

## 1.0 INTRODUCTION

When the directors and/or shareholders of a solvent company wish to wind down a company's affairs, then they may, by resolution of its members wind up the company voluntarily. The relevant legislation regulating members' voluntary winding up is Parts 5.5 to 5.9 and Schedule 2 of the Corporations Act 2001 (Cth) and the Insolvency Practice Rules (Corporations) 2016.

### 1.1 When a Company cannot be Wound up Voluntarily

Except with the leave of the Court, a company cannot resolve that it be wound up voluntarily if an application for the company to be wound up in insolvency has been filed, or the Court has ordered that the company be wound up in insolvency, whether or not the order was made on such an application.

### 1.2 When a Company can be Wound up Voluntarily

Subject to section 1.1 above, a company may be wound up voluntarily if the company so resolves by special resolution.

## 2.0 THE APPOINTMENT PROCESS

### 2.1 Directors' Resolution

To initiate a members' voluntary winding up, the director(s) generally pass resolutions to the following effect:

- (i) that a Declaration of Solvency be made; and
- (ii) that a meeting of members be convened for the purpose of winding up the company; or
- (iii) that a statement setting out the resolutions to wind up the company be circulated to the members.

The resolutions can be passed:

- (a) by the directors circulating a statement of resolutions which they all sign, or in the case of a company with a single director, that director signs the statement; or
- (b) at a formal meeting of directors.

Directors will also seek the consent of a registered liquidator, that is required to present to the members.

### 2.2 Declaration of Solvency

To initiate a members' voluntary winding up, a majority of directors, or where a company has one director, that director, must make a Declaration of Solvency in the prescribed form. This declaration confirms the directors' opinion that the company will be able to pay its debts in full within 12 months of the winding up and provides a summary of the company's assets and liabilities.

### 2.3 Resolutions of Members

Once the directors have resolved that the company should be wound up, the company's members then pass resolutions to the following effect:

- (i) That the company be wound up voluntarily (special resolution);
- (ii) That a specified person be appointed Liquidator of the company (ordinary resolution); and
- (iii) That the remuneration of the liquidator be approved prospectively (ordinary resolution).

A special resolution requires at least 75% in number of members' entitled to vote to approve the resolution in order for it to pass, whereas an ordinary resolution is by simple majority.

The resolutions can be passed:

- (a) by the directors circulating a statement of resolutions which all members sign, or in the case of a company with a single member, that member signs the statement; or
- (b) at a formal meeting of members.

### 2.4 Meeting of Members

If a meeting of members is to be convened, then a director



must sign a notice convening a general meeting of members. A general meeting of members can also be convened by members holding at least 5% of the votes that may be cast at a general meeting.

At least 21 days notice of the general meeting is required to be given. However, this period can be shortened if 95% of the members consent to short notice. Subject to obtaining this consent, the meeting of members can be held immediately after the meeting of directors.

### 2.5 Liquidator's Requirements

Any person can act as a member's voluntary liquidator as long as the company does not owe more than \$5,000 to the proposed person, or a corporation the person has a substantial holding in. In our view, this person should, at minimum, hold professional indemnity insurance.

A liquidator may seek security for their costs in undertaking the liquidation. This is usually done by a Deed of Guarantee and/or Indemnity and may involve the granting of a security over property.

## 3.0 EFFECT OF THE WINDING UP

Following the meeting of members, the liquidator administers the winding up process.

### 3.1 Effect on the Company

The purpose of winding up the company is to effectively convert the company's assets into a pool of funds from which creditor claims can be met, if any. The remaining assets are then distributed to the members in accordance with the company's constitution.

### 3.2 Effect on Directors and Officers

On commencement of the winding up, the powers of directors and officers relating to the management of the company are suspended. However, directors are required to meet certain statutory obligations including the provision of information regarding the company's affairs and financial position and to provide assistance to the liquidator.

## 4.0 THE LIQUIDATION PROCESS

### 4.1 Realisation of Assets

A liquidator will take steps to control, and in most cases realise, the assets of the company.

### 4.2 Tax Clearance

The excess assets are distributed amongst the company's members upon receiving a Notice from the Australian Taxation Office ("ATO") giving clearance to the liquidator to part with the assets of the company.

The liquidator will apply to the ATO for clearance to proceed to distribute the assets of the company. In order for this notice to be granted, a company is required to have lodged all outstanding returns, usually:

- (i) Business Activity Statements;
- (ii) Instalment Activity Statements; and

- (iii) Income Tax Returns

Some other businesses may have additional tax reporting requirements.

