TAXATION ASPECTS OF FINANCING TRANSACTIONS
INCLUDING LIQUIDATIONS AND RECEIVERSHIPS:
THE LENDER’S PERSPECTIVE.

By

Howard Alexander*

A number of common kinds of financing transactions will be referred to so as to illustrate
some of the taxation aspects arising under the Income Tax Assessment Act 1936
("Assessment Act") from a resident financier’s viewpoint. First considered are loans, bill
facilities and convertible notes, with brief mention being made of share based financing
transactions and arrangements involving unit trusts. Some reference is then made to the
taxation aspects of interests secured by guarantees, mortgages and charges, with the position
of mortgagees in possession being canvassed under the latter topic. Various taxation aspects
of the offices of receiver and liquidator are then approached, followed by comments on some
of the statutory provisions, canvassed to protect or prefer the Commissioner of Taxation,
which those officers and secured creditors may need to consider.

Loans

The essence of a loan of money is the payment of a sum of money on the obligation or
condition that at some future time an equivalent amount will be repaid. A taxpayer who
lends money for a stipulated period at interest is treated as exchanging the money lent for a
debt of the same amount, unless the loan is made at a discount or premium, in which case
there may be a gain or loss. Interest is regarded as flowing from the principal sum and is compensation to the
lender for being deprived of the use and enjoyment of the principal sum. The borrower is
simply a debtor who, in consideration for the forbearance of the creditor, has contracted to
pay sums called interest to his creditor at the times stipulated. Generally the lender’s right to
interest is an existing chose in action, viz, a present contractual right to be paid at a future
date a sum or sums of money, to be calculated in the agreed manner. As a general rule, interest derived by a resident lender is income according to ordinary concepts and included in
assessable income under s. 25(1) of the Assessment Act, whether the source of the interest was
within or outside Australia. In the case of taxpayers whose business include money lending,
e.g. banks, insurance companies and finance companies, interest income is derived on an
accruals basis i.e. when it becomes presently receivable upon the lapse of each time period in

* B.Com., LL.B. (Qld.), LL.M. (Syd.), Barrister-at-Law.
3. Id. 163 CLR 199, 218; 87 ATC 4363, 4371.
4. Id. 163 CLR 199, 218; 87 ATC 4363, 4371.
8. Under proposed s. 23AH, interest income of a resident company derived on or after 1 July 1990 in carrying on a
business at or through a permanent establishment in a listed country, i.e. a country whose tax system is comparable to
Australia’s, may be exempt.
respect of which it is payable. Otherwise, in most cases, interest on loans will be accounted for on a cash basis and treated as derived when received or, if one looks at the realities, constructively received within s. 19 of the Assessment Act. The mere capitalization of unpaid accrued interest will not usually be a receipt or constructive receipt; in most cases all that happens is that it is added to the principal indebtedness and itself becomes interest bearing. As between the parties it may be convenient to say that the interest is capitalized, or treated as capital, but for all other purposes the act of capitalization does not alter its quality as interest or constitute payment of the interest, which will only occur when the actual payment is made. On the other hand, where capitalization has the effect of creating a new debt upon an account stated, the character of the interest is destroyed by the discharge and payment of interest will have occurred at the time the account was settled. When a lender sells for a lump sum his right to the interest stream under a loan contract, there will be a derivation of income at the time of sale; he is simply converting future income into present income and the lump sum he receives will be a revenue and not a capital item. A fortiori where the sale of the right is in the course of or incidental to carrying on business. However, where interest is paid in advance, the principle in Arthur Murray (N.S.W.) Pty Ltd v Federal Commissioner of Taxation might permit a deferral of derivation of the prepaid interest as income until the lapse of the period relating to the use of the money, although the Commissioner apparently would not agree with this view. Where interest is payable as deferred interest, the loan may be classed as a "qualifying security" to which the special statutory rules in Div. 16E of Part III of the Assessment Act may apply to bring receipts of deferred interest to tax periodically on an accruals basis.

If a loan carries deferred interest or is made at a discount or, what is essentially the same thing, repayable at a premium, it may be a "qualifying security" within Div. 16E of Part III of the Assessment Act, in which case the deferred payment or discount may be brought to tax on an accruals basis instead of upon receipt, as was formerly the case if it was a revenue item. For the purposes of the Division, "security" includes inter alia debentures, bonds, bills of exchange, promissory notes, deposits with financial institutions, secured and unsecured loans, any other oral or written contract under which a person is liable to pay an amount. A qualifying security is a security that was issued after 16 December 1984; that is not a prescribed security within the meaning of s. 26C (i.e. Commonwealth securities that do not bear interest); that has a term of more than one year; that has an "eligible return" (i.e. the

---


10. See, e.g. St. Lucia Usines and Estates Co. v Colonial Treasurer of St. Lucia [1924] AC 508; Leigh v I.R.C. [1928] 1 KB 73; Cross v London and Provincial Trust Ltd [1938] 1 KB 792.

11. Permanent Trustee Company of New South Wales v Federal Commissioner of Taxation (1940) 2 AITR 109, 111 per Rich J.


17. Parsons, Supra n.9, para. [11.49].

18. Parsons, Ibid. at para. [11.112].

19. Assessment Act, s. 159GP(1).
amount by which the payments (other than periodic interest) under the security are likely to exceed the issue price); and, if the precise amount of the eligible return can be calculated at the time of issue, that amount is greater than 1.5% of the amount ascertained by multiplying the payments (other than periodic interest) to be made under the security by the number of years of the term of the security. A qualifying security can be either a "fixed return security" or a "variable return security".

Where any deferred interest or discount would be included in assessable income in due course upon its receipt (disregarding amounts that would not be so included because it will be subject to withholding tax under s. 128D), then to that extent notional amounts will be included in a taxpayer's assessable income for every 6 months during which he holds qualifying securities which are not trading stock. However, if a taxpayer purchases a variable return security at a premium, instead of a discount, he will be entitled to deduct a fraction of the premium in each period. Where an actual payment, other than a periodic interest or redemption payment, is made, it will not be assessable, unless it is made under a variable return security and differs from the notional accrual amount included in assessable income, in which case adjustments may be made to the taxable income. Where any qualifying securities are transferred, if the transfer price plus any payments (other than periodic interest) exceed the issue or purchase price, there will be a profit amount, and to the extent that the profit amount exceeds the net amount previously included in assessable income, the excess shall be included in assessable income. To the extent that the profit amount is less than the net assessable amount, the shortfall will be allowable as a deduction. On the other hand, if the transfer price plus payments (other than periodic interest) is less than the issue or purchase price, there will be a loss amount, and the net amount previously included in assessable income will be allowable as a deduction. No profit on the transfer of any qualifying securities (not being trading stock) can be included in the assessable income of a resident taxpayer other than under Div 16E. Where any loss incurred by a resident taxpayer on the transfer of such qualifying securities would be an allowable deduction under another provision of the Assessment Act, the loss may be claimed as a deduction under that other provision only to the extent that the loss amount exceeds the net deductible amount under Div. 16E.

Consequently, where a taxpayer carries on a business of dealing in money, if in the ordinary course of that business a loan is made at a discount, any gain on maturity or redemption will be on revenue account, so Div. 16E may apply to bring the amount of the issue discount to tax on an accruals basis. Where the taxpayer is not carrying on a business of dealing in money, if a loan is made at a zero interest rate, or for less than the commercial rate of interest, according to some United Kingdom authorities some or all of the issue discount

---

20. Assessment Act, s. 159GP(3).
21. Assessment Act, s. 159GP(1).
22. Assessment Act, s. 159GX.
23. Assessment Act, s. 159GQ.
24. Assessment Act, s. 159GR.
25. Assessment Act, s. 159GU(1).
26. Assessment Act, s. 159GU(2).
27. See Lomax v Peter Dixon & Son Ltd [1943] 1 KB 671, 683 per Lord Greene M.R.; see also I.R.C. v Thomas Nelson & Sons Ltd (1938) 22 Tax Cas 175, where there was an interest rate of 3% with the premium increasing over time; Davies v Premier Investment Co. Ltd (1947) 27 Tax Cas 27; [1945] 2 All ER 681, where no interest was payable on convertible notes repayable at a premium of 30%, with a lesser premium if paid early.
may be treated as income, so Div. 16E may require the taxpayer to bring some or all of the issue discount to tax on an accruals basis, instead of upon receipt. In contrast, where a loan is made at or above the commercial rate, it is more likely that some or all of the issue discount may be characterised as compensation for the capital risk to the lender in making the loan, so as to be a gain on capital account.\(^{30}\) In Australia, if some part of the discount is capital, there may be an argument that the whole amount is capital, on the basis of the decisions in *McLaurin v Federal Commissioner of Taxation*\(^{31}\) and *Allsop v Federal Commissioner of Taxation*\(^{32}\) and in the absence of separation being available under s. 262 of the *Assessment Act*.\(^{33}\) Where the whole of the gain is on capital account, if no part of the issue discount would, when actually paid or liable to be paid, be included in the assessable income of the taxpayer of a year of income, Div. 16E will not apply to bring the issue discount to tax on an accruals basis.\(^{34}\) However, since Div. 16E was first proposed, Part IIIA has been introduced into the *Assessment Act*, so “net capital gains” are now included in assessable income,\(^{35}\) with the result that Div. 16E might now apply even where the discount payable on the redemption or maturity of qualifying securities has a capital nature, although if Div 16E does apply, it will only apply to the extent that the discount would have been included as a net capital gain in assessable income. But where a qualifying security is disposed of by way of transfer, instead of by repayment or redemption, Part IIIA cannot apply to include any profit in relation to the transfer in assessable income, as only Div. 16E applies to determine the amount of the profit to be included in assessable income.\(^{36}\)

