# ICAEW REPRESENTATION 96/16

# TAX REPRESENTATION

## FINANCE BILL 2016: CLAUSE 35: DISTRIBUTIONS ON A WINDING UP

**Briefing for the Public Bill Committee debates on Finance Bill 2016**
**submitted on 27 June 2016 by ICAEW Tax Faculty**

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Internationally recognised as a source of expertise, ICAEW Tax 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.

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# PUBLIC BILL COMMITTEE BRIEFING

## Distributions on a winding up (clause 35)

- **Measure:** Clause 35 of Finance Bill 2016 introduces a new targeted anti-avoidance rule (TAAR) in respect of certain distributions on a winding up made on or after 6 April 2016.

  The clause introduces new sections 396B and 404A into the Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005).

  Where certain conditions are met, the distribution from a company winding up will be treated as an income distribution, and therefore subject to income tax rather than capital gains tax (CGT).

  This is to tackle scenarios where a number of taxpayers could exploit the current rules by dissolving their company in order to extract value and be liable to CGT rather than income tax, perhaps several times in succession.

  This TAAR has been introduced to ensure the tax payable on a distribution better reflects the nature of the payment to the shareholder. However we are concerned that the scope of the TAAR is wider than originally intended and will negatively impact many genuine commercial transactions.

  Example

  We have already been provided with the practical example of a funeral director who sold his family business two years ago, paying capital gains tax on the distributions made during the winding up of his company. It is usual for the purchaser to want to buy the business 'clean' and so will not also buy the old corporate wrapper. This individual has recently handled a few local funerals in his own village to supplement his retirement pension. This activity will clearly be within Condition C of the new s396B (see below) which will mean that the individual would have to rely on the activity not breaching Condition D. This is likely to be much harder to demonstrate given that one of the purposes of the winding up would have been the avoidance or a reduction in a charge to income tax. Thus, his earlier CGT treatment could be in jeopardy meaning that he should have stayed fully retired.

  HMRC's reassurance through published guidance that he is not caught, does not give the certainty needed where the law could be interpreted otherwise.

- **Our concerns**: In earlier representations, we highlighted this problem which is acknowledged in HMRC's Summary of Responses document published on 24 March 2016. Paragraph 2.50 states that it "would still expect the vast majority of distributions from a winding up to be treated as capital (as it currently the case)." While this is welcome, this expectation should be reflected in the legislation to give the necessary certainty rather than leaving taxpayers having to reply on non-statutory guidance from HMRC.

  Condition C (new section 396B(4)) states that the person who receives the distribution may be caught if at any time in the two years following the receipt, they are involved with the carrying on of a trade or activity that is similar to that of the trade or activity carried on by the company wound up. There are a number of uncertainties within this clause which we consider below:

  - We believe the phrase "involved in" is unclear and would request this is more clearly defined. Would, for example, a father who winds up his company, be penalised if he later offered some business advice to his son who carried on a similar trade?

- The term “similar” and “activity” must also be defined. We are concerned that individuals will be penalised for setting up businesses in the future that may offer services which represented only a small part of the previous company’s trade (e.g. a company that had an accountancy practice is liquidated and an ex-shareholder who was the tax ‘partner’ decides to continue to offer tax advice)

- How far back should the period be over which the company’s trade should be considered. For example, would the activities that the company carried on some years previously, or only those activities carried on just before the winding up? We wonder whether inserting a two-year period prior to the commencement of the winding up would be a sensible legislative solution?

Condition D (new section 396B (5) and (6)) states that it is reasonable to assume that the winding up forms part of arrangements designed to reduce the person’s income tax liability. Virtually all distributions on a winding up will result in a reduced tax liability, so there is great concern that this will mean many individuals are caught out by the anti-avoidance rules. We have seen comments from HMRC that sections 396B(6) and 404A(6) ITTOIA 2005 mean that Conditions C and D must be considered together, so that Condition D is only satisfied if the income tax advantage is linked to the continuation of the company’s activities. But the provisions are not clear in this respect and the intended linkage between them needs to be clarified.

**Clearances**

We understand that HMRC does not intend to introduce a clearance facility for these TAAR provisions. However, we also note that any distributions to which these new rules might apply will also be transactions in securities, as defined in s 684(2)(f), Income Tax Act 2007 (ITA 2007). Most of our members will be likely to apply for formal legislative clearances wherever these are available. This means that they will have to apply for clearances under s 701, ITA 2007 before every distribution during the winding up of a company. They will not be able to rely on published HMRC guidance, as this does not have the force of law and can be changed at any time. This suggests that, no matter how robust HMRC’s guidance, the number of clearance applications under s 701, ITA 2007 is likely to increase significantly as a result of the Finance Act 2016 changes.

## Our recommendations

### Condition C

We suggest that the phrases “involved in”, “similar” and “activity” contained within Condition C are clearly defined for the avoidance of doubt.
When considering if a similar activity is being carried on in the two years after the winding up of the company, we propose the government introduces a maximum period in which to look back at the activities of the former company. We suggest a period of two years prior to the commencement of the winding up. We would also welcome the introduction of a de-minimis whereby if a similar new trade or activity is carried on, it will not satisfy Condition C if it is not substantial when compared to the trade formerly carried on.

### Condition D

We suggest that the legislation be amended to say that for Condition D it is reasonable to assume, having regard to all the circumstances, that Condition C has been fulfilled (as its main purpose or one of its main purposes) in order to avoid or obtain a reduction of a charge to income tax. Subsection 6 is then omitted in each case.

## Clearances

We suggest the government implement, as a matter of practice. that any formal clearance obtained under s701, ITA 2007 will also be treated as satisfying the TAAR.

## FURTHER INFORMATION

As part of our Royal Charter, we have a duty to inform policy in the public interest.
ICAEW offers impartial expert briefing on the Budget, the Finance Bill and ad hoc policy issues for MPs, Peers and parliamentary staff.

To request further information or a briefing from one of our Tax Faculty experts, please contact:
Vincent Paulger, Public Affairs Executive vincent.paulger@icaew.com or 020 7920 8739.

# 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).