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18.1 Pay and File

Pay and File is the new compliance and administration system which has been introduced for submitting corporation tax returns and paying the tax without assessment.

The new system applies to all corporation tax accounting periods ending on or after 1 October 1993. Its principal features are:

The company is required to pay corporation tax within nine months and one day after the end of its accounting period.

The company is required to file a return on form CT 200 together with supporting accounts within 12 months of the end of the accounting period.

Interest is incurred on unpaid tax from the due date and flat rate penalties are imposed where returns are not filed by the due date. The penalties are £100 for returns filed up to 3 months late and £200 if they are over 3 months late. If the return has not been submitted by 18 months after the end of the accounting period the company will incur an additional penalty of 10% of the due tax, increasing to 20% if the return is still outstanding two years after the end of the return period.

Because of the nature of insolvency appointments situations are likely to arise in which the new rules will cause difficulties, and in such cases members will need to explain the situation to the Inland Revenue at an early stage in the proceedings. Some examples of problems which are likely to arise in practice are given below.

Once a liquidator has been appointed he becomes the Proper Officer of the company for tax purposes (s108 (3) TMA 1970). The principles of Pay and File impose a retrospective responsibility on the Proper Officer, and a liquidator therefore might find that he is responsible for filing returns for periods before his appointment. In many cases the information may not be available to enable him to do this, or there may simply be no purpose in incurring the expense if there will be no return to unsecured creditors. In such cases the situation should be explained to the Inspector, but the liquidator should provide whatever information is available to assist the Revenue in establishing its claim.

Under Pay and File the corporation tax return is required to be filed with supporting statutory accounts. As a liquidator is not required to produce statutory accounts he will need to provide the best information available in the circumstances, which in the case of post-liquidation accounting periods will normally be his annual statement of receipts and payments.

In compulsory liquidations there is a mismatch between corporation tax accounting periods and the liquidator’s return periods. Under the provisions of s12 (7) ICTA 1988 an accounting period ends and a new one begins on the presentation of a winding up petition (assuming it proceeds to a winding-up order). Under Pay and File the company is responsible for filing returns based on its accounting periods. The liquidator, however, compiles his accounts by reference to the anniversaries of the winding up order (reg 12 (5) Insolvency Regulations 1986). In theory, therefore, profits or losses which do not arise in the winding up could be included in an accounting period which spans the winding up order and comes to an end during the liquidation. In the past most returns have been submitted on the basis of the liquidator’s accounts.

It may happen that liability to tax arises while a liquidator is in office at a time when he has no funds, for example when a receiver appointed to the same company receives interest or sells a property that gives rise to a chargeable gain. The liquidator may be without funds pending receipt from the receiver who will usually retain all assets until the receivership is considered to be finalised.

In other insolvency proceedings where a liquidator has not been appointed the Proper Officer will remain the company secretary (s108 (3) TMA 1970), who may be unable to act when an insolvency practitioner has been appointed. The insolvency practitioner may have the necessary information but may be unwilling to file corporation tax returns as this may be beyond the scope of his appointment. In such cases it will be necessary to advise the Inspector of the situation as soon as possible.

SPI proposes to submit the text of a Technical Release on Pay and File for Revenue approval shortly.

18.2 Customs and Excise Matters

(i) Reorganisation of Insolvency Branch

Customs and Excise Insolvency Branch, previously known as Debt Management Division, has been reorganised. Policy and general issues are now dealt with by VAT Registration and Collection Policy Branch 7 (VRCP 7), and casework is dealt with by VAT operations (VOPS). They are both located in Queens Dock, Liverpool.

A new telephone enquiry system has been set up to deal specifically with calls from insolvency practitioners with effect from 1 August. The numbers are:

051 703 8711 and 051 703 8743

and the lines are open from Monday to Friday,10.00 am to 4.00 pm.

(ii) VAT Return Reminders

Customs have asked us to remind members that they remain concerned about the high incidence of late VAT returns for periods following the insolvency of traders, particularly as these cases are not subject to the normal penalty regime which applies to solvent traders. In an attempt to address this concern Customs commenced issuing reminders with effect from 1 April 1994. Following representations from practitioners Customs have decided to suspend the issue of reminder letters temporarily while the circumstances of the issue and content of the letters are reviewed. Notwithstanding this review, Customs wish to remind practitioners of their obligations in respect of VAT returns and are considering with SPI the most effective way in which reminders might be issued in the future.

