

## ATO RECEIVABLES POLICY

### PART B The collection of taxation debts

## Chapter 22 VOIDABLE TRANSACTIONS

*The policy in this chapter is to be followed by ATO 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 ATO.*

**Date of effect:** 3 December 2010

**Key legislation:** Division 2 of Part 5.7B of the *Corporations Act 2001*

### PURPOSE

1. This chapter deals with voidable transactions and sets out the circumstances in which the ATO will repay to the liquidator of a company an amount that has been paid by the company towards its taxation debts. Preferences which are void against the trustee in bankruptcy are discussed in Chapter 18 'Bankruptcy action'.

### INTRODUCTION

2. Division 2 of Part 5.7B of the *Corporations Act 2001* deals with voidable transactions and provides liquidators with a means to recover property, money or compensation for the benefit of creditors of an insolvent company.
3. Transactions that may be voidable under the Corporations Act include unfair preferences and uncommercial transactions. The most common voidable transaction claim made by a liquidator against the Commissioner is in relation to an unfair preference.
4. The purpose of the voidable transaction provisions is to ensure unsecured creditors are not prejudiced by the actions of an insolvent 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).
5. 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 a number of orders about voidable transactions including orders for payment, transfer of property, indemnity, release or discharge of debts, security or guarantee, varying an agreement or declaring an agreement to be void or unenforceable (section 588FF of the Corporations Act).
6. 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 superannuation guarantee charge (SGC), despite the fact that the money received has been subsequently paid for the benefit of the employees.

7. The definition of a 'voidable transaction' covers a wide range of transactions (see 'Terms Used' at the end of the Chapter), including 'insolvent transactions'. In order for a transaction to be an 'insolvent transaction' it must be, among other things, either an unfair preference or an un-commercial transaction. Additionally, the company must have:
  - been insolvent at the date of each transaction or payment which forms part of the claim, or
  - become insolvent as a result of entering into the transaction or payment which forms part of the claim.
8. The Commissioner will have a defence to an insolvent transaction claim if it can be demonstrated that:
  - the Commissioner acted in good faith in respect of the transaction or payment
  - at the time of the relevant transaction or payment, there were no reasonable grounds for suspecting that the company was insolvent or would become insolvent because of the transaction or payment
  - a reasonable person in the same circumstances would have no grounds for such a suspicion.
9. A payment received as a result of a notice served on a third party under Subdivision 260-A in Schedule 1 to the *Taxation Administration Act 1953* (TAA) cannot be said to constitute a transaction between the company and the Commissioner and, accordingly, cannot constitute an unfair preference or an uncommercial transaction (see also Chapter 12 'Garnishee').
10. The payments currently affected by indemnity provisions are in respect of liabilities under section 268-20 in Schedule 1 to the TAA (estimates) or a provision of Subdivision 16-B in Schedule 1 to the TAA (withheld amounts).
11. Where a creditor has put the company in the same position as if the transaction has not been entered into because of:
  - a court order under section 588FF of the Corporations Act
  - at the request or the liquidator, or
  - for any other reason,the creditor is permitted to prove in the winding up as if the transaction was not entered into (section 588FI).

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12. There will be instances where it will be appropriate to settle a voidable transaction claim without the need for a liquidator to apply to the court for an order under section 588FF of the Corporations Act. The Commissioner has the power to settle a claim if he is satisfied that settling the claim is an efficient, effective and ethical use of public money, and that it is not inconsistent with government policy. The Commissioner must be satisfied that the claim is a legitimate claim and that settling the claim without litigation would be consistent with the requirements of the *Legal Services Directions 2005*, including that the settlement is in accordance with legal principle and practice. However, the Commissioner will not voluntarily settle a voidable transaction claim where he will be seeking director indemnity pursuant to section 588FGA (see paragraphs 15 to 18).

