Direct Tax Implications of Receiverships, Examinerships and Liquidations

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Introduction

The direct tax implications of liquidations, receiverships and examinerships can raise some unique issues for tax practitioners, and there are certain aspects of tax legislation in this area that can have penal tax consequences. However, there is often the potential to minimise tax liabilities where tax assets, e.g. losses, are identified and dealt with in a timely fashion.

One example of a tax provision that can have penal tax consequences is the obligation of receivers/banks in relation to mortgaged property. This is because a receiver may be assessed to tax in respect of rental income from the mortgaged property and the liability is computed as if the mortgagor were still in possession or no receiver had been appointed. A receiver will often not have sufficient information to compute the liability accurately and will be obliged to pay tax at the top tax rate applicable without taking into account reliefs that may be due to the mortgagor. I understand that the Revenue Commissioners are currently reviewing these provisions with a view to making them more equitable.

There are certain distinctions in law between a receivership and a liquidation. Both involve a formal appointment of someone other than the owners/directors to take control of the assets and perhaps the business with the broad aim of preserving and realising the assets for the benefit of the creditors. The main difference is that a liquidator acts for all creditors whereas a receiver generally acts for a particular creditor, usually a bank. The receiver has no direct responsibility to unsecured creditors of a company, and his or her work is complete when the creditor has been paid all monies due. A liquidator must settle the claims of the creditors and distribute any remaining balance among the owners according to their respective entitlements.

Tax Review on Appointment

It is important to carry out an initial tax review following appointment and to do the following as a starting point:

› Seek clarification in relation to the tax status of the company from employees, former advisers and Revenue.

› Review tax payments and status in the previous five years.

› Identify if there are losses/whether losses can be surrendered on a paid basis within the group.

› Assess the potential for selling any unused losses or capital allowances externally.

› Review any potential exposure to clawbacks of various reliefs previously claimed.

It is important also to have procedures in place to ensure that time limits for paying tax, filing returns and making claims and elections are adhered to. For instance, many loss reliefs have a strict two-year time limit. Also, there is a restriction on the availability of losses if returns are filed late. These matters can easily be overlooked where a receivership or liquidation extends over a number of years without much activity happening in the interim.

Tax Issues on Appointment of a Receiver

The appointment of a receiver does not, of itself, give rise to any immediate tax consequences. It does not result in a discontinuance of the company's business or the end of an accounting period for tax purposes.

Group reliefs unaffected

In a company situation, receivership does not affect a group structure for the purposes of group loss relief, capital gains tax, VAT or stamp duty. Losses of a company in receivership can be claimed by other group companies subject to consent of the receiver, who can demand payment for the surrender of the losses, thus creating value for any losses incurred.

Taxation of trading profits and tax on deposit interest

Taxation of trading profits arising during the receivership remains the responsibility of the owner of the business. In addition, tax on deposit interest is also the responsibility of the deposit holder. This principle was established in the tax case *Wayte (Holdings) Limited*. In addition, s1050 TCA 1997 in essence affords protection to the receiver as agent for the company.

A receiver may be assessed to tax on rental income

A receiver may be assessed in respect of rental income arising from a mortgaged property, and the liability will be computed as though it were that of the mortgagor. This can give rise to some practical issues for the receiver, as outlined in the introduction. The strict position is that the tax should be assessed and paid over to the tax authorities based on the worst-case scenario if the personal tax information of the mortgagor is not available. In the absence of such information, this can give rise to a penal level of tax being paid on the rents. For example, the borrower may have been entitled to capital allowances, losses or other reliefs.

Tax-based investments and clawback of allowances

In the current climate many investors are seeking to exit their tax-based investments before the tax life of the asset has expired. This can lead to harsh treatment in some cases where there is a large clawback on the disposal of the asset. A clawback of capital allowances on rented property would be assessed to tax as rental income at the marginal rate of tax of an individual investor and would also be subject to the Universal Social Charge. A receiver or the bank may be responsible for this tax in respect of the property on the basis that it is treated as rental income as above. In certain circumstances it may be possible to mitigate the charge.

Receiver liable to tax on disposal of assets

Where there is a disposal of assets the receiver will be liable for capital gains tax (and VAT, where applicable) in respect of all disposals made. Receivers' fees, fixed charge and floating charge holders should be discharged out of the proceeds received on the sale of the assets and winding-up of the business. If the debenture holders have a floating charge, the receiver must take account of preferential claims before making any distribution to the debenture holders.

Under s571 TCA 1997 an "accountable person" includes "any person entitled to an asset by means of security or to the benefit of a charge or encumbrance on the asset or, as the case may be, any person appointed to enforce or give affect to the security, charge or encumbrance". Therefore, the CGT is due on the disposal of an asset by an accountable person, i.e. the receiver, and is computed as if the receiver had made the disposal.

Tax is assessable under Case IV of Schedule D as income of the year in which the disposal occurs and is recoverable out of the proceeds on the sale. When calculating the chargeable gain/loss, the following should be borne in mind: losses forward/current-year loss, the personal annual allowance, the base cost of the asset and indexation relief if applicable.

