

Bulletin, Wednesday 17 December 2008

Federal Court changes GST rules for incapacitated entities – boon or bomb?

Taxation

In a decision handed down on Friday 12 December, the Federal Court has, effectively, overturned the accepted understanding of how the GST rules apply to taxable supplies made by 'representatives of incapacitated entities', including a trustee in bankruptcy, liquidators, receivers and administrators. If the decision in *Deputy Commissioner of Taxation v PM Developments Pty Ltd* stands, it will effectively advantage secured creditors over the Australian Taxation Office (ATO) in relation to post insolvency GST liabilities.

The issue is a familiar one in insolvencies. If, for example, a liquidator is appointed for a property development company, it is accepted that, if pre-liquidation the company had sold property (being a taxable supply), the liability for the taxable supply rests with the company, not with the liquidator. In effect, the ATO must prove its unsecured GST debt in the usual way and will rank behind secured creditors. Thus, any money received post-liquidation in relation to pre-liquidation sales goes to secured creditors (and statutorily preferred creditors) before anything goes to the ATO.

Before *Deputy Commissioner of Taxation v PM Developments Pty Ltd*, it was also believed by some that the converse applied to post-liquidation sales made by such a liquidator (or similar representative). That is, the effect of Division 147 of the *GST Act* was that a representative of an incapacitated entity is personally liable for GST (and entitled to input tax credits) in respect of supplies (and acquisitions) that the representative makes, in its capacity as such, while representing the incapacitated entity. As the GST liability fell on a liquidator personally, effectively 1/11th of the sales proceeds (the GST amount) was not available to secured (and preferred) creditors generally. Thus, the ATO effectively had priority over secured and preferred creditors in relation to the GST amount. *Deputy Commissioner of Taxation v PM Developments Pty Ltd* changes this position so that the GST liability ranks after secured creditors of the company.

To read the full Federal Court decision in *Deputy Commissioner of Taxation v PM Developments Pty Ltd* [2008] FCA 1886 (12 December 2008) go to the following web site address:

<http://www.austlii.edu.au/au/cases/cth/FCA/2008/1886.html>

While the decision might be well received by secured lenders – particularly in the current climate – liquidators, receivers and administrators should be treading with some caution. As the decision is contrary to the expressed policy of Division 47 of the *GST Act*, and the way it has been generally applied by the ATO and insolvency practitioners – that is that representatives of incapacitated entities be liable for post insolvency GST liabilities – the Commissioner will either appeal or seek to have the legislation amended to achieve what he sees as the right outcome. Therefore, insolvency partitioners are faced with a period of uncertainty. There is also a dilemma: on the one hand, they will be pressured by secured lenders to go with the decision and release funds that would otherwise be held to pay GST; on the other hand, if they do not hold funds and the decision is overturned on appeal (or the law is changed with effect from 1 July 2000 to restore the status quo), they will be left with a personal liability to be paid from their own pocket.

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