Comments from the

Australian Taxation Office

To the Parliamentary Joint Committee on
Corporations and Financial Services

'Inquiry into Australia's Insolvency Laws'

1. The Parliamentary Joint Committee on Corporations and Financial Services is to consider and report on the operation of Australia's insolvency and voluntary administration laws, including:

    (a) the appointment, removal and functions of administrators and liquidators;
    (b) the duties of directors;
    (c) the rights of creditors;
    (d) the cost of external administrations;
    (e) the treatment of employee entitlements;
    (f) the reporting and consequences of suspected breaches of the *Corporations Act 2001*;
    (g) compliance with, and effectiveness of, deeds of company arrangement; and
    (h) whether special provision should be made regarding the use of phoenix companies.

2. The Tax Office appreciates the opportunity to provide comments for consideration by the Joint Committee. The Tax Office has not suggested any changes to taxation legislation, in recognition that such changes are now the province of Treasury.

General

3. The Tax Office is a major creditor in a number of voluntary administrations and liquidations and, as such, has extensive experience as an unsecured creditor. The Tax Office's response to the Joint Committee draws heavily on that experience.

4. The Tax Office's administration of the revenue and other laws starts from the premise of taxpayers acting honestly and voluntarily complying with their taxation obligations, and is backed by necessary action where taxpayers fail to do that. The Tax Office debt and lodgment management practices are guided by an extensive policy framework designed to provide fairness and equity to all taxpayers in meeting their tax obligation. The policy is a public document and is the basis of action taken in relation to the management and collection of all tax owing to the Commonwealth under the administration of the ATO.

5. Specific chapters of the ATO Receivables Policy that guide Tax Office decisions in relation to insolvency administration and liquidations that are considered directly relevant to the Committee's inquiry are:

    - Principles Underlying the Receivables Policy of the ATO *Chapter 1*
    - Corporations Law – Part 5.3A Arrangements (Voluntary Administration) *Chapter 20*
    - Liquidation Action – Conditions and Factors to Consider *Chapter 21*
    - Voidable Transactions *Chapter 22*
    - Indemnities for Trustees *Chapter 30*
    - Clearances – obligations of trustees and the Commissioner *Chapter 31*

   A copy of each of these chapters is attached for the information of the committee. A full copy of the ATO Receivables Policy can be readily provided to the committee if required. Alternatively, the policy can be directly accessed via the Tax Office website at ato.gov.au.

6. The Tax Office is often in a different position compared with other creditors in regard to quantifying the amount owed by a company at the point of insolvency. The Tax Office is generally dependent on a taxpayer to notify the amount of tax owing. Often in the case of insolvent companies, tax payments have not been kept up to date and the company fails to notify the Commissioner of the amount owed. In addition, the Tax Office may not be aware that the company has a liability in the absence of Income Tax returns, Activity Statements or other forms being lodged as required. As a result, in the absence of prior audit action, the Tax Office is heavily reliant on the professionalism of administrators and the accuracy of information provided to identify the actual liability at the time of the administrator being appointed.

7. This submission makes comment on the specific areas of insolvency law outlined in the Committee's invitation for comment. It highlights the primary concerns of the Tax Office, while conscious of the fact that individual and extreme cases of inappropriate behaviour by directors, administrators or liquidators will generally not justify changes to the detriment of the broader community.

(a) The appointment, removal and functions of administrators and liquidators

8. The Tax Office supports the random appointment of administrators and liquidators. This ensures impartiality and reinforces the principle that administrators and liquidators are independent.

9. The primary concern of the Tax Office in relation to the appointment of administrators and liquidators is in the area of Voluntary Administrations.

10. The Tax Office is concerned that public confidence in the Voluntary Administration process may be undermined by a perceived absence of impartiality on the part of some Voluntary Administrators. The Tax Office suggests that consideration be given to the creation of a roster system under which Administrators could be appointed on a random basis.

11. One of the key functions of an insolvency administrator is the examination of the company's financial position and reporting to creditors. In particular, the Tax Office is of the view that there are opportunities to improve the quality of reporting by Voluntary Administrators.

12. The *Corporations Act 2001* presently requires a Voluntary Administrator to provide a written report to creditors, including a recommendation on whether it would be in the creditors' best interests for the company to be wound up. In the event that the company is wound up, the prospects for recovery of preference payments or actions against the directors for insolvent trading may have a large impact on the size of any dividends that creditors may receive.

13. Creditors need an accurate assessment of the likely proceeds from wind up in order to enable them to make an informed decision about whether they should vote in favour of a proposed Deed of Company Arrangement. The Tax Office has encountered instances of Voluntary Administrators being unable to comment on the prospects for successful insolvent trading actions or recovery of preference payments (to directors or related entities) because they have no knowledge of the financial position of the director or related entity.

14. While acknowledging the time and cost considerations, the Tax Office is of the view that Voluntary Administrators should be required to provide more detailed and accurate reports regarding possible preference or insolvent trading actions. To achieve this, they should be supported by additional requirements placed on the directors and office bearers of the insolvent company. This could be achieved by amending the legislation to allow Administrators to require directors to provide details of any payments or transfer of assets from the company under administration to themselves, associates or their related entities. If necessary, details of their assets and liabilities and the assets and liabilities of related entities under their control could also be required. Such information need not be made available to creditors, but would enable an Administrator to report to creditors about the presence of the potential action and the prospects for recovery from the director or related entity, should the action be successful.

15. The Tax Office is concerned that when administrators and liquidators are appointed, the company records are often incomplete. The cost of bringing the records up to date is often costly and may not be done if there are insufficient funds available to the administrator or liquidator. In the absence of accurate and up to date records, administrators and liquidators are prevented from providing creditors with a full and complete assessment of the company's financial position and potential for recovery of preferential payments. The lack of adequate records has additional consequences for the Tax Office if the company has failed to lodge returns and statements due prior to the appointment of the administrator or liquidator.

16. The Tax Office is of the view that administrators and liquidators should be required, where necessary, to reconstruct company accounts to a standard sufficient to facilitate the performance of the their duties under the Act.. The Tax Office recommends that administrators and liquidators should be able to apply to the Court for an Order against each company director in respect of those costs.

(b) The duties of directors

17. The Tax Office is concerned about the behaviour of directors and associates that use insolvency laws to avoid the payment of unsecured liabilities.

18. In order to avoid potential abuses of external administration by directors, the Tax Office is of the view that legislation could be amended in a number of ways.

19. Section 533 of the *Corporations Act 2001* ('the Act') requires liquidators to provide a report to the Australian Securities and Investment Commission (ASIC) in certain circumstances. One of those circumstances is if the company may be unable to pay its unsecured creditors more than 50 cents in the dollar. The provision is similar to section 428D of the Act requiring administrators to report certain matters to ASIC. The exception is that administrators are not required to report to ASIC companies that will be unable to pay unsecured creditors a specified amount. It is the view of the Tax Office that section 438D of the Act should be amended to introduce a provision similar to that found in 533(1)(c).

20. The Tax Office is concerned that directors, and other office bearers, that have a history of managing insolvent companies able to continue to operate as a director or office bearer in other companies. ASIC currently is required to apply to the Court to disqualify a person from acting as a director. The Tax Office is of the view that, for the benefit of all creditors, a person should at first instance be automatically disqualified from acting as a director or managing a company if they have on two or more occasions been a director of a company which was under some form of external administration. This would shift the

burden of seeking disqualification away from ASIC and place the onus on the director to show cause as to why he should be permitted to act as a director on another occasion. The automatic disqualification could be tempered in appropriate circumstances. For instance, if an external administration yielded a dividend of 90¢ in the dollar or more, the insolvency of that company would not trigger disqualification.

21. Alternatively, creditors could be given the power to apply to ASIC to show cause why an action for disqualification under section 206D of the Act should not be brought when a person has on more than one occasion been a director of a company under some form of external administration.

22. The Tax Office is also concerned at the practice of directors being able to lodge with the ASIC a notice of resignation from their position as director, effective as at an earlier date. The Tax Office believes that directors should not be permitted to avoid director duties or liabilities by backdating resignations. It is suggested that s203A of the Act be amended so that a director's resignation only takes effect from when the director lodges notice of resignation with the ASIC.

