



HM TREASURY

**Consultation on a
disincorporation relief:**
the Government's response

December 2012



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1

Introduction

Background to consultation

1.1 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 might prefer to operate as self employed and highlighted a number of tax charges and administrative issues that might prevent this.

1.2 The OTS referred to the process of a business changing its legal form from a limited company to self employed as “disincorporation”. It recommended that the Government introduce a relief against these tax charges alongside simplifying the administrative procedures required for a business to disincorporate.

1.3 At Budget 2012 the Government announced that it would consult on introducing a disincorporation relief. The consultation was published on 7 June and closed on 30 August. [The consultation document can be found online.](#)

1.4 Following the OTS small business review, the Government is also introducing a new cash basis for small, unincorporated businesses to calculate their tax from April 2013 and is acting on other OTS proposals to simplify tax administration for small businesses.

Purpose of consultation

1.5 The Government recognises that some small businesses who have opted to become a limited company in the past may now feel ‘trapped’ in a more onerous tax regime for companies and could benefit from moving to a simpler legal form. This consultation has looked at options for making disincorporation easier.

1.6 The consultation asked for respondents’ views about the demand for disincorporation, the barriers businesses may face and the level of assets these businesses are likely to hold.

1.7 It also investigated the nature and scale of demand for a disincorporation relief, which the OTS proposed, and what the design parameters should be.

1.8 The consultation highlighted four criteria to assess any policy response. Any relief should:

- meet a commercial need;
- be targeted where it is most effective;
- be simple to understand and straightforward to deliver; and
- not be open to abuse.

Question 1: Do you agree with the criteria for assessing any new policy interventions to support disincorporation? Are there any other criteria you would suggest?

1.9 Most respondents were content to accept the criteria above for assessing policy options.

1.10 A full list of the consultation questions is at Annex A.

Responses received

1.11 The consultation received 13 substantive responses, including from accountancy representative bodies, individual accountants and organisations representing small business. A list of respondents is at Annex B.

1.12 All respondents favoured a relief, claiming tax is the main barrier to disincorporation. Several respondents mentioned other, non-tax barriers, such as liquidator fees, but these were not considered as significant as tax. Few respondents proposed policy measures to reduce non-tax barriers.

1.13 Respondents were split over the target population of any policy response. Several thought small businesses are more likely to want to disincorporate so should be the target, while others did not see why relief should be restricted by either turnover, level of assets or by time, rather it should be permanent and open to all.

1.14 In terms of the scope of a relief, respondents broadly supported the OTS proposals that: relief should cover tax charges on both the company and shareholders, with the former charge being more important; and relief should be available to businesses up to the EU definition of a micro-company, i.e. up to a balance sheet value or turnover of €2m. Respondents wanted a relief to defer any tax charge, so that the tax on any gain is due when an asset or business is eventually disposed of, not an exemption.

1.15 The rationale for many respondents was that disincorporation relief should mirror reliefs already available on incorporation, so that businesses do not face a tax charge solely for changing legal form.¹

Next steps

1.16 The Government wants to allow eligible businesses greater flexibility to choose the most appropriate legal structure in which to operate.

1.17 In light of the OTS review and this consultation, the Government has therefore decided to introduce a time-limited disincorporation relief in Finance Bill 2013, to run for five years from April 2013.

1.18 The proposed disincorporation relief will:

- allow a company to transfer goodwill and an interest in land to its shareholders so that no corporation tax charge on the company arises on the transfer;
- not extend to tax charges that might arise on the shareholders where, for example, the assets are distributed;
- apply to companies with qualifying assets not exceeding £100,000. Qualifying assets are goodwill and land and buildings used in the business; and
- run for five years from April 2013.

1.19 The Government believes a relief covering the company corporation tax charges will tackle the most significant tax barrier on disincorporation and is straightforward to deliver. A limit of £100,000 on the qualifying assets would mean that around 610,000 companies, approximately

¹ Incorporation relief allows an individual to defer a gain on business assets (e.g. goodwill) by rolling-over the gain into the shares of a newly incorporated company. Disincorporation relief cannot exactly mirror reliefs on incorporation as the company and its shares no longer exist.

40 per cent of UK companies, will be eligible for this relief, covering the majority of those businesses which might want to disincorporate.

1.20 Legislation will be introduced in Finance Bill 2013 to introduce disincorporation relief. The draft of this legislation was published on 11 December and is now open for technical consultation. The deadline for responses is 6 February 2013.

1.21 [The Finance Bill 2013 draft legislation can be found online on the Treasury website.](#)

1.22 For the purposes of the “Consultation on introducing a disincorporation relief”, this consultation is now formally closed.

2

Responses to consultation

2.1 The first part of the consultation sought views on the demand from businesses to disincorporate and the barriers preventing them from doing so.

