especially difficult to navigate for victim-survivors.

We therefore recommend that the Commissioner consider the administrative reforms proposed in this submission, including improved identification of vulnerable directors,

¹⁴ Parliamentary Joint Committee on Corporations and Financial Services: Financial Services Regulatory Framework in Relation to Financial Abuse. Proof Committee Hansard, 15 August 2024, page 5

tailored communications, clearer information about DPN defences and appropriate pauses to recovery action where a potential defence has been raised.

We also encourage the Commissioner to use the experience gained through administration of the DPN regime to advise Government of the limitations of the current legislative framework. In our view, legislative reform is warranted to ensure that the DPN regime appropriately recognises circumstances involving coercion and financial abuse and does not unfairly penalise individuals who have been deprived of meaningful control over the affairs of a company.

The objective should be to ensure that the DPN regime remains effective in recovering company tax liabilities while avoiding outcomes that impose personal liability on individuals whose apparent status as a director does not reflect meaningful control over the company's affairs.

The Clinic would welcome the opportunity to provide further information about the experiences of our clients and to assist with the development of administrative or legislative responses to the issues identified in this submission.

If you have any questions about this submission, please contact me at amelia.orourke@unsw.edu.au

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Acknowledgments and endorsements

Much of the analysis in this paper is drawn from the UNSW Working Paper (2026) entitled *Director penalty notices and vulnerable recipients*. We are indebted to the authors – Professors Kevin O'Rourke, Ann Kayis-Kumar and Michael Walpole – for sharing a draft of this paper and for their insights in drafting this submission.

We also acknowledge the invaluable assistance of Clinic Supervisors in the preparation of this submission: Annette Tasker, Tony Martins, Jonathan Dorse, Marlene Binnekamp, Helen Lam, Dianne Hanna, Madhvi M.

Further, we endorse the submission of the Economic Abuse Reference Group.