PS LA 2011/16 - Insolvency - collection, recovery and enforcement issues for entities under external administration

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This practice statement is issued under the authority of the Commissioner of Taxation and must be read in conjunction with Law Administration Practice Statement PS LA 1998/1. It must be followed by tax officers unless doing so creates unintended consequences or where it is considered incorrect. Where this occurs tax officers must follow their business line's escalation process.

SUBJECT: **Insolvency – collection, recovery and enforcement issues for entities under external administration**

PURPOSE: **To provide guidelines for staff to follow in relation to:**

- **The factors to consider in determining whether to initiate bankruptcy or liquidation action**
- **The factors to consider when voting on a proposal to enter an arrangement that provides an alternative to bankruptcy or liquidation**
- **The issues to consider when dealing with legal claims within insolvency administrations, including settlements of amounts due to liquidators, indemnity requests and voidable transaction claims against the Commissioner**
- **How and when we notify trustees of the amount considered is enough to discharge outstanding tax-related liabilities.**
- **The personal liabilities of representatives of incapacitated entities for goods and services tax and fuel tax**
- **The Commissioner's position on the costs of wind up proceedings where we were the applicant creditor and we are asked to stand aside with respect to our priority**
- **The circumstances under which we will provide information about the debtor to an insolvency practitioner**
- **The circumstances under which a garnishee notice will be issued to or withdrawn from an entity under external administration**

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STATEMENT

Bankruptcy and liquidation action

1. Where a tax debtor does not propose or adhere to an acceptable proposal to pay a tax debt, the Commissioner will usually commence legal recovery proceedings. If the debt remains unpaid at the conclusion of those proceedings, in appropriate circumstances the Commissioner will take bankruptcy or liquidation action against the tax debtor. This section deals with the factors and considerations the ATO will take into account when deciding whether to take bankruptcy action against an individual or liquidation action against a company.[1]

Bankruptcy

2. Bankruptcy is the ultimate sanction for an individual debtor who does not pay or make acceptable arrangements to pay a debt. In bankruptcy, the debtor's property is vested in the trustee of the debtor's bankrupt estate for the benefit of creditors.

3. Individual debtors may voluntarily declare bankruptcy by filing their own petition (known as a *Debtor's Petition*) with an Official Receiver under the *Bankruptcy Act 1966*. Debtors may also become bankrupt as a result of a creditor presenting a creditor's petition in the Federal Magistrates Court or Federal Court, but this may only occur if the debtor has committed an *act of bankruptcy* within the preceding six months and owes the creditor (or creditors) at least $5,000.

Liquidation

4. Liquidation is the ultimate sanction for a corporate debtor that does not pay or make acceptable arrangements to pay a debt. When a company is placed into liquidation, the liquidator takes control all of the company's property and will then realise the company's assets and distribute the proceeds among the company's creditors.

5. A corporate debtor can voluntarily take steps to have their company wound up by calling meetings of members and creditors under Part 5.5 of the *Corporations Act 2001*. Corporate debtors may also be placed into liquidation by order of the court as a result of an application for winding up being filed.

6. In the case of a corporate debtor owing more than $2,000, a creditor (or creditors) can seek to have the company wound up in insolvency by serving a statutory demand for payment under the Corporations Act without first obtaining a judgment against the company. If the statutory demand is not satisfied, the creditor can then file an application for winding up with the court.

Initiating bankruptcy and liquidation action

7. Bankruptcy and liquidation proceedings are valid options for dealing with debtors, and the Commissioner, as a creditor, will exercise his right to use these processes in appropriate circumstances. The decision to institute bankruptcy or wind up proceedings against a tax debtor will not be taken lightly. Nor will this decision be made for the purpose of punishing a tax debtor.

[1] A company or corporate entity referred to throughout is one that is incorporated under the *Corporations Act 2001* (Corporations Act).

