



HM TREASURY

Consultation on a disincorporation relief

June 2012



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1

Introduction

Background

1.1 In February 2012 the independent Office of Tax Simplification (OTS) published its final report into small business tax. One of these identified a population of businesses operating as limited companies who would 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 simplified administrative procedures for disincorporation. The full OTS report can be found here: http://www.hm-treasury.gov.uk/ots_smallbusinessreview.htm

Policy intention

1.3 The OTS published two substantial reports on this area – a discussion paper in July 2011 and the final report in March 2012. This consultation builds on these by focussing questions specifically on those businesses identified by the OTS as most likely to want to disincorporate, further investigating the nature and scale of demand for the relief, examining some of the design parameters, and looking more closely at issues around creditor protection.

1.4 The consultation follows the Budget 2012 announcement that the Government would consult on the OTS proposal. A final decision on introducing a relief or other measures will be taken following consultation. The Government is interested in views from a range of audiences, including individual businesses and their representatives, as part of this consultation. It is also interested in views from insolvency practitioners reflecting the links to the Companies Act.

Structure of this consultation

1.5 Chapter 2 seeks comment on the criteria the Government intends to use for assessing options for policy change. Chapter 3 summarises the differences between limited companies and self employed businesses; presents the current processes involved and implications of disincorporation; and seeks views on demand from business to disincorporate and the barriers preventing them from doing so.

1.6 Chapter 4 seeks views on how a disincorporation relief or administrative measures could address the current barriers to disincorporation. Chapter 5 is a consultation stage summary of impacts, Chapter 6 is a summary of consultation questions and Chapter 7 summarises the consultation process, next steps and how to respond to the consultation.

Scope of the consultation

1.7 This consultation does not seek to present or ask for an exhaustive comparison of the merits of different legal forms a business could take. Similarly, it does not specifically seek to examine the effect of wider tax or Companies Act legislation on choice of legal form. The focus is on the transition between legal forms and whether there is an overall demand among small businesses to disincorporate that might be supported by a disincorporation relief.

How to respond to this consultation

1.8 Please send comments by 30 August 2012 to: Alex Darmoo, SME tax branch, Excise and Enterprise Tax team, HM Treasury, 1 Horse Guards Road, London SW1A 2HQ

Email: disincorporation@hmtreasury.gov.uk

Telephone (Treasury switchboard): 020 7270 5000

1.9 The consultation period will last 12 weeks, until 30 August 2012.

2

Criteria for assessing options

2.1 In assessing possible policy or administrative measures following this consultation, the Government proposes to use the criteria listed below. These closely follow the criteria used by the OTS and the Government's wider objectives for the tax system. The criteria are:

- **the change meets a commercial need** – any change in policy, additional legislation or reforms to tax administration should be justified by a clear commercial need. The OTS suggested that some small businesses are looking to disincorporate but may be prevented doing so by tax and administrative barriers. This consultation seeks to investigate further the scale and nature of these issues and how far any reforms would go to addressing them;
- **it is targeted where it is most effective** – any policy change should be focused on those businesses and circumstances where it is most justified. This builds on the OTS findings that the decision to disincorporate appears most relevant for the smallest businesses;
- **it is simple to understand and straightforward to administer** – tax relief or other policy measures to make disincorporation easier should not add significant complexity to the tax system. Reliefs should be simple to understand and accessible to business without large amounts of professional advice; and
- **not open to abuse** – the Government is interested in supporting those with a genuine commercial reason for changing the legal form of their business. Any new policy should not provide opportunities to artificially reduce tax or to avoid liabilities to a business' other creditors.

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?

3

Disincorporation

3.1 Disincorporation refers to the process of a business changing its legal form from a limited company to one run by a self employed individual or partnership; achieved by transferring the business as a going concern, with its assets and liabilities, from the company to one or all of the shareholders. The business is then continued by them in their capacity as a sole trader or a partnership.