Demand for disincorporation

2.2 The consultation asked respondents about the scale of demand for disincorporation, the types of business which are most likely to want to disincorporate and the level of assets they are likely to hold. The OTS had concluded that:

- many small businesses may have incorporated to save tax in the mid-2000s following the introduction of the zero per cent rate of corporation tax in 2002-03. It highlighted that they may now no longer find this legal form suitable for their business;
- a key reason for wanting to disincorporate may be to avoid the additional administrative and regulatory requirements of being a limited company. It also highlighted the generally higher fees from agents for handling incorporated businesses; and
- a number of small businesses may find it difficult to understand the notion of a legal entity separate from the shareholders/directors and consequently fail to keep personal cash separate from the business, resulting in errors or underpayment in their tax returns.

Question 2: What is your assessment of the reasons for disincorporation? How important is reduced administration compared to the other advantages and disadvantages of different legal forms, such as tax and limited liability?

Question 3: For agents and representative bodies – what is your overall impression of the number of companies who, after consideration of these various factors, might wish to disincorporate? How does this vary for businesses of different size or turnover?

Question 4: In practice, for the smallest businesses most likely to want to disincorporate: what level of assets are these companies likely to hold? And which tax charges on the company and shareholders are most likely to be significant? If possible please provide examples.

Response to consultation

2.3 All respondents felt there was a demand for disincorporation. There were differing views as to the type of business that may want to disincorporate. Some respondents felt these were likely to be smaller companies, including the businesses that incorporated in the mid-2000s. Others thought this type of business was less of an issue – they had either wound up or disincorporated anyway, and would have few assets, so tax charges may be less of a barrier to disincorporation.

2.4 Several respondents thought the types of business which may want to disincorporate would include larger businesses that may have downsized, either by choice or as a result of the

recession and cannot justify remaining in corporate form, or owners of family businesses seeking to pass on parts of a business to various family members. However, there was little quantifiable evidence as to numbers of businesses that may want to disincorporate.

2.5 In terms of the level of assets held by businesses that may want to disincorporate, some respondents suggested they could be quite low. Those that gave figures suggested less than £10,000, £25,000 or £50,000.

Barriers to disincorporation

2.6 The consultation asked about the various tax and non-tax factors which might prevent a business from disincorporating and which are the most significant.

Question 5: In practice, how significant an issue is the requirement to hold sufficient reserves in the company to fulfil the obligations of the Companies Act likely to be when a business disincorporates? How does this compare to the other issues listed above?

Question 6: How much do respondents estimate the legal/accountancy charges for disincorporation would be?

Question 7: Overall, which are the most significant barriers to disincorporation and how important is tax in relative terms? Are there other significant barriers or administrative issues not included? If possible, please provide specific examples of time and costs involved.

Tax barriers

2.7 The main tax charges covered by the OTS review and the consultation document were the charges on the company and shareholder on transfer of assets to the shareholders.

Response to consultation

2.8 All respondents said that tax was the main barrier to disincorporation. The company charge was considered the most significant.

Non-tax barriers

2.9 The consultation also asked whether non-tax factors, such as the processes required to disincorporate or agent fees are a significant barrier to disincorporation.

Response to consultation

2.10 Several respondents stated that non-tax barriers were an issue for businesses wishing to disincorporate, including liquidation fees and the need for three years' accounts to get finance. However, these were considered less significant barriers than tax.

Policy options

2.11 The second part of the consultation sought views on possible policy measures to address the barriers to disincorporation, including: whether to introduce a relief; how it should work; and what other, non-tax steps the Government could take to make disincorporation easier.

Views on whether to introduce a relief

2.12 The consultation asked for views on whether to introduce a disincorporation relief and the likely take-up.

Question 8: How effectively would a tax relief help address overall barriers to disincorporation? How well would it meet the criteria we have set out?

Question 11: What are your overall views on the likely take up of a disincorporation relief? How high priority would you place on this reform in comparison to other changes being made or considered for the tax system?

Response to consultation

2.13 All respondents suggested a relief should be introduced, especially as tax was considered the most significant barrier to disincorporation. The rationale for around half of respondents was to mirror reliefs on incorporation and to make it easier for businesses to move to a simpler legal form. Many respondents said that the relief should not just be targeted at small businesses, but also larger businesses seeking to reorganise. Respondents acknowledged that take-up of any relief by larger businesses could be quite low, but considered this an important change to make in principle.

2.14 Few respondents expressed a view on the relative priority of a disincorporation relief when compared with other changes being made or considered for the tax system.

