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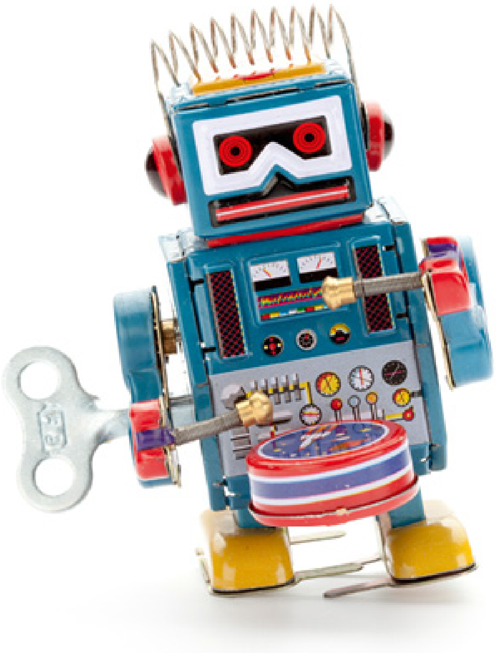
Company wind-ups and TAAR

Is this another wind-up?



KEY POINTS

- The winding-up of a company that had ceased to trade and had substantial reserves and cash leads to questions on whether it is subject to the targeted anti-avoidance rule in ITTOIA 2005, s 396B.
- Would advice to sell rather than liquidate a cash-rich company fall foul of the professional conduct in relation to taxation guidance?
- Parliament clearly stated that ITTOIA 2005, s 396B and s 404A would apply only when a close company was liquidated.
- HMRC chose to combat 'phoenixism' rather than 'money-boxing'.
- The intention of the legislation was clear and approved by parliament.

The question 'Is it a wind up?' in Readers' Forum on 6 July 2017 concerned the professional conduct in relation to taxation guidance (PCRT). In essence, a client owned a company that had (presumably) ceased to trade and had substantial reserves and cash. If it were to be wound up, there was some question as to whether the new targeted anti-avoidance rule (TAAR) at ITTOIA 2005, s 396B would apply. Conversely, if someone were to buy the company, the TAAR would not be in point because it only applies where there is a liquidation. The question largely addressed itself to the PCRT, rather than to the technical efficacy of the planning. Given that it raised issues on which I have strong views, both in terms of that planning and the PCRT itself, I would like to expand on this question.

The new PCRT, effective from 1 March 2017, has a box at 2.29 setting out the standards for tax planning. It states that the arrangements should:

1. be client-specific;
2. be lawful;
3. involve full disclosure and transparency;
4. not be contrary to the clear intention of parliament; and
5. that members must exercise professional judgement and maintain appropriate documentation.

Parliamentary intention

It is the fourth of these that is relevant in the context of the question raised. We are told that ‘members must not create, encourage or promote tax planning arrangements or structures that:

1. set out to achieve results that are contrary to the clear intention of parliament in enacting relevant legislation; and/or
2. are highly artificial or highly contrived and seek to exploit shortcomings within the relevant legislation.’

So, the first question is whether selling a cash-rich company, rather than liquidating it, could be said to be contrary to the clear intention of parliament or artificial or contrived and exploiting shortcomings.

Put simply, I believe the answer is no. In enacting the TAARs in FA 2016, parliament clearly stated that ITTOIA 2005, s396B and s 404A would apply only when a close company was liquidated and would apply to the distributions in that liquidation. Therefore, it seems clear that parliament did *not* intend the rule to apply in some way to the disposal of the shares of a company, rather than the deemed disposal in a liquidation. Nor would I suggest that this was only the intention of HMRC when the legislation was being drafted. This is one of those areas that was sufficiently non-technical such that I think it safe to say that parliamentarians genuinely understood that the legislation was only meant to apply to a liquidation.

So, for once we can genuinely refer to the intention of parliament as not being breached where a company is sold instead of being wound up.

Clear consultation

Furthermore, the intention behind the legislation was made very clear in the December 2015 consultation document *Company Distributions*. Paragraphs 3.7 onwards explain why HMRC was concerned about the tax rules on distributions in a winding-up being exploited and specifically refer to ‘money-boxing’ – the retention of profits in excess of the company’s commercial needs so that the profits can later be realised in capital form – and to ‘phoenixism’, when a new company or entity is set up to replace the old one. However, HMRC chose to deal with only the second of these, as described at 4.14 onwards, alongside some strengthening of the transactions in securities rules.

In other words, while the government was clearly aware that people might accumulate profits in a company with a deliberate view of obtaining a capital return, HMRC chose only to counteract situations where the company was wound up and the individual continued to carry on the same or a similar trade or activity in another company or some other form.

It also explicit, from para 3.4 of the consultation document, that it was not parliament’s intention that a third-party disposal of the shares should be caught by the new rules.

Of course, a rule that has the potential to punish a winding-up is likely to have the behavioural effect of encouraging people to sell their shares to a third party instead. However, a behavioural change, even unforeseen, does not constitute behaviour contrary to the intention of parliament.

