Impact of liquidation and deregistration

Key points

The liquidation and deregistration of a company will affect its membership of a consolidated group.

- However, the *appointment* of a liquidator to a subsidiary company does not affect its membership.
- A company that has been *deregistered* ceases to be a member of a consolidated group at the time of deregistration.

A liquidator has obligations to the creditors and contributories (shareholders) of the company being liquidated and to the Tax Office and the Australian Securities and Investments Commission (ASIC).

- The consolidation core rules do not affect the duties and obligations of the liquidator under the *Corporations Act 2001.*

A liquidator is appointed

The appointment of a liquidator to a company does not of itself affect a company's membership of a consolidated group or the membership of its wholly-owned subsidiaries. Deregistration at the end of the winding up process is the event that will terminate a company's membership of a consolidated group.

Nor does the appointment of a liquidator to the head company cause the deconsolidation of the group – that occurs when the head company is deregistered at the end of the liquidation process.

A liquidator may be appointed by the court or appointed as part of a voluntary process initiated by the company.

A liquidator's duties under the *Corporations Act 2001* include realising any assets, satisfying the company's creditors and returning any remaining capital and funds to the shareholders. A liquidator may satisfy these requirements by transferring assets, rather than realising them, in some circumstances, for example, where there are no creditors, only shareholders (contributories) who require a return of their investment.

Impact of the single entity rule

The single entity rule applies to transfers of funds or assets within a consolidated group. For example, the payment of capital profits from subsidiary B (in liquidation), to its shareholder, subsidiary A (a member of the same consolidated group), is ignored for the purposes of calculating the head company's income tax liability. Similarly, the transfer of an asset as part of the return of capital from the liquidating subsidiary to its shareholder (also part of the same consolidated group) is ignored for the purposes of calculating the head company's income tax liability.

The single entity rule does *not* directly affect:

- the duties and obligations of the liquidator under the *Corporations Act 2001*

- the accounts of the members of the consolidated group (this is determined according to accounting standards and practice), or
- the head company's shareholders (their tax liability is separate and distinct from the head company's tax liability).

For tax purposes, the single entity rule has the following effects:

- Liquidators cannot distribute assets or pay dividends to anyone but the creditors and the direct shareholders of the company (in other words, they cannot make a direct payment to an ultimate shareholder unless they are liquidating the head company of a consolidated group). Distributions within the group are ignored for the purposes of determining the tax liability of the head company.
- Accounts must be kept by each company in a group in accordance with accounting standards and practices, reflecting the nature and amount of distributions they receive from a liquidator, or dividends from their subsidiaries, where those subsidiaries are not being liquidated.
- The head company's shareholder is outside of the consolidated group, with the consequence that the tax liability of the shareholder will be determined according to the nature of the accounts and distributions made to them by the liquidator of the head company.

A liquidator's taxation responsibilities

Subdivision 260-B of the *Taxation Administration Act 1953* (TAA 1953) outlines liquidators' income tax responsibilities (which are separate from, and in addition to, their responsibilities under the *Corporations Act 2001* and other taxing Acts).

Liquidators must:

- notify the Commissioner of their appointment within 14 days of the appointment (preferably by way of the electronic form *Appointment of a representative of an incapacitated entity*, NAT 9504, available at **www.gov.au**)
- after paying secured and priority creditors, retain the remaining company assets until they have received the Commissioner's section 260-45 notice of the amount sufficient to discharge the company's outstanding tax-related liabilities at the time the Commissioner gives his notice (which will include details of the company's income tax, PAYG instalment and franking deficit tax liabilities)
- after receiving the Commissioner's notice, set aside an amount in relation to the outstanding tax-related liabilities worked out using the formula in subsection 260-45 (6) of the TAA 1953 (the amount set aside must come out of the assets available for paying the ordinary unsecured debts of the company), and
- discharge the outstanding tax-related liabilities to the extent of the value of the assets required to be set aside.

Liquidators have a number of reporting requirements under the *Corporations Act 2001*, including lodging returns and providing information as to how the assets and funds of the company have been disposed of. The company's outstanding and settled tax liabilities are included in this accounting.

