

OUR GUIDE TO WHY WE SOLVENTLY WIND UP A COMPANY RATHER THAN USE THE PURCHASE OF A COMPANY'S OWN SHARES PROCEDURE FOLLOWED BY DISSOLUTION

We are occasionally asked what the benefits are of a Solvent (Members' Voluntary) Liquidation ("MVL") compared to other possible solutions to withdraw the cash surplus from a company that has ceased to trade and is to be removed from the register at Companies House. The Purchase of own Shares procedure is well documented and we received a recent enquiry regarding why a company should go into an MVL rather than purchase its own shares from the shareholders before being dissolved, which would remove the professional fees of the liquidator.

What are we trying to achieve?

One of the fundamental aims when closing a company is usually to legally minimise the tax payable to HM Revenue & Customs ("HMRC"). Cash received from a company in respect of a shareholding can either be taxed as a distribution or, in some circumstances, be treated as a capital gain.

Tax Advice

Sadlers does not give tax advice. However, we do have a very good understanding of the tax implications that are relevant to the solvent companies that we advise. We always recommend that the directors and shareholders take advice from their accountants or tax specialists about specific reliefs that may be available and to ensure that the MVL fits any tax planning that is already being implemented before making any decisions about closing a company using the MVL process.

What are the tax rates for a distribution compared to Capital Gains Tax ("CGT")?

A company purchasing its own shares from a shareholder would ordinarily attract tax on the amount received over and above the original subscription value (ie what was paid for the shares), subject to a tax-free allowance of £2,000, from 7.5% to 38.1%.

Tax-free dividend allowance	£2,000
Basic rate taxpayers	7.5% on dividends
Higher rate taxpayers	32.5% on dividends
Additional rate taxpayers	38.1% on dividends

How much CGT you pay will, similarly, depend on your tax band.

Tax bracket	CGT rate on assets
Basic rate payer	10%
Higher or additional rate payer	20%

The table below details your CGT allowance for the tax years 2017-18, 2018-19 and 2019-20.

Tax year	2017-18	2018-19	2019-20
CGT allowance for an individual	£11,300	£11,700	£12,000
Couple's allowance (married or in a civil partnership only)	£22,600	£23,400	£24,000

Entrepreneurs' Relief can further reduce a CGT rate to 10%, subject to certain qualifying requirements.

What is Entrepreneurs' Relief?

Entrepreneurs' Relief means you'll pay tax at 10% on all gains on qualifying assets, up to a lifetime limit of £10 million.

Currently, to qualify for relief, you must have owned shares in the company for at least two years before the date of the Liquidation.

There are also other rules depending on whether or not the shares are from an Enterprise Management Incentive (EMI).

If the shares are from an EMI

You must have both:

- bought the shares after 5 April 2013
- been given the option to buy them at least two years before selling them

If the shares are not from an EMI

For at least two years before you sell your shares, the business must be a 'personal trading company'. This means that you have at least 5% of the:

- shares; and
- voting rights; and either 5% of the:
 - entitlement to profits that are available for distribution
 - entitlement to assets on winding up the company ie the MVL; or
 - 5% of the disposal proceeds on a sale.

You must also be a director, the company secretary or an employee of the company.

If the business stopped being a trading company some time ago

If the company has already stopped being a trading company, you should still qualify for relief if you start the MVL within three years.

So, being able to receive money as capital rather than a distribution and qualifying for Entrepreneurs' Relief can legally reduce your tax rate from as much as 38.1% to 10%.

Why pay a liquidator when the company can buy its own shares of the shareholders?

For a purchase of its own shares to be classed as being subject to CGT and "*not a distribution for the purposes of the Corporation Tax Acts*" a company must fulfil certain legal requirements and go through a clearance procedure with HMRC. Condition A of those legal requirements is set out in Section 1033 of the Corporation Tax Act 2010, which says:

- (a) ***the redemption, repayment or purchase is made wholly or mainly for the purpose of benefiting a trade carried on by the company or any of its 75% subsidiaries [OUR EMPHASIS],***

- (b) *the redemption, repayment or purchase does not form part of a scheme or arrangement the main purpose or one of the main purposes of which is—*
- (i) *to enable the owner of the shares to participate in the profits of the company without receiving a dividend, or*
- (ii) *the avoidance of tax, and*
- (c) *the requirements set out in sections 1034 to 1043 (so far as applicable) are met.*

As the intention is for the company to cease to be, it fails (a) above. ie the purchase of shares is not wholly or mainly to benefit the trade carried on by the company.

Therefore, to implement an immediate closure of a company and for the monies received by shareholders to be subject to CGT, an MVL is definitely the way to go.

When would I consider using the Purchase of own Shares procedure?

We have experience of seeing advisers getting it wrong when guiding director / shareholders to use an MVL to take cash out of their businesses. It was clear in those particular circumstances that the directors had no intention of ceasing to trade and would simply incorporate another company to start over again. This is a clear breach of the Targeted Anti-Avoidance Rule brought in by the Finance Bill 2016.

The correct answer was, of course, to consider with competent tax advisers using the Purchase of own Shares procedure to achieve the same result.

Finally, it was worth noting that for any Purchase of own Shares to be legal it must fulfil the Companies Act requirements of:

- being paid for in cash;
- the company having sufficient distributable reserves; and
- there being authority to undertake the procedure in the Articles of Association of the company.

This is an extremely complex area of the crossover between tax and insolvency law. If you would like specific guidance for you or your company, talk to Sadlers today. We will work alongside your existing accountants and / or tax advisers to find the most tax efficient solution for you.

We also have a comprehensive guide to a solvent (Members' Voluntary) Liquidation for directors & shareholders that you may find helpful.

We are also the only firm of insolvency practitioners that publishes our fees and anticipated disbursements so that directors can be assured of getting value for money and absolute certainty of the costs when closing their company. There are no hidden costs and no fees quoted as "starting from". Fees are based on the level of funds to be distributed.