Where a taxpayer disposes of a “traditional security” that was acquired after 10 May 1989, as a general rule no capital gain will accrue or no capital loss will be taken to have been incurred by the taxpayer for the purposes of Part IIIA,\(^{37}\) but the amount of the gain on disposal or redemption will be included in assessable income under s. 26BB or, if there was a loss, the amount of the loss will be allowable as a deduction under s. 70B. Interest payable under traditional securities continues to be taxable in accordance with s. 25 of the *Assessment Act*. Traditional securities are, broadly speaking, the converse of qualifying securities. A traditional security is a security held by the taxpayer that was acquired after 10 May 1989; that is not trading stock of the taxpayer; that is not a prescribed security to which s. 26C applies; that does not have an eligible return (i.e. one under which the payments (other than periodic interest) will exceed the issue price) or, if it does have an eligible return, the eligible return can be calculated and is less than 1.5% of the payments (other than periodic interest) multiplied by the term in years (and fractions of years) of the security. It will be seen, in contrast to a qualifying security, that a traditional security can include a security with a term of less than one year, but will not include a security with a variable return. It will also be seen, that s. 70B may permit an allowable deduction where one cannot be claimed under s. 51(1) or s. 63(1).

Although no deduction is available for doubtful debts, a deduction may be claimed in respect of bad debts pursuant to s. 51(1) or s. 63(1) of the *Assessment Act*. The deduction will

---

31. (1961) 104 CLR 381.
32. (1965) 113 CLR 341; see also *Federal Commissioner of Taxation v Spedley Securities Ltd* 88 ATC 4126.
33. Parsons, *Supra* n.9 at para. [2.289].
34. *Assessment Act*, s. 159GX.
35. *Assessment Act*, s. 160ZO.
36. *Assessment Act*, ss. 159GS, 159GU.
37. *Assessment Act*, s. 160ZB(6).
be available under s. 63(1) if four conditions are satisfied. First, there must be a debt in existence even if not necessarily irrecoverable absolutely, but as a realistic estimate. Secondly, the debt must have been written off as such before the end of the relevant year of income, generally by book entry but other written particulars might possibly suffice. Thirdly, the debt must have been brought to account as assessable income at some time, or exist in respect of money lent in the ordinary course of business of lending money by a taxpayer who carries on that business. The holder of a qualifying security can claim as a bad debt amounts previously included in assessable income under the accruals method. Where, contrary to expectations, some of the debt written off is subsequently paid, that amount is included in assessable income in the year of receipt. Alternatively, to claim a deduction under s. 51(1), the loss not only must relate to the business producing the taxpayer’s assessable income, but also must have been incurred. For this purpose, a loss will be incurred where the debt is disposed of or extinguished, and sometimes perhaps where it is merely written off. However, the incurring of a loss and the writing off of a debt are not necessarily the same thing, nor will they necessarily take place in the same year of income. Companies which seek a deduction in respect of bad debts have to satisfy the continuing shareholder requirements of ss. 63A and 63B or the continuing business test of s. 63C. In the last case, s. 80F may place further constraints on the carry forward of the loss.

The capital gains provisions in Part IIA of the Assessment Act do not apply, subject to some exceptions, to assets acquired before 20 September 1985 or to the disposal of assets which are trading stock of a taxpayer. No profit on the transfer of a qualifying security will be included in assessable income under Part IIA, as only Div. 16E applies to include such profit in assessable income. As a general rule, upon the disposal of a “traditional security” acquired after 10 May 1989, no capital gain will accrue to, or capital loss will be incurred by, a taxpayer under Part IIA. Those matters aside, a taxpayer who lends money for a stipulated period at interest exchanges the money lent for a debt, and is thereby acquiring an asset to which Part IIA may apply. If the debt is transferred, or discharged or satisfied by payment, or released, that will be a disposal of the asset for the purposes of Part IIA. If

40. If the debtor becomes bankrupt, or executes a deed of assignment or arrangement, the difference between the amount of the debt and the amount which, in the opinion of the Commissioner, will be recovered, is deemed a bad debt: Assessment Act, s. 63(2).
41. Anderton & Halstead Ltd v Birrell (1932) 1 KB 271, 282.
42. See Point v Federal Commissioner of Taxation (1970) 119 CLR 453; 70 ATC 4021.
43. Case 33 (1941) 10 CTBR 101.
44. A bad debt “in respect of money lent in the ordinary course” of a money lending business will encompass all parts of the debt, including principal and interest: Federal Commissioner of Taxation v National Commercial Banking Co. of Australia Ltd (1983) 72 FLR 116; 83 ATC 4715.
45. Assessment Act, s. 63(1A).
46. Assessment Act, s. 63(3).
50. Assessment Act, s. 160L(3).
51. Assessment Act, s. 159GU.
52. Assessment Act, s. 160ZB(6).
54. Assessment Act, s. 160M(3).
55. Ibid.
the release is for no consideration, or if the consideration cannot be valued or if the consideration for the release is greater or less than the market value, the consideration for the disposal of the debt will be deemed to be its market value as if the disposal had not occurred and was not proposed to occur.\textsuperscript{56} If the debt is irrecoverable, the market value will reflect that, so that the release may result in a capital loss. Where, upon the disposal of a debt, a capital gain accrues to a taxpayer under Part IIIA, but the profit is also included in the assessable income under another provision of the \textit{Assessment Act}, the capital gain for the purposes of Part IIIA may be reduced by s. 160ZA(4) to prevent double taxation.

\textbf{Bill Facilities}

Under many bill facility agreements, a financial institution agrees to accept bills of exchange drawn upon it by a customer, payable to the customer or its order, and then either buys or discounts the bills itself, or sells the bills as agent for the customer, remitting or crediting the proceeds to the customer or returns the bills to the customer to sell itself. Once the facility has been utilised, on one view the customer becomes subject to a present liability, to put the financial institution in funds, which continues, uninterrupted by rollovers, throughout the term of the facility, whereas the other view is that it is the drawing and acceptance of the bills themselves which gives rise to separate periodic liabilities of the customer and not the making of the agreement.\textsuperscript{57} The business of buying bills at a discount, that is, for their value at the date of purchase, is well known and quite distinct from moneylending; there is no loan of money and no promise of repayment.\textsuperscript{58} The discount is the difference between the face value and the purchase price of the bill.\textsuperscript{59} In the case of a discount, two economic elements are present, one the value of the usufruct foregone, as measured by interim interest, the other the capital risk that the money will not be repaid.\textsuperscript{60} But the discount is neither interest nor the same as interest.\textsuperscript{61} The discount has been described as the reward which the person discounting the bill obtains for his money\textsuperscript{62} and is income according to ordinary concepts and usages, apparently even if the purchase of the bill was an isolated transaction.\textsuperscript{63} No apportionment for any capital risk appears appropriate.\textsuperscript{64} In cases where a financier merely lends its name as an accommodation party, the fee for this service will be income and if, on payment of the bill on its maturity it does not receive equivalent funds from the party accommodated it suffers a loss, that loss may be deductible if it was carrying on a business of deriving income as an accommodation party. Where the financier is not carrying on such a business, as an accommodation party it will be in the position of a surety and the deductibility of the loss must be considered in that light.

The general principle is that where a financial institution carries on a business of purchasing or discounting bills, and does not deal with them as trading stock, no profit is derived until the bills mature or are sold.\textsuperscript{65} This principle may continue to apply to bills having

\textsuperscript{56} \textit{Assessment Act}, ss. 160ZD(2), 160ZD(2A).
\textsuperscript{57} K.D. Morris \& Sons Pty Ltd \textit{v} Bank of Queensland Ltd (1980) 146 CLR 165, 174-175, 200-201.
\textsuperscript{60} \textit{Lomax v Peter Dixon \& Son Ltd} [1943] KB 671, 681; see R.C. Allerdice, supra n. 58, 606-609.
\textsuperscript{62} \textit{Lomax v Peter Dixon \& Son Ltd} [1943] KB 671, 681.
\textsuperscript{63} \textit{Federal Commissioner of Taxation v Hurley Holdings} (N.S.W.) Pty Ltd 89 ATC 5033, see also \textit{Case W57} 89 ATC 517.
\textsuperscript{64} \textit{Federal Commissioner of Taxation v Hurley Holdings} (N.S.W.) Pty Ltd 89 ATC 5033, 5037-5038.
\textsuperscript{65} \textit{Willingdale v International Commercial Bank Ltd} [1978] AC 834.
a term of less than one year. However, where bills have a term of more than one year, they may be "qualifying securities" to which Div. 16E applies to bring the discount to tax on an accruals basis. Where the bills are the trading stock of a business dealing in bills, then whatever their term they may be brought to account as such and will not be "qualifying securities" to which Div. 16E applies. Further, if bills are trading stock of a business being carried on by a taxpayer dealing in bills, the capital gains provisions in Part IIIA will not apply. But in other cases, the capital gain provisions may apply. Where they do and an amount is also included in assessable income under another provision of the Assessment Act, s. 160ZA(4) will reduce the capital gain in order to provide relief against double taxation.

