QUOTED COMPANIES ALLIANCE

Generating growth in quoted companies

Budget 2018: Proposals for taxation reform

September 2018

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An introduction to the Quoted Companies Alliance

We are the independent membership organisation that champions the interests of small and mid-size quoted companies. We campaign, we inform and we interact to help our members keep their businesses ahead. Through our activities, we ensure that our influence creates impact for our members.

Small and mid-size quoted companies tend to have market capitalisations of below £500 million. There are approximately 1,700 small and mid-size quoted companies on the Main List of the London Stock Exchange and quoted on AIM and NEX Exchange, together comprising 79% of all UK quoted companies. The total market capitalisation of the small and mid-size quoted company sector in the UK is £190 billion (as of September 2018).

Our *Tax Expert Group*, supported by our *Share Schemes Expert Group*, has prepared these proposals for taxation reform. A list of Expert Group members can be found in Appendix F.

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Executive Summary

The UK's impending departure from the European Union in a few months' time is set to fundamentally change the structure of its economy. As Britain adjusts to its new economic relationship with its European neighbours, small and mid-size quoted companies need a government that maintains its commitment to support them in generating the growth required to provide economic stability, and to create jobs and wealth. A future taxation system must be formed on three pillars: **competitiveness**, **simplicity** and **certainty**.

I. Competitive

Once the UK has left the European Union in March 2019, it must build a competitive tax regime that both incentivises and enables smaller, growing companies to raise sustainable, long-term capital more cheaply and efficiently. This will be crucial to supporting long-term economic stability and demonstrating that the UK is an attractive place to do business.

We call on the government to:

1. **Follow the 18 European countries which support a level playing field for capital raising by permitting all costs associated with raising equity to be tax deductible** through:
   - Placing a £1.5 million upper limit to target the relief at smaller companies;
   - Enabling the relief to be applied to IPO and secondary fundraisings; and
   - Allowing the tax relief to be available in the year the costs were incurred.

2. **Allow funds to invest in unlisted companies, such as those on AIM and NEX Exchange, which qualify for Business Property Relief,** so that individual investors are able to fully utilise this tax relief, while spreading their investment risk.

3. **Encourage employee share ownership in smaller companies through Company Share Option Plans (CSOPs)** by:
   - Allowing the exercise price to be at a discount or at nil cost, while retaining income tax relief only for any increase over the market value at grant;
   - Removing the three year holding period before options can be exercised with income tax relief;
   - Relax the leaver and other early exercise requirements; and
   - Increase the £30,000 limit.

4. **Permit non-executive directors taking shares as part of their remuneration to pay income tax only after the sale of the shares**.

5. Either **remove the condition that officers and employees of a company must have at least 5% of the voting rights and ordinary share capital to qualify for Capital Gains Tax Entrepreneurs' Relief** *or* **amend the 5% test so that it only needs to be met for a continuous 12 month period during the five year period ending with the date of sale**, as with the Substantial Shareholdings Exemption.

6. **Ensure that Entrepreneurs' Relief applies to the whole gain**, regardless of whether the selling shareholder receives consideration in the form of a cash earn-out, shares or loan notes.
7. **Exempt or zero-rate from VAT any small-cap investment research that has been paid for by an institution to a broker.**

II. Simple

The UK has one of the world's most complex tax systems. New tax legislation continues to add length and complexity to the existing framework. Additional rules raise the cost of compliance for the smallest companies and create a barrier to them building their business and generating growth.

We call on the government to:

1. **Strengthen the Office of Tax Simplification (OTS) by:**
   - Increasing its resources so that it can play a more active role in assessing the impact of government policy on the simplicity of the taxation system.
   - Establishing a formal relationship between the OTS and Parliament (perhaps through a Committee), so that Parliament is able to better scrutinise the formulation and implementation of tax policy.
   - Review how the OTS could support tax policy formulation to ensure that simplification is at the heart of the policymaking process.
2. **Introduce a Tax Gateway which would allow small and mid-size quoted groups with a turnover of less than £200 million to be exempt from certain, burdensome reporting requirements.**
3. **Increase the Small Companies Enterprise Centre's resources to reduce the complexity and improve timescales when using Enterprise Investment Schemes and Venture Capital Trusts.**
4. **Allow agents to register and de-register companies' employee share plans.**
5. **Remove the requirement to obtain HMRC approval of the form of joint NIC elections used for employee share schemes.**
6. **Introduce new rules to allow UK persons to make interest payments gross or at treaty rates where the person reasonably believes, at the time the payment is made, that the payee is entitled to relief in respect of the payment under double taxation arrangements.**
7. **Extend degrouping charge reform to provisions relating to the intangible fixed assets, loan relationships and derivative contracts regimes.**

III. Certain

For small and mid-size quoted companies to effectively plan for their future development with confidence, they require a tax system underpinned by certainty. This will give companies the confidence to make long-term investment decisions which will help drive sustained economic growth.

We call on the government to:

1. **Introduce a bespoke binding ruling process that can consider queries on all aspects of UK tax law.**
2. **Confirm that medium-sized groups are not required to compile contemporaneous evidence to support transfer pricing policies, unless they wish to do so (if no Tax Gateway is introduced).**

I. Creating a competitive tax system

Exiting the European Union will present the UK with unprecedented economic challenges and, potentially, opportunities. No longer being a member of either the Single Market or the Customs Union will mean that the government will have to fully maximise the effectiveness of the fiscal levers at its disposal to ensure that any subsequent economic turbulence which may occur is temporary and minimal.

Indeed, we note the government's industrial strategy seeks to support a strong economy and deliver long-term productivity growth. Expanding the portfolio of sustainable, long-term funding options available to companies looking to grow is therefore essential to increasing the UK's ability to boosting its economic competitiveness post-Brexit.

The government must build a fiscal framework that rewards long-term thinking; only targeted and decisive action promoting entrepreneurial activity will support Britain's strong economic foundation in the years ahead. Below, we set out our proposals that will allow smaller, growing companies to obtain the funding they need to grow.

A. Levelling the playing field between debt and equity

There is a distinct need to address the preferential treatment of debt over equity as a source of finance for smaller, growing companies. Companies can currently claim tax relief for costs incurred when raising debt finance, but are unable to do the same for equity.

Furthermore, since April 2017, a new corporate interest restriction (CIR) regime disallows interest-like expenses to the extent that the net tax-interest expense for UK companies exceeds the interest capacity[1]. VAT case law[2] has also confirmed that VAT on the costs of raising equity funding is deductible on input tax, if the company's activities are taxable. Hence, there is currently an inconsistency between direct and indirect taxation. This explicit distortion in the tax system makes its much more costly for smaller companies to raise the permanent capital they need to facilitate their growth.

Recent research by Link Asset Services illustrates that the debt of listed UK companies has risen to a record £390.7 billion[3] after nearly a decade of ultra-low interest rates. Any changes in the UK's economic fortunes could mean a significant number of companies facing serious financial pressures, which will substantially impact their ability to create jobs.

A clear international consensus has emerged, which supports the view that an imbalance in the tax treatment of debt and equity contributes to economic instability and hinders economic growth:

– **The OECD** has found that "in most OECD countries more debt is typically associated with slower growth while more stock market financing generates a positive growth effect. Furthermore, recent OECD work[4]

[1] The interest capacity is based on a percentage of tax-EBITDA (earnings before interest, tax, depreciation and amortisation) or, if lower, a modified debt cap limit, but is always at least £2 million. The percentage to be used is derived from either the fixed ratio method or, by election, the group ratio method.

[2] See Kretztechnik AG v Finanzamt Linz, CJEC case C-465/03 (2005).

[3] UK plc Debt Monitor (July 2018): https://www.linkassetservices.com/file.axd?pointerid=5b3a1ace8bcbe7006810403b

[4] Ahrend, R. and A. Goujard (2012), "International Capital Mobility and Financial Fragility - Part 1. Drivers of Systemic Banking Crises: The Role of Bank-Balance-Sheet Contagion and Financial Account Structure", OECD Economics Department Working Papers, No. 902, OECD Publishing, Paris. http://dx.doi.org/10.1787/5kg3k8ksgglw-en

(Ahrend and Goujard, 2012) found that corporate tax systems which favour debt over equity are associated with a higher share of debt in external financing, thereby increasing financial crisis risks. The economic literature and earlier OECD work identified that the debt bias in corporate taxation generates costly economic distortions (De Mooij, 2012; Devereux et al., 2013; OECD, 2007). These findings all underline the growth benefits of reducing the debt bias in corporate taxation. Effective average tax rates on equity finance generally exceed those on debt finance, primarily because interest expenses are cost-deductible."[5]

- **The IMF's analysis** has also shown that "the risks to macroeconomic stability posed by excessive private leverage are significantly amplified by tax distortions. 'Debt bias' (tax provisions favouring finance by debt rather than equity) is now widely recognized as posing a stability risk." It found that excessive private sector debt can "increase the probability of a firm's bankruptcy in case of an adverse shock and amplify liquidity constraints after a shock". It pointed to the fact that, during the 2008 financial crisis, firms which held more debt where more susceptible to declines in employment than those who were not.[6]

Similarly, TheCityUK and King & Wood Mallesons review of the European listings regime indicated that making equity issuance costs deductible for corporation tax purposes would promote greater long term stability and incentivise greater use of capital markets.[7]

In its Capital Markets Union Action Plan[8], the European Commission stated its commitment to addressing the preferential tax treatment of debt in an effort to encourage more equity investments and increase financial stability in the European Union.

It is therefore apparent that reliance on debt finance is not a long-term solution for small and mid-size companies. The UK government should both eliminate the debt bias and incentivise equity finance as a source of long-term, patient capital.

It could do this in two ways:

1. Provide tax relief for the costs of raising equity.

Eighteen other European countries (including 13 member states of the European Union) provide tax relief for the costs of raising equity. If the UK were to do the same, it would encourage a greater number of smaller companies to consider using public equity markets to finance their growth and development. Fully leveraging the true potential of capital markets will ensure that small and mid-size quoted companies – which play a crucial role in the UK economy – are able to raise capital more cheaply and efficiently in a way that will generate employment and wealth, drive sustainable economic growth and support wider financial stability.

