REMINISCING THE TAXATION PRIORITIES IN INSOLVENCY

CHRISTOPHER F SYMES

Christopher F Symes is a Senior Lecturer in Corporate Law, Flinders University, Adelaide.

I INTRODUCTION

Corporate insolvency law provides different methods for assisting creditors who deserve some priority or special treatment. In an insolvent winding up of a company, not all debt is going to be met from the realisation of the company’s assets and the common law and, since the late 1900s, statute has chosen some creditors to be legitimately favoured for payment by the liquidator. Employees’ wages and liquidation expenses are the most obvious areas expressly identified by statute although both the tax due by the company and tax deductions withheld by the company also have been ‘favoured’ by past legislators for special treatment.

In 2005, the special treatment of employees’ wages and tax debts and deductions upon insolvency varies greatly from that of the past. Today, we have a Commonwealth administrative scheme that attempts to contribute to unpaid wages and other employee entitlements. Such treatment occurs while there remains a statutory priority for employee wages and entitlements in the Commonwealth Corporations Act. In tax law, we have ensured that company directors make payments of tax debts to avoid personal liability, and have given the taxing authorities powers to estimate taxes in an attempt, inter alia, to reduce unpaid taxes should insolvency occur.

The statutory priority of the Commonwealth to receive a priority payment in corporate insolvencies was abolished from 1 November 1979,¹ apart from tax instalment deductions and withholding tax.² These amounts were still a priority until 1 June 1993. Earlier the Crown’s right to priority in bankruptcy was removed from 4 March 1968.³

This paper reminisces about the special treatment tax received when insolvency of the corporate taxpayer occurred, and concludes that Australian legislators acted with foresight in the ‘early’ removal of the tax priority. The United Kingdom has recently followed the Australian example, a decade later.

¹ Act No 134 of 1980.
² Sections 221 YU and 221P of the Income Tax Assessment Act 1936 (Cth).
³ Act No 50 of 1966.
II A HISTORY OF PRIORITY

The first Companies Act in England in 1862 did not expressly mention the Crown (and by implication taxes) as being entitled to any special distribution upon the insolvency of the company. However, Re Henley & Co\(^4\) in 1878 provides the first authority that the Crown is entitled to be paid out of assets in priority to all other creditors.\(^5\) By 1923, in the UK, the Crown’s priority in the winding up of a company was taken away except in certain circumstances.\(^6\)

1 Australian Colonial Times

Australian corporate legislation dates back to colonial times, and priorities for employees’ wages upon insolvency are found in such statutes as those from 1860.\(^7\) However, the priorities section in these early statutes remains silent on such matters as tax debts.\(^8\) For example, the 1892 Companies Act in the SA colony provided in s151 for employees’ wages of up to 25 pounds to have priority upon insolvency but no mention is made of tax debts. The Crown was not bound by this Act.\(^9\) Despite this, a number of cases held that ‘the prerogative of the Crown to require payment of debts owing to it in priority to the claims of creditors in equal degree is not taken away’.\(^10\)

As with other insolvency priorities granted by statute, the history of such Australian treatment is rooted in English statutes. The Preferential Payments in Bankruptcy Act (UK) 1888 provided in s 1 that:

in the distribution of the property of a bankrupt, and in the distribution of the assets of any company being wound-up under the Companies Act, 1862, and the Acts amending the same, there shall be paid in priority to all other debts (a) All parochial or other local rates due from the bankrupt or the company at the date of the receiving order, or as the case may be, the commencement of the winding-up, and having become due and payable within twelve months next before that time, and all assessed taxes, land tax, property and income tax assessed on the bankrupt or the company up to the 5\(^{th}\) day of April next before the date of the receiving order, or as the case may be, the commencement of the winding-up, and not exceeding in the whole one year’s assessment.

Priority for taxes, therefore, was given the highest ranking and there was a cap of one year’s assessment. In re HJ Webb & Co,\(^11\) it was held that since the passing of the 1888

\(^4\) Re Henley & Co (1878) 9 Ch D 469.

\(^5\) Other cases supporting this include Re Bonham Ex parte Postmaster General (1879) 10 Ch D 595; Re Oriental Bank Corporation (1884) 28 Ch D 643; West London Commercial Bank (1888) 38 Ch D 364; Exchange Bank of Canada v Reg (1886) 11 App Cas. 157.

\(^6\) Murray CJ in Re Millingen’s Limited (1934) SASR 72, 82 distinguishing the case of Food Controller v Cork (1923) AC 647.

