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Our ref
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Dear CTOCC member,

Extra-statutory Concessions (ESCs) – ESC B49, C10 and C16

As you may know HMRC published a consultation document '*Extra-statutory Concessions – Technical Consultation on draft legislation*'¹ in November 2008. That document presented draft legislation for 19 ESCs the Government intends to enshrine in legislation following the House of Lords' decision in the *Wilkinson* case.

Annex B of that document listed a number of ESCs where clarification is needed before legislation is drafted. As briefly mentioned at a recent CTOCC meeting, we are writing to you seeking the views of your members about three of the ESCs listed in that annex:

- ESC B49 – Section 532 Capital Allowances Act: Grants repaid
- ESC C10 – Group of companies: Arrangements
- ESC C16 – Dissolution of companies under sections 652 and 652A companies Act 1985: Distributions to shareholders

For ease of reference, this letter is broken down into separate sections for each ESC. Each section gives a brief summary of the legislation, where relevant, the purpose of

¹ [Extra-statutory Concessions: Technical Consultation on draft Legislation](#)

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the ESC, followed by a number of questions where we would welcome views and comments by **Friday 1 May 2009**, or earlier if possible. We will naturally be happy to discuss any consequential issues at the next meeting of CTOCC.

Please reply to Nick Williams [Nicholas Williams](#) in respect of ESC B49 and Michael Christy [Michael Christy](#) in respect of ESCs C10 and 16, or alternatively write to the above address.

Yours sincerely

Michael Christy

CTOCC Secretary

HMRC

SECTION 1

ESC B49 'Section 532 Capital Allowances Act: Grants repaid.'

Capital Allowances and contributions a brief background

Introduction

Capital allowances let taxpayers write off the cost of qualifying capital expenditure against taxable income, and take the place of depreciation charged in the commercial accounts, which is not allowable for tax. Capital allowances are not given on all types of capital expenditure. For example, they are not available in respect of expenditure on constructing or acquiring most buildings², residential buildings, land and intangible assets such as trade marks and goodwill (although expenditure on computer software can qualify). The legislation is found in the **Capital Allowances Act 2001(CAA)**.

Contributions to a taxpayer's capital expenditure - overview

In certain cases taxpayers may receive contributions towards their capital expenditure from third parties, the most common example being where a public authority funds by grant part (or the whole) of a taxpayer's expenditure on a qualifying capital item. However, contributions can just as easily be made by private sector organisations. The rules on contributions are in **sections 532 to 543 CAA**.

The general rule on contributions

² Relief is available for qualifying industrial and agricultural buildings, although this is being phased out by 2011.

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For the purposes of capital allowances, the general rule³ is that where a taxpayer has incurred qualifying capital expenditure, any contribution he may have received towards that expenditure (either directly or indirectly) from a third party, is deducted from the expenditure that qualifies for capital allowances. The taxpayer therefore only gets capital allowances on the net amount.

For this general rule it does not matter if:

- the contribution is made by a public body⁴ or another person⁵, or
- the contribution is not received until after the expenditure is incurred. If the expenditure was to be met in whole or part by the contribution then it is still deducted in calculating the qualifying expenditure.

Contributions can include:

- a non-returnable grant of money given by way of gift;
- a grant of money given subject to conditions, eg that it is spent on certain equipment or works;
- a subsidy or contribution towards expenditure that a person becomes entitled to after expenditure has been incurred.

Loans are not contributions because there is an expectation that they will be repaid.

Exceptions to the general rule

There are three exceptions to the general rule:

(i) Northern Ireland regional development grants (up to 31 March 2003)⁶ were not deducted if they were made under Northern Ireland legislation, and declared by Treasury order to correspond to a grant under Part II Industrial Development Act 1982. This meant that the recipient got capital allowances on the whole of the expenditure.

(ii) Insurance and or other compensation⁷ moneys received for the demolition, destruction or putting out of use of an asset are not treated as subsidies or contributions. That means that they are not deducted from expenditure that qualifies for capital allowances;

(iii) contributions made by persons (other than public bodies) who cannot get tax relief on their contribution⁸ are not deducted if the following conditions are satisfied:

- the person making it is not a public body, and

³ Section 532 CAA

⁴ HMRC construes 'public body' to include the Crown or any government, or any public or local authority wherever it is based.