(iii) Set-off under section 21 Finance Act 1988

As indicated in Technical Bulletin 15.3 (February 1994), section 21 of the Finance Act 1988 has been amended by section 47 of the Finance Act 1994 to provide for the exclusion of businesses in all formal insolvency processes from the set-off of post-insolvency VAT credits against pre-insolvency VAT debts. In particular the amendment extends the exclusion from set-off to administrations and administrative receiverships, which were not previously provided for under the July 1988 extra-statutory concession. The changes came into effect on 10 May 1994 and apply to VAT 426 and 427 claims relating to insolvent traders received by Customs on or after 10 May 1994, VAT 100 returns with a post-insolvency tax period ending on or after 10 May 1994 and VAT 193 final returns with a post-insolvency tax period ending on or after 10 May 1994.

Unauthorised amendment of the end date of tax periods is not allowed and any VAT returns received with unauthorised alteration to the period end dates will not be regarded as valid if undue benefit has been gained as a result. Customs intend to apply normal input tax rules in these cases. If it appears that recovery of input tax has been delayed to take advantage of the change in treatment they reserve the right to consider further action (eg under Regulation 62(1) of the VAT (General) Regulations 1985).

18.3 Insolvency (No 2) Act 1994

The Insolvency (No 2) Act 1994 received Royal Assent on 26 May 1994. The Act amends Sections 241 and 342 of the 1986 Insolvency Act to the extent that they provide protection for third parties who acquire property which has been the subject of a previous undervalue transaction or preference.

Under the original provisions, persons acquiring such property in good faith and for value, other than from the insolvent company or individual, were protected provided they did not have notice of the relevant circumstances. The 1994 Act removes the requirement relating to notice of the relevant circumstances, and introduces instead a presumption that the property is not acquired in good faith in cases where the person acquiring it has notice, both of the undervalue transaction or preference and of the commencement of insolvency proceedings, or where he is an associate of or connected with the insolvent company or individual. In such cases the burden of demonstrating that the acquisition was in good faith will fall on the person acquiring the property.

The new Act follows concerns expressed by the Law Society that, under the original provisions, mere notice of an undervalue transaction (which might be entirely innocent and may, for example, take place in connection with family arrangements) might constitute sufficient knowledge to render a purchaser in good faith and for value vulnerable to an action for recovery.

18.4 Data Protection Act 1984

Members are reminded that registration under the Data Protection Act 1984 lasts for three years and data-users must renew their registration at the expiry of the three year period. Members should also be aware that the Registrar must be notified of any change of address of a registered data-user and failure to do is an offence under section 6(5) of the Act. Members should bear this in mind when they arrange for the registered office of a corporate data-user to be changed to their office address and should ensure that appropriate arrangements are made for the Registrar to be notified.

18.5 RICS Valuation Guidance Note 12

Accompanying this Bulletin is a copy of The Royal Institution of Chartered Surveyors' Valuation Guidance Note 12 (VGN 12) which was issued in March 1994 following discussions between the RICS and the British Bankers Association. VGN 12 is for use by valuers who provide services for a client who is lending on the security of commercial land and buildings, and it sets out a range of recommended bases of valuation for secured lending purposes which are fundamentally different from the commonly used 'going concern' and 'break-up' bases. Members will find it useful to familiarise themselves with the concepts contained in VGN 12 as they will increasingly be adopted by valuers and secured lenders and will be of assistance when instructing valuers in insolvencies. A Technical Release dealing with the instructing and reporting process is being developed jointly by SPI and the RICS.

18.6 Section 37 Insolvency Act 1986

Members may be aware that the Insolvency Service is conducting a consultation exercise to consider whether section 37 of the Insolvency Act 1986 as it relates to the liability of non-administrative receivers on adopted employment contracts should be amended in the same way as sections 19 and 44 were amended by the 1994 Insolvency Act. At present, non-administrative receivers remain exposed to the uncertainty caused by the *Paramount*, *Ferranti* and *Leyland Daf* decisions. SPI has consistently argued since the introduction of the Insolvency (No 2) Bill that section 37 should be amended to bring it into line with the amended section 44. The Technical Committee will be interested to receive examples of cases in which potential Paramount claims in non-administrative receiverships have caused the early dismissal of employees or the closure of otherwise viable businesses. Members are asked to send details of such cases to the Technical Secretary at SPI.

18.7 Insolvency Act 1986: Meaning of 'Property'

Messrs Bond Pearce have kindly provided the following information concerning the unreported decision of the High Court in *Re Rae* (15 July 1994).

