

PROPERTY

Escaping tax debts?
Is this the brave new
world of Pt VIII
Family Law Act?

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Escaping Tax Debts? Is this the brave new world of Pt VIIIAA *Family Law Act*?

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Minimising tax paid, if not actively evading tax, is considered by many family law clients to be a justifiable activity or even a national sport. The power of the Family Law Courts to use Pt VIII A *Family Law Act* 1975 ("FLA") to assign a taxation debt owed by one party to a relationship to the other party was considered by the Full Court of the Family Court in *Tomaras & Tomaras and Official Trustee in Bankruptcy and Commissioner of Taxation* (2017) FLC 93-806; [2017] FamCAFC 216. In *Tomaras*, the Full Court agreed that one spouse could be substituted for another spouse as the debtor responsible for the debt, even though it was a taxation debt and therefore owed to the Crown. The Commissioner of Taxation's argument that Pt VIII A A did not bind the Crown failed. Does this mean that the floodgates have opened to a new way to avoid paying tax?

Facts

The background facts can be explained fairly simply in a short chronology:

1992	The husband and wife married.
2009	The parties separated. The wife's tax debt arose prior to separation.
November 2009	The Commissioner of Taxation obtained a default judgment against the wife. She failed to pay the judgment debt and the Commissioner did not take any steps to enforce it.
November 2013	The husband became bankrupt.
December 2013	The wife issued proceedings in the Federal Circuit Court under s 79 FLA. She sought an alteration of property interests between herself and the husband.
February 2016	The Commissioner was granted leave to intervene in the s 79 proceedings.

The orders sought by the wife included:

- “8. Pursuant to s 90AE(1)(b) of the *FLA* in respect of the applicant wife's indebtedness to the Commissioner of Taxation for the Commonwealth of Australia taxation related liabilities in the amount of \$256,078.32 as at 9 August 2016 plus General Interest Charge (GIC), the respondent husband be substituted for the applicant wife as the debtor and the respondent husband be solely liable to the Commissioner of Taxation for the said debt.”

The Federal Circuit Court judge, Purdon-Sully J, stated a case for the opinion of the Full Court in the following terms:

- “Does s 90AE(1)-(2) of the *FLA* (Cth) grant the court power to make order 8 of the final orders sought in the amended initiating application of the wife?”

A case stated involves a court seeking the opinion of another court as to questions of law based on agreed facts.

Relevant legislation

The wife sought to rely on Pt VIII A of the FLA which empowers the Family Law Courts to make orders and injunctions which bind third parties if certain prerequisites are met. In particular, the wife relied on s 90AE(1)(b), which allows the court to direct a creditor to change the debtor or debtors. Section 90AE(1) provides:

“In proceedings under s 79, the court may make any of the following orders ... (b) an order directed to a creditor of one party to a marriage to substitute the other party, or both parties, to the marriage for that party in relation to a debt owed to the creditor.”

Section 90AE(2) specifically allows the court to make any such order that:

- (a) directs a third party to do a thing in relation to the property of a party to the marriage; or
- (b) alters the rights, liabilities or property interests of a third party in relation to the marriage.”

Section 90AE(3) and (4) set out the requirements for making an order under s 90AE(1) and (2).

“(3) The court may only make an order under subsection (1) or (2) if:

- (a) the making of the order is reasonably necessary, or reasonably appropriate and adapted, to effect a division of property between the parties to the marriage; and
- (b) if the order concerns a debt of a party to the marriage - it is not foreseeable at the time that the order is made that to make the order would result in the debt not being paid in full; and
- (c) the third party has been accorded procedural fairness in relation to the making of the order; and
- (d) the court is satisfied that, in all the circumstances, it is just and equitable to make the order; and
- (e) the court is satisfied that the order takes into account the matters mentioned in subsection (4).

(4) The matters are as follows:

- (a) the taxation effect (if any) of the order on the parties to the marriage;
- (b) the taxation effect (if any) of the order on the third party;
- (c) the social security effect (if any) of the order on the parties to the marriage;
- (d) the third party’s administrative costs in relation to the order;
- (e) if the order concerns a debt of a party to the marriage - the capacity of a party to the marriage to repay the debt after the order is made;
- (f) the economic, legal or other capacity of the third party to comply with the order;
- (g) if, as a result of the third party being accorded procedural fairness in relation to the making of the order, the third party raises any other matters - those matters;
- (h) any other matter that the court considers relevant.”

There is very little case law where s 90AE has been successfully used although it commenced operation in 2004. For example, it was unsuccessfully relied on in *Stephens & Stephens & Anor* [2005] FamCA 118 and *B Pty Ltd & K and Anor and Ors* [2008] FamCAFC 113. In *Rand & Ors and Rand* [2008] FamCAFC 50 the Full Court found that the trial judge provided inadequate reasons. *Manichaeus & Manichaeus and Ors* [2010] FamCA 397 was a rare example where s 90AE was used to re-assign liability for a debt, but the court expressed confidence that the husband would be able to pay the debt in full. The creditor bank had been a party to the proceedings earlier, but had elected not to be a party at trial. The bank was given procedural fairness before the final orders were made.