\(^7\) Insolvent Act 1860 (SA).

\(^8\) Insolvent Act 1860 (SA), s 145.

\(^9\) Re Commonwealth Agricultural Service Engineers Ltd (1928) SASR 342.

\(^10\) Re Millingen’s Limited (1934) SASR 72, 82 (Murray CJ).

\(^11\) Re HJ Webb & Co (1922) 2 Ch D 369.
Act, the authority for Crown priority (re Henley) ceased to be directly applicable. The Crown’s right to a priority was abrogated by the *Companies (Consolidation) Act* (UK) 1908.

Australian Colonial laws for taxation were introduced gradually during the 18th century. In SA, the colonial founders touted that it would be a place of ‘few or no taxes to pay’.\(^\text{12}\) For a while, this was the case as government expenditure was met from the land funds, yet the colony became the first to introduce income tax, land tax and probate and succession duties in 1876. The first comprehensive income tax in Australia was levied under the *Taxation Act 1884* (SA). Other colonies followed suit in the 1890s\(^\text{13}\) and, while companies were contemplated as taxpayers (for example, in the Tasmanian Act of 1894 ten pence in the pound was levied on the incomes of companies), their insolvency and the resultant failure to pay taxes was not a feature of this colonial legislation.

2 *Post Federation Times: Companies Act 1934–35 (SA)*

A number of States around 1930 drafted new companies legislation (NSW in 1936, Vic in 1928, Qld in 1931) and included, for the first time, a priority for tax. Section 279 (1) of the *Companies Act 1934–35 (SA)* provided that subject to some subrogation issues: in a winding-up there shall be paid in priority to all other debts after costs, liquidator’s remuneration, and expenses of or incurred in the winding-up … [employees priorities then] … (d) all assessed land tax and income tax assessed prior to the relevant date and having become due and payable within the preceding twelve month, but not exceeding in the whole one year’s assessment.

There were possible two reasons for the inclusion of a tax priority. Firstly, the legislative changes were following recent UK companies’ legislation changes with the imperial legislation expressly mentioning tax debts in its list of priorities.\(^\text{14}\) Secondly, Federation had given the Commonwealth a general power of taxation and the *Income Tax Assessment Act* of 1915 had been enacted to provide additional revenue for Australian involvement in World War 1\(^\text{15}\) and, with companies being a popular choice of business structure, they became a substantial proportion of taxpayers.

3 *From 1961–90*

In the early 1960s, the states agreed to attempt greater uniformity of corporate legislation. Section 292 of the *Uniform Companies Act 1961*, known in SA as *Companies Act, 1962–74 (SA)*, gave priority to taxes. The section read:


\(^{14}\) Other jurisdictions such as Malaysia followed the UK companies legislation and still have an expressed priority for tax.

292. (1) subject to the provisions of this Act, in a winding up there shall be paid in priority to all other unsecured debts … (e) fifthly, the amount of all municipal or other local rates due from the company at the relevant date and having become due and payable within the twelve months next preceding that date, the amount of all land tax and income tax assessed under any Act or Act of the Commonwealth before the relevant date and not exceeding in the whole one year’s assessment …

Later, s 441 of the Companies Code, which was the main Commonwealth–State cooperative corporate legislation operating in Australia between 1981–90 provided for tax priority payments. The section read as follows:

Section 441 Priority Payments
Subject to the following provisions of this Subdivision, in the winding up of a company the following debts shall be paid in priority to all other debts: … (h) eighth –

(i) all amounts of rates, being rates that are, or are in the nature of, municipal or other local rates (other than rates imposed by an Act of the Commonwealth or a law of the Australian Capital Territory) that were due and payable at the relevant date and the liability for which accrued within the 12 months that next preceded that date;

(ii) all amounts of income tax that were assessed under any Act or Act of any other State or law of a Territory other than the Australian Capital Territory before the relevant date, not exceeding in the whole one year’s assessment;

(iii) all amounts of land tax that were assessed under any Act or Act of any other State or law of a Territory other than the Australian Capital Territory before the relevant date, not exceeding in the whole one year’s assessment;

(iv) all amounts of pay-roll tax (other than pay-roll tax imposed by an Act of the Commonwealth) that were due and payable at the relevant date …

