

The Office of Tax Simplification

SEPA: Sole Enterprise with Protected Asset

Final Report

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This paper concludes our investigation on the potential for a simple new trading vehicle – SEPA – to offer a simpler route in tax and related areas for small business ventures. Would it make a positive difference to the UK business environment? The paper takes forward the conclusions in our March report¹ by considering the issues raised in our discussion paper² published in July and the input we have received from stakeholders. It focusses on further findings during this final stage; it does not repeat those previous papers though the summary of the subject in our main March report, which gave rise to this work, is included at Annex E for ease of reference.

¹ 'Small Company Taxation': published on 7 March: <https://www.gov.uk/government/publications/small-company-taxation-review>

² 'SEPA discussion document' published on 18 July: <https://www.gov.uk/government/consultations/sole-enterprise-protected-assets-discussion-document>

Introduction and summary

The OTS's objective is, as always, to provide genuine simplification to the tax system – both in terms of reducing its technical complexity and providing administrative simplification for users. The SEPA concept stems from the second consideration, responding to research findings that one of the main reasons for forming a limited company is to obtain limited liability protection.³ That seems to lead many people into forming a limited company and then struggling to deal with the tax, accounting and reporting requirements. So, in effect, the question we have posed is:

Could a new form of trading vehicle or status offer what sole traders really want from liability protection while retaining the simplicity of a sole trader? If so, would it be used and encourage enterprise?

SEPA would allow traders to protect their primary residence while continuing to trade as a sole trader. If SEPA does meet the trader's needs in this way, potentially it offers simpler administration and less reporting. We are conscious that the tax simplification aspects of the idea are indirect rather than immediately providing a simpler tax route, as the SEPA idea would not mean that the tax position of a sole trader would be any different. Rather, SEPA simplifies the tax and accounting requirements for unincorporated businesses by obviating a key non-tax reason for incorporation. We are conscious that we may seem to be straying from our tax simplification remit but we are exploring wider implications of an earlier recommendation, accepted by Ministers.⁴

As always, we have sought views from all stakeholders and have had several written representations as well as attending meetings and roundtables across the country. Our conclusions and recommendation are based on a combination of the views expressed by stakeholders and further desk-based research. This paper sets out our findings and concludes that the SEPA idea is, on balance, worth pursuing.

Introducing a new trading vehicle does present some potential issues and we have tried to analyse them in this report. We do not see any of them as insurmountable and are encouraged by the interest in the SEPA concept by some bodies with particular connections to the potential target groups. Overall, as our conclusion in Chapter 3 sets out, we think SEPA has potential and our answer to the question above is essentially 'yes'.

³ We do of course recognise that companies are formed for many other reasons, not least tax.

⁴ Small Company Taxation report: <https://www.gov.uk/government/publications/small-company-taxation-review> ; and the letter from the Financial Secretary to the Treasury with Budget 2016: <https://www.gov.uk/government/publications/letter-financial-secretary-to-ots-on-budget-2016> .

What we have done

Following publication of our Small Company Taxation report, Ministers accepted our recommendation that we should explore further the possibilities afforded by SEPA. We therefore:

- published a discussion paper in July
- carried out our own research
- met with a range of stakeholders (often in meetings which also considered Lookthrough) both before and after publishing the July document
- received a number of written submissions
- worked closely with colleagues in HMRC, HMT and BIS (now BEIS)

The themes we posed in our discussion paper, which formed the basis of our meetings were:

- Would the new status be easily understood – or would it cause confusion?
- Would traders want to use it as an alternative to incorporation?
- Would traders that were never considering incorporation use it?
- Would it be accepted as a valid business form by other traders and, crucially, banks and other potential creditors?
- Would the mooted legal protection against personal assets work in practice under the law of insolvency and other areas?
- Would it result in a simpler route for carrying on business?
- In many ways beyond our remit of tax simplification but a key ‘wider issue’ question – would it encourage enterprise?

We are very grateful to Screwfix Ltd, part of Kingfisher plc, and in particular to Andrew Dingwall, their Customer Insight Manager, for running a survey of their customer panel. This survey, designed jointly with the OTS, asked specifically about SEPA and related tax issues. The survey was carried out in September 2016 and attracted [323] responses from sole traders and from small companies. The results of the survey are set out in Annex C, but in summary:

- current sole traders have an appetite for an asset protection scheme as described in the SEPA outline, with asset protection being a leading advantage of becoming limited
- the main hurdle to overcome in becoming a limited company is the perceived volume of paperwork – or added costs in hiring an accountant
- current limited company owners say they registered on advice from their accountant; they tend to be happy with the decision they’ve made

A list of meetings and submissions received is in Annex D.

1

What is a SEPA?

1.1 Unincorporated businesses are not subject to corporation tax (CT) and the GAAP accruals accounts required for reporting purposes and to calculate CT; instead the business owner is subject to - simpler to calculate - income tax and national insurance, without the requirement to produce accruals-based accounts. So as far as the sole trader is concerned, the tax and regulatory regime they will need to deal with will be simpler if they can remain a sole trader.

1.2 Ipsos MORI's research paper⁵ and our own Small Company Taxation review found that the primary reason for incorporation was limited liability protection⁶. When we dug deeper we found that protection for the primary residence was the biggest concern.

1.3 The principle behind SEPA is that it will allow an individual to continue to trade as a sole trader whilst offering protection for their primary residence against claims arising from the business. The primary residence will not be protected from personal claims nor will any other asset be protected.

1.4 A summary of the features of a SEPA, as we have evolved it, is at Annex A.

What's in a name?

1.5 The name SEPA has caused some debate. As we noted in the July discussion paper, the concept can be referred to as Sole Enterprise with Protected Asset(s) and also Self Employed with Protected Asset(s). In both cases 'asset' can be either singular or plural. Helpfully SEPA covers all these permutations. However, we have always been aware that SEPA also stands for Scottish Environmental Protection Agency⁷.

1.6 For the purposes of our discussions this year it seemed simpler to retain SEPA which was already becoming quite well known among our stakeholders but if the concept is to be taken forward, it may be better to change – perhaps to Sole Enterprise with Protected Residence or SEPR (no doubt still pronounceable as 'seeper') which has the merit of emphasising that it is just the residence that is covered.⁸

⁵ HMRC Research Paper 317 "Reasons behind incorporation" published in June 2014

⁶ There are of course many other reasons for incorporating a business, not least of which is lowering tax bills. Indeed this was the primary reason according to some we spoke to. But for the purposes of this exercise we are satisfied that limited liability protection is a major driver and it is appropriate to consider if this can be obtained by other routes.

