

MODULE 4

WINDING UP A BUSINESS

PART OF A MODULAR TRAINING RESOURCE

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WINDING UP A BUSINESS

INTRODUCTION

Winding up a business gives rise to a number of financial, commercial and legal issues that usually impact a number of stakeholders.

Whilst this Module focuses on winding up a business which ceases to operate, the Module also considers instances where there is a sale or merger of a business and the business can no longer operate in its current form.

While these issues will be explored in more detail in this Module, it is important to note that:

- If your organisation is a company, the winding up process is governed by the *Corporations Act 2001* (Cth) (Corporations Act 2001).
- If your organisation is an incorporated association, the rules governing the winding up process (including whether any elements of the Corporations Act 2001 apply) will differ from state to state: further detail relating to incorporated associations can be found on page 13 of this Module.
- In a partnership, the terms of the partnership agreement will dictate how the partnership is dissolved. Where no formal partnership agreement is in place, the rules will differ from state to state, according to the relevant Partnership Act. If the partnership is constituted by two companies, then the winding up rules of the Corporations Act 2001, considered in this Module, may also apply to each individual partner company.
- If your organisation is registered with the Office of the Registrar of Indigenous Corporations (ORIC), the organisation should contact ORIC if it is considering ending the affairs of the organisation. The rules under the *Corporations (Aboriginal and Torres Strait Islander) Act 2006* (Cth) (CATSI Act) for winding up such an organisation are similar to, and often adopt, the rules of the Corporations Act 2001.

If your organisation is considering winding up or merging, it is strongly advised that you seek independent legal and accounting advice on this matter. This Module serves as a guide only.

This Module provides information about the key factors to consider in winding up a business, including:

- the process and legal requirements
- the key risks
- a broad understanding of solvency

- the types of winding up mechanisms available for a company and incorporated association.

Other Modules relevant to this Module include:

- Understanding financial impact (Module 1)
- Staff redeployment (Module 3).

KEY DEFINITIONS

Term	Definition
Liquidation	<p>Liquidation is the orderly winding up of a business's affairs. It is a statutory process undertaken via the formal appointment of a Registered Liquidator pursuant to the Corporations Act 2001. It usually involves the Liquidator realising the business's assets (converting into cash), ceasing or selling its operations, distributing the proceeds of realisation amongst its creditors and distributing any surplus to shareholders.</p> <p>In the case of companies registered with ORIC, the Court or a liquidator (with some of the same powers under the Corporations Act 2001), may undertake the liquidation process in accordance with the provisions set out in Chapter 11 of the CATSI Act.</p>
Solvency	Ability to pay all debts as and when they become due and payable.
Voluntary administration	<p>External administration of a business occurs when Directors appoint an external administrator to:</p> <ul style="list-style-type: none"> • investigate the business's affairs • report and make recommendations to creditors as to the future. <p>Voluntary administration will usually occur if a company is insolvent or likely to become insolvent. It is a statutory process undertaken via the formal appointment of a Voluntary Administrator pursuant to the Corporations Act 2001.</p> <p>The provisions of the Corporations Act 2001 also apply to companies registered with ORIC but only to the extent to which</p>

Term	Definition
	they are capable of applying to an Aboriginal and Torres Strait Islander corporation and with the modifications specified in the regulations. Refer to Chapter 11 of the CATSI Act for further information.

KEY FACTORS TO CONSIDER

The decision to cease to operate or enter into a transaction to sell or merge requires consideration of various factors. The table below explores some of the most important of these for your consideration.

Factor	Issues to consider
Viability	<p>Is the business viable going forward?</p> <p>What is the impact of funding changes on the viability of the business and solvency? Please refer to Module 1 'Understanding the financial impact' and the section below entitled 'Understanding Solvency'.</p> <p>What will the business need to do to remain viable? Can it restructure, merge or sell in order to remain viable?</p>
Advice	Seek timely independent legal and accounting advice.
Indemnities	What indemnities are available?
Insurance	What insurance coverage is required going forward?
Taxation	What is the taxation impact? This is particularly important for private organisations.
Type of entity	<p>The type of entity will determine which legislation will apply. The Corporations Act 2001 is the law relating to companies Australia-wide.</p> <p>The various state-based associations' incorporations Acts apply to incorporated associations. The Act for your state/territory will outline when the Corporations Act may apply, especially in the case of winding up a business.</p>

