



Applications for indemnities made by insolvency practitioners

This article aims to guide company liquidators and bankruptcy trustees (insolvency practitioners) when considering making an indemnity request to the Deputy Commissioner of Taxation (DCT).

The DCT is a major creditor in many bankruptcies and liquidations, and insolvency practitioners often seek indemnities from the DCT to enable them to undertake a wide range of actions. These actions range from obtaining legal opinions and conducting public examinations, to pursuing voidable transactions, insolvent trading or breaches of director's duties. Indemnities may also be sought to cover provision for adverse costs.

As a government agency, the Australian Taxation Office (ATO) is required to operate within the Commonwealth administrative and financial framework which requires the Commissioner of Taxation (Commissioner) and other ATO officials to comply with the legal and policy obligations imposed by a number of relevant laws and policies of the Commonwealth. These include finance circulars and orders, and other guidance publications issued by the Department of Finance and Deregulation (DoFD).

Legal and policy obligations

Before the DCT can approve an indemnity and grant Commonwealth resources (public monies), the DCT must consider a range of legal obligations and government policies, some of which are outlined below.

1. The *Financial Management and Accountability Act 1997* (FMAA) provides for the proper use and management of public money, public property and other Commonwealth resources. In particular:
 - (a) Section 44 of the FMAA requires a Chief Executive (which includes the Commissioner), to manage the affairs of their agency in a way that promotes proper use (efficient, effective and ethical use consistent with government policies) of the Commonwealth resources for which the Chief Executive is responsible. In doing so, the Chief Executive must comply with the FMAA and regulations, as well as Finance Minister's Orders, special instructions and any other applicable laws.
 - (b) Pursuant to section 53 of the FMAA, the Commissioner has delegated powers and functions to a limited number of ATO officials, enabling them to approve indemnities to insolvency practitioners. Such delegations impose strict monetary limits.
 - (c) Pursuant to section 52 of the FMAA, the Commissioner has given written instructions to ATO officials in the form of Chief Executive's Instructions (CEIs) which all ATO officers must comply with (discussed further below).
 - (d) Section 14 of the FMAA provides that misapplication or improper use or disposal of public money by a Commonwealth official could result in a penalty of up to seven years' imprisonment.
 - (e) Section 15 of the FMAA provides that if a loss of public money occurs and that loss was caused or contributed to by misconduct or by deliberate or serious disregard for reasonable standards of care by a Commonwealth official, then that official could be held liable to pay to the Commonwealth the amount equal to the loss.
2. The *Financial Management and Accountability Regulations 1997* (FMAR). In particular:
 - (a) Regulation 9 of the FMAR prohibits the approval of a spending proposal unless the approving official is satisfied, after making reasonable enquiries, that giving effect to the spending proposal will be a proper use of Commonwealth resources within the meaning of section 44 of the FMAA.
 - (b) Regulation 10 of the FMAR prohibits the approval of a spending proposal where the appropriation of money is not authorised pursuant to an existing law or a proposed law that is before parliament, unless the Finance Minister has given written authorisation for the approval. This means that, subject to any delegations or other approved rules issued by the Finance Minister, where a spending proposal will or could result in Commonwealth resources being expended in a future financial year, and where there is not an existing Appropriation Act in place or being proposed before parliament, then only the Finance Minister can give written authorisation for the approval of the spending proposal.
 - (c) Regulation 13 of the FMAR prohibits the entering into of a contract, agreement or arrangement under which public money is or may become payable, unless approved pursuant to FMAR Regulation 9 and, if necessary, authorised first pursuant to FMAR Regulation 10.
 - (d) Regulation 24 of the FMAR provides for the Finance Minister to delegate any of their powers and functions

under the FMAR to a Commonwealth official. FMAR Regulation 26 provides that a Chief Executive of an agency may delegate to a Commonwealth official any of the Chief Executive's powers or functions under the FMAR, including powers or functions delegated to the Chief Executive by the Finance Minister. In exercising powers and functions given under any of the above delegations, the delegated official must comply with any directions given.

3. CEIs issued by the Commissioner pursuant to section 52 of the FMAA and Regulation 6 of the FMAR. In particular:

(a) Regulation 6 of the FMAR authorises the Chief Executive of an agency to give instructions to officials in that agency on any matter necessary or convenient for carrying out or giving effect to the FMAA or the FMAR, in particular any matters including making commitments to spend public money. CEIs are issued to promote and ensure adequate accountability of the proper use and management of public money, public property and other government resources.

