The Tax Summit

Session 3.2: Balancing client support amid ATO debt collection surge

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1. Introduction

In its 2024-25 Budget, the Commonwealth Government reported a surplus of $9.3 billion. However, with gross debt predicted to peak at $35.2 billion in 2026-27[1], it is expected that protecting revenue will remain front of mind.

An example of this is the $187.4 million announced in the 2024-25 Budget to:[2]

> … better protect taxpayer data and Commonwealth revenue against fraudulent attacks on the tax and superannuation systems. Funding will upgrade the ATO's information and communications technologies and increase their fraud prevention capabilities. This will ensure the ATO has dedicated resources to manage increasing risk, prevent revenue loss, and support victims of fraud and cyber crime.

Also of significance is the Commonwealth Government's decision to extend the Tax Avoidance Taskforce for two (2) years from 1 July 2026. In relation to this, the Commonwealth Government states:[3]

> Extending the Taskforce ensures the ATO continues to be well-resourced to pursue key tax avoidance risks, with a focus on multinationals, large public and private businesses, and high-wealth individuals.
>
> This measure is estimated to increase receipts by $2.4 billion and increase payments by $1.2 billion over the 5 years from 2023–24.

The Tax Avoidance Taskforce was formed in 2016 and has been extended in several budgets since that time delivered by both the Labor and Coalition parties. According to the ATO, as of 30 June 2023, the Taskforce has helped the ATO raise $32.7 billion in tax liabilities.[4]

Relatedly, another ongoing key focus of the ATO is addressing collectable debt.[5] In the 2022-23 Annual Report, the ATO stated:

> The **Implement targeted strategies to address collectable debt** key focus area concentrated on the debt balance that increased through actions taken to support clients during COVID-19.
>
> We informed clients of their obligations and the actions we may take if they chose to not engage with us. Clients who chose to not engage with us were subject to firmer and stronger action, to help mitigate the growth in collectable debt.
>
> Our awareness campaigns and firmer action warning notices were followed by director penalty notices (17,901), disclosure of business tax debts to credit reporting agencies (867), garnishees (2,934), or legal recovery action. We intentionally prioritised the recovery of super guarantee debts, high-risk debts and other high-value debt cases, and fraud-related debts such as those raised through Operation Protego.
>
> In 2022–23, we also continued to work closely with clients experiencing financial hardship to understand their circumstances. We encouraged clients to lodge even if they were unable to pay, and we offered support by way of:
>
> - payment plans to help them manage their debt

[1] Refer to the Commonwealth Government's 'Budget overview' (the **Budget Overview**), page 6.
[2] Budget Overview, page 49.
[3] Commonwealth Government's 'Budget Paper No. 2', page 17.
[4] 'Tax Avoidance Taskforce', *Australian Taxation Office* (Web Page, 4 September 2024) < https://www.ato.gov.au/about-ato/tax-avoidance/tax-avoidance-taskforce>.
[5] Refer to Refer to the Commissioner of Taxation Annual Report 2022-2023, October 2023 (the **2022-23 Annual Report**), page III.

- additional time to pay
- remission of penalties and interest (where appropriate).

> Collectable debt was $50.2 billion at 30 June 2023.
>
> Implementing targeted strategies to address collectable debt will remain a key focus area in 2023–24.

Although the ATO has not yet released its Annual Report for 2023-24, there are few signs that its focus on collecting debt will abate.

Indeed, in a speech to the Council of Small Business Organisations Australia National Small Business Summit 2024, the incoming Commissioner of Taxation Mr Rob Heferen reminded businesses that in December 2023, the ATO returned to normal debt collection across all markets.[6] Mr Heferen went on to note:

> The amount of collectable debt (which is ultimately tax and super that has gone unpaid by taxpayers) is now at over $50 billion. 65% of all collectable debt owed relates to small business and 74% of that relates to activity statements.
>
> This means a significant portion of the amount going unpaid is GST collected from consumers or PAYG withholding, withheld from employees pay. We are seeing an increasing number of businesses fall behind on these types of payments, from which point it is very difficult for businesses to get back on top of their obligations and remain viable.
>
> It's critical that all employers – big and small – keep on top of their obligations to their employees first and foremost, as well as their obligations to government in respect to GST, income tax, and other taxes.

The Paper examines the Commissioner's specific debt recovery powers and these are mainly contained in the TAA.

It also examines the broader rights of creditors including the Commissioner to recover unpaid debt. In particular, the Paper covers some of the options such as liquidation, voluntary administration or the entry into a DOCA which are available to corporate entities to address insolvency or pending insolvency including the rights of creditors to instigate these processes.

While it is not the purpose of this Paper to cover every aspect of the Commissioner's debt recovery powers, it is the purpose of this Paper to highlight some of the avenues available to the Commissioner to ensure that outstanding taxes are paid. Many of the measures introduced in the last twenty (20) years or so are aimed at addressing phoenixing activity. Such measures are intended not only to protect the revenue but also to protect other unsecured creditors.

Some measures such as the director penalty regime serve as an early signal to directors to inquire into the company's solvency or risk being personally liable for certain taxation liabilities.

Taxpayers and advisors alike should also be fully attuned to the implications of various tax grouping regimes many of which institute joint and several liability of its group members for unpaid liabilities.

Whilst not covered in this Paper, there are other regimes which go towards facilitating debt recovery. These include the CGT withholding regime for foreign persons[7] and the GST withholding regime for taxable supplies of certain real property.[8]

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[6] Mr Rob Heferen, 'Opening remarks' (Speech, Council of Small Business Organisations Australia National Small Business Summit 2024, 4 April 2024) < https://www.ato.gov.au/media-centre/council-of-small-business-organisations-australia-national-small-business-summit-2024>.
[7] Refer to Subdivision 14-D in Schedule 1 of the TAA.
[8] Refer to Subdivision 14-E in Schedule 1 of the TAA.

Taxpayers are encouraged to review their structures periodically to ensure that there are not unintended consequences arising from the application of these debt recovery regimes.

It is hoped that this Paper raises awareness in respect of some of these regimes.

1.1 Definitions

In this Paper, references to the terms in the first column of the following table are to their meanings in the second column of the following table.

1936 Act	the *Income Tax Assessment Act 1936* (Cth)
1997 Act	the *Income Tax Assessment Act 1997* (Cth)
260-5 notice	to a notice issued in accordance with Subdivision 260-A in Schedule 1 of the TAA
ADJR Act	to the *Administrative Decisions (Judicial Review) Act 1977* (Cth)
ATO	the Australian Taxation Office
Commissioner	the Federal Commissioner of Taxation
Corporations Act	the *Corporations Act 2001* (Cth)
GST	the *A New Tax System (Goods and Services Tax) Act 1999* (Cth)
PBR	a private binding ruling issued by the Commissioner
PS LA 2001/3	Practice Statement Law Administration 2011/3 – Compromise of undisputed tax-related liabilities and other amounts payable to the Commissioner
PS LA 2011/4	Practice Statement Law Administration 2011/4 – Collection and recovery of disputed debts
PS LA 2011/14	Practice Statement Law Administration 2011/14 – General debt collection powers and principles
PS LA 2011/18	Practice Statement Law Administration 2011/18 – Enforcement measures for the collection and recovery of tax related liabilities and other amounts
SIS Act	the *Superannuation Industry (Supervision) Act 1993* (Cth)
TAA	the *Taxation Administration Act 1953* (Cth)
Tax Act	as the context requires, the 1936 Act, the 1997 Act or the TAA or all of them

1.2 Disclaimer

The author does not purport to have raised all of the issues regarding the Commissioner's powers in respect of the collection and recovery of tax-related liabilities and other amounts and avenue available to taxpayers to deal with them. Each taxpayer's circumstances are unique and consideration of all such circumstances is required if appropriate and accurate taxation advice is to be given. No part of this Paper should be regarded as advice.

1.3 Acknowledgment

The author wishes to acknowledge the contributions of Lachlan Smithers, Senior Associate and William Hocking, Associate, both of Johnson Winter Slattery to the Paper for their valuable contributions.

2. Tax-related liabilities

The starting point for this Paper is to set out the types of tax debt for which the Commissioner will seek to collect.

The Commissioner's powers to collect tax debts are largely set out in Part 4-15 in Schedule 1 to the TAA. The title to Part 4-15 is "Collection and Recovery of Tax-Related Liabilities and Other Amounts'.

A 'tax-related liability' is defined in subsection 255-1(1) in Schedule 1 to the TAA to mean:

> … a pecuniary liability to the Commonwealth arising directly under a taxation law (including a liability the amount of which is not yet due and payable).

On the other hand, a civil penalty under Division 290 in Schedule 1 to the TAA or Part 5 of the *Tax Agent Services Act 2009* is not a tax-related liability.[9]

Subsection 255-5(1) of the Schedule 1 to the TAA provides that an amount of a tax-related liability that is due and payable is a debt due to the Commonwealth and is payable to the Commissioner. The Commissioner, a Second Commissioner or a Deputy Commissioner may sue in a court of competent jurisdiction to recover the amount of the tax-related liability after it has become due and payable.[10]

A summary of all 'tax-related liabilities' is set out in the tables in section 250-10 in Schedule 1 to the TAA.

These include the following:

- under the 1936 Act:[11]
    - trustee beneficiary non-disclosure tax;
    - withholding tax on dividends, royalties and interest;
    - diverted profits tax;
    - family trust distribution tax;
- under other Acts:[12]
    - assessed net amounts under the GST Act;
    - income tax under the 1997 Act;
    - fringe benefits tax under the *Fringe Benefits Tax Assessment Act 1986* (Cth);
    - Division 293 tax under the 1997 Act;
    - franking tax under the 1997 Act;
    - managed investment trust withholding tax under the 1997 Act;
    - GIC under the TAA;
    - PAYG withholding taxes in Schedule 1 to the TAA;

[9] Refer to subsection 255-1(2) in Schedule 1 to the TAA.
[10] Refer to subsection 255-5(2) in Schedule 1 to the TAA.
[11] Refer to subsection 250-10(1) in Schedule 1 to the TAA.
[12] Refer to subsection 250-10(2) in Schedule 1 to the TAA.

- administrative penalties in Schedule 1 to the TAA.

In respect of income tax payable, the due date for a tax-related liability is ordinarily twenty-one (21) days of the date of issue on the notice of assessment. Subsection 5(2) of the 1997 Act provides that such income tax is only due and payable if the Commissioner makes an assessment. An assessment is proof of a debt due and payable to the Commonwealth.

The Commissioner is authorised under section 255-10 in Schedule 1 to the TAA to defer the time for payment of the debt having regard to the circumstances of each particular taxpayer. In respect of a class of taxpayers which are affected by the deferral of the due date of the tax debt, the Commissioner is authorised to publish on the ATO's website the new due date.[13] Where the Commissioner does so, the due date is taken to be varied.[14]

The Commissioner sets out his policy as to when he will exercise his discretion to defer the due date of a tax-related liability in paragraphs 29 to 50 of PS LA 2011/14.

Similarly, the Commissioner has power to bring forward a due date of a tax-related liability under section 255-20 in Schedule 1 to the TAA where he *reasonably believes that you may leave Australia before the time at which an amount of a tax-related liability becomes due and payable by you.* According to the Commissioner, for him to bring the due date forward, there must first be a tax-related liability due and payable. However, if there is not, and an amount of the tax-related liability is quantifiable and expected to be payable notwithstanding that the notice of assessment has yet to issue, he can nonetheless issue a notice of assessment with a new due date.

In both cases, subsection 255-20(2) in Schedule 1 to the TAA requires the Commissioner to notify the taxpayer in writing of the new due date.

Where an approved form is to be lodged by a due date, subsection 255-10(3) in Schedule 1 to the TAA provides that the Commissioner exercising his discretion to defer the due date does not affect the due date for the relevant approved form.

In PBR Authorisation Number 1012851827184, the following question was ruled on:

> For the purposes of section 721-25(1) of the Income Tax Assessment Act 1997 (ITAA 1997), is the head company's due time for ACo in relation to its income tax liabilities for the income years ending 30 June 2013, 2014, 2015 and 2016 the time as deferred by the Commissioner under section 255-10 of Schedule 1 to the Taxation Administration Act 1953 (TAA)?

Subsection 721-25(1) of the 1997 Act provides for when a tax-related liability of a head company of a tax consolidated group is covered by a tax sharing agreement being a tax-related liability whose due time is after the date of a tax sharing agreement.

The Commissioner's ruling on this question is as follows:

> In the ordinary course of events, the head company of a consolidated group is the entity that is liable to pay certain 'tax-related liabilities' (called 'group liabilities') such as income tax for the group. Division 721 of the ITAA 1997 operates to secure payment of such a liability where the head company fails to meet the liability by the time it becomes due and payable, called the 'head company's due time' for the liability. (Refer section 721-10 of the ITAA 1997).
>
> The Division operates by making the head company and its subsidiary members jointly and severally liable to pay a group liability that is unpaid at the head company's due time for that liability. The liability arises just after the head company's due time. (Refer section 721-15 of the ITAA 1997).

[13] Refer to subsection 255-10(2A) in Schedule 1 to the TAA.
[14] Refer to subsection 255-10(2B) in Schedule 1 to the TAA.

However, subsection 721-15(3) of the ITAA 1997 provides that this joint and several liability does not arise where the group liability is covered by a 'tax sharing agreement' (TSA). Subsection 721-25(1) of the ITAA 1997 states that for the purposes of the Division, a group liability is covered by a TSA if just before the head company's due time, there is an agreement between the head company and one or more of its subsidiary members, called 'TSA contributing members', that provides for the determination of a particular amount (the 'contribution amount') for each TSA contributing member in relation to the group liability, with such amounts representing a reasonable allocation of the total amount of the group liability among the head company and the TSA contributing members.

Subject to certain exceptions, each TSA contributing member is liable to pay to the Commonwealth an amount equal to the contribution amount for that member in relation to the group liability. That liability arises just after the head company's due time. (Refer section 721-30 of the ITAA 1997).

Where the Commissioner defers the time by which a group liability becomes due and payable under section 255-10 in Schedule 1 to the TAA, it is that deferred time that is the head company's due time for the liability. [**EMPHASIS ADDED]**

Therefore, for the purposes of subsection 721-25(1), the tax sharing agreement will exist just before ACo's due time for the income tax liabilities.

3. Overview – the ATO's legal recovery powers and actions

3.1 Overview

This section considers legal recovery actions in relation to the following two (2) cases, being where there is:

- undisputed debt; and
- a disputed debt.

3.2 Prior to legal recovery action – undisputed tax debts

The Commissioner has issued PS LA 2011/18 which sets out the ATO's policies and guidance to taxation officers in respect of the collection process and the enforcement measures available to the Commissioner for the purpose of collecting outstanding tax debt.

Paragraph 22 of PS LA 2011/18 sets out a summary of the types of enforcement action taken by the Commissioner. These are set out below.

3.2.1 Issuing notices

Prior to legal recovery action being taken, the ATO will ordinarily issue notices calling for the payment of outstanding tax debts. These notices are in most cases automatically generated although in some cases they can be manually prepared and sent.

3.2.2 Offsetting RBA credits against tax debt owing

An outstanding amount payable to the Commissioner will be the amount shown as being in debit on the taxpayer's running account balance (or **RBA**). The RBA shows all credits and debits against the taxpayer's tax accounts. The Commissioner has the power under subsection 8AAZL(2) of the TAA to offset against all tax credits and RBA surpluses against any tax debts.

In some circumstances, the Commissioner may refrain from applying tax credits against a tax debt. One instance is where the taxpayer has entered into a payment arrangement and has been complying with that arrangement.[15]

3.2.3 Entering into a payment arrangement

This will involve accepting payment of the tax debt by instalments. The taxpayer will need to demonstrate that they cannot pay the amount in full by the due date and provide the ATO with all the necessary information to determine whether they can pay by instalments. The Commissioner is empowered by section 255-15 in Schedule 1 to the TAA to enter into payment arrangements with taxpayers. He sets out his policy in PS LA 2011/14.

The author's experience is that where taxpayer's have shown good compliance with their taxation obligations including the payment of tax debt and where the period for the arrangement does not exceed six (6) months, the

[15] Refer to Law Administration Practice Statement **PS LA 2011/20**)

Commissioner will ordinarily approve a payment arrangement based on these terms over the phone or online. Any longer periods involving a significant amount of tax owing will often require the taxpayer to submit a formal payment plan for the Commissioner's approval.

The Commissioner states at paragraph 60 of PS LA 2011/14 that a payment arrangement application must address the following:

> * explain the reasons for non-payment by the due date
>
> * satisfy the Commissioner as to the taxpayer's inability to pay the full amount by the due date, not simply provide reasons why they have decided to not pay by the due date
>
> * contain a detailed statement of the taxpayer's current financial position (including details of what steps have been taken to obtain funds to pay the debt and what arrangements are in place to pay other creditors)
>
> * satisfy the Commissioner that, generally, the taxpayer is treating their tax debts with the same priority they are giving to their other payment obligations (for example, they would need to show that payment of private debts, like credit card debts and mortgage obligations, have not assumed a priority over payment of their tax debts and that any short-term priority afforded to their business debts was appropriate and that the business was viable)
>
> * include a detailed proposal for payment of their debt in full in the shortest possible timeframe
>
> * incorporate additional charges for late payment and reimbursement for any costs incurred pursuant to any recovery action that the Commissioner had commenced in respect of the debt, and
>
> * contain sufficient information to satisfy the Commissioner that payment can be made by instalments without the total debt escalating (taxpayers will need to specify the steps they have taken to ensure that future debts will be met as and when they fall due).

The Commissioner will not approve payment plans that have the effect of treating the ATO as a bank. Taxpayers need to prioritise the payment of their tax debts where they have available financial resources to do so.