⁵ An individual, partnership or company, but not a public authority or the recipient

⁶ Section 534 CAA

⁷ Section 535 CAA

⁸ Section 536 CAA

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- that person cannot claim capital allowances on it or deduct it in calculating profits.

Contributions Allowances

In certain cases⁹ a taxpayer (the contributor) who has made a capital contribution towards capital expenditure on the provision of an asset by another taxpayer (the recipient) can claim capital allowances, called a 'contribution allowance', on the contribution if:

- the recipient would have been treated as incurring the expenditure,
- the recipient would have been able to claim a Plant and Machinery Allowance, Industrial or Agricultural Buildings Allowance, Mineral Extraction Allowance or Dredging Allowance¹⁰, or the recipient is a public body; and
- the contributor and the recipient are not connected.

Repayment of Contributions

A difficulty arises where contributions are repaid by a recipient to a contributor, because there is nothing in the CAA that allows the recipient to claim capital allowances on what effectively becomes additional expenditure of the recipient. In broad terms this is because expenditure only qualifies for allowances if:

- (i) it is qualifying capital expenditure for the purposes of a qualifying activity; **and**
- (ii) the taxpayer incurring the expenditure owns the asset as a result of incurring it¹¹.

In the case of a repaid contribution the recipient taxpayer already owns the asset when incurring the additional expenditure and technically it fails the second test.

ESC B49 - Section 532 Capital Allowances Act: Grants repaid – its purpose

ESC B49, introduced in 1996¹², was designed to deal with such circumstances. It ensures that taxpayers who have repaid a contribution can claim capital allowances (where the expenditure would otherwise have been qualifying expenditure), if certain conditions are met. It provides:

'Where some or all of the expenditure on the provision of an asset has been met by the Crown, any Government, or any other public or local authority, sections 532 to 536 CAA 2001 prevents capital allowances from being given on that expenditure. By concession, where the grant is later repaid in whole or in part, the amount repaid will be treated as expenditure on which capital allowances may be given.'

Capital allowances are also restricted where expenditure on an asset is met by

⁹ Section 537 CAA

¹⁰ Sections 537 to 543 CAA

¹¹ For example see section 11 CAA in the case of plant and machinery allowances; section 271 CAA in the case of Industrial Buildings Allowance.

¹² Although it had existed on an informal basis before that date.

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a person other than the Crown or public body who is entitled to capital allowances or a trading deduction on that amount.

Where a grant which has been deducted from expenditure qualifying for capital allowances under this rule is later repaid in whole or in part, the Inland Revenue will treat the amount repaid as expenditure on which capital allowances may be given provided the repayment falls to be taxed on the person who made the grant through a balancing adjustment or as a trading receipt.'

The ESC also recognises that because the repaid contribution might have come from two sources: a public authority, or a third party who may have claimed a contributions allowance it is necessary to deal with these two scenarios separately.

Legislating the ESC

A scoping study of ESC B49, undertaken to see whether it could successfully be legislated, has shown that the required legislation will be complex, and also needs to take into account recent developments in the way capital allowances are given which were not envisaged when the ESC was first drafted, e.g. the Annual Investment Allowance. Additionally there is the possibility that some of the scenarios the ESC potentially addresses might never arise in practice, and providing for them would significantly increase the length and complexity of the legislation.

Therefore, to ensure that the legislation is as tightly focussed and as targeted as possible, we would like to seek the views of your members on the following issues:

(i) How often is the ESC used?

We do not have any reliable information about the use of the ESC by taxpayers. But we think it likely that the concession is primarily applied in cases where a public sector grant has been repaid, on the basis that it is standard practice for public sector grants to contain clauses requiring repayment if certain events occur.

Question 1 - What is your view on the level of use of ESC B49 by taxpayers in relation to public and private sector contributions?

(ii) Public sector contributions

In the case of public sector contributions, we want to identify the circumstances in which contributions are most likely to be made, and the nature of the expenditure likely to attract contributions (expenditure on plant and machinery, industrial buildings, etc.), and the likelihood of contributions being repaid.

