



## DISINCORPORATION OF SMALL COMPANIES: A DISCUSSION PAPER

Comments submitted in October 2011 by the Tax Faculty of the Institute of Chartered Accountants in England & Wales (ICAEW) to HMRC in response to the consultation on a simpler income tax issued by the OTS in July 2011

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## INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the discussion paper, Disincorporation of small companies, published by the Office of Tax Simplification (OTS) in July 2011 at [http://www.hm-treasury.gov.uk/d/ots\\_disincorporation\\_of\\_small\\_companies\\_discussion\\_paper.pdf](http://www.hm-treasury.gov.uk/d/ots_disincorporation_of_small_companies_discussion_paper.pdf)
2. We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.
3. Information about the Tax Faculty and ICAEW is given below. We have also set out, in the Appendix, the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

## WHO WE ARE

4. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 136,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
5. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
6. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including TAXline, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

## MAJOR POINTS

7. We support the work of the OTS in their efforts to simplify the tax system for the smallest businesses.
8. We would like to see these ideas for a disincorporation relief developed further.
9. The growth in awareness of the Limited Liability Partnership (LLP) as a suitable alternative to a corporate structure for business means that this is now seen as a viable alternative. We consider that more businesses might use this as a vehicle if they could disincorporate easily and cost effectively.
10. We consider that entrepreneurs should be able to operate in the most commercially efficient and appropriate way for their businesses.

## RESPONSES TO SPECIFIC QUESTIONS

### Why introduce a disincorporation relief?

#### Q1 What are the drivers for a company to disincorporate its business? Is it simply a question of administrative savings?

11. We consider the main reason for a company wanting to disincorporate is the administrative cost of running a company.
12. A further driver to disincorporation is the potential national insurance saving for employees and employee incentives. This would be balanced by the increased NIC payable if the dividend extraction route for taking profits from a company is given up.
13. The growth in awareness of the Limited Liability Partnership (LLP) as a suitable alternative structure means that this is now seen as a viable alternative.
14. We consider that an entrepreneur should be able to operate in the most commercially efficient and appropriate way. Too often the 'tax tail wags the corporate dog'. If we can make it easier for a business to adopt a structure appropriate for what it wants to do, that must, in the longer term create larger profits and generate more tax. It should be possible to have a clearance process guarding a tax-free disincorporation, if desired. It should also be possible to effect tax efficient roll-overs so that accrued gains and losses are not lost.

#### Q2 Are there further significant factors that influence the incorporation decision (other than those listed in paragraph 2.13) that need to be considered in the context of a disincorporation relief?

15. Incorporation results in a loss of privacy – which can be a reason for wanting to disincorporate.
16. The burden of regulation is a reason to want to disincorporate, as is the cost of administration, including higher professional costs for companies.
17. That there is a tax driver to incorporate, should not discourage the government from minimising the tax penalty for disincorporation, should entrepreneurs wish to do so.

#### Q3 What evidence is there that businesses would wish to disincorporate? Are there particular categories of business that would wish to take the route?

18. A considerable number of small companies have s 455 Corporation Tax Act 2010 problems which is usually evidence that they do not manage the business cash in isolation from personal cash. This is a more difficult problem if the business is incorporated.
19. Small property investment companies are often the result of property remaining locked in a company after the business has been sold.
20. One instance we have had reported recently, related to a company owned by its directors where not all the directors were putting in the 100% effort, which they once were. As the director/shareholders regard the business as their personal business, they would benefit from operating as an LLP, so that profit shares could be varied easily rather than contemplate the tax risks attaching to dividend waivers or alphabet shares. But there is a tax charge to disincorporation.

### **Current tax implications of disincorporation**

**Q4 Should any disincorporation go hand-in-hand with the company being wound up? Is there any reason to leave the winding up to a separate decision and procedure or would it be sensible to tie the stages together into a single composite procedure?**

21. A company may have more than one activity; disincorporation of identifiably separate parts should be allowed. This would avoid the costs of having to effect a reorganisation prior to disincorporation and then winding up one company.

**Q5 Are there any significant further tax or general issues on disincorporation other than those listed in Chapter 3 that need to be considered?**

22. The costs of the processes involved with liquidations often dictate the route adopted for disposing of a dormant company.

