03 November 2017

HMRC by email

Dear Victor and Claire

Company Winding Up Targeted Anti-Avoidance Rule (TAAR) – HMRC Guidance

On behalf of the Association of Taxation Technicians (ATT) I am writing to you regarding HMRC's guidance on the company winding up TAAR at s396B/s404A ITTOIA 2005 (the *TAAR guidance*) which was published in the Company Taxation Manual at CTM36300 onwards on 19 July 2017.

We have previously commented on the scope and practical application of the TAAR in our response to the consultation document *Company Distributions* published by HMRC on 9 December 2015 together with draft versions of what form clauses 33, 34 and 35 of Finance Bill 2016.[1]

The purpose of this letter is to set out our concerns over the content and scope of the TAAR guidance, and also to suggest areas where we believe it could be improved to provide greater certainty for taxpayers and HMRC staff.

In the body of the letter we outline our main observations regarding the scope of the TAAR guidance together with some specific comments on clearance procedures and penalties. In the Appendix, we include some more detailed technical observations and propose some real life examples for consideration.

The primary charitable objective of the ATT is to promote education and the 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. This letter is written with that background.

General observations on the TAAR guidance

Overall, we find the TAAR guidance disappointingly brief given the time it has taken to be produced. At the time of publication, the TAAR had been in force for over 15 months, and over 11 months had passed since HMRC published the first examples in the standard letter to taxpayers seeking clearance under the TAAR (the *HMRC letter*).

In particular, the guidance contains only limited examples as to how the TAAR will operate in practice. Given the lack of clearance procedures in the TAAR and the subjective nature of the

[1] This ATT's response to that consultation is at: https://www.att.org.uk/technical/submissions/company-distributions-att-comments

legislation, more practical examples would have helped greatly in providing certainty for taxpayers who are required to self-assess whether the TAAR will apply.

We note that the examples that are included in the guidance are relatively basic and the depth of HMRC's analysis inconsistent. Whilst some reach a conclusion as to whether Condition D will apply, others do not. More detailed examples would have been appreciated, especially regarding the operation of Condition D.

The Appendix to this letter contains our more detailed observations on the TAAR guidance and the examples published.

This Association (and doubtlessly other professional bodies) had indicated their willingness to provide comment on draft guidance. Although we appreciate that the purdah periods associated with the EU referendum and the June general election may have made this difficult, we believe an opportunity has been missed to improve the TAAR guidance before it was released to the public.

Clearance procedures under the TAAR

The lack of any clearance facility under the TAAR is unhelpful given the subjective nature of the TAAR legislation and the limited practical examples in the TAAR guidance.

We appreciate that a combination of constrained resources and the focus on the behaviour of the taxpayer in the TAAR legislation may make HMRC reluctant to offer advance clearances. We also understand HMRC's wariness of a clearance procedure becoming used as a tax avoidance tool.

Therefore whilst our very strong preference remains a pre-transaction clearance to ensure certainty for the majority of taxpayers not seeking to abuse the law, we believe that, as a minimum a post-transaction ruling facility should be considered. This might perhaps be modelled on the non-statutory post transaction valuation checks service for capital gains (the Form CG34 procedure). It would potentially have the following advantages:

- It would give taxpayers certainty on their position under the TAAR before they need to file their self-assessment return.
- As HMRC would only be required to express their opinion after a winding up has taken place, there would be no risk of any ruling influencing or encouraging tax planning decisions.
- It might reduce the provision of detailed information in the *white space* section of returns which would otherwise require technical consideration by HMRC officers.
- Although offering such a service would have resource implications for HMRC, it could potentially save HMRC resources in the long term if it reduced the volume of enquiries, appeals and litigation necessary.
- The introduction of such a non-statutory facility would require no legislative change.

We have included in the Appendix some more detailed observations regarding comments made on clearances in the TAAR guidance.

Penalties

The TAAR requires taxpayers to self-assess, there is no clearance facility and, as set out above, we believe that the published guidance provides only limited practical examples.

The resulting uncertainty which many taxpayers will have over the application of the TAAR may expose otherwise compliant taxpayers not seeking to abuse the rules to penalties for errors in

returns under Schedule 24 FA 2007 in the event of HMRC concluding that the TAAR provisions applied.

It would be helpful if HMRC could set out their position regarding when such penalties will be imposed with respect to the TAAR, for example:

- If a taxpayer genuinely believes that the TAAR does not apply, but HMRC concludes it does, will penalties be imposed?
- If the taxpayer provides appropriately detailed information in the *white space* of their self-assessment return would this protect them from penalties under Schedule 24?

