30 Monck Street
London
SW1P 2AP

T: 020 7340 0551
E: info@att.org.uk
W: www.att.org.uk

MODERNISING THE TAXATION OF DISTRIBUTIONS AND REPAYMENTS OF CAPITAL FROM COMPANIES

Response by Association of Taxation Technicians

Introduction

The Association of Taxation Technicians (ATT) is pleased to have the opportunity to respond to the HMRC Consultation on 'Modernising the taxation of distributions and repayments of capital from companies' ('the Consultation') issued on 23 June 2026[1]. We were also pleased to host an online roundtable on the Consultation with interested members on 24 August 2026, which HMRC representatives were able to attend.

The primary charitable objective of the ATT is to promote the education and study of tax administration and practice. We place a strong emphasis on the practicalities of the tax system. Our work in this area draws heavily on the experience of our members who assist thousands of businesses and individuals to comply with their taxation obligations.

We would be pleased to discuss any aspect of this submission further. Relevant contact details can be found in Section 9.

Executive Summary

We were disappointed by the short consultation period of just 12 weeks, particularly as it spanned the summer holiday period. This has placed considerable pressure on stakeholders seeking to engage constructively across multiple consultations at the same time. The volume of consultations issued during this period has reduced the time available to analyse proposals in detail, gather evidence and obtain input from members.

Meaningful stakeholder engagement is particularly important for a consultation of this nature, which proposes fundamental reform across a number of areas. We therefore encourage HMRC to consider the responses received carefully and to undertake further stakeholder engagement where appropriate before finalising any reforms. We also encourage HMRC and HM Treasury to take account of the cumulative impact of overlapping consultations and, wherever possible, avoid consultation periods that coincide with major holiday periods.

[1] https://www.gov.uk/government/consultations/modernising-the-distributions-framework/modernising-the-taxation-of-distributions-and-repayments-of-capital-from-companies--2

We consider this Consultation to be the start of a longer engagement process rather than the sole opportunity for stakeholders to comment on reforms of this significance. We welcome HMRC's indication that it expects to continue engaging with stakeholders as the proposals develop and that no fixed timetable has been set for implementation. Before any changes are finalised, HMRC should publish draft legislation, worked examples and provide further evidence supporting the proposed reforms, and allow sufficient time for detailed consultation. We look forward to continuing to work with HMRC to ensure that any reforms are proportionate, achieve their stated policy objectives and do not create unintended consequences.

We are not convinced that HMRC has demonstrated why the existing Transactions in Securities (TiS) regime is incapable of addressing the arrangements identified in Chapter 2 or why a broader mechanical rule is required. While we recognise the desire to increase certainty and reduce reliance on anti-avoidance legislation, the proposed "frozen capital" approach risks affecting a wide range of transactions undertaken for genuine commercial purposes (see Part 2).

We welcome many of the proposed reforms to the statutory demerger provisions, however they do not sufficiently compensate for the effective removal of the capital reduction demerger route. We also consider that further simplification of the statutory demerger provisions is possible and that aspects of the wider framework, including the chargeable payments provisions, warrant further review (see Part 3).

We support HMRC's objective of providing greater certainty where unlawful distributions arise. In particular, we welcome consideration of priority rules and mechanisms to prevent double taxation. However, the interaction between the distributions legislation, the loans to participators regime and company law is complex, and the practical operation of the proposals will depend heavily on the detailed drafting. We therefore recommend that HMRC undertakes further consultation and publishes draft legislation before proceeding (see Part 5).

While we support the objective of aligning the treatment of UK and non-UK resident companies, we are concerned that imposing a section 455-style charge on individuals who receive loans or advances from non-UK resident closely controlled companies would place complex compliance obligations on taxpayers who may not have access to the information needed to determine whether a charge arises. Any new regime should be carefully targeted, supported by appropriate safeguards, and subject to further consultation to minimise unnecessary complexity and unintended consequences (see Part 6).

We support the principle of the replacement of the trade benefit test for the Purchase of Own Shares (POS) rules with clear statutory conditions. However, we are concerned that some of the proposed conditions would reduce the usefulness of the POS rules in the very circumstances in which they are commonly used (and are intended to be used), particularly in owner-managed and family companies where the POS route is often the most effective route for a shareholder to exit from a commercial perspective (See Part 7).

We are not persuaded that HMRC has demonstrated a clear need for a new capital extraction anti-avoidance rule. The Consultation does not adequately identify the gap in the existing legislation or explain why existing anti-avoidance provisions cannot be amended to address any concerns (See Part 8).

We would also like to take this opportunity to point out that the reforms may have a number of wider implications that have not yet been considered. One particular area that we feel needs further consultation is the impact of these proposals on employee share plans. In our view, several proposals in the Consultation could, if implemented in their current form, have a potentially detrimental impact on employee share plans and the prevalence of employee share ownership more generally. The interaction of these proposals with the employment-related securities (ERS) regime, in particular the 'disguised remuneration' legislation in ITEPA 2003, Part 7A should also be carefully considered (See Appendix 1). We believe this presents an opportunity not only to ensure that any unintended consequences are identified and addressed, but also to clarify and simplify aspects of the existing ERS rules, which remain a significant area of complexity and misunderstanding.

It will be essential that specialists from HMRC's Employee Shares and Securities Unit, including officials involved in the Treasury's Tax Support for Entrepreneurs: Call for Evidence[2], be given the opportunity to input on the impact of these proposals and ensure that any reforms which derive from this Consultation fully consider the policy aims and operational aspects of the existing ERS regime and any potential reforms to support entrepreneurs.

Overall, whilst the intention may be to simplify transactions by removing ambiguity, in reality the proposed measures are likely to increase complexity and may even serve as a barrier to entrepreneurship and succession planning of owner-managed businesses in the UK.

1 Introduction

1.1 **Question 1: How do any of the proposals outlined in this document impact Corporation Tax payers?**

1.2 We have not had sufficient time to undertake a detailed assessment of the Corporation Tax impacts of every proposal in the Consultation. The proposals cover several complex and interrelated areas of legislation, and the potential consequences will depend heavily on which measures are taken forward, how they are drafted, and how they interact with existing provisions.

Throughout this response, we have identified a number of areas where the proposals may have unintended consequences for companies and corporate groups. However, given the volume and complexity of the Consultation, the short consultation period, and the fact that the Consultation has run over the summer holiday period, we are conscious that there may be further Corporation Tax impacts which we have not been able to identify or analyse fully during the period available to respond.

We therefore recommend that HMRC treats the current Consultation as the start of a more detailed process, rather than as the final opportunity to identify impacts. HMRC should publish draft legislation, worked examples and a detailed assessment of the interaction between the proposals before any changes are implemented. Sufficient time should then be allowed for professional bodies, advisers, businesses and HMRC to consider the practical consequences, including any unintended Corporation Tax impacts.

2 Reduction of capital

2.1 **Question 2: What general comments do you have on the proposal to modernise the rules determining the size of a distribution on a reduction of share capital or share buyback?**

2.2 We support efforts to simplify and to reduce uncertainty where possible. However, we are concerned that the Consultation does not clearly identify the perceived issue which the proposed changes are intended to address.

The example in Chapter 2 illustrates an arrangement under which value is extracted from a continuing business, with part of the extraction taxed as a capital gain rather than as an income distribution, despite the shareholder continuing to own and control the business.

[2] https://www.gov.uk/government/calls-for-evidence/tax-support-for-entrepreneurs-call-for-evidence/tax-support-for-entrepreneurs-call-for-evidence#about-this-call-for-evidence

Our understanding is that the arrangement described could be counteracted under the existing Transactions in Securities (TiS) provisions. Despite this, the Consultation proposes *"that share buybacks and other returns of capital* [should] *reflect a 'frozen' amount of capital on the shares in any future holding companies at the amount subscribed on the original investment, thereby matching the CGT deferment of the original base cost."*

It is unclear why HMRC considers the existing TiS rules incapable of addressing the arrangement described, or whether the concern relates to their practical operation. This distinction is important because, unlike the existing TiS regime, the proposed approach would apply regardless of the purpose of the transaction and therefore has the potential to affect a much wider range of commercial arrangements.

We would welcome greater clarity on the perceived gaps in the existing legislation that the proposed change is intended to address. In particular, it would be helpful to understand whether HMRC considers:

- that the Chapter 2 example would not be counteracted under the existing TiS rules, and if so why;
- that the example would be counteracted under TiS, but that the existing provisions are insufficient for another reason and, if so, what that reason is;
- that there are wider categories of transactions which HMRC considers problematic, but which currently fall outside the scope of TiS, and, if so, what types of transactions these are; or
- that there are practical or evidential difficulties in operating the existing TiS regime which cannot be resolved within the current framework, and, if so, what those difficulties are?

The Consultation states that the proposal: "will also reduce the significance of the TIS rules in these cases by producing a clear, consistent outcome that is not dependent on the requirement to establish a tax advantage purpose or on HMRC counteraction activity."

We understand and appreciate HMRC's efforts to simplify the legislation, produce greater certainty and reduce reliance on subjective tests. However, the requirement to establish a tax advantage purpose is not an accidental feature of the TiS legislation. It reflects a longstanding policy decision that anti-avoidance legislation should distinguish between arrangements undertaken for tax avoidance purposes and transactions undertaken for genuine commercial reasons.

During the Parliamentary debates introducing the predecessor to the TiS rules, the then Solicitor-General emphasised the importance of ensuring that anti-avoidance legislation did not affect "perfectly ordinary transactions that are carried out in the ordinary way of business"[3].