8. The Commissioner will not seek to bankrupt or liquidate a debtor where it is apparent that the debtor is solvent. However, the mere fact that a taxpayer can demonstrate a surplus of assets over liabilities will not, of itself, be construed as proof of solvency. The Commissioner will be persuaded by clear evidence that the debtor has sufficient liquid assets to enable all debts to be paid by their respective due dates, or within a reasonable period of time, and that the debtor is making arrangements to pay all of their debts, including those owed to other creditors.

Factors - general

9. Before commencing bankruptcy or liquidation action, the Commissioner will consider each case on its merits, having regard to:

- the asset position of the debtor:
  - If there are no available assets which can be realised to satisfy the debt, bankruptcy or liquidation action may not be worthwhile. Accepting payment of the debt and additional charges for late payment over a period of time may be a cheaper and more viable alternative in these cases (although it would be difficult for debtors with a history of broken promises to satisfy us that they could or would pay over time).
  - It may be unwise to agree to accept payment over time if there are other creditors who are likely to initiate bankruptcy or liquidation action. In these cases, should the debtor become bankrupt or be placed into liquidation, any payments made during the *relation back period* may have to be repaid to the trustee in bankruptcy or liquidator as a preference payment (see ***Voidable transaction claims against the Commissioner – liquidation*** below).
  - The Australian Taxation Office (ATO) recognises that even where the debtor may appear to have no recoverable assets, bankruptcy or liquidation action may still be viable. Assets that the debtor has improperly disposed of or transferred to, or acquired in the name of, other entities (such as a spouse, a director, a company or family trust) may be recoverable by the bankruptcy trustee or liquidator to enable a dividend to be paid to creditors (refer to Division 3 of Part VI of the Bankruptcy Act and Division 2 of Part 5.7B of the Corporations Act; see also ***Indemnity Requests*** below).
  - Bankruptcy and liquidation enable the trustee or liquidator to conduct an examination of the debtor's affairs. Where circumstances exist that prevent an assessment of the full financial position of the debtor, it may be appropriate to take bankruptcy or liquidation action so that such an examination can occur.
- the nature of the debt:
  - It may be appropriate to take bankruptcy or liquidation action to stop a debt from escalating rapidly. A tax debtor wishing to persuade us to refrain from such action would need to demonstrate that steps have been taken to stop debts from escalating.

- Where the debt is comprised of a combination of disputed and undisputed debts, bankruptcy and liquidation action may still proceed even where the debt includes a significant amount of disputed debt. The fact that a debtor has a dispute is a relevant factor to be taken into account, though it is not, in itself, sufficient to prevent bankruptcy or liquidation action. (The trustee in bankruptcy or the liquidator will stand in the shoes of the debtor as far as the dispute is concerned and can decide whether or not to proceed with the dispute.)

- the future income of the debtor:
  - If it can be shown that the debtor's financial position will improve (evidenced by financial statements and any relevant reports) 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 over a period of time. The onus would be on the debtor to demonstrate their ability to pay within that period. This option may not be appropriate for a debtor who has a history of failing to honour promises to pay.
- the risk to the revenue:
  - The ATO will be wary of dispositions of property which indicate that a debtor is divesting of assets. These dispositions would be void against the trustee or liquidator under the antecedent or insolvent transaction provisions if the debtor were to be declared bankrupt or placed into liquidation.
  - If it is evident or becomes apparent that the debtor is taking steps to limit their ability to pay, it may be appropriate to promptly seek the debtor's bankruptcy or liquidation. A freezing order may also be considered; see PS LA 2011/18 Enforcement measures used for the collection and recovery of tax related liabilities and other amounts.
- the cost of bankruptcy or liquidation and the likely return:
  - The cost / benefit analysis of bankruptcy or liquidation is an appropriate test of effectiveness, but should not stand alone as a consideration. The return from bankruptcy or liquidation is not limited to any likely dividend to be distributed to creditors; it also includes the benefit of preventing the escalation of liabilities.
  - In assessing whether to bankrupt or liquidate a debtor, any last minute offers to make payments over time need to be assessed with reference to the debtor's full financial position, their payment history and their ability to comply with the proposed offer of payment.

Factors – specific to bankruptcy

10. In the case of an individual, it may be inappropriate to take bankruptcy action in situations where special circumstances exist (for example, where age or ill health has an impact on the debtor's poor financial circumstances).

