

Disincorporation relief

Who is likely to be affected?

Small companies and their shareholders that choose to disincorporate, that is, to transfer a business and its assets as a going concern to one or more of the company's shareholders, to continue the business in an unincorporated form.

General description of the measure

The measure provides a time-limited opportunity for a company and its shareholders to make a joint claim for qualifying business assets to be transferred from the company to one or more of its shareholders with no immediate corporation tax (CT) charge on the company.

Policy objective

The measure will make it easier for the owners of a small incorporated business to disincorporate by removing some of the tax charges that arise when assets are transferred by the company to the shareholders who wish to continue the business in an unincorporated form. The measure will allow the business greater flexibility to choose the most appropriate legal structure in which to operate. This measure offers a simpler method of carrying on a business.

Background to the measure

In February 2012 the independent Office of Tax Simplification (OTS) published its final reports into small business tax. One of these reports identified a population of businesses operating as limited companies who would prefer to operate in unincorporated form and highlighted a number of tax charges and administrative issues that might currently discourage this.

At Budget 2012 Ministers announced a consultation to consider the OTS proposals for a disincorporation relief. That consultation closed on 30 August 2012. The Government has considered all the responses to the consultation and published a summary of the responses on 11 December 2012.

Detailed proposal

Operative date

The measure will have effect on or after the date that Finance Bill 2013 receives Royal Assent and will have effect for disincorporations on and after 1 April 2013 to 31 March 2018.

Current law

The current legislation requires a company to pay CT under the Taxation of Chargeable Gains Act 1992 when chargeable gains arise on disposals of assets, and CT under the intangible fixed assets rules at Part 8 of the Corporation Tax Act 2009 when credits arise from a realisation of goodwill, based on the market value of the asset at the time of the transfer.

Proposed revisions

Legislation will be introduced in Finance Bill 2013 to allow joint claims to be made by the company and its shareholders to allow qualifying business assets (goodwill and land and buildings used in the business) to transfer at a reduced value for CT and capital gains tax

purposes. The joint claim will allow the asset to be transferred at the reduced value so that no CT will be payable by the company on the transfer of the qualifying business assets.

Claims will be restricted to those businesses where the market value of the classes of assets allowed for disincorporation relief does not exceed £100,000. Joint claims must be made to HM Revenue & Customs (HMRC) within two years of the date of the transfer of business assets and other eligibility criteria will also apply.

Shareholders to whom the assets are transferred will inherit the transfer value for the purpose of capital gains tax and the shareholders must use this transfer value in any subsequent transactions. In effect the gain or profit that would have arisen to the company will be deferred until the disposal of the assets by shareholders.

Summary of impacts

Exchequer impact (£m)	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
	This measure is expected to reduce receipts by approximately £5 million per annum from 2013-14. The final costing will be subject to scrutiny by the Office for Budget Responsibility, and will be set out at Budget 2013.					
Economic impact	The measure is not expected to have any significant economic impacts.					
Impact on individuals and households	The CT free transfer of assets from a company to a shareholder, enabled by the relief, will impact on individuals to the extent that the relief affects the future capital gains tax position of shareholders on subsequent disposals of those assets.					
Equalities impacts	This proposal relates to the owners of small companies seeking to carry on business in self-employment instead. This may have a different impact on different groups which are more likely than others to fall into this category, however no data is available.					
Impact on business including civil society organisations	<p>At an asset limit of £100,000, around 610,000 businesses will be eligible for this relief. It will make it less costly for an eligible company to move to unincorporated legal form.</p> <p>There will be on-going savings for companies choosing to disincorporate such as not submitting a CT return to HMRC and not operating PAYE; on-going costs such as filing ITSA returns to HMRC; and one-off costs, such as notifying HMRC of the new business; transferring VAT numbers; and notifying suppliers and/or customers.</p> <p>There will be other ongoing benefits for business from taking up the relief, outside the savings from their dealings with HMRC. These include no longer having to file annual returns and statutory accounts with Companies House. Businesses may also be eligible to use the new cash basis for unincorporated businesses, simplifying their tax calculations. Unincorporated businesses may be more likely to no longer use an agent to calculate their tax, or if they continue, they may be charged less than in incorporated form, further reducing ongoing administrative costs. It is not currently possible to quantify the level of these savings, but they are expected to be significant.</p> <p>The costs and savings for businesses in dealing with the tax system are summarised in the table below. Please note that this only includes the costs and savings from businesses' interactions with HMRC, these do not include other administrative savings from dealings with Companies House.</p>					

