The Quoted
Companies Alliance

The Quoted Companies Alliance

2011 Budget and Consultative Documents

Outline Proposals for Taxation Reform

February 2011

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Section

1. THE QUOTED COMPANIES ALLIANCE – INTRODUCTION AND CONSTITUENCY

The Quoted Companies Alliance (QCA) is a not for profit organisation which works for small and mid-cap quoted companies in the UK and Europe to promote and maintain vibrant, healthy and liquid markets. The QCA is the only organisation dedicated solely to promoting and pursuing the interests and concerns of small and mid-cap quoted companies and their advisers.

Small and mid-cap quoted companies are the approximately 2,000 companies outside the FTSE 350 on the Main List and those quoted on AIM and PLUS, which comprise 85% of all UK quoted companies. The total market capitalisation of the small and mid-cap quoted company sector in the UK is £110.8 billion (as of January 2011).

Small and mid-cap quoted companies employ some 1 million people, representing 4% of private sector employment. Every 5% growth in employment in this sector could reduce unemployment by a further 50,000.

QCA research shows that small and mid-cap quoted companies contribute substantially to the UK economy:

- £560 million in Corporation Tax payable;
- £3 billion in Employees' Income Tax;
- £3 billion in Employers' National Insurance Contributions; and
- £3 billion in Employees' National Insurance Contributions

These figures do not include the contribution these companies contribute from business rates, VAT and other indirect taxes.

The members of the QCA Tax Committee who compiled these proposals after discussion with the QCA's corporate members are:

Vijay Thakrar (Chairman)	Deloitte LLP
Tim Crosley (Deputy Chairman)	Memery Crystal LLP
Paul Barnes	KPMG LLP
Chris Bond	PKF (UK) LLP
David Boyd	Mazars LLP
Nick Burt	Nabarro LLP
Jason Collins	McGrigors LLP
Paul Fay	Crowe Clark Whitehill LLP
Natasha Kaye	Olswang LLP
Neil Pamplin	Grant Thornton LLP
Michael Ridsdale	Wedlake Bell LLP
Amanda Solomon	Charles Russell LLP
Kate Jalbert	Quoted Companies Alliance
Tim Ward	Quoted Companies Alliance

The QCA Share Schemes Committee also supports these proposals. A list of committee members is available in **Appendix B**.

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2. EXECUTIVE SUMMARY

With banks reluctant to provide finance in the current economic climate, maintaining investment in the small and mid-cap quoted company sector is now more important than ever. Our proposals are designed to help drive private sector growth and employment and include suggestions for funding the proposed changes as follows:

- **CGT Reform of Entrepreneurs' Relief**

Our proposals are designed to help align the interests of employers and shareholders and to encourage the provision of capital and expertise to SMEs, the engines of growth in the UK economy. They would be funded by proposals to only provide favourable CGT relief for longer term investments.

- **Venture Capital Schemes**

Our proposals to simplify and extend the reliefs to businesses with up to 250 employees should lead to increased stimulus for the SME sector to drive growth and help fill the finance gap. Increasing the employee limit would have the knock-on effect of creating more employment within businesses without affecting a company's EIS/VCT status and result in corresponding increases in employment and corporation taxes collected by HMRC.

- **Stamp Duty/ISAs/Costs of Raising Equity**

These proposals are designed to stimulate activity in the shares of small and mid-cap quoted companies, which will help drive investment in the sector.

- **HMRC Administration/ Dispute Resolution**

Our proposal should help bring more collaboration between HMRC and tax-paying companies.

Section 3 of this paper summarises each of our proposals and Section 4 outlines the details of each.