Contact Details

We would be pleased to join in any discussion relating to the TAAR guidance. Should you wish to discuss any aspect of this letter, please contact our relevant Technical Officer, Emma Rawson, on 07773 087111 or at erawson@att.org.uk

Yours sincerely

Michael Steed

Co-Chair of ATT Technical Steering Group

The Association of Taxation Technicians

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 over 8,000 members and Fellows together with over 5,700 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 – Detailed observations on TAAR guidance

In this Appendix we outline our more detailed observations on the TAAR guidance and set out some practical examples where we believe it remains unclear whether the TAAR would apply.

Interaction of Conditions C and D

The TAAR guidance indicates (at CTM36320) that Condition C is intentionally widely drafted but that Condition D then operates to narrow this down with regards to the taxpayer's motive. Given the significance of the inter-relationship of Conditions C and D, we believe that more guidance on the interpretation of Condition C would be helpful. In particular, we think that further practical guidance and practical examples would be helpful regarding:

- What importance will HMRC place on various factors when looking at whether a business or trade is *similar* to that previously operated by the company wound up. For example, what weighting will be given to markets, production methods, geographical locations and products/services offered?
- The definition of *involved with*. For example, would unpaid assistance, lending money on commercial terms or supplies / acquisitions be caught? The TAAR guidance addresses employment in CTM36330, but little beyond this.

Condition C *similar to* examples (CTM36325)

The examples given in CTM36325 regarding what constitutes a *similar trade or activity* for the purposes Condition C are rather basic and the depth of analysis is inconsistent: examples 2 and 4 reach a conclusion on the application of Condition D but examples 1 and 3 do not.

Example 2 is similar to an example given in HMRC's letter of August 2016. However, it departs from the letter in a key aspect – in the letter the company traded as landscape gardeners, in the guidance the company traded as landscape garden *designers*. A designer may never have been involved in gardening activities at all, merely drawing designs on a computer without ever setting foot in the garden. By contrast after the liquidation Mrs F appears to be a very much hands on gardener. This change appears to widen the scope of Condition C beyond that set out in the HMRC letter, which may cause confusion. It would be helpful to know the reason for this change and whether it actually indicates a change in approach from HMRC.

Example 3 appears to show that Condition C has a very wide application by indicating that an individual with two companies, one specialising in loft conversions and the other in extensions, is within the scope of Condition C. The guidance appears to conclude that the fact they are both building companies is sufficient for Condition C to apply. We question whether their common involvement in building activities is of itself sufficient evidence to conclude that Condition C is satisfied. Would other factors such as markets, production methods, labour force, scale of the business , geographical area of operation, etc. not also have to be considered?

It is unhelpful that the wording of Example 3 appears to prejudge the outcome of the Condition C test by stating that "Mr E is a builder who runs his business through two companies". There are as a matter of both fact and law two businesses and each is owned by a separate company.

As noted above, more guidance on the interpretation of *similar* would be a helpful addition to the TAAR guidance.

Condition D guidance (CTM36340)

We find the general tone of the guidance on Condition D helpful. For example, the sentence *"Consideration will therefore be given in particular to whether the tax advantage is a consequence of the winding-up* ***and*** *the continuing involvement with the same or a similar trade or activity"* (our emphasis) indicates that it is important to consider the combination of the winding up and the subsequent activity in the round.

However, we think that practical examples on the application of Condition D would have made the guidance significantly more helpful. The TAAR guidance states that it is *"impossible to give an exhaustive list as individual facts and circumstances will be paramount".* Whilst we appreciate the reality of that statement, the lack of examples covering common scenarios combined with the lack of clarity on the application of Condition C is particularly unhelpful.

The TAAR guidance lists a number of issues *"that are likely to be relevant"* to whether to Condition D applies. However, we note that some of these apply as much to consideration of Condition C as Condition D. See, for example, the second and third bullet points which consider to what extent the trades resemble one another and the level of involvement of the individual. If that is intended to indicate that Condition D permits the gradation of identified Condition C similarity or involvement such that a higher degree of similarity or involvement might increase the reasonableness of the assumption that one of the main purposes of the winding-up was the avoidance or reduction of a charge, it would be helpful for that point to be made explicit. If, conversely, that is not the intention, it would be helpful to include an explanation that reduced the chance of that interpretation of the guidance.

Application of the TAAR to holding companies

CTM36325 states that the provisions apply not only to distributions from trading companies, but also to *"companies carrying on an investment business and to a holding company of a trading group"*.

The TAAR legislation indicates at s396(4)(a) that holding companies can be *looked through* for the purposes of the TAAR to see whether their subsidiaries carry on the same or a similar trade / activity.

It is assumed that the CTM36325 is considering two distinct types of company – investment holding companies and the holding companies of trading groups – and that the actual holding of investments by a holding company is not relevant. If that were not the case, two groups with completely different trading activities but whose holding companies are held by the same individual could meet Condition C.

Clarification on this point would be welcome.

