



Association of Accounting Technicians response to Company distributions

1. Introduction

- 1.1. The Association of Accounting Technicians (AAT) is pleased to have the opportunity to respond to the consultation document “Company distributions” published on 9 December 2015 (condoc).
- 1.2. AAT is submitting this response on behalf of our membership and from the wider public benefit of achieving sound and effective administration of taxes.
- 1.3. AAT has added comment in order to add value or highlight aspects that need to be considered further.
- 1.4. AAT has focussed on the operational elements of the proposals and has provided opinion on the practicalities in implementing the measures outlined.
- 1.5. Furthermore, the comments reflect the potential impact that the proposed changes would have on close companies, many of which employ AAT members or would be represented by our operationally skilled members in practice.

2. Executive summary

- 2.1. The government is concerned that the current distributions rules may be used to secure a capital return in circumstances where that may not be justified and that the changes from April 2016 to the way in which dividends are taxed may provide an increased incentive. The government has been considering the potential scope for this (‘Getting to this stage’, page 2 condoc).
- 2.2. This consultation concerns the tax rules governing distributions by a company (but not distributions received by companies) and whether they can be improved in order to reduce imbalances in the tax system.
- 2.3. The scope covers the specific changes put forward in the draft legislation to Finance Bill 2016, and discussed in paragraphs 3.24 to 3.28 and 3.32 (below), planned to take effect from 6 April 2016 and the distributions rules in general, designed to prevent tax advantages being obtained from specific types of behaviour. The proposed legislation would:
 - amend the Transactions in Securities legislation, which is designed to prevent unfair tax advantages in certain circumstances. The amendments would strengthen these rules, and clarify certain areas; and
 - introduce a new Targeted Anti-Avoidance Rule (TAAR) which would prevent some distributions in a winding-up being taxed as capital, where certain conditions are met and there is an intention to gain a tax advantage.
- 2.4. As explained in paragraph 3.16 (below) it is AAT’s view that the document does not give sufficient indication as to the extent of ‘active tax planning’ for action “to counter imbalances and reduce avoidance” to justify a fundamental change in legislation or to justify government concerns that there may be an increased incentive from April 2016 when changes are made to the way in which dividends are taxed to withdraw money from a company as capital rather than as income for which the current Transaction in

Securities rules may not provide adequate counteraction. The exception to this is phoenixism¹ which paragraphs 3.3 and 3.4 (below) outline.

- 2.5. AAT sets out in paragraph 3.32 (below) reasons for considering how the new proposed TAAR will enable HMRC to challenge this.
- 2.6. In paragraph 3.4 (below) AAT expresses concern at the practice of a small number of advisers who market advice on how to exploit the legislation regarding distributions in a winding-up by way of phoenixism.
- 2.7. AAT explains in paragraph 3.7 (below) considerations as to why taxation is not the main reason for company formation.
- 2.8. AAT explains in paragraphs 3.24 to 3.28 (below) considerations why the proposed new legislation in Finance Bill 2016 will strengthen current legislation in preventing the conversion of income to capital.
- 2.9. In paragraph 3.28 (below) AAT supports HMRC's proposals to modernise and align the counteraction process more closely with the process for compliance checks under self-assessment, apart from the fact explained in paragraph 3.29 (below) that alignment should also extend to time limits.
- 2.10. AAT expresses caution in paragraph 3.36 (below) in respect of the possibility of a reintroduction of a form of "close company apportionment" legislation.
- 2.11. In paragraph 3.41 (below) AAT has expressed interest in participating in a broader consultation on the distributions regime as a whole.

3. AAT response to the consultation paper "Company distributions"

Question 1. 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?

- 3.1. AAT agrees that in certain circumstances, for example as a result of phoenixism (see also para 3.2 & 3.3, below), a shareholder can receive value from a company in such a way that is taxed as a capital receipt rather than income, which can lead to unfair outcomes.
- 3.2. AAT considers the practice of phoenixism to be repugnant for the reasons expressed in paragraphs 3.3 and 3.4 (below), where a company enters into a members' voluntary liquidation only to set up a new company to carry on the same activities. In such a scenario the shareholder(s) receives all of the value of the company in a capital form while the trade continues, albeit via a new company, exactly as before.
- 3.3. AAT is concerned that creditors can lose heavily in insolvent winding up through phoenixism. Although companies subjected to such a process are by definition solvent, small creditors may not be aware of the process of lodging claims with the liquidator and as a result they might lose financially.
- 3.4. In particular, AAT finds the practice of a number of advisers who market advice on how to exploit the legislation regarding distributions in a winding-up by way of phoenixism (4.14, condoc) to be wholly unacceptable.
- 3.5. However, AAT considers the outlook of the condoc to be too narrow. In particular, it does not consider the wider reasons for the existence of a company, for example 2.1

¹ <http://www.hmrc.gov.uk/manuals/nimmanual/nim12204.htm>

(condoc) gives a simplistic comparison with distributions to company shareholders with other forms of trading. "This is different from how people are taxed where they conduct their trade as a sole trader or in partnership."