3.2 This chapter outlines some of the main differences between these two legal forms; seeks further views on the commercial reasons businesses might want to disincorporate; and presents some of the administrative processes and tax issues involved. The Government is interested in further evidence on the overall demand for disincorporation and which barriers to disincorporation are most significant. The following chapter presents potential policy options available including a tax relief as proposed by the OTS.

3.3 Surveys commissioned by the OTS suggested those businesses most likely to be interested in disincorporation had a turnover in the region of £20,000 to £30,000. Responses to their agents' survey supported this by finding that many (about 30 per cent) considered that very small businesses were likely to find disincorporation relief beneficial. **Reflecting this, the Government is particularly interested in understanding how the issues related to disincorporation affect the very smallest businesses.**

Limited company compared to self employed

3.4 When starting up, most entrepreneurs face a choice between running their business as a sole trader or in partnership (an unincorporated business) and setting up a limited company (incorporating).¹ Many choose to start as self employed and incorporate as the business grows.

3.5 Operating a business as a sole trader or in partnership is a broadly simpler way to run a business than a company. For many small businesses, the only tax return a sole trader needs to complete on a yearly basis is the annual Self Assessment tax return.

3.6 Self employed individuals pay Income Tax and National Insurance Contributions (NICs) on business profits. Current rates of Income Tax mean that individuals will generally pay the following rates of tax on business profits: 20 per cent basic rate, 40 per cent higher rate and currently 50 per cent on income above £150,000. Individuals may also have to pay Capital Gains Tax (CGT) on gains in respect of asset disposals.²

3.7 Operating as a company involves relatively more administration. This includes making annual returns to Companies House and sending a Corporate Tax return to HMRC. The directors and shareholders of the company may also need to complete Self Assessment returns. Operating as a company is also likely to entail the running of a PAYE scheme and the making of PAYE returns for the Directors, which would not otherwise be necessary if the business has no other

¹ This consultation focuses primarily on sole traders, partnerships and limited companies. Depending on individual circumstances other legal forms exist such as an association or a limited liability partnership

In addition to the above, some individuals choose to provide their labour through a personal service company and in cases may be required to do so.

² A separate consultation into the OTS proposals for a new cash basis for calculating tax was published on 27 March and can be found at: http://customs.hmrc.gov.uk/channelsPortalWebApp/downloadFile?contentID=HMCE_PROD1_031991

employees. A company has limited liability, which means the owners are not personally liable for the debts of the company.

3.8 Companies pay Corporation Tax (CT) on their profits. Current rates of CT are between 20 per cent and 24 per cent depending on level of profit. Directors and company owners or shareholders also pay Income Tax and NICs on any salary or dividends paid by the company.

3.9 Tax may influence the decision whether to incorporate or not, however the individual business owner will need to balance this against the additional regulatory requirements involved in operating an incorporated business. The table below summarises some of the main differences between unincorporated and incorporated legal forms.³

Table 3.A: Table summarising differences between corporate and unincorporated businesses

Sole trader or partnership	Incorporated business
<ul style="list-style-type: none"> · Ownership and control – both ownership and control of the business rests with the individual(s). · Unlimited liability – the business owner is personally liable for the debts and financial obligations of the business. · Registration – owner needs to register for Self Assessment Income Tax with HMRC. · Filing requirements – must complete an annual tax return to HMRC. · Records – must keep records showing business income and expenses for tax purposes. · Taxes levied – Income Tax on profits, Class 2 NICs and Class 4 NICs on profits. CGT on asset disposals. · Partnerships – partners pay Income Tax, NICs and CGT on their share of the profits. 	<ul style="list-style-type: none"> · Ownership and control – companies are ‘incorporated’ to form an entity with a separate legal personality. Director and shareholder are separate roles but in many small businesses the directors and shareholders are the same. · Limited liability – the business exists in its own right, so a company’s finances are separate from the personal finances of the owner(s). · Registration – must register at Companies House and tell HMRC it exists and is liable for Corporation Tax. · Filing requirements – must file accounts, annual returns and documents notifying changes with Companies House and send an annual return to Companies House. In addition, must send a company tax return to HMRC and Directors must complete a Self Assessment tax return. Company must operate PAYE on Directors remuneration. · Records – record-keeping requirements more extensive than for self employed. E.g. when taking out a loan against company assets, these must be filed with Companies House. · Taxes levied – Corporation Tax on profits. Directors pay Income Tax and Class 1 NICs on earnings. Shareholders pay Income Tax on dividends and CGT on gains involving shares.

