HM Revenue
& Customs

Income tax: special purpose share schemes

Who is likely to be affected?

Higher and additional rate taxpayers who are shareholders of companies that offer special purpose share schemes, often called “B share schemes”.

General description of the measure

Companies use special purpose share schemes to offer shareholders the choice to receive either a dividend or to receive a similar amount through an issue of new shares that are subsequently purchased by the company or sold to a pre-arranged third party. This measure will align the tax consequences of that choice to ensure that all shareholders are taxed as if they had received a dividend.

Policy objective

This measure supports the Government’s objectives of tackling avoidance and unfair outcomes in the tax system. It will remove the tax advantage that is currently offered by special purpose shares schemes by treating as a dividend all returns to shareholders through such a scheme.

Background to the measure

This measure was announced at Autumn Statement 2014.

Detailed proposal

Operative date

This measure will have effect for receipts on or after 6 April 2015.

Current law

Individuals are charged to income tax on dividends and other distributions received from UK-resident companies under Chapter 3, Part 4 of the Income Tax, Trading and Other Income Act 2005 (ITTOIA05). The issue of shares is not normally taxable. The subsequent repurchase or sale of shares will usually be chargeable to capital gains tax which can be at lower rates than income tax.

Proposed revisions

Legislation will be introduced in Finance Bill 2015 to amend ITTOIA05 to include a further charge to income tax on “alternative receipts” offered by special purpose share schemes. A shareholder will have received an “alternative receipt” if:

- the company has given the shareholder the choice to receive either a dividend or something else;
- the shareholder has chosen to receive something other than a dividend; and
- that receipt would not, apart from this new legislation, have been subject to income tax

<table>
<tr><td rowspan="3">Exchequer impact (£m)</td><td>2014-15</td><td>2015-16</td><td>2016-17</td><td>2017-18</td><td>2018-19</td><td>2019-20</td></tr>
<tr><td>-</td><td>nil</td><td>+45</td><td>+40</td><td>+40</td><td>+40</td></tr>
<tr><td colspan="6">These figures are set out in Table 2.1 of Autumn Statement 2014 and have been certified by the Office for Budget Responsibility. More details can be found in the policy costings document published alongside Autumn Statement 2014.

This measure supports the Exchequer in its commitment to protect revenue.</td></tr>
<tr><td>Economic impact</td><td colspan="6">The measure is not expected to have any significant economic impacts.</td></tr>
<tr><td>Impact on individuals, households and families</td><td colspan="6">This measure will affect shareholders in companies offering special purpose share schemes. They are a small proportion of total shareholders and those likely to be affected will be higher rate and mostly additional rate taxpayers.

The measure is not expected to impact on family formation, stability or breakdown.</td></tr>
<tr><td>Equalities impacts</td><td colspan="6">HM Revenue & Customs (HMRC) does not hold data on the protected characteristics of those who benefit from special purpose share schemes. However, individuals that are likely to benefit will be Higher or Additional rate taxpayers so will have above average income. Therefore affected individuals are likely to be from groups which are overrepresented in higher income groups.</td></tr>
<tr><td>Impact on business including civil society organisations</td><td colspan="6">This measure is expected to have a negligible impact on businesses. It will only affect those businesses who continue to offer special purpose share schemes as the measure will allow shareholders that receive an “alternative receipt” to request a statement showing the value of the receipt and the tax credit. HMRC expects few, if any, businesses will choose to offer special purpose schemes following the introduction of this measure.

This measure is expected to have no impact on civil society organisations.</td></tr>
<tr><td>Operational impact (£m) (HMRC or other)</td><td colspan="6">It is not anticipated that implementing this change will incur any additional costs for HMRC.</td></tr>
<tr><td>Other impacts</td><td colspan="6"><u>Small and micro business assessment</u>: this measure is not expected to affect small and micro businesses as they do not operate these schemes.

Other impacts have been considered and none have been identified.</td></tr>
</table>

Monitoring and evaluation

The measure will be monitored through the monitoring of disclosures of new avoidance schemes to circumvent the measure, and through communication with taxpayers and practitioners affected by the measure.

Further advice

If you have any questions about this change, please contact Adrian Coates on 03000 586041 (email: adrian.coates@hmrc.gsi.gov.uk).

1 Arrangements offering a choice of capital or income return

(1) Chapter 3 of Part 4 of ITTOIA 2005 (dividends etc from UK resident companies and tax credits etc in respect of certain distributions) is amended in accordance with subsections (2) to (6).

(2) After section 396 insert—

“Other amounts treated as distributions

396A Arrangements offering a choice of capital or income return

(1) Subsection (2) applies if a person (“S”) has a choice either—
  (a) to receive what would (ignoring this section) be a distribution of a company, or
  (b) to receive from that company, or from a third party, anything else (“the alternative receipt”) which—
    (i) is of the same or substantially the same value, and
    (ii) (ignoring this section) would not be charged to income tax.

(2) If S chooses the alternative receipt—
  (a) for income tax purposes it is treated as a distribution made to S by that company in the tax year in which it is received by S, and
  (b) for the purposes of the following provisions it is treated as a qualifying distribution so made—
    (i) section 397 (tax credits for qualifying distributions of UK residence companies: UK residents and eligible non-UK residents);
    (ii) section 399 (qualifying distributions received by persons not entitled to tax credits);
    (iii) section 1100 of CTA 2010 (qualifying distributions: right to request a statement).

