ARTICLE

# Administration – A Tax Driven Decision?

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The Enterprise Act 2002 ('Enterprise Act') significantly remodelled company administrations in the United Kingdom with effect from 15 September 2003. Significant changes to UK tax legislation, made by the Finance Act 2003 ('FA 2003'), accompanied this remodelling.[1] The general thrust of the tax rules is to treat an administrator in a very similar fashion to a liquidator, recognizing the fact that the remodelled administration process can have a very similar practical effect to a liquidation. The purpose of this article is to explain the major consequences of the tax rules for administrators and to highlight some of the wider practical implications of those changes.

The changes made by FA 2003 (and the accompanying changes to the UK insolvency rules supporting the Enterprise Act) can be identified briefly, the changes having the greatest impact on administrators falling into three categories. First, FA 2003 makes UK corporation tax an expense of the administration. This fact alone significantly changes the priority and extent of corporation tax liabilities in company administrations and leaves the Inland Revenue in a much better position – even though the Enterprise Act abolishes Crown preference for unpaid tax. It will be seen that it may also influence the decision of a floating chargeholder to appoint an administrative receiver (where that option remains available) or an administrator. Second, as FA 2003 makes UK corporation tax an expense of the administration, it also introduces rules on the commencement and termination of a company's accounting period to identify those UK corporation tax liabilities that arise during an administration. But these rules have other practical consequences, particulary in relation to the use of tax losses. Third, FA 2003 charges an administrator with the primary responsibility for ensuring that a company in administration complies with its administrative tax obligations.

## Administration versus administrative receivership

Before the FA 2003 changes to the UK tax rules applying to an administration are discussed, it is necessary to identify, at a broad level, what an administration and what an administrative receivership are.

An administration is the state of affairs that exists when an administrator is appointed to a company. Except in certain specific cases, the Insolvency Act 1986 ('Insolvency Act') governs most forms of administration.[2] The Insolvency Act was extensively amended by the Enterprise Act. Before those amendments, an administrator could only be appointed pursuant to a court order on the petition of the company, its directors or a creditor. Although this option remains, an administrator may now also be appointed more informally by a company, its directors, and certain floating chargeholders.[3] At the same time, the powers of an administrator have broadened considerably,[4] a move that appears designed to encourage the use of the simpler and more flexible administration process instead of liquidation.

One important feature of an administration in the post-Enterprise Act environment is that for the duration of the administration, the affairs of the company subject to administration are to be managed by the administrator. Insolvency proceedings, or other legal process, may not be brought against the company unless the consent of the administrator or the UK courts is obtained. As the administrator is charged with achieving the objectives of the administration, this moratorium is designed to give the administrator an unhindered opportunity to submit and carry out his proposals for accomplishing those objectives.[5] The Insolvency Act requires the administrator to carry out his functions to save the company in administration

*Notes*

1 Section 196 and Schedule 41 FA 2003.

2 Schedule B1 Insolvency Act. Note that these provisions were originally introduced by the Insolvency Act 1985.

3 Paragraphs 14 and 22 of Schedule 16 Enterprise Act.

4 Schedules 1 and B1 Insolvency Act.

5 Paragraphs 42 to 44 Schedule B1 Insolvency Act 1986.

as a going concern or to achieve a better result for the company's creditors than would be likely if the company were wound up without first being in administration.[6] This is a reflection of the 'rescue culture' that pervades the Enterprise Act insolvency changes. Only if it is not reasonably practicable to rescue the company as a going concern or achieve a better result for creditors can the administrator realise property to make a distribution to one or more secured creditors.

In contrast to administration, administrative receivership is the state of affairs that exists when an administrative receiver (often referred to simply as a 'receiver') is appointed to a company. An administrative receiver is appointed under a floating charge and normally has control of the whole (or substantially the whole) of a company's property.[7]

The importance of administrative receivership is expected to diminish as a result of the insolvency changes made by the Enterprise Act. Those changes prohibit a floating chargeholder from appointing an administrative receiver except in certain specific circumstances.[8] The exceptions currently comprise capital market arrangements, utility projects, urban regeneration project companies, public-private partnership projects, certain charges in the financial markets and registered social landlords.[9] Perhaps most relevantly, the prohibition on the appointment of an administrative receiver only applies to floating charges created on or after the commencement date of the Enterprise Act insolvency provisions – that is, on or after 15 September 2003. Charges created before that date are not affected, and the appointment of an administrative receiver by the holder of a floating charge created before that date remains open.