The Income Tax Assessment Act 1936 (Cth) provided an order of priority for tax due in the winding up of a company and referred to the order of priority in the Bankruptcy Act 1966 (Cth) but not company legislation because it was state based. Hence, the need for the abovementioned company legislation provisions. In s 221 of the Income Tax Assessment Act 1936 (Cth), which is the section that dealt with tax due (not to PAYE deductions or withholding tax deductions), the Commonwealth accepted payment after the costs of the winding up and employees’ wages. A different arrangement existed in s 221P and 221YU which dealt with PAYE deductions not yet paid to the Commissioner and withholding tax deductions not yet paid to the Commissioner. In those sections, the priority is expressed as an absolute one, over all other debts.16

The Crown Debts (Priority) Act 1981 came into operation in July 1982 and this short act provided that the Crown, in right of the Commonwealth, would be subject to State and Territory laws with respect to priority. Section 3 provided that

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notwithstanding any perogative right or privilege of the Crown in right of the Commonwealth, the Crown in right of the Commonwealth is subject to any provision of a law of a State or Territory- (a) relating to the order in which debts or liabilities of a body (whether corporate or unincorporate) are to be paid or discharged; (b) relating to the avoidance of preferences received by creditors of a body (whether corporate or unincorporate) …

Section 4 excused sections 221P, 221YHJ or 221YU of the *Income Tax Assessment Act 1936* (Cth) from the operation of this Act and the Companies legislation.

### III LAW REFORM COMMISSIONS

The Australian Law Reform Commission conducted a most extensive inquiry into insolvency in 1987–88 and this culminated in the Harmer Report. The Report recommended the removal of the tax priority and the main arguments in favour of the removal were:

- That the ATO may allow taxation debts to accumulate without prejudicing its position and this may disadvantage other unsecured creditors who may not know that the group tax is owed.
- That the ATO had no incentive to recover payment in the normal commercial manner.
- These taxation debts are relatively insignificant from the point of view of total government receipts but may be critical to a particular creditor.
- The abolition would not be significant in terms of total revenue.
- The ATO should obtain no greater priority than any other person claiming in respect of debts misappropriated by an agent (the agent is the insolvent company).
- There would be a reduction in litigation.

Public policy issues suggest that there is a clear public interest in ensuring that taxes are collected in an efficient manner and that the government revenue is not jeopardised. Balanced with this is the strong community view, according to the Harmer Report, that the ATO’s priority should be abolished and so the Harmer Report recommended this course of action.

There had been no priority for unpaid income tax since 1980, when the *Crown Debts (Priority) Act 1981* (Cth) abolished it as a priority debt. Notwithstanding that, until 1993, the Commonwealth did retain some priority in relation to some tax liability. Eventually, the federal government took up the recommendation and Parliament enacted the *Insolvency (Tax Priorities) Legislation Amendment Act 1993*.

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17 An earlier report in 1978 by the Senate Standing Committee on Constitutional and Legal Affairs had recommended the total abolition of all Crown priority, *Priority of Crown Debts* (Known as the Missen Report.)


IV THE INFAMOUS SECTION 221P

Section 221P of the Income Tax Assessment Act 1936 (Cth) provided that:
Where an employer makes a deduction for the purposes of this Division …
from the salary or wages paid to an employee and refuses or fails to deal with
the amount so deducted in the manner required by this Division … he shall be
liable, and where his property has become vested in, or where the control of his
property has passed to a trustee the trustee shall be liable to pay the amount to
the Commissioner.

The court in Commissioner of Taxation v Barnes established that s 221P applies
whether the defaulting employer either remains in control of the whole of his property
or the whole of that property has vested in or passed under the control of a ‘trustee’
including a receiver.

Then, in Smith & Judge v Deputy Commissioner of Taxation, Brinsden J in the
Western Australian Supreme Court held that a secured creditor could not avoid the
section by simply electing not to appoint a receiver and allowing a liquidator to
administer in insolvency. In such cases, the liquidator having the necessary control
pursuant to his or her appointment, takes subject to the Commissioner’s priority.

Sutherland and Lee, writing in 1985, suggested that the principles by which s 221P
applied had not been easy and that the position at that time was ‘far from settled as
secured creditors devise new techniques in an attempt to avoid the Commissioner’s
priority’. Most of the litigation arose from the interpretation of the phrase ‘control’ of
the company’s property. Barnes’s Case held that ‘control’ must be over all the
company’s property, subject to any assets specifically charged, otherwise control does
not pass to the trustee.

