Legal Review

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Tricks of the Trade – ATO Preference Claims

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Tricks of the Trade – ATO Preference Claims.

At CCSG Legal, we pride ourselves on our ability to reach commercial outcomes in all our disputed matters, particularly, preference claims against the Commissioner of Taxation (the ATO). Commercial liquidators know, upon appointment (as Official Liquidator or otherwise) the first port of call for funding of the liquidator's various duties (after the realisation of assets) is to explore the possibility of a preference claim against the ATO seeking disgorgement of taxes (including SGC, GIC, PAYG and GST) paid during the relation back period, being generally, the 6 months prior to the filing of the wind up application.
There are a number of reasons for this, such as:

- The ATO is not a 'commercial' entity in the usual sense – the ATO has a statutory duty to wind up companies which are insolvent, usually without considering the impact of potential preference claims from broken payment arrangements;

- As an Australian Government entity, the ATO is required to divulge its internal records and case notes upon a successful FOI application – which is more cost effective and timely than preliminary discovery applications;

- The ATO is often in a unique position as regards its intimate knowledge of the Company's insolvency – and therefore it can prove difficult for the ATO to rely on the 'good faith' defence provided in section 588FG of the *Corporations Act 2001 (Cth)* (the Act);

- As an Australian Government entity, the ATO should always be solvent – therefore prospects of recovery for the Company and the liquidator are stronger; and

- The ATO is to act as a "model litigant".

It is this last point which is the subject and focus of this article.

The Model Litigant Policy

The ATO (including most Commonwealth Government Agencies) is required to adhere to the Commonwealth's obligation to act as a model litigant, the nature of which is found in Appendix B to the *Legal Services Directions 2005* (the Legal Services Directions https://www.legislation.gov.au/Details/F2006L00320), which is itself, delegated legislation under the *Judiciary Act 1903 (Cth)*.
Clause 2 of Appendix B of the Legal Services Directions states:

> "The obligation to act as a model litigant requires that the Commonwealth and Commonwealth agencies act honestly and fairly in handling claims and litigation brought by or against the Commonwealth or a Commonwealth agency by:
>
> (a) *dealing with claims promptly and not causing unnecessary delay in the handling of claims and litigation"*

It is the obligation on the ATO to not cause unnecessary delay which is of particular importance when dealing with the ATO, both prior to the commencement of proceedings for preference claims and also once proceedings are on foot.

From our experience, in practise, there is often a significant lacuna between the actions taken by the ATO's preference team and the intention of the Legal Services Directions. This Lacuna, if not managed properly, can lead to unnecessary legal costs for the Company in liquidation (and indeed the Liquidator's internal costs) in bringing the preference claim to completion, being an eventual payment by the ATO. The consequence of these unnecessary costs is ultimately, a reduction in the pool of money available to creditors of the Company in liquidation.

Example

From our extensive experience with ATO preference claims, we have noticed a pattern in the initial objections raised by the ATO. The first step, from our experience, is the transmission of a letter of demand to the ATO. That initial letter is often ignored and not responded to within the demanded timeframe. The second step is a telephone attempt or further letter.

Eventually the ATO is likely to respond with, in most instances, a part admission as to a portion of the monies claimed as the impugned payments (without an offer as to part payment), but will then seek to "put the liquidator to proof" that the monies paid (and recorded as credits on the ATO's running balance account, which is usually provided under the FOI application) were actually paid by the Company.

As the ATO could not possibly depart from the Legal Services Directions, we presume the ATO takes this step as it is of the belief that there is a money fairy, which simply travels around making payments on behalf of distressed companies (not an overly outrageous notion given the current Federal Budget).

In our view, this is merely a delay tactic, and, is arguably, in breach of the Legal Services Directions. Our reasons for this are founded in the decision of the full Court of the Federal Court of Australia in the matter of *Commissioner of Taxation v Kassem and Secatore*[1] (Kassem).

Relevantly, the matter of Kassem is an appeal from a decision unfavourable to the ATO at first instance; which involved a preference claim brought by the liquidators of a company in liquidation (Mortlake Hire Pty Limited) against the ATO seeking the ATO to disgorge an impugned payment of $70,000.00. In finding for the Company (the liquidators), His Honour Nicholas J required the ATO to pay the $70,000.00 plus interest to the Company.

On appeal, the ATO agitated a number of grounds, all but one of which are irrelevant for present purposes. In substance, the ATO submitted that payment by Mortlake's related entity (Antquip) to the ATO on behalf of Mortlake, and at Mortlake's request, failed to satisfy the first limb of a preference payment; i.e. that Mortlake was not a party to the impugned transaction pursuant to section 588FA(1)(a) of the Act.

In finding against the ATO, their Honours Jacobson, Siopson and Murphy JJ, in joint reasons for Judgment, held:

> "*It is clear, as the primary judge found, that the originating source of the payments to the Commissioner was, on each occasion, the bank account of Mortlake's related entity, Antqip. But, as the primary judge found, this was a clear example of a lender paying moneys advanced to a creditor of the borrower in accordance with the borrower's directions.*
>
> *The position as between Mortlake and Antquip was no different from a drawing by Mortlake on an overdraft from its bank with a direction to the bank to pay the creditor directly. Such a payment constitutes a loan by the bank to its customer: see eg Andrews v ANZ Banking Group Ltd[2011] FCA 1376; (2011) 86 ACSR 292 at [82] per Gordon J.*
>
> *Moreover, even if it is not correct to describe the transaction between Mortlake and Antqip as a loan,* ***what is important is the finding that the payment by Antqip to the Commissioner was a payment that was made by or on behalf of Mortlake***"[2] (our emphasis).

Conclusion

From our experience in many ATO preference claims, upon the raising of the aforementioned "objections" to a preference claim by the ATO, a delicate mention of *Mortlake* into verbal negotiations with the ATO's internal solicitors, tends to overcome the

[1] [2012] FCAFC 124
[2] *Mortlake* at [40] – [42]

obstacle of putting the liquidator to proof that the impugned payment was paid *on or behalf of the Company*.

It does not hurt to mention, either, that the ATO's appeal was dismissed, with costs. The above article was drafted and published by Adam Wiederman, Senior Associate, CCSG Legal Pty Ltd. If we can assist you with your next ATO preference claim, please do not hesitate to get in touch by clicking here <HYPERLINK to EMAIL>.