

BETWEEN

**JENNINGS ROADFREIGHT LIMITED
(IN LIQUIDATION)**

First Appellant

**BORIS VAN DELDEN and ROY HORROCKS AS
LIQUIDATORS OF JENNINGS ROADFREIGHT
LIMITED (IN LIQUIDATION)**

Second Appellant

AND

COMMISSIONER OF INLAND REVENUE

Respondent

Hearing: 10 June 2014

Coram: Elias CJ
McGrath J
William Young J
Glazebrook J
Arnold J

Appearances: A W Johnson and C C Mansell for the Appellants
P W O'Regan and P H Courtney for the Respondent

CIVIL APPEAL

MR JOHNSON:

If the Court please, Johnson, with my friend, Ms Mansell, for the appellants.

ELIAS CJ:

Thank you, Mr Johnson, Ms Mansell.

MR O'REGAN:

If the Court pleases, Paul O'Regan with Mrs Pauline Courtney for the Commissioner.

ELIAS CJ:

Thank you, Mr O'Regan, Ms Courtney. Yes, Mr Johnson.

MR JOHNSON:

Your Honours, as a preliminary point, what I have before me is a small bundle of supplementary authorities that I'm seeking to introduce to the Court. The –

ELIAS CJ:

Are these not referred to in your submissions –

MR JOHNSON:

No, they are not.

ELIAS CJ:

– Mr Johnson?

MR JOHNSON:

They are referred to in my oral submissions. They come out of submissions of the – either ones where they've been omitted, pages missing, or they come out of the submissions of the respondent. They're not contentious –

ELIAS CJ:

Yes, that's fine, Mr Johnson.

MR JOHNSON:

Your Honours, the good thing about this case is that the facts are very narrow, and are not in dispute. This case, to my eyes, is strictly about statutory interpretation and the intention when this legislation was passed. My oral submissions are going to cover a number of points, but I thought I'd indicate to you in advance the framework so you can follow me more easily.

First of all I'm going to just refer to the facts, very briefly, then I'm going to give my view of the, my overview of the statutory scheme for recovery and how it works, and

then I'm going to talk about conceptual difficulties with the Court of Appeal's judgment in terms of how this trust operates. After that I'm going to look at the prior New Zealand decisions, I'm going to go to legislative history, I'm then going to talk about practical difficulties with the judgment as it is at the moment, I'm then going to go to specific points in the respondent's submissions that I haven't already covered, and then I'm going to try and conclude.

ELIAS CJ:

Yes, Mr Johnson, we have read of course your written submissions, so you can proceed on that assumption and highlight the points that you're making.

MR JOHNSON:

Yes. The facts that I say are relevant are that the PAYE deduction was made on 28 February 2011. At that date, or, sorry, the day after, the bank account was in overdraft.

WILLIAM YOUNG J:

Sorry, PA – made on 28th February?

MR JOHNSON:

Yes, so that the deduction was made, was deemed to be made, on 28 February 2011.

WILLIAM YOUNG J:

And did that put the account into overdraft?

MR JOHNSON:

The account was actually in overdraft before. The deduction is just a deemed one, so it doesn't actually affect the balance. It's...

WILLIAM YOUNG J:

Ah, of course.

MR JOHNSON:

Yes. So on 28th February the deemed deduction was about \$50,000. On 1 March the account was in overdraft in the sum of \$7525. Now under the PAYE rules the –

WILLIAM YOUNG J:

Sorry, what I actually meant was that salaried payment had put the account into overdraft.

MR JOHNSON:

Yes, yes. Under the PAYE rules the deduction was supposed to be paid to the IRD, to the Commissioner, by 5 March 2011. Now my written submissions are wrong on this point and I will take you through that in a minute, but it's not contested that in fact under the rules the payment was supposed to be made on 5 March. That did not occur, and the remittance of the PAYE did not take place at all up to the date of liquidation, which was on 23 March 2011. But on 23 March 2011 there was \$14,000 approximately in the bank account. So the Court of Appeal's decision, supported by the Commissioner, is that the trust that we're going to talk about applies to that money.

WILLIAM YOUNG J:

What was the – how much was in the account on 5 March, do you know?

MR JOHNSON:

I may – just a moment.

GLAZEBROOK J:

9 March it was overdraft in 1673 according to your submissions but...

MR JOHNSON:

Yes, it was.

WILLIAM YOUNG J:

So it was, presumably it was – okay, sorry.

MR JOHNSON:

The –

GLAZEBROOK J:

It could have gone up and down.

MR JOHNSON:

Yep.

GLAZEBROOK J:

Oh, they had a payment, didn't they, the Crown said they had a payment at some stage?

MR JOHNSON:

The bank statements are in the case on appeal and –

ARNOLD J:

Well, in that chronology attached to the Crown submission, do you dispute that, it gives the figures?

MR JOHNSON:

No, that's fine.

ARNOLD J:

Right.

MR JOHNSON:

That's fine. But in terms of the core document, if you go to page 154 of the bundle, of the case on appeal –

ELIAS CJ:

Sorry, which...

MR JOHNSON:

The case on appeal.

ELIAS CJ:

144.

MR JOHNSON:

Page 154. That indicates that on 4 March the balance was \$18,000 in credit. And then if you follow through those pages you'll see that the account goes up and it goes

down and it's in overdraft and then there's money, but as at the date of liquidation there was about \$14,000 in there.

McGRATH J:

Which is the 23rd of March.

MR JOHNSON:

Yes, it is. Now the appellants' position –

ELIAS CJ:

What was the business advantage account used for? Everything?

MR JOHNSON:

Everything.

ELIAS CJ:

Yes.

MR JOHNSON:

Everything.

ELIAS CJ:

What is a business advantage account – oh, it doesn't matter.

MR JOHNSON:

I was going to make a stupid joke then, Ma'am, but it's just an account for everything.

ELIAS CJ:

Yes, well, it was a stupid question, so I take it back.

MR JOHNSON:

So to the appellant this is crucial that the account was in overdraft a day after the deduction was made, because the appellant's submissions are based on orthodox trust principles, *Re Hallett's Estate* (1880) 13 Ch D 696 is the classic situation where you can trace money into a joint account and you can trace trust money, but that if the account is reduced below the amount of the trust sum then in terms of that amount the trust fund is diminished and can't bounce back. So it's that line of

thinking that the appellant is putting before the Court. So there's two problems with this money. One is that we say it wasn't held. We don't advance the argument that it has to be in a separate account –

ELIAS CJ:

Well, then, how is it held, in your submission?

MR JOHNSON:

It has to be in the account at that time, there has to be a sum in that account equal to the amount of the deduction.

McGRATH J:

Or the trust has been extinguished, do you say?

MR JOHNSON:

Diminished and then eventually, in terms of to the extent of the reduction, the trust fund has gone.

ARNOLD J:

It makes it very easy to extinguish it, doesn't it? You just run your account straight into overdraft and you've extinguished it.

MR JOHNSON:

But the – that's right, and I'm sure the Commissioner will say that, but the consequences under the scheme are quite substantial. The first is, it's a criminal offence, and I'll take you through those provisions.

WILLIAM YOUNG J:

It's a criminal offence only when payment isn't made on the due date, isn't it?

MR JOHNSON:

That's right, that – no, I'm going to say it's not that, Sir.

WILLIAM YOUNG J:

You say that as soon as the money's not kept apart there's a theft by failing to account or something of that sort?

MR JOHNSON:

Under the wording it says that you're using the money for a purpose other than payment of or payment to the Commissioner.

WILLIAM YOUNG J:

Sorry, under the wording of what?

MR JOHNSON:

The criminal provision.

ELIAS CJ:

Could you take us to that –

MR JOHNSON:

Yes, I can.

ELIAS CJ:

– because I haven't seen that.

GLAZEBROOK J:

Well, yes, but many businesses would be running this sort of overdraft and other account, and many businesses would be paying the amount after overdraft. Because if the businesses are running on overdraft then they may always be in overdraft and would pay the money out of overdraft without there being a criminal offence with them fluctuating that overdraft up and down, wouldn't there?

MR JOHNSON:

I accept that this practice has gone on for a long time, and the Commissioner has not sought to prosecute in that position. But if you –

WILLIAM YOUNG J:

But it would be hard to, given the authorities which say that whatever the statute says there isn't an obligation to keep the money segregated.

MR JOHNSON:

There isn't a civil law obligation, is what the judgments say.

WILLIAM YOUNG J:

Well, perhaps you'd better take –

GLAZEBROOK J:

Well, it's difficult to say you could be criminalised for doing something that you're not required to do according to the authorities under the statute.

MR JOHNSON:

Well, if you, as I think the question was – did you want me to take you to the reading of them?

WILLIAM YOUNG J:

Yes.

ELIAS CJ:

I'd like that, thank you. What volume are we looking at? One, is it?

MR JOHNSON:

We're looking at the Crown's bundle, tab 2, and it's section 143A and it's subsection (1)(d) and it's a person commits an offence against the Tax Administration Act 1994 if that person knowingly applies a deduction made or deemed, because I'm going to come onto the deemed part as well, "for any purpose other than in payment to the Commissioner." So, in my submission, if you have that money, because it's deemed to have occurred, you're supposed to hold the money –

GLAZEBROOK J:

Well, how does it work with an overdraft account? Do you have –

MR JOHNSON:

I don't think –

GLAZEBROOK J:

Well, it just doesn't work, does it?

MR JOHNSON:

No, it doesn't.

GLAZEBROOK J:

So it wouldn't be a sensible thing for us to hold that you have to somehow borrow the money separately, because the business advantage account are those ones that fluctuate up and down –

MR JOHNSON:

Up and down.

GLAZEBROOK J:

– depending upon how much you have, you have an overdraft limit and whatever goes in and out is up to that overdraft limit allowed to be applied. Many businesses run an overdraft because they don't want to have specific charges or loans over their assets, so in fact instead of having a fixed loan over their asset they'll have a fluctuating overdraft account, which amounts to the same thing, it means that they don't have, they're not paying interest on anything other than the actual borrowings at the time. So if we had this interpretation of that you couldn't do that –

MR JOHNSON:

No.

GLAZEBROOK J:

– you'd have to go out and borrow separately, and that's not been the way that it's been interpreted, it's not the way the cases have said it's interpreted, and why on earth would we interpret it that way now, when it was totally against business practice and business sense?

MR JOHNSON:

In terms of the Court of Appeal's decision in this matter, again, it's something that has not been applied or interpreted until now, this idea of this trust, this bounce-back trust, this is something new, this is something that has not been applied. In the same way, if you, in my submission, if you work this thing through this is trust money, point one –

WILLIAM YOUNG J:

Can I just ask you to go to section 4A(2)(c) of the Act?

MR JOHNSON:

Yes.

WILLIAM YOUNG J:

Doesn't that answer the point you're making?

ELIAS CJ:

This is the deemed provision?

WILLIAM YOUNG J:

A.

MR JOHNSON:

4A.

WILLIAM YOUNG J:

Little (2) of the Act.

ELIAS CJ:

We have to go to another volume for this, don't we?

WILLIAM YOUNG J:

I'm not sure, I've just got it on my screen.

MR JOHNSON:

It's page 69 of the appellants' bundle.

ELIAS CJ:

Sorry, where do I go there?

WILLIAM YOUNG J:

It's 4A(2)(c).

ELIAS CJ:

Sorry, what volume? I haven't got these up on screen, which I should do.

WILLIAM YOUNG J:

Sorry, it's 69.

GLAZEBROOK J:

Ah, yes, it does totally answer it.

WILLIAM YOUNG J:

And doesn't that state, so there isn't an offence until you don't pay the money?

MR JOHNSON:

In my submission the position is, if you look at the 2 –

ELIAS CJ:

Sorry, section 4A –

WILLIAM YOUNG J:

(2)(c), "that the amount withheld or described in paragraph (b) is withheld," I think it should be, "Is deemed to have been applied for a purpose other than payment if the amount is not paid by the due date".

MR JOHNSON:

So my submission on that is that you have two situations there. One is where you have actually applied the money for a purpose other than payment to the Commissioner. For instance, just for a moment put aside the overdraft situation, go to the situation where the money has genuinely been just taken and used for some other purpose, or taken, not even for the purposes of the –

WILLIAM YOUNG J:

But it's not taken, it's just, it's just not set aside.

MR JOHNSON:

Okay, it has been misappropriated.

WILLIAM YOUNG J:

Well, it just, but of course it might not be there.

MR JOHNSON:

No, I understand it's – just for a moment, if you take away the overdraft position that Your Honour has referred to, you go to the position where the money has been deducted or deemed deduction, if there's money there, just take the situation where it has genuinely been, in the classic sense, misappropriated, it's been taken. Now that, in my submission, is an actual misapplication of the money, and that must be criminal offence under here.

McGRATH J:

If intention is proved.

MR JOHNSON:

Yes.

McGRATH J:

Because there is a “knowingly” requirement.

MR JOHNSON:

Yes, there is.

McGRATH J:

Which is...

MR JOHNSON:

And that might be the answer, the “knowingly”, it might.

WILLIAM YOUNG J:

But knowing what though? Knowing that it's a deduction or knowing you shouldn't do it?

MR JOHNSON:

Well...

GLAZEBROOK J:

Well, it would have to be knowing that you weren't going to have the money by the relevant due date to pay –

MR JOHNSON:

Yes.

GLAZEBROOK J:

– because, I mean, you might take it for another purpose knowing that the next day somebody's going to stick \$500,000 into your account.

MR JOHNSON:

Yes. That may well be the answer.

GLAZEBROOK J:

Or you know that you've got an overdraft limit of \$100,000 so there's no problem with payment.

MR JOHNSON:

That may well be the answer in terms of –

McGRATH J:

So that the "deemed" provision overcomes the problems of proving knowledge that the Commissioner would otherwise have?

MR JOHNSON:

Well, yes, in terms of the actual taking. Because if you've misappropriated to me and if you've done it knowingly, then the offence kicks in then and there.

WILLIAM YOUNG J:

Well, how does this offence work? I mean, "Knowingly applies or permits the application of the amount of a deduction or withholding tax for a purpose other than payment." Isn't it basically the case that if you don't pay the PAYE you are liable to be prosecuted –

MR JOHNSON:

In my submission –

WILLIAM YOUNG J:

– under section 143A?

MR JOHNSON:

– there's two parts here. One is an actual, where you've actually used the money for a purpose other than paying the Commissioner, and that might not be the overdraft situation because of "knowingly", but there are plenty of other examples where that has occurred, that's one form of offence. The other form of offence is, Your Honour's pointed out, as deemed by 2(c), it's a "deemed" provision.

ELIAS CJ:

But why is that deeming not, why does that not cover the entire ground of the offence?

McGRATH J:

Yes.

ELIAS CJ:

In other words, that the offence is only not paying the Commissioner by the relevant due date, knowingly.

MR JOHNSON:

In my submission, if you look at the offence, the offence can, the offence is you've used it for a purpose other than paying the Commissioner, you've used it. Now, in my submission, there's two ways that can happen. One is that you've knowingly taken it and used it, no intention of or ability to pay it back, knowingly.

GLAZEBROOK J:

Well, I suppose what you say is you could commit an offence if you knowingly use it knowing that there's no way you're going to pay it –

MR JOHNSON:

Yep, yep.

GLAZEBROOK J:

– as well as just not paying it –

MR JOHNSON:

That's right, so there's two –

GLAZEBROOK J:

– and it's possible.

MR JOHNSON:

– and the first one –

GLAZEBROOK J:

But that still fixes up the business situation as people who...

MR JOHNSON:

It does, it does. But there's two ways this offence can be committed. One is that way, and the other way is if you haven't paid by the due date, 5 of March here, it's deemed to have been the situation that you have misapplied. Either way, an offence has been committed.

McGRATH J:

And that removes the need for the Commissioner to go into the actual circumstances of application of the money.

MR JOHNSON:

Certainly, yes, that's right.

McGRATH J:

If you take advantage of the "deemed" provision.

MR JOHNSON:

Yes, it is.

WILLIAM YOUNG J:

Well, they've still got to show "knowingly" somehow, don't they?

MR JOHNSON:

Well, isn't – I shouldn't be asking the question. The deeming –

WILLIAM YOUNG J:

Yes, but there has to be knowing this application, because the section 143A is a knowing, is a mens rea offence.

MR JOHNSON:

Mmm.

WILLIAM YOUNG J:

I suspect that that's going to be found in running the business –

ELIAS CJ:

Authorising.

WILLIAM YOUNG J:

– so in such a way that PAYE is not paid at a time when you know or you probably won't be able to pay it when it falls due.

MR JOHNSON:

You know the PAYE rule date, you know that it, what day you're supposed to pay, you haven't done it.

WILLIAM YOUNG J:

So you shouldn't be paying the staff, you shouldn't be paying anyone, you should wind up affairs at a point when it's apparent to you that you won't be able to pay your PAYE.

MR JOHNSON:

Yep. So that's what I say about the offence provisions.

WILLIAM YOUNG J:

What about theft by failing to account, under section 220 Crimes Act 1961? On your approach, wouldn't there be a – well, isn't – sorry. On a stark view of the trust – I don't think it is entirely your approach – as soon as the employer is deemed to have received a deduction the employer really has to ensure that that money is available.

MR JOHNSON:

Well, that's right, that's right. I mean, I – and these submissions are only focused on the tax provisions and – but, yes.

ELIAS CJ:

Well, hang on, that's if there is, that's on the assumption –

WILLIAM YOUNG J:

That there's a trust.

ELIAS CJ:

– that there is a statutory trust –

MR JOHNSON:

Yes.

ELIAS CJ:

– a question that I have.

MR JOHNSON:

So, my submissions are that they're going to go along the lines that the section 167(1) does create a statutory trust but that there are other strict requirements, and if they are not complied with then the trust upon liquidation is no more.

ELIAS CJ:

I don't know why it's necessary for your argument, maybe you're just being –

MR JOHNSON:

Cautious?

ELIAS CJ:

No, honest. I don't know why it's necessary for your argument that section 167(1) does create a statutory trust.

MR JOHNSON:

It's not, it's – what I'm trying to, I'm going to put before Your Honour is that there's actually a scheme put forward here, and it goes through various stages, and in trying to interpret what that scheme is, in my view this is the best way of reading it. In my view, what I'm going to be putting forward is that this scheme is as follows: trust, but if not paid within the remitted period –

GLAZEBROOK J:

Can I just check, you say a trust over any positive balance –

MR JOHNSON:

Yep.

GLAZEBROOK J:

– in a bank account at the time the deduction is made, is that – I just want to just check what the –

MR JOHNSON:

Yes, so at the time it's made.

GLAZEBROOK J:

So the trust over, at the time the deduction is made rather than the payment date. So trust over any positive...

MR JOHNSON:

Yep, identifiable sum. So a –

GLAZEBROOK J:

Well, any positive balance really –

MR JOHNSON:

Yep.

GLAZEBROOK J:

– isn't it, up to the amount of the PAYE, is that the...

MR JOHNSON:

Yes, an orthodox trust. So I don't agree with the suggestion that more money, non-trust money, can come in, and that that can, as Canadian cases refer to it as "revigorating", because I ask –

GLAZEBROOK J:

Well, the Canadian provision is totally different because the Canadian provision not only has a trust over the money, it has a trust over any substitute property.

MR JOHNSON:

Yes.

GLAZEBROOK J:

So it's a totally different provision and a totally different scheme.

MR JOHNSON:

The respondent's submissions rely strongly on the Canadian in support of this concept though, so, and that's why I'm going to deal with the Canadian decisions, because I say that the Canadian decisions, if you read them through carefully, in fact support the appellants' position here, and I'll go into that as to why. What I say, what I submit, is that the scheme here is statutory trust in relation to deduction, if there was actually money there equal to that sum at the date of the deduction, if the remittance does not occur within the due date, then you switch over to what is the section 169 charge, and I'll come on to that. So the New Zealand system says, "Trust if breach," effectively, "charge", section 169, because the charge comes into effect when there's been a failure to pay. Then upon liquidation, however –

GLAZEBROOK J:

So that's on 5 June?

MR JOHNSON:

Yes. It's –

GLAZEBROOK J:

5 March.

ELIAS CJ:

5 March, sorry.

MR JOHNSON:

– five days afterwards, which would be a maximum trust period of 20 days. So how it works now, I can indicate, is that in a company that has funds, has PAYE of over

\$500,000 a year – I can go to the provisions if need be but it's not contested I don't think – is that if it's that sort of scenario then the company has to pay tax twice a month. So for the period from the 1st of the month to the 15th of the month any deductions in relation to PAYE due that period needs to be paid on the 20th of the month, and any deduction from the 16th of the month to the end of the month has to be paid by the 5th of the following month. So what that means is if – the trust has to be adhered to within a maximum 20-day period, because then it has been paid within time. So my position is that you have a trust, you have quite strict rules, the money has to be held, held.

ELIAS CJ:

What does that mean though really, in this rather strange concept, “the money held”, because...

MR JOHNSON:

There has to be a, it has to be a positive bank account equal to the amount of the deduction, or if it's a lesser amount –

ELIAS CJ:

But that would suggest that there has to be some setting aside, there has to be, because the money isn't held, it's, it's a deemed –

MR JOHNSON:

Yes.

ELIAS CJ:

– holding.

MR JOHNSON:

The focus on “held”, “held apart”, is really the issue is, the discussion has been more on does it have to be in a separate account held apart, and I'm conceding that it doesn't have to be in a separation account, it just has to be identifiable –

WILLIAM YOUNG J:

But positive.

MR JOHNSON:

Yes, but positive.

GLAZEBROOK J:

Well, what you say if you've got – let's put it into figures.

MR JOHNSON:

Yep.

GLAZEBROOK J:

If you've got a hundred thousand in the account –

MR JOHNSON:

Yes.

GLAZEBROOK J:

– and you have 40,000 PAYE that's due, the trust is over the 40,000 –

MR JOHNSON:

Yes.

GLAZEBROOK J:

– you are entitled, under your view, to continue to operate your business, and so it may be that by the time of payment that money has disappeared and there's no money in the account and you're entitled to pay it out of overdraft and then you're perfectly all right because you've paid your PAYE?

MR JOHNSON:

In terms of –

GLAZEBROOK J:

Or are you suggesting there's a breach of trust if you don't keep that 40,000?

MR JOHNSON:

Yes.

GLAZEBROOK J:

You are?

MR JOHNSON:

Yes.

GLAZEBROOK J:

All right. So what you say is –

MR JOHNSON:

Orthodox.

GLAZEBROOK J:

– that 40,000 is the deduction and you've got to keep that?

MR JOHNSON:

And if it goes down to 30 then the trust fund has been dissipated by 10, if it goes down to 20 it's been dissipated by 20 –

GLAZEBROOK J:

So you're saying that an orthodox trust over a, any positive balance up to the amount of PAYE –

MR JOHNSON:

Yes.

GLAZEBROOK J:

– totally orthodox, you're not allowed to bite into that. It does seem rather unfair that if you don't have that money you're actually allowed to do what you like.

MR JOHNSON:

It's trust money, it's there for a particular purpose. I know it's used, but you take a risk when it's used.

McGRATH J:

What if you run, what if you have arrangements with your bank whereby you have a standing overdraft of 50,000?

MR JOHNSON:

This is – I accept that point, because that's an argument about whether the true bank – because of your –

McGRATH J:

I'm not interested in if you accept it or not, I want an answer.

MR JOHNSON:

Okay, fair enough. I was trying to work it through in my own mind. Yes, I think that's right, because what you'd be saying in that situation is, "I know that account says it's minus 30 but in fact it's not, it's actually positives.

McGRATH J:

It's as if it were positive.

MR JOHNSON:

Positive 70.

McGRATH J:

That makes sense.

MR JOHNSON:

So that makes sense, yes, I understand that. No, you didn't ask me whether I understand it.

ELIAS CJ:

But that is to say that – I'm just trying to understand. You're argument is you don't have to have a separate account but it does have to be set aside in the sense that it has to be identified –

MR JOHNSON:

Yes.

ELIAS CJ:

– and you have to operate your accounts to ensure that it is held?

MR JOHNSON:

Yes.

ELIAS CJ:

Yes.

MR JOHNSON:

Effectively held.

ELIAS CJ:

So that is a setting apart.

MR JOHNSON:

It is, it's not the setting apart that maybe –

GLAZEBROOK J:

But in fact if you don't have it you can do what you like as long as you pay it on the due date –

MR JOHNSON:

Yes.

GLAZEBROOK J:

– so those businesses that are running always in overdraft can do what they like and those businesses that might happen to have had a big transaction the day before you have to deduct PAYE but in fact can't run their businesses ordinarily. It just doesn't seem a sensible distinction. I mean, you're saying that's what's needed from the, if you have actually a trust that is an orthodox trust –

MR JOHNSON:

Yes, and –

GLAZEBROOK J:

– but if it's not an orthodox trust...