Factor	Issues to consider
	The CATSI Act governs how registered Aboriginal and Torres Strait Islander incorporated organisations are run. The office of Registrar of Indigenous Corporations (ORIC) is an independent statutory office holder which administers the CATSI Act.
Constitution	Consult the organisation's Constitution or Statement of Purpose (in the case of an incorporated association) for specific guidance on meetings and voting thresholds.
Assets	If ceasing to operate, when and how will assets be sold? If merging or selling, when and how will assets be transferred/assigned? Assets may need to be valued beforehand.
Liabilities	If ceasing to operate, when and how will liabilities be paid? If merging or selling, when and how will liabilities be transferred/assigned?
Contracts with customers, suppliers, financiers and landlords	If ceasing to operate, what are the break costs and obligations associated with cancelling/ending a contract? If merging or selling, how will contracts be transferred or assigned?
Employees	If ceasing to operate, what is the impact on industrial relations and employment contracts, in particular employee entitlements and redundancy payments? If merging or selling, how will the employees be transferred or assigned? How will liability for employee entitlements be factored into the merger or sale arrangements?
Buyer or Merging Party	Is the party with whom a merger or sale is proposed, a good strategic fit for the business? What is the value being offered to sell or merge?
Solvency	The Board or Committee (in the case of an incorporated

Factor	Issues to consider
	association) will need to consider solvency. Please refer to this Module, Understanding Solvency, which follows on page 7.
Board meeting	Convene a meeting of Directors/committee members (in the case of an incorporated association) to resolve to wind up.
Shareholder/ member meetings	Convene a meeting of members/shareholders to vote on the wind up.
Engage a liquidator	Engage a liquidator to undertake a solvent wind up or enter into a voluntary administration or creditors voluntary liquidation process under an insolvent wind up—refer below.

KEY RISKS

The following table discusses some of the key risks that you need to be aware of prior to considering winding up or selling your organisation, or merging with another entity.

Key risk	Description
Insolvent trading	<p>Insolvent trading occurs when a business incurs debts which it is unable to pay as and when they become due and payable. The Corporations Act 2001 imposes severe penalties on Directors of companies who trade while insolvent. Directors may be held personally liable in certain circumstances, for example where superannuation guarantee charge obligations are not met.</p> <p>Directors should promptly obtain independent legal advice about their obligations to avoid insolvent trading.</p>
Lack of preparation and/or timely receipt of advice	Insufficient planning/preparation may not identify all costs associated with winding up or selling/merging. This may also lead to a loss of value.
Loss of stakeholder confidence	All stakeholders will need to be carefully managed in order for a smooth and efficient wind up or sale/merger.

Key risk	Description
Company or Board/committee members exposed to liabilities	Board or committee members should consider seeking indemnities (where relevant) to minimise liability.
Reputational risk	Reputation of any ongoing business may be damaged, thus impacting future operations.
Adverse tax consequences	For private organisations, unanticipated tax liabilities may arise.

UNDERSTANDING SOLVENCY

THE CORPORATIONS ACT PROVIDES GUIDANCE ON THE DEFINITION OF SOLVENCY

While Boards or committees normally sign off on the solvency of an organisation on an annual basis when the financial statements of the organisation are completed and audited by an external auditor, solvency needs to be considered on an ongoing basis.

Solvency is defined as the ability to pay all debts as and when they become due and payable. A company that is not solvent is insolvent.

Section 95A of the Corporations Act 2001

One of the primary statutory duties of a Director or Board member as defined by the Corporations Act is the duty to prevent insolvent trading.

Note 1: Section 57A of the Corporations Act 2001 defines a corporation as a company, a body corporate or an unincorporated body that may sue or be sued or may hold property. This definition includes incorporated associations.

A discussion on the legal structures of not-for-profit organisations (NFPs) and their obligations are contained at the end of this Module on page 14. Note that 'not-for-profit' is a tax status and not an indication of legal structure. NFPs are generally companies limited by guarantee or incorporated associations.

You should seek independent accounting and legal advice when determining solvency.