3.2.4 Accepting security

In assessing the risk to the revenue, the Commissioner may accept security such as a mortgage over real property. In deciding whether to take security as part approving a payment arrangement, the Commissioner has stated at paragraph 86 of PS LA 2011/14 that regard is to be had to the following factors:

> • the quantum of the debt
>
> • the nature of the security being offered - this includes the location of the property, the expectation it can be readily and easily realised if default occurs, the taxpayer's equity in the security, the value of the security and how the value has been determined (that is, the basis of any valuation)
>
> • if third party security is offered, whether the third party is solvent and if it is fair and reasonable to take the security
>
> • the value of security compared to the amount of the tax debt outstanding or the amount expected to be outstanding when any outstanding objection or appeal is finally determined
>
> • the period of time the debt has been outstanding
>
> • the taxpayer's past compliance history

• the taxpayer's ability to pay, based on available information (either supplied by the taxpayer or otherwise available to the Commissioner)

• the level of the taxpayer's other liabilities• arrangements made by the taxpayer's other creditors to secure their debts.

The Commissioner’s preferred securities are as follows:

• a registered first mortgage from the taxpayer or a third party, over freehold property

• a registered second or subsequent mortgage from the taxpayer or a third party, over freehold property where there is sufficient equity in the property to secure the tax debt whilst ceding priority to the first or prior mortgagees

• an unconditional bank guarantee from an Australian bank acceptable to the Commissioner (unconditional means the bank pays the Commissioner upon demand).

3.3 Taking legal recovery action – undisputed tax debts

3.3.1 The issue of garnishee notices

This is examined in section **7** of this Paper.

3.3.2 Taking action against directors of companies

The issue of director penalty notices in respect of unpaid PAYG withholding amounts, SGC liabilities and GST withholding amounts are examined in section 6 of this Paper.

3.3.3 The issue of departure prohibition orders (or “DPO”)

The issue of a DPO ensures that a tax debtor cannot depart the country before the tax debt is extinguished. Division 4 of Part IVA of the TAA gives the Commissioner power to impose a DPO.

Section 14Z of the TAA authorises the Commissioner to:

- prevent the departure of a tax debtor from Australia (subsection 14Z(1)(d) of the TAA); and
- require the tax debtor to produce documents or answer questions for the purposes of ascertaining whether a DPO is in force or whether a departure authorisation certificate is in force in respect of the departure of a tax debtor (subsection 14Z(1)(e) of the TAA).

A ‘departure authorization certificate’ (or **DAC**) is issued pursuant to section 14ZA of the TAA which provides that the departure of a tax debtor from Australia is authorized notwithstanding the issue of a DPO to that person. Paragraph 140 of PS LA 2011/18 sets out when the Commissioner is required to issue a DAC. These include where it is likely that the tax debtor will return to Australia within an appropriate period of time and where it is not necessary for the tax debtor to give security.

If the Commissioner is not satisfied of these matters, he can nonetheless issue a DAC where the tax debtor provides security over their assets to the Commissioner or where the Commissioner considers that the DAC should be issued on humanitarian grounds or the refusal of the DAC would be against the interests of Australia.[16]

3.3.4 Warrants

The Commissioner may make an application to a court for the issue of a warrant to a person to enforce a judgement for the payment of a tax debt. Under the warrant, the court authorises a person to seize the tax debtor's property and to sell that property to recover the debt and costs where the tax debtor fails to make payment. The Commissioner regards the use of warrants as effective to motivate the tax debtor to either pay the tax debt or enter into a payment arrangement particularly in cases where the tax debt is not large and is not escalating.[17]

The Commissioner also states that tax officers would proceed with a warrant after judgement in cases where the tax debtor has sufficient unsecured assets or where they have sufficient equity in real estate (even where the tax debtor holds the real estate jointly or as tenants in common with others).

The Commissioner further states at paragraph 173 of PS LA 2011/18:

> The return by the sheriff/bailiff of an unsatisfied execution is an act of bankruptcy which can establish a creditor's petition without the need for a bankruptcy notice to be issued. A decision may then be made as to the whether to commence insolvency proceedings against that tax debtor. For further considerations relating to the commencement of bankruptcy proceedings, refer to PS LA 2011/16.

3.3.5 Mareva Injunctions or Freezing Orders

Mareva injunctions, also known as freezing orders or asset preservation orders, are applied for in circumstances which satisfy Rule 7.32 of the *Federal Court Rules 2011.* This provides that a court may make a freezing order:

> … for the purposes of preventing the frustration or inhibition of the Court's process by seeking to meet a danger that a judgment or prospective judgement of the Court will be wholly or partly satisfied.

The Commissioner has stated that he will generally apply for a freezing order where it is concluded that the tax debtor will dispose or deal with their assets in such a way that poses an unacceptable level of risk to the recovery of any tax debt or the enforcement of a judgement.[18]

The Courts will grant a plaintiff (including the Commissioner) a freezing order where the plaintiff addresses the requisite elements. These elements are outlined in the case of *Third Chandris Shipping Corp v Unimarine S.A* (1979) QB. 645

The Commissioner sets out in paragraph 185 of PS LA 2011/18 the following elements which he sees as relevant when applying for a freezing order:

- there being a prima facie cause of action being the non-payment of a tax debt by is due date. The cause of action must be one where there is a *real possibility of ultimate success* as opposed to a *speculative case*. A freezing order can be applied for whether or not the Commissioner has commenced other legal proceedings for the recovery of the debt. Where legal proceedings have not

[16] Refer to paragraph 141 of PS LA 2011/18.
[17] Refer to paragraphs 168 and 169 of PS LA 2011/18.
[18] Refer to paragraph 177 of PS LA 2011/18.

commenced, the Commissioner must establish a claim against the tax debtor and this is usually satisfied by the production of notices of assessment issued to the tax debtor;

- there is full disclosure by the Commissioner to the court and this will include any matter which could lead to any injustice to the tax debtor. This is seen as important as the applications are often made *ex parte* (that is, without the tax debtor present);
- the existence of assets within the jurisdiction. The Commissioner should make full disclosure where possible of the nature of the assets, their location and their approximate value. Circumstances will often necessitate that applications for freezing orders be made quickly and the courts will grant them even where the Commissioner presents little information. The Commissioner may apply to the court for it to order a tax debtor to file an affidavit of discovery setting out all of their assets. This may also involve the Commissioner issuing section 353-10 notices to the tax debtor before any legal proceedings are commenced. A freezing order may be granted to cover all of the tax debtor's assets, wherever they are located;
- grounds for believing that there is a real risk of dissipation of the tax debtor's assets. Such evidence can include details of the tax debtor's conduct particularly where this conduct has involved any gross dishonesty on the part of the tax debtor;
- the Commissioner giving an undertaking as to damages. This arises in acknowledgement that a freezing order could lead to financial loss caused to the tax debtor or their business and a claim for damages made against the Commissioner where the grant of a freezing order was later found to be unjustified.

It is also noted that the courts can order freezing orders in respect of assets held by third parties. This was what the High Court permitted in *Cardile and Others* v *LED Builders Pty Ltd* [1999] 198 CLR 380. Reference is also made to Sub-rule 7.35(5) of the *Federal Court Rules 2011* which provides that a freezing order can be made over third party assets if the court is satisfied that there is a danger that a judgment or a prospective judgment will not be satisfied in the circumstances set out therein:

> (5) The Court may make a freezing order or an ancillary order or both against a person other than a judgment debtor or prospective judgment debtor (a third party) if the Court is satisfied, having regard to all the circumstances, that:
>
> (a) there is a danger that a judgment or prospective judgment will be wholly or partly unsatisfied because:
>
> (i) the third party holds or is using, or has exercised or is exercising, a power of disposition over assets (including claims and expectancies) of the judgment debtor or prospective judgment debtor; or
>
> (ii) the third party is in possession of, or in a position of control or influence concerning, assets (including claims and expectancies) of the judgment debtor or prospective judgment debtor; or
>
> (b) a process in the Court is or may ultimately be available to the applicant as a result of a judgment or prospective judgment, under which process the third party may be obliged to disgorge assets or contribute toward satisfying the judgment or prospective judgment.

3.4 Disputed Tax Debts

The general principle followed by the Commissioner is that all tax debts must be recovered including those the subject of a dispute.

In the event that the taxpayer fully pays the tax debt and is successful in having an assessment (and thereby a tax debt) overturned, the Commissioner will refund the taxpayer the amount of the tax debt plus interest payable at the rate specified by the *Taxation (Interest on Overpayments and Early Payments) Act 1983*. The current interest rate on overpayments is 4.36% for the period 1 July 2024 to 30 September 2024.

The Commissioner regards a 'disputed debt' to be a tax-related liability which is the subject of an objection, a tribunal review or an appeal to a Court.[19] A tax-related liability for this purpose would include:[20]

- income tax;
- assessed net amounts of GST;
- assessed fringe benefits tax.

However, it does not include other the debts that may arise from making the above assessments such as shortfall penalty, shortfall interest charge (whether Shortfall Interest Charge or **SIC** and General Interest Charge or **GIC**).

Whether the Commissioner will continue to recover the tax debt the subject of a dispute or cease its recovery will depend on whether the Commissioner considers there is an unacceptable risk that the taxpayer will not pay the tax debt.

Other considerations include:

- the taxpayer's attitude, cooperation with the ATO and their compliance and payment history;
- whether the taxpayer is lodging objections or seeking tribunal or Court review to stall the recovery of the tax debt and this is evident from the weak grounds of objection or appeal.

The Commissioner's approach to debt recovery while a tax debt is being disputed is set out in PS LA 2011/4.

Under PS LA 2011/4, there is guidance as to the arrangements that can be agreed with taxpayers in exchange for the temporary suspension of debt recovery action until the dispute is resolved. The main arrangements include:

- entry into the test case litigation programme;
- 50/50 arrangements;
- accepting security;
- payment plans.

3.4.1 Test case litigation programme

The test case litigation programme seeks to provide funding to taxpayers involved in litigation with the Commissioner where certain criteria are met.

The main criteria is that the dispute involves a question of taxation law rather than a question of fact. Its resolution will result in legal precedent being developed which then provides clarity as to the operation of a taxation law to a wide range of taxpayers in similar positions. Accordingly, it must be in the public interest that the matter be litigated and resolved such that the matter will have:

[19] Refer to paragraph 4 of PS LA 2011/4.
[20] ibid

- significance to a section of the public; or
- implications for an industry.

On the ATO's website[21], the ATO states that taxpayers are expected to comply with the following if funding is granted:

> In addition to meeting the funding criteria, your case must:
>
> - have either significance to a substantial section of the public, or significant commercial implications for an industry
> - be likely to provide legal precedent as a principle of law, capable of being used to decide other cases with similar facts
> - not involve a tax avoidance scheme or a scheme to avoid superannuation regulatory provisions, unless it tests the proper meaning within the legal framework of the anti-avoidance provisions
> - not appear to be an attempt to gain a windfall or an outcome contrary to the intent of the legislation and public policy.
>
> You will also need to demonstrate you are willing to progress your case in a timely manner. We will consider your past or current behaviour before we approve an application.

One of the benefits of obtaining test case funding from a tax debt recovery perspective is that where the taxpayer also enters into a 50/50 arrangement, the Commissioner will increase the GIC remission for the period before which the tax dispute is resolved from 50% to 75%.[22]

The author's experience is that test case funding is difficult to obtain and there can be a significant delay before test case funding panel makes a decision to grant or not grant funding. In the meantime, other strategies must be being negotiated with the debt recovery section of the ATO in parallel to the test case funding application.

3.4.2 50/50 arrangement

A 50/50 arrangement can be entered into in respect of a tax-related liability **except** for an SGC assessment under the *Superannuation Guarantee (Administration) Act 1992* (Cth).

On a taxpayer applying for a 50/50 arrangement, the Commissioner will conduct a risk assessment of the taxpayer and the likelihood of the tax debt being paid.

Generally speaking, the Commissioner will not grant a 50/50 arrangement where he is of the view that:

- the taxpayer has the immediate financial means to pay the debt and the payment of the debt in full would not cause undue hardship;
- the taxpayer has not exhausted all other avenues to raise the funds to pay the tax debt. This will include evidence of the taxpayer approaching a third party financial institution and the taxpayer's application for funding to pay the tax debt to be rejected. Put simply, and as stated above, the ATO (as would no other creditor) does not like being treated like a bank when it comes to outstanding tax debt.

[21] Refer to https://www.ato.gov.au/individuals-and-families/your-tax-return/if-you-disagree-with-an-ato-decision/seek-an-external-review-of-our-decisions/test-case-litigation-program#ato-Expectations
[22] Refer to paragraph 29 of PS LA 2011/4.

In respect of the second dot point above, the author's experience is that banks are generally reluctant to lend where the purpose of the funds is to pay a tax debt. Where they do, they normally ask for reliable security to be provided such as over residential or other real estate.

Where a 50/50 arrangement is granted, the broad terms are as follows. The taxpayer is to:[23]

- pay 50% of the tax debt to the ATO within a short period of time;
- cooperate in providing all requested information as to the determination of an objection. This is to ensure that the objection can be decided as quickly as possible;
- pay all other tax debts not in dispute and for which there is no deferral of recovery action.

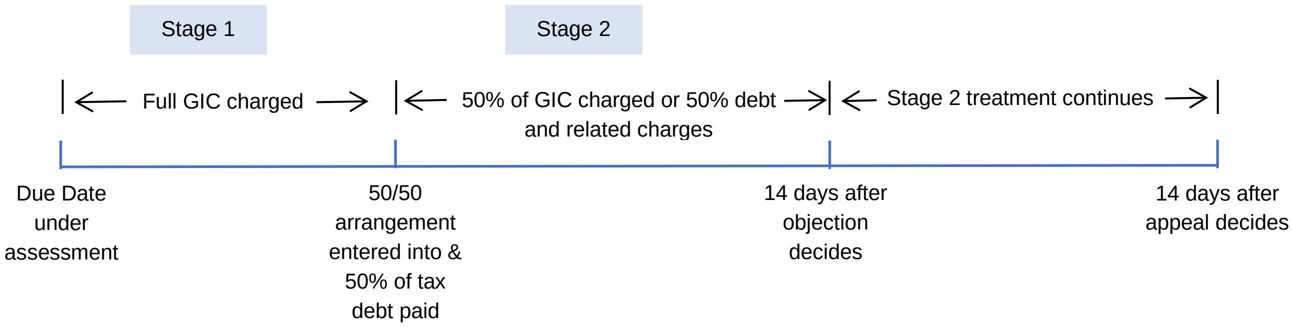
The Commissioner will agree:[24]

- not to recover the unpaid balance of the debt until fourteen (14) days after:
  - an objection decision has been made;
  - a tribunal or a Court has decided the dispute;
- to remit 50% of the GIC which would otherwise accrue on the unpaid balance in the event that the taxpayer is unsuccessful in overturning the relevant tax assessment.

Where a taxpayer decides to appeal against an objection decision, and has entered into a 50/50 arrangement with the Commissioner, the Commissioner will generally agree to continue with the arrangement until after the appeal has been determined. This is subject to an ongoing risk assessment being made of the ultimate collection of the debt should the Commissioner be successful in the appeal.

Where an appeal is similar to another case which has been heard by a Court and the taxpayer in that case is unsuccessful, this will have a bearing on whether the Commissioner continues with the 50/50 arrangement beyond the objection decision being made.

As to the payment of GIC, this is explained in the following diagram:



Currently, taxpayers can claim an income tax deduction for GIC incurred in an income year. This is provided for in subsection 25-5(1)(c) of the 1997 Act. For any GIC that is recouped by the taxpayer, the taxpayer must include that amount in their assessable income. This is provided for in subsection 20-25(2A) of the 1997 Act.

On 13 December 2023, the Commonwealth Government announced in its 2023–24 Mid-Year Economic and Fiscal Outlook (or MYEFO) that general interest charges (GIC) and shortfall interest charges (SIC) incurred on

[23] Refer to paragraph 27 of PS LA 2011/4.
[24] Refer to paragraph 28 of PS LA 2011/4.

or after 1 July 2025 will no longer be deductible. Consequentially, any refund of GIC or SIC imposed on or after 1 July 2025 will therefore no longer need to be included in the taxpayer's assessable income.

As at the date of this Paper, the proposal has yet to be legislated.

3.4.3 Security

The Commissioner may accept security although his policy is generally only to do so in limited circumstances. The grant of security was considered in more detail in section 3.2.4 of this Paper.

3.4.4 Recovery action prior to an objection being lodged

It is often the case that a taxpayer has yet to lodge an objection and is faced with the ATO seeking to recover the tax debt.

The author's approach in these circumstances is to immediately liaise with the ATO's debt recovery arm and seek a suspension of debt recovery action on the basis that the lodgement of an objection is imminent. Details of that objection should also be given as evidence of the taxpayer's clear intention to lodge an objection.

Further, the taxpayer should keep the ATO debt recovery branch informed of all steps being taken to lodge the objection. A copy of the objection and evidence of its lodgement should also be given the ATO debt recovery branch.

The author's experience is that different branches of the ATO may not always be in communication with each other and it is important that the taxpayer or their advisors closely manage both the objections process and the debt recovery process. Unfortunately, the better view to have in these circumstances is to assume that there is little or no internal communication between the different branches of the ATO.

It will also be the case that some taxpayers may continue to receive system generated notices of recovery. It is therefore essential to have a clear line of communication with the relevant ATO debt recovery officer to ensure that more intrusive debt recovery measures will not be taken during the objection stage such as garnishee orders or court proceedings.

4. Issuing Statutory Demands & Initiating Liquidation

If a debtor has unpaid liabilities, the Commissioner may issue a statutory demand as the first step in making an application for the debtor company to be wound up by order of the Court. It is the Commissioner's view that the decision to institute, support or substitute another creditor in winding-up proceedings against a tax debtor will not be taken lightly.[25]

The Commissioner is able to issue a statutory demand if the company's liabilities are $2,000 or greater. Importantly, the Commissioner is **not** required to have obtained a judgment against a company prior to issuing a statutory demand.

Prior to issuing a statutory demand, the Commissioner will generally have attempted to contact the debtor company (and usually its accountants) by various methods including messages via MyGov, letters and phone calls, and will also consider the following factors:

- the asset position of the debtor;
- the size and nature of the debt;
- the future income of the debtor;
- the risk to the revenue;
- the cost of a liquidation and the likely return.

