



## **ANY ANSWERS: ESC C16- Winding up a company. By Nichola Ross Martin**

Queries on winding up are a regular topic in the Any Answers forum. Nichola Ross Martin draws them together and answers some of the most frequently asked questions.

### **What are the options for winding up a company?**

When a company reaches the end of its useful life it is generally wound up, although it is quite possible to just leave a company and it remains dormant. The winding up process is normally necessary to ensure that shareholders have their capital returned and any remaining assets are disposed of.

Formally this is done by a liquidator, and all distributions are then treated as repayment of share capital and capital. When a liquidator is not appointed, S.209 TICTA 1988 treats all distributions as income, however, HMRC's Extra Statutory Concession C16 allows distributions made under an informal winding up to be treated as if made under a formal winding-up procedure, and treated as so treated as capital.

### **What is the advantage of a capital distribution v. an income distribution?**

The advantage of ensuring that a distribution is capital is that it comes within the Capital Gains regime. Providing that the company qualified as a trading company for Business Taper Relief purposes during the last two years of its life, or for part of its life, capital treatment will produce a lower tax charge on capital distributed than income treatment would tax an income dividend. Maximum business taper relief means that only 25% of the gain would be taxable, and then the shareholders may also have their annual exemptions available to offset the remaining gain. Compare this to a normal dividend, which is taxed at the top rate of 32.5%.

### **How do I make a claim under ECS C16?**

Once the decision has been made to cease trading, and the company's remaining affairs are in order, informal striking off can begin. The shareholding directors must sign a statement for HMRC (text as per ECS C16) to say that:

The company:

- does not intend to trade or carry on business in future, and;
- it intends to collect its debts, pay off its creditors and distribute any balance of its assets to its shareholders (or has already done so), and;

The company and its shareholders agree that:

- they will supply such information as is necessary to determine, and will pay, any corporation tax liability on income or capital gains and;
- the shareholders will pay any capital gains tax liability (or corporation tax in the case of a corporate shareholder) in respect of any amount distributed to them in cash or otherwise as if the distributions had been made during a winding-up.

At this point form 652A is also sent to Companies House to apply for striking off to. Companies House will not strike off a company until HMRC give the go ahead, and so you must ensure that all outstanding

forms for PAYE/NIC etc are all filed and you have written to request that the PAYE scheme is terminated.

**If there is a gap between the time when the company ceases to trade and the winding up process, will there be a break that will affect business taper relief?**

In normal circumstances, providing that there is not an undue delay between cessation of trade and a winding up, the company will not change into an investment company in the interim for the purposes of taper relief. This means that after the trade has closed down, the company can settle its outstanding liabilities, collect its debts and sell any remaining assets without the loss of the CGT relief for the shareholders.

Each case is different and it is something to bear in mind, specifically if the company was dangerously close to being labelled as an investment company for CGT purposes when it was trading. It is essential to have board minutes outlining the intentions of the board to wind up the company as soon as the trade stops, and then if there are delays, and the company is receiving what could only otherwise be termed as investment income in the interim period (such as interest and dividends) that will not be regarded as investment activity.

Companies whose main activity is the rental of land or property will not be carrying out a trade for CGT purposes, and so business taper relief is irrelevant to them.

**Are there any problems associated with ESC C16 and tax advantages?**

As C16 is a concession, HMRC do not have to agree to it. The main reasons that they will not allow the concession are:

1. Outstanding tax matters – such as awaiting for a form to be filed, or that they might be considering an enquiry into one aspect of the company's affairs:
2. Tax advantage – if they consider that ECS C16 is being used to confer a tax advantage on the shareholders of the company.

**What about Phoenix companies?**

Obviously, setting up a new company every two years and then winding it up to ensure that all reserves are treated as capital (and so qualify for full business asset taper relief), before starting a new company to do exactly the same thing, will save you a fair amount of tax, and it is easy to see the appeal of such an arrangement.

Unfortunately we have S.703 ICTA 1988 'Cancellation of a tax advantage from certain transactions in securities', a very wide ranging piece of legislation which allows HMRC to undo any tax advantage gained from certain transactions in shares, and this covers the 'phoenix company' scenario outlined above.

A 'tax advantage' is defined at s.709 (1) and takes one of three possible forms:

- Relief (or increased relief) from tax
- Repayment (or increased repayment) of tax
- Avoidance (or reduction) of a charge (or assessment) to tax

This section can bite when a company is wound up, (and the reserves distributed as capital), and then a new company is formed with the same shareholders and following the same trade, and often employing some of the old one's assets.

HMRC say in para. 4524 of the Inspector's Manual, that they will look into the following scenarios:

"... the transfer or sale by a company of its assets or business to another company having some or all of the same shareholders followed by the liquidation of the company whose assets etc have been acquired (see the example at IM4519) or the sale of shares in either company.

- a company reconstruction in which some or all of the shareholders in the original company retain an interest in the second company."

### **What are genuine applications under ESC C16?**

HMRC will not disallow ESC C16 or invoke s.703 for the fun of it, but you will need to outline the full commercial reasons for putting forward some sort of phoenix operation.

Normally you use ESC C16 to get rid of redundant companies, as it is by far the easiest and cheapest option.

The less straightforward cases that I have seen over the years have all resulted in new companies being set up to continue the trade of the old because various shareholders have fallen out, and in those cases, the new shareholders of the new companies are never identical to the original ones, and s.703 is not a problem.

In one case I dealt with recently, the original company was struck off and a new wife replaced the previous shareholding ex-wife. This was picked up on nearly three years after the original striking off during an enquiry when an inspector noticed that the new consultancy company appeared to have the same shareholders and an identical trade. It was easily resolved, but I need to add here that although the first wife did very little (i.e. occasionally answered the phone), the second wife was engaged full time working as a consultant with her new husband. If the same spouse had been the main fee earner, and the other non-working in both companies, then it might have been more difficult to persuade HMRC that there was a genuine reason for striking off the first company other than a method of splitting assets as cheaply as possible for tax reasons.

On balance HMRC do not seem to be too concerned by the odd ESC C16 application that does not mean though that they will not look into an individual cases. "Phoenixing" with one man companies is really not recommended.

### **Is there a Clearance procedure to protect against HMRC applying s.703 after the event?**

S.707 gives procedure for clearance that s.703 will not be applied after date to undo the capital tax treatment.

Most people using ESC C16 will be doing so to just "get rid" of an unwanted company, and there will be no motives of tax advantage, and it is unlikely that they will start a new identical company.

Others may use ESC C16 as part of an overall reorganisation within a group, and so it is worth applying for clearance under s.707 at the same time as other clearances for future peace of mind.

It is worthwhile reading through s.704 in all cases. This section lists the prescribed circumstances for s.703 to apply, together with IM4514 to 4519, which gives HMRC's interpretation of the topic.

### **What happens to a company's assets after it has been struck off?**

Once a company has been struck off and an asset, such as a debt is proved due to it, the asset becomes the property of the Crown. It is possible to have companies re-instated but this is expensive, and seldom recommended.

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