Part B The Collection of Taxation Debts

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

The policy in this chapter is to be followed by Tax Office staff. We have made every effort to ensure it is technically accurate, but in the interests of clarity it has been written in 'plain English' and should not be read or interpreted like legislation. If you feel that something in the chapter is wrong or misleading, please advise the Tax Office.

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20.1 PURPOSE

20.1.1 This chapter:

- deals with provisions under the *Corporations Act 2001* (Corporations Act) that enable an administrator to put forward proposals to creditors under which they would receive 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 Corporations Act provides an opportunity for corporate debtors to reach an arrangement with their creditors which enables them to continue in operation. As it is not always possible for the company or its business to continue in existence, the Part also seeks to provide for the business, property and affairs of an insolvent company to be administered in a way that results in a better return for the company's creditors and members than would result from an immediate winding up of the company.

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 to at least enable the realisation of assets in an orderly manner, to enhance the ultimate position of all stakeholders in the company. Procedures for putting in place a voluntary administration are designed to be:

(i) capable of swift implementation;

(ii) as uncomplicated and inexpensive as possible; and

(iii) sufficiently flexible to enable the most appropriate and beneficial solution to be achieved.

20.3.2 It is not 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 that the company can trade out of its difficulties. The Commissioner is 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:

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

(ii) It preserves a business which, despite having its operations threatened by adverse circumstances, is fundamentally viable;

(iii) 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

(iv) It potentially provides a better return for the revenue.

20.3.4 Administration may be initiated:

(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 that the company is insolvent, or is likely to become insolvent.

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

(i) be wound up; or

(ii) that the administration should end.

20.3.7 From the date on which the administration commences (that is, when the administrator is appointed), there are restraints on dispositions of assets by a company, proceedings by individual creditors against a company, and on alteration in the membership of a company.

20.3.8 The process of a voluntary administration is as follows:

- The administrator is obliged to convene the first meeting of creditors by giving written notice to identified creditors and by publishing a notice of the meeting in a national newspaper or a paper in general daily circulation within each State in which the company had its registered office or carried on business.
- At this first meeting (which is required 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 inspection which is comprised of creditors and consults with, and receives and considers reports from, the administrator.
- After the first meeting and before the second meeting, only the administrator can deal with the company property. The administrator conducts an investigation of the affairs of the company. There is a general moratorium on creditors proceeding

with recovery action and the moratorium continues until the outcome of the second meeting (or proposal meeting) is known.

- Papers will be circulated prior to the second meeting, which must be held within 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 so as to establish his entitlement to vote.
- At the second meeting, creditors of a company are asked to vote on a resolution that the company execute a proposed deed of arrangement, or that the administration should end, or that the company be wound up.
- Creditors should receive sufficient information prior to a meeting in order to be able to make an objective assessment of the proposal to be put to the meeting. If there has been insufficient information provided by the administrator's report to satisfy the creditors' concerns, then they should exercise their right to ask questions before a meeting or to raise issues at the meeting, itself.
- Some issues regarding the administrator's report or recommendations which officers may wish to clarify before deciding how to cast their vote 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 Tax Office;
  - (f) whether cash flow forecasts are based on reasonable assumptions;
  - (g) whether there is some other action that may be pursued (for example, insolvent trading claims against the directors or voidable preference claims against third parties);
  - (h) an assessment of how the directors have handled the financial problems and whether they have shown concern for creditors' best interests, rather than 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 administrator's powers are essentially confined to those expressed in the deed. The deed should clearly declare which property is available for the creditors, which creditors are bound by the deed and the extent to which the company is to be released

from its debts. The deed should also stipulate the circumstances in which the deed may be terminated.

- The company must execute the deed within 21 days of the meeting, or otherwise the company is deemed to have gone into liquidation and the administrator becomes the liquidator. The company remains subject to the terms of the deed until those terms have been completed or until the deed is otherwise terminated or varied. 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 immediately becomes the liquidator.

20.4 POLICY

20.4.1 A debtor has a number of avenues available under various laws that may effectively provide for formal compromise or indeed, that allow for the Commissioner to accept payment of a debt over time. These avenues generally operate to protect debtors and, in the case of the Corporations Act, protect the interests of all creditors, each of whom has 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 Tax Office 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 Tax Office from voting for a deed of company arrangement. (Refer to the chapters entitled 'Personal liabilities of company directors' and 'Payment agreements'.)

