

“ANYTHING OCCURRING ON LIQUIDATION” WHEN A COMPANY REQUESTS REMOVAL FROM THE REGISTER OF COMPANIES

PUBLIC RULING - BR Pub 05/14

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation Laws

All legislative references are to the Income Tax Act 2004 unless otherwise stated.

This Ruling applies in respect of paragraph (b)(i) of the definition of “liquidation” in section OB 1.

The Arrangement to which this Ruling applies

The Arrangement is the liquidation of a company where a request is made under section 318(1)(d) of the Companies Act 1993 that the company be removed from the New Zealand register of companies.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

The first step legally necessary to achieve liquidation where a request is made to the Registrar of Companies to remove a company from the New Zealand register under section 318(1)(d) of the Companies Act 1993 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 culminate in removal from the register. That step starts the period specified in paragraph (b)(i) of the definition of “liquidation” in section OB 1, and anything done after that step for the purpose of enabling liquidation occurs “on liquidation” for the purposes of the Income Tax Act.

The period for which this Ruling applies

This Ruling will apply from 8th November 2005 to 31 December 2008.

This Ruling is signed by me on the 8th day of November 2005.

Martin Smith
Chief Tax Counsel

COMMENTARY ON PUBLIC RULING BR Pub 05/14

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in Public Ruling BR Pub 05/14 (“the Ruling”).

Background

This ruling concerns the meaning of “anything occurring on liquidation” in paragraph (b) of the definition of “liquidation” in section OB 1 of the Income Tax Act 2004.

“Liquidation” includes removal from the register of companies which can either follow the full liquidation process, or can be an alternative means of ending the life of a company in itself. Under section 318(1)(d) of the Companies Act 1993 a request for removal from the register can be made by an authorised shareholder, or by the board of directors or any other person required or permitted to do so by the constitution of the company, after the company has paid its debts and distributed any surplus to its members. Removal from the register under this section is sometimes referred to as “short form liquidation” and is a cheaper and simpler option than a full liquidation.

Paragraph (b) of the definition of liquidation prescribes the period during which anything can occur on liquidation, saying that it starts with “a step that is legally necessary to achieve liquidation”. Establishing the beginning of that period – by the first legally necessary step – is critical in determining what things may occur on liquidation.

Paragraph (b)(i) gives two examples of steps, one of which is a request under section 318(1)(d), and this has given rise to some uncertainty as to whether the request is the first step legally necessary when that process is followed.

One important practical result of this relates to the ability of companies to make tax-free distributions “on liquidation” under section CD 18(2) of the Income Tax Act. If the request is the first step of that section 318(1)(d) removal process, as some commentators have suggested, distributions cannot be made “on liquidation” as all surplus assets must have been distributed before the request is made. So while amounts could be distributed tax-free under section CD 18(2) of the Income Tax Act on a full liquidation, they could not be exempt on a “short form liquidation”.

Legislation

Section OB 1 provides:

OB 1 For the purposes of this Act, unless the context otherwise requires,-

liquidation, for a company, -

- (a) includes -
 - (i) removal of the company from the register of companies under the Companies Act 1993; and
 - (ii) dissolution of the company under the Companies Act 1955; and
 - (iii) termination of the company's existence under any other procedure of New Zealand or foreign law; and

- (b) includes, in references in this Act to anything occurring on liquidation, anything occurring -
 - (i) during the period that starts with a step that is legally necessary to achieve liquidation, including the appointment of a liquidator or a request of the kind referred to in section 318(1)(d) of the Companies Act 1993; and
 - (ii) for the purpose of enabling liquidation

A request to remove a company from the New Zealand register of companies can be made under section 318 of the Companies Act 1993, paragraph (d) of which provides:

318(1) Subject to this section, the Registrar must remove a company from the New Zealand register if—

- ...
 - (d) There is sent or delivered to the Registrar a request in the prescribed form made by—
 - (i) A shareholder authorised to make the request by a special resolution of shareholders entitled to vote and voting on the question; or
 - (ii) The board of directors or any other person, if the constitution of the company so requires or permits—
- that the company be removed from the New Zealand register on either of the grounds specified in subsection (2) of this section; ...

Section 318(2) provides the grounds for making such a request:

318(2) A request that a company be removed from the New Zealand register under subsection (1)(d) of this section may be made on the grounds—

- (a) That the company has ceased to carry on business, has discharged in full its liabilities to all its known creditors, and has distributed its surplus assets in accordance with its constitution and this Act; or
- (b) That the company has no surplus assets after paying its debts in full or in part, and no creditor has applied to the Court under section 241 of this Act for an order putting the company into liquidation.