Following the above, the Commissioner will likely issue a statutory demand if he forms the view the company:

- is unwilling to work towards addressing the debt; or
- does not have the capacity to pay the liabilities; or
- has repeatedly defaulted on agreed upon payment plans; or
- was detected during an ATO audit to have previously engaged in deliberate payment avoidance occurred (and may be continuing); or
- may be engaging in illegal phoenix activity.

Prior to issuing a statutory demand, the Commissioner will have usually already issued DPNs[26] for PAYG, GST or SGC amounts owing. The purpose of doing so is to encourage directors to actively engage with the Commissioner by way of a potential payment arrangement, or to appoint a voluntary administrator or take steps to appoint a liquidator to the company.

If following the Commissioner's review of the information the ATO has at hand, the Commissioner is of the view the director/s of the company have traded it whilst it was insolvent, the Commissioner may also issue a statutory demand with a view to having the company wound up, and a liquidator appointed.

In due course, if following the liquidator's investigations a director is found to have breached their duty to prevent insolvent trading, the Court may make compensatory orders for the director to repay the company those amounts – with a view to a distribution being made to unsecured creditors such as the ATO.

[25] Refer to paragraph 9 of PS LA 2011/16.
[26] Refer to section 6 of this Paper.

Once the Commissioner has issued a statutory demand and service of it has been effected, the company has twenty-one (21) days to do either:

1. pay the Commissioner the liabilities owing;
2. enter into an agreed payment arrangement with the Commissioner (that provides the original obligation to pay the debt has been discharged);
3. make an application to the Federal Court or a State Supreme Court to have the statutory demand set aside. These grounds include, but are not limited to, the fact that there is a genuine dispute as to the existence or amount of the debt.

The twenty-one (21) day period to complete the above is a hard deadline, and is unable to be extended by either Order of the Court or by agreement with the Commissioner.

It is very difficult to prove that a debtor company has a genuine dispute in respect of a taxation liability owing to the Commissioner due to the known prima facie and conclusive evidence provisions contained within the TAA 1953.[27] Therefore, the debtor company should have already, or should immediately engage with the ATO to take steps to progress through the Part IVC of the TAA 1953 regime for disputing the liabilities.

Following the twenty-one (21) day period expiring, it is the author's experience that the Commissioner will take steps to commence winding-up proceedings with little delay.

Once the Commissioner has filed his application for orders to wind up the company, it is not too late for the company to engage with the Commissioner. It is common for the first return date of the Commissioner's application to be four (4) to six (6) weeks after the filing date, which usually provides sufficient time for a company to engage with the Commissioner's solicitors.

It is our experience that the Commissioner is willing to consider suitable payment arrangements to satisfy the debt, and will often be willing to consent to orders providing for the application to be dismissed in certain circumstances. Further, the directors may resolve to appoint a voluntary administrator. This option is discussed in greater detail in section 5.1 of this paper.

It is important to note that the company's failure to attend to any of the steps outlined above during the twenty-one (21) day period creates a presumption of insolvency.[28] The effect of this being that even though the Commissioner may consents to the dismissal of his winding up proceedings, the Court may make orders for the Company to be wound up. An additional risk that may arise is that another creditor with eligible standing may apply to be substituted as the petitioning creditor.

[27] See section 8AAZI, and s 350-10 of Schedule 1 to the TAA 1953.
[28] See section 459C(3) of the Corporations Act.

5. Voluntary administration options

This section of the Paper sets out, at a high level, the various voluntary administration, and other restructuring options available to companies which may have outstanding taxation liabilities. This section does not contain an exhaustive list of the options available, or the intricacies of them, and specific advice should be sought before deciding to pursue them.

5.1 Voluntary Administration

A voluntary administration comprises of two (2) core components:

- the transferring of control of the company and its assets to a qualified insolvency practitioner (the voluntary administrator); and
- a moratorium period during which creditors have limited capacity to take action against the company.

During the moratorium period, the voluntary administrator (**Administrator**) will conduct investigations into the company's affairs and will provide reports to creditors. This report will cover matters including:

- when the company first became insolvent (and whether it continued to trade whilst insolvent);
- whether the directors may be held accountable for certain offences;
- whether any creditors were paid in preference (and if those payment may be recoverable); and
- any other legal action.

During this period, the director(s) or a third party may propose a Deed of Company Arrangement (**DOCA**). This is covered in more detail in section 5.2.1 of the Paper.

The DOCA will usually be provided to creditors for their review at the same time as the Administrator's report. This report will provide an outline of the Administrator's calculated estimated return to creditors in a DOCA scenario and a liquidation scenario (often with high or low estimated ranges). Without this report, it may be difficult for creditors to decide whether a DOCA is in their best interests.

The purpose of the voluntary administration process, is generally to provide for the business, property and affairs of an insolvent company to be administered in a way that:[29]

- maximises the chances of the company, or as much as possible of its business, continuing in existence; or
- if it is not possible for the company or its business to continue in existence--results in a better return for the company's creditors and members than would result from an immediate winding up of the company; and
- to enter into a restructuring plan with creditors.

The benefits of a voluntary administration are:

- the Administrator controls the company;

[29] See section 435A of the Corporations Act.

- there is little cost to appointing an Administrator (though the Administrator will likely need to be remunerated during their appointment and may request funding for this is provided upfront);
- Court approval is not required for a DOCA to be proposed to creditors;
- creditors are involved in a vote to decide the company's future;
- during the moratorium period creditors cannot take action against the company (except in certain circumstances);
- the administration process is not too lengthy (providing certainty to creditors of an outcome in a relatively short period, though also allowing sufficient time for a DOCA to be proposed); and
- winding up of the company cannot occur without leave of the court.

A voluntary administrator is usually appointed by way of resolution of the company's directors once they form the view the company is insolvent, or is likely to become insolvent at some future time.[30] A further prompt, relevant for the purposes of this paper, is that one of a director's defences to a non-lockdown DPN to ensure they are not liable (as outlined in section 6 of this Paper) is to cause a voluntary administrator to be appointed.

During the course of a voluntary administration, two (2) meetings of creditors are usually held.

The first meeting of creditors must be held within eight (8) business days of the appointment of the Administrator.[31] The first meeting is to allow creditors to appoint a committee of inspection (i.e. a representative body of the creditor pool),[32] or to allow creditors to remove and replace the Administrator.[33] Creditors may wish to appoint an alternate Administrator in circumstances where they form the view the Administrator may be too sympathetic to the directors of the company (who often appoint the Administrator) as the Administrator is bound it act in the creditor's interests.

The second meeting of creditors is ordinarily held around twenty-five (25) business days from the date of the appointment of the Administrator.[34] However, the Court may grant further time for convening the second meeting if, on application by the Administrator, the Court determines it is in the best interests of creditors.[35] It is at this meeting that creditors resolve for the voluntary administration to end, in either of the following ways:

- the company executes the DOCA; or
- the administration ends, and control of the company returns to the directors; or
- the company be placed into liquidation, and a liquidator is appointed.

A DOCA, if accepted by creditors at the second meeting, is the document that will regulate any action that can be taken by creditors, and the payment of amounts to creditors to satisfy their debts. If a DOCA is not accepted by creditors, the company will be placed into liquidation, or returned to the control of the directors. DOCAs are addressed further in section 5.2 of this paper, however, liquidations are not discussed.

[30] See section 436A of the Corporations Act.
[31] See section 436E(2) of the Corporations Act.
[32] See section 436E(1) of the Corporations Act.
[33] See section 436E(4) of the Corporations Act.
[34] There are statutory deadlines for the meeting, though these are not addressed in detail in this paper.
[35] See section 439A(7) of the Corporations Act.

5.1.1 Impact on the ATO

Whilst a company is in voluntary administration, there is a statutory moratorium which impacts the actions creditors such as the ATO may take. The Corporations Act provides that during the moratorium period, legal proceedings, winding up proceedings and execution against the company's property cannot commence or continue without consent or leave of the Court.[36]

Often directors of companies may appoint a voluntary administrator following the Commissioner commencing winding up proceedings. If this does occur, the Court is required to adjourn the hearing of the proceedings **if** the Court is satisfied that it is in the best interests of the company's creditors for it to continue under administration rather than be wound up.

It is our experience that the Court is generally minded to grant such adjournments to allow the Administrator to conduct their investigations and to issue their report to creditors (which will usually contain a DOCA). Following receipt of the report, the Commissioner will consider its consents and conduct a thorough assessment as to whether it is in the interests of the Commissioner (as a creditor of the company) for the administration to continue.

5.2 Deeds of company arrangement

A Deed of Company Arrangement (**DOCA**) may be proposed whilst a company is in voluntary administration. Once a DOCA is executed following creditor approval, the administration period formally finishes, and from that point in time onwards the company is known as being 'subject to a deed of company arrangement'.

Whilst a company is subject to a DOCA, a deed administrator (usually the administrator from the voluntary administration period) is appointed. It is their role is to monitor and control the DOCA fund. The DOCA fund is the fund which monies are paid into for distribution to creditors in due course. The deed administrator also monitors that the terms of the DOCA are being complied with.

The aim of a DOCA is to provide a better outcome for creditors than if the company was immediately placed into liquidation. Therefore, a DOCA does not need to result in the company returning to solvent trading or back to business as usual. It may also provide for a structured and managed wind down and sale of the company's assets prior to it eventually being placed into liquidation.

A DOCA may be proposed by the existing directors or shareholders of the company, so that they can purchase the company back from the Administrator. It can also be proposed by a third party to effectively buy all or part of the business. A restructure and sale of a business under a DOCA may be effected by way of a sale of the company's shares, or purchasing specific assets. Each of these may result in separate taxation implications. This is covered in more detail in sections 9.2.7 and 9.3 of the Paper.

A DOCA will usually involve a compromise of creditor claims (partial payment of cents in the dollar of the value of the creditor claim), a deferred payment plan for creditor claims (payment in tranches or a bulk payment at a date in the future), a transfer of assets (often specific assets to specific creditors to discharge their claim, or a debt for equity swap), and a further moratorium period.

At the second meeting of creditors, for a DOCA to be approved, it must be approved by *both* the majority of creditors and the majority in value of the creditors. If approved, the DOCA binds all creditors.

Once the DOCA is executed, control usually reverts to the directors, and the company may continue to trade, which may be important to affect a sale or to realise projected revenue by way of completing certain projects.

[36] See sections 550A, 440D, and 440F of the Corporations Act.

During this period, the company must continue to comply with its taxation obligations, including making all necessary lodgements.

A significant benefit of a DOCA for creditors is that the proponent (commonly a director or shareholder) may contribute funds for distribution to creditors. These funds often would not be available to creditors in a liquidation unless a liquidator was successful in bringing claims against a director and making recoveries. This contribution will often see creditors be paid in a shorter time frame, with less risk than if the company was placed into liquidation.

Once the terms of the DOCA have been complied with (e.g. assets sold and dividends paid to creditors), the DOCA is taken to have been effectuated, and the deed administrator will terminate the DOCA.

5.2.1 ATO guidance in respect of DOCAs

The ATO's PS LA 2011/16 provides guidance as the ATO's position in respect of deeds of company arrangement (**DOCAs**), and other alternatives to liquidation. Key components of this guidance are summarised as follows: [37]

- the ATO publicly recognises that a DOCA may produce beneficial outcomes for creditors as follows:[38]
  - avoidance of a sudden winding up or bankruptcy which often results in only a nominal (or nil) return to creditors;
  - preservation of a business which, despite having its operations threatened by adverse circumstances, is fundamentally viable;
  - an opportunity is provided to reorganise the entity's affairs, with a view to enhancing the position of its creditors, shareholders and/or directors, and
  - potentially providing a better return for the revenue;
- 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;
- as a general rule, the Commissioner will **not** vote in favour of an arrangement under which non-cash items, such as shares or other property, are offered to creditors. This is due to the costs and difficulties that may arise in administering the transfer and sale of that property. However, where the Commissioner is obliged to accept such property, for example, where a deed of company arrangement containing such provisions has been accepted by the majority of creditors and executed, prompt action will be taken to register such property in the name of the Commonwealth. Once such property has vested in the Commonwealth, the ATO will take the necessary steps to realise the property to enable payment of the proceeds to be applied against the taxpayer's debts;
- factors to be taken into account by the Commissioner in determining whether to vote for a DOCA include, but not limited to:
  - any legal advice which the ATO may have obtained;
  - the contents, comprehensiveness and adequacy of relevant reports. That is, regard should be had to the contents, including any relevant omissions, in:

[37] PS LA 2011/16 paragraph 31.
[38] PS LA 2011/16 paragraph 31.

        - the statement of affairs or report as to affairs;
        - the proposal;
        - the report prepared by the trustee or administrator;
    - any liabilities not yet established, such as unissued assessments or outstanding documents;
    - whether the debtor has made appropriate arrangements to meet future tax liabilities as and when they fall due;
    - the debtor's compliance history, and the compliance history of related parties or entities;
    - the extent and seriousness of any taxation offences which may have been committed;
    - the likelihood that the proposals put forward would be achieved;
    - the maintenance of any priority the Commissioner may have had in bankruptcy or liquidation
    - any association between the debtor and other creditors (including associations which involve an assignment of debt);
    - 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;
    - 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;
    - any apparent voidable transactions or dispositions which might be unable to be pursued if the proposal were to be accepted;
    - the tangible benefit to the Commonwealth revenue that is expected to be gained from any proposed arrangement, and
    - the manner in which the proposal would distribute a dividend between all classes of creditors or whether the proposal is considered to be unfairly prejudicial or discriminatory.

The Corporations Act provides a priority for SGC debts under a DOCA. The Corporations 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 a DOCA 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. 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.

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 take, or refrain from taking, some action. Such terms under a DOCA are ineffectual. The ATO will vote against any deed which includes such a clause.

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

5.2.2 Impact on the ATO

If a DOCA is approved, the Commissioner's claims will be compromised as per the terms of the DOCA. A practical example of this is the Commissioner may be paid 3c in every dollar for the liabilities owing by the creditor.

Although the ATO acknowledges that, as a creditor, the Commissioner is bound by the terms of a DOCA, 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 Commissioner or it contains other adverse features.[39]

Whilst a company is subject to a DOCA, there is no moratorium that exists that prevents the Commissioner from commencing winding up proceedings for liabilities that have been incurred post the DOCA being executed.

5.2.3 Small business restructuring process

The small business restructuring process (**SBR**) was introduced following the Covid-19 pandemic. The purpose of the SBR process was outlined in the Explanatory Memorandum to the (*Corporations Amendment (Corporate Insolvency Reforms) Bill 2020 Explanatory Memorandum* at [1.3]) as:[40]

> The intention of the debt restructuring process is to provide an alternative to the "one-size-fits-all" voluntary administration regime for small businesses with non-complex debt. It reduces the complexity and cost of the administration process, providing a greater role for the company directors during the process and allowing them to retain control over the company throughout. These changes are intended to encourage more small businesses to seek debt restructuring earlier, increasing their chances of regaining viability.

The SBR regime is different to that of voluntary administration as it has the intention of trying to allow a company to avoid administration/liquidation if the restructuring plan is able to produce a better outcome.

The SBR process is unique as it is a 'debtor in possession model'. The directors remain in control of the company during the period of the restructure, however they must appoint a restructuring practitioner to assist them with the process. The purpose of the debtor in possession model is to enable the directors to continue to enter into transactions and deal with the assets of the company in the ordinary course of the company's business.

Importantly, for a transaction outside the ordinary course of business, the restructuring practitioner appointed must consent to the transaction. The role of the restructuring practitioner throughout the process is to assist in the preparation of the restructuring plan, and to provide ongoing advice.

To be eligible for a small business restructuring process, on the day on which a restructuring practitioner is appointed, the following criteria must be met:[41]

- total liabilities of the company must not exceed $1 million;
- no person who is a director of the company, or who has been a director of the company within the twelve (12) months before the appointment of the restructuring practitioner, has been a director of

[39] PS LA 2011/16 paragraph 39.
[40] The Explanatory Memorandum to the Bill (*Corporations Amendment (Corporate Insolvency Reforms) Bill 2020 Explanatory Memorandum*
[41] https://asic.gov.au/regulatory-resources/insolvency/insolvency-for-directors/restructuring-and-the-restructuring-plan/

another company that has been under restructuring or subject to the simplified liquidation process within the period of the preceding seven years, unless they are exempt under the regulations; and

- the company must not have undergone restructuring or been the subject of a simplified liquidation process within the preceding seven years.

In addition to the above, a company must have:

- paid all employee entitlements that are due and payable **including superannuation**; and
- all tax lodgements are up to date (or the company must have been ‘substantially complying’ with this requirement).

If a company is able to utilise this process, it is likely that the Commissioner will be a major creditor, and their ‘vote’ at a meeting as to whether the proposal should be adopted will often be required for its success.

5.2.4 Impact on the ATO

During the SBR, unsecured creditors cannot commence, continue or enforce a claim against the company without leave of the Court or the restructuring practitioner’s consent. Further, during an SBR, if a winding up application has already been filed, the Court must adjourn the hearing of it **if** the Court is satisfied that it is in the interest of the company for it continue the SBR rather than be wound up.

Additionally, if the company has entered into a payment arrangement with the ATO where security has been provided, the ATO cannot enforce their security without leave of the Court or the restructuring practitioner’s consent.

6. Director Penalty Notices

To ensure that companies comply with their taxation obligations, the legislature has implemented several measures that can make directors of companies personally liable for a tax-related liability in certain circumstances.

One of these measures is the director penalty notice (**DPN**) regime in Division 269 of Schedule 1 to the TAA. This Division sets out:

a. the circumstances in which directors of companies can be made personally liable for their companies' tax debts;

b. the procedural steps that the Commissioner must adhere to before enforcing the DPN; and

c. the rules for whether a director issued with a DPN can mount a defence to seek to have the DPN remitted.