[5] Cournède, B., O. Denk and P. Hoeller (2015), "Finance and Inclusive Growth", *OECD Economic Policy Papers*, No. 14, OECD Publishing, Paris

[6] 'Tax Policy, Leverage and Macroeconomic Stability', the IMF (2016), available at: http://www.imf.org/en/Publications/Policy-Papers/Issues/2016/12/31/Tax-Policy-Leverage-and-Macroeconomic-Stability-PP5073

[7] Capital Markets for Growing Companies – A review of the European listings regime, TheCityUK, King & Wood Mallesons, available at: https://www.thecityuk.com/assets/2015/Reports-PDF/ELR-Capital-Markets-for-Growing-Companies.pdf

[8] European Commission Action Plan on Building a Capital Markets Union, available at: http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf

For a small and mid-size company, the costs of raising equity represent a disproportionately large percentage of funds being raised and are, therefore, a major disincentive to seeking a listing on a public equity market. The UK is at a competitive disadvantage compared to many other European regimes (outlined in Appendix A), which provide some form of corporation tax relief for raising equity finance.

Providing tax relief for equity raising costs should be composed of the following elements:

(i) Introduce a £1.5 million upper limit in order to target the relief appropriately to SMEs

Placing a limit of £1.5 million on the costs incurred by a company for raising equity finance which would be eligible for corporate tax relief would ensure that any relief is directed to mainly small and mid-size quoted companies, instead of larger listed entities. For the sake of simplicity, no issue size criteria should be attached to the relief.

(ii) Allow the relief to be applicable to both IPO and secondary fundraisings

A number of small and mid-size companies raise funds through public equity markets as bank finance and bond markets are either unavailable or too expensive. In addition, some small and mid-size companies are looking to access investors who invest in quoted companies at a more attractive valuation than might be available through private equity. Primarily, companies usually decide to float to accelerate growth or development capital.

The measure should therefore target costs arising from any fundraising or issuance event, thus including both new (IPOs) and further issues (secondary fundraisings), subject to the £1.5 million threshold mentioned above.

For policy reasons, we consider that it will be important to target the relief to issuances where funds will be employed in the business. We suggest no corporate tax relief should be available where funds raised are received solely/mainly by existing shareholders. This would allow companies to seek and access recapitalisation that allows them to grow their business without the process being overly onerous. It should be noted, however, that the costs of raising debt are allowable even if this is the purpose of repaying existing debt.

(iii) Allow all types of fundraising costs associated with raising equity to be deductible

It should be relatively straightforward to make the distinction between expenses incurred as a direct result of fundraising and other fees (e.g. ongoing fees for maintaining a listing), especially as quoted companies have robust accounting records and controls to clearly identify the costs incurred as a result of a fundraising and most disclose these costs in prospectuses and admission documents.

All types of fundraising costs associated with raising equity (e.g. underwriting fees, professional advisors' fees, direct listing costs, marketing costs, public relations) should be allowed for the purposes of this measure, subject to the £1.5 million threshold mentioned above.

Tables 1 and 2 provide a template for the array of professional costs associated with a company seeking an AIM quotation and the annual costs associated with maintaining that quotation.

Table 1 – Estimated Costs of Floating on AIM[9]

Reporting accountants	£100,000 - £120,000
Company lawyers[10]	£120,000 - £180,000
Nominated adviser's lawyers	£40,000 - £60,000
Nominated adviser/broker corporate finance fee[11]	£100,000 - £250,000
Broker's commission[12]	3% - 4% of funds raised **or** 0.5% - 1% of funds not raised
Printing	£10,000
Registrars[13]	Minimum annual charge £4,000 - £5,000
Public relations	£36,000 - £72.000
London Stock Exchange AIM admission fees[14]	£10,000 + VAT - £112,000 + VAT

Table 2 – Estimated Costs of Maintaining a Quotation on AIM[15]

Financial public relations	£25,000 - £43,000
Broker/nominated adviser annual fee (including analyst research	£50,000 - £90,000
Investor relations press cutting service	£5,400
Basic website service	£6,000
London Stock Exchange Regulatory News Service	£13,500 - £25,000
Analysis of share registrar	£1,500
Registrar	£8,500
Auditors	£10,000
Legal advice on regulatory issues	£10,000 - £50,000
Annual report design	£5,500
London Stock Exchange AIM annual fee[16]	£7,900 - £75,000
London Stock Exchange AIM further issues fee[17]	£0 - £56,000 + VAT
Share option service	£15,500

[9] Quoted Companies Alliance research conducted in February 2018.

[10] These costs are associated with producing the admission/placing document and exclude other costs, such as due diligence/corrective agreements.

[11] Varies depending on market capitalisation/size of the company.

[12] Varies depending on market capitalisation/size of the company.

[13] Excludes other charges such as the AGM.

[14] Fees for Issuers, 1 April 2018: http://www.londonstockexchange.com/companies-and-advisors/main-market/documents/listing2018aprilnew.pdf

[15] Quoted Companies Alliance research conducted in February 2018.

[16] Varies depending on market capitalisation/size of the company.

[17] Fees for Issuers, 1 April 2018: http://www.londonstockexchange.com/companies-and-advisors/main-market/documents/listing2018aprilnew.pdf

We acknowledge concerns that a tax relief measure for the costs of raising equity could lead to higher professional fees in the markets (e.g. for advice or underwriting). However, the same question could be asked for the professional costs associated with debt financing, as these are already tax deductible, but we are not aware of costs increasing or being inflated as a result of tax deductibility. Professional fees fluctuate in line with factors such as competition, market conditions and risks. Given the competitive nature of the market for professional services, we do not anticipate a rise in costs as a result of such a measure. Accordingly, such relief should:

(iv) Allow tax relief for the costs of raising equity to be available in the year these were incurred

In terms of the time scale for claiming these deductions, we believe that, to avoid excessive complication, tax relief for the costs of raising equity should be available in the year these were incurred.

(v) Allow the relief to be available once the implementing legislation comes into effect

We also recommend that the relief should be available immediately (i.e. once legislation comes into effect) to avoid any perceived market distortion.

(vi) Allow the relief to apply to costs incurred as a result of an aborted fundraising

In the event of an aborted fundraising, we believe that professional costs incurred prior to an incomplete issuance should be allowed for tax relief in line with and in similar terms to costs which would be allowable if an equivalent debt financing process failed. There are a limited number of issuances that are aborted. We believe allowing all costs related to successful and cancelled issuances will reduce the level of complexity when drafting the measure.

Introducing a tax relief for the costs up to £1.5 million of raising equity would have cost the Exchequer approximately £76 million in the 12 months of 2017. This would help increase the flow of equity funds into the SME sector, creating jobs and generating additional tax revenues.

This £76 million figure is based on the number of IPOs (96 – of which 91 raised money) and further issues (957) on the London Stock Exchange's Main Market and AIM between 1 January 2017 and 31 December 2017, capping the relief at the £1.5 million per issue and assuming a corporate tax rate of 19%[18].

The data containing the level of fundraisings from the London Stock Exchange for both AIM and the Main Market in 2017 can be found in Appendix B.

[18] Our cost calculations assume that the costs of an IPO are 7.5% of the total amount of money raised and that the costs of a further issue are 5%. We have excluded companies on the International Main Market from the cost calculations in order to capture UK companies raising funds on UK public equity markets. However, no sectors were excluded from the analysis. The source of the data is the London Stock Exchange's New and Further Issues Statistics (available at: http://www.londonstockexchange.com/statistics/new-issues-further-issues/new-issues-further-issues.htm). The data analysed includes all new issues and the following types of further issues: offer for subscription, placing and open offer, placing for cash, rights and placing.

2. Allow equity costs to be deducted up to the £2 million limit set for debt cost deduction

Alternatively, if the government decided against our preferred measure, it could allow the cost of raising equity to be deductible but included within the £2 million *de minimis* threshold, as set out in the proposed restrictions on interest deductibility in the UK government's May 2016 consultation document.[19]

B. Permitting funds to invest in companies which qualify for Business Property Relief

The UK's growth markets are global leaders in stimulating investment in small, growing companies. Since its launch in 1995, the Alternative Investment Market (AIM) has supported 3,800 companies raise £109 billion.[20] This has contributed significantly to employment growth and tax revenue for the Exchequer; the £14.7 billion contribution that the AIM companies make to UK gross domestic product is on par with the automotive industry.[21]

Business Property Relief (BPR) – as identified by the government's Patient Capital Review in August 2017[22] – continues to play an important role in the supporting the growth of smaller quoted companies. It prevents the break-up of businesses upon death of a business owner or major shareholder, while also providing a source of long-term capital to smaller quoted companies seeking to scale-up. This encourages founder-led companies to continue their growth journey on public equity markets. Investors are also incentivised to deploy capital which would otherwise be invested in larger listed companies in qualifying growth companies.

However, one current shortcoming for individuals seeking to invest in these companies is that they must invest directly in stocks, such as those on AIM, through discretionary portfolios which do not necessarily match the risk with the goals of the investor. As fund managers of these portfolios tend to have to be fully invested, and inflows are regular, they have very little discretion in achieving the optimum price in the market.

This has inadvertently resulted in capital being preserved in the largest AIM companies – whose stocks are more liquid – rather than companies at the lower end of the market which would benefit from this capital the most. This means that the companies which suffer most acutely from a lack of access to finance – quoted companies towards the bottom end of the growth market – are less able to attract BPR investment. At the same time, investor choice is stymied; they are less able to spread their investment risk among a wide range of AIM companies.

In order to neutralise this market failure, the government should establish a new BPR fund category – distinct from those available for EIS and VCT investments – which would be allowed to invest in qualifying companies on any growth market, such as AIM and NEX Exchange, and thus be eligible for BPR.

