



# ICAEW REPRESENTATION 31/16

## TAX REPRESENTATION

### Company distributions

ICAEW welcomes the opportunity to comment on the consultation document [Company distributions](#) published by HM Revenue & Customs on 9 December 2015. Specific comments on [draft clauses 16 – 18 Finance Bill 2016](#) are covered separately in ICAEW representation 32/16.

As various stages of the consultation process were omitted before the consultation document and draft legislation were published, and because the legislation will affect a wider group than its target, we consider that it is inappropriate to restrict the consultation to eight weeks. This is contrary to the recommended 12 week period in the government guidance regarding consultations <https://www.gov.uk/government/publications/consultation-principles-guidance>. The proposed changes will impact on many transactions, not just those cited in the consultation document, and lead to unfair outcomes and additional administrative burdens. A proper consultation could help avoid this collateral damage.

This response of 3 February 2016 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

### Contents

	Paragraphs
Major points	
Key point summary	1-3
General comments	4
Responses to specific questions	4-39
Ten Tenets for a Better Tax System	Appendix 1

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ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

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## MAJOR POINTS

### Key point summary

1. We are disappointed at the lack of consultation on this major change which could affect many businesses. This consultation appears to have commenced at stage 3 of the government's policy setting process, alongside the issue of draft legislation.
2. Our members are concerned that the draft legislation is not focussed on its target and will therefore impact many commercial transactions.
3. Furthermore, many of the examples given in the consultation are over simplified and are not comparing like situations.

### General comments

4. While the stated reason for this review is the changes to dividend taxation, as the changes to dividend taxation are driven by the continued desire to reduce the corporation tax rate, the reduction in the corporation tax rate must be the ultimate reason for the review.

## RESPONSES TO SPECIFIC QUESTIONS

**Q1: 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?**

5. Any perceived unfairness is in part due to the policy to encourage investment via lower capital gains tax (CGT) rates. However, any rate advantage from this differential is limited to higher rate and additional rate taxpayers.
6. We take issue with a number of the points made in the consultation document. We are alarmed by the suggestion at paragraph 3.6 that a sale to a third party might be caught by the transactions in securities rules. Why would any sale to a third party fail the motive test?
7. There is also an underlying assumption that reserves are equal to cash. However, a company may be cash rich, but have no distributable reserves. Equally, a company may have no cash, but have distributable reserves. In both cases, the company would be unable to make an income distribution.
8. The consultation document also makes the assumption that a buyer will pay for cash reserves. However, transactions are more likely to take place on a cash free and debt free basis, so vendors will be encouraged to extract cash dividends prior to a sale, where reserves permit.
9. The examples cited in the document are too simple and do not compare like for like eg, a company that continues to trade with a company that has been liquidated (there is no ongoing trade or investment in a liquidated company).
10. The comments above relating to the ability to pay an income distribution apply equally to liquidation cases. Therefore while money boxing is a theoretical possibility it does not follow that it is commonplace. Furthermore, each company will have its own view on its commercial needs for cash based on its ability to raise external finance, which for many is still perceived as too costly.
11. Phoenixism appears to be dealt with by proposed clause 18 and the widening of the transactions in securities rules, although we are concerned about the burdens this will place on many commercial transactions, as set out in response to questions 5 and 6 below.
12. In the experience of our members, the majority of special purpose companies are set up for genuine commercial reasons to ringfence the risks of one project from another. While the use

of a new vehicle for each project might lead to tax advantages, these are incidental. Commercial protection is the main reason for the creation of such structures.

13. HMRC appears nervous of capital reductions following the changes to the capital maintenance rules, as highlighted in the introduction to the consultation. Transactions similar to that described in example 2 of the consultation document have been undertaken for genuine commercial reasons for a number of years and have been granted clearance by HMRC. However, members have also reported cases where a return of capital to investors as described in paragraph 3.11 have not been granted clearance. There is clearly a case for further dialogue in this area to clarify concerns and explain commercial realities.

**Q2: Do you think such issues will be exacerbated by the changes to dividends rules being proposed for April 2016?**

14. Not significantly.

**Q3: 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?**

15. We agree what is proposed will catch some of the desired situations, but are concerned that the impact of new rules could be too wide ranging. We are also alarmed that the consultation document at paragraph 4.8 uses language that merges the two very separate tests at s184(1)(c) and (d), ITA 2007.

**Q4: Do you think these changes will have any unwanted consequences not identified? How might these be mitigated?**

16. We are worried that situations may be caught that should not be. Many small business owners build for their retirement in a way that includes the value built up in their company. These changes introduce a significant additional issue. What cash can a business build up? As highlighted above in response to question 1, each company will have its own view of its needs for cash. If a business is very cash generative is the owner being expected to extract much higher income than they need just to satisfy the new rules? While many will inevitably extract funds to reflect their lifestyle, others may be naturally cautious and will look to build funds in the company "just in case". We think guidance is needed to show where the capital/income divide falls in HMRC's view. Consultation would be sensible before taking this forward.
17. As mentioned in response to question 1 above, dialogue needs to be entered into concerning capital reductions. Paragraph 4.8 is another example where the consultation document talks about capital payments and disposal of shares as if they are an extraction of profits. As a matter of company law, neither is an extraction of profits.