While a mechanical rule may provide greater certainty, it does so by removing this distinction. As a result, transactions undertaken for wholly commercial reasons could be subject to the same treatment as arrangements designed specifically to convert income into capital.

The Consultation states that the "proposals are not intended to impact legitimate commercial restructurings". However, Chapter 2 does not explain what protections would be available to achieve that outcome.

We would also welcome further explanation and supporting evidence for HMRC's statement that the TiS rules reflect an "outdated approach" to anti-avoidance legislation. Although the provisions have a long history, they have been rewritten and amended on several occasions. It would be helpful to understand whether HMRC's conclusion is based on:

- its compliance experience;

[3] https://hansard.parliament.uk/Commons/1960-05-25/debates/c6b36552-f9af-45e6-9523-dde1136f6585/Clause26%E2%80%94(CancellationOfTaxAdvantagesFromCertainTrans-ActionsInSecurities)#:~:text=May%20I%20say,Mr.%20H.%20Wilson).

- changes in taxpayer behaviour;
- relevant case law;
- evidential difficulties;
- the requirement for HMRC counteraction;
- difficulties identifying transactions within the relevant time limits; or
- some other feature of the current legislation.

Until the underlying policy issue has been more clearly identified, it is difficult to assess whether the proposed solution is proportionate or appropriately targeted. We therefore recommend that HMRC:

- provides further evidence of the transactions or behaviours that the existing legislation is failing to address;
- explains why the existing TiS provisions are not an adequate or effective response;
- considers whether the policy objective could be achieved through a more targeted amendment of the TiS provisions rather than a mechanical rule applying to all transactions;
- develops appropriate protection for transactions undertaken for genuine commercial purposes; and
- provides draft legislation and worked examples for consultation before any change is introduced.

Without that further evidence and analysis, we do not consider that the case has been made for replacing the existing targeted anti-avoidance approach with a broader mechanical rule.

2.3 **Question 3: Please describe how this proposal might impact legitimate corporate demergers and share restructuring.**

2.4 We are concerned that the proposed frozen capital rule could have significant consequences for legitimate corporate demergers, business succession arrangements and other share restructurings, particularly because it does not preserve the existing TiS distinction between avoidance-driven transactions and transactions undertaken for genuine commercial reasons.

We believe that this distinction is important. Transactions which may be similar in legal form can have fundamentally different purposes. A rule which applies solely by reference to the steps undertaken, without regard to the purpose or wider circumstances of the transaction, risks affecting legitimate commercial activity alongside the arrangements it is intended to address.

Family business succession

In many family businesses, the next generation often does not have sufficient personal funds to acquire the outgoing shareholder’s entire interest and the company itself may also have insufficient cash or distributable reserves to fund an immediate POS.

From a purely commercial perspective, succession may therefore need to take place over a period of time, allowing the outgoing shareholder to reduce their involvement gradually while supporting the transfer of ownership, knowledge and responsibility to the next generation. This could include the management and transfer of key client relationships, which may take a significant period of time to achieve without disrupting normal business operations.

Where a POS is unavailable or impractical, a holding company structure (management buyout) may provide a viable succession route. This can involve a share-for-share exchange, with the existing owner and the next generation taking interests in the new holding company, followed by the gradual acquisition or capital reduction of the existing owner’s interest.

Such a transaction appears very similar to the example provided in Chapter 2. However, its commercial purpose and practical effect are fundamentally different. The purpose is to:

- facilitate the existing owner's retirement;
- enable the next generation to acquire control;
- preserve the business and the employment it provides;
- allow knowledge and responsibility to be transferred gradually; and
- keep a successful business within the family.

For example, consider an individual who has established and developed a business which is worth £1 million. The owner is approaching retirement and, in this scenario, has two options. They could sell the entire business to an unconnected third party for £1 million, or they could seek to transfer the business to a family member who has recently become involved in its operation but cannot fund an immediate acquisition.

If the owner sells to the unconnected purchaser, the disposal proceeds would ordinarily be dealt with under the Capital Gains Tax (CGT) rules. If the owner instead chooses to pass the business to the next generation a holding company and share-for-share exchange may be required to facilitate a gradual transition. Under the proposed frozen capital rule, a subsequent return of capital to the existing owner could be taxed largely as an income distribution, despite the commercial succession objective.

In view of the government's intention to encourage entrepreneurship, we feel that it is important to maintain a level playing field and that the tax system should not make a sale to an unconnected third party more attractive than the continuation of the business within the family simply because the latter requires a more complex funding and ownership structure to achieve its commercial purpose.

There is also a question about the appropriate treatment of the value built up by the existing owner before the succession takes place. If the business is worth £1 million when the share-for-share exchange occurs, that value reflects the value built up throughout the existing owner's entire period of ownership. Following the restructuring, the business may enter a new phase under the ownership and direction of the next generation.

Under the existing distribution rules, the value transferred to the new holding company can constitute 'new consideration'. On a capital reduction, this allows the existing owner to receive capital treatment by reference to the value accumulated before the succession, while any subsequent increase in value would be treated as an income distribution. The proposed rule would remove that distinction by looking back to the amount originally subscribed, which is likely to be nominal and paid many years earlier.

We therefore believe that HMRC should consider whether an extraction which forms part of a genuine commercial succession arrangement should be treated differently from an extraction undertaken principally to convert profits into capital. If no distinction is retained, the Chapter 2 proposal risks obstructing succession arrangements and encouraging sales to third parties instead, or worse where no suitable purchaser can be identified, liquidation.

Loan notes and deferred consideration

The Consultation does not discuss the interaction between the proposed frozen capital rules and transactions involving loan notes, deferred consideration, preference shares, earn-out rights or other forms of non-cash consideration.

In practice, commercial transactions frequently involve consideration other than cash or ordinary shares. For example, qualifying corporate bonds (QCBs), non-QCBs, deferred consideration arrangements and earn-out rights are commonly used where the purchaser cannot fund the entire acquisition price immediately or where part of the consideration is contingent on the future performance of the business.

The recent changes introduced by Finance Act 2026 have already created a degree of uncertainty regarding the interaction between the reorganisation provisions and the anti-avoidance legislation where securities form part of the consideration. HMRC's published guidance indicates that the anti-avoidance provisions[4] may apply where additional features, such as loan note consideration, are included in a transaction to obtain a tax advantage. However, HMRC also recognises that certain arrangements, such as unascertainable earn-outs satisfied in securities, can represent the intended operation of the legislation rather than avoidance.

More broadly, we are concerned that the cumulative effect of recent legislative changes and the proposals in this Consultation may reduce the practical options available to business owners implementing succession plans.

Increased uncertainty around restructurings, deferred consideration arrangements and future value extraction may encourage some owners to favour a third-party sale or liquidation over transferring a business to the next generation. We do not consider this a desirable outcome. Successful owner-managed and family businesses play an important role in economic growth, employment and investment, and the tax system should support commercially driven succession planning rather than inadvertently discouraging it.

Capital reduction demergers

The Consultation acknowledges that the Chapter 2 proposal would affect 'non-statutory demergers' by removing the capital reduction demergers route (in most cases).

Although some of the proposed reforms to the statutory demerger provisions ('exempt distribution') are welcome (See Part 3), those rules may not provide a complete substitute for capital reduction demergers.

The existing treatment of new consideration following a share-for-share exchange plays an important role in facilitating capital reduction demergers. The example in Annex E illustrates the distinction between a demerger and the extraction described in Chapter 2. In the Chapter 2 example, John receives cash from the company while continuing to own the same business. In Annex E, Charlie receives shares representing part of the business and continues that business through C-New Ltd. Value remains within the corporate structure and Charlie has not received cash or otherwise extracted funds for personal use.

A mechanical frozen capital rule risks treating both transactions in the same way despite their materially different purposes and outcomes. In the context of Annex E, the proposed changes could produce an income distribution based on the value of the business transferred even though Charlie has received no cash with which to meet the resulting tax liability. This could create a significant dry tax charge.

We do not consider that the proposed changes to the 'exempt distribution' demerger rules necessarily resolves this concern (see Part 3).

The existing TiS rules provide an important safeguard for businesses wanting to restructure for genuine commercial purposes. We therefore recommend that the Chapter 2 proposal should not proceed unless and until HMRC has demonstrated that legitimate commercial demergers and restructurings can continue without disproportionate tax charges arising.

[4] https://www.gov.uk/hmrc-internal-manuals/capital-gains-manual/cg-app20

2.5 **Question 4: Can you anticipate any other unintended or unwelcome consequences of this proposal, such as on third party sales?**

2.6 Our principal concern is that the proposed 'frozen capital' rule would extend beyond the behaviour illustrated in Chapter 2 and could create new mismatches and unfair outcomes.

Third-party acquisitions

The Consultation acknowledges that the proposed frozen capital rule may lead to unfairness where shares are subsequently sold at arm's length to a third party.

The proposal is intended to remove a perceived mismatch between the CGT and distributions rules for the original shareholder. However, it may simply replace that mismatch with a different one for a subsequent unconnected purchaser.

Using the Chapter 2 example, suppose that Sarah, an unconnected third party, subsequently acquires the entire shareholding in New Co for its market value at that time of £4 million. Sarah's position would be fundamentally different from John's. She would have made a genuine investment of £4 million and would not have participated in the earlier share-for-share exchange.

If New Co later bought back 50% of Sarah's shares for £2 million, the frozen capital rule could mean that almost the whole payment is treated as an income distribution for Sarah by reference to the nominal amount originally subscribed by John. This would bear little relationship to Sarah's actual investment.