6.1 Director Penalty Notice Regime – Division 269

6.1.1 Object of Regime

The object of Division 269 is set out at section 269-5 in Schedule 1 to the TAA:

> 269-5 Object of Division
>
> The object of this Division is to ensure that a company either:
>
> (a) meets its obligations under:
>
> (i) Subdivision 16-B (obligation to pay withheld amounts to the Commissioner); and
>
> (ii) Division 268 (estimates of PAYG withholding liabilities and superannuation guarantee charge); and
>
> (iii) Part 3 of the Superannuation Guarantee (Administration) Act 1992 (obligation to pay superannuation guarantee charge); and
>
> (iv) Divisions 33 and 35 of the * GST Act in respect of * assessed net amounts; and
>
> (v) Division 162 of the GST Act in respect of GST instalments (within the meaning of the GST Act); or
>
> (b) goes promptly into voluntary administration or restructuring under the Corporations Act 2001 or into liquidation.
>
> Note: The directors' duties are enforced by penalties on the directors. A penalty recovered under this Division is applied towards meeting the company's obligation.

6.1.2 Directors' Obligations

Division 269 seeks to achieve its object by imposing obligations on directors of companies.[42] Broadly speaking, the obligations imposed on directors are that:

[42] See section 269-15 in Schedule 1 to the TAA.

a. directors must cause their companies to comply with their own obligations as corporate taxpayers to withhold and pay various taxes;[43] and

b. where their companies cannot pay their taxes, directors must take prompt action to bring the company under some form of external administration to protect the interests of all creditors.

The Division uses the terms "*initial day*" and "*due day*" in relation to the obligations of companies in respect of withholding and paying tax. This is generally the time that the particular taxes arise (for "*initial day*") and are due and payable to the Commissioner (for "*due day*").

For example, in relation to Pay-As-You-Go (**PAYG**) withholding, the "initial day" is when a company withholds an amount under Division 12 in Schedule 1 to the TAA, and the "due day" is the day that the company is obliged to pay the amount to the Commissioner in accordance with Subdivision 16-B in Schedule 1 to the TAA. [44]

6.1.3 Penalty

At section 269-20 of Schedule 1 to the TAA, directors are made liable for a penalty if:

a. at the end of the "*due day*", the directors of the company are still under an obligation under section 269-15 in Schedule 1 to the TAA (such as the obligation to ensure that the company pays PAYG withholding amounts to the Commissioner in accordance with Subdivision 16-B in Schedule 1 to the TAA);[45] and

b. the directors were under that obligation at or before that time (because they were directors).[46]

While the penalty is due and payable by the end of the "*due day*", section 269-25 of Schedule 1 to the TAA provides that the Commissioner cannot take action to enforce the penalty until the end of twenty-one (21) days after the Commissioner gives written notice (in the form prescribed by the section) to the director of the penalty. That notice is commonly referred to as a **DPN**.

The amount of the penalty is equal to the unpaid amount of the company's liability under its obligation. [47]

6.1.4 New Directors

Something of a safe haven for new directors of companies is provided at subsections 269-20(3) and (4) in Schedule 1 to the TAA as follows:

> Penalty for new director
>
> (3) You are also liable to pay to the Commissioner a penalty if:
>
> (a) after the due day, you became a director of the company and began to be under an obligation under section 269-15; and
>
> (b) 30 days later, you are still under that obligation.
>
> (4) The penalty is due and payable at the end of that 30th day.

[43] See section 269-10 in Schedule 1 to the TAA for the scope of taxes to which the Division applies. Among other things, it covers Pay-As-You-Go (**PAYG**) withholding, superannuation guarantee charge (**SGC**) and goods and services tax (**GST**).
[44] See Item 1 to the table at subsection 269-10(1) in Schedule 1 to the TAA.
[45] See subsection 269-20(1)(a) in Schedule 1 to the TAA.
[46] See subsection 269-20(1)(a) in Schedule 1 to the TAA.
[47] See subsection 269-20(5) in Schedule 1 to the TAA.

> Note: The Commissioner must not commence proceedings to recover the penalty until the end of twenty-one (21) days after the Commissioner gives you notice of the penalty under section 269-25.

However, it is unclear whether this provision will relieve liability in circumstances where a person becomes a director of a company that is under an obligation and then subsequently resigns within thirty (30) days of their appointment, but does not take any steps in the time that they were a director to cause the company to comply with its obligation.

While on one reading of subsections 269-20(3) and (4) of Schedule 1 to the TAA it might seem that the intention is to give new directors a thirty (30) day grace period, in PS LA 2011/18, the Commissioner has stated as follows at paragraphs 55 to 58:

> 55. A director appointed to a company that has outstanding PAYG and SGC obligations will become personally liable for a penalty equal to these amounts within 30 days of their appointment.
>
> 56. However, a new director will not be liable to director penalties for SGC or PAYG amounts due before their appointment if the company is placed into liquidation or administration, or the amounts are paid in full within 30 days of the date of appointment.
>
> 57. For PAYG withholding, the director will also be liable for any unpaid liabilities for reporting periods that started while they were a director, except if they resigned before the first withholding event in that period.
>
> 58. For SGC, the director will also be liable for any unpaid liabilities for reporting periods that started while they were a director, except if they resigned before the last day of the quarter.

It can perhaps be reasonably inferred from the above that a director can be personally liable the moment that they are appointed a director, regardless of whether or not they then immediately (and within thirty (30) days) resign. This highlights the importance of prospective directors doing their due diligence of the company's financial performance and tax compliance record before they accept an appointment.

However, in *Brown v Commissioner of Taxation* [2020] FCA 817 (9 June 2020) (***Brown***), Kerr J referred to the thirty (30) day safe-haven provision at [20], noting:

> It is important to note that as at August 2018 when the Applicant became aware of the company's outstanding withheld PAYG amounts, he had been already a director of the company for a period in excess of 30 days. That is significant only insofar as s 269-20(3) provides a 30 day safe-haven provision for new directors before they will become personally liable for penalties for outstanding company liabilities. Mr Kaskani, counsel for the Commissioner, did not accept that the Applicant could have avoided such liability simply by resigning and ceasing to hold office within that period. I note however the observations of Heydon JA in *Deputy Commissioner of Taxation v Saunig* [2002] NSWCA 390; 55 NSWLR 722 at [23] (albeit in obiter, and in respect of repealed and re-enacted provisions with a shorter time frame) that the only course open to a director who cannot secure the cooperation of his fellow directors is "to resign and thus escape any continuing liability". However, that question does not arise in the facts of this case. It need not be determined.

Accordingly, whether or not a new director to a company can simply resign within thirty (30) days of their appointment and "*thus escape any continuing liability*" is, perhaps, not settled.

6.1.5 Ending of Directors' Obligations

Section 269-30 in Schedule 1 to the TAA provides that a penalty listed in a DPN is remitted if the directors stop being under the obligation in section 269-15 either before the Commissioner issues the DPN or within twenty-one (21) days of the Commissioner so issuing the DPN. As set out at paragraph 6.1.2 of this paper, these obligations are for the directors to either cause their company to pay its tax debts or to cause it to be placed into some form of external administration.

The policy rationale for remission of the penalties listed in the DPN in these circumstances is that the directors have promptly caused their company to address its financial difficulties, thereby meeting the object of Division 269.

Yet the table at subsection 269-30(2) in Schedule 1 to the TAA provides an important qualifier, which is that directors causing their company to be placed into some form of external administration within twenty-one (21) days of receiving a DPN will **not** cause the penalty to be remitted in circumstances where the company did not make timely notification to the Commissioner of the relevant tax debt.

For instance, Item 1 to the table at subsection 269-30(2) in Schedule 1 to the TAA provides that **where** a company's obligation is to pay to the Commissioner a PAYG withholding amount on or before the "*due day*" for that amount, **and** the director stops being under their obligation in respect of that PAYG withholding amount by reason of causing their company to be placed into some form of external administration after three (3) months of the "*due day*", **then** the penalty will not be remitted regardless of whether or not the director took the relevant action within twenty-one (21) days of being issued with the DPN. This is where the company did not notify the Commissioner of the relevant PAYG withholding amount within three (3) months of the "*due day*" for that PAYG withholding amount. The result is that the liability will 'lockdown' and the DPN is referred to as a 'lockdown DPN'.

For SGC amounts, the notification time period is even shorter – liability will 'lockdown' on a director if the full SGC amount was not lodged in that company's SGC statement by the end of the relevant quarter.

Accordingly, where a company did not make timely notification to the Commissioner of a tax debt to which a DPN relates, the only way for the director to have the DPN remitted is for the tax debt to be paid (thereby meaning that the company has complied with its obligation).

6.1.6 Example

The ATO website[48] provides an example as to how these 'lockdown DPN' provisions operate. A modified version of this example is reproduced below:

> Kerry and Claire are directors of ABC Pty Ltd, which is required to pay PAYGW on a quarterly basis. For the January to March quarter in the 2019–20 income year, the company withheld $4,000 from payments made to its employees and directors.
>
> The company did not report or pay the above amount within 3 months of the due date of liability.
>
> Kerry and Claire each receive DPNs.
>
> The only way Kerry and Claire's director penalties can now be remitted is by Kerry or Clare making sure that the amounts are paid in full within 21 days of the date the notices are given to them.
>
> Kerry and Claire place the company into administration. However, Kerry and Claire's director penalty amounts are still payable by either one or both to the equivalent amount of $4,000.

[48] 'Director penalties', *Australian Taxation Office* (Web Page, 4 September 2024) <https://www.ato.gov.au/business/engaging-a-worker/in-detail/director-penalty-regime/#Remittingthepenalty>.

6.1.7 Estimates of unpaid taxes

Division 268 in Schedule 1 to the TAA enables the Commissioner to make estimates of unpaid PAYG withholding amounts, SGC amounts and GST amounts.

The rules of Division 269 in Schedule 1 to the TAA are such that the Commissioner is permitted to issue DPNs in respect of estimates made under Division 268, with such amounts effectively treated as if they were not estimates but actual amounts for the purposes of Division 269.

6.2 Defences to DPNs

6.2.1 Timing to Raise Defences

Section 269-35 in Schedule 1 to the TAA provides for certain defences available to directors who are issued with penalties under Division 269. The time that directors are required to make out these defences is either:

- at court, if the Commissioner has initiated court proceedings to recover the debt;[49] or
- within 60 days of the Commissioner notifying the director in writing that the Commissioner has recovered part of the penalty under section 260-5 in Schedule 1 to the TAA or has otherwise recovered any part of the amounts listed in the DPN.[50]

In relation to the second paragraph above, in *Brown*, Kerr J described such measures that the Commissioner can take as "*self-help*" measures available to the Commissioner to recover part or all of a tax debt.[51] For instance, this could include issuing a garnishee notice.

An important effect of this is that it may be not be necessary for a director to establish a defence to a DPN issued to them within sixty (60) days of the DPN itself being issued. That is to say, the issue of a DPN by the Commissioner is not in and of itself a "*self-help*" mechanism to recover the tax debt.

Instead, the Commissioner needs to give specific notice that he has recovered part of the penalty, and it is at that point that the sixty (60) days starts. Kerr J in *Brown* noted as follows at [39]:

> The Commissioner must then make his or her decision under s 269-35(4A) "on the basis of that information" (being the information provided by the director or former director) within 60 days of his or her having been so notified: s 269-35(4A)(b). That element of the statute has two important aspects. The first is that the director or former director must be provided an opportunity to advance a potential defence if the Commissioner wishes to rely upon non-curial self-help measures. Absent such notice being given, the processes of procedural fairness required by the Act are incapable of being engaged. The consequence, necessarily implied as matter of statutory construction, is that if the Commissioner does not give such a notice he or she cannot lawfully rely on the provisions of Div 269 to authorise his or her use of self-help provisions for the recovery of a penalty.

6.2.2 Types of Defences

Subsections 269-35(1) and (2) in Schedule 1 to the TAA provide as follows:

[49] See subsection 269-35(4) in Schedule 1 to the TAA.
[50] See subsection 269-35(4A) in Schedule 1 to the TAA.
[51] *Brown* at [36].

Illness

(1) You are not liable to a penalty under this Division if, because of illness or for some other good reason, it would have been unreasonable to expect you to take part, and you did not take part, in the management of the company at any time when:

(a) you were a director of the company; and

(b) the directors were under the relevant obligations under subsection 269-15(1).

All reasonable steps

(2) You are not liable to a penalty under this Division if:

(a) you took all reasonable steps to ensure that one of the following happened:

(i) the directors caused the company to comply with its obligation;

(ii) the directors caused an administrator of the company to be appointed under section 436A, 436B or 436C of the Corporations Act 2001;

(iia) the directors caused a small business restructuring practitioner for the company to be appointed under section 453B of that Act;

(iii) the directors caused the company to begin to be wound up (within the meaning of that Act); or

(b) there were no reasonable steps you could have taken to ensure that any of those things happened.

6.2.3 Illness or Some Other Good Reason

In respect of the defence at subsection 269-35(1) in Schedule 1 to the TAA about illness or some other good reason, a director must satisfy its requirements for the entire time they are under the relevant obligation.[52] It is not enough that the director is unable to participate in the management of the company due to illness or some other good reason for only part of the time that the director is under the relevant obligation.

6.2.4 'Reasonable Steps'

In relation to the 'all reasonable steps' defence, there are two (2) distinct strands, being either:

a. that the director took all reasonable steps to ensure that one of the actions listed at paragraph (a) of subsection 269-35(2) happened; or

b. that there were no reasonable steps that the director could have taken to ensure that **any** of the actions the actions listed at paragraph (a) of subsection 269-35(2) happened.

This means that to successfully make out the second listed defence, it is not enough for a director to identify that there are no reasonable steps that they could take to, for example, cause the company to comply with its obligation (that is, to cause the company to pay the relevant tax debts), and therefore not take any steps at all. There may well have been reasonable steps that the director could have taken to, for example, cause an

[52] See *Snell v Deputy Commissioner of Taxation* [2020] NSWCA 29 in which the NSW Court of Appeal cites, with approval, *Deputy Commissioner of Taxation v George* [2002] NSWCA 336.

administrator to be appointed. This is demonstrated in the case of *Deputy Commissioner of Taxation v Heinrich* [2024] QSC 51 discussed below under section 6.2.5 of this Paper.

In contrast, to successfully make out the first listed defence, a director need not necessarily establish that they took all reasonable steps in respect of more than one of the actions listed at paragraph (a) of subsection 269-35(2) happened. Self-evidently, steps taken to ensure that the company complies with its obligations to pay its tax debts may be in direct conflict with steps taken, for example, to begin to have the company wound up.[53]

This was observed in *Canty v Deputy Commissioner of Taxation* [2005] NSWCA 84 (which was about the pre-cursor provisions to Division 269) at [39] to [41] as follows:

> … If the only feasible options are the appointment of an administrator or a liquidator a person under the duty, acting reasonably, may decide to seek a winding up. If so, he or she will not be acting unreasonably by doing nothing to secure the appointment of an administrator at that stage. The converse will also be true.
>
> [40] Thus a person under the duty, who acted reasonably in choosing one of the possible events and took all reasonable steps to bring it about would, to that extent, make out the para (a) defence although no attempt was made at that stage to achieve compliance in any other way. A person who acted reasonably in choosing between the alternatives but failed to take all reasonable steps to bring about the selected event would fail, as would a person who acted unreasonably in choosing the option to be pursued.
>
> [41] If reasonable steps taken in pursuit of one option fail, non-compliance and the obligation of the director or former director will continue. The director or former director will therefore have to take reasonable steps to achieve compliance in another way. If non-compliance continues long enough before a notice is served, each of the four options will eventually have to be addressed and the subs (3) defences will have to cover all options.

6.2.5 What are 'Reasonable Steps'?

Subsection 269-35(3) in Schedule 1 to the TAA provides as follows:

> (3) In determining what are reasonable steps for the purposes of subsection (2), have regard to:
>
> (a) when, and for how long, you were a director and took part in the management of the company; and
>
> (b) all other relevant circumstances.

The test is an objective test, as noted in *Roche v Deputy Commissioner of Taxation* [2015] WASCA 196 (***Roche***) at [29]:

> 29 What is 'reasonable' for the purposes of s 269-35(2) does not depend merely upon the actual knowledge of the director but involves an objective test. The director must prove that he or she took all steps which were reasonable, having regard to the circumstances of which the director, acting reasonably, knew or ought to have known: see *Deputy Commissioner of Taxation v Saunig* [2002] NSWCA 390; (2002) 55 NSWLR 722; (2002) 43 ACSR 387 [25].

In *Roche*, the Court of Appeal rejected the appellant's appeal against summary judgment in the court below upholding a DPN.

[53] See *Shaw v Deputy Commissioner of Taxation; Rablin v Deputy Commissioner of Taxation* [2016] QCA 275 (1 November 2016) (***Shaw***) at [37].

The grounds of the appeal included that the judge in the court below erred in finding that the appellant had failed to adduce any evidence of him taking ‘reasonable steps’ in causing the relevant company to comply with its obligations (that is, to pay its tax debts owing to the Commissioner).

The appellant submitted that that it was at least arguable that he took all reasonable steps to ensure the directors caused ‘FTP’ (the relevant company), first, to comply with its obligations[54] to remit the withheld tax and, secondly, when it was evident that was not possible, to cause an administrator to be appointed.[55] He did so, it was submitted, between mid-2011 and early 2013, by the regular discussions with his father concerning FTP's affairs and by the periodic meetings with his father and Mr Williams at which he considered cash flow projections and received explanations from Mr Williams as to FTP's outstanding liabilities, expected expenses and expected revenue, all of which indicated that continuing trading would result in FTP paying all of its liabilities, including its tax obligations.[56]

The Court of Appeal rejected these submissions, finding as follows at [40]:

> 40 In our respectful view, the master was correct to find that the appellant had no arguable defence to the claim. To establish a defence under s 269-35(2), the appellant was required to prove that from the time he came under the obligation in s 269-15 he took all reasonable steps to ensure that one of the s 269-35(2)(a) events occurred or that there were no reasonable steps that he could have taken to ensure that any of those events happened. The evidence, which, as the master observed, was conspicuous for its paucity, fell a long way short of that. The contention that, prior to the appointment of the administrator, it was reasonable for the appellant to take no steps in light of the information provided to him by Mr Roche and by Mr Williams at their periodic meetings is simply unsustainable.

