

HMRC guidance on S396B ITTOIA 2005

(Lecture P1102 – 15.04 minutes)

S396B ITTOIA 2005 introduced a targeted anti-avoidance rule (TAAR) with effect from 6 April 2016. It applies to certain distributions made by individuals on the winding up of a company.

Briefly, the section states that, if four conditions (known as Condition A, Condition B, Condition C and Condition D) are met, a distribution on a winding up will be treated as an income distribution. It will not be treated as capital, which would normally represent a more favourable tax outcome.

The TAAR is aimed at 'phoenixism', i.e. the practice where a profitable company deliberately enters into a members' voluntary liquidation and a new business is set up to replace the old one and to carry on the same (or substantially the same) activities.

The four conditions are:

Condition A: The individual receiving the distribution in respect of a winding up must hold an interest in the company of at least 5% – this is determined by reference to both ordinary share capital and voting rights;

Condition B: The company must be either a close company when it is wound up or have been a close company at some point in the two years prior to the start of the winding up.

Condition C: Within a period of two years following the date on which the distribution was made, the individual is involved in a similar trade or activity. For this purpose, he may carry on the new trade or activity in his own name, through a partnership, through a company in which he has at least a 5% interest or through a person with whom he is connected (working as an employee for a spouse or some other connected person will meet this condition).

Condition D: It is reasonable to assume, having regard to all the circumstances, that the main purpose (or one of the main purposes) of the arrangements is the avoidance or reduction of an income tax liability.

In July 2017, HMRC published what many people regard as somewhat unsatisfactory guidance, using a variety of examples to demonstrate the type of transactions to which the TAAR should and should not apply. The relevant details can be found in Paras CTM36300 – CTM36350 of the Company Taxation Manual. Recently, they have updated this guidance, with particular reference to the 'main purpose' test in Condition D.

The updated guidance, which appeared on 25 July 2018, confirms the following points:

- A decision not to make an income distribution prior to the company's winding up does not, of itself, mean that Condition D has been met.
- If the recipient of the distribution is confident that there will be enough supporting evidence for an HMRC officer to arrive at a sound conclusion that Condition D was not met, the individual should self-assess on that basis, in which

case HMRC can only displace this argument where the individual's decision was not a reasonable one.

- It is less likely that Condition D will be met if the individual remains involved with the carrying on of the trade or activity as an employee (as opposed to being an owner, shareholder or partner) and has no influence over the business' direction or decision-making.

It is a pity that HMRC have not also used this updating opportunity to improve the practicality and relevance of the examples that they have provided.

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