Sarah's CGT base cost would ordinarily reflect the £4 million she paid for the shares, while the amended distributions legislation would recognise only the historic frozen amount attributable to a different shareholder's original subscription. The proposal would therefore remove one asymmetry for John but create a new asymmetry for Sarah.

In addition, Sarah may not even be aware of the relevant historical transactions, particularly where they took place many years before her acquisition of the shares. This would place significant reliance on her obtaining detailed due diligence information before purchasing the shares (see 'Practical operation and tracking of "frozen" capital').

We do not consider it appropriate for the distributions treatment of an unconnected purchaser to depend on transactions undertaken by previous shareholders, which could have taken place many years before the purchaser acquired the shares.

This could also affect the commercial value of the shares. A purchaser may take account of the restricted ability to receive future returns of capital when determining the price they are prepared to pay. The historic frozen amount could therefore become relevant to due diligence, contractual protections and as a result the ability to locate a suitable buyer on future exit.

We believe that the changes to these rules could deter investment into UK companies and potentially harm the economy. Investors and private equity companies will have a limited return on capital where share buy backs occur, the result of Chapter 2 is that the UK could be seen as less competitive than other jurisdictions because of the limit on the return of capital due to the income tax treatment of such a return of capital.

Possible exceptions

We recognise that designing an exception would be difficult.

One approach might be to reset the frozen capital amount following a genuine arm's-length acquisition. However, such an exception would require rules to determine whether the acquisition was genuinely at arm's length and whether it formed part of wider arrangements. This would reintroduce the need to consider relationships, purpose and the surrounding facts.

Another approach might be to restrict the frozen capital rule to connected-party transactions. However, this would require detailed connected-party provisions and rules dealing with changes in connection, indirect ownership and arrangements involving more than one transaction. Such a rule may be of limited use to families where the business is being passed to the next generation, as family members may be reluctant to acquire shares if their 'connection' to the seller would lead to a less favourable tax treatment on a future return of capital. This could encourage the founder or current owner to consider third party sale or result in liquidation where no buyer can be identified. Again neither of these outcomes would be desirable.

These difficulties illustrate a wider problem with the proposal. A mechanical rule may initially appear simpler, but protecting legitimate transactions from unfair outcomes is likely to require exceptions which reintroduce complexity and factual judgments. Those exceptions may ultimately need to perform a role similar to the distinction already present within the TiS regime.

Wider consequences

If the frozen capital treatment follows the shares indefinitely, it could restrict the options available to the company and its future shareholders long after the original reconstruction. It may also affect commercial decisions about acquisitions, reorganisations, succession and the subsequent return of capital.

In summary, we are concerned that the proposal:

- treats commercially different transactions in the same way;
- may discourage family business succession;
- could prevent or materially restrict legitimate capital reduction demergers, limiting the ability for companies to restructure, and therefore grow;
- may create dry tax charges where no value has left the corporate sphere;
- creates a new mismatch for subsequent purchasers;
- could affect the commercial value and attractiveness of shares;
- may require complex exceptions which undermine the intended simplification; and
- could make the future tax treatment of a shareholder dependent on transactions undertaken by previous owners.

These consequences reinforce our view that HMRC should first establish whether the perceived problem can be addressed through a more targeted amendment to the existing anti-avoidance provisions. If the proposed frozen capital approach is pursued, substantial safeguards will be required for genuine commercial reorganisations, demergers, succession arrangements and arm's-length acquisitions.

Practical operation and tracking of "frozen" capital

The Consultation does not explain how frozen capital would be recorded, tracked or evidenced over time.

While the example in Chapter 2 is relatively straightforward, many real-world structures involve multiple reorganisations, successive holding company insertions, partial disposals and changes in ownership over long periods.

Practical questions therefore arise, including:

- how will shareholders, companies and advisers determine whether the frozen capital rule applies many years after the original restructuring?
- how will the relevant frozen amount be identified where there have been multiple reorganisations or successive holding company insertions?
- where a company is sold, will there be any obligation on the seller to notify the purchaser that the shares are subject to frozen capital treatment?
- if not, how will a purchaser know that future returns of capital may be affected?
- what happens where the issue is not identified during due diligence and only comes to light many years later, potentially after further transactions have been undertaken in reliance on an incorrect understanding of the position?

There is also a broader question as to whether the proposal may create future uncertainty and disputes.

3 Demergers

3.1 **Question 5: In what scenarios would you currently undertake or recommend a non-statutory demerger?**

3.2 In practice, a non-statutory demerger may be considered where the statutory exempt distribution demerger route is unavailable, uncertain or commercially unsuitable. Each client's circumstances will differ, and a competent adviser will consider the possible routes with the client, including the advantages, disadvantages and tax consequences of each. Non-statutory demergers remain important because they can provide a practical route to separate activities, shareholders or assets where the exempt distribution conditions cannot be satisfied.

In particular, a non-statutory demerger may be considered where:

- there are insufficient distributable reserves to carry out a statutory demerger;
- the 'trade' conditions are failed, or
- a sale of part of a company, trade or business is being contemplated.

The Consultation proposes some welcome relaxations to some aspects of the exempt distribution demerger rules. However, it does not address two of the key reasons why non-statutory demergers are used in practice: insufficient distributable reserves and where a sale of part of a company, trade or business is being contemplated. If, the Chapter 2 proposals proceed without addressing these issues, companies may be forced to rely on liquidation demergers or decide not to demerge at all. Neither outcome is desirable. Both could increase costs, reduce flexibility, delay commercial reorganisations and harm business performance.

3.3 **Question 6: Do you think that the statutory demerger rules ought to apply to a broader scope of transactions?**

3.4 Our members report that the exempt distribution rules are not currently well used. This is largely because of issues noted in question 5 and the number and complexity of the conditions.

We therefore agree that the exempt distribution rules should apply to a broader range of transactions. Simplifying the rules and extending them to circumstances involving investment activities, should make the relief more accessible and better aligned with commercial practice.

However, the proposed amendments should not be viewed as sufficient to address the consequences of removing capital reduction demergers under the Chapter 2 proposals. If the statutory exempt distribution demerger route is expected to operate as a practical alternative, it must be capable of applying across the range of commercial circumstances in which capital reduction demergers are currently used (see Question 5).

We are also concerned that the Consultation does not address the chargeable payments regime. The statutory demerger rules require that there are no chargeable payments within five years after the exempt distribution. Typical examples of chargeable payments include the repayment of share capital, or a share buy back.

The chargeable payments regime can therefore create a continuing risk for a period of five years after the exempt distribution. If triggered, the payment may be subject to Income Tax or Corporation Tax on income in the hands of the recipient, regardless of whether it is income in nature. This can make the statutory route significantly less attractive in practice.

We therefore recommend that HMRC reviews these areas alongside our recommendations in response to Question 7. Unless these issues are addressed, the proposed liberalisation of the statutory demerger rules may not provide a practical substitute for capital reduction demergers.

3.5 **Question 7: What comments and suggestions do you have regarding the amendments suggested above to the statutory demerger legislation?**

3.6 As the Consultation correctly identifies, if the proposed changes in Chapter 2 proceed, capital reduction demergers are likely to become extremely difficult to implement without triggering significant tax consequences for shareholders.

This is because the first step in a capital reduction demerger will usually involve inserting a new holding company, which can generate “new consideration”. This allows the subsequent reorganisation to take place without triggering an income distribution, with the transaction instead treated as capital in nature.

For the reasons set out in response to Questions 2 to 4, we do not believe that the Chapter 2 proposals should be enacted in their current form.

The key issue is that statutory direct and indirect demergers (‘exempt distribution demergers’) are subject to a number of conditions, and it is not always possible for all of those conditions to be met. In the example provided in Annex E, Charlie has not made a genuine extraction of value. However, if the Chapter 2 changes were implemented, he could be treated as receiving an income distribution calculated by reference to the market value of his original interest in Old Co. This would create a dry tax charge, because the value and activity represented by his interest in Old Co remains within C-New Ltd.

Annex E is materially different from the Chapter 2 example: in Annex E, the value remains within the corporate structure and there has been no personal extraction by the shareholder, whereas in Chapter 2 John receives money from the company while continuing to own the business. This distinction is important and should not be lost through a mechanical rule.

We welcome the proposal to liberalise the conditions for statutory demergers. This would be a positive development regardless of whether the Chapter 2 proposals proceed.

Condition A

We agree with the proposal to remove Condition A, which currently requires each relevant company to be UK resident or resident in a member state at the time of the distribution.

Condition B

We agree with and welcome the proposal to update Condition B to include investment companies. We also agree that references to 'trade' in the statutory demerger legislation should be expanded to include 'activity'.

The current Condition B can cause difficulties in practice because it only accommodates situations where companies are seeking to separate or divide trading activities. It does not cater for scenarios where, for example, shareholders wish to separate non-trading activities from trading activities. We consider that extending Condition B to include 'activity' would improve the usefulness of the rules.

Condition C

We agree with the proposal to remove Condition C. Condition C currently requires that the distribution must be made wholly or mainly for the purpose of benefiting some or all of the trading activities which—

(a) before the distribution are carried on by a single company or group, and

(b) after the distribution will be carried on by two or more companies or groups.

Condition D

Condition D requires that the distribution must not form part of a scheme or arrangement to which CTA 2010 s1081(5) applies.

CTA 2010 s1081(5) then sets out a number of circumstances in which Condition D is not met.