Deputy Commissioner of Taxation v Heinrich [2024] QSC 51 concerned an application by the Deputy Commissioner of Taxation for summary judgment in the sum of approximately $9.8 million plus interest against Mr Heinrich on the basis that he was required to pay a penalty arising out of the failure of the company Heinrich Formwork Pty Ltd. It was accepted by Mr Heinrich that the amount was of the penalty was properly served in a DPN.

Relevantly, Mr Heinrich’s argued that he had a defence under either the first or second strand of the ‘all reasonable steps’ defence at subsection 269-35(2) of Schedule 1 to the TAA. These two (2) strands are summarised above under section 6.2.4 of this Paper.

In relation to the first strand, Mr Heinrich argued that he took all reasonable steps to cause the company to comply with its obligations by entering into an agreement with the ATO in relation to the payment of the debt. Mr Heinrich alleged that the company’s promises under the agreement satisfied its obligation to pay the debt, even though the agreement itself was ultimately breached. Martin SJA did not accept this, finding instead that the “*agreement between the parties, then, was that there was to be no discharge [of the debt] until performance was complete*”.[57]

In relation to the second strand, Mr Heinrich’s argument was summarised by Martin SJA as follows:[58]

> 37. The second part of Mr Heinrich's argument is that the COVID-19 pandemic and the disruption and delays associated with it caused the Company to lose more than $10 million even though it continued to employ people to perform work at the Queens Wharf project as a subcontractor to Multiplex Constructions Pty Ltd. The contention is that the effects of the pandemic upon the Company and Mr Heinrich occurred entirely beyond his control and that, but for the pandemic, the Company would have had sufficient income

[54] *Roche* at [21].
[55] *Roche* at [21].
[56] Ibid.
[57] *Deputy Commissioner of Taxation v Heinrich* [2024] QSC 51 at [31].
[58] Ibid at [37] – [38].

to discharge its debt to the Commissioner and, therefore, there would have been no debt to which a DPN could attach.

38. The argument advanced is confined to the loss of capacity, due to COVID-19 restrictions, for the Company to make sufficient money to satisfy its indebtedness to the DCT. In the written submissions from Mr Heinrich it is contended that he seeks "to have the benefit of the usual interlocutory process that would allow the collation of further evidence, including as to the impacts on the Company of the COVID-19 restrictions (such as evidence as to the government directives, evidence from a quantity surveyor and construction expert as to the effects on the business and the contracts that were undertaken and forensic accounting to assess the financial impacts on the Company)".

Martin SJA noted that this argument might, if favoured by the evidence, go towards demonstrating that there were no reasonable steps available to Mr Heinrich to ensure that the company complied with its obligation – that is, to pay its taxes.[59] However, it would not assist Mr Heinrich in proving that there were no reasonable steps able to be taken in to achieve any of the matters set out in paragraphs (ii) to (iii) of subsection 269-35(2)(a) of Schedule 1 to the TAA. These matters relate to placing the company into some form of external administration or causing it to be wound up.

This case demonstrates that COVID-19 related business difficulties are unlikely to assist directors in defending DPNs.

[59] Ibid at [39].

7. ATO Garnishee Notices

7.1 Overview

Subdivision 260-A of Schedule 1 of the TAA is contained in Division 260 in Schedule 1 to the TAA and carries the title: ‘Special rules about collection and recovery’. Interestingly, the title to Subdivision 260-A is simply: ‘From third party’. This is somewhat shorthand for ‘garnishee order’.

The boxed text explains what Subdivision 260-A is about and states that:

> This Division deals with the collection and recovery of an amount from a person who is not personally liable to pay that amount. Apart from Subdivision 260-A, which covers a wider range of amounts, this Division primarily deals with amounts of tax-related liabilities.

The terminology adopted by Subdivision 260-A is the collection of tax debts from third parties rather than issue of ‘garnishee notices’.

This compares with *A New Tax System (Family Assistance) (Administration) Act 1999* where ‘garnishee notice’ and ‘garnishee order’ are defined and used throughout that Act.

In the Encyclopaedic Australian Legal Dictionary, a ‘garnishment’ (also known as a ‘garnishee order’) is defined to mean:

> A court order by which a third party who holds money for a judgment debtor is directed to attach certain amounts of that money to the judgment debt. A common example of a garnishment is where a court requires an employer of the judgment debtor to ‘garnish' the employee's wages by paying a portion of those wages directly to the judgment creditor: for example (NSW) Supreme Court Rules Pt 46 rr 3, 10A; (VIC) Supreme Court (General Civil Procedure) Rules 1996 O 71; (QLD) Uniform Civil Procedure Rules 1999 Ch 19

In PS LA 2011/18, the Commissioner uses the terminology ‘Statutory Garnishee’ and describes the concept at paragraph 104:

> Where a person (third party) owes money to or hold money for a tax debtor, section 260-5 in Schedule 1 to the TAA empowers the Commissioner to require the third party to pay that money to the Commissioner rather than paying it to, or continuing to hold it for, the tax debtor. This power is commonly referred to as a ‘garnishee power’ and a written notice issued by the Commissioner under subsection 260-5(2) in Schedule 1 to the TAA is referred to as a ‘garnishee notice’.

Notwithstanding the terminology used, it is clear that for the purposes of the collection of tax-related liabilities by the Commissioner, section 260-5 of Schedule 1 of the TAA contains the Commissioner’s power to collect tax debts from third parties who owe money to the taxpayer through the issue of a notice that complies with the provision.

7.2 Subdivision 260-A

Section 260-5 of Schedule 1 of the TAA provides as follows:

> **260-5(1)** This Subdivision applies if any of the following amounts (the ***debt***) is payable to the Commonwealth by an entity (the ***debtor***) (whether or not the debt has become due and payable):
>
> (a) an amount of a tax-related liability;

(b) a judgement debt for a tax-related liability;

(c) costs for such a judgement debt;

(d) an amount that a court has ordered the debtor to pay to the Commissioner following debtor's conviction for an offence against a taxation law.

Commissioner may give notice to an entity

260-5(2) The Commissioner may give a written notice to an entity (the ***third party***) under this section if the third party owes or may later owe money to the debtor.

Third party regarded as owing money in these circumstances

260-5(3) The third party is taken to owe money (the ***available money***) to the debtor if the third party:

(a) is an entity by whom the money is due or accruing to the debtor; or

(b) holds the money for or on account of the debtor; or

(c) holds the money on account of some other entity for payment to the debtor; or

(d) has authority from some other entity to pay the money to the debtor.

The third party is so taken to owe the money to the debtor even if:

(e) the money is not due, or is not so held, or payable under the authority, unless a condition is fulfilled; and

(f) the condition has not been fulfilled.

How much is payable under the notice

260-5(4) A notice under this section must:

(a) require the third party to pay the Commissioner the lesser of, or a specified amount not exceeding the lesser of:

(i) the debt; or

(ii) the available money; or

(b) if there will be amounts of the available money from time to time – require the third party to pay to the Commissioner a specified amount, or a specified percentage, of each amount of the available money, until the debt is satisfied.

When amount must be paid

260-5(5) The notice must require the third party to pay an amount under paragraph (4)(a), or each amount under paragraph (4)(b):

(a) immediately after; or

(b) at or within a specified time after;

the amount of the available money concerned becomes an amount owing to the debtor.

Debtor must be notified

260-5(6) The Commissioner must send a copy of the notice to the debtor.

Setting off amounts

260-5(7) If an entity other than the third party has paid an amount to the Commissioner that satisfies all or part of the debt:

(a) the Commissioner must notify the third party of that fact; and

(b) any amount that the third party is required to pay under the notice is reduced by the amount so paid.

A 260-5 notice is a notice by the Commissioner to a third party who owes a debt to the taxpayer or may later owe a debt to the taxpayer. An example of the former is where a bank holds funds in the taxpayer's bank account which is payable at call. An example of the latter is where a buyer under a contract of sale is obliged to pay the purchase price under that contract at the settlement date which is yet to occur. The decision in *FCT v Park* [2012] FCAFC 122 highlights the Commissioner's power to collect debts from third parties and potential for the exercise of this power to disrupt third party transactions. This is examined in section 7.2.4 of this Paper.

The notice can cover the tax-related liability itself but also any judgement debt for the tax-related liability, costs for such a judgement debt and any amount a court has ordered the debtor to pay to the Commissioner following the debtor's conviction for an offence against a taxation law.

The circumstances in which a third party owes money to the taxpayer is expanded under subsection 260-5(3) to include circumstances where a third party holds money on account of another person who owes money to the taxpayer. These amounts will be owing notwithstanding that the money is held subject to an unfulfilled condition.

Notices under Subdivision 260-A in Schedule 1 to the TAA have been called both a garnishee order[60] and a statutory charge (or an assignment of debt) in favour of the Commissioner.[61]

This is a powerful debt collection tool of the Commissioner because it advances the Commissioner's position as a creditor ahead of unsecured creditors who do not have a similar debt collection mechanism available to them.

It is a criminal offence for a third party not to comply with a 260-5 notice. This is provided for in section 260-20 in Schedule 1 to the TAA.

The third party is indemnified for the payment it makes pursuant to a 260-5 notice. This is provided for in section 260-15 in Schedule 1 to the TAA which further provides that the amount paid by the third party to the Commissioner is:

…taken to be authorised by:

(a) the debtor; and

(b) any other person who is entitled to all or part of the amount.

7.2.1 Is the Commissioner a secured creditor by the issue of a 260-5 notice?

Cases in both the bankruptcy context and the corporate insolvency context have established that where the Commissioner has issued a 260-5 notice to a third party, the Commissioner is a secured creditor. This is on the basis that the Commissioner holds a security by having issued a 260-5 notice for the purposes of:

[60] Refer to *Bruton Holdings Pty Ltd (in liq) v Federal Commissioner of Taxation* (2009) 239 346.
[61] Refer to *Macquarie Health Corporation v FCT* [1999] HCA 1819.

- subsection 58(5) of the *Bankruptcy Act 1966* (Cth) (the **Bankruptcy Act**) which provides that the vesting of the bankrupt's property in the bankruptcy trust prevents a secured creditor from realising its security. Section 5 of the Bankruptcy Act defines a secured creditor to include a person who holds a '*a mortgage, charge or lien on property of the debtor*';[62]

- section 471C of the Corporations Act which provides that the appointment of a liquidator, among other things, does not affect a secured creditor's right to realise or otherwise deal with the security. This would extend to a 260-5 notice.[63]

7.2.2 Can a 260-5 notice be issued after a company has been placed in external administration?

No. A 260-5 notice cannot be issued to a company after it has been placed into external administration. This was held by the High Court in *Bruton Holdings Pty Ltd (in liquidation) v Commissioner of Taxation* [2009] HCA 32. This case involved a corporate trustee of a trust which had been placed into liquidation. It had funds in a trust account of a law firm and the Commissioner issued a 260-5 notice to the law firm for the payment of the funds to it under the notice.

The High Court held that the 260-5 notice was void because it was issued after the time that a liquidator had been appointed to the taxpayer. This was by operation of section 260-45 in Schedule 1 to the TAA and in particular subsection 260-45(5) which provides:

> However, subsection (4) does not prevent the liquidator from parting with the company's assets to pay debts to the company not covered by either of the following paragraphs:
>
> (a) the outstanding tax-related liabilities;
>
> (b) any debts of the company which:
>
> (i) are unsecured; and
>
> (ii) are not required, by an Australian law, to be paid in priority to some or all of the other debts of the company.

Their Honours stated at paragraph [10] of the judgement:

> The Commissioner's general power to issue a notice under s260-5 is not available if a liquidator has been appointed to a company. In that latter circumstance, only the more particular provisions of s260-45 of the Administration Act are engaged. That being so, there is no disruption of the operation of Ch 5 of the Corporations Act, and, in particular, no attachment to be rendered void by s500(1).

The Commissioner's remedy was in the operation of section 260-45 in Schedule 1 to the TAA rather than in a 260-5 notice.

The Commissioner's position in relation to the High Court's decision in *Bruton Holdings* is set out in his Decision Impact Statement on the decision. On the operation of section 260-5, the Commissioner states:

> It had been the longstanding view of the Commissioner that a notice under s 260-5 should not be issued to third party debtors in respect of tax related liabilities of a company in liquidation, other than tax related liabilities incurred by a company in the capacity of a trustee of a trust.

[62] Refer to *Deputy Commissioner of Taxation (DCT) v Donnelly* (1989) 25 FCR 432.
[63] Refer to *Macquarie Health Corporation Ltd v FCT* [1999] 1819.

> Following the High Court's decision in this matter, the Commissioner will cease to issue notices under s 260-5 in respect of tax related liabilities of companies in liquidation that have incurred their tax related liabilities in the capacity of a trustee of a trust.

On the operation of section 260-45, the Commissioner states:

> Consistent with the Court's view that the remedy available to the Commissioner in respect of a trustee company in liquidation is the regime for liquidations (s260-45) and not the garnishee regime (s 260-5), the Commissioner will seek to apply s 260-45 in respect of all of the tax related liabilities of such a company, whether they are liabilities incurred by the company in the proper administration of the trust or wholly in its personal capacity.

This invalidity extends to a 260-5 notice issued to a liquidator in respect of a tax-related liability that arose after the company was placed in liquidation. This was held by the Federal Court in *Bell Group Limited (in liq) v Deputy Commissioner of Taxation* [2015] FCA 1056.

7.2.3 What are some of the other limits in respect of issuing a 260-5 notice?

Some of other limitations on the Commissioner include:

- issuing a 260-5 notice in respect of a joint bank account where the taxpayer is but one of the holders;
- issuing a defective 260-5 notice, that is, one which contains material errors;
- an action under the ADJR Act.

Joint bank accounts

In *Deputy Federal Commissioner v Westpac Savings Bank Ltd & Ors* (1987) 72 ALR 634, the Commissioner issued Westpac a garnishee notice in respect of a bank account which was held jointly by three (3) persons who were issued identical notices of assessments which totalled the amount of the funds held in the joint account.

The Supreme Court of NSW held that Westpac was not required to comply with the notice because it did not hold the funds in the account for any one of the holders and therefore those funds were not due to any one of the holders. Only the holders acting jointly could authorise the bank to make a payment of those funds to anyone including to any one of them.

Material Errors

Garnishee notices issued by the Commissioner are invalid if they contain material errors.

In *Goodwin and Another v Commissioner of Taxation and Another* (2002) 169 FLR 282, the garnishee notice overstated the amount of the tax debt and was issued to a non-existent party, in this case, being to the 'Senior Partner' of a law firm. The law firm in that case was not a partnership but operated through a corporate entity and therefore did not have a 'Senior Partner'.

Relevant consideration and ADJR Review

In *Denlay v Commissioner of Taxation* [2013] FCA 307, the taxpayers of which there were two (2), owed substantial income tax liabilities arising from undeclared income held in offshore bank accounts. The assessments were raised as part of investigations under Project Wickenby.

The taxpayers lodged objections and when these were rejected, appealed to the Federal Court.

The Commissioner commenced proceedings to recover the debt and enforcement of the judgement was stayed by the Supreme Court of Queensland until after the Federal Court appeal was heard and the outcome reached.

The taxpayer's evidence for the stay proceedings was that they had limited funds to live on and to continue to run the Federal Court appeals. The source of these funds was rent from a residential investment property and funds held in their self-managed superannuation funds (**SMSFs**).

In the meantime, the Commissioner became aware of funds held in the taxpayers' SMSFs and issued a 260-5 notice to the SMSFs for payment of those funds. This was in the context of the Commissioner having cause to believe that the taxpayers had access to funds in offshore bank accounts.

The issues decided by the Federal Court were:

- the effect of the 260-5 notice on the taxpayers' ability to continue the Federal Court appeal;
- the merits of the taxation appeals;
- the stay orders granted by the Supreme Court of Queensland.

The Federal Court held that the issue of the 260-5 notice was invalid and should be quashed pursuant to subsection 5(2)(b) and (g) of the ADJR Act on the grounds that the Commissioner failed to take a relevant consideration into account in the exercise of the power and that it was so unreasonable in the circumstances that no decision maker could have, acting reasonably, made that decision.

The Commissioner issued a Decision Impact Statement in respect of the decision. The Commissioner's view is that he will continue to apply his stated policy in PS LA 2011/18 at paragraph 12:

> Where a tax debtor is appealing to a tribunal or court against the assessments that raised the debt, the Commissioner will consider whether a garnishee would significantly prejudice the tax debtor's rights in pursuing those appeals.

7.2.4 What about the secured rights of others?

The Full Federal Court's decision in *FCT v Park* [2012] FCAFC (***Park***) raises a potential conflict between the powers of the Commissioner to issue a 260-5 notice, which requires third parties to pay specified amounts to the Commissioner in satisfaction, whether in whole or in part, of a tax debt and the rights of other third parties who have first-ranking securities in place over property out of the proceeds of the sale of that property.

The facts of *Park* involved a taxpayer with an outstanding tax debt owing to the Commissioner having entered into a contract of sale with a third party purchaser for the sale of real estate. There were two (2) registered mortgages on title.

In August 2009, the Commissioner commenced recovery action in respect of an outstanding tax debt.

In January 2010, the taxpayer entered into a contract of sale for the sale of real estate. Settlement was to take place on 18 February 2010.

A trustee in bankruptcy was appointed to take control of the taxpayer's property on 5 February 2010. The taxpayer was later placed into bankruptcy in April 2010.

The Commissioner became aware of the sale and issued a 260-5 notice to the buyer under the contract of sale on 9 February 2010. This was followed by a second 260-5 notice on 11 February 2010.

Settlement did not occur on 18 February 2010 as the Commissioner refused to withdraw the 260-5 notice and the first mortgagee (the National Australia Bank) and the second mortgagee also refused to release their mortgages. The problem was that the amount of the purchase price was insufficient to satisfy the debts owing to the NAB and the second mortgagee should the Commissioner have been paid the amount specified in the 260-5 notice.

Settlement of the contract later occurred on 23 February 2010 and it settled on the basis that the mortgages would be released where the entire amount of the purchase price proceeds were to be placed in a solicitor's trust account. This included the amount specified in the 260-5 notice.