Deregistering without a liquidator

In the following circumstances, a company, or a director or member of a company, can apply directly to ASIC to deregister the company without appointing a liquidator to wind it up → Part 5A.1 of the *Corporations Act 2001*:

- all the members of the company agree to the deregistration
- the company is not carrying on a business
- the company's assets are worth less than $1,000
- the company has paid all fees and penalties levied under the *Corporations Act 2001*
- the company has no outstanding liabilities (including taxation liabilities), and
- the company is not a party to any legal proceedings.

Before a company can be deregistered without a formal winding up process, the head company's due date (for the relevant period) must have been reached, and the income tax liability paid. The income tax liabilities that must be satisfied before the application is made include both those that have arisen while the head company was outside a consolidated group and those that have arisen while it was in a consolidated group (ensuring that the company will not become jointly and severally liable, or liable under a tax sharing agreement, for any default of the head company). Consequently, the provisions contained in Subdivisions 260-B, 260-C and 260-E of the TAA 1953 are not relevant to these situations.

The deregistration process (application, notification and mandatory waiting periods) does not affect the company's membership of the consolidated group, nor does it affect its ownership of any assets it holds at any time during the process. (Generally, all assets will be disposed of by the end of the process, and capital will have been distributed – but any assets held by the company at the time of its deregistration will vest in ASIC.) The single entity rule will operate normally until the company is deregistered. Intra-group distributions from the subsidiary to its shareholder will be ignored for the purposes of calculating the head company's income tax liability.

ASIC initiated deregistration

Section 601AB of the *Corporations Act 2001* allows ASIC to initiate deregistration in the following circumstances:

- ASIC has no reason to believe the company is carrying on a business, and:
  - the response to a return of particulars given to the company is at least six months late, and
  - the company has not lodged any other documents under the *Corporations Act 2001* in the 18 months before the date of the decision to deregister a company
- the company has not paid its review fees within 12 months of the due date for payment

- the company is being wound up and ASIC has reason to believe the company's affairs have been fully wound up and the liquidator's return is at least 6 months late
- the company is being wound up and ASIC has reason to believe the liquidator is no longer acting, or
- the company is being wound up and ASIC has reason to believe the company's affairs have been fully wound up under Part 5.4 of the *Corporations Act 2001* and there is not enough property to cover the costs of obtaining a court order for the company's deregistration.

Once ASIC decides to deregister a company, it gives notice of the proposed deregistration:

- to the company
- to the company's liquidator (if any)
- to the company's directors
- on the ASIC database, and
- in the *Gazette*.

ASIC may deregister the company when two months have elapsed from the date of the *Gazette* notice. ASIC must give notice of the deregistration to everyone it notified of its proposal to deregister the company.

Deregistration occurs

Once deregistration occurs (whether or not as part of the liquidation process), the company is no longer eligible to be a member of a consolidated group, as it ceases to exist → section 601AD of the *Corporations Act 2001*. The company ceases to be a member of the consolidated group at the time of deregistration as it is no longer a company and can no longer satisfy the conditions of eligibility.

The head company will need to determine the capital gains tax consequences of the deregistered company ceasing to be a member of the consolidated group. This will require the cost base of the membership interests of the leaving company to be determined under Division 711 of the *Income Tax Assessment Act 1997* (ITAA 1997). The head company will also need to determine if the cancellation of the shares or a declaration by a liquidator that the shares are worthless will give rise to a capital gain or loss under the CGT provisions → CGT event, section 104-25 and CGT event G3, section 104-145 of the ITAA 1997.

Notifying the ATO

The head company of the group must notify the Commissioner (within 28 days of the subsidiary's deregistration) of the change in the group's membership, in the approved form. → table item 2 in subsection 703-60(1) of the ITAA 1997

If the head company is the deregistered company, the group will deconsolidate at the time of deregistration. In this situation, the person who was the public officer of the head company is required to notify the Tax Office of the change in membership in respect of each subsidiary that has left the group, within 28 days of it leaving (which will normally occur before the head company's deregistration, as part of the realisation of its assets). → table item 2 in subsection 703-60(1)

Use form NAT 6782 *Notification of members joining and/or leaving the group* for notifying changes in membership of ordinary consolidated groups.

