MEMBERS' VOLUNTARY LIQUIDATION

It is often talked about how easy a company is to set up. Within 24 hours a company can be established and the company can be used. But how easy is it to close down a solvent company? What are the ways to close down a company? And which option is the most appropriate?

Why?

There are numerous reasons for winding up a solvent company, the most common being:

- the company has outlived its usefulness and no longer suits your clients succession plan
- an owner is choosing a simplified structure which reduces annual compliance costs
- transfer of capital appreciating assets to a more CGT friendly environment
- distribution of paid up share capital and pre-capital gains tax ('CGT') capital reserves free from tax. Outside the liquidation process the distribution of these tax free reserves are likely to have large taxation implications
- large Division 7A issues exist within the company as a result of the tax free profits being withdrawn from the company. Often businesses are sold and funds are stripped out of company structures resulting in Division 7A issues involving minimum repayment requirements and interest charges

How?

Briefly, there are two ways to wind-up a solvent company, being:

- deregistration
- member's voluntary liquidation ('MVL')

The choice of method to wind up a company is determined by factors including the nature of the assets, the level of pre-CGT and post-CGT reserves, the amount of share capital and stamp duty depending on the state jurisdiction.

Which is best?

Deregistration is appropriate when a company ceases to carry on a business, has no liabilities, and has assets of less than $1,000. Deregistration is a relatively quick and easy, cost effective method to simplify a client's financial structure, and once deregistered, there are no further annual compliance costs.

If a company has untaxed capital profits in a company, involving either pre-CGT profits or small business CGT concessions – then a ASIC deregistration is not the most appropriate option.

A member's voluntary liquidation is the most tax effective way to close down a company with pre-CGT profits or tax free profits, as a result of the small business CGT concessions. Distribution of either pre-CGT profits or untaxed small business CGT concessions by any other method would result in the relevant payments being treated as an ordinary dividend. Treating payments as ordinary dividends (most likely unfranked) could result in shareholders facing significant and avoidable tax liabilities.

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What are the taxation implications of a MVL?

When considering the taxation implications of a member's voluntary liquidation, it is necessary to consider them from two perspectives:

1. the liquidator's perspective

2. the member's perspective

The liquidator's perspective

When a liquidator is making a distribution to shareholders, they need to consider whether a distribution of funds is income or capital in nature. The liquidator makes this allocation based on the records maintained by the company or the accountant.

When a liquidator distributes a particular fund or account within the books and records (e.g. pre-CGT profits), this distribution maintains its character when being returned to the shareholders. This treatment is commonly referred to as the Archer Brothers principle, which continues to be accepted by the Australian Taxation Office (see TD 95/10). In order to make this allocation, a proper system of accounting is essential to ensure the distribution of profits is made in the correct proportions of capital and income.

A liquidator will make two types of distributions, including:

- income – if a distribution to members is from income generated by the company, then it will be deemed to be a dividend paid to members out of profits derived from the company (s 47(1) ITAA 1936). Income generated by the company includes income from ordinary concepts, such as trading profits, or income specifically deemed assessable under the taxation acts (.e.g. rental income, interest or dividend income). Distributions of income may be either franked or unfranked, depending on the level of franking credits in the franking account.

- capital – items considered capital are: non-taxable capital gains, capital royalties, Pre-CGT profits or Profits subject to the 50% small business reduction.

The distribution to members can take many forms. For example, it can be made in cash, made of assets via an in-specie distribution accounted for at market value, or may constitute a distribution offset against shareholder debit loan accounts (where they had previously taken the funds).

A liquidator will prepare a distribution statement which will allocate the distribution between income and capital. A member should retain this statement to ensure that these components are correctly disclosed in their tax return.

The member's perspective

A member receiving a distribution from the liquidation will need to consider the tax implications separately to the tax implications for the liquidator.

The member will receive a distribution statement from the liquidator advising if a distribution is being made, and if so, the composition of the distribution.

As outlined above, the distribution will allocate the distribution into the following components:

1. Dividend

A dividend will form part of the member's assessable income for tax purposes. The distribution statement will show the franked and unfranked components of the distribution.

2. Capital

The distribution of capital will comprise a return of initial paid up capital, along with any payments deemed to be of a capital nature by the liquidator. If the liquidator determines that a distribution is of a capital nature, the members will need to consider the CGT consequences of receiving the distribution, which can include:

- a return of capital to a pre-CGT shareholding will generally not constitute assessable income. The instances where a pre-CGT shareholding is assessable occur when CGT event K6 Applies – which is typically in instances where 75% of the market value of the company has post CGT assets, or if the shareholding has changed by more than 50% since the introduction of the CGT rules.

- A return of capital to a post-CGT shareholding will be assessable in the hands of the member. The member may be eligible to apply the 50% CGT discount, the 50% active asset exemption or the $500,000 retirement exemption.

Winding up a solvent company has many legal and taxation implications which advisers should consider. We welcome the opportunity to discuss with you your role and the assistance we provide.

CASE STUDY

Here is an example of the benefits of member's voluntary liquidation. An accountant contacted us seeking some assistance in relation to one of their clients. The client, a trading company, sold its business and was seeking advice as to the most tax effective way to remove funds from the company.

The company's balance sheet is in 'Table A' below.

TABLE A

Net assets	$1,000,000
Represented by	
Issued capital	$1,000
Pre-CGT capital profits reserve	$700,000
Accumulated profits (fully franked)	$299,000
Total equity	$1,000,000

TABLE B

Company closed via			
	De-registration	**Members voluntary liquidation**	**Saving**
Tax payable	$206,778	$44,028	$162,750

There was only one shareholder of the company, and he acquired his shares before 19 September 1985 (pre-CGT shares).

We worked through the calculations and identified that by winding up the solvent company via a MVL rather than deregistration it resulted in a saving of $162,750 in income tax (refer 'Table B' above).

Why RSM ?
We approach an MVL differently.

At RSM, the liquidator works in partnership with our team of local taxation experts. This ensures that the liquidation aspects of the winding up are managed by a registered liquidator and the taxation aspects of the winding up are managed by a registered tax agent.

We have access to specialist expertise
As a national practice, we can call on the resources and expertise of accountants working across the country and in a vast array of industries, including our specialist tax advisory teams in Sydney and Melbourne who regularly advise ASX Listed companies on complex taxation matters.

We have the resources to get the job done fast
Our national team of 12 Liquidators, 100 Insolvency staff and over 950 staff spread across 28 offices nationally gives us unparalleled access to local resources.

We pride ourselves on providing value for money solutions
To this end we can provide fixed fee quotes at competitive rates.

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