11. It is also relevant to consider that under bankruptcy the debtor may be required to make contributions from their future income towards their bankrupt estate if their income exceeds a threshold level.

Factors – specific to liquidation

12. The ATO will usually issue director penalty notices before seeking to have a company wound up if the company's debts are under the withholding tax provisions. This may encourage the directors to enter into a payment arrangement, appoint an administrator or take voluntary liquidation action (see PS LA 2011/18).

13. Where a corporate debtor has ceased trading, has been struck off by the Australian Securities and Investment Commission, or both, the ATO will not usually initiate liquidation action unless there is a compliance-based justification for doing so or where there are assets unaccounted for.

14. Where it is apparent that the company has been trading while insolvent, we may consider seeking its liquidation in order for action to be taken against the directors under Division 3 of Part 5.7B of the Corporations Act. If a director is found to have breached their duty to prevent insolvent trading, a court can order the director to compensate the company – and, by extension, the company's creditors – for debts incurred while trading insolvently.

15. Where there may be evidence of fraudulent or criminal activity on the part of the directors, the ATO will also consider the public interest factors. For example, the company's affairs may have been deliberately structured in an attempt to minimise creditors' chances of recovering debt. In such cases, the liquidation of the company will provide a means to examine officers of the company, or any other person able to provide information, about the company's affairs. These examinations serve the dual purpose of discovering undisclosed assets and identifying offences which may have been committed.

Voting on alternatives to bankruptcy and liquidation

16. From time to time, the Commissioner is asked to consider entering into arrangements that provide alternatives to bankruptcy and liquidation. Under these arrangements, debtors present creditors with proposals under which they would be required to discharge their debts, usually over time and often by paying less than the full amount of the debt in full and final settlement.

Part IX and Part X agreements

17. Part IX and Part X of the Bankruptcy Act provide mechanisms outside the rigid code of bankruptcy by which insolvent debtors can be relieved of the need to pay debts immediately or in full. Arrangements made under those Parts can assist debtors to avoid bankruptcy and often provide creditors with a greater or more timely return on their debts than they would receive if the debtor were to become bankrupt. Debtors are required to provide creditors with details of their financial situation so that the creditors can make an informed decision.

18. The debt agreement provided for in Part IX is, in many respects, similar to the personal insolvency agreement provided for in Part X. The major difference between the two is one of cost; the fees for entering into a Part IX debt agreement are generally much lower than those associated with arrangements under Part X. However, the benefits of Part IX are only available to debtors whose income, assets and liabilities fall below prescribed thresholds.

Composition or Scheme of Arrangement

19. Division 6 of Part IV of the Bankruptcy Act provides a mechanism by which a bankrupt can seek to have their existing bankruptcy annulled by entering into a scheme or composition. The bankrupt, through the bankruptcy trustee, may put to creditors a proposal to satisfy their debts which, if accepted, would bring and early end to the bankruptcy.

Deed of company arrangement

20. Part 5.3A of the Corporations Act provides an opportunity for insolvent companies to reach an arrangement with their creditors which addresses the creditors' debts and enables the company to continue trading. As it is not always possible for the company to continue, 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.

21. The ATO recognises that the voluntary administration process can achieve beneficial outcomes. These can be summarised as follows:

- it avoids a sudden winding up of the company – a process which often results in only a nominal (or nil) return to creditors
- it preserves a business which, despite having its operations threatened by adverse circumstances, is fundamentally viable
- it provides an opportunity to reorganise a company's affairs, with a view to enhancing the position of its creditors, shareholders and directors, and
- it potentially provides a better return for the revenue.

General approach

22. While the ATO will consider each case on its individual merits, it can be accepted that, the Commissioner will generally support proposed arrangements or agreements which have no adverse features and which can provide the Commonwealth with a greater proportion of the provable debt within a reasonable period than would be received under bankruptcy or liquidation.

23. The ATO may engage the services of external professionals to assist in the collection and analysis of material relevant to such decisions.

