

We welcome you to the summer edition of our newsletter, which will focus on payment arrangements with the Australian Taxation Office.

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

PAYMENT ARRANGEMENTS WITH THE ATO

"BE WARNED"

It is common practice for delinquent debtor companies to enter into arrangements with the Australian Taxation Office ("ATO") for payment of outstanding taxation liabilities by way of instalments. In some cases, these payment arrangements will enable a company to successfully navigate its way through troubled waters into safe harbour. However, there are risks attached and if the company sinks into an abyss, either during the period of the arrangement or shortly thereafter, then the consequences for the directors can be dire.

PAYMENT ARRANGEMENTS

In order to put an arrangement in place, the debtor company firstly calculates the debt due to the ATO inclusive of the general interest charge, which continues to accrue during the period of the arrangement. A payment programme, based upon the company's specific circumstances, is then formulated and submitted to the ATO. If acceptable, the ATO will impose a number of, conditions, namely;

- a) Payments must be made as agreed;
- b) All future lodgement obligations must be met by the due dates;

- c) All future payment obligations must be made by the due dates;
- d) Failure to comply may result in the variation or termination of the arrangement and/or the commencement of legal action without further notice.

The assumptions underlying a payment arrangement are that the reasons causing the temporary liquidity crisis have been addressed and that if given the opportunity over time, the debtor company will be able to discharge not only its existing debt but also its on-going obligations.

In many cases, these assumptions prove to be flawed. Directors are often reluctant or unable to confront, in an objective manner, the problems facing the business and are prone, not surprisingly, to adopt unrealistic cash flow and profit projections in the hope that onerous future commitments can be maintained.

CONSEQUENCES OF LIQUIDATION

What happens if the debtor company succumbs and is wound up either during the period of the arrangement or shortly thereafter?

The trouble begins when the Liquidator commences his investigation into the affairs of the company. Inevitably, this investigation will centre upon the question of insolvency and whether or not there are transactions that may be voidable pursuant to Section 588FE of the Corporations Act 2001 ("the Act"); the most common being preference payments made during the six months ending on the "relation back day", as defined in the Act.

The mere fact that payment arrangements were in place provides crucial evidence that the company may have been trading whilst insolvent and that the recipient of such monies, may have been paid in preference to others. Prima facie, and leaving personal guarantees to one side, this appears not to present a problem for the directors of the company as the creditor has received the benefit of the payments and will therefore be the entity that will be the subject of any recovery proceedings that may be initiated by the Liquidator.

However, if proceedings are commenced under Section 588FE of the Act and the

Court makes an order in favour of the Applicant Liquidator and that order is made against the Deputy Commissioner of Taxation ("DCT"), then importantly, Section 588FGA(2) of the Act states that;

"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."

The effect of this Section is that the DCT is able to join directors of an insolvent debtor company to proceedings commenced by a Liquidator with the aim of recovering from them, monies to meet part or all of any losses or damages that are sustained.

The taxation liabilities in respect of which the DCT is indemnified under Section 588FGA of the Act include, inter alia, the liabilities under subdivision 16-B in Schedule 1 of the Taxation Administration Act 1953, namely: group tax liabilities; PAYG withholding and instalment amounts and ITW liabilities.

PRACTICAL EXAMPLE

The foregoing is best illustrated by reference to a recent case; the one chosen being *Palmer (as Liquidator of Domest Building & Design Pty Limited (In Liquidation)) v Deputy Commissioner of Taxation [2006] NSWSC 656*. What transpired is briefly summarised hereunder;

- 1) In September 2002, Domest entered into a monthly payment arrangement

with the ATO to pay outstanding monies. Domest failed to fully comply with the terms of the arrangement;

- 2) In mid 2003, the ATO issued various further demands for payment and on 6 November 2003, Domest entered into another payment arrangement with the ATO;
- 3) On 13 November 2003, an Application to Wind Up Domest was filed in the Supreme Court of New South Wales by another creditor and on 12 December 2003, Mr Palmer was appointed Official Liquidator;
- 4) After conducting an investigation into the affairs of Domest, Mr Palmer commenced proceedings against the DCT for the recovery of monies totalling \$35,146 alleged to be voidable, such monies comprising instalment payments and additional payments made by Domest in respect to on-going taxation obligations;
- 5) Subsequently, the DCT filed and served upon the sole director of Domest, an Interlocutory Process for orders that the director be required to pay the amount of \$19,818 in respect to Group Tax and ITW liabilities;
- 6) On 30 June 2006, the Court found against the DCT and ordered that it pay to Mr Palmer the amount of \$35,146 plus interest and costs. The decision was not appealed.
- 7) The Court made further consent orders that the sole director of Domest be required to pay to the DCT the amount of \$19,818 plus interest and 60% of the costs.

This is an example of one of the many claims brought or pending by OBP against the DCT. The amounts involved range from \$25,000 to \$200,000 plus.

CONCLUSION

Directors of insolvent companies will be tempted to enter into payment arrangements with the ATO as they will see it as a means by which the company may be able to trade out of its difficulties. In doing so, directors should be conscious of the risk of personal exposure should the plan fail and the company be wound up.

Therefore, directors should proceed cautiously, obtain appropriate expert advice and only enter into an arrangement, if confident that the problems causing insolvency have been addressed and that future projections of cash flow and profit are achievable. If there is any doubt, then it would be prudent to consider other options available, one of which might be the appointment of a Voluntary Administrator with the aim of continuing business operations through a Deed of Company Arrangement ("DOCA").

As a footnote, it is interesting to consider the tax deductibility of insolvency related payments, such as contributions made under a DOCA and indemnity payments under Section 588FGA of the Act including interest and costs. It would appear that such payments would be business related and subject to the nature of the payments, deductible in the year they were incurred or over a 5 year period. Directors who make such payments should seek specialist tax advice.

A Time for Action

Early intervention is the key to avoiding financial disaster. Our experience over many years has proved that survival prospects are increased and losses minimised when the right advice is obtained immediately upon the identification of a problem. Swift, decisive action by our experienced and trusted team of professionals is crucial to a successful outcome.

The Firm

OBP is a specialist practice with national affiliations, focusing on corporate and personal insolvency, turnaround management and litigation support. We adopt an innovative and commercial approach to each matter and offer a dedicated point of contact with a senior team member to ensure that every assignment is given the attention it deserves.

Our Services

- * Corporate Insolvency
 - Voluntary Administration
 - Deeds of Company Arrangement
 - Receiverships
 - Court Liquidations
 - Members and Creditors Voluntary Liquidations

- * Personal Insolvency
 - Bankruptcy
 - Part X / Personal Insolvency Agreements
 - Trustee appointments pursuant to Section 66G of the Conveyancing Act

- * Turnaround Management
 - Investigation of business viability
 - Cash flow management and refinancing
 - Creation of an agreed turnaround and growth strategy
 - Negotiation with all stakeholders, creditors etc to reschedule debt

- * Litigation Support
 - Financial investigations
 - Economic loss quantification
 - Alternative dispute resolution, including mediation and arbitration

Without obligation or cost, we are available for an initial consultation.

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