Why companies might consider disincorporation

3.10 The Government is interested in further exploring what factors might lead small companies to consider disincorporating and how many might be considering such a move. The OTS in particular highlighted that:

- many small businesses may have incorporated to save tax following the introduction of the 0 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;

³ For more information on different legal forms see Department for Business Innovation and Skills website: <http://www.bis.gov.uk/assets/biscore/business-law/docs/g/11-1399-guide-legal-forms-for-business.pdf>

- 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.

3.11 A business will also need to consider the broader advantages and disadvantages of the different legal forms outlined in the previous section, in particular, the loss of limited liability status and implications for their overall tax liability.

3.12 As set out above, the Government is particularly interested in understanding how these issues affect the smallest businesses.

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?

Steps required to disincorporate

3.13 The process of disincorporation is potentially complex but broadly could involve the steps outlined below:

- transferring the business assets to the shareholder(s);
- the shareholder(s) registering with HMRC as self employed or as a partnership;
- the company ceasing to trade as a result of the asset transfer; and
- the company being formally wound up or applying to be struck off the Register of Companies.

3.14 The business owner will also need to inform customers and suppliers, set up a new bank account and may have to make other arrangements relating to the finance of the business.

Figure 3.A provides a simplified graphical summary of what a business needs to do to disincorporate.

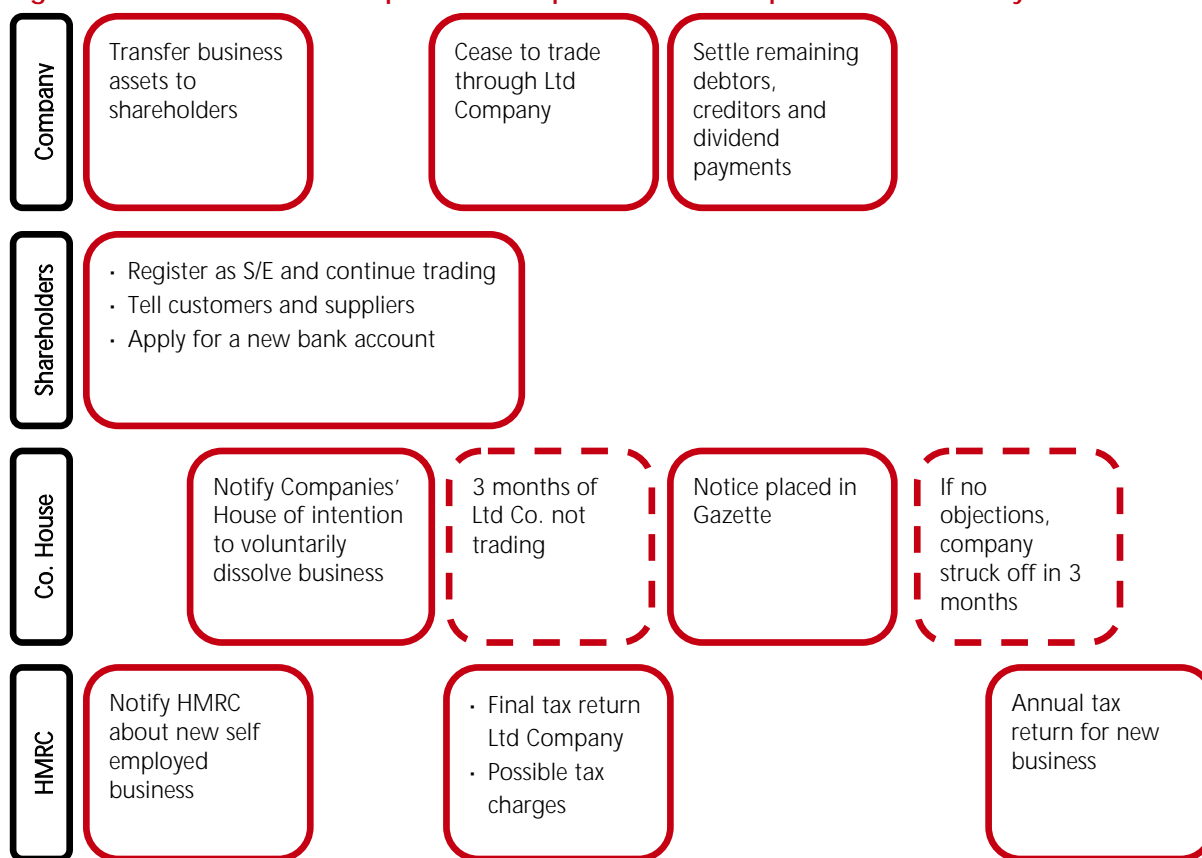
3.15 This consultation assumes that the owners of a company wishing to disincorporate will want to distribute the business and business assets either as part of a **formal winding up** or by applying for voluntary striking off, termed **voluntary dissolution**. A formal winding up procedure involves appointing a liquidator who will charge an administration fee. A voluntary dissolution requires the company to cease trading for at least three months before applying to be struck off the Register of Companies. Once this period has passed the business submits an application form to Companies House. After a waiting period when any other creditors can come forward or object to the application, the company is struck off. The waiting period is to prevent a company trying to avoid paying its debts by striking off.

