

## ATO RECEIVABLES POLICY

### PART B The Collection of Taxation Debts

# Chapter 21 LIQUIDATION ACTION

*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.*

**Date of effect:** 24 July 2008 (This version replaces the 2006 version.)

**Key legislation:** *Corporations Act 2001*

## PURPOSE

1. This chapter deals with the factors and considerations that the Commissioner will take into account when deciding whether to seek the liquidation of a company. It also covers the issues that are pertinent to the Commissioner when deciding how to vote on settlement or compromise proposals.

## INTRODUCTION

2. Where a tax debtor does not propose or adhere to an acceptable proposal to pay the debt by instalments, the Commissioner will usually commence legal recovery proceedings. Those proceedings may involve the service of a claim, followed by the entering of judgment, before the use of a warrant of seizure and sale or an application to have the debtor placed into an insolvency administration. In the case of a corporate debtor which owes more than \$2000, the Commissioner has the option of seeking to have the company placed into liquidation, without first issuing a claim or seeking judgment. The liquidator can then realise the company's assets and distribute the proceeds among the company's creditors.

## POLICY

3. 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.
4. Matters that may be considered before taking liquidation action include:
  - (i) the asset position of the company
    - If there are no assets available for realisation 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 or would pay by instalments over time). If liquidation action does not appear to be worthwhile and the company has ceased trading, the debt should no longer be pursued.

(ii) the risk to revenue

- 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 persuade the Commissioner to refrain from pursuing liquidation action would need to demonstrate that steps have been taken to stop debts from escalating.
- 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 Tax Office will not usually initiate liquidation action unless there is a compliance-based justification for doing so.

(iii) 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.

(iv) 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.
- Where directors have incurred director penalties, the Commissioner will ordinarily issue director penalty notices before seeking to have the company wound up.
- Where it is apparent that the company has been trading while insolvent, the Tax Office will consider seeking the liquidation of the company as a precursor to an action against the directors under Division 3 of Part 5.7B of the *Corporations Act 2001*. If a director is found to have breached their duty to prevent insolvent trading, a Court can order the director to compensate the company (and, by extension, the company's creditors) for debts that the company incurred while it was trading insolvently.

(v) matters that may warrant investigation 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.
- (vi) evidence of fraudulent or criminal activity on the part of the directors.

### **Settlements of amounts due to liquidators**

5. 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.
6. 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).
7. 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:
  - (i) the chances of success if litigation is to be initiated or continued
  - (ii) if the litigation is ultimately successful, the ability of the defendant to meet the judgment debt
  - (iii) the costs of pursuing the debt, particularly if creditors, including the Commissioner, will have to indemnify the liquidator to progress the litigation
  - (iv) 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
  - (v) the attitude of other arm's-length creditors.
8. In some instances, the Tax Office 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 where the offer is a token amount – may only encourage such behaviour in the future. However, before voting against an offer solely on public interest grounds, the Tax Office will also consider the attitude of the other arm's-length creditors and the effect that the Tax Office's vote will have on them – in particular, the extent to which they may be financially disadvantaged by the rejection of the settlement offer.

9. The Tax Office may choose to provide information about the indebted company to a liquidator where the Tax Office 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.

## **TERMS USED**

Committee of inspection – is a representative body of the creditors of a company liquidation. The Committee may guide the liquidator regarding the interests and preferences of the general body of creditors.

### **Chapter 21 - Archived version**

Version 4 – July 2006 (will link to chapter 21 pdf)
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