⁷ And for the Single Euro Payments Area.

⁸ Another possibility might be Sole enterprise with Protected Qualifying Residence or SPQR – a term that may appeal to classicists. These terms also get away from any implications that all of an individual's assets were protected.

2

Key Issues

Key issues: responses to questions

2.1 The discussion paper posed eight formal questions around the principles and practicalities involved with SEPA. The responses we received in formal papers and in meetings are summarised at Annex B, which gives fuller explanations of our findings. This section sets out some of the key points made and conclusions drawn.

SEPA features

2.2 We proposed a very simple, 'light touch' registration process with limited details. As a result of our further work we have modified our proposals, dropping the suggested declaration of solvency and industry sector code but requiring a description of the business and the address of the property covered. Details are in Annex A. Aspects of the register of SEPAs would be public, for consumer protection reasons, but we do not think that would extend to identifying the asset (house) protected.

2.3 The question of an annual return or confirmation was raised with us and on balance we think this is appropriate. We envisage that this would be no more than an additional question and a requirement to confirm details are still correct, ideally completed as part of the tax return.⁹

Which asset(s)?

2.4 We always had in mind that SEPA would protect just the main residence but had deliberately kept open the option of providing protection for more assets. The input we have received confirms our instinct: that protection should just be in terms of the main residence. This is simpler and fairer; if a trader wants wider protection then they would presumably consider the limited company route, which comes with broader reporting requirements to protect other stakeholders¹⁰. There are issues around defining which house would be protected: in principle this would follow the CGT private residence exemption. But as we note in Annex B, there will be some points of detail to clarify.¹¹

⁹ It is for debate as to which agency would keep the 'SEPA register' but our working assumption is that it would be Companies House. However, we think a key point is that there would be 'joined up government' here, with registration of a SEPA notifying HMRC and the annual return/confirmation being fed by HMRC to the registrar.

¹⁰ Further insurance cover may also have a part to play of course.

¹¹ We also investigated whether SEPA could cause any distortions to the housing market. Conversations with HM Treasury specialists indicate that any potential impact would be minimal.

2.5 The one additional asset that we think merits consideration is the individual's pension fund. In more than one meeting the point has been made that one consequence of pension's freedom is that there is access to the funds in the pension scheme. Should SEPA protect these as well? There currently exists protection for pensions that are not yet in payment: workplace pension scheme benefits, personal pension scheme benefits, stakeholder pension scheme benefits and Section 32 benefits are protected against any claim by the receiver in Bankruptcy. However, any payments deemed excessive are not protected and it is unclear whether pensions would be protected in non-bankruptcy claims. This may suffice but we have not been able to fully research this issue; more work would need to be done in order to clarify whether pensions would benefit from being within the scope of SEPA, bearing in mind our aim of simplicity.

Alternatives

2.6 Some of those who opposed or were lukewarm at best about SEPA felt that there were better alternatives. The two most frequent suggestions were:

- Single member LLPs, as the LLP is now well established and understood by advisers. We feel this is a policy question (as to whether it should be allowed) but do note that LLPs have to publish accounts which a SEPA would not. This makes it a much more difficult 'DIY' business structure but it is probably the leading alternative route, with the merit that it does have established and working rules throughout the UK to build on.
- Wider availability of insurance for 'catastrophes'. This is something that we would welcome views from market experts on; it will have cost/benefit issues and may simply not be available in the market.

The banking/financing question

2.7 One issue that has been raised as an area of concern from the start of this project has been whether a SEPA would be able to borrow money. Would it have access to banking finance in the same way as a sole trader? A supplementary point is whether a SEPA would be given credit in normal trading transactions. Some of those we have engaged with were fairly apocalyptic, asserting that banks would not lend to a SEPA and trade creditors would insist that SEPA protection was waived. Clearly if this is the case, the SEPA would be unattractive and probably unworkable for those wanting to borrow or use credit terms, and bodies representing small businesses would not support it. However, our discussions with the banking industry suggests they would not envisage a SEPA business having any issues with access to credit.

2.8 Those who were more positive often pointed out that most sole traders, especially those that one would expect to benefit most from SEPA, tend to not require access to large loans. There may be occasions where credit is required and our researches suggest that banks typically offer unsecured loans of up to £25,000 to sole traders depending on their credit score and income: essentially they will assess the overall risk position. Loans above approximately £25,000 generally require securing. A key banking group noted that where businesses do require large loans, it is typically to buy a major business asset, for example a vehicle or machinery, and in these circumstances the loan is typically secured against the asset itself. For rarer general purpose loans, the most common form of security is a property, through a re-mortgage. We

would still expect SEPA businesses to have access to credit in this way, with the SEPA protection covering the balance of equity in the property.

Access to supplier credit

2.9 Another key area where SEPA businesses access credit is with suppliers. It was suggested in a couple of meetings that traders will evolve standard terms and conditions that would simply circumvent the SEPA protection. We spoke with a major UK-wide trade supplier who stated that the asset protection afforded by SEPA would make no difference to their credit lending decisions. Also, some involved with supplying goods pointed out that many sell goods on the basis that title does not pass until the goods are paid for (though that does not help suppliers of services, of course).

2.10 Access to credit and trustworthiness is part of the benefit of registration. It was noted that one benefit that may accrue is that a unique SEPA registration number would make identification when undertaking a credit search at credit reference agencies easier and give banks greater confidence that they have the right customer compared with sole traders.

2.11 Similarly, one credit reference agency we discussed SEPA with became keen on the idea when they appreciated that a SEPA would be registered, with public access to aspects of the information. To them this made a SEPA better established and less risky than a sole trader.

2.12 Our conclusion on banking and financing generally is that although the question of access to finance/credit is a valid concern, our researches do not suggest it is a significant matter in practice given the likely nature of those opting for SEPA. As with SEPA generally, much depends on education of those involved.

Will SEPA cause confusion?

2.13 It is inevitable that any new entity, particularly as it brings choice, will cause some degree of complexity. Some of our respondents suggested that this would lead to confusion in the marketplace. However, the bodies, businesses and advisers who are likely to deal with SEPA do not see it as a real concern. Certainly there would need to be education and appropriate launch. But as many have pointed out, SEPA is an inherently simple concept and so should be readily understood. We would also note that the considerably more complex LLP has been well absorbed.

2.14 One related issue that is certainly valid is the amount of change the target population for SEPA is currently dealing with. The bodies that raised this issue clearly had HMRC's Making Tax Digital (MTD) in mind. Our response is that we see SEPA as something that would take 3-5 years to introduce – by which time MTD will hopefully have settled down and be 'business as usual', and the potential target population more able to consider other matters. SEPA also would not introduce any new tax treatment and is also entirely optional so would not be a complication *imposed* on existing businesses.

