IN THE MATTER OF ASSOCIATED PROPERTIES LIMITED

SUPREME COURT (Harwood, A.J.): April 14th, 1994

Taxation—income tax—recovery of tax—PAYE not recoverable from company in liquidation as preferential debt under Companies Ordinance, s.241(1)(a)—permits recovery of taxes imposed directly on company only, i.e. taxes due "by" company on own behalf, not those due "from" company on behalf of employees

Companies—compulsory winding up—preferential debts—scope of debt—only tax due for period "within twelve months" immediately preceding liquidation recoverable from company as preferential debt under Companies Ordinance, s.241(1)(a)

The applicant appealed against the respondent's rejection of its proof of debt.

The Commissioner of Income Tax submitted a proof of debt to the respondent as liquidator of a company, in respect of several years of income tax and penalties due under the PAYE system. A substantial proportion of the debt was claimed as a preferential debt under s.241(1)(*a*) of the Companies Ordinance. The respondent rejected that amount, designating a substantially lower figure as payable in priority to other debts under the Ordinance.

On appeal, the applicant submitted that (a) the words "all taxes … due by the company" in s.241(1)(*a*) were sufficiently wide to include the debt to the Treasury under the PAYE system; (b) in any event, s.87 of the Income Tax Ordinance provided for priority to be accorded to PAYE as a debt; (c) s.88(9)(*b*) of the Income Tax Ordinance also gave priority to PAYE debts; and (d) although s.241(1)(*a*) restricted the preferential recovery of overdue taxes to one year's arrears, the Government was entitled to designate the 12-month period, out of several years of arrears, for which most tax was owing.

The respondent submitted that (a) PAYE debts were not covered by s.241(1)(*a*) because PAYE was not a tax "due by the company," but a debt due "to" the Government from the company, as provided by reg. 11(1) of the 1989 Regulations; (b) neither the regulations nor s.87 of the Income Tax Ordinance under which they were made mentioned priority payment of PAYE debts; (c) s.88(9) of the Income Tax Ordinance did not apply, as it related to sums deducted under directions given by the Commissioner under s.88(1), and no such direction had been given; and (d) even if the tax were covered by s.241(1)(*a*), the Government was not

entitled to claim tax due from any period before the 12 months immediately preceding liquidation.

Held, dismissing the application:

(1) The PAYE payable under reg. 11(1) of the Income Tax (PAYE) Regulations did not qualify as a preferential debt on the winding up of a company, since it was not a tax imposed directly on the company itself. The use of different prepositions in s.241(1)(*a*) of the Ordinance when distinguishing between rates and taxes—in the phrases "local rates due *from*" and "taxes … due *by*" the company—indicated that that paragraph was intended to cover only forms of taxation imposed on the company *per se*, and not those due from it in respect of others' liability, such as the liability of its employees (page 337, lines 31–43).

(2) The applicants could not rely on s.87 of the Income Tax Ordinance as according priority to PAYE as a debt, since it merely empowered the Governor to make regulations for various purposes in connection with PAYE. Nor did s.88(9)(*b*) assist them, as it applied only to sums deducted pursuant to a Commissioner's direction under s.88(1), and the Commissioner had not issued a direction and did not base his claim on s.88 (page 337, line 44 – page 338, line 18).

(3) Even if s.241(1)(*a*) were applicable, only tax due to be paid within the 12 months immediately preceding the liquidation would qualify for preferential payment because the words "within twelve months" (next before the relevant date) were the result of an amendment to the section which deliberately restricted its scope (page 338, line 21 – page 339, line 16).

Cases cited:

(1) *Linares Ltd., In re*, Supreme Ct., 1989 L No. 168, unreported, not followed.

(2) *Pratt, In re, Ex. p. Inland Rev. Commrs.* v. *Phillips*, [1951] Ch. 225; [1950] 2 All E.R. 994.

Legislation construed:

Companies Ordinance (1984 Edition), s.241(1): The relevant terms of this sub-section are set out at page 336, lines 30–37.

