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Post-administration Research and Development Tax Offsets Deemed Personal Property in Account

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Companies entering external administration often have outstanding tax filings. The external controllers appointed conduct initial and ongoing reviews as to those filings. Then, in time, they either bring the filings up to date or engage the tax office in order to revisit historical filings.

Aside from being legally required to address a company's filings, external controllers often focus on a company's taxation affairs because there may be offsets or refunds due that can be realised as assets as part of the estate or in any transactions. Depending on the corporate structure used and the rulings by the tax office, research and development (R&D) expenditure (among other expenses) can result in tax offsets and refunds post-administration. Securing those refunds can sometimes result in priority disputes. In a unanimous decision[1] this week, the Court of Appeal considered various issues relevant to R&D offsets and their treatment under the Personal Property Securities Act (Cth) (PPSA) and the Corporations Act (Cth) (Act) in a post-administration context.

Background

Resilient concerned a priority dispute between a secured creditor and a subrogated employee creditor in respect of certain tax refunds received by the liquidators of Spitfire Corporation (Spitfire) *after* the commencement of the winding up (Appointment Date). The priority dispute arose in the context s 561 of the Act. That provision stipulates that in a liquidation scenario, certain categories of debt due to employees specified in s 556, and any amount in respect of which priority is given by s 560 for advances to a company to make such payments, should be preferred to the claims of a secured creditor in relation to a "circulating security interest". The section is intended to ensure that employees, whose efforts have contributed to a company's assets, are not treated adversely *vis-à-vis* the rights of a circulating security interest holder in respect of the same assets.[2]

In the underlying proceedings, the liquidators of Spitfire and a related entity, Aspirio, applied for directions as to the manner in which R&D refunds totalling circa some AU$2 million received by them should be distributed. Both the secured creditor, Resilient, and the subrogated employee creditor, the Commonwealth of Australia (Commonwealth), were heard on the application. The parties agreed that:

- If the R&D refunds received by Spitfire post-liquidation were circulating assets of Spitfire at the Appointment Date, then those amounts were required to be applied by the liquidators to satisfy the employee entitlements of Spitfire's employees under s 556(1), in priority to Resilient's claim as secured creditor
- If certain identified employees were employees of Spitfire at the Appointment Date, their employee entitlements under s 556(1) should be satisfied out of any "circulating asset" of Spitfire

The primary judge concluded that for the purposes of s 561 of the Act and s 340 of the PPSA, the R&D refunds were circulating assets of Spitfire at the Appointment Date, as the R&D refunds were an "account" for the purpose of s 340(5)(a) of the PPSA. Further, the Commonwealth was entitled to the R&D refunds as the subrogated employee creditor of Spitfire under s 560 of the Act, subject to any equitable lien of the liquidators.[3] Resilient sought and was granted leave to appeal.

Alternative Constructions

On appeal, Resilient argued, *inter alia*, that the primary judge erred in finding that the R&D refunds were "personal property" of Spitfire or that they were "circulating assets" within the meaning of the PPSA. The Court of Appeal determined that, as a general proposition, there was some artificiality in treating the concept of "personal property" for the purpose of s 340 of the PPSA as conceptually distinct from the two groups of assets specified in s 340(1)(a) and (b). Further, the question of whether a right or claim to a tax refund is "personal property" for the purpose of s 340(1) is best addressed in context. In *Resilient*, the relevant context was whether, at the Appointment Date, the R&D refunds were personal property for the purpose of s 340(1)(a) because the R&D refunds were an "account" within s 340(5)(a).[4]

1 See *Resilient Investment Group Pty Ltd v Barnet and Hodgkinson as Liquidators of Spitfire Corporation Limited (In Liq)* [2023] NSWCA 118 (*Resilient*).

2 Ibid, [2].

3 Ibid, [5].

4 Ibid, [46].

The court undertook that assessment by determining two underlying questions: first, whether the R&D refunds were a "monetary obligation" at the Appointment Date and, second, if so, whether the entitlement to the R&D refunds was an obligation that "arises from" the provision of services "in the ordinary course of a business of providing services of that kind".[5]

Resilient argued that Spitfire had, at the most, a right to require the tax office to perform statutory duties under taxation legislation, enforceable by public law remedies, and that such an entitlement does not create a "debt" or "proprietary right" in favour of Spitfire (acting by its liquidators). The earliest point in time at which Spitfire could be said to have any "property" arising from the entitlement to receive the R&D refunds was the date on which the tax office issued the relevant assessment under the taxation legislation, or a deemed assessment was taken to have been issued. On that basis, Resilient's contention was that the R&D refunds were not properly characterised as a "monetary obligation" at the Appointment Date because any obligation on the tax office to make payment to Spitfire only arose after the tax office issued the relevant assessment, which had not occurred at the Appointment Date.[6]

The Commonwealth adopted a very different construction. It submitted that the primary judge was correct to find that Spitfire had a right, which came into existence at the conclusion of the relevant year of income, to receive R&D refunds. Further, this right was a "chose in action" that existed independently of, and anterior to, the making of any assessment. The Commonwealth contended, *inter alia*, that:

- Spitfire had a statutory entitlement to receive the refunds
- The statutory entitlement to receive the refunds gave Spitfire an action in debt that amounted to a chose in action and, therefore, "personal property"
- The chose in action was against the Commonwealth as opposed to the tax office
- The making of an assessment was irrelevant because a chose in action can exist even if there is no debt presently recoverable by action[7]