In addition, the person who was the public officer of the head company is required to notify the Tax Office that the consolidated group has ceased to exist, within 28 days of the head company's deregistration. (Use form NAT 6783 *Notification of head company no longer eligible: group ceases to exist* for this purpose.) → table item 3 in subsection 703-60(1)

If the provisional head company of a multiple entry consolidated (MEC) group is deregistered, the Commissioner must be notified within 28 days. The MEC group does not, however, deconsolidate when the provisional head company is deregistered if:

- a replacement provisional head company is appointed, and
- the Commissioner is notified within 28 days of the appointment.

If no replacement provisional head company is appointed, the MEC group will cease to exist.

Use form NAT 7025 *Notification of members joining and/or leaving a multiple entry consolidated group* for notifying changes in membership of MEC groups.

Non-consolidation debts

A company that is being liquidated will continue to be solely liable for any income tax liabilities that have accrued to it while it is outside a consolidated group. These liabilities do not become the responsibility of the head company. The Commissioner will include these liabilities when determining the amount that the liquidator will need to set aside in order to satisfy the company's tax liabilities.

Other taxes, such as GST, PAYG withholding and fringe benefits tax, are not covered by consolidation. Accordingly, the company that is being liquidated will still be responsible for its liabilities in respect of other taxes.

Tax sharing agreements – effect on other parties

Once a company is deregistered, it generally cannot be the subject of further debt recovery action.

Where the Commissioner's ability to recover the liquidating company's potential share of any outstanding liability is compromised, the Commissioner may not be prepared to issue a section 260-45 notice until after the head company's debt has been established and it has been paid by the head company – or the contributories under a tax sharing agreement (TSA).

The head company is expected to pay the group liabilities by the due date. Initially, the Tax Office will seek to recover any outstanding amounts from the head company. If this is unsuccessful, or unlikely to be successful, the Tax Office may seek recovery from the subsidiary members of the group, which may include the company being wound up.

Where no TSA exists (and no members of the group are excluded from joint and several liability), the Commissioner may pursue the debt from the subsidiary members (which may include a company being wound up).

A TSA, or an exclusion from joint and several liability, may limit the liability of a particular member of the group with respect to their share of the group liability in the case of a defaulting head company. A TSA is subject to the specific provisions in Division 721 of the ITAA 1997.

The Tax Office recommends that TSAs contain provisions covering the entry and exit of members of the consolidated group, including where the exit is a result of deregistration. Regard should be had to the continuity of the agreement in the event that one or more parties cease to exist.

It may be in the interests of the liquidator to approach the head company for a copy of any existing TSA, in order to determine the extent of the liquidating company's potential tax liability.

Effect of 'retrospective' decision to consolidate

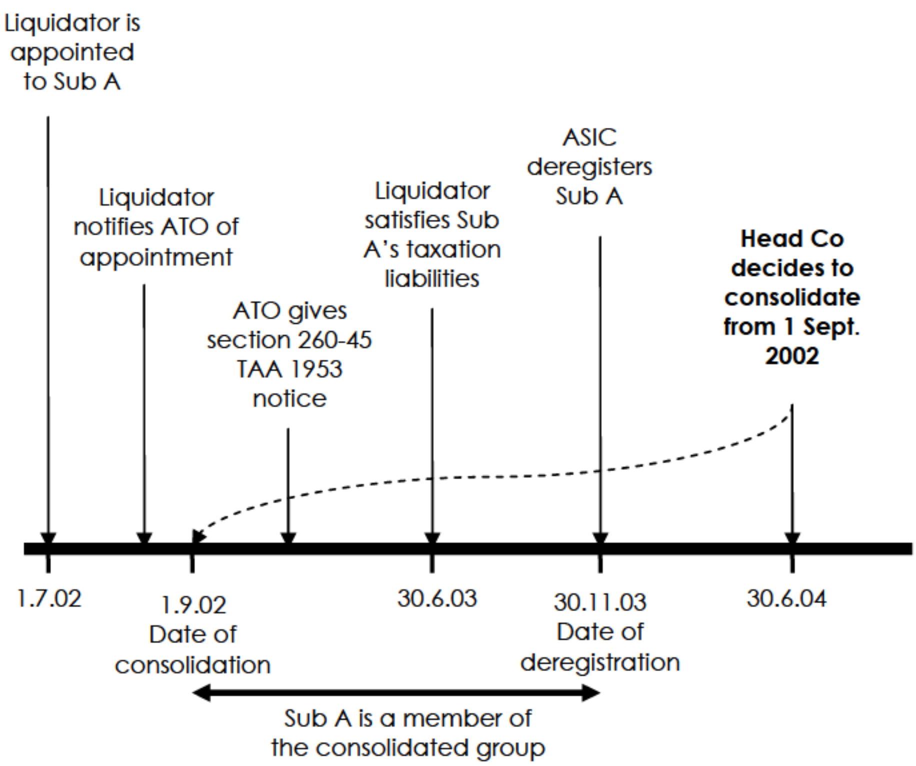
Part 3-90 requires the head company to make a choice to consolidate on a specific date and to manage the group's tax affairs on that basis from that date. However, the head company isn't required to notify the Tax Office of that choice until the date of lodgment of its first consolidated income tax return – or, if a return is not required, the date it would have otherwise been due.

