# Statutory demands: practical points for tax practitioners

by Scott Morris, Barrister, Owen Dixon Chambers

**Tax agents are often appointed as the registered office of a corporate client and, from time to time, receive statutory demands sent by creditors addressed to their client requiring payment of a debt. The tax agent's receipt of the statutory demand constitutes effective service on the client company, giving the company strictly 21 days to respond. If the tax agent fails to inform the client of the demand, it may prejudice the client's ability to respond to it, with the consequence that the creditor may apply to the court to wind up the client in insolvency. In these circumstances, the client may look to their tax agent for the loss and damage caused by the agent's oversight in a claim for negligence. This article discusses some fundamental aspects of the statutory demand "scheme", suggests some practical tips, and highlights the critical need for tax agents to promptly alert their clients to the receipt of a demand and to recommend legal advice.**

A statutory demand is not merely a letter of demand. It is a specific type of demand made in a prescribed form and served pursuant to statute, that is, s 459E of the *Corporations Act 2001* (Cth). It is a mechanism by which a creditor may demand the payment of a debt, of $2,000 or more, owed by a company to the creditor.

If the creditor has not obtained a judgment in respect of the debt claimed, the statutory demand must be accompanied by an affidavit deposing to the fact that the debt is owed and that there is no genuine dispute in respect of the debt.

Once service has been effected, the company has 21 days to respond to the statutory demand. It can do so by:

1. paying the debt owed to the creditor;
2. securing or compounding the amount of the debt to the creditor's reasonable satisfaction[1] (what amounts to satisfactorily securing or compounding a debt will depend on the facts of the case, but a debt will be compounded if the creditor accepts a payment arrangement of the amount claimed or a different sum on the basis that the original obligation to pay the debt is discharged); or
3. issuing (and serving) an application in the Supreme Court or Federal Court seeking to have the statutory demand set aside on grounds that: there is a genuine dispute as to the existence or amount of the debt; the debtor has an offsetting claim; there is a defect in the demand; or "some other reason". If the creditor has obtained a judgment in respect of a debt, it is usually not possible to contend that there is a genuine dispute in relation to that debt — although it may still be possible to set the demand aside "for some other reason" depending on the merit of an appeal or application to set aside the judgment.

The 21-day period is a strict timeframe. It cannot be extended by agreement with the creditor or even by a court.

Failure to respond (by taking one of the steps identified above) within the 21 days available will give rise to a statutory presumption that the company is insolvent,[2] which will allow the creditor to commence winding-up proceedings against the debtor.

It is necessary at this point to recognise the purpose of the statutory demand, which was succinctly stated by Austin J in *Equipped Constructions v Form Architects*[3] as follows:

> "… the statutory demand procedure is not provided by the law as a mechanism for the recovery of debt. The function of a statutory demand is to facilitate proof of insolvency in a winding-up application by creating a presumption of insolvency if the demand is properly served and not met. Courts have said, time and again, *that the statutory demand procedure should not be used as a mechanism to apply pressure on a party who genuinely disputes the existence of the debt that is claimed.* The proper procedure for determining entitlement to an amount claimed but genuinely disputed is to take proceedings for recovery of the alleged debt, where defences may be raised and a decision may be made by the court." (emphasis added)

Accordingly, where there may be a genuine dispute as to the debt and a judgment has not been obtained by the creditor in respect of the debt before serving a statutory demand, there is a real risk that it may be set aside by the court.

## A note for creditors

If the debtor applies to the court and is successful in having the demand set aside, the creditor may expect an order requiring it to pay the debtor's legal costs of the court proceeding. These costs are likely to be substantial and often exceed $20,000. For this reason, the decision to serve the statutory demand should not be taken lightly.

Where judgment has not been obtained, creditors should consider the following points before electing to serve a statutory demand:[4]

– damages and other forms of unliquidated claims are not capable of supporting a statutory demand. Other claims not capable of supporting a statutory demand include, but are not limited to: contingent or prospective liabilities; claims where statutory preconditions to the recovery of the debt have not been met; unquantified/untaxed orders for the payment of legal costs in a proceeding; and distributions under a trust (as these are not a debt claim, they are a claim in equity);

– when hearing an application seeking to set aside a statutory demand, the most common issue for the court to determine is whether there is a genuine dispute as to

the existence or the amount of the debt claimed by the creditor. Relevantly, this is a low threshold. McLelland CJ in Eq, of the Supreme Court of New South Wales, in *Eyota Pty Ltd v Hanave Pty Ltd* observed:[5]

> "… that expression [genuine dispute] connotes *a plausible contention requiring investigation*, and raises much the same sort of considerations as the 'serious question to be tried' criterion which arises on an application for an interlocutory injunction or for the extension or removal of a caveat. This does not mean that the Court must accept uncritically as giving rise to a genuine dispute, every statement in an affidavit 'however equivocal, lacking in precision, inconsistent with undisputed contemporary documents or other statements by the same deponent, or inherently improbable in itself, it may be' not having sufficient prima facie plausibility to merit further investigation as to [its] truth." (emphasis added);

