LIABILITY OF LIQUIDATORS FOR TAXES OF THE COMPANY: WILL MY DUTIES EVER END?

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It is widely known that company directors who own at least 20% of shares can be made personally liable for the company's taxes[1]. It is less common knowledge that under certain circumstances, company liquidators could also be imposed with similar liabilities[2].

This article discusses the pitfalls that liquidators may face in dealing with the tax authorities, suggestions for consideration, and selected tax issues for companies in liquidation that the courts have resolved in the past.

A. DIRECT TAX ISSUES (INLAND REVENUE BOARD (IRB) & THE ITA)

- **Legislation Does Not Specifically Require Tax Clearances From IRB In Winding-Up**

  The steps required to wind up a company are set out in the Companies Act 1965 (**CA 1965**) and Companies Act 2016 (**CA 2016**). Companies which were in the course of winding up before the commencement of CA 2016 shall continue to be wound up under the relevant provisions in CA 1965[3]. There remain 2 modes of winding up a company: a) voluntary winding up; and b) compulsory winding up (by the Court).

  The key point to note is that both the CA 1965 and CA 2016 do not specifically impose any requirements on liquidators to obtain tax clearances from the IRB in the winding-up process. For instance, the steps prescribed under the CA 1965 for voluntary winding-up can be summarised briefly as follows:

  (a) Company directors to make a written declaration of solvency[4] and lodge this with the Registrar of Companies (now Companies Commission of Malaysia (**SSM**)).

  (b) Company directors to appoint a (provisional) liquidator to carry out the winding-up[5]. Notice of the liquidator's appointment must be advertised[6] and lodged with SSM within 14 days[7].

  (c) Company to resolve by special resolution to wind-up the company within 5 weeks from the date of the written declaration of insolvency[8]. A copy of the resolution must be lodged with SSM within 7 days after it is passed[9], and notice of it must be advertised[10].

[1] Section 75A, Income Tax Act 1967 (**ITA**)
[2] Section 75(2) & 75(3) ITA
[3] Section 619(6) CA 2016
[4] Section 257(1) CA 1965
[5] Section 255(1) CA 1965
[6] Section 255(4) CA 1965
[7] Section 280(1) CA 1965
[8] Section 254(1)(b) & 257(3) CA 1965
[9] Section 254(2)(a) CA 1965
[10] Section 254(2)(b) CA 1965

(d) After company affairs have been fully wound up, the liquidator must call and hold a general meeting (final meeting) of shareholders to lay out his final account and to provide any explanation required[11]. The quorum at this meeting is 2 members and the liquidator must lodge a return of the final meeting (Form 69) together with his final account with SSM and the Official Receiver within 7 days after the meeting[12].

(e) The company shall be dissolved upon the expiration of 3 months after the lodgement of the Form 69[13].

Nothing in the CA 1965, CA 2016, or the ITA however specifically requires the liquidator to obtain tax clearance letters from the IRB.

- **Obtaining Of Tax Clearance Letters Is Recommended Practice**

Notwithstanding the absence of a statutory requirement to do so, obtaining tax clearance letters is recommended 'best practice' for liquidators. According to Guidance Notes published by, amongst others, the Malaysian Institute of Accountants[14] and the Malaysian Association of Certified Public Accountants [15], liquidators should obtain 'formal' clearances from the tax authorities (including the IRB) before distributing remaining assets to members. The requirement for a tax clearance letter can also be seen in IRB's Public Ruling (**PR**) 7/2016[16], and Operational Guidelines No. 3/2021[17].

- **Liquidators' Liability Under Section 75(2) ITA**

Section 75 ITA contains the following provisions which are relevant to liquidators:

Section 75(2) ITA	**Section 75(3) ITA**
The **liquidator of a company** which is being wound up **shall not distribute any of the assets** of the company to its shareholders **unless he has made provision** (in so far as he is able to do so out of the assets of the company) **for the payment in full of any tax which he knows or might reasonably expect to be payable by the company** under this Act or to be deductible by the company under section 107[18].	**Any liquidator who fails to comply** with subsection (2) **shall be liable to pay a penalty equal to the amount of the tax** to which the failure relates.