(c) The rights of creditors

23. The Act does not currently prohibit Deed of Company Arrangements that discriminate against certain creditors or classes of creditor. The Full Federal Court *(Re: Solfire Pty. Ltd. (in liq.) 15 ACLC 1487)* upheld discriminatory Deed of Company Arrangements on the basis that compliance with the Deed of Company Arrangement would ensure that every creditor would nevertheless receive more than they would be likely to receive if the company were wound up. The Court accepted that a Deed of Company Arrangement may discriminate in favour of those creditors whose continued relationship with the company is vital to the continuation of its business.

24. The Tax Office is concerned that discriminatory treatment of creditors – ostensibly aimed at maximising the chances that the company will survive – could actually be used to favour related creditors or to routinely avoid payment to non-essential creditors like the Tax Office or Offices of State Revenue. Furthermore, the legality of discriminatory Deed of Company Arrangements seems to be contradictory to the voidable preference provisions. The Tax Office is of the view that section 444A of the Act should be amended to specify that distribution to creditors must be consistent with the principles of s555 of the Act dealing with the distribution of property.

25. The Tax Office is of the view that creditors of the company that have personal guarantees from the directors should be treated as secured creditors to the extent that the guarantee secures the company's debt. It would seem inequitable that a creditor whose debt is effectively secure can vote and influence the dividend payable to unsecured creditors.

(d) The cost of external administrations

26. It appears to be common practice for Administrators to table their work in progress reports at meetings of creditors and then seek creditor approval of the fees incurred for work performed up to the date of the meeting. The Tax Office is of the view that it is unreasonable to expect creditors to cast an informed vote on a resolution to approve the fees unless they have been given a prior opportunity to properly consider the work in progress report. The Tax Office is of the view that Administrators should be required to provide all known creditors with a summary of the work in progress report concurrent with the notice of the meeting at which they will be asked to approve the fees.

(e) The treatment of employee entitlements

27. The Tax Office operates within the framework of insolvency legislation that applies to all creditors. That legislation specifies the relative ranking of classes of debt and claims that shall be used to determine the order in which they are satisfied during the winding up of a company. Wages, superannuation benefits and retrenchment payments are included within that ranking. Accordingly, the Tax Office has no specific comment in relation to the treatment of employee entitlements.

(f) The reporting and consequences of suspected breaches of the *Corporations Act 2001*

28. While statistical evidence is unavailable, Tax Office staff have encountered instances where it appears that directors of companies under Voluntary Administration have committed offences under the Act. The Act requires Administrators to report possible offences to ASIC. The Tax Office supports prosecution activity conducted by ASIC, recognising it as a vital element in maintaining general compliance with the Act. The Tax Office is of the view that directors who have been successfully prosecuted on more than one occasion, should have to show cause to ASIC that they are a fit and proper person before being permitted to be a director or office bearer of any other company.

(g) Compliance with, and effectiveness of, deeds of company arrangement

29. A debtor has a number of avenues available under various laws that effectively provide for formal compromise or allow the Tax Office to accept payment of a debt over time. These avenues operate to protect debtors and in the case of the insolvency laws, protect the interests of all creditors, who each have the opportunity of voting on any compromise proposal. While each case is considered on its individual facts, it can generally be accepted that the Tax Office will support arrangements that have no adverse features and which are formalised by a Deed that may provide the Commonwealth with no lesser proportion of the provable debt within a reasonable period than would occur under wind up.

30. Notwithstanding this, from discussions with practitioners, other creditors and other anecdotal evidence, Tax Office staff believe that a number of Deed of Company Arrangements are defaulted on, leading to the company being wound up and creditors failing to receive the amounts pledged under the deed. The Tax Office supports the Voluntary Administration process, but believes that success of the process should be measured by the quantity of Deed of Company Arrangements which are actually complied with, rather than the number that are proposed and accepted by creditors.

31. Accordingly, the Tax Office is of the view that proposed changes to insolvency legislation should seek to enhance the prospects of viable Deeds being accepted, and non-viable Deeds being rejected by creditors. It is the Tax Office's belief that, for a variety of reasons, there is a tendency for creditors to accept Deeds that are not viable. These reasons may include:

    - insufficient or inaccurate information supplied by company directors;
    - inadequate appraisal or investigation by Administrators; and
    - inexperience on the part of creditors.

32. The Tax Office sees two factors as being fundamental to the integrity of the Voluntary Administration process:-

- Creditors must be provided with sufficient and accurate information to enable them to make an informed decision; and

- Creditors must have the opportunity to cast their vote in accordance with the intention of the legislation.

33. The Tax Office is concerned that the provisions relating to Deed of Company Arrangements are increasingly being used as a mechanism for companies to avoid paying their creditors. It is the experience of the Tax Office that there are very few Deed of Company Arrangements that yield reasonable dividends to creditors.

34. The Tax Office has encountered occasions in which a Deed of Company Arrangement has proposed the immediate issue of Promissory Notes to creditors, rather than direct payment of funds. The Promissory Notes may be for a large proportion of each creditor's debt. The company's obligations under the Deed of Company Arrangement are completely fulfilled as soon as the Promissory Notes are issued, and regardless of whether or not the Promissory Notes are ever honoured. It is recognised that such a Deed of Company Arrangement can only be adopted if a majority of creditors vote in favour. However, inexperienced creditors, related creditors or those with a vested interest in the company's survival may be inclined to accept a Deed of Company Arrangement that pledges the issue of a Promissory Note.

35. Such a Deed of Company Arrangement also seems to subvert the intent of section 450E(2) of the Act. This section seeks to alert creditors of the fact that the company is under administration by requiring that the company include the expression "administrator appointed" next to the company name on every public document and in every negotiable instrument. Though the company may have significant and unfulfilled long-term obligations to its creditors as a result of the Deed of Company Arrangement, the immediate discharge of its obligations under the Deed of Company Arrangement allows it to avoid the inclusion of that expression.

36. The Tax Office is of the view that a Deed of Company Arrangement which incorporates any form of promise of future performance (including, for example, a Promissory Note or similar instrument) should not be construed as finalised until all such promises have been fulfilled.

(h) Whether special provision should be made regarding the use of phoenix companies

37. The use of phoenix type companies is of considerable concern to the Tax Office and requires diligent enforcement of existing law by all regulators.

38. The Tax Office is of the view that consideration should be given to whether the legislative framework surrounding voidable preferences, insolvent trading and fraud is sufficient to counter phoenix type activity and whether specific sanctions should be introduced to prevent assets being held by associated entities beyond the control of creditors. The *Pay-roll Tax Act 1971 (NSW)* now includes provisions grouping provisions to assist in the recovery of State tax debts that might otherwise be irrecoverable due to phoenix activities. The creditors' enhanced capacity to recover debts would, in itself, reduce the incentive for persons to engage in phoenix activity.

39. The Tax Office is of the view that identification of directors who have been directors or office bearers of other insolvent companies, and changes suggested in earlier comments, will assist in reducing the incidence of phoenix type activity.

40. The Tax Office is of the view that some company name changes in the period leading up to external administration are aimed at concealing the fact that the company has had a solvency problem. The Tax Office is of the view that a company which has changed its name in the 12 months prior to external administration should be obliged to include its "*formerly known as*" name on all company documents.

Part A Introduction

1 PRINCIPLES UNDERLYING THE RECEIVABLES POLICY OF THE ATO

1.1 PURPOSE

1.1.1 This document contains the policy of the Australian Taxation Office in relation to the obligations outlined below. The policy is intended for the use of taxpayers, their advisers and ATO staff, to ensure that they have a common understanding of the ATO's approach to debt collection and lodgment matters. The policy relates to:

- legislation enacted prior to 1 July 2001, plus
- the changes announced prior to that date and since enacted in relation to the calculation of the General Interest Charge (GIC).

This policy will be updated on a regular basis.

1.1.2 This policy document does not have the force of law. Each decision taken by the Commissioner is made on the merits of the individual case, having regard to the legislation, this policy document and other relevant documents and information. This document is copyright to the Commonwealth of Australia.

1.1.3 This chapter sets out the principles underlying the ATO's policy as it relates to the obligations imposed on taxpayers by the various taxation laws in respect of:

- the payment of liabilities;
- the lodgment of returns and documents;
- the variation of these obligations;
- the imposition and remission of penalties arising from a breach of those obligations; and
- prosecutions.

1.2 INTRODUCTION

1.2.1 Fully complying with taxation obligations is an important community responsibility. Non-compliance with these obligations imposes a further share of the taxation requirements on those taxpayers that do comply, as well as an additional burden in terms of administrative costs. Taxpayers are expected to lodge correct returns and statements by the due date, and to pay their taxation debts as and when they fall due for payment.