Factors taken into account when casting a vote - general

24. In determining whether to vote for or against the proposal, the Commissioner will have regard to all relevant matters. These may include, but are not limited to:

(i) any legal advice which the ATO may have obtained

(ii) the contents, comprehensiveness and adequacy of relevant reports: that is, regard should be had to the contents, including any relevant omissions, in:

- the statement of affairs or report as to affairs
- the proposal, and
- the report prepared by the trustee or administrator

(iii) any liabilities not yet established, such as unissued assessments, outstanding returns or activity statements

(iv) whether the debtor has made appropriate arrangements to meet future tax liabilities as and when they fall due

(v) the debtor's compliance history, and the compliance history of related parties or entities

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

(vii) the likelihood that the proposals put forward would be achieved

(viii) the maintenance of any priority the Commissioner may have had in bankruptcy or liquidation

(ix) any association between the debtor and other creditors (including associations which involve an assignment of debt)

(x) in the case of a debtor who is being less than candid about their financial affairs, the fact that the process may not provide the extensive investigative tools available to a trustee in bankruptcy or liquidator

(xi) other matters that are considered to be of public interest or which reasonably question the fairness and appropriateness of voting in support of proposals, particularly where the consequence of those proposals is the removal of statutory powers of investigation, examination or the ability to clawback assets or funds

(xii) any apparent voidable transactions or dispositions which might be unable to be pursued if the proposal were to be accepted

(xiii) the tangible benefit to the Commonwealth revenue that is expected to be gained from any proposed arrangement, and

(xiv) the manner in which the proposal would distribute a dividend between all classes of creditors and whether the proposal is considered to be unfairly prejudicial or discriminatory.

Factors taken into account when casting a vote – specific to individuals

25. It is also relevant to consider that under bankruptcy, the debtor may be required to make contributions from their future income towards their bankrupt estate if their income exceeds a threshold level under section 139P of the Bankruptcy Act.

Factors taken into account when casting a vote – specific to deeds of company arrangement

26. The Corporations Act provides a priority for superannuation guarantee charge (SGC) under a deed of company arrangement. That Act also provides for eligible employee creditors, including the Commissioner with respect to SGC, to pass a resolution (by majority) to exclude their priority, before such a deed of company arrangement is voted on by the general body of creditors. It is expected that only rare and unusual circumstances would justify the removal of the 'eligible employee creditor' priority in the first instance. A thorough evaluation of the circumstances will be required prior to the Commissioner deciding that it is appropriate for him to support such a proposal.

27. The ATO 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 ATO will vote against any deed which includes such a clause.

28. If the company were placed into liquidation it may be possible and appropriate to commence an action under section 588M of the Corporations Act to recover personally from a director a debt incurred by the company because it was trading while insolvent.

29. Additional factors need to be considered where a deed of company arrangement is proposed that includes the use of a creditors trust (see below).

Creditors' trusts

30. A *creditors' trust* is a trust entity created under the terms of the deed of company arrangement. It is often used to accelerate a company's exit from external administration to facilitate the relisting of a public company on the Australian Stock Exchange. The company and/or a third party promises to make a payment or transfer property to the trustee in satisfaction of the creditors' claims against the company, and the creditors become beneficiaries of the trust in return for having their rights against the company extinguished.

31. In most cases, the deed of company arrangement is finalised immediately upon the transfer of the company's obligations under the deed to the creditors' trust. The finalization of the deed of company arrangement triggers the end of the company's external administration and the company is no longer required to use the notification '*subject to deed of company arrangement*' on its public documents (as would otherwise be required under subsection 450E(2) of the Corporations Act).

32. The use of a creditors' trust may create additional risks for creditors bound by the deed of company arrangement. These risks may include the following.

- Under the terms of the deed, the deed of company arrangement may be 'effectuated' and creditors' rights against the company extinguished before
  - the amount available for distribution to creditors of the company or beneficiaries of the trust has been ascertained; or
  - the trust fund has been received in full by the trustee; or
  - creditors of the company or beneficiaries of the trust have received any payment from either the deed administrator or the trustee
- Because the creditors' trust regulated by the creditors' trust deed rather than the by the Corporations Act, creditors may have reduced (or no) legal rights if the deed of company arrangement is not fully complied with by all relevant parties. Beneficiaries can, however, seek redress for actual, and in some situations potential, breaches of trust from the State Supreme Courts.

