30 Monck Street
London SW1P 2AP
T: +44 (0)20 7340 0550
E: technical@ciot.org.uk

**Modernising the taxation of distributions and repayments of capital from companies**

**Response by the Chartered Institute of Taxation**

## 1. Executive summary

1.1. The Chartered Institute of Taxation (CIOT) is the leading professional body in the UK for advisers dealing with all aspects of taxation. We are a charity and our primary purpose is to promote education in taxation with a key aim of achieving a more efficient and less complex tax system for all. We draw on the experience of our 20,000 members, and extensive volunteer network, in providing our response.

1.2. In our view, the consultation approaches the modernisation aim too much from an anti-avoidance mindset. This leads to numerous restrictive conditions that are in many cases more complex than they first appear. We suggest applying a commercial perspective first and then considering what is needed to cover particular types of potential avoidance. A simple approach can achieve the same outcome for the distributions framework as well as other areas of the legislation.

1.3. The intention to expand the use of the statutory demerger and purchase of own shares rules is welcome but we outline how and why HMRC could, and we believe should, go further to provide a much greater degree of simplicity. If the rules are unworkable in practice outside of a restricted range of scenarios, taxpayers will find they are reliant on more complex, more expensive alternatives. Our preference is to apply a similar framework as introduced in Finance Act 2026 – a single, targeted anti-avoidance rule instead of multiple detailed conditions and exemptions.

1.4. We question why the thrust of the proposed changes appear to discourage the demerging of businesses for the purpose of enabling third-party sales or passing businesses on to the next generation. In the real world, these are perfectly legitimate reasons to split up businesses but the tax system currently inhibits business growth, through the difficulty of demerging them, by forcing businesses to stay together.

1.5. The consultation does not demonstrate that the existing transactions in securities legislation is failing in practice. Before significant legislative changes are made, we would like to see HMRC provide clearer evidence that existing anti-avoidance provisions are inadequate.

1.6. The international elements of this consultation are peripheral to the core theme of the demergers legislation. We recommend delaying any changes to the tax treatment of non-UK resident company distributions, loans, etc. until the work being carried out by the Personal Tax Offshore Anti-Avoidance Legislation co-creation group has concluded. This would allow a broader review of the UK's competitiveness and how its rules make sense in an international context, particularly from an individual perspective.

## 2. Introduction

2.1. Question 1: How do any of the proposals outlined in this document impact corporation taxpayers?

2.2. The effect of the proposals on corporate restructurings could impact how companies grow their business, adapt to changing market conditions, plan for succession and resolve disputes between shareholders.

2.3. The scale of the changes proposed may also lead to increased costs. Companies and their advisers will need to spend time familiarising themselves with new rules and taking extra steps to gain certainty in the absence of case law.

2.4. We strongly recommend that the impact of any of the proposals should be limited to changes taking effect in future, or at least from the date of any anti-forestalling announcements, with grandfathering provisions provided if necessary. It is not reasonable to apply legislation retrospectively to transactions that have already taken place. Yet if the freezing of new consideration bites on holding company structures already in place, that is precisely the effect the rules would have.

## 3. Reduction of capital

3.1. Question 2: What general comments do you have on the proposal to modernise the rules determining the size of a distribution on a reduction of share capital or share buyback?

3.2. We are not persuaded that the proposed modernisation is necessary. Existing transactions in securities (TiS) legislation already provides HMRC with extensive powers to counteract abusive arrangements.

3.3. The consultation provides an example of a capital reduction involving an individual taxpayer, John, seeking advice on how to reduce tax on a distribution. However, the tax advice John receives is ineffective because the TiS rules would be triggered. The question is, therefore, what problem is the government looking to resolve? We note that the Company Distributions consultation published in December 2015 considered precisely this issue in its example 2 (Sebastian). The outcome was the changes to the TiS legislation through Finance Act 2016.

3.4. It is unclear whether the John example uses share premium for a specific reason. The new company could have just as easily issued £2m of ordinary £1 shares so we query whether HMRC see a difference between the two options.

3.5. We recognise that the mismatch between the distributions legislation and tax legislation creates an unintended tax advantage in certain situations, from which some sought to benefit. But this was countered through changes to legislation in Finance Act 2016, which now applies specifically to these types of distributions. We would therefore be keen to understand in more detail where the government consider the rules to be unfit for purpose, so that we can comment on what may be more appropriate solutions.

3.6. Questions 3 and 4: Please describe how this proposal might impact legitimate corporate demergers and share restructuring. Can you anticipate any other unintended or unwelcome consequences of this proposal, such as on third party sales?

3.7. By removing the option of capital reduction demergers, the proposal could lead to obstacles to third-party sales, group simplifications, succession planning and other genuine commercial transactions.

3.8. Companies may wish to sell just one part of a business that they have built from scratch. Such cases frequently use a share-for-share exchange to insert a new holding company, which then has sufficient new consideration for a demerger to take place as a capital transaction. Clearly, if business owners split out every potentially successful arm of a business into separate companies at a very early stage, a demerger is not necessary. Nevertheless, it seems unreasonable to suggest that those with the foresight, professional support and financial and commercial ability to arrange their business affairs in this way should receive a more beneficial tax treatment on sale. The more likely scenario is that a business will start a new venture or product initially within the main company, where it has the financial and administrative support during the early stages, only looking to spin it out once they have proved the concept.

3.9. Many corporate structures have multiple tiers to allow lenders to rank in different priority (structural subordination). A single group could have several such tiers of, for example, HoldCo, MidCo, BidCo, TopCo, OpCo, as a result of various exits, mergers and acquisitions, none of which are created for tax reasons. We do not consider that the consultation document adequately addresses this.

3.10. The consultation concedes that the proposal may cause issues where share-for-share exchanges take place within corporate groups or the substantial shareholding exemption applies and there are later third-party sales. We would therefore discourage the government from proceeding with this option. Nevertheless, should the proposal go ahead, we believe certain measures could be introduced to reduce unintended consequences.