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[19]https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/525923/tax_deductibility_second_consultation_v2.pdf

[20] https://www.londonstockexchange.com/statistics/markets/aim/aim.htm

[21] 'Economic Impact of AIM' (April 2015): https://www.londonstockexchange.com/companies-and-advisors/aim/publications/documents/gteconomicimpactofaim2015.pdf

[22] Financing growth in innovative firms (August 2017): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/642456/financing_growth_in_innovative_firms_consultation_web.pdf

Doing so would enable fund managers to invest in a full range of smaller companies quoted on these growth markets. This would benefit both individual investors and smaller quoted companies. Investors would benefit from fund managers being able to allocate their capital to a wider range of companies than is currently possible, thus spreading each investor's portfolio risk.

At the same time, this would also create more liquidity and investment in smaller growth companies instead of maintaining the present concentration of such investments in the largest companies on AIM companies would benefit from the additional investment.

We propose that such funds should:

- Be a closed-end fund;
- Limit qualifying companies to those with a maximum individual total market capitalisation of £500 million;[23]
- Ensure that to qualify for BPR, the fund must have at least 90% of qualifying companies' assets still invested in the fund within three years of the share issue;
- Have a capped annual management charge of 1.5% per annum.

Whilst permitting such funds to be used would cost the Exchequer a small amount in foregone revenue in the immediate term, this would be more than offset by the fact that the benefitting investees companies would create more employment opportunities and generate additional economic growth, which would increase tax revenue – including in terms of income tax, national insurance contributions and corporate tax.

Facilitating the development of BPR funds would also support the government's industrial strategy. As the nation's demographics change – a population ageing and living longer – many individuals will seek to continue investing their accumulated capital in their retirement years. BPR funds represent a constructive, cost-effective way of doing this, while supplying a source of long-term, patient capital to smaller, growing companies which provide the employment opportunities that their descendants will require to maintain their prosperity in the twenty-first century.

C. Encouraging employee share ownership

Employee share ownership can offer substantial, mutual benefits to small and mid-size quoted companies, members of the workforce and the economy as a whole.

For many small and mid-size quoted companies, resources are scarce. This, combined with the fact that many operate in economic sectors where highly-skilled employees are in high demand, means that these growing companies can struggle to compete with their larger counterparts in attracting the talent required to drive the company's growth and development. Employee share ownership schemes therefore provide an alternative and cost-efficient way of recruiting and retaining staff when lucrative remuneration packages cannot be offered.

[23] This would capture 95% of AIM companies and all but one of the 88 NEX Exchange companies.

This can generate better outcomes for companies. Numerous studies have indicated that higher levels of employee share ownership can often result in enhanced levels of economic performance – both in terms of turnover and profitability – particularly for smaller, growing companies.[24]

Both companies and employees can also benefit from a greater degree of workforce engagement with respect to goal setting, business planning and decision-making on work practices. This can help boost employee motivation, satisfaction and productivity.

For instance, workforces with a genuine economic stake in the company they work for will have a closer affinity for their business, as they will benefit directly from the additional value their company creates. This can lead to a more entrepreneurial workforce that actively seeks greater efficiencies, thereby raising productivity and improving product quality. This will support the company to deliver long-term value to all shareholders.

These factors in aggregate support the formation of a stable, resilient economy by suppressing unemployment, driving wider economic growth and increasing tax revenue for the Exchequer.

We therefore welcomed the European Commission's decision of 15 May 2018 to approve under EU state aid rules the continuation of Enterprise Management Incentives until 6 April 2023. The scheme plays a key role in supporting small and mid-size quoted companies to more effectively incentivise their employees and directors to own shares in their companies. This, in turn, stimulates growth in the UK economy by rewarding employee contributions in growing the value of the business they work for, while helping smaller companies recruit and retain staff.

Below, we propose ways in which the government should strengthen existing employee share schemes to boost the UK's global competitiveness. HMRC currently offers four types of direct, tax-advantaged employee share scheme[25], to which our comments below relate, available to qualifying companies can use to grant options or make awards over shares directly to their employees:

(1) The Company Share Option Plan (CSOP);

(2) Enterprise Management Incentives (EMIs);

(3) The Save As You Earn (SAYE) Plan; and

(4) The Share Incentive Plan (SIP).

CSOP

The CSOP is a long-established discretionary tax-advantaged share scheme. It is typically used for rewarding full-time managers, executives and employees in small and mid-sized companies that do not qualify to grant EMI options (for example, where the EMI trading activities requirement is not met or where the company has grown such that the number of employees exceeds the 250 full-time employees limit).

[24] The Ownership Effect Inquiry: What Does the Evidence Tell Us? - Banerjee A , Bhalla A, Lampel J (2017): http://theownershipeffect.co.uk/wp-content/uploads/Global_literature_review_The_Ownership_Effect_Inquiry-What_does_the_evidence_tell_us_June_2017.pdf

[25] In recent years, following the findings of the Nuttall review, tax reliefs have been introduced for indirect ownership arrangements involving qualifying employee ownership trusts. These should continue to be available to support wider employee ownership.

It is possible that smaller companies may also qualify for one of the tax-advantaged all-employee share plans (SAYE Plans and SIPs), however in practice all-employee plans are not frequently used by such companies.[26] This is largely due to the proportionately greater administration obligations and higher associated costs of such plans; the company might need to hire an additional person to deal with the administration in-house, or alternatively, pay an administrator and savings provider for SAYE and/or a professional trustee for SIP. This makes the cost per participant significantly higher for SMEs.

Accordingly, in practice, the CSOP is often the only realistic alternative for a company to consider if it does not (or has ceased to) qualify for EMI. If the company qualifies, a CSOP can be governed by a relatively simple set of rules and can be easily administered because there is typically little to deal with between the grant of the option and the option exercise.

There is a significant gap between what a company is able to offer to incentivise its employees under the flexible EMI regime and the more restrictive CSOP. This is particularly due to the individual limits (on the market value of shares which may be placed under option) and the circumstances in which full tax-advantages are available under the applicable legislation. Larger companies may, in part, compensate by offering SIP and SAYE participation but mid-size companies are disadvantaged unable to afford the additional costs of the SIP and SAYE. This presents a particular problem for companies which qualified for EMI but then cease to qualify as the business has grown.

Similarly, mid-size companies still need support to enable them to expand and to attract and retain talented employees. We would suggest that some relatively small changes to the CSOP legislation would make it a far more appropriate and attractive incentive arrangement, thereby increasing its popularity and use, without significant additional cost.

Specifically, these would be to:

- **Allow the exercise price to be at a discount or at nil-cost (while keeping the income tax relief only for any increase over the market value at grant).** Permitting a discounted exercise price would bring the CSOP into line with the more flexible EMI regime. The change would benefit SMEs, and in particular those which previously qualified for EMI. Introducing the ability to grant at a discount under CSOP would mean that CSOP would become a meaningful alternative for companies which cease to qualify for EMI.

  In particular, smaller listed companies often prefer to grant Long-Term Incentive Plan (LTIP) awards over the full value of shares, while the exercise price of a CSOP option must not be less than the market value of a share at the date of grant. One of the main reasons for this is that LTIPs use fewer shares to provide the same reward. This helps smaller listed companies who might have issues with share availability due to lower liquidity in the shares or shareholder dilution limits. It would be hugely beneficial from a corporate point of view if CSOPs could be structured in the same way as LTIPs.

  Further such a change would **not** mean any additional costs to HM Treasury, but would, in fact, generate revenue from the additional income tax and national insurance levied on the discount.

- **Remove the three year holding period before which options can be exercised with income tax relief.** Under EMI, qualifying companies are free to design their plans to reflect their commercial objectives (so that the options may be exit-only or alternatively vest over time and/or subject to performance

[26] Indeed, participation in SAYE fell to about 400,000 in 2016-17; it was close to one million in 2000-2001. Data available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/724516/Table6-5.pdf

conditions). The removal of the three year holding period for CSOP would more closely align the two discretionary tax-advantaged plans, giving SMEs greater freedom to design their plans in a way which reflects their commercial objectives and incentivises their employees.

In practice, many SMEs would opt for a three year holding period to comply with good practice principles and to encourage staff retention. This would mean the additional loss of revenue to the Exchequer would be relatively low, but costs would be reduced by both the simplification itself and for HMRC in terms of its monitoring costs.

- **Remove all leaver and other early exercise requirements.** The removal of the three year holding period would simplify the operation of CSOP in practice. This change would mean that the legislation could be amended to remove the leaver and corporate event early exercise provisions, which often add complexity at present. This would represent a further harmonisation of the EMI and CSOP regimes.

- **Increase the £30,000 limit.** We believe that the best way to encourage employee share ownership in smaller companies that do not qualify for EMI would be to further relax the requirements of the CSOP and introduce more flexibility, in a similar way to that recommended in the report of the Office of Tax Simplification (OTS) in its Review of Tax-Advantaged Share Schemes, published in March 2012[27].

  The OTS report recommended (at para 2.57) that the existing £30,000 limit for all subsisting options be replaced with a rolling three year £30,000 limit. We recommend going further; the £30,000 limit should be reviewed and increased to enable CSOP to provide a meaningful incentive in today's modern workplaces.

  Although the individual limits for all-employee plans and EMI have been increased significantly in recent years, the individual limit for CSOP has remained unchanged, at £30,000 per eligible employee, since 1996. As more than twenty years have elapsed since the current CSOP limit was set (and noting that EMI, SAYE and SIP have all benefited from increases in limits in recent years), it would be appropriate to review the £30,000 limit.

  Given that the EMI individual limit is now set at £250,000 (with a maximum total value of shares which may be placed under option of £3 million), the difference between the two tax-advantaged discretionary arrangements as an effective incentive is significant for companies which do not or cease to qualify for EMI.