<u>CTA 2010 s1081(5)(a) the avoidance of tax</u>

CTA 2010 s1081(5)(a) refers to the avoidance of tax. This provision is very broad, particularly because it applies by reference to whether the distribution forms part of a scheme or arrangement. It can therefore operate as an all-or-nothing test. If the condition is failed because one party to the arrangements has a tax avoidance purpose, the statutory demerger relief may be denied for other shareholders involved in the same transaction. This approach is now different to the approach taken under the share reorganisation rules following the changes made to TCGA 1992, Part IV, Chapter II by Finance Act 2026, which allow HMRC to counteract avoidance by making just and reasonable adjustments. We therefore recommend that this condition is reviewed, where appropriate, aligned with the approach adopted elsewhere in the tax legislation.

<u>CTA 2010 s1081(5)(b) and (c) making a chargeable payment</u>

CTA 2010 s1081(5)(b) and (c) concern the making of a chargeable payment, including payments made in pursuance of arrangements with a company or with any of its main participators.

We would welcome clarification from HMRC as to why these provisions remain necessary particularly if the wider conditions are being revisited.

<u>CTA 2010 s1081(5)(d) sale of the distributing company and other relevant company</u>

CTA 2010 s1081(5)(d) concerns the acquisition by any person or persons, other than the members of the distributing company, of control of—

i. the distributing company,
ii. any other relevant company, or
iii. any company which belongs to the same group as the distributing company or any other relevant company,

The Consultation suggests amending this so that the restriction applies to onward sales within five years of the demerger, and does not apply after that period. It also suggests an exception to the five-year restriction where all trading activities are disposed of.

In practice, companies and groups may restructure in order to facilitate a commercial sale. For example, a third-party purchaser may not wish to acquire a particular element of a trade, activity or subsidiary, or the existing owners may wish to retain certain activities outside the sale. The proposed five-year relaxation would not appear to assist in that type of scenario.

Where a demerger or restructuring is undertaken to facilitate an arm's-length sale on commercial terms, it is difficult to see how taxpayers could reasonably be expected to wait five years before completing the sale. Commercial sale opportunities are often time-sensitive and may be outside the taxpayer's control.

We therefore do not consider that the proposed change would, of itself, make exempt distribution demergers significantly more attractive. There would still be a need to rely on non-statutory methods.

We recommend that HMRC considers Condition D in this context, and establishes whether the test remains necessary and, if it does, what alternative solutions or commercial exceptions should be available for businesses restructuring to facilitate an arm's-length sale on commercial terms.

CTA 2010 s1081(5)(e) the cessation of a trade after the distribution

As noted above, it can be difficult for businesses to plan five years in advance. Trading conditions may change, and a company may need to cease an activity or be wound up for reasons outside the taxpayer's control. Taxpayers will need certainty before undertaking these transactions. It is therefore important for HMRC to clarify what would count as not a voluntary dissolution or winding up, what evidence would be required, and how the rule would apply where circumstances change after the demerger. Without that clarity, the proposal risks introducing a further area of uncertainty which may only be tested years after the original transaction.

Another scenario that should be considered is where a business carries on multiple trades and one trade is underperforming. The shareholders may wish to demerge that trade in order to protect the remaining trades, sell the underperforming trade, or introduce new management to improve it. In those circumstances, s1081(5)(e) could prevent a commercial transaction if the trade is effectively prohibited from ceasing for five years after the distribution. Trading conditions can change quickly, and shareholders may not know whether the trade will recover. This requirement therefore introduces uncertainty. HMRC should consider what mischief this provision is designed to prevent and whether it remains necessary and proportionate.

CTA 2010 s1081(5)(f) the sale of a trade after the distribution

The Consultation states that this would be amended so that there should be no change of control within five years of the demerger.

We have similar concerns as for CTA 2010 s1081 (5)(e). HMRC should consider whether the test remains necessary, what mischief it is intended to address, and whether a more targeted commercial exception would be appropriate where the change of control arises from a genuine arm's-length transaction, succession planning or circumstances outside the taxpayer's control.

Condition E and H

We do not object in principle to the proposed amendment to Conditions E and H, under which "all or substantially all" would be replaced with "all" in order to provide greater clarity.

However, we would add that the phrase “substantially all” may provide useful flexibility in situations where it is not possible for the “all” requirement to be met. Although we do not have a specific example to provide, owner-managed business structures are often complex and unique, and “substantially all” could therefore play an important role.

In addition, we consider that HMRC should also take this opportunity to consider whether these conditions remain necessary and what policy purpose they serve. If the purpose of the wider reforms is to simplify and liberalise the statutory demerger rules, it would be helpful for HMRC to explain the mischief that Conditions E and H are intended to prevent and whether that mischief remains relevant.

Condition F

Condition F requires that the distributing company must after the distribution be either –

(a) A trading company, or
(b) The holding company of a trade group.

This is subject to exceptions contained in CTA 2010 S1082 (3) and (4).

We assume that the proposed amendments to Condition B would also be reflected in Condition F, so that references to a trading company or trading group would be expanded to include investment companies.

As with a number of the other conditions, we consider that HMRC should also review whether Condition F remains necessary and what policy purpose it serves.

Condition G

Condition G requires that if the trade is transferred, the distributing company must either not retain any interest in that trade or retain only a minor interest in it.

We do not foresee any significant issues with the proposed removal of Condition G.

Condition I

Condition I is that the only or main activity of the transferee company, or each transferee company, after the distribution must be—

(a)the carrying on of the trade, or

(b)the holding of the shares transferred to it.

We assume that the proposed amendments to Condition B would also be reflected in Condition I, so that references to the carrying on of a trade would be extended to include investment activity or wider business activity.

We welcome the proposal to soften Condition I so that it applies by reference to the position immediately after the transaction. However, we would urge HMRC to consider whether the condition could be relaxed further or removed altogether.

It would be helpful for HMRC to explain what mischief Condition I is intended to prevent and whether the condition reflects how businesses operate in practice. For example, a demerger may form part of a wider commercial restructuring under which significant changes are made to the trade or activity carried on by the transferee company after the transaction. In those circumstances, it is not clear that relief should depend on the transferee company continuing to carry on the same trade or activity in substantially the same form.

Condition J

Condition J is that the shares issued by the transferee company or each transferee company—

(a)must not be redeemable,

(b)must constitute the whole or substantially the whole of its issued ordinary share capital, and

(c)must confer the whole or substantially the whole of the voting rights in that company.

Unlike the proposed changes to Conditions E and H, we consider that the words "substantially the whole" remain necessary in Condition J. This is because the transferee company may already exist before the demerger, in which case it will have at least one 'founder share'. In those circumstances, it is not possible for the shares issued by the transferee company as part of the demerger to constitute the whole of its issued ordinary share capital or confer the whole of its voting rights.

We therefore do not recommend replacing "all or substantially all" with "all" for Condition J. Removing the flexibility currently provided by "substantially the whole" could prevent relief applying.

Condition K

Condition K requires, that the distributing company must after the distribution be either a trading company or the holding company of a trading group.

The Consultation document proposes relaxing condition K to allow the distributing company to be dissolved post distribution, provided that it contains no assets including cash or loans. It also proposes removing the exemption from Condition K in cases whereby the distributing company is a 75% subsidiary of another company due to redundancy.

First, we assume that the proposed amendments to Condition B would also be reflected in Condition K, so that references to a trading company or trading group would be expanded to include investment companies.

Secondly, CTA 2010 s1084 (2) provides that condition K does not need to be met if,

(a)there are two or more transferee companies each of which has transferred to it—

(i)a trade, or

(ii)shares in a separate 75% subsidiary of the distributing company, and

(b)the distributing company is dissolved without there having been after the distribution any net assets of the company available for distribution on a winding up or otherwise.

From the limited information provided in the Consultation, we believe that the proposed amendment would remove the current requirement in CTA 2010 s1084(2)(a), so that there would no longer need to be two or more transferee companies each receiving either a trade or shares in a separate 75% subsidiary of the distributing company. We agree with this proposed relaxation.

However, we would welcome clarification on the proposed change from the current requirement that the distributing company is dissolved "without there having been after the distribution any net assets of the company available for distribution on a winding up or otherwise" to a requirement that the company contains "no assets including cash or loans".

Conditions L and M

Condition L requires that the group (or, if more than one, the largest group) to which the distributing company belongs at the time of the distribution must be a trading group.

Condition M requires that the distribution ("the original distribution") must be followed by one or more other distributions ("further distributions") falling within section 1076(a) or 1077(1)(a)(ii) which—

(a) are exempt distributions, and
(b) comply with subsection (3).

The Consultation suggest removing both condition L and M. We have no immediate concerns with the removal of these conditions.

Right to apply for automatic appeal by Tribunal

The Consultation states that, given the proposed relaxation of the conditions and clarification of areas of legislative ambiguity, the government is also proposing to remove the right to apply for an automatic appeal to the Tribunal where a clearance request is denied.

We do not agree with this proposal. The right to apply for an appeal to the Tribunal is an important safeguard, particularly in an area of legislation which is complex and where the consequences of failing to obtain clearance can be significant.

This safeguard will become even more important if the Chapter 2 proposals proceed. Those proposals would remove the capital reduction demerger route and would therefore increase reliance on the statutory exempt distribution demerger rules. It would be inappropriate to increase reliance on that statutory route while also removing an important mechanism for independent review where clearance is refused.

Even if the statutory conditions are relaxed, there is likely to remain significant scope for judgement, particularly around whether the conditions are met in complex commercial restructurings. We therefore recommend that the right to apply for an appeal to the Tribunal should be retained.

Whilst we set out the importance of the appeals process above, as we discussed at our roundtable session, there could be situations where HMRC has misunderstood or misinterpreted the facts as they have been presented. We would question whether such a situation could be effectively resolved without the ability to appeal against a conclusion reached by HMRC.

