

Educating, Developing & Representing



Irish Taxation  
Institute

---

—

# **Examinerships, Receiverships & Liquidations: Legal & Taxation Aspects**

---

September 2009

## **1 Introduction**

In this afternoon's Seminar we hope to cover many of the basic legal and tax issues that all of us as Registered Tax Consultants need to be aware of when advising a business in difficulty. In doing so our aim is not to just advise on the legal and tax issues that Receivers, Examiners and Liquidators need to be aware of but also issues that are relevant to those advising companies on the brink of insolvency or those who are creditors of an insolvent company.

My colleague Norman Fitzgerald will now discuss the various structures that can apply in an insolvency situation.

## **2 Main Types of Insolvency Structures**

There are 3 main insolvency processes or structures that can arise in Ireland, namely, examinership, receivership and liquidation. All of these processes will be given recognition as "*primary proceedings*" in member States under the EU Regulation. In addition to these processes, a Company can enter into either a formal or an informal arrangement with its creditors. A formal arrangement under section 201 of the 1963 Companies Act requires Court sanction and approval by 75% of each class of creditor. An informal or outside Court arrangement is in effect a contract between the Company and all of its creditors, i.e. it is binding on a creditor only if that creditor has signed up to it.

We are not concerned for today's purposes with the processes available in relation to bankrupt individuals, although many of the principles applicable to corporate insolvency are applicable to individuals (and in fact the law of Corporate Insolvency derives to a large extent from centuries' old bankruptcy law such as the *pari passu* principle and fraudulent preference of creditors, etc).

In brief terms, liquidation is a form of collective debt collection in which an Insolvency Practitioner is appointed to liquidate the assets and distribute them in accordance with rules and then terminate the Company. Receivership is a form of contractual remedy agreed between debtor and creditor whereby the

creditor is entitled to take possession of certain assets and sell them and distribute the proceeds for the most part to the secured creditor. A Receiver is not obliged to take on the role of a collective debt collector on behalf of all creditors and nor does this role involve the termination of the life of the Company. After he has finished his job he hands the Company back to the Directors (or if the Company is insolvent to a Liquidator).

By contrast, examinership is a form of corporate rescue which came about as part of the “*rescue culture*” engendered by the US Chapter 11 legislation and equivalent UK legislation. The aim of the Examiner is to restructure the Company’s debt, achieve the injection of new capital so that when the restructured and newly capitalised business comes out of the protection of the Court it can trade on a profitable basis going forward.

## **2.1 Examinership**

Examinership is a process whereby a Company that is insolvent or likely to become insolvent may be placed under the protection of the Court for a period of up to 100 days so as to enable the Examiner to formulate a settlement with creditors which is then presented to the Court for approval.

Examinership was introduced under the 1990 Companies (Amendment) Act in order to rescue the Goodman Group of Companies. It has similarities with Chapter 11 in the US and the administration process in the UK.

### **2.1.1 Who may apply?**

It is usually the Directors of the Company who apply to the Court to put the Company into examinership. However, the Company itself or shareholders holding not less than 10% of the issued share capital or any creditor may also apply.

#### *The Application*

The Court application is based on a Petition, a sworn Affidavit and an independent Accountant’s Report. The crucial document upon which the application is assessed is the independent Accountant’s Report.

The independent Accountant may be the Company's auditor or a person qualified to become the Company's auditor. The independent Accountant's Report must include various items set out in the Act and including the following:

- (a) A Statement of Affairs of the Company.
- (b) The independent Accountant's opinion as to whether the Company and the whole or any part of its undertaking has a reasonable prospect of survival as a going concern.
- (c) His opinion as to whether examinership would be likely to benefit the members and creditors more than a winding up.
- (d) Details of the funding required to keep the Company going during examinership and the source of that funding.
- (e) Any conditions that must be met for the business (or part of it) to survive.

Because the 100 day period is deemed to commence as soon as the Petition document is put into the Court system, the application made is usually for the appointment of an interim Examiner on an ex parte basis. In other words, the petitioner's legal team will make an immediate application to an available Judge without putting any of the interested parties on notice and will hand in the papers there and then. If the Court is satisfied that the tests have been met, the Court will make an interim Order and will put the full application back for approximately 10 days. At the full hearing, all interested parties will be given a chance to make submissions to the Court as to whether an Examiner proper should be appointed. Pending that full application, the protection of the Company is in place.

The crucial factors that will influence the Court in making its decision as to whether or not to appoint an Examiner are:

- (i) Is there a likelihood of an ongoing profitable trade?
- (ii) The number of employees whose jobs are at stake;
- (iii) Will the Company struggle and incur significant examinership costs and other debts and ultimately fail shortly after the examinership period?

- (iv) Will creditors be prejudiced even further by allowing the Company to continue instead of winding it up?
- (v) Are the funding requirements of the Company during the protection period going to be significant? and
- (vi) Are there potential investors on the horizon?

### **2.1.2 What are the Effects of Court Protection?**

During the protection period, no action may be taken by creditors to enforce their debts or their security against the Company in general terms. No Liquidator or Receiver may be appointed. There may be no attachment or execution of Judgements. There may be no action to realise security or repossess goods other than goods held by way of retention of title (we shall return to this topic later in the paper). Essentially, there is a freeze on most creditor remedies against the Company so that the Company is given a breathing space during which the Examiner may formulate a potential rescue plan which hopefully will be of benefit not only to the Company but to its entire body of creditors. The intention behind the legislation is that if a Company is given breathing space and (usually) obtains new investment which will enable it to reach a reasonable settlement with its creditors, it should then be in a position to survive which will be of benefit to its suppliers and trading partners going forward.

It should be noted that set off of debts is allowed during an examinership. We will deal with this in more detail later on.

Guarantors of a Company debt cannot be pursued during the protection period, although they will be liable to pay the full amount of their guarantee after the protection period is over. It is important to note that guarantors must be notified by the creditor (for example a bank) and given an opportunity to vote at creditor meetings relating to the rescue plan. If this is not done, the creditor will not be entitled to pursue the guarantor later on.

It is important to note that the Examiner is given the facility under the Act (section 10) to certify certain expenses as being necessary for the survival of the Company. This gives these debts priority over normal unsecured debts in the event of the Company ultimately going into liquidation. This would apply, for example, to necessary expenses such as rent. It might also be used, for example, for customer deposits in order to give customers added comfort in paying deposits during the protection period.

### *The Scheme of Arrangement*

The Scheme of Arrangement is the rescue plan put forward by the Examiner to the members and the creditors in a series of meetings. The Examiner will divide the creditors up into different classes which will normally include secured, unsecured, connected, retention of title, preferential, etc. There may also be other classes such as landlord creditors, etc. The Scheme of Arrangement, together with an explanatory memorandum will be circulated in advance of the meetings. The Examiner may be asked questions by creditors at the meetings and ultimately a vote is taken at each meeting at which majority (in value of debt) rule applies.

The scheme will incorporate an offer of a dividend to each class of creditor. The amount of the dividend obviously will depend on the amount of the deficiency in the Company and the amount of new money which in most cases will be coming in. The rule of thumb is that each class of creditor must be doing better under the scheme than it would on a winding up of the Company. Accordingly, the scheme will have to give favourable treatment to secured creditors and to preferential creditors such as the Revenue. Under the legislation, the Revenue are given statutory authority to agree a write down of Revenue debt as it was thought previously that they had no power to do so.

All creditors within a class must be treated equally and overall the scheme cannot be unfairly prejudicial to any interested party. If the scheme would result in an extreme disparity between what a creditor

would achieve on a winding up and what it is getting under the scheme, this would be deemed by a Court to be unfairly prejudicial to that creditor.

### **2.1.3 Can a Secured Creditor be forced to write down its Secured Debt under a Scheme?**

This issue has been the subject of much press comment recently following the Birchport Limited Scheme of Arrangement. According to press reports, under the terms of the scheme in that case, ACC Bank agreed to take a payment of €950,000 over 15 years in settlement of its €1.37m debt. The remainder of the loan was treated as unsecured and ACC Bank was to receive 10% of that sum as the dividend payable to unsecured creditors. ACC Bank may have felt that the survival of Birchport and the servicing of their debt in the manner set out in the scheme was the best commercial outcome for them. If the Scheme of Arrangement had not been agreed to by ACC Bank, then Birchport would almost certainly have been wound up and the bank would have been left with the prospect of trying to sell the Ocean Bar premises themselves in a depressed market. This was a recognition of commercial reality (where the value of the premises had fallen below the amount of the debt) rather than a precedent for the Court sanctioning a scheme which forced a bank to write down its secured debt against its wishes.

On occasion, a secured creditor may have to accept restructured terms such as deferred payments, an interest moratorium and the like. However, it is another matter altogether to say that a bank can be forced to write down its debt.

Landlords cannot be forced to accept a reduced rent going forward as part of the scheme. It is possible for the Company in the context of a Scheme of Arrangement to apply to the Court to have onerous contracts disclaimed or repudiated. The classic onerous contract is a lease at a prohibitive rent.

