

**Part B The Collection of Taxation Debts****21 LIQUIDATION ACTION - CONDITIONS AND FACTORS TO CONSIDER**

*The policy in this chapter is to be followed by Tax Office staff. We have made every effort to ensure it is technically accurate, but in the interests of clarity it has been written in 'plain English' and should not be read or interpreted like legislation. If you feel that something in the chapter is wrong or misleading, please advise the Tax Office.*

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**21.1 PURPOSE**

21.1.1 This chapter will examine:

- some factors that should be considered before making the decision to liquidate or wind up a corporate debtor; and
- situations where liquidation/wind up action may be inappropriate.

**21.2 LEGISLATION**

21.2.1 The authority to commence action through the Courts in order to recover outstanding taxation debts is provided by:

**prior to 1 July 2000**

- sections 209 (income tax), 220AAZA (reportable payments, tax instalment deductions and prescribed payment amounts), 221YR(1) (interest and royalties withholding tax) *Income Tax Assessment Act 1936* (ITAA 1936);
- section 69 *Sales Tax Assessment Act 1992*;
- section 94 *Fringe Benefits Tax Assessment Act 1986*;
- section 50 *Superannuation Guarantee (Administration) Act 1992*;
- section 26 *Superannuation Contributions Tax (Assessment & Collection) Act 1997*;
- section 22 *Superannuation Contributions Tax (Members of Constitutionally Protected Superannuation Funds) Assessment & Collection) Act 1997*; and
- section 17 *Termination Payments Tax (Assessment & Collection) Act 1997*

**on or after 1 July 2000**

- section 255-5 of Schedule 1 to the *Taxation Administration Act 1953*.

21.2.2 These statutes usually provide for the authority to be delegated to an officer who will be the Commissioner's duly authorised agent.

**21.3 INTRODUCTION**

- 21.3.1 The decision on the most appropriate form of recovery action will depend on a number of factors and considerations. Generally, legal recovery proceedings will be instituted if the debtor does not take steps to advise the Commissioner of an inability to pay and does not put forward an acceptable proposal to pay the debt by instalments.
- 21.3.2 In some cases, the Commissioner or Deputy Commissioner may institute legal recovery proceedings, but may adjourn those proceedings (as opposed to discontinuing proceedings) where the debtor has agreed to pay the debt, along with additional charges for late payment and legal costs, in full either by a specified date or by instalments over a period. However, in other instances, the Commissioner or Deputy Commissioner may consider it appropriate to continue with legal recovery proceedings, notwithstanding such an approach by the debtor. Some debtors only appreciate the consequences of liquidation at a late stage in proceedings and are then prompted to rearrange their affairs to facilitate payment of their taxation debts.
- 21.3.3 Recovery action against companies can follow the same general course as that for amounts owing by individuals. Summonses may be served, and judgment entered, followed by the issue of warrants or writs of execution when necessary. However, in respect of company debtors, an alternative avenue – one that does not require a judgment – may be pursued. When a company is deemed unable to pay its debts, it is possible to seek to have its operations wound up without first obtaining judgment. This avenue should not be viewed simply as a debt collection option. The winding up of a company also serves to prevent further adverse implications for creditors which may result from a company's insolvent trading.
- 21.3.4 Liquidation or wind up is a viable option for creditors, provided the debt exceeds the statutory limit (which is currently \$2000). Normally, the Commissioner will serve a notice pursuant to section 459E of the *Corporations Act 2001* (Corporations Act) on a corporate debtor and, if payment is not made within 21 days or if suitable payment proposals are not agreed within that time, the Commissioner may apply to the court to have the company wound up.
- 21.3.5 Section 459P of the Corporations Act provides that any one of the following parties can apply to the Court for a company to be wound up in insolvency:
- (i) the company;
  - (ii) a creditor (even if the creditor is a secured creditor or is only a contingent or prospective creditor);
  - (iii) a contributory (as defined in section 9 of the Corporations Act);
  - (iv) a director;
  - (v) a liquidator or provisional liquidator of the company;
  - (vi) the Australian Securities and Investment Commission; or
  - (vii) a prescribed agency.
- 21.3.6 When a wind up order is made, an official liquidator is appointed by the court. The granting of a wind up order effectively transfers the control of the company's financial affairs to the liquidator. The liquidator's overall aims are to investigate the company's affairs, realise all known assets

and distribute the funds obtained to creditors in accordance with the priorities in the Corporations Act. The Act provides liquidators with certain powers to achieve the above outcome, including:

- doing such things as are necessary for winding up the affairs of the company and distributing its assets (per para 477(2)(m) Corporations Act);
- selling or otherwise disposing of all or any part of the property of the company in any manner (per para 477(2)(c) Corporations Act);
- carrying on the business of the company to the extent that it is necessary for the beneficial disposal or winding up of that business;
- appointing a solicitor or other agent and obtaining advice with regard to the conduct of the liquidation; and
- commencing or defending any legal proceedings relating to the company.

21.3.7 Liquidators are required to give notice of their appointment to creditors within fourteen days from the date of the appointment. As a creditor, the Tax Office must lodge a proof of debt with the liquidator as quickly as possible. The proof of debt should detail all outstanding taxation debts. The requirement to lodge this proof of debt is in addition to any proofs of debt that may have been lodged previously for this debtor with an administrator appointed under Part 5.3A (even if the liquidator and administrator are the same person).

21.3.8 After terminating the company's operations and selling all available assets, the liquidator distributes the realised proceeds to the creditors in accordance with the priorities in the Corporations Act. Where outstanding debts retain a statutory priority (such as tax instalment deductions and certain other source deduction liabilities which fell due before 1 July 1993 and, to the extent of the prescribed statutory limits, the three components of superannuation guarantee charge), the Commissioner retains preferential status over other creditors. The Tax Office should lodge a proof of debt on or before the date advised by the liquidator.

21.3.9 Once a liquidator has completed the winding up of a company and all proceeds from the administration have been distributed, the liquidator files a final form 524 (account of receipts and payments) with the Australian Securities and Investment Commission.

## **21.4 POLICY**

21.4.1 Action to wind up a company will be taken in circumstances where the company has failed to pay its debts and there has been no agreement on suitable payment proposals. These circumstances may give rise to a suspicion that the company is insolvent and that there could be a detrimental effect on the revenue (and, perhaps, also on other creditors) if it is allowed to continue to trade.

21.4.2 General matters that may be considered before taking liquidation action may include:

### **The asset position of the company**

- If there are no assets available for realisation in order to satisfy the debt, liquidation action may not be worthwhile.

Accepting payment of the debt by instalments over a period of time may be a cheaper and more viable alternative in these cases, but it is first necessary to establish the solvency of the company. (It would be difficult for a company with a history of broken promises to satisfy the Commissioner that it could/would pay by instalments over time). If liquidation action does not appear to be worthwhile and the company has ceased trading, the Australian Securities and Investment Commission should be requested to deregister the company. The debt should then no longer be pursued.

#### **The nature of the debt**

- It may be appropriate to take liquidation action to stop a debt from escalating rapidly. (For example, withholding payments and indirect taxes may be required to be remitted monthly and if those remittances are not paid, the debt can escalate). A corporate debtor trying to avoid liquidation action would need to demonstrate that steps have been taken to stop debts from escalating;
- Where outstanding debts retain a statutory priority (specifically, tax instalment deductions and certain other source deduction liabilities which fell due before 1 July 1993), the Commissioner retains preferential status over other creditors and this may ensure a higher return to the revenue than would be achieved via alternative collection mechanisms.

#### **The future income of the company**

- If reports from the insolvency practitioner, financial statements or other sources of information indicate that the company's financial position will improve and that the debt and the additional charges for late payment can be fully satisfied at some time in the future, it may be appropriate to consider accepting payment by instalments over a period of time. All projections should be carefully analysed, especially the explicit and implicit assumptions relied upon in those financial projections. The onus is on the company to demonstrate the ability to pay by instalments, and that may not be possible in the case of a company which has a history of failing to honour promises to pay.