Convertible Notes

A convertible note has been described as a debt security which effectively gives the holder an option for its redemption by a share issue in the borrowing company or another company, in default of which the company is required to discharge its face value upon maturity. However, as a matter of common practice, the exercise of the option under convertible notes often involves a two step process. Upon the holder notifying the company of its election, the company is obliged to redeem the note for its face value (the first step), but instead of paying the proceeds of redemption to the note holder, it is directed to apply the proceeds in subscribing for or purchasing the shares (the second step). In such cases, it has been asserted, the exercise of the option does not directly result in the redemption of the note by the issue or sale of the shares; instead the note is discharged by the payment, albeit by way of set-off, of the redemption proceeds. Prior to exercise of the option, convertible notes have similar advantages to debt financing, in that interest on the notes is deductible to the company, while after the notes are converted to shares, they have the advantages of equity finance, as they do not have to be repaid while the company is a going concern. For tax purposes, the convertible note will usually be an instrument which complies with the definition in s. 82L and the requirements of s. 82SA of the Assessment Act, for if it does not the interest may not be deductible to the company, while after the notes are converted to shares, they have the advantages of equity finance, as they do not have to be repaid while the company is a going concern. For tax purposes, the convertible note will be income according to ordinary concepts and included in the assessable income of a resident under s. 25(1).

As at July 1986, the Commissioner appeared to take the view that where convertible notes are acquired at a discount, either by original subscription or purchase, any profit derived by the holder on their subsequent sale or redemption is considered to be assessable income to the extent of the difference between the acquisition price and the par value, or the sale price where that is below par value, on the basis that it is part of the reward for the investment in the notes. Further, any amount received in excess of the par value was considered to be assessable if the terms of the notes required redemption at a figure in excess of par value. However, the Commissioner’s view was that where convertible notes were not issued or acquired at a discount, any profit arising on sale would not, as a rule, be assessable income, unless s. 25A or s. 26AAA applied. The position was different for share traders, financial institutions and insurance companies who would be liable to tax on the profits. While the field now appears to have been substantially covered by the provisions dealing with "qualifying securities" and "traditional securities", where the convertible notes fall within neither class, an issue may arise as to correctness of the first part of the Commissioner’s

66. Humes Limited v Comptroller of Stamps (Vic.) 89 ATC 4646, 4648.
68. Taxation Ruling IT 2336.
ruling. If any issue discount or other gain is income according to ordinary concepts or usages, it will be included in assessable income under s. 25(1) and, if Part IIIA applies, s. 160ZA(4) may apply to reduce any assessable capital gain accruing under Part IIIA in order to prevent double taxation. If the issue discount or other gain is not income according to ordinary concepts or usages, but the convertible notes were acquired on or after 20 September 1985, Part IIIA, which is discussed below, may catch the capital gain accruing on any sale or redemption of the convertible notes, as opposed to their conversion.

Where a convertible note has been acquired after 10 May 1989 so as to be a “traditional security” within the meaning of s. 26BB, except in two minor instances, any capital gain or capital loss on disposal of the convertible note itself will not be subject to Part IIIA, but the gain on disposal or redemption will be included in assessable income under s. 26BB or, if a loss is incurred, allowable as a deduction under s.70B. The Commissioner can be expected to assert that the gain is the difference between the cost of acquiring and converting the note and the value of the consideration received on disposal or redemption, for example, the value of the shares or units acquired on conversion. However, if the two step process on conversion referred to above applies, it might be arguable that the consideration received for the discharge of the note is the amount applied by way of set-off and not the shares or units acquired as a result of the application of those redemption proceeds. If convertible notes are issued after 16 December 1984 at a discount or carry deferred interest, they may be “qualifying securities” to which Div. 16E applies, in which case the eligible return (i.e. the return under the note other than periodic interest payments) may be brought to tax on an accruals basis. It would appear that the right of conversion alone will not necessarily mean that a convertible note is a qualifying security or a variable return security, for if that was the case, no convertible notes would be traditional securities (except perhaps those which utilised the two step conversion procedure) and Div. 12B of Part IIIA, which applies to convertible notes that are traditional securities, would be otiose. Where the convertible notes are qualifying securities, if the issue of shares or units in redemption of the convertible note is a “redemption payment” within the meaning of that expression in Div. 16E, then there may be an argument that the gain to the holder at the time of redemption will not be included in assessable income under Div. 16E, unless the convertible note is a qualifying security which is a variable return security.

Where a convertible note is a “traditional security” acquired after 10 May 1989, in general any gain or loss on disposal of the convertible note itself will not be subject to capital gains, being excluded therefrom by s. 160ZB(6), but will be subject to s. 26BB and s. 70B. However, any gain or loss on the subsequent disposal of the shares or units acquired by the conversion of convertible notes which are traditional securities will be subject to Part IIIA, with the consideration for their acquisition being calculated in accordance with Div. 12B of Part IIIA. Where the convertible notes are not traditional securities, their conversion is deemed not to be a disposal, so conversion itself will not have capital gains tax consequences under Part IIIA. However, the subsequent disposal of shares or units acquired as a result of that conversion will be subject to Part IIIA, with the consideration for their acquisition being

69. *Assessment Act*, s. 160ZB(6).
70. Explanatory Memorandum to Taxation Laws Amendment Bill 1990, introductory note to clauses 26, 27 and 28.
72. *Assessment Act*, s. 159GQ.
73. Neither s. 159GR nor s. 159GS applies to a redemption payment.
74. *Assessment Act*, ss. 160ZYZ and 160ZZBB.
calculated in accordance with Div. 12 or Div. 12A respectively. The manner in which the consideration for acquisition is calculated denies a taxpayer the benefit of indexation on the cost base of the convertible notes, so in some cases consideration might be given to selling the convertible notes and acquiring the shares or units on market.

Share Based Financing

One popular method of share based financing used to be effected by the financier subscribing for *redeemable preference shares* in a company, and claiming a dividend rebate in respect of the dividends paid on the preference shares. Money subscribed for the acquisition of redeemable preference shares cannot be described as money lent or money advanced; the moneys are paid for the issue of shares and on the issue of shares the financier becomes a member of the company entitled to the rights which attach to the shares. The preference shareholders merely have a contractual right to insist on redemption, provided the funds specified in s. 120(3) of the *Companies (Queensland) Code* are available.

Another method of share based financing is called *margin lending*, where the borrower has given a legal mortgage over a parcel of shares in a public company and, during the period of finance, the dividends on the shares are directed to the financier as the shareholder and in respect of which he then purports to claim the intercorporate dividend rebate. The Commissioner's view of the efficacy of such arrangements is expressed in Taxation Ruling IT 2513. Section 46D treats dividends paid on shares issued in connection with a financing arrangement entered into after 10 December 1986 to be "debt dividends" where the dividends may reasonably be regarded as equivalent to the payment of interest on a loan. Thus dividends payable on redeemable preference shares issued to financiers would now be "debt dividends". The Commissioner also regards dividends payable under margin lending arrangements as debt dividends. Debt dividends on shares issued on or after 16 August 1989 have been excluded from the definition of frankable dividend. As a result, debt dividends on shares issued after that date will be unfranked dividends, as they will not carry franking credits, and no intercorporate dividend rebate under s. 46 will be available in respect of such debt dividends, as s. 46D(3) denies the intercorporate dividend rebate to the unfranked part of debt dividends. They will also be subject to dividend withholding tax if paid to non-residents.

Financing Unit Trusts

Taxation Ruling IT 2512 deals with arrangements which it describes as "financing unit trusts". The description applies where a financier provides funds for a property development or investment by subscription for one class of units in a unit trust; the financier is guaranteed an agreed rate of return and, often by means of put and call options, the financier's units to be redeemed or purchased at a predetermined date for an agreed price which reflects the financier's initial outlay and the agreed rate of return. Under one type of arrangement, the trustee of the unit trust would purchase the development and appoint the developer as its manager. During the early years of the development, the notional tax deductions for depreciation and building amortisation under Div. 10D would exceed the income, so it was generally argued that tax free cash distributions could be made to the financier unitholder. Some limitations were imposed on this by s. 160ZM, but that provision does not apply to...
building amortisation under Div. 10D and indexation was permitted notwithstanding annual distributions by s. 160L(5), and in respect of disposals prior to 25 May 1988 it was argued that Part IIIA did not apply by virtue of s. 26AAA(3). The Commissioner now takes the view, with effect from 20 December 1988, that Div. 6 is not an exclusive code and that distributions to the finance unitholders are assessable under s. 25, or s. 25A where it is applicable, the investment being as much a part of the business of financiers, like banks, insurance companies and finance companies, as other investments the profits of which are assessable on the principle in *London Australia Investment Co. Ltd v Federal Commissioner of Taxation* 79 The Commissioner has also observed that Div. 16E may have some application. Further, the Commissioner has stated that if his primary view of the arrangement is wrong, the anti-avoidance provisions of Part IVA may be applied.

**Equipment Leases**

The economic effect of many equipment lease transactions is similar in many respects to a seller making a loan to a buyer to purchase property, particularly where there is a tacit understanding that the lessee may acquire the ownership of the property at the expiration of the term. This has been recognised for accounting purposes, as equipment leases are classified as operating leases or financial leases according to their economic substance. 80 Where substantially all of the risks and benefits incidental to ownership of the leased property effectively remain with the lessor, the lease is an operating lease. Alternatively, where substantially all of these risks and benefits effectively pass to the lessee, the lease is classified as a finance lease. Where the lease is a finance lease, the lessor is required to sub-classify the lease into sales-type, direct financing or leveraged lease, as different accounting treatments apply to each sub-type.