(3) For the purposes of this section—
  (a) it does not matter if the choice mentioned in subsection (1) is subject to any conditions being met or to the exercise of any power;
  (b) where S is offered one thing subject to a right, however expressed, to choose another instead, S is to be regarded as making a choice if S abandons or fails to exercise such a right.

(4) If at any time a tax other than income tax (“the other tax”) is charged in relation to the alternative receipt, in order to avoid a double charge to tax in respect of that receipt, a person may make a claim for one or more consequential adjustments to be made in respect of the other tax.

(5) On a claim under subsection (4) an officer of Revenue and Customs must make such of the consequential adjustments claimed (if any) as are just and reasonable.

(6) Consequential adjustments may be made—
  (a) in respect of any period,
  (b) by way of an assessment, the modification of an assessment, the amendment of a claim, or otherwise, and

(c) despite any time limit imposed by or under an enactment."

(3) In section 382 (contents of Chapter 3), in subsection (1), omit the "and" at the end of paragraph (b) and after paragraph (c) insert ", and

(d) treats distributions as made in some circumstances (see section 396A)."

(4) In section 385 (person liable), in subsection (1)(a) for "and 389(3)" substitute ", 389(3) and 396A".

(5) In section 397 (tax credits for qualifying distributions of UK resident companies: UK residents and eligible non-UK residents), after subsection (5) insert—

"(5A) This section needs to be read with section 396A(2) (which treats certain receipts as "qualifying distributions" for the purposes of this section)."

(6) In section 399 (qualifying distributions received by persons not entitled to tax credits), after subsection (5) insert—

"(5A) This section needs to be read with section 396A(2) (which treats certain receipts as "qualifying distributions" for the purposes of this section)."

(7) In section 1100 of CTA 2010 (qualifying distributions: right to request a statement), after subsection (6) insert—

"(7) This section needs to be read with section 396A(2) of ITTOIA 2005 (which treats certain receipts as "qualifying distributions" for the purposes of this section)."

(8) The amendments made by subsections (2) to (4) have effect in relation to the tax year 2015-16 and subsequent tax years.

EXPLANATORY NOTE

ARRANGEMENTS OFFERING A CHOICE OF CAPITAL OR INCOME RETURN

SUMMARY

1. Clause [X] amends the Income Tax (Trading and Other Income) Act 2005 (ITTOIA 05) to remove tax advantages given to shareholders by special purpose share schemes (commonly referred to as "B share schemes"), which offer shareholders a choice between income and capital returns on their shares, with effect from 6 April 2015.

DETAILS OF THE SCHEDULE

2. <u>Subsection (1)</u> provides for the amendment of Chapter 3 of Part 4 of ITTOIA 05.

3. <u>Subsection (2)</u> inserts new section 396A into ITTOIA 05.

New section396A: Arrangements offering a choice of capital or income return

4. <u>New section 396A(1)</u> explains that section 396A will apply where a person has a choice to receive either a distribution or something that is of essentially the same value but is not chargeable to income tax. This something else is defined as "the alternative receipt" and might include a receipt from the company, or a third party, that would otherwise give rise to a chargeable gain.

5. For example, where a shareholder has the choice to receive a dividend from a company of £10 that would provide a net return after tax of, say, £7.50, or an alternative receipt of £9 that would give a net return of, say, £7.40, this return will fall within section 396A(1) as the two amounts are substantially the same.

6. <u>New section 396A(2)(a)</u> treats alternative receipts from UK companies as a distribution.

7. <u>New section 396A(2)(b)</u> treats the alternative receipt as a qualifying distribution for the purposes of sections 397 or 399 ITTOIA05 (which provide dividend tax credits or treat tax as being paid at the basic rate), and for section 1100 Corporation Tax Act 2010 (CTA10) (which allows shareholders to request statements showing the value of a distribution).

8. <u>New section 396A(3)</u> explains that it does not matter whether the choice is subject to the exercise of any conditions or the exercise of any power, and also that the choice can include the failure to exercise a right. So, for example, where the shareholder will receive a bonus "B" share where an election is made and a bonus "C" share where no election is made, the failure to make an election is a choice to receive the "C" share.

9. New sections 396A(4) to (6) provide that a claim for relief can be made where, as a result of this charge on the alternative receipt, there is a "double charge". For example, where a company issues bonus "B" shares to shareholders that so elect, and the "B" shares provide the right to be purchased by a third party, both the issue of the shares and the sale to the third party will create separate tax charges (the first under this section, the second as a capital gain).

10. Where such a claim is received, an officer of HM Revenue & Customs must make any just and reasonable consequential adjustment.

11. Subsections 4 to 7 make various consequential adjustments.

12. Subsection 8 provides that the amendments take effect from tax year 2015-16 onwards, regardless of when the arrangements were entered into.

BACKGROUND NOTE

13. This provision removes the choice between taxation as income or taxation as capital, which some companies offer their shareholders in certain circumstances when returning value to them. Returns where such a choice is offered will be taxed as income where they are received on or after 6 April 2015. This will support the government's objectives of tackling unfair outcomes in the tax system by ensuring parity of treatment with other taxpayers who are not able to choose how they are taxed on their income.

14. If you have any questions about this change, or comments on the legislation, please contact Adrian Coates on 03000 586041 (email: adrian.coates@hmrc.gsi.gov.uk).