#### **2.1.4 Approval of the Scheme of Arrangement by the Court**

Under the 1990 Act, only one class of creditor need vote in favour of the scheme, although in practice the scheme will have a far greater chance of being approved by the Court if it has a good level of support among the creditors. Following the meeting of the members and creditors, the Examiner reports to the Court on the outcome of those meetings (the section 18 report). At that stage, the Court fixes a date for the confirmation/approval hearing at which any creditor or interested party may appear and object.

The Court will **not** approve the scheme unless:

- (i) At least one class of creditors whose interests or claims have been impaired have voted in favour;
- (ii) If the sole purpose of the scheme is the avoidance of tax; or
- (iii) Unless the Court is satisfied that the proposals are (1) fair and equitable and (2) not unfairly prejudicial to the interests of any interested party.

If approved, the scheme becomes effective within 21 days of Court approval. At that time, the investment money is paid in and creditors are paid their dividends. All of the creditor claims are deemed to have been discharged, the protection period ends and the Company continues to trade with new capital and with its debt restructured or discharged.

#### **2.2 Receivership – A Creature of Contract**

A Receiver may be appointed by a secured creditor (usually a bank) on foot of a debenture or other security document. His powers and functions are derived from the security document which has been entered into by the Company and the bank. Before a Receiver can be appointed, there must have been an “*event of default*” which will be defined in the facility letter or agreement.

Under a commercial debenture granting a fixed and floating charge, the Receiver and Manager will be given full powers of management of the Company, carrying on litigation, borrowing on behalf of the Company and selling its assets. The role of the Receiver is to receive the assets charged and to sell them for the best available price.

The most widely known form of Receiver is the Receiver and Manager who is appointed on foot of a Fixed and Floating Charge. The Fixed Charge secures certain specified and ascertained assets (usually property, plant and machinery, etc.); the Floating Charge floats over the entire assets of the Company which will fluctuate and change over time. Because he has been appointed over the entire assets of the Company, the Receiver/Manager will have power to take over the running of the Company, including entering contracts, borrowing, carrying on litigation and selling the business as a going concern. Under the standard debenture, the Receiver will be deemed to be the agent of the Company and so the Company (not the appointing bank) will be responsible for his actions. However, this agency terminates if a Liquidator is appointed to the Company.

The Receiver/Manager collects in and manages the assets of the Company. He must distribute the proceeds of same in accordance with the debenture and in accordance with statute.

Another form of receivership which is gaining popularity is the Fixed Charge Receiver. He is appointed typically on foot of a mortgage over property. He is not appointed under any Floating Charge and, accordingly, does not take over the management of the business itself, but is merely appointed over the secured property. The advantage of this type of appointment is that the Receiver does not have to deal with preferential creditors unlike a Receiver and Manager appointed under the Fixed and Floating Charge.

### **2.2.1 What are the Risks to Receivers?**

A Receiver has personal liability under section 316 (2) of the Companies Act, 1963 to ensure that he obtains the best price reasonably available for the secured assets at that time. It has been held in several Irish cases that a Receiver owes a duty of care to the

bank's borrower to exercise reasonable care in the sale of the secured assets. (See cases of *Holohan - v - Friends First Provident*, *Lambert Jones Estates - v - John Donnelly*, *Rupert Property Company - v - Kielty*).

It is a common complaint from borrowers that a Receiver sold an asset at an undervalue thereby reducing the balance payable to the borrower after repayment of the bank debt and receivership expenses. In all cases, a Receiver will obtain proper independent advice from valuers/estate agents both as to the value of the assets and the most appropriate method of sale. A Receiver is not obliged to await an up turn in the property market before selling the secured assets. He must take advice as to the best means of preserving value and achieving the best price available at that particular time. It is prudent for Receivers to also obtain appropriate advice about other methods of unlocking value on a secured asset, such as obtaining planning permission for a development site, etc.

A Receiver must notify all creditors if he intends to sell an asset to a connected person such as a Director of the Company.

### **2.2.2 Distribution of Assets by a Receiver**

The Companies Acts and the Rules of the Superior Courts set out the priorities for the distribution of assets by Receivers and Liquidators. All creditors within a particular class must be treated equally and their debts must be abated on a pro-rata basis in the event of a shortfall in assets (the *pari passu* principle). The priorities in a receivership are as follows:

- (a) Receiver's costs and expenses,
- (b) Fixed Charge holders, then
- (c) Preferential creditors, and then
- (d) Floating Charge holders.

The proceeds of sale of the secured assets must be applied in this order. Any surplus must then be passed to the person next entitled

which will either be a second ranking Charge holder or the Company itself or, if insolvent, the Liquidator. Section 285 of the 1953 Act sets out certain creditors that must be given statutory preference, including, the Revenue Commissioners. I will deal with this in more detail later on.

## **2.3 Liquidations**

A liquidation is a terminal process which sees the liquidation of the Company's assets, payment to creditors on a pro-rata basis in accordance with statutory rules and priorities, and ultimately the dissolution of the Company and its removal from the Company Register. There are two types of insolvent liquidations, namely:

- (i) a voluntary creditors liquidation, or
- (ii) a Court or official liquidation.

### **2.3.1 Creditors Voluntary Liquidation (CVL)**

This is a process whereby the Company itself decides that by reason of its insolvency, it should be wound up. The Company will appoint its own nominee for Liquidator and will convene a meeting of creditors which must be advertised in the daily press with 10 days notice. At the meeting of creditors, a vote is taken as to whether the Company nominee Liquidator should be confirmed or whether another nominee put forward by the creditors should be appointed. The creditors with a majority in number and value of debt have the power to insist on their nominee being appointed as Liquidator. The other form of voluntary liquidation is the members' voluntary liquidation. This arises where the Company is not insolvent and is capable of meeting its liabilities within a 12 month period. A Liquidator is appointed by the members to preside over the collection of assets and payment of all creditors. It is not an insolvent process as such.

### 2.3.2 Official or Court Liquidation

The second form of liquidation is the Court appointed official Liquidator. Unlike the voluntary Liquidator, the official Liquidator is subject to the Court's supervision and control at all times. The liquidation in practice is supervised by the confusingly named Examiner's Office of the High Court. Ultimately, the Examiner's Office will settle the list of creditors to be paid and the amount of each creditor's claim. Official liquidation is a slow and expensive method of winding up

#### *Who can Petition the Court?*

The Company itself or a creditor or contributory may petition the Court to wind up the Company. It is more normal for a creditor to make the application. In practice, a creditor may issue a section 214 notice which is a 21 day letter of demand for payment of a debt in excess of €1,210. If the debt remains unpaid within a 21 day period, the creditor may issue a Petition in the High Court Central Office. Under the 1963 Companies Act, non payment of a debt within the 21 day period creates a presumption that the Company is insolvent. This process can only be used where the debt is fully ascertained and not disputed. The Courts will strenuously resist any attempt by a creditor to pursue a disputed debt by means of a back door debt collection.

A hearing date for the Petition is normally fixed within 3 – 4 weeks. Seven days before the hearing, the Petition must be advertised in the daily press. This is a key moment as all other creditors of the Company may then be alerted as to the difficulties of the Company. When the Petition is being heard by the Court, any other creditor may appear and make submissions and the Company itself may appear and object to the winding up Order. It sometimes occurs that just prior to the hearing of the winding up Petition, the Company settles its debt with the Petitioner. This is a dangerous course of action given that any other creditor can then turn up in Court and take over the Petition and have a Liquidator appointed. In that event, the Liquidator will seek the repayment of the settlement monies to the other creditor under section

218 of the Companies Act, 1963, which provides that any payment or disposition made after a winding up Petition has been issued is void as against a Liquidator.

The issuing of a section 214 notice and Petition is grounds for a bank to appoint a Receiver to the Company and the bank will often do so in order to have its own Receiver retain control of the secured assets rather than a Liquidator who must act on behalf of the entire body of creditors.

#### *When is a Provisional Liquidator Appointed?*

If a Company decides that it needs to appoint a Liquidator immediately without going to the process of convening creditors meetings, etc., provided it can show good reason for doing so, may apply to the Court for the appointment of a provisional Liquidator. This may be done on an ex parte basis without notice to other parties. The Company in these circumstances will need to show urgency. For example, the Company may need a Liquidator to get in and secure the assets where there is a danger of creditors, or others damaging or removing assets.

### **2.3.3 Powers and Duties of a Liquidator**

The Liquidator's job is to get in all the assets, sell them and deal with creditor claims. A Liquidator may, if he considers it in the interests of the creditors, carry on the business of the Company. He may do so for example to maintain the business as a going concern in order to achieve a better value on sale. This, however, is unusual in a liquidation. On the appointment of a Liquidator, the Directors' powers cease (unlike on an examinership). If Court appointed, the Liquidator will need approval for more significant actions, including a sale of assets.

All Liquidators are required to file a report to the Office of the Director of Corporate Enforcement (ODCE) in which he outlines his opinion as to the performance of the Directors of the Company. Depending on

their review of the section 56 report, the ODCE may direct the Liquidator to bring proceedings under section 150 of the 1990 Act seeking a restriction Order against the Directors (or disqualification under section 160).

Under section 290 of the Companies Act, 1963, a Liquidator may disclaim onerous contracts. We will deal with this in more detail later on.

