

CHAPTER 36

INFORMAL WINDING UP

36.1 Introduction

A distribution by a company is strictly an income distribution under CTA 2010, s.1000.

Where however, a company makes a **distribution followed by an application to be struck off** under s.1003 Companies Act 2006, the distribution can be **treated as capital** under ESC C16.

This treatment will apply providing certain conditions are met.

In the previous chapter we saw that the capital treatment could also be obtained by **liquidating** the company, but this is **unnecessarily expensive** where the company is in a solvent position.

The **tax payable on a capital distribution will be significantly less** than that on an income distribution where the shareholder is a higher rate taxpayer.

Illustration 1

Mr and Mrs Blue own equal shares in Blue Limited, a trading company they set up in 1995.

During July 2010 Mr and Mrs Blue decided to retire and wanted to distribute the company's post tax cash reserves of £900,000 in the most tax efficient manner.

Mr and Mrs Blue are additional rate taxpayers and utilise their annual capital gains tax exemption every year and they are entitled to entrepreneurs' relief.

Without ESC C16 the £450,000 paid to Mr and Mrs Blue would be treated as a net dividend.

Mr and Mrs Blue would both have additional rate tax liabilities as follows:

| | |
|--------------------------|----------|
| | £ |
| Gross dividend (100/90) | 500,000 |
| Higher rate tax at 42.5% | 212,500 |
| Tax credit at 10% | (50,000) |
| Tax due | 162,500 |

Applying ESC C16 and treating the distribution as capital proceeds on the sale of their shares, the position would be as follows:

| | |
|--|----------------|
| | £ |
| Capital distribution | 450,000 |
| Cost | Nil |
| Gain | <u>450,000</u> |
| Entrepreneurs' relief (450,000 × 10%) | 45,000 |
| Remaining gain @ 28% | <u>(Nil)</u> |

Consequently one can see that the use of ESC C16 is a useful way of winding up solvent companies and utilising capital reliefs and exemptions.

36.2 Clearance conditions

The conditions are as follows:

- The company is not one which, if the distributions were in a winding-up, would be reported to the Anti-Avoidance Group (Intelligence), Clearance and Counteraction Team.
- The company is **not the subject of an investigation** either on its own or as part of an enquiry embracing individuals or other companies;
- The company satisfies HMRC that it **does not intend to trade or carry on business in future**;
- The company intends to **collect its debts, pay off its creditors** in full and distribute any balance of its assets to its shareholders (or has already done so);
- The company intends to seek or accept **striking off and dissolution**;
- The company and its shareholders agree that they will supply such information as is necessary to determine, and will **pay, any Corporation Tax liability on income or capital gains**; and
- The shareholders will **pay any Capital Gains Tax liability** (or Corporation Tax in the case of a corporate shareholder) in respect of any amount distributed to them in cash or otherwise as if the distributions had been made during a winding-up;

These conditions should be **confirmed in a letter** sent by the company to HMRC. When HMRC is satisfied that the conditions have been met they will approve the application of ESC C16.

The company can then make capital distributions to its shareholders. Once the distributions have been made, the company should send the appropriate **form (currently 652a (Application for striking off)) to Companies House** together with the application **fee**.

Assuming there are no objections to the striking off, the company will cease to exist within a few months of submitting form 652a.

36.3 Transactions in securities?

Some of the provisions which may cause problems are those found in ITA 2007 s.692 *et seq* and CTA 2010 s.731 *et seq*. HMRC's Company tax Manual indicates that if a tax advantage is identified that is capable of counteraction under the transactions in securities legislation (as above) the case should be reported to the Anti-Avoidance Group (Intelligence), Clearance and Counteraction Team. One of the situations they identify that could require reporting is:

- the **transfer** or sale by a company of its assets or business to another **company having some or all of the same shareholders**, followed by the liquidation of the company whose assets etc have been acquired or the sale of shares in either company.

One would assume that a dissolution under ESC C16 would be regarded as a liquidation for the purposes of the transaction in securities legislation. This condition should deter any shareholders hoping to use ESC C16 every two years as a means of extracting profit.

36.4 Distribution of non-distributable reserves

Another area which may cause concern is the company law position. Since the company is not actually in liquidation, it is technically unlawful to distribute anything in excess of distributable reserves.

Thus it could be claimed that any **share capital and share premium should be left in the company** to pass to the Crown as bona vacantia when the company is struck off.

The alternative view is that since HMRC represent the Treasury which can claim bona vacantia on behalf of the Crown, there is an implicit understanding that all of the funds, including the retained reserves, share premium account and share capital can be distributed.

This is supported by the fact that HMRC's concessionary treatment was established with the agreement of the Registrar. Therefore, while technically there is a breach of company law, there are **no adverse consequences**.

To avoid all confusion the **clearance letter** to HMRC should make it clear that all funds representing share capital and share premium are to be distributed, giving them the **opportunity to raise an objection if they so wish**.

In addition, the client should be informed of the potential for challenge on the company law issue. If anyone did object then the shareholders could apply to the Court to have the company reinstated and a formal liquidation pursued.

There is a legal technicality to be satisfied where the non-distributable reserves exceed £4,000, but with the introduction of Companies Act 2006 this does not add significant costs to the procedure.

36.5 Loans to participators

Loans to participators are a common feature in family owned companies and these should not be overlooked when considering the implications of ESC C16.

If a company is dissolved under s.1003, any assets belonging to the company immediately before dissolution belong to the Crown. This provision, and any liabilities in respect of loans etc, should be drawn to the director's attention.

If the loans to participators are **repaid** to the company prior to dissolution, there should be **no difficulty**. Any CTA 2010 s455 tax on close company loans repaid will be cleared under CTA 2010 S.458 (1)-(3).

However, loans may be **set off, cancelled, released** etc or the right to recovery may be transferred to one or more shareholders in satisfaction of their rights to share in the company's assets. These transactions should be **taken into account in measuring the total amount realised** by any shareholder in respect of his shares for Capital Gains Tax purposes.

Where money due from a shareholder is not collected, but is set against his share of the company's assets (including his debt), the loan should be treated for CTA 2010 s. 458 (1)-(3) purposes as repaid up to the amount of the loan or of his share of the assets, whichever is less.

Where loans to participators etc, which are made in an accounting period ending on or after 31 March 1996, are repaid, whether by set off of the shareholders' assets or otherwise, CTA 2010 s.458(4)(5) applies to the repayment.

Therefore, if a loan is repaid more than nine months after the end of the accounting period in which it was made, relief is deferred until the due date for the accounting period in which the repayment takes place. The practical effect of this is that the company cannot dissolve itself under s.1003 until s.458(1)-(3) relief is due.

36.6 HMRC withdrawal of Extra statutory concessions

The House of Lords' decision in the *Wilkinson* case, made clear that the scope of HMRC's administrative discretion to make concessions that depart from the strict statutory position is not as wide as previously thought.

Where an existing concession exceeds the scope of the discretion of the *Wilkinson* judgement the effect of the concession will be maintained by putting it on to a legislative basis where it is appropriate to do so.

ESC C16 was listed in the November 2008 consultation document as one of the ESCs where clarification is needed before legislation is drafted. At the time of writing no further progress had been made towards putting it into legislation.