

IN THE COURT OF APPEAL OF NEW ZEALAND

CA432/2012
[2013] NZCA 455

BETWEEN COMMISSIONER OF INLAND
REVENUE
Appellant

AND JENNINGS ROADFREIGHT LIMITED
(IN LIQUIDATION)
First Respondent

BORIS VAN DELDEN AND ROY
HORROCKS AS LIQUIDATORS OF
JENNINGS ROADFREIGHT LIMITED
(IN LIQUIDATION)
Second Respondent

Hearing: 9 July 2013

Court: Ellen France, Wild and White JJ

Counsel: P W O'Regan and CIJ Fleming for Appellant
C C Mansell and M A Beattie for Respondents

Judgment: 1 October 2013 at 3 pm

JUDGMENT OF THE COURT

- A The appeal is allowed.**
- B The cross-appeal is dismissed.**
- C No order as to costs.**
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REASONS

Wild and White JJ [1]
Ellen France J (dissenting) [61]

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WILD AND WHITE JJ

(Given by Wild J)

Introduction

[1] This appeal by the Commissioner of Inland Revenue (the Commissioner) challenges the correctness of the High Court's interpretation of s 167 of the Tax Administration Act 1994 (the TAA).

[2] Section 167 governs the status of PAYE (pay as you earn) tax deducted by an employer when paying its employees wages and salaries, and thus the Commissioner's ability to recover the deductions.

[3] The employer here was the first respondent, Jennings Roadfreight Ltd, now in liquidation. The case concerns \$14,076.38 held by Jennings' bank, the Bank of New Zealand (BNZ), when Jennings was placed in liquidation.¹ That \$14,076.38 was part of a total of \$26,777.80 deducted by the BNZ from Jennings' bank account and placed in a suspense account pursuant to a notice earlier given to the BNZ by the Commissioner.

¹ The Commissioner calculated that in the following way:

| | |
|---|--------------------|
| Closing balance on day before liquidation | \$14,318.64 |
| Less: Withdrawal on day of liquidation, possibly before 11 am (this is the only withdrawal on that day for which a time is not known) | <u>\$242.76</u> |
| Balance at time of liquidation | <u>\$14,076.38</u> |

[4] In the High Court Associate Judge Doogue upheld the liquidators' claim that the Commissioner was not entitled to retain the \$14,076.38, but must prove in the liquidation and recover in order of the priorities set by sch 7 (preferential claims) of the Companies Act 1993.²

[5] On this appeal the Commissioner submits the High Court erred because the \$14,076.38 was held in trust for the Commissioner pursuant to s 167(1). Thus, the BNZ properly paid that sum to the Commissioner post-liquidation, and the Commissioner was entitled to retain it.

[6] The liquidators oppose the Commissioner's argument, supporting the High Court's interpretation as correct. The liquidators also cross-appealed against the Associate Judge's rejection of their arguments summarised in [15] below.

The facts

[7] As at 15 March 2011 Jennings owed the Commissioner \$49,889.90 in PAYE for the month of February 2011.

[8] On 15 March the Commissioner issued to the BNZ a notice under s 157 of the TAA requiring it to deduct from Jennings' bank account and pay to Inland Revenue immediately the lesser of \$294,214.82 or the available funds. Although that notice did not specify the nature of Jennings' tax liability, the notice was in fact issued in respect of GST and not the \$49,889.90 PAYE referred to in [7].

[9] The BNZ made four deductions from Jennings' bank account pursuant to the notice, placing the monies deducted in a suspense account:

- At 9.13 am on 24 March 2011 \$10,214.82

(Then, after Jennings was placed in liquidation at 11 am on 24 March 2011):

- At 12.41 pm on 24 March 2011 \$7,896.46

² *Jennings Roadfreight Ltd (in liq) v Commissioner of Inland Revenue* [2012] NZHC 1441.

- At an unspecified time \$44.24
 - On 29 March 2011 \$8,622.28
- \$26,777.80

[10] That \$26,777.80 was subsequently paid by the BNZ to the Commissioner.³ Of that sum, the Commissioner accepts she is only entitled to retain the \$14,076.38 referred to in [3] above, and must account to the liquidators for the balance of \$12,701.42.

[11] On 30 March the Commissioner sent Jennings' liquidators a proof of debt for outstanding GST.

[12] On 11 April the Commissioner became aware that Jennings owed the PAYE for February (referred to in [7] above) and, on 4 October, amended her proof of debt to add this to the outstanding GST.

Section 167

[13] Reduced to what is relevant to this appeal s 167 provides:

Deductions

167 Recovery of tax and payments from employers or PAYE intermediaries

- (1) Every amount of tax ... deducted under the PAYE rules ... shall be held in trust for the Crown, and any amount so held in trust shall not be property of the employer liable to execution, and, in the event of the ... liquidation of the employer ... shall remain apart, and form no part of the estate in ... liquidation ...
- (2) When an amount of tax ... has been ... deducted under the PAYE rules ... and the employer has failed to deal with the amount of the tax ... deducted (or any part of it) in the manner required by subsection (1) or the PAYE rules, the amount of the tax ... for the time being unpaid to the Commissioner shall, in the application of the assets of the employer, rank as follows:

...