#### *What Assets are Outside the Liquidation Process?*

Fixed Charge assets do not form part of the insolvent estate as they are within the ownership and control of the security holder. Therefore, the Liquidator may have no dealings with the secured assets such as property or plant and machinery. In practice, a Liquidator may agree with the security holder that he will manage the secured assets and have them sold and pass on the proceeds to the security holder. Alternatively, the bank will have appointed a Receiver and the Liquidator will have to negotiate with the Receiver as to what assets are caught by the security and what assets are available to the Liquidator.

Furthermore, assets held under retention of title, if valid, are never owned by the Company and therefore are not available to the Liquidator. We will deal with that in more detail later on.

#### *What are the Rules on Priority in a Liquidation?*

The Companies Acts have set out various classes of creditor which must be given preferential treatment in a liquidation. These preferential creditors rank after the Fixed Charge holder, but before Floating Charge holders and other unsecured creditors. For the purposes of this paper, the most important categories of preferential creditor are as follows:

1. All local rates due by the company and payable within twelve months of the liquidation.

2. All assessed taxes including income tax and corporation profits tax.
3. All wages or salary of any employee.
4. All accrued holiday remuneration of any employee.
5. All amounts due in respect of contributions payable by the company as the employer of any persons under the Insurance Act, 1942 or the Social Welfares Act, 1952 to 1961.
6. All amounts (including costs) due in respect of compensation or liability for compensation under the Workmen Compensation Acts, 1934 to 1955.
7. All amounts due from the company in respect of damages and costs applicable to a person employed by the company in connection with an accident incurring before the liquidation and in the course of his employment with the company to the extent that the company is not effectively indemnified by insurers.
8. All sums due to any employee pursuant to any scheme of arrangement for payment while the employee is absent from employment due to ill health.
9. Any payments due by the company to a pension scheme.

In the case of Revenue debt the Revenue are allowed choose whatever 12 month period they wish for each category of tax. Invariably they will look for the highest 12 month assessed period. This is discussed in more detail by Gavin later.

### **3 Principal Tax Issues to be considered during an Insolvency Situation**

#### **3.1**

##### **3.1.1 Direct Tax Issues on an Appointment of an Examiner.**

As Norman has explained examinership is a court procedure whereby all creditors' positions are frozen during a period of 70 or 100 days and the examiner tries to come to an agreement with the company's creditors regarding the debts of the company. The appointment of an examiner does not bring an accounting period to an end or affect the tax status of a company within a group. All tax which arises during the period of the examinership must be accounted for by the company in normal course.

One of the aims of examinership is to negotiate the reduction of the company's debts with third party creditors. Any such reduction must be Court approved, as noted above. Where a reduction occurs an amount will be credited to the Profit and Loss account which could potentially result in a tax liability. Normally a company in examinership would have trading losses and this should mean no tax liability arises as they can be set off against the income. However, in the absence of any current year or carried forward trading losses a tax charge would arise to the company.

It is worth noting that one difference between an examinership and a Section 201 scheme of arrangement is that the Revenue is permitted to compromise their obligations during the course of the examinership. This is a particular benefit of examinership where one of the main creditors is the Revenue.

##### **3.1.2 Direct Tax Issues on an Appointment of a Receiver**

The tax issues on the appointment of a receiver depend in part on the circumstances of the appointment. If the receiver is appointed under a fixed charge debenture then the company will continue to trade as

normal and is accountable for tax in the normal course. The receiver however would be responsible to account for capital gains tax on the disposal of any capital asset in accordance with the provisions of Section 571 of TCA 1997. The provisions of Section 571 are discussed in further detail later.

Where the receiver is appointed under a floating charge then it is quite common for the receivership to result in the dissolution of the business, with the eventual appointment of a liquidator. It is however important to note that in either fixed charge or floating charge receivership the accounting period of the company does not come to an end and corporation tax is assessable on the company in the normal manner in respect of any income period. Also, the appointment of a receiver does not affect any carried forward trading or capital losses.

There may be difficulties in collecting tax on any income that arises to a receiver, excepting capital gains or rents received from a property, during the course of the receivership. This is because there is no legislation that states that a receiver is liable to pay corporation tax on the income arising during the period of receivership, other than rents received from a property taxable under case V, and the company remains the accountable party. In effect therefore a receiver could leave a company without funds to account for tax.

### **3.1.3 Direct Tax Issues on the Appointment of a Liquidator**

Unlike examinerships or receiverships the appointment of a liquidator has a number of direct tax consequences. The appointment of a liquidator has the effect of bringing the accounting period of a company to an end. As the company is to be wound up on the appointment of a liquidator this will effect the use of losses and any claims for relief under Section 397 TCA 1997 which will be discussed further below. A company is liable for all taxes that arise during the liquidation, pursuant to the provisions of section 26(2) TCA 1997. While the tax is assessable on the company the liquidator is liable to account for such tax. Also, on appointment of a liquidator a company

ceases to be a member of a group for the purpose of section 410 TCA 1997. This means that trading losses cannot be transferred within the group. The liquidator is also able to benefit from the carried forward trading and capital losses of the company in assessing any tax liability during this period.

As the appointment of a liquidator commences a new accounting period it may be beneficial to dispose of capital assets prior to the appointment of a liquidator if there are significant carried forward trading losses.

A company ceases to be the beneficial owner of its assets on the appointment of a liquidator, however, it does not affect the company's position within a capital gains tax group. On the dissolution of the company there could potentially be a capital gains tax claw back on any assets transferred intra group but there is an exemption in Section 623 (1)(d) where a group relationship ceases on a liquidation of a company for bona fide commercial purposes.

#### **3.1.4 Stamp Duty Issues on the Appointment of a Liquidator**

No stamp duty charge should arise by virtue of the appointment of a liquidator, subject to my comments below on Section 79. However, where a liquidator fulfils his obligations and proceeds with the winding up of a company then a charge may arise.

Section 80 SDCA 1999 provides for relief on the transfer of an undertaking in a number of circumstances. If this relief is claimed, a claw back arises if the relationship between certain of the parties to the transaction ceases within two years of the relief being claimed. However there is an exemption contained in Section 80 (8) where a relationship ceases by virtue of the parties ceasing to be related on a bona fide commercial liquidation.

The position however is not the same where relief has been claimed under Section 79 SDCA 1999. Section 79 provides for relief on the transfer of assets between members of a stamp duty group where a

number of conditions are satisfied. In order for a stamp duty group to exist there must be a 90% relationship between the parties whereby, either directly, or through a third party company (which satisfies the 90% relationship conditions with both companies), one party is beneficially entitled to not less than 90% of the: ordinary share capital, profits available for distribution, and assets on a winding up, in the other party. Section 79 also requires the group relationship to remain in existence for a period of two years after the transfer has taken place. There is however no exemption in Section 79 where the relationship ceases by virtue of the liquidation of one of the parties.

This provision is clearly inequitable and in the past the Revenue have on a concessionary basis not sought to recover stamp duty where a liquidation has occurred for bona fide commercial reasons. This concession was unpublished and required an application to the Interpretation Section of the Stamps Office. It was given on a case by case basis and Revenue indicated that they had withdrawn it during the course of 2008. However, I understand the Revenue's position on this may have changed yet again and where a stamp duty claw back may arise on the liquidation of a company it is worth contacting Revenue to try and obtain a concession. It is of course unsatisfactory that it is necessary to seek a concession in circumstances of a genuine liquidation and this inequity between Section 79 and Section 80 is something Revenue should re-consider.

As an alternative to obtaining the concession the liquidator could refrain from winding up the company until the two year period is over.

### **3.2 Revenue Priority**

As Norman explained a liquidator is required to distribute any funds from the sale of any assets in a particular order. After payment of the liquidator's costs and any other costs of the liquidation (eg; VAT or CGT on the disposal of any assets during the liquidation) and the fixed charge holders the question arises as to who is the next creditor to be paid. Immediately in line after the fixed charge holders are any preferential creditors. Such preferential creditors are discharged prior to creditors under a floating charge, unsecured creditors and

shareholders. One of the main preferential creditors is Revenue and the issue of Revenue priority is considered in further detail below.

### **3.2.1 Examinership**

As noted above, during a period of examinership the liabilities of the company are frozen. Therefore, the issue of Revenue priority or priority of any other creditors does not arise.

### **3.2.2 Fixed Charge Receivers**

The position of a receiver depends on whether they are appointed under a fixed or floating charge. A fixed charge receiver, who is appointed under a debenture, should account for any CGT or VAT that arises on the disposal of the assets as discussed further below. Also, the receiver's costs and expenses and the fixed charge holder's liability should be discharged from any proceeds on the sale of the assets. Any balance, available after such liabilities are discharged should be paid to the company and not to any preferential creditors, as there is no obligation on a fixed charge holder to pay preferential creditors.

### **3.2.3 Floating Charge Receivers and Liquidators**

Where a receiver is appointed under a floating charge then the issue of Revenue priority arises. I have set out below a table of the different Revenue liabilities that must be paid by such a receiver or liquidator. The Revenue's priority arises primarily under Sections 98 and 285 of the Companies Act 1963. This legislation provides that the preferential debts rank equally amongst themselves and if they cannot be discharged in full then the preferential debts are discharged in equal portions. In addition to the Revenue priority, there are certain non-Revenue debts which also rank as a priority in these circumstances. I have also set these out further below but in basic terms these are:

- Outstanding wages/salaries for a period of four months prior to the relevant period;

- Certain payments due to employees in respect of redundancy;  
and
- Compensation or outstanding claims payable to the employees.

