CHAPTER 40

ADMINISTRATION AND LIQUIDATION

This chapter explains the rules that apply when a company goes into administration or liquidation. It will look at:

- the impact of the appointment of an administrator or a liquidator;
- taxation during administration and liquidation; and
- distributions during liquidation.

40.1 Introduction

In this chapter we are going to look at the tax implications of a company going into administration or liquidation. There is a distinction between an administrator and a liquidator.

A company which is in financial difficulty may go into administration. An ‘administrator’ is appointed to manage the company’s affairs. The company continues to trade and the administrator normally seeks to sell the company as a going concern. If this is not possible, the administrator will normally achieve a better price for the company’s assets than would be likely if the company went straight into liquidation.

Liquidation brings the existence of the company to an end. When a company is ‘wound up’ a liquidator is appointed to sell all the assets, pay all the debts and return any surplus capital to the shareholders. On completion of the winding up the company is dissolved. Liquidation can be voluntary or compulsory.

Voluntary liquidation is where the company chooses to be liquidated. This normally applies where the company is solvent. The liquidation starts when the members pass a resolution to wind up the company voluntarily.

Compulsory liquidation is when the company is ordered by a court to be wound up on the petition of the company’s creditors, directors or one or more members. This normally applies where the company is insolvent and cannot pay its debts.

In either case the liquidator becomes the beneficial owner of the company’s assets and is responsible for the payment of all corporation tax liabilities arising after the commencement of winding up.

40.2 Effect on Accounting Periods

Companies in administration

The appointment of an administrator causes a new accounting period to begin. The old accounting period ends the day before the appointment and a new one begins on the day of the appointment. CTA 2009, s.10(1)(2)

During the administration period, the normal rules with respect to accounting periods apply.

When a company moves out of administration an accounting period will come to an end.
Companies in liquidation

The appointment of a liquidator causes a new accounting period to begin. As with the appointment of an administrator, the old accounting period ends the day before the appointment and a new one begins on the day of the appointment. CTA 2009, s.12(2)(3)

Once a liquidator is in place the accounting period will end on the earlier of 12 months or the conclusion of the winding up. This means that if the company ceases to trade once the liquidator is appointed this will not result in the end of an accounting period. CTA 2009, s.12(4)

However, if the company moves out of liquidation and into administration, an accounting period comes to an end at that date and a new one begins.

Illustration 1

Farcaso Ltd has a year end of 30 September.

On 1 December 2014 a liquidator is appointed, the company ceases to trade on 12 March 2015, and the liquidation is finally completed on 14 January 2016.

Show the accounting periods for the company.

The accounting periods for the company will be:

1 October 2013 to 30 September 2014
1 October 2014 to 30 November 2014
1 December 2014 to 30 November 2015
1 December 2015 to 14 January 2016

Thus we do not end an accounting period when the trade ceases on 12 March 2015, as the liquidator is in place.

If the company ceases to trade before the liquidator is in place then we follow the normal rules and an accounting period will end.

If the company is a close company it may become a close investment-holding company (CIHC) when trade ceases. The section relating to CIHCs in the legislation has a section specifically dealing with the position when a company is being wound up.

The first accounting period of a winding up will not lead to the company being treated as a CIHC, provided that the company was not a CIHC in the accounting period that ends as the winding up starts. In other words, if trade ceases during the first accounting period of liquidation, the company will not be a CIHC until the start of the next accounting period. CTA 2010, s.34(5)

The effect of a company being classified as a CIHC is that it will pay corporation tax at the main rate of tax. The small profits rate and marginal relief are denied to CIHCs.

The rule about a company possibly becoming a CIHC following the appointment of a liquidator does not apply after 31 March 2015. If a company’s accounting period straddles 1 April 2015, the CIHC treatment is, in relevant cases, applied to its
taxable total profits arising before 1 April 2015 only (calculated using time apportionment).

Illustration 2

A close company is going to go into liquidation on 1 December 2014. If the liquidator is appointed while the trade is still being carried on, then the company will not become a CIHC in the accounting period immediately following the appointment of the liquidator (and, indeed, will never become a CIHC).

<table>
<thead>
<tr>
<th>Trading</th>
<th>Liquidator appointed</th>
<th>Trading ceases</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1.12.14</td>
<td>12 months</td>
</tr>
</tbody>
</table>

However, if the trade ceased on 1 September 2014 and then the liquidator was appointed on 1 December 2014, the company would be a CIHC from 1 September 2014 until 31 March 2015.

<table>
<thead>
<tr>
<th>Trading ceases</th>
<th>Liquidator appointed</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.9.14 CIHC</td>
<td>1.12.14 New AP starts</td>
</tr>
</tbody>
</table>

Example 1

Taking the facts from the Illustration above, assume Farcaso Ltd is a close company.

When will Farcaso Ltd become a CIHC? What difference would it make if Farcaso Ltd ceased to trade on 1 November 2014?