MR JOHNSON:

So what I'm saying is that that's your trust, that's, the first step in this scheme is trust. But if the trust is not performed, is effectively, it's not paid within time or the money is not held, then – no, sorry, in terms of the section 169 charge – if the money is not paid within the time then the Commissioner gets something else, which is also very powerful and very strong.

WILLIAM YOUNG J:

Say I'm a worrying person and I'm an employer and I say, "Okay, I'm going to run a PAYE deductions suspense account and every time I deduct PAYE I'm going to pay the appropriate amount into this account and from that account I'll pay my, pay the tax when it falls due a few weeks later.

MR JOHNSON:

Yes.

WILLIAM YOUNG J:

But I'm really pressed and really short at the end of February 2011 so I, for once in my life, don't do it, but I'm worrying and worrying and worrying, worrying myself sick, and two days later I put that amount of money in there. Would there be a trust?

MR JOHNSON:

No, no, there is. No, there isn't.

WILLIAM YOUNG J:

It's all pretty arbitrary, isn't it? I mean, but maybe it's a section that's going to have rough edges –

MR JOHNSON:

Yes, well –

WILLIAM YOUNG J:

– and arbitrary...

MR JOHNSON:

Well, the same point is, is it going to be an orthodox trust, because if it's an orthodox trust the answer is, no.

WILLIAM YOUNG J:

But you see, under section 4A(2)(b) the amount of tax that's deemed to be withheld when the payment is made of, the net amount of PAYE, okay?

MR JOHNSON:

Yes.

WILLIAM YOUNG J:

So when Jennings paid the net tax it was deemed to have been withheld, the amount of tax was deemed to be withheld.

MR JOHNSON:

Pay the net income.

WILLIAM YOUNG J:

Yes, when it paid the net income.

MR JOHNSON:

Yep.

WILLIAM YOUNG J:

So then you get to section 167, which seems to apply, "Every amount of tax withheld under the PAYE rules shall be held in trust for the Crown." Now, it's an unusual trust because it may be a trust of nothing, because there may be no asset to which it applies, but there is an obligation on the part of the employer to make good that money.

MR JOHNSON:

So, in my submission, the position is it is a real trust, an orthodox trust, the amount is the amount of the deduction. Whether it's there or not is the issue.

WILLIAM YOUNG J:

So section – I mean, so I'm not trying to be, to put these too tendentiously, but what you say is section 167 should read, "Every amount of tax withheld under PAYE rules shall be held in trust for the Crown," then in sort of parentheses, "providing there is actually some real money withheld"?

MR JOHNSON:

Well, that's just – yes, just applying tax.

ELIAS CJ:

Well, then, it hasn't been held.

MR JOHNSON:

No.

WILLIAM YOUNG J:

But it's deemed to have been withheld, that's the problem –

ELIAS CJ:

Well, no, no, there's a difference between withholding and holding in this, isn't there?

WILLIAM YOUNG J:

No, well, is "deemed to be withheld", does section 4A(2)(b) deeming provision apply to section 167(1)?

GLAZEBROOK J:

Well, the point is it's withheld from the salaries I suppose.

ELIAS CJ:

Yes.

ARNOLD J:

That's right.

MR JOHNSON:

And that's the employee's situation. So the employee has, it's been deducted, the employee therefore is not liable, a deeming has occurred, under that deeming it's presumed there is – so it covers that off, but to be held would suggest it has to be a sum of money.

ELIAS CJ:

It's a different thing.

MR JOHNSON:

Yes.

GLAZEBROOK J:

So you say, so the money withheld is withheld from the employee –

ELIAS CJ:

Yes.

MR JOHNSON:

Yes.

GLAZEBROOK J:

– in this circumstance –

MR JOHNSON:

Yes.

GLAZEBROOK J:

– and then to the extent that there is money it's held in trust –

MR JOHNSON:

Yes.

GLAZEBROOK J:

– a positive balance, it's held in trust.

ELIAS CJ:

Well, there's an obligation to hold it in trust.

MR JOHNSON:

And I will go through the, as I say, the Canadian stuff is really useful in explaining the, in their view of it anyway, so I will –

WILLIAM YOUNG J:

Can I just – just a couple of questions. Is it section 167(1) which means that the employee doesn't get sued by the Crown?

MR JOHNSON:

Well, my friend has a, may have a different view on that, but my view is that as long as a deduction has occurred, and that could be an actual or deemed, then the employee is not liable, because the employee is only liable if the employee has received a gross sum.

ELIAS CJ:

Yes.

GLAZEBROOK J:

Either in sum or in kind –

MR JOHNSON:

Yes.

GLAZEBROOK J:

– and that's certainly the way it's always been interpreted by the IRD.

MR JOHNSON:

And that's the decision in case P44 which is in the supplementary as well.

GLAZEBROOK J:

Well, that's certainly always been the way it's interpreted by the Revenue and it's the only sensible way to interpret it, because otherwise the employee would be paying tax on the gross income, having not received it.

MR JOHNSON:

Yes.

GLAZEBROOK J:

And then every time any company went into liquidation owing a PAYE, the poor hapless employee who had no control whatsoever over the money would be required to cough up the remainder, and that just can't be the situation.

ELIAS CJ:

And yet it is what the Commissioner's arguing, isn't it?

GLAZEBROOK J:

Well, it is.

MR JOHNSON:

I know, I know. That's why I have sought to introduce P44. Sir, was there another question?

WILLIAM YOUNG J:

No, I just – I find the whole issue a bit elusive because it's hard to have a trust of something that doesn't exist –

MR JOHNSON:

Yes.

WILLIAM YOUNG J:

– which may suggest that it's a different sort of trust that's envisaged –

GLAZEBROOK J:

Well, it's why it has to be held, isn't it?

WILLIAM YOUNG J:

Well, yes, but say I pay the money – you say it all depends on the day of the deemed deduction –

MR JOHNSON:

Yes.

WILLIAM YOUNG J:

– so even though I get a cheque for \$100,000 the next day, it's not held in trust, even though it's my obligation to hold it in trust, even though I intend to hold it in trust, it's not...

MR JOHNSON:

No, that's right, because under orthodox principles you have to have a fund, a date of the creation of the trust, an identifiable sum, or –

WILLIAM YOUNG J:

So the employee can't, employer just can't make it good?

MR JOHNSON:

Yes, he can, yes, he can.

WILLIAM YOUNG J:

By not going into liquidation.

MR JOHNSON:

Or paying the money.

WILLIAM YOUNG J:

But why wouldn't that money then be subject to claw-back?

MR JOHNSON:

My position on that is this – and that was of course the *Commissioner of Inland Revenue v Smith* [2000] 2 NZLR 147 (CA) case.

WILLIAM YOUNG J:

Yes.

MR JOHNSON:

But what the *Smith* case didn't do was consider section 169. So under section 169 what you have is a charge over all the property, and this is, the fact that it's a charge over all the property's quite relevant because if you look at the progression 167 says, "I have, there's this certain money and it's trust money, it's not the company's money." Then there's this failure to pay and then you have section 169 that says, "You now have a charge over all the assets." Now, under the Companies Act 1993 a charge is deemed, a charge is effectively a secured creditor, and that was the provision I attached here or at the back of this thing actually.

ELIAS CJ:

But the Commissioner doesn't need, on liquidation, because he has higher priority under schedule 5.

MR JOHNSON:

The problem is that, although he has a high priority under Schedule 7 –

ELIAS CJ:

7, sorry.

MR JOHNSON:

– yes, under Schedule 7, he actually, she actually ranks behind other preferential creditors.

ELIAS CJ:

Yes.

MR JOHNSON:

So section 292 you would think could apply, and that was the *Smith* case, and the Commission raises it in their arguments here. But if –

ELIAS CJ:

I don't see a problem with section 292 applying.

MR JOHNSON:

I don't. But the reason I say I don't –

WILLIAM YOUNG J:

Well, why not, why don't you? Why isn't it just a preference if the Commissioner says, "Crikey, I better pay," if the Jennings people say, "Crikey, we better pay the PAYE because otherwise we might get prosecuted" –

MR JOHNSON:

Yes.

WILLIAM YOUNG J:

– why isn't that a preference to the Commissioner if they didn't have the money at the time the deduction was made but it came in a day later?

MR JOHNSON:

Because the payment is being received by a secured creditor under the charge provisions, and a payment to a –

GLAZEBROOK J:

Probably a voluntary payment under section 92 as well as the PPSA.

MR JOHNSON:

I haven't thought of the that but it – and that wasn't raised in *Smith* either.

WILLIAM YOUNG J:

So was this raised in *Smith*, section 169?

MR JOHNSON:

Not at all, not even referred to, and I think one of the difficulties with *Smith* is that it's just looked at 167 where the true scheme is actually 167 and 169, and I'll show that when this legislation first came into effect they were all in the same section, 31 I think, 31 sub-point (2), (3), (4), they followed. Then what happened subsequently, they sort of got split up a bit. So when you got to the *Smith* decision there's not one mention of section 169. Now to be fair, when the liquidator was involved in this matter it also raised the possibility of a section 192 claim, same thing, but I think the position is actually you have to look at 167 and 169 together. 169 creates a charge, that charge equates to a secured creditor position. A payment received as a secured creditor is one that is not subject to claw-back under 292.

WILLIAM YOUNG J:

But, sorry, just – does section 169 not help the Commissioner here because it's effectively displaced by section 167(2)?

MR JOHNSON:

Up until the date, at the time of the payment, if you're talking about before liquidation, then the payment is made to a secured creditor.

WILLIAM YOUNG J:

Right.

MR JOHNSON:

In my view, it doesn't matter that upon liquidation the position changes again, then you become –

WILLIAM YOUNG J:

But the Commissioner can't rely on section 169 here, in the present case.

MR JOHNSON:

It was never used, it was never utilised. You have to utilise section 169 up until the date of liquidation. Upon – and this is the third point – I'd say first of all trust, then if not paid, charge, and then if not paid by liquidation, 7th schedule. And the reason for that is, if you look at section 169(10) it says section 169 has to be read having regard to 167.

WILLIAM YOUNG J:

Well, that's what I meant, so it's displaced by section 167(2).

MR JOHNSON:

At liquidation.

WILLIAM YOUNG J:

Yes.

MR JOHNSON:

At liquidation. Because 167(2) only comes into effect upon liquidation. So I think that's, in my –

ELIAS CJ:

Is that so? Sorry, I meant –

MR JOHNSON:

Yes.

ELIAS CJ:

– to check that because it was a query in my mind.

MR JOHNSON:

So...

GLAZEBROOK J:

If you look – well, it can be on receivership as well.

MR JOHNSON:

Oh, yes. 167 is at page 68 of the appellant's bundle.

GLAZEBROOK J:

Page 80, I think.

MR JOHNSON:

80 is 169, thank you. Oh, 80, sorry. So, it's (b) –

ELIAS CJ:

Oh, it's just, it's about the ranking, so.

MR JOHNSON:

Yes, it's 2(b). So when the employer is in liquidation, that's when the ranking occurs.

ELIAS CJ:

Yes.

MR JOHNSON:

And just to cover that off, if I go to page 87, this is the subsection (10), is that this section shall apply subject to section 167. Now that's all of 167, not just 167(1), it's 167(2) as well, so. So that's my theory of how this scheme works.

In support of that, I'd like to take the Court to historic provisions and just show how that supports what I'm saying. So the first enactment of a similar nature appears to be the Employment Promotion Act 1936, which is tab 1 of the respondent's bundle. So, 31, subsection (2), "The amount so deducted shall be deemed to be held in trust

for the Crown and shall be paid at the time and manner prescribed by regulation under the Act.” Now, that's the equivalent of section 167(1) really.

But then if you go on to subsection (5), which is over the page, it talks about, “In the situation where the,” they describe it as an “unemployment charge”, that's what, that's PAYE. So, “When the employment charge is not held by the employer or other person paying the salary in such manner as to be distinguishable from other monies, the amount of the charge,” I think you drop down to, “shall until payment be a charge on all the real and personal property of the employer.” So even in this Act you have step one, trust, something goes wrong, I called it a “breach”, then you have charge.

GLAZEBROOK J:

Of course in these days you probably didn't have overhead in this type of flexible banking arrangements that they have now –

MR JOHNSON:

No.

GLAZEBROOK J:

– so that probably worked reasonably well in the sense that you were probably expected to be running a cash business –

MR JOHNSON:

Yes.

GLAZEBROOK J:

– that always had cash to pay your liabilities as they fell due.

MR JOHNSON:

Yes. Subsection (6) is a departure from what the position is now. Subsection (6) says in that stage that that charge actually takes priority over existing securities. So it's a very powerful tool. It's not a trust, breach, still a trust, but it is a trust, breach, charge taking preference over existing securities situation, and a charge over all the assets of the company. Not the trust assets, all the assets.

The next one is the Social Security Act 1938. Now that's, if you can go to the appellant's bundle, page 6.

ELIAS CJ:

So it's not the trust that has the effect, it's the charge?

MR JOHNSON:

If there's been a breach.

WILLIAM YOUNG J:

The trust has an effect too.

ELIAS CJ:

Well...

MR JOHNSON:

Until a breach, in my submission.

WILLIAM YOUNG J:

Yes.

ELIAS CJ:

Yes.

WILLIAM YOUNG J:

I mean, if it's held in trust then it's in effect a charge, you know, in, like a Romalpa clause –

MR JOHNSON:

Yes.

WILLIAM YOUNG J:

– within effect of charge.

MR JOHNSON:

I mean, the charge is a proprietary interest –

WILLIAM YOUNG J:

Yes.

MR JOHNSON:

Sorry, the trust, the trust is a proprietary, yes.

WILLIAM YOUNG J:

Yes, it beats other charges.

ELIAS CJ:

Yes.

MR JOHNSON:

Yes.

GLAZEBROOK J:

Sorry, I didn't get your page number.

MR JOHNSON:

Page 6.

ELIAS CJ:

Sorry, 6 of...

MR JOHNSON:

6 of the appellant's bundle. Now, subsection (6) is the equivalent of the trust element of this. So again it's, "The amounts so deducted shall be deemed to be held in trust for the Crown and should be paid in the time and manner prescribed. So that's section 118, but then you'll see, in terms of the charge provisions, they were switched over to section 119. So if you go to page 8, and it's subsection (4) and (5), and it's effectively the same as the previous one. So there you had that split that's occurred between, it's been taken out of one section and now you've got it in two distinct sections, they follow each other, 118 and 119.

GLAZEBROOK J:

Is the wording the same? What subsection was it, (4) and (5)?

MR JOHNSON:

(4) and (5).

ELIAS CJ:

On page 8?

MR JOHNSON:

Yes.

GLAZEBROOK J:

So at the end it's got that, their view is indistinguishable from other monies, so that's effectively saying, if it's not in a separate account there's a charge.

MR JOHNSON:

Yes.

GLAZEBROOK J:

So if it's in a separate account there's a trust –

ELIAS CJ:

Yes.

GLAZEBROOK J:

– if it's not in a separate account there's a charge. But actually only...

MR JOHNSON:

It's not held by the employer.

GLAZEBROOK J:

Well, until payment. So it does sort of assume that you can have it not distinguishable but you, you actually –

MR JOHNSON:

It's still that held argument –

GLAZEBROOK J:

– you actually are allowed to pay –

MR JOHNSON:

– that I raised earlier.

GLAZEBROOK J:

– sorry, it's a charge on every single asset, because you might have no money but you might have property, it's a charge on that until you've actually paid it.

MR JOHNSON:

Yes. I mean, that's the thing about the charge, it's actually a very powerful beast, especially in 1936 and 1938, because, yes, you had a trust but it didn't work out, but you then got a charge and that charge was over everything, not just the bank account, point one, and, point two, it at that stage even took priority over existing securities, very powerful.

McGRATH J:

Super charge.

WILLIAM YOUNG J:

Was there – there was no, it wasn't an offence not to keep money separate, as far as I can see.

MR JOHNSON:

I think it was – oh, I haven't looked at that.

WILLIAM YOUNG J:

The offence basically seems to have been not to pay it when required.

MR JOHNSON:

Yep, yes, okay.

GLAZEBROOK J:

Well, assuming again that businesses have fluctuations and –

WILLIAM YOUNG J:

I don't think you know –

MR JOHNSON:

If it's been genuinely taken, if it's been genuinely misappropriated, in my submission that is an offence, you know.

GLAZEBROOK J:

Well, knowing that you're not going to be able to pay it back.

MR JOHNSON:

Knowing that you're not going to pay it back.

GLAZEBROOK J:

But that's the difference.

MR JOHNSON:

Yes.

GLAZEBROOK J:

If you use it for other purposes but know that you're getting money in the day before you have to pay it that will more than cover it, then...

MR JOHNSON:

The mens rea element.

WILLIAM YOUNG J:

But if it's an ordinary trust, it's a trust that would be subject to section 220 of the Crimes Act, then, "I stole the money but I intended to pay it back," isn't a defence.

GLAZEBROOK J:

Yes.

MR JOHNSON:

It's never a defence to say, "Well, I took the money to go to the races and I was going to repay it out of my winnings.

MR JOHNSON:

Yeah.

WILLIAM YOUNG J:

So I'm not sure that that line of argument is a complete answer to the conceptual difficulty the case throws up. Maybe there isn't an answer, a logical answer.

GLAZEBROOK J:

Well, here it seems to suggest that if you put it aside in a separate account there's a trust, but if you don't do that then it's a charge.

MR JOHNSON:

If it's –

ARNOLD J:

Yes.

GLAZEBROOK J:

A charge on everything.

ELIAS CJ:

And it's only a scheme for priority. If you've got a trust you don't need...

MR JOHNSON:

You don't trust. Trust, you've got trust.

ELIAS CJ:

Trust trumps.

MR JOHNSON:

Yeah. But if trust goes –

ELIAS CJ:

But the trust is –

MR JOHNSON:

– then you have charge.

ELIAS CJ:

– if you have kept it apart.

MR JOHNSON:

And paid within the period, time period. Because it's not – it's hold and pay, hold and remit.

McGRATH J:

If the charge is, attaches as soon as the trust disappears, is that...

MR JOHNSON:

Yes, and it actually makes sense, I think, because you have a trust, it didn't work, there was a breach, you know, the charge, if the – it then goes, well, all that's left at that stage is the personal property so, "We're going to charge all of that." The charge doesn't say, "Oh, and we also charge that money that's still in the trust."

WILLIAM YOUNG J:

But what happens – just looking at this statute – what happens in the situation I postulated earlier where, you know, the anxious employer doesn't keep the money separate immediately but a day or so later puts it into a separate account? Under this, the charge, under the Social Security Act the charge would be displaced once it was distinguishable, wouldn't it, and the trust would prevail?

MR JOHNSON:

Yes.

GLAZEBROOK J:

Yes.

MR JOHNSON:

Could you put that particular section you're referring to again?

WILLIAM YOUNG J:

All right. Well, okay, say, if we postulate the situation I did before, the employer who normally keeps the money separate, fails on one occasion to do so, gets worried about it and replenishes the account two or three days later –

MR JOHNSON:

Yes.

WILLIAM YOUNG J:

– perhaps going into overdraft to do it, on another account.

MR JOHNSON:

Yes.

WILLIAM YOUNG J:

From the moment the money's in a separate account it's distinguishable, the charge lapses, presumably that money is then held under the, under...

GLAZEBROOK J:

117.

WILLIAM YOUNG J:

Yes...

MR JOHNSON:

167(1).

GLAZEBROOK J:

118, 6.

WILLIAM YOUNG J:

Yes, the one that's at page 6

MR JOHNSON:

In my submission, no, because that would be a bounce-back trust.

GLAZEBROOK J:

But at that stage the charge doesn't apply because it's held distinguishable from other money in a PAYE suspense account.

MR JOHNSON:

The charge – the fact that the money, that other money, not the trust money, has been put into an account, doesn't –

ELIAS CJ:

But it's always going to be like that, because that's the nature of PAYE. It's not a sum that you're receiving, you're going to have to make that provision. But if you do set it aside, surely the scheme of this is that – and it does parallel the provisions in 161 – 167(1) and (2), it's, then you have held it on trust, it does go directly. If you don't, then the charge attaches.

MR JOHNSON:

The charge attaches to all the personal property. If you get some more money in and you put it in the, an account, even in a separate account, it's still, in my submission it's still the company's money at that stage. It can be in a separate account, it could be held apart, but at that stage it is still the company's, the employer's separate money. It's not, in my submission, it's not suddenly become the trust money, it's still, even if it is separate, even if it is, you know, apart, it's still, at that stage this –

ELIAS CJ:

But it may be the employer's money. I mean, all of that depends on this question of whether a statutory trust has been imposed. But the language, I must say, of these earlier provisions is much more consistent with that perhaps than section 167 –

MR JOHNSON:

Yes.

ELIAS CJ:

– and it is possible to see section 167(1) as simply imposing an obligation on the employer to keep the money apart.

MR JOHNSON:

In my submission, 136 – sorry, 1936 and 1938 is, you know, is a much stronger sort of position for the Commissioner, and even if you, when we go to Hansard, it talks in stronger language. But if you look at 1936 and you look at 1938, there are a number of things. The first is that there's no reference to the other preferential creditors, that only comes in in 1957, so it's almost like it's a clear path to the, for the Commissioner at this stage. So, trust, charge, it didn't really matter too much because, one, you took priority over any secured creditors and, two, there's no suggestion here that wages and what have you are going to jump in ahead of you.

GLAZEBROOK J:

Well, they may still have, because they may have ranked ahead of any charge. I don't know when those preferential provisions came in but I imagine relatively –

MR JOHNSON:

They certainly –

GLAZEBROOK J:

– early.

MR JOHNSON:

They did, but if – and we'll go to the next, the 1957 one was when they first introduced it in the subsection (2).

GLAZEBROOK J:

Well, they –

MR JOHNSON:

Referred to it.

GLAZEBROOK J:

Referred to it. But I suspect they were still there and just – because they ranked ahead of any charge that ranks ahead of the statutory charge under 118 as well.

MR JOHNSON:

Yeah.

GLAZEBROOK J:

Because it only says it ranks ahead of all charges, including existing charges –

MR JOHNSON:

Yes.

GLAZEBROOK J:

– but it would have to still take its place as a charge, and the preferential debts you'd think would come above that –

MR JOHNSON:

Yes.

GLAZEBROOK J:

– which would be in line with the worker protection view of this.

MR JOHNSON:

Yes. I acknowledge that I've only focused in terms of when it changed in '57.

WILLIAM YOUNG J:

Mr Johnson, when Jennings didn't pay, didn't set aside the PAYE withholding amount, there was a charge over all its book debts in favour of the IRD, under section 169.

GLAZEBROOK J:

I don't – but doesn't it –

MR JOHNSON:

That only comes in, I think, when – that only comes in when there's a failure to pay it.

WILLIAM YOUNG J:

Okay. Well, as of the 5th of March –

MR JOHNSON:

Yes.

WILLIAM YOUNG J:

– a charge accrued.

MR JOHNSON:

Yes.

WILLIAM YOUNG J:

Would it follow that any payments that came in after the 1st of March, after the 5th of March, could be seen as coming off the charge and coming into the trust?

MR JOHNSON:

That would be, that would still be, in my submission, the reinvigorating of the trust, when the trust fund is being dissipated. I think that the position is actually, in my submission, it's, the money's come in, it's personal money of the company, the Commissioner has –

WILLIAM YOUNG J:

But it's subject to a charge.

MR JOHNSON:

Yes.

GLAZEBROOK J:

Well, it might be subject to a charge but that doesn't help the Commissioner in this case –

MR JOHNSON:

No.

GLAZEBROOK J:

– because that wouldn't be ranked –

WILLIAM YOUNG J:

Because of the – yes, but I'm looking at the position before, immediately before liquidation.

MR JOHNSON:

So, yes, so if money or any other asset comes in after there's a failure to remit, then all that money is subject to the Commissioner's charge to the extent of the outstanding PAYE deduction. So you have the charge over all the assets. You don't need the bounce-back.

WILLIAM YOUNG J:

Well, you want the bounce-backs better though, isn't it? We wouldn't be here, the case wouldn't be on if the section 167(1) wasn't a better option for the Commissioner.

MR JOHNSON:

Well, I think, in my submission the issue we have here, and because this has never, you know, this has not actually been worked through, the Commissioner's worked a certain way for many, many years in terms of a number of things, prosecutions, in terms of not seeking this money upon liquidation until now. But I think, in my submission, what actually is required is that when it's not paid within the remitted date then it's incumbent upon the Commissioner to actually take steps to exercise its rights under that very, very powerful tool, the charge. They don't do it. And as a result, come liquidation, the charge is lost. The Commissioner is in a much more powerful position, in my submission, to know about these breaches, as a creditor, than compared with many, many other creditors, unsecured creditors. They – because they don't choose to exercise their 169 charge rights, it's only then that we reach the position where we are today.

