Briefing

Corporate Turnaround and Insolvency

BURGES SALMON

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Tax changes for individual shareholders receiving a distribution in a liquidation by way of MVL

The tax treatment for individual shareholders receiving a distribution from a members' voluntary liquidation ("MVL") may be affected by changes applying from 6 April 2016.

The background

Recently proposed changes may change the tax treatment for individual shareholders who receive a distribution as part of an MVL in a close company. (Very broadly, a close company is one that is controlled by five or fewer people.)

Generally, capital gains tax treatment might be expected to apply on a liquidation of a company. This can result in a lower rate of tax applying than if the company had simply paid a dividend (taxed as income).

In connection with changes to increase the rate of tax on dividends (also from April 2016), the Government has been consulting on rules to ensure that shareholders do not obtain tax advantages from arranging to liquidate their company rather than receiving dividends.

The new rules (to be enacted as part of Finance Act 2016) will apply from 6 April 2016.

The issues

The consultation identified three potential concerns:

1. **"Moneyboxing"** – a company retains profits in excess of its needs (without paying out dividends) and the shareholders receive those profits as capital upon liquidation;
2. **"Phoenixism"** - a company carrying on a trade is liquidated and a new company is set up to carry on the same (or substantially the same) trade as the old company; again, this might allow shareholders to receive profits in capital form even though in substance the trade continues;
3. **"Special purpose companies"** – separate companies are set up for specific contracts or projects and then liquidated at the end of that contract or project, again potentially allowing shareholders to receive the profits in a capital form rather than as income.

The changes

The proposals involve (i) tightening-up existing anti-avoidance legislation dealing with "transactions in securities" and (ii) introducing a new Targeted Anti-Avoidance Rule ("TAAR").

The existing transactions in securities legislation is already aimed at countering tax advantages arising from transactions involving shares. The rules did not clearly apply to distributions in a winding up. One of the changes will ensure that these anti-avoidance rules can apply (where the other conditions are met) in relation to such distributions.

In addition, the TAAR is intended to ensure that some distributions in a winding-up are taxed as income where certain conditions are met. The TAAR will apply to distributions made to an individual shareholder in a winding-up of a company if:

1. the individual had at least a 5% interest in the company (by reference to ordinary share capital and voting rights) immediately before the winding up;
2. the company is a close company (or was a close company within the last two years);
3. within a period of two years following the distribution, the shareholder continues to be involved, directly or indirectly, in a similar trade or activity carried on by the company (including through a new company or partnership); and
4. the main purpose, or one of the main purposes of the winding-up, is to obtain a tax advantage.

An exemption applies for distributions of irredeemable shares. This is to ensure that the TAAR does not apply to standard liquidation (s.110) demergers.

What does this mean for practitioners?

The Government expects the vast majority of distributions in a winding-up to continue to be treated as capital. But greater care is now required when a members' voluntary liquidation is carried out and individual shareholders expect capital gains tax treatment to apply.

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