3.11. A frozen capital amount attached to the shares could result in an unconnected purchaser being charged to income tax on the return of their own money. We suggest that there should be a refresh of the frozen capital and of the base cost on a genuine arm's-length acquisition.

3.12. We suggest a statutory tracing mechanism for the frozen amount, with a de minimis and a long-stop, so the figure is not reconstructed from incorporation across several tiers and decades; and an explicit carve-out for intra-group exchanges where the substantial shareholding exemption would otherwise apply.

3.13. The frozen capital proposal suggests a mechanism akin to Enterprise Investment Scheme deferral relief, whereby gains are deferred into the capital gains tax base cost of the new shares. It will be important to ensure any frozen amounts do still retain the same characteristics for other tax purposes (business asset disposal relief, holdover relief).

**4. Demergers**

4.1. Question 5: In what scenarios would you currently undertake or recommend a non-statutory demerger?

4.2. Statutory demergers must meet stringent criteria to qualify, limiting their use to simple scenarios envisaged by government rather than what are often more complex real-life situations. Non-statutory demergers are therefore commonly used where the statutory demerger rules cannot apply, for example in respect of pre-sale reorganisations as highlighted above.

4.3. Other scenarios include the separation of trade and investment assets to better manage risk, and reorganisations to resolve shareholder disputes, enable succession planning and allow for shareholder exits even where shareholdings are below the 75% subsidiary requirement.

4.4. One of the most common uses for a non-statutory demerger is to enable a sale to go ahead where the purchaser does not want to buy the entire business. We see no reason why such pre-sale demergers and the transactions in our other examples should not be enabled through a statutory demerger.

4.5. Given the far more flexible non-statutory demerger routes available, their flexibility and their familiarity among professional advisers, many will use these as a preference even where they would qualify for a statutory demerger.

4.6. Question 6: Do you think that the statutory demerger rules ought to apply to a broader scope of transactions?

4.7. Yes. The statutory rules should apply to a wider range of commercial transactions. This would help to achieve the original policy aim of allowing businesses to be more easily split up and run separately where it is more effective to do so. The statutory rules should be brought closer to the position applying to liquidation and reduction of capital demergers, which can already apply to a much broader range of transactions.

4.8. An alternative would be not to go ahead with the proposed changes to reduction of capital demergers, relying instead on the TiS rules to counter inappropriate distributions. This would require more detailed consideration of where the government believe the rules need strengthening, as we set out in the above section.

4.9. Question 7: What comments and suggestions do you have regarding the amendments suggested above to the statutory demerger legislation?

4.10. We welcome the proposed relaxations to the statutory demerger conditions A to C, E, and G to M, though we suggest the relaxations could go further. We comment against each condition below.

4.11. Condition A forms part of the general conditions and requires each company to be resident in the UK or a member state. We do not envisage any negative consequences from the proposed removal of this condition.

4.12. Condition B would be amended to replace the references to 'trade' with 'activity' to encompass investment companies. Currently, the existing rules are restricted to companies separating trading activities but cannot apply to companies wishing to separate trades from non-trade activities. This change is therefore particularly welcome as it should allow more commercial transactions the option of a statutory demerger.

4.13. Condition C would be removed: this makes sense in the context of other legislative changes that have removed the requirement for a commercial purpose for the transaction.

4.14. Condition D (CTA 2010 s1081(5)) is made up of multiple anti-avoidance tests, as set out below.

4.15. Condition D (a) - The tax avoidance test prevents a statutory demerger where one of the main purposes of the transaction is the avoidance of tax. HMRC do not propose any changes.

4.16. We suggest that the opportunity should be taken to bring this test in line with other anti-avoidance rules and the most recent changes to s139 of TCGA 1992, given the stated aim of modernising the legislation. In other words, restrict the tax avoidance test to capital gains tax, corporation tax and income tax. And restrict any counteraction to only those taxpayers obtaining a tax advantage, rather than all parties to the transaction.

4.17. Condition D (b and c) - The chargeable payments tests prevent a statutory demerger where one of the main purposes of the transaction is the making of a chargeable payment. HMRC do not propose any changes but acknowledge that they have been challenged on this point already.

4.18. We would add our voice to this challenge, on the basis that chargeable payments subject to tax under the exempt distributions rules are unheard of in practice and the test is inconsistent with those for other types of demergers.

4.19. Condition D (d) - The sale of demerged entities test prevents a statutory demerger where one of the main purposes of the transaction is the acquisition of the demerged entity by a third party. HMRC propose changing this requirement to stipulate that there should be no change of control within five years of the demerger. HMRC note that this would "legislate what is commonly accepted as normal succession planning in family businesses".

4.20. In our view, HMRC's proposal fails to appreciate that one of the most common reasons for a demerger is to separate the trading from non-trading activities of a company. This allows the trade to be sold while, for example, the investments are retained for the business owner's retirement. HMRC's manuals at CG-APP20 explain the change of anti-avoidance rules legislated for in Finance Act 2026, highlighting an acceptable capital reduction demerger (example 4) that involves the sale of one part of the business to an employee ownership trust. The guidance notes that "the scheme of reconstruction is to separate out businesses to be sold. There are no additional arrangements affecting the structure of the scheme that avoid or reduce the shareholders' liability to CGT." Under the new proposals, this type of arrangement would no longer be considered acceptable.

4.21. We suggest that, contrary to HMRC's comments, most family businesses do not plan their succession at least five years in advance. A variety of circumstances could bring forward a business sale or transfer: a major shareholder becoming ill, irreconcilable shareholder disputes, the need for strategic investment in a defined part of the business, and so on. In reality, therefore, the proposed changes would continue to leave statutory demergers as an unattractive or unfeasible option.