It is important to ensure that sufficient information is obtained on deductible expenditure incurred on the asset for CGT purposes before disposal, as the tax charge impacts on the amount available to be paid over to the secured creditor.

Where there have been disposals of assets by the receiver and by the company in an accounting period within the period of the receivership, it will be necessary to identify the part of the total corporation tax liability that must be paid by the receiver as an accountable person.

Tax Issues on Appointment of Examiner

The aim of an examiner is to negotiate the reduction of the company's debts to third-party creditors. The appointment of an examiner does not bring an accounting period to an end and has very little impact on the tax status of the company.

The appointment does not affect the tax status of the company if it is in a group for corporation tax, CGT and VAT purposes. All tax that arises during the period of the examinership must be accounted for by the company in the normal course.

An examiner has the power, subject to the approval of the courts, to sell the assets of the company in order to raise funds to pay creditors. Any resulting liabilities are the responsibility of the company.

Tax Issues on Appointment of Liquidator

End of an accounting period for tax

The appointment of a liquidator has the effect of bringing an accounting period to an end (and a new accounting period begins). The new accounting period will not end until the completion of the winding-up or the expiration of 12 months from the beginning of the new period, if earlier.

A company is liable for all taxes that arise during the course of a liquidation (s26(2) TCA 1997). However, although the tax is assessable on the company, the liquidator is responsible for accounting for such tax and for filing tax returns under a separate tax number in the case of voluntary liquidations. The tax obligations of the liquidator differ somewhat in the case of court liquidations (discussed below).

Group loss relief ceases

When a liquidator is appointed, the company ceases to be the beneficial owner of its assets, including shares in subsidiaries. Therefore, on the appointment of the liquidator, a company ceases to be a member of a group for corporation tax loss relief purposes. Accordingly, liquidators are not able to sell losses intragroup as the group relationship ceases to exist on the appointment of a liquidator. Therefore, it is critical to consider the utilisation of losses before the appointment of the liquidator.

An example of the negative impact is in a group situation where a group finance company has borrowed from a bank and lent money intragroup to trading or rental companies for the purpose of their businesses. The interest paid on borrowings in the finance company may be relieved by way of group relief. If a liquidator is appointed to the finance company or the group holding company and the other companies are put in receivership, the interest paid cannot be relieved by way of group relief against the profits generated by any of the companies in receivership, leaving the tax on their income unsheltered.

Capital gains tax group reliefs unaffected

The appointment of the liquidator does not affect a group for the purposes of group capital gains relief, so assets may still be transferred on a tax-neutral basis within the group, as the acts of the liquidator are deemed to be those of a company, and there is a deferral of CGT on intragroup transfers until the company leaves the group (if this occurs within ten years of the date of transfer).

Exemption is available from clawback of CGT group relief on the eventual dissolution of the company if it can be proven that the winding-up is for bona fide commercial reasons and not part of a tax-avoidance scheme.

Court liquidation

In the case of court liquidations, it is important to note that there is no statutory obligation on the liquidator to pay corporation tax. This is supported by the decision in the *Hibernian Transport* case.

However, this decision is not upheld with regard to the liquidator's liability to account for capital gains tax or corporation tax on capital gains in the case of a court liquidation. This is supported by the decision in the *Van Hool McArdle Ltd* case and provided for in s571 TCA 1997.

Cessation of trade

The appointment of a liquidator does not necessarily result in the immediate cessation of the trade. It is necessary to look at the facts of each case in order to determine whether the trade has ceased. The relevant issue is whether the liquidator is carrying on a trade or realising assets. If the trade has ceased, terminal loss relief may apply whereby losses of the last year of trading may be offset against the profits of the prior three years. Trade losses forward cease to be available for use, and balancing allowances and balancing charges may arise.

Unused capital losses continue to be available for offset against capital gains arising up to the date of completion of the liquidation.

Liquidator is assessable on disposal of assets

On any disposal by a liquidator of the company, or any person entitled to an asset by way of security or to the benefit of a charge or encumbrance, such person is deemed to be an accountable person for CGT purposes.

The CGT due is to be settled out of the disposal proceeds. Such tax is treated as discharging a corresponding liability of the original debtor. Tax is assessed under Schedule D, Case IV, and not as a CGT receipt. The liquidator is liable to pay CGT or corporation tax on chargeable gains in both voluntary and court liquidations.

CGT Clearance Certificate

Section 980 TCA 1997 provides for a withholding tax from the purchase price of certain assets by a purchaser where a tax clearance certificate is not produced.

If the vendor obtains a tax clearance certificate (Form CG50A), the vendor is entitled to the full proceeds on the disposal. There is a formal procedure for obtaining clearance. However, this is not applicable in cases where the proceeds are less than €500,000.