[11] Section 272(1) CA 1965
[12] Section 272(3) CA 1965
[13] Section 272(5) CA 1965
[14] IGN L1: Insolvency Guidance Note: Member' Voluntary Winding Up (Malaysian Institute of Accountants), accessed at https://www.mia.org.my/v2/downloads/handbook/guidelines/ign/IGNL1.pdf
[15] Insolvency Guidance Note: Members' Voluntary Winding Up (Malaysian Association of Certified Public Accountants), accessed at http://www.micpa.com.my/micpamember/hb-insolvency/ig5.pdf
[16] PR 7/2016: Basis Period of companies under Liquidation at paragraph 6.3, accessed at: http://phl.hasil.gov.my/pdf/pdfam/PR_07_2016.pdf
[17] "Garis Panduan Operasi Bi. 3 Tahun 2021: Permohonan Surat Penyelesaian Cukai bagi Syarikat, Perkongsian Liability Terhad dan Entiti Labuan" accessed at http://phl.hasil.gov.my/pdf/pdfam/GPO_3_2021.pdf
[18] Deduction of tax from emoluments and pensions

Against this backdrop, it is not hard to fathom why insolvency practitioners are recommended to obtain tax clearance letters from the authorities as part of their 'closing duties'. In short, liquidators are duty-bound under the ITA to make provision for taxes **which he knows or might reasonably expect to be payable** before making any distribution of assets. If he fails to do so, the IRB can effectively impose personal liability on him for such taxes.

One would imagine that in circumstances where the liquidator has obtained the requisite tax clearance letters before distribution of assets, the liquidator could not therefore be subsequently faulted and affixed with personal liability. Armed with a 'clearance' from the tax authorities themselves confirming that no taxes are outstanding, how could the liquidators be said to have **known** or **might reasonably have expected** that any taxes remain outstanding at all?

- **Do Tax Clearance Letters Offer Adequate Protection for Liquidators?**

The unfortunate thing to note about so-called 'formal' tax clearance letters is that they are not technically issued under the law. Under the ITA for instance, only a composite assessment made under Section 96A ITA is 'final and conclusive'. Otherwise, Section 91(1) ITA empowers the Director General of Inland Revenue (**DGIR**) to raise assessments or additional assessments according to his 'best judgment'. Tax clearance letters by the IRB are not issued pursuant to any specific provision under the ITA.

There have been cases where the IRB had subsequently issued tax assessments against companies which are in liquidation, or which have been wound up, despite tax clearance letters having been duly obtained by the liquidators. In ***Ketua Pengarah Hasil Dalam Negeri v Suruhanjaya Syarikat Malaysia & Anor*** **[2019] 10 CLJ 203**, the IRB even applied to reinstate a company that had been wound up for almost 2 years so that it could raise tax assessments against it.

In such cases, if and where distributions have been made and the members can no longer be easily located, it is not hard to imagine that the IRB may seek to recover the alleged taxes from the liquidators instead under Section 75(3) ITA. It is noteworthy by comparison that prominent lawsuits have been filed in recent months by plaintiffs against even their own solicitors and auditors in a bid to recover monetary losses. Professional liquidators may be seen in this context to be similarly appealing targets for recovery.

- **Can Liquidators Better Protect Themselves?**

It may seem a tad unfair if liquidators were to face such an action for recovery of taxes. After all, they have relied in good faith on a tax clearance issued by the IRB themselves. Further, the professional remuneration which liquidators are paid is also unlikely to be anywhere near the amount of taxes which the IRB would be seeking in such cases. However, the courts have held in the past that estoppel cannot be invoked against the DGIR as it is his duty under the law to raise the correct tax assessments[19].

