

Finance Bill 2016: Company distributions consultation

Comments from ACCA to HMRC
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SUMMARY

ACCA understands the rationale for the proposed changes to company distribution rules. We agree that the ability to obtain tax advantages by extracting value from companies in the form of capital, rather than income distribution, can distort decision-making, and we agree that this is undesirable from an economic perspective. While there is a need for the differing treatments, they should be available only where appropriate.

However, the changes proposed under Finance Bill 2016 could have undesirable consequences on entrepreneurial companies, leading to potentially negative impacts on the UK economy as a whole. We would urge the government to bear in mind that sound planning for tax is essential to operating and growing viable businesses. Any anti-avoidance legislation should therefore be balanced against the need to encourage the creation and continued operation of such businesses.

We have concerns and would suggest a review and reconsideration of clause 17 of Finance Bill 2016 in relation to the counteraction process. We believe the changes could result in taxpayers being disproportionately penalised where counteraction procedures are unjustified. We explain our position in the 'Other Matters' section below.

AREAS FOR SPECIFIC COMMENT:

Q1. 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?

- SME incorporations occur principally for commercial reasons. HMRC's June 2014 Research Report 317 *Reasons behind incorporation* show that it is the reduction of personal liability, rather than tax savings, which is the predominant reason for incorporation.
- Capital distributions are made for many different reasons besides tax avoidance. Changes in the business environment – to which small businesses falling within the definition of close companies are particularly vulnerable – can cause companies to be sold to third parties or enter into members' voluntary liquidation.
- The lower rates of CGT compensate shareholders and entrepreneurs for the risks that they have taken in investing in or creating business. Economically viable businesses play an important role in the UK economy.

- Administrative burdens have been cited in research as a major concern of small businesses. Any changes to tax policy aimed at removing unfair tax outcomes should be tempered with the need to continue to support such small businesses, including ensuring simplicity, certainty and stability around tax.

Q2. Do you think such issues will be exacerbated by the changes to dividend rules being proposed for April 2016?

- Existing distortions may be exacerbated by the changes to the dividend rules being proposed for April 2016. However, counter measures need to be weighed against the possible effects on the government's policies to aid company growth.
- Specifically in the case of close companies, the proposed dividend rules will result in a significant increase in tax liabilities for participators in close companies who receive the majority of their income in the form of dividends. Some participators may be obliged, by financial need, to extract a high proportion of profits in the company by way of salary or dividends each year. Higher tax rates apply to the payment of salary than dividends. However, those who can afford to do so will typically prefer to retain profits in the company.
- Retaining profits does reduce the participators' immediate tax liabilities at present. However, profits may need to be retained as a result of bank covenants. The retention of profit is also part of sound financial management, providing not only funds for reinvestment but also a buffer against the negative financial impact of any future uncertainties.
- Profits also needs to be retained for other company working capital needs, including the fulfilment of legal or statutory requirements such as sick pay, holiday pay and maternity cover for employees.
- For example, contractors who work through incorporated businesses may retain profits in their companies if they anticipate worsening prospects in their industry. As the expected downturn occurs and these contractors see their contracts terminated, some may seek to extract funds from their companies through a repayment of share capital or liquidation as they look for new contracts or employment. These individuals are then likely to be negatively impacted by the proposed changes to company distributions, as discussed below.

Q3. Do you agree that changes to the Transactions in Securities rules as proposed will be effective in terms of preventing the conversion of income to capital?

- We believe that the proposed changes to the Transactions in Securities rules would be effective in preventing the conversion of income to capital.
- In particular, we believe the amendments to section 684(2) of Chapter 1 of Part 13 of ITA 2007 strengthen the scope of the TiS rules.
- We agree with the amendments to section 686(2) – (5) of Chapter 1 of Part 13 of ITA 2007. The amendments remove the anomaly in the existing rules. The changes to this section define a fundamental change of ownership as one where the original shareholder will no longer be able to influence the company's affairs significantly, by being able to block a company special resolution.
- However, we would urge the government to reconsider the proposed amendment under subsection (10)(c) of clause 16 of the Finance Bill. This amendment, applying retrospectively to allow clearance previously obtained under section 701 of ITA 2007 to be voided, would introduce unwonted uncertainty to taxpayers who have actively sought to ascertain their tax positions. We believe that such legislation should incorporate comprehensive grandfathering and/or transitional provisions.

Q4. Do you think these changes will have any unwanted consequences not identified? How might these be mitigated?

- The changes allow greater scope for distributions over and above the capital originally invested in the company to be assessed as income distributions.
- The interaction of the TiS rules with the changes in the dividend rules (sections 6, 8, and 13A of ITA 2007) and the impact of both on small owner-managed companies should be considered carefully. As proposed, the revised dividend rules are likely to encourage owner-managers who are participators of close companies to retain profit in their companies; the revised TiS rules penalise the retention of profit. We believe the simultaneous implementation of both rules will cause significant uncertainty and instability.
- Section 684(1)(c) states that the TiS rules apply where 'the main purpose, or one of the main purposes, of the person in being a party to the transaction in securities, or any of the transactions in securities, is to obtain an income tax advantage.' We are concerned that commercially-driven transactions which involve legitimate

forward tax planning will fall within the scope of the rules.