Definition of *connected*

In CTM36335, the guidance confirms that *connected* is defined in s989 ITA 2007 (read in accordance with s993 and s994) in the same terms as s575 CAA 2001. The definitions in s575 CAA and s989 ITA are identical, and we believe that the reference to CAA 2001 could cause confusion. We would therefore recommend that the guidance only refer to s989 ITA 2007.

Clearances

The TAAR guidance states in CTM36350 that HMRC do not believe non-statutory clearances are appropriate for the TAAR as *"the applicant would not be uncertain about purpose, which is a subjective matter"*. We would query this statement given that several statutory clearance mechanisms deal with taxpayer purpose / intent, for example Transactions In Securities (TIS) clearances under s701 ITA 2007 and clearances under s138 TCGA 1992.

The TAAR guidance also sets out HMRC's position that clearances given under s701 ITA 2007 in respect of the TIS rules do not necessarily extend to the TAAR. Where clearance is given under s701 that a transaction will not be subject to counteraction on the grounds that the main purpose (or one of the main purposes) is not to obtain an income tax advantage, we would assume that this would provide some comfort that Condition D of the TAAR would not be met. If HMRC consider that this is not the case then it would be helpful to indicate why and, if possible, provide examples of where this might be the case.

Practical examples

In June 2016 the Chartered Institute of Taxation (CIOT) wrote to HMRC expressing their concerns over the Finance Bill 2016 clauses introducing the TAAR and setting out a number of examples which they thought were suitable for guidance.[2] We note that none of these examples have been adopted in the TAAR guidance. We understand that the CIOT are writing to you separately regarding these examples, and we have therefore not commented in this letter on areas covered by them.

We have, however, recently identified two practical examples where we believe the TAAR analysis remains uncertain based on the current guidance. We would appreciate your comments on these scenarios.

Gradual retirement from a business

A self-employed consulting engineer wants to wind up their company with a view to retiring. They pick up occasional work as a sole trader during the course of the winding down, including a substantial, though short term, project abroad.

We believe that, on the winding up, conditions A, B and C of the TAAR would be met as the engineer continues to work in a similar trade as a sole trader.

However, it is not clear whether condition D would be met in these circumstances:

- The taxpayer's main aim is to gradually retire from their business. With a view to this, they have decided to avoid the administrative burdens of running a company, although continuing to undertake occasional work as a sole trader.
- The taxpayer could actually be subject to increased taxation given that the higher income tax rates will apply to the occasional work to be undertaken as a sole-trader. If they had maintained the company, the lower corporation tax rates would have applied to this income.

Arguably, the winding up itself does not result in an income tax advantage when looking at the future taxation of profits from the business. This particular winding up results in a charge to

[2] The CIOT's submission is at: https://www.tax.org.uk/policy-technical/submissions/ciot-comments-hmrc-finance-bill-2016-clause-35-distributions-winding

income tax (and possibly National Insurance contributions) which may not have arisen if the trade had been run down to extinction within the company, with profits retained until its eventual liquidation. Similarly, if the company had not been wound up and had paid all of its profits out as dividends, the overall income tax charge may also have been lower, as the tax free dividend allowance (currently £5,000 p.a.) and lower income tax rates for dividends would have applied. In considering whether it is reasonable to assume that the main purpose or one of the main purposes of the winding up is the avoidance or reduction of a charge to income tax, is the fact that the post winding up activity was virtually indistinguishable from that of the company and the post winding-up activity was foreseen relevant?

Overall we believe that a key factor in this gradual retirement scenario is that, even if on balance there was a tax advantage arising from the winding up of the company, the taxpayer's intention was to gradually retire from his business. It is perfectly understandable that in doing so, they may seek to wind up the company in order to reduce administrative obligations.

As such gradual retirements are likely to be fairly common, it would be helpful if they were addressed in the TAAR guidance.

Winding up a corporate partner

Prior to the change in the tax rules regarding corporate partners in March 2014 it was not uncommon for family partnerships (such as farming partnerships) to have a corporate partner.

If such a corporate partner is now wound up, presumably conditions A, B and C will be met if the partnership continues to be operated by its shareholders or their connected parties.

However, it is unclear whether Condition D would be met in this scenario:

- The main motive for the creation of the corporate partner structure was tax planning so the winding up will mean that more tax will be payable in future.
- Similar to the previous example, the particular winding up will therefore result in a greater charge to income tax on the remaining partners which would not have arisen if the corporate partner had remained, meaning that it is difficult to conclude that a main purpose of that winding up was such avoidance or reduction for future taxes.

It is unclear from the TAAR legislation and guidance what (if any) weight will be given to the motive for setting up the structure, any past tax savings from it, or the potential future increase in taxation when looking at whether Condition D will be met.

Further guidance on this point and examples would be helpful.

Association of Taxation Technicians

2 November 2017