4.22. Our members highlight that the limited scope of the statutory demerger route means it is little used in practice. Alternative options (capital reduction demergers, liquidation demergers) do not require an alphabet's worth of conditions to be met and therefore provide much greater flexibility to cover a wider range of circumstances.

4.23. Condition D (e) - The cessation of trade test prevents a statutory demerger where one of the main purposes of the transaction is the cessation of a trade after the distribution. HMRC propose changing this requirement so that the restriction applies to prevent any voluntary winding up or dissolution of the company within five years.

4.24. The proposed changes envisage a situation where a company intends that one part of its business will cease but first separates it out via a demerger. This might be done to allow the successful part of the business to preserve its goodwill, for example if the ceasing trade has failed in some way. By restricting statutory demergers in commercial scenarios such as these, taxpayers will be obliged to use more complex, expensive alternatives, which as we note above do not carry such onerous restrictions.

4.25. Condition D (f) - The sale of trade test prevents a statutory demerger where one of the main purposes of the transaction is the sale of a trade after the distribution. HMRC propose changing this requirement to restrict onward sales within five years of the demerger, other than where all trading activities are disposed of. But we do not now and have never understood the rationale behind this restriction, as a demerger cannot facilitate the sale of a trade from a company.

4.26. The sale of a trade from a demerged company in this scenario would see the sale proceeds taxed in the corporate group at corporation tax rates, similarly to the sale of stock and other assets had there been no demerger. We therefore see little reason to retain a restriction that produces no obvious tax advantage.

4.27. Conditions E and H require that shares must constitute "all or substantially all" of the distributing company's share capital and voting rights, which the consultation proposes changing to simply "all". Condition E further requires that shares must not be redeemable. We suggest that both conditions could be removed entirely as we are unaware of any possible tax avoidance targeted by this restriction. Transactions that involve the distributing company retaining an interest in the demerged company are rare in practice and the requirement for no redeemable shares seems to be a legacy of advanced corporation tax anti-avoidance. Again, removing these conditions would also provide consistency with alternative demerger mechanisms.

4.28. Condition F is not specifically mentioned in the consultation document but has the same effect as condition B (requiring distributing companies to be trading). We assume this would be amended to expand 'trade' to also include 'activity', which we would support.

4.29. Condition G specifies that the distributing company must not retain a major interest in a transferred trade. HMRC propose removing this condition in order to legislate commonly accepted practice, which we support.

4.30. Condition I requires that, after the transfer, the only or main activity of the transferee company is the carrying on of the trade (or holding the shares transferred to it). HMRC propose clarifying the requirement by amending it to "immediately after the transaction." The reference to 'trade' would presumably also be expanded 'activity' in line with conditions B and F above.

4.31. This condition is currently quite restrictive, limiting businesses to growing organically following a demerger as they are prohibited from acquiring new trades from third parties. The proposed change is on the face of it a welcome relaxation. Our only comment is that the suggested wording of "immediately after" is not ideal, being subjective and open to interpretation. Nor is it clear what the goal is by imposing this condition for a limited period. We suggest either a statutory timeframe to avoid the possibility of misinterpretation or, better yet, no restriction on the activities of the companies involved in the transaction.

4.32. Condition J mirrors earlier conditions requiring that shares must constitute “all or substantially all” of the distributing company’s share capital and voting rights, which the consultation proposes changing to “all”. However, in this case the proposed change cannot feasibly be met, since an existing company will have at least one share that, since it was issued on incorporation, will not have been issued in respect of the distribution.

4.33. Condition K mirrors earlier conditions requiring the distributing company to be trading in cases where there is a distribution of a trade or shares to another company in exchange for the issue of shares by the transferee company. HMRC propose a relaxation to allow the distributing company to be dissolved following the transfer if there is nothing left in the company.

4.34. We note that the paragraph after condition K in the legislation confirms that the condition does not need to be met if the distributing company has no net assets and is subsequently dissolved. HMRC’s proposal is therefore not in fact a relaxation but a more restrictive requirement, converting no net assets to no assets whatsoever.

4.35. Conditions L and M relate to intragroup distributions and would be repealed on the basis they are effectively redundant already. We support their removal.

4.36. HMRC go on to suggest that, in light of their proposed relaxations, there should be little need to appeal when HMRC deny taxpayers’ requests for clearance, and so the right to apply for automatic appeal to the Tribunal should be removed.

4.37. We question whether removing the right to appeal to Tribunal is a fair exchange for the proposed legislative tweaks. Or indeed whether a quid pro quo approach is the right framework for legislative reform. In our members’ experience, few taxpayers will take their cases to Tribunal so it is unlikely to be a significant cost to HMRC. Nevertheless, it remains an important safeguard if the government accept that HMRC can sometimes get things wrong.

4.38. Question 8: Are there any other specific parts of the legislation which you think the government should re-examine?

4.39. Although not mentioned in the consultation document, there are additional conditions that must be met before a company can qualify for a statutory demerger. These are set out in CTA 2010 ss1076(1)(a) and 1077(1)(a)(ii). Essentially, a transfer of shares can only qualify if the parent company holds at least 75% of the shares.

4.40. There are several commercial reasons why a subsidiary may not be 75% held by its parent company or group. For example, for businesses operating internationally, some jurisdictions require substantial local shareholdings that would prevent a company being more than 50% held by the group. Outside investors may also take stakes in the subsidiary in recognition of the funds they provide, reducing control by the group below 75%.

4.41. As for the other statutory demerger conditions, there is no minimum holding requirement when opting for the alternative demerger routes.

4.42. We suggest that a 75% holding is a fairly arbitrary requirement that no longer reflects modern commercial practice. We recommend that, unless such a condition can be justified by policy, this requirement is removed.