1.2.2 In limited, genuine circumstances, the Commissioner is prepared to defer the time to lodge and/or pay (without incurring failure to lodge penalties, or the GIC or to permit payment by instalments (which normally attracts the GIC).

1.2.3 When deciding the most appropriate manner in which to deal with outstanding taxation obligations, the Commissioner will give considerable weight to the taxpayer's compliance history e.g. their history in lodging correct returns and documents and paying obligations on time.

1.3 PRINCIPLES

1.3.1 Taxpayers are expected to take responsibility for their taxation obligations, and to organise their affairs in such a way as to be able to discharge those responsibilities when required. The Commissioner expects that taxpayers will give the same priority to taxation obligations as their other responsibilities.

1.3.2 The Commissioner recognises that individuals and businesses affected by the introduction of the new tax system and subsequent arrangements require considerable support and assistance from the ATO. While the ATO will provide the information they need, there is a clear expectation that those individuals and businesses will take reasonable steps to implement the new system. If they do take these steps, yet make a mistake, they will not be penalised other than by payment of the normal interest imposition (usually the GIC).

1.3.3 It is expected that taxpayers will take steps to ensure that mistakes are not repeated as penalties would then be imposed in accordance with usual ATO policy.

1.3.4 The Commissioner will adopt or adapt the best practices of both public and private organisations to ensure professional, efficient and effective administration of the taxation laws.

1.3.5 In dealing with taxpayers, the Commissioner will:

- advise taxpayers of their rights and will respect those rights (Refer to the chapter in this policy titled: "Accountability and Review of Decisions"); and
- meet the requirements and adopt the intent of the Taxpayers' Charter.

1.3.6 In dealing with any non-compliance by taxpayers, the Commissioner will :

- adopt the most appropriate remedy, i.e. the remedy that, based on the taxpayer's compliance history, will most likely result in both current and future compliance; and
- adopt a full range of appropriate options, which may include:
  - telephone contact and/or correspondence requiring compliance with taxation obligations prior to the institution of legal action;
  - the issue of a default assessment or "garnishee" notices;
  - legal action up to and including prosecution and/or bankruptcy/liquidation and the use of appropriate writs or injunctions.

1.3.7 Usually, the Commissioner will not instigate legal action, issue a default assessment or take "garnishee" action without the taxpayer being advised previously of the possibility of such action.

1.3.8 However, the Commissioner will proceed with appropriate action without further notice where a taxpayer fails to respond to approaches or fails to enter into genuine negotiations.

1.3.9 If taxpayers cannot (or anticipate they will not be in a position to) meet their taxation obligations (either lodgment or payment), it is in the interests of all parties if those taxpayers contact the Commissioner at the earliest opportunity to discuss the matter and make appropriate

alternative arrangements. Preferably, such contact should be made prior to the due date for lodgment or payment.

1.3.10 A fundamental principle in taxation administration is that any alternative arrangements should also be perceived as equitable by those taxpayers who do comply with their obligations. A decision to enter into an alternative arrangement will take into account the particular circumstances of the taxpayer, including:

- the taxpayer's compliance history;
- whether the reasons for the potential non-compliance were beyond the taxpayer's control, and the steps taken to mitigate the effects of those circumstances;
- the ability of the taxpayer to meet the obligation within a reasonable timeframe; and
- the steps taken to ensure future taxation obligations are met on time.

1.3.11 If the Commissioner agrees to an arrangement to vary the taxation obligations:

- Additional charges/GIC are imposed by various statutory provisions (other than for deferments of time to lodge or pay), and will not ordinarily be remitted;
- it is expected that future obligations will be met as and when they fall due; and
- any default on the arrangement may lead to legal action or similar sanctions.

1.3.12 The transition to the new tax system may mean that businesses, particularly small businesses, encounter these situations more often. During this transitional period, the Commissioner will be empathetic to viable businesses that have made a genuine attempt to implement the new tax system. If those businesses make a mistake e.g. miscalculate their cash flows, the Commissioner will consider all their circumstances, and adopt an empathetic approach to payment arrangements to ensure that the debt with the ATO is not, of itself, the reason for a viable business to founder.

1.3.13 The Commissioner will need to have regard to the overall circumstances of the taxpayer e.g. the position of other creditors where the taxpayer has a debt to the ATO. In particular, as legal action to recover debts is usually instituted by other creditors, the Commissioner has no choice in those circumstances but to respond appropriately in order to safeguard the revenue. (See chapter 'Arrangements to pay tax-related liabilities by instalments').

Part B The Collection of Taxation Debts

20 CORPORATIONS ACT 2001 - PART 5.3A ARRANGEMENTS (VOLUNTARY ADMINISTRATION)

20.1 PURPOSE

20.1.1 This chapter deals with:-

- provisions under the Corporations Act 2001 (CA 2001) that enable an administrator to put forward proposals to creditors to pay less than the full amount of a debt in full and final settlement of that debt; and
- sets out the matters that the Commissioner will take into account when deciding how to vote at a meeting called to vote on proposals put by an administrator.

20.2 LEGISLATION

20.2.1 Part 5.3A of the CA 2001 provides an opportunity for corporate debtors to reach an arrangement or agreement with their creditors to enable them to continue in operation. If this is not possible, then it provides a mechanism for winding up the company, with the object of providing a better return for its creditors and members than would have resulted from an immediate winding up.

20.3 INTRODUCTION

20.3.1 The aim of Part 5.3A is to structure a cooperative solution between the company and its various classes of creditors for the purpose of either rehabilitating the business, or at least to enable the realisation of assets in an orderly manner which enhances the end position of ALL stakeholders in the company. Procedures for putting in place a voluntary administration are designed to be:-

capable of swift implementation;

as uncomplicated and inexpensive as possible; and

flexible towards finding the most appropriate and beneficial solution.

20.3.2 It would not be unusual for an insolvent company to have no significant assets which could be realised to pay a reasonable dividend to creditors. It could be expected therefore that an administrator may offer equity in the company to creditors where it is possible the company can trade out of its difficulties. The Commissioner would be bound by the terms of any deed accepted by the majority of creditors, although he will vote against any proposal offering equity in lieu of legal tender unless there is a high probability of the company trading out of its difficulties within one year.

20.3.3 There are a number of strong arguments for supporting voluntary administration. These can be summarised as follows:-

it avoids a sudden winding up (or liquidation) of the company which often results in a nominal (if any) return to creditors;

it preserves a fundamentally viable business where its operations are threatened;

it provides an opportunity to reorganise a company's affairs with a view to enhancing the position of its stakeholders (that is, members, creditors, directors); and

it potentially provides a better return for the revenue.

20.3.4 Administration may be initiated either:-

(i) by the company itself; or

(ii) by a secured creditor with a presently enforceable charge over the whole, or substantially the whole, of the company's property; or

(iii) if the company is in liquidation/provisional liquidation, by the liquidator.

20.3.5 The company, or its liquidator/provisional liquidator, must be of the opinion the company is insolvent, or likely to become insolvent.

20.3.6 The administration commences when an administrator is appointed and generally ends when a deed of company arrangement is executed or creditors resolve that the company:-

(i) be wound up; or

(ii) that the administration should end.

20.3.7 Restraints on dispositions of assets by a company, or proceedings by individual creditors against a company and alteration in the membership of a company all begin at the date an administration commences.