3.7 **Question 8: Are there any other specific parts of the legislation which you think the government should re-examine?**

3.8 As noted in our response to Question 7, we consider that HMRC should use this review to consider whether other conditions within the exempt distribution demerger rules remain necessary and whether the proposed simplifications could go further. In particular, where a condition no longer serves a clear policy purpose, HMRC should consider whether that condition could be removed or further relaxed.

In addition, the legislation which sets out "exempt distributions" in the context of demergers is contained in CTA 2010 Part 23, Chapter 5. CTA 2010 s1075 provides that an "exempt distribution" means a distribution which is an exempt distribution by virtue of s1076, s1077 or s1078.

Part 23, Chapter 5, CTA 2010 s1076 states that "*A distribution is an exempt distribution if –*

> *(a)it consists of the transfer by a company to all or any of its members of shares in one or more companies which are its 75% subsidiaries,*
>
> *(b)each of conditions A to F in sections 1081 and 1082 is met in respect of the distribution, and*
>
> *(c)if the company making the transfer is a 75% subsidiary of another company, conditions L and M in section 1085 are met in respect of the distribution."*

Chapter 3 discusses Part 23, Chapter 5, CTA 2010 s1076 (b) and (c). However, the Consultation documents does not discuss Part 23, Chapter 5, CTA 2010 s1076 (a).

In practice, this requirement can prevent the statutory exempt distribution route from being used where the company or companies intended to be demerged are not 75% subsidiaries, even where there are genuine commercial reasons for the ownership structure.

We therefore recommend that HMRC considers whether the 75% subsidiary requirement in CTA 2010 s1076(a) remains necessary, or whether it could be relaxed or replaced with a more targeted safeguard.

The exempt distribution rules also include provisions on chargeable payments connected with exempt distributions. These rules are not always well understood and may add complexity. We recommend that HMRC also considers whether these provisions remain necessary, what policy purpose they serve, and whether they could be simplified as part of the wider review.

3.9 **Question 9 In what way do you think the demerger rules ought to be liberalised in order to account for the removal of capital demergers?**

3.10 The exempt distribution demerger route remains subject to a substantial number of detailed conditions. Even with the proposed amendments, there will continue to be circumstances in which a genuine commercial demerger cannot qualify for relief.

By contrast, capital reduction demergers and liquidation demergers have historically provided alternative routes where the statutory conditions could not be met, with anti-avoidance protection provided through targeted provisions, including the relevant CGT reorganisation rules.

It is worth noting that liquidation demergers are normally used as a last resort, and it is not desirable for this method to be relied upon where the exempt distribution demergers are not possible. The effect of a liquidation demerger is largely the same result as a statutory indirect demerger, without the same conditions having to be met, or the chargeable payment regime.

However, liquidation demergers are often not the preferred method because from a commercial perspective, there are negative perceptions associated with companies being involved in a liquidation. Liquidation demergers are normally more time consuming and costly to undertake, hence why Capital Reduction Demergers are often favoured.

We therefore recommend that HMRC considers whether further alignment is needed between the different demerger routes. In particular, HMRC should consider whether all of the detailed statutory conditions remain necessary, or whether some could be removed or relaxed and replaced.

3.11 **Question 10: Do you anticipate any unintended consequences as a result of the proposals set out in this chapter?**

3.12 As noted in our responses to Questions 7 to 9, we welcome simplification. However, if the Chapter 2 proposals proceed and capital reduction demergers are removed, the statutory demerger rules will need to operate effectively across a much wider range of commercial circumstances. If they do not, taxpayers may be left without a practical route to undertake genuine demergers or commercial reorganisations.

This could have a number of unintended consequences, including:

- increased reliance on liquidation demergers, which are generally more complex and should not become the default alternative;
- greater pressure on the clearance process;
- increased costs for owner-managed and family businesses;
- commercial restructurings being delayed or abandoned;
- increased uncertainty where businesses need to respond to commercial opportunities or changing trading conditions; and
- potential dry tax charges where value remains within the corporate structure and has not been extracted by shareholders.

We therefore consider it essential that additional consultation is carried out before proposals are finalised, with sufficient time for detailed review. We would also recommend that HMRC works with clearance teams to fully understand the breadth of transactions and the more practical issues companies and in particular owner managed businesses face when they need to restructure.

4 Income Tax treatment of distributions from non-UK resident companies

4.1 We have received no feedback from our members in respect of these questions in the time available and are unable to comment on these questions.

5 Interaction between debt, loans and the distributions legislation

5.1 **Question 22: Are you aware of instances where dividends or other distributions have been improperly paid? If so, were the distributions repaid to the company and on what timescale? What was the tax treatment generally adopted on the repayment?**

5.2 We are aware of situations in which dividends or other distributions have been improperly paid, most commonly because the company did not have sufficient distributable reserves at the relevant time. This may arise where a company is unrepresented, where the adviser involved does not have sufficient experience of company law requirements, or where the reserves position is not checked carefully before the distribution is made.

Issues can also arise where amendments or adjustments are later made to accounts following the discovery of an error. In those circumstances, there may have appeared to be sufficient distributable reserves at the date of the distribution, but subsequent amendments may show that this was not in fact the case. Similar difficulties can arise where the valuation used for goods or assets taken from, or sold to, the company is later found to be incorrect or is challenged.

Another example is where legal documentation has not been prepared correctly or the relevant company law requirements have not been met. For example, a transaction may rely on a dividend being paid by a subsidiary to create distributable reserves. If the documents are executed in the wrong order, or if the company's Articles of Association are not followed, the intended distribution may be invalid because the necessary reserves were not available at the relevant time. Owner-managed business tax planning can involve a large number of documents and, even where review processes are in place, errors can occur.

In smaller companies, particularly where a director-shareholder previously operated the business as a sole trader before incorporation, there may be limited understanding of the corporate veil and the distinction between personal and company ownership. It is therefore not uncommon for assets or goods to be taken from the company without the individual appreciating that tax consequences may arise. This is likely to be a particular issue for unrepresented taxpayers, who may be unaware of the complexities involved and we would suggest this should not automatically be treated as deliberate behaviour.

It is important that HMRC does not assume that every unlawful dividend must necessarily be repaid in all circumstances. Section 847 Companies Act 2006 provides that:

(2) If at the time of the distribution the member knows or has reasonable grounds for believing that it is so made, he is liable—

> *(a)to repay it (or that part of it, as the case may be) to the company, or*
>
> *(b)in the case of a distribution made otherwise than in cash, to pay the company a sum equal to the value of the distribution (or part) at that time.*

(3)This is without prejudice to any obligation imposed apart from this section on a member of a company to repay a distribution unlawfully made to him.

It should therefore not be assumed, when HMRC is considering the legislation in this area, that a shareholder will be required to repay the distribution in every case. For example, where a director has relied on accounts prepared or audited by a competent professional, it may be arguable that they did not know, and had no reasonable grounds for believing, that the distribution was unlawful at the time it was made.

Where no repayment obligation arises, the distribution would remain subject to Income Tax and no tax liability under Section 455 CTA 2010 should arise.

5.3 **Question 23: Would priority rules to establish what the primary charge will be on an extraction address the issue? Are there any adverse consequences to this?**

5.4 **Option 1: establishing a priority rule**

Priority rules could help address the issue, provided they are carefully targeted. In particular, a rule providing that the company is not liable under Section 455 CTA 2010 to the extent that the extraction has already been charged to Income Tax on the shareholder appears to offer a sensible starting point. This would provide a clearer hierarchy between the distributions code and the loans to participators rules, and could help prevent uncertainty about which charge should take priority.

We believe that the exception where “the company has recognised the debt and pays, or has paid, the charge due under section 455 on that amount within a certain period of time” is also important. However, the relevant period should run from the time the issue is discovered, rather than from the date of the original extraction. This would better reflect the practical reality that historic errors may only come to light several years later.

This would be particularly helpful where the issue relates to a historic extraction, such as the example in Annex G, and is only identified some years later. It may also provide greater certainty where a company is undergoing due diligence before a sale. If an historic unlawful distribution is identified during the due diligence process, a purchaser may require disclosure to HMRC, specific indemnities, warranties or other contractual protections. In some cases, uncertainty over the correct tax treatment could delay or even prevent the transaction from proceeding. The priority rule would provide certainty in this situation.

However, any priority rule would need to be carefully drafted to avoid creating new unfairness or opportunities for manipulation. In particular, HMRC should consider how the rule would operate where there are multiple shareholders or where ownership has changed since the original extraction. There may also be a risk of avoidance if taxpayers are able to characterise an amount as an unlawful distribution after the event, arrange for Section 455 to be paid, and then seek to recover Income Tax previously paid by the shareholder, the rule could potentially be used to shift the effective tax charge into a later period or a period in which lower rates apply.

For that reason, any priority rule should include safeguards. HMRC should also consider whether claims to displace one charge in favour of another should be subject to appropriate, evidence requirements and anti-avoidance protections.

We discuss the double taxation issue in our response to Question 25.

We cannot identify any fundamental objection to the principle of a priority rule, subject to the points above and to our response to Question 25. However, the practical consequences will depend heavily on the detailed drafting of the relevant legislation. It is therefore essential that HMRC publishes draft legislation and provides sufficient time for professional bodies, advisers and businesses to consider whether the rule operates as intended and whether any adverse consequences arise.

5.5 **Question 24: Do you have any views as to whether legislating for the current discretionary practice of unwinding unintentional gratuitous transfers would provide a solution?**

5.6 We consider that legislating the current discretionary practice could be helpful, but only as a limited solution for genuinely unintentional transfers. It would provide welcome certainty where the parties did not intend a distribution or other extraction to arise, and where the position is corrected once the error is identified.