(b) CEIs which the Commissioner has issued relative to the spending of Commonwealth resources include Spending approvals, Payments made by the ATO and Managing our financial responsibilities. All ATO officers and any person who performs a financial task on behalf of the ATO must comply with these CEIs. These documents include important factors for all ATO officers and delegated officials to consider, including:

- All spending decisions must make efficient, effective and ethical use of Commonwealth (government) resources and aim to deliver value for money.
- The use of public resources must be consistent with relevant legislation and government policies.
- The Commissioner and all ATO officials are accountable to the government and the public for how those resources are used. Every spending decision must be transparent and able to withstand external scrutiny.
- Delegated approving officials are personally responsible and accountable for the decisions they make in approving spending proposals.
- Spending proposals can only be approved if there are sufficient funds available in the budget to commit to that expenditure.
- Spending proposals which involve or may involve the spending of resources in a future financial year have significant and separate approval processes.
- A proposal to spend public money must be approved by a delegated official before a contract, agreement or arrangement can be entered into.

4. The DoFD has issued numerous documents which provide assistance and guidance to Australian government departments in relation to managing their legal and policy obligations relating to the commitment and spending of government resources. Some of these publications, which are freely available on the [Department of Finance and Deregulation](#) website, include:

(a) Finance Circular (FC) 2003/02, together with Financial Management Guidance (FMG) No.6, Guidelines for Issuing and Managing Indemnities, Guarantees, Warranties and Letters of Comfort. While this FC and FMG primarily apply to Commonwealth procurement processes, the DCT still has regard for these publications when providing indemnities to insolvency practitioners, given the similarities in respect of risk, etc

(b) FC 2007/01, which provides guidance on the application of FMAR Regulation 10

(c) FC 2009/05, Commitments to spend public money (FMA Regulations 7 to 13)

(d) FMG No.10, Guidance on Complying with Policies of the Commonwealth in Procurement. While the provision of an indemnity to insolvency practitioners is not considered to be a procurement process, the DCT still has regard for this publication when providing indemnities, given that the commitment and spending of Commonwealth resources must be consistent with the policies of the Commonwealth

(e) Financial Management and Accountability (Finance Minister to Chief Executives) Delegation 2009. In particular, Part 1 of Schedule 2 sets out the delegations and directions given by the Minister for Finance and Deregulation to Commonwealth Agency Chief Executives in respect to FMAR Regulation 10, being approval of spending proposals for future financial years.

There are significant and strict legal and policy obligations imposed on Commonwealth officials who are delegated to approve spending proposals and commit Commonwealth/public resources. When an insolvency practitioner seeks an indemnity from the DCT sufficient information must be provided to enable the DCT (through their delegated officials) to make an informed and justifiable decision, which complies with all the necessary legal and policy obligations and is able to withstand external scrutiny. If the necessary information is not provided, the DCT will reject the indemnity request.

Due to these requirements, the decision making process can take considerable time and any indemnity request should be made as soon as the need is identified.

Analysis of rejected indemnities in 2008–09

At the end of 2008–09, the Commissioner undertook a review of rejected indemnities for that year.

The Commissioner received 252 indemnity requests (which in some cases included multiple requests for the same case), of which 226 (90%) were rejected and 26 (10%) were approved. The main reasons for rejection were:

1. the total costs will likely exceed the value of the DCT's proof of debt – 64 requests (28%)
2. the merits, prospects of success and risk were unable to be determined to the satisfaction of the DCT – 33 requests (15%)
3. the DCT was not a creditor – 33 requests (15%)
4. the potential risks outweigh the potential benefits – 21 requests (9%)
5. the proposed defendant (or defendants) had insufficient assets to pay a dividend if the action was successful – 20 requests (9%)
6. the DCT's claim was minor (<\$5,000) – 20 requests (9%)
7. insufficient information was provided to enable the DCT to make a decision and no response was received when the DCT requested further information – 12 requests (5%).

Analysis also highlighted the following:

- Numerous requests were included in general circulars to creditors at a time when the insolvency practitioner was winding down the liquidation or bankrupt estate. The circulars generally highlighted that the insolvency practitioner was without funds and that if any creditor wanted the insolvency practitioner to undertake further investigations an indemnity would need to be provided.
- The circulars to creditors referred to above generally did not highlight any specific cause of action or explain the benefits to creditors in providing an indemnity.
- The amount of the indemnity sought was often not specified, or where specified, was not particularised.
- Most approved indemnities were initiated by the DCT because of the DCT's interest in the matters prior to liquidation or bankruptcy. The DCT initiated contact with the insolvency practitioner, highlighted the potential recovery actions and provided relevant information to assist the insolvency practitioner in their investigations. This led to thorough indemnity requests being submitted and ultimately approved where all the DCT's legal and policy obligations were met.