[19] Albeit in a different context where Section 75(2) does not apply

Even if the liquidator succeeds ultimately in relying on the defence in Section 75(2) ITA i.e., he could not have known or reasonably expect any taxes to be payable, he would still be out of pocket for the legal costs he would have had to incur, costs he would be unlikely to fully recover from the IRB. Similar costs issues would arise for a liquidator intending to dispute the correctness of the tax assessments raised by the IRB, post-dissolution and distribution of assets.

One option for liquidators to consider is the obtaining of indemnities from shareholders in respect of the company's tax liabilities, before making the final distribution of assets. The efficacy of such indemnities is admittedly not without limitations. In the event of a recovery action, the IRB would still pursue its claim directly against the liquidator under Section 75(3) ITA. Again, costs issues may arise should the shareholders resist the liquidator's attempt to enforce the indemnities given. Nevertheless, this would still give liquidators some protection in the event of a belated tax recovery action by the IRB post-dissolution.

B. INDIRECT TAX ISSUES

- **Duty to Give Notice & Set Aside Sum for Taxes**

Unlike under the ITA, a liquidator has a duty to notify the Director General of Customs (**DGC**) on the winding-up of companies with indirect tax liabilities. In general, when an effective resolution is passed, or an order is made for the winding-up of a company that is liable for customs duty[20], excise duty[21], sales tax[22], and services tax[23], a liquidator has a legal obligation to:

(a) give a notice of winding up to the DGC within 14 days ; and
(b) set aside a sum to pay the indirect taxes that is or will become payable by the company, before disposing of any of the assets.

Unlike income tax however, not all companies have indirect tax liabilities, and the legal obligation of a liquidator may vary under the respective indirect tax legislations. For example, s.65B(1) of Customs Act only requires a liquidator to give notice of winding-up for a company which is licensed under Part VIII of Customs Act, such as licensed warehouse, licensed manufacturing warehouse and duty-free shop. On the other hand, s.23A(1) of Excise Act imposes such obligation for companies which are licensed under the Excise Act and also extends such obligation to companies also to importers. As for sales tax and service tax, they are two different taxes that affects companies from different industries. Whilst manufacturers and importers of taxable goods will be liable for sales tax under Sales Tax Act 2018, only service providers of taxable services and businesses who acquire taxable services from foreign supplier has service tax liability under Service Tax Act 2018.

[20] s.65B(1) of Customs Act.
[21] s.23A(1) of Excise Act 1967
[22] s.97 (1)(a) of Sales Tax Act 2018
[23] s.82(1)(a) of Service Tax Act 2018

- **Strict Liability Offence & Personal Liability For Indirect Taxes**

A liquidator's failure to give a notice of winding up or to provide for payment of the relevant indirect taxes is a strict liability offence. Upon conviction under the:

Customs Act or Excise Act	A liquidator can be punishable by a fine not exceeding RM50,000 or imprisonment for a term not exceeding 3 years or to both[24].
Sales Tax Act or Service Tax Act	A liquidator who is convicted under can be punishable by a fine not exceeding RM10,000[25].

In addition, it is important for liquidators note that the SST return (SST-02 form) for sales tax and services tax, needs to be submitted to Customs until the company is officially de-registered. During the goods and services tax (**GST**) regime, there were instances where Customs had prosecuted liquidators for failure to furnish GST returns on behalf of the GST registered companies, even though there were no GST accountable for those taxable periods. Although the provisions under the current Sales Tax Act and Service Tax Act is different from that under the GST Act 2014, Customs may conceivably adopt a similar approach for failure to furnish SST returns.