Section 221P was said to have few friends and many critics. Menzies J in
Commissioner of Taxation v Card said the section was ‘an incredibly ill-drawn
section’; Brinsden J in the Smith & Judge Case said the extent of the operation of the
section remained ‘a matter of considerable uncertainty and the section clearly calls for

20 A number of helpful articles tried to explain the intricacies of s 221P: C Y Coleman, ‘The
Commissioner of Taxation’s Advantage Over Other Creditors on Insolvency’, paper presented to ALTA 46th
Taxation In Australia 318; G Sutherland, and B Lee, ‘Secured Creditors v Federal Commissioner of
Taxation Priorities under s.221P of the Income Tax Assessment Act’ (1985) 17/5 Commercial Law
Association Newsletter 87; D T Brealey, ‘Section 221P of the Income Tax Assessment Act; A Garrotte

21 Commissioner of Taxation v Barnes (1975) 133 CLR 483.

22 Smith & Judge v Deputy Commissioner of Taxation 78 ATC 4561.

23 G Sutherland, and B Lee, ‘Secured Creditors v Federal Commissioner of Taxation Priorities under

24 Commissioner of Taxation v Barnes (1975) 133 CLR 483, 499; and above n 23.

25 Above n 23, 91.

26 Commissioner of Taxation v Card (1963) 109 CLR 177, 194.
amendment’. 27 Gibbs J in Barnes said the section ‘presents considerable difficulties of construction’. 28

The effect of s 221P was to make the liquidator liable to pay out of the property that passes under his or her control the amount of any tax deductions from the salary or wages of an employee to the Commissioner of Taxation. These were amounts that had not been made in the statutorily prescribed manner by the company. Section 221P (2) made this amount payable in priority to all other debt, whether preferential, secured or unsecured, but this was qualified by s 221P (3) to the extent of permitting prior payment of the costs and expenses of winding up where these were payable in priority to all other debts in the winding up. Since, by virtue of s 556 (1)(a) of the Corporations Law (now the Corporations Act), the expenses of winding up are payable as a priority, it followed that the effect of s 221P (3) was to relegate any amount due under s 221P to the status of second priority in winding up. However, such a high priority meant that, in most estates, the Commissioner received what was owed or, if not, at least more than any other creditors.

As a trade off for abolishing any priority, a regime for dealing with unremitted group tax deductions was introduced in 1993 at the time of the abolition of the priority and it is contained in Div 8 of the Income Tax Assessment Act 1936 (Cth). The Division empowers the Commissioner of Taxation to begin recovery proceedings much sooner than was permitted previously. Division 9 of the Income Tax Assessment Act 1936 (Cth) applies specifically to companies and has the potential of imposing penalties on company directors. As a consequence of the operation of ss 222AOB and 222APB, duties are imposed on directors to cause their company either to comply with payment obligations, enter into a payment agreement, appoint an administrator under Pt 5.3A of the Corporations Act or initiate the winding up process.

V THE LEGISLATORS’ VIEWPOINTS ON TAX PRIORITIES IN INSOLVENCY

It is helpful, in light of what has transpired since 1993, to review the parliamentary debates that preceded the removal of tax priorities.

In 1993, Senator McMullan introduced the Insolvency (Tax Priorities) Legislation Amendment Bill to the Senate. In his second reading speech, he said the new legislation was abolishing the existing priority of the Commissioner of Taxation for debts in relation to certain unremitted amounts. The changes meant that the Commissioner would be able to recover the unremitted amounts more quickly through an estimation process and it would encourage company directors to face emerging problems as soon as possible.

The 1993 legislation would treat debts due to the Commissioner arising because of a failure to remit amounts deducted in a similar manner to debts payable to other unsecured creditors.

27 Smith & Judge v Deputy Commissioner of Taxation 78 ATC 4561, 4565.

28 Commissioner of Taxation v Barnes (1975) 133 CLR 483, 498.
Senator McMullan remarked that the removal of the Commissioner’s priority was essential to the smooth operation of the scheme of voluntary administration introduced under new insolvency provisions of the Corporation Law in June 1993. He added that ‘any loss of revenue from abolishing the priority will be offset by the revenue recovered under the new recovery regime’. And he went on to point out to the Senate that ‘the revenue recovered belongs to employees or payees and has been deducted but not remitted to the Commissioner as required by law’.29

Senator Watson, during debate in the Senate, suggested that there were three limbs to this Bill.30 Firstly, it sought to ensure that employees’ entitlements and the rights of unsecured creditors, which might otherwise have been lost, are protected. He observed such is a good measure. This is a change that is sustainable for the pragmatic reason that the Consolidated Revenue is better able to sustain a reduction of the proceeds from an insolvency administration than employees or unsecured creditors might be. The pain caused to employees who have been left with nothing after the collapse of their employer and to unsecured creditors who have had to write off huge losses because of the failure of a major debtor should not be underestimated.31 Unfortunately though, we now know that this was not the effect. The media reports during 1999 and 2000, of the failure in the system to meet employee entitlements, demonstrated that the changes of 1993 did not alleviate the ‘pain’.32