However, this would not address the wider issues considered in this chapter. In particular, it would not assist where value was intentionally extracted but the transaction is later found to have been unlawful under company law.

We agree that, if this option is taken forward, the legislation will need to draw a clear boundary around the circumstances in which unwinding is available. Without clear rules on timing, evidence and consequences, there is a risk that legislating the practice simply replaces one area of uncertainty with another.

Overall, we would support this option as part of the package of measures.

5.7 **Question 25: What are your views on allowing Income Tax paid on an unlawful distribution to be set off against liabilities incurred on rectifying the issue?**

5.8 **Option 3**

We consider that Option 3 is necessary to prevent unfair outcomes arising from the interaction between the distributions legislation, the loans to participators rules and company law requirements.

Options 1 and 2 would not change the company law position. Where a distribution has been unlawfully made, the shareholder may still be required to repay the amount to the company in certain circumstances. A priority rule of the kind described in Option 1 may address the company's Section 455 position by providing that the company is not liable to Section 455 to the extent that the distribution has already been charged to Income Tax. However, it does not fully address the shareholder's position where the amount taxed as income must subsequently be repaid to the company. In that situation, the shareholder may have paid Income Tax on value that they are no longer entitled to retain.

This can produce an unfair result. For example, in the scenario described in Annex G, if Jane has suffered an Income Tax charge on a £200,000 dividend but is then required to repay that amount to the company under company law, she may be left having paid tax on value which she has not ultimately retained (assuming she cannot reclaim the Income Tax paid). If the position is later rectified by a further dividend or other distribution, there is also a risk of a second Income Tax charge unless appropriate relief or set-off is available.

We therefore support, in principle, allowing Income Tax paid on an unlawful distribution to be set off against liabilities arising when the issue is rectified, provided that the rules are carefully targeted. This would help prevent double taxation. The set-off should be available only to the extent that the same value has already been subject to Income Tax and the subsequent rectification gives rise to a further tax charge.

However, the detailed operation of the set-off would need careful consideration. In particular, HMRC should clarify how the rules would apply where the repayment is left outstanding as a loan to the shareholder from the company, where that loan is later waived or written off, or where the position is rectified through a later dividend or other transaction.

We also recommend that HMRC considers how the set-off would be evidenced and tracked over time. The rules should be designed so that they are practical to operate and do not create additional uncertainty.

Overall, we consider that Option 3 is an important part of the solution. Without a mechanism to relieve Income Tax already paid, priority rules may resolve the company’s Section 455 position but still leave the shareholder exposed to unfair double taxation or taxation on value which has had to be returned to the company. We therefore recommend that HMRC develops Option 3 alongside any priority rule, rather than treating it as a separate or secondary measure.

5.9 **Question 26: What alternative solutions might be implemented to address the issues raised in this chapter?**

5.10 We believe that all three options in this section should be taken forward, subject to consultation on the draft legislation and impact of the measures.

6 Loans and other temporary extractions from non-UK resident companies

6.1 **Question 27: Given that the tax would need to be paid by individuals rather than by the companies making the loans, would this result in particular administrative difficulties? If so, please provide examples.**

6.2 We agree with the underlying principle that the treatment of UK resident companies and non-UK resident companies should be aligned where possible. However, alignment should not be achieved in a way that creates disproportionate complexity for individual taxpayers or imposes obligations which they may not be able to meet in practice.

We are concerned that this proposal could create significant practical and administrative difficulties unless the rules are carefully targeted and supported by clear safeguards.

Unlike the existing loans to participators regime for UK close companies, under these proposals the tax would be payable by the individual rather than by the company making the loan. The individual would need to identify whether the company would be close if it were UK resident, whether they are a participator or associate, whether the loan falls within the proposed charge, and what amount should be reported.

We do not agree with the statement that “*The close company definitions are written broadly, such that it should not be onerous to determine whether a person is a participator in an overseas company that would be close if it was UK resident*.”

The loans to participators rules are already complex and are often misunderstood by UK close companies. Extending a similar regime to non-UK resident companies, and placing the compliance obligation on individuals, risks applying already difficult rules to taxpayers who may not have the information, control or technical understanding needed to identify whether a charge arises. This would be more likely to be the case where the individual is unrepresented, as the non-UK resident company is unlikely to make them aware of any potential reporting requirements.

In particular, a UK resident individual may be involved in a non-UK company structure that they did not create and do not control. They may not have access to the company’s ownership structure, accounts, connected-party information, loan records or wider arrangements needed to determine whether the company would be closely controlled, whether they are a participator or associate, and whether the loan falls within the proposed charge. Non-UK companies and their advisers may also be unfamiliar with UK close company and loans to participators concepts, making it difficult for the individual to obtain the information needed to take advice and report correctly.

A further practical difficulty is that the existing close company rules can already be complex to apply where for example a company has multiple classes of shares. Non-UK companies may have complex share and capital structures that do not readily align with UK concepts. Applying the UK close company rules in these circumstances can be challenging and may require detailed analysis, further increasing compliance burdens and uncertainty.

There is also a risk that the charge could be overlooked where the loan is not intended to be a substitute for a dividend or other profit extraction. In those circumstances, the individual may only become aware of the issue some time after the relevant reporting deadline has passed.

We are therefore concerned that, while the proposal may be understandable, it may not be realistic to expect individuals to identify and report these charges. If HMRC’s concern is that loans from non-UK resident closely controlled companies are being used deliberately to extract value without an Income Tax charge, we suggest that a more targeted anti-avoidance rule may be preferable to a broad regime which places significant compliance obligations on individuals.

It should be noted that the Consultation states that these proposals are targeted at loans that represent extractions of profits in lieu of taxable payments. We recommend that HMRC consider how the proposals would interact with the Foreign Income and Gains (FIG) regime. For example, where an individual has recently become UK resident and elects into the FIG regime, a dividend paid by a non-resident company during the individual's first four years of UK residence may not be subject to UK Income Tax. In these circumstances, we do not consider that it is appropriate for a Section 455 charge to arise. HMRC should consider interactions with the FIG regime further to ensure that there are no unintended consequences.

If the proposal is taken forward, HMRC should clarify what information individuals will reasonably be expected to obtain, how they will be able to obtain it, and what protections will apply where an individual has taken reasonable care but does not have access to the information needed to determine whether the charge applies. HMRC should also consider carefully how any changes would be communicated to affected taxpayers, and we strongly recommend that these proposals are subject to further consultation.

6.3 **Question 28: What general comments do you have on the proposal to introduce a temporary tax on loans received from non-UK resident closely controlled companies?**

6.4 The Chapter 6 proposals may impact employee share plans. See Appendix 1, Case Study 1, for an example. It will be essential that specialists from HMRC’s Employee Shares and Securities Unit, including officials involved in the Treasury’s Tax Support for Entrepreneurs: Call for Evidence, be given the opportunity to input on the potential impact of these proposals and ensure that any reforms which derive from this Consultation fully consider the policy aims and operational aspects of the existing ERS regime and any potential reforms to support entrepreneurs.

Please also see our response to Question 27.

6.5 **Question 29. Do you have any specific comments on the four options outlined above? Do you have any suggestions as to what time periods would be appropriate?**

6.6 We have significant concerns about the practical operation of all four of the options (see question 27).

Option 1

There is a practical difficulty where the company's accounting period does not align with the UK tax year. The individual may need to identify the amount outstanding at 5 April, even though the company prepares its accounts to a different date. This could require additional reconciliation work part way through an accounting period, and may be particularly difficult where the individual does not control the company or have ready access to its records.

The same issue arises on 31 January where the individual will need to determine whether or not the loan has been repaid since the end of the tax year.

We consider this to be a fundamental issue as, especially where the individual does not control the company, they may not be able to access the information that they need to determine whether a Section 455 charge has arisen.

In relation to Option 1, we note that it is common for individuals to submit their Self Assessment tax returns before 31 January following the end of the tax year. At the point the return is submitted, it may not yet be known whether the loan will be repaid before the proposed deadline. If this option is adopted, HMRC should provide a simple reporting mechanism which allows an individual to report the charge on or before 31 January without needing to amend or resubmit a tax return which has already been filed.

We assume that, if a temporary charge is introduced, any amount charged would be repayable when the loan is repaid or written off in relevant circumstances. This should be made clear in the legislation. Where a loan is written off, the individual may also be subject to an Income Tax charge on the release. As both the temporary charge and the Income Tax liability would fall on the individual, HMRC should consider whether any repayment of the temporary charge could be set off against the Income Tax liability arising on the write-off, rather than requiring separate payments and repayments.

Option 2

We have similar concerns in relation to Option 2. However, note that the additional time may be helpful for example where more time is needed to carry out the additional reconciliation work to calculate the value of the loan at the end of the tax year. However, the other concerns raised under option 1 are still relevant.

Option 3

Option 3 seems to offer the most straight forward solution. However, similar concerns arise where the individual might not be aware or have the rights to request the information to calculate whether or not a charge has been triggered. There may also be legal differences to consider. Further consultation is required before we can determine if this is an appropriate option.

Option 4

We do not support Option 4. A deemed realisation rule after a fixed period would not align the treatment of non-UK resident companies with the existing rules for UK resident close companies. The stated aim of this part of the Consultation is to align the treatment of distributions from non-UK resident companies with the treatment of distributions from UK resident companies. Introducing a deemed realisation rule for non-UK companies only would appear to go beyond that objective and would create an asymmetry between UK and non-UK companies**.**

We recognise that a material interest test could help to target the measure more effectively and reduce the risk of applying the charge to individuals with only minor interests. However, HMRC should consider how such a test would interact with the wider objective of alignment.

