Company distributions in a winding up and Spotlight 47

General Features

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HMRC's updated view on attempts to avoid an income tax charge when a company is wound up.

CIOT and ICAEW recently met with HMRC to discuss Spotlight 47. HMRC published Spotlight 47 on 4 February 2019. The Spotlight provides 'information about tax avoidance schemes that try to avoid an income tax charge on distributions when winding up a company'. The ICAEW and CIOT sought a meeting with HMRC with a view to better understanding HMRC's position.

The relevant legislation is in ITTOIA 2005 s 396B and s 404A (as inserted by FA 2016 s 35). It is a targeted anti-avoidance rule (TAAR), which treats distributions made to an individual in respect of share capital in the winding up of a UK resident company as a distribution subject to income tax, rather than subject to capital gains tax, if four conditions are met. The provision applies to distributions in a winding-up made on or after 6 April 2016. The CIOT has previously commented that the legislation is widely drafted, and as a result has caused uncertainty over when, or if, it might apply.

The purpose of the TAAR is to stop someone avoiding income tax when they wind up a company and was introduced principally to tackle 'phoenixism'. Phoenixism describes where a company goes into liquidation and a new company is set up to replace the old one with the purpose of carrying on the same, or substantially the same, trade as before. The shareholder receives the value of the company in a capital form while the trade continues exactly as before – albeit now in the new company. There is usually no commercial purpose behind it.

The Spotlight goes on to say that HMRC are aware of phoenixism schemes that claim the TAAR will not apply 'by making an artificial modification of the arrangements

aimed at defeating the intention of the legislation (by selling the company to a third party rather than winding it up, for example)'. HMRC say that these schemes are within the scope and purpose of the legislation, and hence the TAAR does apply to them. They will also consider whether the General Anti-Abuse Rule (GAAR) applies to these schemes.

During our meeting, HMRC explained that they had seen a change in behaviour since the introduction of the TAAR and this had prompted them to issue the Spotlight. Clearances received by HMRC showed instances of people selling off companies rather than liquidating them, in an apparent attempt to avoid the TAAR.

HMRC confirmed that they considered that in some cases the TAAR could apply to such disposals. Where the TAAR might not apply, HMRC are of the view that the GAAR could apply.

Looking at the two extremes:

1. If a business owner wanted to cease running their business and sold their company owning the business as a going concern to a third party and had no intention of working in this area again, then it is likely that the TAAR would not be in point. In such circumstances the sale to a third party would not usually change this.
2. However, if a business owner wanted to liquidate one business and start a similar business (phoenixism), the TAAR is likely to be in point on liquidation. Attempting to avoid this by disposing of the assets and liabilities, turning the company into a 'money box', then selling this to a third party, who would liquidate it immediately and use the proceeds to pay the vendor, is likely to lead to HMRC thinking that the TAAR should apply. Then, even were a tribunal to not accept the TAAR applied, HMRC consider that they could invoke the GAAR due to a TAAR being deliberately avoided.

Although not specifically stated, it seems possible that HMRC might consider that the TAAR would apply even if the money box company is not liquidated by the third party but kept as a dormant subsidiary.

Between the extremes of the above two examples, HMRC indicated that the result of any case would depend on the particular facts, but we understood that the gist of their feeling was that selling shares in a company as an alternative to liquidation would be unlikely to reduce any uncertainties around whether the TAAR or GAAR

would apply.

HMRC acknowledged that the scope of anti-abuse rules can lead to uncertainties and that ultimately addressing them is a matter for the courts. But they take the view that the chargeable gains treatment of disposals of shares is in general confined to straightforward sales and company liquidation distributions untrammelled by tax considerations. It follows that they will seek to apply anti-abuse rules in situations where the purpose of the legislation appears to be being circumvented and there is evidence that this is being achieved deliberately through what HMRC consider to be artificial means.

Alternative views could therefore be given on what the specific will of Parliament was in this area. However, members advising in this area will want to ensure that relevant clients are aware of HMRC’s updated views on this matter.