3.16 If a business is seeking to disincorporate, it also has to inform HMRC that the company has ceased trading and is being wound up. It must also meet its commitments to HMRC as a creditor, paying any taxes it owes in the course of running its business, such as Corporation Tax or PAYE.

Requirements to protect creditors

3.17 While the limited company exists, normal company law rules will continue to apply and the directors must fulfil their duties under the Companies Act. This means, if the business chooses the voluntary dissolution route, the directors will have to ensure that either: they pay the full market value for any assets transferred into the business; or where the assets are distributed to the shareholders at undervalue, that the company should have sufficient capital and distributable reserves to meet any potential outstanding liabilities including its creditors. **This could require the owner to be able to deposit and leave an amount of cash in the business for the period of disincorporation.**

Figure 3.A: Illustration of the processes required to disincorporate via voluntary dissolution



Possible tax charges on disincorporation

3.18 Research conducted for the OTS suggested 14 per cent of incorporated respondents would like to disincorporate but saw tax charges as a barrier to doing so. When transferring the assets of the limited company to the shareholders, the tax charges that can occur can be split into two broad categories below:

- **Charges on the company** on the disposal of the assets liable to Corporation Tax. This includes gains or profits on disposal of goodwill, plant and machinery, stock or land. Goodwill refers to the additional value of a business over the sum of its assets and liabilities, and must be accounted for on the transfer of the business; and
- **Charges on the shareholders** in relation to their shares. This includes tax charges on any dividends/distribution of the company's assets (including cash). The nature of the charge on distributed assets will depend on whether the assets are treated as

an income distribution (liable to an Income Tax charge) or a capital distribution as part of a formal winding up (liable to a Capital Gains Tax charge).

3.19 More detail on possible tax charges is outlined below and set out in the example on page 12. The Government is interested in views on: how relevant these circumstances are to very small businesses, for example, those with turnovers of around £30,000; the likely scale of the charges involved; and which present the most significant barriers to disincorporation.

Charges on the company

3.20 If the company transfers the business to its shareholders it will have to pay Corporation Tax on any gains/profits in relation to the transfer of goodwill, based on its market value at the time of the transfer. The amount of the gain/profit will depend on whether the Capital Gains⁴ rules or the Intangible Fixed Assets⁵ rules apply.