### 4.3 Distribution to Creditors

Should the company have any outstanding creditors at the date of the winding up, a liquidator will distribute funds to those creditors. A liquidator is obliged to distribute assets to creditors under a dividend process, which takes approximately eight (8) weeks.

### 4.4 Distribution to Members

The distribution is made in accordance with the company's constitution which sets out distribution rights for particular classes of shares. A distribution can be made either:

- (i) by cash; or
- (ii) in-specie. For example, an asset may be a loan account that is due from the member(s). In this instance, the asset is generally distributed "in-specie" so as to avoid the process of collecting the debt just to redistribute it to the member(s) as a dividend.

### 4.5 Distribution Statements

After the distribution is made, the Liquidator will provide members with a statement for tax purposes showing the type of asset distributed, and which equity account was utilised for the distribution. The common types of equity accounts are:

- (i) Issued Capital – being the shares purchased on appointment;
- (ii) Post-CGT Capital Reserve – being the profitable reserves held from sale of assets acquired after 1985;
- (iii) Pre-CGT Capital Reserve - being the profitable reserves held from sale of assets acquired before 1985;
- (iv) Retained Earnings.

## 5.0 LIQUIDATOR'S REMUNERATION

A liquidator is entitled to remuneration as determined by the members. A liquidator, prior to their appointment, must prepare a report setting out:

- (i) such matters as will enable the members to make an informed assessment as to whether the proposed remuneration is reasonable;
- (ii) a summary description of the major tasks performed; or likely to be performed, by the liquidator; and
- (iii) the costs associated with each of those major tasks.

There is no fixed scale of remuneration. There are principles and guidance as to how remuneration is to be claimed. In most members voluntary windings up, a fixed fee basis is appropriate, while other methods of calculation may be warranted in certain cases. There are also requirements for disclosure of fee rates and estimates of total fees to be charged in a winding up.



The Liquidator's remuneration is determined at the meeting of the company's members, or by circular resolution.

## **6.0 TAX EFFECT ON DISTRIBUTIONS**

| <b>Equity Account</b>           | <b>Normal Distribution – Tax Treatment</b> | <b>Liquidator's Distribution – Tax Treatment</b> |
|---------------------------------|--|--|
| Paid Up Capital                 | Capital                                    | Capital  |
| Retained Earnings               | Dividend                                   | Dividend   |
| Pre-CGT Capital Profit Reserve  | Dividend                                   | Capital  |
| Post-CGT Capital Profit Reserve | Dividend                                   | Dividend   |

Capital distributions are not deemed as income in the hands of the member(s) and accordingly are tax-free, whereas dividends are taxable in the hands of the member as income at personal tax rates. Companies must be careful to separate their Pre and Post-CGT reserves in their capital accounting.

Members can also obtain the benefit of franked dividends in respect of Retained Earnings and Post-CGT reserves, however this is subject to the company holding sufficient franking credits.

A liquidator does not deal with tax issues in respect of any distribution. Members should seek the advice of their tax adviser in respect of any distribution that they have received.

## **7.0 COMPANY CAN'T PAY ITS DEBTS**

If it transpires that the company is insolvent and cannot pay its debts, then the members' voluntary liquidation cannot continue as the company must be solvent. The members then have the option to contribute sufficient funds for the company to return to solvency.

However, if this cannot be managed, then the Liquidator must, as soon as practicable:

- (i) apply to the Court to have the company wound up in insolvency; or
- (ii) appoint an administrator to the company; or
- (iii) convene a meeting of the company's creditors to have the liquidation converted to a creditors' voluntary winding up.

This can prove to be a costly exercise, so directors and members should ensure that the company is solvent.

## OUR SERVICES

### Corporate Insolvency

- Voluntary Administration
- Deeds of Company Arrangement
- Receiverships
- Court Liquidation
- Members' Voluntary Liquidations
- Creditors' Voluntary Liquidations
- Provisional Liquidations
- Official Liquidations

### Personal Insolvency

- Bankruptcy
- Part X Personal Insolvency Agreements
- Part XI Deceased Estate Administration

### Dispute Resolution

- Statutory Trusteeships (s66G)
- Deceased Estate Administration
- Expert Reports

### Other Services

- Business Viability Reviews
- Prelending/Refinancing Reviews
- Security Reviews
- Management Reporting
- Cash-Flow Management
- Turnaround Management

**Without obligation or cost, we are available for an initial consultation. Please contact:**

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