Would it be used?

2.15 The critical question is whether enough people would use SEPA to justify its introduction. The responses from our discussion is that SEPA would be adopted on a reasonable scale. Indeed, some have argued that it could become the norm for unincorporated sole traders¹² while some others expect take up to be low. The Screwfix survey results (see Annex C) are particularly relevant here as they suggest that there could be significant interest among sole traders.

2.16 We have probed for views on what sort of people would opt for SEPA. The views expressed give two broad 'cuts':

- Traditional trades (painters, plumbers and so on) rather than 'knowledge workers'. The reason for the latter being less interested in SEPA is that they mostly work with businesses or agencies who demand they work through companies as insulation against possible PAYE issues and employment rights concerns.¹³ Without that factor, they would probably also be good candidates for SEPA.
- Those in their 40s and 50s who are starting up a new venture, either diversifying or enforced through redundancy. They will of course be far more likely to have property that they wish to protect.

2.17 The gig/sharing economy may lead to more SEPA candidates as it develops but at the moment most workers in the sector are simply regarded as self-employed (though of course many are arguing for aspects of employment rights).

2.18 We also acknowledge that while SEPA addresses some of the limited liability/status reasons for incorporating, it doesn't address the other reasons why people incorporate, including tax incentives, access to allowances and a separate legal identity.

2.19 It is also worth noting that since SEPA status is not incorporation, business owners will retain some protections offered by the Consumer Credit Act, namely:

- a) Borrowing by unincorporated SMEs falls under the Consumer Credit Act, but once incorporated they lose that regulatory protection; in principle unincorporated SMEs are protected regardless of size, however credit facilities of more than £25,000 are exempt from regulation.

¹² We have never envisaged more than a small handful of existing small companies converting to SEPA status. Most, once settled in the incorporated regime, will have administration and reporting under control and will wish to retain benefits such as full limited liability and lower taxes. The limited nature of the disincorporation relief also means that many that would consider disincorporation may not go through with it. It is possible, though, that if SEPA is introduced, there could be a review of the disincorporation relief and related procedures which would encourage wider use and reversion to SEPA.

¹³ This is a false perception as it is the nature of the engagement rather than the structure of the business entities that determines employment rights. There also are suggestions that the employment rights issue will develop and so this area may be subject to change.

- b) Section 138D FSMA gives unincorporated businesses a legal right of action against a financial services firm for detriment caused by the breach of an FCA rule. Incorporated ones largely cannot.¹⁴
- c) In addition, regulated lending to unincorporated SMEs is also subject to FCA rules.

Would it encourage enterprise?

2.20 Some have commented that SEPA would discriminate in favour of those with property, possibly at the expense of those without. In turn it is suggested that it would be more for older taxpayers rather than younger ones. Although we recognise the point, we do not think it is a significant issue and in many ways the justification for any perceived bias would be that there would be a net benefit to the economy by way of encouragement to enterprise.

2.21 Several people have indicated that SEPA would offer some encouragement for entrepreneurship by giving sole traders some protection. Some have also added that it could act as a useful incubation phase for new ventures. Our conclusion is that SEPA's introduction would indeed help, not least by sending a signal to the marketplace that the government is interested in trying new ideas and encouraging enterprise while balancing this encouragement with fair protection.

¹⁴ Incorporated businesses do not have this right under s.138D FSMA with regards to losses suffered while carrying on business of any kind. The courts' interpretation of s.138D, generally speaking, means that companies cannot sue firms on the basis of a breach of FCA rules, although they can sue firms on different grounds (for example misrepresentation).

3

Conclusion

Conclusion: overall, should this be developed?

3.1 The case for SEPA's introduction is not by any means cast iron. But our work indicates that SEPA has the potential to be a useful simplification for those that would otherwise consider incorporation. Furthermore it could provide a boost to enterprise.

3.2 Accordingly, we recommend that it should be developed into a formal proposal. While doing so, one would have to address some of the issues that we have raised in this report as well as fully assessing any impact on the creditor and debt collection markets.

A

What is a SEPA?

In the OTS report on Small Company Taxation we outlined the concept of a SEPA¹⁵: a Sole Enterprise with Protected Asset¹⁶. We developed the characteristics of a SEPA more fully in our SEPA discussion paper, published in July 2016. Feedback on that paper has, as we intended, caused us to modify our previous thinking; this annex summarises the characteristics of a SEPA as we now see it.

Core principles

- SEPA status is attained through registration by a sole trader (intending or existing)
- SEPA would not have a separate legal identity
- a SEPA user would still be taxed as a sole trader: there would be no tax differences resulting from registering or trading as a SEPA compared with a sole trader
- business would be carried on in the name of the SEPA, for example it would be 'John Smith SEPA' rather than 'John Smith'
- assets would be (or continue to be) held by the trader: the SEPA could not hold assets separately from the individual as it has no separate identity
- SEPAs would be able to use cash accounting, in the same way as sole traders
- there would be no size limit/threshold for SEPA: it would be self-selecting
- once registered, all of a trader's activities (not companies or LLPs) would be covered by the SEPA status

Registering as a SEPA

We have always envisaged that the SEPA registration process would be as 'light touch' as possible. Stakeholders firmly endorsed this: it potentially competes with ordinary sole trader (no registration requirements as such) and limited company (various requirements but well automated and cheap on-line registration easily available). We envisage SEPA registration as on-line, taking only a few minutes and requiring a minimum amount of information, including:

- trader's full name, date of birth, National insurance number and Unique Taxpayer Reference (UTR) if known

¹⁵ See Annex D.

¹⁶ To repeat what is contained in the report proper for ease of reference and completeness, as we noted in the July discussion paper, the concept can also be referred to as Self Employed with Protected Asset. In both cases 'asset' can be either singular or plural. Helpfully SEPA covers all these permutations. However, we have always been aware that SEPA also stands for Scottish Environmental Protection Agency and Single Euro Payments Area. For the purposes of our discussions this year it seemed simpler to retain SEPA which was already becoming quite well known among our stakeholders but if the concept is to be taken forward, it may be better to change – perhaps to Sole Enterprise with Protected Residence or SEPR (no doubt still pronounceable as 'seeper') which has the merit of emphasising that it is just the residence that is covered. Another possibility might be Sole enterprise with Protected Qualifying Residence or SPQR – a term that may appeal to classicists.