3.21 In principle other charges might arise, for example on the transfer of plant and machinery for Capital Allowances (for example a van or piece of equipment), or gains on the transfer of property. The Government's initial view is that these charges rarely arise in practice for the smallest businesses.

3.22 On disincorporation, some reliefs (e.g. unused loss relief) will not be transferrable to the new business owners. While this would not result in an immediate tax charge, disincorporating may mean foregoing these reliefs.

Charges on the shareholders

3.23 On disincorporation, the assets of the company may be transferred to the shareholders. However, the tax rules will vary depending on how the assets are transferred. For example:

- in general, if the assets are distributed to the shareholder, this is treated as income and taxed like a dividend and will be liable to an Income Tax charge on the value of the distributed assets. This applies for similar reasons to tax charges on a dividend payment paid out in cash by the company to its shareholders;
- however, if the assets are distributed to the shareholders as part of a formal winding up, the shareholders will be instead liable for Capital Gains Tax, which could reduce the value of the charge. CGT rates are 18 per cent, rising to 28 per cent to the extent that gains and income exceed the amount of the basic rate band;
- if the company undergoes a voluntary dissolution and fulfils certain qualifying conditions⁶ and the value of the assets is under £25,000, then the shareholders will also pay CGT as if the assets were distributed as part of a formal winding up; and
- if the assets are instead transferred for cash consideration (payment to the company) equal to their market value, no charge will arise on the shareholder on the asset transfers at that time, but the shareholder may still be liable on any subsequent distribution of the cash by the company on formal winding up or voluntary dissolution.

3.24 The OTS highlights that these charges that arise on the shareholders could in some circumstances present a barrier to disincorporation. The precise amount of these charges would

⁴ Companies pay Corporation Tax on Capital Gains computed by reference to the Taxation of Chargeable Gains Act (TCGA) 1992.

⁵ The Intangible Fixed Assets (IFA) regime legislation can be found at Part Corporation tax Act (CTA) 2009. The IFA rules apply to companies that create goodwill on or after 1 April 2002, or where the goodwill was created before 1 April 2002, when it was acquired from an unrelated party on or after 1 April 2002.

⁶ This follows the recent legislation of Extra Statutory Concession (ESC) 16 into section 1030A of the Corporation Tax Act 2009

depend on the individual's circumstances, including whether they are liable to higher rate tax or, if liable to CGT, the rate of CGT, the amount of the annual exemption (the annual exempt amount allows taxpayers to make a certain amount of gains each year before having to pay CGT, currently £10,600) and availability of other reliefs.

3.25 The Government's initial assessment is that for businesses with assets under £25,000, where the owners have not realised significant capital gains from other sources over the course of the year (for example from selling a second home), the charges on the shareholders will be small in comparison to the charges on the company. For business with assets over £25,000, where the owners are higher rate tax payers and/or have realised higher capital gains from other sources, the charges could be more significant.

Example: Window Cleaners Ltd

Window Cleaners Ltd a one man company that incorporated on 1 April 2004 and the shareholder, Mr Smith, had previously carried on the business as a self employed individual before 1 April 2002. Turnover is below the VAT threshold. The business has an established repeat customer base. The only significant business assets are a van, equipment and goodwill. The van and equipment are worth around £3,000 and the goodwill is valued at £15,000, together worth £18,000. The goodwill was acquired from Mr Smith for £5,000 on 1 April 2004. The Capital Gains rules apply and Corporation Tax is payable @ 20 per cent.

Tax chargeable on goodwill:

If the assets are distributed back to the shareholder (Mr Smith) on 1 February 2012 the following charge would arise on the goodwill:

- Corporation Tax on goodwill gain £8,540 (£15,000 - £5,000 less indexation £1,460 (£5,000 x 0.292)) @ 20 per cent = £1,708

There is no Corporation Tax to pay on any gains made on the transfer of the van and equipment because these are chattels worth no more than £6,000.

