

Dear Paul

## Office of Tax Simplification focus paper “Disincorporation relief – what of the future?”

The Association of Accounting Technicians (AAT) welcomes the opportunity to respond to the Office of Tax Simplification (OTS) focus paper “Disincorporation relief – what of the future?”

AAT supports the OTS in its aim to draw attention “...to the potential for this relief to fall by the wayside unless action is taken, and to stimulate debate about whether it is achieving its purpose.” Furthermore, AAT supports any appropriate actions to reduce the administrative burden on business, especially SMEs.

In recognising that the published paper is not a consultation document, it is hoped that AAT’s response will help to ensure that entrepreneurs, who had been able to make use of holdover reliefs at the time of incorporation to avoid triggering a tax charge that would have impacted on their ability to trade, be afforded a similar measure of relief on exit.

It would seem reasonable for similar reliefs to be available to close companies<sup>1</sup> and their owners, where the correct trading vehicle is no longer a limited company and it will continue trading post disincorporation.

### Challenges created by current disincorporation relief

Disincorporation relief currently allows transfers of interests in land and goodwill to be made at cost or written down value (unless the market value is lower) without a company experiencing a capital charge. Charges arising on shareholders are unrelieved. This situation leads to the owners of a close company facing an asymmetrical tax position at the time of disincorporation compared to the time of incorporation. Furthermore, the availability of the relief is limited to businesses with qualifying assets valued at less than £100,000 at the time of the transfer. When applying a goodwill valuation of three times net profit it removes all but the smallest of business from being within the scope of the relief.

A joint OTS/AAT focus group meeting<sup>2</sup> indicated there was a general lack of awareness of the relief’s existence. These initial findings were supported by a subsequent small scale survey of AAT licensed accountants, which found that well over half (58%) were unaware that it existed.

### Less favourable for smaller entities to remain incorporated

A narrow form of disincorporation relief as originally suggested by the OTS in section 5 of the recent focus paper<sup>3</sup> would largely address concerns with the relief i.e. that “...some small businesses who have opted to become a limited company in the past may now feel ‘trapped’ in a more onerous tax regime for companies and could benefit from moving to a simpler legal form.”<sup>4</sup>

Many businesses incorporated in 2002 to make legitimate use of the £10,000 starting rate band (corporation tax), taxed at 0%, as a good way of maximising the working capital that could be retained. Since then, there has been a systematic erosion of the tax benefits accruing to company owner managers. The most significant of these policy changes has been the introduction of the dividend allowance at the start of the 2016/17 tax year.

AAT does not seek to comment upon the appropriateness of successive Chancellors’ tax policies, other than to observe; government policy in 2002 encouraged owners of small businesses to incorporate and in doing so to be able to claim holdover reliefs to negate a charge to tax.

It would seem reasonable that at a time when government policy is making it significantly less attractive to remain incorporated, that similar exit reliefs should be made available on disincorporation.

<sup>1</sup> s.439 of the Corporation Tax Act 2010

<sup>2</sup> Held on 5 July 2017 at AAT’s head office

<sup>3</sup> OTS Small Business Tax Review: Final report – Disincorporation relief Published 2 February 2012

<sup>4</sup> Page 1, OTS focus paper “Disincorporation relief – what of the future?”

## The impact of changes in the taxation of dividends

2016/17 tax year saw the introduction of the dividend allowance resulting in maximum tax savings of circa £2,600 for owner managers trading via a company structure with a taxable profit of £60K and only £300 for a taxable profit of £25,000. These savings are set to fall further from 2018/19 if the mooted reduction in the dividend allowance from its current £5,000 ceiling to £2,000 comes into force.

Even with the dividend allowance as it stands, the minor tax savings achievable at the lower end of the taxable profit scale are outweighed by the cost of the additional compliance burden born by companies. Should the dividend allowance be reduced, the meagre tax savings for owner managers of close companies would disappear altogether.

On one hand HM Treasury would like to stop tax motivated incorporations, but on the other it is perfectly happy to leave those who no longer find the corporate wrapper attractive trapped within one.

This is further evidenced by the findings an OTS/HMRC survey undertaken in 2012 by the Futures Company, which reported that 14% of companies surveyed would prefer to operate as unincorporated<sup>5</sup>.

AAT supports the 2012<sup>6</sup> OTS proposal to “...enable a company holding internally generated goodwill, plus land and buildings and machinery and plant used wholly for the trade, to pass to an unincorporated structure, with no tax charge arising on the company, and no distribution charge on the shareholders, as a result of the transfer of those assets.”

HM Treasury may have had concerns about the number of companies who might have tried to make use of the above OTS proposal but AAT does not share these. AAT would only expect the enhanced reliefs to be available where exit from the corporate shell is for genuinely commercial reasons and in instances where a business is to continue trading.

One possible way to address HMT’s concerns about numbers, and at the same time broaden the appeal of disincorporation relief, would be to replace the 2013 legislation with OTS’s 2012 proposition, but using the companies act micro-entities definition.

The definition of a micro-entity is contained in sections 384A and 384B of the Companies Act 2006. The qualifying conditions are met by a company in a year in which it does not exceed two or more of the following criteria:

- (a) Turnover £630,000
- (b) Balance sheet total £316,000
- (c) Number of employees 10 or fewer.

As a means of addressing any residual concerns HMT might have over the introduction of a bolder form of relief, or to facilitate its removal due to a continued lack of take up, a revised 5-year sunset-clause could be inserted into the revised legislation.

## Conclusion

OTS is right to draw attention to the potential loss of what is a very important relief.

The very low take-up of the existing relief is because it is 1) set at too low a level – as stated above, even applying a goodwill valuation of three times to a modest net profit removes all but the smallest of business from the scope of the relief and 2) most are unaware it exists - an enhanced relief would attract advocates such as tax-writers and lecturers which in turn would raise awareness throughout the tax profession. Raised awareness would drive take-up.

Ultimately, disincorporation relief could enable many micro-entities, encouraged into a corporate shell during more favourable times, to transition back to a less administratively burdensome environment as currently occupied by the self-employed.

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<sup>5</sup> OTS Small Business Tax Review: Final report – Disincorporation relief Published 2 February 2012

<sup>6</sup> 5.1 of OTS Small Business Tax Review: Final report – Disincorporation relief

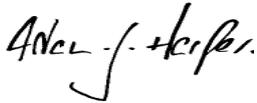
## About AAT

AAT is a professional accountancy body with approximately 50,000 full and fellow members and over 90,000 student and affiliate members worldwide. Of the full and fellow members, there are over 4,250 licensed accountants who provide accountancy and taxation services to individuals, not-for-profit organisations and the full range of business types.

AAT is a registered charity whose objectives are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

Please do not hesitate to contact me should you have any queries or require any further information.

Yours sincerely,



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