20.3.8 The process of a voluntary administration is as follows:-

- The administrator is obliged to convene the first meeting of creditors. At this meeting (to be held within five business days after the administration begins), the creditors may remove the administrator and appoint another. The creditors may also appoint a committee of creditors (inspection) which is to consult with and receive reports from the administrator;
- After the first meeting and before the proposal meeting, only the administrator can deal with the company property. The administrator will be investigating the affairs of the company. A general moratorium on proceeding by creditors is also in place. The moratorium continues until the outcome of the second meeting (or proposal meeting) is known;
- Papers will be circulated prior to the proposal meeting, which must be held 26-33 days after the administration begins. Prior to or at this meeting, the Commissioner must lodge a proof of debt detailing all outstanding taxation debts to establish his entitlement to vote. At the meeting, creditors of a corporation will be asked to vote on alternative proposals, namely that the company execute a deed of arrangement, or the administration should end, or that the company be wound up (section 439C CA 2001). Prior to any meeting, creditors should be able to make an objective assessment of the proposals to be put to the meeting. If there has been insufficient information provided by the administrator to satisfy the creditors' concerns, then they should question the administrator's recommendations.
- The Commissioner, as a creditor, has a right to enquire and should clarify issues of concern about the recommendations by questioning the administrator before a meeting (or raising issues at the meeting). Some issues that officers may wish to clarify before deciding how to vote on an administrator's recommendations include, but are not limited to:-

(a) whether the cause of the company's financial difficulties has been identified and can be fixed;

(b) whether management will cooperate;

(c) an evaluation of the financial information and the quality of that information;

(d) whether consideration has been given to realising assets to meet debts, and if so, the impact of that realisation on the company's operations;

(e) whether the proposal will maximise the return to the ATO;

(f) whether cash flow forecasts are based on reasonable assumptions;

(g) whether there is some other action that may be pursued against the directors of the company;

(h) an assessment of how the directors have handled the financial problems (with creditors best interests in mind or their own); and

(i) whether the directors, the company and associated parties are going to share the same burden as other creditors.

- If a Deed of Company Arrangement (deed) is approved by the necessary majority, the company's administrator becomes the administrator of the deed unless the creditors resolve otherwise (the deed should clearly set out what property is available for the creditors, which creditors are bound by the deed and the extent the company is to be released from its debts).
- The company must execute the deed within twenty one days of the meeting, otherwise the company is deemed to have gone into liquidation and the administrator becomes the liquidator. It remains subject to the terms of the deed until its terms are completed or otherwise terminated. If the creditors resolve that the company be wound up, the company is deemed to have entered a creditors' voluntary winding up and the administrator becomes the liquidator immediately (section 446A CA 2001).

20.4 POLICY

20.4.1 A debtor has a number of avenues available under various laws that effectively provide for formal compromise or indeed, that allow for the Commissioner to accept payment of a debt over time. Generally, these avenues operate to effectively protect debtors and in the case of the CA 2001, protects the interests of ALL creditors, who each have the opportunity of voting on any compromise proposal.

20.4.2 The Commissioner's authorised representatives can register a vote at a creditors' meeting in favour of an arrangement that provides for payment of less than the full amount in settlement of the corporate debtor's liabilities, including the tax debts.

20.4.3 The fact that the ATO is taking action against directors under Division 9 of Part VI of the Income Tax Assessment Act 1936 (ITAA 1936) to collect penalties representing unpaid company tax debts does not preclude the ATO from voting for a company deed of arrangement.

20.4.4 While each case must be considered on its individual facts, it can be generally accepted the Commissioner will support arrangements that have no adverse features and which are formalised by a deed if that deed can be readily seen as providing the Commonwealth with a greater proportion of the provable debt within a reasonable period than would be forthcoming under a liquidation or winding up.

20.4.5 When deciding whether arrangements that are put to creditors have any adverse features, the Commissioner will have regard to all relevant matters including, but not limited to:-

(i) the views of the ATO's solicitor where these have been sought;

(ii) the contents and comprehensiveness of relevant reports;

(iii) the adequacy of those reports (regard should be had to what is in, and relevant omissions, from the reports);

(iv) antecedent transactions and voidable dispositions, including the prevalence of any insolvent trading engaged in by the company;

(v) future income;

(vi) the investigative powers available to a liquidator, particularly when they are compared with the more limited powers available to an administrator;

(vii) the debtors taxation compliance history and the compliance history of related parties or entities;

(viii) the level of certainty that the proposals put forward will be achieved;

(ix) the compliance history of other corporations or entities which the directors of the debtor company are currently also managing or are a director, or have managed or been a director during the last three years;

(x) the maintenance of any priority the Commissioner may have in a liquidation;

(xi) other matters that are considered to be of public interest or reasonably question the fairness and appropriateness of voting in support of proposals, particularly if those proposals have as a consequence, the removal of statutory powers of investigation, examination and "clawback" of assets or funds;

(xii) the tangible benefit to the Commonwealth revenue that is to be gained from any proposed arrangement;

(xiii) any association (whether or not arising by way of assignment of debts) between the debtor and other creditors;

(xiv) the extent and seriousness of any taxation offences which may have been committed; and

(xv) any particular aspect of the proposal for the deed which is considered to be unfairly prejudicial, oppressive or discriminatory (such as for example rankings within and between the various creditors for the purpose of receiving proposed dividends, or a term that seeks to absolve the directors from any personal liabilities).

20.4.6 The Commissioner may seek external professional advice to assist in the collection and analysis of material relevant to such decisions. Officers

should note the discussion on secrecy in the chapter titled "Accountability and Review of Decisions".

20.4.7 The Commissioner will not stay or withdraw any action against a director where the terms of a deed purport to limit the Commissioner's rights to do, or not to do, some action. Such terms are ineffectual and the Commissioner will vote against any deed which purports to include such a clause.

20.4.8 While any arrangements approved under the CA 2001 bind the Commissioner, appropriate relief will be sought by the Commissioner through the courts where an arrangement is considered to unreasonably disadvantage the Commonwealth revenue or include adverse features.

20.4.9 The Commissioner may, in accordance with Regulation 5.6.23 of the Corporations Regulations 2001, make a just estimate of any tax debt which is thought to be owed by the company, but the value of which has not been established. Any such estimate will be included in proofs of debt for voting purposes.

20.5 DISPOSAL OF ASSETS

20.5.1 Where the Commissioner is obliged to accept shares or assets under a deed executed pursuant to Part 5.3A of the CA 2001, enquiries should be made quickly of either the Insolvency and Trustee Service Australia (ITSA) or the Department of Finance and Administration to ascertain an appropriate person or organisation to dispose of the assets on behalf of the Commonwealth.

20.5.2 The appropriate person or organisation will vary between cases. As the Commissioner may receive shares (including options), debentures, artworks, commodities, buildings, motor vehicles etc, it is unlikely that any one person or organisation will have the diverse expertise to ensure the maximum return to the Commonwealth is achieved.

20.5.3 All assets are to be registered in the name of the Commonwealth.

20.5.4 Arrangements are to be made with the appropriate person or organisation to ensure that they are responsible for:

- taking physical possession and control of the asset, where feasible (the assets are not to be left in the debtor's control);
- insuring the asset, if appropriate;
- storing the asset in appropriate conditions, having regard to the nature of the asset;
- arranging appropriate physical security for the asset;
- providing advice on what actions, if any, ought to be taken to improve the saleability of the assets and maximise the return to the Commonwealth;
- generally managing the assets prior to sale; and
- arranging for the sale of the assets.

20.5.5 The appropriate person or organisation should decide when and how to dispose of the assets. Subject to advice from this person or organisation, the Commissioner may incur additional expenses on the assets to clean, repair, restore, exercise options, or to improve the saleability of the asset if it is in the interests of the Commonwealth to do so.

20.5.6 All assets should be sold quickly unless there is a good commercial reason to do otherwise. The outcome sought is a fair market price (ie, the value one might expect to be negotiated on either a one to one basis or by auction between a willing but not anxious vendor and purchaser who stand at arms length) and to avoid the forced sale situation (ie the value calculated to be the fair market value, discounted to entice a purchaser to complete a privately negotiated transaction in a minimum of time).

20.5.7 The same approach should be followed irrespective of whether the asset is held solely in the name of the Commonwealth, or in joint names (ie with other creditors).

20.5.8 The following guidelines should be applied:

- The amount to be credited to the debtor's account is the amount received from their sale, net of expenses including commission. This is the amount the debtor would have paid to the Commissioner, had the debtor personally arranged the sale;
- No amount will be credited to a debtor's account until, for all assets apart from shares, the assets are sold. The balance can then be written off as irrecoverable at law. Any share script received in an insolvent debtor company is to be valued at nil. In these cases, the debt is to be written off in full under the "no assets/no funds" category. If some consideration is subsequently received for the shares, the debt should be re-raised in full, the consideration received credited to that account and the balance written off as irrecoverable at law. The same procedures should be followed if the Commissioner subsequently receives advice that the shares are valueless; and
- Where the asset cannot be sold quickly, it should be recorded in the ATO's asset register so that it will be included in the ATO Financial Statements.

20.5.9 Where it is in the interests of the Commonwealth to incur expenditure on an asset prior to its sale, the Commissioner can incur the expenditure and charge it to the ATO's running costs budget. The expenditure can be recouped and returned to the running costs budget from the proceeds of sale.