	Cost	Time Period (yrs)
Compliance Costs		
One-off Costs	£6.9m	N/A
Average Annual Costs	£6.1m	5
Total Costs (PV)	£34.2m	N/A
Compliance Benefits		
One-off Benefit	N/A	N/A
Average Annual Benefit	£9.5m	5
Total Benefit (PV)	£42.4m	N/A
Net Benefit (NPV)	£8.2m	N/A
Impact on Administrative Burden (included in Net Benefit)		
Increase	Decrease	Net Impact
£3.5m	£5.4m	-£1.9m
<p>Note: The impact on administrative burden (included in net benefit) represents the expected costs and benefits for the first year. The £6.1 million included in compliance costs and £9.5 million included in compliance benefits represent the average amounts over the five years.</p>		
Operational impact (£m) (HMRC or other)	HMRC does not envisage changes to income tax systems and forms, however additional resource may be required to administer the relief. Further work to cost the operational impact will be carried out during the consultation on draft legislation.	
Other impacts	<p><u>Small firms impact test:</u> The Government consulted on a relief to reduce some of the tax charges on disincorporation, to make this process easier for small businesses. This should help the owners of small businesses to choose the appropriate legal form for their business, which will have a positive impact on their businesses by reducing their admin burdens.</p> <p>The relief may not address non-tax barriers to disincorporation, such as those connected to winding up a company. These burdens, as well as the relative tax advantages of being a company, may affect the number of businesses using the relief.</p> <p>Other impacts have been considered and none have been identified.</p>	

Monitoring and evaluation

The measure will be monitored through data published on number of liquidations by Companies House.

Further advice

If you have any questions about this change, please contact Alex Darmoo on 020 7270 6056 (email: alexander.darmoo@hmtreasury.gsi.gov.uk) or John Williams on 020 7147 3117 (email: john.r.williams@hmrc.gsi.gov.uk).

1 Disincorporation relief

- (1) A claim for relief under this section (“disincorporation relief”) may be made where –
 - (a) a company transfers its business to some or all of the shareholders of the company,
 - (b) the transfer of the business is a qualifying business transfer (see section 2), and
 - (c) the business transfer date falls within the period of 5 years beginning with 1 April 2013.
- (2) As to the consequences of a claim for disincorporation relief being made, see –
sections 162B and 162C of TCGA 1992;
section 849A of CTA 2009.
- (3) In this section and sections 2 to 4 “the business transfer date”, in relation to the transfer of a business, is the date on which the business is transferred.

For this purpose, where the business is transferred under a contract –

- (a) the date on which the business is transferred is to be determined in accordance with section 28 of TCGA 1992, and
 - (b) if the business in question is transferred by more than one contract, then for the purposes of that section the contract under which the business is transferred is to be taken to be the contract under which the goodwill of the business is transferred.
- (4) This section and sections 2 and 3 apply to a transfer of a business with a business transfer date on or after 1 April 2013.

2 Qualifying business transfer

- (1) The transfer of a business from a company to some or all of the shareholders of the company is a qualifying business transfer for the purposes of section 1 if conditions A to E are met.
- (2) Condition A is that the business is transferred as a going concern.
- (3) Condition B is that the business is transferred together with all of the assets of the business, or together with all of those assets other than cash.
- (4) Condition C is that the total market value of the qualifying assets of the business included in the transfer does not exceed £100,000.
- (5) Condition D is that all of the shareholders to whom the business is transferred are individuals.
- (6) Condition E is that each of those shareholders held shares in the company throughout the period of 12 months ending on the business transfer date.