3. Summary of Proposals

Financing Private Sector Recovery and Incentivising Investors and Stakeholders

Issue	Proposal	Reference
Capital Gains Tax (CGT) Reform of Entrepreneurs' Relief	Rebrand Entrepreneurs' Relief as **'Stakeholders' Relief'** to identify those parties that make a meaningful contribution to the success of a business and more clearly align employee and shareholder interests to promote long-term growth and employment.	**4.1**

Target this relief for three categories of stakeholder: **Employees and Officers, Business Angels,** and **Long-Term Investors.**

For Employees and Officers:

- Remove the personal company definition (5% voting rights and 5% of ordinary share capital in the company must be held to qualify for the relief), as currently outlined in Entrepreneurs' Relief.
- Have the relief applied from the date the option is granted (rather than exercised) for HMRC "approved" schemes, including Enterprise Management Incentive Schemes.
- To fund the above relaxations and to promote long-term thinking, extend the current holding period from 12 months to 36 months (three years).

For Business Angels:

- To encourage more business angels to support growing businesses, remove the condition that those qualifying for the current Entrepreneurs' Relief must be an employee or officer.
- Define the materiality of their equity investment by retaining the requirement to hold 5% voting rights and 5% of ordinary share capital in the qualifying company, as currently outlined in Entrepreneurs' Relief.
- Introduce a three year holding period for shares to encourage long-term commitment.
- Consider targeting this relief to the SME sector by defining a qualifying company as:

    a) any publicly traded company with a market capitalisation below £100m at the time of investment (but with no such limit for private companies); **OR**

    b) any company that is considered 'unlisted', including those that are private and/or quoted on AIM and PLUS-quoted in the UK, similar to the Inheritance Tax 100% Business Property Relief.

For Long-Term Investors:

- To encourage external long-term investment in SMEs remove the condition that those qualifying for the current Entrepreneurs' Relief must be an employee or officer.

- Remove the personal company definition (5% voting rights and 5% of ordinary share capital in the company must be held to qualify for the relief), as currently outlined in Entrepreneurs' Relief, and do not require a minimum material stake in a qualifying company.

- To fund above suggestions and to only reward long-term investment growth, introduce a five year holding period for shares.

- Consider targeting this relief to the SME sector by defining a qualifying company as:

    c) any publicly traded company with a market capitalisation below £100m at the time of investment (but with no such limit for private companies); **OR**

    d) any company that is considered 'unlisted', including those that are private and/or quoted on AIM and PLUS-quoted in the UK, similar to the Inheritance Tax 100% Business Property Relief.

Venture Capital Schemes (Venture Capital Trusts (VCTs) and Enterprise Investment Scheme (EIS))

Remodel the schemes with the purpose of creating jobs by raising the employee limit from 50 to 250. **4.2**

Expand the availability of the schemes through increasing the employee, gross assets and annual investment limits to fill the growing equity gap and to fall in line with the Research and Development tax regime.

Consult with industry as to the best way to finance this relief extension.

Explore technical changes to the schemes which would allow more smaller companies to qualify (e.g. business angel investors' connection with the company discounting their qualification for the EIS).

Allow Venture Capital Trusts to participate in the secondary market.

Stamp Duty

Eliminate Stamp Duty on shares quoted on exchange regulated markets (e.g. AIM and PLUS-quoted) and announce the intention to eliminate Stamp Duty for all shares over a three year period. **4.3**

ISAs

Allow investments quoted on exchange regulated markets (e.g. AIM and PLUS) to qualify for inclusion in ISAs. **4.4**

Develop a retail investment product, structured similarly to an ISA, in which investors could specify the industry and/or locality they would like their money to be invested.

Cost of raising equity

Costs to be deductible up to a limit of £500,000 or extended to "small or medium-sized" companies. **4.5**

Administration/ Dispute Resolution	Formal announcement of revised approach to HMRC's litigation and settlement strategy and encouragement of HMRC to help promote UK on collaboration and certainty issues.	**4.6**

4. DETAILED PROPOSALS - Financing Private Sector Recovery and Incentivising Investors and Stakeholders

4.1 Focus area: Capital Gains Tax (CGT Reform) of Entrepreneurs' Relief

- **Introduction**

We believe that well targeted and cost effective capital gains tax reliefs to encourage equity investment in private and public companies will demonstrate that the Coalition Government is prepared to act quickly and decisively to promote entrepreneurial activity (the key message in the CGT arena in the Coalition's paper "Our Programme for Government"). We also note that CGT reform and the taxation of equity stakeholders in business is closely connected with the discussion in HM Treasury's and the Department of Business, Innovation and Skills' (BIS) consultation – *Financing a Private Sector Recovery*. Furthermore, it is generally accepted that the alignment of employee and shareholder interests promote long-term growth in corporate profitability and therefore a higher tax yield for the Exchequer.

