

Insolvency & Tax Alert

ATO Tightens Enforcement Options - Statutory Garnishees

October 2011

On 14 June 2011, it was reported in the Australian Financial Review (AFR) that money owed to the ATO by bankrupted individuals and insolvent companies had soared by 20% to nearly \$5 billion in the past year, as accountants warned that the potent mix of an uncertain economy and strict debt recovery may push more to the brink.

The same article also noted that recent insolvency figures recorded that nearly 800 companies per month had collapsed for the tax year to date – higher than the monthly average in each of the previous two tax years.

A professional quoted in the AFR article has noted that the ATO only really started “going down that path in the last 6 months”.

An even gloomier picture was painted in an AFR article on 8 September 2011 where it was noted that the latest insolvency figures showed 921 businesses called in administrators in July, the fifth highest number on record and the third month this year to hit ‘top five’ status.

According to Taylor Woodings’ Managing Partner, Michael Ryan, “2011 is shaping up as the year where insolvency appointments look like they are going to be the highest on record”.

Accountants nominate the activities of the ATO, in part, for the rise.

Andrew O’Bryan, Partner of Hall & Wilcox, observed that, “The most alarming development is the Tax Office issuing garnishee orders to recover outstanding tax – there’s been a noticeable spike in the last couple of months”.

The ATO has recently noted its policy of actively chasing debts after a lenient approach being adopted during the economic downturn.

Hayes Knight Director, Greg Hayes, predicted a lot more companies would fail in the next few months partly due to the ATO being more inclined to issue garnishee orders and director penalty notices and being less inclined to extend debt payment terms.

On 16 September 2011 the AFR outlined the ATO position as follows:-

“The ATO does not hide the fact that it has got tougher on Businesses with overdue tax bills, but it has hit back at accusations that it should bear much of the blame for the number of companies going under – accusations levelled by tax and insolvency practitioners”.

The AFR spoke to ATO Chief Operating Officer Paul Duffus and recorded his observations that the ATO had more than 375,000 payment arrangements in place but that it initiated nearly 11%, or 1066, of the total number of wind-ups for the 2011 fiscal year – double the figure for 2010 and the highest number in five years.

This journey started with the publication by the ATO in December 2010 of a ‘Fact sheet for taxpayers with debt’ which noted that there would be a firmer action approach to debt collection.

Taxpayers and their advisors should have been left in no doubt of the nature of that approach having regard to the initial paragraph of the fact sheet which is in these terms:

“OUR FIRMER ACTION APPROACH

To ensure we maintain a level playing field for taxpayers, there are situations where we need to take firmer action to recover outstanding debts. Our approach takes into account individual circumstances to determine the best way to clear your debt. For businesses, we may also review viability to determine the appropriate firmer action to take.”

The ATO helpfully sets out a number of circumstances where firmer action will be taken including:

- The taxpayer choosing not to work with the ATO despite multiple attempts by the ATO to contact the taxpayer.
- The taxpayer defaulting on payment arrangements.
- The taxpayer's debt escalating where the ATO believes that there is no evidence that the taxpayer will be able to meet the tax obligations.
- The taxpayer has been subject to an audit where a deliberate avoidance was detected and payment avoidance is continuing.
- In relation to business operators where there is evidence that liquidation is being used to avoid financial obligations without risking assets and with the full intention of resuming business operations through a new entity (known as 'phoenix' activity).

What options are available to the ATO?

The ATO sets out a number of enforcement and recovery options available to it.

Directors' penalty notices will be the subject of a forthcoming Alert by Thomsons Lawyers which will focus on change in that area.

The issuing of Creditors Statutory Demands to companies by the ATO underwent a significant change as a result of the decision slightly over two years ago in the High Court of Australia in the matter of *DCT v Broadbeach Properties Pty Ltd, Neutral Bay Pty Ltd and M A Howard Racing Pty Ltd*.

Prior to that case, taxpayers in Queensland (particularly in the KW & KM McQuinn Investments Pty Ltd litigation) had been successful in applying to the Court and setting aside Creditors Statutory Demands issued by the ATO, specifically where taxpayers had tax appeals on foot and where they were able to demonstrate that they were legitimately challenging their tax liabilities as assessed by the ATO.

The author of this Alert acted for the successful taxpayer in the KW & KM McQuinn Investments Pty Ltd litigation which was conducted in the Supreme Court of Queensland and on appeal in the Queensland Court of Appeal.

Although the landscape in relation to Creditors Statutory Demands may have changed, taxpayers may not be

totally bereft of cogent arguments in seeking to challenge Creditors Statutory Demands and the possibility of insolvency proceedings being issued by the ATO. However, that topic is one to be explored on another occasion.

What is a Statutory Garnishee?

The focus of this Alert is the statutory garnishee option which is available to the ATO for debt enforcement and recovery. A Statutory Garnishee which is often colloquially called a '260 Notice' is a term used to describe the power of the Commissioner for Taxation under *Section 260.5 of Schedule 1 to the Taxation Administration Act 1953* to issue a notice requiring a third party to pay money to the Commissioner to meet the tax debt of a taxpayer.

A third party receiving the notice (such as a bank) is required to pay to the Commissioner any monies which may be held for, owed to, or accruing to, the taxpayer. The Third Party is indemnified in respect of any money paid to the Commissioner. Notices of this kind, as issued by the Commissioner, are similar to, but legally distinct from, a Garnishee Order which might be issued by the Courts after a Plaintiff in Court proceedings were to obtain a Judgment.