We would also welcome further detail on the alternative suggestion of broadening the existing exclusion for loans or advances made in the ordinary course of business. We cannot comment fully without understanding how that exclusion would be defined, what conditions would need to be met, and whether any equivalent change would also be made for UK resident close companies.

6.7 **Question 30: The close company definition is extremely broad. Can you see this proposal affecting loans made on arm's length terms to participators with very minor interests, and if so, can you provide examples?**

6.8 See comments in questions 27 and 30.

6.9 **Question 31: What impacts would the proposal have on arm's length commercial lending?**

6.10 As noted in our response to Question 27, individuals may not always have the information needed to determine whether the overseas company would be close if it were UK resident. This could make ordinary commercial lending more complex and may lead taxpayers to avoid transactions which are not within the intended mischief.

6.11 **Question 32: Would limiting this charge to participators and associates of participators with material interests in the overseas companies help to target this at loans which represent extractions of profit?**

6.12 Yes, a material interest test could help to target the proposal more effectively. It would reduce the risk of the charge applying to individuals with only very minor interests in an overseas company, where the loan is less likely to represent an extraction of profits in substance.

While a 5% threshold would be helpful in removing some minor interests from scope, it would only assist to a limited extent. There may be many cases where an individual holds more than 5% of the overseas company, for example 7%, 8% or 9%, but still does not control the company or have access to the information needed to determine whether the proposed rules apply. Such an individual may still face the same practical difficulties identified in our response to Question 27.

There is also a practical difficulty for individuals who ultimately fall below the material interest threshold. In order to determine that they are outside the scope of the charge, the individual would still need to carry out an analysis of their interest, the interests of their associates and the relevant rights attaching to the shares or other interests in the overseas company. That analysis may itself be complex, particularly where there are indirect holdings, connected persons, different classes of shares or incomplete information about the company's ownership structure.

This means that a material interest threshold may reduce the number of individuals who are ultimately within scope, but it will not necessarily remove the compliance burden for those who need to establish whether they are within or outside the threshold. That burden may be particularly difficult where the company is incorporated or resident in another jurisdiction and the individual does not have access to all relevant records.

6.13 **Question 33: If we expand the exclusion for loans or advances made in the ordinary course of business, what changes would be necessary to avoid curtailing normal commercial activity?**

6.14 We would support further consideration of an expanded exclusion for loans or advances made in the ordinary course of business. For consistency, this should apply to both UK and non-UK resident companies.

HMRC should also ensure that the exclusion does not become too narrow to be useful.

7 Purchase of Own Shares rules

7.1 Question 34: What general comments do you have on the proposals set out in this chapter?

7.2 We support the principle of the replacement of the trade benefit test with clear statutory conditions. However, we are concerned that some of the proposed conditions could reduce the usefulness of the POS rules in the very circumstances in which they are commonly used (and are intended to be used), particularly in owner-managed and family companies.

The POS rules provide an important exit mechanism where a shareholder needs to leave a company and the company wishes to continue. They can be particularly important where there is no third-party purchaser, where the remaining shareholders do not wish a third-party purchaser to be introduced, or where a management buy-out would be too costly or complex. It is therefore important that any simplification reflects the commercial reality of these transactions.

Minimum 5% shareholding and working requirement

We are concerned about the proposed requirement that the departing shareholder must have held at least 5% of the company's equity for two years and must have worked for the company throughout that period. This contrasts with the existing five year ownership period without the working requirement.

The apparent reduction of the ownership period from five years to two years is welcome, although the Consultation does not make it clear whether this replaces or is in addition to the existing five year ownership period. In any case, we question whether any minimum ownership period provisions are necessary at all where the shareholder is genuinely exiting and the buyback is being undertaken to enable the company to continue. For example, if a shareholder has held shares for one and a half years rather than two years, it is not clear why that should prevent capital treatment where the commercial purpose of the transaction is otherwise clear.

We are also unclear on the rationale for a 5% minimum holding requirement. A company may have a genuine commercial reason to buy out a shareholder with a smaller interest. For example, shares may have been passed down through a family over time and a minority shareholder may have little involvement in the business. It may nevertheless be in the company's interests to simplify the ownership structure by buying back that shareholder's shares. If capital treatment is not available in those circumstances, taxpayers may be pushed towards more costly structures, such as management buy-outs, even where a purchase of own shares would be simpler and more appropriate.

The proposed requirement that the shareholder must have worked for the company is also problematic. In owner-managed and family run companies, it is common for some shareholders to work in the business while others do not. For example, a spouse or older relative may hold shares but have limited involvement in the company.

Another example is where a founder who has built and managed a business over many years is diagnosed with a serious illness and must step back from the company. A family member may assume responsibility for running the business and, if their condition subsequently deteriorates or the condition becomes terminal, that family member may be the natural successor from a commercial perspective. Where that individual cannot afford to purchase the company outright, a POS could provide a sensible succession route. However, the proposed working requirement may prevent relief from being available in precisely these circumstances.

If a working requirement is introduced, HMRC should clarify what "worked for the company" means. For example, would part-time work be sufficient? Would there need to be an employment contract? Would acting as a director or company officer be sufficient? How would the test apply to unpaid roles or informal involvement in a family business? How would it apply where there is a period of maternity leave or sick leave?

Requirement to surrender the entire shareholding and any directorships

We do not support a requirement for the departing shareholder to surrender their entire shareholding and any directorships on departure.

In many family and owner-managed businesses, a founder or long-standing shareholder may have spent many years building the company. Allowing that individual to retain a small shareholding for sentimental reasons may provide comfort and make succession more achievable. Removing that flexibility could make the POS route less attractive and result in companies instead being liquidated to allow the founder to secure capital treatment.

In addition, allowing the seller to remain a director following the transaction may be essential to the continued success and stability of the business. Requiring an individual to cease their directorship immediately following a POS would remove the opportunity for a transitional handover period, during which the incoming management team can be trained, key relationships transferred and knowledge passed on. This could make succession planning more difficult and potentially impact the long-term success of the business.

Tranche payments and the two-year exit period

We welcome the proposal to allow relief where sales take place in tranches to reflect the availability of reserves although would question how this would operate given the changes in the context of the HMRC guidance[5] announced in early 2022. This is a practical issue that can prevent a purchase of own shares from being used under the current rules.

However, we consider that the proposed two-year period is likely to be too short. HMRC should gather evidence from clearance teams, advisers and businesses on the typical duration of owner-managed business buyouts before setting a fixed period. A period of five years, or possibly longer, may better reflect commercial reality.

Consideration not exceeding market value

TCGA 1992 s17 and s18 should already provide this protection, therefore we do not consider it necessary to introduce a new condition.

Family connections and five-year period

We strongly disagree with extending the holding and working period requirements to five years where the departing shareholder retains family connections with remaining shareholders or directors.

Family succession is one of the key contexts in which POS is currently used. A family connection does not, of itself, mean that the transaction is a tax-motivated extraction of value. The tax rules should support commercially sensible succession planning, not make it more difficult.

Such a rule may discourage lifetime succession, push businesses towards more costly structures, or make third-party sale or liquidation more attractive than passing the business to the next generation.

Re-entry within five years

[5] https://assets-eu-01.kc-usercontent.com/220a4c02-94bf-019b-9bac-51cdc7bf0d99/c0957d52-b133-4b2c-9743-88ba49b443f8/220218%20HMRC%20note%20on%20PoS.pdf

We are also concerned about the proposal to withdraw relief if the departing shareholder becomes a director or shareholder again within five years.

In the context of POS, there may be genuine commercial reasons why a former shareholder or director needs to return to the business. For example, a family business may require support from the former owner if the next generation encounters serious illness, death or unexpected trading difficulties. Preventing that person from returning could harm the company and may discourage sensible contingency planning.

We also do not consider it reasonable to require an individual who inherits shares following a previous buyback to dispose of those shares as soon as practicable in order to preserve the original tax treatment. It is unclear what mischief such a rule is intended to prevent, particularly as the acquisition arises as a result of death rather than any tax-motivated arrangement.

For example, a father may sell shares to the company to facilitate succession planning, with those shares subsequently being inherited by his son. If the son then dies unexpectedly and the shares pass back to the father, we do not consider it appropriate to require the father to dispose of the business in order to preserve his original tax position. In practice, it may not be possible to identify a suitable purchaser within a short timeframe, particularly where the business is closely held or family-run. Such a requirement could therefore force a sale on unfavourable terms or, in extreme cases, contribute to the cessation of an otherwise viable business, with potentially harmful economic consequences.

If HMRC is concerned about arrangements under which a shareholder exits and then deliberately re-enters the company, the rule should be targeted at cases where re-entry formed part of arrangements in place at the time of the buyback. It should not apply automatically to unforeseen circumstances arising after the transaction.

7.3 **Question 35: What unintended consequences do you anticipate as a result of these changes?**

7.4 The main unintended consequence is that the proposed simplification may make the POS route less useful in practice, particularly for owner-managed and family companies.

Although we support the objective of greater certainty, several of the proposed conditions do not appear to reflect the commercial reality of these transactions. In particular, the proposed working requirement, minimum 5% shareholding, full exit requirement, two-year tranche period, family connection rule and five-year re-entry restriction could all prevent capital treatment in situations where a purchase of own shares is being used for genuine commercial reasons.

This may push companies towards more complex and costly alternatives, such as management buy-outs, liquidation, or third-party sale. In some cases, it may mean that a business cannot be passed to the next generation at all. That would be an undesirable outcome, particularly for successful owner-managed and family businesses which may otherwise continue to provide employment, investment and economic activity.