While the economic substance of a transaction may be important for classifying a lease for accounting purposes, the taxation of leases will not be determined by economic equivalence without reference to the legal relationship. However, the economic substance cannot be completely ignored. Consequently, if periodic payments extend over the useful life of the asset, they may be characterised as payments for the use of that property and on revenue account, whereas if periodic payments confer a right to use an asset for a term not limited to a period commensurate with those payments but for a substantially greater term corresponding to the useful life of the asset, the payments may be regarded as instalments of a purchase price and interest thereon. 82 In Taxation Rulings IT 28 and IT 2051 the Commissioner has set out the considerations he will take into account when determining whether to treat a transaction as a genuine equipment lease or a purchase agreement. If the transaction is not a genuine lease, but a contract under which an amount or amounts are payable, consideration may have to be given to whether it is a qualifying security within Div. 16E.

Under the statutory method for calculating income from equipment leasing transactions, sometimes called the “asset method”, the lessor includes gross rentals in assessable income and claims deductions for depreciation, with a balancing adjustment being made if the equipment is disposed of for more or less than its written down value. Until 1 July 1990, the

80. Statement of Accounting Standards AAS 17.
81. See *Federal Commissioner of Taxation v South Australian Battery Makers Pty Ltd* (1978) 140 CLR 645; 78 ATC 4412, which concerned s. 51, although this case may now be decided differently, even apart from the expenditure recoupment provisions (ss. 82KJ-82KL).
Commissioner was prepared to accept taxable income from finance leases calculated using the finance or actuarial accounting method if certain conditions and assumptions were satisfied. This in effect permitted the revenue component from equipment leasing transactions to be brought into taxable income on a profit emerging basis, usually applying the "rule of 78" or actuarial tables to calculate the revenue component of each instalment. However, as a result of Taxation Ruling IT 2594, the asset method must now be used to calculate taxable income in respect of all genuine equipment leasing transactions entered into after 1 July 1990, or 1 August 1990 if that is too short a time for administrative reasons, which are not subject to s. 51AD (which applies to deny deductions under non-recourse leveraged leases to tax-exempt end-users) or Div. 16D of Part III (which applies a statutory asset method to limit deductions under non-leveraged finance leases to tax-exempt end-users).

Where equipment is disposed of for a price greater than its original cost, an issue may arise as to whether the gain should be included in assessable income as a revenue item. In *The Gloucester Railway and Wagon Carriage Co. Ltd v Inland Revenue Commissioner*, the taxpayer bought and sold railway wagons but also carried on a hiring business, the wagons used in the hiring business being treated as plant and depreciated. When an opportunity arose to sell some of the wagons above their written down values, it was held that the wagons were none the less sold as an incident of the business of buying and selling notwithstanding that they had been hired out and that there was no similarity between the wagons and "plant" in the proper sense, e.g. machinery, or between the wagons and investments, the sale of which would be a capital increment. In *Memorex Pty Ltd v Federal Commissioner of Taxation*, the taxpayer supplied equipment either by hire or sale and periodically sold equipment which had previously been hired, the profits on the sales of the same being a substantial recurring element in its receipts. It was held that there was no analogy between the case before the Court and the sale of plant used as part of the structure of the enterprise and that the profits were revenue gains; the argument that if the sales were to be brought into taxable income it could only be as trading stock was rejected. However, in *Federal Commissioner of Taxation v Cyclone Scaffolding Pty Ltd*, where the taxpayer first treated scaffolding as trading stock but if it was not sold or treated as sold in the same financial period it was devoted to the hiring side of its business, at which time it was treated as plant and depreciated, the majority of the Federal Court held that later sales of the equipment hired were disposals of part of the taxpayer's profit making apparatus and thus on capital and not revenue account.

A leveraged lease is a finance lease under which financiers (debt participants) provide non-recourse finance to the lessors (equity participants) to acquire the leased property, the finance being secured on the underlying leased property and the rental flow under the lease. From the financiers' point of view, the tax treatment will depend upon the nature of the finance facility provided. The Commissioner has set out some of the guidelines he applies to leveraged lease transactions in Taxation Ruling IT 2051. In an equity leasing transaction, the finance to buy the equipment is provided by the equity partners from their own sources, or on their own credit, or from lenders who will have recourse in the event of default. The Commissioner has issued Taxation Ruling IT 2169 setting out guidelines for such transactions, the breach of which might attract his determination to apply Part IVA. In the

83. ATO Document No.'s 11072872, 11092880; Taxation Rulings IT 2162, IT 2166.
84. [1925] AC 469.
85. (1987) 77 ALR 299; 87 ATC 5034.
86. (1987) 77 ALR 319; 87 ATC 5088.
case of non-leveraged finance leases with certain tax exempt lessees, e.g. government authorities or non-residents, who assume substantially all of the risks and benefits associated with the ownership of the property, Div. 16D operates to include in the lessor's assessable income only so much of the rental as is, effectively, the interest component and denies to the lessor depreciation and capital expenditure deductions, thus requiring income from the leases to be calculated using the asset method.  

A premium for the grant of a lease of property will be included in assessable income under s. 26AB if it is to be used for non-income producing purposes; other premiums are now caught by Part IIIA. It can be argued relying on Arthur Murray (N.S.W) Pty Ltd v Federal Commissioner of Taxation that prepayments of rent or terms charges where there is a contingent obligation to return the same if the lease is terminated, and if it is not in the nature of a capitalized sum payable by instalments, may not amount to a derivation of income by the financier until the time for provision of the use or service to which it relates has arrived. However, the Commissioner has asserted that nothing was said in the judgment that has any bearing on the point of time at which rentals of plant or machinery should be regarded as derived, and in Taxation Ruling IT 2282 he treated a rental prepayment to a finance company by a head-lessee who on-leased the equipment to a sub-lessee as wholly assessable in the year of receipt. Under Part IIIA, where a person leases property to another, not being a long term lease of land, it is not a disposal of part of the property but the disposal of an asset (i.e. the lease) created by the lessor for a consideration equal to the premium payable, if any, for the grant of the lease.

Hire Purchase

Under the common form of hire purchase agreement, the term often will be shorter than the useful life of the equipment and no property will pass to the hirer until he exercises the option to purchase on or after payment of the last instalment. For income tax purposes, the hire purchase agreement is equated with a purchase on terms and each instalment as including a capital component, so the finance or actuarial accounting method may be used to calculate the revenue component of each instalment to be included in the owner's assessable income. Under Part IIIA, where a person hires an asset to another under a hire purchase agreement, it is a deemed disposal of the asset by the owner to the hirer when the hirer first obtains its use, although if title does not ultimately pass to the hirer the deemed disposal will be rescinded and any relevant assessment amended. Where a retailer sells trading stock on credit terms, the "sale price" for the goods will be treated as derived at the time of the transaction and the elements of interest in any terms instalments will be treated as subsequently derived in the year in which the instalments accrue. The treatment appears to be, to some degree, a consequence of the trading stock provisions of the Assessment Act and would appear to apply irrespective of whether title passes at the time of sale or subsequently upon payment of all the instalments.

87. See Taxation Ruling IT 2376.
88. (1965) 114 CLR 314.
89. R.W. Parsons, supra n.9 at para. [11.112].
90. Ibid.
91. Assessment Act, s. 160ZS.
92. Assessment Act, s. 160M(3)(d).
93. Assessment Act, s. 160U(7).
94. Assessment Act, s. 160M(4).
Guarantees

A contract of guarantee is, subject to any qualifications in the particular instrument, a collateral contract to answer for the debt, default or miscarriage of another who is or may become liable to the person to whom the guarantee is given. A contract of guarantee must be evidenced in writing. Once default has occurred, the party having the benefit of the guarantee can call on the guarantor to honour his promise before calling on the principal contracting party to account by virtue of the doctrine of subrogation. If the subject of the guarantee is payment of a debt or a sum of money which has accrued due, the Australian view is that the creditor may, on default of the principal debtor, sue the guarantor instead of the principal debtor for the debt or sum of money, his claim being for a liquidated amount; but if the subject of the guarantee is the performance of some other obligation, then the person having the benefit of the guarantee may, upon default, sue the guarantor for damages for breach of contract.

There are two views on the nature of the payments made under a guarantee upon a debtor's default in his obligation to make a payment of a certain character. The question has been considered in respect of the obligation to pay interest. The first view is that what the guarantor pays and what the creditor receives is not interest but a payment due under the secondary obligation of guarantee, notwithstanding that the payment discharges the primary obligation to pay interest. The operation of the compensation receipts principle, which stated without qualification means compensation for an item that would have had the character of income takes the same character, and, if the expression "insurance or indemnity" is given a broad interpretation, s. 26(j) of the Assessment Act will ensure that a receipt under a guarantee which substitutes for a receipt that would have been income will be income of the creditor. The other view is that when the guarantor pays under the guarantee, he pays the interest which the principal debtor should have paid, so the payment is truly interest in the hands of the creditor. On the latter view, it is said that what matters is the nature or quality of the thing paid and not the source of the obligation to pay it. Looked at from the point of view of the recipient what he receives in discharge of the obligation does not change its character according to who pays it and under what obligation; so a debt is a debt and interest is interest, whoever pays it. Of course, while this suggests there is a receipt of "interest" by the creditor, it does not bear on the question whether there is a payment of "interest" by the guarantor.