Senator Watson’s second limb was that the abolition of the priority would remove ‘what may have been a cause of the new voluntary administration scheme falling into a heap almost immediately upon its introduction’.33

Perhaps this contributed to the success of the voluntary administration scheme. The priority’s abolition or its maintenance has not been the subject of research into the voluntary administration success but practitioners and academics acknowledge the scheme as a success.34

Senator Watson’s third limb was that the legislation will provide by way of a new estimates procedure a more effective way of collecting unremitted amounts held by entities on behalf of the Commissioner as unpaid tax collectors. It would also provide ‘a means to force company directors to confront insolvency problems before being tempted to use deducted amounts as emergency working capital’.35 Again, the more recent reported experience of employees missing out on entitlements suggests that

30 Hansard, Australian Senate, Wednesday 26 May 1993, 1296.
31 Ibid.
32 For example, the losses of entitlements for employees at Cobar Mines, National Textiles and later the Ansett failure.
33 Hansard, Australian Senate, Wednesday 26 May 1993, 1296.
34 For example, Philip Crutchfield in the foreword to Crutchfield’s Corporate Voluntary Administration (3rd ed, 2003) expresses the view that the ‘perceived’ success has been noted by UK legislators.
35 Hansard, Australian Senate, Wednesday 26 May 1993, 1296.
unscrupulous directors continued to use employee entitlements as ‘emergency working capital’.36

The Australian Democrats, through their leader, Senator Kernot, supported the new legislation. During the debate, Senator Kernot observed that the new legislation was ‘designed to protect the revenue’.37 She said that ‘the reason for the abolition is probably industrial in nature. We are aware that last year there were some vigorous complaints from various unions about the unfair nature of the priority’. She went on to cite the building and textile industry as major instances where workers do not get paid. In light of this, she said that the legislative measure was ‘fair to employees and other creditors’.38

Senator Kernot showed clarity in her understanding of what the legislation was attempting to achieve. In supporting the move to make directors remit the amounts of tax to the tax office, she observed ‘the principle here is quite simple. At no time is the tax ever the property of the directors; it is the income of the worker and it is claimed by the government as a prepayment of an employee’s tax liability for the year. If the directors do not fulfil the duty to remit the money to the Tax Office, basically they are committing theft’.39 These may seem strong words, suggesting that the company and its directors are thieves, yet in 2000 legislation was passed making some director behaviour relating to deprivation of employee entitlements subject to criminal consequences.40

In the House of Representatives, Mr Rocher, (the member of Curtin), explained the need for new legislation:

as the situation now stands these arrangements can cause considerable hardship for employees as a result of an insolvency because the ATO’s priority means that there is little or nothing left for employees and other creditors following the payment of these outstanding taxes.41

Mr Rocher concentrated on the position that the ATO would be in after the legislation stating that ‘[t]his will put the Tax Office on an equal footing with other creditors, as might be expected’.42

Mr Rocher was prepared to support the legislation because one of the many problems he saw with the existing arrangements was that the size of the debts owed to the Tax Office was allowed to grow to ridiculous proportions. He suggested this was because the Tax Office was so slow to recoup the money that was owed by the insolvent entity. Under the existing legislation, the ATO had no incentive to take quick and decisive action in these cases because its priority under the existing arrangements guaranteed

36 Behaviour that has been hard to prove; and failures like Oakdale Mines and National Textiles had satisfactory resolutions to their much publicised collapses.

37 Hansard, Australian Senate, Wednesday 26 May 1993, 1297.

38 Ibid.


41 Hansard, Australian House of Representatives, Thursday 27 May 1993, 1125.

42 Hansard, Australian House of Representatives, Thursday 27 May 1993, 1126.
that it would get its money regardless of the consequences this might have for other creditors and, most importantly, employees.\textsuperscript{43}

Mr Swan (Lilley) stated that, in his opinion, ‘it is simply a false economy to put the Commissioner of Taxation ahead of employees and other small businesses in terms of insolvency’. He saw the insolvent company as being given two choices: to enter a voluntary administration or a wind up voluntarily. Either way, it means ‘that the company does not continue … to accumulate huge debts to the Taxation Office, thereby prolonging and creating an even bigger problem for itself and for its employees.’\textsuperscript{44}

Mr Rocher provides justification for the change to the legislation because while the unpaid funds which are the subject of this Bill are not assets of the company, there is always the temptation for companies to make use of deductions on behalf of employees as emergency working capital which can be ultimately disastrous for the employees.\textsuperscript{45}

Later, he spoke of these provisions in the new legislation as ‘intended to prevent the use of PAYE money being used as emergency working capital’.\textsuperscript{46} It could be observed that employee entitlements continue to be used as ‘emergency working capital’ and, so, the removal of the tax priority merely diminished the amounts available to the companies engaging in this practice.