Question 2 - How often are public sector contributions made towards expenditure which qualifies for capital allowances; what types of investment most frequently attract contributions; and under what circumstances are such contributions likely to be repaid?

(iii) Private sector contributions

In the case of contributions from private sector interests, we would be interested to know in which circumstances contributions are most likely to be made and repaid. For

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example are private sector contributions most commonly given towards the purchase of Plant and Machinery, or other assets such as Industrial and Agricultural buildings, Mineral Extraction etc?

Question 3 - How often are contributions from private sector interests made towards expenditure which qualifies for capital allowances; what types of investment most frequently attract contributions; and under what circumstances are such contributions likely to be repaid?

(iv) Repayments to contributors who have claimed capital allowances

Sections 537 to 543 CAA provide that in certain cases a contributing party can claim allowances on his contributions. Under the terms of the ESC where such a contribution is repaid, a recipient can claim capital allowances on his repayment of the contribution '*provided the repayment falls to be taxed on the person who made the grant through a balancing adjustment or as a trading receipt*'. This ensures that no double allowances are given, and that, where a revenue deduction has been claimed for the contribution, any repayment is treated as taxable income.

Question 4 - How often are contribution allowances claimed, and in respect of what kinds of contributions and investments?

We are also concerned that legislating this requirement might result in an administratively burdensome process for all parties, particularly for those businesses that, having claimed a contribution allowance, receive a repayment from the recipient of the contribution.

Question 5 - In order to keep the legislation and process as simple as possible we would welcome your views on ways to address this.

(v) Withdrawal of Industrial Buildings and Agricultural Buildings Allowances (IBA and ABA)

Legislation in Finance Act 2008 provided for the phased withdrawal of Industrial Buildings and Agricultural Buildings Allowances (IBA and ABA) by April 2011. It is possible that businesses might have received contributions towards the construction or acquisition of qualifying properties, and the contributors claimed a contribution allowance. If it is necessary to provide for such eventualities it is possible that the legislation will be complex especially as it relates to reliefs that are to end shortly.

Question 6 - Would any legislation need to make provision for contributions towards expenditure that qualified for IBA and ABA?

Question 7- If yes, in order that the legislation is keep as simple as possible we would welcome your views on ways to simplify the adjustment process.

(vi) Assured Tenancy Allowance

In the case of Assured Tenancy Allowances, which applied to expenditure incurred before 1 April 1992, we consider the likelihood of any contributions being repaid now, either to public or private sector contributors, to be remote in the extreme. Therefore our current thinking is that there is no need to legislate for such an eventuality. This

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means that no relief will be available to taxpayers who repay contributions towards expenditure on assured tenancies.

Question 8 - Is legislation required in the case of contributions towards expenditure on assured tenancies?

SECTION 2

ESC C10 – Group of companies: Arrangements – See Annex 1

Introduction to ESC C10

Under this ESC certain types of agreement which might involve the transfer of shares or securities in a company, are not treated as 'arrangements' or 'option arrangements' for the purposes of the following provisions of ICTA 1988 until a 'triggering event' occurs. The triggering events are listed in the concession itself and comprise:

- Section 240(11)(a) – Surrender of Advance Corporation Tax (ACT) to a subsidiary company;
- Section 247(1A)(b) – Group Income Elections in certain consortium cases;
- Section 410(1) and (2) – Group and consortium reliefs; and 'option arrangements' in paragraph 5B(1) of Schedule 18 – Group and consortium reliefs.

There is also a statement of practice (SoP 3/93) – see Annex 2. The statement of practice gives general guidance in conjunction with the ESC on how HMRC interpret 'arrangements' and 'option arrangements'.

However, when ACT was abolished from 6 April 1999, both section 240(11)(a) and 247 (1A)(b) were repealed. Hence ESC C10 is now partly obsolete and currently only applies to section 410 and para 5B(1) of Sch 18 ICTA 1988.

How ESC C10 modifies the anti-avoidance provisions in section 410 and para 5B(1) of Schedule 18

Under section 402, group relief may be given by allowing certain specified losses of one member of a group against the profits of another, and this relief is also available to a consortium by allowing a proportion of the trading company's loss to any of the joint owners.

