APPENDIX B

DETAILED PROPOSALS - Creating a level playing field for equity and debt

i. Tax relief for the costs of raising equity

There is a specific entitlement to claim a tax deduction for costs incurred in raising debt finance, whereas the costs of raising finance through the issue of equity is not tax deductible. This represents an unnecessary and pronounced distortion in the tax system, which has been referenced in the recent Mirrlees Review[1] [any other updated review?] and raised in a number of debates surrounding the causes and consequences of the financial crisis.

Raising debt is failing small and mid-size companies – we need to shift the focus to long-term, permanent capital – equity finance. A tax relief for the costs of raising equity will level the playing field between debt and equity finance and encourage more companies to raise public equity.

[Add data on costs/ calculations IPO & Secondary:

- Detailed list of all costs (listing and ongoing) / distinguish between direct expenses and ongoing expenses / which expenses should be excluded from the measure: would the measure more appropriately apply to ongoing listing costs (e.g. annual listing fees), or just costs arising from the issuance event? There are various types of listing costs (underwriting fees, professional advisers' fees, direct listing costs, marketing costs, PR etc.). Which of these – if any – do you think should be excluded from the scope of the measure?

- Analyse how significant is the risk that the measure would lead to higher fees in the markets for advice, underwriting, etc.. (HM Treasury is concerned that banks, for example, would raise their fees as a creeping economic effect over time.)]

- Check if the table below can be updated (data from Oct. 2008):

Costs of Listing in the UK - AIM and PLUS Market				
AIM				
Costs of Floating			Costs of Maintaining a Listing	
Accounting	£90,000 - £150,000		**PR and IR**	
Legal	£100,000 - £200,000		Financial PR	£43,000
Corporate Finance	£100,000 - £200,000		Broker (including analyst research)	£20,000
Broker's Commission	5 - 7% of funds raised		IR Press Cutting Service	£5,400
Printing	£10,000		Website Service	£3,600
Registrars	£5,000 - $10,000		RNS	£2,000
AIM Admission Fees	£5,870 - £66,250	*Varies depending on market cap	Analysis of Share Registrar	£1,500
AIM Annual Fees	£4,750		**Total**	**£75,500**
Public Relations	£10,000 - £20,000			
			Regulatory Costs	
			Nomad	£20,000
			Registrar	£8,500
			Auditors	£5,000
			Annual Report Design	£4,500
			LSE AIM Annual Fee	£4,750
			Share Option Service	£4,500
			Total	**47,250**
PLUS				
Costs of Floating			Costs of Maintaining a Listing	
Corporate Adviser	£50,000 - £100,000		Annual Fees for Corporate Adviser	£25,000
Lawyers to the company	£50,000 - £100,000			
Broker's Commission	5-8% of funds raised			
Reporting Accountants	£25,000 - £75,000			
Lawyers to the placing	£10,000 - £25,000			
Incidental Costs	£5,000 - £10,000			
PLUS Admission Fees	£6,000 - £25,000	* Varies depending on market cap		
PLUS Markets Annual Fees	£4,900 - £10,000			

[1] The Mirrlees Review – Reforming the tax system for the 21st century, *Tax by Design* (September 2011), available at: http://www.ifs.org.uk/mirrleesReview

For a smaller company, the costs of raising equity represents a disproportionately large percentage of funds being raised and is, therefore, a major disincentive to seeking a listing on a public equity market.

The UK is at a competitive disadvantage compared to other European regimes, such as Austria, Belgium, Bulgaria, France, Germany, Greece, Hungary, Italy, the Netherlands, Luxembourg, Poland, Portugal, Russia, Serbia, Spain, Switzerland and the Ukraine, which provide some form of corporation tax relief for raising equity finance. We have included our analysis of this in Table 2 below.

Also, recent VAT case law [insert references] confirms that VAT costs of raising equity funding are deductible on input tax, if the company's activities are taxable. Hence, there is currently inconsistency between direct and indirect tax in terms of the ways of raising equity finance.