The decision is important, firstly, because it deals with the rights of a trustee in bankruptcy in respect of fishing licences issued under the Sea Fish (Conservation) Act 1967 and secondly, because it provides a detailed examination of what constitutes 'property' for the purpose of ascertaining a bankrupt's estate. It is this second feature of the case which is of particular significance because the same definition of 'property' applies to all personal and corporate insolvency procedures by virtue of section 436 of the Insolvency Act 1986. In this case Warner J concluded that an interest which was not enforceable in a court of law but which was nonetheless marketable and so capable of being turned into money was 'property' for the purposes of the Act. However, there are limitations on the indiscriminate application of this decision, as explained later in this note.

Immediately prior to his bankruptcy Mr Rae was the owner of four fishing vessels and held licences in respect of all of them. Licences are granted by the Minister of Agriculture, Fisheries and Food, and are personal and not transferable. Licences may be suspended, revoked or varied at the discretion of the Minister. In order to restrict the size of the fishing fleet the number of licences is capped. However, in exercising the discretion to grant licences, the Minister recognises an 'entitlement' to apply for a licence as resting with the previous licence holder who can either apply for a new licence in his own name or waive the entitlement thereby enabling another party to apply for a licence. In practice, licence entitlements are traded for value.

The indirect consequence of the bankruptcy was to invalidate the licences because Mr Rae had ceased to satisfy the conditions on which they had been issued. However, the Ministry recognised an entitlement in respect of the grant of new licences. The essential issue was whether the entitlement should ensure for the benefit of Mr Rae's creditors or for the benefit of Mr Rae himself.

The trustee in bankruptcy wished to sell the four vessels with the benefit of the entitlement to licences. Although the Ministry regarded the competing insolvency interests as a matter to be determined by the Court, it recognised the entitlement as resting with Mr Rae. Mr Rae refused to waive his entitlement in favour of his trustee in bankruptcy who commenced proceedings to determine the matter. If the trustee had been the liquidator of an insolvent company no difficulty would have arisen because any entitlement would have remained with the company and the Ministry recognise a liquidator as competent to sign the appropriate forms in the name of the company.

It was held that Mr Rae's entitlement to fishing licences constituted 'property' for the purposes of s436 of the Insolvency Act 1986 and that accordingly the entitlement as well as the vessels had become vested in his trustee in bankruptcy. The bankrupt was given leave to appeal to the Court of Appeal but it is not yet known whether any such appeal will be pursued. Meanwhile, the decision in Re Rae provides an authoritative consideration of the definition of 'property' in s436, which is in the following terms:

> '"property" includes money, goods, things in action, land and every description of property wherever situated and also obligations and every description of interest, whether present or future or vested or contingent, arising out of, or incidental to, property'.

The court approached the interpretation of this provision by reference to the purpose of the legislation. Bankruptcy was held to be a process whereby all the debtor's property, with certain specific exceptions (which did not apply), is vested in his trustee for realisation and distribution of the proceeds amongst creditors (the corollary being relief from personal liability to those creditors). However, the court was not prepared to conclude that the entitlement fell within the wide definition of 'property' simply from the fact that its exclusion would be contrary to the purposes of the Act.

The s436 definition is not exhaustive: it merely provides for what the term 'includes' which Warner J held could be taken to imply that 'property' also included other things than those expressly mentioned. He also observed that the definition is, to some extent, circular in that it defines 'property' by reference to that word itself. As a matter of interpretation, it was held that the phrase 'every description of property wherever situated' used the word 'property' as meaning anything which is capable of being owned and of which the ownership can be asserted or defended in legal proceedings. That being so, the second limb of the definition, commencing with the words 'and also' had to be wider.

The words 'every description of interest' could be construed as meaning only interests capable of being asserted or defended in legal proceedings, but there was nothing in the words themselves to confine them to that meaning. Accordingly, it was right to adopt the meaning which gave effect to the statutory purpose and to treat those words as including an interest which was not enforceable in a court of law. The court held that the entitlement constituted an interest 'incidental to' the vessels. The definition is not limited to an interest in property. Further, it is not necessary, in order for an interest to be within s436, for it both to arise out of and be incidental to property - it is enough for it to be incidental to property.

Warner J considered that the most powerful argument put forward on behalf of the debtor was that the 'entitlement' was the creature of ministerial discretion existing in such person as the Minister recognised to the exclusion of all others. That argument would have been both compelling and conclusive were it not for the Ministry's own acknowledgement that it was for the court to adjudicate on the competing insolvency interests. It is this aspect of the judgment which prevents *Re Rae* being indiscriminately applied so as to treat mere commercial opportunities as being 'property' for the purposes of the Act.