- 3.6. Often a large organisation will not trade with a person outside a company structure and AAT MIPs have anecdotal experience of where banks will not lend to unincorporated customers.
- 3.7. AAT does not consider that taxation is the main reason for company formation. In fact at a joint OTS/AAT event² members listed three reasons for incorporation, as follows:
 - 3.7.1. Limitation of liability
 - 3.7.2. Credibility
 - 3.7.3. In order to gain contracts that would not otherwise be available
- 3.8. At the same meeting members acknowledged that as soon as the decision to incorporate was taken, shareholders/officers of the companies concerned stated that they were aware of the significant tax savings that were available. Nevertheless tax was a close secondary consideration. Companies were predominantly formed for other reasons, as above (see 3.7), and in order for there to be a separation of the founders from the company, in order to develop and grow a business, and as an aid to succession and continuity.
- 3.9. Apart from phoenixism (3.1 to 3.4, above), Part 3 of the condoc "Current issues with company distributions" looks at four ways in which a shareholder can receive value from a company that is in a form subject to Capital Gains Tax (CGT):
 - 3.9.1. a disposal of shares to a third party
 - 3.9.2. a distribution made in a winding up,
 - 3.9.3. a repayment of share capital
 - 3.9.4. a purchase of own shares

AAT considers below at 3.10 to 3.16 whether or not the extent to which any of the four ways can result in an unfair outcome(s).

- 3.10. A disposal of shares to a third party (3.4, condoc) is described as the most common way an individual can realise a capital gain on their holdings. For example, where a shareholder sells his or her shares to a new investor or retires. It is conceded at 3.5 (condoc) that "provided that the disposal is not contrived.....this.....is usually an appropriate time for a shareholder to receive a capital return on their shares." The transactions in Securities rules enable HMRC to proceed against contrived arrangements.
- 3.11. AAT does not consider that the winding up of a company, apart from the contrived circumstances outlined in paragraph 3.3 (above), will generally lead to unfair outcomes because usually a company is set up with a long term view.
- 3.12. AAT would point out that prior to 1 March 2012, shareholders were able to invoke HMRC extra statutory concession C16³ to withdraw capital from their company in a winding up without the cost of a formal liquidation. However from that date this facility is limited to £25,000 on the statutory basis⁴. Since 1 March 2012 where shareholders wish to wind up their company and the distributable reserves exceed £25,000 they must now incur the costs of a formal liquidation in order to have the resultant distribution treated as capital in nature.

² AAT/OTS Autumn event at Grange City Hotel on 26 Nov 2015

³ ESC C16 allowed distributions to be treated as if they had been made in the course of a winding-up when the company declared its intention to seek striking off and dissolution, subject to HMRC clearance.

⁴ Section 1030A Corporation tax Act 2010

- 3.13. AAT does not consider that shareholders, generally seek to wind up their company in the manner set out in 3.12 (above) except after many years of trading and we do not consider that this would be an example of an unfair outcome in terms of tax as addressed by question 1.
- 3.14. AAT supports the view expressed in 3.11 (condoc) that “the government is satisfied that this is the correct position” that a repayment of share capital involves the company merely returning to the shareholder what the shareholder originally paid in and should not involve an income tax charge. However, an apparent elaborate avoidance scheme is outlined in 3.13 (condoc) where, by creating a holding company and a share for share exchange, new capital can be created in a reconstruction that does not require shareholders to invest fresh capital. AAT agrees that this is capable of counteraction by Clause 16 which introduces new legislation in Section 685(7B) to ITA 2007. The provision is that the assets of a company that are available for distribution include assets which can be distributed to the company by a subsidiary under the company’s control.
- 3.15. AAT notes that the government would like to retain the rules governing the Purchase of Own Shares which allow a shareholder to exit a company, where that exit carries a benefit to the trade shareholders, although “government is concerned that the current tests might be exploited in the future when incentives to convert income to capital are increased.” (3.17, condoc).
- 3.16. AAT further notes the HMRC statement in para 4.1 (condoc) that they “have seen examples of the behaviours discussed in this document, and examples of active tax planning in areas it believes lead to unfair outcomes.” However, AAT considers that it would have helped respondents if the condoc had given an indication as to the extent of ‘active tax planning’ for action “to counter these imbalances and reduce avoidance” to justify a fundamental change in legislation.

Question 2. Do you think such issues will be exacerbated by the changes to dividends rules being proposed for April 2016?

