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**POSSIBLE EXPOSURE FOR REPRESENTATIVES ON GST – PROPOSED
RETROSPECTIVE PERSONAL LIABILITY OF REPRESENTATIVES OF INCAPACITATED
ENTITIES FOLLOWING PM DEVELOPMENTS [2008] FCA 1886**

We have provided the within written submission.

We are very concerned at the nature and extent of the proposed retrospective GST amendments.

Section A - Summary

1. Our Peter Mills (a co-writer of this submission) was the partner who personally had the carriage of the matter of the PM Developments Case, and so respectfully has a closer view than some of the ramifications of the proposed legislation.
2. Given the limited time given for the making of submissions, we have concentrated on only several areas. This is not an acceptance of the remaining amendment provisions.
3. In summary, our respectful submission is that:
 - 3.1 The likely effect of the amendments will be to significantly reduce the number of suitably qualified appointees prepared to accept appointments and/ or appointers prepared to provide suitable indemnities, which will be a major impediment to the administration of insolvent entities in Australia and business generally.
 - 3.2 The provisions which seek to make the representatives personally liable for GST should be re - drafted to reflect that such liability:
 - (a) Is not a joint liability of all representatives of the incapacitated entity (“IE”).

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- (b) Does not impose on the representative any greater liability than that amount which is currently available if such GST were treated under section 556(1)(a) *Corporations Act (2001)*.
 - (c) Is not retrospective.
- 3.3 The provisions which seek to impose a duty upon representatives for the lodging of Business Activity Statements (“BAS”) for both pre and post appointment periods should be re - drafted to reflect that such obligation is limited to only those circumstances where the IE has not been deregistered.

Section B - Background

1. The ATO had in the past alleged that liquidators and other “representatives” of IE (eg receivers, managers and voluntary administrators) were personally liable for GST on post appointment transactions by which assets of the entity were sold.
2. This was based on the ATO’s interpretation of Division 147 of *A New Tax System (Goods and Services Tax) Act 1999 (Cth) (the GST Act)*.
3. However, in the recent landmark decision in the *PM Developments Case*, the Federal Court ruled that the liquidator was not personally liable for GST.
4. In response, the Federal Government has now published draft legislation which it intends to introduce in August 2009 to retrospectively overcome the *PM Developments Case*.

Section C- Some specific areas of concern

Due to the limited period available for making submissions, it is not currently possible to give a complete view as to all of the amending legislation. Some more specific areas of concern (due to their affect upon rights of representatives and other creditors) are:

1. *The provisions which seek to make the representatives personally liable for GST*
- 1.1 Secured creditors/ petitioning creditors
- (a) In taking control of assets and managing the affairs of a defaulting debtor/ customer (eg by appointing a receiver), a secured creditor or a person appointed by them will become a “representative” for the purposes of the GST Act.
 - (b) It is common under deeds of appointment for a secured creditor (“**appointer**”) to agree to indemnify the representative for any liabilities properly incurred by him or her in such role.
 - (c) The changes will mean that the representative may be lumped with additional GST liabilities, which will need to be passed on to the appointer.
 - (d) We can foreshadow whereby unsecured creditors will be asked to provide deeds of indemnity (not currently commonly sought) before a representative will take on an appointment.
 - (e) It is perhaps somewhat presumptuous, however it is foreseeable that:
 - (i) Secured creditors and petitioning creditors will refuse to provide deeds of indemnity because of the increased exposure if such indemnities are called upon. This is separate to the retrospective effect of the amendments, which will unfairly capture those who have already granted such indemnities.
 - (ii) The number of representatives prepared to undertake appointments will substantially reduce due to the limited number of appointers willing to or capable of providing deeds of indemnity.

- (iii) This will lead to a concentration of appointments to occur only on behalf of substantial secured creditors, who are the common providers of deeds of indemnity.
- (iv) It will lead to fewer appointments, or persons prepared to be appointed, as Voluntary Administrators or liquidators, and therefore result in a lack of experience and choice in Australia for these very important roles.

1.2 Joint and several liability

- (a) Under the exposure draft, where there are several representatives appointed to an incapacitated entity, such as a voluntary administrator and/or a receiver, or receiver and manager, and/or a mortgagee in possession, there could be joint liability had by all of them. In that regard, I note:
 - (b) Under section 58-10(1)(a) of the intended amending legislation, a representative will be liable for GST payable by an incapacitated entity in respect of a taxable supply if:
 - (i) The making of supply...to which GST "relates",
 - (ii) "is within the scope" of the representative's "responsibility or authority" for "managing" the incapacitated entity's affairs.
 - (c) The explanatory memorandum provided with the proposed legislation denoted that liability was intended to be imposed due to the positive acts of the representative.
 - (d) It is not uncommon for several appointed representatives to have competing rights over the same property of the company, and it is simply a matter of which of them either has priority or chooses to not exercise such priority, however the running of the business may be within both their scopes of "responsibility or authority" eg.
 - (i) Under section 420C *Corporations Act 2001* a receiver may carry on the business of the company in liquidation if the liquidator consents or the Court approves.
 - (ii) Under section 477 (1)(a) and (2)(m) *Corporations Act 2001* a liquidator may:
 - (A) carry on the business of the company insofar as necessary for the orderly winding up of the company, and
 - (B) do all such other things as are necessary for winding up the affairs of the company and distributing its property
 - (e) If there are multiple representatives appointed however (eg a Voluntary Administrator as well as a receiver and manager), it would appear that they may have joint liability for any GST incurred by one of them.
 - (f) Having considered the common indemnities which appointer's might provide to receivers and managers, in effect it would appear that appointers may ultimately become jointly liable for an unpaid GST liability of its appointee for a GST supply made by another appointee. We expect this would cause concern to appointers.
 - (g) That this liability is also intended to be retrospective should cause additional concern to appointers.

