

*Any coward can fight a battle
when he's sure of winning.*

----- George Eliot

Voluntary Solvent Liquidation or Deregistration

WHY IS THE DECISION SO IMPORTANT?

We often receive queries about the merits of winding up an unwanted company through a Members' Voluntary Liquidation as opposed to deregistration of the company. The wrong choice may prove to be a very costly one.

The purpose of this news letter is to examine when the rules will allow you to deregister a company (rather than liquidate it), and by way of example, illustrate how important the correct choice of liquidation or deregistration can be, from a tax aspect.

RESTRICTIONS ON DEREGISTRATIONS OF COMPANIES

The restrictions relating to the deregistration (rather than liquidation) of a company are fairly straightforward. In essence, before a company is deregistered, the Corporations Act requires the following:

- All members of the company must agree to the deregistration;
- The company must not be carrying on business;
- The company's assets must be worth less than \$1,000;
- The company must have paid all fees and penalties payable under the Act;

• The company must not have any outstanding liabilities, and

• The company must not be a party to any legal proceedings.

BEWARE OF TAX ASPECTS

Despite the increased cost, a Members' Voluntary Liquidation can often be the way to go.

TAX IMPLICATION

The relative tax benefits of liquidation may become apparent where a company has significant net assets that are represented in shareholders' equity by accumulated profits and capital reserves. The winding-up of the company will inevitably require a distribution of these profits and capital reserves to shareholders. Outside of a liquidation, these amounts will be fully taxable to shareholders as dividends. However, a liquidator's distribution is not subject to the ordinary tax provisions dealing with dividends. A liquidator's distribution is dealt with under specific income tax provisions and the capital gains tax regime. In some circumstances this distinction will provide definite tax advantages for shareholders.

Two common situations where shareholders may benefit on liquidation are as follows:

- Shares acquired before 20 September 1985.

The principal benefit arises where the company has gains that were realized on the disposal of pre-CGT assets (i.e. assets acquired before 20 September 1985). Such gains can be distributed

to the relevant shareholders tax-free, on liquidation. A distribution of these

gains would otherwise be assessable to shareholders.

- A company which has utilised the small business CGT concessions.

Often the sale of the business assets may qualify for a 50% CGT exemption if certain criteria are satisfied. If this tax-free gain is distributed to shareholders, then it will ordinarily be fully assessable as a dividend. By contrast, a liquidator is able to preserve a significant proportion of this tax concession for the benefit of shareholders.

EXAMPLE

Beach House Pty Ltd was incorporated in 1982 with \$2 in share capital. Neville and Joy were allotted one share each which they continue to hold. Neville and Joy lent \$200,000 to the company to acquire a property in 1983. This property was sold recently for \$700,000 realising a tax-free capital gain of \$500,000. The company has approximately \$500,000 in the bank after repaying the debt to shareholders. Neville and Joy wish to wind-up the company.

OPTION 1 – DEREGISTRATION

The company would need to distribute the cash to Neville and Joy prior to deregistration. All but \$2 of this amount will be assessable as an unfranked dividend. A dividend of \$500,000 will be liable for tax of up to \$235,000 (based on the top marginal tax rate of 47%).

OPTION 2 – LIQUIDATION

The capital gain may be distributed tax free to Neville and Joy.