Where the taxpayer that gives the guarantee is engaged in a business of giving guarantees for reward, any investments that result from payments under guarantees will be revenue assets and may give rise to loss deductions. For purposes of Part IIIA of the Assessment Act.

97. Property Law Act 1974, s. 56.
98. Sunbird Plaza Pty Ltd v Maloney, supra n.96, at 254.
102. Parsons, supra n. 9 at para. [6.248].
105. Parsons, supra n.9 at para. [6.248].
106. Parsons, supra n.9, at para. [6.251].
Act, a loan may give rise to an asset in the form of a debt in the hands of the lender, as may the discounting of bills. A guarantor may have an equitable right to indemnity before payment, but that right does not create an existing debt due from the principal debtor to the guarantor until actual payment. Where the debt is paid by a guarantor, the guarantor becomes subrogated to the rights of the creditor and entitled to the benefit of any securities, so there may be a disposal of the asset by the creditor, by the discharge of the debt, and an acquisition of a new asset by the guarantor, namely the debt created by the payment and now owing by the debtor to the guarantor. If the guarantor is unable to recover the money from the debtor, a capital loss might be incurred by the guarantor.

Mortgages and Charges

The classic definition of mortgage is that it is a conveyance of land or an assignment of chattels, either in law or equity, as a security for the payment of a debt or the discharge of some other obligation for which it is given. In contrast, a charge does not itself transfer legal or equitable title to the property or to possession, but creates a proprietary interest in the chargee which carries with it the right to resort to the property for payment; the same right continues after default with any enforcement remedies that may become available. Under the Real Property Act 1861 mortgages operate by way of charge only and not by way of transfer, and the mortgagee is not entitled to enter into possession until default has occurred. The Property Law Act 1974 confers on a mortgagee implied powers of sale and power to appoint a receiver.

A floating charge is an existing and present, rather than a future, security; at the same time it is not a specific security plus a licence to the company to dispose of the secured assets in the course of its business, but a floating security applying to every item comprised in it but not specifically affecting any item until some event occurs or some act is done which causes it to crystallize into a fixed security. Prior to crystallization, the chargee is not entitled to possession of the particular assets and does not have any proprietary interest in any particular assets. However, because it is an existing charge, even before the security becomes crystallized, in certain circumstances the chargee can apply to a Court for an injunction or the appointment of a receiver to protect its security.

Once a floating charge over all assets (present and future) of a taxpayer has crystallized, moneys due to the taxpayer by third parties are no longer payable to the taxpayer but to the chargee, and only the chargee can give a valid discharge for debts due to taxpayer. The same may be said in respect of future debts as they fall due and persons who hold or may hold money for or on account of the taxpayer.

Although the manner in which the mortgagee in possession is required to account for his receipts and profits has some similarities with that of a constructive trustee,
the relationship between the mortgagor and mortgagee is really sui generis. A mortgagee in possession is not a trustee or a fiduciary, for he exercises his powers for his own benefit and not for the benefit of others;\(^\text{118}\) nor is he an agent, as he enjoys possession in his own right — although he enjoys it for the purpose of securing payment of the mortgage money and is therefore accountable for what he receives or ought to receive.\(^\text{119}\) Admittedly, after the mortgagee has exercised his power of sale, a statutory trust is imposed upon the proceeds of sale by s. 88 of the Property Law Act 1974, but that does not have any general effect. On the other side, the owner of the property which is subject to a charge does not owe fiduciary obligations to the chargee\(^\text{120}\) and the interest of the charge in the property is distinct from that of a cestui que trust. As the mortgagee is neither a trustee or fiduciary of trust property nor a beneficiary of any trust, there does not appear to be a relevant “trust estate” to which the provisions of Div. 6 of Part III of the Assessment Act will apply, with the result that the mortgagee in possession is not assessable on the receipts and profits of the mortgaged premises as the trustee of a trust estate nor is he assessable on those receipts and profits as a beneficiary of a trust estate in the hands of the owner. However, it does appear that in certain circumstances a mortgagee in possession may derive interest income by reason of its collection of the rents and profits of the mortgaged premises. In Falk v Haugh\(^\text{121}\), where there was a mortgage of property of which the mortgagee had gone into possession, the issue was whether or not a statutory precondition was satisfied, by interest having been paid to a date within the period of twelve months immediately preceding the commencement of proceedings. Rich, Dixon, Evatt and McTiernan JJ. (Starke J. delivered a separate judgment) observed:

"The true view appears to be that a mortgagee in possession is treated as having satisfied the interest accruing under the mortgage when he has in his hands moneys received from the mortgaged premises which, after the deduction of expenditure allowable to him, are sufficient to keep the interest down. But, when under a provision of a statute or of the mortgage deed itself, payment by or on behalf of the mortgagor is required, the discharge of the obligation out of the receipts of the mortgagee in possession is not enough, at any rate without some active appropriation of the moneys on his part."\(^\text{122}\) [Emphasis added].

They then referred to the relevant statutory provision to be construed and commented:

"It is possible to construe the language in which this provision is expressed as requiring that the mortgagor or some one on his behalf shall have paid the interest to the mortgagee. It is possible, on the other hand, to construe the language as requiring no more than that the mortgagee shall have obtained payment of his interest, shall have received or derived the amount of the interest in question."\(^\text{123}\) [Emphasis added.]

After referring to the considerations for each view, they concluded that the conditions precedent laid down by the statutory provision, “do not require actual payment by or on behalf of the mortgagor himself, but are satisfied if the interest is obtained by the mortgagee so that, either at law or in equity, the mortgagor’s obligation to pay it would be discharged.”\(^\text{124}\) However, their Honours went on to emphasise that the rule that rents and


\(^{119}\) Falk v Haugh (1935) 53 CLR 163, 172.

\(^{120}\) Re Oliver (1890) 62 LT 533.

\(^{121}\) (1935) 53 CLR 163.

\(^{122}\) (1935) 53 CLR 163, 175.

\(^{123}\) (1935) 53 CLR 163, 176.

\(^{124}\) (1935) 53 CLR 163, 177.
profits are applicable to interest before principal operates in the absence of an express appropriation.\textsuperscript{125} Consequently, it would appear that in the absence of an express appropriation, when the receipts of the mortgagee in possession are sufficient, after expenses, to satisfy the interest payable, the mortgagee will be treated as having derived the amount of that interest and it will be included in his assessable income.\textsuperscript{126} Where a person entitled to the benefit of any security, charge or encumbrance over an asset does any act in relation to the asset for the purpose of giving effect to the security, charge or encumbrance, Part IIIA will apply as if the act was the act of the person who owned the asset subject to the security, charge or encumbrance.\textsuperscript{127} Any provision in a mortgage which has the purpose or effect of passing onto the mortgagor the obligation of paying income tax on the interest to be paid under the mortgage is rendered void by s. 261. For the purposes of the section, mortgage includes any charge lien or encumbrance to secure the repayment of money and any collateral or supplementary agreement.

\textbf{Receivers}

A receiver is a person appointed to collect, protect or realise income or property. A receiver-manager has greater powers and duties than a receiver; the essential difference being that the receiver-manager has the power to carry on the business of the debtor whereas the receiver does not.\textsuperscript{128} The distinction is now of little significance where a receiver is appointed to a corporation as, subject to his instrument of appointment, s. 324A(2) of the \textit{Companies (Queensland) Code} ("\textit{Code}") confers additional powers on such a receiver including power to carry on any business of the corporation.\textsuperscript{129} A receiver may be appointed either out of court or by a court. A receiver appointed by the court is neither an agent of nor a trustee for any of the parties, but is an officer of the court\textsuperscript{130} and occupies a fiduciary position.\textsuperscript{131} He is appointed to act on behalf of all the persons interested in the property according to their entitlements.\textsuperscript{132} If he contracts he will be personally liable as a principal, as he is not an agent.\textsuperscript{133} A receiver appointed out of court is \textit{prima facie} merely an agent for the person or creditor appointing him\textsuperscript{134}, so that, apart from statute,\textsuperscript{135} the receiver incurs no personal liability for acts done within his authority. However, by statute a receiver appointed by a mortgagee pursuant to the provisions of the \textit{Property Law Act 1974} is expressly made the agent of the mortgagor;\textsuperscript{136} and charges or debentures invariably contain corresponding provisions making the receiver agent for the charger.\textsuperscript{137} The purpose of the provision is to ensure that the secured creditor will not be liable to account as a mortgagee in possession or