[Add data on how much this measure would cost the Exchequer with the chosen (500k?) relief threshold and why/calculations]

Table 2 – Comparison of European states' regimes for tax relief for the costs of raising equity [check if analysis is still up-to-date and if something should be added or deleted]

Country	**Is there any corporate tax relief for flotation costs?**	**Are the costs of issuing new equity generally deductible for corporation tax purposes?**
United Kingdom	No	No
Austria	Yes Flotation costs are generally deductible for corporate tax purposes without any restrictions (cf. sec. 11 (1) (1) of the Austrian Corporate Income Tax Act).	Yes The costs of issuing new equity are generally deductible for corporate tax purposes without any restrictions (cf. sec. 11 (1) (1) of the Austrian Corporate Income Tax Act).
Belgium	Yes Flotation costs and, more generally, restructuring costs can be tax deductible if incurred to develop taxable income.	Yes In order to align the tax treatment of equity financing on the one hand and debt financing on the other, Belgium legislation provides for a notional interest deduction ("Déduction pour capital à risque" – "Aftrek risicokapitaal"). A fictitious interest calculated on the "net equity" of companies or branches can be deducted for their cost of capital. The notional interest is calculated as risk-free interest with reference to 10 year government bonds. The rate to apply in tax year 2014 (income 2013) is 2.742% for large companies and 3.342% for small companies.

		The "net equity" is determined by adjusting the equity, primarily by deducting the tax book net value of any financial fixed assets that are grouped under "participations and other shares" on the company's balance sheet. There are other deductible items, such as the net equity assigned to foreign permanent establishments or non-Belgian real estate property.
Bulgaria	Yes Flotation costs (i.e. costs incurred by a publicly traded company with regards to issuing new securities) are not subject to a specific tax regime in Bulgaria and are generally deductible for corporate tax purposes.	Yes The costs of issuing new equity should generally be tax deductible for corporate tax purposes.
France	No	Yes The costs of issuing new equity are deductible expenses for the financial year in which the costs are incurred. The taxpayer may also elect to capitalise those costs and amortise them over a maximum period of 5 years. However, such costs are not deductible in specific cases where they are not incurred in the interests of the company, e.g. upon capital reduction followed by a capitalisation of retained earnings (which protects only the interests of shareholders).
Germany	Yes Flotation costs (underwriting fees, management fees, selling concessions, legal fees and registration fees) for primary offerings are deductible as business expenses. The same is true for secondary offerings if they are conducted mainly in the interests of the company (this is usually the case).	Yes In general, all costs of issuing new equity are deductible for corporate tax purposes. Only costs that are directly related to the acquisition of shares by shareholders (e.g. notarisation costs for a takeover agreement, if notarised separately) may be treated as a hidden profit distribution when paid by the company (and

		therefore not subject to relief).
Greece	Yes	Yes
Hungary	Yes	Yes
Italy	Yes Based on Italian accounting principles, flotation costs may generally be capitalised. In this case, they may be depreciated (and deducted) over five fiscal years.	Yes Based on Italian accounting principles, the costs of issuing new equity may generally be capitalised. In this case, they may be depreciated (and deducted) over five fiscal years.
Luxembourg	Yes Flotation costs are tax deductible as general expenses.	Yes The costs of issuing new equity are considered as operating costs. In principle, they are tax deductible for the issuer for corporation tax purposes to the extent they are booked as expenses in the Luxembourg GAAP accounts of the issuer. However, if the new equity finances assets that generate exempt income, the portion of the costs that finances the exempt income is non-tax deductible.
Netherlands	Yes Costs that do not qualify as equity (e.g. management and underwriting commission) are allowable as deductions under Dutch jurisprudence.	Yes Dutch corporate income tax law approves the deductibility of incorporation costs and costs related to the issue of capital.
Poland	No	Yes The law is not clear on the tax deductibility of the costs of issuing new equity. According to the most common interpretation, public and similar costs (such as court fees, administrative charges, stock exchange fees and notary fees) related to the issue of new shares on a stock exchange are not tax deductible. Other costs , such as advisory costs, are tax deductible.
Portugal	Yes	Yes