- before the creditor serves a statutory demand, it can be useful for the creditor[6] to speak with the debtor by telephone and ask the debtor when payment for the debt is likely to be received. Debtors will often be inclined to make a promise to pay the debt on a certain date in the future, and in doing so, they (perhaps arguably) make a concession to the effect that the debt is due and payable. A contemporaneous file note of the debtor's promise to pay can be useful evidence;
- debtors will often (but not always) ask for the statutory demand to be withdrawn if they consider there are reasonable grounds for the statutory demand to be set aside. In circumstances where the demand is withdrawn without a resolution of the dispute (or without an agreement in respect of the costs incurred by the debtor in responding to the statutory demand), the timing of the withdrawal has important implications. If the withdrawal ultimately occurs after the debtor has issued and served its application to set aside the demand, the creditor may expect to receive an order that it pay the debtor's costs of making the application. Conversely, if the demand is withdrawn and the debtor then proceeds to make its application to the court, the court has no jurisdiction to hear the application (so the application will be dismissed with costs to be awarded in favor of the creditor); and
- creditors should also be aware of the risk that a payment in response to a statutory demand may become the subject of an unfair preference claim if the debtor is ultimately placed into liquidation. Therefore, it is important to keep this issue in mind when negotiating a resolution of the debt and payment terms.

*"A barrister should be engaged early in the process."*

## A note for debtors

For debtors seeking to set aside a statutory demand, there are different (and perhaps a greater number of) issues to consider:

- to satisfactorily apply to set aside the statutory demand within the 21-day period, the debtor must attend to the following within that 21-day period:
  - issue an application to set aside the demand with an appropriate affidavit in support; and
  - serve[7] on the creditor the application together with the affidavit (and any annexures). The application must contain:
    - the proceeding number;
    - the return date for the hearing; and
    - the seal of the court;
- if the 21st day is a Saturday, Sunday, a public holiday or a bank holiday, the application may be made on the next working day.[8] Notably, the court vacation is not a public holiday and, as noted above, the 21-day period cannot be extended by agreement with the creditor or even by the court;
- the affidavit in support of the application must be carefully prepared and meet a number of minimum requirements. For example, it must disclose facts demonstrating that there is a genuine dispute and cannot merely assert that there is a genuine dispute or deny the existence of the debt;
- having regard to the fact that some time is needed to take instructions, prepare the application and affidavit, then file and serve them, it is prudent to ensure that this process begins early in the 21-day period so as to permit time for the documents to be filed with the Supreme Court or Federal Court registries (which both operate electronic filing systems) with enough time for those documents to be processed and returned from the court registry in time for service. A barrister should be engaged early in the process;
- where the merits justify the debtor making an application to the court, the debtor should engage a solicitor to write to the creditor articulating the arguments in favor of the debtor and asking the creditor to withdraw the demand;
- a statutory demand can be withdrawn by the creditor either orally or in writing. However, if the statutory demand is withdrawn orally, it is important to ensure that this fact is promptly confirmed in writing so as to avoid a dispute over this issue at a later time. The withdrawal should also be unequivocal. It is common for parties to make the mistake of accepting the words "[the creditor] *will* withdraw" (as a future proposition) rather than simply "[the creditor] withdraws the statutory demand dated …"; and
- for practitioners acting for debtors (taxpayers) who have received a statutory demand from the Deputy Commissioner of Taxation, it is important to understand the existence and effect of the prima facie[9] and conclusive evidence provisions[10] contained in the *Taxation Administration Act 1953* (Cth)[11] (TAA) and the objections process. In the usual course of things, it is difficult to conceive of a circumstance in which an application should be made seeking to set aside a demand issued by the Deputy Commissioner of Taxation,[12] rather, efforts should

be made to engage with the ATO and to progress through the Pt IVC TAA regime.

It is hoped that this short article assists with understanding the operation of statutory demands and the importance of responding to statutory demands promptly.

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### Disclaimer

This article is intended to assist tax practitioners to become familiar with some relevant issues regarding the statutory demand scheme. It does not supplant the need for legal advice nor is it given as legal advice.

### References

1 Such an arrangement should be recorded in writing. Furthermore, it should be negotiated by a legal representative to ensure that the company's position is protected.

2 The statutory presumption arises under s 459C(2) of the *Corporations Act 2001* (Cth).

3 [2006] NSWSC 500.

4 Note that some of these points are also relevant to circumstances where the creditor has obtained judgment. For example, where a creditor has obtained default judgment against a debtor, a creditor may still seek to set aside the default judgment and the statutory demand, albeit in more limited circumstances (*Body Corporate Repairers Pty Ltd v Oakley Thompson & Co Pty Ltd* [2017] VSC 435 per Randall AsJ). Similarly, the risks of a preference claim being made by a liquidator of the debtor company arise whether there is a judgment debt or not.

5 (1994) 12 ACSR 785.

6 In the context of their usual dealings with the debtor.

7 Service does not need to be effected within business hours to be effective.

8 S 36(2) of the *Acts Interpretation Act 1901* (Cth).

9 For example, a running balance account (RBA statement) is prima facie evidence of the debts due (s 8AAZI of the *Taxation Administration Act 1953* (Cth) (TAA)). There are numerous other similar prima facie evidence provisions.

10 See, for example, s 350-10 of Sch 1 TAA which, among other things, provides that a notice of assessment is conclusive evidence that the assessment was properly made and that the amounts and particulars of the assessment are correct (save and except for Pt IVC TAA proceedings).

11 See also *DCT v Broadbeach Properties Pty Ltd* [2008] HCA 41.

12 Perhaps this proposition can be tempered by saying that there will be few (if any) circumstances where an application should be made. But, as with most propositions, this can be assessed on a case-by-case basis.

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