TAXATION
Your partner in tax law, practice and administration

Published on *Taxation*(https://www.taxation.co.uk)

By: Andrew Hubbard , Pete Miller
02 August 2017

Professional conduct in relation to taxation guidance

All wound-up

KEY POINTS

- Comparison of the alternatives when withdrawing cash reserves from a company.
- The targeted anti-avoidance rule should not apply because there is no liquidation.
- There is an exemption for a fundamental change in ownership in the transactions in securities legislation.
- The vendor is making a clear choice within the scope of the legislation.
- The purchaser is buying a company at arm's length and paying tax on the transaction.
- The emphasis of PCRT is on behaviour and not outcomes.

Pete Miller's article ('Is this another wind-up?') elicited much interest in the *Taxation* office and Pete and I had a long discussion about it afterwards. What follows is a summary of the main points of our conversation. We think that readers will be interested in our thoughts, not only on the technical issues but also because the issue shows how the new professional conduct in relation to taxation (PCRT) guidance has put into sharp focus the considerations that we must consider when we give advice. For the avoidance of doubt what follows are our personal opinions and should not be regarded as an officially sanctioned interpretation of PCRT.

Hubbard: I read your response and agreed completely with your technical analysis. Nevertheless, I have some doubts about the proposed planning, which I hope you can help me assuage. Let's put some figures on this to help put things into perspective.

Assume that the company has ceased trading, has paid off all of its creditors, has no contingent liabilities and is left with £1m in cash. Assume also that there is no base cost and that the disposal would meet all the conditions for entrepreneurs' relief.

The owner could extract the cash by way of dividend and pay £381,000 in income tax, leaving him with £619,000. Clearly, he is unlikely to do that. So he may decide to liquidate the company instead. To make the numbers easy, and ignoring the annual exemption, costs and such like, this would result in a capital gains tax bill of £100,000 and cash of £900,000 in his pocket. If he intended to disappear into the sunset, there should be no risk that the new rules would bite. So presumably he would not be attracted to the idea of selling the company. But perhaps he is worried about the new rules – he might intend to resume similar activity after a break or may want to keep his options open. In that case, he would not want to run the risk of HMRC pursuing him for another £281,000 in tax. So, by selling the company for a discount, he seems to have eliminated his risk.

Let's assume that the purchaser pays £900,000 for the company. Our client would pay £90,000 in tax and would be left with £810,000 in cash. He is worse off by £90,000, but has apparently eliminated all risk so could restart a similar business without the threat of a big tax bill hanging over him.

Now let's look at the purchasing company. It has bought a company with £1m in cash for £900,000. If it liquidates the company it will make a profit of £100,000 on which it will pay corporation tax of, say (depending on the rate at the time), £19,000. So it has made a net profit of £81,000.

In total, therefore, HMRC will have received tax of £109,000 (£90,000 plus £19,000). That is more than would have been paid on a simple liquidation by the original owner and HMRC appears to have benefitted from the transaction. But, viewed another way, it would have lost the opportunity to invoke the TAAR and receive £381,000 in tax. Have not the buyer and seller co-operated (some might even be tempted to say conspired) to deprive HMRC of invoking the TAAR and potentially collecting more revenue?

***Miller*:** I can see where you are coming from but your gut feeling (if I can use that expression) is not relevant. This is not a situation where we are talking about a possible *Ramsay* approach or even the general anti-abuse rule (GAAR). The intention of parliament could not be clearer.

As far as the TAAR is concerned, we are nowhere near it because there is no liquidation. So, the TAAR cannot apply because there is a sale, not a liquidation. This result was very clearly the result intended by parliament.

Nor can the transactions in securities (TIS) legislation apply because of the exemption for a fundamental change in ownership. In introducing this exception in 2010 – and in particular when amending it in 2016 – parliament put it beyond doubt that a disposal that constituted a fundamental change of ownership was not caught by those rules. Thus, there was no risk of re-characterisation as a dividend. If this condition is satisfied, that is the beginning and end of the matter: motive does not come into it. I cannot see any justification, even on the most liberal or purposive interpretation of the legislation, to say that the disposal to the third party was somehow a disposal to an associate and therefore was not a fundamental change in ownership. That test is one of the rare bright line tests in the taxcode.

That seems to me to be a complete answer to your concerns.

***Hubbard*:** Let's explore a couple of issues. First let's look at the purchasing company. It is entering into a transaction to, in substance, buy cash for more than its face value. It knows that it can access that cash and make a post-tax profit. It also knows that the only reason the buyer is prepared to sell cash at a discount is to remove himself from a potential tax liability. We both remember the problems some major firms got into a couple of decades ago when they were caught up in an arrangement under which their clients sold companies that had nothing but a tax liability and the cash to pay it. Those companies had no net value, but the purchaser was prepared to pay real money for them. The new owner then somehow made the tax liability 'disappear' and got hold of the cash. HMRC took a dim view of this and certainly tried to argue that it was cheating the public revenue. They also suggested that the vendors' advisers should have been more sceptical about what the purchasers were going to do to make the liability disappear. The legislation was, of course, amended to stop these sorts of arrangements.

