



Response from ICAS to the HMRC Consultation 'Company Distributions'

3 February 2016

Company distributions

About ICAS

1. The following submission has been prepared by the ICAS Tax Committee in consultation with the ICAS Insolvency Committee. The ICAS Tax Committee, with its five technical sub-Committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants and ICAS Tax Professionals working across the UK and beyond, and it does this with the active input and support of over 60 committee members. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 20,000 members working across the UK and internationally. Our members work in all fields – predominantly across the private and not for profit sectors.

General comments

2. ICAS welcomes the opportunity to respond to the HMRC consultation document 'Company Distributions' issued on 9 December 2015.
3. ICAS recognises that there may be concerns around the changing dividend rates and the possible resulting increase in taxpayers considering whether to convert income receipts into capital receipts. However, our members have expressed concerns about the additional complexity introduced by these proposed anti-avoidance measures, particularly the TAAR, and the unintended adverse consequences which could arise. In particular we are concerned about the impact on non-tax motivated members' voluntary liquidations.
4. We do not believe that the measures address the real cause of the problem which is the disparity between the additional and higher rates of income tax and the CGT rates (28%, 18% and 10% where entrepreneurs' relief applies).
5. We note that HMRC highlights phoenixism and moneyboxing in the consultation. However we question how extensive these abuses are and whether the best approach to dealing with them is via the proposed changes. For many companies the cost and inconvenience of winding up the old company and setting up a new company (with all the administrative requirements this entails), together with the potential adverse effects on relationships with customers and suppliers, would outweigh any tax advantage that could be gained. We can see that it might be relevant to personal service companies in certain sectors – which also present other tax problems – but we do not consider the current proposals for a new TAAR to be the best way of dealing with them. We suggest that further consideration needs to be given to a more targeted approach to tackling abuses.
6. The consultation also mentions special purpose companies but we are not convinced that these are usually set up with the intention of gaining a tax advantage. We understand that they are often used to ring-fence and mitigate commercial risks. For example they are widely used in the property sector (and in many cases required by lenders) to ensure that if a specific development goes 'bad' that it will not bring down the remainder of the business.
7. If the proposed changes go ahead we suggest that consideration should be given to transitional rules excluding liquidations commenced before 9 December 2015 but which cannot be concluded before 6 April 2016 when the new rules will come into effect.
8. If the proposed TAAR goes ahead we also believe it is essential that there should be a clearance mechanism to mitigate the adverse consequences for non-tax motivated transactions which are discussed in our responses to the specific questions below. Uncertainty will inhibit genuine commercial transactions whilst the small number of taxpayers who are exploiting the current rules may proceed anyway in the hope that they get away with it.

Specific Questions

Question 1. Do you think that the ways in which a shareholder can receive value from a company in a form that is subject to CGT rather than income tax, as explored above, can lead to unfair outcomes?

The ICAS Tax Committee does not hold policy positions in relation to 'fairness' or 'unfair outcomes' of particular elements of tax legislation. Such decisions are political and for Parliament to address. In response to the debate on tax avoidance and evasion, the ICAS Tax Committee has called for five key actions:

- The law must work properly: we must have simpler, better legislation because it is the law passed by Parliament that the Courts apply and determines the tax HMRC can collect. The accepted principle of us all paying the right tax at the right time has been overshadowed recently, but the right tax means the law has to be right; this means clear and unambiguous drafting of Parliament's intentions.
- High standards of behaviour are required all round: From CAs, tax advisers, tax administrations, businesses and individuals; ICAS members are governed by a Code of Ethics and the Professional Conduct in Relation to Taxation guidelines. ICAS supports measures being introduced by government to ensure all those involved in giving tax advice should be qualified and part of the regulated environment. However, regulation will not solve the issue of poorly drafted tax laws.
- Better information is needed: The public at large deserves to be better informed on tax, with clear explanations being given of business tax complexities and current tax practices.
- Tax policy needs clarity: Governments need to be clear on the underlying principles which govern their tax policy approach. They also need to be clear on which taxpayers benefit from their tax policies and why.
- Businesses need to be transparent: Businesses should consider providing accessible and coherent narrative explanations of their overall tax contributions (not limited to corporation tax) in response to the demand for greater transparency in corporate reporting.

Question 2. Do you think such issues will be exacerbated by the changes to dividends rules being proposed for April 2016?