Shareholder charges:

Mr Smith will also have to consider what tax he will have to pay on the value of the distributed assets of £18,000. The amount of charge will depend on whether the assets are treated as income or capital.

If distributed as capital, the actual amount of Capital Gains Tax that Mr Smith will have to pay will depend on a number of factors, including how much was paid for the shares, whether incorporation relief was claimed, whether Entrepreneurs' Relief conditions are satisfied and availability of capital loss relief.

Assuming £100 was paid for the shares, that Mr Smith has no other gains in the tax year (and so the annual exempt amount of £10,600 can be used against the gain) and that he is entitled to Entrepreneurs' Relief, then the amount of Capital Gains Tax to pay would be:

- (£18,000 - £100 - £10,600) x 10 per cent = £730

If the assets are distributed as income (i.e. a dividend) Mr Smith will only have to pay Income Tax if any part of the dividend is liable to Higher Rate Tax.

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.

4

Policy options

Disincorporation relief

4.1 The OTS recommended introduction of a time-limited tax relief for businesses looking to disincorporate. A disincorporation relief would mean the business could postpone or remove some or all of the tax charges described in Chapter 3. It would also remove the need to value assets on disincorporation – this is required because the company's assets are deemed to have been disposed of at market value. The OTS report suggests this can be a lengthy and burdensome process. More information on the OTS proposed relief can be found at: <http://www.hm-treasury.gov.uk/ots>.

4.2 If the Government were to introduce a disincorporation relief, key decisions would be: the scope of charges it covered; the size of business that would be eligible for the relief; and the lifetime of the relief before it is reviewed or brought to an end.

Scope of charges relieved

4.3 A simple disincorporation relief might remove the Corporation Tax charges to the company on the capital gain on the goodwill. With additional legislation, it would also be possible to extend this to charges to the company relating to plant and machinery and land, if the value of these assets and the likely tax charges were significant for the affected businesses.

4.4 A more comprehensive relief would cover charges arising on shareholders in respect of distributed assets. Providing relief for shareholders would require additional rules to ensure fairness between different taxpayers and prevent opportunities for abuse. This might include:

- a targeted anti-avoidance rule to deal with any abuse from shareholders being exempt from Income Tax or CGT charges on disposal; and/or
- rules to ensure that, while a charge is not applied when the assets are transferred to the shareholders, the right amount of tax is collected when the assets are eventually sold or disposed of by the self employed business. These rules might involve an adjustment to the recorded value of the assets when they are transferred on disincorporation.

4.5 Reflecting the above, the Government is particularly interested in establishing the commercial need and likely administrative requirements for a disincorporation relief which covered charges arising on shareholders. For example, the Government is interested in how many of the smallest businesses would face significant charges arising on the shareholders on disincorporation; and for this part of the relief, what additional rules might be required – both to calculate the relief and ensure it is not open to abuse.

Size of business eligible

4.6 OTS survey evidence suggested the smallest businesses would be more likely to be interested in a disincorporation relief, for example those with a turnover in the range of £20,000 to

£30,000. Its final recommendations suggested, for practical reasons, to use a familiar definition, that the relief should be open to companies meeting the EU definition of a micro-company¹.

4.7 An alternative eligibility threshold for a disincorporation relief would be the VAT registration threshold of £77,000.² This would also capture those businesses identified by the OTS surveys as most likely to disincorporate and could help reduce the scope for abuse of the relief.

Lifetime of the relief

4.8 The OTS recommended introducing a disincorporation relief for five years, after which it would be reviewed. The Government is interested in views on this proposal and the merits of shorter or longer life spans.

4.9 Overall, the Government is interested in how effectively a tax relief, of the sort outlined above, might reduce the barriers to disincorporation, how well it meets the criteria set out in Chapter 2 and the priority respondents place on this reform in the context of wider policy changes.

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?