Presumption with respect to binding the Crown

The presumption that the statutory provisions expressed in general terms do not bind the Crown was considered by the High Court in *Bropho v State of Western Australia* [1990] HCA 24; (1990) 171 CLR 1. In *Tomaras*, Thackray and Strickland JJ discussed this case and noted that the presumption does not apply to provisions which, properly construed, confer a benefit on the Crown (*Madras Electricity Supply Corporation v Boarland* [1955] AC 667; *McGraw-Hinds (Aust) Pty Ltd v Smith* [1979] HCA 19; (1979) 144 CLR 633 at 656). They said (at [17]) that it could be reasonably argued that s 90AE can only impose a benefit on the Crown since:

- "(a) instead of an impecunious taxpayer being responsible for a tax liability, his or her more wealthy spouse may be made solely responsible pursuant to s 90AE(1)(a), thereby increasing the prospects of recovery;
- (b) instead of one spouse being responsible for a tax liability, **both** spouses may be made liable pursuant to s 90AE(1)(b), thereby providing a remedy for recovery that otherwise would have been unavailable;
- (c) whilst an order might be made leaving the less wealthy spouse to meet a tax debt, such an order could not be made if it was foreseeable that the order would result in the debt not being paid (s 90AE(3)(b)); and
- (d) the legislation permits the court to make such order as it considers just for the payment of the reasonable expenses of the creditor incurred as a necessary result of the order (s 90AJ(2))."

Section 90AE could therefore only operate to the detriment of the Crown if the court, in making an order (at [18]):

- "(a) relieved a spouse of their obligation to pay tax which they would have paid if the order had not been made; and
- (b) instead imposed the obligation on a spouse who, although appearing at the time able to meet the liability in full, ultimately was unable to do so for some **unforeseeable** reason."

Of course, as noted by Thackray and Strickland JJ, the Commissioner would be on notice that an order under s 90AE was sought and was entitled to be heard as required by s 90AE(3)(b) and 4(e) on the issue of the foreseeability of the tax not being paid if one party were to be substituted for the other. They concluded (at [20]):

"that the possibility of the Commissioner being **adversely** affected by an order under s 90AE does not arise by operation of the Act but only by the happening of an event that could not have been reasonably anticipated." There was therefore no place for the presumption that statutory provisions are not binding on the Crown in relation to s 90AE."

Although finding that the presumption did not apply, Thackray and Strickland JJ went on to consider the Commissioner's arguments which were based on the view that the presumption did apply.

Taxation debts are not connected with particular assets

The Commissioner argued that a substitution order could only be made if a debt was associated with a specific item of property. Otherwise, it could not be seen as "reasonably necessary" or "appropriate and adopted" in order "to effect a division of property (s 90AE(3)(a)). Thackray and Strickland JJ were not convinced that there "was any sound basis for construing the provision so narrowly" (at [27]) and then said (at [28]):

"In any event, this argument goes only to the exercise of the power, rather than the existence of the power. It would always be open to the Commissioner to argue in a particular case that a proposed order was not "reasonably necessary, or reasonably appropriate and adopted, to effect a division of property."

Commissioner's other grounds

The Commissioner had other arguments which were rejected by the Full Court. These included:

- There was no express statement in s 90AE that the section bound the Crown
- There were alternative provisions in the FLA to deal with the circumstances where it was appropriate for one spouse to be responsible for a taxation liability incurred by the other spouse. In particular, s 80(1)(f) FLA gives the court the power to make an "order that payments be made ... to a public authority for the benefit of a party to the marriage".
- Permitting tax debts to be transferred between spouses would create absurdities in the application of the tax scheme because objection, review and appeal rights associated with the tax debt could not be transferred.
- The Explanatory Memoranda to the Bill which amended the FLA to include Pt VIII A did not refer to tax debts or other liabilities owed to government agencies.

Use of the word “creditor”

The wife argued that as the Commissioner was a “creditor” for the purposes of s 79 and s 79A of the FLA, it was also a “creditor” for the purposes of s 90AE.

Thackray and Strickland JJ found that there was an express link between s 79 and s 90AE and it would be surprising if different meanings were given to the word in the two linked sections. They said (at [55]):

“Had Parliament intended to exclude the Commissioner as a “creditor” when expanding the existing powers of the court, it would have readily done so in precisely the same way that it excluded a species of property from the ambit of the section when enacting s 90ACA, which is in these terms...”

Minority judgment

Aldridge J agreed generally with the majority and the orders made, but made two further points. He expressed a “tentative” view that s 90AE could not be regarded as beneficial to the Crown. He also considered that in relation to the rights to object and appeal in relation to a taxation liability, the original creditor could still exercise these rights even if one spouse was substituted for another and, perhaps a more complete answer was that an order was unlikely to be made if there was a genuine dispute as to the debt.

Outcome

The Full Court answered the case stated in the affirmative, but with the proviso that s 90AE(1) confers power only to make an order that the Commissioner be directed to substitute the first respondent for the applicant in relation to the debt owed by the applicant to the Commissioner of Taxation. The words “and the respondent Husband be solely liable to the Commissioner for the said debt” were omitted. The reason for the omission was that otherwise there was (at [60])

“... the potential to create the impression that whatever rights the applicant may have had to challenge the debt (which senior counsel for the Commissioner acknowledged might still exist) are extinguished by the making of the order. For the reasons given earlier, we are not entirely persuaded that such rights would be extinguished by an order under s 90AE”.

What next?

It is difficult to see what the wife was seeking to achieve in *Tomaras*. The husband was bankrupt, so unless the husband was likely to have a surplus after his bankruptcy ended, or there was a chance of an annulment, it appeared on the face of the judgment unlikely that the court would

order that the taxation debt be borne solely by the husband as this would mean, contrary to s 90AE(3)(b) and (4)(e), that the debt was not likely to be paid.

Rather than opening the flood gates, the Full Court emphasised that s 90AE(3) requirements had to be satisfied before one party could be substituted for another party in relation to a debt as the Full Court has now clarified that s 90AE can bind the Commissioner of Taxation, so there may be other cases where one party can be substituted for another in relation to a tax debt, although the court will need to be satisfied that it is not foreseeable that the debt will not be paid in full if the order for substitution is made.

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