Application of the Legislation

A request to remove a company from the register of companies under section 318(1)(d) of the Companies Act 1993 can be made by a shareholder authorised by shareholders' special resolution, or by the board of directors or any other person where the constitution requires or permits them to do so.

It is clear from the two alternative grounds for requesting removal under this section (set out in section 318(2)) that at the time the request for removal is made any surplus assets must have already been distributed.

The function of paragraph (b) of the definition of “liquidation” in the Income Tax Act is to set out when anything may occur on liquidation. Subparagraph (i) defines the period. The beginning of the period is most important and starts with “a step that is legally necessary to achieve liquidation”. This puts the focus on the first of such steps. Subparagraph (ii) limits the “anything occurring on liquidation” to things occurring within that period that are for the purpose of enabling liquidation. Things that occur for another purpose will not occur “on liquidation”.

What is meant by “a step that is legally necessary to achieve liquidation”?

The phrase “a step that is legally necessary to achieve liquidation” distinguishes between steps that are legally necessary and any other steps, and between steps that are to achieve liquidation and those taken for any other purpose.

The ordinary meaning of the word “step” implies an “action” so the focus is on overt acts rather than, for example, the existence of circumstances or beliefs. Some steps necessary to achieve liquidation in practice may not be legally necessary. For example, a step that is necessary in practice for a liquidation by special resolution of shareholders is to decide who the liquidator will be. That decision is not a legally required step even though it must have occurred. The closest legally necessary step would be appointing the liquidator or obtaining the liquidator’s written consent to appointment.

The words “to achieve liquidation” further narrow the range of steps that are legally necessary that can commence the period. Some steps legally necessary to achieve liquidation may be taken for some other purpose than to achieve liquidation. For example, paying all creditors is necessary before making a section 318(1)(d) request, but may be done in the ordinary course of business rather than for the purpose of enabling liquidation.

Other steps may not reach the required threshold to be “to achieve liquidation”. For each liquidation procedure, the series of steps involved will largely be settled by the governing legislation – usually the Companies Act 1993. However, in relation to each procedure there will be some preliminary activities, which will culminate in the decision to act being made, followed by a series of acts in implementation. Potential early “steps” include the formulation of a belief, the existence of certain circumstances, giving of notices, holding of meetings, making decisions, and passing resolutions.

The word “achieve” requires that an end or goal is established and committed to. In paragraph (b) this means that the steps are taken with liquidation as the established end. Until that goal is established and the path to it committed to, steps cannot be taken “to achieve liquidation”. Essentially this requires that the decision has been made to liquidate.

This emphasis on the established goal of liquidation means that steps that are preparatory to the liquidation process proper (for example, the exercise by the liquidator of his or her functions) are capable of being the first step to achieve liquidation. However, a decision must have been made. Preliminary activities such as investigating circumstances, exploring and evaluating options and the mere formulation of an idea will not suffice.

The silent making of a decision is not an overt act so will not be a “step” as required by paragraph (b). Further, while a decision has to be made in practice, the step required by law in relation to a company’s decision is usually the passing of a resolution. It is an overt act - a “step” - and in most cases is the first step legally necessary to achieve liquidation, and for the purpose of enabling liquidation.

The first step that is legally necessary to achieve liquidation where a request is made to remove a company from the register under section 318(1)(d)

One of the two grounds in section 318(2) must be satisfied before making a request for removal from the register under section 318(1)(d). Only ground (a) applies where the company will have surplus assets to distribute, and so only this ground is considered here.

It requires that the company has ceased business, paid its creditors and distributed any surplus assets in accordance with its constitution and the Companies Act.

Therefore the first step that is legally necessary to achieve liquidation when a request is made to remove the company from the register under this ground will relate to ceasing business, paying all creditors and distributing surplus assets, but there is no set order that these must occur in.

To be the first step legally necessary in terms of the definition of “liquidation” in section OB 1, the relevant step under section 318(1)(d) must be an overt act on or following the decision to carry out the necessary actions to satisfy the grounds in section 318(2)(a) with the aim of achieving liquidation. It will usually be a resolution to cease business, pay all creditors, distribute surplus assets and to then request removal. The Commissioner will be satisfied that a resolution in these terms is the first step that is legally necessary to achieve liquidation. A company’s constitution may provide another means of making that decision which, where it is an overt act, can also be the first step that is legally necessary to achieve liquidation.

