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Paying the Tax Man

Students of taxation law often see little connection between tax and other practice areas. In reality, tax tends to raise a variety of interesting issues in almost every other field of law. This post is about one such example.

Those who have bought and sold real property would be aware that at 'settlement' the buyer pays the purchase price and in exchange, they receive the clear title to the land. Clear title means that any mortgage over the property is released. To release the mortgage, the seller's mortgagee will need to be paid out. Usually, all this happens in one place at the same time. While it looks like a single seamless transaction, in fact it involves two discrete transactions: that between the outgoing mortgagee and the seller; and that between the seller and the buyer.

A 2012 decision of the Full Court of the Federal Court has called into question the position of the releasing mortgagee at settlement through the operation of a tax statute.

The Case

In *Commissioner of Taxation v Park*:

- Bassili owed money to the Australian Taxation Office ('ATO').
- She had two registered mortgages over her property.
- She signed a contract to sell her land.
- After signing the contract, two things happened:
 - A trustee (Park) was appointed over her estate under the *Bankruptcy Act 1966* (Cth) on the application of a creditor; and
 - The ATO served a notice on the purchasers under the *Taxation Administration Act* requiring them to pay the ATO \$75,508.64 immediately the purchase price was owing to Bassili.
- The purchase price was not enough to cover payment to the first mortgagee, the second mortgagee and the ATO.
- The parties agreed that the first mortgagee should be paid in full - therefore there was a question as to whether the second mortgagee would be paid in priority to the ATO.

This last issue caused a delay in the date of settlement as the parties negotiated about who was entitled to the funds. Eventually it was agreed that settlement would occur and the disputed amount would be paid to the trust account of the solicitor for the second mortgagee. The ATO made it clear that in agreeing to settlement, it was not surrendering its claim under the notice, and reserved the right to seek declaratory orders from the Federal Magistrates Court for recovery of the funds from the trust account.

Federal Magistrates Court

The Federal Magistrate found that the ATO's demand did not operate over the money

About Me



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I lecture in land law at James Cook University and I write and think about the nature of

property and its representations in the law; about issues affecting women; about justice generally; and about legal education.

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tendered at settlement. He reasoned that the demand covered money to be paid in respect of *mortgaged* land. Therefore, to the extent that the money tendered was attributable to the secured debt, it was not money due to the taxpayer (the seller, Bassili).

The Appeal

The majority on appeal, Jessup and Katzmann JJ, rejected the Federal Magistrate's reasoning.

First, the majority correctly pointed out that there were two transactions - the release mortgage as between Bassili and the mortgagees; and the sale between Bassili and the purchasers.

Secondly, the majority characterised these transactions thus:

- The release of the mortgages was a precondition to the completion of the sale - as Bassili had contracted to sell an unencumbered property. So this needed to occur first. The mortgagees released their charges, handing over the documents of release. At this point, the mortgagees lost their security interest over land. They held no security interest over the proceeds of sale. Their only recourse against the borrower (Bassili, or her trustee in bankruptcy) was under the personal covenant in the mortgage.
- Once the mortgages were released and the seller (Bassili) had an unencumbered title to the property, she had a full beneficial interest in all the purchase money to be paid. The ATO's demand attached to these funds. Because the mortgages had *already* been released, the ATO's interest took priority to the mortgagees' securities.

Siopis J in dissent found that even if there were some temporal interval between the release of the mortgage and the mortgagee's receipt of the proceeds of sale (ie a scintilla temporis - a tiny bit of time) the mortgagee would have had an equitable charge over the land. Because of this equitable charge, Bassili would not have had a beneficial interest in the purchase money. Therefore the ATO's notice would not attach to this money.

Observations

The first observation to make concerns the majority's conceptualisation of the conveyancing process and the apparent separation of the two transactions. While there are indeed two transactions, I have always seen them as intrinsically interrelated.



The transactions are finely balanced at this point. Before this point, in my view, the parties have not completed either transaction. It is only now that each party can satisfy themselves that it is safe to complete; that their interests are fully protected. Namely, that the mortgagee (bank) has its security paid; and the buyer has a clear title. Any payment or delivery of documents until this moment, in my view, has been conditional.

I characterise the two transactions as then completing simultaneously, and in an interconnected way. On this understanding, there is no temporal interval between the two transactions - there is no moment at which the ATO's demand can attach to the funds. Even though the buyer has no obligation to or relationship with the outgoing mortgagee, the nature of the transaction is such that the title remains encumbered until the mortgagee,

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not the vendor (Bassili) is in receipt of the funds.

I find it puzzling indeed that the majority found that the mortgagee 'voluntarily' released the charge. It was this voluntary act that, in the view of the majority, resulted in the attachment of the ATO's demand to the purchase money. If this is the case then in transactions involving ATO demands, no mortgagee will ever release their mortgage. This will result in mortgagees exercising their power of sale in preference. The power of sale creates a relationship between the buyer and mortgagee, so the debtor (in this case Bassili) is removed from the transaction.

What is also concerning for buyers and mortgagees, is that [s260-5 \(5\) of Schedule 1 of the Taxation Administration Act](#) requires payment when the amount *becomes owing* to the debtor (Bassili). Section 260-5 (3) provides that:

The third party (the purchaser) is so taken to owe the money to the debtor (Bassili) even if:

- (e) the money is not due...unless a condition is fulfilled; and
- (f) the condition has not been fulfilled.

This appears to mean that if the money is only due on condition of clear title, then even if clear title is not given (ie the condition is not fulfilled) then the purchasers are still taken to owe the money. And it is *owing* the money that results in their liability - the liability of an unrelated party to pay the tax debts of another. If this is the case, then whether or not the mortgage is actually released is not material.

For a mortgagee, this devalues the registered security, effectively rendering it defeasible to the unsecured interest of the ATO. For the buyer (the unrelated third party) it means paying purchase money to the ATO without receiving an unencumbered title.

For the short term at least, it seems the decades-long rejection of the legal fiction of *scintilla temporis* has been enlivened by the court. Because of the effect of this decision on conveyancing practice and the practice of banks holding security over real property, either the operation of s260-5 needs review, or banking practice will need to change. A change in practice will, of course, simply remove the viability of the s260-5 notice in these sorts of circumstances.

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