Mr Bevis (Brisbane) noted that regrettably, employers faced with a liquidity problem have in some cases found the need or the desire to hold onto that money and not remit it to the Tax Office. Equally regrettably, it would appear that for some time the Tax Office has not been particularly efficient in its perusal, policing and collection of that money…

He concluded that employers who decide to solve their short-term liquidity problems by dipping into the employees’ pocket, which is effectively what they do when they hold onto that group tax, should face the force of the law. It is not their money, never was, never will be and should not be held by them on behalf of the employees out of the employees’ income. It should be seen fairly and squarely in that light.\textsuperscript{47}

He finished his contribution to the debate by acknowledging that they are employees’ wages. Employers should never have used them for any purpose other than payment of tax. Those employers who did that were not only breaking the law but also breaking the confidence and trust that their employees had in them on those occasions where it has occurred.\textsuperscript{48}

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\textsuperscript{43} Hansard, Australian House of Representatives, Thursday 27 May 1993, 1127.

\textsuperscript{44} Hansard, Australian House of Representatives, Thursday 27 May 1993, 1131.

\textsuperscript{45} Hansard, Australian House of Representatives, Thursday 27 May 1993, 1127.

\textsuperscript{46} Hansard, Australian House of Representatives, Thursday 27 May 1993, 1128.

\textsuperscript{47} Hansard, Australian House of Representatives, Thursday 27 May 1993, 1134.

\textsuperscript{48} Hansard, Australian House of Representatives, Thursday 27 May 1993, 1135.
Mr Rocher (Curtin) also saw the crucial benefit for the voluntary administration of the change to the legislation. He thought that creditors will not agree to the use of this (voluntary administration) procedure if the only or principal beneficiary for such an arrangement is the Australian Taxation Office because of its priority under existing arrangements. Clearly the ATO needs to be put on an equal footing with other creditors to permit some entities to trade out of difficulty and do so effectively.\footnote{Hansard, Australian House of Representatives, Thursday 27 May 1993, 1127.}

He summarised that the new legislation would afford employees a greater measure of protection than was available under the current arrangements. Clearly, this was not enough protection, given the developments in the late 1990s and the subsequent need to change the Corporations Law to add directors’ duty to prevent misuse of employees in insolvency\footnote{Corporations Law Amendment (Employee Entitlements) Act 2000 (Cth).} and the Employee Entitlements Support Scheme fund that was set up in 2000.

Mr Swan (Lilley) was convinced that employees ‘will have much improved prospects of being paid their outstanding wages. For that reason alone it is an historic reform … [it] gives workers and others a better go.’\footnote{Hansard, Australian House of Representatives, Thursday 27 May 1993, 1130.} Yet, in hindsight, it was not much ‘better’ than the situation described in parliament and the media at the end of the 1990s.

Mr Bevis (Brisbane) claimed that:

\begin{quote}
in the past it has been a sad fact that, with the priority claim the Commissioner of Taxation has on those moneys, those employees left without a job and little resources to support themselves found themselves unable to get their wages, long service leave and other entitlements to which they were due.\footnote{Hansard, Australian House of Representatives, Thursday 27 May 1993, 1134.}
\end{quote}

Arguably, this situation did not change until 2000 with the implementation of the Employee Entitlements Support Scheme (EES).

Mr Cadman (Mitchell) spoke of the prime objective of the legislation: that of getting the Commissioner of Taxation ‘in the queue with other creditors when a bankruptcy occurs’.\footnote{Hansard, Australian House of Representatives, Thursday 27 May 1993, 1136.} He bemoaned that the Commissioner of Taxation … has got into the queue ahead of those with claims for the first payment of wages and salaries. In that way workers’ rights have been denied, as have the rights of a whole range of people—whether they be suppliers, people leasing property, landlords or others—who come together when there is difficulty in the company…\footnote{Ibid.}

Mr Williams (Tangney), representing the Liberal opposition, conceded that the ‘taxation debts of insolvents are insignificant in terms of total government receipts’.\footnote{Hansard, Australian House of Representatives, Thursday 27 May 1993, 1132.}
He even conceded that ‘the amount foregone by a private creditor may be the difference between the creditor surviving or failing.’