- contact details (current residence, telephone number and email address)
- trading name (if any) and a description of what the business is
- the house that is to be covered by SEPA, with a confirmation that it is the property that also qualifies for CGT exemption as the taxpayer's main residence
- a declaration that the trader is eligible to register as a SEPA

Following feedback we would not include:

- the relevant Standard Industrial Classification (SIC) code(s)
- a declaration of solvency

Public information

Some information in relation to the SEPA business, needs to be publicly available to enable those engaging with a SEPA to check its validity:

- the business name and address (which would not necessarily be the 'protected property')
- the proprietor's name
- a unique SEPA reference number

There is a balance with privacy for the individual: making the business address public does seem to conflict with the privacy of the home address as often these will be the same, but this is the equivalent of a registered business address.

Characteristics

The legal environment requirements for SEPA would be as for sole traders. This leads to some features of the SEPA once it is established. Again these reflect some modifications from our further discussions with stakeholders.

- an individual should inform existing clients/customers that they are converting to SEPA
- once trading as a SEPA, all correspondence, including promotional materials would have to state that the business is a SEPA and quote the registered number
- individuals can have multiple businesses covered by SEPA but they will only be given one unique SEPA number
- SEPA status is for individuals; two or more people cannot jointly share a SEPA status but would presumably consider forming an LLP. Multiple individuals with their own SEPA statuses can be involved in a joint enterprise just as multiple sole-traders are able to do
- as SEPA status attaches to the sole trader personally, it is not something that can be passed on to heirs or sold. If the business were sold, the new owner would then have to register afresh as a SEPA
- SEPA would not protect against losses incurred in relation to contracts agreed before registration

- there would be no requirement for a separate business bank account, or public trading records that are often associated with more formal business structures¹⁷
- creditors (in particular banks) may still ask for a loan to be secured against a residence (through a re-mortgage). This would override the general SEPA protection, though any balance of value in the property would still be protected
- the SEPA-registered sole trader would still be liable personally if they are found guilty of fraud or other serious failures in their business responsibilities

We noted under core principles that a SEPA would be able to use cash accounting. As noted in the discussion paper, this is an issue we have explored carefully. We are satisfied that the requirement under accounting regulations for (in effect) those with limited liability to use accruals accounting would not apply, as the SEPA user does not have limited liability. Instead they have a measure of (specific) asset protection. We are grateful to BIS/BEIS colleagues who have helped with this.

¹⁷ However, a separate business bank account would be recommended, as it is for sole traders.

B

Summary of comments

Summary of comments against discussion questions

Within the discussion paper we posed eight questions, a mix of wide principles and more detailed points. Our aim was to stimulate discussion rather than generate exact answers to all the questions posed and most people we spoke to or received comments from did not attempt to answer all the questions in turn. Here we give a summary of the 'answers' to the questions that we distilled from the input we received.

Question 1. Do you agree with this broad outline of the SEPA model? In particular do you agree with protection being only in terms of business debt? If not, what would be the most practical approach?

Most of the debate was with SEPA as a concept: was it needed? Was it practical? Would it simply cause confusion in the marketplace? If it passed these tests, people were generally content that the OTS outline was about right.

Those stakeholders who were negative about SEPA generally argued that the existing alternatives – mainly sole trader and limited company if we are talking about an individual – are well established, well known and easy to set up. Considerable doubt was cast by some on the Ipsos MORI's research for HMRC¹⁸ used in the OTS work, which found that limited liability was the key driver for company formation: to many stakeholders it was all about tax saving, though asset protection and other drivers were acknowledged as important secondary issues.

Against this, many echoed the OTS and other research that suggests that too many companies are formed without proper knowledge of the consequences: as more than one person put it: '...people fall into being a company'. On balance, the majority of respondents thought SEPA was an interesting idea and worth pursuing.

It is worth noting that some responses cautioned against more change being introduced into a small business sector that already seems swamped. Against this we see SEPA as a longer term project, but it is interesting that a couple of submissions link their caution to the need for a proper long-term framework for taxation rather than further piecemeal changes.

Who would use SEPA?

There were strong views that few existing companies would transfer to being a SEPA: the procedure would inevitably be too complex for something intended as simple.¹⁹ Accordingly,

¹⁸ [HMRC Research Report 317 - Reasons behind incorporation](#)

¹⁹ If a sole trader has incorporated and wants to move their business to the SEPA model, they may be able to take advantage of the disincorporation relief. In order to have any significant impact we repeat our earlier

SEPA was essentially for new businesses and sole traders. This was what we had thought all along but we wanted confirmation.²⁰

Potential users for SEPA were suggested as including:

- 40/50 year olds starting in business, perhaps after redundancy
- those wanting to diversify (for example a farmer in a partnership, starting to carry out some contracting)
- one professional body suggested it would appeal to 'e literate' people (presumably as on-line registration was envisaged)
- more than one accountant stated that they had particular clients in mind to whom they would recommend SEPA because the clients didn't want to incorporate because of the amount of information that would be made public
- a trade body thought that the users would be traditional trades for example painters and plumbers as opposed to 'knowledge workers'

The reason for the last point is important: the knowledge worker generally goes to work for a business that wants him/her to operate through a limited company so that the engager has insulation against the worker being classed as an employee for PAYE purposes and for employment rights purposes – also perhaps to ensure there is no risk to headcount restrictions. SEPA, as it does not provide separate business identity, cannot help in these regards. In some of our discussions, stakeholders suggested that what was needed was attention to these drivers rather than helping the sole trader.

The conclusion we draw is that there would be a market for SEPA. It was suggested a number of times that SEPA could become the norm for sole traders – the default. As some said 'why wouldn't you register as a SEPA?'

Would it cause confusion in the marketplace?

This is a valid concern: as evidence suggests some people find companies difficult and confusing; introducing another vehicle could make life more difficult for unrepresented traders. However, most did not see it as a significant issue and some were quite robust in their views – at one professional body meeting the strong majority view was that LLPs had been explained and absorbed so what was the problem with SEPA? Most were clear that advisers would easily absorb the idea; as for the unrepresented, although some did suggest it was a potential problem, a body dealing with unrepresented taxpayers broadly supported SEPA '...and think that it could be potentially attractive to many small businesses...'.

One professional body pointed to the amount of change affecting small businesses at the moment (MTD no doubt being the main issue) and worried that SEPA would add to burdens. We accept the point about the amount of change of course – it is something that we constantly highlight as a key cause of complexity – but SEPA can simply be ignored if the trader is

recommendation that disincorporation relief is amended as per our original recommendations, rather than the restricted version that has been introduced. As of March 2016, less than 50 companies had made use of the relief.
²⁰ We undoubtedly made a slight mistake in not saying this in our discussion paper as some respondents' views of SEPA in general were coloured by their conviction that it would be of no interest to existing companies...therefore it was of no use.

overburdened²¹. One of our stakeholders, expressing the view that SEPA would cause confusion, called for more education generally for those embarking on business.²² That is a very valid point and although it is beyond our remit to be specific in terms of education, we have in the past made the point that simple on-line guides²³ are needed with information easily accessible and well signposted. We certainly see SEPA as needing proper guidance.