4.43. We also suggest that consideration should be given to relaxing the requirement to submit a return to HMRC within 30 days of a statutory demerger where clearance has already been given. In such cases, the return merely confirms that the transaction was carried out in accordance with the clearance application. This could just as effectively be reported in the company's annual corporation tax return, reducing additional administration.

4.44. Question 9: In what way do you think the demerger rules ought to be liberalised in order to account for the removal of capital demergers?

4.45. The consultation explains that the aim of the current statutory demerger provisions is to remove any tax disincentive to demerge and therefore support businesses to adapt. It goes on to recognise that the provisions are not well used; companies instead rely on other options to achieve the same effect. With this in mind, we are surprised that there is little exploration of why companies tend to use alternative routes like capital reduction demergers.

4.46. Our analysis of the consultation's proposed changes to the numerous statutory demerger conditions, pre-conditions and processes highlights a recurring theme: virtually none of these are required to achieve the same outcome through other means i.e. through capital reduction demergers or liquidation demergers. We believe this simplicity is crucial in explaining companies' preferences. We therefore support a much greater degree of simplicity in the proposed changes, focusing more heavily on countering tax avoidance involving capital distributions to individual shareholders.

4.47. Our suggestion is that a single targeted anti-avoidance rule similar to TCGA 1992 s139 would be preferable to multiple detailed conditions. This would also be consistent with the alternative demerger options.

4.48. Question 10: Do you anticipate any unintended consequences as a result of the proposals set out in this chapter?

4.49. The government's stated intention is to liberalise the conditions to allow businesses to operate more freely, allowing statutory demergers to be used in a wider variety of circumstances. This is seemingly at odds with the proposal to remove the commonly used capital reduction demerger option while retaining most of the conditions (albeit with some easements) for statutory demergers. There is therefore a risk that the proposals could produce the opposite outcome, creating a barrier for many businesses that do not meet all the conditions.

4.50. Although it is a matter of company law rather than tax legislation, it is pertinent to note that a company without sufficient distributable reserves cannot use a statutory demerger even if all of the tax conditions are met.

4.51. The remaining alternative if a company does not meet the conditions to qualify for a statutory demerger or cannot do so under company law would be a liquidation demerger, which is generally more expensive and time-consuming. This could result in a competitive disadvantage for those businesses who cannot afford to work through a liquidation demerger quickly or at all. Avoiding such a barrier to businesses that are trying to restructure to turn things around and become profitable again benefits all stakeholders, including the Treasury.

**5. Income tax treatment of distributions from non-UK resident companies**

5.1. Question 11: Do you have any general comments on aligning the charge to Income Tax on distributions from non-UK resident companies with the rules that already apply to distributions from UK-resident companies?

5.2. We agree with the high-level principle that UK resident taxpayers should be taxed on distributions of profits from UK and non-UK resident companies in the same way.

5.3. Where we are more cautious is the practical implementation of such a principle. The simplicity of the proposed changes to bring other types of distributions into the scope of income tax belies an underlying difficulty; that of establishing how distributions should be categorised in the first place in jurisdictions with very different legal structures.

5.4. As we comment in response to question 30, the definition of a close company may benefit from review, and this holds true for non-UK resident companies also. The current approach of a company “which would be close if it were UK resident” creates various technical issues.

5.5. We also highlight that there is clear cross-over between this chapter of the consultation and other ongoing consultations led by other HMRC teams. These include the proposed changes to how UK-resident members of certain non-UK entities are taxed, and the substantial programme of reform to the offshore anti-avoidance rules for individuals.

5.6. While we are reassured that different HMRC teams work closely together, it is difficult to see how a cohesive plan can be formed when the aims and timelines of the various consultations differ.

5.7. We suggest that any action in this area is deferred until the outcome of the other consultations is known. In particular, the topic of non-UK resident company distributions should be definitively brought into scope of the more comprehensive personal tax offshore anti-avoidance legislation review.

5.8. Question 12: Can you foresee this proposal having any impact on obtaining relief for double taxation where the distribution is subject to tax in another state?

5.9. Yes, there may well be implications for claiming double tax relief under treaty terms. This could apply where the UK treats a distribution as income whereas another state treats it as capital.

5.10. We have not sought to identify any specific instances of double tax treaties that would be affected by the proposed changes. This would need to be reviewed to fully appreciate the impact.

5.11. Question 13: Do you anticipate this proposal deterring any commercial corporate actions? If so, please provide details and suggestions of how this impact could be addressed.

5.12. We have no comments on this point.

5.13. Question 14: Do you have any comments on the proposal to extend the charge to stock dividends? In particular, are there difficulties with the classification of shares in non-UK jurisdictions?

5.14. We agree that there may be difficulties with the classification of shares in non-UK jurisdictions, especially where minor shareholders have little access to detailed information. There will need to be guidance issued to cover these situations.

5.15. Question 15: Do you have any comments on extending the charge to redeemable bonus shares and securities?

5.16. Similarly to question 14 above, the issue of classification and identification of bonus shares and securities is key, as the consultation document points out. Again, there will need to be clear guidance for taxpayers to follow in cases where the information is insufficient or entirely lacking.

5.17. Question 16: Do you have any comments on to what extent the charge to Income Tax on distributions should apply to payments on special securities and non-commercial securities?

5.18. We have no comments on this point.

5.19. Question 17: Do you have examples of where instruments that would be treated as special securities and non-commercial securities are used in existing structures where the return would be paid to UK residents within the charge to Income Tax?

5.20. We do not have any relevant examples.

5.21. Question 18: Do you have any comments on the potential tensions between the definitions used in the UK distributions rules and non-UK corporate legislation, especially with regard to the distinction between income and capital? In particular, are there any difficulties around what constitutes a 'repayment of capital'? How could these be addressed?

5.22. The UK's distribution rules can and regularly do come into conflict with non-UK corporate legislation. Different legal structures make it difficult to determine whether distributions or transactions should be treated as capital or income and therefore how they should be taxed.

