

Spotlight 47

(Lecture P1149 – 13.21 minutes)

HMRC published Spotlight 47 on 4 February 2019. This document provides information about schemes which 'try to avoid an income tax charge on distributions when winding up a company'.

More recently, the CIOT and the Tax Faculty have met with HMRC to discuss Spotlight 47 with a view to having a better understanding of HMRC's official position on the relevant legislation which can be found in S396B ITTOIA 2005 (as inserted by S35 FA 2016). This contains a targeted anti-avoidance rule (TAAR) which treats distributions made on or after 6 April 2016 to an individual in respect of share capital on the winding up of a UK-resident company as income (as opposed to capital), but only where the four conditions specified in S396B(2) – (5) ITTOIA 2005 are met.

The CIOT have previously commented that the FA 2016 legislation is very widely drafted and, as a result, there has been considerable uncertainty over when, or if, it can apply. Unfortunately, the guidance which HMRC produced in July 2017 (and updated 12 months later) is far too brief and lacks practical case studies – as evidence of this, see Paras CTM36300 – CTM36350 of the Company Taxation Manual.

The purpose of the TAAR is to prevent income tax avoidance when someone winds up a company and it was introduced principally to tackle what is known as 'phoenixism'. This term describes the situation where a company goes into liquidation and a new company is then set up to replace the old one, with the purpose of carrying on the same, or virtually the same, trade or business as before. The shareholder receives the value of his company in a capital form, while the trade or business continues, albeit now in the new company. Typically, there is no commercial rationale behind these arrangements.

Spotlight 47 goes on to explain that HMRC have become aware of phoenixism schemes which claim that the TAAR does not apply because the parties involved have made 'an artificial modification of the arrangements aimed at defeating the intention of the legislation (by selling the company to a third party rather than winding it up)'. HMRC assert that these schemes are within the scope and purpose of the FA 2016 legislation and that therefore the TAAR does apply to them. They have also confirmed that they will consider using the GAAR regime, if necessary.

During the meeting referred to above, HMRC said that they had seen a change in taxpayer behaviour since the introduction of the TAAR and that this is what had prompted them to issue Spotlight 47. Clearance applications, which are not of course relevant for S396B ITTOIA 2005, seemingly showed increasing numbers of instances where individuals were selling off companies rather than liquidating them, in an apparent attempt to sidestep the rigours of the TAAR.

Looking at two extremes:

1. If an individual wanted to stop running his business, sold the company which operated that business to an independent third party as a going concern and had no intention of working in that area again, it is pretty clear that the TAAR would not be in point.
2. However, if the businessman simply wanted to liquidate that business and start afresh doing something similar, it is likely that HMRC would apply the TAAR. Attempting to avoid this outcome by disposing of the company's assets and liabilities, effectively turning it into a money-box company, and then selling this to a third party who immediately winds it up and uses the proceeds to pay the vendor would almost certainly lead to HMRC invoking the TAAR. Even if a tribunal subsequently ruled that the TAAR did not apply in these circumstances, HMRC have stated that they would not hesitate to use the GAAR, given that the TAAR was being deliberately avoided. Although not specifically mentioned, it seems probable that HMRC would still have recourse to the TAAR if the money-box company was not liquidated by the buyer but kept instead as a dormant subsidiary.

Between the extremes of the above two examples, HMRC indicated that the result of any case would depend on its particular facts, but the CIOT understood that HMRC's position, in essence, was that selling shares in a company as an alternative to winding it up would not decrease their chances of invoking the TAAR.

The CIOT concluded their summary of the meeting with these words:

'HMRC acknowledged that the scope of anti-abuse rules can lead to uncertainties and that ultimately addressing them is a matter for the Courts. But they take the view that the chargeable gains treatment of disposals of shares is in general confined to straightforward sales and company liquidation distributions untrammelled by tax considerations. It follows that they will seek to apply anti-abuse rules in situations where the purpose of the legislation appears to be being circumvented and there is evidence that this is being achieved deliberately through what HMRC consider to be artificial means.'

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