HM Treasury/QCA meeting (22 September 2014)

Following the previous meeting with Roland Phillips and members of the QCA Tax Expert Group (4 March 2014) regarding the QCA Budget 2014 Representations on costs of raising equity being tax deductible, HM Treasury needs input from the QCA on the details of these measures.

Please find below the various queries raised by HM Treasury alongside a draft response. We should be grateful for your input/comments by 16 September 2014, prior to the QCA Tax Expert Group meeting on 22 September 2014 with Roland Phillips.

To provide some context and numerical analysis to our responses, we have gathered data from the London Stock Exchange for both the AIM market (covering the period 1 December 2012 to 30 June 2014) and the Main Market (covering the period 1 December 2013 to 1 June 2014). A summary of both data sets is outlined below:-

Main Market							
	Total Number of companies	Total Market Value (M)	Value of Funds Raised (M)	Mean Market Value (M)	Median Market Value (M)	Mean Funds Raised (M)	Median Funds Raised (M)
All Companies	69	52,832.79	18,422.62	765.69	392.49	266.99	200.00
IPO	66	52,058.93	18,497.29	788.77	406.17	280.26	200.00
Not IPO	3	773.86	432.33	257.95	373.02	144.11	170.00

AIM							
	Total Number of companies	Total Market Value (M)	Value of Funds Raised (M)	Mean Market Value (M)	Median Market Value (M)	Mean Funds Raised (M)	Median Funds Raised (M)
All Companies	161	9,723.76	2,977.52	60.40	30.75	18.49	8.19
Companies raising funds	130	8,608.13	2,977.52	66.22	31.10	22.90	8.19
IPO	109	7,488.47	2,699.19	68.70	32.83	24.76	10.00
Non IPO	52	2,235.28	278.34	42.99	29.43	5.35	3.41
AIM fees	Total estimated fees (M)	Mean fees (M)	Median fees (M)				
Based on estimates for 53 transactions	146	2.75	1.69				

- Thresholds. The QCA submission mentioned this as a possibility. But what would be the level at which the measure would best target SMEs? Would the threshold be more appropriately applied to issue size or to the deductible amount? Which companies to target in view of potentially targeting smaller companies?

  We recommend a limit of £1.5m is placed on the listing costs incurred by a company which would be eligible for corporate tax relief. The cost of listing on any of the European Borses would be deductible within the cap. Our recommendation is based upon the data reflecting on average a cost of listing on AIM of £2.75m and a median cost of listing of £1.7m, including brokerage costs. The £1.5m cap will direct corporate tax relief to SME companies proportionally far more than large listed entities. In our opinion, for sake of simplicity therefore, no issue size criteria should be attached to the relief.

- Types of equity issue. Would the measure more appropriately apply to all types of issues, including secondary raisings, or merely to IPOs? Should/could the measure be available to all types of issuance (e.g. to fund an acquisition) or solely issues where cash is being raised for specified purposes (e.g. to invest in the issuer's business). What would be the practical challenges of seeking to limit the relief in such a way? HM Treasury is interested in finding out what is the rationale behind an issuance, and whether there would be a policy case in making the distinction (concerned about restructuring).

  It is noticeable from our sample that a number of companies raise funds via capital markets as bank finance or bond markets are not available or is too expensive for SME companies. In addition, SME's are looking to access investors who only invest in quoted companies at a more attractive valuation than might be available through private equity.

  We have detailed narrative as to the drivers behind 38 of the 161 companies raising funds on AIM. 8 out of the 38 companies sought a fund raising via AIM to repay existing debt.

  We suggest there is no restriction of costs incurred as a result of either an IPO or secondary placing. For policy reasons, we consider that it will be important to target relief to listings 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 was applicable (in part) only to 3 of the 38 AIM raisings analysed.

- HM Treasury would like to understand the reasons why companies float, and why equity is a preferable solution to debt.
  There are a number of different reasons why companies float, some are outlined above. However the principle reason is very much to raise growth or development capital, particularly from investors who would not invest in unquoted businesses.

  Out of the 38 AIM listings analysed the key reasons for listing are shown as:- funding future growth/expansion - 65%, repayment of existing debt -20%, acquisitions or other reasons e.g. raising funds for existing shareholders - 15%.

- How practical is it to distinguish between expenses incurred as a direct result of an IPO / issuance event, and other fees?