Checklist to assist insolvency practitioners

To assist insolvency practitioners when preparing their indemnity requests, the ATO has developed an [indemnity checklist](#) (PDF 170 KB) for insolvency practitioners.

It is important the online version is referred to each time an indemnity request is prepared. This will ensure the information is current.

The indemnity checklist is comprised of Part 1, Part 2 and Annexure A. All indemnity requests must be in writing and address Part 1. Part 2 will also need to be addressed in all written indemnity requests where the indemnity is being sought to commence a litigation action. It is not necessary to submit Part 1 and Part 2 with the request. These documents are only intended as a guide to ensure the request includes the required information.

Annexure A breaks down the total costs of an indemnity sought on a task-by-task basis, which will provide a total for the indemnity being sought. The DCT will incorporate the Annexure A document into the written indemnity agreement in the event that the indemnity is approved. The terms of the indemnity agreement will not only seek to limit the amount of the indemnity to the overall total approved, but will also seek to limit the amount that the DCT will indemnify on a task-by-task basis, unless approved otherwise in writing. When an insolvency practitioner makes an indemnity request, they should give careful consideration to each task that is required to be undertaken and calculate the cost required to complete each task.

The DCT will not agree to pay the costs and expenses incurred by an insolvency practitioner, pursuant to the indemnity agreement, where these relate to:

- preparing and submitting the indemnity request
- communicating with the DCT's officials in relation to the request
- executing the indemnity agreement
- general ongoing administration of the indemnity agreement.

Costs and expenses should be treated as costs of the liquidation or bankrupt estate and paid in the prescribed order of priorities pursuant to section 556 of the *Corporations Act 2001* (in the case of company liquidations) or section 109 of the *Bankruptcy Act 1966* (in the case of bankrupt estates).

The following is an example of how the indemnity checklist may be used when initially seeking an indemnity to commence a public examination:

Available evidence may indicate that an insolvency practitioner has a viable cause of action, but as there is insufficient evidence to commence the main action, an indemnity may be sought to commence a public examination as the practitioner is without funds. As well as completing Annexure A, Part 1 of the checklist will need to be addressed in a written indemnity request.

At the conclusion of the public examination, if sufficient evidence was obtained to justify and support the commencement of recovery action, a second indemnity request may be sought to obtain a counsel opinion on the merits and prospects of success and recovery of the proposed action. If such an indemnity request is sought, then the written request must address at least Part 1 of the checklist, while Annexure A must also be completed in respect of the costs of obtaining a counsel opinion.

Where an insolvency practitioner seeks a further indemnity to pursue action once counsel has provided their opinion and indicated the proposed litigation action has good merit and prospects of success and recovery, another written indemnity request must be submitted to the DCT, thoroughly addressing Part 1 and Part 2 of the checklist. Annexure A must also be fully completed, detailing the costs on a task-by-task basis and the overall total cost of the litigation action.

Engaging solicitors and legal counsel and negotiating rates

Legal and policy obligations imposed on the DCT require that all spending proposals must make efficient, effective and ethical use of Commonwealth resources and aim to deliver value for money. Therefore, the DCT will normally seek to have input into, and ultimately approve, the solicitor and legal counsel engaged by the insolvency practitioner.

The DCT will also normally seek to negotiate the best possible rates with the insolvency practitioner and require the insolvency practitioner to negotiate the best possible rates with their solicitor and legal counsel. If rates which are satisfactory to the DCT cannot be negotiated, the indemnity may be rejected.

Payment of the insolvency practitioner's costs and expenses will be made pursuant to the terms of the written indemnity agreement. This means there is a low risk of the insolvency practitioner not being paid for the tasks performed pursuant to the indemnity agreement. This is in contrast to unfunded administrations where the insolvency practitioner is often at risk of not being paid or at least not being paid the full amount of their remuneration.

There will usually be a range of suitably experienced and skilled solicitors and legal counsel for an insolvency practitioner to choose from. The DCT will require the practitioner to make a choice based on value for money, taking into account the nature and complexity of the action, the tasks required to be undertaken and the level of knowledge, skills and experience that are required to achieve the desired outcome in each case.

The DCT may suggest solicitors and legal counsel or provide a short list for the insolvency practitioner to choose from. Ultimately, as the indemnifying creditor, the DCT will need to be satisfied of the solicitors and legal counsel to be engaged and the rates they propose to charge, or else the indemnity may not be approved. However, the DCT is always willing to work with insolvency practitioners to resolve any difference of opinion.