The case was heard first in the Federal Magistrate Court and then taken on appeal to the Full Federal Court.

At first instance, the Federal Magistrates Court held that the Commissioner was not entitled to any of the sale proceeds. The effect of the mortgages against title was synonymous with a floating charge having been granted over the taxpayer's property. When the floating charge had crystallised, the debts would then become payable to the chargee and not the taxpayer.

Accordingly, the purchase price was owed to the first and second mortgagees rather than the taxpayer. It followed that the 260-5 notice could not require the buyer under the contract of sale to pay an amount to the Commissioner because the buyer owed the purchase price to the first and second mortgagee and not the taxpayer.

This decision was overturned on appeal to the Full Federal Court. This was because the registered mortgages gave the first and second mortgagees rights to deal with the property and not any rights whether beneficial or otherwise in proceeds of its sale.

The Commissioner issued a Decision Impact Statement in respect of the decision. He states that his policy on issuing a 260-5 notice is that set out in PS LA 2011/18 (which is examined in more detail section 7.2.5 of this Paper).

While this decision greatly advances the position of the Commissioner in respect of recovering tax debt by issuing a 260-5 notice to a buyer under a contract for the sale of the taxpayer's property, it severely disadvantages third party mortgagees and other security holders. It also has the potential to disrupt commercial transactions affecting not only the taxpayer, its mortgagees but also third party purchasers without notice.

Advisors acting for all parties should therefore proceed carefully in respect of the drafting of the relevant contract including clauses which allow the buyer to terminate if the Commissioner issues a 260-5 notice which might lead to title not being delivered to the buyer.

7.2.5 The ATO's approach to 260-5 notices – PS LA 2011/18

The Commissioner recognises that the issue of 260-5 notices to recover tax debt is:

- an effective and cost-efficient way to collect tax debt;
- a coercive power and therefore care must be taken when exercising the power.

There is no doubt that the issue of 260-5 notices to third parties can severely impact taxpayers both in terms of access to their financial resources but also the reputational damage that may be caused.

Accordingly, the Commissioner states at paragraphs 108 and 109 of PS LA 2011/18 that:

> 108. In considering whether to issue a garnishee notice, the Commissioner will have regard to:

* the financial position of the tax debtor and the steps taken to make payment in the shortest possible timeframe having regard to the particular circumstances of the tax debtor;

* the extent of any other debts owed by the tax debtor;

* whether the revenue is placed at risk because of the actions of the tax debtor, such as the tax debtor making payment to other creditors in preference to paying the Commissioner;

* the likely implications of issuing a notice on a tax debtor's ability to provide for family to maintain the viability of a business.

109. The Commissioner will consider any reasonable request from a tax debtor to either withdraw or vary the requirements of a garnishee notice, provided the tax debtor makes suitable alternative arrangements for payment.

The Commissioner has indicated his approach to the issue of garnishee notices against the following categories of entities.

Employers

The Commissioner will not seek to garnishee more than 30% of a person's salary and wages. A higher percentage may be sought if the taxpayer has other sources of income. This may also be reduced if the taxpayer is the subject of another garnishee order.

Purchaser of Mortgaged Property

In issuing a 260-5 notice to a purchaser of mortgaged property, the Commissioner will take into account all of the individual circumstances and may only require that the notice be in respect of that part of the purchase price to be paid to the vendor taxpayer after the mortgage has been discharged.

This is subject to there being no evidence that the mortgage was granted over the property for the purpose defeating the Commissioner's ability to recover the tax debt.

The Commissioner may also issue a 260-5 notice to a receiver appointed by a secured creditor in order to attach the balance of any moneys that would be otherwise payable to the vendor.

Bank accounts

The Commissioner may issue a 260-5 notice to a financial institution. It is common for the Commissioner to require the financial institution to disclose all accounts held by the tax debtor and for the 260-5 notice to attach to each account.

Superannuation funds

While a 260-5 notice may be served on a tax debtor's superannuation fund, it will not be effective until the tax debtor's entitlement to superannuation fund payments are payable under the rules of the fund.

Insurance policies

Similarly to the position with respect of superannuation funds, a 260-5 notice issued to an insurance body will not be effective until the tax debtor's entitlement to be paid insurance proceeds crystallises.

Trust funds

A 260-5 notice can be served on a solicitor or an accountant holding funds in trust for the tax debtor. The notice will not be effective where the funds are charged by a lien of the solicitor or accountant.

Shares

A 260-5 notice can be issued to a company in which the tax debtor holds shares. The effect of the notice is to have the company pay any dividends payable on the shares held by the tax debtor to the Commissioner.

7.2.6 Can non-compliance with s 260-5 notice itself give rise to a tax-related liability?

In *Fyna Projects Pty Ltd v Deputy Commissioner of Taxation* [2018] FCA 2041, the Commissioner sought to argue that the issue of a s 260-5 notice to an entity, and that entity's non-compliance with it, created a "tax-related liability" of the entity that the Commissioner could then issue a subsequent s 260-5 notice in respect of that alleged "tax-related liability". Ultimately, Thawley J found that non-compliance with a s 260-5 notice **did not** give rise to a "tax-related liability" within the meaning of s 260-5(1)(a) and s 255-1(1) of Schedule 1 to the TAA.[64] We set out a summary of this case below.

In this case, an entity named Pladmira Pty Ltd (**Pladmira**) had accrued running balance account deficit of $777,643.47. The Commissioner issued a s 260-5 notice to Fyna Projects Pty Ltd (**Fyna**) (the **Fyna Notice**). The Fyna Notice directed Fyna, in respect of amounts it owed or would owe to Pladmira, to instead pay these amounts to the Commissioner up to $777,643.47.

After the Fyna Notice was issued, Fyna made payments to Pladmira totalling $455,100, meaning that Fyna failed to comply with the Fyna Notice. The Commissioner took the view that Fyna's non-compliance with the Fyna Notice gave rise to a "tax-related liability" within the meaning of s 255-1 of Schedule 1 to the TAA on the part of Fyna to the Commissioner. The Commissioner considered Fyna's "tax-related liability" was a "debt" within the meaning of s 260-5(1) of Schedule 1 to the TAA, such that the Commissioner could issue notices under s 260-5(2) to third parties who owed or might later owe money to Fyna, as "debtor" to the Commissioner. The Commissioner subsequently issued ten (10) s 260-5 notices to third parties (the **Other Notices**).

Fyna sought review of the Commissioner's decision seeking to have the Fyna Notice and the Other Notices set aside.

One of the issues considered by the Court was whether Fyna had a "tax-related liability" within the meaning of s 255-1(1) of Schedule 1 to the TAA, which was necessary in order for the Commissioner to be able to issue the Other Notices.

"Tax-related liability" is defined at s 255-1 of Schedule 1 to the TAA as follows:

> **255-1 Meaning of tax-related liability**
>
> (1) A ***tax-related liability*** is a pecuniary liability to the Commonwealth arising directly under a taxation law (including a liability the amount of which is not yet due and payable).
>
> Note 1: See section 250-10 for an index of tax-related liabilities.
>
> Note 2: A taxation law, or a provision of it, may be excluded from being applied to this Part. See section 265-65.

[64] *Fyna Projects Pty Ltd v Deputy Commissioner of Taxation* [2018] FCA 2041 at [76].

> (2) A civil penalty under Division 290 of this Schedule or Part 5 of the Tax Agent Services Act 2009 is not a tax-related liability.

Thawley J placed emphasis on the word "directly" in s 255(1) of Schedule 1 to the TAA. His Honour noted that:[65]

> A liability to pay an amount for breach of s 260-5 does not arise *directly* by operation of the statute in the same way as liabilities for tax, interest and penalties. There can be no potential liability absent the giving of a notice and it is then default or non-compliance which triggers the Commissioner's ability to recover in an action in debt.

Thawley J considered that s 260-5 of Schedule 1 to the TAA created an obligation which has the effect of redirecting payment of Fyna's debt to the Commissioner instead of Pladmira, and that this obligation was not captured by the phrase "pecuniary liability to the Commonwealth arising *directly* under a taxation law (including a liability the amount of which is not yet due and payable)".[66]

Other factors that went towards this conclusion included:

- the language of s 260-15 of Schedule 1 to the TAA which provides that payment to the Commissioner of an amount which a third party owes the "debtor" is taken to have been authorised by the debtor and any other person entitled to the amount, and the third party is indemnified for the payment;[67]
- the absence in s 250-10(2) of a reference to s 260-5 in the "index of each tax-related liability" arising under various Acts, including the TAA;[68] and
- the legislative history of the provision.[69]

Accordingly, Thawley J found that non-compliance with a s 260-5 notice does not give rise to a "tax-related liability" within the meaning of s 260-5(1)(a) and s 255-1(1) of Schedule 1 to the TAA, and therefore that the Other Notices had no operative effect and should be set aside.[70]

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[65] Ibid at [56].
[66] Ibid at [58].
[67] Ibid at [59] – [62].
[68] Ibid at [63]
[69] Ibid at [64] – [75].
[70] Ibid at [76].

8. Some of the implications of phoenixing and insolvencies

8.1 Phoenxing

Illegal phoenix activity occurs when assets of the original company are transferred to a new company, for little or no value, or when the newly established company continues the business of an existing company that has been liquidated or otherwise abandoned to avoid paying outstanding debts, which can include taxes, creditors and employee entitlements.

This illegal practice usually happens when company directors abandon the company or transfer the business of an existing company to a new company without paying true or market value, leaving debts with the old company. Once the assets have been transferred, the old company is placed in liquidation or abandoned. If the liquidator is appointed, there are often no assets to recover, which means creditors cannot be paid. [71]

The implications of illegal phoenixing are generally as follows:

- the Commissioner may seek to wind up a company by the issue of a statutory demand in circumstances where he has formed the view the company may be engaging in phoenix activity (see section 4 of this Paper);
- ASIC may order for the company to be wound up; [72]
- the Commissioner may issue a DPN for unpaid PAYG, GST or SGC (see section 6 of this Paper); and
- a director may be disqualified from managing corporations.

The primary purpose of the either the Commissioner or ASIC seeking to wind up the company is for the appointment liquidator. Once appointed, a liquidatior will commence investigations into the company's affairs. During these investigations, they will inform creditors as to any potential claims against current or former directors of the company, including any prospects of recoveries that may be made for the ultimate distribution to creditors.

8.1.1 Director disqualification

ASIC possesses the power pursuant to section 206F of the Corporations Act to disqualify a person from managing a corporation for up five (5) years. There are several criterium for this power to be enacted, however, they include that within seven (7) years immediately prior to the disqualification the person has been a director of two (2) or more corporations that, whilst the person was director, or within twelve (12) months after they ceased to be a director, the corporations were wound up and a liquidator lodged a report under subsection 533(1) about the companies' inability to pay its debt.

It is important to recognise that a disqualification under this provision is not automatic, and there is a process provided for a director to make submissions and for there to be hearing on the notice.

Additionally, pursuant to section 206C of the Corporations Act, ASIC may make application to the Court to disqualify a director from managing corporations for a period greater than five (5) years.

[71] https://asic.gov.au/about-asic/contact-us/reporting-misconduct-to-asic/concerns-about-illegal-phoenix-activity/#what
[72] See section 489EA of the Corporations Act.

8.1.2 ATO and ASIC funding of further investigations and claims

The ATO and ASIC fund liquidators whilst they complete investigations or pursue claims both against directors and third parties for recoveries on monies (with a view to recoveries being ultimately be distributed to creditors in due course). In respect of ASIC's method of funding, it administers the Federal Australian Government's Assetless Administration Fund (**AAF**). AISC's website provides the following information in respect of the AAF:

> [The AAF] funds preliminary investigations and reports by liquidators into the failure of companies with few or no assets, where it appears to us that enforcement action may result from the investigation and report. A particular focus of the AA Fund is to curb fraudulent phoenix activity.
>
> The AA Fund enables a liquidator to carry out a proper investigation and report, which then helps us decide whether to commence enforcement action. It also funds a liquidator to take action to recover assets when fraudulent or illegal activity is suspected.

- Additionally, the AA Fund:
- funds a liquidator appointed by ASIC to an abandoned company under Pt 5.4C of the Corporations Act 2001 (Corporations Act), and
- funds a reviewing liquidator appointed by ASIC under section 90-23 of Schedule 2 to the Corporations Act to review a matter that relates to the external administration of a company.

8.1.3 ASIC Monitoring

Of particular importance to practitioners attending this summit, ASIC has confirmed it uses various internal and external data sources and intelligence to identify and monitor those who may engage in illegal phoenix activity. ASIC's surveillance work includes:

- director surveillance (Phoenix Surveillance Campaign): working with the ATO to identify high risk directors and jointly conducting meetings with directors who may be at risk of engaging in illegal phoenix activity; and
- registered liquidator surveillance: considering allegations of illegal phoenix activity in relation to registered liquidators including whether to appoint a reviewing liquidator funded from the Assetless Administration Fund.

8.2 Insolvencies

The implications of an insolvency event occurring for a corporate entity not only impact the company, but also significantly impact the body of creditors (both secured and unsecured), employees, directors, and shareholders. For the purposes of this paper, we will focus primarily on the personal liability for directors in a liquidation scenario, and implications in respect of superannuation guarantee charge and the priority the ATO enjoys for payment of these amounts.

8.2.1 Personal liability for directors in a liquidation scenario

In section 6 of this Paper, the topic of director penalty notices (**DPNs**) is examined. DPNs are an instance where the directors of a company can be made personally liable for certain tax-related and other liabilities of a company.

Under the DPN regime, and provided that the DPN itself is not a ‘lock down DPN’, the director who has been served with the notice has the option of causing a liquidator to be appointed to the company. However, this does not end the potential exposure for directors.

The Commissioner does not need to wait for a company to enter liquidation before issuing DPNs. Further, the Commissioner is also known to issue DPNs in respect of companies that have been de-registered, even those de-registered for several years.

This section examines two (2) other provisions of the Corporations Act which pose not insignificant risk for company directors as a consequence of insolvency.

The first is section 588G of the Corporations Act which deals with insolvent trading.

The second is the indemnity that directors are required to give the Commissioner in section 588FGA of the Corporations Act.

8.2.2 Section 588G

Subsection 588G(1) of the Corporations Act provides as follows:

(1) This section applies if:

(a) a person is a director of a company at the time when the company incurs a debt; and

(b) the company is insolvent at that time, or becomes insolvent by incurring that debt, or by incurring at that time debts including that debt; and

(c) at that time, there are reasonable grounds for suspecting that the company is insolvent, or would so become insolvent, as the case may be; and

(d) that time is at or after the commencement of this Act.

Subsection 588G(2) of the Corporations Act provides the circumstances in respect of certain payments as to when a debt is incurred. For example, a company paying a dividend. The debt is incurred when the dividend is paid.

Subsections 588G(3) and (4) of the Corporations Act set provide the liability provisions as follows:

(3) A person commits an offence if:

(a) a company incurs a debt at a particular time; and

(aa) at that time, a person is a director of the company; and

(b) the company is insolvent at that time, or becomes insolvent by incurring that debt, or by incurring at that time debts including that debt; and

(c) the person suspected at the time when the company incurred the debt that the company was insolvent or would become insolvent as a result of incurring that debt or other debts (as in paragraph (1)(b)); and

(d) the person's failure to prevent the company incurring the debt was dishonest.

Section 588G of the Corporations Act imposes a positive duty on a director to prevent the company trading while it is insolvent.

This duty contains five (5) elements:

- The first is that it only applies to a person who is a director at the time that the company incurred the debt.
- The second is that the company must have been insolvent at that time or become insolvent as a result of incurring the debt.
- The third is that the debt was incurred after the commencement of Part 5.7B of the Corporations Act being 23 June 1993.
- The fourth is that there needs to be reasonable grounds for suspecting that the company was insolvent or that a reasonable person in the same position in a company in the company's circumstances would be so aware.

A person contravenes the provision where each of the five (5) elements above are contravened.

While section 588G imposes a positive duty, and where breached, liability, on those who are directors of a company, subsection 592(1) of the Corporations Act imposes personal liability for insolvent trading on those persons that, while not directors on the ASIC register, are managers of the company.

The debts of a company include the company's taxation liabilities. [73] Under section 588F of the Corporations Act, a debt will include a company's liability under a remittance provision including those under Division 16-B in Schedule 1 of the TAA. It provides:

(1) For the purposes of this Part, a company's liability under a remittance provision to pay to the Commissioner of Taxation an amount equal to a deduction made by the company, after 1 July 1993, from a payment:

(a) is taken to be a debt; and

(b) is taken to have been incurred when the deduction was made.

(2) In this section:

"remittance provision" means any of the following former provisions of the Income Tax Assessment Act 1936 :

(aa) section 220AAE, 220AAM or 220AAR;

(a) section 221F (except subsection 221F(12)) or section 221G (except subsection 221G(4A));

(b) subsection 221YHDC(2);

(c) subsection 221YHZD(1) or (1A);

(d) subsection 221YN(1);

or any of the provisions of Subdivision 16-B in Schedule 1 to the TAA.

(3) This section is not intended to limit the generality of a reference in this Act to a debt or to incurring a debt.

[73] Refer to *Powell v Fryer* (2001) 159 FLR 433.

At paragraph 102 of PS LA 2011/18, the Commissioner states:

102. The Commissioner will look to support the activities of a liquidator or administrator in appropriate actions against directors where there is a view that the action of directors has adversely affected the revenue. In particular, the Commissioner will support a liquidator in their pursuit of directors in certain insolvent trading cases (see paragraph 42 of this practice statement) where there is a significant amount of tax involved, and where there is a potential for recovering that amount by initiating action against the directors (see also PS LA 2011/16).

The author is aware that the Commissioner is increasingly funding liquidators to conduct public examinations of directors and in some cases funding substantive proceedings against directors.

Where the Commissioner (and any other creditor for that matter) indemnifies a liquidator in recovering more assets of the company, the Commissioner is able to seek orders under section 564 of the Corporations Act. This provides:

Power of Court to make orders in favour of certain creditors

Where in any winding up:

(a) property has been recovered under an indemnity for costs of litigation given by certain creditors, or has been protected or preserved by the payment of money or the giving of indemnity by creditors; or

(b) expenses in relation to which a creditor has indemnified a liquidator have been recovered;

the Court may make such orders, as it deems just with respect to the distribution of that property and the amount of those expenses so recovered with a view to giving those creditors an advantage over others in consideration of the risk assumed by them.