- 3.17. AAT does not consider that the changes to the dividend rules proposed for April 2016 outlined will exacerbate any of the issues outlined in Part 3 of the condoc.
- 3.18. AAT acknowledges that the proposed changes will lead to the consideration of dividend planning by shareholders in order to extract funds from their companies in an efficient manner. However, AAT’s view is that this will not necessarily increase the amount of active planning that leads to unfair outcomes.
- 3.19. For the reasons in 3.20 and 3.21 (below), AAT does not share government concern that “the attractiveness of the lower rates of GCT (and the 10% relief for those who qualify for Entrepreneurs Relief) may encourage individuals to structure their affairs mainly to benefit from lower tax rates” (2.6, condoc).
- 3.20. AAT notes that the condoc does not appear to cover the fact that from 2008/9 until 2010/11 the higher rate band of CGT was only 18% which would have increased the incentive to convert income to capital. Furthermore, the document does not provide evidence of conversion to capital within this period.
- 3.21. As mentioned in 3.19 (above), AAT does not share the view set out in para 2.5 (condoc) that Entrepreneurs’ Relief might be a contributory factor to “encourage individuals to structure their affairs mainly to benefit from lower tax rates. AAT would point out that Entrepreneurs relief has been available from 6 April 2008 and that it was, in fact, recently restricted by the Finance Act 2015. The relief is available not only on disposal of shares but a disposal of the whole or part of a business, which may have taken years to build up, carried on by an individual alone or in partnership.

Question 3. 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?

- 3.22. In responding to question 3, AAT notes that the rules on Transaction in Securities were fundamentally changed in Schedule 12 of the Finance Act 2010 in order to effectively target arrangements involving tax avoidance.
- 3.23. AAT agrees that the changes to the Transaction in Securities rules, as proposed in the Finance Bill 2016, will be effective in terms of preventing the conversion of income to capital with regard to the concerns outlined 4.7 (condoc) for the reasons given in paragraphs 3.22 et seq. (above).
- 3.24. The proposed Finance Bill 2016 Clause 16 widens the Transactions in Securities rules in Section 684(1) ITA 2007 in order to counter the concern “where a person is a party to a transaction in securities” (4.7, condoc). The measure targets a tax advantage obtained by any person, not just the person who is a party to the transaction and amends section 687 ITA 2007 to include an associate, that is a connected person, to ensure that the legislation cannot be simply avoided by obtaining an advantage on someone else’s behalf or by exploiting family or other relationships, including those with trusts and companies.
- 3.25. AAT agrees that Clause 16 will achieve the government’s objective in strengthening HMRC’s ability to challenge “some people who are intent on exploiting the rules” (4.9, condoc). The measure extends the definition of transactions to include a distribution in respect of securities in a winding up and clarifies that a repayment of share capital or share premium is a transaction in securities.
- 3.26. A concern of government is that income tax may be avoided where capital is dispersed across a group. New section 685 (7B) provides that the assets of a company are available for distribution where held by a subsidiary.
- 3.27. AAT agrees that Clause 16 will achieve the government’s objective to “more clearly define the fundamental change in ownership” (4.12, condoc). The measure changes the way that the ‘fundamental change of ownership’ applies, considering the interests which the original shareholders of the company still hold after the transaction, rather than the new ownership structure.
- 3.28. AAT agrees with the proposals to modernise the way in which interventions are conducted to align the counteraction process in Part 13 Income Tax Act 2007 as set out in clause 17 Finance Bill more closely with the process for compliance checks under self-assessment.

Question 4. Do you think these changes will have any unwanted consequences not identified? How might these be mitigated?

- 3.29. AAT considers that the point identified in paragraphs 3.30 (below) introduces anomalies in to the purpose set out in para 4.12 (condoc) to “change the procedural rules for counteraction so that they operate in a similar fashion to the Self Assessment compliance rules”.
- 3.30. AAT considers that the time limit for the Notice of Enquiry under S695 ITA 2007 (as amended by Clause 17 Finance Bill 2016) should align with the time limit under Section 9A TMA 1970 for the enquiry into a return, that is the period of twelve months after the filing date as opposed to the period of six years proposed in Clause 17.
- 3.31. AAT also considers that the time limit for an assessment made in accordance with a counteraction notice should align with the time limits for making assessments as enacted in Schedule 39 Finance Act 2008.

Question 5. 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?

- 3.32. AAT agrees that the introduction of the new TAAR, as proposed by Clause 18 Finance Bill 2016, will be effective in counteracting phoenixism by targeting a person(s) who becomes involved in a similar trade or activity, either directly or through another company, within two years of the winding up of the earlier company.
- 3.33. However, AAT envisages that there may well be unwanted consequences, which AAT is not now in a position to identify, where for good commercial reasons a company is wound up and a successor company formed to carry on a similar trade or activity within the following two years.
- 3.34. AAT considers that there might be instances of valid commercial reasons for the winding up of one company and then within a period of under two years a new company being formed in order to commence. AAT suggests that Clause 18 should be modified to enable shareholders in such circumstances to outline the commercial reasons for the setting up of the successor company.

