

## Alert - Commissioner Jumps the Queue – section 260-5 notices still effective after liquidation



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### Why is this case important?

The Deputy Commissioner of Taxation has for many years been able to issue a notice to someone that owes money to a tax payer requiring them to pay the debt to the ATO. If that payment is made, the tax payer and any secured creditor whose charge is not fixed cannot complain. The notice is issued under section 260-5 of the *Taxation Administration Act, 1953* (Cth) which replaced the former section 218 of the *Income Tax Assessment Act, 1936* (Cth).

### What happens if the notice is issued *after* the tax payer is in liquidation?

In *Commissioner of Taxation v Bruton Holdings (in liquidation)*<sup>1</sup> the Full Court of the Federal Court of Australia overturned an earlier decision of Allsop J, and held it still valid. The Commissioner can issue a notice and effectively enter into possession of the debtors, provided any secured creditor has not already fixed their charge over them.

While this has been the position in bankruptcy, for corporations the commercial implications are very serious. Debtors are the life blood of any business. They can fund a trade on, and the practitioners' remuneration and expenses. These funds usually pay the employee entitlements, even where a secured creditor has appointed its own receiver. It would be a strange outcome if employees are denied these recoveries, only to find their entitlements funded by the tax payer through the GEARS scheme.

Where debtors form a significant element of a lenders' security, it is advisable to have a formal invoice finance facility, assuming absolute ownership of them and (at least) provisions which make clear that any charge is fixed immediately such a notice is issued.

As the Liquidator intends to apply for special leave to appeal to the High Court of Australia, the Commissioner must urgently indicate his likely attitude to the issue of notices of this kind, pending the outcome of that process and any law reform that might follow.

### How the case was decided

The Company was the trustee of a trust. It had no other business at all. The Trust Fund was invested and generated income. There was a dispute with the Commissioner as to whether it had been properly endorsed as an income tax exempt charity and in June 2006 it commenced proceedings against the Commissioner regarding that. The case was to come on for trial in mid 2007.

In February 2007 the sole director, apparently concerned about the mounting costs, appointed voluntary administrators. In April the creditors voted to wind up the company, and the administrators became the liquidators. Although it was a term of the Trust Deed that that Company automatically ceased to be the trustee after it entered into administration, a new trustee was not appointed.

The Commissioner's claim was for \$7.7 million. It issued an assessment in March 2007, and lodged a proof of debt in the liquidation. On the day the administrators were appointed, \$450,000.00 was deposited into a trust account operated by the company's lawyers on account of their costs and expenses, apparently earmarked to fund the continuation of the litigation. In May 2007, it issued notices to the lawyers under section 260-5 directing that it pay the Commissioner any amounts otherwise due by them to the company.

At first instance, the Liquidator successfully argued that the notices were invalid. He relied on section 500(1) of the *Corporations Act, 2001* (Cth) which says, "Any attachment, sequestration, distress or execution put in force against the property of the company after the passing of the resolution for voluntary winding up is void". Allsop J found that the relevant notice was an "*attachment*" for these purposes. But the argument was not without difficulties.

Firstly, in *Donnelly*<sup>2</sup>, the Full Court held that for the purposes of section 118(1) of *Bankruptcy Act 1966* (Cth) a notice of this kind was not an attachment, because it was not issued in or as a result of Court proceedings.

Section 118(1) gave a right of recovery to the Trustee if, within 6 months of the presentation of the petition, the creditor was paid money "as a result of the attachment by him or her, or on his or her behalf, of a debt due to the debtor". In such a case the Trustee could recover "the amount by which the amount of those monies exceeds the taxed costs of the ...attachment". The Court held that the reference to the recovery of "taxed" costs suggested that for these purposes an "attachment" meant that some form of attachment, by curial (i.e. Court) order.