In view of the differentials between income tax and capital gains tax rates many taxpayers will be inclined towards the less costly option. Despite the notion of 'fairness', very few taxpayers will want to pay more tax than they are legally required to do. We also note that when a company has ceased to have any purpose, there are a number of options available to the shareholders to bring the company to an end. These options will have different tax consequences. Inevitably most shareholders in this position will be likely to choose the most tax advantageous option. Under the proposed new TAAR it seems possible that this might bring the transaction within the scope of the anti-avoidance legislation even though the decision to bring the company to an end is not tax motivated. We discuss this further in the response to Question 6 below.

Question 3. Do you agree that changes to the Transaction in Securities rules as proposed will be effective in terms of preventing the conversion of income to capital?

We have no detailed comments on most aspects of these changes. The extension of the definition of 'transaction in securities' to include liquidations may mean that more members' voluntary liquidations fall within the scope of the rules.

Question 4. Do you think these changes will have any unwanted consequences not identified? How might these be mitigated?

See the response to Question 3. We believe this could have an adverse impact on non-tax motivated members' voluntary liquidations by causing uncertainty and leading to increased costs. Additionally whilst it will at least be possible to obtain clearances for the transactions in securities rules these will not cover the proposed new TAAR – this is discussed further in the responses to questions 5, 6 and 7.

Question 5. Do you agree that the introduction of this new TAAR will be effective in terms of preventing the behaviour outlined in this section, and are there any better alternatives?

Most companies are highly unlikely to adopt phoenixism because the cost and inconvenience of winding up the old company and setting up a new company (with all the administrative requirements this entails), together with the potential adverse effects on relationships with customers and suppliers, would outweigh any tax advantage that might be gained. However the proposed TAAR will have an impact on these companies if they are considering liquidation for non-tax reasons. It is likely to cause uncertainty, particularly as we understand that there are currently no plans for a clearance mechanism, and could deter some shareholders from undertaking commercially motivated business reconstructions (not all of which will be able to utilise the proposed exemption in the draft legislation). This is discussed further in the responses to questions 6 and 7 below.

The consultation notes that the current rules are being exploited by a 'small number of taxpayers in specific circumstances' mostly through 'phoenixism'. These taxpayers are likely to try to find ways round the TAAR. We suggest that it would be preferable to tackle them by other more targeted means which do not adversely impact on other companies. We assume that some of the taxpayers referred to are likely to be personal service companies in certain sectors, which also present other tax problems. Proposals to address some of these issues have been subject to a separate consultation and we suggest that any solution should also address phoenixism in this sector.

Failing that we wonder if a different approach would be possible using the Company Directors Disqualification Act to tackle abusive repeated phoenixism. Members Voluntary Liquidations could be brought within the scope of Company Director Disqualification reporting so that insolvency practitioners would have to consider the conduct of directors and shadow directors in this context and report to the insolvency service where it amounted to misfeasance. In addition there are new compensation order provisions which entitle an order to be made against a director. The present rules would have to be amended as they are aimed at insolvent companies and losses to creditors but this could be changed so that where abuse of the winding up process is demonstrated, compensation orders could be made in favour of any party shown to have suffered a loss (in this case HMRC would have suffered a tax loss).

Question 6. Do you think that the TAAR will have any unwanted consequences not identified? How might these be mitigated?

We consider that the proposed measures are likely to cause difficulties for legitimate and non-tax motivated members' voluntary liquidations (MVLs). The uncertainty over whether HMRC will consider the MVL as having a main purpose, or one of its main purposes to avoid or reduce income tax, is likely to mean that shareholders want a clearance from HMRC prior to entering into the MVL. We understand however that there are no plans for any clearance mechanism either through a statutory procedure or using the non-statutory route.

Without a clearance mechanism, shareholders undertaking MVLs will be left with uncertainty. HMRC may also waste time on ultimately pointless enquiries. It is also likely to inhibit some commercial transactions, including commercially motivated reconstructions (outside the scope of the proposed exemption) with adverse consequences for jobs and the economy. The abusive minority may proceed anyway in the hope that they get away with it. If the proposed TAAR goes ahead we therefore believe that provision of a clearance mechanism is essential.

Whilst this could result in increased costs and delays for the majority in order to tackle the abusive minority, we believe it would be less damaging than the uncertainty which would exist under the current proposals.

