Unfair preference claims and the involvement of third parties

Pieter Oomens & Rosanna Maiorana | June 2017 | Commercial Disputes & Transactions

Summary

In *Rambaldi v Commissioner of Taxation* [2017] FCA 567 the Federal Court has recently dealt with the vexed issue of a transaction claimed to be an unfair preference but in which a third party provided the subject funds. The key element was not that a third party provided funds, or that the payment discharged the underlying debt but determining who had beneficial interest in the funds until their receipt by the creditor. The case is consistent with earlier authority but for practitioners raises the interesting issue of whether in the instance of third party payments in unfair preference claims a *Quistclose* trust might arise.

Facts

In *Rambaldi*, trustees of a bankrupt's estate claimed that a payment made to the Commissioner was a preference under section 122 of the *Bankruptcy Act 1966* (Cth) (the Act).

- On 18 March 2014, the Commissioner presented a Creditor's Petition against the estate of Ms Alex (the taxpayer).
- On 1 June 2014, the taxpayer subsequently entered into a Loan Agreement with Quality Australia Investments (QAI) by which QAI agreed to lend the taxpayer (and a company of which the taxpayer was the sole director) monies to satisfy the income tax debt, the subject of the Petition.
- Clause 4 of the Loan Agreement provided that the taxpayer 'must only use the loan for the purpose presented to the Lender, namely the payment of the Income Tax Debt.'
- The taxpayer signed an authority to pay, authorising and directing QAI to pay the monies to the Commissioner by way of bank cheque. Payment was subsequently made.
- On 8 December 2014, a sequestration order was made against the taxpayer's estate and the trustees were appointed.

The issue – was the payment to the Commissioner a preference or did the loan to the taxpayer create a Quistclose Trust?

The trustees argued that the loaned money was property of the taxpayer and the transfer of that property had the effect of giving the Commissioner a preference over other creditors within the meaning of section 122 of the Act. The trustees contended that the money when lent to the taxpayer became the taxpayer's property.

The Commissioner argued that the money was not property of the taxpayer but rather that the terms of the loan by QAI to the taxpayer created a *Quistclose* trust.

The law

The trustees relied upon the well-known authority of *Re Emmanuel (No 14) Pty Ltd (in liq); Macks v Blacklaw & Shadforth Pty Ltd* (1997) 147 ALR 281. In that case, a company (X) owed a debt to another company (Y). A third party paid money which had the effect of discharging X's debt to Y. X subsequently went into liquidation. In making the payment the third party discharged a contractual obligation that it itself had to X. Although the debt was discharged by the use of funds that were physically paid by a third party, the Court held that the dealing was initiated by X for the purpose of extinguishing its own debt. The Court held that the subject payment could still be deemed to be an unfair preference notwithstanding the participation of the third party. The key was that the funds were at the material time the property of X: in effect by paying Y, the third party discharged its own obligation to pay that money to X.

More recently, in *Kassem v Federal Commissioner of Taxation* [2012] FCA 567, a third party made payments to the Commissioner to reduce another company's tax liability. The Full Court held that the loaned monies were paid to the Commissioner at the debtor company's direction and the recipient of those monies could not argue that such payment was not an unfair preference.

The Commissioner argued that the written loan agreement between the third party and the taxpayer expressly stated that the taxpayer was obliged to only use the loan to pay the taxpayer's income tax liability (the description of which was carefully detailed). The Commissioner relied on the principle in *Barclays Bank Ltd v Quistclose Investments Ltd* (1970) AC 567, which was neatly summarised by the High Court in *Australasian Conference Association Ltd v Mainline Constructions Pty Ltd* (1978) 141 CLR 335.

> Where money is advanced by A to B, with the mutual intention that it should not become part of the assets of B, but should be used exclusively for a specific purpose, there will be implied (at least in the absence of an indication of a contrary intention) a stipulation that if the purpose fails the money will be repaid.

Findings

His Honour found that the intention of the parties was to be inferred from the written agreement and concluded that the substance of the Loan to the taxpayer was identical to the transaction in *Quistclose*.

His Honour held that 'the written agreement leaves no room for doubt that they [the taxpayer and QAI] intended the loan money to be provided for the purpose of payment to the Commissioner.' The funds paid by QAI to the taxpayer were held on a *Quistclose* trust and did not ever become property of the taxpayer. The money was therefore not recoverable by the trustees from the Commissioner.

The trustees' application was dismissed.

Implications

The decision has significant implications on both trustees' and liquidators' recovery of unfair preferences where third parties have played a role in the underlying transactions. Where a third party loan to a person is created exclusively for a specific purpose such that the borrower is not free to apply the money for any other purpose, the borrower will have a fiduciary obligation as to that money. In such a circumstance, the loaned monies never become the property of the debtor and a Court is likely to find that, as here, a *Quistclose* trust is created.

For more information, please contact:

Pieter Oomens
Managing Partner
T: 02 8257 5709
M: 0417 268 334
pieter.oomens@turkslegal.com.au

Rosanna Maiorana
Lawyer