18. Please also see specific comments related to draft clause 16 in ICAEW representation 32/16.

**Q5: 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?**

19. We agree what is proposed will catch some of the situations highlighted in the consultation document, but think the impact of new rules will be too wide ranging.
20. We have provided examples of scenarios that we consider will be unfairly caught by the rules below in response to question 6 and in our specific comments on draft clause 18 in ICAEW representation 32/16.
21. Focussing on just a few years around the liquidation may not be adequate and may mean the law misjudges business circumstances. The rules should be more clearly drafted to focus on abusive behaviour.

- 22.** We are not suggesting any alternatives, but consider that further consultation is required to ensure that the rules are focussed on their target.

**Q6: Do you think that the TAAR will have any unwanted consequences not identified? How might these be mitigated?**

- 23.** The purpose of the TAAR appears to be to reduce phoenixism and the number of special purpose companies created for the purposes of a contract and then liquidated (although as highlighted above in response to question 1, the driver for special purpose companies will be commercial rather than tax driven).
- 24.** Unfortunately, the TAAR is not focussed on this target and therefore will need to be considered in a wide range of circumstances.
- 25.** For example, a corporate business disposal to an unconnected third party could be structured as a share disposal or a sale of trade and assets. A purchaser may be more inclined to purchase the trade and assets of the company rather than the shares from a commercial perspective in order to avoid any unexpected liabilities. Following the sale of the trade and assets, the company is wound up. This means that the TAAR will need to be considered. If the sale had been structured as a share sale, it would not have applied.
- 26.** Many small businesses, in our experience, are wound up (and/or sold) with the (former) owner then working for the successor or carrying on consultancy in a small way after the liquidation of the business. For example a chartered accountant may sell their business then wind up their company, extracting the cash value of the sale, as part of their retirement planning, but then continue in a consultancy role with the purchaser, or even carry on a small lower key operation with just a handful of clients or work to have some activity into retirement.
- 27.** For those that wish to continue working into retirement on a smaller scale, it would be useful to exclude activities that are small or insubstantial in comparison to the activities of the company. The comparison could be made at the time of the distribution or at any time in the previous two years (to allow for the fact that the business may have been in decline prior to sale).
- 28.** There should also be a test that considers whether the former owner has any ongoing rights to profits from the trade or activity. This would deal with the otherwise absurd situation created by proposed s396B(3)(b) and s404(3)(b), ITTOIA 2005, that relatives that happen to carry on the same type of business activity through another company (perhaps because there is a family tradition in the business), could be caught. If the trade or activity was not in a company, then it would not be caught, which seems strange.
- 29.** A test that considers ongoing rights to profits from the trade or activity should also be framed in such a way that would permit employment in a consultancy capacity following a business sale.
- 30.** A family may have more than one company active in a business area and may decide to cease one. This is another situation which becomes less certain under the changes proposed. It should be clear that re-investing income and then releasing it towards the end of the life of a business is acceptable.
- 31.** We found the overlap between the proposed TAAR and the amendments to the TIS rules hard to define, but in any event think in particular that the new TAAR should have a clearance procedure that can be used in advance of a potentially relevant transaction being carried out, this will enable a subjective assessment to be made and assist small businesses, many of whom like certainty and comfort before proceeding.
- 32.** It is envisaged that there will be significant contention over whether the trade or activities are the “same as, or similar to” those carried out by the company that has been wound up. Clear statutory provisions would be better than guidance.

- 33.** Condition C (proposed s396B(4) and s404A(4)) would appear to catch every distribution on a winding up because realistically everything could be distributed in advance as a dividend. Is this intentional? In the absence of being able to target the legislation better, will HMRC provide guidance on this?
- 34.** As set out in paragraph 25, above, a corporate business disposal to an unconnected third party could be structured as a share disposal or a sale of trade and assets. With the introduction of the TAAR, it is conceivable that there will be a growth in share sales to unconnected investors (perhaps overseas), who then subsequently liquidate the companies.
- 35.** Please also see specific comments related to draft clause 18 in ICAEW representation 32/16.

**Q7: 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?**

- 36.** The consultation alludes to the fact that HMRC has concerns that the current purchase of own shares rules could be open to abuse. Our members do not agree and consider these rules, together with the transaction in securities rules, to be working well and sufficient to prevent abuse.
- 37.** Furthermore, the consultation mentions the close company apportionment rules. We do not perceive any benefit from the reintroduction of such rules as they will be complex to administer and unfair in their application.

**Q8: Are there any particular areas of the wider distributions regime that cause difficulties or complexities? If so, which areas?**

- 38.** The one area that members have commented that could benefit from a review is the exempt distributions regime at Chapter 5, Part 23, CTA 2010.

**Q9: 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?**

- 39.** Yes, this area should be subject to further review and dialogue as further complications are inevitable as a result of the changes.

## APPENDIX 1

### ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see via <http://www.icaew.com/en/about-icaew/what-we-do/technical-releases/tax>).