20.6 "GARNISHEES" AND ADMINISTRATORS

20.6.1 A "garnishee" notice should not be withdrawn, simply because an Administrator has been appointed.

20.6.2 The law clearly states that the service of a valid "garnishee" notice creates an immediate charge over any funds (to the extent detailed in the notice) due by the "garnishee" recipient to the debtor company. A charge created over funds due to the debtor company prior to the appointment of an Administrator, even if the debt is not payable until after the date of appointment, is a valid charge and must be paid to the Commissioner by the third party when the debt becomes payable. The third party is under a legal obligation to comply with the "garnishee" notice and must do so despite the appointment of the Administrator.

20.6.3 A "garnishee" notice would not be served on a third party in respect of pre-appointment tax liabilities of a company after an administrator has been appointed to the company unless such action is warranted to protect the Commissioner's position having regard to the circumstances

of a particular case. If a "garnishee" is issued in these circumstances, the charge so created is not enforceable by the Commissioner while the company remains in administration (section 440B of the CA 2001) ie until the execution of a Deed of Company Arrangement or the company is returned to the directors. However, if the company proceeds to be wound up, the charge so created will be void (section 468 of the CA 2001; *Macquarie Health Corp Ltd v FC of T* 2000 ATC 4015). If it is considered that the circumstances of a particular case warrant a "garnishee" notice being issued after the appointment of an administrator, the Advanced Legals Team should be consulted as to the possible consequences.

20.6.4 In relation to a "garnishee" notice served prior to the appointment of an Administrator, the notice still has the effect of creating a charge over third party debts due to the debtor company that come into existence after the date of appointment. The charge so created is not enforceable by the Commissioner while the company remains in administration (section 440B of the CA 2001) ie until the execution of a Deed of Company Arrangement or the company is returned to the directors. Whether or not the Commissioner would enforce / demand payment of these further third party amounts that came into existence after the date of appointment of the administrator would depend on the facts of the particular case. Under normal circumstances, the Commissioner would revoke the "garnishee" particularly where its enforcement could adversely impact on the viability of the business or third parties such as employees. If the company proceeds to be wound up, the charge so created will be void (section 468 of the CA 2001). However the Commissioner will consider enforcing the "garnishee" where the existence of other debts or the conduct of the administration is open to question.

20.6.5 If the Commissioner serves a "garnishee" notice and creates a charge over funds due by the recipient to the company, prior to the mortgagee of a registered mortgage (ie. a bank) exercising its power of sale for default under a mortgage, then legally, the third party is required to comply with the "garnishee" notice first, irrespective of whether the registered mortgage was in place before the "garnishee". It is the Commissioner's policy to allow registered mortgages (fixed or floating) to be paid in full prior to payment being made pursuant to the "garnishee" (refer to TR98/18 and paragraph 12.4.6(vi) in the chapter "'Garnishee' Notices"). If the debtor company claims that there is an unregistered mortgage in place then it will be necessary to gather as much evidence as possible to be satisfied that it is genuine, in which case the Commissioner will allow it to be paid before the "garnishee". However, if any mortgage is considered to be contrived, particularly with the intention of defeating the "garnishee" notice, then the Commissioner will demand compliance with the notice. If the recipient fails to comply, the matter should be referred for prosecution.

20.6.6 Where the ATO has become a secured creditor as a result of a charge being created upon service of a "garnishee", then the Commissioner's proof of debt must comply with Regulation 5.6.41 of the Corporations Regulations 2001 which states;

"A proof of debt or claim must state:

(a) whether the creditor is or is not a secured creditor; and

(b) the value and nature of the creditor's security (if any); and

(c) whether the debt is secured wholly or in part."

20.7 TERMS USED

20.7.1 "Insolvent" found in section 95A of the CA 2001 describes when a person (which includes a company) is solvent or insolvent as follows:-

- "95A(1) A person is solvent if, and only if, the person is able to pay all the person's debts, as and when they become due and payable.
- 95A(2) A person who is not solvent is insolvent."

Part B The Collection of Taxation Debts

21 LIQUIDATION ACTION - CONDITIONS AND FACTORS TO CONSIDER

21.1 PURPOSE

21.1.1 This chapter will examine:-

- some factors that should be considered before making the decision to liquidate or wind up a corporate debtor; and
- situations where liquidation/wind up action may be inappropriate.

21.2 LEGISLATION

21.2.1 The authority to commence action through the Courts in order to recover outstanding taxation debts is provided by:-

prior to 1 July 2000

- sections 209 (income tax), 220AAZA (reportable payments, tax instalment deductions and prescribed payment amounts), 221YR(1) (interest and royalties withholding tax) Income Tax Assessment Act 1936 (ITAA 1936);
- section 69 Sales Tax Assessment Act 1982 (STAA 1982);
- section 94 Fringe Benefits Tax Assessment Act 1986 (FBTAA 1986);
- section 50 Superannuation Guarantee (Administration) Act 1992 (SGAA 1992); and
- section 26 Superannuation Contributions Tax (Assessment & Collection) Act 1997 [SCT(A&C)A 1997];
- section 22 Superannuation Contributions Tax (Members of Constitutionally Protected Superannuation Funds) Assessment & Collection) Act 1997 [SCT(CP)(A&C)A 1997];
- section 17 Termination Payments Tax (Assessment & Collection) Act 1997 [TPT (A&C)A 1997].

on or after 1 July 2000

- section 255-5 Taxation Administration Act 1953 (TAA 1953).

21.2.2 These statutes usually provide for the authority to be delegated to an officer who will be the Commissioner's duly authorised agent.

21.3 INTRODUCTION

21.3.1 The decision on the most appropriate form of recovery action will depend on a number of factors and considerations. Generally, legal recovery proceedings will be instituted if the debtor does not take steps to advise the Commissioner of an inability to pay and does not put forward an acceptable proposal to pay the debt by instalments.

21.3.2 In some cases, the Commissioner or Deputy Commissioner may institute legal recovery proceedings, but may adjourn those proceedings (not discontinue) where the debtor has agreed to pay the debt, additional

charges for late payment and legal costs, in full either by a specified date or by instalments over a period. On the other hand, the Commissioner or Deputy Commissioner may see it as appropriate to continue with legal recovery proceedings notwithstanding an approach by the debtor. It is not unusual for debtors to fail to appreciate the consequences of liquidation until this late stage and then rearrange their affairs to pay their taxation debts.

21.3.3 Recovery action against companies can follow the same general course as that for amounts owing by individuals. Summonses are served, judgment entered and warrants or writs of execution are issued when necessary. However, when a company is deemed unable to pay its debts, the option of winding up its operations is available without judgment.

21.3.4 Liquidation or wind up is a viable option for creditors (provided the debt exceeds the statutory limit). Normally, the Commissioner will serve a notice in terms of section 459E of the Corporations Act 2001 (CA 2001) on a corporate debtor and if payment is not made within 21 days or if suitable payment proposals are not agreed within that time, the Commissioner may apply to the court to have the company wound up.

21.3.5 Section 459P of the CA 2001 provides that any one of the following parties can apply to the Court for a company to be wound up in insolvency:-

- the company;
- a creditor (even if the creditor is a secured creditor or is only a contingent or prospective creditor);
- a contributory (as defined section 9, CA 2001);
- a director;
- a liquidator or provisional liquidator of the company;
- the Australian Securities Commission; or
- a prescribed agency.

21.3.6 When a wind up order is made, an official liquidator is appointed by the court. The granting of a wind up order effectively transfers the control of the company's financial affairs to the liquidator. The liquidator's overall aims are to investigate the company's affairs, realise all known assets and distribute the funds obtained to creditors in accordance with the priorities in the CA 2001. The CA 2001 provides liquidators with certain powers to achieve the above outcome, including:

- doing such things as are necessary for winding up the affairs of the company and distributing its assets (para 477(2)(m) CA 2001);
- selling or otherwise disposing of all or any part of the property of the company in any manner (para 477(2)(c) CA 2001);
- carrying on the business of the company so far as is necessary for the beneficial disposal or winding up of that business;
- appointing a solicitor or other agent and obtaining advice with regard to the conduct of the liquidation; and
- bringing, commencing or defending any legal proceedings relating to the company.

