OTS focus paper on disincorporation relief: CIOT and ATT responses

General Features **OMB**

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The CIOT and ATT agree with the OTS that the time is right to address whether disincorporation relief is achieving its purpose and to investigate what, if anything, can be done to make it more useful and more effective if it continues.

Members will be aware that disincorporation relief was intended to help address the problems faced by some small businesses that had chosen to become a limited company in the past and may have wanted to return to a simpler legal form.

The relief allows transfers of interests in land and goodwill to be made at cost or written down value (unless the market value is lower), so that no gain is chargeable on the company. However, the tax charges on the shareholders are unrelieved. The relief is limited to businesses with qualifying assets (goodwill or interests in land) valued at less than £100,000 at the time of the transfer. The legislation in Finance Act 2013 contains a ‘sunset clause’, meaning that if no action is taken the relief will automatically cease to apply from 1 April 2018.

There has been a very low take up of the relief since it was introduced. Indeed, the OTS paper reveals that fewer than 50 claims had been made as of March 2016.

Feedback from members generally has been that they have not considered using disincorporation relief for corporate clients which might be contemplating disincorporation, and one of the main reasons is because the threshold is too low, especially given the rise in property values over the last decade. In the view of a number of advisers, the relief also does not go far enough in relieving tax charges. Incorporation can be undertaken with no tax burden, but tax charges remain on disincorporation in respect of the individual shareholders.

In their response the CIOT recognise that there will be revenue and avoidance issues in determining how generous a relief it should be, but it may be that a more generous relief with some anti-avoidance provisions might play a sensible part in a more rational overall system which tries to reverse the current tax incentive to incorporate.

Rather than letting the relief lapse, we should search for a solution that fits into an overall government strategy for the taxation of small businesses, one that addresses the differences between the taxation of different types of income, and between incorporated and unincorporated businesses, particularly seen in the context of potential increases to dividend tax rates in the future which could see interest in disincorporation relief increase.

The CIOT suggest that the government could consider the option of a deferral of tax liabilities as opposed to full relief, which would minimise any eventual revenue loss to the Exchequer.

Finally, the CIOT also note that the targeted anti-avoidance rule (TAAR) in Finance Act 2016 section 35 has created a great deal of uncertainty over the tax treatment of distributions in liquidation, particularly where the taxpayer is carrying on in the same sort of business, as would be the case where they disincorporate in order to continue in business as a sole trader or partnership. They echo the OTS's plea that clarification is needed that a straightforward disincorporation would not fall within the TAAR.

The full text of the CIOT response can be found on the CIOT website.

In their response the ATT stress that the original policy rationale behind disincorporation relief – that tax charges should not act as a barrier to proposed changes in the structure of a business – is still valid today. If anything, recent and proposed legislative changes (including changes to the taxation of dividends and personal service companies) mean there may be more small companies looking to disincorporate in the future, not less. The ATT therefore believe that a disincorporation relief in some form should be retained beyond 1 April 2018 as a relief whose time has not yet come.

The ATT note that the current £100,000 limit creates a cliff edge based solely on asset values, with no consideration given to the underlying gains relieved. For example, a company with no land and buildings, but internally generated goodwill of

£100,000, can have a gain of £100,000 exempted. By contrast a company with qualifying assets worth £101,000 will receive no relief at all even if the potential gain is much lower.

The ATT suggest that this cliff edge effect could be avoided by replacing the current limit with an alternative qualifying condition based on the amount of gains and not solely asset values.

The full text of the ATT response can be found on the ATT website.