Class: B.Com (Prog)   Semester III

Subject : BCP 3.3 CORPORATE ACCOUNTING

Topic: Liquidation of Companies: Meaning and types.

1: Introduction

Liquidation the process of bringing a business to an end and distributing its assets to claimants. It is an event that usually occurs when a company is insolvent, meaning it cannot pay its obligations when they are due.

Liquidating a company refers to the procedure in which a limited company is brought to a close by an appointed Insolvency Practitioner (Liquidator).

The company's assets are then sold (liquidated) and any realisation of revenue is redistributed in order of priority.

The company is struck-off the registrar of companies and this is known as dissolution, which is the final stage of the liquidation process.

- The term liquidation in finance and economics is the process of bringing a business to an end and distributing its assets to claimants.
- A bankrupt business is no longer in existence once the liquidation process is complete.
- Liquidation can also refer to the process of selling off inventory, usually at steep discounts.

1.2: Types of Liquidation:

There are two voluntary liquidation procedures and one compulsory procedure.

- The voluntary procedures
  - Creditors Voluntary Liquidation
  - Members Voluntary Liquidation are initiated by the shareholders and directors.
- The compulsory procedure is usually initiated by creditors like HMRC via a court order.

1.3: Voluntary Liquidation of an Insolvent Limited Company with Debts

A Creditors' Voluntary Liquidation (CVL) used by insolvent companies and is initiated by a shareholders' resolution. It involves the dissolution of the insolvent company and the redistribution of the company's assets to the creditors. This procedure enables directors to write off unsecured limited company debts that are not personally guaranteed.

Directors may see voluntary liquidation as a welcome and safe exit from a stressful situation; whilst addressing all of the creditors, appropriately.

If the limited company has liabilities that it cannot afford to pay and you would like to move on without the stress of the company's debts hanging over your head, this type of business liquidation may be an appropriate option.

Although it should be seen as a last resort, liquidating a company via this route can be considered a rational decision and it may not necessarily mean the end of business.

1.4: Voluntary Liquidation of a Solvent Company

A Member's Voluntary Liquidation (MVL) is the appropriate way to liquidate a solvent UK company and can be used as part of an exit strategy.

An MVL may be considered if you have a solvent company that you want to close as part of your business plan and reduce taxation. Your company may have outlived its purpose and be heading towards a natural end of trading, or you may wish to extract the value of cash and assets from the company in a tax efficient manner.

For an MVL, the directors must sign a declaration stating that there are no remaining creditors. One example of a creditor could be tax arrears with HMRC for VAT or PAYE, so this need to be considered before going into liquidation.

1.5: Compulsory Liquidation

Compulsory liquidations are usually initiated by a creditor that is looking to force a company into closure via a court order application. The process is usually instigated with a winding up petition and once it is heard at court, it can become a winding up order.

This procedure is often used to wind up your business as a last resort by disgruntled creditors after failed negotiations over missed payments. This insolvency procedure is usually handled by the Official Receiver, or an appointed Insolvency Practitioner. Therefore, this is not a voluntary process for directors.

The conduct of the directors is reported back to the Secretary of State at the end of the liquidation proceedings and failure to cooperate with the Official Receiver can have serious repercussions.

If you cannot pay the creditor and do not act immediately the situation can escalate quickly. Do not ignore any threat in the form of a winding up petition, as the intention is to forcefully liquidate your company.

1.6: What is the Process of Liquidating a Company?

The details of the process when voluntarily liquidating a limited company depend largely on the type of liquidation that is chosen. However, the five basic steps below are included within all of the procedures:

1. An Insolvency Practitioner is appointed as Liquidator.
2. The company's assets are then assessed and realised (liquidated).
3. If there are any creditors they are then paid in order of priority.
4. Surplus cash is distributed to the shareholders.
5. The company is finally dissolved and struck-off the registrar of companies (Companies House).

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