Essentially, where the investigations of the liquidator and funded by the Commissioner results in more assets being recovered, the Commissioner is entitled to an increased distribution in respect of the company's outstanding assets.

8.2.3 Section 588FGA

There is another instance where a director can be personally liability and it arises in the following circumstances:

- a company has made a payment of a taxation liability;
- the company is placed into liquidation;
- at the time the taxation payment was made, the company was insolvent;
- the liquidator seeks to claw back the payment from the ATO.

Section 588FGA of the Corporations Act provides as follows:

Directors to indemnify Commissioner of Taxation if certain payments set aside

(1) This section applies if the court makes an order under section 588FF, or ASIC makes an order under section 588FGAA, against the Commissioner of Taxation because of the payment of an amount in respect of a liability:

(a) under any of the following provisions:

(i) former section 220AAE, 220AAM or 220AAR of the Income Tax Assessment Act 1936;

(ii) former section 221F (except subsection 221F(12)), former section 221G (except subsection 221G(4A)) or former section 221P of the Income Tax Assessment Act 1936;

(iii) former subsection 221YHDC(2) of the Income Tax Assessment Act 1936;

(iv) former subsection 221YHZD(1) or (1A) of the Income Tax Assessment Act 1936;

(v) former subsection 221YN(1) of the Income Tax Assessment Act 1936;

(vi) section 222AHA of the Income Tax Assessment Act 1936;

(vii) Subdivision 16-B in Schedule 1 to the Taxation Administration Act 1953; or

(b) to pay the amount of an estimate of unpaid superannuation guarantee charge under Division 268 in Schedule 1 to the Taxation Administration Act 1953.

(2) Each person who was a director of the company when the payment was made is liable to indemnify the Commissioner in respect of any loss or damage resulting from the order.

(3) An amount payable to the Commissioner under subsection (2):

(a) is a debt due to the Commonwealth and payable to the Commissioner; and

(b) may be recovered in a court of competent jurisdiction by the Commissioner, or a Deputy Commissioner of Taxation, suing in his or her official name.

(4) The court may, in the proceedings in which it made the order against the Commissioner, order a person to pay to the Commissioner an amount payable by the person under subsection (2).

(5) A person who pays an amount under subsection (2) has the same rights:

(a) whether by way of indemnity, subrogation, contribution or otherwise; and

(b) against the company or anyone else;

as if the payment had been made under a guarantee:

(c) of the liability referred to in subsection (1); and

(d) under which the person and every other person who was a director of the company as mentioned in subsection (2) were jointly and severally liable as guarantors.

Directors may claim any one of the defences in section 588FGB of the Corporations Act which provides:

Defences in proceedings under section 588FGA

(1) This section has effect for the purposes of:

(a) proceedings to recover from a person an amount payable under subsection 588FGA(2); and

(b) proceedings under subsection 588FGA(5) against a person of the kind referred to in paragraph 588FGA(5)(d).

(2) The time when the payment referred to in subsection 588FGA(1) was made is called the payment time .

(3) It is a defence if it is proved that, at the payment time, 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.

(4) Without limiting the generality of subsection (3), it is a defence if it is proved that, at the payment time, the person:

(a) had reasonable grounds to believe, and did believe:

(i) that a competent and reliable person (the other person) was responsible for providing to the first-mentioned person adequate information about whether the company was solvent; and

(ii) that the other person was fulfilling that responsibility; and

(b) expected, on the basis of information provided to the first-mentioned person by the other person, that the company was solvent at that time and would remain solvent even if it made the payment.

(4A) Subsections (3) and (4) of this section do not apply if the order mentioned in subsection 588FGA(1) was made wholly or partly because the condition in 588FE(6B)(b)(iii) was met.

(5) It is a defence if it is 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.

(6) It is a defence if it is proved that:

(a) the person took all reasonable steps to prevent the company from making the payment; or

(b) there were no such steps the person could have taken.

(7) In determining whether a defence under subsection (6) has been proved, the matters to which regard is to be had include, but are not limited to:

(a) any action the person took with a view to appointing an administrator of the company or a restructuring practitioner for the company; and

(b) when that action was taken; and

(c) the results of that action.

In his guidance on the compromise of undisputed tax debt in PS LA 2011/3, the Commissioner states the following in respect of section 588FGA:

64. Under section 588FGA of the Corporations Act the Commissioner is entitled to seek an indemnity against a director of a company in respect of any loss or damage resulting from an order obtained by a liquidator against the Commissioner in respect of an unfair preference or other voidable transaction relating to a pay as you go withholding payment. Where directors have a liability under section 588FGA, they may seek to compromise that debt. It should be borne in mind that the effect of section 588FGA is to return the Commissioner to a similar legal position that the Commissioner would have been in had the disgorged payments not been made and the Commissioner had invoked the director penalty recourse set out under Division 269 of Schedule 1 to the TAA (and in Division 9 of Part VI of the ITAA 1936 for penalties due prior to 1 July 2010). Although liabilities of directors arising under section 588FGA are not taxation debts as such, the Commissioner will adopt a similar approach to the compromising of such debts as he would with a director penalty liability (see paragraph 63 of this practice statement).

for Section 588FGA applies to a person if:

- there is a court or ASIC order made against the Commissioner on the basis that payments made by a company to the ATO for PAYG withholding amounts or an estimate for unpaid superannuation guarantee charge under Division 268 to Schedule 1 of the TAA were an unfair or other voidable transactions;
- the person must have been a director at the time of the payment notwithstanding that they may have resigned after the payment was made and before the company was placed into liquidation;
- the company must have been insolvent or become insolvent because of the payment.

In PS LA 2011/16, the Commissioner has stated that the relevant factors that he will have regard to in deciding whether to pursue an indemnity against a director are: [74]

- the potential defences available to the director (see below);
- the director's capacity to pay;
- the director's history with other companies and their compliance record as measured against the ATO's risk management guidelines (refer PS LA 2011/6).

The available defences considered by the Commissioner are set out in paragraph 77 of PS LA 2011/16. This paragraph reproduces the defences in section 588FGB of the Corporations Act.

The indemnity imposed on directors under Section 588FGA of the Corporations Act raises a dilemma for directors.

If they do not make the relevant payments to the ATO, company directors run the risk of the Commissioner issuing them a DPN. If they do make the payment, and it is later struck down as a voidable transaction, they run the risk of the Commissioner seeking indemnification of their loss.

It is therefore important that directors:

- keep all their PAYG withholding and other lodgements up to date for the period leading up to the company's insolvency and for the period up to when a liquidator is appointed so that the company is able to be placed in liquidation and have the DPN lifted;
- ensure that appropriate action is taken to ensure that the company is not trading while insolvent.

8.2.4 DPNs issued in respect of de-registered companies

In a case decided in the Supreme Court of Western Australia in February of 2024, [75] a director was required to make an urgent application to have a company reinstated to then cause it to be immediately placed into liquidation, in a bid to have amounts under a DPN remitted.

The Commissioner issued two DPNs to a director of a company on account of SGC and PAYG amounts. The company had been deregistered close to 3 years prior on account of having to pay ASIC fees. As the ATO issue DPNs by reference to a company's ABN rather than their ACN, de-registration of a company is no effect or concern to the ATO when pursing its debt collection strategies. As the company was de-registered, it could not be placed into liquidation until it had been re-instated. To avoid the penalty of the DPN, the director made their application to have the company re-instated to allow a liquidator to be appointed. Ultimately, the application was successful.

[74] Refer to paragraph 75 of PS LA 2011/16.
[75] *Perrin v Australian Securities and Investments Commissioner* [2024] WASC 38.

Of particular interest, and a potential concern for accounting and taxation practitioners across Australia, is that the Court noted the director had given evidence that he acted in accordance with professional accounting and taxation advice when he allowed the company to lapse on its registration requirements with ASIC, so as to allow for deregistration to occur in circumstances where he believed the company to be insolvent.

8.2.5 Liquidated companies

The Commissioner ranks as an unsecured creditor for the purposes of the priority of payments to creditors in the liquidation of a company (other than SGC for the reasons discussed below). Previously the Commissioner enjoyed priority as a secured creditor, however, this is no longer the case and in place of this the Commissioner now has the extensive powers of the DPN regime to collect unpaid amounts from directors (where applicable).

Relevant to the ATO's debt collection, in the case of a liquidation, it is the Commissioner who proves as creditor for unpaid SGC. These amounts are paid to the ATO, who then distributes those amounts to the employees' complying superannuation fund. Employees of the company, despite being unsecured creditors, have their own categorisation as 'priority unsecured creditors'. These priorities are set out in sections 556, 560 and 561 of the Corporations Act. Employees have priority for wages, superannuation contributions and SGC payable by the company before the relevant date.

8.2.6 Deeds of Company Arrangement

Should a DOCA be proposed, section 444DA of the Corporations Act requires that the DOCA include a provision that eligible employee creditors will be entitled to a priority at least equal to what they would have been entitled to if the company's assets were applied in circumstances of a liquidation (see sections 556, 560 and 561 of the Corporations Act). This provision may only be excluded in circumstances where eligible employee creditors have passed a resolution agreeing to its non-inclusion. [76]

8.3 Some other taxation implications – taxation offences

It is noteworthy to refer to the Crimes (*Taxation Offences*) Act 1980 (Cth) (the **CTOA**) and in particular to:

- section 5 of the CTOA which provides for a criminal offence where a person enters into an arrangement or transaction with the intention that a company or trustee will be unable, or will be likely to be unable, having regard to the other debts of the company or trustee, to pay income tax payable by the company or trustee; and

- section 7 of the CTOA which provides for a criminal offence for a person who enters into an arrangement or transaction or aids or abets another to do so knowing or believing that the arrangement or transaction will cause the company or trustee to be unable to, having regard to the other debts of the company or trustee, pay the income tax payable by the company or trustee.

Advisors and taxpayers alike should be well aware of the provisions in circumstances which may come close to enlivening them given the criminal penalties attaching. These being ten (10) years imprisonment or 1,000 penalty units (currently one (1) penalty unit is equal to $313).

[76] Refer to section 444DA(2) of the Corporations Act.

9. Some common options and the various tax implications

9.1 Pre-distress – some common options

In the ideal world, a client will obtain advice from their advisors as to the most appropriate structure through which the proposed business will be conducted.

In advising on the most appropriate structure, advisors will have regard to a number of factual positions which include:

- Who the owners will be?
- Who will be the controllers including the directors?
- What is the nature of the business to be conducted and how might this change in the short term, medium term and possibly long term?
- What are the exit plans for the owners?
- How will be the business be funded?
- Will third parties including capital providers and employees be given the opportunity of gaining equity ownership?

An understanding of the above factors will drive the choice of structure – that is, whether the business will be conducted in a company or a group of companies, a unit or discretionary trust or a partnership of one or more of these entity types.

There are obviously commercial, financial, legal and taxation implications arising from the choice of structure and these can arise during the course of ordinary business and while there are no signs of distress.

There can be implications from the choice of structure which may not be known or understood at the time of formation and during the so-called ‘good times’, which can come painfully home when things are start to deteriorate.

For these reasons, it is advisable that business owners obtain comprehensive structuring advice at the time of establishing a business structure which has regard to as many implications as possible. More realistically, given that business owners in start-up phase may have limited funds to spend on comprehensive advice, they should consider doing this by seeking a review of their structure at a time when there is no prospect of distress on the horizon.

While it is acknowledged that a review might result in a reorganisation or restructure of the current business structure, and this may attract not insignificant transfer tax liabilities such as capital gains tax or State duties, there are tax concessions and rollovers that might be available to defer any of these taxes or duties until ultimate third party sale.

While it is beyond the scope of this Paper to examine these in detail, these include the following.

The Small Business Restructure Relief which is contained in Subdivision 328-G of the 1997 Act (the **SBRR**) and applies for certain asset transfers on and after 1 July 2016. The SBRR is available to ‘small business entities’ and for the purposes of Subdivision 328-G of the 1997 Act, this is defined to mean a small business entity with a turnover of less than $10 million.

According to the Explanatory Memorandum to the *Tax Laws Amendment (Small Business Restructure Roll-over Bill 2016* (the **SBRR EM**), the SBRR was introduced in recognition of some of the limitations of the then available rollovers as they applied to small business entities. At paragraph 1.8 of the SBRR EM:

> Currently, roll-over relief is available in limited circumstances for business restructures. For example, roll-overs are available for restructures involving the transfer of a capital gains tax (CGT) asset, or all the assets of a business, from an individual, trustee or partner to a wholly owned company (Subdivisions 122-A and 122-B). However, no roll-over is available, for example, for a restructure that transfers business assets from a company to a sole trader, partnership, or trust.

The purpose of the SBRR is to enable small business to change to a more suitable structure[77] by removing the income tax impediments that might arise.

These tax concessions and rollovers include:

- the CGT Small Business Concessions in Division 152 of the 1997 Act, the 50% CGT discount in Division 115 of the 1997 Act;
- any available rollovers such as the replacement asset rollovers such as in Subdivision 124-M of the 1997 Act (the 'scrip for scrip' rollover') and in Subdivision 124-N of the 1997 Act (the 'unit trust to company' rollover) or the same asset rollovers in Subdivision 122-A of the 1997 Act (the 'disposal of assets by individual or discretionary trust to company' rollover);
- the use of the grouping rules such as the tax consolidation rules and the GST grouping rules,

and in each case these concessions may be used to eliminate or reduce any capital gain or revenue gains arising from the transfer of assets as part of a restructure.

While not the subject of this Paper, there is also corporate reconstruction relief available in Australian State duty jurisdictions where dutiable assets or interests in landholders also need to be transferred. It is important to examine each jurisdiction's corporate reconstruction provisions as there are differences. In some cases, particularly the differences between Victorian and New South Wales on the one hand and Queensland on the other, restructures might be delayed where a business structures has assets in all three jurisdictions.

Where advice is obtained earlier enough in the life of a business structure, it is the author's view that in any structure established:

- trading activity be the sole activity of the business structure with non-trading activity and non-trading assets taken out of the structure;
- investment assets are kept outside of the business structure and where those assets are needed in the business such as business premises, significant plant and equipment, valuable intellectual property capable of independent valuation etc, appropriate arm's length arrangements are entered into in respect of them. These might include, in relation to the business premises, a lease containing arm's length terms including lease surrender rights in the event of the company's external administration;
- related loans made to the business entity are documented and secured and registered on the PPSR even in the circumstance where such security may be subordinate to primary securities given in favour of third parties such as banks;

[77] Refer to paragraph 1.16 of the SBRR EM.

- profit accumulation is minimised and managed by way of being paid out as dividends and where working capital is needed such dividends being lent back on a secured basis to the business entity. This strategy works best where the business entities', assume in this instance the business is conducted by a company (**BusCo**), shareholder is a discretionary trust and such dividends are distributed to a corporate beneficiary. Unless BusCo is a base rate entity whose corporate tax rate is 25%, then there should be no further tax payable when the dividend is distributed to the corporate beneficiary provided that the dividend is fully franked. Where it is not, the corporate beneficiary will be subject to a 5% top up tax on the distribution. Where the dividends are paid to natural persons and even where fully franked, then top-up tax will be payable. The author's experience is that the top-up tax can dissuade trading company from paying out their profits and the result is that historical profits retained in the company are then available to more recent creditor claims;

- at risk individuals are not the ultimate owners of the trading entity or related structures holding investments. This includes ensuring that at risk individuals are not owed significant unpaid present entitlement balances from related trusts. In each of these scenarios, and where the at risk individual becomes subject to personal bankruptcy proceedings, these assets become part of his divisible assets available to satisfy creditor claims;

- care is taken as to the giving of guarantees and indemnities by related parties to the business entity noting that while separation of trading activity and investment assets might be achieved, this can come undone if entities holding investment assets give such guarantees and indemnities which are then called on.

The other way in which entities might be exposed to the liabilities of trading entities is through the various grouping regimes under the taxation law. These would include:

- the tax consolidation regime;
- GST group;
- payroll tax grouping;
- land tax grouping,

where entities might become jointly and severally liable the unpaid tax liability of the group. It is beyond the scope of this paper to examine these grouping regimes in any detail other than to raise awareness of them and factor them into any post review of the structure and implementation of any restructure proposals. In respect of tax consolidation and GST grouping, it is noted that a tax sharing agreement (in the case of tax consolidation) and an indirect tax sharing agreement (in the case of GST grouping) can be entered into to limit the operation of joint and several liability of group members.

9.2 Post distress - some common options

Where things start wrong and the business is in distress, then the common options available will each have their own taxation implications.

Those options might include:

- some form of external administration such as placing the company into liquidation or pre-external administration as referred to earlier in this Paper;

- liquidating assets to raise funds to pay creditors. This could include the sale of the business or business assets to related parties provided that the sale proceeds on an arm's length basis to ensure that any subsequent liquidation of the company does not result in the liquidator clawing back the assets as part of voidable transactions;

- the sale of entity itself to related or third party who will then assume the liabilities;
- the making of related party loans to provide urgent funding to distressed entities to starve off the threat of external administration;
- the forgiveness of related party debt (or assignment of debt) to improve the entity's balance sheet and put it in a better position to trade;
- use of tax rollovers to effect restructures.

Some of the above actions could be achieved outside of any formal process and within the control of the current board. Each of these actions could also be undertaken as part of more formal processes such as the entry into voluntary administration or the entity and its creditors entering into a DOCA.

It is beyond the scope of this Paper to explore all options and all tax issues arising from those options. Some of the tax issues arising from the options set out above are explored in this next sections below.