21.3.7 Liquidators are required to give notice of their appointment to creditors within fourteen days from the date of the appointment. As a creditor, the ATO must lodge a proof of debt with the liquidator as quickly as possible. The proof of debt should detail all outstanding taxation debts. This requirement to lodge the proof of debt is in addition to any proofs of debt that may have been lodged previously for this debtor with the administrator appointed under Part 5.3A (even if the liquidator and administrator are the same person).

21.3.8 After terminating the company's operations and selling all available assets, the liquidator distributes the proceeds realised to the creditors in accordance with the priorities in the CA 2001. Where outstanding debts retain a statutory priority, that is tax instalment deductions and certain other source deduction liabilities which fell due before 1 July 1993 and the three components of Superannuation Guarantee Charge, the Commissioner retains preferential status over other creditors. The ATO should lodge a proof of debt by the date the liquidator has advised.

21.3.9 Once a liquidator has completed the winding up of a company and all proceeds from the administration have been distributed, the liquidator files a final form 524 (account of receipts and payments) with the Australian Securities Commission.

21.4 POLICY

21.4.1 Action to wind up a company will be taken in circumstances where the company has failed to pay its debts and there has been no agreement on suitable payment proposals. This action will also be taken in circumstances where it is considered a company is insolvent and there will be a detrimental effect on the revenue if it is allowed to continue to trade.

21.4.2 General matters that may be considered before taking liquidation action may include:-

(i) the asset position of the company

- if there are no assets available that can be realised to satisfy the debt, liquidation action may not be worthwhile. Accepting payment of the debt by instalments over a period of time may be a cheaper and more viable alternative in these cases, but the solvency of the company would need to be determined first. (It would be difficult for a company with a history of broken promises to satisfy the Commissioner it could/will pay by instalments over time). If liquidation action is not worthwhile and the company has ceased trading, the Australian Securities Commission is to be requested to deregister the company. The debt should then be written off.

(ii) the nature of the debt

- it may be appropriate to take liquidation action to stop a debt from escalating rapidly (for example, withholding payments and indirect taxes may be required to be remitted monthly and if those remittances are not paid, the debt can escalate). A corporate debtor trying to avoid liquidation action would need to demonstrate that steps have been taken to stop debts escalating;

- where outstanding debts retain a statutory priority, that is tax instalment deductions and certain other source deduction liabilities which fell due before 1 July 1993, the Commissioner retains preferential status over other creditors and this may ensure a higher return to the revenue than alternative collection mechanisms.

(iii) the future income of the company

- if it can be shown that the company's financial position will improve (as revealed by financial statements and any reports that may have been obtained from an insolvency practitioner) and the debt and the additional charges for late payment can be fully satisfied at some time in the future, it may be appropriate to consider accepting payment by instalments over a period of time. All projections should be carefully analysed, especially the stated and unstated assumptions inherent in those projections. The onus would be on the company to demonstrate the ability to pay by instalments. This option may not be available to a company that has a history of failing to honour promises to pay.

(iv) the risk to the revenue

- if it is evident or becomes apparent that the company is avoiding payment or taking steps to limit the ability to pay, it may be appropriate to take immediate liquidation action to secure the assets of the company to enable a distribution to creditors;
- Where a debtor has ceased trading and/or has been struck off by the Australian Securities Commission, the Commissioner generally will not initiate liquidation action unless there is a compliance justification for doing so (eg section 600 CA 2001).

(v) the potential to recover from directors

- officers attempting to recover debts from companies may take whatever steps are necessary to expand the Commissioner's options enabling recovery from directors;
- directors of companies are personally liable to pay some amounts not remitted by the company (sections 222AOC and 222AOD ITAA). A notice in terms of Division 9 of part VI cannot be served once a corporation is placed in liquidation (see chapter titled " Payment Agreements"). Accordingly before taking action to wind up a company that has not remitted these specific amounts, a notice in terms of section 222AOE or section 222APE ITAA 1936 should be issued;
- the CA 2001 also provides for the personal liability of directors for debts incurred by a company when it was trading insolvently. It may be appropriate to wind up a company with the view to having the liquidator pursue the directors for payment of the outstanding debt;
- cases where directors of a current company owing an amount to the Commissioner have a past association with companies that have gone into liquidation leaving significant amounts

owing, should be brought to the attention of the Advanced Legals Unit to take appropriate action.

(vi) there are matters that may warrant an examination by a liquidator

- the CA 2001 provides a means by which officers of a company, or any other person who may be able to provide information, can be examined about a company's affairs, including details of the promotion, formation, management, administration or winding up or any other affairs of a company;
- these examinations are generally conducted, not only for the purpose of discovering undisclosed assets, but also to assist in identifying any offences which may have been committed.

(vii) there is evidence of fraudulent or criminal activities on the part of the directors

- action to wind up the company in these circumstances should be discussed with compliance assurance or special investigation area to coordinate actions on both civil and criminal matters.

Settlement of amounts due to liquidators

21.4.3 In the course of the winding up, a liquidator is required to pursue amounts due to or claimed by the company. Common examples of such claims are trade debts due to the company and loans to associated parties. More complex claims could involve a breach of contract or insolvent trading actions against directors.

21.4.4 When seeking to recover these amounts, it is common for the liquidator to receive settlement offers for a sum less than the full claim. Under subsection 477(2A) of the CA 2001 if the amount claimed is more than $20,000 the liquidator cannot compromise the debt without the approval of the Court, the committee of inspection or a resolution of creditors. It should be noted that such approval is not needed for a preference claim which is not considered a debt for the purposes of subsection 477(2A) (Re Luxtrend Pty Ltd (1996) 14 ACLC 1786).

21.4.5 The Commissioner, as a creditor, will generally vote in favour of such a compromise offer when it appears that the settlement will result in a greater return to the liquidation administration than if litigation was allowed to take its full course. In coming to such a decision, some of the relevant considerations include:

- the chances of success if litigation is to be initiated/continued
- if the litigation is ultimately successful, the ability of the defendant to meet the judgment debt
- the costs of pursuing the debt, particularly if creditors, including the Commissioner, will have to indemnify the liquidator to progress the litigation further
- the time it may take to achieve recovery through litigation (including the additional costs of the liquidator that will be incurred in this period and which will rank ahead of the unsecured creditors claims)
- the attitude of other arms length creditors

21.4.6 In some instances the Commissioner may for public interest reasons consider that an offer should be rejected and litigation continued. For example the claim may be against a director who has deliberately structured the company's and his own affairs in an attempt to minimise creditors' chances of recovery. To accept an offer in these circumstances, especially for a token amount, may only encourage such behaviour in the future. However before voting against an offer solely on public interest grounds, the Commissioner will also consider the attitude of the other arms length creditors and the effect that his vote will have on them. In particular, the extent to which they may be financially disadvantaged by the rejection of the settlement offer.

Part C The Collection of Taxation Debts

22 VOIDABLE TRANSACTIONS

22.1 PURPOSE

22.1.1 This chapter discusses voidable transactions and sets out the circumstances when the Commissioner will refund an amount to a liquidator of a company. Preferences which are void against the trustee in bankruptcy are discussed in the chapter "Bankruptcy Action – Conditions and Factors to Consider".

22.2 LEGISLATION

22.2.1 Division 2 of Part 5.7B of the Corporations Act 2001 (CA 2001) deals with voidable transactions and provides liquidators with a means to recover property or compensation for the benefit of creditors of an insolvent company.

22.2.2 The payments affected by indemnity provisions are in respect of liabilities under various parts of the Income Tax Assessment Act 1936 (ITAA 1936) (group tax, PPS, natural resource payments and withholding taxes) for deductions made prior to 1 July 2000.

22.3 INTRODUCTION

22.3.1 The purpose of the provisions is to ensure unsecured creditors are not prejudiced by the actions of a company, which result in the disposal of assets or the incurring of liabilities, that may favour certain creditors or other persons (including related entities), shortly before a winding up.

22.3.2 Transactions falling for consideration under this aspect of the legislation include unfair preferences, uncommercial transactions (transactions at an undervalue) and unfair loans (loans where the rate of interest is extortionate).

22.3.3 If it appears to a liquidator that a company which is being wound up has entered into a voidable transaction, the liquidator may seek an order of the court to have the transaction set aside. The court has the power to make any orders to restore the company to the position it would have been in if it had not entered into the voidable transaction.

22.3.4 The Commissioner is not immune from a claim by a liquidator that an amount paid by a company in relation to a tax debt is a voidable transaction. It seems clear that such claims may extend to all tax types, including sales tax (see the case of Sands & McDougall Wholesale Pty Ltd (In Liquidation) (ACN 008 435 121) & Anor v. The Commissioner of Taxation of The Commonwealth of Australia (40 ATR 322).