40.3 During the Liquidation

Expenses

If the liquidator continues to carry on the trade of the company, normal rules apply regarding calculation of trade profits. Expenses will be allowable as long as they are incurred wholly and exclusively for the purposes of the trade.

CTA 2009, s.54

The expenses of the liquidator (their fees) will be allowable so long as they relate to the trade. The fees and expenses relating to the actual winding up of the company, being the sale of the company's assets followed by distribution to creditors and shareholders, will not be allowable as such expenses do not satisfy the 'wholly and exclusively' purpose test.

Once the company ceases to trade, its income will be reclassified and it will no longer be able to get a trading deduction for expenses. Post cessation receipts are taxable and post cessation expenses can only be deducted from these post cessation receipts. Thus the cost of collecting debts should be taken into account when valuing assets at cessation and expenses accrued wherever possible.

CTA 2009, ss.188–190
Statutory redundancy payments made to employees are specifically allowable. There is a problem with ex-gratia payments however, as the company cannot claim that they are wholly and exclusively for the purpose of the trade as the company is no longer trading. Hence, there is a rule allowing a maximum ex-gratia deduction of 3 times the statutory payment, calculated on an employee basis. So the maximum total deduction per employee is 4 times the statutory payment. 

CTA 2009, s.76; CTA 2009, s.79

Assets

Any stock held by the company is deemed to be sold at market value at the date trade ceases, giving rise to trade profits or losses. CTA 2009, s.162

Any plant and machinery held at cessation is also deemed to be sold at market value, resulting in balancing adjustments. CAA 2001, s.61

Capital assets are not deemed to be sold at cessation, and so gains are not realised until actual sale of these assets.

Losses

A company in liquidation is often a loss making company. When a loss making company ceases to trade, relief is available for these trading losses by:

- Offset against total profits before charges of the loss making period, and then
- Carry back 3 years, on a last in first out basis, against total profits (terminal loss relief). CTA 2010, s.39

Therefore it is advantageous for the company to realise chargeable gains within the accounting period in which it ceases to trade to ensure that the gain is in the same accounting period as the trade loss. This enables the trading losses to be used against the company’s total profits including these chargeable gains. Remember that the cessation of trade will not trigger the end of an accounting period when the company is in liquidation so the gains simply need to be realised before the earlier of the anniversary of the liquidator’s appointment or the conclusion of the winding up.

Alternatively, the trading losses may be group relieved to other members of the same group relief group, however this may not be possible if the parent company is the one in liquidation (see below).

Group issues

There are two types of ownership – legal ownership and beneficial ownership. Legal ownership is simply the name of the person registered on the deeds or land register with regard to real property or the registered owner of shares in respect of shareholdings. The beneficial owner is the person who has all the benefits of ownership (e.g. the right to receive rents or dividends). It is common for the same person to be both the legal and beneficial owner.

However, when a liquidator is appointed a company loses beneficial ownership of its assets. Thus if a parent company is in liquidation it will lose beneficial ownership of any shareholdings, and hence any group relief groups formed via its share holdings will be broken from that date. Thus a company might consider a pre-liquidation reorganisation to ensure group relief is retained for as many group members as possible, notwithstanding that one of the group, possibly a former holding company, is being liquidated.
Entering liquidation does not however result in that company, nor any other company, ceasing to be a member of a capital gains group. TCGA 1992, s.170(11).

A degrouping charge does not arise if a company leaves a gains group as a result of another company ceasing to exist. Thus in the case of a parent with a single subsidiary, the final winding up of the subsidiary will not cause a degrouping charge to arise in the parent.

The substantial shareholdings exemption normally requires the investing company (i.e. the owner of the shares) to have beneficial ownership of its shares in the investee company. However, where the investing company goes into liquidation, it is still able to benefit from this exemption on a subsequent disposal of any qualifying shares it owns. TCGA 1992, Sch 7AC para 16.

If the investee company is the one that has gone into liquidation and has ceased trading, this would cause the denial of the substantial shareholding exemption as both the investor and investee companies must be trading in a qualifying period. The second subsidiary exemption covers this situation. If the shares would have qualified for the substantial shareholding exemption if they had been disposed of within the last 2 years, they will qualify for substantial shareholding exemption notwithstanding the fact that the company is no longer trading. TCGA 1992, Sch 7AC para 3.

From a practical perspective, this means that the company should aim to have the winding up completed and distributions made to shareholders within 2 years of ceasing trade.

**40.4 Distributions**

A distribution made before the liquidator is appointed is a straightforward dividend. For individual shareholders this will be taxable at their usual rate – for higher rate taxpayers this will be 32.5% plus 10% tax credit, for additional rate taxpayers this will be 37.5% plus 10% tax credit. For corporate shareholders the dividend will be exempt, and may be treated as franked investment income.

However, distributions made during a winding up (after the liquidator has been appointed) are capital not income, thus the shareholder is treated as having made a disposal of his shares in return for the amount distributed.