  We would suggest that the CSOP limit be increased to a figure between the current £30,000 limit and the EMI limit of £250,000 – we would suggest £50,000 – and that consideration be given to an appropriate figure for the total aggregate value of unexercised CSOP options (assuming such a maximum is considered to be necessary).

  We appreciate that this would require careful analysis of the fiscal impact of such changes, but believe that, if implemented, CSOP would become more attractive to qualifying small and mid-size quoted companies as a means of incentivising their employees.

Consequently, we believe that the additional cost to the Exchequer of all of the above measures would be relatively low. However, the extra flexibility for design of CSOPs could substantially boost the levels of employee share participation and therefore the Exchequer's potential return through capital gains tax and

[27] Available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/198444/ots_share_schemes_060312.pdf

stamp duty. This would provide incentives to promote growth, in particular in small and mid-size companies. HMRC statistics show that the number of participants granted CSOP options has fallen from 415,000 in 2000-2001 down to only 40,000 in 2016-2017.[28] This is largely due to the flexibility of the EMI schemes designed to encourage smaller companies to grow.

Although there have been some helpful relaxations introduced by Finance Acts in recent years, we believe that the CSOP legislation has not been sufficiently adapted to meet modern remuneration practices.

D. Permitting non-executive directors taking shares as part of their remuneration to pay income tax only after the sale of the shares

Non-executive directors who wish to align their interest with those of shareholders, and subsequently agree to accept a portion of their remuneration in shares, are currently required to pay income tax upon issue of the shares. However, this comes at a time when the non-executive director will not have the cash to pay the tax.

To encourage non-executive directors to align their interests with shareholder interests, we propose that the government should allow non-executive directors to pay income tax only after the sale of the shares.

We believe that this will not only help attract a higher standard of non-executive director, but also cultivate a closer relationship between the company, shareholders and the non-executive director.

E. Reforming Entrepreneurs' Relief

Well-targeted and cost-effective capital gains tax (CGT) reliefs encourage equity investment in private and public companies. It is generally accepted that the alignment of employee and shareholder interests promotes long-term growth in corporate profitability and, therefore, a higher tax yield for the Exchequer.

In recent years, we have welcomed the changes to Enterprise Management Incentives (EMI) implemented in Finance Act 2013 with respect to the extension of Entrepreneurs' Relief to shares acquired through EMI options; the introduction of an investors' relief for external investors in unlisted trading companies for newly issued shares in Budget 2016; and the changes to the qualifying rules of Entrepreneurs' Relief, which will ensure that entrepreneurs are not discouraged from seeking external investment through the dilution of their shareholding announced in Autumn Budget 2017.

These measures are, in aggregate, playing an important role in stimulating new investment in smaller, growing companies, including those quoted on AIM and NEX Exchange.

We continue to support the availability of Entrepreneurs' Relief. It plays an important role in small and mid-size quoted companies being able to attract the necessary talent and investment to grow and create more employment, which is essential to the UK's economic growth.

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[28] Available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/724508/Table6-4.pdf

However, a number of issues remain:

- The 5% requirement is inconsistent with the shareholding requirements that need to be met by external investors looking to obtain Investors Relief. It is unclear why employees should be treated differently to external investors, particularly where stated government policy is to encourage employee share ownership.

- Employees who hold actual equity, but fail to meet the 5% requirement, are in a materially worse after-tax position than those employees who acquire their shares through EMI options. Again it is unclear why this should be the case.

- The 5% requirement creates inequality between companies and LLPs (as there is no requirement for a minimum percentage interest in an LLP.

  The 5% requirement is, in any event, arbitrary in nature particularly given the focus on nominal share capital. There have been a number of cases recently, including the recent case of Castledine vs Revenue and Customs (Entrepreneurs' Relief: meaning of 'ordinary shares')[29] which highlighted the potential situation where the presence of deferred shares can reduce an entrepreneur's holding from an initial 5% to a value below that, all of which demonstrate the arbitrary (and unfair) nature of the test.

There are many case studies which demonstrate difficulties faced by small and mid-size quoted companies in this regard, without which there would be improved opportunities for successful growth and investment plans, greater liquidity, which would all help to generate further economic return to HM Treasury.

We divide our proposals into two parts by:

(1) Expanding our rationale for removing the 5% requirement; *and*

(2) Outlining other measures that would ensure that Entrepreneurs' Relief operates on a fair, logical and coherent basis in the context of cash earn-outs and non-cash consideration received on a share disposal.

Implementing any of these measures will help small and mid-size businesses better incentivise their employees to own shares in their companies, which will help these companies to grow.

(1) Removal of the 5% requirement

Share-based employee incentive packages are a key tool in a company's recruitment and retention arsenal, as well as the most tried and tested way to align the performance of the individual with the performance of the business. Such awards are ever more important in an environment where the employer's ability to increase salaries is restricted.

Providing Capital Gains Tax relief to employees and officers who own shares in the business stimulates growth in the UK economy by giving employees an incentive to grow the value of the business for which they work. It also helps close the "them and us" perception gap that often exists between management and employees.

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[29] Castledine v Revenue and Customs (Entrepreneurs Relief : meaning of 'ordinary shares') [2016] http://www.bailii.org/uk/cases/UKFTT/TC/2016/TC04930.html

Employees' involvement in their businesses through ownership of shares is considered to be a significant contributor to employee engagement and economic growth. In many cases, it can represent a considerable exposure in terms of employees' own disposable wealth and is a risky one too, as their own financial prospects are already linked via their employment to the company. While the effect of the annual exemption is useful, a favourable headline rate for employees to align with owners would encourage further engagement and ultimately help drive growth through alignment of employee and shareholders' interests.

The personal company definition in Entrepreneurs' Relief means that an individual must hold 5% of the voting rights and 5% of the ordinary share capital (by nominal value) in the company in which he/she holds shares to qualify for relief. This is in addition to the need to be an employee or officer of the relevant company. This means that employees who own actual shares are treated more disadvantageously than both employees who hold EMI options and external investors in the company who can benefit from Investors Relief. The former would seem to be simply unfair. The latter would seem to prioritise outside investment over encouraging employee ownership, and would seem to run against other government policy – as reflected in the Employee Ownership Trust legislation.

The 5% requirement can also result in inequality between companies and LLPs. It is possible for a member of an LLP to qualify for relief on the sale of any part of his/her interest in the LLP, regardless of his or her percentage interest in the LLP. This inequality demonstrates that the business world has moved on since retirement relief was phased out in 1999 and questions again the appropriateness of the 5% requirement for companies.

Such tension could perhaps be tolerated if there was a well-reasoned argument behind the 5% requirement. However, the limit appears to be an arbitrary way in which to define a 'material stake' in a business – it was simply lifted from the old retirement relief with no critical thought as to whether it was appropriate. As recent case law shows, the application of the relief, with its focus on ordinary share capital, can result in perverse results.

The 5% requirement creates unnecessary costs and difficulties for small and mid-size businesses in practice. Costs are created through lost time and distraction in negotiating transactions and the delays caused in dealing with a tax point, rather than concentrating on the commercial factors and business.

Below are some general examples of the practical difficulties that small and mid-size quoted companies have faced:

One example of the practical difficulty that small and mid-size quoted companies have faced concerns deals for new funding, which can result in continuing managers each holding less than 5% of the company's capital. The commercial transaction can be complete with the price agreed and the funding ready. However, in our experience, far too much time can be spent in negotiations considering the Entrepreneurs' Relief points.

We have collated and anonymised several examples of small and mid-size companies that have had practical difficulties with the 5% Requirement in Appendix C. They illustrate the need to address this area for growing businesses.

For those reasons, we consider that the 5% requirement is inappropriate in the modern business world and propose that it is removed for employees and officers of the business.

We acknowledge that HMRC might consider it necessary to introduce some form of target anti-avoidance rule (TAAR) to restrict the 'banking' of Entrepreneurs' Relief to genuine commercial circumstances rather than contrived structures.

(2) Entrepreneurs' Relief treatment of non-cash consideration

– **"Marren v Ingles" rule and cash earn-outs**

To ensure that Entrepreneurs' Relief operates on a logical and coherent basis, we request that a further category of qualifying business disposal is included within Entrepreneurs' Relief – the disposal of an earn-out which has arisen from the disposal of shares which, had the consideration not consisted of an earn-out, would itself have qualified for the relief.

In current law, where shares are sold and the consideration consists of or includes a cash earn-out, the net present value of the earn-out is treated as consideration received on the sale. Where the disposal meets the conditions for Entrepreneurs' Relief, the earn-out portion of the consideration, along with any cash received upfront, will form part of the consideration for the share disposal which qualifies for the relief.

However, in the event that a sum is subsequently received under the earn-out which is higher than the value estimated at time of the share disposal, that excess is treated as arising on the disposal of the earn-out, not on the disposal of the shares, and so is not eligible for Entrepreneurs' Relief. Sellers qualifying for Entrepreneurs' Relief ordinarily expect that the whole amount received under an earn-out will be eligible for the relief (subject only to the £10 million lifetime cap on eligible gains).

An earn-out is a legitimate, commercial method of valuing a business being acquired and there is no commercial logic as to why cash sums received under an earn-out should be treated any differently from cash sums paid on completion of the share sale. We therefore propose that disposals of earn-outs in cases such as this are treated as qualifying business disposals for Entrepreneurs' Relief purposes.

The following anonymised example illustrates the need to address this issue:

Company A

Number of Employees: 75
Turnover: £20 million
Market Cap: £5 million

Company A had to seek advice on the application of Entrepreneurs' Relief to different types of consideration, including a cash earn-out element. Individuals related to Company A assumed that they would receive Entrepreneurs' Relief on all proceeds, including under the commercially negotiated earn-out, whereas in fact the profit on the earn-out would not qualify for Entrepreneurs' Relief and would be subject to capital gains tax at the prevailing rate.