³ By four payments, three on 29 March 2011 and one on 31 March 2011.

- (b) where the employer is a company, upon the liquidation of the company, the amount of the tax ... shall have the ranking provided for in Schedule 7 of the Companies Act 1993 ...

[14] Broadly,⁴ sch 7 of the Companies Act prescribes this order of priority of payment to preferential creditors:

- first, the liquidators for their fees, expenses and remuneration;
- secondly, employees for their wages or salaries, holiday pay and redundancy compensation; and
- thirdly, the Commissioner in respect of “amounts deducted by the company from the wages or salary of an employee in order to satisfy obligations of the employee (including amounts payable to the Commissioner in accordance with ... s 167(2) of the [TAA])”.

High Court judgment

[15] Associate Judge Doogue rejected the liquidators’ argument that the Commissioner could retain the \$26,777.80 for the related reasons that she was not aware, pre-liquidation, that Jennings owed PAYE, and had given the notice and received the payments in respect of GST. The Associate Judge took the view that the s 167 trust arose as a matter of law at the point an employer made deductions from an employee’s wages or salary, and did not depend on the Commissioner’s state of mind or knowledge. He also noted that it was not disputed that Jennings had deducted PAYE for February that exceeded the \$26,777.80 the BNZ had paid the Commissioner.

[16] There followed these paragraphs which the Commissioner challenges on this appeal:

[16] It is clear that by the time that the liquidation commenced, the funds had not been paid to the Commissioner. The funds had been transferred by the BNZ to a suspense account pending a decision being made as to whether it would pay them to the Commissioner.

⁴ We have omitted some priorities not relevant here, for example for an administrator or for a creditor who protects or recovers assets of the company.

[17] It would appear that the effect of this section is to protect the interest of the Commissioner in PAYE deductions until such time as the Commissioner receives them. If the Commissioner has not received the PAYE deductions by the time liquidation occurs, the protection of s 167 is lost. That appears to be what is meant by s 167(2) when it speaks of the case where the:

[E]mployer has failed to deal with the amount of the [tax or payment withheld or deducted (or any part of it)] in the manner required by subsection (1) or the PAYE rules ...

[18] If the Commissioner does not receive the funds by the time the liquidation commences, then his position is the less favourable one of being a creditor of the company in the liquidation, albeit a preferential creditor.

[19] In the light of the last conclusion in the above paragraph, it is difficult to see that s 167(1) of the TAA has any effect on the outcome in this case. The trust would operate to prevent the employer dealing with the funds while under his control in a way that is inconsistent with its obligations under s 167, which are, broadly, to pay the money to the Commissioner as part of the return process provided for in the PAYE rules. But if the money is out of the employer's possession and beyond its reach, the trust imposed on the plaintiff has no relevance. Section 167(2), in expressly providing for what should happen if the employer fails to deal with the amount of PAYE withheld in the manner required by the PAYE rules, makes it clear that the trust has no relevance after the company goes into liquidation. Therefore, the Commissioner cannot rely on s 167(1) of the TAA.

Opposing interpretations of s 167

[17] As mentioned, Ms Mansell for the liquidators supported the Associate Judge's interpretation. Her succinct summary was this:

- (a) Section 167(1) creates a trust over any funds deducted by the employer and dealt with in accordance with the PAYE rules and paid to the Commissioner prior to liquidation.
- (b) This trust extinguishes upon liquidation of the company in accordance with s 167(2). Any funds not dealt with in accordance with the PAYE rules will be considered a tax debt owed to the Commissioner and recoverable as a preferred debt in accordance with sch 7 of the Companies Act.

[18] For the Commissioner, Mr O'Regan accepted that s 167(1) and (2) appear on their face to be inconsistent.⁵ Based on the legislative history and the scheme of the TAA, Mr O'Regan submitted that the best reading of s 167 is:

- (a) Section 167(1) applies to amounts representing PAYE deductions made prior to liquidation. The trust status of those amounts does not change on liquidation. The trust attaches to any credit balance in the employer's bank accounts prior to liquidation.⁶
- (b) Section 167(2) applies to amounts that are subject to the trust at the time of liquidation but there is either a deficiency in the credit available or no credit available in any of the company's bank accounts.

Our view

[19] Section 167(1) and (2) deal with two quite different situations, with different thresholds and consequences. These can be summarised as follows:

- (a) Section 167(1) deals with the situation where the employer has dealt properly with the PAYE deduction(s), while s 167(2) deals with the situation where the employer has "failed" to deal properly with the deduction(s).
- (b) When the employer has dealt properly with the PAYE deduction(s), s 167(1) provides that there are two consequences:
 - the money is held on trust for the Crown; and
 - the money held in trust is not the property of the employer and therefore not part of the employer's estate upon liquidation.

⁵ For the reasons explained in [19] following, we do not agree with Mr O'Regan that s 167(1) and (2) are inconsistent.

⁶ Applying *Commissioner of Inland Revenue v Smith* [2000] 2 NZLR 147 (CA).