Practical observations in relation to Statutory Garnishee Notices

The ATO maintains that the decision to issue a Garnishee Notice is subject to a range of considerations which include:

- The financial position of the taxpayer and the steps taken to make payment in the shortest possible timeframe, having regard to the particular circumstances of the taxpayer.
- The extent of any other debts owed by the taxpayer.
- Whether the revenue is placed at risk because of the actions of the taxpayer, such as the taxpayer making payments to other creditors in preference to the Commissioner of Taxation.
- The likely implications of issuing a Garnishee Notice on a taxpayers' ability to provide for a family or to maintain the viability of a business.
- If the taxpayer is appealing a decision by the Commissioner to a Court or Tribunal in relation to tax assessments the issuing of the Garnishee Notice would significantly prejudice the taxpayers' rights in pursuing those appeals.

Unfortunately, in the same way that beauty is in the eye of the beholder, a consideration of how a taxpayer might be affected by a Garnishee Notice being issued may be viewed very differently by a taxpayer than the view taken by representatives of the ATO.

Credit card merchant facilities

In the age of e-commerce and the increasing usage of e-commerce for transacting business, the ATO has recognised that financial institutions may hold money on behalf of taxpayers on account of business transacted through their merchant card facility. This includes business that may be transacted electronically with clients whether those transactions originated by a cheque, savings or credit card account. The ATO has the garnishee power to require a financial institution, such as a bank, to pay the ATO amounts transacted through a business' merchant card facility before the amounts are deposited into the business' account. They do use that power.

Financial institution accounts

The ATO will serve Garnishee Notices in accordance with arrangements made for service of those notices with specific banks and other financial institutions. The ATO will expect the financial institution to undertake searching procedures to locate all of the accounts of the taxpayer held at all branches. To assist in that process, the ATO will list any known account numbers of the taxpayer in the notice.

The ATO contends that it is unquestioned that Garnishee Notices continue to apply on an ongoing basis, but would generally not expect the financial institution to carry out continuing searches where all of the money in a particular account has been paid to the ATO as required by the notice. However, be warned that if the balance of an identified account is \$100 or less, the Garnishee Notice is taken to remain in force for a period of three months.

Where an investment account has not yet matured but is identified, the Garnishee Notice will remain in force until the account matures or becomes payable because of closure of the account or other circumstances. In particular circumstances, the Commissioner may request the financial institution to engage in ongoing monitoring of particular accounts.

Salary and wages

Where the Garnishee is in respect of salary or wages, the ATO 'usually' will not seek to garnishee more than 30 cents in the dollar of the amount of salary and wages

payable. However, the ATO may elect to seek a higher percentage where it believes the debtor has another source of income or where the debtor's financial position indicates that, in the ATO's opinion, it would be fair and equitable to do so.

Superannuation fund

A Garnishee Notice in respect of any tax related liabilities may be served on a superannuation fund, but it will not be effective until the taxpayer's benefits as a member are payable under the rules of the fund, for example until the taxpayer retires. Generally, a notice that is served on a fund will request payment as a lump sum unless the anticipated retirement income stream can guarantee payment within a satisfactory period of time.

Shares

A Garnishee Notice may be served on a company in which a taxpayer holds shares. The ATO would contend that this would entitle the Commissioner to receive any dividend payable to the taxpayer in respect of those shares.

Trust funds

A Garnishee Notice may be served on trust funds held by a solicitor on behalf of a taxpayer. In those circumstances, care should be taken to analyse the basis upon which the funds are held and the possible entitlement by the solicitor or any other party in respect of the lien or some equitable or other claim to the funds.

The author of this Alert has had dealings with the ATO and the legal representatives of the ATO in relation to claims made on funds present in the trust account maintained by a firm of solicitors. There may be many subtle nuances which apply in particular circumstances and accordingly, it may be possible to oppose the claims made by the ATO under the Garnishee Notice, especially where the funds in question arise from litigation and the 'fruits of the labour' of the solicitors or the involvement of third parties.

External control or insolvency administrations

The ATO has particular policies in place in relation to how Garnishee Notices will be used where a taxpayer, whether a company or an individual, is the subject of external control or some form of insolvency administration.

In accordance with the High Court decision of *Bruton Holdings Pty Ltd (in liquidation) v The Federal Commissioner of Taxation* from 2009, the ATO will not issue a Garnishee Notice in respect of tax debt owed to a company after an Order has been made or a resolution has been passed for the winding up of the company.

What can a taxpayer do?

It will be noted that the powers of the Commissioner in respect of Statutory Garnishees are extensive.

The real message is that any individual or company, particularly if they are involved in the business and commercial world and have fiscal and taxation responsibilities, should take every step available to them to conduct their affairs in an ordered manner, making the necessary arrangements best suited to them.

In other words, if there is a genuine dispute about a tax debt or liability which the ATO might seek to enforce,

those issues should be confronted and dealt with and appropriate arrangements made from the beginning, rather than allowing a situation to develop where the Commissioner uses available power to issue a Statutory Garnishee and to unexpectedly deprive the taxpayer of receiving funds from a third party or having access to funds which the taxpayer believed were available, such as from bank accounts or other deposits.

It may be possible to challenge or vary action that has been taken by ATO representatives or steps that have been put in place, but, as with most things in life, it is generally more difficult to deal with matters on a reactive, rather than on a proactive basis.

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