The same applies to other experts of any nature that may need to be engaged by an insolvency practitioner during the course of litigation and pursuant to the terms of a written indemnity agreement.

Legal Services Directions

The DCT may require insolvency practitioners, through their solicitors, to engage a legal counsel who is prepared to charge daily and hourly rates at their Commonwealth rate as set by the Attorney-General's Department (AGD), Office of Legal Services Coordination (OLSC). This is pursuant to the *Legal Services Directions 2005*, in particular Appendix D, which is issued by the AGD. A copy of the [Directions](#) can be obtained from the AGD's website.

The Directions apply to an Australian Government FMAA agency for the provision of legal services and the engagement of legal counsel and do not apply to an insolvency practitioner who seeks the provision of legal services and engages legal counsel pursuant to an indemnity provided by the DCT, as it is the insolvency practitioner and not the DCT who is seeking the legal services and engaging legal counsel.

However, as the provision of legal services is being paid for by the Commonwealth, pursuant to the terms of an indemnity agreement, the DCT still needs to ensure the services are efficient and effective and that the various laws and policies of the Commonwealth are properly complied with.

As a condition of an indemnity being approved by the DCT, it will generally be a requirement for insolvency practitioners to comply with at least certain parts of the Directions, such as:

- conducting litigation as a Model Litigant (see Appendix B of the Directions)
- not commencing court proceedings unless written legal advice has been obtained indicating that there are reasonable grounds for starting the proceedings
- engaging legal counsel in accordance with Appendix D of the Directions.

The approval of an indemnity and entering into of an indemnity agreement does not remove any legal obligations that may be imposed on insolvency practitioners to seek creditor, committee of inspection, or court approval of their

remuneration, or any other amounts where approval is required to be obtained before being paid. Where such approval is required, the DCT will only pay amounts that have been properly approved and only up to the limits specified in the written indemnity agreement. For example, if creditors, the committee of inspection, or the court approves a lesser amount than has been provided for in the written indemnity agreement, the DCT will only pay the lesser approved amount.

DCT's requirements for future indemnity requests

Due to the strict legal and policy obligations imposed on government agencies in relation to the expenditure of public money and as a result of the ATO's analysis and findings over recent years, all indemnity requests from insolvency practitioners must now comply with a minimum standard in order to be considered.

This standard consists of the following requirements:

- All requests must be in writing and either posted to:

Deputy Commissioner of Taxation
Australian Taxation Office
PO Box 9003
PENRITH NSW 2740

or,

sent by facsimile using the [Debt insolvency facsimile template](#).

- Requests must be for the sole purpose of seeking an indemnity, rather than included as one of numerous items contained in lengthy reports or circulars to creditors.
- In order to assist our mail scanning and sorting facilities and to ensure indemnity requests are referred to the correct team for actioning, the first page of the indemnity request must be clearly marked as 'Indemnity request'.
- The request must fully address part 1 of the indemnity checklist, as well as part 2 if required. It must also be accompanied by the completed annexure A document which is attached to the indemnity checklist. The annexure A document must be completed in detail and clearly set out the costs and required particulars for each task to be undertaken.
- When preparing an indemnity request, it is necessary to refer to and comply with [chapter 30](#) of the ATO *Receivables Policy*. The *ATO Receivables Policy* undergoes regular reviews and is subject to change. Practitioners should refer to the online version of chapter 30 of the policy prior to preparing and submitting each indemnity request.
- Except in exceptional circumstances, all indemnity requests must be made before an action is commenced and before committing to the use of particular solicitors, legal counsel or other experts. This is necessary in order for the DCT to provide input regarding the solicitors, legal counsel and any other experts to be used and the rates proposed. The DCT will also need to assess the risks, merits and prospects of success and recovery of a proposed action before making a decision to commit any Commonwealth resources.

Indemnity requests which do not comply with the above minimum standards will usually not be treated as a genuine request and will not receive a response. Where it is clear an insolvency practitioner made every attempt to comply with these standards but not all aspects were properly addressed, the DCT will consider the request and seek further information if necessary.

Written indemnity agreement

If an indemnity is approved, the DCT will draft an indemnity agreement. The DCT will not be liable to pay any amounts until an indemnity agreement has been executed.

If the terms of the indemnity agreement cannot be agreed upon by the parties, the DCT's offer to provide an indemnity will be withdrawn. It is the DCT's primary responsibility, pursuant to section 44 of the FMAA, to ensure the affairs of the ATO are managed in a way that promotes the efficient, effective and ethical use of Commonwealth resources and in a manner which is not inconsistent with any policies of the Commonwealth. If the DCT is not satisfied that these requirements have been fulfilled before executing the indemnity agreement, then the DCT cannot legally execute it.

