QUESTIONS WE'VE BEEN ASKED

First step legally necessary to achieve liquidation when a liquidator is appointed

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This Question We've Been Asked considers when the first step legally necessary to achieve liquidation occurs when a liquidator is appointed under the Companies Act 1993. The item is designed to sit alongside "Public Ruling BR Pub 14/09: Meaning of 'Anything Occurring on Liquidation' When a Company Requests Removal from the Register of Companies". The item confirms that the first step legally necessary to achieve liquidation when a liquidator is appointed is the special resolution of shareholders to appoint a named liquidator.

Key provisions

Income Tax Act 2007 – definition of "liquidation" in s YA 1

RELATED TO: BR Pub 14/09

Question

Is the first step legally necessary to achieve liquidation when a liquidator is appointed (a long-form liquidation) the same as the first step legally necessary in a short-form liquidation?

Answer

No – The first step legally necessary to achieve a short-form liquidation is a resolution by the shareholders or board of directors or, where applicable, another overt decision-making act provided for in a company's constitution to adopt a course of action that will end in removal from the register.

The first step legally necessary to achieve a long-form liquidation is a shareholders' resolution appointing a named liquidator as required by the Companies Act 1993.

Key terms

Long-form liquidation means a liquidation carried out under the process set out in part 16 of the Companies Act 1993 where a liquidator is appointed to wind up a company. For ease of reference, this Question We've Been Asked refers to the most likely scenario for a solvent liquidation where the shareholders of a company appoint a named liquidator by way of a special resolution under s 241(2)(a) of the Companies Act 1993. It does not consider insolvent liquidations.

Short-form liquidation means the removal of a company from the register under ss 317 and 318 of the Companies Act 1993 as a process on its own without the formal appointment of a liquidator. For ease of reference, this Question We've Been Asked refers to the most likely scenario for a solvent company where a request for removal from the register is made by a shareholder authorised by special resolution, or the board of directors, under s 318(1)(d) of the Companies Act 1993.

Explanation

1. Under the Income Tax Act 2007, the term "liquidation" includes, in references to anything occurring "on liquidation", anything occurring during the period that starts with a step that is legally necessary to achieve liquidation.

2. This definition is important because it describes when the period of "liquidation" begins for tax purposes. Among other things, this is important because the Income Tax Act allows a company to make tax-free distributions of capital gains to its shareholders "on liquidation".

3. The Commissioner set out her views on how this definition of "liquidation" should be interpreted in "Public Ruling BR Pub 14/09: Income Tax – Meaning of 'Anything Occurring on Liquidation' When a Company Requests Removal from the Register of

Companies", *Tax Information Bulletin* Vol 27, No 1 (February 2015): 3. BR Pub 14/09 applies to short-form liquidations.

4. In summary, the commentary to BR Pub 14/09 explains that "liquidation" is a process, and that the period of liquidation starts with a "step", which requires an overt action that is:
   - "legally necessary" or legally required; and
   - made "to achieve liquidation", rather than for any other purpose.

Short-form liquidations

5. The Companies Act 1993 requires decisions regarding the management of a company to be made by the company's board of directors, by way of resolution. Therefore, it is the Commissioner's view that any decision to adopt a course of action that will end in removal of the company from the register will ordinarily be recorded in a director's resolution. However, a company's constitution may require another course of action for making such a decision, such as a shareholders' resolution or other overt decision-making act.
6. In the commentary to BR Pub 14/09, the Commissioner accepts that the first step legally necessary to achieve a short-form liquidation could be a resolution to:
   - cease business;
   - pay all creditors;
   - distribute surplus assets; and then
   - request removal from the register of companies.
7. The Commissioner also accepts that, depending on the facts, other steps may be taken that could be the first step that is legally necessary to achieve a short-form liquidation.
8. This item is intended to supplement the commentary provided in BR Pub 14/09.

Long-form liquidations

9. The Commissioner's view is that the first step legally necessary to achieve a long-form liquidation is not the same as for a short-form liquidation.
10. The Companies Act 1993 contains detailed rules describing the process for a long-form liquidation. Under those rules, a long-form liquidation of a solvent company generally commences when the shareholders pass a special resolution to appoint a named

liquidator. The Commissioner considers that this is the first step legally necessary to commence a long-form liquidation for tax purposes.

