



Chartered  
Institute of  
Taxation

Excellence in Taxation

## **Extra statutory concessions – fourth technical consultation on draft legislation Response by the Chartered Institute of Taxation**

### **1 Introduction**

- 1.1 The Chartered Institute of Taxation sets out its comments on the proposals to legislate for Extra-Statutory Concession (ESC) C16: Dissolution of companies under S652 & S652A Companies Act 1985.

### **2 Executive summary**

- 2.1 Our understanding is that the intention of putting existing ESCs on a legal footing, following the Wilkinson case, is to retain the existing tax treatment provided under the ESC concerned, wherever possible.
- 2.2 Section 160 FA 2008 provides the enabling power which allows the tax treatment afforded by existing published concessions to be retained and legislated for by Treasury order.
- 2.3 Although the scope of an ESC may be varied or reduced when legislating for it, we believe that where possible the scope of the ESC should not be restricted. ESCs fill a gap in existing legislation and if an ESC's application is restricted all that happens is that a gap is left that will need to be filled.
- 2.4 In particular, ESC C16 fills a significant gap in the legislation where a company is wound up and we therefore believe it should be fully enshrined in law.
- 2.5 In our opinion, the proposal to limit the scope of ESC C16 to total distributions of no more than £4,000 runs counter to the Government's stated objective of simplifying the tax system for small businesses.
- 2.6 We believe that the limitation to a maximum capital distribution of £4,000 is a retrograde step that could cause significant stranded capital losses to arise as well as possibly a higher tax rate than if the business were sold for a similar sum.

- 2.7 However, if the Government is minded to proceed with a cap, and we do not believe a monetary cap is the right way forward, we would suggest that the £4,000 limit is increased to a more appropriate amount which would allow small companies to be dissolved cost effectively. A limit of £4,000 is in practice so low that the legislated concession would have little or no practical relevance for those wishing to wind up their businesses without appointing a liquidator.
- 2.8 Finally, if the Government is concerned that tax is being evaded through the use of ESC C16, despite the fact that concessions are not available for the purpose of evading tax, we would welcome further information as to how the concession is being exploited. The experience of our members is that their clients used ESC C16 for the entirely commercial purpose of winding up a solvent company without incurring the unnecessary cost and formal delay of using a liquidator.

### **3 Background to ESC C16**

- 3.1 We understand that what is now ESC C16 first came into existence during the 1970s, as an unpublished concession, and that it was used to allow companies to be dissolved without the formality and cost of a formal liquidation.
- 3.2 We also understand that, at that time, if the amount involved exceeded £1,000 the matter had to be referred by the local Inspector to Head Office for agreement.
- 3.3 The concession was first published in May 1985 as part of an agreement that the Inland Revenue would publish hitherto unpublished concessions.
- 3.4 When ESC C16 was published there was no limit to the amount that could be distributed nor was there any indication of a limit above which required Head Office approval. The plain inference is that there never was a perceived problem in allowing those who wound up their business informally the same tax treatment as those who chose a formal liquidation. It was a fair practical solution to a problem involving a distinction without a difference.

### **4 ESC C16: Dissolution of companies under S652 & S652A Companies Act 1985**

- 4.1 We believe that ESC C16 is a simple and straightforward way to get rid of companies that are no longer required and that its methodology should be perpetuated in the replacement legislation.
- 4.2 A company may be formally wound-up or dissolved – either process is acceptable in law and both are used extensively. Winding up a solvent company that is no longer required avoids the formality and considerable expense of appointing an Insolvency Practitioner to place the company into formal member's voluntary liquidation.
- 4.3 By treating distributions received in the course of winding up as 'capital' receipts rather than 'income' receipts, the shareholder is put in the same position as he (or she) would be if the distribution were made in the course of a formal liquidation.

- 4.4 In our opinion, a formal procedure to provide equality of treatment where a company is dissolved rather than liquidated is required. ESC C16 currently fills this void and is used on a regular basis.
- 4.5 In the past, the dissolution of a company has not been able to proceed without HMRC's agreement and since this is a Companies House procedure we imagine that this sanction will remain. Furthermore, numerous conditions had to be satisfied, inter alia that what is now Part 13, Chapter 1, Income Tax Act (ITA) 2007 did not apply and that the company and/or its shareholders were not under investigation. How will the proposed legislation address these requirements?
- 4.6 The company and the shareholders also had to agree that they would supply such information as is required to ensure that the company's and shareholders' tax liabilities would be ascertained and paid – effectively a 'joint and several' guarantee of the company's liability. We note that the legislation as drafted does not deal with this aspect of ESC C16 and we wonder what HMRC proposes in this respect.

