

DISINCORPORATION: DOES IT MAKE SENSE FOR YOU?

At one time, incorporating a business once profits reached a modest level was almost the default advice. Today, the conversation is more nuanced, and some existing company owners may even be asking themselves, “Do I still need a limited company?”

This question may be prompted by rising tax bills, driven by reductions in the dividend allowance and increases in dividend tax rates. In some cases, it may now be more tax-efficient to trade as a sole trader rather than through a limited company. However, tax is only one part of the picture.

This article explores some of the key factors involved in disincorporating a business, helping you decide whether it is something you should consider.

Loss of limited liability

A limited company is a separate legal entity. While this does not remove all risks, it does provide a layer of protection between the business and your personal assets.

As a sole trader, that protection no longer exists. This means that if something goes wrong, you could be personally liable.

For some businesses, this risk is low and can be adequately insured against. For others, limited liability remains a compelling reason to stay incorporated, even if the tax savings are minimal.

What happens to the company’s assets?

Because a company has a separate legal identity, disincorporation involves transferring assets from the company to the shareholders personally. This becomes particularly important where property or goodwill is involved. The transfer is usually treated as taking place at market value, meaning corporation tax may be payable, even if no money changes hands. This is a key reason why disincorporation requires careful planning rather than a quick decision.

What about VAT?

Ordinarily, when a VAT-registered business sells an asset, the sale is subject to VAT. However, in many cases, transferring a business from a company to an individual can qualify as a transfer of a going concern. If the relevant conditions are met, VAT will not be charged.

Ensuring those conditions are satisfied is essential to avoid unexpected issues and potentially significant VAT costs



DISINCORPORATION: DOES IT MAKE SENSE FOR YOU?

How is the company closed?

In addition to transferring the trade out of the company, the company itself must also be closed.

In some cases, a members' voluntary liquidation may be the most appropriate route. This can be relatively costly and requires the involvement of an insolvency practitioner.

For smaller companies, a voluntary strike-off may be sufficient. This is typically a simpler and more cost-effective option.

The chosen method of closure will also affect how any reserves or retained profits distributed to shareholders are taxed.

Ongoing tax position after disincorporation

As a sole trader or partner, profits are taxed as they arise. In other words, there is no flexibility to time when income is drawn from the business, nor to retain profits at a lower tax rate while the business grows.

Some individuals may find the cash flow impact of these tax payments challenging, particularly due to the payments on account system that applies to sole traders and partnerships.

Commercial and practical considerations

Aside from tax, disincorporation can affect:

- Contracts held in the company's name
- Banking arrangements and finance agreements
- Professional registrations and insurance policies
- How the business is perceived by customers and suppliers

Is disincorporation right for you?

As you can see, disincorporation is not simply the reverse of incorporation. The tax system generally makes it easier to move into a company than to come back out.

If you are considering disincorporation, it is important to take the time to review both the financial implications and the practical steps involved.

If you would like personalised advice on whether disincorporation could benefit you, please feel free to get in touch. We would be happy to guide you through both the numbers and the process.