We are also concerned that there is a likelihood that the new rules will drive increasing numbers of directors to use the 'striking off' provisions in s1003 Companies Act 2006 rather than taking the proper route to wind up a company via liquidation. Under s1030A CTA 2010 up to £25,000 can be treated as a capital distribution on striking off. As the proposed new provisions only appear to apply to winding up the incentive to use the striking off approach will be increased.

Additionally there may be a rise in court applications to have a company wound up on 'just and equitable' grounds or because the company has passed a resolution to be wound up by the court on the basis that the purpose of the company has been achieved. This could be a defence against the suggestion that the winding up had a main purpose of avoiding or reducing a charge to income tax. The cost of a court application may be seen as worthwhile if it puts beyond doubt or significantly strengthens the argument that a main purpose or one of the main purposes was not tax avoidance or reduction. However it is unlikely to be desirable in terms of court workloads.

Given that there are always alternative ways of dealing with the end of a company the taxation consequences of each approach will inevitably be a consideration and a driver in making the final decision. As noted above those involved in legitimate solvent winding ups will therefore be concerned about possibly being caught by the proposed new rules. We set out below two examples of scenarios which could potentially be caught – where we do not think the legislation is intended to apply but where the shareholders concerned would want certainty. As noted above we believe that if the proposed TAAR goes ahead a clearance mechanism is essential.

Example 1

Company A has three director shareholders and has traded successfully for a number of years building up significant levels of retained profits. Each of the director/shareholders brings a separate area of skill or service product to the company. The directors disagree on the future strategy of the company and decide to go their separate ways, continuing their own trade but under a different entity. In order to extract themselves from the business they can either:

- draw down fully the retained profits as a dividend and either have the company struck off or wound up
- draw down the retained profits as dividends over a number of years
- draw dividends to leave retained profits just under £25,000 and then apply to have the company struck off the register of companies
- wind the company up via a MVL
- apply to the court to have the company wound up on 'just and equitable' grounds.

Each of the five options (all of which are equally valid) will have different tax consequences for the shareholders. Assuming the most tax advantageous option is chosen this would then appear to be potentially within the scope of the new provisions albeit the decision to wind up is not tax motivated.

Example 2

Company B has a husband/wife director/shareholder structure and has traded successfully for a number of years with a small number of retail chemist shops. The director/shareholders are approaching retirement age and secure a sale of the business resulting in a large goodwill payment into the company. With the business sold there is no purpose for the company and so the company must be drawn to a close. As part of the transfer of trade arrangements the husband who is a qualified pharmacist is to continue to work for the new business for one year, with an element of the purchase price dependant on continued turnover levels in the

shops during that period. In order to achieve closure of the company there are several options:

- draw down fully the retained value as a dividend and either have the company struck off or wound up in due course
- draw down the retained profits as dividends over a number of years
- draw dividends to leave retained profits just under £25,000 and then apply to have the company struck off the register of companies in due course
- wind the company up via a MVL while working for the new owners as a self-employed pharmacist consultant
- apply to the court to have the company wound up on the grounds that the company passes a resolution to be wound up by the court as the purpose of the company has been achieved.

Each of the five options (all of which are equally valid) will have different tax consequences for the shareholders. Assuming the most tax advantageous option is chosen this would then appear to be potentially within the scope of the new provisions, albeit the decision to wind up is not tax motivated.

Question 7. Do you think that the government should consider making further changes to address the conversion of income to capital? If so what other solutions do you think the government should consider?

As noted in our general comments above we believe the fundamental problem arises from the differential rates of income tax and CGT, particularly where entrepreneurs' relief is available. Adding increasingly complex anti-avoidance legislation will increase uncertainty and costs for legitimate business reconstructions and company dissolutions but may not be effective in tackling avoidance by those determined to exploit the rules.

We note the suggestion at the end of the consultation that some form of close company apportionment could be re-introduced. Again this would impose a significant administrative and compliance burden on large numbers of companies which are not seeking to avoid tax but would not necessarily assist in dealing with the minority seeking to avoid tax. We are also concerned that HMRC no longer has the resources to deal with a complex, nuanced regime which would allow for retention for business reasons and that therefore the result might be a flat rate, blunt instrument approach which could damage businesses.

Question 8. Are there any particular areas of the wider distributions regime that cause difficulties or complexities? If so, which areas?

Question 9. Do you believe there is any value in extending this consultation to consider the regime as a whole, after the changes proposed for April 2016?

We suggest that the proposed TAAR should not be implemented from April 2016 to allow time and further consultation on measures to tackle the abusive minority through more targeted alternative measures.