## Abolition of crown preference

Historically, the Crown enjoyed a priority in bankruptcy for *all* taxes. This priority was successively diminished by various enactments.[10] Immediately before the Enterprise Act changes came into effect, the Crown ranked as a preferential creditor (after the expenses of the insolvency) in respect of certain taxes and amounts in respect of tax. Those taxes and other amounts included deductions under the 'Pay As You Earn' ('PAYE') and construction industry schemes,[11] value added tax,[12] certain other amounts due to HM Customs & Excise[13] and national insurance contributions liabilities.[14]

The Enterprise Act has removed the Crown's preference in respect of all taxes and amounts in respect of tax with effect from 15 September 2003.[15] Accordingly, debts due to the Inland Revenue and HM Customs & Excise now rank as ordinary unsecured creditors for the purposes of companies subject to insolvency proceedings. However, even after this change, the Inland Revenue remains in a better position with respect to UK corporation tax arising during an administration, for reasons that shall be explained in a moment.

## Corporation tax as an expense of the administration

The Crown's preferential claim for corporation tax was abolished nearly twenty years ago by the Insolvency Act. This eventually led to some confusion about the status of corporation tax arising during an administration, and more precisely, the manner in which it was to be collected. For some time, the prevailing wisdom was that UK corporation tax liabilities were not an expense of the administration, a view historically confirmed by the Inland Revenue.[16] Though the Inland Revenue's published practice remained in

**Notes**

6 Paragraph 3 Schedule B1 Insolvency Act.

7 Section 29(2) Insolvency Act.

8 Section 72A Insolvency Act.

9 Section 72GA Insolvency Act (though note that further exceptions may be created by statutory instrument).

10 Commencing with the Bankruptcy Act 1849.

11 Formerly paragraphs 1–2 of Schedule 6 Insolvency Act.

12 Formerly paragraph 3 of Schedule 6 Insolvency Act.

13 Including certain insurance premium tax (paragraph 3A of Schedule 6 Insolvency Act), landfill tax (paragraph 3B of Schedule 6 Insolvency Act), car tax (paragraph 4 of Schedule 6 Insolvency Act), betting and gaming duties (paragraph 5 of Schedule 6 Insolvency Act), excise duty on beer (paragraph 5A of Schedule 6 Insolvency Act), lottery duty (paragraph 5B of Schedule 6 Insolvency Act) and air passenger duty (paragraph 5C of Schedule 6 Insolvency Act).

14 Paragraphs 6-7 of Schedule 6 Insolvency Act.

15 Section 251 Enterprise Act.

16 Published by the Institute of Chartered Accountants in England and Wales (ICAEW TR 799, June 1990); see also paragraph 9030 Creditors Voluntary Liquidation Manual.


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existence, its view changed in recent years, making the position ambiguous – an ambiguity that has been eliminated by the new insolvency rules supporting the Enterprise Act[17] and the FA 2003.

The rules governing the expenses of administration now specifically provide for the payment of any 'necessary disbursements' by the administrator in the course of the administration.[18] These rules replicate (almost identically) the corresponding provisions that apply to companies in liquidation. Under those latter provisions, corporation tax (other than corporation tax on chargeable gains) is a 'necessary disbursement' by a liquidator.[19] As the same language is used in the administration provisions, it seems clear that the intention of the parliamentary draftsperson is that UK corporation tax (again other than corporation tax on chargeable gains) will also be a necessary disbursement by an administrator.

## Administration versus administrative receivership – a tax driven decision?

One of the consequences of bringing the rules governing the expenses of administration into line with those applying to liquidation is that, from a UK taxation perspective, a greater distinction now exists between administration and administrative receivership – a distinction that may well influence the choice of administration versus administrative receivership, assuming the latter option remains open to a floating chargeholder.