Can I – I'd like to take you now to the 1957 Act, which is page 22.

GLAZEBROOK J:

Of yours?

MR JOHNSON:

Yes, it is. The trust equivalent is section 31(1), and then what is now 167 subsection (2) is section 31(2).

GLAZEBROOK J:

Do we – was there anything else helpful in the Parliamentary debates apart from that relatively brief statement that really just said what they were saying?

MR JOHNSON:

When I take you that, Hansard, in my submission what it will show is that in the earlier provision, '36, His Honour, the Honourable Mr Armstrong, it was all about, "We're going to get the protection here," and, "It's a trust," and, "We get a charge," and really it went to that extent in my view only. All the commentary from 19 – all the commentary in 1957 onwards in fact stresses the importance of the employee's preference over the Commissioner, in preference to the Commissioner, and I –

GLAZEBROOK J:

So that was really, you say, the explanation for the change because they were bringing in the preference on the preferential –

MR JOHNSON:

Yes.

GLAZEBROOK J:

– although it probably applied under the previous legislation anyway?

MR JOHNSON:

Probably. But the commentary doesn't suggest that –

GLAZEBROOK J:

All right –

MR JOHNSON:

– but –

GLAZEBROOK J:

– I'll wait for you to take us to it.

MR JOHNSON:

Yes.

GLAZEBROOK J:

I just, I was just asking because it wasn't a terribly helpful statement –

MR JOHNSON:

No.

GLAZEBROOK J:

– when they first introduced it but...

MR JOHNSON:

No, yeah, I will take you to that. So here in subsection (2), 31, you have this re-jigging. So before you had trust charge, now you have trust charge upon liquidation,

something else. And this is the, this provision is the genesis of what we have now, in 167(2).

ELIAS CJ:

In section 31(2), it's in the manner required by subsection (1) or the other provisions of this part of the Act, now we have in accordance with the PAYE rules.

MR JOHNSON:

Yes.

ELIAS CJ:

Are there other provisions of the Act which deal with how the employer is to deal with the amount of tax deduction, in this legislation? It just might throw light on what is meant by –

MR JOHNSON:

Yes.

ELIAS CJ:

– “dealing with it”.

MR JOHNSON:

I haven't gone there. This provision, these provision – and this was, all come under the heading, “Recovery of tax deductions,” so it's a tax – that part of the Act is section 31 through to 32, that's the particular version. My reading of this was that, “In the manner required,” which was the requirement to hold, you know, hold, for it to be identifiable, or to be paid within the timeframe, so if, similar to what the position is now.

ELIAS CJ:

Yes, I see, thank you.

MR JOHNSON:

But it says, “If those,” and this is new.

ELIAS CJ:

So it's only held or paid, those are the ways in which –

MR JOHNSON:

That's how I –

ELIAS CJ:

– it has to be dealt?

MR JOHNSON:

That's how I – I interpret, “in the manner,” actually means, “to hold”, to actually hold an identifiable sum of money. So it has to be held or, and remitted. If those two things do not occur then –

GLAZEBROOK J:

Well, what you might have to do is to actually look at the 1957 Act and find out what it means, “Tax deductions to be made, credited or applied to employees,” if you look at page 21. Because I suspect the same, I don't think there was a change in the Tax Administration Act, I think it was an emphasis on the time of payment rather than requiring things to be held separately but...

MR JOHNSON:

Well, we'll look at that if get to it.

GLAZEBROOK J:

Well, just because of the difficulties with business. Because you don't necessarily – to require someone to hold something and go into overdraft when you couldn't actually borrow when the next day you're getting a huge payment, especially the 20th of the month, that will be why they do the 20th of the month presumably. But the 5th of the month is a difficult one because often you're not paid till the 20th.

WILLIAM YOUNG J:

But when did PAYE come in? Was it about this time, '57?

ELIAS CJ:

'36.

WILLIAM YOUNG J:

No, no, there wasn't PAYE.

MR JOHNSON:

No, no, and back in '36 they describe it in a different way, they, as a...

ELIAS CJ:

Oh, yes.

McGRATH J:

Yes.

ELIAS CJ:

But it's the same thing, isn't it?

McGRATH J:

The Labour government...

WILLIAM YOUNG J:

I thought PAYE did come in in the late '50s.

McGRATH J:

Yes.

WILLIAM YOUNG J:

I might be wrong.

MR JOHNSON:

Okay, don't know the answer.

ELIAS CJ:

Can I just ask you, so your submission is based on a scheme in the legislation which you say is carried through throughout of trust, charge on failure to pay and then priorities on liquidation?

MR JOHNSON:

Yes.

ARNOLD J:

So just taking, following on from that, if the employer did have an identifiable sum equal to the amount of the PAYE and the due date had not arrived and the employer went in to liquidation, you'd accept in those circumstances that the trust would continue to operate in terms of section 167(1)?

MR JOHNSON:

No.

ARNOLD J:

You wouldn't?

MR JOHNSON:

No, and I appreciate that answer and the connotations, but it's – the obligations of the trust are to hold and, two things, both hold and pay.

ARNOLD J:

But if the due date for payment has not arrived?

MR JOHNSON:

Oh, if the due date for payment has not –

ARNOLD J:

That was the hypothetical that I was putting to you.

MR JOHNSON:

Sorry, no – yes, sorry. I was taking the next one afterwards, which is a curly one.

ARNOLD J:

Right, well that – so let's just focus on the fact that you've got the money, the due date for payment hasn't arrived, but you go into liquidation beforehand.

MR JOHNSON:

No, my – that's right. My view on that is the trust still remains. So the liquidation doesn't, in that instance, bring the trust to an end, the trust is still there. The liquidation doesn't bring the trust to an end in all situations, it's only when there's been a breach.

ARNOLD J:

Right, so that was the next question.

MR JOHNSON:

Yes.

ARNOLD J:

Your –

MR JOHNSON:

I jumped the gun on you.

ARNOLD J:

– analysis –

MR JOHNSON:

Yeah.

ARNOLD J:

– hinges on the fact that there's been a failure by the employer to meet its obligations in terms of making the PAYE payment to the Commissioner, and if there's a failure and then there's a liquidation, 167(2) applies.

MR JOHNSON:

Yes.

ARNOLD J:

Yes.

MR JOHNSON:

And it's a – and there are two sorts of failures – I keep saying this – not holding an identified sum and not paying, hold and remit, they're the obligations.

GLAZEBROOK J:

Although you accept that there isn't an obligation to hold it because there's not a criminal offence to hold it, and that you accept that in many instances people

operating overdrafts in these type of business advantage accounts won't actually hold the month?

MR JOHNSON:

I, well, I accept that I think on that was the comments in relation to criminal sanction, because the question then was, well, would they have –

GLAZEBROOK J:

Well, if there's a deemed deduction, how can you hold it?

MR JOHNSON:

Well, this is the difficulty with the words, it's –

ELIAS CJ:

Well, unless –

MR JOHNSON:

If there's a balance there's –

GLAZEBROOK J:

Well, unless you just interpret them in a sensible business manner in accordance with how businesses operate and how sensibly one might administer it.

MR JOHNSON:

A credit in the bank account is effectively how it's held, and that bank account may be at the position as referred to earlier where we have got the true credit balance rather than the actual account number. But you have to hold – if I can go to 167...

ELIAS CJ:

Well, if "hold", if 167(1) is imperative rather than constitutive of a trust, then I don't, it seems to me that that makes sense.

MR JOHNSON:

Mmm.

GLAZEBROOK J:

But now you have to look at the other provisions that tell you what you've got to do. Because there's no point saying 167 does that if under the other provisions there's no – and certainly it hasn't been interpreted as requiring you to get a separate fund and set it aside –

MR JOHNSON:

No.

GLAZEBROOK J:

– and virtually, I suspect that virtually every business in New Zealand would be unable to operate on that basis, certainly the small business. Now one might say that they operate too tightly on cash flow anyway, but that's a problem of under-capitalisation, and if you're going to add an extra obligation to hold PAYE in trust I suspect many of them would go under.

WILLIAM YOUNG J:

Well, I suppose you could, I mean, you could simply say, "Well, my average PAYE deduction is \$40,000, I need a separate, I need more overdraft accommodation to enable me to keep \$40,000 a month in a sort of PAYE suspense account," –

MR JOHNSON:

Mmm.

WILLIAM YOUNG J:

– but no one ever does that.

MR JOHNSON:

No, no.

GLAZEBROOK J:

And I suspect they'd have terrible difficulty doing so and maintaining their cash flow.

ELIAS CJ:

But it may be that that could be addressed by, well, by looking at what "hold" means.

MR JOHNSON:

Yes.

ELIAS CJ:

Because if it –

GLAZEBROOK J:

Just means “have available”.

ELIAS CJ:

If it means “have available”...

ARNOLD J:

Or “have the capacity to pay”.

ELIAS CJ:

Yes, yes.

ARNOLD J:

So if you have an overdraft arrangement with your bank and you're constantly running on overdraft and you're making your PAYE payments regularly using that overdraft –

MR JOHNSON:

Yes.

ARNOLD J:

– surely then you've got the capacity to pay.

MR JOHNSON:

This is a similar phrase to Her Honour's before in terms of the real credit balance, the real balance in the account, taking into the facility. Here, however, there's two breaches –

ARNOLD J:

Just let me be clear though.

MR JOHNSON:

Yes.

ARNOLD J:

You're not accepting that that, that 167(1) would operate in that – well, that's consistent with 167(1)?

MR JOHNSON:

167(1), in my submission, the trust is breached when two things happen: when the money is not held and it is identifiable, that what that actually means is a question for determination, I suppose. But –

GLAZEBROOK J:

Well, it's sufficient for your purposes –

MR JOHNSON:

Yep.

GLAZEBROOK J:

– isn't it, to say –

MR JOHNSON:

The second one.

GLAZEBROOK J:

– that there's a trust up until the time it's paid, as soon as it's not paid it goes to a charge, and as soon as there's liquidation it goes to 167(2)?

MR JOHNSON:

Yeah, that's right. So, in my submission there are two sorts of breaches the liquidator can rely on: one which is the subject of this discussion, or can also rely on that it wasn't remitted within the time.

WILLIAM YOUNG J:

The trouble is that the latter part of 167(1) does rather suggest legislative contemplation, that the money will be still subject to a trust, despite PAYE not having

been paid, because in the event of bankruptcy – I mean, well, there's no, if the PAYE's been paid there's no need to worry about what happens in bankruptcy.

GLAZEBROOK J:

Well, it might be if you've got that interval between –

MR JOHNSON:

Yes.

GLAZEBROOK J:

– the situation of Justice Arnold was indicating you've got an interval between liquidation and payment, so that you go into liquidation on the 23rd of March –

MR JOHNSON:

That's right.

GLAZEBROOK J:

– and the payment date is actually the 5th of April.

MR JOHNSON:

If the provisions of the trust, the obligations of the trust, had not been breached as at the date of liquidation then the trust remains and that's why there needs to be that provision down the bottom, 167(1).

GLAZEBROOK J:

So what it means is that if just before payment somebody tries to get in, then the trust operates?

MR JOHNSON:

Yes.

GLAZEBROOK J:

If between deduction and payment the trust operates to protect those assets from creditors.

MR JOHNSON:

And that's effectively a maximum 20-day period.

GLAZEBROOK J:

And then after that there's a –

MR JOHNSON:

Yes.

GLAZEBROOK J:

– if it's not paid there's a charge.

MR JOHNSON:

Yes, that's my submission.

WILLIAM YOUNG J:

So, even if the money's held in this notional PAYE suspense account, dedicated for the purposes of paying PAYE, but one liquidation intervenes and after the date for payment's expired, then it's all to nothing.

MR JOHNSON:

And that's when I jumped the gun before and it goes to that issue where the money is held in that bank account, in a credit balance, but it hasn't been remitted within the time period, it's still there –

GLAZEBROOK J:

No, no, but let's see what your time period is.

MR JOHNSON:

The payment period, the 5th –

GLAZEBROOK J:

So you're accepting the – let me just check.

MR JOHNSON:

Sure.

GLAZEBROOK J:

So say that payment in this case was due on the 23rd of April – sorry, the 5th of April –

MR JOHNSON:

Yes.

GLAZEBROOK J:

– and the liquidation was on the 23rd of March. Are you accepting in that case that there would be a trust still up till the 5th of April or...

MR JOHNSON:

Yes.

GLAZEBROOK J:

So there's a trust whatever – so if money had been held in a PAYE suspense account, there would be a trust over that amount, and at the time of the deduction, so –

MR JOHNSON:

Yes.

GLAZEBROOK J:

– you're accepting there'd be a trust over that amount under 167(1) –

MR JOHNSON:

Yes.

GLAZEBROOK J:

– but we'd passed liquidation?

MR JOHNSON:

Yes, it was still in existence.

GLAZEBROOK J:

If it was still under an obligation –

MR JOHNSON:

Mmm.

GLAZEBROOK J:

– to be paid to the Commissioner –

MR JOHNSON:

Yes.

GLAZEBROOK J:

– is that the...

MR JOHNSON:

Yes, I'd – it is.

GLAZEBROOK J:

And then only if it isn't paid –

MR JOHNSON:

Then there isn't –

GLAZEBROOK J:

– the liquidation provisions pop in.

MR JOHNSON:

That's right.

GLAZEBROOK J:

So if it – and that would be for the balance?

MR JOHNSON:

If –

GLAZEBROOK J:

Are you saying in this case the payment date was missed?

MR JOHNSON:

Yes.

GLAZEBROOK J:

Therefore it went to a charge –

MR JOHNSON:

That's right.

GLAZEBROOK J:

– and then to, on liquidation, to 167(2).

WILLIAM YOUNG J:

But you say it went anyway, because there was never any money on hand at the date of the withholding.

MR JOHNSON:

Limb one, if you like, limb one, limb two, I think they fail on both limbs.

ARNOLD J:

So, and just taking what I understood to be Justice Young's proposition, that is, that the payment is due on, let's say the 21st of March, and the money is sitting in a suspense account but it's not actually paid over to the IRD before the liquidation occurs on 23 March, what's the position then?

MR JOHNSON:

Yes, that's what I understood Justice Young's thing was, and that was the thing I was referring to earlier when I jumped the gun. So, in my submission, if it hasn't been paid by the date then the trust has been breached, the money has effectively misapplied, deemed to have been misapplied. It doesn't matter at that stage that the money's in, still there, that at that stage what the liquidator has is a charge over that money.

ELIAS CJ:

But that seems a very odd result. I mean, it makes me wonder whether there really are two limbs and whether the – in other words, where the payment is part of the requirement in section 167(1), or whether it's simply the capacity and the identification, because it seems very odd that if you've simply not paid it and you've got the money sitting in a designated account impressed with what you would say is

the statutory trust, but I have my doubts about that, that, hey presto, you've only got a charge.

MR JOHNSON:

In my submission this comes about because 169 says if you don't pay within a certain date then you get something, you get something in an alternative, a charge, that's the first point.

ELIAS CJ:

But that's of general application.

MR JOHNSON:

And the second point is that the non-payment within the due date is actually a deemed misapplication of the money. So it has been misapplied. You might still hold it but the statute says in that situation a deemed misapplication has occurred. So if there's been a deemed misapplication, or let's just say "a" misapplication, then it doesn't matter that the money's there any more, it's been misapplied, it's gone.

McGRATH J:

You're really saying that this, we've got to focus on the statutory element, which may have inconsistencies with what we generally understand or the normal principles of trust, but it's the statutory element that is the predominant one you focus on, is that...

MR JOHNSON:

I'm applying, I'm attempting to apply orthodox trust principles –

McGRATH J:

Correct.

MR JOHNSON:

– and with the overlay of the statute as, in my view, the scheme sets it out.

ELIAS CJ:

Now, is that a convenient time for us to take the adjournment? Yes, all right, we'll take it for 15 minutes, thank you.

MR JOHNSON:

Already? Yes, thank you.

COURT ADJOURNS: 11.31 AM

COURT RESUMES: 11.51 AM

ELIAS CJ:

Yes, Mr Johnson.

MR JOHNSON:

So I was up to the 1957 amendment and subsection (2) of section 31 that sets out that now, or now, this statute anyway, recognises that upon liquidation outstanding PAYE ranks behind certain preferential creditors. So this was a change, a change to the scheme, and of course this is the issue we have still today. The other change in 1957 was in section 32(2), which said now that charge, provision, was going to rank behind existing charges. So the scheme changed.

ELIAS CJ:

So when was that, in the inventory?

MR JOHNSON:

1957 Act at page 22, section 32(2). And in simple terms that provision as it now is remains in the position today, except that, as I indicated earlier, the charge provisions are now also deemed to be subject to the 167 provisions, in other words upon liquidation, the charge doesn't survive. That's how I submit the scheme should be read. Just a few points from –

GLAZEBROOK J:

Well, is that right? Why doesn't the charge survive liquidation? I mean, it might be subject to section 167(2) in that the preferential debts come above it, but they would anyway.

MR JOHNSON:

Yes...

GLAZEBROOK J:

All that says is that it just has the priority, doesn't it? I would have thought the charge remains for the remainder, that it doesn't have priority for – because the PAYE priority is a limited priority.

MR JOHNSON:

It has hasn't been – accept, I understand your point and for the purposes of this discussion that it comes behind preferential is enough, but in fact in liquidations the liquidator, after the company goes into liquidation, has never sought to continue to exercise, to allege it's got a charge.

GLAZEBROOK J:

So it's just become an unsecured creditor, you mean?

MR JOHNSON:

A preferential, yes. A unsecured preferential creditor.

GLAZEBROOK J:

Okay.

MR JOHNSON:

And that charge is over the all the assets, not just the bank account we're talking about here, so that's now how it's been applied. Just, in the break there was just a few points. The question of the criminal sanction, that criminal sanction is set out in *Pongi v R* [2012] NZCA 127, (2012) 25 NZTC 20-114, the deemed misapplication of the money is, in *Pongi*, that refers to it be a breach of the fiduciary duty. So that's the seriousness of the misappropriate –

WILLIAM YOUNG J:

Where's *Pongi*?

MR JOHNSON:

Pongi in the supplementary, and it's – I'm sorry, it's not. Just a moment, my mistake. It's in the respondent's bundle.

ELIAS CJ:

Tab 12.

MR JOHNSON:

Tab 12, thanks. Page 26, 131 – 26, 031. And it indicates, “On the other hand, the failure to deduct PAYE amounts to a criminal – oh, that’s the other provision, sorry. Yes, so it’s paragraph 24, “Where PAYE is deducted the amount deducted are held in trust for the Crown. Using trust money for a purpose other than paying to the Commissioner is a breach of a fiduciary duty.”

WILLIAM YOUNG J:

Well, that's quite a sort of a simplistic approach to section 167.

MR JOHNSON:

That's the interpretation of the criminal provision rather than 167.

WILLIAM YOUNG J:

But it's founded on the criminal provision though.

MR JOHNSON:

Yes, the comment relates to the criminal provision. But it's consistent to say it's been a misappropriation of trust money, a misapplication of trust money. That is a breach of a fiduciary duty and that's why that provision, in the prosecution, in the offences section, is much more serious and carries a higher penalty than the provision that just says, “You failed to deduct,” that's what *Pongi* says. That's the – and it all stems to the fact that you have, you are deemed to have misapplied, you've breached your fiduciary duty, effectively you've misappropriated, and that's how the language is used in other jurisdictions as well.

The other point was in terms of the PAYE rules, failure to pay in relation to the PAYE rules. The PAYE rules have provisions in them that says you are required to pay within certain dates and do certain things, so a failure under the, a failure to pay is a failure under the PAYE rules.

If I can now – I have touched upon what I submit is the conceptual difficulties with the Court of Appeal's approach. Now this is this fluctuating balance where the trust fund crystallises at the date of liquidation, and that's really what I want to focus on now. As I've indicated earlier, in my view this goes against orthodox trust principles and in my submission that the wording of this, of section 167 and 169 do not actually go

down, does not actually go down that path. What I'm suggesting is the more consistent meaning of the scheme, the overall scheme.

The respondent's position is that the Canadian authorities very much support their interpretation, and you'll find that the Court of Appeal's use of the words "fluctuating balance" and "crystallising", those sort of things, are reflected in the *First Vancouver Finance v Minister of National Revenue* 2002 SCC 49, [2002] 2 SCR 720 decision, but I want to seek to take you to those provisions and indicate that rather than support the respondent's position, what those cases indicate, and *Royal Bank v Sparrow Electric Corporation* [1997] 1 SCR 411 is the most crucial one, what they indicate is that the New Zealand equivalent, sorry, the Canadian equivalent of section 167(1), the 167(1) trust, fails, but that because of a subsequent provision it's now a section 277(4.1) the trust becomes reinvigorated and kicks back into play, and what I'm going to be submitting is that those sort of provisions in the Canadian legislation are not in the New Zealand legislation. What is in the New Zealand legislation is you get a charge.

ELIAS CJ:

Do you think that you need to develop this at this stage in your submissions or would it be sufficient to respond to the respondent if we get to that?

MR JOHNSON:

I'm –

ELIAS CJ:

I mean maybe others would like you to develop this, but for myself I have some difficulty in seeing that the Canadian position is comparable.

GLAZEBROOK J:

Well, you just want to show us that's not the case, don't you, so that the, because the provisions are totally different because there is a trust imposed over any replacement property.

MR JOHNSON:

I want to show it, to show that, in fact, not only do they say it, because it's, it's a trust/trust type situation, trust 1 fails then a new trust, trust/trust but I also am very interested in indicating to you what they say about the position or how trust 1 fails

because that's what I'm saying, that's what I'm submitting to the Court now. It – so I would like the opportunity to cover that.

ELIAS CJ:

All right, I am quite anxious that we should allow the Commissioner an opportunity, so I would hope that you can complete within the next 40 minutes or so, Mr Johnson.

MR JOHNSON:

Ma'am. If I can draw the Court's attention to page 439 of the bundle.

ELIAS CJ:

Of your bundle?

MR JOHNSON:

Yes, that's volume 2. Sorry, Ma'am, I've given you the wrong number. It's tab 13 of the respondent's bundle and in there it's page 439. The first part I would like to refer to is right at the bottom where Justice Gonthier indicates he agrees, it starts, "I agree with the observations of the mechanics 227(4) –

GLAZEBROOK J:

Sorry, I think I might be on a different page.

MR JOHNSON:

It's page 439 of tab 13.

GLAZEBROOK J:

And which paragraph is it?

MR JOHNSON:

It's the second to last paragraph.

GLAZEBROOK J:

Okay, right at the end, sorry, thank you.

MR JOHNSON:

And Justice Gonthier indicates, "I agree with the observations of the mechanics 227(4)," and 227(4) is the equivalent of 167(1) where he states, "Although

section 227(4) cause the trust created by a D1, the trust is in truth a real one,” and that’s my submission for 167. “The employer is required to deduct from the employer’s wages the amount due by the employer under the statute. The money does not belong to the employer anymore, it belongs to the employees. The employer holds it in statutory trust to satisfy their obligation. The conceptual difficulty arises, of course, when the tax debtor fails to set aside moneys which are to be remitted.” At this point it goes on to talk about intermingling and then it says, “As Twaddle J rightly observed Her Majesty then becomes that of a beneficiary under a non-existent trust. In short, the misappropriation of statutory deductions conceptually problematises the legal vehicle.” But then it goes on and says, “This concept dilemma is resolved by section 227(5),” and it’s that provision, the 227(5) which reinvigorates the trust and it’s that provision that’s not in the New Zealand statute. What that provision does is that it indicates that in that situation an amount equal to any amount deemed to be deducted shall be held in trust. Quite a different provision than in the New Zealand one which says that if it’s not held in the manner then you get a charge over the personal property, quite different.

GLAZEBROOK J:

Page 442, it’s explained in more detail than what 227(5) is.

MR JOHNSON:

Yes, yes, that's right, 442, about the last paragraph in 442, what is getting talked about at the bottom there is about the new trust created by 227(5) and it says that trust or that that trust, the trust is not in truth a real one, the subject matter of the trust cannot be identified. These are the sort of things that we were talking about before, however section 225 has the effect of revitalising the trust whose subject matter has lost all identity.

WILLIAM YOUNG J:

Why can't it be, I mean, is it possible for the subject matter of a trust to be an obligation to come up with the money? So that after paid in money then becomes affected by it?