A respondent with experience of the French system – which we had looked at in developing the SEPA idea – commented that ‘...my experience of...trying to set up and run a business where there are multiple models from which to choose is negative. It is costly and confusing...’ We had previously had more positive views of the French options but this view is cautionary and reinforces the need for proper guidance if SEPA does go ahead.

Trading SEPA, Investment SEPA or both?

We developed the SEPA idea with traders in mind and that has been followed by almost all our respondents. But one professional body raised the important point of whether an ‘Investment SEPA’ would be allowed.²⁴ Our instinct is, in keeping with simplicity, to allow such an activity – but to note that:

- registering as a SEPA would not turn an investment activity into a trade, in keeping with the SEPA not having any different tax consequences to the individual
- would an investment activity warrant the need for SEPA protection in any event?

Question 2. Do you agree that only the primary residence should be protected?

The majority of responses were simply ‘yes’. Most argued that this was simple and easy to understand. One or two did suggest wider types of assets, including cash in a Help to Buy ISA and perhaps a choice of what could be included, but most rejected this as too complex. As one of our alumni pointed out, if someone wanted to protect a range of assets, they could always incorporate a company (the same point applies to wanting the trading vehicle to own assets of course).

There were some cautionary notes sounded. Did this protection favour those who were already wealthy (that is those who had property) against the less well-off? And was it unfair generationally – a help to the older rather than the younger? These will undoubtedly be factors that will be considered in the decision about whether to take forward SEPA. However, our response in part at least is that such people can protect their wealth through using a company already; SEPA offers a simpler (and less powerful) alternative rather than a complete new ‘break’.

²¹ In any event, we see SEPA as a long term, 3-5 year project, by which time MTD should have settled down as ‘business as usual’.

²² It was suggested that in France those embarking in business have compulsory education. We have not had time to research this but it would be worth following up.

²³ In saying on-line we are mindful of the position of the digitally excluded; we would envisaged those developing SEPA working with charities who are particularly interested in the digitally excluded to ensure they are able to access guidance in a way that works for them.

²⁴ They went on to point out that if it was not so allowed, opening up a small trading activity via, say, eBay could perhaps circumvent any block.

The one asset that did feature a number of times, particularly in later meetings, was the individual's pension fund. The point was made that with pension freedom, creditors have potentially got access to the fund. Surely this would be just as important to protect – possibly even more so – than the house? We have some sympathy with this and it is clearly something to be explored if SEPA is taken forward, though our inclination remains to keep the concept as simple as possible and focus solely on the house. Would a better route be to look at wider protection under pension freedom?²⁵

The key for many was identifying the house to be protected. Our working assumption was that this would equate to the main residence for CGT purposes and this was generally endorsed. We did have some queries raised in this context:

- Wouldn't there be a risk of flipping of residences? The tie to CGT would mitigate against it so we think this is very marginal.
- What of the person who resides in one property for work whilst owning another (a tenant farmer is a good example)? We think SEPA would protect the owned property.
- Wouldn't joint ownership cause difficulty? We didn't think so: the SEPA user would register their property; it would be protected so there would be no call against it and so the fact that it was jointly owned would not be a factor.
- What of divorces or bridging while changing property? There would have to be guidelines but in principle the protection would follow the CGT rule, which may mean something equivalent to the '18 month' rule to cover bridging.
- What of mixed home and business property, such as the flat above the shop? If these could be sold separately the SEPA protection works; if not it may be simply that such properties would not be protected. Clearly this would be an issue to explore.

We did have some pushback on the protection for houses on the grounds that it could distort the housing market. We explored this with HMT housing specialists; they thought that any impact would be negligible and similarly that any encouragement of renters to become buyers would be very small, if any.

Question 3. *We have not proposed that we cap the value of the protected primary residence. Do you think this would be necessary to prevent risk of abuse? If so what would be a suitable cap?*

Most stakeholders were for no capping on grounds of simplicity. One professional body did express concern about the wide differences in values of properties regionally: was this a possible source of unfairness? This in many ways replays the point about protecting those with wealth. Against this possible capping is simply that such differing values are a fact of life.

A related point, which the OTS noted in developing the SEPA concept, is that protection for the house could lead taxpayers to prioritise paying off mortgages as against trade creditors. This could be particularly tempting if the business is starting to struggle. We raised the issue in a

²⁵ There currently exists protection for pensions that are not yet in payment: workplace pension scheme benefits, personal pension scheme benefits, stakeholder pension scheme benefits and Section 32 benefits are protected against any claim by the receiver in Bankruptcy. However, any payments deemed excessive are not protected and it is unclear whether pensions would be protected in non-bankruptcy claims. This may suffice but we have not been able to fully research this issue.

number of meetings and it was readily acknowledged but not seen as something that was new: arguably it exists already. Sanctions against wrongful trading and false preferences which already exist would presumably give some protection but this is an issue that would need to be probed.

Question 4. *Are these qualifications and restrictions [on those who could use a SEPA] reasonable? Or would they damage someone's ability to get back into business after having problems? Are there any other individuals who should or should not be allowed to apply for SEPA status?*

Our concept was avoiding someone who was disqualified from acting as a director from using the SEPA route. This was generally endorsed: this sort of safeguard was needed.

One interesting question raised was around husband and wife: what if husband was disqualified but wife was not and set up the SEPA that husband ran? If they had a jointly-owned property, it could be that the husband's activities would expose claims against him and thus against his interest in the house but it is a point to explore.

Question 5. *Is there any other information that should be required for SEPA registration?*

In the discussion paper, we noted that we envisaged the SEPA registration taking only a few minutes and requiring a minimum amount of information, including:

- full name
- date of birth
- national insurance number
- contact details (correspondence address, telephone number and email address)
- trading name(s)
- the relevant Standard Industrial Classification (SIC) code(s)
- a declaration of solvency

The initial points were readily endorsed; UTR (unique taxpayer reference) was often added and we agree. Many also said that the 'protected property' should be included, which we agree makes sense. We suggest that the trader is required to confirm that this is the property that qualifies for their CGT main residence exemption²⁶.