We believe that now is the right time for the new Coalition Government to address, for the long-term, this vitally important area of personal taxation, being an area where the previous Government's recent policy and legislation has been in various measures short-termist and poorly implemented.

The QCA represents small and mid-cap quoted companies, which are dependent on their ability to attract talented individuals to contribute to the success of their businesses, whether as employees, officers, business angels, or long-term investors. Our members need to attract investors who are willing to commit capital over a period of years to small and medium-sized businesses, which are essential to the UK economy.

The Government can help small and medium-sized businesses to attract the necessary talent and investment by adapting the existing Entrepreneurs' Relief, at least in so far as it relates to disposals of shares rather than other business assets, and perhaps even rebranding it as "Stakeholders' Relief". In doing so we are, necessarily, conscious that any potential additional costs for the Treasury involved in an extension of the current rules need to be carefully justified and any rebranded tax relief needs to be well targeted and effective. We have added some suggestions regarding how these changes could be funded in these proposals below.

- **The History of Entrepreneurs' Relief**

The introduction of Entrepreneurs' Relief was a reaction to the severe criticism accompanying the abolition of taper relief. The announcement that Entrepreneurs' Relief was to be introduced was made on 24 January 2008 (almost four months after the Pre-Budget Report which prompted such an outcry). The Finance Bill, which implemented this measure, was published only two months later. In view of this timetable the parliamentary draftsmen evidently decided to use the old retirement relief (abolished in 1999) as a basis for the new provisions.

Therefore the current definition of "personal company" is similar to, but not the same as, that for retirement relief. The key differences are the removal of the requirement for involvement in a "managerial or technical capacity" and the additional requirement to hold 5% of the ordinary share capital in the company, as well as 5% of the voting rights.

The figure of 5% appears to have been lifted from retirement relief with little thought being put into whether or not this was appropriate. HMRC's representative to the House of Lords Select Committee on Economic Affairs, when asked to explain why this level was set, stated that "where to draw the line in determining the appropriate percentage was a matter for Ministers, but 5% had been in retirement relief". The relief was said to be directed at "those with a material stake in a company and those who play an active role in it"[1].

[1] Jane Kennedy, Public Bill Committee, 8 May 2008 (PM), column 136.

- **Proposals for Reform**

Our proposals are directed at more accurately targeting the relief by identifying those who make the most meaningful contribution to the success of a business. We are proposing that such relief should be targeted at what we have termed 'stakeholders' in companies, by virtue of the contribution (and risks) that such an individual makes in building up a successful business. We have identified the following types of stakeholder as being key to the long-term growth of the private sector:

a) employees and officers;
b) business angels; and
c) long-term investors.

We have outlined below the changes to Entrepreneurs' Relief for each category of stakeholder.

A. Employees and Officers

The rationale for providing relief to employees and officers who own shares in the business is that this will make share-based employee incentivisation packages (a key weapon 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) more attractive to individuals and reward their contributions to the business for which they work. Employees involvement in their businesses through ownership of shares is considered to be a significant contributor to employee engagement. 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 prospect 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 investors would encourage further engagement and ultimately help drive growth through alignment of employee and shareholders interest. This will help businesses to attract the talented people they need to grow successfully – a company's personnel are its key stakeholders.

We would, therefore, request the removal of the inappropriate personal company definition. 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 in the company in which he holds shares to qualify for relief (the "5% Requirement"). This is in addition to the need to be an employee or officer of the relevant company.

The 5% Requirement penalises those shareholders working within high-capital-requirement, high-growth businesses as their need for significant outside investment is more likely to result in those shareholders actually involved in the running of the business having to accept dilution of their rights (often to below the qualifying 5%) or not being able to negotiate 5% packages due to the high value of such a holding. This is at odds with the overarching aim of promoting entrepreneurial business activity.