  Listed companies have robust accounting records and controls to clearly identify the costs incurred as a result of an IPO or issuance event. We do not view this as an issue.

  A requirement could be that companies clearly outline in the listing prospectus the professional costs associated with the listing.

- There are various types of listing costs (underwriting fees, professional advisers' fees, direct listing costs, marketing costs, PR etc.). Which of these – if any – do you think should be excluded from the scope of the measure?

We recommend that all cost types are allowable, subject to the £1.5m cap. Outlined in the table below is an example of professional costs associated with an AIM listing.

Costs of Listing in the UK- AIM		
AIM		
Costs of Floating		
Accounting	£90,000 - £150,000	
Legal	£100,000 - £200,000	
Corporate Finance	£100,000 - £200,000	
Broker's Commission*	3 - 7% of funds raised	*Varies depending on market cap
Printing	£10,000	
Registrars	£5,000- £10,000	
AIM Admission Fees	£5,870 - £66,250	
AIM Annual Fees	£4,750	
Public Relations	£10,000 - £20,000	

- Would the measure more appropriately apply to ongoing listing costs (e.g. annual listing fees), or just costs arising from the issuance event?

  We believe the measure should therefore target costs arising from an issuance event.

- HM Treasury would like to have an estimate of all the costs in detail (listing and ongoing).

  The table above outlines an estimate of professional fees on a listing. Below we have outlined the on-going professional costs associated with an AIM listing:-

Costs of Maintaining a Listing	
PR and IR	
Financial PR	£43,000
Broker (including analyst research)	£20,000
IR Press Cutting Service	£5,400
Website Service	£3,600
RNS	£2,000
Analysis of Share Registrar	£1,500
Total	**£75,500**
Regulatory Costs	
Nomad	£20,000
Registrar	£8,500
Auditors	£5,000
Annual Report Design	£4,500
LSE AIM Annual Fee	£4,750
Share Option Service	£4,500
Total	**£47,250**
Costs of Maintaining a Listing	
Annual Fees for Corporate Adviser	£25,000
Overall costs	**£147,750**

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

  We have not seen professional costs associated with an issuance increase over the last 3- 5 years, and given the competitive nature of the market for professional services we do not anticipate a raise in costs as a result of the measure.

  The professional costs associated with debt financing are already tax deductible and we are not aware of costs increasing as a result of tax deductibility. Professional fees will move in line with market conditions, risks etc.

- Timing. How long could the deductions span over time (e.g. 2/3/4 years) and when would it start (e.g. year it was incurred)?

  To avoid excessive complication, we recommend that corporate tax relief should be available in the year it was incurred.

- Which would be the best way to bring this measure into effect (tax years/ accounting periods/ set date in legislation/ sunset clause for review)?

  We recommend that the measure should be available immediately to avoid any perception of market distortion.

- What happens if the issuance does not come through?

  We would recommend professional costs incurred prior to an issuance not completing should allowed in line with similar costs which would be allowable if equivalent debt financing failed.

- Which types of companies would benefit in practice (so for example some data and commentary on how many new and further issues are conducted by growing, finance-constrained corporates versus, for example, distressed corporates or investment trust companies)

  The analysis provided by the London Stock Exchange shows that out the 130 companies raising funds on AIM between 1 December 2012 and 30 June 2014:-
  6 involved in investment business or involved property investment.
  Circa 40 companies were involved in high technology/biotechnology, pharmaceuticals and renewable energy.
  The remaining companies were involved in a range of industries including retail, media, manufacturing and telecommunications.

- How much it would cost the exchequer with the chosen (500k?) relief threshold, and the workings for that
  We estimate that over a 12 month period the relief would cost approximately or up to £60m. This is calculated based upon:-

Approximately 130 companies undertaking issuances on AIM and 60 on the Main market over a 12 month period,
£1.5m corporate tax relief available for each at a corporate tax rate of 20%.

A notable number of the 130 companies undertaking an issuance on AIM were registered offshore and may not be subject to UK tax, which would reduce the possible costs to the exchequer.

- Various details in designing a relief including the treatment of costs incurred for rights issues that are subsequently cancelled, etc
  As stated above, aborted costs would be treated as allowable in line with the treatment of abortive costs associated with debt financing. There are a limited number of issuances that are aborted and costs are likely to reduced due to contingent nature of costs. We believe allowing all costs related to successful and cancelled issuances will reduce the level of complexity when drafting the measure.