\begin{itemize}
\item \textsuperscript{125} (1935) 53 CLR 163, 179.
\item \textsuperscript{127} \textit{Assessment Act}, s. 160V(2).
\item \textsuperscript{128} See \textit{Re Surfside Palms Motels} (1984) 9 ACLR 179, 181.
\item \textsuperscript{129} \textit{Ibid}.
\item \textsuperscript{130} \textit{Evans v Clayhope Properties Ltd} [1987] 2 All ER 40; see also Meagher Gummow & Lehane, \textit{Equity — Doctrines & Remedies} Butterworths, Sydney (2nd. ed., 1984), para. 2829.
\item \textsuperscript{131} \textit{Visbord v Federal Commissioner of Taxation} (1943) 68 CLR 354, 384; and see P.D. Finn, \textit{Fiduciary Obligations} The Law Book Company Ltd., Sydney (1977), para. 628ff; Meagher, Gummow & Lehane, \textit{supra} n.130 at para. 2833.
\item \textsuperscript{133} Meagher, Gummow & Lehane, \textit{supra} n.130 at para. 2830.
\item \textsuperscript{135} \textit{Companies Code}, s. 324.
\item \textsuperscript{136} \textit{Property Law Act 1974}, ss. 83(1)(c), 92.
\item \textsuperscript{137} \textit{Property Law Act 1974}, s. 4 defines mortgage to include a charge on any property securing money or money's worth, so the power to appoint a receiver under s. 83(1)(c) will be implied unless excluded or varied.
\end{itemize}
liable as principal on contracts entered into by the receiver. Nevertheless, subject to his statutory duties to pay preferential creditors having priority to the chargee, for example where there is a floating charge, the primary duty of such a receiver is to realize the security in the interest of the secured creditor; of course, he has duties also to the mortgagor or company to provide proper accounts and hand over surplus assets and will be liable if he acts ultra vires, mala fide or recklessly. Part X of the Code sets out other obligations and liabilities of receivers appointed to corporations, including personal liability where a receiver incurs certain debts in the course of his receivership. The appointment by a court of a receiver and manager over the assets and business of a company does not dissolve or annihilate the company, but supersedes the company’s power to carry on its business or to sell pledge or otherwise dispose of assets put into the possession or under the control of the receiver and manager. The same position applies where the appointment is made under a charge or debenture, so that the capacity of the organs of the company, i.e. the board of directors and the members in general meeting, to function after the appointment of a receiver bears a direct and inverse relationship to the validity and scope of the powers of the receiver and manager. No property of a company vests, either at law or in equity, in a receiver upon his appointment by a court or under an instrument. Consequently a receiver is not a trustee, although once the receiver has acquired money either by the sale of mortgaged assets or receipt of income, he may hold the surplus on trust for those entitled to it. Further, the appointment itself does not necessarily give him the possession or occupation of the property. Upon the winding up of a company, a receiver appointed under an instrument as its agent will cease to have authority to bind it; he will be either a principal with a right of indemnity, which is not dissimilar to the position of a court appointed receiver or, where the terms of the instrument so provide or a new authority given, an agent for the chargee. In such a case the receiver retains the assets the subject of the charge and deals with them as the charge permits, but obligations incurred by him in carrying on business will not be obligations for which the company is liable. However, the receiver will retain his right of indemnity over the assets, so the obligations incurred by him will be discharged in priority to the general creditors in any event.

The accepted view appears to be that a receiver or receiver and manager who has entered into possession and control of property is not treated a trustee to whom Div. 6 of Part III, relating to the assessment of trustees and beneficiaries, applies. The issue has been considered in an article by T.W. Magney and R. Holz. The argument appears to be that although the

---

139. Ibid.
140. Code, s. 324.
142. Hawkesbury Development Co. Ltd. v Landmark Finance Pty Ltd [1969] 2 NSWLR 782, 790; see also Re Scottish Properties Pty Ltd (1977) 2 ACLR 264.
definition of trustee in s. 6(1) of the *Assessment Act* includes a receiver, there is no relevant "trust estate" for the purposes of Div. 6. first, no property vests in the receiver by virtue of his appointment or entry into possession; and, secondly, subject to the right of the receiver to pay the outgoings and his commission thereout, the receipts and profits collected by the receiver are not the "net income" of a trust estate but the corpus of a trust fund. In *Expo International Pty Ltd (in liq.) v Chant*, Needham J. observed that the receiver did not stand in a fiduciary position vis-a-vis the mortgagor from the time of his appointment, but only after he had collected the receipts and profits into a fund. However, it has been suggested that after a liquidator is appointed, the receiver is a trustee of moneys he recovers for the chargee and after the chargee, for the company and its creditors. It is not clear how this can be reconciled with the view expressed in *Gosling v Gaskell*, which is referred to below. Nor is a secured creditor treated as liable to assessment as the beneficial owner of the receipts and profits collected by the receiver. The general principle appears to be that, notwithstanding that the profits once earned may have been paid away in satisfaction of debts, the profits still clearly accrue for the benefit of the company, since it is the company's debts which are being paid. Thus, where a receiver, appointed as an agent for a company, enters into possession of property of the company and carries on its business, it appears that the company will continue to be the relevant taxpayer and assessed in respect of the income profits and gains of the property and business, subject to relevant allowable deductions incurred in gaining or producing the assessable income. That would appear to continue to be the case even where a winding up terminates the agency of the receiver. In *Gosling v Gaskell*, Lord Hershell said: "The profits made by the carrying on of the business of the company were, before as well as after the winding up order, part of the security for the payment of debts to the debenture-holders, and after as well as prior to the winding up the profits of the business, subject to the claim of the mortgagees, belonged to the company." As the position of a receiver whose agency has been terminated by winding up is not dissimilar to that of a court appointed receiver, neither being a trustee or an agent, it would appear the same principle should apply to a court appointed receiver.

Although the secured creditor may not be the beneficial owner of the receipts and profits collected from the secured property under the control of the receiver, in *Visbord v Federal Commissioner of Taxation* the High Court held that the moneys collected by a receiver (appointed under statutory power in that case) may be assessable income of a secured creditor.
to the extent, in each year, he is entitled to be paid interest out of those moneys. Williams J.
observed that the income of the secured creditor is the interest on his debt, so that any income
in the hands of the receiver applied by the secured creditor in reduction of principal after any
accrued interest on the security had been paid would not be the secured creditor's income for
the purposes of income tax.\(^{159}\) In that case there were some special features, but it shall be
observed that the effect of the decision was not dissimilar to the view taken in \textit{Falk v Haugh},\(^{160}\) where the issue was whether interest income is derived by a mortgagee in possession
of sufficient receipts and profits (after meeting expenses) from the mortgaged premises to
meet them. However, in \textit{Visbord v Federal Commissioner of Taxation} the secured creditor
was a money lender and the decision appears to have been supported on three different
grounds. First, derivation of interest income by the secured creditor on an accruals basis gave
the correct reflex of income as the receiver had the money available and was bound (by the
\textit{Property Law Act 1928} (Vic.)) to apply it in the manner required by the statute and was ready
and willing to pay it.\(^{161}\) Secondly, the accumulation in the receiver's fund at the direction of
the secured creditor amounted to a constructive receipt of interest income by the secured
creditor pursuant to s. 19 of the \textit{Assessment Act}.\(^{162}\) Thirdly, under the statute the secured
creditor had a proprietary interest in the fund to the extent to which it consisted of moneys
representing interest to which he was entitled.\(^{163}\) Consequently, a later attempted
appropriation of the fund at the time of actual payment to the repayment of principal,
instead of interest, by the mortgagee with the assent of the mortgagor was too late and not
effective for tax purposes.\(^{164}\) Under the capital gains provisions in Part IIIA of the
\textit{Assessment Act}, s. 160V(2) provides \textit{inter alia} that where a person appointed to enforce or
give effect to a security in relation to an asset does any act in relation to that asset for the
purposes of enforcing or giving effect to the security, Part IIIA will apply as if the act were
the act of the person who owned the asset that was subject to the security.

\textbf{Liquidations}

Where a winding up order is made, the corporate personality and powers continue to exist,
until the company is finally dissolved.\(^{165}\) The powers of the directors cease, except insofar as
they may be continued, in the case of a compulsory winding up, by the committee of
inspection or creditors or, in the case of a voluntary winding up, by the company in general
meeting with the consent of the liquidator.\(^{166}\) The liquidator is required to take custody and
control of the company's property, but the property itself does not vest in the liquidator,
unless the liquidator obtains a court order to that effect.\(^{167}\) The nature of the interest which a
company has in its assets following a winding up order has not been resolved.\(^{168}\) On one view
the company continues to hold its property beneficially, but that interest is subject to the

\begin{thebibliography}{168}
\bibitem{159} Visbord \textit{v Federal Commissioner of Taxation} (1943) 68 CLR 354, 390.
\bibitem{160} (1935) 35 CLR 163.
\bibitem{161} Visbord \textit{v Federal Commissioner of Taxation} (1943) 68 CLR 354, 377.
\bibitem{162} Visbord \textit{v Federal Commissioner of Taxation} (1943) 68 CLR 387, 373-374, 388.
\bibitem{164} Visbord \textit{v Federal Commissioner of Taxation} (1943) 68 CLR 354, 378, 389.
\bibitem{165} Companies Code, s. 394(1).
\bibitem{166} Companies Code, ss. 400(4), 396(2).
\bibitem{167} Companies Code, s. 374; B.H. McPherson, \textit{The Law of Company Liquidation} The Law Book Company Ltd., Sydney
\bibitem{168} Federal Commissioner of Taxation \textit{v St. Hubert's Island Pty Ltd} (1978) 138 CLR 210, 232, 249; 78 ATC 4104, 4115, 4124.
\end{thebibliography}
statutory powers and obligations involved in the liquidation. On another view the winding up order divests the company of its beneficial ownership of the assets, since it cannot thereafter use them for its own benefit, and although the assets acquire the character of a fund destined for the payment of the debts and distribution among members, it does not immediately vest the beneficial ownership of those assets in any person or group of persons. On either view, the company is not a trustee of its assets, in the ordinary sense, and neither creditors nor members acquire proprietary interests in the assets by reason or in consequence of the winding up itself, at least not until after the final dissolution of the company.