The 5% Requirement can also lead to an anomalous 'cliff–edge' two-tier system amongst employees, with those unable to negotiate compliant packages now receiving even more unequal tax treatment in view of the fact that their colleagues will receive increased relief (following the welcome increase of the overall lifetime limit), whilst some of them will be subject to the newly increased 28% rate of capital gains tax.

We note that the 5% Requirement also can 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/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 which was simply lifted from the old retirement relief with no critical thought as to whether it was appropriate. For the reasons stated above we consider the 5% Requirement is inappropriate in the modern business world and should be abolished for employees/officers of the business.

In addition, to align the treatment of employees who own shares with those companies that have HMRC "approved" schemes (including Enterprise Management Incentive Schemes), we request that Stakeholders' Relief is applied from the date an option is granted (rather than exercised).

We realise that dropping the 5% Requirement will be a cost to the Treasury. As such, we would propose that employees and officers could only claim the capital gains relief if the shares were held for an ownership period of at least three years (the current period under Entrepreneurs' Relief is now 12 months). This would help defer the cost to the Treasury and also encourage these stakeholders to be long-term investors.

B. Business Angels

We would ask the government to include within the restructured relief 'business angels', who may not for very good commercial reasons wish to be officers or employees, but who are considering investing for a material stake in the equity capital of a company. At present, notwithstanding that such a potentially significant entrepreneurial investor may provide key financing for the company, no Entrepreneurs' Relief is available.

We believe that it may be appropriate to define the materiality of the equity investment in order to qualify for the relief. We would recommend retaining the current 5% Requirement in Entrepreneurs' Relief for business angels (e.g. they must hold 5% of the voting rights and 5% of the ordinary share capital in the company). However, we would remove the current requirement in Entrepreneurs' Relief for the need of the business angel to be an employee or officer of the company.

In order to target this category of "Stakeholders' Relief" more precisely to address the increased difficulties of obtaining equity investment in the SME sector, it may also be appropriate to set a limit on the size of the business whose shares can qualify. Such a limit should be straightforward to apply. Two potential qualifying options could be based on:

i. **Market Capitalisation** – Qualifying companies would be those whose shares are publicly traded on any UK market below £100 million at the time of investment (but with no such limit for private companies). We consider £100 million to be in line with the definition of a 'company with a reduced market capitalisation' as defined in the amending Directive to the Prospectus Directive.

OR

ii. **Market Segment –** Qualifying companies would be those that are considered 'unlisted', including those that are private and/or quoted on exchange regulated markets (i.e. AIM and PLUS-quoted). This would be similar to the current qualifying criteria of the Inheritance Tax 100% Business Property Relief, which only applies to 'unlisted' companies.

C. Long-Term Investors

We would argue that investors who choose to invest over a period of years in smaller companies, which are often perceived as 'riskier', make a valuable contribution by providing the stable financial base necessary to promote growth. These individuals are true stakeholders in the business, and such a relief would encourage longer-term rather than speculative investing. Taper relief recognised and rewarded this (although we have sympathy with the view that the reduction in the qualifying period to just two years was too generous), and the current Entrepreneurs' Relief includes a general condition that the shares have to be held for 12 months. As with business angels, it does not seem to be relevant in this context whether the investor is an employee or officer of the business.

We would propose that those who invest in a qualifying company long-term should also be eligible for "Stakeholders' Relief", with no minimum equity stake required, but requiring a five year holding period of shares. As with business angels, it may be appropriate to target this category of relief more precisely, and we would view it as appropriate to set a limit on the size of the business whose shares can qualify similar to that outlined above in **Section B - 'Business Angels'**.

D. Table 1 – Outline of Stakeholders' Relief Proposals

Types of Investor	Requirement to hold 5% voting and share capital?	Requirement to be an Employee/Officer?	Requirement of a Holding Period?	Other Conditions
Employees and Officers	No	Yes	3 years	None
Business Angels	Yes	No	3 years	Target relief to the SME sector by requiring a qualifying company test based either on market capitalisation or market segment, such as AIM/PLUS-quoted.
Long-Term Investor	No	No	5 years	Target relief to the SME sector by requiring a qualifying company test based either on market capitalisation or market segment, such as AIM/PLUS-quoted.

