

## MORTGAGES

## Registered mortgagee loses priority to the ATO

By MARCUS YOUNG SC and MATTHEW BRANSGROVE

The decision of a mortgagee to permit the mortgagor to sell its own property meant that it was left short-changed by the amount of mortgagor's unpaid tax bill, a loss that would have been averted had the mortgagee exercised its power of sale, a majority of the Federal Court has found.

The decision in *Commissioner of Taxation v Park* [2012] FCAFC 122 has important ramifications for mortgagees because a decision to permit a mortgagor to sell property converts their position to that of an unsecured creditor upon release of their security. A consequence avoided in the case of a mortgagee sale.

#### Background

In *Commissioner of Taxation v Park*, there were two mortgages registered against the property, one in favour of the bank and the other in favour of a second mortgagee. The total amount owed under both mortgages exceeded the purchase price. The mortgagor was permitted to sell the property and intended to pay the sale proceeds to the mortgagees to procure the release of the registered mortgages.

Between the time the contract was signed and settlement, the tax office served a notice under s.260-5 of the *Taxation Administration Act 1953 (Cth)* on the purchasers. The notice, operating in a manner similar to a garnishee notice, required the purchasers to pay money from the purchase price to the Commissioner of Taxation to repay the vendor's tax debt, and to pay that money in priority to any other payment due in relation to the purchase of the land.

Settlement was delayed because the tax office insisted on receiving a cheque at settlement for the unpaid tax. In the end, it consented to the money payable to the second mortgagee being held in its solicitor's bank account, not to be

released without their consent.

Following settlement, the tax office claimed that it was entitled to the disputed monies and the second mortgagee



Marcus Young SC of University Chambers and Matthew Bransgrove of Bransgroves Lawyers are the authors of the Lexis Nexis textbook "The Essential Guide to Mortgage Law in NSW".

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disagreed. The disputed sum was paid into the Federal Magistrate's court by consent while the contested proceedings were heard.

The Federal Magistrate found that the purchase monies were not owing to the taxpayer, but owing to the mortgagees and hence there were no monies to which the Commissioner's notice could attach. The Federal Magistrate compared the mortgages with a floating charge that had crystallised and noted that the mortgagor/chargor had no beneficial interest in the money paid to it because the money was not owed to it but to the mortgagee/chargee.

The Commissioner appealed and argued that the purchasers did not owe any money to the mortgagees but only to the mortgagor as vendor, and the mortgagees could claim no proprietary interest in the purchase money until it reached the hands of the mortgagor. As the garnishee notice operated upon the purchase money held in the hands of the purchaser as soon as it became owing to the vendor, the notice was thus able to intercept the sum sought by the Commissioner before it could reach the mortgagor and be subject to a valid claim by the mortgagees.

#### Federal Court decision

The majority of the full Federal Court, being Jessup and

Katzmann JJ, accepted the Commissioner's argument. The same majority rejected the counter-argument that s.260-5 of the *Taxation Administration Act* should not be construed in that fashion as it would deprive mortgagees of their security.

A constitutional challenge by the mortgagee on the basis that if s.260-5 of the *Taxation Administration Act* functioned as the Commissioner argued, then it involved the acquisition of property by the Commonwealth other than on just terms was rejected by the same judges both on formal grounds (due to the failure of the respondents to file the notices required to raise a constitutional point) and because it was considered that the challenge misrepresented the way the section worked. The court thus upheld the appeal and ordered that the Commissioner be paid the disputed money rather than the second mortgagee.

The minority judge, Siopis J, would have dismissed the appeal, taking the view that the mortgagees' interest in the land was immediately converted into an interest in the proceeds of sale on release of the mortgage, that there was thus no time at which the mortgagor was beneficially entitled to the proceeds of sale, but that the mortgagor was no more than a trustee for the mortgagees. Siopis J consid-

ered that the Commissioner could be in no better position than a typical creditor serving a garnishee notice and hence was subject to the mortgagee's proprietary interests.

It is clear from the ratio of this case that if the mortgagees had not allowed the mortgagor to sell the land as vendor but the land had instead been the subject of a mortgagee sale, the Commissioner's notice would have been of no avail. If one of the mortgagees had been the vendor, the purchase money would have been payable by the purchasers directly to that mortgagee, and hence there would have been no debt due to the mortgagor that could be the subject of garnishment by the notice. □