5.23. The correct approach to this problem was first established in Rae v Lazard Investment Co Ltd (1963) 41 TC 1 and more recently summarised in the First-tier Tribunal decision in Beard (2025) EWCA Civ 385. In short, the solution is a complex analysis of a host of different factors.

5.24. The proposal to extend income tax to additional categories of distribution does not resolve this complexity, since it would still be necessary to decide how to classify that distribution.

5.25. The UK starts with corporate law, moves to corporation tax and then hinges income tax treatment off the corporation tax definition of distribution. And capital gains tax (TCGA 1992 s37) then follows that. Starting instead with the question of what transactions should be capital and what are effectively disguised dividends may make it easier to compare non-UK corporate legislation.

5.26. Question 19: Do you have any insights from other jurisdictions which also use the capital/income divide in their tax legislation?

5.27. We do not have examples of other jurisdictions using the capital/income divide.

5.28. Question 20: Are you aware of any particular existing difficulties around whether a distribution from a non-UK incorporated company is a 'dividend'? Should the government consider introducing provisions to clarify the treatment where the non-UK company law is unclear?

5.29. We would support introducing provisions to clarify the treatment where the non-UK company law is unclear. Under a self-assessment system, taxpayers should make reasonable efforts to understand what is required of them and obtain all necessary information. But there must also be guidance on what position to take when those reasonable efforts are insufficient to reach a conclusion.

5.30. Question 21: When calculating what amount of a distribution is a repayment of capital, would it be effective to permit small shareholders in widely held or quoted companies, who do not have access to the necessary information, to simply use the nominal value of the interest they hold on a share buyback? Are there any difficulties with calculating the nominal value of the share in some jurisdictions?

5.31. We agree that using nominal value for small shareholders of widely held companies would be an effective and pragmatic option where they cannot reasonably obtain the necessary information. It may be simpler still to allow this approach across the board, regardless of whether the shareholder is 'small'. A shareholder with a more substantial holding is no better off for being so if they cannot reasonably obtain the information; the only difference is that the hurdle for what is reasonable is likely to be higher for a larger shareholder.

5.32. We also agree that there will be difficulties in calculating the nominal value of shares/equivalent interests in some jurisdictions. In these cases, there should be clear steps to follow in priority order. For example, looking at original subscription amounts, or the foreign equivalent of the capital/member account. HMRC guidance could usefully provide examples from commonly problematic jurisdictions so that taxpayers face as little uncertainty as possible.

**6. Interaction between debt, loans and the distribution legislation**

6.1. Question 22: Are you aware of instances where dividends or other distributions have been improperly paid? If so, were the distributions repaid to the company and on what timescale? What was the tax treatment generally adopted on the repayment?

6.2. Yes, we are aware of instances of dividends that have been improperly paid. This occurs for several reasons.

6.3. A relatively common occurrence is the reclassification of previously paid dividends (for example, as salary or loan) where the year-end accounts show that there were insufficient distributable reserves.

6.4. As the consultation document identifies, failing to meet all the conditions of a company purchase of own shares, whether due to the timing of payment or the level of distributable reserves, can result in a deemed income distribution.

6.5. Accidental distributions can also arise due to transfers to shareholders at undervalue and where incorrectly prepared accounts result in overstated distributable reserves.

6.6. The action taken and the tax treatment adopted depend on the circumstances.

6.7. In those cases where shareholders did not know and had no reasonable grounds to know that distributions were unlawful, there may be no requirement on them to repay the company. They would be subject to income tax as if the dividends had been lawful.

6.8. In cases where repayment is required, the timescales can be years and even decades. The issue giving rise to the improperly paid dividend may only come to light as a result of an HMRC enquiry, an audit or change of accountant, or a transaction prompting a due diligence exercise. The time limit for amending all relevant returns may have passed, creating the problem the consultation seeks to resolve.

6.9. Question 23: Would priority rules to establish what the primary charge will be on an extraction address the issue? Are there any adverse consequences to this?

6.10. A priority rule preventing a CTA 2010 s455 ("s455") tax charge where it is established that the distribution has already been charged to income tax would be a sensible solution for most close companies. The alternative, that income tax is not repayable on a repaid distribution unless the company has paid a s455 tax charge, assumes that an unlawful distribution would be repayable and therefore a debt. However, this is not always the case as we set out above.

6.11. The risk of this approach is the potential overpayment of income tax if the distribution is repaid, keeping the tax rules at odds with company law. If a repayment of the dividend is needed and subsequently takes place, there should be a process to recover the income tax that is no longer due, even where that falls outside the normal time limits.

6.12. Question 24: Do you have any views as to whether legislating for the current discretionary practice of unwinding unintentional gratuitous transfers would provide a solution?

6.13. We would be in favour of legislating for the current discretionary practice of unwinding unintentional gratuitous transfers, in addition to a priority rule.

6.14. One of the reasons for the practice was a recognition that taxpayers often accept HMRC's amended valuations rather than incur the cost of challenging it. It is important this recognition is not lost in the drafting of the legislation.

6.15. Question 25: What are your views on allowing Income Tax paid on an unlawful distribution to be set off against liabilities incurred on rectifying the issue?

6.16. The consultation document highlights that an individual could pay tax twice on the same dividend: once on a rectified, properly paid dividend and, if they are out of time to reclaim it, once on the improperly paid dividend. Is it therefore proposed to allow the original income tax to be used as a credit against the tax due on the later rectified dividend, regardless of how much time has passed.

6.17. We support the overall concept of this proposal, which brings a greater degree of fairness to the tax system. The way the tax credit would work in practice may, however, need some thought.

6.18. There will need to be clarity as to whether the rules apply to all rectifications made after the date the legislation comes into force or only to distributions made after that date.

