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COMMENTARY

Australian High Court Finds Liquidators Are Not Required to Set Aside Money for Pre-Assessed Tax Liabilities

Key Points

- Under the *Income Tax Assessment Act 1936* (the "Act"), Australian liquidators are authorized and required to retain money which comes to them in their representative capacity that is sufficient to pay tax which is or will become due in respect of the income, profits or gains of the company.
- In *Commissioner of Taxation v Australian Building Systems Pty Ltd (In Liquidation)*; Commissioner of Taxation v Muller and Dunn as Liquidators of Australian Building Systems Pty Ltd (In Liquidation) [2015] HCA 48, the High Court of Australia determined that the retention authorization and obligation does not arise upon the crystallization of a tax event but only upon the making of an assessment or deemed assessment in respect of the income, profits or gains.
- The High Court of Australia did not address the question of whether liquidators and other insolvency practitioners are otherwise authorized to retain money for the purposes of satisfying potential tax liabilities prior to the issuance of an assessment. The High Court's decision also leaves open the question of what consequences may flow to insolvency practitioners who have retained money for pre-assessed potential tax liabilities in the absence of authority.

Background

The liquidators of Australian Building Systems Pty Ltd ("ABS") caused ABS to enter into a contract for the sale of real property, which gave rise to a capital gain tax event. The liquidators sought a private ruling from the Commissioner of Tax on the question of whether they had an obligation under the Act to retain, out of the proceeds of sale, money sufficient to cover any capital gains tax liability from the time that the capital gain crystallized or only when a tax assessment had issued.

Section 254 of the Act provides "with respect to every agent and with respect … to every trustee" that he or she is:

- answerable, as tax payer, for the payment of tax on any income, profits or gains of a capital nature derived in his or her representative capacity;
- 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

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become due in respect of the income, profits or gains"; and
- personally liable for the tax payable in respect of the income, profits or gains to the extent of any amount he or she has retained or should have retained.

The term "trustee" is defined under the Act to include administrators, receivers and liquidators.

The Commissioner ruled that section 254 of the Act required the liquidators to retain money for tax purposes from the time of the crystallization of the capital gain and that the liquidators were required to account to the Commissioner for that liability out of the proceeds of sale.

The liquidators objected to the ruling and pursued the matter through the Federal Courts of Australia. Both the trial judge at first instance and the Full Court on appeal determined that section 254 did not impose any obligation on liquidators to retain money from the proceeds of sale of ABS's land unless and until a tax assessment had issued. However, the trial judge noted that a prudent liquidator would be entitled to retain the income, profit or gain until the tax position in respect of the relevant tax year becomes certain. No authority was cited for this proposition, and the Full Court did not comment or express any position on it.

The Competing Arguments

The Commissioner argued that the language "tax which is or will become due" in section 254 is broad enough to include a tax which will be assessed in the future. For the Commissioner, construing the retention authorization and obligation as arising only upon assessment would leave trust or agency receipts liable to being depleted prior to assessment and diminish the extent of the potential personal liability of the agent or trustee to satisfy the tax.

In response, ABS argued that a tax which "will become due" is one that has been assessed and which is not yet due for payment. In support of this, ABS asserted that section 254 of the Act imposes a personal liability on the agent or trustee which is limited by the clause "to pay tax which is or will become due", and that this imposition is conditioned upon certainty as to the amount of tax due. Such certainty, ABS argued, could arise only upon assessment.

The Decision

Three members of the High Court bench (French CJ, Kiefel J and Gageler J) determined that section 254 does not authorize or require a liquidator to retain any money for tax purposes unless an assessment has issued. Justice Gageler noted that this interpretation minimizes the potential for disharmony between the obligations and liabilities of liquidators under section 254 of the Act and the obligations of liquidators and rights of creditors under Ch 5 of the *Corporations Act* 2001 (Cth).

In dissent, Gordon and Keane JJ disagreed and determined that a tax which will become due includes a tax which has not yet been, but will be, assessed.

Ramifications

A possible consequence of the High Court's decision is that liquidators who retain money for the purpose of satisfying a potential tax liability prior to the issuance of an assessment have exceeded the authority provided under section 254. A question arises: Are liquidators otherwise authorized to retain money from income, profits or gains for the purposes of satisfying a potential tax liability prior to the issuance of an assessment and, if not, what are the consequences of liquidators doing so?

Under general law, a trustee is entitled to retain trust property against a beneficiary pending determination of contingent liabilities of the trust for which the trustee is liable.[1] However, a liquidator cannot be described as a "trustee" under general law.

In her dissenting judgment, Gordon J reasoned that a tax expense incurred by a liquidator may fall within section 556(1)(a) of the *Corporations Act 2001* (Cth), being a winding-up

1 *Vacuum Oil Co Pty Ltd v Wiltshire* (1945) 72 CLR 319 at 335-336; [1945] HCA 37; *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360 at 367; [1979] HCA 61; *Chief Commissioner of Stamp Duties (NSW) v Buckle* (1998) 192 CLR 226 at 245-247 [47]-[51]; [1998] HCA.

expense incurred in preserving, realizing or marshalling property of the company, or in carrying on the company's business. Such an expense must be paid in priority to all other unsecured debts and claims. However, this does not address whether a pre-assessed tax is a tax expense "incurred" and does not provide an answer for situations where secured property is sold by a liquidator.

In the face of uncertainty, liquidators and other insolvency practitioners may need to seek the direction of the Court on these questions in appropriate cases.

Lawyer Contacts

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com/contactus/.

Tim L'Estrange
Sydney
+61.2.8272.0561
tlestrange@jonesday.com

Philip J. Hoser
Sydney
+61.2.8272.0537
phoser@jonesday.com

Maria Yiasemides
Sydney
+61.2.8272.0770
myiasemides@jonesday.com

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