The starting point is the effect of the appointment of an administrative receiver. An UK resident company to which an administrative receiver has been appointed remains chargeable to UK corporation tax. The company's liability to corporation tax is calculated on the same basis as any other UK resident company that is not subject to insolvency proceedings, and by reference to the company's usual accounting periods (at least until the company's trade ceases). The administrative receiver is granted certain powers by the Insolvency Act, so long as those powers are consistent with the floating charge under which the administrative receiver is appointed. The administrative receiver is also deemed to be the agent of the company to whom he has been appointed until the company is placed into liquidation.[20] Importantly, the company to whom the adminstrative receiver has been appointed remains the beneficial owner of all its assets.[21]

In the absence of any other specific provisions, it follows from the previous paragraph that an administrative receiver has no personal liability to pay UK corporation tax on income received or gains made by a UK resident company after his appointment. This includes any UK corporation tax liability that arises as a result of transactions carried out by the administrative receiver. The key is that the administrative receiver acts as the agent of the company and the company remains the beneficial owner of all its assets. It is also confirmed, in a sense, by the fact that an administrative receiver is not the 'proper officer' of the company to whom he has been appointed, meaning that the administrative receiver is not personally liable for administrative tax compliance by the company.[22] Further, and despite occasional arguments by the Inland Revenue to the contrary, it appears to have been generally accepted that tax arising during an administrative receivership is not an expense of the receivership.[23]

Other specific provisions support the proposition that an administrative receiver is not personally liable for UK corporation tax liabilities of the company to whom he is appointed. For example, any corporation tax on trading profits remain specifically chargeable on the UK resident company alone, and not on an administrative receiver.[24] Similarly, subject to two points, corporation tax on chargeable gains made during an administrative receivership by the company remains a liability of the company itself.[25] The first point is that the UK chargeable gains legislation contains specific rules dealing with corporation tax on chargeable gains arising from a disposal of assets by an administrative receiver.[26] These specific rules provide that administrative receivers (and floating chargeholders) are to be treated as nominees of the

**Notes**

17 That is, changes to the Insolvency Regulations 1986.

18 Rule 2.67(f) Insolvency Regulations 1986.

19 *Kahn & anor (liquidators of Toshoku Finance UK Ltd) v Inland Revenue Commissioners* [2002] STC 368.

20 Sections 42-49 and Schedule 1 Insolvency Act.

21 *English Sewing Cotton Co Ltd v Commissioners of Inland Revenue* [1947] 1 All ER 679, 682 (Lord Greene MR).

22 Compare with the position of liquidators under section 108 Taxes Management Act 1970.

23 Particularly since the decision in *Re Mesco Properties Ltd* (1979) 54 TC 238

24 Sections 6(1) and 8(1) Income and Corporation Taxes Act 1988 ('ICTA 1988'). See also *Re Wayte (Holdings) Limited (in receivership)* [1986] IR 448.

25 Sections 6(1) and (3) ICTA 1988; section 8 Taxation of Chargeable Gains Act 1992 ('TCGA 1992').

26 Section 26(2) TCGA 1992.


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company in receivership when dealing with charged property. The second point is that the UK chargeable gains legislation provides that where assets are held by a person as nominee, the assets are treated as though they were held by the beneficial owner and not the nominee. This means that the acts of the nominee in relation to the assets are treated as acts of the beneficial owner.[27] The effect is that the acts of a chargeholder or administrative receiver will be treated as acts of the company to which the administrative receiver has been appointed. There will also be no disposal of assets by the company to the administrative receiver or floating chargeholder when the administrative receiver is appointed to the company.[28]

In light of the fact that they cannot be recovered directly from the administrative receiver, an administrative receiver is unlikely to be concerned with the UK corporation tax liabilities of the company to which he has been appointed. It is this point that creates the major distinction in a corporation tax sense between administrative receivership and administration. The proceeds of a disposal of assets subject to a floating charge by an administrative receiver will, after the expenses of the administrative receivership and the administrative receiver's remuneration have been met, be available to the floating chargeholder. Any surplus will only then be available to unsecured creditors, including the Inland Revenue in respect of corporation tax arising during the administrative receivership.

The analysis in an administration is quite different. The proceeds of a disposal of assets subject to a floating charge by an administrator will first be applied in discharging the expenses of the administration, *including* UK corporation tax (except corporation tax on chargeable gains). The administrator's remuneration is next to be satisfied, after which comes any corporation tax on chargeable gains arising during the administration. It is only at this point that the remaining proceeds of the disposal (if any) are available to the chargeholder, after which any remaining surplus is available to unsecured creditors. Such unsecured creditors will *not* include the Inland Revenue in respect of corporation tax arising during the administration, as this has already been satisfied.[29]

In effect, in the post-Enterprise Act insolvency environment, the Inland Revenue is further ahead than it would have been under an administrative receivership, even taking account of the abolition of the Crown's former preferential right to recover (some) taxes. It is likely that this fact will encourage many chargeholders to continue employing the administrative receivership mechanism where it remains open to them.