- (7) For the purposes of condition D, the reference to individuals includes an individual acting as a member of a partnership, but does not include an individual acting as a member of a limited liability partnership.
- (8) Section 60 of TCGA 1992 (nominees and bare trustees) applies for the purposes of this section as it applies for the purposes of that Act.
- (9) In this section “market value”, in relation to an asset, means the price which the asset might reasonably be expected to fetch on a sale in the open market.
- (10) In this section a “qualifying asset” means –
 - (a) goodwill, or
 - (b) an interest in land which is not held as trading stock.

3 Making a claim

- (1) A claim for disincorporation relief under section 1 –
 - (a) is to be made jointly by the company and all of the shareholders to whom the business is transferred, and
 - (b) is irrevocable.
- (2) Any claim for disincorporation relief must be made within the period of 2 years beginning with the business transfer date.

4 Effect of disincorporation relief

- (1) In Part 5 of TCGA 1992 (transfer of business assets), in Chapter 1 (general provisions), after section 162A insert –

“Transfer of business from company to shareholders

162B Disincorporation relief: assets (including pre-FA 2002 goodwill)

- (1) This section applies where –
 - (a) a company transfers its business to some or all of the shareholders of the company, and
 - (b) a claim for disincorporation relief in respect of the transfer has been made under section 1 of the Finance Act 2013.
- (2) The disposal and acquisition of any qualifying asset of the business included in the transfer is to be deemed to be for a consideration equal to the lower of –
 - (a) the sums allowable under section 38 as a deduction in the computation of the gain accruing to the company on the disposal of the asset in question, and
 - (b) the market value of the asset.
- (3) Subsection (2) does not apply to the goodwill of the business if section 162C applies to it.
- (4) In subsection (2) a “qualifying asset” means –
 - (a) goodwill, or
 - (b) an interest in land which is not held as trading stock.

162C Disincorporation relief: post-FA 2002 goodwill

- (1) This section applies where –
 - (a) a company transfers its business to some or all of the shareholders of the company,
 - (b) a claim for disincorporation relief in respect of the transfer has been made under section 1 of the Finance Act 2013, and
 - (c) section 849A of the Corporation Tax Act 2009 (disincorporation relief) applies to the transfer of the goodwill of the business.
- (2) The acquisition of the goodwill of the business is deemed to be for a consideration equal to the value at which the goodwill is treated as transferred by virtue of that section.”
- (2) In Part 8 of CTA 2009 (intangible fixed assets), Chapter 13 (transactions between related parties) is amended as follows.
- (3) In section 845 (transfer between company and related party treated as at market value), in subsection (4) (exceptions to basic rule) –
 - (a) omit the “and” immediately following paragraph (ca),
 - (b) after paragraph (d) insert “, and
 - (e) section 849A (disincorporation relief).”
- (4) After section 849 insert –

“Transfers treated as being at tax written down value or market value etc

849A Disincorporation relief

- (1) This section applies where –
 - (a) a company transfers its business to some or all of the shareholders of the company, and
 - (b) a claim for disincorporation relief in respect of the transfer has been made under section 1 of the Finance Act 2013.
- (2) If section 735 applies to the transfer of the goodwill of the business, the transfer is treated for the purposes of this Part as being at the lower of –
 - (a) the tax written-down value of the goodwill, and
 - (b) its market value.
- (3) If section 736 applies to the transfer of the goodwill of the business, the transfer is treated for the purposes of this Part as being at the lower of –
 - (a) the cost of the goodwill, and
 - (b) its market value.
- (4) If section 738 applies to the transfer of the goodwill of the business, the proceeds of realisation of the goodwill are treated for the purposes of this Part as being nil.
- (5) In subsection (2)(a) the reference to the tax written-down value of the goodwill is to its tax written-down value immediately before the transfer.
- (6) In subsection (3)(a) “the cost of the goodwill” means the cost recognised for tax purposes (determined in accordance with section 736(6) and (7)).
- (7) In this section market value has the meaning given in section 845(5).”

