Part B The Collection of Taxation Debts

22 VOIDABLE TRANSACTIONS

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.

Date of effect: 4 July 2006 *(This replaces the 2003 version.)*

22.1 PURPOSE

22.1.1 This chapter discusses voidable transactions and sets out the circumstances in which 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 entitled '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 Section 588FGA of the CA 2001 requires directors to indemnify the Commissioner for any loss or damage resulting from a court order under section 588FF in relation to certain payments made by the company.

22.2.3 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, or under a provision of Subdivision 16-B in Schedule 1 to the *Taxation Administration Act 1953* (TAA).

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 prior to a winding up, that may favour certain creditors or other persons (particularly related entities).

22.3.2 Transactions that may be voidable under the legislation include unfair loans and insolvent transactions.

22.3.3 A transaction is an insolvent transaction if it is an unfair preference or uncommercial transaction of the company, entered into when the company was insolvent, or which has the effect of causing the company to become insolvent.

22.3.4 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 effectively 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.

22.3.5 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).

22.3.6 The Court needs to be satisfied that the company was insolvent at the date of each payment. 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.

22.3.7 The Commissioner is able to establish a defence to unfair preference action if it can be 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 that nor would a reasonable person in the Commissioner's circumstances would have had grounds for such a suspicion.

22.3.8 A payment received as a result of a notice served on a third party under section 218 ITAA 1936 and equivalent provisions in other legislation pre 1 July 2000, and under sub-division 260-A of Schedule 1 to the TAA post 1 July 2000 (see the chapter entitled '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 is precluded from voluntarily refunding amounts in response to a claim from a liquidator under the provisions of section 588FF of the CA 2001 for two reasons.

22.4.2 The first reason is that the Commissioner believes he 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 benefit from an unfair preference or an uncommercial transaction.

22.4.3 The second reason 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 or uncommercial transactions 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 order under section 588FGA of the CA 2001, 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 the chapter entitled 'Risk management').

22.4.6 Any claims by liquidators for repayment of an alleged unfair preference or uncommercial transaction should be discussed with the case officer's team leader. All claims should be brought to the attention of the relevant technical area as soon as the claim is received. Generally, either Technical Advisers or the relevant technical area will provide advice on cases involving actions to recover a purported preference payment. No response should be given to the liquidator until the advice of a Technical Adviser, the relevant technical area or the ATO Legal Services Branch, 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 made in either the Supreme Court or Federal 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 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 the Commissioner is satisfied that there is a high probability that a court will determine that the payment is a preference or uncommercial transaction the Commissioner may consent to judgment, thereby relieving the liquidator of the expense of preparing the necessary evidence. Where the directors' indemnity is to be pursued, notice of any 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 so as not to compromise the Commissioner's ability to enforce the indemnity under section 588FGA.

22.4.11 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).

22.4.12 The Commissioner will be unable to enforce an indemnity under section 588FGA of the CA 2001 where a director successfully raises a defence under section 588FGB of the Act. The defences available are:

- if it can be proved that at the time of the payment, the person had reasonable grounds to expect and did expect that the company was solvent at that time and would remain solvent even if it made the payment;
- if at the time of the payment, the person had reasonable grounds to believe and did believe that a competent and reliable person was responsible for providing to the first person adequate information about whether the company was solvent and that the other person was fulfilling their responsibility and that they expected on the basis of that information that the company was solvent and would remain solvent even if it made the payment;

- if it can be proved that because of illness or for some other good reason the person did not take part in the management of the company at the payment time; and
- if it can be proved that the person took all reasonable steps to prevent the company from making the payment or there were no such steps that the person could take (having regard to any action they took with a view to appointing an administrator, when that action was taken and the results of that action).

22.5 TERMS USED

22.5.1 'Indemnity' – section 588FGA of the CA 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 section 588FF because of certain payments.

22.5.2 'Insolvent transaction' is an unfair preference or uncommercial transaction entered into when the company was insolvent, or which caused the company to become insolvent.

22.5.3 'Unfair loan' – in terms of section 588FD, a loan to a company is unfair where the interest or related charges are, or were, extortionate.

22.5.4 'Unfair preference' is a transaction that results in a creditor receiving more from the company than they would be entitled to in the event of proving in a winding up of the company

22.5.5 'Voidable transactions' are transactions in respect of which the court may make an order under section 588FF of the CA 2001. Two classes of transactions can be voidable – Unfair Loans and Insolvent Transactions.