There were some objections to requiring the SIC code: one respondent suggested these were out of date and often difficult to decide. We are happy to drop that and would suggest that the trader makes a simple description of the business. Of more significance was the declaration of solvency: this aroused a number of objections, mainly because of the probable need to get advice or assistance in making it. On balance we are persuaded it is not needed: this is in keeping with simplicity and indeed what is required for a company²⁷.

²⁶ We accept that some traders will need guidance on what this means. The SEPA registration would presumably have context-sensitive help in this regard. If that leads some to need assistance in deciding which property is potentially covered, arguably they need professional help anyway and not just because of SEPA.

²⁷ This would avoid some of the issues with the French *entreprise individuelle à responsabilité limitée* (EIRL) where an agent must sign off on the declaration of a property valued at over 30,000 Euros.

Public or not?

The OTS has always envisaged that there would be a SEPA register and that it would be public: consumer protection demands that people can find out if the SEPA registration is genuine and who is covered for example. This was endorsed but there were naturally concerns about private information being made public. Would it mean their private address became public?

We think this valid area of concern is manageable. The key public information is in relation to the SEPA business and so what needs to be on the public register is surely:

- the business name and address (which would not necessarily be the 'protected property')
- the proprietor's name
- the fact that it is a SEPA

The rest of the registration information can be private. Anyone checking and finding that Joan Smith was indeed registered as a SEPA would deduce that Smith's house was protected; if that raised concerns, the route would be to discuss the issue with Ms Smith. Making the business address public does seem to conflict with the privacy of the home address as often these will be the same, but some make the point that some form of registered business address would be appropriate.

Who keeps the register?

A number of stakeholders, questioned who would keep the register of SEPAs. Our working assumption is that it would be kept in the same way a company and LLP registers: thus it would be part of the Companies House activities. This needs to be confirmed if SEPA is taken forward, but it seems logical and simple in terms of ease of extension of existing systems.

HMRC would have a clear interest in SEPA registration and we have always envisaged that the SEPA registration process would have a link to HMRC and, for a new business, would incorporate appropriate registration with HMRC²⁸. SEPA is an obvious candidate for a system that requires only a single notification.

Question 6. Are there any other formalities and procedures that would have to be considered?

The OTS's listing of wider formalities/procedures was generally endorsed. There were two main questions raised:

- (1) Would a trader registering as a SEPA be required to inform their creditors?

We had suggested not, on the basis that there is no requirement to inform on incorporation. However, some suggested that this was different: moving to a company was a different entity whereas this was changing something about the individual. We therefore think such a requirement would be reasonable: the trader would have to start using SEPA in the business name in any event and requiring a note to existing creditors would not be onerous. The SEPA registration process could be conditional on a requirement to so notify in (say) 30 days and automation would lead to a reminder to the trader requiring them to confirm it has been done – and if they do not, SEPA status is cancelled.

²⁸ We have always thought that SEPA could help HMRC in that registration would bring an automatic feed into HMRC systems. If SEPA was attractive and became the 'norm' for small businesses, that would help HMRC's compliance activities.

(2) Would SEPA status require some form of annual return or confirmation?

We had not considered the point in our discussion paper but it seems a small administrative requirement to do so. The SEPA user would be completing an annual tax return; that filing could easily incorporate a requirement to confirm

- that they are still operating as a SEPA, in the same business and the same name
- that the protected property remains the same (or changed on [date] to [new details]²⁹)

Although that return would go to HMRC, joined-up systems would make it easy to send the relevant details to the keeping of the SEPA register.

An interesting point raised by one respondent was whether a SEPA would be required to hold public liability insurance. It is tempting to say 'yes' to the point but there seems no reason why SEPAs should be singled out in this way. Clearly many SEPA users could have requirements from their professional body or similar to carry insurance.

Question 7. *Are there any other negative impacts that we need to consider?*

This aroused a lot of debate, primarily around bank lending and the position of creditors, as we expected. Our premise is that SEPA protects the user's home against business debts – but not private ones.

Business debts

A preliminary point was how to define business debt: what of the trader who uses their credit card indiscriminately for business and personal purchases? We were reminded that this often happens in practice, both with sole traders and companies (leading to problems over 'untangling' and directors' loan accounts). We do not have a solution for this: we can observe that SEPA does not make the position (of separating business and personal items) any worse though it brings it into focus as a possibly significant matter.

A specific point was raised a number of times in relation to HMRC: would unpaid taxes be business debts or not? We have not had time to get a definitive answer but suspect it may be a case of VAT being a business debt but direct tax being personal. Clearly this would need to be clarified and a reasonable position arrived at that does not give HMRC an unfair advantage – or unfair disadvantage.

Bank lending

We were regularly told that banks would not lend to a SEPA as they would no longer have access to the house as security; and if the trader acceded to a charge over the house, that negated the point of the SEPA. We had naturally seen this as an issue from the start. One

²⁹ It is for consideration whether there would be a requirement to notify the register in-year of a change in property. Our instinct for simplicity suggests the answer is 'no': the fact that there is a property being protected is arguably enough as far as the general creditor is concerned (who would not be able to access details of the property under our suggested principles and so the fact that the property had changed may not matter). The one thing against this is that a requirement to notify a change might add a small brake on 'flipping'. But writing the rules that the protection followed the CGT rules could suffice.

immediate balancing factor that some pointed out is that most small sole traders do not take out significant bank loans: they do not have the need for significant finance. Buying assets on hire purchase or leasing them is a more common route. There is also the point that if (say) a £100,000 bank loan is taken and secured against the house which is currently worth £200,000, that still means that the SEPA status protects the other £100,000 value in the house. We therefore discussed the issue with representatives from the banking industry, as well as with experts within HMT. Some of the points arising:

- banks tend to lend on overall risk – not just on the security provided by the house, so any impact may only be at the margins
- the vast majority of the businesses that SEPA is aimed at will have little in the way of borrowing requirements
- procedures would be needed to cover existing customers who convert to SEPA (for example, the notification of creditors discussed above under question 6)
- banks do not tend to require tangible security for loans under £25,000
- when finance is required, it is likely to be for a vehicle or other business assets, which may be taken on the security for the loan
- if SEPA protects the house against other creditors, that may make the position more attractive to the bank
- the Enterprise Finance Guarantee (EFG) helps SMEs access credit; it is used in place of (or in conjunction with) as asset to secure a loan. EFG prohibits use of the primary residence as part of the security. It is possible that SEPA usage would mean banks use the EFG more, so increasing risks for the government and costs for the customer.

One response noted that with other forms of finance becoming more widely used, bank funding may be less of an issue. However, we were also reminded at various times of the difficulties many small businesses have in raising finances, so SEPA should not make it more difficult. Nor must it make the process more complex.

