

SUPREME CT.

IN RE LINARES LTD.

[1988–90 Gib LR 231]

IN THE MATTER OF LINARES LIMITED (IN LIQUIDATION)

SUPREME COURT (Kneller, C.J.): April 25th, 1990

Companies—voluntary winding up—costs of liquidation (including costs of liquidator; Director of Social Security and Commissioner of Income Tax) to be paid out before distribution of company’s assets to preferential creditors—just and beneficial treatment of liquidators

Companies—voluntary winding up—PAYE recoverable as preferential debt—Government may choose tax year in respect of which priority claimed—taxable profits likely to be smallest in year immediately preceding winding up

Companies—voluntary winding up—Social Insurance contributions in arrears and contributions claimed by Director of Social Security recoverable as preferential debts—employees’ contributions classed as tax and still recoverable as preferential debt—priority of debt unaffected by contributions’ “quasi-trust” status

The liquidator of a company sought directions from the court.

The company went into voluntary liquidation in October 1988, and a liquidator was appointed. By May 1989, the majority of the company’s assets had been collected, and the liquidator was in a position to distribute them. The Commissioner of Income Tax and the Director of Labour and Social Security claimed deductions of £28,018.93 and £39,529.26 respectively, in respect of unpaid income tax and social insurance contributions that should have been paid by the company under the PAYE scheme.

The Commissioner of Income Tax and the Director of Social Security submitted that (a) the tax and social insurance contributions owed to the government were held on trust by the company, or (b) in the alternative, the sums due were debts due to the government and recoverable as such, and, by virtue of the Companies Ordinance, s.241(1), were payable in preference to all other debts.

Held, making the following orders:

(1) All costs, charges and expenses properly incurred in the winding up of the company (including the costs of the liquidator, the Director and the Commissioner) should be paid out of the company’s assets before the

distribution of assets to the preferential creditors. This constituted a just and beneficial treatment of liquidators (para. 4; para. 6; para. 13).

(2) PAYE deductions owed by the company in respect of any one 12-month period were to be classed as a preferential debt. The Government could choose the tax year for which it claimed priority, to ensure that it was not limited to recovery of taxes which fell due during the year preceding liquidation, as the company's profits (in respect of which taxes would be assessed) were likely to be smallest in that year (para. 4; paras. 8–10).

(3) All Social Insurance contributions in arrears were also preferential debts, as were all contributions claimed by the Director. The moneys contributed by the company's employees were not, strictly speaking, trust moneys, though they were both part of the company's revenue and belonged to the Government; their "quasi-trust" status did not affect the priority of debt, as they were still a tax (para. 4; paras. 11–12).

Cases cited:

- (1) *Lo-Line Elec. Motors Ltd., In re.*, [1988] Ch. 477; [1988] 3 W.L.R. 26; [1988] 2 All E.R. 692; [1988] BCLC 698; (1988), 4 BCC 415, applied.
- (2) *Lord Advocate v. Kelman* (1958), 51 R. & I.T. 177, applied.
- (3) *New S. Wales Taxation Commrs. v. Palmer*, [1907] A.C. 179; (1907), 76 L.J.P.C. 41; 96 L.T. 278; 23 T.L.R. 304, applied.
- (4) *Pratt, In re, ex p. Inland Rev. Commrs. v. Phillips (Trustee in bankruptcy)*, [1951] Ch. 225; [1950] 2 All E.R. 994; (1950), 31 T.C. 506; 29 A.T.C. 300; 43 R. & I.T. 964; [1950] T.R. 293, *dicta* of Lord Evershed, M.R. applied.

Legislation construed:

Companies Ordinance (1984 Edition), s.204:

“(1) A company may be wound up voluntarily—

- (a) when the period (if any) fixed for the duration of the company by the articles expires, or the event (if any) occurs, on the occurrence of which the articles provide that the company is to be dissolved, and the company in general meeting has passed a resolution requiring the company to be wound up voluntarily;
- (b) if the company resolves by special resolution that the company is to be wound up voluntarily;
- (c) if the company resolves by extraordinary resolution to the effect that it cannot by reason of its liabilities continue its business, and that it is advisable to wind up . . .”

s.231: The relevant terms of this section are set out at para. 5.

s.232: The relevant terms of this section are set out at para. 6.

s.241(1)(a): The relevant terms of this paragraph are set out at para. 8.

s.241(1)(e): The relevant terms of this paragraph are set out at para. 11.

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I. Marrache for the liquidator;
J.M.P. Nuñez, Ag. Senior Crown Counsel for the Commissioner of Income Tax and the Director of Labour and Social Security.

1 **KNELLER, C.J.:** Linares Ltd. (“Linares”) was put into creditors’ voluntary liquidation pursuant to the provisions of s.204 of the Companies Ordinance on October 3rd, 1988. Kenneth Alan Robinson was appointed its liquidator.

2 His solicitors issued a summons on May 26th, 1989 for directions under s.231 of the Ordinance as to—

- (a) the status of the following creditors:
 - (i) the Commissioner of Income Tax as collector of contributions deducted by the company from its employees under the Pay As You Earn (PAYE) provisions of the Income Tax Ordinance;
 - (ii) the Director of Labour and Social Security as collector of contributions deducted by the company from its employees’ wages under the Social Security (Employment Injuries Insurance) Ordinance and under the Social Security (Insurance) Ordinance,

and as to—

- (b) whether the above-named creditors are—
 - (i) entitled to specific moneys held on trust to be paid out in the liquidation in priority to the liquidator’s expenses and disbursements; or
 - (ii) preferential creditors pursuant to s.241 of the Ordinance; or
 - (iii) unsecured creditors.