(c) When the employer “fails” to deal properly with the PAYE deduction(s) (ie the threshold in s 167(1) is not met), s 167 applies with two different consequences:

- the unpaid tax remains part of the employer’s estate (because there is no trust); and
- upon liquidation the unpaid balance will rank under sch 7 of the Companies Act.

[20] The purpose of s 167(1) is to create the statutory trust and to ensure that the money in the trust remains outside the employer’s estate on liquidation. The trust can only attach to any credit balance(s) in the employer’s bank account(s). That is because the subsection refers to “any amount so held in trust”. Accordingly, when the total of those balances is less than the payments deducted under the PAYE rules (ie is less than the amount the employer owes the Commissioner for PAYE), the s 167(1) trust fund will be the fluctuating credit balance of the employer’s bank accounts.

[21] Following from that, in the event of the employer’s liquidation, the trust fund crystallises at the credit balance of the employer’s bank accounts if that balance is less than the amount of PAYE owed. In that situation the whole of the credit balance represents the employer’s available deductions under the PAYE rules, so all of it is held in trust for the Crown.

[22] The employer’s liquidation does not extinguish the s 167(1) trust. So to hold deprives of any force the final part of s 167(1) which describes what is to happen to the monies held in trust in the event of the employer’s liquidation:

... in the event of the ... liquidation of the employer ... [any amount so held in trust] shall remain apart, and form no part of the estate in ... liquidation ...

That language only makes sense if the money is still held in the statutory trust created by s 167(1) when the liquidation of the employer commences. Parliament would not have created the trust and provided for the exclusion of the trust money

from the employer's estate upon liquidation if it had intended otherwise. This to us is the critical point.

[23] It follows that we disagree with the Associate Judge's interpretation that the protection of s 167(1) is lost for PAYE deductions not received by the Commissioner by the time liquidation occurs. Similarly, we do not accept Ms Mansell's argument that the s 167(1) trust extinguishes upon the liquidation of the employer.

[24] Section 167(1) applied to the \$14,076.38 in Jennings' bank account when it was put into liquidation at 11 am on 24 March 2011. The effect of s 167(1) is that the \$14,076.38 "shall remain apart, and form no part of the estate in ... liquidation".

[25] Section 167(2) applies to PAYE deducted and neither paid by the employer to the Commissioner, nor held by the employer in its bank accounts available for payment to the Commissioner. That in our view is what the legislature intended by the wording "and the employer has failed to deal with the amount of the tax ... deducted ... in the manner required by subsection (1) or the PAYE rules ...". The employer will fail to deal with the PAYE in the manner required by s 167(1) if it no longer holds the PAYE it has deducted but not yet paid to the Commissioner. In other words, if the employer has misapplied the monies held in trust for the Crown. The employer will fail to deal with the PAYE as required by the PAYE rules if it has not paid the PAYE to the Commissioner as required by s RD4 of the Income Tax Act 2007 (the ITA). Section RD2(1) of the ITA defines "the PAYE rules" as meaning a series of sections of the ITA and TAA which it lists. Those sections include ss RD3 to RD24 of the ITA. Section RD4 requires an employer to pay the PAYE it has withheld to the Commissioner within specified periods.

[26] Section 167(2) applies to the \$35,813.52 difference between the \$49,889.90 PAYE Jennings had deducted and the \$14,076.38 Jennings held in its bank account when it was put into liquidation. Pursuant to s 167(2), the Commissioner's claim for that \$35,813.52 ranks under the sch 7 priorities.

Legislative scheme

[27] Mr O'Regan accepted the Commissioner had not in the recent past been enforcing the s 167(1) trust. Instead, the Commissioner had been content to take priority under sch 7 of the Companies Act for a debt in respect of PAYE. Ms Mansell argued that implementation of the Commissioner's interpretation of s 167 – which we have upheld – would have a prejudicial affect on liquidations. In particular it would assure to the Commissioner monies that would otherwise be available to meet the liquidators' costs and remuneration. Given that situation, and that concern, we have wanted to be sure that the scheme of the legislation, and its history, support our interpretation of s 167(1) and (2).

[28] Some of the PAYE rules are in Part RD of the ITA.⁷ Sections RD4 and 22 respectively require an employer who deducts PAYE from wages and salary paid to employees to pay, and to return, the amount deducted to the Commissioner. Section 4A(2)(b) of the TAA deems PAYE to be withheld when an employer pays salary or wages net of PAYE.⁸

[29] The basis for the s 167(1) trust is that the PAYE deducted is notionally paid by the employer to the employee, and by the employee to the Crown. The employer holds the amount after deduction and before payment in an administrative as well as trustee capacity. It is for that reason that the PAYE remains apart and forms no part of the employer's estate upon liquidation.

[30] The s 167(1) trust applies to “every amount” and to “any amount” deducted for PAYE. It does not apply to a specific amount deducted. This acknowledges that the amount deducted will seldom be set aside in a separate account. In the interim between deduction and payment to the Commissioner it provides valuable working capital for the employer.

⁷ The other PAYE rules are in other sections of the Income Tax Act 2007 [ITA], and also in the Tax Administration Act 1994 [TAA]: ITA, s RD2(1).