Income Tax Ordinance (1984 Edition), s.87, as amended by the Income Tax (Amendment) (No. 4) Ordinance, 1989, s.9:

> "The Governor may make regulations for the purpose of requiring tax to be deducted upon the making of certain payments of or on account of income from office and employments and from pensions; for the purposes of determining the amounts of such deductions, the payment of tax so deducted, the keeping of records, the making of assessments and other related matters."

s.88(9): "All sums which have been or should have been deducted in pursuance of a direction served by the Commissioner under the

provisions of subsection (1) but which have not been paid to the Commissioner, shall be included among the debts which—

(*a*) under the provisions of section 33 of the Bankruptcy Ordinance are, in the distribution of the property of a bankrupt, to be paid in priority to all other debts; and

(*b*) under the provisions of section 241 of the Companies Ordinance are, in a winding up, to be paid in priority to all other debts."

Income Tax (Pay As You Earn) Regulations 1989 (L.N. No. 114 of 1989), reg. 11(1):

"…[T]he total amount of tax deducted … from emoluments … shall be a debt due to the Government and shall be recoverable as such."

S.V. Catania for the Attorney-General;
A.V. Stagnetto, Q.C. for the respondent liquidator.

HARWOOD, A.J.: Joseph L. Caruana is the liquidator of Associated Properties Ltd. ("the company"). He was appointed by extraordinary resolution of the company on December 23rd, 1992, when the company's liquidation commenced. On February 5th, 1993 a proof of debt in excess of £95,000 was lodged on behalf of the Commissioner of Income Tax in respect of several years of income tax and penalties under the PAYE system, over £60,000 of which was claimed as a preferential debt. Within a few days the liquidator rejected that amount and specified, as having priority, a very substantially lower figure.

This difference of opinion owes its origin to a differing construction put upon s.241(1)(*a*) of the Companies Ordinance, which reads as follows:

"(1) In a winding up there shall be paid in priority to all other debts—

(*a*) all local rates due from the company at the relevant date, and having become due and payable within twelve months next before that date, *and all taxes* assessed on or otherwise *due by the company within twelve months next before the relevant date, and not exceeding in the whole the amount assessed or due in respect of one year*…" [Emphasis supplied.]

There is no dispute about the "relevant date," which is December 23rd, 1992, but otherwise it is the words which (for the purposes of this judgment) are italicized that gave rise to difficulty.

Shortly stated, the point at issue was this: The Commissioner contends that the Government is entitled, out of the several years of arrears accrued, to choose whichever period of one year is the most favourable to ensure that the greatest possible amount of tax is secured as a preferential debt to the Treasury. On the contrary, says the liquidator, the Government

is not entitled to go back beyond the tax due within 12 months immediately preceding December 23rd, 1992. There was also a dispute as to the amount owing, but that is to be considered at a later stage, if necessary.

However, a submission put forward by Mr. Stagnetto, as a preliminary point, is that tax payable under the PAYE system is not covered at all by s.241(1)(*a*) for two reasons. First, because PAYE was not introduced in Gibraltar until 1974 and is not mentioned in the Companies Ordinance, except possibly by way of a much later amendment. Secondly, PAYE is not a tax "due *by* the company," it is a debt due *to* the Government, as provided by reg. 11(1) of the Income Tax (PAYE) Regulations 1989 ("the Regulations") made under s.87 of the Income Tax Ordinance. Together, in any event, these contain no mention of any priority to be accorded to the debt.

Mr. Catania countered that submission by saying that the words "all taxes due by the company" are sufficiently wide and far-reaching to include any tax, whenever imposed (*i.e.* whether before or after the enactment of s.241(1)(*a*)) and that an employer is liable to account to the Treasury for PAYE as a person liable to tax just as much as an employee, and that you only have to look at the relevant parts of the regulations to see that this must be so.

Dealing with the preliminary point above, it is the fact that PAYE as such was not introduced into the legislation of Gibraltar until 1974, when what is now s.87 of the Income Tax Ordinance was inserted by way of amendment. If that were the only point for consideration, I would hold that this form of taxation is clearly covered by the words "all taxes" in s.241(1) of the Companies Ordinance because paras. (*a*), (*b*) and (*c*) of that sub-section are always speaking of and are intended to cover *all* company debts of the different categories expressed in specific terms. However, it is necessary to examine the question more closely than that.