6.19. The suggestion is to allow an offset against a liability arising specifically from rectifying the situation via a valid distribution. This could be difficult to identify and could leave room for dispute, for example if it takes place indirectly, in multiple stages or after other planned/expected dividends. The legislation should take these more complex cases into account by setting out clearly how the credit should be matched.

6.20. There ought to be a succession mechanism so that the overpaid tax is not lost if the original taxpayer dies or (for trusts and estates) is wound up, but is instead passed on to their beneficiaries. Allowing this extra level of flexibility would remove a potentially unfair restriction that conflicts with the policy aim of removing a double tax charge.

6.21. There will also be cases where rectification takes the form of a full or partial repayment, with no new dividends issued and therefore no tax against which to set off the credit. The proposal would therefore work best in conjunction with, rather than instead of, the consultation's other options.

6.22. Question 26: What alternative solutions might be implemented to address the issues raised in this chapter?

6.23. We support the broad principle of all the proposals in this chapter. With the adjustments we mention above and suitability clear legislation and guidance, we do not see a need for further solutions.

**7. Loans and other temporary extractions from non-UK resident companies**

7.1. Question 27: Given that the tax would need to be paid by individuals rather than by the companies making the loans, would this result in particular administrative difficulties? If so, please provide examples.

7.2. We do not argue against the logic of extending a form of s455 tax to non-UK resident companies and agree that in principle such a charge would level the playing field.

7.3. An individual in receipt of cash funds from a non-UK resident company should reasonably be expected to know, or be able to find out, the nature of the payment and other information relevant to their tax affairs. However, a 'payment' may not always so obvious, for example where an accounting entry credits a loan account that the director is able to draw on.

7.4. Administratively, it can be more difficult to obtain information from non-UK resident companies than UK companies. This may be due to differences in legal structures, tax systems, standard reporting information, and language barriers, though close companies should fare better.

7.5. We recommend that guidance accompanying any new rules in this area clarifies (or cross-references to other existing guidance) when exactly the loan arises. Those dealing with the administration and accounting records for non-UK resident companies will need time to change their processes to avoid inadvertent loans and/or late reporting to shareholders.

7.6. Question 28: What general comments do you have on the proposal to introduce a temporary tax on loans received from non-UK resident closely controlled companies?

7.7. Any extension of the loans to participators regime to overseas closely controlled companies should avoid double taxation. Options should provide relief when loans are repaid and should mirror the existing treatment of loan write-offs under the close company rules.

7.8. We also reiterate our earlier comment that these proposals must be considered alongside other consultations on international personal tax issues.

7.9. Question 29. Do you have any specific comments on the four options outlined above? Do you have any suggestions as to what time periods would be appropriate?

7.10. The first two options seem to lead to a potential double tax charge. An individual receiving a loan or advance would face the initial charge under the new s455-style regime, with a further charge arising under ITTOIA 2005 s415 (“s415”) when the loan is released or written off. This contrasts with the position for a UK-resident company, which would receive a repayment of the previously paid s455 tax on a write-off of the loan.

7.11. To be workable, the options need a mechanism allowing amounts paid on the original loan to be credited against the charge arising under s415 on a later write-off/release.

7.12. The options are also silent on the consequences of a loan repayment. In our view, where a loan is repaid, the corresponding tax charge on the participator should either be refunded or available as a credit against any income tax liability arising where the loan is subsequently cleared via a dividend. A default of the latter with the option of the former may help prevent complexity where the individual themselves becomes non-UK resident.

7.13. Option three seems reasonable but does not solve the problem of applying the rules consistently, since non-UK resident companies could continue to allow shareholders the use of their funds on a long-standing or permanent basis.

7.14. Option four provides a solution to the shortfall in option three. However, we question whether there is sufficient policy justification for a deemed write-off after 5 years. Creating a fictional transaction after an arbitrary period of time could introduce an unnecessary layer of complexity and drive taxpayer behaviour in unintended ways. Our preference is therefore for greater consideration to be given to how options one or two could work in practice.

7.15. We note that none of the options address the national insurance charge that may arise when a loan is released or written off. Likewise, there is no discussion of how the benefit-in-kind rules might apply in these circumstances.

7.16. Question 30: The close company definition is extremely broad. Can you see this proposal affecting loans made on arm’s length terms to participators with very minor interests, and if so, can you provide examples?

7.17. We appreciate the consideration given to limiting any negative impact of the proposals on ordinary commercial loans and other transactions. And while restricting the s455 tax charge to only those with material interests may well achieve that, it is arguably incompatible with the policy aim of comparable treatment regardless of residence. Additionally, establishing whether a participator’s interest is material is not always straightforward in UK resident companies let alone non-UK resident entities, as discussed earlier in this response.

7.18. If policy dictates that the loan charge should not affect participators with very minor interests, one might reasonably suggest that this should extend to participators in UK resident companies as well. Otherwise, the proposal leaves the tax regime more onerous for UK resident companies compared to those overseas.

7.19. Furthermore, the definition of a participator in this context extends beyond shareholders to include loan creditors, for whom the 5% threshold could be difficult to apply. Clarity will therefore be needed on whether the intention is that somebody who does not hold shares in the company but is a loan creditor would simply be subject to the new rules.

7.20. The 5% share capital, voting rights and winding up rights threshold is also trickier to determine than it may at first appear. We see this in the case law for business asset disposal relief, which in itself arguably no longer warrants the level of complexity involved for the benefit provided.

7.21. On a related note, we wonder whether the extremely broad definition of close company is something that should be open for discussion. The current definition can produce anomalies in terms of what one might typically consider to be a close company, and is poorly understood by those who most need to be aware of its impact (as highlighted in our payments to participators consultation response[1]).

7.22. Question 31: What impacts would the proposal have on arm's length commercial lending?

7.23. In answer to this question, we refer to the consultation document's further option of broadening the existing exclusion for loans or advances made in the ordinary course of business. If this option were adopted, the impact on arm's length commercial lending should be minimal.