⁸ The term “PAYE income payment” used in s 4A(2)(b) of the TAA is defined in s RD3(1) of the ITA.

[31] This Court in *Commissioner of Inland Revenue v Smith* described the s 167(1) trust as “a statutory creation”.⁹ Where the PAYE monies held on trust are mixed with the employer’s own monies in a bank account, this Court held that the Commissioner “has a charge on the mixed fund to recover the amount subject to the trust”.¹⁰

[32] That is consistent with s 169(1) of the TAA which provides that “an amount equal to the total for the time being unpaid to the Commissioner” in respect of the PAYE “shall be a charge on all the real and personal property of the employer”. As s 169(10) provides that s 169 is subject to s 167, the TAA envisages a charge over the trust amount. As we have pointed out, that may be part of a mixed fund.

[33] The other obvious consequence of s 169(10) is that the s 167(1) trust remains available to the Commissioner, notwithstanding the charge created by s 169(1). In practical terms, the Commissioner would resort to the s 169(1) charge only to the extent that monies deducted for PAYE were not held in any s 167(1) trust fund.

Legislative history

[34] Section 167 of the TAA can be traced back to the Employment Promotion Act 1936 (the EPA) and its successor, the Social Security Act 1938 (SSA). Section 31(2) of the EPA and s 118(6) of the SSA each impressed an amount deducted from wages or salary for tax with a statutory trust for the Crown. For example, s 31(2) of the EPA provided that the amount deducted by the employer, except where represented by employment stamps duly affixed and cancelled, “shall be deemed to be held in trust for the Crown”. If the amount deducted was not held separately by the employer there was a charge on all the employer’s real and personal property: s 31(5) of the EPA; s 119(4) of the SSA.

[35] In moving the third reading of the EPA the then Minister of Employment explained to Parliament:¹¹

⁹ *Commissioner of Inland Revenue v Smith*, above n 6, at [11].

¹⁰ At [11], referring to *Re Hallett’s Estate* (1880) 13 Ch D 696 (CA).

¹¹ (28 April 1936) 244 NZPD 645, see also 627–628. Rather than “deceased person”, we think the Minister meant to refer to “the bankrupt employer”.

If I happen to be an employer of labour and I collect from my employees the wages-tax of 8d. in the pound, I hold it in trust for the Crown. It is not my money, and if I use it for any purpose instead of paying it at once to the Crown I have misappropriated that money. If I become bankrupt and I have wrongfully used, say, £500 or £600 that belongs to the Crown, surely it is not unreasonable for the Crown to suggest that the first charge upon my estate is the money that I held in trust for the Crown. That is all that the subclauses do. The money never belonged to the deceased person: it was always the property of the Crown, and the Crown comes first. I think that is fair and reasonable.

[36] The SSA was replaced by the Income Tax Assessment Act 1957 (ITAA 1957). The statutory trust previously in s 118(6) of the SSA was re-enacted in s 31(1) of the ITAA 1957. A new s 31(2) was added, the initial predecessor of the present s 167(2):

Where a tax deduction has been made under this Part of this Act and the employer has failed to deal with the amount of the tax deduction ... the amount of the tax deduction for the time being unpaid to the Commissioner shall, in the application of the assets of the employer upon the bankruptcy or liquidation ... rank, without limitation in amount and notwithstanding anything in any other Act, in order of priority immediately after preferential claims for wages or other sums payable to or on account of any servant or worker or apprentice or artiled clerk, and in priority to all other claims.

[37] At the second reading, the then Minister of Finance explained cl 31 of the Income Tax Assessment Bill in this way:¹²

Clause 31 deals with the recovery of tax deductions from employers. The tax deductions made by an employer are of course from money belonging to the employee, not to the employer. They are to discharge the tax liability of the employee to the Crown. This clause therefore provides that tax deductions made by an employer will be held in trust for the Crown. They will not be property of the employer liable to execution, and will not form part of his estate in bankruptcy or liquidation. Subclause (2) of this clause provides that if an employer has misapplied tax deductions they will rank in order of priority immediately after preferential claims for wages in the event of bankruptcy.

[38] Section 31(2) of the ITAA 1957 was amended in 1968.¹³ At the second reading of the amending Act the then Minister of Finance explained that the amended provision:¹⁴

... deals with the preference given to unpaid tax deductions on the bankruptcy or liquidation of an employer. It was always intended when PAYE was introduced that unpaid tax deductions in these circumstances

¹² (8 October 1957) 314 NZPD 2900.

¹³ By s 42 of the Land and Income Tax Amendment (No 2) Act 1968.

¹⁴ (19 November 1968) 358 NZPD 3205.

were to rank in preference immediately after certain debts referred to in section 308 of the Companies Act. These debts comprise, in the main, wages, holiday pay, and workers' compensation claims, with certain limitations on the amount of the preference. The purpose of [the clause] is to make it clear, following an adverse decision in the courts, that this original intention is properly achieved.