ELIAS CJ:

That’s a very strange concept –

WILLIAM YOUNG J:

Well, what I'm thinking of is –

ELIAS CJ:

An obligation as trust?

WILLIAM YOUNG J:

– yes, I'm talking about the worried employer who thinks, "Crickey, I haven't set the money aside. I better make sure there's \$44,000 in there," and that money effectively crystallises perhaps an obligation to set the money aside, so why wouldn't that apply?

MR JOHNSON:

In my submission, the date of deduction actually determines the amount of money so it becomes certain as at that date, so as at that date it is a sum of money, it's identifiable, it's, that is the subject of the trust and –

WILLIAM YOUNG J:

But why can't the subject of the trust be an obligation sort of chose in action, an obligation to make good?

MR JOHNSON:

Because, in my submission, the trust requires money, the money to be actually held and then paid.

WILLIAM YOUNG J:

Are there cases where –

ELIAS CJ:

Never heard of it.

MR JOHNSON:

– a trustee has misapplied money and then repaid it? I would have thought if a trustee steals money then puts the money back in probably the trust would apply?

MR JOHNSON:

I haven't looked at cases to that effect –

WILLIAM YOUNG J:

When there might be –

MR JOHNSON:

In this application or misappropriation and there's authorities in there that talk about when the trust money, the fund is, has been used up or misappropriated or diminished, then to that extent the trust fund is gone.

WILLIAM YOUNG J:

But is it really as simple as that?

MR JOHNSON:

Well, that's the sort of logic in *Re Hallet's Estate* and it's also the logic in, after that the decision *James Rosco (Bolton) Limited v Winder* [1915] 1 Ch 62 (HC) and the *James Rosco* case is, the case where the balance goes up and down so, you know, classic trust situation where you have \$100 of trust money, it goes, it goes down to \$30, the trust, then that account goes back up to 50 what have you, but come the termination of what is the trust money it's equal only to the lost sum, which is the \$30 and it didn't matter that money had been put back in to take it back up to 60 or 70, that sort of thing. That's your classic orthodox trust situation.

McGRATH J:

But where the money's put back in with the express purpose of re-establishing, sort of rebuilding the trust funds, that is a different situation isn't it?

MR JOHNSON:

The question is have you got ability to do that, I suppose. Under orthodox trust principles, no.

WILLIAM YOUNG J:

Well that can't be right really can it? If I, if I'm a trustee and by mistake I pay a debt out of a trust account instead of my own account and think, "Crikey, I've got to put that money back in," put it back in, it can't be seriously suggested that that money isn't subject to the trust.

MR JOHNSON:

Subject to the charge.

WILLIAM YOUNG J:

To the trust.

GLAZEBROOK J:

Just on ordinary trust principles I would've thought it must be subject to the trust because you're intending it to be subject to the trust and trust is built on intention.

MR JOHNSON:

Mmm. Mmm.

GLAZEBROOK J:

Because it couldn't be permanently lost to the trust because you happen to have pocketed it in that scenario by mistake.

MR JOHNSON:

By mistake.

GLAZEBROOK J:

Well even on purpose and then you're made to pay it back. That must be subject to the trust if you're made to pay it back on ordinary trust principles.

WILLIAM YOUNG J:

Yes, on suit by the trust.

GLAZEBROOK J:

I'm not – it doesn't matter what happens under 167 but in ordinary trust principles if –

MR JOHNSON:

Right.

GLAZEBROOK J:

– if the trustee's pocketed it and has to pay it back then the money must be subject to the trust when he or she does.

MR JOHNSON:

Yeah.

ELIAS CJ:

When it's, again, set aside –

GLAZEBROOK J:

Well this is the –

ELIAS CJ:

– for trust purposes.

GLAZEBROOK J:

I'm just doing absolutely normal trust principles, which assumes that you've got a trust bank account.

MR JOHNSON:

But it's trust, the – it's the money that's actually coming back in, you're purporting to put it back into the trust but that money in any event is still subject to your charge.

GLAZEBROOK J:

Well you just say it doesn't work under this statutory scheme. It's not that it, so that that's a modification of what might be ordinary trust principles. But in any event you're probably not – well in – actually in Justice Young's you are intending it to be set aside for PAYE with his anxious employer. But I don't know that there are many anxious employers around of that nature.

ELIAS CJ:

There may be after this.

MR JOHNSON:

Yes. If I – because I appreciate the time indication – just also on page 439, and this is where the money has been utilised, “In this sense it is not inaccurate to characterise the non-remittance”, that's the non-payment on time, “of payroll deductions as a misappropriation of the property of another. Indeed, the authorities, correctly in my view, commonly refer to the conduct of a tax debtor in that manner as

being a misappropriation.” That’s consistent with the money effectively disappearing. It’s been taken.

Now, just in terms of the effect of this, if you can go to the next paragraph down, the effect of non-remittance was summarised by Lyon J and it’s, “Either the tax debtor used the misappropriated deductions for its own purpose or the pool of money available for distribution to the tax creditors has been increased by the amount which the tax debtor failed to remit to the Receiver-General.” So what we have there is consistency, what I’m submitting, which is that it’s been misappropriated for its own purposes or if it hasn’t been paid in time what it actually becomes is for the benefit of all the creditors under the, under the normal unsecured creditor regime.

What happened under, after the *Sparrow* decision is that the – Parliament wasn’t happy with the decision and they, and that 227(5), even in its wording then, wasn’t considered tough enough to ensure this continued trust or this reinvigorated trust. So the law was changed and 227(5) became 227(4.1), which is the current provision, and that’s a much tougher provision and that sets out very clearly what happens, which is, and if we can go to 227(4.1), it’s at –

ELIAS CJ:

85?

MR JOHNSON:

It’s actually in the respondent’s bundle and it’s at tab 7, page 2885. And what this provision indicates is that, about line 6 down, if the money – well if it is not paid to Her Majesty in the manner and at the time provided under the Act, that is similar to our provisions, “the property of the person”, and then go right to the bottom, “equal in value to the amount so deemed to be held in trust is deemed to be held in trust.”

So if it’s not paid in time what this provision says is then in relation to any money there will be a deemed trust over that other money, the personal money of the employer.

WILLIAM YOUNG J:

And the secured creditors.

MR JOHNSON:

And the secured creditors, exactly. So it – and the reason for that, Sir, was that the earlier decision had turned on the fact that the earlier section 227(5) didn't defeat secured creditors, so they changed the provision to throw that one in there as well. So these are very strong powerful provisions to create the position that the Court of Appeal in New Zealand is now trying to suggest is the position.

The other case, Canadian case I'd like to quickly refer to is the (inaudible) decision and that's at tab 11 of the respondent's submissions. If we can go to page 29 please? Now this is about the sales tax and it's a provincial piece of legislation and in that, in this particular case the issue was that a trust could not be – the provinces could not create a trust that affected the federal bankruptcy laws. So that was the main focus of the case. But if we look at section 18 we have a provision here that is actually very similar to, or in parts anyway, is similar to the New Zealand provision because it creates a trust. Unlike the New Zealand provision it says if the trust, if the money's not held then we create a new trust. And then it also says the amount of tax under this Act is collected and held in trust or is required to be collected, and then it's got forms of lien and charge. So this is a Canadian provision having reference to a lien and charge.

Now, at page 34, Justice McLachlin talks about this piece of legislation, and in my submission the crucial point I'd draw your attention to is the paragraph that starts, "I turn next to section 18 of the Social Service Act," and this really encapsulates what we're talking about today and the difficulties. "In this case, in an attempt to meet the problem," this is the problem of tracing, "the tax collector shall be deemed to be held separate from and form no part of the collector's money, asset or estate." The next sentence, "But as the presence of the deeming provision tacitly acknowledges, the reality is that after conversion, misappropriation, misapplying, the statutory trust bears little resemblance to a true trust. There is no property which can be regarded as being impressed with the trust. Because of this section 18.2 goes on to provide that the unpaid tax forms a lien in charge of the entire assets of the collector," an interest in the nature of a secured debt. So my submissions are that our piece of statute, the whole scheme, fits into that section 18 scenario.

The next part which I'll talk about are the New Zealand cases. I can get through those quite quickly. The first one is *Commissioner of Inland Revenue v J F McCormick* [1964] NZLR 56 (SC). Now the point about *J F McCormick* – and it's at

page 137 of the appellant's bundle, I'd like to refer you to. This is a prosecution case and the Judge indicated the money doesn't have to be kept in a separate account. But if we look at line 22...

ELIAS CJ:

Sorry, page 187?

MR JOHNSON:

It's page 137 of the bundle and it's line 22.

ELIAS CJ:

Yes, thank you.

MR JOHNSON:

"It doesn't have to be kept in a separate account, but it does contemplate that he shall have each tax deduction in his possession and under his control from the time that it is made." "Possession and control," ie, held, in my submission. That decision was, nothing really happened for a long time until – actually the *McCormick* case was in '64. The next decision is *Re Westmoreland Box Company Limited (in liq) v Commissioner of Inland Revenue* [1968] NZLR 826 (SC) and that's at, from 138. Now the then Supreme Court, the equivalent of a High Court, Justice Hardie Boys indicated – and this is at 145 – we go to the last paragraph, Mr Palmer, that's the lawyer for the Commissioner, was prepared to accept that subsection (1) applies only to the unlikely event that an employer who is has made a tax deduction and not paid it as the Act requires him to do, is still holding the money represented by the deduction, so that on bankruptcy liquidation or assignment it's still in actual existence." Again, that's consistent with the submissions I'm putting forward. That was the Supreme Court.

You then went to the Court of Appeal in that decision, *Re Westmoreland Box Company Limited (in liq) v Commissioner of Inland Revenue* [1968] NZLR 826 (CA), and if I can take you to 154, and this is at line 46 where His Honour indicates, "I say nothing more about this possibility because I am inclined to agree with the Solicitor-General," so it was acknowledged by the Commissioner at that stage, "that whatever the intentions of the draft men may have been the provisions of section 31(2) are against the view that unpaid tax deductions as such are trust property." And then if we go to Justice Turner in the same judgment, page 156...

ELIAS CJ:

These have of course been set out in your submissions, these passages?

MR JOHNSON:

I have, I just wanted –

ELIAS CJ:

So you can touch on them fairly quickly, I would hope.

MR JOHNSON:

I'm only going to – this is the...

ELIAS CJ:

Yes.

MR JOHNSON:

156 at the top, but the section goes on in subsection (2) to provide what shall happen if the employer has failed to deal with the amount of the tax deduction or any part thereof, "And it seems to me clear that in the context subsection (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 money deducted." So those two decisions, in my submission, are consistent with these submissions today.

Smith was the next case, the Court of Appeal decision, and I accept that that decision did effectively talk about some form of floating charge. But, in my submission, the difficulty with *Smith* was that the Court was grappling with the section 292 issue, that's what that case was all about. The case was about the Commissioner being required to pay back payments, and the Court's view was, well, that can't be the case because they're meeting tax obligations. So my submission is that the more correct answer is that it can't be clawed back because of the secured creditor status in section 169, afforded by section 169.

So to me this case is about if the Court reads into section 167(1) as being a trust where there isn't identifiable money held at the date of the deduction or the deducted sum is not paid by the required date under the rules, however the trust still remains if

more money comes in, non-trust money comes in to the account at a later date. If the Court of Appeal essentially makes that finding, my submission is that the wording of this statute does not, in the whole scheme, does not go near that. It doesn't actually suggest that – if you take into account the Canadian commentary, what it suggests is a trust. If something's happened, the trust fund is gone, then you have a charge, and that's really the thrust of, as in my submission the, how this is to be interpreted, and why the provision shouldn't be interpreted as the Court of Appeal has interpreted it. Just – I now quickly turn to the legislative history and Your Honour's indicated it's already in the written submissions, but I'd like to give the Court a flavour of what happened after 1936, 1938, where Parliament went because what, what I've indicated to you is that things changed in 1958. The employee situation was specifically referred to and then the secured creditor priority was changed. So if I can quickly go please to, first of all page 451 of the appellant's bundle.

WILLIAM YOUNG J:

Sorry, what page, 451?

MR JOHNSON:

451, thank you. And this is the Honourable Mr Watts, if you go about two-thirds of the way down it's got sub clause 2 there and this is when the reference to preferential creditors was introduced. "Subsection (2) of this clause provides that if an employer has misapplied tax deductions they will rank in order of priority immediately after preferential claimed or wages in the event of bankruptcy. Clause 32 provides that the tax deduction which an employer fails to make or for which he fails to account shall be a charge on the real and personal property of the employer." This is a machinery clause which is self-explanatory. So that comment is consistent with the position that I'm putting forward to the Court today.

If you then go to page 455 and this is the Honourable Mr Muldoon and it's the top of the second column and this is 10 years later. It's got, "It was always intended when PAYE was introduced that unpaid tax deductions in those circumstances were to rank in a preference immediately after certain debts referred to in section 308 of the Companies Act. These debts comprise in the main wages holiday pay, et cetera," so there's Parliament confirming what the intention was 10 years later.

If we then go to –

ELIAS CJ:

What was the adverse determination in the Court?

MR JOHNSON:

Westmoreland actually, yes. The next one is page 467 and this is Honourable Mr Coleman and it's about a third of the way down.

GLAZEBROOK J:

And you'd say I suppose that if you interpret section 167(1) in that way that's been suggested then that goes against them ranking behind wages because, in fact, they'd rank above it?

MR JOHNSON:

If the trust remains in place, they do.

GLAZEBROOK J:

Yes.

MR JOHNSON:

About a third of the way starting with the word, "What did soften the blow."

ELIAS CJ:

Sorry, what page?

MR JOHNSON:

It's page 467, "What did soften the blow was the fact that the Commissioner of Inland Revenue and the Customs Department, although by their own special rules entitled to take preference, have established a rank after wages and salaries and that is now cemented into the order of preference, so at least the wages, wage and salary earners and those who have had money deducted from their wages have the satisfaction of knowing that the Inland Revenue Department will not take preference over them in the winding up and disposal of the assets of a company." And then at 541, so these are, these are in 10 year jumps these, so we're not up to 2003 and the Honourable Mr Sowry, if we go to 541 and it's the last paragraph starting, "The member did not give the credit to the previous National Government that changed the law. I do not expect him to give the credit either to make sure that wages, salaries and holiday leave was paid before the Inland Revenue got its slice." And then over

the page, "We changed the law so that wages and salaries did get paid out before the tax department was paid." So this is in 1980 with Mr Coleman, 2003 with Mr Sowry.

On top of that, the Law Commission had a go at this, and if we go to page 527 and it's paragraph 113, "PAYE is regarded as being held on trust for the Crown but the PAYE component is really set apart in the manner contemplated by section 167(1) of the Tax Administration Act. A remedy in trust will not be available where moneys have been mixed with other fungibles and the right to trace lost. As the Court report points out it's commercially impractical to treat PAYE as impressed with the trust," presumably in that situation.

GLAZEBROOK J:

Well, I think they probably said in any situation because businesses don't operate in that manner.

MR JOHNSON:

All right.

GLAZEBROOK J:

But I don't, I'm not exactly sure what the, the Court report said but I think it was probably part of the quid pro quo requiring employers to collect this that they had the use of the money in the meantime before they paid it.

MR JOHNSON:

Yes. The Court report was the English report that resulted in a determination that there would be no trust provisions in England.

GLAZEBROOK J:

Well, probably for those reasons because ...

MR JOHNSON:

Right.

GLAZEBROOK J:

There were some tax reports around, in New Zealand. I suspect some of them might have said something about this.

MR JOHNSON:

That's what I wanted to say in terms of the Hansard and commentary that, in my submission, again supports what I've proposed is how this thing should be interpreted.

I'd like to turn now to practical difficulties with the –

ELIAS CJ:

Is this the last topic that you are going to address, Mr Johnson?

MR JOHNSON:

I'm almost there. What –

ELIAS CJ:

Yes, yes, that's perfect, thank you.

MR JOHNSON:

Did you give me until one, Ma'am?

ELIAS CJ:

No, I didn't actually. Gave you 40 minutes and it's 20 to

MR JOHNSON:

I was trying to figure out what time did you ask me. Did you –

ELIAS CJ:

Twenty to –

MR JOHNSON:

The practical difficulties is, in fact, the last page. Those submissions, that those practical issues, difficulties are set out in my written submissions, but I just want to point to three in particular. One is the question of competing, competing proprietary claims to the money in the bank account, for instance, money that has been put in there by mistake. Where does this, where does the legislation, where does the decision stand in terms of that money? The decision is, the decision is if it's in the bank account, it's the IRD is subject to the Commissioner's trust proprietary interest,

but it doesn't address the issue about where there might, in fact, be other proprietary claims to the money and who gets preference to it in terms of timing, which proprietary claim comes first. It also doesn't address the issue of the ability to trace. So if for instance in the PPSA you have a PMSI – the item's sold, the money goes into the bank account. Who has priority in that situation? It doesn't address that issue.

There's also the question of section 310 of the Companies Act talks about the requirements to set off debt, so if the bank account, one bank account's credit and another bank account's debit and the bank says, "You've taken that money out of that account, that credit account Mr Commissioner, therefore I'm now going to prove for just the debit sum," is the bank able to do that?

Now, the – just those three examples there, the Commissioner's position is that, "Oh, these can be determined at a later date." But my submission to you is, to Your Honours is that these sort of issues are the ones that have been looked at over and over in Canada in terms of who's got the priority for various situations. You've got the operations for instance, if it's someone else's actual property and it's now going to become the property of the Commissioner, you've got that principle that says someone else's property should not be used to make tax payments. So it runs directly against that principle. But this doesn't address any of this. So for Parliament to have intended that scenario then in my submission you would need very clear language to set that out. In my submission what we've got in 167 is not clear language at all as to that proposition. In fact in my interpretation the clearer view is the one that I put forward.

Thank you.

ELIAS CJ:

Thank you Mr Johnson.

Yes Mr O'Regan.

MR O'REGAN:

Your Honours, my colleague and I are going to split the submissions today and I am presenting on the first part of our submissions which relate to the actual Commissioner's case in this case and the rebuttal of their case, this case, and Mrs

Courtney will deal with the legislative history, comparative jurisdictions and the discussion of the relevant case law to the extent it is not covered within the initial submissions.

Now, there seems to have been an increased emphasis in this new submission we've heard today on the traditional trust nature of the trust and the existence of some sort of scheme relating to section 167 and 169 in that there is a sort of a clear delineation of where they all apply. Now that's new. That's not in the submissions so I'm at a slight disadvantage in having to respond to it without having notice of it, but we do deal with the relationship between 167 and 169 in our submissions and in our view, the Commissioner's view, submission, that is that the 169 trust is just simply complementary to the 167 – 169 charge is simply complementary to the trust, and actually in most cases it is worthless. As in this case, for instance, I don't think there is any dispute that Jennings Roadfreight had a charge under which about \$12 million was owed. So the utility of a trust, of a charge in most cases is going to be relatively little.

Second, Your Honours, the trust has to be registered to be effective against a liquidator.

GLAZEBROOK J:

You mean the charge.

MR O'REGAN:

The charge, sorry, and that would render it in most cases unlikely to happen. So I think –

GLAZEBROOK J:

But isn't that a specific choice of the legislature? Having made the charge initially the first priority they've now said no it doesn't have priority over fixed charges, so that's a specific choice of the legislator. So it's changed from the 1936/1938 position where it was a first charge which had priority over everything to a situation where it doesn't.

MR O'REGAN:

Yes I'm certainly not –

GLAZEBROOK J:

So you can't complain about that.

MR O'REGAN:

I'm certainly not trying to in any way move away from the clear delineation of change in the situation in 1957 where what was a trust and charge combination effectively similar to the Canadian one now. It has been clawed back, presumably because it was thought too generous to the Commissioner so now we're dealing with a trust in relation to amounts withheld only to the extent that there are funds available. And –

WILLIAM YOUNG J:

Sorry, what's the legislation that requires registration? Is it the...

MR O'REGAN:

Section 169 itself.

WILLIAM YOUNG J:

Is it actually? All right.

MR O'REGAN:

Yes.

GLAZEBROOK J:

Yes.

MR O'REGAN:

And also –

GLAZEBROOK J:

But then are you not overriding the view of the legislature that employees' wages should take preference over PAYE? Because if you do have a trust –

MR O'REGAN:

We are – what we're –

GLAZE BROOK J:

– then – and say there's only money in a bank account, that's all that's left, then the employees miss out despite numerous indications from Parliament that the employees weren't to miss out to the Inland Revenue.

MR O'REGAN:

Well I think that numerous references is, with respect, not correct. There's been numerous references to the Schedule 7 priorities but throughout that period from 1936 to now the section 167 trust has survived and continues, and it's never even been part of those discussions where they've been talking about priorities under Schedule 7.

GLAZE BROOK J:

But –

MR O'REGAN:

And we – I have no, we have no dispute –

GLAZE BROOK J:

But in fact under your argument the priorities under – the employees still miss out because there's a trust rather than it coming under 167(2).

MR O'REGAN:

You've put it that way. We don't, I wouldn't use the word "priority" in this situation. This is a trust situation. The effect may be that in the end there is priority but we are dealing here with money that doesn't belong to the employer at all. There is absolutely no policy reason why –

ELIAS CJ:

Isn't the whole scheme of these provisions, isn't it all about priority? You say it's about –

MR O'REGAN:

No the priorities – if you have a look at Schedule 7, that deals with the priorities in the event of a liquidation.

ELIAS CJ:

But, but –

MR O'REGAN:

This deals with a payment to the Commissioner of an amount available at liquidation which doesn't belong to the company. That's not a priority. That is a payment of an amount deemed to be held in trust and therefore payable to the Commissioner as of right –

ELIAS CJ:

Well – but in effect –

MR O'REGAN:

– because it's –

ELIAS CJ:

The effect is to set up a priority. What I'm saying is isn't the whole scheme of these three provisions directed at determining when the Commissioner takes ahead of others?

MR O'REGAN:

I suppose that's one way of looking at, Your Honour, yes. But the Commissioner would prefer the submission to be that section 167(1) deals with a pre-liquidation situation of amounts held in trust for her which are paid to her and therefore protected by virtue of the trust mechanism.

ELIAS CJ:

Yes, you want to deal with it on the basis of property. I have a query which I'd like you to address in due course on whether really this is a statutorily deemed trust, as opposed to a direction to employers.

MR O'REGAN:

I saw those throwaway words by Turner J but those didn't seem to me to have any merit when you look at the words which says any amount – and I use the words – I – quote marks around “trust”. I don't think there's any doubt that the trust can be by the Government can, by Parliament can be made any sort of trust it likes, and in this particular case this trust has never had the hallmarks of a trust from the very

beginning because there has never been any requirement that it be kept separate from the funds of the, of the person who's the trustee. So at best we've had a charge over a mixed fund and words to those effect. But I think that –

ARNOLD J:

Was that true even under the very early ones which did talk about a trust applying where it was kept in a separate –

MR O'REGAN:

It did.

ARNOLD J:

– account?

MR O'REGAN:

It did. But so does this. It doesn't – well I mean it says, "remain apart" and so on but – well, you see, the question that I think is important here, in my submission is important is whether or not simply because there is a charge the trust ceases to exist. This is why I think the scheme of this Act is of a sort which means that notwithstanding that there is no corpus there is still a trust. There is a notional deduction. From an overdrawn account. If you have to pay – in this case there was 49,000 owing. At the end of the – before liquidation there's 14,000 held in trust. The rest was subject to section, subsection (2).

WILLIAM YOUNG J:

Mr O'Regan, why does the trust apply to the cash and not the rest of the assets, or why does the charge not apply to the cash? I mean at the start there's nothing – just let me carry on a minute – at the start there's nothing. The cash that comes in in fact represents what were book debts, presumably, at the time of the, of the deemed withholding. So a question that sort of has been going through my mind is why are we treating one form of asset, cash, as different, in a different way from other form of assets such as book debts or other assets that are less readily transmissible into cash?

MR O'REGAN:

Well we're talking about cash because that's all that is available to the Commissioner once the liquidation has set in.

WILLIAM YOUNG J:

But what about book debts?

MR O'REGAN:

No. they're dealt with under – subsection (2) would mean that those book debts – sure, that's what the purpose of the amendment was in 1968 was to ensure that the Commissioner took his, its priority position, which of course was subject to a dispute in the *Westmoreland* case, ahead of secured charges in the same way as the other first four in that list, employees, liquidators' fees et cetera, did. That's why that was done. So there's no question and under the old rule and now of course under the new rules it's accounts receivable under the – but that's all post liquidation and so that's irrelevant here because subsection (2) says any recoveries after liquidation are subject to subsection (2) in the Schedule 7 priorities. That is not disputed. We're only dealing with a trust asset that's in existence at the time of liquidation. And the only one that is in this case and the only one that is connectable to the trust in our case is the cash, the actual deduction as it's permeated through the fluctuating account.