7.24. Question 32: Would limiting this charge to participators and associates of participators with material interests in the overseas companies help to target this at loans which represent extractions of profit?

7.25. We have no further comments beyond those already made.

7.26. Question 33: If we expand the exclusion for loans or advances made in the ordinary course of business, what changes would be necessary to avoid curtailing normal commercial activity?

7.27. We have no further comments beyond those already made.

**8. Purchase of own shares rules**

8.1. Question 34: What general comments do you have on the proposals set out in this chapter?

8.2. The purchase of own shares (POS) rules provide an exemption from income tax on distributions where certain conditions are met. In the same vein as our comments in the demergers chapter, we are not persuaded that many of these conditions are required. We are even more cautious about the proposal for a series of extra conditions.

8.3. The consultation gives no justification for why the distributions legislation should be given greater protection than the capital gains rules that apply in buyout transactions. This is relevant because, in practice, many of the commercial outcomes available through a POS can be achieved through a buyout structure. The difference is that a transaction using a new company to buyout shareholders does not impose the same restrictions (either under the current rules or those that are now proposed). Restricting POS transactions further, for example through minimum holding and employment requirements, will lead to taxpayers using buyouts instead. This would be a disappointing outcome given that, when it works, a POS is by far the simplest option.

8.4. The capital gain rules have recently (in Finance Act 2026) been updated with a relatively straightforward main purpose test, and with counteraction limited to those obtaining the tax advantage. If the government now wish to modernise the distributions rules so that they work as intended and do not give rise to distortions, we suggest that adopting a similar framework in place of a series of restrictive conditions would be a good starting point.

[1] Reporting company payments to participators - CIOT response

8.5. Leaving aside our preferred solution, we comment against each of the proposals below.

8.6. The commercial purpose test has been removed as a requirement under the TiS rules and the capital gains rules for reorganisations and reconstructions. Removing the trade benefit test from the POS rules is broadly in line with those changes, providing a degree of consistency and expand the relief to non-trading companies. Indeed, we strongly suggest that HMRC should go further and remove completely the requirement that the company be a trading company or holding company of a trading group. This would be in line with the similar proposal for exempt distributions and would remove an unwarranted restriction against using a POS for an investment company or group.

8.7. The proposed 5% holding requirement would prevent the use of a POS in various commercial situations where a POS would otherwise be a useful option. For long-established family companies held by multiple generations, there may well be founding members and other family shareholders with less than a 5% holding but who nevertheless have strong opinions on the business. Buying out those minority shareholders via a POS when (or before) disagreements escalate would no longer be possible with a minimum holding requirement despite the potential impact on the business.

8.8. The reduction of the minimum holding period from five years to two years is a helpful relaxation, although removing the minimum holding period entirely would be more welcome.

8.9. We do not agree that there should be a need for the shareholder to have worked for the company throughout this period. The proposal suggests an attempt to mirror the employment condition for business asset disposal relief (entrepreneurs' relief as was). However, that relief is designed to benefit individuals who have built and are actively involved in their business, which differs fundamentally from the purpose of a POS. Indeed, a common use of the POS rules is specifically to remove shareholders who are not involved in the business, for example where directors have moved on to competing companies or a shareholder has inherited shares from a former employee. It is also not possible for a trust shareholder (often used for succession planning) to work for a company.

8.10. Requiring a dissenting shareholder to remain an employee during the weeks or, more likely, months before a deal can be concluded for the sale of their shares is not only uncommercial but could have a detrimental impact on the running of the business in that period.

8.11. The option to allow a departing shareholder to retain a small proportion of their shares has long been established to give companies the flexibility to fit different circumstances. As well as for sentimental reasons, the retiring shareholder may wish to hold on to some shares to benefit from a small level of dividends in their retirement. Or over the course of a phased buyback they may retain preference shares to preserve inheritance tax treatment, or some golden share that allows them to take back control if the buy-back isn't paid for in full. It may support the company brand to advertise themselves as owned by multiple generations (e.g. father and son). The company may also find it easier to significantly reduce a shareholder's interest rather than remove them entirely, which can be more expensive and less palatable for the individual. The proposal to further restrict the variety of transactions that can benefit from the POS rules is therefore difficult to square with the stated aim of modernising our legislation.

8.12. The consultation recognises that a POS does not work in situations where the consideration needs to be paid in multiple tranches. We therefore welcome the proposal to allow payments to be spread out. However, the proposed two-year time limit for full payment is not long enough and seems to be guided by the existing rules rather than what is commercial. With PE ratios at 10-20, it could easily take ten years to fully buy out a departing shareholder. Even a five-year period would be more manageable than two years. Without this, the proposal may only be of use to a small proportion of buyback agreements.

8.13. We do not object to the proposal that a company must take reasonable steps to ensure the consideration paid for the shareholding does not exceed market value. We do question why more legislation is needed to achieve this, given the long-standing market value rules at TCGA 1992 ss17-18 and existing requirements for taxpayers to take reasonable care. Our vision is for a more efficient and less complex tax system and so we must caution against introducing additional legislation for the sake of emphasis. We suggest that if there is uncertainty as to how market value should be ascertained (and bearing in mind that the valuation of an unquoted minority holding is not an exact science), HMRC could provide more prescriptive guidance on what they believe is needed to meet the reasonable care threshold.

8.14. The consultation proposes extending the holding and working period requirement from two years to five years where the departing and remaining shareholders retain a family connection. The justification given is that this should prevent family members obtaining a capital extraction while not meaningfully contributing to the business. We assume the policy aim is not to encourage shareholders to sever family connections but to impose greater restrictions on family companies wishing to make use of a POS. Either way, we are not convinced this is a reasonable restriction. Individuals may contribute to family companies through formally recorded working hours and injection of funds but also in myriad other direct and indirect ways that may not be measurable by HMRC. We do not share the consultation's view that family companies must be held to a higher standard because of the inherent threat of improper behaviour.