- (5) The amendments made by this section have effect in relation to a transfer of a business with a business transfer date on or after 1 April 2013.

EXPLANATORY NOTE

DISINCORPORATION RELIEF

SUMMARY

1. These clauses introduce legislation to allow a company to transfer goodwill and interests in land to its shareholders so that no corporation tax charge arises to the company on the transfer.

DETAILS OF THE CLAUSES

Clause 1

2. Clause 1 introduces disincorporation relief.
3. Subsection (1) limits the circumstances when a claim for disincorporation relief may be made. It limits claims to transfers of a business from a company to some or all of its shareholders provided that the transfer is a qualifying business transfer (as defined in section 2) and it takes place within the 5 year period starting on 1 April 2013.
4. Subsection (2) explains that the consequences of a claim are set out in new sections 162B and 162C of the Taxation of Chargeable Gains Act (TCGA 1992) and new section 849A of the Corporation Tax Act (CTA 2009).
5. Subsection (3) defines the term “the business transfer date” as the date on which the business was actually transferred unless transferred under a contract.
6. Where the business is transferred under a contract subsection (3)(a) uses the same rule as in section 28 of TCGA 1992 to determine the time of the transfer i.e. if the contract is unconditional the time of the transfer is the date the contract was agreed and if it is conditional the time of the transfer is the date on which the contract became unconditional.
7. Subsection (3)(b) provides for situations where a business is transferred under more than one contract and provides that the contract that transfers the goodwill of the business is the relevant contract to determine the business transfer date.
8. Subsection (4) provides that disincorporation relief will apply to business transfers occurring on or after 1 April 2013.

Clause 2

9. Clause 2 defines a qualifying business transfer.
10. Subsection (1) provides that a qualifying business transfer is one where conditions A to E are met.
11. Subsection (2) provides that condition A is that the business must be transferred as a going concern.
12. Subsection (3) provides that condition B is that the business must be transferred with all of the assets of the business, or all assets apart from cash.
13. Subsection (4) provides that condition C is that the total market value of the assets that qualify for disincorporation relief must not exceed £100,000.
14. Subsection (5) provides that condition D is that all the shareholders to whom the business is transferred must be individuals.
15. Subsection (6) provides that condition E is that the shareholders must have held shares in the company throughout the 12 months prior to the business transfer date.
16. Subsection (7) confirms that the reference to individuals in condition D includes individuals acting as members of a partnership but excludes individuals acting as members of a limited liability partnership.
17. Subsection (8) provides that section 60 of TCGA 1992 applies for the purpose of disincorporation relief, so that the qualifying assets could be transferred to a nominee or bare trustee for individuals who are shareholders or the shares could be held by a nominee or bare trustee for an individual.
18. Subsection (9) defines the market value of an asset as its price if sold on the open market.
19. Subsection (10) defines qualifying asset as goodwill or an interest in land other than land held as trading stock.

Clause 3

20. Clause 3 provides that a claim to disincorporation relief must be made jointly by the company and the shareholders to whom the business is transferred (subsection (1)) within 2 years from the business transfer date (subsection (2)).

Clause 4

21. Clause 4 inserts new provisions into existing legislation within Part 5 of TCGA 1992 and Part 8 CTA 2009.

22. Subsection (1) inserts new section 162B and new section 162C into TCGA 1992.

New section 162B TCGA 1992

23. Subsection (1) of new section 162B provides that the section applies where a company transfers its business to its shareholders and a claim to disincorporation relief is made.

24. Subsection (2) provides that the transfer of any qualifying asset by the company is deemed to be for a consideration which is equal to the lower of the cost of the asset to the company, as determined by section 38 of TCGA 1992, and the market value of the asset.

25. Subsection (3) provides that goodwill falling within new section 162C TCGA 1992 (post-Finance Act 2002 goodwill) is excluded from subsection (2).