However, the anti-avoidance provisions of section 410 deny group relief where arrangements are in existence under which a company in the group may come under the control of a third unrelated company, and there are similar anti-avoidance provisions for consortia. These provisions are framed in very wide terms and it is possible that on a strict interpretation the existence of a simple 'first refusal agreement' of the type described in the concession would be sufficient to deprive the members of a consortium to entitlement to group relief.

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Such arrangements are in normal commercial usage unconnected with tax avoidance and the concession is designed to avoid the legislation biting too harshly without at the same time opening a possible loophole by attempting to distinguish between commercial and uncommercial arrangements.

The anti-avoidance provision in paragraph 5B(1) of schedule 18 relate to 'option arrangements', and have significance for all grouping tests that depend on measuring entitlement to profits and to assets in a winding up. Again, under ESC C10 certain types of agreement which might involve the transfer of shares or securities in a company, are not treated as 'option arrangements' for the purposes of para 5B(1) of Schedule 18 until a triggering event occurs.

Our initial view

Our initial work leads us to believe that the legislation required to formally implement this ESC would be lengthy and complex. This is due to the fact that any potential legislation would be capable of disapplying the anti-avoidance legislation in section 410 without creating any further avoidance opportunities.

Therefore, in order to ensure that the legislation is as tightly focused and as simple as possible we would like to seek your comments and suggestions on a number of issues as follows:

Questions:

We would be grateful for your view on the following:

1. How often is the ESC used?
2. We would welcome your views on the need to legislate this ESC and your perception of the likely benefits of doing so
3. Your perception of any problems/issues of legislating this ESC and how HMRC might mitigate them
4. Ideas for a suitable legislative framework to let-out arrangements and option arrangements for joint venture companies which are totally unconnected with tax avoidance from section 410 and para 5(B)(1) of Schedule 18
5. As both section 410 and para 5B(1) of Schedule 18 are essentially anti-avoidance legislation, we would need to be very careful not to create scope for avoidance. We would be grateful for your comments and ideas for a suitable legislative defence
6. Any other comments or concerns

SECTION 3

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ESC C16 – Dissolution of companies under sections 652 and 652A companies Act 1985: Distributions to shareholders

Introduction to ESC C16

This concession provides that where certain assurances are given and certain conditions are met a distribution, made by a company that has ceased business and is awaiting dissolution, may be treated as though it has been made in a formal winding up. The assurances are listed in the concession itself and the conditions are listed in CTM36220.

If the concession applies, the value of the distribution is treated as a capital receipt of the shareholders for calculating any chargeable gains arising to them on the disposal of their shares in the company. In arriving at their chargeable gains the shareholders are entitled to any capital gains arising on a formal winding up.

How ESC C16 modifies the general distribution rule

A distribution is income in the hands of the shareholders. But subsection 209(1) specifically excludes distributions made by a company 'in respect of share capital in a winding up' leaving these to be treated as capital payments taken into account in calculating any chargeable gains of the shareholders under section 122 of Taxation of Chargeable Gains Act 1992 (TCGA 1992).

A company that has ceased business altogether and paid off its creditors may not wish to undertake the formal winding up procedures under the Companies Act. In such a situation the company may simply distribute its remaining assets to shareholders and then either wait or seek to be struck off the Joint Stock Companies Register and dissolved under sections 652 or 652A Companies Act 1985. A dissolution under sections 652 or 652A is not a winding up so section 209(1) does not apply. Accordingly where a company is so dissolved the distribution of its surplus assets (in specie or in cash) to the shareholders is an income distribution so, depending on their rates of personal tax the shareholders may be subject to further income tax liability on the value of the distribution.

Where the conditions of ESC C16 are met a distribution is treated in the same manner as a distribution in a winding up, section 209(1) applies and the distribution is a capital payment taken into account in determining the capital gains tax liabilities of the shareholders. The conditions of ESC C16 include the company agreeing to pay over any Corporation Tax liability and the shareholders any capital gains tax in respect of the amounts distributed to them.

A company incorporated in an overseas jurisdiction will not, of course, be subject to the Companies Act. Nevertheless, HMRC currently allow such a company resident in the UK for tax purposes to be granted the benefit of ESC C16 if the company seeks striking off under its overseas jurisdiction where the provisions are equivalent to those of sections 652 and 652A Companies Act 1985.

