Australian Government
Australian Taxation Office

Preference payments for companies

What are unfair preferences?

Unfair preferences usually involve transactions that discriminate in favour of one creditor at the expense of other creditors. The aim of the law outlined below is to ensure creditors are treated equally by preventing any unsecured creditors from receiving an advantage over others.

The proceeds of any property you, as a liquidator, recover and realise will form part of the funds available for distribution amongst all unsecured creditors after the winding-up expenses have been paid.

New developments

From 1 March 2011, we will be able to settle all voidable transaction claims, regardless of the amount of the claim, without you needing to obtain a court order under section 588FF of the **Corporations Act 2001** (the Act) where:

- we are satisfied you have proved that an unfair preference or uncommercial transaction, as defined by the Act, has been received
- the amount repaid is in full and final settlement of your claim
- we do not intend to defend the claim or seek an indemnity against directors under **section 588FGA** of the Act.

Where you meet these criteria, being able to settle voidable transaction claims without a court order means the repayments can be made promptly and costs can be kept to a minimum for both parties.

You will still need to take legal action where we intend to defend your claim or seek an indemnity against the directors of the company. If we intend to seek an indemnity against the directors of the company, we will ask you to institute proceedings in the Federal or Supreme Court, and the directors will be put on notice that they will be joined as a party to the legal proceedings.

Under **subsection 588FF (3)** of the Act, we cannot settle unfair preference claims after the latter of the following:

- three years from the relation-back day
- 12 months from the date a liquidator was first appointed as part of winding up the company.

Claims over $25,000

We have certain obligations we must meet under the Legal Services Directions 2005 when handling monetary claims. In particular, we can only settle a claim (including interest and costs) that exceeds $25,000 if we receive written advice from an external legal provider that the settlement is in accordance with legal principle and practice.

We have now obtained approval to settle claims with a monetary value of up to $500,000, provided we can establish the proposed settlement is in accordance with legal principle and practice as advised by our legal services branch. Even if we believe the liquidator has established a valid claim and there is no statutory defence available to us, we cannot enter into any settlement negotiations until we meet this obligation.

The four elements of a preference claim

In assessing claims for repayment of alleged unfair preferences, we must consider all of the relevant evidence, including evidence of the company's insolvency at the time of the alleged transactions. We must:

- assess whether a court would be satisfied that you can prove each element of the claim
- consider whether any of the statutory defences are available to us.

To demonstrate that a preference has been made, as the liquidator, you must provide documentary evidence showing the following:

1. **The company was insolvent when each transaction was entered into or became insolvent as a result of entering into each transaction.**

   You should place emphasis on the cash flow test, rather than profitability analysis or a deficiency in working capital alone. You should also supply evidence that supports cash flow insolvency. If you choose to rely on deemed insolvency, we will need full details of the circumstances you relied on.

   You should also provide documents including the following:
   - a copy of the company's bank statements from at least six months leading up to the relation-back day, to the date of liquidation

- a copy of the company's list of aged creditors for periods leading up to and including the relation-back period
- identification of whether the company maintained an overdraft facility or was using any other type of financing such as debtor financing (factoring) and if so, the details of that facility
- monthly or quarterly balance sheets, profit and loss statements and cash flow statements for the period leading up to and during the relation-back period
- a general ledger cashbook reconciliation
- copies of demands and similar documents (or a sample thereof) received from the company's creditors during the relation-back period
- copies of an insolvency report already prepared as part of your duties, if available.

You do not have to incur the expense of preparing an insolvency report solely in support of a voidable transaction claim. It is only necessary to demonstrate to a reasonable standard that a voidable transaction has occurred. This means you should not incur any unreasonable additional duties or costs when providing this information.

2. **The ATO and the company were parties to each transaction.**

   You should provide evidence of how and when the impugned payments were made, such as copies of the company's bank statements and cheques records. If any payments were made by a third party entity on behalf of the company, you should also provide a detailed explanation of the circumstances surrounding those payments.

3. **The transaction resulted in the ATO receiving more than it would have if the transaction were set aside and the ATO proved for the debt in the winding up of the company.**

   To help work out whether this is the case, review the company's payment history with other creditors.

4. **The transaction was entered into during the six months ending on the relation-back day, or if after that day, on or before the day on which the winding up began.**

Providing us with this information in the original letter of claim will save time and reduce the need for us to request more information. If we do need more information, we will contact you as soon as practicable after we receive the letter of claim.

You must also provide the following information:

- the company's name and Australian company number
- details of the alleged preference payments, including the amounts, date of issue and date the cheque was presented for payment
- your name and address as the liquidator, the date of your appointment and the relevant court making the winding-up order
- if an administrator had been previously appointed to the company, the date of the administrator's appointment and details of the administration, such as their name and address
- details of the relation-back day
- grounds of insolvency, including the facts supporting your claim that the company became insolvent due to the alleged preference payment or was insolvent when the payments were made
- if payments (that form all or part of the preference claim) were made by third-party entities, documentary evidence detailing the source of the payments.