Where the Tax Office has been notified, the liquidator of a company, on seeking information from the Tax Office about the consolidatable group's status, would be advised that the company is a member of a consolidated group and would then be in a position to act on that information.

However, during the transitional period, the situation may arise where a head company of a consolidatable group makes the decision to consolidate after a member of the group has been deregistered but with the date of effect of consolidation prior to the date of deregistration. → figure 1

The deregistered member of the consolidatable group will be a member of the consolidated group from the date of effect of consolidation until the date of deregistration. The fact that the deregistered entity was no longer in existence when the consolidation decision was made has no effect on its membership eligibility. The test is whether it would have satisfied the membership tests on the date chosen by the head company to form a consolidated group.

Figure 1: 'Retrospective' decision to consolidate



In this example, Sub A will be a member of the consolidated group from the date of consolidation, 1 September 2002, until it is deregistered, on 30 November 2003.

Where the liquidating company is a member of a *consolidatable* group, the liquidator should advise the Tax Office of this when applying for the section 260-45 notice. This will enable the Tax Office to ensure that the correct taxpayer (which may in fact be the head company, not the liquidating subsidiary) is identified and its income tax liability correctly calculated. Consolidation will affect which company is treated as the taxpayer, and may also have an effect on that taxpayer's income tax liability.

In some rare cases during the transitional period, the liquidator may be unaware that the company they are liquidating is a member of a consolidatable group at the time the liquidation is being carried out. In those instances the liquidator may have paid income tax liabilities which they believed were liabilities of the liquidated company, but which were in fact liabilities of the head company (for example, as the result of a retrospective decision to consolidate).

The head company is nonetheless required to lodge an income tax return that includes income, deductions, gains, losses, credits and offsets from the activities of the liquidated company during the period in which it was a member of the consolidated group. The head company's income tax liability will be determined according to its income and deductions from *all* its subsidiaries, including the liquidated company.

The liquidated company's income tax liability will be adjusted so that it reflects only the period of time it was not a member of the consolidated group (for example, the periods before the choice to consolidate became effective, and any other periods in which it was outside the consolidated group). Any excess payment will be:

- **where deregistration *has not* yet occurred**: refunded to the liquidator, who may then make further distributions to the creditors and contributories, or
- **where deregistration *has* occurred**: refunded to ASIC, as all property rights of the company now vest in ASIC.

The head company will be liable to the full extent of its income tax liability, which includes any liability that arises as a result of the activities of the deregistered subsidiary. The head company's remedy (for the mistake made by the liquidated subsidiary member of the group) is to ask ASIC to reinstate the company → section 601AH of the *Corporations Act 2001*. ASIC will refund amounts held on behalf of that company to the company's liquidator or the directors of the company on its behalf (where the company was not liquidated). The amount returned to the company will be distributed among the creditors of the company (of which the head company may be one if there is a tax funding agreement in place) or contributories, where no unsatisfied creditors are left.

Thus, it is in the interests of the potential head company to carefully consider all taxation consequences of the appointment of a liquidator to one of its wholly-owned subsidiaries in advance of the decision to consolidate.

Revision history

Section C7-1-220 first published 11 March 2005.

Proposed changes to consolidation

Proposed changes to consolidation announced by the Government are not incorporated into the *Consolidation reference manual* until they become law. In the interim, information about such changes can be viewed at:

- **http://assistant.treasurer.gov.au** (Assistant Treasurer's press releases)
- **www.treasury.gov.au** (Treasury papers on refinements to the consolidation regime).