The status of a liquidator has been described as threefold: he is an officer of the court (in a compulsory winding up), he is an agent for the company in some of his activities and in certain respects he is a trustee for the creditors and contributories as a general body. By statute, even in a voluntary winding up he is subject to the control of the court. He also has the power to bind the company without personal liability and is subject to fiduciary duties of care and skill. McPherson states: “The true position is that, like a director, the liquidator is at most a quasi trustee: he has some of the rights, duties and liabilities of a trustee, but he is principally and really an agent for the company who occupies a position which is fiduciary in some respects and is bound by the statutory duties imposed by the [Companies] Act.”

Once again, the accepted view appears to be that the provisions of Div. 6 of Part III of the Assessment Act, relating to the assessment of trustees and beneficiaries of trust estates, do not apply to a liquidator or a company in liquidation. There are a number of arguments to support the proposition. First, no trust property vests in the liquidator in the absence of an order to that effect. Second, even if the liquidator acts as agent for the company, if the correct view is that upon a winding up a company ceases to be the beneficial owner of its property, the preferred view is that it does not result in the property becoming “trust estate” for the purposes of Div. 6; the statute merely has the effect that the property could not be used or disposed of by the company, its legal owner, for its own benefit but must be used and disposed of for the benefit of other persons (who, during the winding up, are not cestui que trust). Third, if Div. 6 were to apply, the liquidator would be assessed under ss. 99 or 99A, as there would be no beneficiaries presently entitled to the income of the trust estate; but s. 99 only applies where s.99A does not, and while s.99A gives the Commissioner a discretion not to apply s. 99A to the estate of a person who has become bankrupt or entered into an arrangement under bankruptcy laws, it fails to give any such discretion in the case of a company in liquidation. Fourth, the presence of s. 47 suggests Div. 6 does not apply to the liquidation of a company. Also, the history of the Assessment Act is not consistent with the application of Div. 6. Finally, it is noted that in a number of cases it has been assumed,

---

175. Companies Code, s .420.
177. Magney & Holz, supra n.149 at 73, 77, 81-82, 87-92.
178. Ibid., at 81-82.
179. Ibid., at 91-92.
180. Ibid.
though not specifically held, that Div. 6 does not apply to a company in liquidation. The practical consequence is that Div. 6 is not treated as applying to a liquidator or a company in liquidation. Concomitantly, the creditors are not assessable as the beneficial owners of the income, profits and gains derived, in that character, in the course of winding up the company. For the purposes of determining taxable income, income earned in the course of winding up is treated as being derived by the company as if no liquidator had been appointed. For the purposes of the capital gains provisions in Part IIIA of the Assessment Act, where an asset owned by a company becomes vested in the liquidator of the company under s. 374 of the Code, i.e. where an order is made to that effect, which is rare, Part IIIA applies as if the asset continued to be vested in the company and any acts of the liquidator were acts of the company. If the view, expressed in Franklin Selfserve Pty Ltd v Federal Commissioner of Taxation that a winding up order does not divest a company of its beneficial ownership of its assets, is not correct, then a winding up order might be thought to effect a disposal of property and thus might have immediate consequences under both the capital gains provisions and other provisions of the Assessment Act.

Section 215 of the Companies Code requires every liquidator of any company, or “receiver for any debenture holders ... who has taken possession of any assets of a company” to notify the Commissioner of his appointment within 14 days after he has become a liquidator or, in the case of a receiver “has so taken possession of assets”. It is not inconceivable in some cases that a receiver might be able to perform all his duties without taking possession of any of the assets of a company, but if he does take possession of even some of those assets, notice must be given. As soon as practicable thereafter, the Commissioner is required to notify the liquidator or receiver of the amount that should be set aside as sufficient to provide for any tax that is or may become payable. Until he receives the Commissioner’s notice, the liquidator or receiver cannot, without leave of the Commissioner, part with the assets of the company, except to pay secured or preferential debts. When he receives the Commissioner’s notice, the liquidator or receiver must set aside “out of the assets available to pay the ordinary debts of the company” a proportion of those assets in value, the proportion being the same as the amount of tax notified under s. 215 has to the sum of that amount, plus prescribed tax notified by the Commissioner under other statutes, plus the ordinary debts of the company. If the liquidator or receiver fails to comply with the provisions, he is personally liable to pay the tax notified to the extent of the value of the assets that he failed to set aside. But if a receiver has distributed the balance of the available assets in accordance with a s. 215 notice, before the Commissioner revokes or amends his notice, it will not constitute a breach of s. 215, unless the receiver knew or should have known an error had been made, at least in a case where the receiver was an officer of the court.

---


182. See *Joshua Bros. Pty Ltd v Federal Commissioner for Taxation* (1923) 31 CLR 490; Magney & Holz, *supra*, n. 149 at 77-78.

183. *Assessment Act*, s. 215(2).


185. *In re Marriage, Neave & Co.* [1896] 2 Ch 663, 676.


188. *Assessment Act*, s. 215(4).

does not apply to a mortgagee per se, whether he has entered into possession or not, unless he also appoints a receiver. Even if a liquidator or receiver has been appointed, s. 215 will not prevent the receiver or liquidator paying any secured debts owing to secured creditors. Where there is a floating charge, it is only after any debts to any secured creditors, or preferential creditors under s. 331 of the Code, have been paid that the moneys in the liquidator's or receiver's hands will be "assets available for the payment of the ordinary debts of the company" for the purposes of s. 215 of the Assessment Act.  

Section 218 of the Companies Code authorises the Commissioner to serve a written notice on a person requiring him to pay to the Commissioner, out of any money which may become due to a taxpayer, so much of the money, when it becomes due, as is sufficient to pay the tax due by the taxpayer. The service of such a notice will prevent a taxpayer from thereafter assigning or otherwise dealing with a debt, the subject of the notice, which may become owing to him, so as to defeat the Commissioner's right to payment in accordance with the section. As a result, if a pre-existing floating charge only crystallizes after a sec. 218 notice has been given, there is nothing to defeat or intercept the operation of that notice according to its tenor. But if the charge crystallizes before the sec. 218 notice is given, at the time the notice is given the moneys will be payable to the chargee and not the taxpayer, so the s. 218 notice cannot give the Commissioner priority over the charge. A fortiori in the case of a fixed charge. In Taxation Ruling IT 313 issued 4 June 1986, the Commissioner resiled from the view expressed in Taxation Ruling IT 2042, as amended in Taxation Ruling IT 2079, that s. 218 gave the Commissioner priority over a mortgagee (other than a mortgagee exercising a power of sale) with respect to the sale proceeds of property and recognised that where a vendor directed a purchaser to pay a mortgagee sufficient moneys to discharge the mortgage on the property, s. 218 notices operate only on the balance purchase moneys as remain after the discharge of the mortgage.

Where a taxpayer fails to remit employee tax instalment deductions, or deductions of principal amounts from prescribed payments, or withholding tax, if his property vests in or becomes controlled by a trustee, then by virtue of ss. 221P, 221YHJ or 221YU ("the priority provisions") the trustee may become liable to pay those unremitted amounts to the Commissioner in priority over all other debts, whether preferential, secured or unsecured, except for costs, charges and expenses of a trustee in bankruptcy incurred in the administration of a bankrupt's estate or of a liquidator in the course of winding up unless, in the latter case, the Crown in right of the State or a creditor is entitled to payment of a debt in priority to such costs, charges and expenses and does not waive such priority. The Commissioner thus claims priority over a receiver's costs charges and expenses, but not necessarily those of a liquidator and never those of a trustee in bankruptcy.

The priority provisions only apply where property becomes vested in or controlled by a "trustee", an expression which is defined to include inter alia a liquidator, a receiver and "every person having or taking on himself the administration or control of income affected by an express or implied trust, or acting in a fiduciary capacity, or having the possession,
control or management of the income of a person under a legal or other disability". Thus, liquidators and receivers are trustees by definition. A scheme manager under a scheme of arrangement may be a "trustee", as he is subject to fiduciary obligations in the exercise of his powers over the company's property and income for the benefit of others in accordance with the scheme of arrangement.197 However, a mortgagee in possession will not be a "trustee" as he exercises his powers for his own behalf as mortgagee and not for the benefit of others.198 Nor will a provisional liquidator necessarily be a trustee, as his primary function is to maintain the status quo pending determination of the winding up proceedings.199 The mere fact that some time after a person has taken control of property he later becomes a trustee of part of the proceeds thereof will not of itself make him a trustee for the purposes of the priority provisions.200 A trustee is only liable under the priority provisions if the whole of a non-remitting taxpayer's property either has vested in the trustee or control thereof has passed to the trustee.201 For this purpose, a taxpayer's property does not include property which is the subject of a (prior ranking) specific charge202 or property which is in the possession of the debtor but owned by another or others: such property may include, for example, land already mortgaged, machinery over which there is a bill of sale or a motor vehicle under a lease or hire purchase agreement.203 Also, it has been suggested that property which is worthless or which a bankrupt may retain after sequestration or which has no commercial or practical significance may be ignored.204 However, where all that which can vest in or pass to the control of trustee does so, then for the purposes of the priority provisions the whole of the taxpayer's property will have vested in or passed to the control of the trustee, even if it does not include the beneficial interest of a chargee under a specific charge.205 Although it has been held that the priority provisions apply to the trust assets of a corporate trustee in liquidation, in that case the corporate trustee's right of indemnity exceeded the available trust assets, so the entire beneficial interest in the trust assets was in the company and not the cestui que trust.206 Control, in the sense required by the priority provisions, will pass to a trustee where the trustee's control is sufficient to enable him to reduce the assets and undertaking of the taxpayer into a fund out of which a particular debt or in some cases all the debts of the taxpayer, secured and unsecured, are able to be paid if the fund so far extends.