Estimated extra cost to company in advisor fees: £15,000

We note that any concern regarding whether an earn-out is properly to be treated as further consideration for the value of shares is effectively already addressed in HMRC guidance at ERSM110940. If the earn-out passes the tests in that guidance, HMRC accepts that the earn-out is capital and not income and that it is

further consideration for the sale of the shares. If that is accepted (and the earn-out is not 'disguised future reward') then there is no reason why its tax treatment should be any different from the tax treatment of any upfront cash proceeds.

We also note that it is usually the buyer that insists on an earn-out rather than the seller (a seller would normally prefer all consideration up front rather than over time and uncertain as to amount) – so an earn-out is without exception a purely commercial construct based on the negotiating position and strength of the parties rather than a 'tax based tool' (and if used as a tax based tool then the principles set out in ERSM110940 already protect HMRC in this regard).

- **Shares and loan notes received as consideration**

We are also aware of problems which arise when individuals receive shares or loan notes as consideration for the sale of their private companies and who do not own at least 5% of the ordinary share capital in and/or are not employees of the company that acquired the shares ('the acquiring company') at the time that those subsequent shares or loan notes are sold or redeemed.

Where shares or non-qualifying corporate bonds (non-QCBs) are received, the portion of the gain from the original sale related to this consideration is 'rolled-over' into the base cost of the new shares/loan notes. When those shares or loan notes are subsequently disposed of, the rolled-over gain then falls into charge as part of the overall gain/loss arising on their disposal.

A similar effect arises where qualifying corporate bonds (QCBs) are received, except that in that case the gain is held-over until such time as the QCB is disposed of.

Due to the way that the Entrepreneurs' Relief rules are drafted, whether or not any resulting gain qualifies for relief depends on whether the individual holds 5% or more of the ordinary share capital in the acquiring company and is an employee of that company throughout the 12 months up to the date of the subsequent disposal or redemption. Hence, if the individual does not meet these tests, he/she will not qualify for the relief, even if he/she met the tests in relation to the original company at the time of the original disposal.

It is possible to elect under Section 169Q or Section 169R of the Taxation of Chargeable Gains Act (TCGA) 1992 to disapply the roll-over or holdover treatment respectively (and pretend that cash had been received as consideration instead). The effect is that Entrepreneurs' Relief is available on the full consideration received (provided the qualifying tests are met), but the gain is deemed to arise at the time of the original disposal and cannot then be rolled over into the new shares or loan notes acquired. However, unless sufficient cash has been received as part of the deal, individuals often do not have the resources to pay the resulting additional tax liability.

We believe that the way these rules work is having a distorting effect on share deal negotiations and, in some cases, is prohibiting sales from being agreed where the purchaser does not have sufficient cash to pay for the shares without issuing shares or loan notes and the vendor is unwilling to accept the tax consequences. A change in the rules would help to encourage further share sales which would feed growth in the 'real economy', given that it is only shares in qualifying trading companies that qualify for the relief.

Therefore, we propose that the Entrepreneurs' Relief rules are amended so that, where an individual meets all the qualifying conditions for the relief to apply on the disposal of shares, the whole of the gain arising on the disposal should qualify, whether or not an element of that gain is rolled-over into new shares or non-QCB loan notes or held over into QCBs. This could be achieved by amending Section 169I of the TCGA 1992

to provide for an alternative new condition (condition E) under which the disposal of shares or securities in a company could qualify for relief (i.e. where an earlier qualifying gain had been rolled over or held over into the shares or securities concerned). Sections 169Q and 169R could also then be repealed.

F. Exempting or zero-rating from VAT any investment research on small-cap companies

Independent investment research on SMEs is essential in increasing their visibility and stimulating trading in their shares. This eases price discovery and enhances liquidity, which in turn reduces the cost of capital for companies and encouraging growth.

However, such research has experienced a significant drop since 2007 when MiFID [30] came into effect. In the UK, research has become a marketing communication and the financial promotion rules means that it cannot be made generally available. This has created a considerable information inequity between the professional investment community and other investors. The economics of SMEs dictate that sponsorship of coverage is the only realistic means by which the market can be provided with quality investment research.

Recent research by Hardman and Co has indicated that, on average, only companies listed on the Main Market of the London Stock Exchange with an individual market capitalisation above £500 million and AIM companies above £700 million will be covered by anyone other than the house broker or a paid-for research house (this assumes that a non-house broker can capture all of the non-house broker trade).[31] Therefore, most companies with an individual market capitalisation of under £50 million are very scarcely covered, only being covered by their own house broker and in some cases by research that they pay for.

Following our consistent campaigning, we welcomed the Financial Conduct Authority's decision in July 2017 to continue allowing fund managers to receive small cap research without payment where it has been commissioned and paid for by a smaller quoted company, including when issuing new shares.

However, for research that has not been commissioned and paid for by a company – that is, where an institution pays a broker to undertake investment research on a company – the institution must pay VAT in addition to the broker's fee, as the broker is deemed to be providing a service to the institution. This effectively reduces a broker's revenue yield by 20%, which in turn limits the resources it can deploy to conduct the research. This disincentivises brokers and other provider of independent investment research to undertake such activities and effectively reduces the quantity of research on SMEs.

Therefore, we propose that small-cap research that has been paid for by an institution to a broker should be liable to either a zero rate or, at least, a reduced rate.

Not doing so will curtail the distribution of SME research which will damage the interests of issuers and investors alike and reducing competition in the SME funding sector. Levying VAT on investment research is an unintended consequence of the unbundling of research from execution commissions. Research has always been paid for through execution commissions which are not subject to VAT. Therefore we are not proposing a reduction in known tax revenue, rather one that has been inadvertently created.

[30] Markets in Financial Instruments Directive (2004/39/EC)

[31] "Liquidity – little understood, even before MiFID II", Hardman and Co (October 2017): http://www.hardmanandco.com/docs/default-source/mohtnly-newsletters/hardman-monthly-october-2017.pdf

Alternatively, if the government is unable to amend investment research's VAT rate, we propose using the new tax revenue generated to reinvest in tax incentives for small and mid-size quoted companies, such as facilitating IHT funds, outlined in item D of this section.

II. Simplifying the tax system

The UK has a reputation for having one of the world's longest and most complex tax systems. Estimates have put the length of tax handbooks at nearly 12,000 pages.[32]

New tax legislation has added yet more complexity and volume to the existing framework, which in turn adds to the cost of compliance for companies. These additional costs are especially punitive for smaller, growth companies who are, in many cases, not the target for much of the recent anti-avoidance legislation.

An unwieldy tax system which requires companies to employ expensive advisers will both act as an obstacle for companies looking to set up their operations in the UK and disincentivise companies already located here from remaining in this country.

It is our experience that small and mid-size quoted companies are willing to pay their fair share of taxation, in order to contribute to the society in which they operate. However, it is imperative that an easy to understand and comply tax system is formed, so that they are able to reduce compliance costs in terms of both time and money and thus focus on their growth.

Below, we outline our proposals both for reforming the institutional framework which lies behind the tax policy making process, as well as how the tax system itself should be simplified.

A. Strengthening the Office of Tax Simplification

Since its creation in 2010, the Office of Tax Simplification (OTS) has used its technical expertise to undertake valuable analysis of aspects of the UK tax system which should be simplified to reduce tax compliance burdens on UK businesses. We continue to support its efforts in this regard. We have appreciated the open nature in which successive OTS tax directors have engaged with the QCA Tax Expert Group.

Similarly, we welcomed the OTS becoming a statutory body under the Finance Act 2016[33] as a positive step forward in putting the OTS on a more permanent footing. This marked a much-needed recognition of its value to the tax policymaking process.

Yet, as the Institute for Fiscal Studies[34] has noted, the OTS's remit continues to be largely limited to only being able to assess existing law and not proposed policy changes. This had led to instances where the OTS has made recommendations, while changes are being introduced by the government, which contradict or overlook the OTS's recommendations.

The government should therefore take additional steps to strengthen the OTS's influence on tax policymaking, while maintaining its collaborative working partnership with HMRC, HM Treasury, as well as external stakeholders, such as taxpayers and advisers.

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[32] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/193496/ots_length_legislation_paper.pdf

[33] Finance Act 2016: http://www.legislation.gov.uk/ukpga/2016/24/pdfs/ukpga_20160024_en.pdf

[34] Institute for Fiscal Studies, The Office of Tax Simplification: Looking Back and Looking Forward (2014): https://www.ifs.org.uk/uploads/publications/TLRC/TLRC_OTS_DP_11.pdf

This should be done in three ways.

(i) The OTS's resource should be increased, so that it can more effectively promote tax simplification, including playing a more active role in scrutinising the impact of changes made by the government's Budgets. With approximately just eight full-time equivalent staff available, we question the true extent to which it can do this.

(ii) Perhaps most importantly – the government, as part of recognising the OTS's importance to tax policymaking, should establish a formal relationship between the OTS and Parliament. This could take the form of either a dedicated subcommittee of the Treasury Select Committee or a Joint Select Committee, which the OTS could directly present reports on tax simplification. This would strengthen Parliament's ability to effectively scrutinise the government's formulation and implementation of tax policy. A similar precedent exists in the relationship between the Subcommittee on the Work of the Independent Commission for Aid Impact and the International Development Select Committee.

(iii) The government should assess how the OTS could play a role in formulating tax policy, without hindering the Chancellor's political freedom. For example, empowering the OTS to work alongside HM Treasury from the start of the tax policymaking process to assess simplification, the OTS could provide more effective advice on alleviating the complexity of the tax system

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B. Introducing a Tax Gateway for small and mid-size quoted companies

New tax rules aimed at reducing tax avoidance has, while undoubtedly well-intentioned, disproportionately affected small and mid-size quoted companies, despite being targeted at larger listed, multi-national companies.

Legislation is often drafted in a way that compels small and mid-size quoted companies to incur substantial costs to discharge their obligations under the relevant rules. The fact that different areas of tax legislation contain different size thresholds make things more difficult for mid-sized companies to plan effectively. We would strongly encourage alignment of these thresholds.