- (h) Even the 'carve out' under proposed section 58-10(2)(a) & (b) (which deals with pre and post appointment GST liability; credits and adjustments) is problematic. It provides that a representative is not personally liable and section 58-10(1) not applicable (see grouping provisions at section 58.10(5)) if the incapacitated entity "... received the consideration for the supply before the representative became a representative".
- (i) However, it is not always clear whether consideration might be received before and/or after the date of appointment (such as, for example, where leases are concerned).
- (j) It is sufficiently clear, however, that a post-appointment GST supply (eg sale of property by a personal representative) will fall under this provision. It is common in such cases for the appointer/ mortgagee/ chargee to take the whole of the proceeds, with the result that any GST liability had by the incapacitated entity is not remitted. In such case the representative will stand exposed with no assets available to cover such liability.

1.3 Priority of payments – breach of Section 556 (1)(a) *Corporations Act 2001*

- (a) Section 556 (1)(a) sets out the order in which liabilities in the liquidation must be paid out (subject to secured creditors).
- (b) The order of priorities is, inter alia, that costs and expenses of the realisation and preservation of the property of the company are paid out first, provided that if there are not sufficient funds then such expenses are paid pro rata under the *pari passu* rule (see section 559).
- (c) GST on post appointment sales of company property fall within section 556(1)(a) (see orders made in *PM Developments Case*).
- (d) The Court has limited scope to vary the order in section 556(1)(a), namely only where there is an funding/ indemnity arrangement in place with creditors (see section 564). The liquidator's proposed personal liability for GST does not fall within this scope it would appear, and so the Court could not alter the *pari passu* rule. It would therefore appear that if a liquidator paid out GST in breach of the *pari passu* rule, he would be in breach of the *Corporations Act*.
- (e) The court does have power to excuse a company officer (including liquidators) for breach of the *Corporations Act* (section 1318 *Corporations Act*). It is considered however that the current limited scope of such power would not be used where the representative is knowingly in breach of same, because he wishes to discharge his personal liability for GST.
- (f) The intended amendments:
 - (i) therefore should not be made retrospective due to this inconsistency with section 556(1)(a) *Corporations Act*.
 - (ii) such personal liability should be limited to that amount which the representative has available to and is properly able to apply to meet the GST liability according to law.
 - (iii) should set out how past and future contravention of section 556(1)(a) *Corporations Act 2001* and breaches of the duties owed by liquidators (which will have occurred in the past as to any representatives who followed the DCT's Receivables Policy as to the effect of Div 147 GST Act) will be resolved by perhaps a statutory excuse/ defence being granted retrospectively also.

2. *BAS statements*

- 2.1 Under section 58-55 (which deals with pre-appointment Business Activity Statements (“BAS”) obligations):
- (a) The obligation to lodge BAS’ is intended to be retrospective.
 - (b) ATO can require representatives to give pre-appointment BASs if the incapacitated entity has failed to do so. [Given the likely deregistration of many incapacitated entities and destruction of their documents since 2000, we query how this will work and are concerned with the consequential financial burden that will be had by the representatives to recreate such records. That will undoubtedly generate significant practical problems.].
 - (c) Personal representatives should therefore be excused at least where the IE has been deregistered.
- 2.2 Under s58-60 (dealing with prevention of representative from declaring a dividend):
- (a) Representatives can be stopped from declaring a dividend to unsecured creditors if the representative becomes aware of certain matters.
 - (b) The effect of this and the above amendments may be that the ATO becomes a priority creditor for pre and post appointment GST, which is a substantial change in the current law.
 - (c) This amendment is unfair and will cause loss of confidence in the rule of law in Australia, respectfully by way of sovereign risk for business.
3. *Retrospective effect of legislation*
- 3.1 A fundamental concern is the constitutional validity of the proposed legislation in circumstances where it is intended to be retrospective.
- 3.2 In doing so, it seeks to hold representatives [and in effect their appointers where an indemnity has been provided] liable for GST in respect of supplies occurring in the past, when at the time those supplies occurred there was no such GST payable by them under the then prevailing law.
- 3.3 The unfairness is accentuated when one also considers the practical difficulties that representatives will have trying to deal with these matters when the incapacitated entities to which they were appointed have long been de-registered, and their records destroyed.
- 3.4 The general impropriety of enacting retrospective legislation is dealt with in articles texts and cases in a far better manner than that which this submission can by itself¹. The effect however of insolvency law being made retrospective, especially in the context that international obligations will be affected (eg by the UNCITRAL obligations under cross border insolvency matters being thrown into retrospective uncertainty) mean that this legislation should not be made retrospective at all.

We trust that the submissions are constructive and would enjoy the opportunity to submit or respond further if possible to any queries you may have to the above.

Yours faithfully



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PARTNER**



**STEPHEN DICKENS
PARTNER**

¹ Eg Corkery, J and Gerard, A, “Retrospectivity”, Revenue Law Journal, Volume 17, Issue 1, (2007) Article 12.