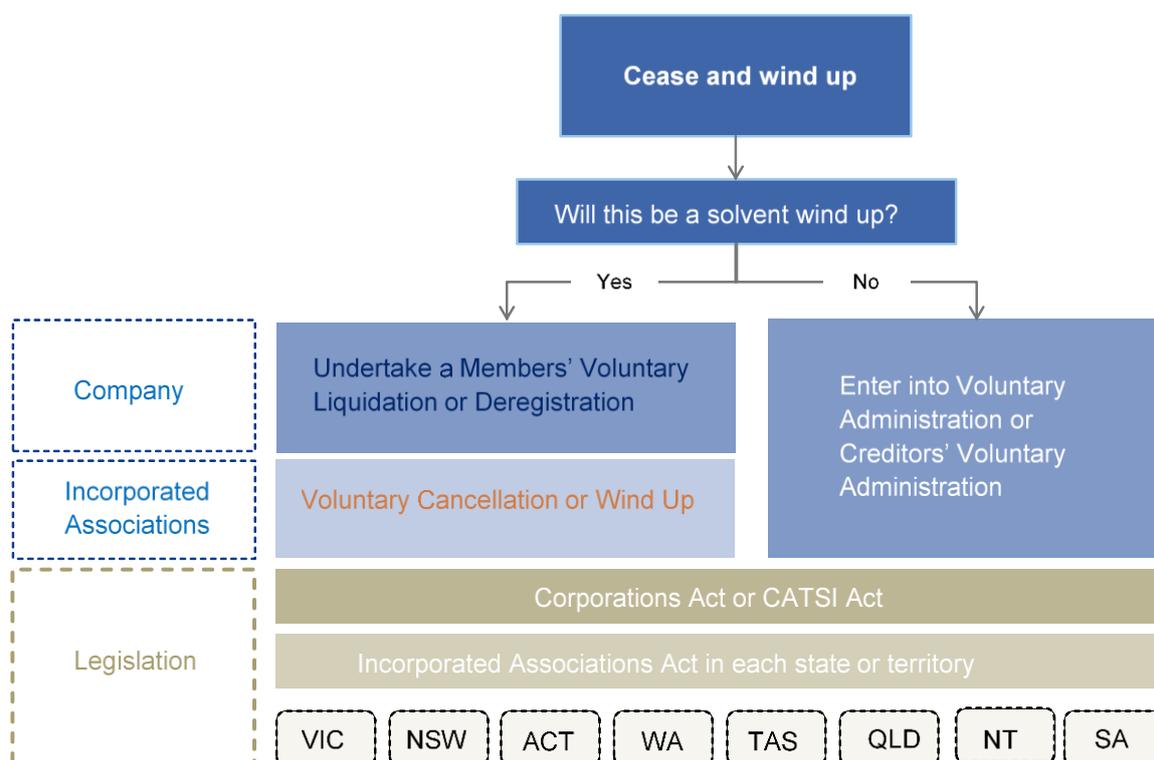
- Solvency is primarily a cash flow based test
- The preparation of a forecast cash flow will assist in determining if a company or incorporated association is able to pay all its debts as and when they become due and payable
- Please refer to Module 1 Understanding financial impact.

There are also other indicators of solvency which should be considered. These include but are not limited to the following:

- the amount of cash held
- whether assets exceed liabilities
- the ability and timing required to convert assets readily into cash in order to meet liabilities
- the ability to negotiate the timing and quantum of payments to creditors/suppliers/statutory authorities
- the ability to secure financing or bank funding
- the ability to obtain equity or third party contributions/investments
- the ability to meet any potential or contingent liabilities that crystallise
- the trading/income and expenditure of the company or incorporated association.

APPROACHES TO WIND UP

The following diagram outlines the different approaches regarding solvency when ceasing and winding up a business, and the legislation underpinning these.



SOLVENT WIND UP OF A COMPANY

The *Corporations Act 2001* outlines two ways (other than by the courts) to wind up a company that is solvent.

LIQUIDATION

- The process is usually initiated by the company, because the company or the purpose for which the company was established is no longer required.
- A company must be solvent to initiate a members' voluntary liquidation (MVL). The Directors will need to make a Declaration of Solvency.
- A MVL involves the orderly winding up of a company's affairs and includes ceasing or selling its operations, realising the company's assets, distributing the proceeds of realisation among its creditors, and distributing any surplus among its shareholders.
- A MVL does not require a registered liquidator to be the liquidator of the company, although the liquidator must have the necessary skills and experiences. Section 532 of the *Corporations Act 2001* outlines who may act as a liquidator of a company and the exceptions for a MVL.

- Under subsection 495(2) of the Corporations Act 2001, upon appointment of a liquidator, all the powers of the Directors cease except so far as the liquidator, or the company in general meeting with the consent of the liquidator, approves the continuing of any of those powers.
- A company is deregistered after the MVL is completed.
- Refer to Division 526-20 of the CATSI Act for information regarding this process as it applies to companies registered with ORIC.