Secondly, the Full Court considered a case where the notice had been issued to a person who owed money to a corporation. In *Macquarie Health*<sup>3</sup> the Company was wound up by the Court in February 2007, which terminated a voluntary administration commenced in November 2006. A critical issue was the date the liquidation commenced and the Court found in this case it was when the voluntary administrators were appointed in November 2006. This was important, because one of the Commissioner's notices was issued at the start of February, before the winding up order.

The Court held that this notice was invalid because it operated as a charge over the Company's property, and was therefore void because of section 468(1), which renders void any disposition of its property after the winding up commenced.

The Liquidator had also relied on section 468(4), which also deals with an "attachment". Again this is void, against the property of the Company, after the commencement of the winding up by the Court. The Commissioner relied on *Donnelly*, but the Liquidator argued there was a distinction, because section 468(4) does not refer to "taxed" costs, so it was open to argue that for the purposes of the *Corporations Act*, this is not limited to something which emanates from the Court. The Court recognised the force in the argument and set out a number of reasons why the result might be different<sup>4</sup>, but they were careful not to decide the point, because they did not have to.

Returning to *Bruton*, Allsop J said it was open to him to find that the notice was an "attachment". He said that *Ramsay* confined itself to the operation of the *Bankruptcy Act*, and the matter had not been decided in *Macquarie*. He also noted that the general scheme of recent amendments to insolvency and taxation law was to remove the Commissioner's priority altogether.

However, the Full Court disagreed. They referred to the argument mounted by the Liquidator in *Macquarie Health* noting it had been described as having "considerable force", but also noting the Court had "carefully ... avoided coming to any conclusion".<sup>5</sup> In the face of this, they felt there was no reason to confine the reasoning in *Donnelly* to the *Bankruptcy Act*:

*"Donnelly was decided in 1989 and has not prompted any amendment to the Bankruptcy Act or change of language in the corporations legislation. It is reasonable to infer that the decision has not caused problems in practice. Proper regard for earlier decisions and the need for certainty in the law can best be recognized by applying the decision in Donnelly to s 500. .... We hold that the process prescribed by s 260-5 is not an attachment for the purposes of s 500."*<sup>6</sup>

They were also not persuaded by his Honour's decision that the section should now be considered in the context of the Commissioner having lost his statutory priority:

*"We accept that such priority has been largely abrogated. However, in Deputy Commissioner of Taxation v Dexam Australia Pty Ltd (2003) 129 FCR 582, the Full Court held that such abrogation did not necessarily revoke all provisions which confer an advantage upon the Commissioner"*.<sup>7</sup>

With respect to the Court the suggestion that there may have been no "problems in practice", does not sufficiently address the very real difference in the consequences for a bankrupt individual who may be owed discrete sums of money by particular individuals and a trading corporation with very substantial book debts. This is especially disappointing given the clean slate the Court had deliberately left for itself in *Macquarie*.

Finally, the decision may be significant for another reason and may, therefore, persuade the High Court to consider granting leave to appeal. The Commissioner argued that the money the lawyers were obliged to pay back to the Company (after the lawyers had discharged their lien for unpaid fees over the \$450,000 held in their trust account), was not "property of the Company" but property of the Trust, and could therefore not be used to pay the Liquidator's expenses, costs and remuneration.

In reviewing this issue, the Court considered at some length the various legal basis that have been advanced to support the recovery of these items from the assets of the Trust, and there is good reason to suggest the High Court may be persuaded to use this case to revisit the topic, which it has not looked at since its 1989 decision in *Octavo*.<sup>8</sup>

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<sup>1</sup>[2008] FCAFC 184. The decision of the Court at first instance is reported at [2007] FCA 1643

<sup>2</sup>*Commissioner of Taxation v Donnelly* [1989] 25 FCR 432

<sup>3</sup>*Macquarie Health Corp Ltd v Commissioner of Taxation* [1999] FCA 1819

<sup>4</sup>@ 266 - 267

<sup>5</sup>Paragraph [69]

<sup>6</sup>Paragraph [72]

<sup>7</sup>Paragraph [71]

<sup>8</sup>*Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360