22.3.5 A payment remains valid and the Commissioner is under no obligation to pay any money to a liquidator unless and until ordered to do so by the Court, even if the payment is made in circumstances that would clearly enable a Court to make an order about a voidable transaction.

22.3.6 The Commissioner is able to establish a defence to unfair preference action if it can established that the Commissioner acted in good faith, and, at the time of the transaction, there were no reasonable grounds for suspecting that the company was insolvent or would become insolvent

because of the transaction, and a reasonable person in the Commissioner's circumstances would have had no such grounds.

22.3.7 A payment received as a result of a notice served on a third party under s218 ITAA 1936 and equivalent provisions in other legislation pre 1 July 2000, and under sub-division 260-A of Taxation Administration Act 1953 (TAA 1953) post 1 July 2000 (See chapter "Garnishee Notices") cannot be said to constitute a transaction between the company and the Commissioner, and accordingly cannot constitute an unfair preference.

22.4 POLICY

22.4.1 The Commissioner accepts that there will be instances where it would be appropriate to voluntarily pay an amount to a liquidator because a transaction was voidable (to avoid unnecessary costs and reduce the return to creditors). However, the Commissioner believes he/she is precluded from voluntarily refunding amounts in response to a claim from a liquidator under the provisions of Division 2 of Part 5.7B of the CA 2001 for two reasons.

22.4.2 The first is that the Commissioner believes he/she is statutorily barred from making a refund of revenue in these circumstances in the absence of a court order. This is so even if it is apparent he had received a preference payment.

22.4.3 The second relates to the legislation which imposes a liability on the directors of an insolvent company to indemnify the Commissioner in respect of any loss or damage that may arise if a court sets aside a payment as a voidable transaction. The Commissioner understands that it would be unlikely this indemnity would operate if an amount was voluntarily repaid without a court order.

22.4.4 As a result, refunds of alleged unfair preferences will not be made to a liquidator unless a court orders otherwise. If it is clear from the circumstances of the case that a transaction was voidable, then the Commissioner will not oppose an action by a liquidator and will consent to judgment.

22.4.5 In deciding whether to seek an indemnity, focus will be on the directors' capacity to pay and other factors including the directors' history with other companies by reference to Risk Management guidelines. (See chapter 'Risk Management').

22.4.6 Any claims by liquidators for repayment of an alleged unfair preference should be discussed with the case officer's team leader. All claims should be brought to the attention of the Advanced Legals Team as soon as the claim is received. Generally, either Technical Advisors, or the Advanced Legals Team, will provide advice for cases involving actions to recover a purported preference payment. No response should be given to the liquidator until the advice of Advisor, the Advanced Legals Team or the Legal Practice, has been received.

22.4.7 If it has been decided that the Commissioner will seek indemnification from the directors, the liquidator's application to the Court for an order under section 588FF should be undertaken in the Supreme Court.

22.4.8 If the Commissioner is not seeking indemnification from the directors, the order may be given by a lower court.

22.4.9 Where the Commissioner defends against the Liquidator's claim, the Commissioner is still entitled to join directors as third parties to the action and may seek to enforce indemnity in the event that the Court makes an order that the payments in question are voidable transactions.

22.4.10 If there is a high probability that a court will determine that the payment is a preference, the directors have no defence and are solvent with sufficient assets to cover the debt, the Commissioner may consent to judgment, and seek indemnification from the directors.

22.4.11 For the Commissioner to consent to judgment, it would be necessary for evidence to be presented to the Court that would be sufficient for the liquidator to obtain summary judgment, assuming there was no appearance for the Commissioner. Notice of the proposed consent order should be given to the directors before the order is made to afford them the opportunity to raise any objection. This is necessary in order for the Commissioner not to compromise the ability to enforce the indemnity under section 588FGA.

22.4.12 Directors become liable to indemnify the Commissioner in respect of the amount paid by the Commissioner under section 588FF as soon as the Commissioner pays the amount to the liquidator. The liability is not deferred until the outcome of the liquidation is known. (Refer Browne v Deputy Commissioner of Taxation (1998) 16 ACLC 559).

22.5 TERMS USED

22.5.1 "Voidable transactions, voidable preferences, undue preferences" are transactions that may be avoided if considered insolvent transactions within the meaning of section 588FE Corporations Act 2001.

22.5.2 "Indemnity" – section 588FGA of the Corporations Act 2001 provides that the directors of a company may be made liable to indemnify the Commissioner for any loss or damage resulting from a court order under s 588FF because of certain payments.

Part B The Collection of Taxation Debts

30 INDEMNITIES FOR TRUSTEES

30.1 PURPOSE

30.1.1 This chapter discusses the Commissioner's power to bind the Commonwealth in relation to contracts of indemnity and sets out some considerations when deciding whether to grant an indemnity.

30.2 LEGISLATION

30.2.1 The power to bind the Commonwealth in relation to contracts of indemnity rests with the Minister acting within the scope of his legal responsibility. The Minister may authorise the Commissioner and other officers to exercise those powers on behalf of the Commonwealth.

30.3 INTRODUCTION

30.3.1 A trustee is required by relevant legislation to perform certain duties regardless of whether the estate being administered has sufficient funds to cover the expenses incurred in carrying out those duties. If the administration has insufficient funds, the trustee is only required to perform the statutory duties of filing required reports and documents with the relevant authorities.

30.3.2 On occasions the Commissioner, as a creditor in an insolvency administration, will be asked to help fund recovery action by the trustee of the administration where the trustee identifies some potential cause of action that may result in more funds being available to creditors.

30.3.3 The request for funding may take the form of a request for indemnity against, or advance for, the costs, charges and expenses which will be incurred by the trustee in the course of legal recovery proceedings on behalf of the creditors of the administration (eg obtaining legal opinions, recovering preferences, recovering assets, investigations, the public examination of relevant parties).

30.4 POLICY

30.4.1 The question of whether or not to agree to indemnify a trustee can be complicated and each request must be treated on its merits. In deciding his response to a request for an indemnity, the Commissioner will need to determine whether:-

(i) it is appropriate for the trustee to seek an indemnity for the proposed action (it would be inappropriate for a trustee to seek an indemnity to perform what is required to be performed and trustees are not entitled to be indemnified for losses arising from their negligence);

(ii) the ATO's proof of debt had been admitted;

(iii) the funds/assets likely to be recovered, including whether the expected benefits to the Commonwealth are likely to outweigh the costs of the indemnity;

(iv) legal arguments or counsel's opinion (where that has been obtained) supports the proposed action of the trustee;

(v) the request is in writing and whether the trustee has clearly explained the reason for the request by providing the necessary facts and documents to support the request and set out the likely outcomes and reasons for those views;

(vi) other creditors are prepared to participate;

(vii) the debtor has made any counter claims or disputed the debt if the indemnity is sought to recover outstanding debts, and whether the counter claims have been fully evaluated;

(viii) there are any "public interest" arguments to consider;

(ix) the trustee is prepared to make an application to give indemnifying creditor(s) priority under subsection 109(10) Bankruptcy Act 1966 (BA 1966) or section 564 Corporations Act 2001;

(x) the trustee has explained what specific action or actions the indemnity is likely to cover and whether there are alternatives to the proposed action;

(xi) the amount of the proposed indemnity (the trustee should provide a break down of costs involved in each step of any proposed action - the Commissioner will not agree to give an unlimited indemnity);

(xii) the potential for recovery against the third party against whom the action is to be taken; and

(xiii) the proposed timeframe (statutory limitations may apply - the need for timely actions and follow up will need to be considered).

30.4.2 It is appropriate in many requests for indemnities to seek external professional advice about the prospects of success if the indemnity is granted. If there is a strong possibility the action will not succeed, the indemnity should not be granted.

30.4.3 The officer deciding the indemnity has the choice of contributing towards an indemnity (ie with other creditors), granting the indemnity, granting a partial indemnity (ie up to a certain point, at which time the ATO's position can be reconsidered), or declining to indemnify the trustee.

30.4.4 If the Commissioner decides to indemnify the trustee and other creditors do not provide an indemnity in proportion to their respective claims, the trustee will be asked to seek an order granting the Commissioner an advantage over other creditors in relation to distribution of the funds recovered by the action.