[39] The “adverse decision in the courts” referred to by the Minister was *Re Westmoreland Box Company Ltd (in liq), Crawshaw v Commissioner of Inland Revenue*, to which we refer in more detail in [45]–[47] below.¹⁵ This Court in *Westmoreland* held that the Commissioner, in respect of unpaid PAYE, did not have priority over the floating charge created by the company over its undertaking in favour of its bank. To counter the effect of *Westmoreland*, the 1968 amendment inserted into s 31(2) a new subparagraph (b) which provided that the priority afforded PAYE debt where the employer was a company was to rank immediately after the debts referred to in s 308(1) of the Companies Act 1955, but before the claims of holders of debentures under any floating charge created by the company.

[40] The Income Tax Act 1976 replicated s 31(1) and (2) of the ITAA 1957 in its s 365(1) and (2).

[41] In turn, the wording of s 365(1) and (2) became what is now s 167(1) and (2) of the TAA.

[42] We consider these successive provisions, and the ministerial explanations of them offered to the Parliament of the day, support our interpretation. In particular, successive ministers have explained to Parliament that the PAYE deductions are money belonging to the employee not to the employer. They are to discharge the employee's tax liability to the Crown. That is the basis for the statutory trust established by s 167(1).

[43] Ms Mansell submitted that the interpretation of s 167 argued for by the Commissioner, which we have upheld, cannot be correct because it has the practical effect of subverting the intention of the legislature in enacting the priorities under sch 7 of the Companies Act. In support of this argument, Ms Mansell directed us to

¹⁵ *Re Westmoreland Box Company Ltd (in liq), Crawshaw v Commissioner of Inland Revenue* [1968] NZLR 834 (CA).

a range of parliamentary materials,¹⁶ and to the Law Commission's study paper on priority debts.¹⁷ She argued that since the predecessors to s 167 were first enacted, the priority scheme has changed considerably. It has been examined by Parliament several times, and the position now is that debts owed to the Commissioner rank below a range of other claims.¹⁸ To impress PAYE deductions with a trust which remains in existence after liquidation of a company is to subvert the intention of the legislature.

[44] While we accept that the priority scheme has changed, we consider that s 167 of the TAA remains as a specific exception to the general order of priorities set out in sch 7. General provisions do not derogate from specific ones.¹⁹ While there is obvious convenience in assembling in one place the priorities afforded to all unsecured debts in a liquidation, that has not happened. Had the legislature intended to remove the priority afforded to PAYE debts under s 167, it could have done so on one of the numerous occasions on which it considered the priority scheme.

Case law

[45] The first case of relevance, although only peripherally, is this Court's decision in *Westmoreland*.²⁰ The issue there was whether the predecessors of s 167(1) and (2) gave the Commissioner, in respect of unpaid PAYE deductions, priority over a floating debenture upon liquidation of the employer company. The funds available in the liquidation were the proceeds of the realisation of the company's assets in the course of the liquidation, not monies the company had held when it went into liquidation.

[46] The point about *Westmoreland* is that there was no money held in the statutory trust under s 31(1) (now s 167(1)). The case dealt with the position under

¹⁶ Including materials on the Insolvency Reform Bill 2005, the Status of Redundancy Payments Bill 2003, the Companies Amendment Bill 1980 and the Companies Bill 1993.

¹⁷ Law Commission *Priority Debts in the Distribution of Insolvent Estates: An Advisory Report to the Ministry of Commerce* (NZLC SP2, 1999).

¹⁸ These include, for example, the costs of liquidation and employee claims. See above at [14].

¹⁹ *New Zealand Law Society v B* [2013] NZCA 156, [2013] NZAR 970 at [58]; J F Burrows and R I Carter *Statute Law in New Zealand* (4th ed, LexisNexis, Wellington, 2009) at 457–461.

²⁰ *Westmoreland*, above n 15.

s 31(2) (now s 167(2)). As s 31(1) had no application, it is understandable that the Solicitor-General did not attempt to bring the Commissioner's case under it.

[47] The relevance of *Westmoreland* is the following comments of North P which support our interpretation of s 167(1), had its predecessor applied:²¹

First of all I should mention that the Solicitor-General did not attempt to bring his case within the provisions of s 31(1). The view he took was that by reason of the provisions of subs (2) he could not claim in this case at all events that the unpaid tax deductions were trust property. He may well be right but I must confess that I find the provisions of subs (1) somewhat perplexing. I would imagine that few New Zealand companies place the tax deducted from their employees' wages into a separate trust account and indeed the subsection does not require them so to do. I would think it likely that all that happens in most cases is that the deductions are recorded in the books of the company and are accounted to the Commissioner of Inland Revenue each month (s 20). Yet if the true interpretation of s 31(1) is that these moneys are trust property there may be something to be said for the view that the Crown may be entitled in equity to a first charge on all moneys lying in the company's bank account: see *Underhill's Law of Trusts and Trustees*, 11th ed. 562–566.

