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Insolvency Alert
Liquidators Liability for CGT

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In *Australian Building Systems Pty Ltd (in liquidation) v Commissioner of Taxation* [2014] FCA 116, Justice Logan was asked to clarify the circumstances where a capital gains tax liability will be imposed on liquidators by section 254 of the *Income Tax Assessment Act* 1936. Thomsons Lawyers acted for the company and its liquidators in seeking to resolve this topical question. The decision answered a critical point around when the obligation will be imposed on liquidators, but left to another day the question as to how the tax liability, once imposed, is to be treated by liquidators as part of a liquidation, despite this question being extensively argued by the parties.

Introduction

The Applicants, a Company in liquidation and its liquidators, commenced proceedings seeking to clarify the law around certain obligations imposed on a liquidator when a capital gain is made consequent on a sale of property by an insolvent estate.

The company appointed voluntary administrators. At the second meeting, creditors resolved to place the Company into liquidation. Subsequently, the liquidators sold a commercial property. It was common ground that there would be a substantial capital gain which would give rise to a tax liability. The liquidators caused the Company to obtain a private ruling from the Commissioner of Taxation ("Commissioner") as to the obligations imposed on the liquidators by virtue of section 254 of the Income Tax Assessment Act 1936 ("ITAA36").

Legislative Framework and the Private Ruling Process

Relevantly, Section 254(1)(a) of the ITAA36 makes a 'trustee' (which is defined to include a liquidator and a receiver) 'answerable as taxpayer' for all income, profits or capital gains derived by him or her in his or her representative capacity. Section 254(1)(d) of the ITAA36 requires a liquidator to retain from money coming to him or her an amount sufficient to pay the income tax which is or will become due in respect of any income, profits or gains. Section 254(1)(e) of the ITAA36 makes the liquidator personally liable to pay any tax to the extent of the money he or she retained, or should have retained.

The questions posed by the private ruling, and answers given, were as follows:

Question 1

Is the liquidator required under s254 of the ITAA36 to account to the Commissioner out of the proceeds of sale, any capital gains tax liability that crystallises on the sale of an asset that belonged to the company before liquidation?

Commissioner's Answer: Yes.

Question 2

If the answer to question 1 is yes, are the monies to be retained once an assessment issues?

Commissioner's Answer: No.

Question 3

If the answer to question 2 is no, are the monies to be retained at crystallisation of any capital gain?

Commissioner's Answer: Yes.

The liquidators and the company objected to the private ruling. They argued that an assessment had to issue before the liquidators were required under section 254(1)(d) to retain from the sale proceeds sufficient money to pay the tax that would then be due. They also argued, in respect of that tax, that sections 254(1)(d)and (e) provided the Commissioner with a statutory priority that is inconsistent with section 555 of the Corporations Act 2001 (Cth) ("Corporations Act"), a provision which requires debts and claims provable in a winding up to rank equally, and be paid proportionately where property of the company is insufficient to meet all of those debts and claims in full.

The Commissioner disallowed the objection. In consequence, the company appealed the objection decision and the liquidators sought declaratory relief, essentially in the same terms as the company's appeal. The two matters were heard together.

The Decision

In relation to the first question posed by the private ruling, Justice Logan found in favour of the liquidators. His Honour applied by analogy a decision of the High Court in *Bluebottle UK Ltd v Deputy Commissioner of Taxation* (2007) 232 CLR 598. That decision construed section 255 of the ITAA36, a provision which seeks to impose obligations on a person in receipt or control of money belonging to a non-resident. Sections 254 and 255 of the ITAA36 use similar language. In particular, they both require the relevant person to retain from money coming into their hands an amount of money which is sufficient to pay the *'tax which is or will become due'*. The High Court held that phrase '*must be read as referring to an ascertained sum. If the paragraph is not read in that way, the obligation to retain money which is imposed on the controller is an obligation of undefined content.*'

Justice Logan agreed. He said that whilst the net capital gain might be *assessable income*, the taxpayer's *taxable income* will only be known at the conclusion of any given tax year and this amount may be far from certain when the CGT event occurs. Accordingly, '*content can be given to the obligation imposed by s254(1)(d) only if an assessment has issued.*' In consequence, Honour held that section 254 of the ITAA36 '*had no application to the liquidators*'.

Discussion

Having got that far, His Honour considered it unnecessary, absent an assessment, to answer any other questions posed by the private ruling or the declarations sought by the liquidators. In particular, he said the controversy between the liquidators and the Commissioner as to the reconciliation of section 254 of the ITAA to certain provisions of the Corporations Act '*can and should await the issuing of an assessment*'.

The question His Honour found unnecessary to answer is this: once an assessment is issued, how is the tax to be treated by the liquidators under the provisions of the Corporations Act, given the obligations imposed on the liquidators section 254 of the ITAA36? The parties addressed His Honour and made lengthy submissions on the point.

Whilst it does not bear from the judgment itself, the liquidators argued that the tax payable by reason of a gain was a debt admissible to proof along with other unsecured creditors under section 553 of the Corporations Act. They said that the liability was latent, depending only on the contingent event of a sale at a gain. The Commissioner argued that the liability was an expense that enjoyed the first priority under section 556 of the Corporations Act. He said the liability crystallised after the commencement of the winding up and that it should be considered an expense properly incurred by the liquidator in the preserving, realising or getting in the property of the company, or in carrying on the company's business. The liquidators said that if the tax is to be considered an expense of the liquidation, it fits much lower in the list under the catch-all in sub-paragraph 556(1)(dd): '*any other expenses properly incurred by the liquidator*'.

His Honour's Warning

Despite considering it unnecessary to answer that controversial point, His Honour warned in obiter comments against a liquidator (or for that matter a receiver) making a distribution from any realisation whilst an assessment is pending: '*a prudent liquidator, like a prudent trustee of a trust estate or executor of a will, would be entitled to retain the gain for a time against other expenses which might arise in the course of the administration*.' He said that a liquidator (and receiver) would be entitled to retain the gain until the income tax position in respect of the tax year in which the gain was made had become certain.

Practical Implications of His Honour's Warning

His Honour's comments against making a distribution whilst an assessment is pending is likely to cause some practical issues for future liquidations and receiverships.

For instance, if the liability is a first priority expense in a winding up, the comments presumably mean that liquidators must be careful when incurring – and paying – any other first priority expenses over the course of the tax year whilst an assessment is pending (given debts of the same priority are to rank equally).

Those comments pose yet greater difficulties for receivers. In the very least, they might see receiverships becoming more protracted as receivers are seemingly justified when confronted with a gain and personal liability under section 254 of the ITAA36 to wait until the end of the tax year before dealing with the funds that they have realised.

Ultimately, liquidators and receivers should ensure that they factor in CGT issues prior to their appointment and at every stage during their appointment to ensure that any capital gains tax liability is adequately addressed and they do not put themselves at risk of personal exposure.

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