Government response

2.15 The Government considers that introducing a disincorporation relief will allow businesses greater flexibility to choose the most appropriate legal structure in which to operate. **Therefore the Government has decided to introduce a disincorporation relief.**

2.16 For small businesses in particular the administrative burdens of operating the business through a company may outweigh the benefits. A relief will reduce the tax charges on businesses making this change in legal structure and may allow some businesses to access other simpler tax measures currently being introduced, including the new cash basis for calculating tax for small, unincorporated businesses.

Design of a relief

2.17 The consultation asked if the Government was to introduce a relief, how it should be designed.

Question 9: If the Government were to introduce a disincorporation relief, which charges should it cover? How important is the element of the relief for shareholders, and what is your view on the additional rules that might be needed to make this element of this relief work and prevent abuse?

Question 10: Do you have any other comments on how the Government could design a relief, including the size of business eligible or its lifespan?

Tax charges to cover

2.18 The OTS proposed deferral of tax charges on the company and exemption of tax charges on the shareholder(s) when a business transfers its assets. It had looked at other tax charges but thought these would overcomplicate the relief and result in the Government needing to introduce anti-avoidance legislation.

Response to consultation

2.19 Respondents agreed with the OTS proposal to cover both tax charges on the company and the shareholders, whilst noting that the company charge is the more significant. All respondents proposed that the shareholder charge should be covered by a roll-over relief to ensure tax is paid when the asset or the unincorporated business are finally disposed of.

2.20 Other tax charges mentioned by respondents included: potential tax on cash balances, Stamp Duty Land Tax, loss of loss relief and balancing events for capital allowances purposes. However there was no consensus on these and they have not been taken forward.

Government response

2.21 The Government wants to focus support where it is most needed and ensure relief is simple and not open to abuse. **It has therefore decided to relieve tax charges on the company when assets are transferred to the shareholders.** This tax charge is considered the most significant tax charge on disincorporation and this relief would be relatively simple to administer. On a valid claim, the company will not have to pay corporation tax on gains or profits on qualifying assets. Instead, the assets transferred will be treated as transferred for an amount that ensures there is no corporation tax to pay.

2.22 The Government believes that a relief for charges borne by shareholders is less of a priority. Many of the businesses at the smaller end of the spectrum may not face a shareholder charge at all. For example, if the company is wound up, the capital gains tax annual exempt amount might cover some or all of the capital gain. And if the assets are distributed as income, there will be no additional tax charge if the shareholders are basic rate taxpayers.

Assets to cover

2.23 The OTS proposed that disincorporation relief should cover goodwill, plant and machinery and land and buildings used wholly for a trade. It had looked at other assets (related to other tax charges), but concluded that they would complicate the relief.

Response to consultation

2.24 Respondents favoured a relief at least as wide as the OTS. Some suggested other assets (and tax charges) but there was little consensus. Few proposed that all assets should be covered and a few said that including cash could be an avoidance risk where it is accumulated in the company.

Government response

2.25 The Government has decided that the qualifying assets covered by disincorporation relief should be limited to goodwill and land and buildings used in the business, the assets on which a tax charge is most likely to arise. The relief will allow a company to transfer goodwill and an interest in land to its shareholders so that no corporation tax charge on the company arises on the transfer.

2.26 The Government will exclude plant and machinery from the definition of qualifying assets. Plant and machinery is a depreciating asset, so in practice it is unlikely to give rise to a capital gain. However if it is included as a qualifying asset it would still count towards whether a business is eligible for the relief or not. Removing plant and machinery from qualifying assets will increase the number of companies eligible for the relief from approximately 520,000 to 610,000 companies and simplify the relief by removing the need for businesses to value their plant and machinery to see if they are eligible.

Eligibility

2.27 The OTS had proposed that disincorporation relief be available to businesses up to the EU definition of a micro-company. The consultation document had looked at a turnover limit of £77,000, matching the VAT registration threshold and the entry limit for the cash basis, to better target the relief and limit avoidance risks.¹

Response to consultation

2.28 Several of those who favoured a wider relief supported the OTS limit. However overall most respondents either favoured lower limits or said that the EU definition was too high, particularly if looking to target smaller businesses. Some suggested that the EU definition may also lead the Government to bring in anti-avoidance legislation which could complicate the relief.

2.29 Some of the respondents did not think a turnover limit would be appropriate for this relief as it could be exploited by much larger businesses downsizing to use it or by asset-rich businesses with low turnovers.

Government response

2.30 The Government has concluded that an asset, rather than turnover, limit would be a more appropriate way to best target support at smaller businesses least suited to corporate status.

2.31 The Government has therefore decided that the relief should apply to businesses with qualifying assets not exceeding an asset limit of £100,000. This would apply to the sum of the assets of the business that qualify for the relief. It would not include, for example, the stock or cash held by the business. It is estimated that 610,000 businesses will be eligible at this asset limit, covering about 40 per cent of UK companies.