26. Subsection (4) defines a qualifying asset as goodwill or an interest in land, other than land held as trading stock.

New section 162C TCGA 1992

27. Subsection (1) of new section 162C TCGA 1992 provides that this section applies where a company transfers its business to its shareholders, a claim to disincorporation relief is made and any goodwill is post-FA 2002 (i.e. new section 849A CTA 2009 applies to the transfer of goodwill).

28. Subsection (2) provides that goodwill to which the section applies acquired by the shareholders from the company is acquired for a consideration equal to the transfer value determined by new section 849A CTA 2009.

Amendment to section 845 CTA 2009

29. Subsections 4(2) and 4(3) amend Chapter 13 of Part 8 CTA 2009, adding a new subsection 845(4)(e) (disincorporation relief) to the list of exceptions to the basic rule.

New section 849A CTA 2009

30. Subsection 4(4) inserts new section 849A CTA 2009 immediately after section 849 CTA 2009.
31. Subsection (1) of new section 849A provides that new section 849A CTA 2009 applies where a company transfers its business to some or all of its shareholders and a claim to disincorporation relief is made.
32. Subsection (2) provides that the transfer value of goodwill within Part 8 CTA 2009 is the lower of the tax written-down value of the goodwill or market value where the realisation of goodwill is dealt with under section 735 CTA 2009 (asset written down for tax purposes).
33. Subsection (3) provides that the transfer value of goodwill within Part 8 CTA 2009 is the lower of cost or market value where section 736 applies (asset shown in balance sheet and not written down for tax purposes).
34. Subsection (4) provides that the transfer value is nil where section 738 applies (asset not shown in balance sheet).
35. Subsection (5) provides that the tax written-down value is a reference to the tax written-down value immediately before the transfer.
36. Subsection (6) defines “the cost of the goodwill” as the cost recognised for tax purposes (sections 736(6) and (7) of CTA 2009).
37. Subsection (7) provides that the same definition of market value is to be used as that in section 845(5) of CTA 2009.
38. Subsection 4(5) of the clause provides that the amendments made by this section have effect to business transfers occurring on or after 1 April 2013.

BACKGROUND

39. In February 2012 the independent Office of Tax Simplification (OTS) published its final reports into small business tax. One of these reports identified a population of businesses operating as limited companies which would prefer to operate in unincorporated form and

highlighted a number of tax charges and administrative issues that might currently discourage this.

40. At Budget 2012 the Government announced a consultation on the OTS proposals for a disincorporation relief. That consultation closed on 30 August 2012. The Government has considered all the responses to the consultation and will publish a summary of the responses on 11 December 2012.
41. Disincorporation relief responds to proposals made by the OTS, which recommended that a relief be introduced to remove the tax barriers that currently exist when business assets are transferred by a company to its shareholders who wish to continue the business as a going concern in an unincorporated form.
42. The current legislation requires a company to pay corporation tax under the Taxation of Chargeable Gains Act 1992 when chargeable gains arise on disposals of assets, and corporation tax under the intangible fixed assets rules at Part 8 of the Corporation Tax Act 2009 when credits arise from a realisation of goodwill, based on the market value of the asset at the time of the transfer.
43. Legislation will be introduced in the Finance Bill with effect from 1 April 2013, to allow a company to transfer qualifying assets (land and goodwill used in the business) to shareholders as individuals who wish to continue the businesses in an unincorporated form. The relief will allow qualifying business assets to transfer at a reduced value for corporation tax.
44. Claims will be restricted to those businesses where the market value of the classes of qualifying assets does not exceed £100,000 and the relief will be available for a period of 5 years commencing from 1 April 2013 (subject to Royal Assent).
45. Joint claims must be made in writing to HMRC by the company and the shareholders who wish to continue the business within two years of the date of the transfer of qualifying assets. Other eligibility criteria will also apply. HMRC will publish guidance on what information will need to be included in the claim.
46. Disincorporation relief does not cover the tax charges that might arise to the shareholders when assets are distributed below market value in the course of a disincorporation.
47. If you have any questions about this change, or comments on the legislation, please contact John Williams on 020 7147 3117 (email: john.r.williams@hmrc.gsi.gov.uk).