[48] *Commissioner of Inland Revenue v Smith*, to which we referred in [31] above, is the only authority really in point. Mr Smith was the liquidator of Town and Country Excavations Ltd, which was placed into voluntary liquidation on 31 October 1997. As we understand the facts, the company discharged all its PAYE obligations to the Commissioner before it was put into liquidation, with a final payment of \$40,062.35 on 30 September 1997. Those payments of PAYE were made by the company from its bank account which it likely operated "in overdraft throughout the relevant period".²²

[49] The High Court declined an application by the Commissioner for an order that certain GST and PAYE payments not be set aside pursuant to s 294 of the Companies Act 1993. On appeal the Commissioner accepted that amounts paid by the company in respect of tax penalties were not held in trust under s 167(1). In the course of dismissing the balance of the Commissioner's appeal this Court stated:

[13] The Judge's other reason for holding that the PAYE deductions lost their trust status was that they were not paid within the time specified in s NC15(1)(a) of the Income Tax Act. This finding was made on the basis

²¹ At 842.

²² *Commissioner of Inland Revenue v Smith*, above n 6, at [11].

that s 167(2) of the Tax Administration Act qualified the clear statement in s 167(1) of that Act. With respect, we do not accept that s 167(2) of the Tax Administration Act terminates the trust if the PAYE payment is not made to the Commissioner by the due date. Such a finding would import to the statute an intention to allow a trustee to terminate a trust by the wrongful unilateral action of failing to make payment by due date. Section 167(2) of that Act does mean that in the present case, the trust came to an end on the liquidation of the company. As the PAYE deductions had not been set aside in a separate account, it is unnecessary to consider whether the trust would have come to an end if they had been so set aside. Section 167(2) of the Tax Administration Act can have no application in the present case because the Commissioner was paid the amount of the deductions prior to the date of the liquidation.

[50] Although all the observations in this passage are obiter dicta, the first part supports our interpretation of s 167(1). It correctly recognises that when PAYE is held in trust under s 167(1), the trust remains in existence upon liquidation and is not terminated by s 167(2). The last three sentences of the passage are a little more difficult, but appear to be directed to the facts of *Smith* where there was no trust with the result that s 167(1) had no application. We do not interpret these sentences as suggesting that s 167(2) might have terminated the trust, because that would be inconsistent with what the Court had stated clearly earlier in the passage.

Cross-appeal

[51] The liquidators cross-appealed the Associate Judge's findings set out above in [15]. In submitting that those findings were wrong, Ms Mansell advanced three arguments. First, she pointed out that the s 157 TAA notice the Commissioner had given the BNZ related to GST. Consistent with that, the Commissioner had applied the \$14,076.38 paid to her by the BNZ in reduction of the GST Jennings owed. Further, the Commissioner had not reapplied that sum to PAYE deducted by Jennings.

[52] The Commissioner accepts those points. But we do not consider it assists the liquidators to recover the \$14,076.38 from the Commissioner. Notwithstanding that the Commissioner was unaware of it at the time, the legal position was that the \$14,076.38 was held in trust for the Crown. While that money remained in Jennings' bank account, that trust was imposed by s 167(1). The status of the money did not

alter when it was placed by the BNZ in a suspense account, since that was a step toward payment to the Crown in discharge of the trust.

[53] While the deductions and payments pursuant to the s 157 notice in respect of GST may have been a convenient happenstance for the Commissioner, it was not one which altered the legal position. Once the \$14,076.38 was paid by the BNZ to the Commissioner it seems to us to matter not that the Commissioner applied it to GST owed by Jennings. In law the money was held in trust for the Crown.

[54] Ms Mansell argued the Commissioner had made an election to apply the \$14,076.38 to the GST debt and should not later be permitted to argue that she could apply it to outstanding PAYE, when faced with the liquidators' exercise of their powers under s 292 of the Companies Act. We simply reiterate our view that it matters not whether the Commissioner applied/applies the \$14,076.38 to GST or to PAYE (ie to the employees' income tax) or to some combination of the two. The Commissioner has not made an election, so as to raise some form of estoppel or otherwise prevent the Commissioner exercising her statutory powers.

[55] Secondly, Ms Mansell argued that the s 167(1) trust was defeated once the \$14,076.38 was withdrawn by the BNZ from Jennings' bank account and placed by the Bank in a suspense account. We do not agree, for the reason we have given in [52] above. Even if that were not the position, and s 157 applied, the effect of s 157(8) or (9) would have been that the \$14,076.38 placed in the suspense account was "deemed to be held in trust for the Crown". The words in s 167(1) making it clear that the money held in trust is not the employer's property and, upon the liquidation of the employer remains apart from the estate in liquidation, are not in s 157(8) or (9). But we consider those words do no more than spell out the legal position that would anyway govern money held in trust by the employer for a third person, be it the Crown or any other beneficiary. For example, if the employer was a real estate company which held \$1 million in trust for clients (deposits under agreements for sale and purchase), those monies would not be available to the liquidators.