First, one should note the words in para. (*a*) "all local rates due from," and compare the preposition "*from*" with the two which appear in italics in the expression which follows: "all taxes assessed *on* or otherwise due *by*" the company. Having regard to the distinction between rates (which are not levied directly upon a company but usually upon property) and taxes (which are a form of direct imposition upon an individual or company), the use of those different prepositions is, I think, of some significance, and indicates that para. (*a*) was never intended to cover any form of tax other than one which is imposed directly upon the company itself. Thus, an amount of outstanding PAYE owed to the Treasury under reg. 11(1) of the Regulations on the winding up of a company has to be accounted for and is, in reality, a debt due to the Government "from" and not "by" the company.

Secondly, s.87 of the Income Tax Ordinance merely empowers the Governor to make regulations for the various purposes in connection with

PAYE—it does not itself provide for the priority to be accorded to PAYE as a debt.

It would, as Mr. Stagnetto submitted, have been easy enough to make such provision in relation to s.87 had this been the intention of Parliament. Similar specific provision has been made in England. Indeed, it is not clear to me why s.88 of the Income Tax Ordinance was not utilized for the purposes of the PAYE system, for it seems to me that this might have been more appropriate. In that event, the question of priority to be given to sums of tax owing from an employer on bankruptcy or winding up would have been already adequately provided for under sub-s. (9) so long as they had been, or ought to have been, deducted pursuant to a Commissioner's direction under s.88(1). But s.88(1) cannot be regarded as covering PAYE due as a debt to the Government because in the present case the Commissioner was neither purporting to claim the debt under that sub-section nor had he made the sums of PAYE due from the company the subject of a direction by him to the company to deduct and account for the same. Therefore, the provision as to priority contained in s.88(9)(b) is of no application to any of those sums.

If that view of the applicability of s.241(1)(a) of the Companies Ordinance is correct, that is the end of the matter; if it is not correct, it remains to consider the point of construction already outlined above. The same question was dealt with, but on a different footing, in *In re Pratt, Ex. p. Inland Rev. Commrs.* v. *Phillips* (2). The construction contended for by the Crown purports to be supported by *In re Linares Ltd.* (1)—a decision of the Chief Justice on a summons by a liquidator for the determination of certain questions arising in a winding up, including those now in point. However, it does not appear that there was any argument such as is now advanced in the course of the proceedings, and it appears to have been wrongly assumed that s.88 was applicable in the case of PAYE. For those reasons, I do not consider that decision to be binding, even if it were so otherwise.

In re Pratt was a decision in which the section being considered was s.33(1)(a) of the Bankruptcy Act 1914, exactly the same as the original s.243(1)(*a*) of the Companies Ordinance, which in turn originated from s.264 of the Companies Act 1929. The Companies Ordinance was, however, amended from 1934 to its present form by the insertion of the words "within twelve months" (next before the relevant date) in place of the words "up to the fifth day of April" because, no doubt, it was found that the latter expression had inadvertently been included in error. It seems to me that that amendment had the intended and actual effect of restricting the claims for tax to be given preferential treatment to those in respect of tax falling due (whether by assessment or otherwise) within the stated 12-month period.

The breadth of choice on the part of the Crown, upheld in *In re Pratt* in respect of assessed tax, thereupon ceased to exist except to the extent that

where more than one assessment is made within that period the Crown may still be entitled to make a choice by virtue of the concluding words "and not exceeding in the whole the amount assessed or due in respect of one year." I think the correctness of this construction tends to be confirmed by the substitution for the expression found in the original Ordinance "and not exceeding in the whole one year's assessment" of the expression as it is found in its present form. *In re Pratt* is not, therefore, in my opinion an authority upon which the Crown in Gibraltar may any longer rely for the purpose contended.

In the result, I hold that the amounts of PAYE owed by the company do not rank for treatment by the liquidator as preferential debts. In any event, the only amount qualifying for such treatment would be such amount as fell due to be paid by the company within the period of 12 months immediately preceding December 23rd, 1992—namely £2,470.78, or such other amount as may be determined by the court in default of agreement between the parties.

However, I hold that there is no question of priority and on the preliminary point I give judgment for the respondent. There may still arise a question as to the amount, or amounts, of tax or penalty owing and for that purpose I grant liberty to restore the motion on a date to be fixed by the Registrar.

Order accordingly.