There may be cases where we need more information from you. Even when you have provided sufficient information, we usually issue an interim response to confirm we have received the request and to provide the name of a contact officer for any enquiries.

We will advise you of our position within 28 days of receiving the relevant information and assessing the merits of the claim.

Liability of directors under indemnity provisions

Under **section 588FGA** of the Act, directors may be liable to indemnify us against any loss or damage resulting from an order under **section 588FF** of the Act that requires us to repay an amount as a voidable transaction. As this indemnity is dependant on the court making an order under **section 588FF** of the Act, legal proceedings will be necessary in cases where we intend to seek an indemnity against directors.

The courts have:

- recognised we have a statutory right to bring indemnity proceedings as an interlocutory application in the liquidator's recovery proceedings in accordance with **section 588FGA(4)** of the Act
- found the directors have a right to be heard on the primary dispute between the liquidator and us.

Where we accept that we have received the benefit of an unfair preference, any offer of settlement we make with you must be conditional on the directors of the company not disputing your claim.

If we intend to seek an indemnity against the directors of the company, we will ask you to institute proceedings in the appropriate court and the directors will be put on notice that they will be joined as a party to the legal proceedings. In these circumstances, we will resist any premature application you make for judgment against us without reference to the rights of the directors, and we may also seek costs in relation to that application.

Particular payments not transactions

The **section 260-5 of the Taxation Administration Act 1953** allows us to collect tax debts by serving a notice, commonly referred to as a garnishee notice, on a debtor of the company. Payments made under such a notice cannot be regarded as unfair preference payments because they do not constitute a transaction between the company and us.

We will scrutinise claims involving third-party payments since individuals often pay outstanding company withholding debts from their own funds to satisfy the compliance provisions of the **Income Tax Assessment Act 1936 Part VI, Division 9**.

Application of credits and preferences

Credits other than payments can arise on a debtor's account as a result of account adjustments, transfers, credit assessments or GST refunds.

Under our statutory offset provisions, credits owing to the company must be offset against any outstanding debts. These offsets are not transactions of the company.

Whilst we must offset credits that arise under various tax laws, we have occasionally been challenged as to whether the application of such credits would be a preferential payment. In the case of **Driver (as liquidator of Tilse Building Pty Ltd) v Federal Commissioner of Taxation (1999)**, the liquidator sought to claim a preferential payment from us where we had offset a credit arising from an amendment against an existing tax debt. The application of the credit is in fact a unilateral act of the Commissioner. It was held that a company cannot be a party to a transaction unless it takes some part in it. Because of this, under **section 588FA** of the Act, the transaction did not constitute an unfair preference.

Provision of information

We can provide information to an insolvency practitioner who has an alter ego status in relation to the insolvent entity. For example, as a liquidator, you are an insolvency practitioner with alter ego status because you effectively assume the same role the directors had as the controlling mind of the company. In such cases, you have the same entitlement to the company's information as the company, and we can provide you with any information that would normally have been available to the company. You can obtain this information without charge by requesting it from us - you do not need to submit an application under the *Freedom of Information Act 1982*.

Before requesting copies of documents we hold, consider whether obtaining those documents is necessary for your claim and limit your request to only those documents you believe will help you identify any payments that may be preferential. This will allow us to action claims in a timely and efficient manner, particularly where we do not intend to raise a statutory defence.

Where you obtained information supporting a voidable transaction claim, do not return this information to us in support of the claim. You do not have to demonstrate that a statutory defence is not available to us. We rely on you to provide sufficient proof that the elements of a preference exist and that the claim is valid. When assessing claims for repayment of alleged voidable transactions, we examine all of the relevant evidence available to us about the solvency of the company and then work out whether any of the statutory defences ordinarily available to us exist.

What to read/do next

For more information, refer to:

- **Preference payments for individuals**
- **Contacting insolvency teams**
- **Release of taxpayer information**
- **PSLA 2011/18**
- **PSLA 2011/16**
- **PSLA 2011/21**

Last Modified: Monday, 8 August 2011

Our commitment to you

We are committed to providing you with accurate, consistent and clear information to help you understand your rights and entitlements and meet your obligations.

If you follow our information and it turns out to be incorrect, or it is misleading and you make a mistake as a result, we will take that into account when determining what action, if any, we should take.

Some of the information on this website applies to a specific financial year. This is clearly marked. Make sure you have the information for the right year before making decisions based on that information.

If you feel that our information does not fully cover your circumstances, or you are unsure how it applies to you, contact us or seek professional advice.

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