	Pursuant to Portuguese GAAP, which follows IAS, such costs do not meet the criteria to be treated as intangible assets and therefore should be treated as a cost in the P&L. From a corporate tax perspective, such costs are therefore tax deductible on the basis that they are necessary for the company to run its business.	Any administrative and similar costs incurred are tax deductible on the basis such costs are necessary for the company to run its business.
Russia	Yes Expenses associated with affecting an issue of securities (in particular the preparation of an issue prospectus, the manufacture or acquisition of blank forms and the registration of securities) as well as expenses associated with the servicing of own securities are accounted for as non-sale expenses for Russian tax purposes (Article 265 Item 1 Subitem 3 of Russian Tax Code). The above rule applies only for the issue of securities by the taxpayer. If, however, there are costs for setting up a subsidiary, these costs may become tax deductible only after disposal (retirement) of the subsidiary shares. All expenses recognised for Russian tax purposes should be properly documented and economically justified (Article 252 Item 1).	Yes Expenses associated with affecting an issue of securities (in particular the preparation of an issue prospectus, the manufacture or acquisition of blank forms and the registration of securities) as well as expenses associated with the servicing of own securities are accounted for as non-sale expenses for Russian tax purposes (Article 265 Item 1 Subitem 3 of Russian Tax Code). All expenses recognised for Russian tax purposes should be properly documented and economically justified (Article 252 Item 1).
Serbia	Yes	Yes
Spain	Yes No restrictions on the tax deductibility of flotation costs are established in the Corporate Income Tax ("CIT") Law, as long as they are duly recognised in the P&L.	Yes No restrictions on the tax deductibility of flotation costs are established in the Corporate Income Tax ("CIT") Law, as long as they are duly recognised in the P&L.
Switzerland	Yes The general principles regarding costs of issuing new equity should apply to the tax deductibility of flotation costs. That is, such costs	Yes The costs for incorporation, capital increase and general company organisation can either be capitalised and depreciated

	can either be capitalised and depreciated over five years or booked directly as an expense, in both cases with tax deductible effect provided that the costs are economically justified.	over five years or booked directly as an expense, in both cases with tax deductible effect provided that the costs are economically justified.
Ukraine	No	Yes As there are no direct restrictions in the Tax Code regarding deductibility of the costs of issuing new equity, one may assume that such costs are generally tax deductible. However, the Ukrainian tax authorities may try to challenge deductibility claiming that such costs are not directly related to the issuer's business activity.

Proposals for reform

We believe that all costs in connection with the issue of new shares as part of a public offering (either at IPO or in a secondary fundraising) should be tax deductible. This would help increase the flow of equity funds into the SME sector, which will create jobs and tax revenues within the UK and thereby support the Government's drive to stimulate growth UK economy.

[add arguments why it should be both IPO and secondary offerings; explain rationale behind an issuance, why companies float, why equity is a better solution to debt; add examples on which types of companies would benefit in practice: e.g. data on how many new and further issues are conducted by growing, finance-constrained corporates versus, for example, distressed corporates or investment trust companies]

[define cap/ upper limit: size of equity issuers, or equity amount of all sizes of issues, or hybrid cap; explain why that is the best option; and/or define small and mid-size companies and/or issue size or deductible amount]

[define when deduction starts (e.g. year it was incurred) and how long it spans (e.g. 2/3/4 years); define which would be the best way to bring this measure into effect e.g. tax years, accounting periods, set date in legislation, sunset clause for review…; explain why we think that that is the best option]

[define scenario and solution for failed issuance in connection to tax deduction]

~~The costs to the Treasury could be managed by, for example:~~

- ~~Making the relief subject to an upper limit;~~
- ~~Restricting the relief to those companies considered 'small and mid-size' under an appropriate definition; or~~
- ~~Writing the costs off over a five year period.~~