33. In view of these additional risks, generally the Commissioner will vote against any proposed deed of company arrangement which includes the use of a creditors' trust. However, this does not mean that the Commissioner will never choose to vote in favour of such a proposal. For example, it may be appropriate to vote for the proposal where the relisting on the stock exchange of a public company is an essential step in procuring the funds that are to be made available for creditors.

Application to the Court to terminate an agreement or arrangement

34. Although the ATO acknowledges that, as a creditor, the Commissioner is bound by:

    - agreements under Part IX or Part X of the Bankruptcy Act
    - compositions or schemes of arrangement under Division 6 of Part IV of the Bankruptcy Act, and
    - deeds of company arrangement under Part 5.3A of the Corporations Act

    the ATO will nevertheless seek appropriate relief through the courts where an agreement, scheme or arrangement which has been accepted by creditors appears to unreasonably disadvantage the Commonwealth revenue or it contains other adverse features.

Legal claims in insolvency administrations

Settlements of amounts due to liquidators

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

36. When seeking to recover 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 Corporations Act, 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. Note that such approval is not needed for a preference claim as it is not considered a debt for the purposes of subsection 477(2A).

37. The ATO will generally vote in favour of such a compromise offer if it appears that the settlement will result in a greater return to the liquidator than litigating the matter to conclusion. In coming to such a decision, some of the relevant considerations include:

    (i) the chances of success if litigation is to be initiated or continued

    (ii) if the litigation is ultimately successful, the ability of the defendant to meet the judgment debt

    (iii) the costs of pursuing the debt, particularly if creditors will have to indemnify the liquidator to progress the litigation

    (iv) the time it may take to achieve recovery through litigation (including the additional costs the liquidator will incur in this period, particularly as these will rank ahead of the unsecured creditors' claims)

    (v) the attitude of other arm's-length creditors.

38. In some instances, we may, for public interest reasons, consider rejecting an offer and continuing litigation. For example, the claim may be against a director who has deliberately structured both the company's and their own affairs in an attempt to minimise creditors' chances of recovery. To accept an offer in these circumstances – especially where the offer is a token amount – may only encourage such behaviour in the future. However, before voting against an offer solely on public interest grounds, we will also consider the attitude of the other arm's-length creditors and the effect that our vote will have on them – in particular, the extent to which they may be financially disadvantaged if the settlement offer is rejected.

Indemnity requests

39. A trustee of a bankrupt estate or a liquidator of a company (referred to collectively as 'trustee' subsequently in this section) is required by relevant legislation to perform certain duties regardless of whether the estate or company 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.

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

41. 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 possible or actual legal recovery proceedings on behalf of the creditors of the administration (for example, obtaining legal opinions, recovering preferences, recovering assets, conducting investigations, public examination of relevant parties).

42. 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.

Factors taken into account when determining an indemnity request

43. The question of whether or not to agree to indemnify the trustee can be complex and each request must be treated on its merits. In deciding on a response to a request for an indemnity, the ATO's considerations will include 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) our proof of debt has been admitted

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

    (iv) the amount of any proposed indemnity is limited - we will not agree to an unlimited indemnity

    (v) 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) legal arguments or counsel's opinion (where that has been obtained) supports the proposed action of the trustee, for example, the facts alleged are capable of being proved in evidence and the risks of litigation have been assessed

    (vii) the trustee has explained what specific actions the indemnity is likely to cover, provided a break down of costs involved in each step of any proposed action and advised of the alternatives, if any, to the proposed actions

(viii) (if the funding is sought to recover outstanding debts) the debtor has made any counter claims or disputed the debt and the counter claims have been fully evaluated

(ix) there is potential for recovery against the third party against whom the action is to be taken

(x) there are any 'public interest' arguments to consider

(xi) other creditors are prepared to participate

(xii) if relevant, the trustee is prepared to make an application to give indemnifying creditors priority under subsection 109(10) of the Bankruptcy Act or section 564 of the Corporations Act. (Note that such orders will be at the discretion of the court and not all funding can be the subject of such an order. For example, moneys advanced which are expended on the general costs of the liquidation, rather than on an action to recover, are not generally considered payments made which protect or preserve assets.)

