HM Revenue & Customs

Enactment of Extra-Statutory Concession C16

Who is likely to be affected?

Companies and their shareholders, where a company goes out of business and does not wish to go through the formal winding up procedures under the Companies Act.

General description of the measure

Legislation is being introduced in The Enactment of Extra-statutory Concessions Order 2012 ("the ESC Order") to give legislative effect to extra-statutory concession (ESC) C16: Dissolution of Companies under section 1000 and section 1003 of the Companies Act 2006.

A distribution is income in the hands of the shareholders. But distributions made by a company "in respect of share capital in a winding up" are specifically excluded, leaving these to be treated as capital payments to be taken into account in calculating any chargeable gains of the shareholders.

A company which has ceased business altogether may not wish to undertake the administration and incur the costs etc involved in going through the formal winding up procedures under the Companies Acts. In such a situation the company may simply distribute its remaining assets to shareholders and then either wait or seek to be struck off the Joint Stock companies Register and dissolved under sections 1000 or 1003 of the Companies Act 2006 (or any comparable provisions).

A dissolution under section 1000 or 1003 or comparable provisions is not a winding up and so the distribution of its surplus assets to the shareholders is as a matter of law an income distribution. Depending on their rates of personal tax the shareholders may be subject to further income tax liability on the value of the distribution.

ESC C16 allows a distribution in such circumstances to be treated as the equivalent of a distribution in a winding up. The distribution is treated as a capital payment to be taken into account in determining the capital gains liabilities of the shareholders. This normally results in the shareholder paying less tax.

For anti-avoidance reasons the legislation enacting ESC C16 narrows the category of distributions which are to be treated as equivalent to distributions following a formal winding up by imposing a monetary limit of £25,000.

Policy objective

To allow shareholders in small businesses to withdraw the fruits of their investment at the end of a company's life in a tax efficient way.

Background to the measure

The House of Lords' decision in R v HM Commissioners of Inland Revenue ex parte Wilkinson [2005] UKHL 30 clarified the scope of HMRC's administrative discretion to make concessions that depart from the strict statutory provision. Legislating ESC C16 is part of a legislative programme intended to give statutory effect to existing ESCs where these may exceed the scope of that discretion.

A company with straightforward affairs which has ceased business altogether and paid off its creditors may not wish to incur the costs and administrative burden of a formal winding up. ESC C16 equalises the tax treatment of a company distribution made in such circumstances with the tax treatment of a company distribution made in the course of winding up, and is of particular value to small businesses where the cost of a winding up may be disproportionate.

The legislation has been subject to consultation. A consultation document entitled 'Extra statutory concessions: fourth technical consultation on draft legislation' was published on 13 December 2010. The proposal to legislate ESC C16 was welcomed, but concerns were expressed about the level of the proposed ceiling on the use of the concession (originally £4000). This was considered too low to be of value to business.

Detailed proposal

Operative date

Subject to Parliamentary approval the measure will have effect for distributions on or after 1st March 2012.

Current law

The current law on company distributions is in Part 23 of the Corporation Tax Act 2010 and contains provisions about what is and what is not a distribution. Section 122(5) of the Taxation of Chargeable Gains Act ("TCGA") 1992 provides that a distribution made in the course of dissolving or winding up a company is a capital distribution unless it is a distribution which constitutes income for income tax purposes in the hands of the shareholder.

Proposed revisions

The ESC Order amends Chapter 3 of Part 23 of CTA 2010 to provide that a distribution made by a company prior to its dissolution is not treated as a distribution for the purposes of the Corporation Taxes Acts provided that the total distributions made do not exceed £25,000. The Order also amends section 122(5) of TCGA 1992 to make this type of distribution a capital distribution. This means it is treated as capital receipts of the shareholders for the purpose of calculating any chargeable gains arising to them on their disposal of shares in the company.

Summary of impacts

Exchequer impact (£m)	2011-12	2012-13	2013-14	2014-15	2015-16
	+/-	+/-	+/-	+/-	+/-
	This measure is expected to have a negligible impact on receipts.				
Economic impact	No significant economic impact envisaged.				
Impact on individuals and households	A negligible impact on individuals and households is expected. The measure, which enacts a current ESC, potentially affects individuals who are shareholders in small and micro businesses. If the total distributions made by the company in anticipation of its dissolution do not exceed £25,000, there is no change to the current position. Such distributions are treated as a capital payment to be taken into account in determining the capital gains liabilities of the shareholders.				

	If the total distributions exceed £25,000, they will be taxed as dividends in the hands of shareholders. Basic rate taxpayers will pay no tax, but higher and additional rate taxpayers will have a higher liability than at present. This can be avoided, however, if the company is formally wound up. A distribution made in respect of share capital in a winding up is treated as capital receipts of the shareholders for the purpose of calculating any chargeable gains arising to them on their disposal of their shares in the company.
Equalities impacts	This measure concerns the taxation of shareholders in companies that go out of business but are not formally wound up. Many of these company dissolutions involve small or micro businesses where the directors simply wish to retire. It is therefore likely that this group is older on average than the population as a whole. No significant different impact on those groups protected by equality legislation is expected as a result of this measure.
Impact on business including civil society organisations	In 2010 about 325, 000 companies were dissolved informally and struck off without going into liquidation. It is possible that some companies making large distributions on the cessation of business may now opt to be formally wound up, in order to protect the tax position of their shareholders. The cost of a winding up will vary with the size and complexity of the business, but is thought to be about £7,500 for a small business with straightforward affairs. Otherwise the impact on business is negligible in terms of administrative and compliance costs.
Operational impact (£m) (HMRC or other)	The change will not increase HMRC processing or compliance resource costs. The £25,000 ceiling will provide inbuilt protection against avoidance/evasion.
Other impacts	Legislating this concession will have a positive impact on investors in small businesses. Small firms' representatives have engaged with the consultation and welcomed the proposal to legislate the ESC - the ceiling on distributions has been increased in response to their concerns. Simple guidance will be put in place to help small businesses and their advisers.

Monitoring and evaluation

The policy will be subject to ongoing monitoring through monitoring information collected on tax returns.

Further advice

If you have any questions about this change, please contact Andrea Pierce on 020 7147 2591 (email: andrea.pierce2@hmrc.gsi.gov.uk).

Declaration

David Gauke MP, Exchequer Secretary, has read this Tax Information and Impact Note and is satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impacts of the measure.