Other steps may be taken that are the first step that is legally necessary to achieve liquidation, for example, the company may act less formally than by passing a resolution to carry out the grounds in section 318(2). If the step is overt and carried out with the aim of achieving removal from the register it could be the first step that is legally necessary to achieve liquidation.

The significance of the parenthetical examples in paragraph (b)(i)

After the phrase “a step that is legally necessary to achieve liquidation”, paragraph (b)(i) sets out two parenthetical examples: “including the appointment of a liquidator or a request of the kind referred to in section 318(1)(d) of the Companies Act 1993;”.

The examples can be read as being first steps of relevant processes put in the section by Parliament specifically as illustrations of first steps that commence the period. However, in the Commissioner’s view, the wording of paragraph (b) is ambiguous. The examples could be either of:

- a) a step that is legally necessary to achieve liquidation: or
- b) *the first* step that is legally necessary to achieve liquidation;

in respect of relevant liquidation processes.

Probably the more obvious meaning is that the examples are of first steps – it is suggested by the immediate context, and the emphasis in the section. The focus of paragraph (b)(i) is on determining “the period” and its commencement which suggests that the examples are of first steps rather than any steps of the processes which they are relevant to. However, this is not conclusive. Whether the examples should be taken to be the first steps or just any steps in the processes they are relevant to becomes clear when the examples are examined.

In the processes of “liquidation” in which a liquidator is appointed, the appointment of a liquidator is *not* the first step legally necessary to achieve liquidation. For example, where the shareholders resolve to appoint a liquidator, obviously the resolution is a legally necessary step that precedes the appointment.

Regarding the second example, where removal from the register is requested under section 318(1)(d), the request is also *not* the first step legally necessary. Passing a resolution to cease business, pay all creditors, distribute surplus assets and to then request removal will usually be the first step that is legally necessary to achieve liquidation, and for the purpose of enabling liquidation.

Notwithstanding any implication to the contrary, it is clear that the steps given as examples in paragraph (b)(i) are not the first steps legally necessary to achieve liquidation in the liquidation processes that they relate to, but are examples of *a* step (in fact fundamental steps) in the processes.

Exemption of distributions upon liquidation where a request is made to remove a company from the register under section 318(1)(d)

One situation where this is important is in relation to the exemption of dividends “on the liquidation” of a company under section CD 18(1). Under section CD 2 of the Income Tax Act 2004, the term “dividends” includes a wide range of payments, distributions, or transactions where essentially value is transferred to shareholders. Section CD 18(2) excludes any amount distributed that is essentially of subscribed capital (“available subscribed capital per share”) and capital gains (“excess return amount”) where the distributions are made “on the liquidation of the company”.

To be excluded from being dividends by section CD 18(2), amounts distributed in relation to a request to remove a company from the register under section 318(1)(d) of the Companies Act 1993 must be made during the period which starts with a step that is legally necessary to achieve removal from the register. Accordingly, there may be an extended period between the initial step legally necessary to achieve liquidation and the removal. In some situations, as the period may span different tax years, a distribution may be made in a period preceding removal from the register. The Commissioner will assume that such distributions are made pursuant to a bone fide intention to liquidate. However, it should be noted that, if the liquidation is not completed then such a distribution will not have occurred “on liquidation” and the exclusion under section CD 18 (and the ruling) will not apply.

As discussed above, the Commissioner’s view is that the first step is not the making of the request under section 318(1)(d), but is ordinarily the passing of the resolution to cease business, pay all creditors, distribute surplus assets and to then request removal. It is noted that a company’s constitution may provide another means of making that decision which, where it is an overt act, can be the first step legally necessary to achieve liquidation.

Amounts distributed in respect of shares in the company following that step will be distributed “on liquidation” and be eligible for exclusion from being dividends under section CD 18(2). The other criteria of section CD 18(2) would also have to be met.

A company taking some other overt action with the aim of achieving removal from the register under section 318(1)(d) may be able to show that this is the first step legally necessary to achieve liquidation. However, a company taking such a course of action may be required to produce evidence establishing the taking of the step was carried out with the aim of achieving liquidation.

Taxpayers making distributions should ensure that they keep adequate records of relevant resolutions or other decision-making acts so that they can demonstrate that the essential genuineness of the resolution or other act preceded distribution of the company's assets, and that the distributions were for the purpose of enabling liquidation.