ELIAS CJ:

But what's the point of principle? Why should there be a difference?

MR O'REGAN:

Well why should they have the provision at all you mean, Your Honour?

ELIAS CJ:

No, no, why should there be a difference between the cash and the fluctuating balance in the account and any other assets of the company?

MR O'REGAN:

Because notionally the amount that's still held in trust is not the employer's money.

ELIAS CJ:

Well, yes, although I mean it does buy back into the question of whether it's been set apart.

MR O'REGAN:

Well. I think to address that question Your Honour I think I have to say straightaway that the best way to address this is to, in my submission, is to ask the question, "Is the \$14,076 that was held in the bank account in credit at the time of liquidation, is that money held in trust for the Commissioner under subsection (1)?" That's the question to ask. And my friend has for various reasons said it's not. And the main reason it's not is because he maintains that traditional trust principles apply. The amount of the, of the fund was lost because the company went into overdraft. Ipso facto there is no longer any trust fund. So in fact what that would result in, with respect, is basically a section that had no value whatsoever, no effect whatsoever. Virtually, virtually.

ELIAS CJ:

My position is previous to that, earlier than that, and that is why construing the section, why is it not the case that the – that unless it is set apart it is not held on trust? Because then the –

MR O'REGAN:

That's not consistent with business practice full stop.

ELIAS CJ:

Well I understand that –

MR O'REGAN:

I mean if it was –

ELIAS CJ:

Well, I understand that but just looking at it as a matter of statutory interpretation first, because then section, subsection (2) makes perfect sense. In other words, why is the, is subsection (1) not a direction as Turner J suggested and I'm not sure that it was a throwaway line.

MR O'REGAN:

Well, the deduction, the direction is made in different sections, different parts of the Act as you've already seen, I mean, there's no suggestion that there isn't a requirement to deduct under law –

ELIAS CJ:

No, no, I'm not talking –

MR O'REGAN:

– that's not under section 167, that's assuming –

ELIAS CJ:

– I'm not talking about the deduction. I'm talking about the holding.

MR O'REGAN:

Yes, yes, well, there's no offence for not holding either.

ELIAS CJ:

No.

MR O'REGAN:

So there is no requirement to hold –

WILLIAM YOUNG J:

Was there a –

MR O'REGAN:

– anyway in the Act as this found and as I think my friend conceded he did come up with some other possible route to that but it didn't and frankly wasn't convincing because there is no obligation to hold and if there was, that would be a huge change in commercial practice in this country, a huge change. It would mean –

ELIAS CJ:

Well, it – does it not say that any amount so held in trust?

MR O'REGAN:

Any amount, yes.

ELIAS CJ:

I am querying this deemed statutory trust –

MR O'REGAN:

Yes.

ELIAS CJ:

– because it doesn't seem to me the language of subsection (1) necessarily points to that –

MR O'REGAN:

Well, I think –

ELIAS CJ:

– if it is however held on trust, then different consequences apply.

MR O'REGAN:

Well, I just want –

WILLIAM YOUNG J:

Can I just ask, cut across that slightly because there's a point arising out of it. Was it possibly held on trust once it was set aside pursuant to the Commissioner's notice because at that side, at that point the money was segregated? It wasn't an undifferentiated part of the, of the company's assets. It was a part of the assets that were set aside as able to meet the claims of the Commissioner. As it turned out a rather different claim.

MR O'REGAN:

Are you talking about the –

ELIAS CJ:

The GST?

MR O'REGAN:

– section 157 bank –

WILLIAM YOUNG J:

Yes.

MR O'REGAN:

Yes, well, that's section 157, 8 and 9. That section, we're not dealing with that section here, Sir, but that section creates a separate trust. That creates a trust in favour of the, of the Commissioner as soon as the notice is given to the bank. That's a separate trust because obviously the amount is no longer held by the employer, it's held by the bank so what is the bank basis is the bank holding it on, the bank is holding it on trust for the Commissioner. If you want to – I don't know whether we've even got those sections here, Sir, because –

WILLIAM YOUNG J:

No, no, just –

MR O'REGAN:

– because that section is no, not, not –

GLAZEBROOK J:

So you, say, what, well, you're just saying that's just a mechanics section –

MR O'REGAN:

Yes.

GLAZEBROOK J:

– to the bank to require the bank to do something? It doesn't have anything to do with what the company has or hasn't done.

WILLIAM YOUNG J:

Yes, but, no, just, as a matter of fact the funds were no longer available for the company's general purposes.

MR O'REGAN:

Some of them because two of the – one's, one was taken before liquidation and two after, yes, but that's true, those sums were then in the possession of the bank, yes.

WILLIAM YOUNG J:

One was taken before –

MR O'REGAN:

One was taken bef –

WILLIAM YOUNG J:

– oh just immed – the same day, was it just, yes.

MR O'REGAN:

Right, the bank delete and then eventually took, at 11.23 or something, obviously the bank rang the company so the company immediately put itself into liquidation to stop anything more being taken and the bank did then take a couple of things more, but they were, they were, that's all been dropped out of the significance to this case now. We're now concentrating solely on the \$14,000 that's everybody –

WILLIAM YOUNG J:

Well, I'm just concentrating the 14,000 too.

MR O'REGAN:

Mhm, well, these amounts didn't add up to the 14,000 either, Your Honour, they were random amounts taken by the bank. I don't know how they came about, but I don't think there's any dispute but in the end we ended up with 14,000 –

WILLIAM YOUNG J:

Yes, I know, I don't think you quite follow what I'm saying. I'm simply saying that at the point the company was liquidated, this \$14,000 was actually ring-fenced.

MR O'REGAN:

Yes, that's true, Your Honour, yes.

GLAZEBROOK J:

But it begs the question of what happens to priorities at that stage though, doesn't it, because –

WILLIAM YOUNG J:

Yes, that's right, so –

GLAZEBROOK J:

– if, in fact, it wasn't intended that the Department or the Commissioner have priority over the payment of wages, then to allow that just because you happen to make a notice to the bank to override those priorities seems somewhat against the scheme.

ARNOLD J:

Could I just ask –

MR O'REGAN:

With respect I think that's, it's consistent with the scheme because what the scheme is saying, what the bank, what section 157 says is that you take it from one trust position to another. All that's happened is that what was held on trust by the company is now held on trust by the bank.

GLAZEBROOK J:

But that assumes that that is what the prov – position was and it was, it assumes that it was intended that if you did have the money, then if you go into liquidation the wage earners actually miss out. They don't get their wages.

MR O'REGAN:

Well, let's put it into perspective. In this particular case there was 49,000 PAYE and 347 something of GST and of the 49,000, 14,000 came to the Commissioner under section 167(1) and 35,000 went to the, went into the general pool, was paid out of the general pool. I would say with respect Your Honour that the likelihood of this being a major, a major event in terms of the amount of times it's going to happen, that is that there is a credit in the bank account and the company that goes into liquidation would be, I would hope, I wouldn't have to guess, but I would say it would be relatively rare, relatively rare, so we are talking about a situation that upon liquidation there is a company that had some money in its bank account. This is the first case since 1936 that's come up with this, with this factual scenario. That probably, that probably –

GLAZEBROOK J:

Well, that's because the Commissioner hasn't taken –

MR O'REGAN:

– indicates something in itself.

GLAZEBROOK J:

But isn't that because the Commissioner hasn't even taken this view before?

MR O'REGAN:

I don't know, I don't know that. We haven't taken this view before but I don't know whether the factual situation has come before the Commission before to take that view, but I certainly –

WILLIAM YOUNG J:

Sorry, in what sense has the Commissioner not taken the view? I mean has there been a practice of allowing money in bank account –

MR O'REGAN:

As far as, as far as I'm aware the situation doesn't arise very often, but if it has it's possible that previously the Commissioner hasn't realised that it has a claim on the amount that it's in credit in the account and that the liquidators have just simply treated it as payable under schedule 2 and have dealt with it accordingly and the Commissioner has gone along with that. That is just surmise because, as I say, this is the first case that's come up and I don't know whether there's been others which the Commissioner has had a chance to look at and has turned down, I don't know.

ARNOLD J:

Can I ask something just before the break and it's following up from the question that Justice Young put to you about the focus on money and why, for example, you can't take book debts into account or something like that, and this, and there's a passage in the *Smith v Commissioner of Inland Revenue* at page 201 which puzzled me a bit when I read it, but I wonder if this is the idea that they're getting at, but if you look at about line 15 they talk about the view of Justice MacArthur and the obligation to set aside, require most businesses to change existing administrative practices at some considerable cost. In many if not most cases it may not be a segregation of the PAYE deduction, but there is a deduction from the gross remuneration due to the employee and then the Court says, "Consequently a portion of the employer's assets to the value of such deduction must be regarded as impressed with a trust in favour of the Commissioner. The employer cannot unilaterally repudiate in those cases where the moneys held on trust are mixed," and then they go on to say, "It's likely that the company here operated an overdraft throughout the relevant period." Now, I wonder if by talking about the assets there, they're getting at this idea that the

company will have a whole lot of debts that come, it will be owed money that will be paid periodically and its account will fluctuate and, and they're just getting at the idea that this strange trust attaches to the fluctuating balance from time to time –

MR O'REGAN:

Yes, I couldn't, I couldn't agree more, Your Honour.

ARNOLD J:

– and so, so that explains the reference to assets rather than cash.

MR O'REGAN:

Yes, that's correct. I would say that is definitely correct, Sir, the formation of the position and, in fact, is reflected in our submissions that that is – I mean, there, they're using the, the idea, pre-liquidation they're saying that there is a, the assets must include this notionally deducted amount because it was never deducted, in fact – and there's no book entry recording and it's just a notional deduction which is deemed to be held in trust. The section itself deems something to be held in trust which probably doesn't exist which it accepts probably doesn't exist, so it's never been a trust where tracing principles and general trust principles there has never been a requirement that there be an actual corpus which is what my friend is saying there must be, but there is not a requirement.

ELIAS CJ:

But it may be that if it is held apart, then it is impressed with a trust, leaving...

MR O'REGAN:

Do you think so, Your Honour?

ELIAS CJ:

Well, I think it's the only thing that makes sense really.

WILLIAM YOUNG J:

Well, it doesn't make sense with commercial practice, it may make some sense in terms of the history, where it does rather look as though the legislature did envisage that money would be set aside and distinguished from other assets.

MR O'REGAN:

Yes. It certainly says, "Every amount of tax deducted under the PAYE rules shall be held in trust for the Crown, but –

WILLIAM YOUNG J:

Sorry, is –

MR O'REGAN:

– but the deduction doesn't have to be an actual deduction. So it assumes that you can have a notional zero, non-existent deduction which is impressed with a trust. Now, if you take the situation in *Smith*, this is the way, it must be the way the Judges in that case thought about the situation. There – and this is an interesting point because it's crucial to, when you're looking at 167, to realise that lateness, separate account-ness, all of that is irrelevant under section 167 once the payment has been made. So, in this particular, in *Smith* there's a whole lot of payments that were made to the Commissioner, all late, all late. Now it can only be that the way that the Court must have, must be assuming it is, is that it's in overdraft, it borrows money from the bank, increases the overdraft to that extent. To that extent that money briefly becomes the company's property, it is then impressed with this trust, because the trust is that sort of trust, the payment is then made to the Commissioner, and it's deemed to be pursuant to the trust. That must be the legal way of ensuring that payments of that nature are not clawed back under section 292, and that must be inherent in the thinking of those Judges in *Smith*, because there's no other explanation for it. They're saying the money was held in trust, the payments were pursuant to trust. At the same time they are saying that the company operated in overdraft throughout the whole period.

We are dealing here with a different beast, there's no doubt about it, it's unique probably, except for Canada, it's unique, but it's not a trust in the conventional sense. If it was there would have no, in my submission we'd have no use at all.

ELIAS CJ:

All right, we'll take the lunch adjournment now, thank you.

COURT ADJOURNS: 1.07 PM

COURT RESUMES: 2.17 PM

ELIAS CJ:

Thank you Mr O'Regan.

MR O'REGAN:

Yes Your Honours.

I was in the situation of posing the questions in a slightly different way and the first one was, was the 14,076 held in JRL's bank account at the point of liquidation money held in trust for the Crown? And if the answer to that question is no then of course that's the end of the case.

The Commissioner doesn't argue with the fact that the account was in overdraft and doesn't argue either with the notion that if this is a traditional trust then the Commissioner's case is non-existent. But of course her submission is that normal trust principles never have and still do not apply to this trust. This is what the Court of Appeal determined in this case and also what the Court decided in *Smith*.

So, assuming that the first, the answer to the first question is yes, the 14,076 was money held in trust for the Crown, then the next question is, did the trust end at the point of liquidation so that 167(2)/Schedule 7 priorities applied? The appellants say it did end upon liquidation because the trust fund wasn't kept in a separate account, even though I think they've conceded that wasn't so now, but a large part of the submission was about the separate account, and because it hadn't been paid to the Commissioner on the due date. The Commissioner's submission is that if it is money held in trust for the Crown then section 167(1) must apply and so the amount held in trust forms no part of JRL's estate in liquidation. A majority of the Court of Appeal in this case agreed with the Commissioner's submission.

Now, I'm going to go to the summary in a sec.

GLAZEBROOK J:

Can I just check, in *Smith* they did say the trust came to an end on liquidation?

MR O'REGAN:

They did, because the case was one not involving any credit balance.

GLAZEBROOK J:

Well I don't think that was their reasoning was it?

MR O'REGAN:

Their reasoning is not clear because it was entirely irrelevant to the position since all the payments have been made to the Commissioner prior to liquidation, so there was no trust in fact to come to an end, because no more money was owed to the Commissioner.

GLAZEBROOK J:

All right.

MR O'REGAN:

Or if it was, it was subject to schedule 2, because ipso facto. So I find those words slightly misleading because, as the Court of Appeal points out, they are inconsistent with what they say at the beginning of that same statement.

I just wanted to go to section – to the submission that we've heard today that this is a scheme involving section 167(1) if an amount is actually withheld as a corpus, and then that trust lasts until the date that that amount should have been paid to the Commissioner and then ceases, upon which time a charge under section 169 takes its place, and then on liquidation the charge is I think subsumed by the wording of subsection 2 so that, notwithstanding the charge, subsection (2) applies. Now that, in the Commissioner's submission, is not supported at all by the text of the statute. There is nothing in section 169 which indicates that it supersedes section 167 in circumstances when it applies, and it applies under section 169(1) when either the employer has failed to make a deduction at all or has failed to make a payment to the Commissioner when due, that's when the trust emerges – the charge emerges. Now, that section, 169, is expressly stated to be subject to 167. That would be unnecessary if it actually replaced 167, which is the appellants' submission. The Commissioner's submission is that 169 is only a means whereby the amounts held in trust but not paid, and presumably not in existence, can be secured to the Commissioner by way of charge.

GLAZEBROOK J:

Why would you need that if you have a trust? One answer is because it's over assets, but is there another answer?

MR O'REGAN:

Well, the trust, and as always we must put point marks around here in the context of how this has evolved through legislation and through the decisions of the Court, in that it's not a real trust with a corpus which has to remain in existence, it's a trust notionally applicable to amounts which may not exist. The point that I'm making here, Your Honour, is that there is nothing in 169 which says that the 167 trust comes to an end when the payment is late.

GLAZEBROOK J:

I think the submission was actually made rather that 169 came to an end if the Commissioner was relying on 167(2), I think that was the context, but there may have been a wider context as well.

MR O'REGAN:

Well, that's not how I heard it, with respect, Your Honour.

GLAZEBROOK J:

Well, I think there was concession –

MR O'REGAN:

I think the –

GLAZEBROOK J:

– that if amounts fell due after, and were in the bank account, fell due for payment, then it didn't proceed, but I might have misunderstood.

MR O'REGAN:

If they felt – no, they didn't supersede if the payment was made on time. But if the payment was late, then section 169, according to the appellants' submission, superseded, then took over from the trust –

GLAZEBROOK J:

Yes.

MR O'REGAN:

– and so that money was no longer deemed to be held in trust, notwithstanding the clear words of section 167(1). There's nothing in the Act that indicates that that type of scheme is evidence, in fact section 167(1) trust depend on payment being on time or the amounts being kept separate, up until the point of liquidation. Subsection (2) only applies upon liquidation, therefore the –

GLAZEBROOK J:

Or receivership.

MR O'REGAN:

Oh, yes, but in this context we're – yes, receivership and personal bankruptcy in an individual and so on. But the point is is that until that point lateness of payment or failure to keep in a separate account or even failure to hold do not, in any way, impinge upon the trust under section 167(1).

GLAZEBROOK J:

The reason I brought up receivership is that receivership isn't necessarily the end of an entity, so that receivership you can come out of receivership at the end. So are you accepting that 167(2) on a receivership overrides 167(1)?

MR O'REGAN:

Well, first of all, a receivership is treated the same as a liquidation under the Receiverships Act 1993 for the purposes of establishing priorities and so on. So while it may be that you can emerge from a receivership intact, the fact is for the purposes of establishing priorities and so on the point of receivership is treated as the same as the point of liquidation, and so most of those sections, like section 167 and others which refer to liquidations or other alternatives like administration obviously will have them in tandem when relating, referring to priorities. I don't – that, in the situation we have here at the present we're dealing with a liquidation and, if there is a complicating factor with a receivership – to be truthful, I haven't considered it – but –

GLAZEBROOK J:

Well, just when you're construing the scheme, I wouldn't have thought you could ignore it. But your answer –

MR O'REGAN:

Well, as far as –

GLAZEBROOK J:

– is that it's just dealing with priorities under (2)?

MR O'REGAN:

That is my answer, yes.

GLAZEBROOK J:

But does it supersede (1) or not?

MR O'REGAN:

In the circumstances where there was no money held on trust, then obviously subsection (2) would seem to apply, whether it's a receivership or a liquidation, yes.

GLAZEBROOK J:

Right.

MR O'REGAN:

But it doesn't – the word "supersede" there, it's not right, Your Honour, with respect, they are two separate sections applying at specific times, and the Commissioner's case is that subsection (1) applies up until the point of liquidation and that there's money held on trust, then the words in the event of liquidation of the company apply and the money held on trust forms no part of the estate of the employer. If there's nothing in trust then subsection (2) applies or subsection (2) applies to the shortfall in the amount held on trust.

GLAZEBROOK J:

Well, subsection (2) then applies to then applies to anything that comes in after receivership –

MR O'REGAN:

Absolutely.

GLAZEBROOK J:

– or liquidation, is that the submission?

MR O'REGAN:

That's absolutely right, yes, Your Honour. So, in other words, in short, the Commissioner's submission is that that's, the scheme submission of the appellants, which was newly made today, doesn't have any substance within the framework of the legislation.

So, just reverting now back to the Commissioner's submissions, I can see the time is going to become scarce and so it's important, because we do have a right of reply and there's no extension until tomorrow, presumably, so I'm going to start –

ELIAS CJ:

Sorry, I wasn't thinking that you would have a further right of reply.

MR O'REGAN:

Not us, no.

ELIAS CJ:

No, yes, yes. I don't think you should feel constrained, we want to hear your argument, and if that causes difficulty we'll deal with it.

MR O'REGAN:

Okay.

ELIAS CJ:

We may sit late or we might look at a further time, if we need it.

MR O'REGAN:

Thank you, Your Honour. If I can move to – let's go to page 2 of our, of the Commissioner's submissions. I think it's important to us that we summarise the position of the case that the Commissioner had put forward both here and in the Court of Appeal, and first of all I think we have to get into mind the fact that an amount deducted from wages is not the property of the employer. That's the starting point for this trust, that money is taken from a third party, namely the employee, for payment by the employee through the employer to the Commissioner and that money is never the money of the employer.

ELIAS CJ:

Well, having said that though under section 167(2), it is treated as part of the estate of the employer.

MR O'REGAN:

It is because it's been misappropriated and ceased to exist and therefore, in those circumstances, the Courts have decided in 1957 to claw back the width of the original provision and have a sunset levelling bringing it down to being in the priorities under Schedule 7 rather than having the all-encompassing impact it had before which was effectively to say that it was held in trust indefinitely even into the, into liquidation à la Canada.

GLAZEBROOK J:

Well, I'm not absolutely certain it did that if there were priority payments before, because the only priority was given – well, I mean, we don't need to argue about this, but I'm not certain if there were preferential payments under the earlier Act that they didn't rank above this unless it was kept in the separate account –

MR O'REGAN:

Well, the –

GLAZEBROOK J:

– because if it wasn't an identifiable account, then there was only a charge that was only a charge that ranked above other charges. If there were preferential payments for wages then they would rank above that. Because it's quite clear under the 36 and 38 that if it wasn't kept in the separate account, then, or identifiable in some manner, then it was a charge only and it was a charge that had priority over all charges including any fixed charges, but not if there were preferential payments over those and I don't know the answer to whether they were preferential payments, but I think they were, they have been in for some time.

MR O'REGAN:

Well, there seems to be this view that the words “charge” and “trust” here or either/or and even in 1936. The Commissioner doesn't accept that. These are two separate matters and they're not either/or. The charge is, in fact, there to protect the amount that's then to be deducted on, and held on trust.

So you can call it a charge, but what's it protecting? It's protecting –

GLAZEBROOK J:

Well, it actually says – well, there's no point arguing about the 1936 and 1938 –

MR O'REGAN:

No, exactly because it – no.

GLAZEBROOK J:

– except to the extent that you, you are saying there's, that, that, it's been a change from that provision and I'm just challenging that. I don't think they had absolute priority over – if there were preferential payments of wages I don't think it had absolute priority but we don't know the answer to that anyway, unless you do.

MR O'REGAN:

I wish I could say I did but I don't, no. I have read the section as it's written there and on the face of it you have a charge which has a priority over all other charges and so, yes, I can see there is a possibility that the rules applying under section – well, I'm not sure there were priorities but if there was priorities it's possible that the rule relating to a floating charge having, you know, debts receivables having preference over the secured charge might have applied for the benefit of the beneficiaries, of the wages and the administrative costs and so on. It's possible. It's something that, you know, with hindsight we should probably have looked up but we didn't so I can't answer the question.

ELIAS CJ:

Mr O'Regan, I'd like you to tell me once more because I'm wondering what is the policy of this scheme in section 167? It seems to me that it is entirely possible that the policy – and it makes sense – is that if it's not set aside, if the money is not set aside then the priorities go according to Schedule 7 and that that is looking at the section as a whole.

MR O'REGAN:

Well, with respect, Your Honour, that would mean that every single company would immediately not – would never set aside the money because by virtue of that particular action on their part the trust is over.

ELIAS CJ:

Well, we understand that they don't and it sounds as if they don't so that –

MR O'REGAN:

That's why the trust has evolved the way it has, so it can cover situations where they haven't and they never do.

ELIAS CJ:

No, but the origins of the legislations seem to have envisaged a setting aside. That is not what happens on the side but the action –

MR O'REGAN:

Actually, a point on that, in those days there were social security stamps that you actually had to take a stamp and put it in the book, so to that extent, I suspect, you were actually setting it aside by having to go down to the post office and buy it and put it in the book.

ELIAS CJ:

That's what I'm saying, that that is the historical origin of it. But if you look – if you don't think it about technically, perhaps, for the moment and look about the policy of what the legislature is trying to achieve, you said a moment ago that the money that is deducted never becomes the employer's money but that's manifestly not so under subsection (2) and I'm putting to you that there is good policy in the notion that if you have set it aside then it becomes inviolate and it never becomes part of the employer's money. If you haven't, then the legislature has come up with a system of priorities which preserves a special advantage for the Commissioner but not at such a high level.

MR O'REGAN:

Well, that would mean, of course, Your Honour, that there would never be any protection from 292 claw-back if you hadn't set it aside.

GLAZEBROOK J:

Well, apart from the charge.

MR O'REGAN:

Honestly, the charge is – to be frank, is not worth anything.

WILLIAM YOUNG J:

Because it's never registered. It's not practical to register.

MR O'REGAN:

No, it's not practical. It's always subject to other charges. So the charge is, with respect, a red herring.

ELIAS CJ:

But why shouldn't there be claw-back beyond the priority that the legislature has provided for?

MR O'REGAN:

The legislature has provided for that in circumstances of liquidation. Before liquidation, those two elements in subsection (2) are not relevant to the existence of the charge. It doesn't matter if the payments are laid. There's criminal sanctions and everything else, but they're not covered by section 167(1). It doesn't matter if it's not kept in a separate account. That's not covered by section 167(1) either. And so any payments made –

GLAZEBROOK J:

The question was in policy terms, not in terms of the legislation but in policy terms, why shouldn't there be claw-back if the legislature has set priorities? Because that's why there's claw-back under 292 in any event because there's been payment not in the ordinary course of business or whatever the words are now. Not in accordance with priorities at a time when the company is insolvent.