Apart from criminal liability, a liquidator could be made personally liable for indirect taxes that is or would become payable if there is a failure to notify the DGC, or to set aside the relevant taxes due and payable[26]. This imposes an enormous burden on the liquidators to ensure that they send a notice of winding-up within 14 days to the DGC and to set aside relevant taxes. Unlike income tax, the legal provisions for indirect taxes do not require actual knowledge on the part of the liquidator that there is tax due and payable. The defence of reasonableness is not available. Customs may seek to recover the taxes from liquidators personally should they fail to ensure that the requisite sums are set aside for payment of taxes.

- **Priority for Payment of Federal Taxes**

It should be noted that the legislations above are meant to ensure that liquidators do not distribute assets before setting aside the requisite sums for payment of taxes. They do not operate to give priority for payment of federal taxes over other preferential debts of the company.

Priorities for unsecured debts is stipulated under the Companies Act[27], where federal taxes only ranks sixth amongst other unsecured debts. In ***Lim Tian Huat v Ketua Pengarah Hasil Dalam Negeri***[28]***,*** the Court of Appeal held that the IRB could not rely on s.103 of ITA to claim priority for payment of income tax over claims of the debenture holders. The Court took the

[24] s.65B(2A) of Customs Act & s.23A(2A) of Excise Act
[25] S.97(3) of Sales Tax Act & s.82(3) of Service Tax
[26] S.65B(2) of Customs Act, s. 23A(2) of Excise Act, s.67(2) of Sales Tax Act and s.82(2) of Service Tax Act
[27] S.292 of Companies Act 1965 and s.527 of Companies Act 2016
[28] [2002] 4 CLJ 605

view that s.103 of ITA merely states that tax becomes due and payable upon service of notice of assessment; this has nothing to do with priority.

In ***Director of Customs Federal Territory v Ler Cheng Chye (Liquidator of Castwell Sdn Bhd (In Liquidation))***[29]***,*** Customs sought to argue that s.69(1) of the Sales Tax Act 1972 had given sales tax priority over other claims. The Supreme Court held that s.69 merely directs the setting aside of sufficient moneys to provide for taxation; it does not provide for federal taxes to take priority over all other secured debts. If the Legislature had intended otherwise, it would have conferred that privilege in clear and unequivocal words.

Although the provisions under the current Sales Tax Act or Service Tax Act varies slightly with s.69 of the Sales Tax Act 1972, this does not alter the fact that such provisions are merely administrative directions for the liquidators to set aside taxes and do not affect the priority for payment of federal taxes as an unsecured debt.

- **Is There A Duty To Set Aside Taxes Under the Repealed Legislations?**

Although the GST Act 2014 has been repealed on 1.9.2018, there is a saving provision under the GST Repeal Act 2018 for the enforcement and collection of GST which has been due and payable before 1.9.2018. S.4(1) of the GST Repeal Act states:

"Notwithstanding the repeal of the Goods and Services Act 2014—

(a) any liability incurred may be enforced; or
(b) any goods and services tax due, overpaid or erroneously paid may be collected, refunded or remitted,

under the repealed Act as if the repealed Act had not been repealed."

As such, a liquidator's duty to set aside GST due and payable by the company before the liquidation remains enforceable by Customs[30]. Similarly, there are saving provisions for the Customs to collect and enforce taxes due and payable by the company under the repealed Sales Tax Act 1972 and Service Tax Act 1975[31].

Conclusion

Liquidators, by virtue of their professional skills and experience, are uniquely qualified to carry out the winding-up of a company. In carrying out such duties however, it may occasionally be necessary for liquidators to engage other professionals e.g., to seek specific legal and / or tax advice. Given the risks faced by liquidators in terms of potential personal liability and impact on their professional reputation, doing so would certainly be prudent. At the very least, actions that have been taken upon professional advice (in addition to tax 'clearance' letters or representations from the authorities) would help establish the defence of 'reasonableness' for liquidators if and when they are faced with recovery actions down the road.

[29] [1995] 3 CLJ 316
[30] s.31(3) of GST Act 2014
[31] Read s.4 (2) of GST Repeal Act together with s.178 and s.181 of GST Act.