Indeed it can be difficult, and therefore costly, for mid-sized companies to even determine that certain legislation does not impact them due to the complexity and significant amount of legislation that needs to be considered. Unless companies have in-house tax teams they are unlikely to be able to do this analysis themselves and therefore would be required to pay advisors to do this for them.

Specific examples of legislation where we consider this situation to often arise include:

(a) **Diverted profits tax:** Whilst we understand that this legislation was aimed at the very largest international groups of companies the de minimis limits in the legislation mean that some mid-sized companies are caught by these rules. As the tests are fairly subjective in nature a business can face substantial work in order to conclude the rules do not apply to them.

(b) **Corporate interest restriction:** Although there is a £2 million per annum de minimis limit in the Corporate Interest Restriction rules, this limit is fairly low and many mid-sized businesses can find themselves caught by this legislation. They can then face significant compliance costs even if the rules do not result in any interest being treated as not deductible for tax purposes, primarily due to the significant amount of legislation and the numerous definitions and adjustments included in the

legislation. This is particularly the case where a business needs to perform calculations under the group ratio rule, which can be a very complicated and time consuming exercise.

(c) **Transfer pricing:** Whilst the Transfer Pricing rules do contain size thresholds, groups that fall into the definition of "medium sized" face uncertainty on the application of the rules to their business due to the possibility that HMRC could issue a Transfer Pricing Notice under s168(1)(b) TIOPA 2010, thus forcing them to comply with the rules.

This means many mid-sized companies are unsure of the extent to which these rules apply to them and therefore can incur significant costs in order to mitigate the perceived risk of being caught by the Transfer Pricing rules in full. Whilst from our experience it appears that HMRC use s168(1)(b) fairly infrequently, we would like to see more protection for mid-sized companies such as safe harbour tests, in order to provide more certainty of the position.

(d) **Anti-hybrid rules:** Whilst we acknowledge the intention of the Anti-hybrid legislation, as there is no formal de minimis limit included in the rules mid-sized companies can face significant costs to determine whether the rules apply to them. This can be particularly difficult where a company does not have full visibility of the tax treatment applied by the counterparty to any transactions, such as an external investor.

It is difficult to quantify the costs of complying with these rules for a mid-sized company as it depends on the facts and circumstances of each case, and then the costs will vary between advisors. However, we would estimate that for an average mid-sized company a review to determine the impact of any of the above pieces of legislation could easily cost between £10,000 and £20,000.

To counter this, we propose that the Government introduces a Tax Gateway, which would allow small and mid-size quoted groups with a turnover of less than £200 million – to align with the threshold set for the Senior Accounting Officer (SAO) regime threshold – to be exempt from certain reporting requirements and disclosure (such as those mentioned above).

In order to mitigate the risk of companies establishing a number of different corporate groups to stay below the turnover threshold (despite being economically being in one single group), there should also be a common control test.

We believe that a Tax Gateway would play a pivotal role in reducing administrative burdens for small and mid-size quoted companies.

C. Making it easier for small and mid-size quoted companies to utilise venture capital schemes

We believe that HMRC's guidance on the Changes to the Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCT) rules introduced by Finance Act (No.2) 2015 was adequately drafted and contained much needed clarifications as to how certain rules apply.

However, we still believe that the EIS and VCT rules should continue to be refined and simplified to ensure that small and mid-size quoted companies are able to fully leverage venture capital schemes and thus raise the finance they need to grow and create employment.

Whilst we appreciate the hard work provided by the inspectors within the Small Companies Enterprise Centre and their contribution in respect to venture capital schemes, the new rules have placed an

additional, yet preventable, burden on many advance assurance applications. This has led to increased waiting time for responses, which can stretch to up to 16 weeks. This in turn has placed further constraints on companies seeking to raise financing for their businesses.

The government should increase investment into the Small Companies Enterprise Centre to reduce complexity and bring down timescales, so that the service allows the venture capital schemes to achieve their objective of supporting small, growing companies.

We believe that improvements can be achieved to reduce their negative impact on small and mid-size quoted companies.

D. Allowing agents to register and de-register companies' share plans

Since April 2014, companies that operate employee share plans or that have otherwise issued shares or other securities (as detailed in section 420(1) of the Income Tax (Earnings & Pensions) Act 2003) by reason of employment, are required to make annual returns via the HMRC online reporting system.

A number of practical difficulties have been noted. However the most straightforward to resolve relate to the authorities required to register and close plans.

The company itself must register a plan (whether or not it operates a formal share scheme) in order to make the annual return rather than being able to delegate this task to an authorised agent. Once registered, however, the annual returns and in the case of EMI, option notifications, can be completed by an agent. Equally the company itself must close any inactive scheme. This process is time consuming for the company and can lead to difficulties in undertaking the process if the company does not have the necessary administrative functions in house, particularly where it outsources its payroll and similar functions.

We have collated and anonymised several examples of small and mid-size companies that have had practical difficulties with ERS returns for 2017/18 in Appendix D.

HMRC should allow agents to register and self-certify plans on behalf of companies if authorised by the company that established the plan. This would save time and resource, particularly for small and mid-size quoted companies. Likewise, agents should be able to de-register following a plan termination (e.g. takeover). In practice, we have seen that with a reduction in staff as part of a post-takeover reorganisation login details may be lost, making it difficult for companies to close a scheme. ERS agents should be able to enter a plan termination date to close a plan registration (which at present can only be done by the company).

To this effect, the agent would need formal confirmation from the client that the statements in the return are true to the best of their knowledge and belief and that the agent submitting the return is merely an agent and not responsible for certifying the scheme. This would be similar to the confirmations used to authorise an adviser to deal with corporate tax issues; we believe that it should be relatively straightforward for HMRC to extend the procedure to these proposed agent arrangements.

E. Removing the requirement to obtain HMRC approval of the form of joint NIC elections used for employee share schemes

A further simplification would be to remove the need to obtain HMRC approval of the form of joint NIC elections used in connection with employee share plans. This would free up HMRC resources and remove an administrative task for companies and advisers in connection with share plans.

We would suggest a process similar to that in place for section 431 elections be adopted. Provided that the NIC elections are in a published form which is acceptable to HMRC, the election could be used by the company and option holder without any need to obtain approval from HMRC. Details of awards (specifying whether an NIC election has been entered into) would continue to be included in the end of year annual return.

F. Extending the withholding tax regime

We believe that further simplification benefits could also be obtained from extending the treatment set out at Section 911 of Income Tax Act 2007, which applies to withholding taxes on royalties paid by a UK person who reasonably believes, at the time the payment is made, that the payee is entitled to relief in respect of the payment under double taxation arrangements. This treatment could also be applied to interest payments made in situations where the double taxation treaty passport scheme is not in operation.

We propose the introduction of new rules which allow UK persons to make interest payments gross or at treaty rates where the person reasonably believes, at the time the payment is made, that the payee is entitled to relief in respect of the payment under double taxation arrangements.

G. Reforming the degrouping charge for intangible assets

The government made several changes to the capital gains rules for companies in Finance Act 2011. One of those changes related to the 'degrouping charge' in Section 179 of the Taxation of Chargeable Gains Act (TGCA) 1992. Under those new rules, any 'degrouping charge' is now added to the consideration for the disposal so that the charge is levied on the seller company rather than the target company.

One of the government's principal aims in introducing this change was to "simplify the capital gains rules for groups of companies as far as possible, for taxpayers undertaking commercially-driven transactions, consistent with affordability and with preserving the integrity of the regime"[35].

The changes that the government made were well received, and, in conjunction with the changes made simultaneously under the substantial shareholder exemption regime – allowing businesses to hive down assets into a new subsidiary before its onward sale and not lose entitlement to the substantial shareholdings exemption – were designed to promote the UK as an increasingly attractive jurisdiction for firms to do business.

The practical impact of a chargeable gain on the deemed disposal being added to the consideration for the disposal, and the charge falling on the vendor company, is indeed a tangible promotion of business efficacy.

[35] HMRC, Simplification Review: Capital Gains Rules for Groups of Companies, a Summary of Consultation Responses, December 2010 (3.5)

It reduces due diligence, disclosure of any intragroup transfers within the past six years is less onerous, and parties no longer need to spend time and cost negotiating whether there should be an election made under Section 179A TCGA.

However, while these changes have been welcomed, and are undoubtedly in line with the government's expressed goal of simplification, by only introducing changes in respect of the TCGA provisions which apply to chargeable assets, an inconsistency in regimes has arisen. There has been no contemporary change made in respect of the very similar degrouping charge provisions relating to the intangible fixed assets, loan relationships and derivative contracts regimes.

This inconsistency is significant and in practice has fundamentally undermined the benefits that the government sought to achieve with its changes in 2011. Intangible assets are becoming increasingly central to valuing companies, and their significance is not necessarily confined to small and mid-size quoted companies driven by intellectual property. In practice, the benefits that should therefore accrue under the TCGA revisions are stymied for many transactions, as the pre-Finance Act 2011 regime must be adhered to in respect of intangible assets created after 1 April 2002.

The government indicated in HMRC's December 2010 summary of consultation responses that it did "not currently intend to extend the degrouping proposal beyond the capital gains regime for companies"[36]. However, as referred to above, the government did not justify this position, yet noted that extending the changes beyond this regime was a "related area of work", albeit under a separate body of legislation. Specifically, the government acknowledged its awareness that by omitting at that stage to introduce similar changes to the other regimes referred to above, there was "a potential issue for future simplification work".

Moreover, in the 2016 Autumn Statement, the government restated its commitment to the Business Tax Road Map[37]. One of the fundamental principles was to "modernise and simplify the tax system [enabling] businesses that comply with tax rules fairly and consistently [to] find the tax system easy to understand and navigate"[38]. Removing this inconsistency in the degrouping provisions is aligned with this objective, and would promote the original aim of Finance Act 2011's provisions. Furthermore, the reasoning that catalysed the changes made to the TCGA under the FA 2011 equally applies to intangible assets, loan relationships and derivative contracts.