Our initial view

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Initial reappraisal of this ESC led us to believe that the legislation required to formally implement it as it currently stands would significantly increase the length and complexity of the legislation. This is due to the fact that there would need to be an avoidance rule that prevent the legislation from being used to gain a tax advantage. HMRC is also mindful of the fact that winding up is the normal process for a company to end its existence and it would be inappropriate for HMRC to seek statutory backing for a practice which encourages companies to accept dissolution in preference to a formal winding up.

In addition, HMRC have concerns that ESC C16 has been and continues to be used for avoidance purposes. If ESC C16 were to be legislated it would have to be in a manner that gave no opportunity for abuse.

In order to ensure that any possible legislation is as tightly focused and as simple as possible we would like to seek your comments and suggestions on a number of issues as follows:

Questions:

We would be grateful for your view on the following:

1. How often is the ESC used?
2. We would welcome your views on the need to legislate this ESC and your perception of the likely benefits of doing so
3. Have you any suggestions on ways to legislate this concession without HMRC being seen to be providing statutory backing for a practice, which encourages companies to accept dissolution in preference to winding up?
4. What criteria or condition should be imposed in the legislation?
5. As mentioned above, HMRC have concerns that ESC C16 has been and continues to be used for avoidance purposes hence there would need to be an avoidance rule that prevent any potential new legislation from being used to gain tax advantage. We would be grateful for your suggestions in this area
6. Do we need to include companies struck off under their overseas jurisdictions when the provisions are similar to those of sections 652 and 652A companies Act 1985 as part of any possible legislation? If yes, how could we mitigate any avoidance opportunities?
7. Your perception of any problems/issues of legislating this ESC and how HMRC might mitigate them
8. Any other comments or concerns

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Annex 1

ESC C10: Group of companies: arrangements

The following provisions of ICTA 1988 contain special rules which apply if there are 'arrangements' in existence which may involve a future change in the ownership of the shares or securities in a company:

- s240(11)(a) - surrender of ACT (in respect of accounting periods ended before 6 April 1999) to a subsidiary company;
- s247(1A)(b) - group income elections in certain consortium cases;
- S410 (1) and (2) - group and consortium relief.

In addition, paragraph 5B(1) of Schedule 18 applies if there are 'option arrangements'.

Joint Venture Companies

But in practice these special rules are not applied in relation to certain types of agreement regulating the affairs of two or more member companies holding shares or securities in a joint venture company carrying on a commercial undertaking. The types of agreement to which the concession applies are ones which could involve the transfer of shares or securities in the joint venture company on, or as the result of, the happening of one or more triggering events. Until such a triggering event occurs, such agreements are not regarded as 'arrangements' or 'option arrangements'.

Triggering events are:

- a. the voluntary departure of a member;
- b. the commencement of liquidation, administration or receivership of a member;
- c. a serious deterioration in the financial condition of a member;
- d. a change in the control or ownership of a member;
- e. a default by a member in performing its obligations under the terms of an agreement between the members or with the joint venture company, including its articles of association;
- f. an external change in the commercial circumstances in which the undertaking operates such that its viability is seriously threatened;
- g. unresolved disagreement among the members;
- h. any contingency of a similar kind provided against, but not intended to happen, when the agreement in question was entered into.

The details of such agreements will vary but they will be of a kind (a) allowing or requiring remaining members to acquire the holding of a departing company, or (b) allowing or requiring a departing company to transfer its holding to remaining members.

The transfer of the shares or securities will be on the basis of

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- an offer pro rata to the remaining members' holdings of shares or securities, with price fixed by agreement or independent valuation (which may allow for a penalty against a defaulting company), or
- a competitive tender among the remaining members, or
- a reciprocal process where one member offers to sell its holding to another at a certain price per share, when that other can either accept the offer or require the offeror to buy the offeree's holding at the same price (and the reverse, offer to purchase/call option arrangement), or
- other arrangements designed to ensure that a price appropriate to the commercial circumstances is struck.

The Articles of a joint venture company may provide for the suspension of a member's voting rights on the happening of a triggering event. Such a provision is not of itself regarded as 'arrangements' before the triggering event occurs.