(xiii) there is a proposed timeframe (statutory limitations may apply; the need for timely actions and follow up will need to be considered) and

(xiv) it is possible to assign or insure the action, or the liquidator has indicated that they are prepared to proceed with the action on a contingency fee basis.

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

45. Once a decision has been made, any further requirements for funding will need to be considered as a separate request.

46. The officer authorised to make the decision about the indemnity has the choice of contributing towards the funding or an indemnity (that is, with other creditors), approving the funding or granting the indemnity, granting a partial indemnity (that is, up to a certain point, at which time our position can be reconsidered) or declining to indemnify the trustee.

47. A partial indemnity may be considered where a regular assessment of the risk will be required. It is possible for proceedings that have been commenced to be discontinued at any time. The possibility of mediation will also be considered.

48. If the ATO decides to indemnify the trustee for litigation action 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.

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

- specify the actions to which it relates, and be expressed to cover only the actions specified
- specify the maximum amount which will be payable to the trustee and be expressed to be paid progressively (indemnity funds will not be paid in a lump sum)

- specify the costs which it covers and whether it relates to professional fees to the trustee
- 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 reimbursement is claimed prior to any payment being made
- require the trustee to provide copies of any legal advice received in taking actions funded by the indemnity, and
- contain terms, where appropriate, requiring the trustee to make application under subsection 109(10) of the Bankruptcy Act or section 564 of the Corporations Act.

50. In addition, the indemnity should allow for a regular assessment of the risk and may require the trustee to seek the Commissioner's agreement to any negotiated settlement of actions funded by the indemnity.

51. The ATO will also usually require the trustee to provide a plan of action and timelines whenever an indemnity is provided. Both expenditure and progress will be monitored against this plan.

52. 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.

Voidable transaction claims against the Commissioner - liquidation

53. Division 2 of Part 5.7B of the Corporations Act 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.

54. 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.

55. 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).

56. 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).

57. 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 SGC, despite the fact that the money received has been subsequently paid for the benefit of the employees.

58. The definition of a 'voidable transaction' includes insolvent transactions, uncommercial transactions, unfair preferences, unfair loans to a company and unreasonable director-related transactions. In order for a transaction to be an 'insolvent transaction' it must be, among other things, either an unfair preference or an uncommercial 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.

59. 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; and
- 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; and
- a reasonable person in the same circumstances would have no grounds for such a suspicion.

60. 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 PS LA 2011/18).

61. 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).

62. 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 of the Corporations Act).

Circumstances in which the ATO will refund a voidable amount to a liquidator

63. 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 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 of the Corporations Act (see paragraphs 65 to 71 of this practice statement).

64. 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 claim under paragraph 556(1)(e) of the Corporations Act.

Director indemnities

65. 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[2].

66. 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 PS LA 2011/7 Settlement of debt recovery litigation).

67. Where the Commissioner is satisfied that a court will determine that the payment is a voidable transaction and 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.

68. In considering whether to pursue indemnity against a director, the ATO will focus on any potential defences available to the directors (see paragraph 71 of this practice statement), the director's capacity to pay and other relevant factors including the director's history with other companies by reference to the risk management guidelines (see PS LA 2011/18).

69. 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.

70. The director's liability to indemnify the Commissioner arises once the Commissioner pays an amount to the liquidator in accordance with an order made 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) 82 FCR 1.)

[2] Section 588FGA of the Corporations Act.

71. 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 of the Corporations Act. 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).

Clearances

72. This section deals with:

- the obligations of trustees[3] to notify the Commissioner of their appointment and to set aside an amount to pay tax-related liabilities and
- the Commissioner's obligations to advise the trustees of the amount of tax-related liabilities.