We also note that HMRC and HM Treasury is currently analysing feedback on its February 2018 review of the corporate intangible fixed assets regime.

We propose the government reviews its position in respect of further degrouping charge reform. While the inconsistency is most acutely felt under the intangible assets regime, and that is our primary concern, our representation would be to also extend the successful changes that the government has made to other instances where a degrouping charge arises, including loan relationship and derivative contract regimes. Extending this reform will promote its purpose, further business efficacy and contribute to

[36] HMRC, Simplification Review: Capital Gains Rules for Groups of Companies, a Summary of Consultation Responses, December 2010 (3.26)

[37] Autumn Statement 2016 (4.23):
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/571559/autumn_statement_2016_web.pdf

[38] HMRC, Business Tax Road Map, March 2016 (2.43):
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/509249/business_tax_road_map_final2.pdf

making the UK an attractive jurisdiction for businesses worldwide. We do not believe that there would be any material cost to the Exchequer in making these changes.

III. Building certainty into the tax system

Certainty is an undervalued, yet crucial, attribute to a successful tax system. Without it, companies of all sizes are unable to effectively and confidently plan for their future development. Where uncertainty exists in a tax system, companies are far more likely to defer, or abandon altogether, plans to deploy funds to finance crucial investments that could grow their business, boost economic growth and create employment opportunities.

At the same time, increasing certainty in the tax system will decrease the number of disputes between companies and HMRC, which will remove unnecessary costs for all parties. Government will also gain from a certain tax system; one which seldom changes will ensure that HM Treasury is better able to estimate its total revenue intake in any given fiscal year and, therefore, assess its future spending plans more realistically.

We welcomed the government's decision to hold one major fiscal event per year. This move will help to promote certainty in the tax system as businesses face fewer ad hoc changes. We outline our proposals for building further certainty into the tax system below.

A. Establishing a binding ruling service

As a key cornerstone to building certainty into the tax system, we propose introducing a binding, paid-for clearance/ruling process along similar lines to those provided in the Netherlands and Luxembourg, which HMRC could also use as a small revenue-raising mechanism. At a time when the UK will want to be seen as an attractive place to do business, such a service would be a useful tool.

In the Netherlands, we understand that there is a dedicated team within the Rotterdam office of the Dutch Tax Authorities that deals with requests for binding rulings. There is no cost to the tax payer in seeking or obtaining a ruling but there is a clearly set out list of required information to enable the rulings team to fully consider the request. The team deals only in matters pertaining to international tax, including, but not limited to, application of participation exemption, permanent establishment and foreign tax payer rules. Rulings are considered by one Inspector of Taxes with another co-signing once the ruling has been granted.

In Luxembourg, an advance tax clearance mechanism is in place to allow tax payers to apply for a ruling on all aspects of Luxemburg tax law. The clearance must be submitted prior to the implementation of the proposed structure or transaction and include an accurate description of the facts as well as the anticipated tax treatment. Applications for clearance attract a fee of between €3,000 and €10,000, depending on the complexity of the matter, and are considered by a panel of six Inspectors of Tax. The panel has two months to consider the application. Where the clearance is granted, the ruling is binding on the tax authorities for a period of five tax years from the date of implementation.

It will, of course, be necessary to ensure that any proposed clearance/ruling process is not in breach of state aid regulations by virtue of being perceived to create unfair competition. It should be noted that both the Netherlands and Luxembourg have recently amended their own ruling processes (to those set out above) following challenges from the European Commission.

B. Clarifying the position of medium-sized entities with respect to transfer pricing

As we discussed in II.B., although medium-sized groups (as defined in the legislation) are given a partial exemption from transfer pricing rules , HMRC still has the power to direct transfer pricing adjustments. This leaves medium-sized groups in an untenable position of not knowing for certain whether or not transfer pricing adjustments may ultimately be required. The result is that such companies are compelled to collate, compile and update transfer pricing documentation and incur the necessary costs of doing so, in order to protect themselves from potential challenge by HMRC.

However, we understand that the number of HMRC directions issued to medium-sized entities is minimal. This suggests that the uncertainty of the application of these rules to medium-sized entities serves little purpose.

If the government elects not to establish a Tax Gateway for small and mid-size quoted companies, we encourage the government to clarify the position for medium-sized groups in this regard. This could be achieved by raising the threshold at which the transfer pricing rules apply.

Alternatively, HMRC should confirm that a taxpayer in these circumstances is not required to compile contemporaneous evidence to support pricing policies unless they wish to and that HMRC will not seek to discount the value of evidence compiled at a later date following the commencement of HMRC enquiries.

Our members continuously tell us that the onerous cost of compliance outweighs any commercial benefit of any possible increase in tax revenues. We have detailed anonymised examples of companies that have experienced practical difficulties applying the transfer pricing rules in Appendix E. They illustrate the complexities and costs incurred by small and mid-size quoted companies.

Appendix A: European regimes for tax relief for the costs of raising equity[39]

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, the Belgian legislation provides for a notional interest deduction ("Déduction pour capital à risque" – "Aftrek voor risicokapitaal" or "NID) according to which companies are entitled to deduct a certain percentage ("NID rate") of their adjusted net equity from their taxable income base. The company's adjusted net equity is calculated on the basis of the capital shown on its balance sheet at the end of the preceding taxable period, adjusted by excluding certain items from the net equity amount (e.g. company's own shares, shares in other companies that qualify as financial fixed assets, capital subsidies, etc.). The applicable NID rate for tax assessment 2018 (income 2017) is 0.237% for large companies and 0.737% for small and medium sized companies. As from 2018, the qualifying net equity on which the NID rate will apply will be equal to the adjusted net equity which has accrued over the previous five taxable periods (so-called "incremental equity"). In other words, the NID regime will effectively allow for a deduction, provided that the eligible adjusted net equity has given rise to a surplus (upon which

[39] Research conducted by the Quoted Companies Alliance in August 2018 (except Greece and Norway, which was conducted in October 2014).

Country	Is there any corporate tax relief for flotation costs?	Are the costs of issuing new equity generally deductible for corporation tax purposes?
		the NID rate will apply), in comparison with the average adjusted net equity of the previous five taxable periods.
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	Yes.	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 from an accounting and tax perspective. Generally there is no cap on the amount of the deduction that can be obtained. 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). The deduction works as follows. The costs of raising equity are considered as general expenses and are included in the P&L of the company. – Costs of raising new equity can also, from an accounting perspective, be offset against the share premium issued. In that case, such costs may however be deducted from as a pure tax deduction (without any P&L entry).
Germany	Yes.	Yes.

Country	Is there any corporate tax relief for flotation costs?	Are the costs of issuing new equity generally deductible for corporation tax purposes?
	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).	In general, all costs of issuing new equity are deductible for corporate tax purposes. Generally, there is no financial cap on the availability of the deduction. 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). If the costs are not directly linked to the respective shareholders then the costs are deductible business expenses.
Greece	Yes.	Yes.
Hungary	Yes. Such costs are deductible as general expenses.	Yes. Such costs are deductible as general expenses.
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. Generally, there is no financial cap on the availability of the deduction. There is only a limit on the availability of the deduction of interest charges (net of interest income) which is a cap equal to 30% of EBITDA. The deduction operates as follows: • Under Italian accounting principles, the Italian company should capitalise costs incurred to increase the share capital and then depreciate these costs over a five year period. Such depreciation is deductible for corporate income tax purposes; • Under Italian accounting principles, the Italian company should capitalise costs incurred to increase the debts and then depreciate these costs over the duration of the loan. Such depreciation is deductible for corporate income tax purpose; • Interest charge deduction is subject to a cap

Country	Is there any corporate tax relief for flotation costs?	Are the costs of issuing new equity generally deductible for corporation tax purposes?
		(30% of EBITDA).
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.
Norway	Yes. Listing costs are deductible in the year the costs are incurred.	Yes. The cost of raising new equity is deductible in the year the cost is incurred. There is no cap on the amount of costs for which a deduction may be claimed.
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 costs of advisory, law services, audit, due diligence are in general tax deductible
Portugal	Yes. Pursuant to Portuguese GAAP, which follows IAS, such costs do	Yes. Any administrative and similar costs incurred are tax deductible on the basis that such costs are necessary

Country	Is there any corporate tax relief for flotation costs?	Are the costs of issuing new equity generally deductible for corporation tax purposes?
	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.	for the company to run its business.
Russia	Yes. Expenses associated with effecting 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, Sub-item 3 of the 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 effecting 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, Sub-item 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.	Yes.

Country	Is there any corporate tax relief for flotation costs?	Are the costs of issuing new equity generally deductible for corporation tax purposes?
	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.	No restrictions for the tax deductibility of issuing new equity are established in the CIT Law, as long as they are duly recognised in the P&L. Generally, there is no financial cap on the availability of the deduction.
Switzerland	Yes. The general principles regarding costs of issuing new equity should apply to the tax deductibility of flotation costs. That is, such costs 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.	Yes. The costs for incorporation, capital increase and general company organisation 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. On 1 January 2013, the accounting rules of the Swiss Code of Obligations were revised. A transitionary period was in place until 1 January 2015. As of this date, it will no longer be admitted to capitalise incorporation, capital increase and organisation costs, but rather such costs have to be treated immediately as an expense. NOTE: The Corporate Tax Reform III was rejected in a popular vote on 12 February 2017. The federal parliament is currently drafting a new reform proposal (called "Tax Proposal 17"). Contrary to the rejected Corporate Tax Reform III, the Tax Proposal 17 will not provide for the Notional Interest Deduction on the federal level nor on the cantonal level. However, as per the latest parliamentary discussions, the cantons shall be entitled to implement a Notional Interest Deduction regime provided that the corporate income tax rate in the respective canton amounts to at least 13.5%, which will be foreseeably the case in the canton of Zurich. The Tax Proposal 17 might be subject to a popular vote and is expected not to enter into force before 2019/2020.
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

Country	Is there any corporate tax relief for flotation costs?	Are the costs of issuing new equity generally deductible for corporation tax purposes?
		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.