## Administration and a company's accounting period

As FA 2003 made corporation tax an expense of administration, it was necessary to introduce rules that clearly identified those corporation tax liabilities that arise during the course of the administration.[30] Those rules provide that when a company enters administration, an accounting period of the company is deemed to end on the day prior to administration.[31] A new accounting period of the company will commence with the administration itself. The rules also provide that a company ceasing to be in administration will bring an accounting period of the company to an end.[32] The time when a company enters and leaves administration are dictated by the Insolvency Act.[33] So a company is treated as entering administration when the appointment of the administrator is taken to have effect by the Insolvency Act. This will either be when the notice of appointment is filed with the court (when a chargeholder, the company or its directors makes the appointment),[34] or when the court order provides (in the case of a court appointment).[35] It should also be noted that these rules do not override the normal rules for accounting periods ending.[36] So, for example, if an UK resident company ordinarily has a 31 December 'accounting reference date' (i.e. the end of its accounting period), and is placed in administration on 1 September, an accounting period of the company will be taken to end on 31 August. The next accounting period of the company will commence on 1 September and end on 31 December.

**Notes**

27 Section 60 TCGA 1992.

28 See also *Re Mesco Properties Limited* (1979) 54 TC 238.

29 Note that the Inland Revenue remains an unsecured creditor in respect of corporation tax arising *before* the administration.

30 Section 12 ICTA 1988.

31 Section 12(7ZA) ICTA 1988.

32 Section 12(3)(da) ICTA 1988.

33 Paragraph 1(2) Schedule B1 Insolvency Act.

34 Paragraphs 19 and 31-33 of Schedule B1 Insolvency Act.

35 Paragraph 13 Schedule B1 Insolvency Act.

36 Section 12(3) ICTA 1988.


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Although these rules at first glance appear relatively straightforward, they can have significant practical consequences.

For example, tax losses in one UK resident group company can only be offset against profits in another UK resident group company in the same accounting period (or the overlapping portion of accounting periods that are not co-extensive).[37] The fact that administration causes a new accounting period to commence means that trading losses arising in accounting periods before the commencement of the administration can only be carried forward and set off against income from the same trade in a subsequent accounting period.[38] Accordingly, if a company in administration makes a chargeable gain on the disposal of an asset, it cannot use pre-administration trading losses (if any) brought forward to shelter that gain.

The fact that the rules relating to the termination of accounting periods on commencement of an administration do not override the usual rules may in fact limit an administrator's ability to achieve the objectives of the administration. The general rule is that an administration terminates automatically after one year (unless it comes to an end earlier if the administrator thinks that the purposes of the administration have already been achieved and an exit from administration is instigated). Extensions are only available in limited circumstances.[39] Yet, unless an administration coincides with the ordinary start of a company's accounting period, or the end of the company's accounting period (i.e. its accounting reference date) is changed, an administration will always span at least two accounting periods of the company. The first accounting period will be that which commences with the administration and ends on the company's usual accounting reference date. The second accounting period will be the one immediately following the first.

Given the restrictions on the use of losses discussed earlier, it may be preferable for an administrator to realise assets that give rise to losses (both trading and capital losses, but more particularly the latter) in the earlier of the two accounting periods. In those circumstances, the relevant losses could be carried forward to the next accounting period and set off against profits and gains arising in that next period, resulting in a lower overall corporation tax charge. In contrast, if disposals made by the administrator in the later of the two accounting periods give rise to a loss, those losses cannot be carried back and set off against profits or gains arising in the earlier accounting period. Hence it may actually be preferable for an administrator to delay the realization of certain assets, a fact that is somewhat ironic given the usual preference of floating chargeholders towards rapid realization of assets.

## Beneficial ownership and group company relationship?

One issue that has assumed greater prominence since the FA 2003 insolvency-related changes is whether, on going into administration, a company ceases to be treated as the member of the same group of companies for UK tax purposes. The issue arises at two levels. The first is where a subsidiary company is placed into administration, in which case the issue is whether it ceases to be a member of the same group as its parent company (and any sibling entities). The second level is where a parent company goes into administration, in which case the issue is whether the parent company ceases to be a member of the same group as any subsidiaries it owns.