There is also a risk that the rules become simpler in form but more restrictive in substance. A mechanical test may provide certainty only by denying relief in cases where the current trade benefit test would have allowed HMRC and advisers to take account of the commercial context. If the new conditions are too rigid, they may replace uncertainty with unfairness.

The Chapter 7 proposals may impact employee share plans. See Appendix 1, Case Study 2, for an example. It will be essential that specialists from HMRC's Employee Shares and Securities Unit, including officials involved in the Treasury's Tax Support for Entrepreneurs: Call for Evidence, be given the opportunity to input on the potential impact of these proposals.

We recommend that HMRC works closely with clearance teams, professional bodies, advisers and businesses to understand how purchase of own shares relief is used in practice. The rules should be simplified in a way that supports genuine exits and succession planning, while retaining targeted safeguards against tax-motivated extraction of value.

8 Updated capital extraction anti-avoidance

8.1 **Question 36: What general comments do you have on the proposal set out in this chapter?**

8.2 Our comments in response to Questions 2, 3 and 4 are also relevant to the proposal in this chapter. In those responses, we explain our concern that the Consultation does not clearly identify the specific gap in the existing legislation which the proposed changes are intended to address.

We would welcome further evidence from HMRC on where the current rules are not operating effectively. In particular, it would be helpful to understand whether HMRC considers that the existing TiS rules are ineffective, whether there are practical or evidential difficulties in applying them, or whether there are specific categories of transaction which fall outside the current regime.

We are reluctant to support the introduction of a new rule without a clearer explanation of the underlying policy issue. The existing case law and HMRC practice in this area provide a degree of certainty for taxpayers and advisers. Replacing or supplementing the current framework with a new rule risks creating more uncertainty than it removes, particularly if the new rule does not clearly distinguish between tax avoidance arrangements and transactions undertaken for genuine commercial purposes.

HMRC should work closely with professional bodies, advisers and clearance teams to understand the practical consequences of any change before the proposals are taken forward.

8.3 **Question 37: What unintended consequences do you anticipate as a result of this proposal?**

8.4 As noted in our responses to Questions 2, 3 and 4, the main unintended consequence is that a new rule could apply more broadly than the mischief it is intended to address. If the rule applies mechanically, without sufficient regard to the purpose or commercial context of the transaction, it may affect genuine commercial restructurings, family business succession arrangements, third-party sales and demergers.

We are concerned that a new rule could in practice therefore increase complexity rather than simplify the legislation. In particular, it may generate a need for further exceptions, safeguards and guidance to prevent ordinary commercial transactions from being adversely affected. This risks recreating many of the judgement-based issues already present in the existing regime, while removing the benefit of established case law and practice.

We therefore recommend that HMRC should not proceed with a new rule unless it can clearly identify the gap in the current legislation, explain why the existing anti-avoidance provisions cannot be amended to address that gap, and consult on draft legislation with sufficient time for detailed review.

9 Contact details

9.1 We would be pleased to join in any discussion relating to this Consultation. Should you wish to discuss any aspect of this response, please contact us at atttechnical@att.org.uk.

The Association of Taxation Technicians

10 Note

10.1 The Association is a charity and the leading professional body for those providing UK tax compliance services. Our primary charitable objective is to promote education and the study of tax administration and practice. One of our key aims is to provide an appropriate qualification for individuals who undertake tax compliance work. Drawing on our members' practical experience and knowledge, we contribute to Consultations on the development of the UK tax system and seek to ensure that, for the general public, it is workable and as fair as possible.

Our members are qualified by examination and practical experience. They commit to the highest standards of professional conduct and ensure that their tax knowledge is constantly kept up to date. Members may be found in private practice, commerce and industry, government and academia.

The Association has more than 10,000 members and Fellows together with over 7,000 students. Members and Fellows use the practising title of 'Taxation Technician' or 'Taxation Technician (Fellow)' and the designatory letters 'ATT' and 'ATT (Fellow)' respectively.

Appendix 1

Case Study 1: loans to facilitate senior executive share ownership

Scenario

A UK resident trading company has an overseas resident parent company which, were it UK resident, would be a 'close' company.

To align the interests of shareholders and senior management, the group establishes a global Management Incentive Plan (MIP).

This facilitates the market value acquisition of meaningful equity stakes in the parent company by executives using loans provided by the parent company.

The current position

Under current legislation, participating UK executives would be subject to income tax charges on receipt of the loan from the overseas parent company only if it is a 'cheap taxable loan' within the meaning of ITEPA 2003, section 175 and no relevant exceptions apply (e.g., where all qualifying conditions are met, relief for interest on a loan used to acquire shares in an EEA resident company which would be 'close' were it UK resident). Any annual cash equivalent of the benefit of the loan based on the UK official rate of interest would be treated as earnings.

Depending on the size of the loan required to participate in the MIP, such annual income tax charges under the benefits code do not generally present a barrier to participation in such plans for UK resident executives.

Additionally, any amount of the loan that is released or written-off would be treated as earnings under ITEPA 2003, section 188 (unless, broadly, that release or writing-off is otherwise subject to income tax).

Possible impact of suggested reforms (Chapter 6 of the Consultation)

In many cases, imposing a tax charge under CTA 2010, section 455 (currently at 35.75%) on UK resident participants on receipt of the loan, presumably in addition to any annual income tax charges due under the benefits code, would present a material new barrier to participation in a MIP.

This could put UK resident individuals at a disadvantage in relation to their overseas peers, in that the increased personal tax cost of the parent company loan (even if refunded on repayment of the loan) could reduce the extent to which UK resident executives could participate in, and benefit from, the MIP.

Reduced MIP participation could also reduce the extent to which UK resident executives are incentivised to grow the UK businesses that they lead.

Deferring a tax charge under CTA 2010, section 455 to, or deeming the loan to have been released or written-off for income tax purposes at, the end of a set period after the loan is made (e.g., three or five years) could have a similar effect. This could be the case if UK executives are concerned that this period would end before an exit or other opportunity to sell their shares to fund repayment of the loan arises.

Potential alternative approaches

The impact that any additional personal tax charges (even if refundable) could have on UK executives' ability to participate in such global MIPs on a similar basis to their international peers should be carefully considered.

One potential approach would be to exclude loans made for the purposes of a *bona fide* employee share plan (perhaps defined in line with CA 2006, section 1166) from the scope of CTA 2010, section 455 (potentially, and for consistency, for both UK resident as well as non-resident companies to remove the competitive disadvantage currently placed on UK resident companies who wish to offer such arrangements).

Any such alternative approaches should be subject to specific stakeholder consultation.

Case Study 2: company purchase of own shares acquired under a tax-advantaged employee share plan

Scenario

A UK resident trading company operates a tax-advantaged Enterprise Management Incentives (EMI) share option plan.

For many individuals, the gain realised on disposal of their shares will be the main financial benefit of employee share ownership (Graeme Nuttall, Sharing Success: the Nuttall Review of Employee Ownership (Department for Business, Innovation & Skills 2012), p. 65, para. 5.34). Additionally, a market in the company's shares has been associated with increased productivity in companies which offer tax-advantaged employee share plans (HMRC Research Report 33, Tax advantaged employee share schemes: analysis of productivity effects (Oxera Consulting Ltd, 2007), page 5).

However, a sale or listing of the company is not in prospect.

The company is therefore concerned that the lack of any opportunity for current employee shareholders who acquired shares under the EMI plan to sell some or all of their small minority shareholdings makes the company's EMI plan less effective as an incentive for employees generally.

Having considered the alternatives, the company identifies a purchase of own shares as the simplest and most cost-effective liquidity event for current employee shareholders, and therefore to ensuring that the EMI plan continues to attract, retain, and incentivise a high-quality workforce to grow the company's business.

The current position

Whilst the current qualifying conditions mean that this relief is narrowly targeted, in principle it is possible for small minority shareholdings to be bought back by the issuing company with Capital Gains Tax (CGT) treatment for the vendors (e.g., where HMRC accept that the buyback benefits the company's trade by ensuring that its employee share plans effectively incentivise the workforce and all other qualifying conditions are met).

This would allow employee shareholders who acquired shares through the EMI plan to participate in the value they create at CGT rates (potentially at a reduced Business Assets Disposal Relief (BADR) rate) in line with the EMI code's policy intent.

Possible impact of suggested reforms (Chapter 7 of the Consultation)

Amending CTA 2010, section 1033(2) Condition A to require a minimum 5% shareholding (which we note is not required to access BADR for 'relevant EMI shares') and limiting it to employee shareholders whose employment ceases would mean that CGT treatment could not be available in this scenario.

Instead of EMI plan participants realising the value they helped create at CGT rates, the difference between the price paid for their shares on exercise of the EMI option and the disposal proceeds received would be subject to income tax at rates of up to 39.35% (instead of CGT potentially at 18%). This appears to undermine the policy underlying the EMI code, and in any case substantially reduces the tax advantages that arise from EMI options.

Potential alternative approaches

One way to replace the subjective trade benefit test with more objective criteria generally, whilst allowing companies to incentivise employees effectively using purchases of own shares in conjunction with employee share plans by widening the circumstances in which CGT treatment could be accessed, would be to introduce a specific exemption (potentially modelled on ITTOIA 2005, section 385A but accommodating continued employment and with no minimum shareholding period etc.) from distribution treatment on the buy-back of shares acquired under a *bona fide* employees' share plan (perhaps defined in line with CA 2006, section 1166), or at least acquired under a tax-advantaged share plan such as EMI or CSOP.

Any such alternative approaches should be subject to specific stakeholder consultation.