Application of s 157 of the TAA

[56] Associate Judge Doogue also held that the fact that the BNZ had made deductions pursuant to the s 157 notice did not assist the Commissioner, because the payments the Commissioner received from the BNZ were made after Jennings was placed in liquidation, and therefore were caught by s 251 of the Companies Act.²³

[57] As a second issue on appeal, Mr O'Regan argued that those holdings by the Associate Judge were in error. The Commissioner submitted a s 157 notice is not an attachment in terms of s 251 of the Companies Act. We also heard argument as to the validity of the s 157 notice, which Mr O'Regan conceded "did not quite fit within the scheme of s 157". We need not rule on any of these matters. Ms Mansell accepted – we think rightly – that if the Commissioner succeeded on her s 167(1) TAA argument, then s 157, and with it s 251 of the Companies Act, became academic.

Result

[58] For the reasons we have given the Commissioner's appeal is allowed. The judgment of the High Court entering judgment for the liquidators is set aside.

[59] The liquidators' cross-appeal is dismissed.

[60] We make no order as to costs. Although this judgment will be a guide to the Commissioner and liquidators alike, this appeal has been brought by the Commissioner to re-establish a position she has apparently not enforced for some time. Given that they shouldered the burden of a contrary argument on an issue of general importance, we think it inappropriate to visit a costs award on the liquidators.

ELLEN FRANCE J

[61] I take a different view on the interpretation of s 167 of the Tax Administration Act. In particular, I do not agree with the majority as to the impact of liquidation on the situation where the employer has not dealt with the amount deducted for PAYE in

²³ *Jennings Roadfreight Ltd (in liq) v Commissioner of Inland Revenue*, above n 2, at [49].

the required manner. In that case, where the sum remains unpaid to the Commissioner, the effect of s 167(2) is that the amount ranks as a debt payable in accordance with sch 7 of the Companies Act. That is the case even if on liquidation there are sufficient funds in the company's bank account to meet the tax liability. My reasons follow.

[62] It is necessary first to put s 167 in its context. The section is in pt 10 of the Act dealing with recoveries and appears under the heading "Deductions". The first group of sections in this part, appearing under the heading "General", deal with general matters such as the ability of the Commissioner to recover unpaid tax on behalf of the Crown "by suit in the Commissioner's official name".²⁴

[63] When it comes to deductions, ss 167–169 deal with PAYE. In terms of s 169, where an employer has failed to withhold or deduct or pay PAYE, the amount unpaid is a charge on the employer's property. Section 169 is subject to s 167.²⁵ The remaining sections in this part deal with the recovery of resident withholding tax (RWT). Section 170(1) dealing with RWT mirrors s 167(1).²⁶ Section 170(2) provides that the provisions of s 167(2) shall apply to any amount of RWT made in accordance with the RWT rules by any person as if it were a tax to which s 167(2) refers and as if the person were the employer to which that section refers. Section 170(3) states that the section shall apply notwithstanding anything in any other Act. In particular, s 308 of the Companies Act 1955 dealing with preferential payments applies subject to this section.

[64] When considered in context, s 167 is setting out the effect of obligations on the employer and then dealing with the position on liquidation when those obligations are not met. In terms of s 167(2) it is necessary to give some meaning to the fact that the section applies when the employer has failed to deal with the deduction in the manner required by s 167(1) or the PAYE rules. I accept that there

²⁴ Section 156.

²⁵ Section 169(10).

²⁶ Deductions for other purposes are also held "in trust": compare Tax Administration Act, s 157; Goods and Services Tax Act 1985, s 43; and Income Tax Act, s RP 18. The Canadian Income Tax Act RSC 1985 c 1 also utilises the trust concept: see *Toronto-Dominion Bank v Canada* 2010 FCA 174, [2012] 1 FCR 197 at [27] and [47]; aff'd 2012 SCC 1, [2012] 1 SCR 3.

is no utility in triggering the trust concept when the PAYE has been paid but if the trust remains no matter what, the latter approach gives no meaning to s 167(2).

[65] Section 167(2) is dealing with a situation when PAYE is deducted and has fallen due prior to liquidation but has not been paid to the Commissioner by the time liquidation occurs. The relevant PAYE rules are those in the Income Tax Act²⁷ and, in particular, s RD 4(1) which provides for the employer to pay amounts withheld as PAYE to the Commissioner on a monthly basis.

[66] The New Zealand authority on the point is limited but in my view it supports the interpretation I have adopted of the section.

[67] In *Westmoreland*, this Court concluded that money due to the Commissioner for PAYE deducted but not paid to the Commissioner did not take priority for payment ahead of a floating debenture upon the liquidation of the employer company.²⁸

[68] The equivalent to s 167 at that time was s 31 of the Income Tax Assessment Act which read:

- (1) The amount of every tax deduction made under this Part ... shall be held in trust for the Crown; and any amount so held in trust shall not be property of the employer liable to execution, and, in the event of the bankruptcy or liquidation of the employer ... form no part of the estate in bankruptcy, liquidation or assignment.
- (2) Where a tax deduction has been made under this Part of this Act and the employer has failed to deal with the amount of the tax deduction ... in the manner required by subsection (1) of this section or the other provisions of this Part of this Act, the amount of the tax deduction for the time being unpaid to the Commissioner shall ... rank ... in order of priority immediately after preferential claims for wages or other sums payable to or on account of any servant or worker or apprentice or articed clerk, and in priority to all other claims.

...