QCA Proposal:

Rebrand Entrepreneurs' Relief as 'Stakeholders' Relief' to identify those parties that make a meaningful contribution to the success of a business and more clearly align employee and shareholder interests to promote long-term growth and employment.

Target this relief for three categories of stakeholder: Employees and Officers, Business Angels, and Long-Term Investors.

For Employees and Officers:

Remove the personal company definition (5% voting rights and 5% of ordinary share capital in the company must be held to qualify for the relief), as currently outlined in Entrepreneurs' Relief.

Have the relief applied from the date the option is granted (rather than exercised) for HMRC "approved" schemes, including Enterprise Management Incentive Schemes.

To fund the above relaxations and to promote long-term thinking, extend the current holding period from 12 months to 36 months (three years).

For Business Angels:

To encourage more business angels to support growing businesses, remove the condition that those qualifying for the current Entrepreneurs' Relief must be an employee or officer.

Define the materiality of their equity investment by retaining the requirement to hold 5% voting rights and 5% of ordinary share capital in the qualifying company, as currently outlined in Entrepreneurs' Relief.

Introduce a three year holding period for shares to encourage long-term commitment.

Consider targeting this relief to the SME sector by defining a qualifying company as:

a) any publicly traded company with a market capitalisation below £100m at the time of investment (but with no such limit for private companies); OR

b) any company that is considered 'unlisted', including those that are private and/or quoted on AIM and PLUS-quoted in the UK, similar to the Inheritance Tax 100% Business Property Relief.

For Long-Term Investors:

To encourage external long-term investment in SMEs remove the condition that those qualifying for the current Entrepreneurs' Relief must be an employee or officer.

Remove the personal company definition (5% voting rights and 5% of ordinary share capital in the company must be held to qualify for the relief), as currently outlined in Entrepreneurs' Relief, and do not require a minimum material stake in a qualifying company.

To fund above suggestions and to only reward long-term investment growth, introduce a five year holding period for shares.

Consider targeting this relief to the SME sector by defining a qualifying company as:

a) any publicly traded company with a market capitalisation below £100m at the time of investment (but with no such limit for private companies); OR

b) any company that is considered 'unlisted', including those that are private and/or quoted on AIM and PLUS-quoted in the UK, similar to the Inheritance Tax 100% Business Property Relief.

4.2 Focus area: Venture Capital Schemes – Venture Capital Trusts (VCTs) and the Enterprise Investment Scheme (EIS)

- **Introduction**

The Enterprise Investment Scheme ('EIS') and Venture Capital Trusts ('VCTs') were introduced in the mid 1990s by the last Conservative government, to provide assistance to small and medium sized companies who were facing the "equity gap". The 'equity gap' (between £2m and £10m) has become more pronounced since 1995, as traditional institutions have moved away from providing finance to smaller companies.

The schemes are targeted at companies which might otherwise find it difficult to raise funds. Certain businesses are excluded from benefiting from the schemes because of the nature of their operations or because they typically have significant property assets which could be used as collateral for raising money.

Companies which are intended to benefit from the schemes are inherently risky in nature, and not all have succeeded. However many companies have grown by virtue of receiving funds under the schemes, and it is believed that such companies have helped increase employment and exports in line with the original policy objectives. As a result the Exchequer has received further PAYE and social security contributions, and potential unemployment costs have been avoided. Such companies continue to provide corporation tax and VAT receipts.

As such, the QCA believes that these current tax incentives should be maintained.

- **Proposals for Reform**

A. Qualifying Company Definition – Employee, Gross Assets and Annual Investment Limits

Since 2006 the schemes have been restricted apparently as a result of seeking EU State Aid approval and, for example, now exclude companies which have 50 or more employees. The EIS and VCT schemes have the potential to assist in the financing of a private sector recovery, and the QCA recommends that the Government look again at the range of companies that can receive funds from EIS and VCT sources.