MR O'REGAN:

Yes. So are we going to have the result that opens up all payments to the Commissioner prior to liquidation subject to claw-back? I would have thought that if that's true it would be a monumental change in business practice. I just can't contemplate that that would be the situation. You've also got to remember, Your Honour, that there's been a Law Commission report into this which has been made much of by the appellants. I can't understand why because their recommendations were ignored. They recommended section 167 go and it didn't go. In fact, it's still there and it's been there in spite of different changes to Schedule 7 and section 308 of the Companies Act 1955 and so on, it's still there more or less in its original form

and expected to operate. So what the Courts have to do, in my humble submission, is to make it work in a way that is intended to give the greatest protection to the fact that this money doesn't belong to the company. Now, the concession that was made between 1936 and 1958 –

ELIAS CJ:

Why does it belong to the company under 167(2)?

MR O'REGAN:

Well, it's converted to the company's money under 167(2), yes, but that would – is a good policy to have a situation where money is held on trust and through the actions of the trustee it ceases to be held on trust? No, it's not. I can answer that question myself.

ELIAS CJ:

Well, I am questioning whether it is held on trust unless it is set aside.

MR O'REGAN:

Right, so your – that's fine. The prerogative of this Court, of course, the great advantage of it, is it can start from scratch.

ELIAS CJ:

Well, no, we probably aren't.

MR O'REGAN:

But –

WILLIAM YOUNG J:

Well, it would amount to repealing section 167(1) because it would construe as applying only in circumstances which we all know never exist.

MR O'REGAN:

Exactly.

ELIAS CJ:

Which is why it hasn't been invoked.

MR O'REGAN:

It is invoked every day with respect to pre-liquidation payments. This is the – if your theory was carried through, Your Honour, that would then be, no longer would those payments be protected because on the tracing rules there's no tax, there's no payment deducted, so it's never existed, the trust has never existed. Therefore, no payment to the Commissioner prior to the liquidation could be payments pursuant to the trust, they'd be just payments, which will be the same as any other creditor payment and liable to forfeiture under section 292. Well, that would be completely contrary to commercial practice in New Zealand at present, as I say, but it's open to that type of interpretation. But, as I say, I think the Courts have to, have tried to make sense of a provision which is probably less well-worded than one would like, especially when read in conjunction with the later edition, namely subsection (2).

So, anyway, I was returning to our submissions on page 2 in the –

GLAZEBROOK J:

Well, why is the charge so impractical?

MR O'REGAN:

Because –

GLAZEBROOK J:

Because the Commissioner has had a return saying that PAYE is payable, it hasn't been paid –

MR O'REGAN:

Yes.

GLAZEBROOK J:

– why doesn't the Commissioner just slap the charge on a matter of course?

MR O'REGAN:

Well, in this case there was 12 million owing under the first charge. What's the point?

GLAZEBROOK J:

Well, the point is –

MR O'REGAN:

You know, the point is that –

GLAZEBROOK J:

– it's not subject to claw-back if you do get paid by the...

MR O'REGAN:

Well, actually, is that true? Because the submission of the appellants is that the charge ceased to have effect upon liquidation and we go back to Schedule 7. So what is – that even more if that's that case –

GLAZEBROOK J:

Well, yes, but if it's had effect –

MR O'REGAN:

– even more lessens the impact of the charge. In fact, it improves it, doesn't it, because you're becoming ahead of the charge, but, by virtue of being in that top four in Schedule 7.

GLAZEBROOK J:

Well, that's why I think he said that they normally rely on section 167(2) at that stage, because it does give priority.

MR O'REGAN:

The situation, as I understand it, with section 169 is that sometimes a company in trouble might come to the Commissioner and say, "We're having real trouble paying our PAYE as due, but we think there's light at the end of the tunnel," and so the Commissioner might then enter into an arrangement whereby they'll register a charge under section 169. But otherwise, of course, registration is not required, it's an automatic by law charge, but it's subject to other charges, and if it's not registered it's not valid against a liquidator. So, practically speaking in the scheme of things, we have got money accruing of a two or three month period and then the company going into liquidation. I don't think this charge has much utility at all.

So, 5.2 of our submission is at the time – the plain meaning of the words of section 167(1) say that at the time a PAYE deduction is made or deemed to be made a

statutory trust to protect the amount of the deduction from forming part of the employer's estate in the event of liquidation of the employer is formed. Now, the Commissioner's submission is that is so even if the wages are paid from an overdrawn account, as was the case with *Smith* and was the – well, it wasn't the case here entirely but it was, the account did go into overdraft two days later.

If the employer company is liquidated and the company holds an amount equal to or less than the amount of the deduction in credit in its bank accounts, the Commissioner says that is an amount held in trust for the Crown and the Crown is entitled to it under section 167(1). However, because of subsection (2) the trust comes to an end in respect of unpaid deductions greater than the amounts that were held in trust and paid to the Commissioner under subsection (1). And in this case, as we know, as the Court of Appeal said at paragraph 26, they did the figures, the figures were 14,000 paid under schedule 1 and 35,000 recoverable under subsection (2) or Schedule 7.

Now the reasons for the conclusion that we have come to, we have submitted on, and which is what the Court of Appeal agreed with, it is settled law and practice that the section 167(1) trust is a deemed statutory trust and does not require actual segregation of funds. It does not have the characteristics of a normal equitable trust and is akin to a floating charge over the employer's bank accounts, and that's what the Court of Appeal had. So the plain words of subsection (1) are that any amount so held in trust shall remain apart and form no part of the estate in liquidation. Some meaning has to be given to those words. In our view the –

ELIAS CJ:

What meaning do you give to "remain"?

MR O'REGAN:

Well, I don't – first of all, that was put up by the appellants, was put up in the context that you have to have something held apart for it to remain apart, and therefore that meant that there had to be a separate account, well, a separate, had to be kept in a separate account and therefore remained apart. That submission, I suspect, has been withdrawn, because it's contrary, completely contrary to the authorities. I see it only as just being a draftsman's way of saying, "It's trust property so ipso facto it's already apart and it must remain apart," that's all. It's not indirectly trying to legislate to make people keep it apart, as the original submission was.

In our view, both the legislative history and section 169, the charge for, they show in our view that this was always intended to be something that was not necessarily attached to a trust corpus and that it was always sort of floating along inside the assets and becoming a trust once there's a credit balance but remaining there, nonetheless, in the event that the money was spent, so it's a fluctuating bank account balance, it comes back up, goes down, comes up, and the trust attaches from time-to-time. Otherwise, as I've said before, there is going to be very little point in anything under section 167(1).

And also, that point that I've just made about the floating and mixed nature of this, the non-existent nature of it, being no corpus and so on, is consistent with what's happening in Canada. In Canada, of course, we have a far more reaching clause, but of course it applies before liquidation as well as after liquidation. Our submission is that the situation before liquidation is exactly the same as it is here in that the trust applies, irrespective of whether or not the money's in existence at the time.

GLAZEBROOK J:

That's not what the passages were, said, that we were taken to in relation to the trust. The only reason that was the case was because of the extension of the trust to other assets, so that was quite clear from both of those passages. Do you have other passages that would say that's not the case.

MR O'REGAN:

It says that the amount held in trust shall be deemed to be held in trust.

GLAZEBROOK J:

Well, do you want to –

MR O'REGAN:

So it's the same amount.

GLAZEBROOK J:

Well, do you want to just look at the provisions we were taken to, because it basically said that the trust disappears once you've mingled the funds, and the only reason it is held in trust is because the extension under the legislation to the other assets and the replacement assets, that these were the –

MR O'REGAN:

This is subsection 4.1?

GLAZEBROOK J:

No, no, these were the passages –

MR O'REGAN:

There's a word –

GLAZEBROOK J:

– of the judgments.

MR O'REGAN:

Well, I'd go to the provision itself, if you wouldn't mind. It's –

GLAZEBROOK J:

Well, but they've –

MR O'REGAN:

– page –

GLAZEBROOK J:

– they've interpreted the provision which says it's held in trust –

MR O'REGAN:

Yes.

GLAZEBROOK J:

– as saying, "As soon as you mingle that disappears," and it's only the –

MR O'REGAN:

Has there been a case –

GLAZEBROOK J:

– extension that creates the trust on, after acquired money.

MR O'REGAN:

Yes. Unfortunately, these Canadian cases don't have when they – those cases you referred to were, as I understand it, cases that pre-dated the change to the law which I was going to refer you to and –

GLAZEBROOK J:

What, the change to the provision that they were interpreting, being the first bit of the provision?

MR O'REGAN:

I'm comparing the Canadian position now with the New Zealand position.

GLAZEBROOK J:

Well, it's only the first part of the Canadian provision that has any resemblance to our part, and it was that first part, as I understand it, that was being interpreted in these cases we were taken to.

MR O'REGAN:

Well, may I take you to respondent's bundle, number 13, page 438. Now, this case has been superseded, but if you have a look at the words there underneath 438, the fourth paragraph down, "As a practical reality, however, these deductions are often not remitted as required and instead the withholding are commonly made so as the book entry and therefore the deduction of taxes from wages becomes merely a notional transaction. No cash is actually set aside for remittance and often the deductions are not transferred to the Receiver-General. While it can be said that the matter at this point becomes de facto due to a credit of the non-remitting, the arrangement is dissimilar to an ordinary credit to debtor, create a situation first in two fundamental respects. First, in contrast to usual negotiated credit, this transaction is of manifestly a non-consensual nature. Second, by virtue of 1353, the debtor can in law can be considered to be utilising an asset which is the property of its employee. In this sense it is not inaccurate to characterise the non-remittance of payroll deductions as a misappropriation of the property." So all I'm putting out there, Your Honour, is that the Canadians are thinking exactly the same way as we are in terms of how this is formulated prior to liquidation and the ...

GLAZEBROOK J:

Well, I was really looking at what they said at 4.40 that the conceptual difficulty arises when they fail to set aside the money becomes intermingled and Her Majesty's claim then becomes that of a beneficiary under a non-existent trust.

MR O'REGAN:

Well, that was before the amendment, Your Honour, to which is now ...

GLAZEBROOK J:

Well, yes, but then they go on and say that the conceptual difficulty is fixed up by the extension to the assets, the other assets of the company which is the position now but is being further strengthened, but do you want to take it, do you want to say why this has been superseded because this seems to me to the exact same wording as we have under section 167(1) and they've said it becomes an asset under a non, it becomes a beneficiary of a non-existent trust if there's intermingling.

MR O'REGAN:

That – if I can take you to page, the respondent's bundle, number 7, page 2884 in terms of the current Canadian position. There we've got the position under subsection (4) at the top of page 2885. And then we have 4.1 which is referred to as extension of the trust.

GLAZEBROOK J:

Well, that – look at subsection (4). It is different from our section and it says you have to hold it separate and apart from the property if the person –

MR O'REGAN:

Yes, that's right but, of course, –

GLAZEBROOK J:

Well, that's different from our section, isn't it?

MR O'REGAN:

Well –

GLAZEBROOK J:

Well, it isn't different from the 1938 and 1936 and 1938 possibly, oh, no, it is different because ...

MR O'REGAN:

It's no different from, in terms of the actual effects though because it's –

GLAZEBROOK J:

Well, it has subsection (4) –

MR O'REGAN:

– I mean if it's not held in trust, if it's not –

GLAZEBROOK J:

Can you perhaps just answer me? Has subsection (4) been interpreted in a different way from the way whatever the previous provision was interpreted by, in those cases.

MR O'REGAN:

Subsection (4) was inserted to overcome the problem in this –

GLAZEBROOK J:

No, subsection (4.1) was inserted to overcome the problem as I understand it.

MR O'REGAN:

In the – yes, yes, I'm sorry, yes, Your Honour, that's right.

GLAZEBROOK J:

So is – well, let's have a look. Is subsection (4) the same section as was interpreted in those Canadian cases? I actually don't, I genuinely don't know the answer to this, I'm sorry.

MR O'REGAN:

No, well, in fact, it's not the case because some of them are – the one that was put in this morning was a sales tax from the provinces. There's another –

GLAZEBROOK J:

No, but this one is, the *Sparrow* one is, is payroll deductions.

MR O'REGAN:

Yes.

GLAZEBROOK J:

So what was the actual provision in that case 2774? Have we got it set out anywhere?

MR O'REGAN:

Good point. I don't think we have. Oh, yes, here it is – no, we've only got 27, 2775.

ELIAS CJ:

Well, it will be set out in the judgment.

MR O'REGAN:

Well, that's what we're looking for, Your Honour, but ...

ELIAS CJ:

There are a lot of provisions set up in the judgement.

GLAZEBROOK J:

227(4) –

MR O'REGAN:

It's all about, this is all about the nature of the charge.

GLAZEBROOK J:

"Every person who deducts or withholds any money under this Act shall be deemed to the amount so deducted or withheld in trust for Her Majesty," which ...

MR O'REGAN:

It's referred to throughout as a deemed trust and so on.

GLAZEBROOK J:

Well, "It's every person who –

MR O'REGAN:

I mean –

GLAZEBROOK J:

– deducts or withholds to be deemed to hold the amount so deducted or withheld in trust for Her Majesty,” that’s page 431 of the report and subsection (5) is set out there as well. So this one has been expanded to say held apart, but has there been, has there been anything specifically on – probably not, because of the extension in (4.1) probably makes any argument otiose on 4 unless there’s a priority issue in terms of – because (8.1) and (81.1) and (81.2) I looked them up for something to do was selling farming assets.

MR O'REGAN:

So, in fact, my point then is correct, Your Honour, that section 227(4) as it was interpreted in these cases is very similar to our section, subsection, section 167(1).

GLAZEBROOK J:

But then the point is that they interpreted that as soon as you had an intermingling you lost the trust.

MR O'REGAN:

No, with respect that’s not right, Your Honour, what they decided was –

GLAZEBROOK J:

Well, well, what –

MR O'REGAN:

– that they decided that the trust was beaten by a secured charge.

GLAZEBROOK J:

No, no, well –

MR O'REGAN:

And or a sales, sales in the ordinary course of business.

GLAZEBROOK J:

– what they, what they said in – well, just have a look at what they said at page 4439, 440, where they said that Her Majesty’s claim becomes that of a beneficiary under a non-existent trust if there’s intermingling.

MR O’REGAN:

That’s an interesting use of words, isn’t it, because if, can you be a beneficiary under a non-existent trust?

ELIAS CJ:

No, well, that’s what the point they’re making.

GLAZEBROOK J:

That was the point they were making.

MR O’REGAN:

I think what they’re saying is, what they’re saying is, they’re saying there, with respect, Your Honour, they’re saying a beneficiary under a trust for which there is no corpus and that –

GLAZEBROOK J:

Well that’s because as soon as the funds are intermingled there’s no trust, that’s what was held.

MR O’REGAN:

Well, I think –

GLAZEBROOK J:

Well, you might say it’s obiter because –

MR O’REGAN:

And he said the descending, he’s also the descending –

GLAZEBROOK J: 2

– in actual fact the actual, the actual decision was about a secured creditor.

MR O'REGAN:

Yes, yes.

GLAZEBROOK J:

But it's quite high level obiter explaining the scheme of the provision, isn't it, if it is obiter.

MR O'REGAN:

It's possibly only obiter but the result, in fact, is – the only reason why the trust didn't survive, didn't, it didn't gazump the creditors here was because of the charge.

GLAZEBROOK J:

No, that's no right. The only reason the trust – well, the trust didn't survive, it was only the extension of the trust that survived under subsection (5) not subsection (4).

MR O'REGAN:

Well ...

GLAZEBROOK J:

As I understand it. If I'm wrong, please tell me.

MR O'REGAN:

Well, can you – I'm just reading, the old –

GLAZEBROOK J:

Well, it says, 227(4) didn't help you because as soon as the funds were intermingled it was non-existent. Then it says, but 227(5) revitalises the trust, if I can use Mr Johnson's term, which is at 442.

MR O'REGAN:

Well, actually if you read that, Your Honour, 431, page 431, where we're looking at the actual law, we've got subsection (4), which is our equivalent of 267, an abbreviated form of 26 – 167(1), and then we've got number 5, which is, "Notwithstanding any other provision of the Bankruptcy Act, in the event of liquidation or assignment or a bankruptcy an amount equal to any amount deemed by subsection (4) to be held in trust," so we're still talking about the same trust, "Shall be

deemed to be separate from and form no part of the estate,” so that's becoming very, very similar to what we're talking about here.

GLAZEBROOK J:

Well, so you say 167(1) actually encompasses both 227(4) and (5) –

MR O'REGAN:

Exactly, yes.

GLAZEBROOK J:

– of the Canadian legislation?

MR O'REGAN:

That's the old 5, yes, Your Honour. Yes, Your Honour.

GLAZEBROOK J:

I'm not sure where you get that from, but...

MR O'REGAN:

Well, just the wording of the section, Your Honour.

GLAZEBROOK J:

Well, the wording of the section, of subsection (5), seems to me totally different from section 167(1) though, because you deem to be held in a separate account.

MR O'REGAN:

The difference is – well, actually, maybe you could tell me what the differences are that you see, Your Honour, because I can't see any difference. “Notwithstanding any provision the bank, in the event of any liquidation, the amount deemed to be held in trust under subsection (4) shall be deemed to be separate from and form no part of the estate in liquidation, whether or not that has been kept separate.” Sure, they go that little bit extra with whether or not it has been in fact kept separate, but the point is that that's exactly, in my view, what we've got here.

GLAZEBROOK J:

Right, so that's the submission.

MR O'REGAN:

Yes, Your Honour. And also this case has been since superseded by later statute to amend it to the position it's got to now where the trust is extended so that it can operate above, ahead of any secured charge or any sales in the ordinary course of business and so on.

GLAZEBROOK J:

And how does 167(2) fit in to that then?

MR O'REGAN:

Well, it doesn't fit into the Canadian provision, of course, because then they extended it to cover liquidation as well. But in our situation it covers every amount that been notionally deducted and either is not represented by a credit balance in the account at the point of liquidation, which is money held in trust, or there is no such money, so there'd be either a shortfall or the total amount. And, as I said, in this case it was 14,000 under subsection (1) and 35,000 under subsection (2).

So, to move on then to the, number 7 on page 3, we say that this, the appellants' position is not tenable because it would deprive the words of section 167(1) of any meaningful effect. The Commissioner's interpretation gives effect to the words of both subsection (1) and subsection (2). Now, as I say, it's an unclear mix of statutory interpretation and established trust principles. As I say, if trust, if tracing, if normal trust principles apply, then this was definitely not money held on trust for the Commissioner, that is conceded. But if that is the case, as I've said before, there is a can of worms being opened in terms of the potential for payments made up until the date of liquidation to be clawed back if, in fact, tracing rules, that is, strict normal trust principles applied, that there has to be a corpus. If there has to be a corpus then there would be no protection, in most cases, under subsection (1).

As I see the position with this submission and, with the greatest respect, to Justice Ellen France with her judgment, the position seems to be that she herself accepted that this was money held in trust, up until the point of liquidation, but she then held that, in her view, the trust came to an end by virtue of the words under subsection (1). The Commissioner's submission on the other hand is that the trust exists, up until the point of liquidation, and is given effect to, in the event there is any money held in trust, by the words, "In the event of liquidation shall remain apart and shall

form no part of the estate.” So that money is trust money and that's paid to the Commissioner.

Now, it's quite a step to go that next step and say, but subsection (2) says that that trust, that money held in trust, is no longer held in trust simply by virtue of the fact that the company's gone into liquidation, because then you're not really giving any effect to the words in subsection (1) which say that it remains apart.

To illustrate this point by going to her judgment, which is on the case on appeal, page 26, and this is paragraph 64. So it says there, “When setting out the effect of obligation on the, and then dealing with the position on liquidation when those obligations are not met. In terms of section 167(2) it is necessary to give some meaning to the fact that the section applies where the employer has failed to deal with a deduction in the manner required by section 167(1) of the PAYE rules.” Well, of course, the Commissioner's submission is that there was 35,000 paid under subsection (2) compared with 14 under the first. Of course it has meaning, and in fact in the vast majority of liquidations this situation would not arise, only subsection (2) would apply, and it would be the primary section in most cases.

She then goes on to say, “I accept that there is no utility in triggering the trust concept when the PAYE has been paid.” Now, I understand that to mean – and I'm not sure what the word “triggering” means there, but I understand that to mean that as long as the money, irrespective of lateness and everything else, is actually paid up until the point of liquidation that's okay, because it's money held in trust. But then, even though it's still money held in trust, liquidation comes and subsection (2) says the trust fails. So that would mean, Your Honour, that the day – if this 14,000 had been paid the day before liquidation, on Justice France's argument that would mean that that would not be able to be clawed back.

GLAZEBROOK J:

I think she's just answering an argument that there's no point in having a trust if the amount's already being paid because there's nothing to have a trust over. I don't think she was making any further point than that, was she?

MR O'REGAN:

But it is important to have something to have a trust over if, because if the payment is paid within the restricted period or within the two-year period of liquidation, without it being payment pursuant to the trust it would be subject to claw-back.

GLAZEBROOK J:

Well, then, you're saying she's wrong, there might be some utility in it. But I don't think she was making that point, that's all, as I read what she was saying.

MR O'REGAN:

She's saying if the trust got – when the PAYE's been paid, okay, but, well –

GLAZEBROOK J:

But I understand –

MR O'REGAN:

– I beg to differ –

GLAZEBROOK J:

– your point as well.

MR O'REGAN:

– I beg to differ with her there. But then she's saying, "But if the trust remains, no matter what, the latter approach gives no meaning to 167(2)." Well, as I've said, I reject that entirely because in fact 167(2) is going to be the governing section in the vast majority of occasions where it has to be dealt with.

So, the point that I'm making though here, Your Honours, is that subsections (1), section 167(1), does not rely for its, it does not get impacted upon, I should say, by late payment or failure to keep in a separate account, or even failure to hold, because they're not covered by section 167(1). They're covered elsewhere with different sanctions, but the trust is not impacted by those failures, and, as I said, that's probably because when payments are made they're made pursuant to the trust and therefore are given protection. But that means, Your Honour, though that one minute before liquidation that \$14,000 in the bank account was money held in trust, because it was, it doesn't matter the fact that it was late, it was overdue, it doesn't matter at that stage. It's only, only, according to Ellen France J in the appellants'

submissions, that on liquidation that money held on trust ceases to be money held on trust because of what subsection (2) says. The Commissioner says, no, it remains money held on trust and it's held under subsection (1) and it's payable to the Commissioner because it's trust money. It remains apart and forms no part of the estate in liquidation, and that's what the Court of Appeal held in this case as well. If we go to their judgment, paragraph 22, the only difference between them and the appellant, paragraph 25, Your Honours. They're the majority here, and I take your point, Your Honour, in terms of what Justice France might have been saying, but she didn't seem to rule out that – she seems to be saying the trust came to an end rather than saying that it wasn't trust money. That's the point I'm making there.

GLAZEBROOK J:

Which is what *Smith* actually said, the trust came to an end.

MR O'REGAN:

Yes, but *Smith*, as I said before –

GLAZEBROOK J:

I know the submission made on that, but one can understand where that might have come from.

MR O'REGAN:

So they're actually saying, in section 25, what section 167(2) applies to, this is on page 16, "It applies to PAYE deducted and either paid by the employer to the Commissioner nor held by the employer's bank accounts available for payment to the Commissioner." That is fully supported by the Commissioner, that interpretation. That is our case. As long as there is a credit balance fluctuating as it may be this notional trust, the tax to it, the terms and to the extent that there are unpaid deductions, and remains attached to it right up to the point of liquidation and stays as money held in trust, subsection (1) applies. After that, subsection (2) applies. We certainly reject entirely the contention that you could have money held in trust up to the point of liquidation but then it ceases to be held in trust by virtue of the liquidation, which is what, as I understand it, because the only reason that would cease to be held in trust on liquidation would be because it hasn't been paid on time. As we've said before, we make it in the submissions and the point is made in *Smith* and in this case, there is something fundamentally wrong with a proposition that enables a

trustee by its own wrongful actions to terminate a trust, and the wrongful action here being not paying it on the due date or possibly not holding it at all.

The much better solution to the apparent conflict between the words of, "In the event of liquidation on the one hand and upon liquidation on the other," is to adopt the position whereby there is a trust in existence at liquidation. It remains in existence, and the proceeds of it, the amount held in trust, is paid to the Commissioner and the rest is dealt with under subsection (2) on the assumption that the payments are late, et cetera, et cetera.