In order to benefit from the right of priority any person claiming preferential status must notify the liquidator or the liquidator must become aware within six months of the advertisement by the liquidation for claims. In the absence of proper notification the potential preferential creditor status is lost.

It is interesting to note that Revenue priority was abolished in the UK in 2003 after a number of submissions by financial and business representatives. However it is unlikely that any such change will occur in Ireland in the foreseeable future.

With respect to “superpreferential” PRSI in the table below it should be noted that clarity is awaited on the issue of whether such debts must be paid in priority to the liquidator’s remuneration and expenses and whether Revenue’s entitlements under the Social Welfare legislation ranks in priority to any charge on a company’s assets. Revenue may however choose any period of twelve months up to 5 April before the “relevant date” for the purpose of each tax and Revenue may choose different twelve month periods for different taxes. As can be expected usually Revenue will choose the twelve month period with the greatest amount of tax owed.

“Relevant date” means in a compulsory liquidation the date of the appointment, or first appointment, of a liquidator or receiver or possession being taken of the asset and where none is appointed then it is the date of the passing of a resolution for winding up.

<b>Tax</b>	<b>Preferential Debt</b>
<b>1.</b> Superpreferential PRSI	Certain employee deductions which are unpaid rank before preferential debts and may rank before costs of liquidation and receivership
<b>2.</b> PAYE and interest on PAYE	PAYE and Interest on PAYE becoming due and payable during the period of 12 months before the relevant date
<b>3.</b> PRSI	PRSI due and payable during the period of 12 months before the relevant date
<b>4.</b> VAT and interest on VAT	VAT and interest on VAT due and payable for taxable periods which have ended during the period of 12 months before the relevant date
<b>5.</b> Income Tax and interest on Income Tax	Income Tax and interest on Income Tax due for any period of 12 months assessed up to 5 April before the relevant date <sup>1</sup>
<b>6.</b> Corporation Tax and interest on corporation tax	Corporation Tax and interest on corporation tax due for any period of 12 months assessed up to 5 April before the relevant date
<b>7.</b> Capital Gains Tax and interest on Capital Gains Tax	Capital Gains Tax and Interest on Capital Gains Tax due for any period of 12 months assessed up to 5 April before the relevant date
<b>8.</b> Deductions on Construction/Sub-Contractor Contracts	Deductions on Construction/Sub-Contractor Contracts due for the period of 12 months before the relevant date
<b>9.</b> Stamp Duty and other Assessed Taxes and interest on Stamp Duty and other Assessed Taxes <sup>2</sup>	Stamp Duty and other Assessed Taxes and interest on Stamp Duty and other Assessed Taxes for any period of 12 months assessed up to 5 April before the relevant date
<b>10.</b> Rates	Certain local rates due for the period of 12 months before the relevant date
<b>11.</b> Distraint	Distraint by a creditor may rank equally with preferential debts in relation to the proceeds of the sale of the goods distrained

<sup>1</sup> It is interesting to note that the adoption of the calendar year has not occurred as the twelve month period up to 5 April prior to the relevant date is the period which is still utilised.

<sup>2</sup> Assessed taxes in the table means all taxes assessed or assessable on a company, in addition to those noted above and includes tax on loans to participators in close companies and tax deductible at source on payments.

## Employees

<b>Employee Specific Debt</b>	<b>Preferential Debt</b>
<b>12.</b> Wages and Salaries	Wages and salaries due for the period of 4 months before the relevant date subject to an upper limit per employee
<b>13.</b> Holiday Pay	All outstanding holiday pay
<b>14.</b> Notice	Minimum notice entitlements and pay in lieu of notice entitlements awarded by the Rights Commissioner or Employment Appeals Tribunal
<b>15.</b> Redundancy	Statutory redundancy payments due for the period of 12 months before the relevant date
<b>16.</b> Liability for Compensation for Employee Accidents	Damages and cost due which are not covered by insurance held by the company
<b>17.</b> Workmen's Compensation	Amounts due which are not covered by insurance held by the company
<b>18.</b> Sickness Benefit	Amounts due under any sickness benefit scheme
<b>19.</b> Pensions/Superannuation Contributions	Contribution payments due by a company under a pension scheme and contribution payments deducted from employees
<b>20.</b> Unfair Dismissal	Compensation payable under the Unfair Dismissal Acts 1977
<b>21.</b> Subrogated Claims	Certain payments made to employees from funds advanced by a bank or third party and payments made from the Employers Insolvency Fund for claims which would rank as preferential

One important point to note on preferential debts where a liquidator is appointed, is where the company was a member of a VAT group. All members of a VAT group are jointly and severally liable for the VAT obligations of companies in the group. Potentially this could have a material effect on the total VAT liability which would be treated as a priority creditor.

### 3.3 Accounting for CGT

As noted above, the appointment of an examiner does not affect the tax position of the company. Accordingly, the company is liable to account in the normal course for any CGT that arises on any disposal during the period of examinership.

The position of a receiver, whether under a fixed or floating charge, or a liquidator in respect of any disposals during that period of appointment is contained in section 571 TCA 1997. The legislation contained in section 571 was introduced in the Finance Act, 1983 in response to the decision in the *re Van Hool Case*<sup>3</sup>. In that case the Supreme Court held that there was no provision in the legislation to recover CGT on the sale of certain properties in the case of liquidation.

Section 571 provides that on any disposal by;(a) a liquidator of a company; or (b) any person entitled to an asset by way of security or to the benefit or charge or encumbrance to an asset, or as the case may be any person appointed to enforce or effect a security charge or encumbrance; such person is deemed to be the “accountable person” for CGT purposes.

The legislation further provides that:

- (a) Capital gains tax is assessable and recoverable from such accountable person;
- (b) The tax is treated as a necessary disbursement of the disposal and is payable out of the disposal proceeds; and
- (c) Such tax is treated as discharging a corresponding liability of the original debtor.

The tax chargeable to the accountable person is not collected as a CGT receipt but instead under Schedule D Case IV. More importantly,

---

<sup>3</sup> In re Van Hool McArdle Ltd (in Liquidation), Revenue Commissioners v Donnelly [1983] ILRM 129

even though the accountable person is liable to account to Revenue for the tax, the tax charge is calculated taking into account the personal circumstances of the original debtor. Accordingly, the tax liability is assessed having taken into account the base cost of the original debtor; any allowable expenditure during the period of ownership; any losses available for set off and any other unused reliefs. When acting for a receiver or liquidator it is therefore important to obtain as much information as possible regarding the deductible expenditure for CGT purposes prior to the disposal of an asset. As the CGT is a necessary cost of the disposal any overpayment of CGT in effect potentially reduces the amount available to pay off the secured creditor.

Often it is quite difficult for the receiver or liquidator on being appointed to obtain this information and therefore it is important to try and obtain as much of this information in advance where acting for a bank for example. Where there are a number of disposals during the period any losses should be properly apportioned. Also, in circumstances of a bankruptcy as well as losses any personal allowances need to be apportioned between any other gains of the borrower during the period of disposal.

Where tax paid is overpaid then relief is given by way of repayment or set off to the accountable person. It is also worth noting that where a person is entitled to an asset by way of security, ie. a mortgagee in possession, and they sell an asset on the basis of such security then they are liable to account for CGT on the basis as set out above in accordance with the provisions of Section 537 TCA 1997. This could be the case for some fixed charge receivers.

## **3.4 VAT Issues**

### **3.4.1 Introduction**

For the reasons as set out above, there are no VAT issues on the appointment of an examiner.

However, a number of VAT issues arise on the appointment of a receiver or a liquidator. In advising on the VAT issues in these circumstances the following questions need to be asked:

1. Is the receiver acting pursuant to a fixed or floating charge?
2. If the receiver is a 'floating charge' receiver or a liquidator, is it their intention to continue to trade or only dispose of the assets?

In the case of a fixed charge receiver the receiver is only accountable for VAT on the disposal of the asset. The company is still liable to account for VAT on all other activities of the company. If no VAT is due in respect of the asset being disposed of then there is no obligation on the fixed charge receiver to register and account for VAT.

### **3.4.2 Registration**

In the case of a floating charge receiver or liquidator there will be a liability to account for VAT in respect of all disposals. This is the case, even though the receiver or liquidator are not taxable persons in respect of the goods disposed of on the basis of the legislation. Accordingly, the receiver or liquidator is required to register and account for VAT as if it were a taxable person. The relevant legislative provisions are Section 3(7) and Section 9(2A) of the VAT Act 1994. Any application for registration should be made on Form TR2 in the name of the company with the suffix "*in liquidation or in receivership*" as appropriate. When applying for a VAT number Revenue will often

need to be satisfied that title to the assets have passed from the company to the receiver or liquidator prior to granting the application.

A new VAT number is then allocated to the receiver or liquidator. It is also possible for a receiver or liquidator to apply for a group registration if all companies were group registered prior to their appointment.