The second issue is perhaps the lesser of the two issues and can be dealt with briefly. It is really a question of what happens to the beneficial ownership of a company's assets (in this case, shares in a subsidiary company) when it goes into administration. Under the pre-Enterprise Act insolvency regime, the Inland Revenue indicated that they would not normally regard a company as ceasing to be the beneficial owner of its assets when the company became subject to an administration order.[40] However, according to the Inland Revenue, proposals of the administrator approved under the Insolvency Act[41] could well give rise in an appropriate case to such loss of beneficial ownership. It is thought that under the post-Enterprise Act and post-FA 2003 administration regime, a company does not lose beneficial ownership of its assets. Although an administrator has broad powers under the Insolvency Act to deal with a company's assets, the primary objective of the administrator must be to rescue the company as a going concern. It is therefore not apparent, on the appointment of an administrator, what will happen to the company's assets and who will (or may) benefit from them. This is to be contrasted with the case of a

**Notes**

37 Section 403A ICTA 1988.

38 Section 393 ICTA 1988.

39 An administration can be extended for a single six month period with the prescribed consent of creditors. Other extensions are only available with the sanction of the court.

40 Paragraph 9(c) ICAEW TR 799.

41 Section 24 Insolvency Act.




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liquidation, where it has been held that a company ceases to be beneficially entitled to its assets given the statutory framework in which a liquidator operates.[42]

The first, and arguably more important, issue is whether a company that goes into administration will cease to be a member of the same group as its parent or sibling entities for UK tax purposes. One example is corporation tax group relief (i.e. where one company in a group wishes to surrender losses to another company within the same group). The Inland Revenue take the view in these circumstances that there are arrangements in existence by virtue of which group relief will be denied.[43] Essentially, the Inland Revenue's argument is that the relevant arrangement is one by which the administrator has 'control' of the company in administration, meaning that the company itself ceases to be part of the group of companies under common control.[44] Once an administration order is made, the shareholders of the company no longer have the ability to ensure that the affairs of the company are conducted in accordance with their wishes. It is understood that this issue is subject to ongoing litigation, the outcome of which remains to be seen. However, in the author's opinion, even if the Inland Revenue is correct in its analysis, the result does not appear to be an intention of the changes made by FA 2003.

## Administrator as the company's 'proper officer'

Prior to the FA 2003 changes, it was not clear whether an administrator was the 'proper officer' of the company.[45] Those changes make it clear that the administrator is the proper officer (or where there are joint administrators, the administrators can choose which of them is to be the proper officer).[46] As the proper officer of a company, an administrator will have the responsibility for ensuring that the company complies with its administrative tax obligations in a number of respects. The administrator will be responsible for dealing with Inland Revenue enquiries (even those which relate to accounting periods arising before the administrator's appointment). The administrator will also be responsible for ensuring that tax returns are lodged, records are retained, and in the event of default, paying any penalties. As proper officer, the administrator will also be required to ensure compliance with the PAYE system,[47] and depending upon the nature of the business of the company in administration, the construction industry scheme.

## Conclusion

The changes to the UK tax rules applying to administration have generally been welcomed as an example of a sensible example of taxation policy being driven by changes in other environments. However, even where tax changes have reasonable policy objectives, they usually have significant (and often unintended) practical consequences. Administrators in the post-Enterprise Act environment will now be concerned with their UK taxation responsibilities. Given that corporation tax arising during an administration is now an expense of the administration, administrators may well be minded to take the Inland Revenue's preference into account in evaluating the most appropriate means to deal with a company in administration. Floating chargeholders may also prefer to appoint an administrative receiver where that option remains open to them. As a consequence, although the change in taxation policy reflected in FA 2003 flow from the Enterprise Act insolvency changes, it may actually be the FA 2003 changes that drive the choice of administration, and the manner in which an administration is conducted.

**Notes**

42 *Ayerst v C & K Construction Ltd* (1975) 50 TC 651, 670 (Lord Diplock).

43 Section 410(1) ICTA 1988.

44 Section 840(1) ICTA 1988.

45 Section 108 Taxes Management Act 1970.

46 Paragraph 2 Schedule 41 FA 2003.

47 Section 684 Income Tax (Earnings and Pensions) Act 2003 and regulations made under it; see also *Commissioners of Inland Revenue v Lawrence & anor* [2001] 1 BCLC 204 (CA).


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