196. Assessment Act, s. 6(1).
206. Re Neander Constructions Pty Ltd 88 ATC 4113 (S.C., Qld.).
Consequently, control of property cannot be said to have passed unless the trustee has power to realise that property.\textsuperscript{208} Control does not extend to particular assets that are separately secured under a charge with priority.\textsuperscript{209} But it is not control of the assets which must pass, but control of the taxpayer’s property in them.\textsuperscript{210} So merely because the effective capacity to possess and realise all assets formerly in the possession of the taxpayer does not pass to a trustee, does not mean that control of the whole of the taxpayer’s property has not passed.\textsuperscript{211} In the case of a liquidator, where a winding up order is made the liquidator is under a statutory duty to take into his custody or under his control all of the property to which the company is or appears to be entitled.\textsuperscript{212} Thus, it has been said that the mere appointment of a liquidator is sufficient to bring the priority provisions into operation.\textsuperscript{213} Not so a provisional liquidator, as his primary function is to preserve the status quo; and even if a provisional liquidator had control of a bank account, he would not have control of the property of the company in a manner that would satisfy s. 22IP.\textsuperscript{214} Receivers appointed by debenture holders almost invariably have such a power, so they may have control of the assets they can sell.\textsuperscript{215} As a matter of construction, control may mean the right to control or actual physical control, depending on the context in which it is used.\textsuperscript{216} Where there is competition between a receiver appointed out of court and a liquidator, the latter would take precedence, as the law gives precedence to a judicial act over a non-judicial one.\textsuperscript{217} However, in other circumstances there is support for the view that “control” in this context means actual or \textit{de facto} control.\textsuperscript{218} But mere actual control without the right to control may not be enough, for where a trustee is permitted to realise the property of a company, including specific items subject to a separate charge, pending the decision of the Court as to the proper destination of the latter, that will not be the \textit{de facto} control with which the sections are concerned if it turns out that he was in fact realising them for a prior separate charge.\textsuperscript{219}

Where a secured creditor has a charge over all of the assets of the company, but allows the liquidator to realise the assets the subject of his security, the liquidator will be a trustee to whom the priority provisions may apply and the Commissioner will be entitled to priority in respect of the unremitted amounts over the secured creditor.\textsuperscript{220} But where there is a charge over particular assets of the company, the property which is subject to the charge does not appear to be property of the company in respect of which the liquidator is a trustee for the


\textsuperscript{210}Judson v Federal Commissioner of Taxation [1988] VR 308, 315; 87 ATC 4489, 4496.

\textsuperscript{211}Federal Commissioner of Taxation [1988] VR 308, 317; 87 ATC 4489, 4497.

\textsuperscript{212}Companies Code, s. 374(I).


\textsuperscript{216}Federal Commissioner of Taxation v A.G.C. (Advances) Ltd [1984] 1 NSWLR 29, 33; 84 ATC 4177, 4179.


\textsuperscript{218}Russell v A.G.C. (Advances) Ltd [1988] VR 97, 104; 87 ATC 4392, 4398; Smith and Judge v Federal Commissioner of Taxation 78 ATC 4561 (S.C., W.A.); Re L.G. Holloway Transport Pty Ltd 83 ATC 4164 (S.C., Tas.).


\textsuperscript{220}Re Mzimba Pty Ltd 89 ATC 4229; Smith and Judge v Federal Commissioner of Taxation 78 ATC 4561; see also Vector Capital Ltd v O’Brien 89 ATC 5269.
purposes of the priority provisions.\footnote{Re Obie Pty Ltd [1985] 1 QdR 464, 469; sub. nom. Federal Commissioner of Taxation v A.G.C. (Advances) Ltd 84 ATC 4776, 4779; aff'd Re Obie Pty Ltd 84 ATC 4067 (Thomas J.); Federal Commissioner of Taxation v A.G.C. (Advances) Ltd [1984] 1 NSWLR 29; 84 ATC 4177.} This would appear to be so even if the liquidator realised the assets subject to the particular charge.\footnote{Federal Commissioner of Taxation v A.G.C. (Advances) Ltd [1984] 1 NSWLR 29; 84 ATC 4177.} Where a receiver is appointed under a charge over the whole of the assets of a company, if he takes control of the whole of the company's property,\footnote{Federal Commissioner of Taxation v Horsburgh (No. 2) [1988] VR 773; sub. nom. Horsburgh v Federal Commissioner of Taxation 84 ATC 4501; Hart v Barnes 83 ATC 4077.} whether or not there are later charges, the receiver may be a trustee to whom the priority provisions apply.\footnote{Federal Commissioner of Taxation v Horsburgh (No. 2) [1988] VR 773; sub. nom. Horsburgh v Federal Commissioner of Taxation 84 ATC 4501; Hart v Barnes 83 ATC 4077.} Also, where a receiver is appointed to the whole of the assets of the company which, subject to prior charges in respect of particular assets, could lawfully pass to and remain in him, he may be a trustee to whom the priority provisions apply.\footnote{Federal Commissioner of Taxation v Horsburgh (No. 2) [1984] 1 NSWLR 29; 84 ATC 4177.} But where, under a charge over the whole of the assets of a company, a receiver is appointed only in respect of part of the assets of the company, for example the book debts,\footnote{Re L.G. Holloway Transport Pty Ltd 83 ATC 4146; see also Judson v Federal Commissioner of Taxation [1988] VR 308, 313; 87 ATC 4489, 4494.} or if he is appointed receiver in respect of all of the assets but only takes control of part of them,\footnote{Russell v A.G.C. (Advances) Ltd [1988] VR 97; 87 ATC 4392.} he will not have sufficient control of the company's property to be a trustee to whom the priority provisions apply. \footnote{Federal Commissioner of Taxation v A.G.C. (Advances) Ltd [1984] 1 NSWLR 29; 84 ATC 4177.} \textit{A fortiori}, where a charge is only over some of the assets of the company, a receiver appointed pursuant to that charge to collect those assets will not be a trustee to whom the priority provisions apply.\footnote{Federal Commissioner of Taxation v A.G.C. (Advances) Ltd [1984] 1 NSWLR 29; 84 ATC 4177.}

Section 254 of the \textit{Assessment Act} requires agents and trustees to lodge returns of income, profits and gains derived by them in their representative capacity or by virtue of their agency, and retain sufficient money to pay the tax on such amounts, for which they are personally liable. In \textit{Howey v Federal Commissioner of Taxation}\footnote{(1930) 44 CLR 289, 294.} it was suggested that this was a collecting provision, and not a taxing provision. The section would not appear to apply to a mortgagee in possession as he is not a trustee or agent, unless the Commissioner is entitled, under paragraph (b) of the definition of "agent" in s. 6(1), to declare the mortgagee to be agent for the mortgagor in relation to the mortgaged property. Nor does the section appear to apply to provisional liquidators, who are not within the definition of trustee.\footnote{Re Obie Pty Ltd [1985] 1 QdR 464; sub. nom. Federal Commissioner of Taxation v A.G.C. (Advances) Ltd 84 ATC 4776.} By definition, receivers are defined to be trustees, so the section may apply to them, at least in respect of those receivers who are also agents, as it is not clear other receivers can be said to derive income, profits and gains in a "representative capacity". The section also applies to liquidators, as they are also defined to be trustees.\footnote{Assessment Act, s. 6(1); Re Mzimba Pty Ltd 89 ATC 4229.} In \textit{Joshua Bros Pty Ltd v Federal Commissioner of Taxation}\footnote{(1923) 31 CLR 490, 495, 496, 501.} the section was treated as applying to a liquidator to require him to account for income derived in carrying on the business of the company. Once again, however, it is not clear that a liquidator derives income, profits and gains in a "representative
capacity". It has been held that income tax on profits earned in the course of winding up, or in respect of assets realised after the commencement of the winding up, is an expense of the winding up\textsuperscript{233} and therefore has to be paid first in priority to other unsecured debts.\textsuperscript{234} Consequently, unsecured lenders may rank after the Commissioner in respect of income tax incurred in the course of the winding up.

**Conclusion**

The tax aspects of financing transactions from the lender's perspective has been considerably complicated by the piecemeal introduction into the *Assessment Act* of concepts such as "qualifying securities", "traditional securities" and the capital gains provisions. For the secured creditors under a floating charge, there is an undignified scramble for priority with the Commissioner, who often seeks to jump ranks with s. 218 notices. For the well informed, the Commissioner's statutory priorities for unpaid employee tax instalment deductions, principal amounts of prescribed payments and withholding tax are merely hurdles for the unwary. There is no doubt that the provisions require reform so that such preferential impositions, as are to be maintained, are borne with greater equity by all creditors.

\textsuperscript{233} Re Beni-Felkai Mining Co. [1934] Ch 406; Re Nesco Properties Ltd [1980] 1 All ER 117.

\textsuperscript{234} Companies Code, ss. 414, 441(1).