The QCA believes that, while the original policy objective of the schemes should be maintained, the schemes should be remodelled with a specific purpose in mind – the creation of jobs. As such the qualifying criteria should be refocused accordingly, including a revision of the limits upwards to encourage the creation of private sector jobs.

VCTs have assets of some £2.5 billion under management, and tax relief has already been given to investors. Many older VCTs have recycled the funds under management, having made successful realisations and invested the proceeds into other investments. It is thought that at any one time somewhere around one quarter of VCT funds is available for investment. This is a significant sum which has the potential to be harnessed in the near future to support small and medium sized businesses, particularly if some of the investment limits were raised. There would be no further tax cost to the Exchequer in making these funds available to more businesses.

The previous Government announced in the March 2010 Budget that they intended to consider the case for increasing the employee limit, the gross assets limit and the annual investment limit. The current State Aid Risk Capital Guidelines permit State Aid to companies with up to 250 employees, and with an annual balance sheet total of €43 million (or equivalent in local currency).

We recommend that the limits in the EIS and VCT legislation are reviewed to allow the schemes to provide finance to small and medium sized companies within the State Aid criteria and away from companies where it is not clear that value is being added to the economy. The employee limit has reduced the supply of funds to companies with 50 or more employees. The number of employees has no bearing on the ability of the employing company to raise finance, and it appears that the current limit of 50 employees is contrary to the original policy purpose of the schemes and does not seem justified by the EU State Aid guidelines. As such, we would recommend that employee limit be raised to 250.

We appreciate that this has a cost implications for the Exchequer and we would recommend that HM Treasury consult with industry on how best to finance the extension of the relief. Nonetheless, we would strongly encourage the Government to look at the overall benefits of increasing the employee limit, as this would have the knock-on effect of creating more employment within businesses without affecting a company's EIS/VCT status and result in corresponding increases in employment and corporation taxes collected by HMRC.

The State Aid Risk Capital Guidelines permit the Commission to agree an annual investment limit above the current level if evidence of market failure is given. The Rowland's Growth Capital Review, which identified the funding gap as being between £2m and £10m, could be used as part of that evidence to raise the threshold to at least £5m (or higher).

B. Technical Changes to the Schemes

Aside from the employee, balance sheet total and annual investment limits, the Government can make changes to the schemes to make it easier for private individuals to provide much needed capital. The EIS permits 'business angel investors' to receive EIS income tax relief, but the conditions are onerous. Such business angels provide expertise and may also be able to provide finance, but if they have had any connection with the company at any time prior to their investment, or received any payment, they may not be able to qualify for the tax relief. The QCA believes this is a disincentive to the provision of both expertise and finance and that further funds and expertise from business angels might be forthcoming for small and medium-sized companies if these restrictions are eased.

We believe that there may be a number of technical changes to EIS and VCT schemes, such as the 'business angel investors' point above, that HM Treasury could make to the schemes without affecting the schemes' State Aid approval status. Many smaller companies find it difficult to qualify for the schemes because of small and strict technicalities. For example, we have compiled these two case studies of smaller companies that had difficulty qualifying for EIS relief as a result of the qualifying trade requirement:

Case Study 1

A group of musicians produced a demonstration album and they were advised to seek funding via the EIS to develop it. The receipt of royalties and licence fees is not a qualifying activity unless they are attributable to the exploitation of 'relevant intangible assets' (s195 ITA 2007). In order for intellectual property (the album) to be a relevant intangible asset, it has to be created in circumstances in which the right to exploit it vests in the company (whether alone or jointly with others) - s195(5).

In this case, the adviser did manage to find evidence of the intention for the IP to belong to the company, such as production invoices for the album being paid on behalf of the company, and so HMRC agreed that the trade did qualify – but it was quite a battle.

There must be many entrepreneurs, who create IP which they subsequently wish to exploit, but fail to meet the qualifying trade requirements because they either did not know that the IP would be worth exploiting at the time they created it or were unaware that it had to be created in circumstances (with evidential support) where it belongs at least partially to the company, which the investors will acquire shares in (or a subsidiary). It would be helpful if the legislation could be amended so that IP is still a relevant intangible asset if it is created by a person who subsequently becomes a connected person with the EIS company.