Mr Swan (Lilley) suggested that it is pretty hard to find many people who have a bad word to say about [the removal of the legislation]. Let us say goodbye and good riddance to the old legislation and welcome the new legislation as a very substantial reforming achievement.

In summary, the concerns during 1993 were the slow debt recovery by the ATO, the wish to make corporate rescue legislation work and to assist employees to be paid wages and other entitlements owing from failed corporate employers. So, with the benefit of hindsight, the corporate rescue legislation has been a tremendous success but it would not be possible to attribute this to the removal of the tax priority. The assistance that the removal provided for employees was probably minimal. Since 2000, the government has needed to introduce two administrative schemes (EESS and GEERS) to pay employee entitlements. This suggests that it was a major problem seven years after the removal of essentially all tax priorities. Whether debt recovery by the ATO has been speeded up by removing the tax priority is debatable, and hard to ascertain from available public records.

VI UNITED KINGDOM REMOVAL OF THE TAX PRIORITY IN 2003

In the United Kingdom, revenue authorities used bankruptcy law as a form of debt collection for unpaid taxes. The government used the bankruptcy laws to both collect back taxes, and so that they could seize assets ahead of small creditors at the bottom of the priority list. Carruthers and Halliday suggest it was somewhat to the government’s surprise that it discovered how unfair most other players judged the taxman’s special advantages.

In 1982, the Cork Committee began with the presumption that all preferences (priorities) should be abolished. Preferences worked against principles of equity and harmed the weakest creditors and preferences diverted resources from reorganisations.

Carruthers and Halliday express it this way: taxes are equivalent to the property rights of the state. … the mechanisms of fiscal extraction … become critically important in the capacity of the state to carry out one of its most basic functions. Its capacity to capture lost or delayed

56 Hansard, Australian House of Representatives, Thursday 27 May 1993, 1134.
57 Hansard, Australian House of Representatives, Thursday 27 May 1993, 1130.
58 General Employee Entitlements and Redundancy Scheme.
61 Above n 59, 240
revenues should not have been impaired in the area of bankruptcy law for the state was not only the most powerful of creditors, but the ultimate arbiter of the rules by which all creditors played. As a referee, it could enhance its capacity as a player.
They further observe that this position presented not just a ‘fiscal asset’ to the state but a ‘political liability’ as well.62
The state could not maintain the priority because the government could not get any sympathy from the private sector over its long delays in collecting back-taxes. Carruthers and Halliday suggest that ‘such rank inefficiency merely confirmed to private creditors that government needed stronger incentives to keep abreast of taxpayer delinquency’.63 This type of credit slackness was a luxury the unsecured creditor could not afford and, so, it was not surprising that they had no sympathy for the state.

Furthermore, there is not a direct link obvious to creditors that the state, in missing out on taxes, will not produce expenditure in health or education or defense. For the state to argue from a position of keeping a priority, they had a fight with every other creditor and all stakeholders. Carruthers and Halliday suggest consumer groups, professionals, the finance industry and major business groups would all stand against such an argument.64

Finally, the Enterprise Act 2002 (UK) s 251 removed the Crown priorities with respect to Inland Revenue and Customs and Excise and Social Security contributions previously found in Schedule 6 of the Insolvency Act 1986 (UK). It basically puts into effect the abolition of Crown preference. An earlier White Paper65 committed the government to abolish the Crown’s preferential status and to ensure the benefit went to unsecured creditors of companies that have floating charges. Prior to the change, in force since 2003, the Crown could claim its debts from an insolvent company ahead of secured creditors who held floating charges. Obviously, they would also claim before unsecured creditors. The priority debts were previously in ss 386 and 387 and schedule 6 of the Insolvency Act 1986 (UK) and so included debts due to both the Inland Revenue for 12 months prior to the relevant date, and social security contributions for the 12 months prior to the relevant date.

What remains in the Insolvency Act 1986 (UK) is priority status for contributions to occupational pension schemes (superannuation in Australia), remuneration of employees for the relevant period, and levies on coal and steel production under the European Coal and Steel Community Treaty.

The Enterprise Act 2002 (UK) also removes the Secretary of State priority in the Employment Rights Act 1996 (UK) and so will no longer be paid in priority to other preferential claims by former employees.