Trade creditors

Would traders refuse to engage with a SEPA or try and circumvent the position? The idea of refusing to trade strikes us as a little extreme and when we spoke with one major supplier of trade creditor, they stated that SEPA status would make no difference to their credit decisions.

We discussed the issue with a major credit reference agency. They started from the premise that a limited company is well established, has to file data which is accessible to creditors and is well understood. Given that SEPA would also be registered, that helped and indeed some of the characteristics of SEPA would be positively helpful (compared with the sole trader situation) as:

- a SEPA has more standing than a sole trader with no registration
- the SEPA is clearly 100% 'owned' by the trader
- the trader is known to have a property and so a base³⁰
- there is the register

³⁰ It would clearly be useful to the agency's assessment of the SEPA's creditworthiness if they could access the home address from the public register. We have argued against that being public information but it is a point for debate: at least the agency would know that there was a base for the trader, even if the house was not available to ordinary creditors. We have suggested that a 'trading address' is public but that may not be the home address.

Accordingly they did not see this as a significant issue – on balance it may even be positive. A trade body we discussed the issue with were of a similar mind. One of the points they made was that in practice goods sold tend to remain the property of the vendor until paid for under many contracts: thus many goods can be repossessed in cases of difficulty. (This does not of course help with services.)

However, against this, one insolvency expert suggested that traders may evolve standard terms and conditions against a SEPA, namely that the condition of supply of goods/services is that if they are unpaid then the purchaser accepts that a charge is created against their property irrespective of the SEPA registration. We respect the point, but wonder how much this would be used in practice – and whether it would concern the SEPA user greatly as the main objective is to protect against major claims and not general unpaid purchases?

Bankruptcy rules

We have carried out a number of discussions to test whether SEPA would work under bankruptcy rules. There seems no reasons why properly drafted SEPA rules would not work in the manner intended. However, one point to be careful about is that this is an area of law that is devolved to Scotland, recognising that Scots laws have differences from the rest of the UK.

***Question 8.** What is your evaluation of the SEPA concept? Will it be a useful addition to the UK business landscape and encourage enterprise?*

On balance, stakeholders supported the SEPA concept, though with various levels of caution. For some, support was in effect conditional on resolving concerns about availability of bank funding (see discussion above). Whether SEPA would cause confusion remained an issue for debate but again on balance the views were that it would not – or simply that it would be manageable (again, see earlier discussion). One body did refer to the OTS’s own principle that choice adds complexity – and SEPA does of course mean an extra choice for the trader. Taking a quick straw poll at a conference of a professional association showed considerable interest in the idea; hardly definitive or authoritative but typical of the reaction we found among those who would be the potential target for SEPA.

There were a number of alternative routes suggested to address the issues SEPA seeks to address. Some the OTS had identified; some were mooted by stakeholders:

- Single member LLP: LLPs are well established – wouldn’t it be better to legislate for these to be available to individuals rather than introducing a new vehicle?³¹ This clearly has possibilities but LLPs do have to publish accounts. Allowing single member LLPs is something that would have to be considered in the context of policy around LLPs generally and is not something the OTS has explored.³² A key test of the simplicity of SEPA is whether traders could self-register without any specialist training. It is unlikely that most traders would be able to set up an LLP without support or training.

³¹ We noted in our discussion paper and report that some had in effect established single-member LLPs by incorporating a (dormant) company and using that as the other member.

³² One body professional stressed that it would be a logical route that would allow the single-member LLP to take in a ‘partner’ and become a ‘normal’ LLP. In other words, the single member LLP, if introduced, would be an adjustment to the existing LLLP rules rather than a separate, new system.

- Insurance: why not simply work with the insurance market to provide better cover that would give appropriate protection? It is clearly sensible for any business to have insurance protection against claims; SEPA would not protect against a claim that damages or wipes out the business. Whether wider cover against 'catastrophe' claims could be made available on a cost-effective basis is questionable.
- Simpler micro-company procedures: one business body suggested that simpler compliance procedures for the smallest companies would solve at least part of the issues. This is something the OTS will bear in mind for our current Corporation Tax review, but it is hard to see that accounts filing requirements can be trimmed much further and directors' loan accounts will presumably remain an issue. Cash accounting for such entities would undoubtedly help as an option.
- A general level of asset protection or 'protected equity': some standard/basic level of protection against claims available to all citizens. This has some attractions in terms of sending signals but we suspect it would be seen as too expensive for the country and too easily manipulated.

A number of people did make the point that the existing landscape of sole trader vs limited company is well established and that companies are so easy to form. Hence it would be difficult to change attitudes and shift to considering a new business form. Nor was forming a company all about asset protection or tax saving: we were reminded by some that incorporation is seen as bringing prestige and presence – and also protection for a name. These are all valid concerns but in response we would note:

- LLPs have become well established
- SEPA would bring a measure of prestige/presence with registration (as noted above by the credit reference agency)
- presumably registering the SEPA with a trade name could also have the same protection of doing so via a company
- an arguably more significant benefit of SEPA over a limited company is not the ease of registration, but the significant reduction in ongoing reporting requirements

There is no doubt that if SEPA is established, it would need a good and sustained launch /education campaign.

All of which led us to a summary 'challenge question': would SEPA encourage enterprise? Again the verdict is nuanced but on balance the view seems to be 'yes – at the margins'. One professional body put their assessment in terms of their not being convinced – but that it was worth exploring further.³³ We do put weight on the views of bodies who are close to the potential targets for SEPA: we note that LITRG, NFU and FCSA support the idea and the Screwfix survey generated good support for SEPA. We were rather taken with comments at one meeting we had with a business body where the view was expressed along the lines of: try it by starting small – if it works, expand it; we need to find routes to encourage enterprise.

³³ Another contributor suggested that the problem in the UK was not start-ups but getting those start-ups to grow: and if SEPA encouraged some to go for a non-corporate structure that may hinder growth. We note the point, but it seems unlikely that this would be a real issue in practice as anyone establishing a business with an aim of growing fast would no doubt take advice and be pointed towards limited company status.



Results from Screwfix survey

We are very grateful to Screwfix Ltd, part of Kingfisher plc³⁴, and in particular to Andrew Dingwall, their Customer Insight Manager, for running a survey of their customer panel. This survey, designed jointly with the OTS, asked specifically about SEPA and related tax issues.

The survey was carried out in September 2016 and attracted 323 responses from sole traders and small companies.

