

We welcome you to the autumn edition of our newsletter, which will focus on the collection of taxation liabilities from third parties.

We hope you find the following of interest. If you have any questions regarding the article then please contact us for clarification.

Should there be other insolvency related issues that you wish to see covered in future editions, then please let us know by return email, as this will assist in keeping our topics relevant to readers.

SECTION 260-5 NOTICES COLLECTING TAXATION DEBTS FROM THIRD PARTIES

You may have read in the press that the Deputy Commissioner of Taxation is considering the appointment of mercantile agents to collect monies from recalcitrant taxpayers. This is yet a further indication of the increasingly aggressive and belligerent attitude being adopted by the Commissioner in regard to those taxpayers who do not pay their purported tax debts. Mind you, those taxpayers who pay their fair share would in all probability support this approach. One of the weapons available to the Commissioner is the issuance of notices pursuant to Section 260-5 of Schedule 1 of the Taxation Administration Act 1953 (as amended) which allows the Commissioner to collect monies from third parties in satisfaction of taxation liabilities of other entities. We suspect that the issuance of such notices will become more frequent in the future.

Pursuant to Section 260-5 of Schedule 1 of the Taxation Administration Act 1953 ("the TAA"), the Commissioner is empowered to issue a notice to a third party who owes monies or who later may owe monies to an entity with tax related liabilities, requiring the third party to pay the monies directly to the Commissioner rather than to the entity. This power enables the Commissioner to collect monies towards the satisfaction of debts without having to incur the costs of initiating legal proceedings for the recovery of those debts.

Subdivision 260-A of the TAA applies in relation to any debt payable before, on or after 1 July 2000 and effectively replaces Section 218 of the Income Tax Assessment Act. Although Subdivision 260-A is drafted in

terms that are different from Section 218, the underlying policy has not changed. Therefore much of the case law developed under Section 218 remains relevant to the interpretation of Subdivision 260-A of the TAA.

Although not so described, the notices are often referred to in practice as "garnishee notices". This is no doubt based upon the decisions in a number of older cases where a Section 218 notice was held to be akin to a garnishee order. However that interpretation was far from settled for the effect of a Section 218 notice had also been held to be an assignment of the debt which is the subject of the notice. More recently, the balance of authority now favours the view that a notice under Section 218 and therefore Subdivision 260-A, creates a

statutory charge in favour of the Commissioner making the Commissioner a secured creditor for bankruptcy and winding up purposes (*Macquarie Health Corporation Ltd v FC of T* 2000 ATC 4015; 96 FCR 238).

It is useful to summarise the principles surrounding the issuance of a Section 260-5 notice.

- 1) The interaction of Sections 260-5(2) and (3) make it clear that the notice relates to monies presently due, accruing or held by the third party and monies that may become due or held at any time in the future.
- 2) The term "money" denotes more than cash or notes which are legal tender and

<p>will include obligations to pay money such as cash at bank & on deposit and debtors. Conversely, non money assets such as choses in action, real property and chattels are not included until such time as they are converted into money (Conley & Anor v DFC of T & Anor 98 ATC 4161).</p> <p>3) An entity (with tax related liabilities) has the same meaning as in the Income Tax Assessment Act where it is defined to include, inter alia, an individual, a body corporate, a partnership and a trust.</p> <p>4) Tax related liabilities are all encompassing as set out in</p>	<p>Section 250-10 of the TAA. The liability must be payable but not necessarily due (Section 260-5(1)) and be an amount that is ascertained or ascertainable as at the date of the notice.</p> <p>5) The third party is not entitled to advance notice and is legally required to comply with the notice. Failure to do so could result in severe penalties being imposed.</p> <p>6) In complying with the notice, the third party is protected by Section 260-15 of the TAA which provides that any payment made under the Subdivision is taken to have been authorised by the entity.</p>	<p>The practical effect of such a notice is that the cash flow of the taxpayer debtor could be irretrievably impaired to the extent that it is forced into an insolvency administration.</p> <p>The Commissioner's power to issue a notice under Section 260-5 is an administrative discretion. For further information, you are referred to a policy document entitled ATO Receivables Policy (http://law.ato.gov.au/atolaw/print.htm?DocID=RMP%2FRP0012), in which the Commissioner sets out, inter alia, examples of circumstances where a notice may be issued and the limitations on the power to issue such notices.</p>
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EFFECT OF A SECTION 260-5 NOTICE ON INSOLVENCY

A. LIQUIDATION

As noted above, a Section 260-5 notice has the effect of making the Commissioner a secured creditor over the debts due to the tax debtor. The notice operates as an "attachment" of debt and because of the operation of Section 468 of the Corporations Act 2001 ("the Act"), must be served before the commencement of the winding up. If it is served after the winding up commences, then Section 468 will render the notice invalid.

The charge will rank as a fixed charge and in priority to a floating charge which normally does not become fixed until crystallisation. This means that the

Commissioner has the right to realise or enforce the charge notwithstanding the winding up of the tax debtor.

Any payment made by a third party pursuant to a Section 260-5 notice is not a voidable transaction within the meaning of Section 588FE of the Act as the payment is directed to the holder of a fixed charge, viz the Deputy Commissioner of Taxation.

B. BANKRUPTCY

The position in relation to a bankrupt estate is more complicated. If a Section 260-5 notice is served more than six months before the date of presentation of the bankruptcy

petition and the relevant debt arises before the making of the sequestration order, the Commissioner has priority over the trustee in bankruptcy in respect of the debt. If the notice is served during the relation back period, (ie the date of the earliest act of bankruptcy committed during the six months immediately preceding the date of presentation of the creditor's petition or application for the sequestration order), or after the date of the sequestration order, then the notice will be ineffective against the Trustee.

Sub-division 260-A of the TAA and its interaction with insolvency law is complex. Kindly contact us for specific advice on individual circumstances.

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