It is important to note that on a fixed charge receiver being appointed the company must continue to account for tax in the normal course and furthermore ensure that it does not double count for VAT which is accountable by the receiver or liquidator. The returns must be lodged in the normal way on the 19<sup>th</sup> of the month on a bi-monthly basis. Also the amount of VAT that must be paid across is again accounted for on the normal basis. It should be noted that where the liquidator disposes of an asset in specie for example to a shareholder or outstanding creditor then even when no cash is received by the liquidator they may have to account for VAT on the bi-monthly return. This should be taken into account in calculating any distributions by the liquidator.

Another point to be taken into account by a receiver or liquidator is that bad debt relief can be claimed subject to the normal conditions which are discussed in more detail later in this paper.

### **3.4.3 Credit Notes and VAT Recovery**

When issuing a credit note the liquidator or receiver should issue the invoice or credit note on the same basis as the company and state on the document that it is being issued "*Company A in liquidation (Receivership) per court application Y*". The VAT number on the document is the VAT number issued to the receiver or liquidator. As well as making returns to Revenue the receiver or liquidator must notify the company of any supplies and VAT accounted for on each return, to ensure that the company does not double count for VAT.

In a protracted receivership or liquidation in order to maximise the VAT recovery position it is important that the receiver or liquidator

does not sell all of the assets prior to issuing the last VAT invoice. Therefore, a small quantity of assets should always be held onto in order to retain VAT registration and these should be disposed of immediately subsequent to raising the final invoice. This should ensure an input credit in respect of such invoice.

#### **3.4.4 VAT on Property Rules**

It is not possible to consider the new VAT on property rules in detail here but they should be considered in the context of a receivership or liquidation.

One issue that arises from the changes introduced in July last year is whether it is possible to provide a capital goods scheme record. Section 12E of the VAT Act provides that on the disposal of moveable property the taxable person must supply a capital goods scheme record to the purchaser. In my experience the production of a capital goods scheme record is becoming an issue both for receivers and liquidators, and for purchasers acquiring from them. The issue is often that the VAT records have not been kept properly and that it is not possible to provide the capital goods scheme record to the purchaser. Also, as the record can be viewed as an important document relating to the value of the property its absence can create issues for lending institutions. In my view this is likely to become more of an issue as insolvency circumstances increase and the longer the new rules are in existence.

When acting for a bank who is involved in this area, I would suggest that the bank seeks on an annual basis a copy of the capital goods scheme record from the borrower in order that if an insolvency situation arises, it should be possible to create a document which could serve as a capital goods record.

A further issue that needs to be considered in light of the new VAT on property rules is whether a receiver or liquidator should seek to elect to charge VAT on the disposal of property where such property is not a "new property" for the purposes of the VAT Act. In basic terms

where a property is more than five years old and in the five years since construction it has not been either (a) materially altered or (b) the amount of expenditure incurred in respect of the property is not more than 25% of the sale consideration, save for normal repairs and maintenance, no VAT is chargeable on the sale. However, it may be possible to elect to charge VAT where a purchaser is willing to do so thereby increasing both the cash flow for the receiver or liquidator and potentially the overall receipt.

For example, in the case of a liquidator appointed to a property where the company did not have any recovery in respect of the original acquisition of the building, it may be possible to receive a refund from the Revenue where a joint option to tax was put in place. Furthermore, where a company has recovered VAT and a receiver or liquidator fails to make a joint option to tax there may be a net payment to be made to Revenue as a capital goods scheme adjustment.

As Norman has noted above, there are statutory obligations on a receiver and common law obligations on a liquidator to ensure that the maximum amount is received in respect of the disposals of any assets and therefore failure to make such an election may result in a breach of either these statutory or common law obligations.

### **3.4.5 Revenue Guidance**

Revenue has published a useful guide of the VAT issues for receivers and liquidators. The guide VAT leaflet 9/83 is presently being re-drafted and I understand a new version will be issued in the coming weeks.

## **4 Commercial Planning and other Issues on Insolvency**

### **4.1 Commercial Planning**

Key Factors for any business facing financial difficulty are as follows:

- (a) Communication with Creditors and other stakeholders – often problems arise where banks and other creditors are not kept informed about difficulties facing companies. The banks and other creditors are far more likely to exercise some forbearance if they are being kept informed and given real financial information;
- (b) Obtaining proper financial and legal advice;
- (c) Documenting decisions – it is important for directors to be able to demonstrate their commercial and management thinking at any one time and that they did not act recklessly;
- (d) Timing – If a company continues trading when in financial difficulty, there may be no funding left to pay for a professional team to apply an examinership; there may be insufficient funding to keep the company going during the period of protection and the company may have been bled dry so that it is no longer attractive to potential investors. There is also a real risk of the director being held to have traded recklessly. Generally speaking the earlier financial difficulties are addressed, the more options are available to the business.

## 4.2 Retention of Title

Retention of Title is a contractual arrangement whereby legal title does not pass on goods supplied to a company until payment has been made to the supplier. Retention of Title (“ROT”) clauses must be incorporated into the contractual terms i.e. the terms and conditions and invoices passing between the parties. If the clause has not been validity incorporated into the contractual framework, it will not be binding on the company. Generally speaking, the supplier must be in a position to show that the clause was brought to the notice of the company.

There is often a dispute in insolvencies about the validity of such clauses. If the clause goes too far for example, it may be interpreted as a charge on the goods which would then be void and unenforceable unless registered in the Companies Registration Office under the Companies Acts.

The best advice for suppliers is to keep it simple along the lines of *“the ownership of the material to be delivered by the sellers will only be transferred to the purchasers when they have paid all that is owing to the sellers no matter on what ground”*.

Frequently liquidators and receivers have to deal with goods held on retention of title. If there is a dispute as to what goods are or are not included, the best advice is to have an agreed stock take of the goods and set the goods to one side until the matter can be resolved at a later date. This will generally prevent the supplier attending at the company’s premises and seeking to remove goods.

## 4.3 Set-Off

Set-off is a mechanism whereby a debt owed **to** a company can be set-off against a debt owing **by** the company to the same third party. A frequent example is where a company has several accounts with a bank, some with negative and others with positive balances. All banks give themselves the contractual right to set-off various accounts against each other (provided they are held by the same company).

Set-off is allowed in both liquidations and in examinerships. Set-off is not considered a breach of the prohibition on enforcement of debt in an examinership. For example in the Structured Credit Company (SCC) Examinership, which involved credit swaps carried out under ISDA documents, counterparties of SCC had access to monies in a collateral account which could be drawn down by the customer if a mark to market call was defaulted upon by SCC. It was accepted in that examinership that the customer could apply set-off and retain the collateral account proceeds.

The Netting Acts specifically allow by Statute set-off as between swaps and other financial instruments notwithstanding that one of the parties are in an insolvency process.

For set-off to apply, there must be mutuality between the debts i.e. the debts must be owed and owing between the same parties. Set-off does not create a security interest; it is merely a contractual right. A debt owing to the Revenue can be set off against a company's terminal loss (Re: Harrex (1961)). Pre-liquidation and post-liquidation debts cannot be set-off. In other words, if a debt is incurred after the appointment of a liquidator, this cannot be set off against a pre-liquidation debt. Of course some debts owing to Revenue may have both preferential and non-preferential status. A company cannot choose which of the debts to set its loss off against; this will operate in accordance with the applicable priority i.e. the preferential Revenue debt must be paid first.

#### **4.4 Personal Liability of Directors**

##### **4.4.1 Fraudulent Trading**

Under Section 297 of the Companies Act, 1963, a Director may be liable for all or part of the company's debts if he is found to have *"knowingly been a party to the carrying on of any business of the company with intent to defraud creditors of the company, or creditors of any other person or for any fraudulent purpose"*.

Proceedings may be taken by a liquidator, a receiver, an examiner or any creditor or contributory. Proceedings may be taken against any officer, including an auditor of the company. Fraudulent trading is also a criminal offence carrying a significant fine and/or seven years imprisonment. Two examples of cases of fraudulent trading are Kelly's Carpetdrome Limited (1983) and Hunting Lodges Limited (1985). In Kelly's Carpetdrome, the parties transferred the stock to another one of their companies and then on a second occasion to another company of theirs. On each occasion monies were paid but the companies were left with substantial Revenue debt. The situation was worsened by the absence of proper records and books of account and the failure to record cash receipts. The Court found that its directors were guilty of fraudulent trading and directed them to discharge a significant portion of the debts of the company.

#### **4.4.2 Reckless Trading**

Reckless trading arises where an officer knew or ought to have known that his actions would cause loss to the creditors of the company or where he allowed the company to incur further debt when he knew that it was unlikely that the company could pay its debts as they fell due.