Repayment of indemnity

Where any amounts are paid to an insolvency practitioner pursuant to an executed indemnity agreement (indemnity expenses) and any recoveries are made, the DCT will expect as a minimum that the indemnity expenses will be repaid as a priority expense under [paragraph 556\(1\)\(a\)](#) of the *Corporations Act 2001* (for company liquidation matters) or [paragraph 109\(1\)\(a\)](#) of the *Bankruptcy Act 1966* (for bankruptcy matters).

Where property has been recovered, realised, protected or preserved as a result of the indemnity provided by the DCT, the DCT will usually require an application be made to court pursuant to [section 564](#) of the *Corporations Act 2001* (for company liquidation matters) or [subsection 109\(10\)](#) of the *Bankruptcy Act 1966* (for bankruptcy matters). Whether or not the application is made will depend on the circumstances of each case and whether the outcome of the application is likely to benefit the DCT. The outcome of any application will be at the discretion of the court. The application will either be made by the insolvency practitioner and funded from the assets of the liquidation or bankrupt estate or alternatively,

the DCT may choose to make an application at their own expense.

Where an application is made pursuant to [section 564](#) of the *Corporations Act 2001* or [subsection 109\(10\)](#) of the *Bankruptcy Act 1966*, in addition to seeking a priority dividend on their proof of debt, the DCT may also seek priority repayment of the indemnity expenses. The orders sought in relation to priority repayment of the indemnity expenses may seek repayment before all other priorities prescribed in [section 556](#) of the *Corporations Act 2001* – including paragraph 556(1)(a) expenses, or [subsection 109\(1\)](#) of the *Bankruptcy Act 1966* – including paragraph 109(1)(a) expenses.

Terms covering the above issues will be incorporated into all indemnity agreements.

Rejection of indemnity

Where an indemnity request that meets the minimum standards is rejected, the DCT will write to the insolvency practitioner notifying that the indemnity has been rejected.

Decisions made by the DCT to reject an indemnity are not reviewable decisions and the DCT is under no obligation to provide reasons for rejection. However, it is the normal practice of the DCT to provide general reasons for rejection, unless the DCT determines that it is not in the interests of the Commonwealth to provide reasons, or unless the DCT is of the view that providing reasons could be in breach of privacy or secrecy laws or any other legal obligation that the DCT may be subject to.

It should be noted that it is possible that the DCT may reject an indemnity in circumstances where an insolvency practitioner believes that the proposed action has very good merit and prospects of success and recovery. Such situations may arise from time to time for reasons which include:

- Staff resource and/or budgetary constraints. The ATO is required to operate within tight budgetary and staff resource limits. There may be times where, no matter how strong the merits and prospects of success and recovery of a particular action, the DCT cannot afford to invest and risk the potentially significant amount of Commonwealth resources, both in terms of dollars committed and staff resources.
- The DCT may have other viable means of recovery which are more cost-effective and efficient. For example, an indemnity may be sought to commence litigation against a company director who may also be liable to pay director's penalties to the DCT. In such cases, the DCT may choose to pursue recovery of the director's penalties rather than commit potentially significant Commonwealth resources into the provision of an indemnity.
- The likely indemnity expenses will exceed the value of the DCT's proof of debt. Even if the likelihood of recovery is good, if the DCT's proof of debt is not significantly higher than the indemnity sought, the request is likely to be rejected on the basis the risk to the DCT is considered unacceptable. The DCT will generally not risk an amount of Commonwealth resources to recover the same or less than the amount risked unless there are exceptional circumstances which justify such a decision.
- The DCT will generally need to be satisfied that in the event that proceedings are successful, the defendant (or defendants) will have sufficient recoverable assets to enable the insolvency practitioner to repay the indemnity expenses in full, plus pay a reasonable dividend on the DCT's proof of debt. If the DCT cannot be satisfied that a successful action is likely to result in the realisation of sufficient assets, then unless exceptional circumstances exist, the DCT will usually have no choice but to reject the indemnity. This is because the DCT may not be able to comply with legal and policy obligations which must be satisfied before a decision can be made to commit Commonwealth resources.

Changes to applicable law and policies

The content of this article is correct as at April 2010 and is subject to change if there are any relevant law or policy changes implemented, including any internal policy changes that the DCT may decide to implement from time to time.

Contacting the ATO with questions about indemnity requests

If you have any general questions relating to issues addressed in this article, direct your enquiries to [Darren Nissen](#).

Last Modified: Friday, 25 June 2010

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