Case Study 2

A company wished to establish a trade specific to the 2012 Olympics. Obviously this trade will not continue much beyond the Olympics and so they will not be able to satisfy the requirement that the trade is carried on for 3 years (s181(1)). After speaking to the SCEC on a no names basis recently, their view was that if the Company was wound up after the Olympics that would not be an exemption within s182 (companies ceasing to meet the trading requirements because of administration or receivership), and that in order for investors to qualify to EIS relief the company would have to start another trade after the Olympics with no more than a short break between the two.

It may be useful to explore widening the exemption in s182 so that it includes companies which cease trading for genuine commercial reasons within the 3 year period and where there has not been any tax avoidance motive behind their establishment.

HM Treasury should explore in depth more technical issues in the schemes that make it difficult for companies to qualify, in addition to the re-evaluating the limits. The schemes should not dictate business behaviour or business models, or restrain entrepreneurial behaviour. We would be happy to find more case studies, such as the ones above, and make further suggestions in due course.

C. VCT Participation in the Secondary Markets

- **Introduction**

We strongly support the London Stock Exchange's proposals that the scope of VCTs should be extended to include the secondary market.

VCTs have in the past been successful in encouraging new investment in groundbreaking ventures. VCTs currently can only invest in shares when they are newly issued (i.e. the primary market). However, many small and mid-cap quoted companies are unable to raise capital cost-effectively by issuing new shares.

The current economic conditions mean that a more defensive approach to the small and mid-cap quoted company sector. In particular, steps should be taken to encourage maintenance of capital levels.

- **Proposal for Reform**

We believe that the current scheme should be extended to include issued shares in order to protect VCTs from an overall withdrawal of capital and help increase trading in the secondary market. This would then have the knock-on effect of increasing liquidity in markets, at a time when investor confidence and market participation is low.

QCA Proposal:

Remodel the schemes with the purpose of creating jobs by raising the employee limit from 50 to 250.

Expand the availability of the schemes through increasing the employee, gross assets and annual investment limits to fill the growing equity gap.

Explore technical changes to the schemes which would allow more smaller companies to qualify (e.g. business angel investors' connection with the company discounting their qualification for the EIS).

Allow VCTs to participate in the secondary market.

4.3 Focus Area: Stamp Duty

- **Introduction**

London is the only one of the world's three major financial centres with a tax on the transfer of shares and the UK has by far the highest rate among the G-8 economies, which makes the UK an unattractive market, particularly for European investors. A study by the ABI, City of London Corporation, IMA and London Stock Exchange entitled "Stamp Duty: its impact and the benefits of its abolition" (May 2007) confirmed this and showed that Stamp Duty increases the cost of equity for publicly listed companies by 7-8.5%. The same report indicates that Government's tax-take could increase if Stamp Duty were abolished as a result of increased turnover. The study estimates that the annual tax-take could increase by as much as £4,000m, which would exceed the estimated cost of abolition by well over a £1bn. Also, the study indicates that its abolition would have a one-off increase in Capital Gains Tax intake of £281m.

Even a gradual reduction in Stamp Duty could yield significant up front benefits if there was a firm commitment from Government to abolish the duty over a period of three years. Such a commitment would have a beneficial impact on the markets as a result of increased investment.

Abolition of duty on shares will significantly enhance the UK's attractiveness as an investment centre. Alongside the substantial shareholding exemption and the proposed exemption for foreign dividends, this measure could create a UK 'participation exemption', "which is likely to lead to an increased level of direct foreign investment" (The Tax Reform Commission, *Tax Matters: Reforming the Tax System*, October 2006).

- **Proposal for Reform**

We believe that the Government should announce its commitment to eliminating Stamp Duty/SDRT over a three year period.

However, the Government should immediately remove Stamp Duty on shares which are quoted on exchange regulated markets (e.g. AIM or PLUS-quoted), as we do not believe that this would significantly reduce the Government's tax income.