Summary of the survey results

- 68% of the sole traders would be interested in asset protection without limited company status
- 41% say an asset protection scheme would make them less likely to become a limited company
- Paperwork is a hurdle to overcome – both generally and specifically with limited company status
- Existing limited company owners are happy with the decision they made and are likely to be using an accountant to deal with the extra paperwork

Concerns of the sole trader

- The main cause of concern is finding a steady stream of work; for 26% the next biggest concern is making sure they complete tax returns accurately and on time

Paperwork is a big issue

- About a third of small businesses have thought about and dismissed the idea of becoming a limited company; over 70% of these said the extra paperwork required was a significant disadvantage; 50% cited corporation tax as an issue.

Debt liability is a concern

- Nearly half of sole traders see protection from business debts offered by incorporation as a limited company as a main benefit
- A third suggest that being a company would allow them to claim a wider range of expenses – and so bring benefit
- 28% cite general tax efficiency

³⁴ Screwfix is the UK's largest multi-channel supplier of Trade Tools, Plumbing, Electrical, Bathrooms and Kitchens, supplying tradesmen, handymen and serious DIY enthusiasts all over the UK.

Existing limited companies

- Around 4 in 10 limited company owners became such primarily because they were advised to by their accountant (around 30% felt that it was simply “what you did” when your business reached a certain size – often linked to becoming VAT registered).
- The overwhelming secondary reason – and a likely major selling point from the accountant – was the personal asset protection limited status gives.
- About a third find the extra paperwork a hassle; a similar number find the detailed accounts requirement an issue
- But over half say there was no disadvantage in becoming a company (this appears to correlate to those who use an accountant for their accounts)
- 63% of limited businesses think that the asset protection for sole traders would be useful, but the majority (69%) suggest it would not have made a difference in their decision to become a limited company (of the others, 21% say ‘a little less likely to become a limited company, 10% ‘much less likely’).

When did you become a company?

- 42% said they did so as they registered their business.
- Beyond this, it seems that year 2-3 of a business, once it’s established, is the ‘sweet spot’ owners to change to a limited company (24%).

It was noted that some respondents felt that more information on the benefits of being a company during company registration may be beneficial to business owners, though given that accountants/advisers seem to have been involved with most this may not be too significant, though would clearly help those trying to ‘go it alone’.

D

Contributors and acknowledgements

As with all of the OTS's work, we have gathered evidence to support our work, as well as carrying out our own researches. Our main report generated a useful amount of comment and following publication of our interim paper we had had a good number of responses to some or all of the issues we raised. We have talked extensively to members of our consultative committee and have carried out a limited number of meetings with interested parties, though given the timescale and restricted nature of the project we have not carried out as extensive a series of meetings as we did for the initial Small Companies report.

We are confident we have gathered sufficient evidence to support our conclusions and are very grateful to all of those who have taken the time and trouble to write to and meet with us. This includes especially our consultative committee members, the Federation of Small Businesses (who organised a series of four workshops around the country), the BBA and Screwfix plc who kindly organised a survey of their trade members for us.

We should also note that during the summer the SEPA work was taken forward with considerable involvement from a working party involving colleagues from HMT, HMT and BIS (now BEIS) as well as the OTS. We have also consulted the DWP and Ministry of Justice.

Contributors (comments and meetings)

Angela Williams

Asif Ahmed

Association of Accounting Technicians

Association of Independent Professionals & the Self Employed

Association of Taxation Technicians

Ben Baruch, Federation of Small Businesses

Brian Palmer

British Bankers Association

British Business Bank

Chartered Institute of Taxation (Owner Managed Business committee)

David King

Emily Coltman, FreeAgent

Experian

Federation of Small Businesses (submission and meetings in Croydon, Maidstone, Newcastle and Salisbury)

Freelancer & Contractor Services Association

Gary Richards

Institute of Chartered Accountants in England & Wales

Institute of Chartered Accountants of Scotland

JC Wallace & Co.

Professor Judith Freedman

Land Registry

Lloyds Bank

Low Incomes Tax Reform Group

Moore Green Chartered Accountants

National Farmers Union

On The Spot Accountants

PricewaterhouseCoopers LLP

Prism

Rebecca Benneyworth

Ross Martin Tax Consultancy

Screwfix Ltd

Suzanna Ingham

Tony Thorne

As always, we apologise to anyone we have inadvertently omitted from the above listing.

We should also acknowledge with thanks the various articles and commentaries in the professional press on our work. We have read them all with interest.

E

Extract from March 2016 Small Company Taxation report

Summary recommendation

OTS develops an outline of a 'Sole Enterprise Personal Assets' (SEPA) vehicle to test its practicability and whether it would deliver the desired personal asset protection in practice.

Extract from the report

1.14 The UK tax system has not been specifically designed to accommodate modern small company forms. This has caused a fairness issue among the 723,000 nano companies and the broader 4.1 million nano businesses of which these are a sub set. They are treated differently by the tax system depending on their legal form, but are all non-employing businesses and, on the whole, do not plan to grow.

1.15 Incorporating creates a significant problem for many micro businesses, especially nanos. Many proprietors simply do not understand the accounting and tax requirements of a company but are comfortable with the requirements of an unincorporated business.

1.16 The tax system also puts disproportionate administrative burdens on smaller companies. Micro companies spend an average of at least 27p in advisory fees for every £1 of corporation tax they pay. While micro companies may gain further benefits from a prepared set of accounts provided by advisers, the primary use for most is to meet the reporting obligations of Companies House and HMRC.

1.17 Simplification on this front also has a key benefit to HMRC. By simplifying the reporting requirements, HMRC can simplify the monitoring and enforcement arrangements for most small companies and better target resource at those who are deliberately abusing the system.

1.18 The easiest way to simplify the tax burden for these companies would be to remove them from the corporation tax system altogether. Given that limited liability is cited as the most common reason for incorporating, we think that there is merit in a system that provides protection for personal assets for sole traders, limiting their personal liability while allowing them to continue to trade as a sole trader with the associated accounting and tax treatment. This is discussed in more depth in the *Legal* chapter. France already has a similar system in place called *déclaration d'insaisissabilité* (declaration of unseizability) that is covered in greater detail in the *Lessons from other countries* and *Legal issues and alternative forms* chapters. We recommend that the OTS develops an outline of such a vehicle (a 'Sole Enterprise Personal Assets' or SEPA) to test its practicability and whether it would deliver the desired personal asset protection in practice. As part of this work we will consider further the single member LLP route noted in the *Legal issues* chapter.

1.19 Such a personal asset protection system would provide something akin to limited liability, but not the assumed enhanced credibility and formalised structure that incorporation provides. In particular, incorporation also provides the separate legal entity that is essential for many personal services companies to win contracts. The vast majority of potential customers in this sector will only award contracts to companies, their main driver being to try and insulate themselves against employment law consequences.