If there is more than one distribution in the course of a winding up then each one is treated as a part disposal by the shareholder of his shares, the cost of the shares being calculated using the formula A/A+B.

This is an area where planning can be useful. If the company declares a dividend prior to the appointment of the liquidator, the shareholders will be treated as receiving an income distribution (i.e. a dividend) – taxable on individual shareholders as above.

If the dividend is paid after the liquidator is appointed it will be a capital distribution so that any gain is taxed at 18% or 28% which may result in a lower tax liability.

Corporate shareholders, however, may prefer a dividend since companies are not taxed on dividends received, whereas they are subject to corporation tax on chargeable gains. However, the substantial shareholding exemption may apply which would reduce any chargeable gain to nil. The company would need to
have held at least 10% of the shares in the company for a minimum 12 month period and also satisfy various conditions before and after disposal.

**Illustration 3**

Siniestro Ltd pays a dividend of £30,000 to Jinny on 1 July 2014. The company appoints a liquidator on 1 September 2014. The winding up is completed and a final dividend paid on 1 August 2015. Jinny receives £40,000.

Jinny is an additional rate taxpayer. She paid £1,500 for her shares. She has other gains that will use her annual exemption.

**Calculate the tax payable on the two dividends received by Jinny.**

The first dividend will give rise to dividend income for Jinny in the tax year 2014/15, when additional rate tax on dividends was 37.5%.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross dividend</td>
<td>£33,333</td>
</tr>
<tr>
<td>Income tax @ 37.5%</td>
<td>£12,500</td>
</tr>
<tr>
<td>Less: Tax credit</td>
<td>(3,333)</td>
</tr>
<tr>
<td>Income tax due (effective rate 30.56%)</td>
<td>£9,167</td>
</tr>
</tbody>
</table>

The final distribution is capital in nature and occurs in the tax year 2015/16. Jinny will have a capital gain of:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale proceeds</td>
<td>£40,000</td>
</tr>
<tr>
<td>Less: Cost</td>
<td>(1,500)</td>
</tr>
<tr>
<td>Chargeable gain</td>
<td>£38,500</td>
</tr>
<tr>
<td>CGT @ 28%</td>
<td>£10,780</td>
</tr>
</tbody>
</table>

**Example 2**

Would it have been better in the above Illustration for no dividend to have been paid on 1 July 2014 so that Jinny receives a final dividend of £70,000 on 1 August 2015?

40.5 **Other Tax Implications of Liquidation**

**Corporation tax rates**

If the rates of corporation tax have either been fixed or proposed in the final year of the liquidation period, then these fixed or proposed rates are to be used. Therefore in the vast majority of cases the normal corporation tax rates will apply. 

[CTA 2010, s.628](https://www.legislation.gov.uk/ukpga/2010/26/section/628)

If the rate has not been fixed or proposed, the rate fixed or proposed in the penultimate year should be used.

This assists liquidators to finalise a company’s liability in advance of a formal winding up, even if the rates have yet to be fixed.
Loan relationships

The **connected party rules do not apply** to companies which have gone into insolvent liquidation as they are specifically overridden by the legislation. However, this override will only apply while the company remains in liquidation. Where the company comes out of liquidation the connected party rules will be reinstated as they were before. *CTA 2009, ss.322, 357, 359*
ANSWERS

✓ Answer 1

The accounting periods for the company will be:

1 October 2013 to 30 September 2014
1 October 2014 to 30 November 2014
1 December 2014 to 30 November 2015
1 December 2015 to 14 January 2016

Thus we do not end an accounting period when the trade ceases on 12 March 2015 as the liquidator is in place.

Farcaso Ltd will not be a CIHC in the accounting period beginning 1 December 2014 (and, indeed, will never be a CIHC).

However, if Farcaso Ltd had ceased to trade on 1 November 2014 then there would be an accounting period from 1 November 2014 to 30 November 2014 during which it was not trading. It would be a CIHC for this accounting period and the subsequent accounting period, but only from 1 December 2014 until 31 March 2015.

✓ Answer 2

If Jinny receives a final dividend of £70,000 she will not have the income tax liability of £9,167 in 2014/15 and her capital gains tax liability in 2015/16 will be:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds</td>
<td>70,000</td>
</tr>
<tr>
<td>Less: Cost</td>
<td>1,500</td>
</tr>
<tr>
<td>CGT at 28%</td>
<td>19,180</td>
</tr>
<tr>
<td>Tax paid previously (9,167 + 10,780)</td>
<td>19,947</td>
</tr>
</tbody>
</table>

Overall the tax bill is £767 lower, and in addition the initial tax is paid later giving a cash flow advantage.

However we have only considered one type of shareholder.

The position of a higher rate taxpayer would be different, as the effective rate of tax on dividends is only 25% compared with 28% capital gains tax.

Corporate shareholders may prefer to receive pre liquidation dividends as these are not taxable on companies. Capital proceeds may create a chargeable gain, albeit subject to the substantial shareholding rules.