18.8 Other Recent Legal Decisions

(i) Unfair dismissal before transfer of business

Ibex Trading Co Limited v Walton & ors, The Times, 29 July 1994

This was an Employment Appeal Tribunal case and concerned the dismissal by administrators of employees who had declined to accept a cut in wages as part of the administrators' strategy to reduce costs. The dismissals were made on 16 October 1991. An offer to purchase the business was made on 11 November 1991 and contracts were exchanged on 13 February 1992. The EAT held that the employees were not dismissed by reason of the transfer of the business for the purposes of reg 8 (1) of the Transfer of Undertakings (Protection of Employment) Regulations 1981 because at the time of the dismissals the transfer was no more than a mere possibility. Nevertheless, in the present case the dismissals were unfair by reason of section 57 (3) of the Employment Protection (Consolidation) Act 1978 because no consultation took place, and the liability was that of the transferor.

(ii) Future rent not covered by voluntary arrangement

Burford Midland Properties Limited v Marley Extrusions Limited & ors,[1994] BCC 604; [1994] EGCS 108

A company entered into a voluntary arrangement with its creditors which was expressed to bind all creditors, present or potential, whether their claims were future, present, contingent or otherwise. The company held a property under a lease and the landlord sought to obtain recovery of the rent arising after the date of the arrangement. The company argued that the rent was a liability within the scheme, albeit payable in the future. The judge in the Chancery Division drew a distinction between arrears of rent at the date of the arrangement and rent accruing due subsequently. The arrears were a debt, ie an obligation to pay that was fully crystallised, whereas a right to future rent was a right essentially of property. Therefore the arrangement only covered the rent already actually due, and not the future rent.

(iii) Original lessee still liable after disclaimer

Hindcastle Limited v Barbara Attenborough Associates Limited & ors, The Times, 6 July 1994; [19941 EGCS 109

The Court of Appeal has held that the disclaimer of a lease under section 178 of the Insolvency Act 1986 by the liquidator of a company which had taken an assignment of the lease did not determine the liability of the original lessee and any surety for the original lessee to pay the rent due under the lease.

Where the lease was vested in the original lessee and was disclaimed by a trustee in bankruptcy or liquidator the disclaimer operated to determine the lease and the lessee's obligations thereunder, with the result that the liability of any surety for the lessee was necessarily discharged (*Stacey v Hill* [1901] 1 KB 660). There was a clear distinction between such a case and the case where the lease was vested in an assignee. Section 178 (4) (a) determined all the liabilities of the insolvent assignee in respect of the disclaimed property. This included not only the liability to pay the rent to the lessor but also the liability to indemnify the original lessee for his liability to pay the rent to the lessor. However in order to release the assignee from liability to indemnify the original lessee it was not necessary to extinguish the liability of the original lessee to the lessor. This was in line with the decision in *Hill v East and West India Dock Co* ((1884) 9 App Cas 448) which was decided before the Bankruptcy Act 1883 introduced provisions corresponding to the present section 178 (4).

(iv) Scottish receivers not liable for rates

McKillop and Watters, Petitioners, The Times, 14 April 1994

The Outer House of the Court of Session held that a receiver was not the occupier of premises for the purpose of liability for rates. Receivers appointed to a company were therefore not personally liable to pay rates in respect of the occupation of certain heritable property owned by the company, and the rates were not a receivership expense in terms of section 60 (1) (c) of the Insolvency Act 1986.

(v) Bank owes no duty to wife under Scottish law

Mumford v Bank of Scotland; Smith V Same, The Times, 4 August 1994

The Outer House of the Court of Session held that where a wife was induced by her husband's misrepresentations to grant real security over her property or personal security as a cautioner for his debts, in the absence of actual knowledge of the misrepresentations the creditor was under no duty either to explain to the wife the nature of the transaction into which she was entering or its consequence, nor to require her to take independent advice. The fact that the creditor knew that the granter was the spouse of the debtor did not mean that the creditor had constructive notice of the misrepresentation. The decision of the House of Lords in *Barclays Bank plc v O'Brien* (The Times, 22 October 1993; [1994] 1 AC 180: see Technical Bulletin 14.6, November 1993) was not the law in Scotland.

(vi) **Update on Technical Bulletin 15**

The case of *Calor Gas Limited v Percy and Edwards* has been fully reported in [19941 BCC 69. It will not now be appearing in the Weekly Law Reports.