Now clearly what is proposed here is a very long way from those cases, but I think there are some resonances, and I suppose it is those that bother me. Am I right to be worried?

***Miller*:** I do not see the resonance here. I don't think that the situations are at all comparable. My recollection of the cases you refer to is that there was a great deal of mystery about the purchaser's plans and there was a real tax liability in the target company. Here there is no question of any tax liabilities disappearing. Everybody will pay everything that is lawfully due. The vendor is simply making a clear choice within the scope of the legislation. He can liquidate his company and receive £900,000 with a risk of a higher liability if HMRC invokes the TAAR or sells for a lower figure, but eliminates that risk. That is a choice he is entitled to make. The purchaser is buying a company in an arm's-length sale and paying tax on the profit he makes on the transaction. I think that you are worrying unnecessarily.

***Hubbard*:** What about the situation where you know full well that the client intends to start up a similar business almost straight away? If he liquidated his company and then set up a new company the following month to do the same thing he would fall straight into the TAAR. So can it really be right that, by selling to a third-party purchaser which is clearly only buying because it can make a profit by helping the vendor sidestep a potential tax problem, an individual can benefit from a capital gains disposal and start on his merry way again in an identical business?

***Miller*:** What is right or wrong is a matter for parliament and it chose to exercise its authority in a particular way. It deliberately decided not to invoke a law that says, in effect, 'however you get your hands on accumulated profits you are taxed as dividend'. It specified the circumstances in which those profits could be taxed as a dividend and when they could not.

Even more ‘helpful’ in this respect are the contents of the so-called consultation document referred to in my article. HMRC (and, by extension, parliament) was clearly aware that disposal and liquidation were alternative options. And HMRC (in other words, parliament) clearly decided to change the law only for liquidations. So the intention of parliament was not to apply a similar rule to a sale of the shares to a third party.

That really is the beginning and end of the matter.

***Hubbard**:* Let’s look at the PCRT and, in particular, the intentions of parliament. I agree with you completely that parliament decided not to attack money box companies as such, but to limit its attack on phoenixing. Hence the TAAR, with its references to the vendor continuing to carry on the same activity. Parliament clearly wanted to defeat phoenixing involving liquidations. I suppose it is then an open question as to whether its intention was only to defeat phoenixing by liquidation or could it be considered to have intended to stop people taking money out of a company in any capital form and then continue with the same activity? So would a sale of a company in the circumstances which we have been discussing, in the knowledge that the vendor fully intended to start up again in the same business, not be contrary to the intention of parliament.

***Miller**:* That is to look at the test too widely. In my view, PCRT is deliberately drafted in a narrow way. It does not refer to planning as something that parliament might not have liked had it thought about it – it says that it must not be contrary to the *clear* intention of parliament. I think that my article demonstrates that the clear intention of parliament was exactly the opposite, in other words that liquidations are caught and sales are not. There is absolutely no evidence for saying that parliament may have intended, let alone clearly intended, that sales of companies to third parties should be caught by the TAAR or the TIS rules.

I think that this is a point of fundamental importance. I am not a supporter of contrived and artificial schemes and I endorse the use of the PCRT to stop their promotion and implementation. But what we are talking about in this discussion is something fundamentally different. The TIS legislation and the TAAR sets out clearly and unambiguously a set of circumstances in which anti-avoidance legislation applies and a set of circumstances where it does not. The transactions proposed are not contrived and there are no smoke and mirrors.

The tax system has created a situation where it can be in the interest of both the purchaser and vendor to follow a particular route and I see absolutely no problem in advising a client about the advantages and disadvantages of following that route. Of course, as I say in my article, all the other PCRT principles must be followed as well, but I don’t see that any of them would cause a problem here.

***Hubbard**:* Finally, what about the original questioner’s suggestion – which I think was probably made tongue in cheek – about buying companies directly from his clients and cutting out the middle man. Does that work?

***Miller**:* In a very narrow technical sense the analysis is no different to any other third-party purchaser. But, of course, it would be a serious breach of professional conduct to do this. The accountant couldn’t possibly give independent or objective advice to his client about a transaction in which he was a party and where he stood to make a profit. I’m sure our questioner knew that perfectly well and was simply teasing us!

***Hubbard**:* Thanks Pete. You’ve given us plenty of food for thought. If we go back to John Cullinane’s original reply it is useful to be reminded that the emphasis of PCRT is on behaviour and not outcomes. In many ways, this conversation is an example of the thought processes that an adviser must go through to decide whether a piece of advice would create a problem under the PCRT.

In the end, it is the way that an adviser has come to a judgement, and how they document that process that is critical. I suspect that we may arrive at a slightly different conclusion about some aspects of this planning idea, but I don’t see that this means that one of us has not complied with the requirements of the PCRT.

Back to top
Tax Topic Tags: Comment & Analysis [1]

[2] [2]

SourceURL: https://www.taxation.co.uk/Articles/2017-08-01-336773-professional-conduct-relation-taxation-guidance

Links:
[1] https://www.taxation.co.uk/category/content-type/comment-analysis