Mortgage of shares or securities

If shares or securities in a company are used as security under a mortgage (or legal or equitable charge) the mortgage will not by itself be regarded as constituting 'arrangements' or 'option arrangements' until the default or other triggering event occurs which allows the mortgagee to exercise his rights against the mortgagor. This only applies if prior to default the mortgagee possesses no more control over the shares or securities which are the subject of the mortgage than is required by the mortgagee to protect his interest.

If a default occurs but is remedied before the mortgagee exercises his rights, 'arrangements' and 'option arrangements' will be regarded as not having come into existence as a result of the default

Application

The concession does not apply when the person or persons standing to acquire shares, securities or control could, alone or with connected persons within the meaning of s839, ICTA 1988, dictate the terms or timing of the acquisition in advance of the triggering event having occurred. For this purpose members will not be regarded as connected by reason only of their membership of the joint venture company and a mortgagee will not be regarded as connected with the company whose shares are the subject of the mortgage by reason only of the mortgage.

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Annex 2 The text of SoP 3/93 is as follows:

1 This statement supersedes statement of practice SP 5/80. Some features of the earlier statement have been omitted or revised but this does not indicate a more restrictive approach on the part of HMRC.

2 This statement gives general guidance on how HMRC interpret 'arrangements' in the following provisions of TA 1988—

- s 240(11)(a)—surrender of ACT to a subsidiary company;
- s 247(1A)(b)—group income elections in certain consortium cases;
- s 410(1), (2)—group and consortium reliefs; and 'option arrangements' in—
- Sch 18 para 5B(1)—group and consortium reliefs.

Extra-statutory concession C10

3 Certain types of 'arrangements' or 'option arrangements' relating to groups and consortia which fall within the above legislation are in practice excluded from its scope by ESC C10, as revised January 1993.

General

4 This statement of practice gives general guidance in conjunction with ESC C10. Comprehensive guidance cannot be given about what constitutes 'arrangements' or 'option arrangements', nor about precisely when they come into existence. Particular cases depend on the particular relevant facts.

5 As regards 'option arrangements' the Commissioners for HMRC view is that if an agreement provides for the creation of specified option rights exercisable at some future time 'option arrangements' come into existence when the agreement was entered into.

Disposal of shares or securities in a company

6 Where a holder of shares or securities in a company is preparing to dispose of them, straightforward negotiations for the disposal will not give rise to the existence of 'arrangements' before the point at which an offer is accepted subject to contract or on a similar conditional basis. Equally, unless there are exceptional features, an offer made to the public at large of shares or a business will not at that stage bring 'arrangements' into existence.

7 If a disposal requires the approval of shareholders, operations leading towards disposal will not give rise to the existence of 'arrangements' before that approval is given or until the directors become aware that it will be given.

8 If following negotiations with potential purchasers a holder of shares or securities concentrates on a particular potential purchaser this will not of itself be regarded as bringing 'arrangements' into existence. But 'arrangements' might exist if there were an understanding between the parties in the character of an option. For example, an offer, whether formally made or not, might be allowed to remain open for an appreciable period so that the potential purchaser was allowed to choose the moment to create a bargain.

Company reconstructions

9 The approval of shareholders for a company reconstruction may be required under company law or to comply with the rules of a stock exchange. 'Arrangements' will not

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come into existence before approval is given or until the directors become aware that it will be given.

Enforceability

10 'Arrangements', though not 'option arrangements', may exist between parties even though they are not enforceable.

Annex 3

ESC C16. Dissolution of companies under sections 652 and 652A Companies Act 1985: Distributions to shareholders

A distribution of assets to its shareholders by a company that is then dissolved under section 652 or Section 652A Companies Act 1985 (or any comparable provisions) is strictly an income distribution within section 209, ICTA 1988. In most circumstances, and providing that certain assurances are given to the Inspector before the event, the Revenue is prepared for tax purposes to regard the distribution as having been made under a formal winding up so that the proviso to section 209(1) applies. The value of the distribution is then treated as capital receipts of the shareholders for the purpose of calculating any chargeable gains arising to them on the disposal of their shares in the company.

The assurances include:

- The company
 - does not intend to trade or carry on business in future; and
 - 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
 - intends to seek or accept striking off and dissolution.
- 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.

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