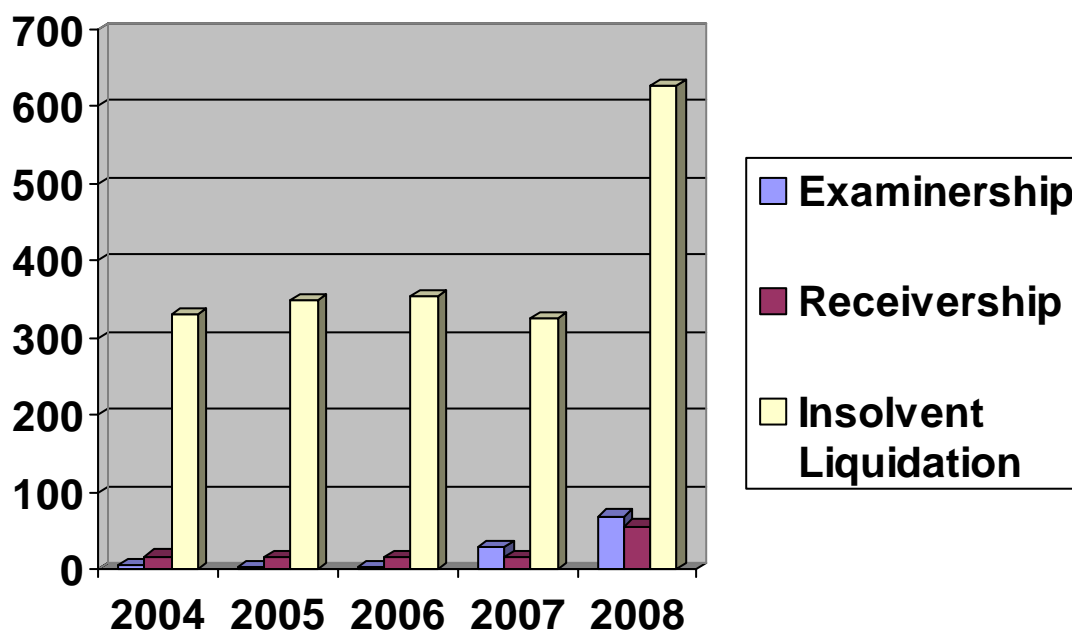
It is sufficient to establish that the officer was grossly careless in taking a risk that would be regarded as reckless. There must be a significant risk of significant damage to creditors or other parties. The officer must have ignored the risk because of his *"selfish desire to keep his own company alive which overrides any concern which he ought to have for others"* (Re: Hefferon Kearns Limited 1993).

#### **4.4.3 Failure to keep Books of Account**

Under the Companies Act 1990 (Section 202) a Director is personally liable if he is responsible for the company failing to keep proper books of account which give a true and fair view of the state of the company's affairs and explains its transactions.

Section 202 imposes criminal liability on the company and on the director for failure to comply with its obligation. The liquidator or any creditor of the company may apply to the Court for an Order directing that one or more former officers of the company who are in default should be personally liable for the debts and other liabilities of the company without limitation.

**Examinerships, Receiverships and Insolvent Liquidations Notified to the CRO**  
**2004 to 2008**



	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
<b>Examinership Notifications*</b>	6	4	3	29	70
<b>Receivership Notifications**</b>	18	17	17	16	56
<b>Insolvent Liquidation Notifications***</b>	331	349	354	325	627

(Source CRO and FGS Partnership)

\*The above figures represent court ordered appointments of Examiners

\*\* The above figures represent the number of companies which went into Receivership during each year

\*\*\*Insolvent Liquidation includes only Creditors Voluntary Liquidations and Court Ordered Liquidations

## 5 Reliefs, Claiming Deductions and Timing Issues

### 5.1 Cessation of a Trade

The cessation of a trade will have a number of tax consequences. Whether or not a trade has actually ceased is a question of fact. Generally a trade ceases when all the assets of the trade have been disposed of, as distinct from the capital assets. Where a liquidator is appointed resulting in the end on an accounting period then Section 882 TCA 1997 applies and the liquidator must notify Revenue within 30 days as there is a material change “to the business”. As noted above, there are VAT reasons why all the assets should not be disposed of prior to the payment of the principal costs of the receiver or the liquidator. While the realisation of capital assets does not prolong a trade it is possible that certain trade assets are disposed of but the trade has already deemed to have ceased.

In the case of *Gordon Blair Limited v Inland Revenue Commissioners* (40 TC 358) the company was deemed to have ceased its original trade and commenced a new trade. Originally, the company had manufactured and sold beer, however, it ceased manufacturing the beer and only continued to sell it. The court held that in these circumstances that the trade of manufacturing and selling beer had ceased and a new trade of selling beer had commenced.

Where a trade is deemed to have ceased any income received after that date will be treated as Schedule D Case IV and not Schedule D Case I income and the receiver or liquidator would be liable to account for tax accordingly. Where possible the appointment of a liquidator should coincide with the end of an accounting period to avoid having to use split year rules in calculating any terminal loss relief claim.

Section 81 TCA 1997 provides the general rule on the deductibility of costs incurred by a trade. In order to be able to claim a deduction the cost must be incurred “*wholly and exclusively for the purpose of the trade*”. Where costs are incurred after the cessation of a trade then in the absence of a specific statutory provision such costs may not be deductible for tax purposes. This

may have the effect of increasing the overall costs of the receivership or liquidation.

The question of whether closure costs incurred after the cessation of a trade qualifying as a trading deduction for tax purposes has been considered by a number of UK decisions. While these cases are of course not binding authority in Ireland they are persuasive. The UK courts have consistently held over a period of time that any costs incurred after the cessation of a trade as part of the closure business are not deductible for tax purposes. Accordingly, in the absence of a statutory provision, and on the basis of UK case law, any costs incurred solely in connection with the closure of business are not allowable for tax purposes. However by careful documentation and ensuring the correct timing of expenditure, it should be possible to claim a deduction for most costs. Particularly of importance will be any redundancy costs or ex gratia payments paid in connection with the termination of employments.

## **5.2 Loss Relief and Terminal Loss Relief**

Another point to be borne in mind is that the cessation of a trade is the end of an accounting period for tax purposes. Where a trade ceases the provisions of Section 397 TCA 1997 apply to determine what terminal loss relief is available. These will particularly be relevant in the circumstances of receivership or liquidation. Terminal loss relief allows a company, which makes a trading loss in its final 12 months trading, to make a claim to carry back this loss against income of the same trade in the three years preceding the period of cessation of the trade. It should be noted that relief will only be given where all other claims for loss relief have been made. However, excess charges incurred wholly and exclusively for the purpose of trade in the last 12 months can be carried back against trading income. A claim for terminal loss relief must be made within five years of the date the company ceased to trade.

A practical issue where terminal loss relief is claimed is this may result in tax having been overpaid for the prior accounting periods. In these circumstances even though a liquidator or receiver would argue the company is entitled to an immediate repayment it is highly unlikely that Revenue will make a repayment unless all other tax liabilities of the company have already been paid.

Section 1006 TCA 1997 provides that a taxpayer may require and Revenue may offset any repayment against an outstanding liability. The Offset Regulations published in October 2001 set out the order in which any repayment is set off against an outstanding tax liability. The Offset Regulations apply to most tax heads but do not apply to RCT, excise duties, CAT, stamp duty, RPT and VRT. Also it should be noted that pre and post-liquidation liabilities are usually not offset against each other. The Revenue are also entitled to set off any tax owing to a Company in liquidation against tax due by the Company subject to the comment above regarding the offset of pre and post-liquidation debts.

As well as making a claim under section 397 TCA 1997, there are other possible uses for any losses in the company. Where an examiner is appointed it will assess whether there are any tax losses in the company and whether these can be used in deciding whether it is possible to rescue the business as a going concern. Also, if any of the debts of the company are written down as part of a negotiation with creditors then a tax charge will arise to the company as noted above.

A fixed charge receiver will normally be disposing of an asset or assets and in these circumstances losses are likely to be relevant in assessing any CGT liability under Section 571 as noted above.

Where a company is a member of a group then a floating charge receiver should consider whether he has a charge over any losses of a particular company and whether it is possible to receive payment from another group company for these losses. As a receiver needs to consent to the transfer of losses intra group (as agent for the company) it could refuse to surrender the losses in the absence of a payment. Any such payment is not taxable under the provisions of Section 411 (5) TCA 1997. A number of conditions need to be met in order for a group to exist. In basic terms means there must be a 75% relationship between the companies, either directly or indirectly and that the 75% relationship must relate not just to the ordinary shares but to the rights to distributions and assets in a winding up.

A liquidator will not be able to sell losses inter-group as the group relationship ceases to exist on the appointment of a liquidator for the purposes of transferring group losses.

A further issue which a receiver may wish to consider is whether or not he will undertake a hive down and if so whether any losses can transfer with the trade pursuant to the provisions of Section 400 TCA 1997. The question of hive down is considered further below.

### **5.3 Bad Debt Relief**

One issue which an examiner, receiver or liquidator should always consider is whether or not any of the debts due to the company are bad debts. In terms of writing off bad debts, it is preferable if this is done prior to the cessation of a trade on the basis that a deduction will be taken for trading purposes for the bad debts incurred in the final accounting period. Such deduction may then be available to be carried back pursuant to section 397 TCA 1997.

Where the company can make a specific provision for bad debt in respect of payments due to them it should also be able to claim VAT bad debt relief which may result in a reduction of any payment due to Revenue or potentially a refund depending on the company's tax position. VAT regulations 2006 (SI No. 548/2006) ("the Regulations") set out the circumstances in which VAT bad debt relief can be claimed. Amendments were made in the Finance Act, 2007 in respect of Finance Houses which means they are now also allowed to make claims for bad debt relief in respect of hire purchase transactions.