No Chose in Action

The Court of Appeal concluded that a taxpayer is not entitled to enforce payment of a tax offset refund against the Commonwealth at the end of the relevant income year. The Commonwealth argued that the right to a tax offset refund exists at the conclusion of the relevant year of income because it is at that point that the taxpayer is capable of knowing both its basic income tax liability and the tax offsets that it is entitled to subtract from that liability. However, the court rejected that argument. It found that the fact that an entitlement to a tax offset refund is capable of calculation at the end of the income year is not determinative of whether the taxpayer has a chose in action against the Commonwealth at that date.[8]

No Services Provided in the Ordinary Course

The primary judge had considered that the R&D activities of the Spitfire group were for the ultimate benefit of its customers who used its products and services, and that this was a sufficient connection between the "account" (being the monetary obligation) and the provision of services in the ordinary course of a business of providing (financial platform) services. On appeal, Resilient argued that the primary judge's approach overlooked the fact that any entitlement to receive the R&D refunds arose from "undertaking research activities" and not by reason of the provision of services to customers. The provision of services to customers in the form of financial platform services was a separate step. Further, the primary judge erred in construing the causal connection in s 340(5)(a) of the PPSA such that the incurring of R&D expenditure enables the provision of services, rather than whether the R&D refund arises from the provision of services in the requisite sense.[9]

Resilient also submitted that the entitlement to:

- A tax offset in respect of R&D expenditure arises from the Spitfire group incurring deductible expenses or becoming entitled to claim a deduction in respect of depreciating assets, rather than providing financial platform services to Spitfire's customers
- Receive the R&D refunds did not arise in the ordinary course of providing financial platform services[10]

5 Ibid, [47].
6 Ibid, [75] – [76].
7 Ibid, [78] – [79].
8 Ibid, [88].
9 Ibid, [139]-[140].
10 Ibid, [141].

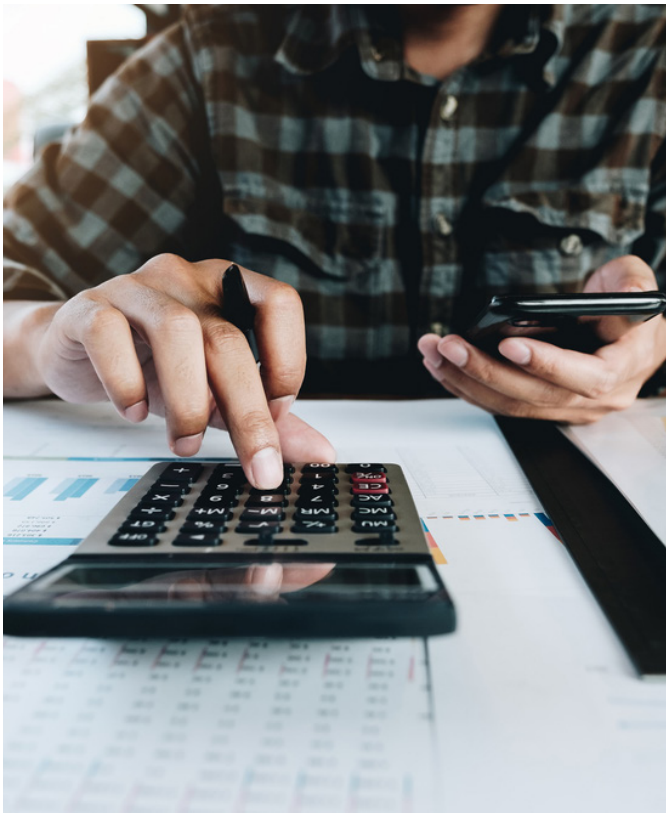
The Court of Appeal determined that:

> "It is an error to equate R&D activities in the form of experimental activities whose outcome cannot be known or determined in advance, and that are conducted for the purpose of generating new knowledge, with the provision of services in the ordinary course of a business of providing services intra-group in the form of paying wages and expense of staff engaged in R&D activities. Similarly, it is an error to equate such R&D activities with the provision of services in the ordinary course of a business of providing services of that kind (financial platform services)."[11]

In rejecting the Commonwealth's construction and accepting Resilient's contentions, the court undertook a detailed examination of the statutory and regulatory taxation instruments relevant to the priority dispute. It also determined the identity of the relevant employer that was central to the Commonwealth's standing in priority. Those matters are beyond the scope of this note but warrant due consideration.

The Implications

The leading judgment of his Honour, Justice Gleeson, is thorough and includes a close inspection of the intersection between corporate income tax, insolvency and industrial relations laws relevant to the priority dispute. The approach taken by the Commonwealth on appeal was novel in the sense that it argued in favour of its own future potential liabilities to choses in action vesting in external controllers. Perhaps fortunately for the Commonwealth, its arguments were not accepted. Spitfire's liquidators acted with due care and consideration by proactively seeking judicial advice and then not opposing Resilient's application for leave. The course they followed is commendable, including in respect of their efforts to realise the tax refunds. Secured creditors who occupy similar positions to Resilient will welcome the judgment on appeal. The Commonwealth's Department of Employment will likely receive the news with reduced enthusiasm. More importantly, the department might take a more cautious approach to seeking recourse against what it considers circulating assets going forward.



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11 Ibid, [144].