The liquidation committee decided that the liquidator should seek the court’s answer to these conundrums.

3 The assets of Linares had nearly all been collected by May 24th, 1989, and the liquidator was in a position to distribute them in obedience to the court’s answers. The Commissioner claimed deductions under the PAYE system of £28,018.93, and the Director claimed £39,529.26 for Social Insurance contributions.

4 At the end of counsel’s submissions, orders were made that—

(1) all costs, charges and expenses properly incurred in the winding up, including the remuneration of the liquidator, be paid out of the assets of

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Linares prior to the assets being distributed amongst the preferential creditors;

(2) PAYE deductions owed by Linares in respect of any one 12-month period to the Commissioner, who was to choose any one year in respect of which arrears were owed, be classed as a preferential debt under s.241(1)(a);

(3) the balance of PAYE arrears claimed by the Commissioner were to rank as unsecured for the purpose of this liquidation;

(4) all contributions claimed by the Director were to be classified as a preferential debt in pursuance of s.241(1)(e) of the Ordinance; and

(5) the costs of the liquidator, Commissioner and Director were to be costs in the winding up.

5 The law relating to these arcane points is this. The Companies Ordinance, s.231(1) provides that—

“the liquidator [in a voluntary winding up] . . . may apply to the court to determine any question arising in the winding up of a company, or to exercise, as respects the enforcing of calls, or any other matter, all or any of the powers which the court might exercise if the company were being wound up by the court.”

Section 231(2) states that—

“the court, if satisfied that the determination of the question or the required exercise of power will be just and beneficial, may accede wholly or partially to the application on such terms and conditions as it thinks fit, or may make such other order on the application as it thinks just.”

6 Section 232 provides that “all costs, charges and expenses properly incurred in the winding up, including the remuneration of the liquidator, [are] payable out of the assets of the company in priority to all other claims.”

7 PAYE was introduced into Gibraltar by the Income Tax (Amendment) Ordinance 1974, which made appropriate amendments to ss. 42, 46, 46A, 62A and 87 of the Income Tax Ordinance. Section 88(1) of the Income Tax Ordinance, as amended, provides that the Commissioner—

“may require the [PAYE] tax charged upon individuals employed in Gibraltar . . . to be deducted by . . . employers . . . at such times and in such amounts as the Commissioner may determine, and may require employers . . . to account for and pay over to him any tax required to be so deducted which shall be a debt due to the Government and recoverable as such, and the Commissioner may

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serve on such persons a direction to deduct and account for tax accordingly.”

8 Arrears of income tax (including PAYE) taxed or included among the debts in a winding up are “to be paid in priority to all other debts”: Income Tax Ordinance, s.88(9)(a). This is qualified, however, because it is only “all taxes assessed on or otherwise due by the company within twelve months next before the relevant date, and not exceeding in the whole the amount assessed or due in respect of one year” that should be paid in priority to all other debts: Companies Ordinance, s.241(1)(a).

9 The Government is entitled to select any one tax year—that is, the most favourable tax year, but only one—before the date of the winding-up order, and to claim priority for taxes payable in respect of that year: *In re Pratt, ex p. Inland Rev. Commrs. v. Phillips (Trustee in bankruptcy)* (4). It can choose different years for different taxes: *Lord Advocate v. Kelman* (2).

10 It is a matter of construction and what those few words mean in English. The explanation for this is that the Crown in right of the Royal Prerogative was entitled to priority in respect of all assessed taxes: *New S. Wales Taxation Commrs. v. Palmer* (3). Lord Evershed, M.R. pointed out ([1951] Ch. at 238) that—

“wages and similar debts accrue regularly and probably at a constant rate. Taxes are different: they are the subject of assessments which may be postponed by argument and other devices for years so that at any particular date it may be wholly uncertain what will be the debts due when the taxes have been finally assessed”

and (*ibid.*, at 239) that—

“as a trader approaches insolvency, the profits in respect of which taxes would be assessed will (presumably) be falling, so that if the last year were the one for which alone the Crown could claim priority, it would probably be getting a prior claim for the smallest of many years’ taxes likely to be in arrear.”

11 Social Security contributions are also taxes. Employers must participate in the system and contribute. The employee has to participate and have his contribution deducted from his wages by his employer, and “all amounts payable by the company [being wound up] in respect of contributions as the employer of any person under the Social Security (Employment Injuries Insurance) Ordinance and under the Social Security (Insurance) Ordinance” are to be paid in priority to all other debts on winding up: Companies Ordinance, s.241(1)(e).

12 There were some submissions on whether or not the sums contributed by the employee were trust moneys and, if so, whether this made any

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difference to the priorities. The answer is that the sums for which the company is liable to the Commission and/or Director in respect of income tax, PAYE and insurance contributions are still part of the revenue as are other “quasi-trust moneys,” so far as the company is concerned. These sums belong to the Government. They are not strictly trust moneys: *In re Lo-Line Elec. Motors Ltd.* (1). The sums contributed by the employee are still a tax. So the priorities are not affected by the fact that these sums are quasi-trust moneys.

13 I was satisfied on all this that the determination of the questions arising from the winding up of this company will be just and beneficial not least for the liquidator in this matter but also liquidators in other windings up, so I acceded wholly to the application and made the orders on it which I thought were just for the reasons I have already set out.

Order accordingly.