²⁷ Section RD 2.

²⁸ *Westmoreland*, above n 15.

[69] Although North P made the observations cited by the majority at [47], it is relevant that his Honour went on to say:²⁹

I say nothing more about this possibility because I am inclined to agree with the Solicitor-General that whatever the intention of the draftsman may have been the provisions of s. 31 (2) are against the view that unpaid tax deductions as such are trust property.

[70] Further, Turner J stated:³⁰

But the section goes on in subs. (2) to provide what shall happen if the employer “has failed to deal with the amount of the tax deduction ... in the manner required by subs. (1) ...” ; and it seems to me clear that in this context subs. (1) cannot be construed as constituting the money withheld a trust fund in all circumstances. I am of the opinion that it does no more, in this context, than direct the employer so to hold the moneys deducted.

[71] In the Supreme Court in that case, Hardie Boys J referred to a passage in *Cunningham’s Taxation Laws of New Zealand* citing another case where it was held that if the fund is not in existence then s 31(1) is inapplicable.³¹ Hardie Boys J went on to say:³²

Be that as it may, the provisions of s. 31 (2) and s. 32 would appear to be surplusage if every PAYE deduction, not paid to the revenue authorities, is to be treated as notionally in existence and never forming part of the company’s estate in liquidation; as such it would enjoy a priority of such high order that it would take precedence over even those debts which s. 31 (2) says it ranks after, for those debts are payable in the course of “application of the *assets* of the employer” upon bankruptcy, liquidation etc.

[72] The passage from *Cunningham’s Taxation Laws of New Zealand* referred to in *Westmoreland* reads as follows:³³

Sections 31 and 32 provide that tax deductions made by an employer shall be deemed to be held in trust for the Crown in the event of a bankruptcy or liquidation of the employer and that it ranks in priority immediately after preferential wages.

In a recent unreported case where a Bank appointed a receiver under a debenture, it was argued by the liquidator that he should distribute the

²⁹ At 842.

³⁰ At 844.

³¹ *Re Westmoreland Box Company Ltd (in liq), Crawshaw v Commissioner of Inland Revenue* [1968] NZLR 826 (SC) at 833 citing H A Cunningham *Cunningham’s Taxation Laws of New Zealand* (5th ed, Butterworths, Wellington, 1963) at [435].

³² At 833.

³³ At [435].

proceeds from the realisation without any regard to the priority claim by the Department for tax deductions. It was claimed that s.31 was not effective prior to liquidator's appointment. The liquidator was empowered on 8 December 1958, but the receiver was appointed on 6 November 1958.

It was decided that the claim for tax deductions by the Department rank immediately after the debenture and other preferential payments (*e.g.*, wages) because—

...

(b) Section 31 (1) was of no relevance because the tax deductions were not in fact held in trust.

[73] The text goes on to refer to *R v Lambert* where, in the context of a criminal case, the words “duly paid” in s 31(3) were interpreted to mean paid on the date required by the Act to be paid.³⁴ In that case payment had not been made by the 20th day of the particular month as required by the Act but subsequently. The Court said that was not a payment “duly” made.

[74] As I read the passage in *Smith* referred to at [49] of the majority judgment three propositions emerge.

[75] First, an employer cannot terminate the trust simply by failing to make payment by the due date. That is logical because otherwise the employer could evade the requirement. Secondly, however, if that is the position (that is, the tax remains unpaid) as at the date of liquidation then the trust comes to an end. Finally, the Court queried whether the position might have been different if at the time of liquidation the amount representing the PAYE deduction had been set aside. For example, the Court may have been envisaging the situation where the money, although not required to be set aside in a separate account, may in fact have been placed in a trust account or similar.

[76] I do not see the approach I take as inconsistent with the legislative history. The focus in my view has been on the concept that PAYE deductions do not become the employer's property and that if the employer uses the money for his or her own purposes then that amounts to a misappropriation. Secondly, there is force in Ms Mansell's submission that when the history of the income tax legislation is

³⁴ *R v Lambert* [1962] NZLR 38 (SC).

considered alongside that of the companies and insolvency legislation it is plain that the intention was that PAYE liabilities covered by s 167(2) would rank in accordance with sch 7. Ms Mansell notes that the Companies Amendment Act 1980, s 23, amended s 308 of the Companies Act 1955 to include tax deducted from employees in the same priority regime as other preferential claimants.

[77] Finally, there are policy considerations that support the approach I prefer. There are two relevant points. The first is that made by the Law Commission, namely, that in the case of PAYE and GST the Commissioner obtains regular returns from taxpayers or at least should know if a regular return has not been made. The point made by the Commission is that the Commissioner accordingly has “*more* information on which to base a decision to take action to collect arrears of revenue than most trade creditors would have”.³⁵

[78] Secondly, the Commissioner’s approach would mean that PAYE debts and other deductions referred to in s 167(1) would rank ahead of other matters such as liquidator’s fees and expenses, employees’ wages or salary and holiday pay.

[79] Because the majority view means that the appeal is allowed, I do not deal with the respondents’ cross-appeal.

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³⁵ Law Commission, above n 17, at [99].