Duration of relief

2.32 The OTS proposed a time-limited relief, with a formal review after five years to see if it should be made permanent.

2.33 Some respondents thought a relief should be made permanent, particularly those who argued that disincorporation relief should mirror reliefs on incorporation, while others were content with the OTS proposal.

¹ The cash basis, to be introduced from April 2013, will allow unincorporated businesses with receipts up to £77,000 to calculate their tax on the basis of cash receipts and payments, simplifying the tax calculation.

2.34 The OTS proposal for the relief to be time-limited would enable the Government to see if it is meeting its objectives and is still needed. **The Government has therefore decided to introduce the relief for five years, from April 2013.**

Non-tax measures

2.35 The consultation document highlighted the path a business can take if it wants to disincorporate. The OTS proposed a one-stop disincorporation process for businesses to carry out the various HMRC and Companies House processes that need to be undertaken to disincorporate. The consultation asked whether this or other non-tax measures, such as consolidated guidance, could help make disincorporation easier.

Question 12: How effective could improved guidance be in reducing overall barriers to disincorporation?

Question 13: What changes would you suggest to simplify the process of disincorporating without reducing creditor protection? How would these meet the criteria set out?

Response to consultation

2.36 There were few views on non-tax changes to make disincorporation easier, although there were a few references to the OTS one-stop process. While a few suggested liquidation fees are a barrier to disincorporation and some that the current striking-off rules are not practical and are disruptive, few offered any suggestions for addressing them. A number thought that consolidated guidance could be useful to have, but was not essential and less important than a relief.

Government response

2.37 The Government will be publishing guidance on the disincorporation relief when it is introduced. Alongside this guidance, **the Government will also look to summarise the guidance published on the processes involved in disincorporation.**

A

Consultation questions

- **Question 1:** Do you agree with the criteria for assessing any new policy interventions to support disincorporation? Are there any other criteria you would suggest?
- **Question 2:** What is your assessment of the above reasons for disincorporation? How important is reduced administration compared to the other advantages and disadvantages of different legal forms, such as tax and limited liability?
- **Question 3:** For agents and representative bodies – what is your overall impression of the number of companies who, after consideration of these various factors, might wish to disincorporate? How does this vary for businesses of different size or turnover?
- **Question 4:** In practice, for the smallest businesses most likely to want to disincorporate: What level of assets are these companies likely to hold? And which tax charges on the company and shareholders are most likely to be significant? If possible please provide examples.
- **Question 5:** In practice, how significant an issue is the requirement to hold sufficient reserves in the company to fulfil the obligations of the Companies Act likely to be when a business disincorporates? How does this compare to the other issues listed above?
- **Question 6:** How much do respondents estimate the legal/accountancy charges of disincorporation would be?
- **Question 7:** Overall, which are the most significant barriers to disincorporation and how important is tax in relative terms? Are there other significant barriers or administrative issues not included? If possible, please provide specific examples of time and costs involved.
- **Question 8:** How effectively would a tax relief help address overall barriers to disincorporation? How well would it meet the criteria we have set out in Chapter 2?
- **Question 9:** If the Government were to introduce a disincorporation relief, which charges should it cover? How important is the element of the relief for shareholders, and what is your view on the additional rules that might be needed to make this element of this relief work and prevent abuse?
- **Question 10:** Reflecting the above and the criteria in Chapter 2: do you have any other comments on how the Government could design a relief, including the size of business eligible or its lifespan?
- **Question 11:** What are your overall views on the likely take up of a disincorporation relief? How high priority would you place on this reform in comparison to other changes being made or considered for the tax system?
- **Question 12:** How effective could improved guidance be in reducing overall barriers to disincorporation?
- **Question 13:** What changes would you suggest to simplify the process of disincorporating without reducing creditor protection? How would these meet the criteria set out in Chapter 2?
- **Question 14:** Can you provide more information about the possible impact of a disincorporation relief against these categories, in particular, the overall impact on small business and administrative burdens?

B

List of respondents

Overall, there were 15 responses received to the consultation. The following businesses and representative bodies submitted responses. Representations from individuals were also considered, but are not listed below:

- Bishop Fleming Chartered Accountants
- Chartered Institute of Taxation
- Country Land & Business Association
- Federation of Small Business
- Forum of Private Business
- Insolvency Lawyers Association
- Institute of Chartered Accountants in England and Wales
- Institute of Chartered Accountants of Scotland
- KJD Freeth LLP
- Law Society of Scotland
- Patricia J Arnold & Co. Ltd
- Try Lunn & Co
- Whitefield Tax Limited

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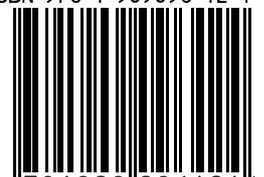
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