There's no need to, in the Commissioner's submission, to actually have a provision which, on its own, says it terminates the trust. That's not necessary. That sounds repugnant. It is repugnant. In our submission, it's not necessary to come to that conclusion to get the right result in this case.

There's a summary of that position again, Your Honours, on page 7 of our submissions at 28 and this is adopting the submission we put to the Court of Appeal and which was adopted by the Court of Appeal. So that's 28(1) and (2), the language that we, the Commissioner, puts forward as being the right answer to this question. That's certainly supported by the Court of Appeal's majority decision.

As we say in 29, this best reflects the plain language of the section in light of its context and purpose and in light of the authorities on it to date.

GLAZEBROOK J:

You are adding words to 167(2), aren't you?

MR O'REGAN:

Which ones?

GLAZEBROOK J:

Well, where the employer does not hold the amount in credit at the time of liquidation. I mean, I understand you're just summarising how you best interpret the way the sections run together but they don't run together particularly well, it has to be said, in any event. And so I think whichever interpretation you're adding words somewhere, aren't you?

MR O'REGAN:

Well, I'm not suggesting that 28.2 is a summary of section 28.

GLAZEBROOK J:

I understand that.

MR O'REGAN:

It's just in contrast with what we've said under 28(1). It applies where there's no money held on trust.

GLAZEBROOK J:

All right.

MR O'REGAN:

Now, if we continue through the submissions, Your Honour, we get to this situation where we're talking about the purpose, and the purpose, obviously, is to protect deductions made by an employer on behalf of an employee so that the Commissioner is paid those amounts which don't belong to the employer but belong to the Commissioner as tax payable by the employee. This is relatively trite, this stuff, so I'm not going to spend too much time on the policy reasons. On page 9, I move over to every amount shall remain apart.

I'm a little confused by the appellants', I think, change of heart in relation to the submission because the submission has remained apart connected with an obligation to keep separate which I think the appellants have now dropped, so anyway, that confirms the view that there is no obligation expressed in the Act to actually keep the trust monies apart and in fact there is no obligation to make an actual deduction, but notwithstanding that, there is a trust.

If section 167 was read as being limited to a situation where an actual amount is deducted, then what would be the point of the notional deduction? There wouldn't be any, with respect. There has to be a notion or deduction once the net amount is paid and it's difficult to see where, why that would be needed if there was no trust able to be created in respect of the notional amount.

So it's the Commissioner's case that even when you're running an overdraft as they were in *Smith* and as we hear from time to time, there is a notional deduction and a

notional trust imposed on that amount, the amount of that deduction, notwithstanding that deduction hasn't been made. That amount, not the actual deduction, but the amount of it, the equal to it, is held on trust notionally, notwithstanding that it doesn't exist in trust corpus terms. That continues, payments are made from time-to-time to the Commissioner, and then, whether late or not, they are not subject to claw-back because they're pursuant to the notional trust, and then when they get to the point of liquidation there is an amount held in trust in the account, it stands to reason that that would fall within section 167(1). This is all summarised at section 36, 37 and 38.

Now, at paragraph 106 onwards in these submissions, which were the rebuttal submissions, we deal with the actual separation point which, I'm not going to go there now at all because I think it's been accepted that there isn't – as I understood the appellants' position it was that it wasn't necessary for the amount to be kept separate but it was necessary for there to be an amount, or "the" amount.

WILLIAM YOUNG J:

Had to be a positive bank balance –

MR O'REGAN:

Right.

WILLIAM YOUNG J:

– that seems to be the submission.

MR O'REGAN:

On an –

WILLIAM YOUNG J:

I don't think it's a view that is necessary held by all members of the Bench, however.

MR O'REGAN:

No. Well, I would hope not.

WILLIAM YOUNG J:

No, I'm...

ELIAS CJ:

There might be a worse view held.

WILLIAM YOUNG J:

It's a worse view, I think, that there has been – and that is that despite that concession the section only applies where there is a fund segregated and nominated effectively as a trust account.

MR O'REGAN:

Right.

GLAZEBROOK J:

Which again isn't necessarily the view of all members of the Bench.

WILLIAM YOUNG J:

No.

GLAZEBROOK J:

I'm still relatively attracted to Justice Ellen France's view that it applies to matters that are paid afterwards, leaving, and whether it, whether *Smith* is right or not it's not something that's before us, it's not something that we'd be making – it may well be that a trust as long as you're not in liquidation does remain, to protect both payments, it may be that it doesn't and the Commissioner needs to go to his or her charge, depending on what sex the Commissioner is at the time.

ELIAS CJ:

It does occur to me that you're principally arguing *Smith* really. Is that right, that you're indicating that the real concern of the Commissioner is with pre-liquidation payments?

MR O'REGAN:

Well, I certainly wouldn't want the result of this case to be that those payments were suddenly subject to dangerous claw-back –

ELIAS CJ:

Claw-back.

MR O'REGAN:

– provisions which could cost a huge amount in terms of litigation and so on, when we've got a settled practice that they're not, you know, so, that is a concern, but that, to – definitely, Your Honour, that is a concern, but that's not the, I wasn't thinking as pessimistically as that, that we would end up in that situation. I was pointing out only that, in the situation, if you followed the logic of the tracing rules and the idea of the trust, there would never be, in most cases, a trust under section 167, and that's the logic of the appellants' submissions, and that is not, in the Commissioner's submission, consistent with the concept of a notional deduction also being subject to the trust, which it is, in our submission, because most deductions are notional and it would be very rare that there is an actual deduction.

GLAZEBROOK J:

I still actually have some difficulty with the point that's been made earlier as to why is it just cash rather than any assets such as – especially ones that are readily convertible to cash. What's the policy behind it just being cash?

MR O'REGAN:

Well, it wasn't, because it was more than cash before subsection (2) was introduced, it was spreading down into the assets. Now it has to –

GLAZEBROOK J:

But because of the charge which –

MR O'REGAN:

It's cash because that's what it says. It says, "Every amount deducted," and refers to any amount. I think it's definitely, seems to be limited to connection with a deduction, which is –

WILLIAM YOUNG J:

By "amount" you mean –

MR O'REGAN:

Cash.

WILLIAM YOUNG J:

– a fee's an amount of money?

MR O'REGAN:

Yes, an amount of money, I would have thought so.

ELIAS CJ:

What's so special about bank accounts though?

WILLIAM YOUNG J:

Well, it could be in cash, couldn't it, if someone put it all –

MR O'REGAN:

It could be in cash.

ELIAS CJ:

Yes, well, money.

GLAZEBROOK J:

Well, it probably was, actually, in the times when wages were handed out.

ELIAS CJ:

Yes.

GLAZEBROOK J:

Because in fact you could have actually paid – just to get to the next point – you could have actually paid the gross amount to the employee, so you actually aren't holding any money. You're just deemed to be. In fact, the employee's holding the gross amount of money in his or her brown envelope which used to be the way that wages were given.

MR O'REGAN:

That's true, Your Honour. You could pay the gross amount and that is definitely dealt with in the Act.

GLAZEBROOK J:

There may be not only a notional deduction but there has been no deduction, in fact, apart from this deemed deduction.

MR O'REGAN:

Yes. Well, even in that circumstance, Your Honour, of course, where they haven't made the deduction they're still deemed to have made the deduction and that deemed deduction will be subject to the trust. So notwithstanding that a gross amount has been paid to the employee, I don't think that changes much. There's still the deemed deduction. There's still the trust, which must be deemed by logic because the deduction is deemed notional. It is a very unusual sort of arrangement, but giving effect to it in this way makes perfect sense of it as long as there's money held in trust and, as I said at the beginning, if it's not money held in trust then the case is over. If it is money held in trust, then we're down to just that simple point of whether the subsection (1) words "remain apart" apply or the subsection (2) words "upon liquidation" apply. Now, in the Commissioner's submission, the giving effect to subsection (1) by using the words, by giving effect to those words, is the best way to rationalise the position between the two sections. Otherwise subsection (1) has, I would think, virtually no effect including, as I say, protection from claw-back.

WILLIAM YOUNG J:

So how did Justice France deal with the last words of section 167(1)? She treats 167(1) as spent when the company gets into liquidation.

MR O'REGAN:

I ran into her at one stage and said to her, "You say that by the interpretation of the majority you give no effect to the words of subsection (2)," and I said, "By your way, you give no effect to the words of subsection (1)."

WILLIAM YOUNG J:

Well, did she give her reasons?

MR O'REGAN:

No, it's not dealt with, it's not dealt with, Your Honour.

WILLIAM YOUNG J:

Okay. Unless it's meant to mean that at the claw-back rules that would otherwise apply post-liquidation et cetera don't apply. Even that's not quite right, actually, I think.

GLAZEBROOK J:

I thought she envisaged that there was payment after liquidation then the trust applied.

ARNOLD J:

That's the way I interpreted what she said.

GLAZEBROOK J:

So the trust only applied to matters that remained unpaid but not due at liquidation and the trust applied to that, and I think that is accepted by the appellant but in this case, of course, not applicable because all of the payments were due before liquidation.

MR O'REGAN:

Yes. That implies, though, obviously, that the setting apart words are not applicable.

GLAZEBROOK J:

That's set apart from liquidation because normally it would come under 167(2) but if you have a payment after liquidation and there is money to make it, then it's made, is how I'm reading it.

WILLIAM YOUNG J:

I'm looking at paragraph 75 of her reasons and if the tax is unpaid at date of liquidation then the trust comes to an end.

GLAZEBROOK J:

But due and unpaid is how I'd interpreted that rather than – well, that's what they said in *Smith*, of course.

ARNOLD J:

Yes. If you look at paragraph 64, Justice France sets out section 167(2), deals with this situation where PAYE is deducted and has fallen due prior to liquidation.

MR O'REGAN:

Yes, but that is a fair way of looking at it but the point I'm making, Your Honour, is that because lateness and holding and separating et cetera are not relevant up until the point of liquidation, the point we're making is that the lateness makes no

difference to whether or not this is money held in trust if you accept the fluctuating bank accounts analogy.

GLAZEBROOK J:

Well, she may agree with that up until the point of liquidation, protecting everything under *Smith* before liquidation.

MR O'REGAN:

To get to her answer, though, you have to say that if that is money held in trust, which I think she seems to be accepting, then the words "remain apart" are ignored but you go to the "upon liquidation" words in subsection (2) and that means that you have got a situation where a trust is terminated by the wrongful act of the, in this case, trustee.

GLAZEBROOK J:

Well, it's terminated by virtue of section 167(2) which says so. That's what she would say, I'm sure.

ARNOLD J:

It's terminated by two things. There are two conditions to 167(1), one, that there's been a failure to meet the obligations, and two, there's been a liquidation or receivership of something else.

MR O'REGAN:

Yes. What is the failure to meet the obligation? That is the failure to pay it on time.

GLAZEBROOK J:

No, to pay at all, probably.

MR O'REGAN:

Well, pay it on time, I think it is. Pay on time.

ARNOLD J:

It certainly seems to me that where there's a late payment prior to liquidation there's a strong argument that that is paid pursuant to the trust obligation. But it's the intervention then of the liquidation that changes the character in which the money is held.

MR O'REGAN:

That's the point you made about the late payment being protected is the point that I've been making about the words of subsection (1). Because right up until – even though that payment was late, the payment that hadn't been made, the \$14,000 was still money held in trust because late payment doesn't affect it prior to liquidation. So therefore when you get to the point of liquidation there is money held in trust for the Crown. The Commissioner's submission is then the words "in the event of liquidation, it shall remain apart" apply. It doesn't matter if it's late because it's money held in trust. Then you get to the situation where there's no money held in trust, there's late payments due, and they all fall under the seventh schedule under subsection (2). What your position means is, as I've said before, you have to then say that the trust comes to an end, and I know you're saying it's because the statute but the statute only applies because of the wrongdoing of the employer. The employee's money or the Commissioner's money, whichever way you look at it, is converted by the wrongful act of the employer not paying on time to the general pool, to his own property.

ARNOLD J:

But aren't you sort of – I can't remember the expression, running with the hares and hunting with the hounds or something. What you're saying is that under section 167(1) there's this very odd sort of trust. You don't need a corpus and you just – so it's a statutory trust which has to operate in ways that don't fit neatly with our traditional concept of trust. To me, that has a lot of force, but I think the flip side of that is that when it comes to the operation of section 167(2), you can't really go back to the fundamental notions of trust and try and assert a sort of traditional view of trust in that context. The point is that this is a statutory construct in terms of subsection (1) and another statutory construct in terms of subsection (2).

MR O'REGAN:

I can't deny the – I haven't tried to rely on, you know, the fact that the trustees are given the benefit of the doubt and deemed to be honest, and therefore the money will definitely be money held for the Commissioner. I haven't tried those sorts of things because I agree with you. You can't have your cake and eat it. I am only here applying what was said by what was said by the Court of Appeal in Smith and to me it makes a lot of sense.

WILLIAM YOUNG J:

Can I just tease this out a little? The argument that's been put to you based on the interpretation of the judgment of Justice France that has been offered, is that on liquidation the trust terminates, save in relation to payments which have not yet fallen due for payment. Now, if you look at section 167(1), it says that in the event of bankruptcy or liquidation, shall remain apart from for no part of the estate. Now, those words have to be construed with some vigour to say that they have no application where the money has already fallen due for payment, because the criticism of the approach of Justice Ellen France is that she is saying that contrary to what those words say, the assets in question don't remain a part and form no part of the estate where the underlying debt has already fallen due. It would be an odd distinction that the Commissioner is better off in relation to payments already in arrears than payments yet to be in arrears. There's not much logic to me in that distinction.

GLAZEBROOK J:

But that's because section 167(2) says that. I mean, it's not that you would construe it just by itself as saying that, but the difficulty is that 167(2) suggests that. That's unless you take the Canadian provision that says that 167(2) is effectively a non-existent – unless it's held in a separate account.

WILLIAM YOUNG J:

Section 167(2) and 169 really only apply to the extent that the trust doesn't apply. They come in behind the trust.

GLAZEBROOK J:

Well, that's the argument for the questioner. It doesn't seem to be the way that the sections were meant to operate because what it actually means is that the Commissioner comes in ahead of the wage and salary earners which most of the reports indicate is not the intention. It's all very well being moral about it not being the employer's money but the employee's money, but in fact what's happening is the Commissioner's getting priority over the wages and salary despite the priority in Schedule 7 that's referred to in subsection (2).

MR O'REGAN:

I don't use the word "priority", as you know, because it's trust money.

GLAZEBROOK J:

I understand that, but this is the actual effect.

MR O'REGAN:

The priorities are dealt with under Schedule 7 and the Commissioner falls third behind salary and wage earners and behind the – this is not a situation of priorities. This is a trust, and –

GLAZEBROOK J:

Well, you say that but why would they say we are wanting to make sure the Commissioner doesn't get in before the wage and salary earners, and then put in a very odd provision in respect of trusts which isn't a real trust that means the Commissioner does have priority.

MR O'REGAN:

With respect, Your Honour, you seem to be adopting a section from Hansard as the law. Just because somebody in Parliament expresses a view, usually ill-informed, about what the purpose of a statute is, doesn't really have any influence, with respect, on our thinking of it.

GLAZEBROOK J:

Well, it usually does, in fact. It's just looking at what the purpose is, but in any event, just looking at the words themselves you have a policy in 167(2) which sets out that wages and salaries come above the Commissioner.

MR O'REGAN:

All I can say is that we have a situation where if it is determined that the 14,000 was money held in trust you have to ignore completely the "remain apart" and "form no part of the estate" words to make – to get it into subsection (2). If you do that, that's fine. That's the choice you're entitled to make. The suggestion we're making, the Commissioner is making, through our submissions is that you don't have to give disservice to one set of words in favour of another. Both of them operate logically and consistently. If the money is money held in trust at the time of liquidation, then subsection (1) words apply. If there's no money held in trust, which is the vast majority of cases, subsection (2) words apply if the payments are late, et cetera, so to me there is no question that there is any need for there to be an Act whereby the trust fails, which is what we have to come to.

GLAZEBROOK J:

Well, the only other way of interpreting it is the way the Chief Justice has been suggesting, that they only apply to monies that have been held apart, which wouldn't be your preferred option, either, or the Commissioner's preferred option, I imagine.

MR O'REGAN:

Well, I think they're both as bad, frankly.

ELIAS CJ:

But if you're only dealing with words and not the reality of what's being going on out there and throwing everything into chaos, then it is all reconcilable. But the problem is we've had a – we've got to take account of the real world. What we're trying to do in this courtroom is focus on the words, and words have to be pushed.

MR O'REGAN:

Well, they have to be pushed in terms of old trust principles. They certainly don't have to be pushed to decide that any amount that's held in trust on liquidation is paid under section 167(1).

ELIAS CJ:

I tend to agree with that, I must say. You've probably covered everything that you wanted to take us to, haven't you, Mr O'Regan?

MR O'REGAN:

I think I probably have, Your Honours, yes.

ELIAS CJ:

I think we really do understand the force of your argument, but if there's anything else you want to add, we'll sit until 5.00.

MR O'REGAN:

To be truthful, I think I probably have said ...

WILLIAM YOUNG J:

You don't rely at all on the fact that some of this money was, in fact, segregated before liquidation?

MR O'REGAN:

No, because it's not the same money or anything and we don't ...

WILLIAM YOUNG J:

Well, it's exactly the same money. It's the \$14,000.

MR O'REGAN:

It was segregated when it was in an account.

WILLIAM YOUNG J:

Yes, but no longer available for any purpose other than meeting tax.

MR O'REGAN:

That's only by accident at the time.

WILLIAM YOUNG J:

I know it's only by accident. What I am interested in is whether you rely on it or not.

MR O'REGAN:

Our position is that the trust is akin to a floating charge of the bank account, so therefore what we're saying is that the money is money held in trust.

WILLIAM YOUNG J:

I understand the argument, but if the case turned on something which took the money out of the control of or separated it from any other assets of the company, would you rely on the fact that, in fact, it had been separated out by reason of the notice? I know it's accidental.

MR O'REGAN:

Well, actually, that's a very interesting point because you've got a situation there where you could have it completely separated out but late. What would be the situation then? On the appellant's submission, notwithstanding that you've got all the money sitting there waiting to be paid to the Commissioner but it's late. You'd say, oh, well, subsection (2) applies. That's how extreme it becomes.

WILLIAM YOUNG J:

Do you entirely abandon any argument based on the fact that the money had, by accident, come to be segregated by reason of the statutory notice?

MR O'REGAN:

No, Your Honour. That wouldn't help us in terms of the overall interpretation of the section.

ELIAS CJ:

You're not worried about the \$16,000. You're worried about the point of principle.

MR O'REGAN:

I understand. You're talking about section 157. The whole point of this case, really, is to get a ruling on how this section works. If we complicated it by bringing in the section 157 separation, which just happened to be an accident in history in this case, that would have not meant that we had a meaningful result unless we suddenly decided to issue 157 notices as a matter of course willy-nilly from then on and we might end up with something. Normally 157 notices don't operate like that. They operate on an immediate transfer. For some reason here, the bank didn't pay the money to the Commissioner until sometime later, so normally there would never be any segregation.

WILLIAM YOUNG J:

If the bank had followed the normal course and paid the money, then that would be a possibly significant wrinkle?

MR O'REGAN:

If the bank had paid the money under the theory that's been put forward for Her Honour, for instances, and Justice France's theory, that would be all right because notwithstanding that it was late it was paid before liquidation and therefore it was okay because the lateness and things doesn't apply until subsection (2) applies, which is upon liquidation.

WILLIAM YOUNG J:

Okay.

MR O'REGAN:

So, yes, that would've been okay, if the money had've been paid for that to the, to the Commissioner by the bank, because it would've meant that the company has effectively paid it prior to liquidation.

Anyway, Your Honours, there's probably not much more I can say. I pass on to my colleague Ms Courtney.

ELIAS CJ:

Thank you. Thank you Mr O'Regan.

MS COURTNEY:

Your Honours, it is probably a little awkward to do this in that part, the first part of what I'm intending to say relates to the legislative history and was obviously covered slightly by the appellants earlier this morning but I do think that there are a couple of things which I can usefully add, and so I don't start at the 1936 employment promotion position but at the 1954 Companies Act and section 308 of that, and that's at the appellant's bundle 1, page 18.

GLAZEBROOK J:

Page 18 did you say?

MS COURTNEY:

Yes.

And that provided for preferential payments in a winding up. Wages or salary came first, holiday pay second, workers' compensation and then a catch-all provision in (d), all sums required by any other enactment to be included among the debts which are to be paid in priority to all other debts in the winding up, and the debts were to rank equally among themselves. And that was section 308(4)(a) over the page. And then Your Honours asked about the introduction of PAYE, and that was in 1957, and the Income Tax Assessment Act 1957 which is at page 26 of that volume is the next part of the statutory jigsaw, and...

ELIAS CJ:

Sorry, was there any point that you wanted us to draw from the Companies Act provision?

MS COURTNEY:

Just the – how they fitted in relation to each other, Your Honour.

ELIAS CJ:

Yes.

MS COURTNEY:

And when the Land and Income Tax Act was enacted it carried on the Social Security Act provisions and the wording, “shall remain apart”, which is at the end of section 167(1) came into that section. And it was also –

ELIAS CJ:

What page are we at?

MS COURTNEY:

– the first – sorry Your Honour?

ELIAS CJ:

What page?

MS COURTNEY:

Oh, 26, Your Honour.

ELIAS CJ:

Thank you.

MS COURTNEY:

Sorry, 21, 22. And that’s in 31.1 –

ELIAS CJ:

Yes.

MS COURTNEY:

– at the top of that page. And following on that, in 31.2, that was the first introduction of what is now section 167(2) and the failed to deal wording

Then the next part comes after the *Westmoreland* case, which was the Land and Income Tax Amendment Act 1968 in 1968, and there section 42 of that section, and that's at page 26 of the same bundle, at page 27 there's a section, subsection (3), and that says, "This section shall apply notwithstanding anything in any other Act and in particular section 308 of the Companies Act, and that's now in section 167(3) of the current Act, the Tax Administration Act. And that, that amendment Act was also the first time that the charge over real and personal property was included in the Act as set out as well. And so then –

GLAZEBROOK J:

There were charges earlier.

MS COURTNEY:

Sorry, sorry, yes Your Honour, there were. That's right. But what is now section 169 –

GLAZEBROOK J:

All right. Separated out.

MS COURTNEY:

– that's – yes.

GLAZEBROOK J:

Yes.

MS COURTNEY:

Yes Your Honour.

And then following on from that there was another amendment to the Companies Act in 1980 and there was a cap on priority brought in at that time. But those were really the two or three main points that I thought possibly hadn't come out of the legislative history this morning.

In terms of the reform of the Crown preference and the policy reasons for, the appellants referred to a Law Commission paper and that's in the appellant's bundle, volume 2, at page 523, and it sets out there the competing policy arguments for the preference, and I want to draw in particular attention to the one which is at –

ELIAS CJ:

Sorry, can you just tell me again where to find it?

MS COURTNEY:

Oh, it's in the appellant's bundle of authorities, volume 2.

ELIAS CJ:

Yes. Page?

MS COURTNEY:

523 it starts.

And right at the very bottom it has a number of bullet points but the one in particular that I want to draw the Court's attention to is the final of those bullet points where it refers to PAYE, resident withholding tax, non-resident withholding tax, accident compensation, child support and student loans representing moneys payable by the debtor to the Commissioner on behalf of another person. Thus it's argued that there is an analogy to the law of trusts so that the debts should be afforded priority even though the moneys may have been mingled with other fungibles and are therefore no longer traceable. And that's part of the policy that the Commissioner relies on.

And below that, not referred to in this paper but, and I won't take Your Honours to it either, but there is an article in the bundles where another argument that's referred to is, "If no priority or trust is imposed the moneys collected by the debtor will increase the estate for the benefit of unsecured creditors. It cannot be right that statutory provisions enacted for the more convenient collection of the revenue should (inaudible 15:53:00) benefit of private creditors," and that is at the respondent's bundle of authorities, volume 1, at tab 17, and in particular at page 465 of that tab. But there's no need to go to that, Your Honours.

GLAZEBROOK J:

Although they don't in this case, do they, because the Commissioner's a preferential creditor. This is all that's been discussed.

MS COURTNEY:

These are reasons why there is a preference.

GLAZEBROOK J:

It's not a reason – and the Commissioner is, has a preference. I'm just not sure where it gets you. Sorry, that was the question.

MS COURTNEY:

Oh. It explains the – why the priority comes high up when you get into – first of all the trust under section 167(1) but then if there is a default in that in that, and so you then cascade into section 167(2), the Schedule 7, why it comes high up in the priorities there.

