

Tax Alert April 2011

Living in a fool's paradise

A practitioner faced with the prospect of a dormant company with outstanding liabilities often advises a client to voluntarily deregister a company, usually on the grounds of cost, and in the belief that it completely ends that company's existence.

However, such advice is often given without a full appreciation of the provisions of the *Corporations Act 2001 (Act)*, because it invariably ignores the fact that a company that has been voluntarily deregistered can easily be reregistered.

Recent case law illustrates the Commissioner's willingness to go to court to reregister a company. The effect of this can come as a shock to those who believe that the liabilities of a deregistered company are 'dead and buried'. Unfortunately, those practitioners are living in a fool's paradise!

A number of recent cases in the Federal Court have illustrated the Commissioner of Taxation's willingness and ability to reinstate previously deregistered companies, where those companies have had substantial amounts due to the Australian Taxation Office.

For the purposes of the Act, section 601AA allows a company to be voluntarily deregistered if the following criteria are satisfied if:

- all the members of the company agree to the deregistration;
- the company is not carrying on business;

- the company's assets are worth less than \$1,000;
- the company has paid all fees and penalties payable under the Act;
- *the company has no outstanding liabilities; and*
- the company is not a party to any legal proceedings.

A director or member of the company, amongst others, can initiate the process. If a company is deregistered, it is a statutory requirement that the directors of the company immediately before deregistration must keep the company's books for 3 years after the deregistration (subsection 601AD(5)), with potential criminal ramifications if the books are destroyed in that time.

However, section 601AH also provides that a company can be reinstated by the court if a person has been *aggrieved* by the deregistration, and the court is satisfied that it is *just* that the company's registration be reinstated.

A person being "aggrieved" has been broadly interpreted and includes a person who has been damaged or injured in a legal sense.

A reregistration of a company is "just" if there is no apparent injustice or prejudice caused by the reinstatement, and the court has a very wide discretion in assessing any factors it thinks are relevant.

Even if there is clear evidence that a company does not possess any assets to meet an outstanding claim for income tax liabilities this will not deter the Commissioner pursuing the reregistration of a company, and invariably, the court will order the company to be reinstated.

Recent cases in the Federal Court show the extent to which the Commissioner is now agitating this area of the law, which was once considered to be dormant, with little reported activity.

These cases include *Anttila Enterprises Pty Ltd* [2011] FCA 203, *Binetter* [2011] FCA 184, and *Civic Finance Pty Ltd* [2010] FCA 1411. The relative ease in which the Commissioner was successful in each instance in having the court order the relevant companies reinstated, makes for sobering reading.

The reason why the Commissioner seeks to reinstate companies where there is an outstanding taxation liability is so that the Commissioner can immediately place the company back into liquidation and appoint a liquidator to the company. Although a company's resurrection only to immediately put it to death yet again seems counter-intuitive, it is in the public interest to do so, because it allows the provisions of the tax law and the Act to be properly followed.

In the case where outstanding taxes are owed, the Commissioner should not be deprived of the opportunity to pursue the claim.

It is to be expected that a liquidator appointed to a reregistered company could be funded by the Commissioner to undertake the usual duties that a liquidator undertakes when a company is placed under liquidation as soon as it is reinstated.

The types of duties that a liquidator must undertake are to:

- establish that the company is insolvent;
- determine when the company became insolvent;
- investigate where there is potential insolvent trading claim against directors;
- determine if there have been any preferential payments to creditors that may be recovered;
- ascertain if company's officers have committed offences under the Act; and
- determine whether any recoveries could be made.

A liquidator has the ability to hold public examinations, seize books and records and gain access to property and detain persons relevant to the investigation. A liquidator

also has the power to recover unreasonable related party transactions or preferential claims.

Each of these could be problematic for people who have deregistered a company with outstanding liabilities because when it is reinstated a liquidator can then exercise powers to recover company property and to prosecute directors for potential offences under the Act.

In particular, the effect of subsection 601AH(5) needs to be understood. If a company is reinstated, the company is taken to have continued in existence as if it had not been deregistered. A person who was a director of the company immediately before deregistration becomes a director again as from the time when ASIC or the Court reinstates the company.

Because of this statutory continuity, if it is determined that there has been insolvent trading, a director can be held personally liable for those liabilities. A liability for the purpose of insolvent trading can be a present liability as much as a contingent liability (*Civic Finance Pty Ltd*).

Clearly, incurring taxation debts which cause a company to become insolvent, including as trustee of a corporate trustee, can also give rise to a director's personal liability.

If you are aware of a company with outstanding tax liabilities you need to seek specialist taxation and solvency advice. Simply relying on what is commonly referred to as an "informal liquidation", by relying on the deregistration provisions of the Act, is realistically not a viable option, unless the company truly has no present or contingent liabilities.

The Commissioner has shown that he is now prepared to have companies reinstated for the purpose of pursuing debts. Whereas in the past he may have chosen not to reinstate a company, that can no longer be presumed as being the case in future.

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