Benefits of a voluntary liquidation

A company may be placed into voluntary liquidation for a variety of legal, commercial and taxation reasons. With careful planning and execution a voluntary liquidation can produce significant tax advantages. Failure to plan and execute carefully can result in significant amounts of unnessacary tax being paid.

The primary tax advantages of liquidation relate to the definition of dividends for tax purposes. Outside of liquidation, the distribution of company profits or capital gains to shareholders will be taxable as dividends. Broadly, liquidator’s distributions employ a much narrower definition of dividends for tax purposes, and consequently provide greater opportunity for tax-effective capital distributions to shareholders.

Examples of where a members’ voluntary liquidation can provide significant benefits include where the company has:

- Capital reserves or gains resulting from the sale of pre-CGT assets;
- Non-taxable gains resulting from application of the small business CGT concessions;
- Debit loans to shareholders or associates;
- Debt forgiveness reserves;
- Tax sheltered gains where a pre-CGT asset of the company was deemed to become a post-CGT asset due to a majority change in ownership.

Capital vs dividend

The basic role of the liquidator is to distribute the assets to shareholders after meeting the company’s liabilities. The shareholder receives a liquidator’s distribution in connection with the cancellation of their shares in the company. This receipt in the hands of the shareholder is distinctly capital in nature.

A liquidator’s distribution is not a dividend under the ordinary tax definition. A liquidators distribution is deemed to be a dividend if it is sourced from profits. Profit may include:

- ordinary income – income according to ordinary concepts
- statutory income – assessable income that is not ordinary income
- assessable capital gains – calculated without reference to indexation or capital losses

The ability of the liquidator to identify and specifically determine the composition of the distribution can be critical from a tax perspective.
Archer Brothers principle

The Archer Brothers principle provides guidance on how a liquidator can classify the components of a payment. The principle can be summarised as follows:

“By a proper system of book-keeping the liquidator, in the same way as the accountant of a private company which is a going concern, could so keep his accounts that these distributions could be made wholly and exclusively out of those particular profits or income.”

The ATO generally accepts the use of the Archer Brothers principle.

Liquidators should maintain accounting records, appropriate minutes and shareholder distribution statements which enable the specific source (i.e. equity account) of the distribution to be identified. As a practical consideration, this process is generally easier if the company maintains appropriate accounting records prior to the liquidator’s appointment. Capital and revenue reserves should be reviewed and properly characterised. If done correctly, this process can maximise the after-tax returns to shareholders.

The liquidator and company

From the company’s perspective, the tax consequences of liquidation are usually straightforward. The sale or transfer of the assets may result in a taxable gain and the liquidator will pay the relevant income tax and then distribute any cash or remaining assets to shareholders.

In-specie distributions of CGT assets to shareholders can become more complicated and require additional consideration.

The shareholders

Dividends

Shareholders are assessable on the dividend component of a liquidator’s distribution. The dividends may be franked.

Cancellation of shares

When shares in a company are cancelled at the completion of the liquidation, a capital gain or loss may occur at the time the shares are cancelled.

Company not dissolved within 18 months of liquidator’s distribution

If the company is not dissolved within 18 months of a liquidator’s distribution, a separate capital gain may arise.

Bringing forward capital losses

If a shareholder will ultimately realise a capital loss on the cancellation of shares, then this loss is typically available when the shares are cancelled. There is an exception where the liquidator declares in writing that he/she has reasonable grounds to believe that there is no likelihood of further distributions. Where such a declaration is made, shareholders are able bring forward their capital loss. However, we note that this rarely has practical application for a members’ voluntary liquidation.

Want to know more?

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