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The Commissioner of Taxation's right to garnish proceeds from the sale of secured property under section 260-5 of the *Taxation Administration Act 1953* (Cth)

Introduction

The recent Federal Court decision in *Commissioner of Taxation v Park and Anor* [2012] FCAFC 122 (**Park**) affirms the imperative for receivers and trustees of bankrupt estates to proceed with caution when voluntarily releasing security for the purposes of facilitating the sale of secured assets by the mortgagor to a third party. The decision highlights the result of an unintended substitution of a proprietary right for a personal covenant, which is perilous for creditors given the latter class of legal right is so often proven valueless in the context of an impecunious debtor.

The facts

In Park, the Commissioner of Taxation (**Commissioner**) sought payment for outstanding tax of $75,508.64 owing to the Commonwealth. The taxpayer (**Mrs Bassili**) had entered into a contract for the sale of land which was subject to two registered mortgages in favour of the National Australia Bank and Instyle Developments Pty Ltd (**Instyle**). The Commissioner issued a notice on the purchasers under section 260-5 of Schedule 1 of the *Taxation Administration Act 1953* (Cth) (**Act**) requiring payment of a portion of the purchase price, being monies owing to the taxpayer by the purchasers, to be made directly to the Commissioner in satisfaction of Mrs Bassili's debt (**Notice**). The Commissioner informed the purchasers that he was 'enforcing his entitlement ahead of earlier secured creditors'.[1]

1 *Commissioner of Taxation v Park and Anor* [2012] FCAFC 122, [9]

A statement of adjustments was prepared in anticipation of settlement under the contract of sale. The statement revealed that not only was the combined value of the secured debt in excess of the purchase price, the interjection of the Commissioner's asserted priority left an additional shortfall of $75,508.64, which was to be borne entirely by Instyle as second mortgagee. Unsurprisingly, Instyle initially refused to release its security; however, it eventually discharged its mortgage on the condition that $325,613.66 (being the maximum amount payable to Instyle) was paid into the trust account of its solicitors, Warlow Scott. The matter proceeded to settlement on 23 February 2010.

The Commissioner brought proceedings to recover the amount claimed in the Notice, ultimately appealing against the decision of the Federal Magistrate, which ruled that Instyle was entitled to retain $75,508.64 which had subsequently been paid into court. In the case before the Full Court of the Federal Court, Justices Jessup and Katzmann (Justice Siopsis in dissent) held that the Commissioner's statutory right to issue a notice under s 260-5 of the Act was not to be subordinated to a party's security rights in the property and the Commissioner was entitled to payment of $75,508.64 in priority to the second mortgagee.

The Appeal decision

Their Honours rejected the Federal Magistrate's reliance on an analogy between the circumstances of the present matter and those which follow the crystallisation of a floating charge over the debts due to a company. In the latter scenario, the debts previously owing to the taxpayer are instead deemed to be owing to the chargee (or receiver) following crystallisation of the charge, thus rendering a section 260-5 Notice incapable of attaching to those debts. However, the court found that this reasoning was not amenable to application in respect of Torrens system land, which permits security interests to be granted only in the land itself and not to monies owing to a taxpayer.

In the course of rebutting the various arguments put forward by the respondents, the court also held that:

- on the proper analysis of the accrual of rights in the process of delivering good title, the purchasers never owed any money to the mortgagees and they were not under any obligation to *'give effect to the terms of the vendor's security'*;[2]
- the execution of an unconditional contract for the sale of unencumbered title to the property where such title was not in fact held by the registered proprietor did not give rise to an equitable charge over the proceeds of sale in favour of the mortgagees; and
- it was erroneous to conclude that the Commissioner's right to garnish monies under section 260-5 of the Act altered vested security interests because Instyle's mortgage could only ever have been affected by either the repayment of the secured monies or the voluntary release of its security.

With regard to the cause of the second mortgagee's compromised position, their Honours stated at [114]:

> *'if there is a discernible point at which Instyle's position was compromised by the sequence of events which occurred on 23 February 2010, it was when it released its mortgage over the property'.*

Implications for secured creditors, receivers and trustees of bankrupt estates

Secured creditors, trustees and receivers should be mindful that the voluntary release of a mortgage to facilitate the sale of property will not result automatically in an entitlement to a portion of the proceeds of sale. A debtor's personal obligation to apply the proceeds of sale towards discharging their debt may also prove illusory where the debtor's liabilities exceed the value of their

2 Ibid [106]

assets. Furthermore, secured creditors must consider the prospect that the debtor has an outstanding taxation liability owing to the Commonwealth that may be subject to a Notice under section 260-5 of the Act. A valid Notice issued to the purchasers of charged property may, in practice, enable the Commissioner to rank in priority to a registered mortgagee.

In many cases, where a debtor is in default, the advisable course of action will be to enter into possession of the property and exercise a statutory power of sale. In all cases, secured creditors and their representatives should give due consideration to their options when presented with a request to discharge a security interest in property.

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