DEREGISTRATION

In the absence of a MVL, a deregistration and strike off of a company can only occur if all of the following conditions are met:

- all members of the company agree to the deregistration (a meeting should be convened)
- 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 Corporations Act 2001
- the company has no outstanding liabilities
- the company is not a party to any legal proceedings.

Please refer to subsections 601AA (1) and (2) of the Corporations Act 2001 for further detail.

Australian Securities and Investments Commission's (ASIC) Form 6010 *Application for voluntary deregistration of a company* needs to be submitted to ASIC.

THE DIFFERENCES BETWEEN A MEMBERS' VOLUNTARY LIQUIDATION AND DEREGISTRATION

- A MVL involves, amongst other things, a clearance process with the various taxation authorities and advertising for external creditors. This provides Directors with the highest level of comfort that the company has met all of its liabilities.
- The deregistration process is faster, simpler and cheaper than the MVL process.
- When an application is made to ASIC to deregister a company (without a MVL), the applicant is at risk in relation to the Statutory Declaration made that all the deregistration conditions are satisfied. This risk is higher for Directors where the trading history of the company is not known or the current Directors have held the position for a short amount of time.

- A significant drawback of a deregistration can be that if a person or company is aggrieved by the cancellation of the registration of the company, they may make an application to the court to have the company reinstated.
- The effect of a successful application is that the company shall be deemed to have continued in existence as if its registration had not been cancelled. The Directors would be reinstated and would then be required to attend to statutory matters such as filing annual returns for the period between deregistration and reinstatement. In the reinstatement of a company that has been liquidated, it is the liquidator who has these obligations.
- The liquidator can make a distribution of undisclosed assets at the time of appointment as part of the MVL process whereas any undisclosed assets at the time a company is deregistered will vest in ASIC.

THE KEY STEPS TO PLACE A COMPANY INTO MEMBERS' VOLUNTARY LIQUIDATION

(Liquidation commences on the passing of the resolution at Step 8)

- 1** **TIMING:** ASAP
Complete a pre - liquidation questionnaire for review by the proposed liquidator to enable identification of key issues.
- 2** **TIMING:** Day 1
Hold Directors meeting and sign Directors meeting minutes resolving to wind up the company subject to members / shareholders meeting.
- 3** **TIMING:** Usually Day 1
Majority of Directors execute Form 520 – Declaration of Solvency.
- 4** **TIMING:** ASAP after signed
Return Form 520 to proposed liquidator to arrange lodgement with ASIC.
- 5** **TIMING:** ASAP
Lodgement of Form 520 with ASIC.
- 6** **TIMING:** ASAP
Proposed liquidator notifies company of lodgement of Form 520 and advises when Notice of Meeting can be sent to shareholders.
- 7** **TIMING:** At least one day after step 4, but within five weeks of signing and dating Form 520.
Send Notice of Meeting to shareholders together with Consent to Short Notice. (The consent must be signed by a majority in number of shareholders holding at least 95% of the voting rights, otherwise, 21 days notice of the meeting is required.)
- 8** **TIMING:** As per notice and consent but within five weeks of signing and dating Form 520.
Hold a general meeting of the company to pass the special resolution to wind up the company. Chairperson signs the following documents: minutes of the meeting; Form 205; Form 911; and Annexure A to the Form 911.
- 9** **TIMING:** Within seven days of step 7
Provide to proposed liquidator the following documents for lodgement with ASIC: minutes of the meeting; Form 205; Form 911; and Annexure A to the Form 911.

SOLVENT WIND UP OF AN INCORPORATED ASSOCIATION

Generally there are two ways (other than by application to the court) to wind up an incorporated association.

VOLUNTARY CANCELLATION

An incorporated association can apply to the Registrar (or equivalent in your state) for voluntary cancellation if all the following conditions are met:

- the Incorporated Association is not operating
- a special resolution has been passed
- gross assets are less than \$10,000
- there are no outstanding debts or liabilities
- all fees and penalties under the relevant associations incorporation Act have been paid
- there are no current or proposed legal proceedings.

VOLUNTARY WIND UP

An incorporated association with more than \$10,000 in assets must:

- pass a special resolution to wind up
- be solvent
- appoint a liquidator.

Generally a voluntary wind up will follow a similar process used for a company; however, legal advice should be obtained as different legislation applies in each state/territory.

INSOLVENT WIND UP

The Corporations Act 2001 outlines the law relating to companies which enter external administration due to insolvency. Chapter 11 of the CATSI Act outlines the law in this area as it applies to corporations registered with ORIC.