- This is particularly concerning when considered in conjunction with the changes to section 695 of Chapter 1 of Part 13 of ITA 2007 which removes the possibility of the taxpayer to make a statutory declaration when a counteraction notice is served (discussed in the Other Matters section below).
- We would recommend that the government considers revising section 684(1)(c) to focus on transactions which lack commercial purpose, rather than transactions the main purpose of which is to obtain an income tax advantage.

Q5. 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?

- We agree that TAAR in respect of distributions in a winding up will be effective in discouraging 'phoenixism.'
- Proposed section 396B(3) of Chapter 3 of Part 4 of ITTOIA 2005 makes reference to the notion of persons connected to each other or with a company. What constitutes a connection for the purpose of this section is not explicitly defined. We would recommend that a specific reference is made to section 993 of ITA 2007, if that section provides the intended meaning of connected persons in this context.

Q6. Do you think that the TAAR will have any unwanted consequences not identified? How might these be mitigated?

- As discussed under our response to Q2, we believe that the proposed TAAR is likely to apply to commercially-driven winding up scenarios: such as where a start-up venture fails and the owner wishes to start a new business afresh. After all, an important motive for incorporation is the ability to start afresh without fear of personal liability.
- Section 396B(4) is drafted to capture winding up where 'main purpose or one of the main purposes [...] is the avoidance or reduction of a charge to income tax.' As discussed above, we are concerned that commercially-driven transactions which involve legitimate forward tax planning will fall within the scope of the rules.
- We understand the rationale for extending the TAAR to non-UK resident companies under proposed section 404A of Chapter 3 of Part 4 of ITTOIA 2005. However, the inclusion of non-UK resident companies within the TAAR as set out

in section 404A(8), when non-UK resident companies are specifically not considered close companies under existing legislation, is liable to cause uncertainty. The application of the close company definition is likely to give rise to distortions, particularly given the differences in corporate structures in foreign jurisdictions. For example, non-share corporate entities in certain jurisdictions would be excluded from the TAAR, thus giving rise to inconsistent treatment.

Q7. 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?

- We do not believe any further changes to address the conversion of income to capital should be considered at this time.

Q8. Are there any particular areas of the wider distributions regime that cause difficulties or complexities? If so, which areas?

- We would recommend the government to consider the potential added complexities as the distributions regime interacts with the proposed Making Tax Digital and Simple Assessments regimes.

Q9. 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?

- Yes. We would urge the government to consider how the distributions regime in general, and the TiS rules in particular, will operate under Making Tax Digital.

Other matters

Clause 17: Transactions in securities: procedure for counteraction of advantage

- The current consultation on company distributions does not appear to seek any views regarding the counteraction process for the TiS legislation, set out under clause 17. However, we are concerned by the proposed changes in this area.
- Clause 17 subsection (2) amends section 695 of Chapter 1 of Part 13 of ITA 2007, with the effect of removing the existing requirement for a counteraction notice to specify the transaction or transactions to which the notice relates (original section 695(2)). Clause 16 subsection (5) further removes the 6 year time limited for assessments currently provided under section 698 (5), allowing assessments to be made 'at any time (without regard to any time limit on making the assessment that would otherwise apply).'

- The combined effect of the removal of section 695(2) and the revision of section 698 (5) could lead to HMRC officers to give notice immediately before the end of the 6 year assessment period without specifying the transaction(s) which he or she intends to counteract, therefore allowing the HMRC an extended period of time to examine an extended scope of transactions. This is likely to lead to a high level of instability for small companies.
- Clause 17 subsection (3) omits existing section 696, effectively removing the opportunity for taxpayers to make a statutory declaration where a counteraction notice is received. The taxpayer will thus lose the ability to present a case against the counteraction notice, before counteracting adjustments are imposed by HMRC.
- Clause 17 subsection (3) also omits existing section 697, effectively removing requirement for a tribunal to be appointed at the start of the counteraction process. This, in connection with the new section 698A, puts the onus on the taxpayer to apply to a tribunal for a counteraction notice or a no-counteraction notice.
- The combined effect of the removal of both sections 696 and 697 significantly shifts the financial and administrative burden of undertaking tribunal proceedings onto the taxpayer. Where the counteraction proceedings are unjustified, this could result in taxpayers accepting an incorrect assessment in order to avoid the greater financial burden of applying to tribunal.
- In summary, we urge the government to reconsider the changes proposed under clause 17, as we believe that they could result in incorrect outcomes and disproportionate administrative burden for the taxpayers concerned.

Textual comments

- Subsection (10)(c) of clause 16 of the Finance Bill appears to have one word missing: it should perhaps read 'the transaction, or any one or more of the transactions, occurs **on** or after 6 April 2016.'
- The replacement in ITA 2007 Part 13 Chapter 1 section 684 subsection (1) paragraph (d) of 'the person' with 'any person' is unclear. This states that a person is liable to counteraction when any person obtains an income tax advantage. Therefore, where a taxpayer has obtained an income tax advantage for other persons, this taxpayer is liable to counteraction even if he or she does not directly benefit. How the counteraction would apply to the taxpayer in question in this case, when no adjustment can be made to his or her own income tax position, is unclear. Further, how the other persons, who have benefited from an income tax

perspective from the transaction, are to be assessed, is equally unclear. We suspect that the change might have been introduced with tax agents in mind, but the wording of the text makes it difficult to understand the circumstances to which the proposed change is intended to apply.