62 Ibid.
63 Ibid.
64 Ibid.
Ms Hewitt (Secretary of State for Trade and Industry) in the Second Reading debates in the Commons stated that ‘the bill will abolish the Crown’s preferential rights to recover unpaid taxes ahead of other creditors. That too will bring real benefits to unsecured creditors’. 66 She said that, with measures that contribute towards refining the Insolvency Service’s financial regime ‘[ensuring] that money does not flow, in effect, from the coffers of the creditors into the coffers of the Treasury’, the two provisions will make up to 110 million pounds 67 available for distribution to all creditors. 68

Mr Borrow (South Ribble), in welcoming the removal of Crown preferential status, said it was ‘crucial’ not only to many employees in companies that currently lose out because the Crown takes the first cut of any resources left in insolvency, but to many other small businesses that are dependant as creditors on the business that is going into bankruptcy (liquidation). He said that, if the Crown had not been a preferential creditor, some failed companies in his constituency might well have received enough from businesses that went into liquidation to enable them to survive instead of finding that the scale of loss incurred was just enough to push them into bankruptcy (liquidation) too. 69

Dr Cable (Twickenham) said the government should proceed with caution in removing the Crown’s prerogative because if the Inland Revenue continues to operate in the same way regarding itself more or less as driven by a need to get at assets before other creditors the same problems will arise. 70

Mr Page (South West Hertfordshire) supported this, suggesting ‘we must take care to discover whether the actions of the Crown will precipitate a more rigorous collection method, which may, in turn cause businesses to have to close much sooner’. 71

Mr Ross Cranston (Dudley) [but also a well known commercial law academic] said that it was ‘altruistic of the government to abolish it (the priority) and ‘magnanimous behaviour’. 72

As we can see from these excerpts the debate is very similar to the one held in the Australian federal parliament ten years earlier.

66 Hansard, Commons, 10 April 2002, 53.
67 When this was mentioned in the House of Lords, Lord Sainsbury said it was 115 million pounds! Hansard, 2 July 2002, 143.
68 Hansard, Commons, 10 April 2002, 53.
69 Hansard, Commons, 10 April 2002, 68.
70 Hansard, Commons, 10 April 2002, 68.
71 Hansard, Commons, 10 April 2002 68.
72 Hansard, Commons, 10 April 2002, 97.
VII CONCLUSION

This paper reminisces on the special treatment tax received when insolvency of the corporate taxpayer occurred and is purely of historical interest to Australia. Yet, Australian legislators acted with foresight in the ‘early’ removal of the tax priority during the period from 1970 through until 1993. The United Kingdom has recently followed the Australian example, some ten years since our final attempt to remove the priority.

As a postscript, it is interesting to note a recent case that questions the absolute removal of tax as an insolvency priority. In Deputy Commissioner of Taxation v Dexcam Australia Pty Ltd (in liq), the DCT had been a creditor in Dexcam’s Deed of Company Arrangement (DOCA) and had participated in the deed including submitting proofs of debt. The DCT had submitted amended proofs of debt which took into account the purported application of the PPS credits and interest under s 221YHG ITAA and s 13(1) of the Tax Interest Act (Cth). Dexcam went into liquidation in January 1998 after the DOCA was terminated. As we have discussed, the Insolvency (Tax Priorities) Legislation Amendment Bill 1993 abolished the priority enjoyed by the Commonwealth conferred by ss 221P, 221YHJ, 221YHZD and 221YU of the Income Tax Assessment Act 1936 (Cth). The Bill was to abolish debts due to the Crown in the right of the Commonwealth and made specific reference to the above four sections. Finn J in the Dexcam Case observed that there was nothing in the language of the legislation to suggest a legislative purpose beyond those four sections. This leaves s 221YHG which was not expressly subject to the abolition. It was a provision that required the Commissioner to apply various tax credits in payments of other tax or designated debts of the person otherwise entitled to those credits.

In particular, the Australian legislative moves of 1993 in removing the tax priority in insolvency administration form an interesting study in the larger discipline, that of ‘distribution’, which is said to be the most complex issue in insolvency. Distribution has been a feature of the employee entitlements in insolvency debate that has ‘exploded’ in Australia since such high profile insolvencies as Cobar Mines, National Textiles and Ansett. Had those legislative moves of 1993 not been taken, the tax priority would most certainly have been sacrificed by the federal government in an attempt to placate those in the Australian society calling for a more fair distribution of an insolvent company’s assets.