8.15. The final suggestion is to withdraw relief where a person becomes either a shareholder or director of the company again within five years of leaving.

8.16. The rationale for the shareholder requirement is to prevent the POS rules allowing someone to give up their shares to obtain preferable tax treatment, then immediately reacquire them. It is suggested in the consultation document that in some cases, there may be genuine reasons why a previously departed shareholder reacquires shares, for example through inheritance. The proposal goes on to explain that further conditions could allow someone who has inherited shares to retain the relief i.e. provided they sell the shares as soon as possible. Our concern is that not only is this not particularly practical for a minority shareholding in an unquoted company, but that the additional conditions add further unnecessary complexity.

8.17. We suggest that if the aim is to restrict the relief in cases where a tax advantage is sought, the rules could simply say so, as they do for other reconstructions through TCGA 1992 s139(4A) – (4C). This may be simpler than introducing new rules that need a range of exceptions to work as intended.

8.18. We feel that the director requirement should be reconsidered with a wider range of scenarios in mind. The relief is intended to facilitate the departure of a shareholder for the benefit of the company's trade. It does not benefit the trade if the individual who has given up their shares cannot stay on as a director for a transitional period to ensure a smooth handover. Nor is there a benefit in preventing their return if the company runs into difficulties requiring their help.

8.19. What is more, the withdrawal of a relief for something as innocuous as inheriting some shares or returning to help a failing business is a comparatively severe penalty when the overall objective of the relief has still been met. The proposal differs to, for example, income tax relief on Enterprise Investment Scheme Shares which is designed to encourage long-term investment and is therefore withdrawn when shares are sold in the short-term. This is compounded by the implication that the revised tax assessment would apply retrospectively up to five years prior, on top of five years' worth of late payment interest. At the very least, the clawback should be assessed in the year of the disqualifying event instead.

8.20. We are concerned that by limiting the practical use of the POS rules and introducing harsh clawback mechanisms, they will simply cease to be recommended by professional advisers. In all situations where a POS is no longer possible or is considered too risky as a result of the proposed changes, companies may be left with the difficult decision of a more complex, costly buyout transaction or to settle for taking no action to the possible detriment of the business.

8.21. For those that can make use of newly revised POS rules, there will be borderline cases – shareholdings a fraction under the 5% threshold; exits contemplated but executed days over the two-year limit. A clearance route for those would preserve certainty for the standard case without turning near-misses into the full income charges.

8.22. The above comments all relate to Condition A of CTA 2010 s1033 (broadly, the trade benefit test). The consultation notes that there is no intention to change Condition B, which deals with discharging inheritance tax (IHT) in cases of undue hardship. We believe this would be a missed opportunity.

8.23. The IHT rules underwent a significant change from 6 April 2026 with the restriction of agricultural and business property relief (APR/BPR). Further changes impacting businesses will come into effect from 6 April 2027 when pension schemes holding business property become fully liable for IHT without the benefit of APR/BPR.

8.24. We have heard from practitioners and business owners about the substantial impact these changes will have on UK companies and undoubtedly the government is also aware of them. While we do not repeat our concerns[2] here, one point is worth making: death is not a planned event. Family businesses suddenly faced with an IHT liability on the deceased's shareholding must find ways of funding that liability, most obviously by selling the shares back to the company.

8.25. However, Condition B restricts the POS rules from applying unless the family dealing with the estate can prove they would suffer undue hardship to fund the liability in any other way. HMRC guidance provides no further clues as to what might count as undue hardship and it is difficult to contemplate in advance of death whether this might be the case. So in addition to needing to find 20% IHT on the share value, families face uncertainty over whether they also need to fund income tax on paying out dividends to meet the IHT charge, if a dividend is even possible with other individuals holding the same share class.

8.26. We recommend that the undue hardship element of Condition B is removed. The test was largely irrelevant when 100% APR/BPR applied and pensions were out of scope of IHT, so this change would represent a sensible modernisation to remove a subjective test.

8.27. Question 35: What unintended consequences do you anticipate as a result of these changes?

8.28. The proposals introduce multiple new conditions for taxpayers to self-assess against to decide on the correct tax treatment. The risk is that, even with the best of intentions for clear principles-based rules, new legislation will be untested and open to interpretation. This could lead to more enquiries and more litigation. There is also the potential for cases to go against taxpayers carrying out transactions exactly as parliament intended but who for one reason or another fall foul of a technical condition.

**9. Updated capital extraction anti-avoidance**

9.1. Question 36: What general comments do you have on the proposal set out in this chapter?

9.2. It is difficult to comment on the proposed amendment or replacement of the anti-avoidance rules without knowing quite what is being proposed and why it is needed. In our view, the existing rules are generally well understood and effective at countering tax avoidance.

9.3. We would welcome further clarification from HMRC, on a confidential basis if preferred, of the types of scenarios it is seeking to counteract, to allow us to suggest options for reform.

9.4. To our knowledge, most of the judgments in this area have gone in HMRC's favour on the technical arguments, suggesting there are very limited routes to circumnavigate the rules. If there are still areas where the rules are failing, our preference would be for those specific areas to be fixed, as opposed to a wholesale replacement of the legislation.

9.5. Question 37: What unintended consequences do you anticipate as a result of this proposal?

9.6. As noted above, any consequences would depend entirely on what the detail of proposals actually is.

[2] CIOT FB25-26 CWH c62 IHT APR BPR; CIOT letter to FST IHT on Pensions

9.7. However, the removal of these rules, which have been strengthened and fine-tuned over the decades and for which a significant body of case law and guidance exists, may lead to more uncertainty and more disputes for taxpayers and HMRC.

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· Greater certainty, so businesses and individuals can plan ahead with confidence.

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