

# CITY INSOLVENCY DISCUSSION GROUP

**Wednesday, 2 May 2018**

## **TOPIC**

Personal Liability of External Administrators

## **PRESENTED BY**

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# **Personal Liability of External Administrators**

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## Today

- Circumstances where external administrators (voluntary administrators and liquidators) can be held personally liable for:
  - Tax obligations.
  - Penalties associated with environmental obligations.
  - Legal costs.

## Tax obligations

- Land tax.
- GST.
- CGT.

## Tax obligations – Land Tax

- External administrators can be held personally liable.
- S 9(1) of the *Land Tax Assessment Act 2002* (WA) (**Land Tax Act**) provides that an agent of taxable land is liable to pay tax.
- Agent includes liquidator, administrator and receivers and managers.
- S 9(2) of the Land Tax Act provides that agents not personally liable to any **greater extent** than the funds / securities of the principal that the agent holds.
- What does this mean?

## Tax obligations – Land Tax

- S 9(5) of the Land Tax Act makes external administrators personal liable and subject to penalties for:
  - refusing to pay or failing to pay land tax equal to the amount of the taxpayer's primary liability.
  - late payment, penalty equal to 20% of amount outstanding.
- S 9(3) of the Land Tax Act – external administrator who pays land tax is entitled to be indemnified.

## Tax obligations – Land Tax

- If funds are available to pay land tax and external administrator fails to pay or pays late, then unlikely to rely on indemnity.
- If no funds available, no obligation to pay – suggest writing to Department of Finance.

## Tax obligations – GST

- Previously external administrators **not** personally liable to pay GST.
- Introduction of s 58 of the *A New Tax System (Goods and Services Tax) Act 1999 (Cth)* (**GST Act**) makes external administrators personally liable.
- S 58.65 of the GST Act - external administrator who is liable to pay GST is authorised and required to apply money which they hold for the company.

## Tax obligations – GST

- However, external administrator can breach duty if they do not pay GST if:
  - Funds available; or
  - Insufficient funds available to pay debts in s 556(1)(a), then if they do not pay debts proportionately: *Deputy Commissioner of Taxation v Tideturn Pty Ltd* (2001) 46 ATR 446.
- A breach of duty means external administrator unlikely to be able to rely on right of indemnity.

## Tax obligations – CGT

- In *Commissioner of Taxation v Australian Building Systems Pty Ltd (in liq)* (2015) 257 CLR 544, High Court considered whether liquidators came under the retention obligations in the *Income Tax Assessment Act 1936* (Cth).
- Outcome hinged on interpretation of “amount due” and whether tax is due before an assessment has been issued.
- No obliged to retain sufficient amount if an assessment has **not** been made.

## Environmental Obligations

- Legislation provides that if a company commits an offence under relevant environment legislation, the directors / officers also commit an offence.
- Does disclaiming assets associated with an environmental protection order (**EPO**) mean you did not need to comply with an EPO?

## Environmental Obligations

- Facts:
  - Linc operated a coal gasification demonstration facility in Queensland.
  - EPO issued to Linc whilst the company was under administration.
  - Subsequently Linc went into liquidation.
  - EPO imposed numerous obligations on Linc, including to conduct environmental monitoring and reporting, and prohibited Linc from disposing of, and obliged Linc to maintain the infrastructure, on the facility site.
  - Disclaimed the land, various mining licenses and the infrastructure on the land.

## Environmental Obligations

- Primary decision:
  - The liquidators sought directions from the court under section 511 as to whether they were justified in not complying with the EPO because of the disclaimer.
  - Liquidators were obliged to comply with the EPO despite the disclaimer.
  - Further, the liquidators were executive officers for the purpose of the EP Act.
  - Liquidators personally liable for not complying with EPO.

## Environmental Obligations

- The Appeal:
  - Disclaimer had the effect of terminating Linc's obligations to comply with the EPO.
  - Linc no longer had the authority or ability to engage in the activities to which the EPO applied because of the disclaimer of land, licenses and infrastructure.
  - The disclaimer terminated Linc's rights and obligations to carry out activity on the land pursuant to the licenses, meaning Linc was incapable of discharging the EPO.

## Environmental Obligations

- S 118(1) of the *Environmental Protection Act 1986* (WA) expressly provides: “if a body corporate commits an offence under this Act or the regulations, each person who is a director or who **is concerned in the management of the body corporate is taken to have also committed the same offence**”.
- No binding authority in WA.
- Await special leave hearing in High Court.

## Costs in Legal Proceedings

- General rule – a successful party is entitled to recover the party/party costs.
- Usually proceedings are ex-parte and costs will be ordered out of the assets of the company.
- If you have to litigate and are unsuccessful, then you may be personally liable to pay costs but can usually rely on your right of indemnity.
- However, in rare circumstances you may be unable to rely on your right of indemnity.
- Note - external administrators do not escape personal liability just because proceedings are in the company's name.

## Costs in Legal Proceedings

- If external administrator **commenced** proceedings which were unsuccessful, then the courts will generally order the costs against the external administrator, which can be recovered pursuant to the right of indemnity.
- If external administrator **defended** proceedings which were successful, then the courts will generally order the costs against the external administrator, which can be recovered pursuant to the right of indemnity.
- However, if external administrator acted unreasonably, then costs not recoverable pursuant to right of indemnity.

## What is unreasonable?

- Whether the external administrator acted unreasonably requires an objective assessment (reasonable person in the shoes of the external administrator).
- Whether legal advice was sought, the extent of that legal advice and whether that advice was followed, is relevant to the inquiry of reasonableness.

## What is unreasonable?

- *International Cat Manufacturing Pty Ltd (in liq) & Anor v Rodrick & Ors (No 2)* [2013] QSC 307:
  - Liquidators personally liable on basis that they had been unreasonable in:
    - failing to give meaningful consideration to a sensible settlement offer;
    - having no reasonable prospect of succeeding; and
    - causing the receiver to incur significant legal costs.

## What is unreasonable?

- *J A Westaway Pty Ltd (in liq)* [2016] NSWSC 868:
  - Liquidators personally liable on basis that they had been unreasonable in:
    - convening final meeting without making an inquiry as to whether applicant still sought to lodge proof of debt;
    - failing to initially notify applicant of final meeting; and
    - too readily assuming not bound to determine applicant’s proof of debt.
  - However, costs could be recovered pursuant to right of indemnity because the “pursuit of claim for costs may well have caused both parties to incur greater costs than were incurred in the original application for relief”.

## Takeaways

- External administrator will only be personally liable for costs and unable to rely on their right of indemnity where they were unsuccessful in the proceedings **and** acted **unreasonably**.
- The extent of any costs award against an external administrator personally depends upon several factors, including the cost required to argue that the external administrator should not be entitled to rely on its indemnity as a proportion of the substantive proceedings.

## Indemnity

- Notwithstanding personal liability imposed by some of the above circumstances, external administrator will generally be able to indemnify themselves out of the company's assets.
- However, if:
  - court orders that you cannot;
  - creditors object based on conduct being **improper**, in **bad faith** and / or **negligent**; or
  - breach an obligation,You may be unable to rely on your right of indemnity.

# Questions?

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# CITY INSOLVENCY DISCUSSION GROUP

Next CIDG Session

Wednesday, 6 June 2018

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