13. If the liquidator is claiming that the Commissioner has received an unfair preference and the claim relates to payments made towards SGC, the Commissioner will only agree to repay those amounts to a liquidator without the need for a court order if the liquidator can establish preferential effect by providing evidence that at least one other creditor with the same statutory ranking existed at the time of the transaction and that that creditor remains a creditor in the winding up. This is on the basis that SGC is subject to a priority payment and must be paid in priority to all other unsecured debts and claims under paragraph 556(1)(e) of the Corporations Act.
14. Where a Court makes an order against the Commissioner under section 588FF of the Corporations Act to set aside a transaction as a voidable transaction, each person who was a director of the company at the time the payment was made is liable to indemnify the Commissioner in respect of any loss or damage resulting from the order (section 588FGA).
15. As a result, where voidable transaction claims are made in respect of payments applied to liabilities affected by the indemnity provisions, repayments of alleged unfair preferences or uncommercial transactions will not be made to a liquidator unless:
  - a court orders the payment, or
  - the directors are prepared to settle the Commissioner's potential claims against them without the need for an indemnity order (see Chapter 39 'Settlement of debt recovery litigations').
16. Where the Commissioner is satisfied that a court will determine that the payment is a voidable transaction and the Commissioner wishes to pursue indemnity from the directors, the Commissioner will invite the liquidator to commence proceedings and join the directors to the proceedings to allow the directors the opportunity to be heard.
17. In considering whether to pursue indemnity against a director, we will focus on any potential defences available to the directors (see paragraph 20), the director's capacity to pay and other relevant factors including the director's history with other companies by reference to risk management guidelines (see Chapter 3 'Risk management').
18. 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 the indemnity in the event that the Court makes an order directing the Commissioner to make a payment to the company equal to the voidable transactions.
19. The director's liability to indemnify the Commissioner arises once the Commissioner pays an amount to the liquidator in accordance with an order under section 588FF of the Corporations Act. The liability is not deferred until the outcome of the liquidation is known. (Refer *Browne v. Deputy Commissioner of Taxation* (1998) 16 ACLC 559.)
20. The Commissioner will be unable to enforce an indemnity under section 588FGA of the Corporations Act where a director successfully raises a defence under section 588FGB. The defences available to a director are:
  - At the time of payment the director 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.
  - At the time of payment the director had reasonable grounds to believe and did believe that:

- a competent and reliable person was responsible for providing to the director adequate information about whether the company was solvent, and
    - the other person was fulfilling their responsibility,
- and that the director expected, on the basis of that information, that the company was solvent and would remain solvent even if it made the payment.
- Because of illness or for some other good reason the director did not take part in the management of the company at the time of the payment.
  - The director took all reasonable steps to prevent the company from making the payment or there were no such steps that the director could take (including 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).

## TERMS USED

**Indemnity** – section 588FGA of the Corporations Act provides that, where a Court makes an order under section 588FF against the Commissioner to set aside a transaction as a voidable transaction, each person who was a director of the company at the time of the payment is liable to indemnify the Commissioner for any loss or damage resulting from a Court order.

**Insolvent transaction** – is defined under section 588FC of the Corporations Act as an unfair preference or uncommercial transaction entered into when the company was insolvent, or which caused the company to become insolvent.

**Uncommercial transaction** – is defined under section 588FB of the Corporations Act as a transaction that a reasonable person in the company's circumstances would not have entered into having regard to certain matters such as the benefits and the detriment to the company of entering into the transaction, the respective benefits to other parties and any other relevant matter.

**Unfair preference** – is defined under section 588FA of the Corporations Act as a transaction to which the creditor and the company are parties and which results in a creditor receiving more from the company in respect of an unsecured debt that the company owes to the creditor than they would receive if the transaction was set aside and the creditor was to prove in a winding up of the company.

**Voidable transactions** – are defined in section 588FE of the Corporations Act and include insolvent transactions, uncommercial transactions, unfair preferences, unfair loans to a company and unreasonable director-related transactions. The court may make an order under section 588FF in respect of a voidable transaction.

### Chapter 22 - Archived versions

Version 4 – July 2006 (will link to chapter 22 pdf)
Version 5 – August 2008 (will link to Chapter 22 pdf)