11. When a liquidator is appointed by a shareholders' resolution, it will be necessary to take some steps before appointing the liquidator. These steps include calling a special meeting of the shareholders and ensuring that the named liquidator has validly consented in writing to be appointed prior to the shareholders passing the resolution (see *CIR v Service Equipment Limited* (2000) 19 NZTC 15,832). However, the Commissioner's view is that these are merely preparatory steps. Neither of these steps guarantees that the liquidation will actually commence. For example, a liquidator could agree to be appointed but the shareholders' resolution may not pass. Therefore, while obtaining written consent from the liquidator is a "legally necessary" step, it is not necessarily one that will "achieve liquidation".

Changing processes

12. Sometimes, a company that has embarked on a short-form liquidation may find it necessary due to unforeseen circumstances to appoint a liquidator. This could occur, for example, where a dispute arises in the course of winding-up the business that would be better to have a third-party liquidator resolve. The Commissioner considers that the period known as "on liquidation" began when a valid resolution was passed commencing the short-form liquidation process.

Time delays

13. In some cases, there may be an extended period between the first step legally necessary to achieve liquidation and the removal of the company from the register. The period may even span different tax years, so that a distribution is made in a period preceding the removal of the company from the register. The Commissioner will assume that any distributions are made pursuant to a genuine intention to liquidate. However, if the liquidation is not completed or, in the case of a short-form liquidation, the company does not cease to trade after a resolution to cease to trade is passed, then such a distribution will not have occurred "on liquidation" and the distributions will be taxable.

Examples

Example 1 – Short-form liquidation

The directors of Oak Tree Enterprises Limited decide to wind-up the company. They pass a resolution to cease business, pay all creditors, distribute surplus assets and then request removal from the register of companies. After passing the resolution, the directors resolve to pay a dividend to the shareholders consisting of capital gains derived from selling a building. Two years later, after winding up the business, paying all creditors and distributing the last of the assets, the company is removed from the register.

The period of liquidation began when the directors made their resolution to carry out a course of action that would end with the company being removed from the register. Therefore, the distribution of capital gains was made "on liquidation".

Example 2 – Long-form liquidation

The directors of Sequoia Industries Limited decide that the company is ready to be wound up. They arrange a special meeting of shareholders and obtain the written consent of a liquidator to act. At the meeting, the shareholders pass a special resolution to appoint the liquidator. During the course of the liquidation, past capital gains are distributed to the shareholders.

The period of liquidation began when the shareholders passed the resolution to appoint the liquidator. Therefore, the distribution of capital gains was made "on liquidation".

Example 3 – Not "on liquidation" – Short-form liquidation

The directors of Spruce Sales Limited pass a resolution to cease business, pay all creditors, distribute surplus assets and then request removal from the register of companies. The directors then make a distribution of past capital gains to the shareholders. However, over the next year, Spruce Sales Limited continues to trade, including purchasing new trading stock.

In this situation, the Commissioner would not consider that the directors made a genuine resolution to adopt a course of action that would end in the company being removed from the register. Therefore, the distribution of past capital gains would not be made "on liquidation" and will be taxable as a dividend. The dividend cannot be imputed because imputation credits can only be attached at the time a dividend is paid.

Example 4 – Not "on liquidation" – Long-form liquidation

The directors of Totara Trades Limited decide to wind up the company. They talk to a liquidator about acting and obtain their oral consent. However, they pass a resolution of shareholders prior to obtaining written consent of the liquidator. The directors then make a distribution of past capital gains to the shareholders.

In this situation, the liquidators have not been validly appointed because they did not accept the appointment in writing before the shareholders resolution. Therefore, the distribution of past capital gains would not be made "on liquidation" and will be taxable as a dividend. The dividend cannot be imputed because imputation credits can only be attached at the time a dividend is paid.

References

Legislative references

Companies Act 1993 – ss 241, 317, 318

Income Tax Act 2007 – s YA 1 ("liquidation").

Other references

"Public Ruling BR Pub 14/09: Income Tax – Meaning of 'Anything Occurring on Liquidation' When a Company Requests Removal from the Register of Companies", *Tax Information Bulletin* Vol 27, No 1 (February 2015): 3

About this document

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