WILLIAM YOUNG J:

So do you say section 167, the recommendation was that that should be repealed, section 167(1)? It's implicit I think that it should be persistent.

MS COURTNEY:

The – it's – it was certainly the Law Commission did consider that it should be repealed but it never was. And similarly there were a couple of other occasions too when the Companies Act 1993 was enacted and also the introduction of the Insolvency Law Reform Bill, you know, similar arguments were made but it never was put into effect.

WILLIAM YOUNG J:

Okay. I think they did recommend it although in rather general terms in 133. They're treating – that's assuming section 167(1) is a priorities provision, which...

GLAZEBROOK J:

Well, I thought they actually said you should keep the priority provision for the rather stupid reason which isn't even true at 112.

WILLIAM YOUNG J:

I think 114 (inaudible 15:55:15) priority for PAYE but in a modified form, that's 114 and then 132 they set out that the, these more specific recommendations.

GLAZEBROOK J:

Yes, it's just that the arguments for priority – well, in fact, 113 seems to be in accordance with the view of the Chief Justice the trust in 167(1) is only if it's set aside

and as it's not it's not much use. If you look at page 527, paragraph 113, "A remedy in trust will not be available where moneys have been mixed with other fungibles in the right to trace loss," which is what the Canadian cases say of course.

MS COURTNEY:

But the Commissioner's view, Your Honour, is that –

GLAZEBROOK J:

Well, they just, they want to rely on some of it but not other bits so I can understand that, but paragraph 113 is directly in accordance with the view of 167(1) that the Chief Justice suggested that has been decided in Canada.

MS COURTNEY:

Your Honour, the Commissioner submits that section 167 remains on the statutory books and so despite the Law Commission's recommendation –

GLAZEBROOK J:

Well, they say, they say it's useless because it's not set apart, so it might remain on the books but it's a useless provision.

ELIAS CJ:

It's only an argument, it's only, it's only cited by both of you in terms of arguments, it's not authoritative so you don't need to worry.

MS COURTNEY:

No, Your Honour, it doesn't, that's right, Your Honour.

ELIAS CJ:

But the Cork report might be useful. What – when was that?

MS COURTNEY:

Ah, 1968. We do have an extract from it in the bundles.

GLAZEBROOK J:

It may actually have been on other grounds because it's sort of individual suffering for the general good, so I think it was an argument about whether there should be a priority for the revenue which is a different argument from what we're looking at now.

MS COURTNEY:

And the 1982 –

GLAZEBROOK J:

Sorry, I've only taken that from what was said for the Law Commission at page 525 that's all that ...

MS COURTNEY:

The extract that we've got in the bundles, Your Honour, is respondent's bundle of authorities in volume 2 at tab 20 and it was 1982, but the position in the UK moved on and the legislation was amended in about 2002 and a copy of that is in the Commissioner's bundle as well.

GLAZEBROOK J:

And that's basically no priority isn't it?

MS COURTNEY:

Yes, Your Honour. And then –

GLAZEBROOK J:

No, I've found your volume 2 through our system. So what, what tab was it did you say?

MS COURTNEY:

That was at 20.

GLAZEBROOK J:

Thank you.

ELIAS CJ:

"In our view the ancient prerogative of the Crown to priority for unpaid tax cannot be supported by principle or expediency." Different where it's PAYE though.

MS COURTNEY:

Yes, Your Honour, and –

ELIAS CJ:

Yes, I see.

MS COURTNEY:

– and the preference having been maintained it's in respect of quasi-contract – quasi-trust type debts such as PAYE, deductions for child support, deductions for student loan, Accident Compensation levies which are taxpayer amounts and then also goods and services tax, non-residential withholding tax and resident withholding tax and it's submitted that it's a clear indication of parliamentary intention that that section 167 remains in the statute despite there having been requests on a number of occasions that it not continue.

Your Honour, quite a lot has been said already and I don't want to go over it too much about the *Smith* case apart from to say that in that case the Court of Appeal had accepted that normal trust principles do not apply if to apply those principles would subvert the purpose of the statute being achieved and that's at paragraph 11 of that decision.

Most of the other points that we wanted to make about that case have already been covered before Your Honours. It is, as we say, not on all fours with this case because of all of the money having been paid to the Commissioner ahead of the liquidation occurring whereas in this case that's not the facts, and we submit that *Westmoreland* is distinguishable because the issue in that case related to the ranking of PAYE deductions compared to debts with high priority under s 308 of the Companies Act and the holders of debentures under a floating charge, and that position was clarified by the legislative amendment in 1968 and so in our submission that case again is distinguishable, so again not on point.

ELIAS CJ:

Thank you Ms Courtney.

MS COURTNEY:

Thank you.

ELIAS CJ:

Yes Mr Johnson.

MR JOHNSON:

The first point I want to address in reply is the section 169 charge a little bit more because the suggestion during the respondent's submissions was that it wouldn't be able to have any –

WILLIAM YOUNG J:

Would never work.

MR JOHNSON:

It would never work. And the reason that was given was because the registration provisions, being one, I think one of the things that was put at, put forward. But in my submission 169 creates a charge. That charge gives a secured position. Now registration in 169 only relates to the priorities as between secured creditors. It doesn't change the fact, and my friend confirmed that, that the charge is still in place. Now what that means is that any payment received pursuant to that charge is still a payment to a secured creditor. So what that means is that those payments cannot be challenged under section 292. Registration doesn't come into that situation.

GLAZEBROOK J:

Can we just check the section for that? Because I thought the submission was that it said it wasn't valid against the liquidator. So do you want to just...

MR JOHNSON:

On that, on that, so the argument there is section –

ELIAS CJ:

Can you take us to the section, sorry, so that we have it in front of us.

MR JOHNSON:

Yes, it's 84 is section 169.

GLAZEBROOK J:

And where's – it's 169(9) is it?

MR JOHNSON:

(10).

GLAZEBROOK J:

(10).

MR JOHNSON:

Which is –

GLAZEBROOK J:

Oh it applies subject to 167 but where's the registration bit?

MR JOHNSON:

Registration provisions are referred to –

ELIAS CJ:

Sorry, I still haven't found it.

WILLIAM YOUNG J:

Sorry what page are we looking at?

GLAZEBROOK J:

It's the coloured bundle, page 84. Volume 1.

WILLIAM YOUNG J:

84.

MR JOHNSON:

We are just focusing on section 169. It goes from page 84 through to 88. Now, throughout 169 there is references to registration and the effect of registration vis-à-vis other secured parties.

GLAZEBROOK J:

And you say that just affects priorities?

MR JOHNSON:

Yes.

GLAZEBROOK J:

Which it looks like it does.

MR JOHNSON:

I, I do. I do. And –

GLAZEBROOK J:

But where's the – where does it say it's not valid against the liquidator? Because I thought –

MR JOHNSON:

That's subsection (10).

GLAZEBROOK J:

Well that just – on my thing that just says, "This section shall apply subject to 167."

MR JOHNSON:

Yes. And what – so –

GLAZEBROOK J:

Which doesn't actually say it doesn't apply to a liquidator.

MR JOHNSON:

No. No it doesn't. so – but what I, how I read section 1 – subsection (10) is that upon liquidation, and –

GLAZEBROOK J:

So you say upon liquidation the priorities are as set out –

MR JOHNSON:

Yes, rather than –

GLAZEBROOK J:

– in 167(2)?

MR JOHNSON:

– the charge provisions. But that –

GLAZEBROOK J:

But when – but that doesn't matter to your argument.

MR JOHNSON:

No, because the payments had been made prior to liquidation as to a secured creditor.

GLAZEBROOK J:

Right.

MR JOHNSON:

So that's why I say there's real strength in 169 in countering this concern that the Commissioner has in relation to 292.

GLAZEBROOK J:

So you say *Smith's* right but for the wrong reason? Is that –

MR JOHNSON:

And I'll come on to that for – and that's actually my next point is, and I made the point earlier that *Smith*, 169 was never referred to in *Smith*. At all. That was just overlooked.

ELIAS CJ:

You make that point in your submissions.

GLAZEBROOK J:

Yes.

MR JOHNSON:

And I'm not going to say it again. Sorry.

ELIAS CJ:

No, no, you can say it again because it's useful –

GLAZEBROOK J:

Yes.

ELIAS CJ:

– for us to have it.

MR JOHNSON:

All right.

ELIAS CJ:

I hadn't really appreciated it when I read it in your submissions.

MR JOHNSON:

Now, then I want to go to the position in *Smith*, which is – their reference in to the charge – no, sorry, to the trust in fact being a trust over all the assets of the employer. That was at page 201 of the first volume of the appellant's bundle.

WILLIAM YOUNG J:

Sorry, can I just pause there? What's the provision in section 292 that exempts payment made under a charge?

MR JOHNSON:

Section 292, in my submission, is a payment made to a creditor, and creditor is defined as being a creditor proving in the liquidation, would've, would've – is a payment made to a creditor that would've enabled that creditor to receive more in the liquidation than they actually received. Now in my submission if you get paid as a – that provision –

WILLIAM YOUNG J:

But there's nothing there that says exempts payment made under a charge explicitly.

MR JOHNSON:

In my submission, and I probably haven't put it very well, a payment to a secured creditor is not captured by section 292.

WILLIAM YOUNG J:

Well I'm not sure that's right. It's just simply a payment made to a person which enables that person to receive more in satisfaction of the debt than that person would receive or would be likely to receive on liquidation. That's what you're talking about it isn't it?

MR JOHNSON:

Yes, that's the section 292.

WILLIAM YOUNG J:

Well why wouldn't a payment – why wouldn't the payment in *Smith* have been caught under that?

MR JOHNSON:

Because if it didn't then any payment to any secured creditor –

WILLIAM YOUNG J:

No, no. Because that would be – because the security here's so useless that any payment to the creditor in this case gives that creditor an advantage. Normally a payment to a creditor who's secured isn't going to have that effect.

MR JOHNSON:

But a payment made to a secured creditor, which is what the payment was at the time of the payment, is one that is never clawed back in a liquidation.

WILLIAM YOUNG J:

Even if it does give that person an advantage they wouldn't otherwise receive?

MR JOHNSON:

Yes, because their payment is pursuant to the security rather than –

WILLIAM YOUNG J:

Well no, we're just saying that, but is there authority for this or is this just your, what you, how you construe that provision?

MR JOHNSON:

It is how I construe it Sir.

WILLIAM YOUNG J:

Okay.

MR JOHNSON:

Payment made – because the rules under 292 are all about addressing the pari passu requirements.

ELIAS CJ:

So once that aspect has been cleared away and all the secured creditors have been treated pari passu –

MR JOHNSON:

All the unsecured creditors.

ELIAS CJ:

All the – I thought registration was, I may be quite wrong in this, what's the effect of registration?

MR JOHNSON:

Registration is a, effects as a competition between the priorities (inaudible 16:10:32).

ELIAS CJ:

Yes, so that sorts out the priorities between them so if a secured creditor doesn't gain an advantage in that pool, you say there's no, that he's not caught by section 292, is that what –

MR JOHNSON:

What I'm saying –

WILLIAM YOUNG J:

Right, say I've got –

GLAZEBROOK J:

No, probably what does happen is that if you've got a first priority you'd then sue, so it could be the Commissioner could lose priority this way but you'd say, well, that's just because, that's the way the priority would work.

ELIAS CJ:

Yes.

WILLIAM YOUNG J:

Well, yes, but we're going back to *Smith* for a minute – say I have a fifteenth mortgage and I'm also the creditor's brother, the debtor's brother and so right on the eve of bankruptcy I get paid the entire amount of my mortgage –

MR JOHNSON:

Yes.

WILLIAM YOUNG J:

– whereas the debt is hopelessly insolvent and there's no way that anyone other than the first mortgagee is going to get any payment, wouldn't I, wouldn't that be able to be clawed back under this section? Because wouldn't I be a person who received more towards satisfaction of a debt than I would have received on liquidation?

MR JOHNSON:

In my submission, no, because what happens upon a liquidation is that, first of all, all secured creditors then still in existence have to be paid in the order of –

WILLIAM YOUNG J:

But I'd get nothing –

MR JOHNSON:

Yes, yes.

WILLIAM YOUNG J:

– on the liquidation I'd get nothing whereas on this scenario I've got a lot of money.

MR JOHNSON:

How, in my submission, it works is that upon liquidation, first of all, the liquidator is required to make all payments pursuant to the secured position so in order of payment to secured creditors, one, two, three, four, 13 you said –

ELIAS CJ:

15.

MR JOHNSON:

15. What happens then is if there's money left then you got to the seventh, Schedule 7 preferential and you pay those out in the correct order.

WILLIAM YOUNG J:

But can I beat the priorities by scooping the pool on the eve of liquidation?

MR JOHNSON:

You haven't beaten the priorities. If you get paid as the fifteenth secured creditor, then the people who can come after you are the 14, 13, 12 and 11 secured creditors.

WILLIAM YOUNG J:

But couldn't – on what basis would they come after me?

MR JOHNSON:

Because you have received money that should have gone to them I guess. No, sorry, that just jumped into my head, so ...

WILLIAM YOUNG J:

But couldn't the liquidator do it too?

MR JOHNSON:

The liquidator could do it on their behalf but would still then have to distribute pursuant to –

WILLIAM YOUNG J:

Absolutely.

MR JOHNSON:

– that arrangement which means you're not getting the unsecured creditors –

GLAZEBROOK J:

I think – don't you set aside the charge –

WILLIAM YOUNG J:

Well, no, but I've got – the charge is a good, but I've got a really good charge –

GLAZEBROOK J:

– there's a – you don't set aside the transaction. Well, I'm not, I'm not sure I think, I think you ...

WILLIAM YOUNG J:

It's a voidable charge but that's when charges, the charge itself is given –

MR JOHNSON:

293, yes, yes.

WILLIAM YOUNG J:

– and that's a preference.

GLAZEBROOK J:

Yes.

WILLIAM YOUNG J:

But anyway, well, we may just have to look at this because at the moment, you can't take us to any authority on this?

MR JOHNSON:

No I can't and I accept that. Can I, I'll just make one more point about that though that in terms of how this works, in my submission, the section 292 is all about, in terms of the unsecured creditors, it's all about the obligation to treat them *pari passu* equally other than the issue of preferential, so if you had a charge, when you got paid pursuant to that charge that never effected the *pari passu* arrangement, that's my submission. In terms of *Smith*, if I can go to page 201 of the, my, of the appellant's first bundle and this is the sentence, "Consequently, a portion of the employer's assets to the value of such deduction may be regarded as impressed with the trust in favour of the Commission." Now, it's that statement that I have problems with because even as the Commissioner is arguing, the trust is only over the account, the cash amount. In my submission, what the Court in *Smith* was actually getting at was – is addressed by the charge because that's exactly what the charge gives, because if you substitute the word "trust" there for the word "charge", the section 169 charge, you've got, "Consequently, a portion of the employer's assets to the value of such deduction must be charged in favour of the Commissioner." That's what section 169 does, and that is not a trust. That is a charge.

GLAZEBROOK J:

Well, you're saying that that's what they're saying in the next sentence, that because it's a trust as in mixed funds, you have a charge on it?

MR JOHNSTON:

Yes, and again, that's consistent with the charge under section 169 because the crucial point, and I've heard comments that section 169 is a charge not over the trust money, it's over all the personal assets of the employer, and in my submission that is a powerful beast and it includes the money because assets include the bank account as well.

WILLIAM YOUNG J:

But to the extent on which section 167(1) applies, there can't be a charge because the money already belongs to the Commissioner.

MR JOHNSTON:

Yes. That's right.

WILLIAM YOUNG J:

So they're mutually exclusive.

MR JOHNSTON:

That's right. I agree with that, and that's not what the respondent has submitted, I think. That's why I'm saying you have your – if the trust has been constituted and there is money there, if it's at that stage, fine. You're not going to go to 169 but if something goes wrong, there is a breach, then 169 is not there any more. Then what happens is you can go to your charge and of course the money that was in trust then has gone and – because it's been misappropriated or misapplied it's effectively gone into the personal assets, then it becomes subject to the charge.

A question was put as to what concessions the Commissioner has previously made in relation to these provisions. I think that's worthwhile because if we're talking about fundamental changes about how business is going to be done and application of this provision, then we need to look at why have we been working in this way for the last 50 years? So I would like to take you to those concessions. The first is at page 145 of the bundle. This is the one I referred to earlier in *Re Westmore* where it said "Mr Palmer" – this is down the bottom – "Mr Palmer was prepared to accept that

subsection (1) applies only to the unlikely event that an employer who has made a tax deduction and not paid it as the Act requires him to do is still holding the money represented by the deduction so that on bankruptcy it is still in actual existence but impressed with the trust to which the subsection refers.” So that was the concession made there because that wasn’t the situation in *Re Westmoreland*. Now, what – my submission on that is was what you’re talking about is the actual deducted sum. That’s my take on that concession. The respondent’s position is that it, if money bounces back into the account or comes into the account it wasn’t the subject of the deduction but it was money that that comes back in, then that is still, can somehow be identified as the money the subject of the deduction. So that’s the first concession.

The next one is at page 189, and this is the second column, *In Re*, this is *In Re Smith* in the High Court, not the Court of Appeal, in the High Court, the concession was made page 189, second column, about – just over half way down where it says, “In the present case the defendant conceded that unpaid PAYE deductions lose the trust status upon a liquidation if the company has not put the money aside.” And then if – 187, second column, second bullet point, “That if the transactions had not occurred” that is the payment – in this instance it was the payment to the IRD, to the Commissioner, if the transaction had not occurred, “on the respective dates they did, then the defendant would only have been able to recover to the extent that it was accorded priority as set out in the Seventh Schedule to the Act.”

WILLIAM YOUNG J:

But that’s true isn’t it? Because the company, as we know, was in overdraft? Or was likely to be in overdraft.

MR JOHNSON:

Yes.

WILLIAM YOUNG J:

On any view of the position.

MR JOHNSON:

Yes.

WILLIAM YOUNG J:

Any view of the law I mean.

MR JOHNSON:

Yes. but if that – factually that’s correct but it can also be read as saying the payments weren’t made then they can only recover then they would only have been able to recover – the payments had not been made.

The next thing I want to raise is that the respondent indicated that not paying or not treating it in the manner required did not impact upon whether the section 167(1) trust remained in place. That was my understanding of the submission he made. But if we go to the majority decision in this case, and it’s in the case on appeal, paragraph 19.1, page 14 of the case on appeal, and this is the, the Court of Appeal’s reasoning, “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).”

And then it says, “When the employer has dealt properly with the PAYE deduction(s), s 167(1) provides that there are consequences: money held in trust and not the property of the employer”.

But (c), over the page, when the employer fails to deal properly with the PAYE deductions the threshold in 167(1) is not met and in those circumstances 167(2) applies. And that is what the appellant has been submitting to the Court and it applies with two consequences: the unpaid trust remains part of the employer’s estate and upon liquidation Schedule 7 applies. Now that’s what the majority interpreted 167(1) and (2) to mean. They then, they said, however, the trust remained in place in this instance and that these weren’t breached, these provisions weren’t breached because some non-trust money came back into the bank account. And therefore to the extent of that non-trust money a breach hadn’t occurred.

So the appellant agrees in terms of the workings of 167 and 169 with the majority, but doesn’t agree that what’s happened doesn’t constitute what’s in (c). Because what the appellant is submitting is that there was not a payment on time and the money, because of the overdraft, was not held.

ELIAS CJ:

You put that only on the overdraft?

MR JOHNSON:

Well, hmm, my submissions have been that if the – if the money is in an account, actually in an account, the positive thing, but is identifiable – so when we're talking about hold, hold apart, my submissions have been that, similar to *Re Hallett* if I'm going to argue orthodox principles, then if it can be identified or which includes the ability to trace then that's okay. And I accept Your Honour has talked about if it's not even in a separate account that might be the end of it – that's not...

ELIAS CJ:

So the test you're advocating is the ability to trace?

MR JOHNSON:

Well, yes, identifiable is really comes down to it's in there or if it's not in there it could be traced through to something else.

GLAZEBROOK J:

Trace money rather than trace through to assets though I'm assuming.

MR JOHNSON:

Only money. Only money.

GLAZEBROOK J:

So what you're really saying, well, is the example before, if you had 100,000 in your account and you had 40,000 PAYE at the time you were supposed to make the deduction and you never got below 40,000 then the trust would be over the 40,000.

MR JOHNSON:

Yes, but –

GLAZEBROOK J:

But if you get below the 40,000 then the trust would be only over, say, to 30,000 at any time then the trust is only over the 30,000.

MR JOHNSON:

And that's the classic equity-type reasoning in *James Roscoe*, except in –

GLAZEBROOK J:

Unless you've shifted it into another account in which case you can –

MR JOHNSON:

You can trace it.

GLAZEBROOK J:

– trace it into the other account.

MR JOHNSON:

In *James Roscoe* they don't talk about 100,000, they talk about \$100 down to 80, 60, 40, but the same thing.

GLAZEBROOK J:

Yes. So it's *James Roscoe*.

MR JOHNSON:

Yes, *James Roscoe*. *James Roscoe's* the one that says that, that very thing. You can only get in terms of the trust, you can only get in terms of what the trust fund is up to the minimum amount that was, that it's gone down to.

Effectively in fact what I should do is point out the specific wording, because I hadn't got it right. If you can go to volume 2, page 433? And this is in effect the interpretation from *Re Hallett*. So you've got, two-thirds of the way down, "Certainly after having heard in *Re Hallett* estates stated over and over again I should have thought that the general view of that decision was that it only applied to such an amount of the balance ultimately standing to the credit of the trustees as did not exceed the lowest balance of the account during the intervening period."

So as a result of that in *James Roscoe*, if you go over the page in 434, there was a balance in the account at the appropriate date of £385 but in the last paragraph it was confirmed that the only part of the balance of £385 which can be made available to the plaintiffs is the sum of £25, I think that number is, being the smallest amount to which the balances to the credit of that account had fallen. So if it goes down – it

goes down to a certain amount and that's where it is, because if other money comes in, that's not trust money we're talking about here, then that's not part of the trust fund. So that's traditional trust policy.

GLAZEBROOK J:

Traditional with a mixed account but not with just a totally trust account, presumably.

MR JOHNSON:

Yes, mixed account, mixed account. And there's also the comment in *Re Goldcorp Exchange Limited (in receivership)* [1994] 3 NZLR 385 (PC) that confirms that the trust fund is effectively destroyed, that's the Privy Council, *Goldcorp*, when the money is paid into an overdraft bank account, overdrawn account. I refer to that in my written submissions as well.

The other issue question was, that was raised, was what would be the point of having a deemed deduction if these sort of provisions as I am putting forward...

WILLIAM YOUNG J:

Don't mean anything.

MR JOHNSON:

Yes. And my answer –

WILLIAM YOUNG J:

Or don't mean very much.

MR JOHNSON:

My answer very much is the point I raised earlier, which this deeming provision, it actually serves a very important purpose, which is it protects the employee. Because once a deduction has occurred, that means the employee is off the hook and a deemed deduction does that. otherwise it's a gross amount and the employee becomes responsible.

WILLIAM YOUNG J:

But when – is section 167(1) the only provision that protects the employee?

GLAZEBROOK J:

No.

MR JOHNSON:

No.

GLAZEBROOK J:

No it's section 4(h) or something.

ELIAS CJ:

Yes.

ARNOLD J:

That's right.

GLAZEBROOK J:

Or 4 whatever it is, which isn't –

ELIAS CJ:

The definition thing.

GLAZEBROOK J:

– isn't interpreted correctly, in the Crown submissions, but –

MR JOHNSON:

But it is –

GLAZEBROOK J:

But it also relates to criminal liability of course because if you had a deemed deduction then you failed to pay that deemed deduction and therefore you've got a failure to pay.

MR JOHNSON:

Yes. It really distinguishes between – its purpose is to distinguish between the position where there has been a failure to deduct at all and a position where you go through a particular process, you pay the employees the net, and on that basis it's said to be a deemed deduction. And that has consequences about who is

responsible and who isn't responsible in terms of criminal liability. But it still does have – if there's money, if you use traditional trust principles, if there's money in the account then well and good. And it goes back to the policy really, and I'm not going to go any further on the policy thing, but yes there is reference to, "Oh, people have always done this." And they've used it for their capital. And that's, you know, the commercial reality and that's acknowledged. But is that the purpose of this trust? Is that what this provision is all about? If you look at the commentary of the Parliamentarians that's not what's suggested.

I don't have anything else.

ELIAS CJ:

Thank you.

Thank you counsel. We will reserve our decision in this matter but I'd like to thank you for a very interesting and rather difficult case, and I think we've all enjoyed the argument very much.

COURT ADJOURNS