30.4.5 The terms of the indemnity should always be detailed in writing, cleared though the ATO's solicitor where appropriate, and signed by both parties. This approach is taken so that both parties are under no misunderstanding of their rights and obligations. The following list is not intended to be exhaustive of the matters that should be covered by an indemnity agreement. The indemnity should:

- specify the actions to which it relates, and be expressed to cover only the actions specified;
- specify the maximum amount which should be payable to the trustee. Payments up to this amount will be made progressively, not in a lump sum;
- specify the costs which it covers. If it relates to professional fees to the trustee, this should be stated;

- state that every indemnity is considered on its merits and that any further requirements for funding will have to be considered as a separate request;
- contain a requirement that the trustee provide regular reports as to progress of the action;
- require the trustee to provide a break up of the expenses for which he claims reimbursement, prior to any payment being made to a trustee;
- require the trustee to provide copies of any legal advice received in taking actions funded by the guarantee; and
- contain terms, where appropriate, requiring the trustee to make application under subsection 109(10) of the BA 1966 or section 564 Corporations Act 2001.

In addition, the indemnity may require the trustee to seek the Commissioner's agreement to any negotiated settlement of actions funded by the guarantee between the trustee and another.

30.4.6 The Commissioner will also usually require the trustee to provide him with a plan of action and timelines whenever he agrees to provide an indemnity. Both expenditure and progress will be monitored against this plan.

30.4.7 An officer, properly delegated to authorise expenditure of public monies, is responsible for checking details of expenditure and querying the trustee if some doubt exists. That officer will also be responsible for checking the accounts when received against the indemnity, to ensure the amounts claimed come within the terms of the indemnity and do not exceed the amount for which the indemnity was granted.

30.5 TERMS USED

30.5.1 "Indemnity" is a contract whereby one party agrees to compensate the other for loss or damage which may be incurred by the other.

30.5.2 "Trustee" in this context refers to registered insolvency practitioners and includes bankruptcy trustees appointed under the Bankruptcy Act 1966 and liquidators dealing with both individual and corporate insolvency administrations.

Part B The Collection of Taxation Debts

31 CLEARANCES - OBLIGATIONS OF TRUSTEES AND THE COMMISSIONER

31.1 PURPOSE

31.1.1 This chapter deals with:-

- the obligations of trustees to notify the Commissioner of their appointment and to set aside an amount to pay tax-related liabilities;
- the Commissioner's obligations to advise the trustees of the amount of tax-related liabilities; and
- the priority afforded to costs incurred by the Commissioner as applicant creditor in a Court winding up

31.2 LEGISLATION

31.2.1 Before 1 July 2000, there were specific sections under the various Acts administered by the Commissioner that set out the obligations of liquidators, receivers and certain agents and the obligations of the Commissioner when notified of the appointment. These sections were :-

- section 215 Income Tax Assessment Act 1936 (ITAA 1936);
- section 96 Fringe Benefits Tax Assessment Act 1986 (FBTAA 1986);
- section 123 Sales Tax Assessment Act 1992 (STAA 1992);
- section 53 Superannuation Guarantee (Administration) Act 1992 (SGAA 1992).

From 1 July 2000, the following provisions of the *Taxation Administration Act 1953* (TAA 1953) set out those obligations:-

- section 260-45 (for liquidators)
- section 260-75 (for receivers)
- section 260-105 (for agents)

The provisions of the TAA 1953 above apply to trustees appointed on or after 1 July 2000 (whether the tax-related liabilities concerned arise before, on or after that date).

However, section 260-45 does not apply in relation to a debt for Superannuation Guarantee Charge. Such debts are given priority in a liquidation in accordance with section 52 SGAA 1992.

31.3 INTRODUCTION

31.3.1 Trustees are required to notify the Commissioner within 14 days of:-

(i) their appointment as a liquidator; or

(ii) their taking possession of the assets of a company as a receiver; or

(iii) receiving instructions from a non-resident principal to wind up a business of the principal.

31.3.2 As soon as practicable after being notified of the appointment, or of a trustee taking possession of assets, the Commissioner is obliged to

provide the trustee with advice of the amount which would be sufficient to meet any tax-related liabilities that are , or will become, payable (including additional charges for late payment/general interest charge(GIC)). The trustee should be told whether the debtor's lodgments are up to date and any outstanding returns requested.

31.3.3 While a liquidator or receiver is entitled to part with assets in order to pay secured or preferred debts at any time, neither can, without leave of the Commissioner, part with any of the assets of the company to pay ordinary debts (that is, unsecured debts) until the Commissioner provides the notification required. However, an agent for a non resident principal cannot part with any assets to pay secured or preferred debts until receiving notice of the likely debt from the Commissioner and setting aside an amount to meet that debt.

31.3.4 After receipt of the Commissioner's notification, the trustee (unless they are an agent for a non resident as described above) is only required to set aside sufficient assets to pay a pro-rata share of the tax-related liabilities when that debt is compared to the total amount of ordinary debts. The Commissioner may subsequently vary the notification to increase the amount. However, if the trustee has paid the debt notified by the Commissioner and distributed the assets, the obligations imposed on the trustee will have been met and a personal liability avoided. This situation may be different if the trustee knew, or had the means of knowing, the Commissioner's estimate was wrong.

31.3.5 Where a trustee fails to comply with any provision or pay the tax-related liabilities for which the trustee is liable, the trustee becomes personally liable to pay the debt notified, but only to the extent of the assets that the trustee was required to set aside. The trustee is also guilty of an offence which is punishable on conviction by a fine not exceeding 10 penalty units .

31.4 POLICY

31.4.1 The obligations contained in sections 260-45, 260-75 and 260-105 of the TAA 1953 provide a dual service to the ATO by way of notification of appointment and by requiring the setting aside of assets to meet unpaid tax debts.

31.4.2 The Commissioner will respond in a timely manner to any notification received from a trustee by advising of the amount of unpaid tax-related liabilities that are due. If the proper amount due has not been ascertained at the time of notification, then appropriate action will be taken as soon as possible to determine the correct debt due to the Commissioner. The trustee should be notified of any delay that might arise in providing the relevant information.

31.4.3 Where it is not possible to determine the amount of a debt (for whatever reason) and the Commissioner is not prepared to raise a default assessment (if appropriate) or issue an estimate notice in relation to an unremitted amount, the trustee will be advised there is no amount to be set aside.

31.5 NOTIFICATION OF LIABILITIES

31.5.1 Where there is more than one type of tax-related liability that is to be notified in satisfaction of the requirements of a section of the TAA 1953 ,

a single notice showing each separate amount of tax-related liability will be sent to the trustee.

31.6 COSTS OF WINDING UP PROCEEDINGS

31.6.1 In the winding up of a company that results from the order of a Court, the costs associated with the application for the order are ranked second in priority, only after the expenses of the liquidator "...in preserving, realising or getting in property of the company, or in carrying on the company's business;" (see section 556(1) of the Corporations Act 2001).

31.6.2 It would not be appropriate that payment be made other than in accordance with the ranking as provided by law. Where the Commissioner has an entitlement as the applicant creditor, any request to stand aside to permit payment of other debts or claims against the company, including the remuneration of the liquidator, will be declined.

31.7 TERMS USED

31.7.1 A "trustee", for the purposes of this chapter, may be either:-

- a liquidator of any company being wound up; or
- a receiver for a debenture holder, who has taken possession of the assets of a company; or
- an agent for a non-resident principal, who has been instructed by the principal to wind up a business of the principal.

31.7.2 "Tax-related liability" or "liability" is a term used to define any pecuniary liability to the Commonwealth arising directly under a taxation law (including a liability the amount of which is not yet due and payable). It thus encompasses all types of taxes, penalties, additional charges for late payment, etc (including amounts previously defined under the Income Tax Assessment Act 1936 (ITAA 1936) as "tax" and under the Superannuation Guarantee Administration Act 1992 (SGAA 1992) as "superannuation guarantee charge" etc). A table which lists the tax-related liabilities is found at section 250-10 of Schedule 1 of Taxation Administration Act 1953 (TAA 1953). This includes excise and diesel fuel rebate debts administered under the provisions of the Excise Act 1901, diesel fuel rebate debts administered under the 'diesel fuel rebate Customs provisions' of the Customs Act 1901 and both grant scheme debts administered under the provisions of the Diesel and Alternative Fuel Grants Scheme Act 1999 and Product Grants and Benefits Administration Act 2000.