Artificial or contrived?

Are such arrangements highly artificial or highly contrived? I suggest not because there is no complexity or contrivance in the simple decision to sell shares to a third party rather than wind-up a company which is, if anything, a more complex procedure.

Just to complete the standards for tax planning, we should look at the other standards.

- Client-specific. We would always expect a decision as to whether to liquidate or sell a company be made by reference to the client’s specific situation. For example, since a sale of a moneybox company will invariably be at a discount to the cash in the company, we must consider the likelihood that the TAAR would apply to a liquidation and not simply encourage a client to sell because it is simpler.
- Lawful. In acting ‘lawfully and with integrity’ a decision as to whether to sell or liquidate must be based on ‘a realistic assessment of the facts’. Given the contents of the consultation document, it is clear that HMRC agrees that a sale of shares to a third party is a capital gains transaction.
- Involve full disclosure and transparency. We would always insist that a client makes full disclosure of the fact that they have sold the shares in the company to a third party, and pay any appropriate capital gains tax.
- Must not be contrary to the clear intention of Parliament.
- Members must exercise professional judgement and maintain appropriate documentation. It goes without saying that, as already implied, proper professional judgment would be applied and appropriate documentation of any

decisions would be retained.

Transaction in securities

We must also consider the transactions in securities rules. These were also strengthened by FA 2016 and, in particular, the distribution of assets on the winding-up of a close company was brought within the scope of the rules. This was after 56 years when they had been specifically excluded from the scope of the transactions in securities legislation.

The effect of this is to create a double level of risk when a company is to be liquidated. If there is any suggestion that the individual shareholder might carry on the same or similar trade or activity in another form, the TAAR could apply and the client would be expected to self-assess an income tax charge on any distributions from the winding-up. However, the transactions in securities rules operate simply to allow HMRC to counteract an income tax advantage arising as a result of a transaction in securities, which would now include the liquidation of a company.

These rules are outside the scope of self-assessment, so if the TAAR applies, no income tax is avoided and the transactions in securities rules cannot apply. But if the TAAR does not apply, the transactions in securities rules might apply if HMRC considers that the decision to liquidate the company is motivated mainly by a desire to obtain an income tax advantage. This would be by receiving proceeds subject to capital gains tax at 10% or 20%, rather than to income tax at up to 38.1%.

Moribund companies

In reality, it is highly likely that any decision to liquidate a moribund company will be based on the tax liabilities that will arise. This means that, arguably, HMRC could invoke the transactions in securities rules for any liquidation of a close company – which may be one of the main reasons that liquidations were originally excluded from the legislation in FA 1960.

Now that liquidations have been included within the scope of these rules, HMRC has nevertheless stated in various public forums that it has no intention of applying the transactions in securities rules to normal commercial windings-up of moribund companies. Nevertheless, some small risk remains and I would certainly advise anyone who is potentially the recipient of a distribution in the winding-up of a close company to apply for pre-transaction clearance from HMRC that no counteraction of any perceived income tax advantage will apply.

In contrast, the transactions in securities rules cannot apply to a genuine third-party sale, which is the direct result of the fundamental change of ownership test at ITA 2007, s 686. Put simply, if an individual sells the shares of his close company to a person who is not an associate of his, the transactions in securities rules cannot apply, even if one of the main motives is to obtain an income tax advantage. There are various definitions of an associate, including various relatives, certain relationships between trustees and settlors of trusts, and relationships between bodies of persons (see ITA 2007, s 681DL). However, it is unlikely that a third-party disposal to a company that is set up specifically to acquire these moneybox companies would be a disposal to an associate.

Once again, if we consider the standards for tax planning, I think the only one that might be of relevance here is that of whether this result is in line with the intention of parliament. And both the structure of the fundamental change of ownership test and its history make it clear that this is, indeed, the intention of parliament. So much so that the first version of the test, introduced in 2010, was amended in 2016, simply because it was deficient in not excluding enough transactions from the scope of the transactions in securities rules.

Conclusion

Taking all the above points into consideration, I consider it perfectly legitimate tax planning to choose to sell a moneybox company to a genuine third party, rather than wind the company up and take the risk that this might be caught by one of the new TAARs or by the transactions in securities rules. I believe that to offer such planning in situations where it is appropriate to the client to accept the discount against cash value, rather than to take the risk of an adverse tax result, complies with the PCRT and is in line with the clearly stated intention of parliament in passing the relevant legislation.

In effect, the changes in FA 2016 introduced substantial uncertainty to any situation where a close company is being liquidated, while the tax results of a direct disposal of shares to a third party not only remain absolutely clear, but that tax result has been strengthened in the case of the fundamental change of ownership test in the transactions in securities rules.

What this means is that, subject to fully understanding the advice himself, or taking a second opinion if necessary, the reader who raised the original query is fully entitled to advise his client that a disposal of the shares might be the better option if there is any doubt as to the treatment of distributions in a winding-up.

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