9.2.1 Corporate liquidation

The appointment of a liquidator to a company does not cause the company to cease to exist. The effect is that the management of the company is removed from the directors and shareholders and placed in the hands of the liquidator. The liquidator is empowered to carry on the business of the company for the sole purpose of the winding up of the company and in so doing liquidating the company's assets for the purpose of satisfying creditor claims.[78]

The main issues in a corporate liquidation include:

- the treatment of the company's losses;
- the treatment of unrelated and related party loans;
- the liquidator's tax exposure in respect of the gains made on the sale of assets to fund distributions to creditors and its overall tax obligations;
- liquidator distributions, if any;
- the tax treatment of shareholders and the timing of any capital losses that might be made in respect of their shares.

9.2.2 Corporate losses

When the company is placed into liquidation, and provided the carry forward loss rules in Division 165 of the 1997 Act are satisfied, it can continue to apply such losses to any assessable income (including capital gains) that the company (in liquidation) may derive. The issue is that any excess carry forward losses not used by the time the liquidation is complete and the company is deregistered will be lost.

[78] Refer to Parts 5.4B, 5.5 and 5.6 of the Corporations Act.

9.2.3 Related party loans

The company will have both credit and debit loans and these may be with shareholders who are natural persons or discretionary trusts. There may also be loans entered into with companies. Each will have their own tax treatment should they be forgiven whether whole or in part.

9.2.4 Credit loans

As part of the liquidation process, some or all of the credit loans of the company might need to be forgiven. This will have consequences under the commercial debt forgiveness rules in Division 245 of the 1997 Act. Suffice to say, it would be expected that:

- each loan would be a ‘commercial debt’ for the purposes of section 245-10 of the 1997 Act;
- the forgiveness by the lenders would constitute a forgiveness for the purposes of section 245-35 of the 1997 Act;
- a ‘net forgiven amount’ under Subdivision 245-D of the 1997 Act would arise;
- the net forgiven amount would then be applied to reduce the various tax attributes of the company including the reduction of revenue losses, net capital losses, reduction of certain expenditure, reduction of cost bases of CGT assets etc.

Accordingly, as a result of the forgiveness of such loans, carry forward losses may be reduced or eliminated or the cost bases of CGT asset reduced or eliminated potentially resulting in more income tax payable as a result of any capital gains made on the sale of the company’s assets as part of the liquidation.

A forgiveness of a loan can also occur where:

- the loan is assigned where the ‘new creditor’ is the debtor’s associate or occurred under an arrangement where the new creditor and debtor were parties;[79] and
- the creditor subscribes for shares in the debtor company and the debt is forgiven to the extent that the debtor company applies the subscription monies in or towards payment of the debt – otherwise known as a debt for equity swap.[80]

In respect of the position of the lender, and more specifically a related party lender who is not in the business of providing finance, they will be interested in at least obtaining a capital loss in respect of the forgiveness of their loan.

Two (2) issues arise here:

- the first is that the recovery of the loan is legally barred as a result of the forgiveness and not simply treated in the books of the lender as a bad debt.[81] This is required if the capital loss in respect of the balance of the loan forgiven will arise and this will be the case only if CGT event C2 in section 104-25(1) of the 1997 Act happens. A deed of forgiveness to this effect should be entered into between the parties with the appropriate drafting to achieve this outcome;
- the loan is not a personal use asset.

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[79] Refer to section 245-36(a) of the 1997 Act.
[80] Refer to section 245-37 of the 1997 Act.
[81] Refer to ATO Interpretative Decision **ID** 2003/215.

A ‘personal use asset’ is defined in subsection 108-20(2)(d) of the 1997 Act to include:

> (d) a debt arising other than:
>
> (i) in the course of gaining or producing your assessable income; or
>
> (ii) from your carrying on a business.

It is therefore important that where the related party lender is not in the business of providing finance, then the loan that is made is one in which interest had been charged. If it was an interest-free loan throughout its term, then it is likely to be a personal use asset. The consequence is that any capital loss made would be disregarded by operation of subsection 108-20(1) of the 1997 Act.

The other issue in respect of ensuring that the lender obtains a capital loss is that the lender had a cost base in the loan at the time the loan was made. In the case of a loan which involved multiple draw downs, then the question is whether the lender is able to increase its cost base at the time of each drawdown.

The lender should obtain a cost base in the loan equal to the amount advance if at the time of the making the advance the borrower had the financial capacity to repay the loan. If this is not the case, then the lender’s cost base will be dependent on the extent to which the borrower has financial capacity to repay the loan.

This is an operation of the market value substitution rules in Division 112 of the 1997 Act and they should apply where the lender and borrower may not be dealing with each other on an arm’s length basis.

Evidence of the borrower’s financial capacity to pay at the time a loan is made is therefore critical should the lender want to obtain a cost base in the loan made equal to the amount lent.

9.2.5 Debit loans

The other aspect of this section is the existence of debit loans to shareholders or their associates for which Division 7A of Part III of the 1936 Act applies.

Where minimum yearly repayments are not met, there may be deemed dividend treatment arising. The problem here is that the liquidator may nonetheless seek recovery of the loan resulting in the borrower having to repay the loan including that part which might be taxed to it as a deemed dividend.

The borrower’s loan obligations continue to apply until they are statute barred.

9.2.6 Further credit loans

Just prior to a company being placed into liquidation, shareholders and their associates might make loans to the company to fend off its pending insolvency.

If at the time of making such loans, the company did not have the financial capacity to repay, then it might be the case that the lender will not obtain a cost base – that is, its cost base will not equal the amount lent and is highly likely to be nil or a much smaller amount than the amount lent.

Where the loans are later forgiven whether in part or in whole, the company will suffer the consequences of reduction of its tax attributes pursuant to the commercial debt forgiveness rules in Division 245 of the 1997 Act and the lender may not obtain a capital loss from CGT event C2 occurring because of its lack of a cost base.

The take home message here is that the tax system frowns upon good money being thrown after bad – that is, lending to a company in distress – or subscribing for shares in such a company and contributing equity – will not always be tax effective because of the lack of cost base, whether in the loan or in the shares subscribed for.

9.2.7 Liquidating assets

As part of the winding up of the company, the liquidator will no doubt dispose of the company's assets.

However, before it can do this, it must first give written notice to the Commissioner within fourteen (14) days of becoming a liquidator.[82]

On receipt of the notice, the Commissioner must as soon as practicable notify the liquidator of the amount that is needed to discharge the company's outstanding tax-related liabilities.[83] These notices are referred to as the 'clearance notice'. Any outstanding superannuation guarantee charge amounts is excluded from tax-related liabilities by operation of section 260-40 of Schedule 1 of the TAA because these amounts are subject to priority under subsection 556(1)(e) of the Corporations Act and to this extent treated in the same way as salary and wages of employees.

The liquidator must not, without the Commissioner's permission, dispose of any assets of the company until it receives the clearance notice.[84] This is subject to subsection 260-45(5) of Schedule 1 of the TAA. This provides:

> **260-45(5)** However, subsection (4) does not prevent the liquidator from parting with the company's assets to pay debts of the company not covered by either of the following paragraphs:
>
> (a) the outstanding tax-related liabilities;
>
> (b) any debts of the company which:
>
> (i) are unsecured; and
>
> (ii) are not required, by an Australia law, to be paid in priority to some or all of the other debts of the company.

The liquidator is obliged to pay the following amount to the Commissioner which is calculated in accordance with subsection 260-45(6) of Schedule 1 of the TAA. This provides:

> **260-45(6)** After receiving the Commissioner's notice, the liquidator must set aside, out of the assets available for paying amounts covered by paragraph 5(a) or (b) (the ***ordinary debts***), assets with a value calculated using the following formula:

$$\text{Total value of assets available to pay ordinary debts} \times \left(\frac{\text{Notified amount}}{\text{Notified amount} + \text{Amount of remaining ordinary debts}} \right)$$

After the above procedural steps are taken, the liquidator may commence the process of liquidating the company's assets.

Legal title to the company's assets remains in the company notwithstanding the appointment of the liquidator[85] and the taxation status and taxation treatment of the company assets remains the same despite the liquidation.

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[82] Refer to subsection 260-45(2) of Schedule 1 of the TAA.
[83] Refer to subsection 260-45(3) of Schedule 1 of the TAA.
[84] Refer to subsection 260-45(4) of Schedule 1 of the TAA.
[85] Refer to *FCT v Linter Textiles Australia Ltd (in liq)* (2005) 220 CLR 592

To the extent that that the sale of assets generates taxable gains, the liquidator must disclose such gains in the company's tax return for the relevant year. To the extent that corporate tax is payable by the company, it must be paid by the liquidator.

This is by operation of section 254 of the 1936 Act. This provides:

(1) With respect to every agent and with respect also to every trustee, the following provisions shall apply:

(a) He or she shall be answerable as taxpayer for the doing of all such things as are required to be done by virtue of this Act in respect of the income, or any profits or gains of a capital nature, derived by him or her in his or her representative capacity, or derived by the principal by virtue of his or her agency, and for the payment of tax thereon.

(b) He or she shall in respect of that income, or those profits or gains, make the returns and be assessed thereon, but in his or her representative capacity only, and each return and assessment shall, except as otherwise provided by this Act, be separate and distinct from any other.

(c) If he or she is a trustee of the estate of a deceased person, the returns shall be the same as far as practicable as the deceased person, if living, would have been liable to make.

(d) He or she is hereby authorized and required to retain from time to time out of any money which comes to him or her in his or her representative capacity so much as is sufficient to pay tax which is or will become due in respect of the income, profits or gains.

(e) He or she is hereby made personally liable for the tax payable in respect of the income, profits or gains to the extent of any amount that he or she has retained, or should have retained, under paragraph (d); but he or she shall not be otherwise personally liable for the tax.

(f) He or she is hereby indemnified for all payments which he or she makes in pursuance of this Act or of any requirement of the Commissioner.

(g) Where as one of 2 or more joint agents or trustees he or she pays any amount for which they are jointly liable, each other one is liable to pay him or her an equal share of the amount so paid.

(h) For the purpose of insuring the payment of tax the Commissioner shall have the same remedies against attachable property of any kind vested in or under the control or management or in the possession of any agent or trustee, as the Commissioner would have against the property of any other taxpayer in respect of tax.

Accordingly, the liquidator has the responsibility of the tax affairs of the company from the time of his appointment. The liquidator is responsible for the income tax payable on the profits and gains coming into his hands from the transactions that he/she will enter into and shall be personally liable for that tax if not paid to the Commissioner.

Accordingly, and among other things, in entering into contracts for the sale of the company's assets, and to the extent that the sale of any assets are to non-arm's length parties, the liquidator must ensure that:

- the sale proceeds reflect their market value. This is to ensure that the market value substitution rules in Division 116 of the 1936 Act do not apply to deem market value sale proceeds to have been received;
- he retains from such proceeds the relevant tax payable.

In all other respects, the Tax Act applies to the assessment of gains made by a liquidator in the same way as it would apply to other taxpayers. That is, to extent that CGT concessions are available, they should be available to the liquidator subject to any specific carveouts.

9.2.8 Liquidator's distributions

To the extent that there by any surplus assets in the company after the payment of all creditor claims and the liquidator's costs, then those assets could be distributed to shareholders by way of a liquidator's distribution.

The accessibility of distributions by a liquidator and received by a company's shareholders is given in section 47 of the 1936 Act.

For all intents and purposes, the franking of such distributions and their inclusion the assessable income of shareholders reflects the position outside of liquidation with one exception.

The common law position is that a liquidator's distribution on the winding up of a company is a distribution of capital. The effect of section 47 of the 1936 Act is to reverse this characterisation[86] except that any profits to a pre-CGT profits reserve or any exempt CGT amounts retain their characterisation as capital distributions.

This is provided by subsection 47(1A) of the 1936 Act where it only requires that income derived by a company includes *a net capital gain that would be included in the company's assessable income for a year of income*. Accordingly, this would exclude pre-CGT gains and exempt CGT gains such as the active asset exemption in Subdivision 152-C of the 1997 Act.

The Commissioner requires that these amounts be separately accounted for and that evidence be retained as to their pre-CGT exempt nature as the case may be.[87]

To the extent that a capital distribution is received by a shareholder and is not included in their assessable income as ordinary income as is the case under section 47 of the 1936 Act, the following taxation treatment should apply:

- if the shareholder's shares are pre-CGT, the capital distributions will be tax-free;
- if the shareholder's shares are post-CGT, the receipt of capital distributions will either cause:
    - CGT event C2 occurring where they are received within eighteen (18) months of the final winding up of the company **and** the cancellation of the shares; or
    - CGT event G1 occurring where they are not received within eighteen (18) of the final winding up of the company.[88]

9.2.9 Position of shareholders

It is not ordinarily expected that shareholders will be in receipt of a liquidator's distribution of surplus assets in the case of a distressed winding up. If they are, they will include the income components of these distributions in their assessable income, and franked to whatever extent, or treat the capital components as capital amounts (either or not subject to tax as set out in section 9.2.8 of the Paper.

It is ordinarily to be expected that on the winding up of the company, shareholders will make a capital loss on their shares equal to their cost base.

This capital loss will arise on the happening of either:

[86] Refer to subsection 47(2) of the 1936 Act.
[87] Refer to Taxation Determination **TD 95/10** which references the so-called *Archer Brother* principle.
[88] Refer to subsection 104-135(6) of the 1997 Act and the note immediately under this provision.

- CGT event C2, which occurs on the deregistration of the company which results in the cancellation of the shares[89]; or
- CGT event G3, see immediately below.

CGT event G3 is contained in subsection 104-145(1) of the 1997 Act which provides:

> **104-145(1)** ***CGT event G3*** happens if you own shares in a company, or financial instruments issued or created by or in relation to a company, and a liquidator or administrator of the company declares in writing that the liquidator or administrator has reasonable grounds to believe (as at the time of the declaration) that:
>
> (a) for shares – there is no likelihood that shareholders in the company, or shareholders of the relevant class of shares, will receive any further distribution for their shares; or
>
> (b) for financial instruments – the instruments, or a class of instruments that includes instruments of a kind., have no value or have only negligible value.

Subsection 104-145(2) of the 1997 Act provides that the time of the event is when the declaration is made.

Subsection 104-145(4) of the 1997 Act provides that the shareholder can choose to make a capital loss in respect of its shares or financial instruments as at the time of the declaration. That choice is ordinarily made by the way the shareholder completes its tax return.[90]

Shareholders might be interested in CGT event G3 happening instead of CGT event C2 where it might wish for the loss to made in a particular income year and that the deregistration of the company might not occur within that income year. It is noted that ASIC might take up to two (2) months after the relevant application is made to deregister a company.

9.3 Sale of the company or company's business

The following options might be instigated whether or not the company is in external administration and they include:

- the sale of the company to a related party or third party or both;
- the sale of the business of the company to a related party or third party or both.

A further option might be the introduction of a new investor in the existing company.

It might be the case that the company can avoid insolvency through one of the above options.

The broad tax and legal issues regarding the sale of the business as opposed to the sale of a company apply whether the company is or is not distressed.

A purchaser might be more inclined to purchase the business because of the higher risks of purchasing the shares in a company on the brink of insolvency.

This might be the safer course of action.

[89] Refer to Taxation Determination **TD 2000/7** and noting in particular paragraph 2 which sets out the various legislative provisions of the Corporations Act which give effect to the deregistration of a company.
[90] Refer to subsection 103-25(2) of the 1997 Act.

This is because there is one scenario the writer has come across in practice where a sale of the business probably should have occurred rather than the acquisition of shares in the company that actually did occur. This was where the target company was a subsidiary company of a corporate group.

While the target company was not itself insolvent or distressed, members of the corporate group were and were placed into liquidation as part of a group restructure. The sale of the target company for market value consideration was also part of the restructure.

The problem was that the companies in liquidation had failed to properly disclose taxable wages for NSW payroll tax purposes in more than one (1) year prior to its liquidation. Following an audit, payroll tax assessments were raised. The companies were members of a payroll tax group by operation of section 70 of the *Payroll Tax Act 2007* (NSW) (the **Payroll Tax Act**). Each were jointly and severally liable for the unpaid payroll tax by operation of section 81 of the Payroll Tax Act.

Given the low prospects of recovering the outstanding payroll tax amount together with interest and penalties from the companies in liquidation, the Commissioner sought to recover these from the total outstanding amount from the target company notwithstanding that it had exited the group some years earlier but after the audited years in question.

Similar facts were litigated in *Integrated Construction Equipment Pty Ltd v Chief Commissioner of State Revenue (NSW)* 2019 NSWCATAD 131. It was held that the liquidation of an employer after the time it became liable to payroll tax, but before the issue of assessments to that employer and to other group members, has also been found to have no effect on the operation of the joint and several liability of the other group members.[91]

Accordingly, even where an entity leaves a payroll tax group subsequent to becoming jointly and severally liable to a liability for payroll tax, that leaving entity continues to be jointly and severally liable for a historical unpaid liability.

Care must therefore be taken when a third party or even a related party purchases the shares in a company of a corporate group with members that are in distress to be aware of the effect of applicable grouping and the ambit of any joint and several liability.[92]

The safer course of action might be to purchase the business of the company notwithstanding the additional time this might take and the greater disruption that it may cause.

Where the risks are identified and accepted, purchasers may wish to purchase the shares in the target company for the following reasons:

- the business of the company can continue without any significant interruption. This is as opposed to a business sale where third party consents are required and a new entity is introduced as the counterpart to various business contracts including supplier and customer contracts;
- retention of franking credits and where applicable carry forward losses. On the issue of carry forward losses, the continuity of ownership test is likely to be failed and therefore the new owners will need to rely on the similar business test. This is often a challenge particularly where substantial changes to the business might need to made in light of distressed circumstances. It is for this reason that little value be given to the losses given the little prospects of their availability. Further, if the target company will join a tax consolidated group, the application of the available fraction might result in the loss utilisation

[91] Refer to paragraph [34] of *Integrated Construction Equipment Pty Ltd v Chief Commissioner of State Revenue (NSW)* 2019 NSWCATAD 131.

[92] On 4 September 2023, section 74A of the Payroll Tax Act was enacted. This provision might be enlivened where a business from a liquidated entity is transferred to a new entity with the effect that the new entity is grouped with the former entity provided that certain requirements are met.

being at a very slow rate particularly where the market value of the joining entity is low in comparison to the remainder of the tax consolidate group.

10.Conclusion

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