Tax Issues in Common for Liquidations and Receiverships

Cessation of the trade

During the course of a receivership/liquidation, quite often a company will cease to trade. The date of cessation is a question of fact and signifies the end of an accounting period, i.e. the formal closure of the business. However, difficulty occurs when deciphering whether the company is carrying on a trade or simply realising trading assets. If the company is simply collecting debts and realising assets, it is likely that the trade has ceased.

When a trade has ceased, any income received after the date of cessation will be taxed as a post-cessation receipt under Schedule D, Case IV, at 25%, as opposed to the 12.5% trading rate.

In arriving at the amount chargeable under Case IV, tax deductions are allowed for any loss or expense that would have been deductible in computing taxable profits had the trade or profession not ceased (but losses arising directly or indirectly from the cessation are excluded).

When trading ceases, plant and machinery is treated as if it had been sold at market value for tax purposes, and any balancing allowances/charges will arise in the final period of trading.

A cessation of trading may not of itself give rise to a balancing adjustment in respect of industrial buildings, but a sale of the building itself will give rise to a balancing adjustment. A balancing charge will typically not arise or give rise to taxation in a receivership or liquidation as the market value of the assets may well be below the tax-written-down value or there may be sufficient losses to cover any balancing charge.

It is important to note that any bad debts recovered after cessation are treated as not having been brought into account and are charged under Case IV. Therefore it is advisable that bad debts are written off before cessation so that the company can claim a deduction.

In the case of both the liquidator and the receiver, if any debts of the company are written down as part of negotiation with creditors, a tax charge will arise to the company, which could be at 12.5% or 25%, depending on whether the company has ceased to trade.

Offset of losses

In the case of a receiver, capital losses may be offset against capital gains arising in the same accounting period. Additionally, any capital losses may be carried forward for offset in future periods (s31 TCA 1997).

Any capital losses incurred on development land are available for offset only against chargeable gains on development land, i.e. the losses are ring-fenced (s653 TCA 1997).

In cases where a company is a member of a group, it is important that the floating charge receiver considers whether it is possible to receive payments from another group company for the surrender of trading losses. In some cases, depending on the powers of the receiver, he or she may be able to demand payment for the surrender of group relief.

Payments for group relief are not taxable in the hands of the surrendering company as long as the payment does not exceed the amount of losses surrendered (s411(5) TCA 1997).

Another potential option in relation to recognising the value of trading losses is the potential hive-down of the trade.

Liquidators will not be able to sell losses intergroup as, on the appointment of a liquidator, the group relationship ceases to exist as between it and its subsidiaries and between the subsidiaries themselves. If possible before liquidation, consideration could be given to creating a subgroup so that at least group relief will be preserved between the subsidiaries.

When the trade ceases, terminal loss relief may be available; however, the company will lose the benefit of trade losses carried forward. It is important to consider whether it would be more beneficial either to cease trading in order to claim terminal loss relief or to transfer the trade to another company with a view to selling it to a third party.

Capital losses may be offset against capital gains arising in the same accounting period, and any capital losses may be carried forward for offset in future periods. Even if the trade ceases, any unutilised CGT losses will continue to be available for offset against capital gains arising up to the date of completion of the liquidation.

Hiving down the trade

A receiver will normally be able to identify a part of the business that could be carried on profitably when freed of existing liabilities. The trade could be transferred to a new company, which may be retained within the group or sold to a third party. Tax legislation provides relief where a trade is transferred to a subsidiary company whereby the benefit of past losses and capital allowances are carried forward within the new company. There should be common 75% ownership within one year before and within two years after the transfer.

Any tax on a disposal of chargeable assets intragroup can be deferred, but a sale of the company with the trade hived down to a third-party purchaser will break the group and crystallise the chargeable gains that were deferred. The gains may be covered by indexation relief, and it is likely that they will be confined to real estate. The real estate could be sold separately from the business if this is an issue.

The group break-up may also give rise to a clawback of stamp duty relief on transfers between associated companies.

Capital distributions – multiple charges to CGT

A distribution of chargeable assets to the shareholders in the course of a liquidation is regarded as a part-disposal of the shareholders' shares, as well as being a disposal of the assets at market value by the liquidator. There can be multiple charges where there is a liquidation of a vertical chain of companies.

A transfer of chargeable assets within a group is normally treated as being for no gain/no loss. Consideration could be given to transferring the assets to the top holding company before the liquidation of the subsidiaries to avoid multiple charges at the level of each subsidiary in the chain.

Tax Issues on redundancy/termination

In many cases the liquidator and receiver decide to retain a number of key personnel of the company during the liquidation or receivership. It is important to consider the tax treatment of any payments to these individuals

Where the employee has a contractual right to receive the payment, the receiver or liquidator should be able to claim a tax deduction. However, where the payment is *ex-gratia* and made after the cessation of the trade, no tax deduction can be made.

Where the payment is contractually secured, it would not be considered an *ex-gratia* termination payment, and therefore the tax reliefs provided on retirement or removal from employment cannot be claimed by the employee.