23. The National Insurance cost, which could increase or decrease depending on the circumstances.

### **Which companies may benefit from a disincorporation relief?**

**Q6 Do the five examples in paragraph 4.2 correctly identify situations where a disincorporation relief may be commercially desirable? Are there any further examples?**

24. We agree that the five examples in paragraph 4.2 correctly identify situations where a disincorporation relief may be commercially desirable.

25. Partial disincorporation is a further example (see answer to Q4 above).

**Q7 Should investment companies, including property investment companies, be excluded from any disincorporation relief?**

26. No.

27. While we understand why it could be appropriate to exclude them, it would be harsh if a business that was winding down, and so became an investment company, was excluded from reliefs benefitting a business that disincorporated before it was finally 'dead'. However, the purpose behind any disincorporation relief would usually be to encourage ongoing businesses to operate in the most efficient and effective way.

**Q8 What would be the best way to define the size and type of companies that should benefit from a possible disincorporation relief?**

28. We recommend keeping the matter as simple as possible so if it is deemed necessary to impose a size limit, using existing size criteria rather than introducing new definitions would be best. If a threshold is required, the EU Micro business definition seems appropriate.

29. However, we note that the current reliefs for incorporation are not limited by size criteria, and therefore wonder why disincorporation relief should be restricted. The principles should be applied consistently.

### **What might a disincorporation relief look like?**

**Q9 What are people's views on the suggestions we have put forward for a narrow and wide form of disincorporation relief? Are there any other suggestions for a relatively simple form of relief?**

30. Similar reliefs to those available on incorporation should be available for disincorporation, for example, rollover and holdover reliefs.

31. Full relief for tax trading losses should be available both on incorporation and on disincorporation, provided that the same business is continuing, possibly subject to a 'change in control' anti-avoidance test.
32. We note that it is not proposed that there should be any carry forward for capital losses. In our view, capital losses could be allowed if a 'used for the purposes of the business test' could be devised, possibly restricted to the categories used for company rollover relief.

**Q10 Does the “narrow form” of relief successfully address the main tax barrier to disincorporation?**

**Are there any simpler ways in which a narrow form of relief could be designed to tackle the capital gains tax barriers to disincorporation?**

33. The 'narrow form' of relief successfully addresses one of the main tax barriers to disincorporation, but there are other tax barriers.
34. We do not see any simpler way in which a narrow form of relief could be designed to tackle the capital gains tax barriers to disincorporation.

**Q11 Is there evidence that any of the further tax issues listed, outside the narrow and wider options for relief, are preventing companies from disincorporating?**

35. Probably not, but if losses truly relate to expenditure incurred in the course of the business, we can see no reason for denying relief simply because the business is to be undertaken in a different form. There would be a similar rationale for allowing capital losses to be preserved.

**Q12 Would the “wider” relief be open to abuse? If so, how? Would a bona fide commercial test be sufficient to protect the revenue? Would the protection need to go further, such as the chargeable payments rules in the demerger relief?**

**Would a disincorporation relief be a simplification?**

36. A purposive test would be useful to prevent flagrant abuses. The bona fide commercial purpose test is of course widely used in legislation.
37. Perhaps a clearance procedure could be introduced or the relief could be mandatory provided certain factors applied, for example, all assets transferred, with company law protection for creditors.
38. A disincorporation relief could be seen as a simplification because it would avoid the creation of artificial structures designed to avoid the tax charges imposed at present. However, the proposal for disincorporation relief around the disincorporation event is not in itself simplifying the tax code.

**Q13 Do you have any comments on the balance of simplification (of business structures) against the added complexity of further legislation?**

39. Disincorporation relief will make it easier for businesses to restructure if they want to. There are fewer legal requirements and less paperwork for a small business trading as an unincorporated entity.
40. More tax revenue should be generated by allowing businesses to operate in the most efficient and effective way possible.

41. Providing that the anti-avoidance provisions are reasonable, there is a balance to be struck between any short-term loss and long-term benefits to the Exchequer.

**Q14 Could a disincorporation relief be written simply – perhaps just the “narrow” option presented.**

42. The narrow option is a good starting point, but consideration should be given to taking this further so that it is attractive to more businesses.

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## APPENDIX

### THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see [http://www.icaew.com/~media/Files/Technical/Tax/Tax%20news/TaxGuides/taxguide\\_towards-a-better-tax-system.ashx](http://www.icaew.com/~media/Files/Technical/Tax/Tax%20news/TaxGuides/taxguide_towards-a-better-tax-system.ashx))