73. The following provisions in Schedule 1 to the TAA set out the obligations of trustees and the obligations of the Commissioner when notified of the appointment:

- section 260-45 (for liquidators)
- section 260-75 (for receivers)
- section 260-105 (for agents winding up a business for a foreign resident principal).

74. Trustees are required to give written notice to the Commissioner within 14 days of:

- their appointment as a liquidator
- their taking possession of the assets of a company as a receiver, or
- receiving instructions from a foreign resident principal to wind up so much of the principal's business as is carried on in Australia.

[3] For the purposes of this section, the term ‘trustee’ covers a liquidator, receiver or an agent for a foreign resident principal.

75. As soon as practicable after receiving the notification, the Commissioner is obliged to notify the trustee 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).

76. The tax-related liabilities notified to a liquidator do not include SGC because it is subject to a priority payment under paragraph 556(1)(e) of the Corporations Act. However, additional SGC under Part 7 of the SGAA, including general interest charge, is included in the tax-related liabilities of which the Commissioner is obliged to notify a liquidator.

77. The total SGC debt, including additional SGC, is included in the amount of tax-related liabilities that will be notified to the receiver.

General approach

78. 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 outstanding, if any. 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.

79. 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.

Consolidated groups

80. If a company is, or has been, a member of a consolidated group, the Commissioner will include in the notification required to be given to the liquidator under subsection 260-45(3) in Schedule 1 to the TAA any liability the company has incurred as head company or as a contributing member under the joint and several liability and tax sharing agreement liability provisions in Division 721 of the *Income Tax Assessment Act 1997* (ITAA 1997).

81. Situations may arise where it may not be possible to immediately determine if a contributing member will become subject to a liability under Division 721 of the ITAA 1997 as the due date of the liability (being the head company's due time) is at some point in the future. In these circumstances, a notice under subsection 260-45(3) in Schedule 1 to the TAA will not be provided until the Commissioner is satisfied that all liabilities to which the company may be exposed have been established or the ATO otherwise forms the view that no other liabilities will arise.

Notification of liabilities

82. Where there is more than one type of tax-related liability that is to be notified to a trustee in satisfaction of the requirements of the TAA, a single notice showing each separate amount of tax-related liability will be sent to the trustee.

Representatives of incapacitated entities[4]

83. Representatives of incapacitated entities are required to lodge goods and services tax (GST) returns (see sections 58-20 and 31-5 of *A New Tax System (Goods and Services) Tax Act 1999*) and fuel tax returns (see sections 70-25 and 61-15 of the *Fuel Tax Act 2006*) for tax periods during which they are registered in that capacity and are personally liable to pay any GST and fuel tax law debts they incur during that period. However, in some circumstances, a GST or fuel tax law liability that arises while a representative is registered may remain the liability of the incapacitated entity, for example, an adjustment that relates to a pre-appointment supply.

84. Representatives who are 'trustees appointed under the Bankruptcy Act (for example, trustees of bankrupt estates, controlling trustees and trustees of personal insolvency agreements under Part X) and who require an ABN are required to apply for a separate ABN. That is, they cannot use the ABN of the insolvent individual.

85. The Commissioner, in his capacity as Registrar of the Australian Business Register, allows representatives other than 'trustees appointed under the Bankruptcy Act' (for example liquidators, receivers and administrators) to continue to use the ABN of the incapacitated entity.

86. A GST or fuel tax credit due to a representative in his or her capacity as a representative of an incapacitated entity cannot be offset against liabilities of the incapacitated entity. This is because, for GST and fuel tax law purposes, the representative and the incapacitated entity are considered to be different entities.

87. Before commencing legal action against a person in their capacity as a representative of an incapacitated entity, advice must be obtained from the relevant technical area.

88. Although an increasing adjustment may arise after the date of the appointment of a representative, as the circumstances giving rise to the adjustment occurred before the date relevant to the proving of debts (for example, date of liquidation, date of the appointment of an administrator, date of the bankruptcy) the adjustment would be a debt provable in the relevant insolvency administration. This includes an adjustment that may arise as a result of the payment of a dividend to creditors.