As noted above, section 57A of the Corporations Act 2001 defines a corporation as a company, a body corporate or an unincorporated body that may sue or be sued or may hold property. This definition includes incorporated associations.

The Incorporated Associations Act in each state or territory will outline when the Corporations Act may apply, especially in the case of winding up a business.

Generally a company will enter into voluntary administration or creditors' voluntary liquidation. If an insolvent winding up process is required, a court can also appoint a liquidator.

Given the potentially complex nature of insolvency issues, you will need to seek independent legal and accounting advice if you believe your organisation may be insolvent. A liquidator undertaking an insolvent winding up must be registered with ASIC.

LINKS TO ACTS

The following are links to the relevant Acts.

ASSOCIATIONS INCORPORATION ACTS

- [WA Act](#)
- [SA Act](#)
- [Victorian legislation website](#) - *Associations Incorporation Act 1981* (Vic) Act number 9713/1981
- [NSW Act](#)
- [NT Act](#)
- [ACT Act](#)
- [TAS Act](#)
- [QLD Act](#)
- [Corporations \(Aboriginal and Torres Strait Islander\) Act 2006 \(CATSI Act\)](#)

CORPORATIONS ACT 2001

[Corporations Act](#)

PARTNERSHIP ACTS AND OTHER INFORMATION

For links to each state Partnership Act, as well as links to each state's government business authority see: [Business.gov.au – Dissolving Partnerships](#)

Please obtain legal advice relevant to your specific circumstances.

LEGAL FRAMEWORK FOR NOT-FOR PROFIT (NFP) ORGANISATIONS

The following section discusses the legal framework in which Directors of NFPs operate.

NOT-FOR-PROFIT ORGANISATIONS

'Not-for-profit' is essentially a taxation status rather than an indication that an organisation does not make an income and a profit. The essential feature is that these organisations cannot distribute profits to their members. NFPs are usually companies limited by guarantee or incorporated associations. NFPs need to inform the Australian Tax Office that they are winding up or closing and must ensure it transfers remaining assets to another 'deductible gift recipient'.

Not-For-Profit Organisations which are charities can find further resources through the Australian Charities and Not-For-Profits Commission at: [ACNC Website](#) or by calling 13 22 62.

Justice Connect is an NGO which administer the *Not for Profit Law Information Hub*, a service which provides information relevant to not-for-profit law applicable in NSW, Victoria, and the Commonwealth. The service includes information about ending an organisation's affairs. You can access the hub via the Website at: [Not For Profit Law Information Hub](#).

Justice Connect may be able to arrange for free legal assistance to be provided to eligible NFPs in Victoria and NSW. For further information, see: [Justice Connect Not-for-Profit Law](#).

COMPANIES LIMITED BY GUARANTEE

Larger NFPs that operate nationally often incorporate as a company limited by guarantee. Section 9 of the *Corporations Act 2001* defines company limited by guarantee as 'a company formed on the principle of having the liability of its members limited to the respective amounts that the members undertake to contribute to the property of the company if it is wound up'.

The directors of these companies are subject to the director's duties set out in the *Corporations Act 2001*. The National Safety Council of Victoria case (*Commonwealth Bank v. Friedrich*¹) made it clear that the duties of a company director are the same, regardless of whether the company is for profit or not-for-profit.

¹ *Commonwealth Bank v. Friedrich* (1991) 9 ACLC 946.

INCORPORATED ASSOCIATIONS

Most NFPs are incorporated associations under the relevant state or territory Incorporated Associations Acts. An incorporated association has a separate legal identity from its committee and members.

The common law fiduciary duties for Board/committee members mean the incorporation will only offer protection to Board members who carry out their responsibilities in good faith, with care and diligence and with skill. The statutory duties of Board members of associations vary. Where there is no express statutory obligation, the common law fiduciary duties still apply.

By way of example, the following table outlines some of the provisions relating to **insolvent trading** and the penalties for breach and applies to NFPs (as well as for-profit companies under the Corporations Act 2001).

Legislation	Relevant section and description
Commonwealth Corporations Act 2001	Section 588G Penalty: Fine of up to \$200,000 or order to pay compensation, or if dishonest \$340,000 or 5 years imprisonment or both
NSW Associations Incorporation Act 2009	Section 68 Penalty: \$5,500 or 1 year imprisonment or both
NT Associations Incorporation Act 2003	Section 90 Penalty: \$59,600 or 2 years imprisonment
SA Associations Incorporation Act 1985	Subsection 49(AD) Penalty: \$5,000 or 1 year imprisonment