



### **Sole Enterprise Protected Assets Discussion Paper**

ICAEW welcomes the opportunity to comment on the *Sole Enterprise Protected Assets Discussion Paper* published by Office of Tax Simplification on 18 July 2016, a copy of which is available from [this link](#).

This ICAEW response of 12 September 2016 reflects consultation with the Business Law Committee which includes representatives from public practice and the business community. The Committee is responsible for ICAEW policy on business law issues and related submissions to legislators, regulators and other external bodies.

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## MAJOR POINTS

1. The proposal involves changes to the liability regime for business rather than to taxation, although there may, of course, be tax implications if use of companies is reduced as a result. Our response therefore focuses on general business and legal issues rather than taxation as such.
2. We can see that it may be inefficient for individuals to be required to incorporate limited liability companies simply to have the benefit of limited liability. In principle, therefore, we welcome government initiatives to consider alternative forms of business.
3. However, we believe that the SEPA itself could give rise to many practical difficulties, some of which have been noted in the proposal itself, and that the form would most likely be used only by a relatively small number of businesses. It is difficult to see that it will transform the business environment in a radical way in the long term. In the short term, it risks simply adding another option and, therefore, complication, for small business. We do not, therefore, believe that the proposal should be pursued in this form, particularly at a time when business is having to deal with many practical issues such as digital tax reporting.

## RESPONSES TO SPECIFIC QUESTIONS

### Why SEPA?

**Q1: 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?**

4. We do not believe that the SEPA model would be sufficiently attractive to cause existing incorporated businesses to un-incorporate. Some sole proprietors might in future use the form in preference to incorporation, but it seems unlikely that the limited protection would of itself promote enterprise in the sense of resulting in more people operating businesses than would otherwise be the case. A large number of practical issues would arise that have not been explored fully in the paper and we believe these would ultimately make a SEPA regime more complicated than might appear to be the case from the consultation paper. We do not, therefore, think that the proposal would justify the work involved by Government in creating it and additional complexity (with resultant costs to business) that would result.
5. The proposal focuses on protection of the primary residence and our subsequent responses generally assume that this will be the only protected asset. However, we do not believe that this is the best basis for a business protection regime, for a variety of reasons, including:
  - It can be expected to have a distorting effect, whereby SEPAs may artificially maximise the amount of their assets invested in the primary residence (however defined) and minimise the amount of debt secured against it.
  - It fails to level the playing field between businesses of individuals and those of companies, because a limited liability company provides protection for all assets of the shareholders (absent personal guarantees or the like, on which we comment below).
  - It protects the relatively wealthy who can afford a primary residence while doing nothing for the less fortunate although they may be equally as entrepreneurial, legitimately concerned about protecting what personal assets they do have and relatively most disadvantaged by the costs involved in incorporating limited liability companies.
6. For many individuals, pension savings will constitute material assets of a similar level of importance to their primary residence. Apart from ease of implementation, it is not readily apparent to us why assets such as these, designed for the long term well-being of individuals and their families should not be protected, when the primary residence is protected. The same thing might be said of ISAs and other savings; it would be difficult to know where to draw the

line. We are not, therefore, suggesting that SEPA should include pension savings, indeed the same sort of concerns would arise if pension assets were protected as outlined above in respect of the primary residence; if the proposal is to be taken forward it may well be sensible to restrict the protected assets to the primary residence in the interests of simplicity. However, this is another consideration that brings into question whether the SEPA proposal is worth pursuing at all.

7. The proposal asks about the distinction between business and personal assets and liabilities. This is a potentially wide ranging issue and we suggest that further consideration would be required regarding the potential impact of the protection regime on different types of creditor and how those dealing with a SEPA could know how they are impacted. There do not appear to be any controls to restrict a SEPA from increasing the value of the protected assets at the expense of creditors who may be relying upon recourse against the unprotected assets. This is in contrast to the position for limited liability companies, where the company's separate legal personality and accounting requirements give a degree of certainty regarding assets available to creditors who have contracted on a limited liability basis, transparency through accounting requirements and protection regarding moving assets out of the company (eg controls on distributions).
8. A key issue is whether or not security interests will continue to be valid and whether or not SEPAs may agree to allow recourse against assets that would otherwise be protected. The paper suggests that SEPAs will be able to grant effective mortgages over their primary residence in relation to their business liabilities. We assume that they will also be able to give 'personal' guarantees against which there would ultimately be recourse against the primary residence. As owners of small companies are frequently asked to provide personal guarantees and security by their funders, the same is likely to apply to SEPAs. This means that, in practice, the protected assets will not, in fact, be protected in many cases. If recourse were not to be permitted, many SEPAs might find it difficult to obtain funding, at least through traditional means.
9. In many cases when a business becomes insolvent, HMRC is the largest creditor. It will be important to make it clear whether or not the protected assets are protected against tax claims (ie whether or not they would be characterised as 'business' liabilities). The paper suggests that 'tools of the trade' are already protected assets, but it appears from [HMRC's tax manual](#) that there are cases where HMRC would seek to seize such goods where there are insufficient other goods to seize.
10. The limited liability form is so common that some businesses are uncomfortable dealing with businesses that have adopted other forms. It should not be supposed that the SEPA form will be widely understood or universally accepted by those with whom a SEPA deals, which may, again, limit the take-up of this form of business if it is introduced.