Costs of winding up proceedings

89. 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 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 subsection 556(1) of the Corporations Act).

90. It would not be appropriate that payment be made other than in accordance with the ranking 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 remuneration of the liquidator, will be declined.

[4] For information about the income tax responsibilities of these representatives, refer to Practice Statement Law Administration PS LA 2011/15.

Provision of information to an insolvency trustee

91. One of the roles of an insolvency trustee[5] is to investigate the affairs of the insolvent entity. Where the records have not been maintained well, the trustee may need to access information held by the ATO to fulfil their role. A taxation officer can lawfully disclose any information to the insolvency trustee to assist the trustee in relation to their investigations, regardless of whether it is anticipated that the disclosure would serve to increase, or decrease, any dividend payable to the Commissioner. Such disclosure will include, but is not limited to, disclosure in order to assist the trustee in understanding their obligations under tax law and to ensure that the Commissioner collects the correct amount of revenue owed.

92. Before disclosing any information, the ATO must consider the information privacy principles in the *Privacy Act 1988* and the confidentiality provisions in Division 355 in Schedule 1 to the TAA.

93. Where it is not clear that the information can be given without breaching confidentiality provisions, advice should be sought from our Legal Services Branch.

Garnishees

94. A garnishee notice will not generally be withdrawn, simply because an insolvency trustee[6] has been appointed. In such circumstances, the notice will continue to operate on the relevant amounts. The third party is under a legal obligation to comply with the garnishee notice and must do so despite the appointment of the insolvency trustee.

95. Although a garnishee does not need to be withdrawn by virtue of the debtor entering into a Part IX debt agreement, we acknowledge the potential impact of paragraph 185K(3)(b) of the Bankruptcy Act on the operation of that garnishee. (Refer to PS LA 2011/18.)

96. Once a trustee (with the exception of a liquidator) has been appointed, the ATO will only issue a garnishee notice in respect of amounts due (or expected to become due) to the debtor after having regard to a number of factors. These factors include the need to ensure that the Commissioner is able to collect the amount legally owing and the expected impact that the garnishee will have on the debtor's unrelated, arm's-length creditors.

97. Although subsection 139ZIG(8) of the Bankruptcy Act specifically permits the use of the Commissioner's garnishee power in respect of 'supervised accounts' of a bankrupt created under Division 4B of Part VI of that Act, the ATO may withdraw or refrain from using the garnishee power in respect of a supervised account where the bankruptcy trustee indicates that it would have a detrimental effect on the trustee's ability to collect income contributions.

[5] For the purposes of this section, the term 'trustee' covers a 'representative' of an incapacitated entity as defined under section 195-1 of the *A New Tax System (Goods and Services) Tax Act* 1999. It includes a liquidator, a trustee or debt agreement administrator under the Bankruptcy Act, an administrator or deed administrator under the Corporations Act and a receiver or receiver and manager.

[6] For the purposes of this section, the term 'trustee' covers a liquidator, a trustee or debt agreement administrator under the Bankruptcy Act, an administrator or deed administrator under the Corporations Act and a receiver or receiver and manager.

Legislative references	Income Tax Assessment Act 1936 Income Tax Assessment Act 1997 Taxation Administration Act 1953 A New Tax System (Goods and Services) Tax Act 1999 Bankruptcy Act 1966 Corporations Act 2001 Fuel Tax Act 2006 Privacy Act 1988 Superannuation Guarantee Charge Act 1992 Superannuation Guarantee (Administration) Act 1992
Related practice statements	PS LA 2011/6 Risk and risk management in the ATO PS LA 2011/7 Settlement of debt recovery litigation PS LA 2011/15 Lodgment obligations, due dates and deferrals PS LA 2011/18 Enforcement measures used for the collection and recovery of tax related liabilities and other amounts PS LA 2011/20 Payment and credit allocation
Case references	Browne v. Commissioner of Taxation (1988) 82 FCR 1; 98 ATC 4721; (1998) 38 ATR 331
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