Appendix B: Data used to calculate allowing the costs of raising equity to be tax deductible

Further Issues on London Stock Exchange (1 January 2017 – 31 December 2017) [40]

Market	Number of Further Issues
AIM	618
UK Main Market	339
Grand Total	**957**

New Issues on London Stock Exchange (1 January 2017 – 31 December 2017) [41]

Market	Type of new issue	Number of the types of new issue	Number of new issues that raised money
AIM	IPO	50	48
	Not IPO[42]	30	15
AIM Total		**80**	**63**
UK Main Market	IPO	46	43
	Not IPO	19	7
UK Main Market Total		**65**	**50**
Grand Total		**145**	**113**

[40] London Stock Exchange – Further Issues (www.londonstockexchange.com/statistics/new-issues-further-issues/new-issues-further-issues.htm)

[41] London Stock Exchange – New Issues (www.londonstockexchange.com/statistics/new-issues-further-issues/new-issues-further-issues.htm)

[42] For example, re-admission to the market or transfer with a fundraising.

Appendix C: The practical difficulties with the 5% Requirement

Company B

Number of employees: 250
Turnover: £60 million

Company B restructured as part of a new investment by a third party corporate and, as part of the restructuring, certain key employees and directors also invested significant sums in Company B and purchased shares. Commercially, the relevant individuals were meant to have less than 5% of the voting rights, but the restructuring involved new holding companies so that the individuals could have more than 5% of the voting rights and ordinary share capital in the relevant holding companies and so should qualify for Entrepreneurs' Relief. New shareholders in the future could also be accommodated to qualify for Entrepreneurs' Relief, but further careful planning and negotiation with the other shareholders would be needed.

Estimated extra cost to company in management time: £30,000
Estimated extra cost to company in advisor fees: £60,000

Company C

Number of Employees: 20
Turnover: £6 million

Company C had its advisors restructure a transaction to ensure that the relevant individuals had 5% of the voting rights. Commercially they were only meant to have 4.23% of the voting rights. Therefore, the shares that were issued did not have straightforward rights and the deal was made much more complex by this issue. Furthermore, soon after this transaction, an incoming new Chairman wished to also be included within the planning. This aim (to qualify for Entrepreneurs' Relief) was felt to be uncommercial by existing management and created tension within the management team.

Estimated extra cost to company in management time: £20,000
Estimated extra cost to company in advisor fees: £25,000

Company D

Number of Employees: 200
Turnover: £40 million
Market Cap: £25 million

Company D had inadvertently broken the personal company test for a short period, while in the process of a share reorganisation. It was due to a technicality in the “ordinary” share capital requirement.

Estimated extra cost to company in management time - uncertain over the management cost, however it cost the shareholder £1.8 million in lost Entrepreneurs’ Relief over the 12 months

Extra cost to company in advisor fees: £10,000

Company E

At exit, the CEO of Company E had share options but did not have the required 5% of fully paid up shares. Upon a successful exit, Company E’s start-up CEO was penalised at a tax rate more than twice the 10% tax rate applied to the company founders, despite being involved very early on and having worked full-time with the company for nine years.

Company F

Number of Employees: 200
Turnover: £20 million

Company F’s balance sheet was not attractive to lenders as there was a large shareholder debt present. The shareholder proposed to capitalise debt; however, the form of share (which would have been commercially acceptable and accounted for/disclosed as shareholder funds) would have been classed as "ordinary share capital". The issue of these new ordinary shares would have diluted all the managers’ holdings below 5%. There was an enormous amount of time and effort, and not inconsiderable professional cost expended, in debating and solving an issue that was far removed from the very laudable commercial aim of trying to attract new funding to the business.

Estimated extra cost to company in management time: very significant
Estimated extra cost to company in advisor fees: in excess of £20,000

Company G

Company G, which operates share option schemes, is highly acquisitive – issuing shares to buy businesses. It has one executive with a 5% shareholding and he has had to top up his interest from time to time to keep the 5% holding as further shares are issued. In the meantime, the worry of getting numbers right gives the company secretary extra work.

The company concerned would say it is wrong that this executive is penalised for the success and growth of the company. Once someone has met the conditions, he/she should retain the relief so long as he/she remains an employee/director – however small his/her shareholding becomes. EMI options do not lose their relief because a company grows in size; neither should Entrepreneurs' Relief be lost in the same way.

Company H

Company H had to restructure its share capital to get round the fact that B Preference Shares, which had no right at all to dividends (and were effectively subordinated interest free debt rather than equity), were arguably "ordinary share capital" (and not fixed rate preference shares). The need to arguably take the B Preference Shares into account when determining whether the 5% condition meant that certain employees, who had, in practice, an equity interest of greater than 5%, would have been prevented from obtaining Entrepreneurs' Relief without the share capital restructuring.

Estimated extra cost to company in advisor fees: £5,000 - £10,000

Appendix D: Difficulties encountered when making ERS returns for 2017/18

Company J

Company J is a biotech company undertaking research and development in the UK with its head office in Europe. The shares are listed albeit the business is early stage. The company outsources its administrative functions where possible in order to focus on its core business.

The Company set up an EMI share option plan and was able to register and self-certify the arrangement but required their adviser to guide them through each step of the process. This was a more costly process than would have been the case had the agent been able to simply register the plan on the company's behalf and have authority to self-certify (in the same was as on notification of the grant of EMI options).

We understand that the agent authorisation code was sent to the company's offshore head office address but it was not received. The company had to request another adding to the time taken to register the plan. Due to postal delays in the code being delivered, language differences etc. and since the company's administrative function was in the UK, this process took some weeks. When the code was finally received and processed, the Company was close to the deadline for notifying the grant of the EMI options. This would not have been the case if the agent had been able to register the plan on behalf of the company.

Company K

Company K is a US headquartered global technology company, which had operated a CSOP for a number of years for its UK employees. The company was dual listed. No options had been granted since 2014/15 and from 2017/18 there were no subsisting options and no plans to make any further grants. Therefore the company wished to close the scheme. An agent had been making annual returns on behalf of the company.

Due to staff changes in the US where the share plans were administered, the company was unable to locate its login details to close the scheme and asked the agent to do so on its behalf. The agent was unable to do so. The company wrote to HMRC and asked them to close the scheme. HMRC would not do so and required that this be done via the online portal

New login details will have to be requested. This has been very time consuming process for something which should be a very simple exercise for an agent to undertake and an additional nil annual return has had to be filed as a result.

Appendix E: The difficulties faced by small and mid-size quoted companies applying transfer pricing rules

Company L

Number of Employees: 500
Turnover: £100m
Market Cap: £40m

Company L's group has only UK to UK intercompany transactions, yet has to spend internal time and professional fees on UK transfer pricing documentation, which generates no benefit to the group or UK Exchequer.

Estimated extra cost to company in management time: £20,000
Estimated extra cost to company in advisor fees: £20,000

Company M

Company M is a UK sub-group of a German parent, which operates in a number of territories globally, manufacturing and distributing video camera equipment. The other territories in which it operates have tax rates equal to or higher than the UK. The group is classed as medium for UK transfer pricing purposes. The UK sub-group was recently reorganised and had to rework its UK transfer pricing support documentation at a cost of some £40,000 (management time and professional fees), with future annual costs anticipated to refresh the documentation.

Estimated extra cost to company in management time: £20,000
Estimated extra cost to company in advisor fees: £20,000

Company N

Company N, a UK aviation group, is medium for UK transfer pricing purposes and has annual costs (management time and professional fees) of some £25,000 to maintain/refresh transfer pricing documentation. This documentation has never been requested or queried by HMRC since the introduction of the new transfer pricing regime.

Estimated extra cost to company in management time: £12,500
Estimated extra cost to company in advisor fees: £12,500

Appendix F: Expert Group members

Quoted Companies Alliance *Tax Expert Group*

Paul Fay (Chair)	**Crowe UK LLP**
Paul Attridge	Beavis Morgan LLP
Ray Smith	Clyde & Co LLP
Mark Joscelyne	CMS
Daniel Hawthorne	Dechert
Hannah Jones	Deloitte LLP
Emma Bailey	Fox Williams LLP
Douglas Tailby	Grant Thornton UK LLP
Mark Allwood	haysmacintyre
Peter Vertannes	KPMG
Matthew Rowbotham	Lewis Silkin
Catherine Hall	Mazars LLP
Tom Gareze	PKF Littlejohn LLP
Emma Locken	PricewaterhouseCoopers LLP
Dan Robertson	RSM
Oliver Gutman	Shakespeare Martineau LLP
Andrew Snowdon	UHY Hacker Young
Vijay Thakrar	

Quoted Companies Alliance *Share Schemes Expert Group*

Fiona Bell (Chair)	**RSM**
Phil Norton	Aon Hewitt
Andy Goodman Philip Fisher	BDO LLP
David Daws	Blake Morgan
Graham Muir	CMS
Caroline Harwood	Crowe Clark Whitehill LLP
Juliet Halfhead	Deloitte LLP
Danny Blum	Eversheds Sutherland
Richard Sharman	FIT Remuneration Consultants
Emma Bailey	Fox Williams LLP
Isabel Pooley	Grant Thornton UK LLP
Sara Cohen	Lewis Silkin
Travis Adams	Link Asset Services
Liz Hunter	Mazars LLP
Stephen Diosi	Mishcon De Reya
Stuart James	MM & K Limited
Michael Carter	Osborne Clarke
Robert Postlethwaite	Postlethwaite Solicitors
Daniel Hepburn	PricewaterhouseCoopers LLP
Jennifer Rudman	Prism Cosec
Martin Benson	RSM
Kim Hawkins	Shakespeare Martineau LLP
Dave Bareham	Smith & Williamson LLP
Barbara Allen	Stephenson Harwood
Elissavet Grout	Travers Smith LLP