# Comment

## Distributions received by small companies: a purposive interpretation

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CTA 2009 Part 9A (ss 931A–931W) embodies the code dealing with the corporation tax treatment of dividends and other distributions received by companies. Part 9A Chapter 1 imposes a charge to corporation tax on income in respect of dividends and other distributions 'but only if the dividend is not exempt'. Chapter 2 then confers an exemption on dividends and other distributions received by a company in an accounting period in which it is a 'small company'. Chapter 3 confers an exemption on dividends and other distributions received by companies that are not small.

Chapter 2 consists of two sections: ss 931B, 931C. In principle the application of a simplified system to small companies is to be welcomed. But as will be seen, Chapter 2 includes an anti-avoidance rule which is of such apparent width that it creates considerable uncertainty as to the circumstances in which it may fall to be applied.

Looking now at Chapter 2 in more detail, s 931B provides:

*'A dividend or other distribution of a company that is received in an accounting period of the recipient in which the recipient is a small company is exempt if—*

*(a) the payer is a resident of (and only of) the United Kingdom or a qualifying territory at the time that the distribution is received,*

*[(b), (c)] and*

*(d) the distribution is not made as part of a tax advantage scheme.'*

Leaving aside sub-para (*d*), this is very straightforward. In particular, the receipt of a dividend from a company resident only in the UK is exempt. In the case of a dividend from a company resident only in a qualifying territory that does not allow a tax deduction for the dividend, that dividend is also exempt.

### Reviewing the anti-avoidance

Turning to sub-para (*d*), 'tax advantage scheme' is defined by s 931V: 'tax advantage scheme' means a scheme the main purpose, or one of the main purposes, of which is to obtain a tax advantage (other than a negligible tax advantage).

'Tax advantage' is for this purpose defined by CTA 2010 s 1139:

*'(a) a relief from tax or increased relief from tax,*

*(b) a repayment of tax or increased repayment of tax,*

*(c) the avoidance or reduction of a charge to tax or an assessment to tax, or*

*(d) the avoidance of a possible assessment to tax.'*

'Tax', if neither income tax nor corporation tax is specified, means either of those taxes (CTA 2010 s 1119).

So, taken at face value, this anti-avoidance provision is capable of applying in any circumstances where the dividend or other distribution is part of a scheme which has as a main purpose to achieve an income tax or corporation tax advantage. Consider, for example, the prospective sale by a small company of a UK-resident subsidiary (Target) where the sale would not be covered by the substantial shareholdings exemption.

It is standard practice for Target to pay a pre-sale dividend to the vendor so as to reduce the gain on the disposal. Thus, the purpose of the dividend would be to reduce a charge to corporation tax. Would the exemption apply in these circumstances? Let us leave that question unanswered for the moment while we consider the same situation but with a vendor company that is not small.

Part 9A Chapter 3 applies to exempt a dividend received by a company that is not small if the dividend falls into an exempt class and meets two other conditions not material for present purposes. The exempt classes overlap but in relation to the pre-sale dividend we can consider just the exemption for dividends paid by controlled companies (s 931E). The exemption does not apply if the dividend is part of a scheme to secure the exemption and the dividend is paid out of pre-control profits (s 931J). Also the exemption would not apply if paid as part of a tax advantage scheme and (broadly):

**Chapter 2 includes an anti-avoidance rule which is of such apparent width that it creates considerable uncertainty as to the circumstances in which it may fall to be applied**

- a payment is made in return for the right to receive the dividend (s 931O);
- a non-arm's length payment is made for goods or services (s 931P);
- the scheme involves the diversion of a dividend that would otherwise have been trade income (s 931Q).

None of the above would apply in the circumstances now under consideration so that the pre-sale dividend would be exempt in the hands of the vendor company that is not a small company.

### Why a purposive interpretation is appropriate

The anti-avoidance provisions of Chapter 3 are targeted at situations in which the essence of the avoidance is the obtaining of the exemption as distinct from a collateral advantage such as a reduction in the charge to corporation tax on chargeable gains. But s 931B(*d*) is not expressly limited in that way. Does it therefore apply to any form of income tax or corporation tax avoidance of which an exempt dividend is a component? This surely must be a situation in which a purposive interpretation is appropriate. The context of s 931B(*d*) points to it being limited to schemes that are intended to secure the exemption for a small company in circumstances in which it would not otherwise apply, as for example where a company resident in a qualifying territory is interposed between a small company and a company not resident in a qualifying territory. That s 931B(*d*) should be given effect as a GAAR would be beyond any rational legislative purpose.