

Closure of a Company

Under the Enactment of Extra Statutory Concessions Order 2012, the provisions of ESC C16 are being replaced by a statutory instrument, taking effect from 1st March 2012. The new rules would allow a company to be informally liquidated where the reserves do not exceed £25,000, effectively putting a ceiling on the tax advantage that can be obtained by utilising the former concession.

Shareholders looking to wind up their companies in the future will therefore be left with the following options:

1. Ensure that the reserves are below £25,000 (by declaring dividends) when making a distribution and then take advantage of the new statutory provision by informally striking off the company.
2. Go through a formal liquidation process (Members Voluntary Liquidation) by appointing an insolvency practitioner. The fees payable in this scenario are relatively high but if the company's reserves are significant, the tax saving could quite possibly outweigh the fees of an insolvency practitioner.

Any distribution made to shareholders in liquidation (formal or informal) is treated as capital for tax purposes and therefore is subject to Capital Gains Tax (CGT) rather than income tax (applicable to dividend distributions). This can be extremely advantageous to shareholders of a company as it allows them to utilise their CGT annual exemption (£10,600 in 2012/13) and if they are eligible to claim entrepreneurs relief, any gains in excess of the annual exemption are taxed at 10%.

Nixon Williams have established a relationship with a licensed insolvency practitioner who will formally liquidate a company introduced by us for a fixed fee of £3,500 + VAT and disbursements (approximately £300). The VAT on these costs will be reclaimed by the insolvency practitioner, assuming the company was VAT registered. If your company has reserves in excess of £25,000, Nixon Williams can calculate whether the tax saving obtained from formally liquidating the company will exceed the fees associated with the appointment of the insolvency practitioner.

We estimate that if you are seeking to close a company with reserves in excess of £50,000, formally liquidating the company will generally yield the highest return, after having paid all taxes and professional fees. This statement assumes that your income has already/or will during the tax year, exceed the higher rate tax threshold and that the gain is eligible to entrepreneurs relief.



What does a Members Voluntary Liquidation involve?

1. The directors of the company being wound up must make a declaration of solvency on behalf of the company; this is broadly a statement that after having made inquiry the director's believe that the company's liabilities will be settled within 12 months of entering liquidation. In order to speed up the process we recommend that liabilities be settled prior to beginning liquidation proceedings.
2. The members must pass a special resolution to wind up the company voluntarily which will then be filed with the Registrar of Companies (within 15 days) and advertised in the London Gazette (within 14 days).
3. The liquidator will be formally appointed and will notify all creditors (if applicable, within 28 days), publish the appointment in the London Gazette (within 14 days) and notify the Registrar of Companies (within 14 days). In practice, providing all liabilities have been paid prior to the appointment of the liquidator, we estimate that proceedings should not take any longer than a week.
4. Any cash held by the company will be transferred to a holding account by the liquidator and distributed to shareholders once all liabilities have been paid, if there are no creditors at the time of appointment then the distribution can be made almost immediately. Any other assets held by the company can be treated as an 'in specie' payment where the asset is not readily transferable into cash and forms part of the distribution to shareholders at its accounting 'book value'.

Dividend vs. Capital

When closing a company, it is worth considering which method of withdrawal would maximise the amount of money that the shareholders would be left with after having paid all taxes or professional fees.

Taxation of Dividend Distributions

Any funds extracted from a company prior to liquidation (formal or informal) are automatically treated as dividends in the hands of shareholders, distributions made in excess of the £25,000 statutory limit are also treated as dividends in their entirety. Directors may however choose to pay dividends out to shareholders in some instances.

The effective rates of tax on dividends declared (net amount) are 0% for basic rate tax payers, 25% for higher rate tax payers and 36.11% for additional rate tax payers. Clearly, if the taxpayer's income falls within the basic rate threshold and they do not expect to receive any further income during the tax year, it would be advantageous to pay a dividend up to the point that they would hit the higher rate threshold.

Taxation of Capital Distributions

Individuals have an Annual Allowance for CGT of £10,600 (2012/13), if this has not already been utilised would mean that the first £10,600 of any capital distribution made upon closure of the company to be tax free. The rate of tax applicable to capital gains is 18%/28% (depending upon your higher rate tax status), however if you are eligible to claim for entrepreneur's relief, the rate of tax applied would be 10% (on first £10,000,000 of lifetime gains), the following criteria must also be met:

1. You must have held the shares in a trading company for at least 12 months up to the date trade ceased;
2. Hold at least 5% of the issued share capital of the trading company; and
3. The holder of the shares must have been an officer or an employee of the company throughout the period concerned.

As a rule of thumb, provided the following conditions are met HMRC should accept the company to be a trading company:

1. Non Trading income does not exceed 20% of the company's income; and
2. Net current assets do not exceed annual turnover.

These are, however only guidelines and each case should be considered on its own merits, especially if the company has been trading for a substantial period of time or if the company is seen to be actively managing any cash reserves.

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