In order for VAT bad debt relief to be claimed the conditions in regulation 16A of the Regulations must be satisfied, these are:

1. The taxable person must have tried to recover the debt;
2. The bad debt must have been taken at deduction for the purposes of the corporation tax of the trade and being written off in the financial accounts of the taxable person;
3. The requirements of regulation 8(1) (m) of the Regulations must be fulfilled. This means details of the debtor, the nature of the goods or

services, the date of the debt and date of the write off must be included; and

4. The debt must not be due from a person connected with the taxable person within the meaning of Regulation 15 (5)(b) of the Regulations.

It should be noted that recent amendments to the Regulations set out in Revenue e-brief 34/2008 note that in circumstances where a person is not liable to tax under TCA the person may still be entitled to make a claim for bad debt relief in respect of VAT. Also, Revenue published a leaflet in December 2008 on the calculation of relief of VAT in respect of bad debts generally and particularly in Hire Purchase Agreements where VAT bad debt relief has been claimed. Finally, VAT bad debt relief is claimed at the rate applicable when the debt is written off rather than when the original invoice was issued. In light of the recent change to the VAT from 21% to 21.5% this will have an effect for anybody claiming VAT bad debt relief in the coming year.

#### **5.4 Tax Issues on Redundancy and Termination of Employment**

In almost all receiverships or liquidations staff will end up being made redundant. The key tax questions to consider in such circumstances are:

1. Whether there is any obligation to make a payment to the employee?
2. Whether any tax deduction can be claimed in respect of such payment?
3. If any refund can be claimed in respect of such payment?
4. Any tax considerations that need to be taken into account in the timing of such payment?

In order to consider the tax issues on making an individual redundant it is necessary to understand the basic employment law in this area.

In order for an individual to be able to claim statutory redundancy the following conditions must be met:

1. The employee must have at least two years continuous service (104 weeks);

2. The employee must be in employment which is insured under the Social Welfare Acts;
3. A full time employee must be in employment which is fully insurable for all benefits under the Social Welfare Acts – this does not apply if the employee is a part time employee. The question of insurability is decided by the Department of Social & Family Affairs in accordance with the rules and appeals procedure provided for under the Social Welfare Acts. An employee must be over sixteen years of age. Prior to 8 May 2007, the employee must have been less than 66 years old but this upper age cap has now been abolished.
4. The employee must have been made redundant as a result of a genuine redundancy situation; that is in general terms, no job longer exists for that person. This is likely to be the case with most receiverships or liquidations.

The Redundancy Payments Act provides that an eligible employee is entitled to two weeks statutory redundancy payment for every year of service, plus a bonus week. All statutory redundancy payments are tax free. For redundancy purposes, a week's payment is subject to a maximum statutory ceiling which currently stands at €600. Relevant service is calculated on a pro-rata basis so that in a situation where the total amount of service is not an exact number of years, the excess days are credited as a proportion of a year.

A weekly pay rate for redundancy purposes is calculated by adding together gross weekly wage, average overtime and benefits in kind. If the amount to the payee varies, a weeks pay is calculated at the average hourly rate in respect of a period of 26 weeks ending 13 weeks before the date of dismissal. The variation in payment will include commission, piece work rates or similar payments with varied amounts. It should be noted that a 60% rebate is available to employers on the statutory redundancy payments from the Social and Insurance fund. In order to claim this sum the employer must claim a rebate on a form RP50 and submit this to the Department of Enterprise Trade & Employment. It generally takes 12 weeks for the rebate application to be processed.

Often a receiver or liquidator will decide that a number of individuals are key to ensuring that the highest amount can be obtained during the running down

or disposal of the assets of the business. In this context one issue that needs to be considered is what is the tax treatment of any payment to these individuals, particularly where any payment on the termination of their employment is in excess of their statutory redundancy entitlements?

This question has been considered on a number of occasions by the UK courts which has held that determining whether a tax deduction can be claimed what is key is why the payment was made to the individual. As noted above UK case law is not binding in Ireland but is persuasive authority. The conclusion from the UK cases seems to be that where the employee has a contractual right to receive the payment then the receiver or liquidator can claim a tax deduction for making the payment, however where the payment is genuinely *ex-gratia* and made after cessation of the trade then no deduction can be claimed. In advising a receiver or liquidator on any payments made to such employee it is important to consider the contractual terms of the individual in this context. However, it may be that there is a conflict between the employee and the receiver or liquidators' position. While an employee generally would want any payment to be contractually secure in doing so it reduces the possibility of such payment coming within the ambit of Section 123 TCA 1997.

Section 123 TCA 1997 provides that on termination of employment an employee can choose one of three methods in determining what amount of *ex gratia* payment is exempt from income tax. The three methods are the basic exemption, increased exemption and the SCSB calculation. A full discussion of these outside the scope of this talk, but in advising a receiver or liquidator regard should be had to these provisions as often an employee may be willing to receive a lesser gross sum where it is received in a tax efficient way ensuring a greater net receipt for the employee.

## **5.5 Hive Downs**

As Norman noted above, receivers, unlike liquidators, have no statutory mechanism to reduce their exposure under a contract. This can cause concern to receivers and it is why they always seek to have their position indemnified by the company. However, as receivers are only agents of the company they cannot be made personally liable by any third party and they

can frustrate performance by the company of its contracts and to an extent disclaim them. Often a receiver uses this power to disclaim contracts to undertake a hive down and achieve value for creditors.

Most floating charges now empower a receiver to incorporate a subsidiary and to sell the assets of the company to it. A recent example of where this is likely to occur is in the receivership at Waterford Wedgewood. It is understood at the moment that it is likely that the receiver at Waterford Wedgewood will hive down the assets to a new subsidiary which will be disposed of to a third party.

There are a number of direct and indirect tax consequences of a hive down. A key consideration of a hive down is whether any losses of the trade are available for a newly incorporated company.

Usually the transfer of a trade between companies it is an automatic discontinuance of a trade which means that the transferor can avail of terminal loss relief and the transferee cannot benefit from any unused trading losses. However, section 400 TCA 1997 provides that where a trading company ceases to trade, and following the cessation a different company, whether newly incorporated or not, continues to carry on the trade, the trade is not treated as being discontinued or recommenced where both parties make an election and:

1. At any time within two years after the transfer;
2. The trade or not less than 75% interest in it belongs to the same person as the trade or interest belonged to at any time within a year before the transfer.

If all the other requirements are met then the trading losses can be carried forward and used by the transferee against profits of the same trade. Furthermore, the transferee is deemed to have taken over the assets at their tax written down value and no balancing allowances or charges should arise.

It should be noted that non-trading profits cannot be transferred pursuant to this section. Where the transferee ceases to trade within one year of the transfer the transferor will only be entitled to terminal loss relief in respect of

the previous losses while the transferee will only be entitled to terminal loss relief in respect of the period they carry out the trade.

Section 400 is a valuable provision particularly in the case of a transfer of a loss making trade by a receiver. It is important to note that the same trade must be continued afterwards and that if there is a material change in the nature of the conduct of the trade after the transfer then the losses may be denied. However, where the trade continues to be carried on then the losses are available to the purchaser of a Newco and this should allow the receiver to obtain value for these losses. As noted it is essential to ensure that the trade after the hive down is owned by the same person who owned the trade beforehand, this can be achieved by either transferring the trade to any existing group company or, is more commonly achieved by transferring the trade to a new subsidiary of the existing company in consideration of an issue of shares.

Where a trade and the assets of a trade are transferred as part of a hive down then Section 3(5)(b)(iii) of the VAT Act 1994 should apply and no VAT should be chargeable by the receiver of the transfer. One of these conditions is the transferee must be registered for VAT prior to the transfer. Revenue by concession allow the provisions of Section 3(5)(b)(iii) to apply where the transferor has applied for registration but has not received a VAT number at the time of the transfer. However, as this is a concession it should only be relied upon if at all possible. If section 3(5)(b)(iii) does not apply then depending on the assets being transferred VAT may be chargeable.

Stamp duty is another issue that needs to be considered in the context of a hive down. Where the assets are transferred from the company in receivership to a subsidiary company it may be possible to mitigate stamp duty. Relief potentially could be claimed under the provisions of Section 79 of the SDCA 1999. However, as noted above, this legislation contains a claw back where the two companies cease to be in a group relationship within two years of the transfer taking place. Alternatively, it may be possible to structure the transfer as a transfer of an undertaking pursuant to the provisions of Section 80. However, there may be certain company law issues which are not surmountable depending on the circumstances. In particular, in order to affect the transfer under Section 80 there must be distributable profits in the

transferor company as the transfer is deemed to be a distribution for the purpose of the companies legislation. Where the value of the assets and liabilities being transferred together are equal then it may be possible to overcome this issue.

If however, the provisions of Section 79 and Section 80 cannot be used to mitigate any liability consideration should be given as to whether it would be possible to effect the transfer of some or all of the assets without creating a stampable instrument. As stamp duty is only chargeable on an instrument which conveys or transfers property which comes within the ambit of Schedule 1 of SDCA 1999 it may be possible to affect a transfer without creating such an instrument. Particularly, this may be the case where the assets are non-fixed assets and goodwill.