#### **The risk to the revenue**

- If it becomes apparent that the company is avoiding payment or is taking steps to limit its ability to pay, it may be appropriate to take immediate liquidation action to secure the assets of the company so as to enable a distribution to be made to creditors;
- Where a debtor has ceased trading and/or has been struck off by the Australian Securities and Investment Commission, the Commissioner will not usually initiate liquidation action unless there is a compliance-based justification for doing so.

### **The potential to recover from directors**

- Officers attempting to recover debts from companies may take all necessary steps to expand the Commissioner's options to facilitate recovery from directors;
- Directors of companies may be personally liable to pay a penalty equivalent to some amounts which have not been remitted by the company (per sections 222AOC and 222AOD of the ITAA 1936). A notice in terms of section 222AOE or section 222APE of Division 9 of Part VI of the Act (known as a Director Penalty Notice) cannot be served once a corporation is placed in liquidation (see chapter entitled 'Payment agreements'). Accordingly before taking action to wind up a company that has not remitted these specific amounts, a notice in terms of section 222AOE or section 222APE ITAA 1936 should be issued;
- The Corporations Act also provides for directors to assume personal liability for debts incurred by a company while it was trading insolvently. It may, therefore, be appropriate to wind up a company with the view to having the liquidator pursue the directors for payment of the outstanding debt;
- Cases where a director of a company currently indebted to the Commissioner has a past association with another company that went into liquidation leaving significant amounts owing, should be brought to the attention of the relevant technical area to take appropriate action.

### **There are matters that may warrant an examination by a liquidator**

- The Corporations Act provides a means by which officers of a company, or any other person who may be able to provide information, can be examined about a company's affairs, including details of the promotion, formation, management, administration or winding up or any other affairs of a company;
- These examinations are generally conducted, not only for the purpose of discovering undisclosed assets, but also to assist in identifying any offences which may have been committed.

### **There is evidence of fraudulent or criminal activities on the part of the directors**

- Action to wind up the company in these circumstances should be discussed with the Serious Non-Compliance area to coordinate actions on both civil and criminal matters.

### **Settlement of amounts due to liquidators**

21.4.3 In the course of the winding up, a liquidator is required to pursue amounts due to or claimed by the company. Common examples of such claims are trade debts due to the company and loans to associated parties. More complex claims could involve a breach of contract or insolvent trading actions against directors.

21.4.4 When seeking to recover these amounts, it is common for the liquidator to receive settlement offers for a sum less than the full claim. Under

subsection 477(2A) of the Corporations Act if the amount claimed is more than \$20,000 the liquidator cannot compromise the debt without the approval of the Court, the committee of inspection or a resolution of creditors. It should be noted that such approval is not needed for a preference claim, as it is not considered a debt for the purposes of subsection 477(2A) (*Re Luxtrend Pty Ltd* (1996) 14 ACLC 1786).

- 21.4.5 The Commissioner, as a creditor, will generally vote in favour of such a compromise offer when it appears that the settlement will result in a greater return to the liquidation administration than if litigation was allowed to take its full course. In coming to such a decision, some of the relevant considerations include:
- the chances of success if litigation is to be initiated/continued;
  - if the litigation is ultimately successful, the ability of the defendant to meet the judgment debt;
  - the costs of pursuing the debt, particularly if creditors, including the Commissioner, will have to indemnify the liquidator to progress the litigation further;
  - the time it may take to achieve recovery through litigation (including the additional costs of the liquidator that will be incurred in this period, particularly as these will rank ahead of the unsecured creditors' claims); and
  - the attitude of other arm's-length creditors.
- 21.4.6 In some instances, the Commissioner may, for public interest reasons, consider that an offer should be rejected and litigation continued. For example, the claim may be against a director who has deliberately structured both the company's and his own affairs in an attempt to minimise creditors' chances of recovery. To accept an offer in these circumstances - especially for a token amount - may only encourage such behaviour in the future. However, before voting against an offer solely on public interest grounds, the Commissioner will also consider the attitude of the other arm's-length creditors and the effect that his vote will have on them - in particular, the extent to which they may be financially disadvantaged by the rejection of the settlement offer.
- 21.4.7 The Commissioner may choose to provide information about the indebted company to a liquidator where the Commissioner believes that it is reasonably likely that the provision of such information will lead to the Commissioner receiving a greater dividend or distribution from the liquidation.