Administrative options

4.10 In addition to a disincorporation relief, the OTS had recommended a joint Companies House and HMRC working group be set up to look into the introduction of a simplified one-stop process to carry out the disincorporation and dissolution of the company. Reflecting this, the Treasury will be working with the Department for Business and the Insolvency Service over the course of the consultation on what could be done to make disincorporation easier.

4.11 Simplifying the process of disincorporation could be achieved through improving or consolidating the guidance available to businesses or aligning or changing some of the rules and procedures involved.

Guidance

4.12 Guidance is available for businesses looking to dissolve their company voluntarily or bring their business to an end. Similarly there is general guidance on the tax treatment of assets transferred from a limited company to a shareholder or other party. Examples include:

¹ EU definition of a micro company – fewer than 10 employees and with either a turnover or balance sheet of under €2 million

² The VAT registration threshold applies to the turnover of supplies taxable to VAT, however a threshold for disincorporation relief would apply to total turnover.

- guidance on either formally winding up the company or being struck off the Companies House register is on the Companies House website, at: <http://www.companieshouse.gov.uk/about/gbhtml/gp4.shtml>;
- what needs to be done to set up a business as a sole trader can be found on the Businesslink website, at: <http://www.businesslink.gov.uk/bdotg/action/layer?topicId=1073858805>; and
- tax charges on the transfer of particular assets can be found on the HMRC website, at www.hmrc.gov.uk.

4.13 Currently there is no single, consolidated guidance available which covers all of the steps involved in disincorporation in one place. One option would be to provide consolidated guidance on disincorporation. This might address some of the issues listed below:

- information about why a business may choose to disincorporate;
- the implications of disincorporation: what the loss of limited liability could mean, what administrative burdens a business would no longer need to fulfil, that the business would still need to ensure it pays its creditors;
- what a business would have to do to disincorporate: who to contact, forms to fill in, how long the process takes, costs of the insolvency process; and
- what are the tax implications for a business on disincorporation: these include both the one-off tax charges the company and shareholders may face, as well as what taxes are paid by the self employed.

Simplifying processes

4.14 Going further than improving guidance would require changes to the individual processes involved in disincorporation. This might include:

- looking for instances where information provided to HMRC and Companies House is similar and alignment would significantly reduce administrative burdens; or
- looking for ways to reduce the amount of information HMRC or Companies House require from a business when it disincorporates, or reducing the timescales over which the information is required.

4.15 Simplified processes would not include those aspects of disincorporation outside the Government's control. This includes the need to notify suppliers and customers, set up a new bank account and, if applicable, appoint an adviser or liquidator to provide individual advice.

4.16 **The Government is interested in suggestions in this area provided they do not increase scope for tax avoidance or reduce creditor protection.** The majority of the processes involved in disincorporation also apply to businesses looking to dissolve and fully cease trading. Any proposals would therefore need to easily distinguish companies looking to disincorporate from those looking to fully cease trading.

4.17 Where simplified processes require changes to tax forms and HMRC systems or the Companies Act, the Government would require clear evidence of the potential benefits and absence of additional risks as outlined in the criteria in Chapter 2.

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?

5

Tax Impact Assessment

Summary of impacts

5.1 The following is a consultation stage Tax Impact Assessment of the impact of the OTS proposal for a disincorporation relief:

Exchequer impact (£m)	2012-13	2013-14	2014-15	2015-16	2016-17
	Exchequer cost not yet estimated.				
Economic impact	No macro-economic impact, although may support growth by levelling the playing field between different legal forms and driving lower costs throughout the SME sector.				
Impact on individuals and households	While the Corporation Tax elements of a relief would relate to companies, there may be an impact on individuals as the relief covers the Capital Gains Tax or Income Tax charge on shareholders.				
Equalities impacts	This proposal relates to small companies seeking to become self employed. This may have a different impact on different groups which are more likely than others to fall into this category. No data is available.				
Impact on businesses and third sector	<p>Disincorporating should lower admin burdens for a business, for example it would no longer need to file annual returns to Companies House.</p> <p>A disincorporation relief could enable very small companies who wish to become partnerships or revert to self employed status to move assets into the new non-corporate form without some immediate tax charges arising, reducing a barrier to disincorporation.</p> <p>A relief may not address the non-tax, administrative burdens involved in disincorporation, such as those involved in winding up a company. These burdens, as well as the relative tax advantages of being a company, may limit the number of businesses that would choose to make this switch.</p>				
Operational impact to HMRC (£m)	<p>The full details of the proposals are yet to be settled and the changes that might be required have not therefore been formally assessed.</p> <p>HMRC considers there could be pressure placed on Income Tax and VAT processes if significant numbers of companies were to use the relief.</p>				
Other impacts	Small business impact: a disincorporation relief may make it easier for small businesses to choose the appropriate legal form for their business – i.e. making it easier to switch back from a limited company to sole trader – which would be a positive impact.				

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?

6

Summary of 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?

7

Next steps

The consultation process

7.1 This consultation is being conducted in line with the Tax Consultation Framework. There are 5 stages to tax policy development:

- Stage 1 – Setting out objectives and identifying options;
- Stage 2 – Determining the best option and developing a framework for implementation including detailed policy design;
- Stage 3 – Drafting legislation to effect the proposed change;
- Stage 4 – Implementing and monitoring the change; and
- Stage 5 – Reviewing and evaluating the change.

7.2 This consultation is taking place during stage 1 of the process. The consultation is a call for evidence regarding how to help small companies disincorporate.

7.3 While the consultation will assess a model for a disincorporation relief, announcement of whether to introduce a relief, and when, is subject to responses to the consultation.

7.4 Alternative proposals to help small companies disincorporate are actively being considered in this consultation.

Timetable and implementation

7.5 The consultation period will last 12 weeks, until 30 August 2012.

7.6 The responses to the consultation will be considered in preparation of draft legislation for Finance Bill 2013, which we intend to publish in the autumn.

7.7 If the Government decides to introduce a disincorporation relief from April 2013, legislation will be introduced in Finance Bill 2013.

How to respond

7.8 Please send comments by 30 August 2012 to: Alex Darmoo, SME tax branch, Excise and Enterprise Tax team, HM Treasury, 1 Horse Guards Road, London SW1A 2HQ.

Email: disincorporation@hmtreasury.gov.uk

Telephone (Treasury switchboard): 020 7270 5000

Confidentiality

7.9 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOI), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

7.10 If you want the information that you provide to be treated as confidential, please be aware that, under the FOI, there is a statutory Code of Practice with which public authorities must comply and which deals amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury or HMRC.

7.11 HM Treasury and HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

The Government's Code of Practice on Consultation

7.12 This consultation is being conducted in accordance with Government's Code of Practice on Consultation. A copy of the Code of Practice criteria and a contact for any comments on the consultation process can be found in Annex A.

A

The Government's Code of Practice on Consultation

About the consultation process

A.1 This consultation is being conducted in accordance with the Code of Practice on Consultation.

A.2 The consultation criteria:

- 1 When to consult – Formal consultation should take place at a stage when there is scope to influence the policy outcome;
- 2 Duration of consultation exercises – Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible;
- 3 Clarity of scope and impact – Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals;
- 4 Accessibility of consultation exercise – Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach;
- 5 The burden of consultation – Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained;
- 6 Responsiveness of consultation exercises – Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation; and
- 7 Capacity to consult – Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

A.3 If you feel that this consultation does not satisfy these criteria, or if you have any complaints or comments about the process, please contact:

Amy Burgess, Consultation Coordinator, Budget & Finance Bill Coordination Group, HM Revenue & Customs, 100 Parliament Street, London, SW1A 2BQ

E-mail: hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk.

HM Treasury contacts

This document can be found in full on our website: <http://www.hm-treasury.gov.uk>

If you require this information in another language, format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 5000

Fax: 020 7270 4861

E-mail: public.enquiries@hm-treasury.gov.uk

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