## 5 The draft legislation

- 5.1 Our main concern with the legislation as drafted is the proposal to limit the scope of ESC C16 by introducing a further condition – Condition B – that the total amount of all distributions does not exceed £4,000.
- 5.2 At present there is no limit to the total amount of money that can be distributed to shareholders. Hence, the proposal to limit distributions to £4,000 is a significant, restrictive and adverse change to the terms and application of ESC C16.
- 5.3 There is a £4,000 agreed limit for share capital (but not for distributable reserves generally) in BVC17 (The Treasury Solicitor Bona Vacantia Division – Guidelines about the Distribution of a Company's Share Capital) but this concerns unlawful distributions and, in our opinion, is not relevant to most ESC C16 cases, which are concerned with amounts that can be lawfully distributed. In any case, new simplified procedures under Companies Act 2006, enabling the reduction of share capital, reduces the risk of an illegal distribution to an extent that makes the risk optional in practice.
- 5.4 The introduction of a £4,000 limit would have the effect that the statutory provision would be of very little practical benefit to those wishing to wind up a company. As a consequence, many companies would be required to adopt a more burdensome and expensive alternative to an informal winding up - owners will either have to distribute the majority of funds by way of an income distribution (dividend), which puts them at a considerable disadvantage against those either selling their companies or those using a formal liquidation where the commercial result is indistinguishable, or incur the costs of an Insolvency Practitioner and place the company into formal liquidation.
- 5.5 We do note that the explanation in the current consultation indicates that the £4,000 ceiling is being introduced as ESC C16 is needed in relation to micro and small businesses, and that this £4,000 ceiling is broadly equivalent to the cost of winding up a small company. We are concerned that the figure has

simply been copied from BVC17 without any substantive research into the true cost of liquidation; but in any case the whole concept of the potential cost of liquidation is a red herring that has surfaced only after its publication in BVC17.

- 5.6 We suggest that ESC C16 has never been intended to apply only to the element of a distribution equal to the putative cost of a liquidation, and that to introduce that concept now undermines and subverts the whole basis of the concession. We note too that the idea that the new legislation should apply only to small and micro businesses is not an inference that can be drawn from the original concession.
- 5.7 Evidence from our members would suggest that £4,000 is very low and the cost of a formal liquidation can easily exceed that figure (figures provided to us varied between £7,000 and £40,000 (plus VAT)). It is unlikely that an Insolvency Practitioner would take on a case with so few assets: they would refer any enquiries to the Official Receiver, which would involve further unacceptable delay.
- 5.8 We believe that companies using ESC C16 will, more often than not, have net assets well in excess of £4,000. Therefore, a £4,000 limit would result in a significant number of companies having to decide whether to pursue the formal member's voluntary liquidation route or make an initial income distribution to shareholders to reduce assets to beneath the £4,000 ceiling. Both of these options appear to us to be an unnecessary restriction to the ability to informally wind up a company through its dissolution without any significant commercial benefit, since in all cases creditors will be paid in full.
- 5.9 We understand that HMRC is concerned that ESC C16 is being used for avoidance purposes. This is an issue of concern to us too if true and we would welcome further information on this aspect. Our experience is that this is not what ESC C16 has been used for – it provides a cost effective alternative to a formal member's voluntary winding up. We find it hard to believe that any marketed scheme could use a published concession as part of an avoidance strategy when the availability of a concession is always dependent on it not being used for an avoidance purpose. Perhaps the concession may have been prayed in aid of an abusive strategy; but if so its non-availability takes such a strategy straight into the world of evasion. HMRC should tackle that in the normal way rather than limit a relief that is of such clear benefit to such a wide and compliant constituency of taxpayers.
- 5.10 We think that HMRC should explore other ways of including safeguards in the legislation, other than imposing a monetary limit, to minimise any concerns with the existing concession being exploited and, as a consequence, tax evaded.
- 5.11 However, if a monetary cap is determined to be the only option – in our opinion it is not the right way forward – we would suggest that, firstly, the proposed £4,000 limit be increased to a more realistic amount and that, secondly, that the limit be set by Statutory Instrument, so that it may easily be changed in due course to keep pace with the costs of a formal liquidation.
- 5.12 We also have some concerns about the interpretation of new section 1030A(2); in particular, the meaning of 'intends'. The draft legislation provides that distributions made during the period when the company intends to make an application under Section 1003 CA 2006 would also 'qualify' as capital distributions. In our opinion, this could cause an income distribution to be reclassified as a capital distribution with the result that the all-or-nothing £4,000

cap is exceeded.

- 5.13 For example, a company has net assets valued at £6,000. The shareholders:
- (1) pay a distribution of £2,000 which will be taxed as income as normal;
  - (2) make an application under section 1003 CA 2006; and
  - (3) pay a distribution of £4,000 which will be taxed as capital under the proposed new legislation.

It may be unclear exactly when the company intended to make the application under section 1003 CA 2006. If this is subsequently determined to be before the income distribution was made, the £2,000 distribution could be reclassified as a capital distribution with the result that the full £6,000 distributed will be taxed as an income distribution.

- 5.14 We are also concerned that the draft requirement for all debts to be collected is likely to prove unworkable in practice. A debtor may have gone into liquidation. Alternatively the debtor may be unable or unwilling to pay and the cost of pursuing recovery may be uneconomical. There should be a safeguard built in to the rules so that there is no opportunity for the relief to fail because of trivial or irrecoverable debts being outstanding at the date of dissolution.
- 5.15 In view of the new provisions in Companies Act 2006 allowing a simplified procedure for the reduction of share capital, we think that formal legislative provision should be made for such reductions in anticipation of a winding up to be treated as giving rise to capital distributions, so that there is not a conflict of statutory purpose that undermines the policy intention of the new provisions.

## **6 The Chartered Institute of Taxation**

- 6.1 The Chartered Institute of Taxation (CIOT) is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

The CIOT's comments and recommendations on tax issues are made solely in order to achieve its primary purpose: it is politically neutral in its work. The CIOT will seek to draw on its members' experience in private practice, Government, commerce and industry and academia to argue and explain how public policy objectives (to the extent that these are clearly stated or can be discerned) can most effectively be achieved.

The CIOT's 15,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA'.

The Chartered Institute of Taxation  
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