Finally, the CGT consequences of any hive down need to be considered. Where the assets are transferred to a subsidiary company then the provisions of sections 616 and 623 of the TCA 1997 should apply that is the transfer should be on a no gain, no loss basis. In contrast to stamp duty provisions there is no CGT claw back on an inter-group transfer where the company ceases to be related by virtue of one of the companies going into a bona fides commercial liquidation. This is often the case where a floating charge receiver undertakes a hive down and then winds up the "parent" company. However, where there are any fixed assets standing at a gain, CGT may be payable. Furthermore, where the group relationship ceases except in the circumstances of a bona fide commercial liquidation, a CGT claw back will be payable in accordance with the provisions of Section 623 TCA 1997. Finally, where a receiver does dispose of any capital assets as part of a hive down then the provisions of Section 571 as set out above will apply and they should account for tax accordingly.

## **6 Notice of Attachments, Revenue's Current Attitude and Conclusion**

### **6.1 Section 1002 Attachment Order**

#### **6.1.1 Introduction**

Where a taxpayer (the "Defaulter") defaults on an amount due to the Revenue, section 1002 of the Taxes Consolidation Act 1997 gives Revenue the power to issue a Notice of Attachment to a third party (the "Attachee") for any sum due from the third party to the taxpayer.

There is no requirement for Revenue to first obtain judgment in relation to the debt and they may proceed directly to issuing a Notice of Attachment once the following conditions have been satisfied:

- The Defaulter has been in default for at least 14 days on any tax, interest on tax, or penalty due to Revenue;
- Revenue has reason to believe that an Attachee has a debt due to the Defaulter; and
- The Defaulter has been notified in writing, at least 7 days before receipt of the order by an Attachee, that an attachment order is due to issue, unless the relevant amount is paid.

An attachment order may be issued in relation to almost any debt due to the Defaulter. The only debt specifically excluded from attachment is any amount due as an emolument to an employee. Revenue practice manuals also indicate that solicitor's client accounts are not suitable for attachment order, and amounts due on foot of a court order are suitable for attachment in some, but not all, situations. Funds held in a bank account are considered debts due from the bank to the Defaulter, and may therefore be attached.

The Notice of Attachment is issued by Revenue to the Attachee and must show the Defaulter's name and address along with the aggregate of the tax, interest and penalties due. Revenue practice is

to post the 7 day warning to the Defaulter, and to hand deliver the Notice of Attachment to the Attachee.

An Attachee who receives such a notice must make a return to Revenue (the "Return"), within 10 days of receipt of the notice. The Return must detail the amount (if any) due from the Attachee to the Defaulter (amounts which are disputed are disregarded for determining the amount of the debt). However, if the debt due to the Defaulter from the Attachee exceeds the amount demanded by Revenue, then it is sufficient to make a return showing the debt as equal to the amount demanded. For example, if a Notice of Attachment for €100 is received by an Attachee, and a debt of €200 is due from the Attachee to the Defaulter, the Attachee need only include the amount €100 on the Return.

The Attachee must also pay over to Revenue the amount specified in the Return within 10 days of receiving the Notice of Attachment (however this does not have to be submitted at the same time as the Return). If the amount specified in the Notice of Attachment is greater than the debt outstanding between the Attachee and the Defaulter, the full amount of the debt must be paid over. Also, if a further debt becomes due from the Attachee to the Defaulter after the Notice of Attachment has been received, but before payment by the Attachee is made to Revenue, a second Return and payment must be made to Revenue within 10 days of the further debt becoming due. This process can continue repeating until all outstanding amounts have been paid.

Once a Notice of Attachment has been received, the Attachee should not make any payments to the Defaulter, unless:

- Such payment will not reduce the overall debt due to the Defaulter below the amount contained in the Notice of Attachment, or
- The payment is required to be made pursuant to an order of a court.

### **6.1.2 Insolvency**

Revenue may not issue a Notice of Attachment in relation to a Defaulter company which is in liquidation (or an individual who is declared bankrupt). Furthermore if a company enters into liquidation (or an individual is declared bankrupt), after a notice has been issued the notice is deemed to expire.

It would appear that there is nothing in the legislation which would prevent Revenue issuing a Notice of Attachment against a Defaulter company which is in examinership, as the company is not actually being wound up. Of course, any such action could severely damage plans made by an examiner to rescue a company, if such plans are reliant on a significant sum due to be received from a debtor who becomes an Attachee.

If the Attachee were the company under examinership, then Revenue may issue a Notice of Attachment, however they may not attempt to enforce the Notice without the consent of the Court.

### **6.1.3 Confidentiality**

Section 1002 exempts Revenue from their duty of confidentiality to the Defaulter in respect of the Attachee. However, any wrongful delivery to another third party would constitute a serious breach of confidentiality. The legislation states that Revenue must "have reason to believe" a debt is due from the Attachee to the Defaulter. Where this is not the case, the Defaulter may have grounds to issue proceedings against Revenue.

### **6.1.4 Revenue Practice**

Revenue practice manuals contain a *non-exhaustive* list of suitable Attachees as follows:

An Post, Banks/Building Societies, Co-Ops/Creameries, Dept. of Social Welfare, Dept. of Agriculture, Dept. of Justice, General Medical

Scheme, Health Boards, Insurance Companies, Office of Public Works, Principal Contractors, Major Companies, Local Authorities, Credit Unions, Legal Aid Board.

It is interesting that specific reference is made to "*Major Companies*", however one should not assume that Revenue will never seek to attach a small company with whom the Defaulter trades.

When a 7 day warning letter is issued, Revenue practice manuals indicate that; if the Defaulter contacts Revenue and begins realistic negotiations, which the Revenue caseworker believes are likely to succeed, then a Notice of Attachment should not issue. Alternatively, where a Defaulter does not contact Revenue, but a part payment is received, the caseworker may decide based on the circumstances whether to proceed or not. As the damage to a company's credit rating following the issue of Notice of Attachment may be irreversible, it is important to be aware that engaging Revenue at the earliest opportunity may prevent the a Notice from issuing.

The advantage to Revenue in Section 1002 over judgment is that there is no need to petition the court in order to try and seek payment of certain parts of the debt.

## **6.2 Revenue's Current Attitude**

There have been a number of representations by the Institute to the Collector General regarding the collection of tax in a down turn. In the current economic climate all tax payers are aware of the cash flow issues. However, many practitioners have noticed that the flexibility which third party creditors may be giving to some of their clients does not seem to be reciprocated by Revenue. Revenue published their most recent guide on 19 February on the issue of recovery of debt and this is available on the Institute's website.

Revenue has stated that the key in their approach to any company in difficulties is that the company and their advisors keep the Revenue fully apprised of the client's ongoing ability to meet their debts. Revenue will in the absence of being kept fully informed notify the Collector General. In the

absence of immediate contact the Collector General has stated they will immediately seek collection and use all methods at their disposal to collect the debt, in particular this includes notifying the Sheriff using attachment orders, seeking judgment or petitioning for liquidation. Also, last month the Revenue published an update guide entitled "Agents Guide to the Collector General's Division", which it is worth being familiar with. Like many other creditors Revenue are not as supportive of the examinership process though this is not always the case, particularly if the process allows all the creditors to be paid in full.

In light of the new rules on audits and penalties introduced by Finance (No. 2) Act 2008 the position for tax payers is perhaps worse than last year. I would advise any practitioner who is dealing with a tax payer who is potentially close to an insolvency position to maintain open a line of communication and correspondence with Revenue in order to ensure that some pre-emptive action by Revenue does not force their client into insolvency. In particular, this is likely to happen where the Revenue notice that annual returns or any other statutory returns have not been filed in time.

A further issue to consider is whether Revenue will agree to a phased payment. Even if Revenue does agree to payments in instalments they will seek to impose interest and recover the tax in full. The Collector General is not willing to agree to a phased payment in the absence of clear reasons as to why the tax has been outstanding and will require details of the outstanding creditors of the company which will ensure the possibility of the company repaying the debt.

## **Conclusion**

It has not been possible in such a short period to advise on all of the legal and tax issues in depth. The aim of this afternoon's talk is to cover the key structures that apply in insolvency and liquidation situations and the tax issues that need to be considered. All advisers need to be aware of the risks that come with the current economic climate and directors need to consider the potential personal exposure where they do not continue to take advice during any period prior to insolvency. It is difficult to minimise tax liability once the company enters receivership or liquidation however by not taking the steps in the correct order it is possible that a tax liability is increased. Again in light of the statutory obligation on receivers, and the common law duty of liquidators there may be potential exposure if proper advice could have minimised such tax liability.

### *Disclaimer*

*The object of this paper is to explain in broad detail the principles in regard to buying and selling businesses in Ireland. The paper is not intended as a detailed exposition of the extensive legislation in relation to examinerships, receivership or liquidations.*

*Neither Eversheds O'Donnell Sweeney nor the authors accept any responsibility for loss or damage occasioned by a person acting or refraining from acting as a result of the material in this paper.*

**COPYRIGHT - Gavin McGuire and Norman Fitzgerald**

**Eversheds O'Donnell Sweeney**