**Q2: Do you agree that only the primary residence should be protected?**

11. If particular assets are to be protected, then it is likely to be simplest to limit the assets to the primary residence. However, we do not believe a regime protecting only the primary residence should be introduced including for the reasons outlined above. Even a regime limited to primary residence is likely to give rise to the need for further regulation (for instance, defining what is meant by primary residence and on how changes in primary residence would be accommodated).

**Q3: 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?**

12. No, the risk of abuse exists irrespective of the absolute value of any property. Caps of this kind inevitably lead to their own complications and distorting behaviours and are often indicative of an inherent weakness in the underlying strategy, as we think would be the case in this context

(the lifetime allowance for pensions savings being perhaps another illustration of the complications, if nothing else). Most obviously, house prices vary enormously according to region, so that unless the cap is set at a level reflecting the highest cost areas, it will impact those in high cost areas most. In any case, if the objective is to enable a SEPA to take business risk without fear of having to sell the primary residence, the monetary value of the residence would be a largely academic issue.

### **Becoming a SEPA**

**Q4: Are these qualifications and restrictions 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?**

13. If the SEPA proposal is to be taken forward, we agree that restrictions of this kind are appropriate.

**Q5: Is there any other information that should be required for SEPA registration?**

14. We agree that any registration requirements should be 'light touch' otherwise the objective of providing a simpler and cheaper alternative to incorporating a limited liability company will not be met.

15. While the information specified in the proposal may appear innocuous it is not clear why it would serve 'consumer protection purposes' as suggested in the paper. Indeed, it is unclear how persons dealing with SEPA's will have any protection at all, given that they will not know what the value of the protected assets may be or whether assets that might otherwise have been available to business creditors have been channelled into protected assets, for instance, by paying off mortgage debts secured on the primary residence.

16. It would, of course, be possible to introduce more transparency by, for instance, requiring the primary residence to be identified on registration and, possibly, the amount of any security granted over it. However, this would increase the administrative work involved and, potentially, raise concerns regarding privacy. The more disclosure requirements of this kind that are required, the less likely it is that the SEPA form would be used in preference to limited liability companies.

### **Some wider SEPA formalities and procedures**

**Q6: Are there any other formalities and procedures that would have to be considered?**

17. If a light touch is to be maintained, it will be important that all issues that might lead to calls for regulation are considered. For instance, will SEPA's need to declare any 'persons of significant control' behind them, as is the case of UK companies?

18. The requirement to include a SIC code seems to be unduly onerous as individuals may change their activities frequently if they wish. In some cases, no single SIC code describes the business activity involved resulting in use of the 'other' code. What is this requirement intended to achieve?

### **Evaluating SEPA**

**Q7: Are there any other negative impacts that we need to consider?**

19. We think it likely that other negative impacts of the SEPA would become clearer if and when the proposals are developed in more detail so that, if government does decide to pursue this proposal further, it would be helpful for further consultations to be undertaken.

**Q8: What is your evaluation of the SEPA concept? Will it be a useful addition to the UK business landscape and encourage enterprise?**

20. We agree that legal forms of business are a fundamental part of the business landscape and that Government should provide good alternatives to enable business to flourish. It appears that individuals are increasingly setting up businesses on their own, both as sole proprietors and through limited liability companies and the sort of issues raised in the proposal are worth exploring further. However, we think that the SEPA proposal in itself will have limited impact and risks creating yet another choice for business with the added complications and related costs that entails, so that a SEPA will not, ultimately, be sufficiently useful to justify adopting this proposal.