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Practice Group(s):
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Capital Gains – Not so Taxing for Receivers and Liquidators?

Asia Pacific Finance Alert

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The High Court of Australia has settled an important issue causing Insolvency Practitioners some concern involving Capital Gains Tax (CGT) and when a trustee (which includes Receivers and Liquidators) must retain funds to pay CGT. It has been determined that a trustee's obligation to retain funds only arises upon an assessment or deemed assessment being made, and not before that time.

Income Tax Assessment Act 1936 (Cth) (ITAA36)

Under section 254 of the ITAA36 there is an obligation on trustees and agents to retain sufficient funds to pay tax which is, or will become due, in respect of income, profits or gains. Importantly, this obligation gives rise to personal liability for trustees and agents.

Facts in the ABS case

By way of recap of the facts, in the Australian Building Systems Pty Ltd (ABS) case,¹ ABS was placed into Voluntary Administration on 2 March 2011 and the creditors resolved to appoint the Liquidators on 6 April 2011. The Liquidators subsequently sold real property of ABS in Queensland which gave rise to a capital gain in the sum of approximately AUD1.12 million.² The Liquidators applied to the Commissioner of Taxation (Commissioner) for a private ruling to determine (amongst other things) whether they had an obligation under the ITAA36 to retain from the proceeds of sale a sum sufficient to cover any CGT liability from the time the capital gain crystallised or only when the assessment had been issued.

The Commissioner ruled that the Liquidators were required to retain funds from the proceeds of sale prior to an assessment. The Liquidators objected to the ruling and the Commissioner disallowed that objection.

Federal Court Proceedings

Federal Court of Australia

The Liquidators then applied to the Federal Court of Australia to appeal the Commissioner's private ruling and seeking declarations. At first instance, Logan J found that the Liquidators were not obliged to retain money from the proceeds of sale until an assessment had been issued.

Logan J made a comment that a prudent liquidator would be entitled to retain the gain for a time against other expenses which might arise in the course of the administration.³ Whilst Logan J's decision provided guidance for trustees in similar circumstances, his

¹ *Commissioner of Taxation v Australian Building Systems Pty Ltd (In Liquidation)* [2015] HCA 48.

² Pursuant to section 104.10(4) of the *Income Tax Assessment Act 1997* (Cth).

³ *Australian Building Systems Pty Ltd v Commissioner of Taxation* [2014] FCA 116 at 31.

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comment caused some confusion for Insolvency Practitioners looking to distribute proceeds from the sale of assets where CGT liabilities may arise.

Full Court of the Federal Court of Australia

The Commissioner appealed the decision of Logan J to the Full Court of the Federal Court of Australia (Full Court). However, the Full Court dismissed the Commissioner's appeal.

High Court Decision

The Commissioner's appeal of the Full Court's decision to the High Court was dismissed in a 3-2 decision.

In their reasoning, each judge looked at the previous High Court decision in the case of *Bluebottle UK Limited v Deputy Commissioner of Taxation*⁴. In that case, the High Court considered the construction of the words "sufficient to pay the tax which is or will become due" pursuant to section 255 of the ITAA36.

The majority of French CJ, Keifel J and Gageler J in the High Court in the ABS case determined that in line with the Bluebottle case, the retention obligation was limited to retaining money after an assessment has been made. Gageler J concluded that this result produced certainty as to the total amount to be retained.⁵

Gageler J also considered that this position minimises the potential for disharmony between the obligations and liabilities of a liquidator under section 254 of the ITAA36 and under Chapter 5 of the *Corporations Act 2001* (Cth).⁶

What does this mean for Insolvency Practitioners?

On the basis of the High Court decision the obligation to retain funds by a trustee for CGT does not arise until a tax assessment has been issued (not when the asset is sold). It appears that the obligation to retain funds attached to any money which comes to the liquidator after an assessment has been issued. Whether Liquidators follow the suggestion made at first instance by Logan J to retain funds until an assessment is issued, will be a decision each will need to make on an individual basis. Liquidators will need to balance that practice against the interest of all creditors who want to be paid a dividend. The decision may lead to some legislative change in favour of the Commissioner so it is still a matter of "watch this space".

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⁴ [2007] HCA 54.

⁵ *Commissioner of Taxation v Australian Building Systems Pty Ltd (In Liquidation)* [2015] HCA 48 at 60.

⁶ *Commissioner of Taxation v Australian Building Systems Pty Ltd (In Liquidation)* [2015] HCA 48 at 63.

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