Question 7. 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?

- 3.35. AAT concludes from the considerations in Part 5 'Income to Capital Conversions' that the government has thought through the possibility of making further changes to address the conversion of income to capital, including those mentioned in 5.2 (conduc):
- Amending the parts of the existing distributions legislation that deal with income and capital
 - Re-introducing some form of the close company apportionment legislation, which dealt with similar issues.
- 3.36. AAT notes the following extract from HMRC Company Taxation Manual⁵. "The close investment-holding company (CIC) legislation in CTA2010/S34⁶ was introduced to "discourage people from putting their investments into a company to avoid the higher rates of IT" and "replaced the close company 'apportionment' provisions for accounting periods beginning on or after 1 April 1989. The 'apportionment' provisions were labyrinthine and were abolished by FA89/S103".
- 3.37. CTM 60705 continues to say "the main effects of the provisions are:
- a CIC is not entitled to the starting or lower rate of CT or to claim marginal small companies relief.
 - where a person received a distribution from a CIC, made before 6 April 1999, the payment of tax credit in respect of that distribution was restricted."
- 3.38. AAT notes that there is now only one rate of CT and that tax credits will be withdrawn, albeit with a dividend allowance on the first £5,000, above which rates will be higher than pre 2016.

⁵ [CTM 60705 - the introduction to Close Investment Holding Companies](#)

⁶ formerly ICTA88/S13A

Question 8. Are there any particular areas of the wider distributions regime that cause difficulties or complexities? If so, which areas?

- 3.39. AAT has identified in paragraph 3.36 (above) the difficulties and complexities of resurrecting the apportionment legislation which we do not recommend not only due to its labyrinthine complexity but also the heavy staff resource requirements this legislation would incur from both agents and HMRC at a time of departmental savings.

Question 9. 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?

- 3.40. AAT considers that there would be a value in extending this consultation to consider the regime as a whole, after the changes proposed for April 2016, and AAT would like to see evidence of the more general practice of converting income to capital for tax purposes.
- 3.41. AAT supports interest expressed in para 5.6 (conduc) “in whether a broader consultation on the regime as a whole might be justified,....to consider all of the rules, but particularly key terms that are known to have caused difficulty in the past (such as ‘principal secured’ and ‘to any extent dependent on the results of the business’). It could also consider whether there is an alternative way to approach the rules, for example by introducing a more ‘principles-based’ set of rules supported by specific definitions and Targeted Anti-Avoidance Rules where required.” Furthermore, AAT would welcome the opportunity to engage with such consultation opportunity should it arise.

4. Conclusion

- 4.1. Paragraph 3.16 (above) sets out why AAT does not consider that the conduc gives sufficient indication as to the extent of ‘active tax planning’ for action “to counter imbalances and reduce avoidance” to justify a fundamental change in legislation or to justify their concern that there may be an increased incentive from April 2016 when changes are made to the way in which dividends are taxed to withdraw money from a company as capital rather than as income for which the current Transaction in Securities rules may not provide adequate counteraction. The exception to this is phoenixism which paragraphs 3.3 and 3.4 (above) explain.
- 4.2. In paragraph 3.4 (above) AAT expressed concern in respect of the practice by a small number of advisers who market advice on how to exploit the current legislation regarding distributions in a winding-up by way of phoenixism.
- 4.3. Paragraph 3.32 (above) sets out why AAT considers that the new proposed TAAR will enable HMRC to challenge this.
- 4.4. Paragraph 3.7 (above) explains AAT considerations as to why taxation is not the main reason for company formation.
- 4.5. Paragraphs 3.24 to 3.28 (above) states why AAT considers that the proposed new legislation will strengthen current legislation in preventing the conversion of income to capital.
- 4.6. Paragraph 3.28 (above) agrees with and supports HMRC’s proposals to modernise and align the counteraction process more closely with the process for compliance checks under self-assessment. However, paragraph 3.29 (above) explains that AAT considers alignment should also extend to time limits.
- 4.7. In paragraph 3.36 (above) AAT urges caution in respect of the possible reintroduction ‘of some form of the close company apportionment legislation’.
- 4.8. In paragraph 3.41 (above) AAT expressed interest in becoming involved in a broader consultation on the distributions regime as a whole.

5. About AAT

- 5.1. AAT is a professional accountancy body with over 49,700 full and fellow members⁷ and 85,500 student and affiliate members worldwide. Of the full and fellow members, there are over 4,200 members in practice who provide accountancy and taxation services to individuals, not-for-profit organisations and the full range of business types.
- 5.2. AAT is a registered charity whose objectives are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

6. Further information

If you have any questions or would like to discuss any of the points in more detail then please contact AAT at:

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⁷ Figures correct as at 31 Dec 2015