20.4.4 While each case must be considered on its individual facts, it can be generally accepted that the Commissioner will support arrangements which have no adverse features and where the deed is expected to provide 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 a proposed deed has any adverse features, the Commissioner will have regard to all relevant matters including, but not limited to:

(i) any legal advice which may have been obtained by the Commissioner;

(ii) the contents and comprehensiveness of relevant reports;

(iii) the adequacy of those reports (with regard to the contents and also to any relevant omissions);

(iv) any apparent insolvent transactions, including the presence of any insolvent trading engaged in by the company;

(v) anticipated future income;

(vi) the fact that the investigative and other powers available to an administrator are not as extensive as those available to a liquidator;

(vii) the debtor's taxation compliance history and the compliance history of related parties or entities;

(viii) the likelihood that the undertakings in the proposals would be achieved;

(ix) the compliance history of other corporations or entities which the directors of the debtor company have managed or of which they have been a director during the preceding three years;

(x) the consequent loss of any priority the Commissioner may otherwise have had in a liquidation (for example, in respect of Superannuation Guarantee Charge);

(xi) other matters that are considered to be of public interest or which reasonably question the fairness and appropriateness of voting in support of a proposed deed, particularly where a consequence of the deed would be the removal of statutory powers of investigation, examination and 'clawback' of assets or funds;

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

(xiii) any association between the debtor and other creditors, including an association which only arose pursuant to an assignment of debt;

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

(xv) any particular aspect of the proposed 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 entitled 'Accountability and review of decisions'.

20.4.7 The Commissioner may choose to provide information about the debtor to an administrator of the company or an administrator of the deed where the Commissioner believes that it is reasonably likely that the provision of such information will lead to the Commissioner receiving a greater dividend or distribution from the insolvency process. Before disclosing any information, the Tax Office decision-maker must consider two separate pieces of legislation. The first is the relevant secrecy provisions of the *Taxation Administration Act 1953* and similar provisions in other acts (eg section 16 of the ITAA 1936). The decision should be guided by Chapter 2 of the *ATO Receivables Policy* and, if disclosure is permissible under the relevant section, the Tax Office decision-maker may have a discretion to disclose information to the administrator of the company or administrator of the deed. It is important to note that the relevant secrecy provision is the one under which the information was obtained. Where it is not clear that the information can be given without breaching secrecy provisions, advice should be sought from the Legal Services Branch of the Tax Office.

20.4.8 The Commissioner will not withdraw or stay any action against a director where the terms of a deed purport to limit the Commissioner's rights to

do, or refrain from doing, some action. Such terms are ineffectual and the Commissioner will vote against any deed which purports to include such a clause.

20.4.9 While any arrangements approved under the Corporations Act are binding on the Commissioner, he will nevertheless seek appropriate relief through the courts where an arrangement appears to unreasonably disadvantage the Commonwealth revenue or include other adverse features.

20.4.10 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, where the value of that debt 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 Corporations Act, prompt enquiries should be made to either the Insolvency and Trustee Service Australia (ITSA) or the Department of Finance and Administration to assign an appropriate person or organisation to dispose of the assets on behalf of the Commonwealth.

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

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 that is feasible. (The assets are not to be left in the debtor's control);
- insuring the assets, if appropriate;
- storing the assets in appropriate conditions, having regard to the nature of the assets;
- arranging appropriate physical security for the assets;
- providing advice on what actions, if any, ought to be taken to improve the saleability of the assets and to 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 connected with the need to exercise options on certain assets or to clean, repair, restore or improve the saleability of an 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 a purchaser who stands at arm's length) and to avoid a forced sale situation in which the value calculated to be the fair market value, must be 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 the sale, net of expenses including commission, which 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 the assets are sold (except in the instance where those assets are shares). The balance is then considered as irrecoverable at law. Any share script received in an insolvent debtor company is to be valued at nil. In that situation, 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, and the consideration received should then be credited to that account with 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 Tax Office’s asset register so that it will be included in the Tax Office 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 Tax Office’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 where 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 should 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 in 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 Corporations Act), ie not until the execution of a deed of company arrangement (DOCA) or until the company is returned to the directors. However, if the company continues to wind up, the charge so created will be void (per section 468 of the Corporations Act and *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 relevant technical area should be consulted regarding 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 comes into existence after the date of appointment. The charge so created is not enforceable by the Commissioner while the company remains in administration (per section 440B of the Corporations Act), ie not until after the execution of a DOCA or once the company has been returned to the directors. Whether or not the Commissioner chose to enforce or 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 have an adverse impact on the viability of the business or on third parties, such as employees. If the company continues to wind up, the charge so created will be void (per section 468 of the Corporations Act). 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 entitled ''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 Tax Office 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 Corporations Act describes when a person (a term 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.