QCA Proposal:

Eliminate Stamp Duty on shares quoted on exchange regulated markets (e.g. AIM and PLUS-quoted) and announce the intention to eliminate Stamp Duty for all shares over a three year period.

4.4 Focus Area: Individual Savings Account (ISAs)

A. Inclusion of investments on exchange regulated markets in ISAs

The tax status of AIM and PLUS quoted companies has changed radically following the abolition of Business Asset Taper Relief. Consequently, companies quoted on an exchange regulated markets do not qualify for certain reliefs that are available to listed companies.

Currently shares in AIM and PLUS quoted companies do not qualify to be included as ISA investments. Given that this sector has recently lost significant CGT advantages, this would be a reasonable step to assist this market sector.

We view this measure as redirecting investment into a much-needed area, and hence we believe it can be implemented without significant cost to the Treasury.

B. Regional ISAs

HM Treasury's and BIS's consultation *Financing a Private Sector Recovery* discussed the possibility of the development of regional stock exchanges to encourage more local investments in UK companies.

If the theory behind regional stock exchanges is to harness local investors to invest in local businesses, we believe that, as stock exchanges no longer have any physical trading floor, this is not likely to be a particularly fruitful way of proceeding.

However, we would like to see more enquiry made as to the untapped potential of 'local' investing. We recommend consideration of a retail investment product – which might be structured similarly to an ISA – under which retail investors could invest small amounts of cash, perhaps on an annual basis, but which would give them some influence on how the money was invested. They could perhaps specify the industry and/or locality in which they would like their money to be invested. The actual investment would be undertaken by the administrators of the fund and their reward would be related to fund performance rather than the individual company their money was invested in.

QCA Proposal:

Allow investments quoted on exchange regulated markets (e.g. AIM and PLUS) to qualify for inclusion in ISAs.

Develop a retail investment product, structured similarly to an ISA, in which investors could specify the industry and/or locality they would like their money to be invested.

4.5 Focus Area: Tax relief for costs of raising equity (e.g. listing costs)

- **Introduction**

There is a specific entitlement to claim a tax deduction for costs incurred in raising debt finance, whereas the costs of raising finance through the issue of equity is not tax deductible. This represents an unnecessary and pronounced distortion in the tax system.

For a smaller company, this cost represents a disproportionately large percentage of funds being raised and is, therefore, a major disincentive to seeking a listing.

The UK is at a competitive disadvantage compared to other European regimes, such as Germany, Switzerland, Austria, Greece and Bulgaria, which provide tax relief for flotation costs. In Germany, Greece and Bulgaria, costs for issuing new equity are also tax deductible.

- **Proposal for Reform**

We believe that all costs in connection with the issue of new shares as part of a public offering should be tax deductible. If necessary, the relief could be limited to a specified amount, for example £500,000, or restricted to those companies that fall within the European Union small or medium-sized enterprise definition. This would target the relief and reduce the costs to the Treasury. The costs would be written off over the average period of a loan, e.g. 5 years.

QCA Proposal: All costs in connection with the issue of new shares as part of a public offering should be tax deductible for small or medium-sized companies and/or subject to an upper limit of £500,000.

4.6 Focus Area: HMRC Administration/ Dispute Resolution/ Litigation and Settlement Strategy

In recent years, arguably the relationship between HMRC and taxpayers/their advisors has tended to become confrontational where in a difference of view on the interpretation of tax legislation. Whilst it is entirely incorrect that HMRC should seek to collect the "right amount of tax", it is also hopefully accepted that taxpayers should pay no more than the "right amount of tax". As tax law is complex, it is inevitable that in some cases the interpretation thereof and the view of the "right amount of tax" will vary as between HMRC and taxpayers.

There is a view, which is now appearing to be acknowledged by HMRC (e.g. In a *Tax Journal* article of 10 January 2011) that some HRMC inspectors have interpreted the litigation and settlement strategy too narrowly and have adopted and "all or nothing" approach to grey areas of tax law and practice. This has led to, amongst other things:

- Prolonged disputes between HMRC and taxpayers;
- HMRC/HM Treasury not collecting tax in dispute at a time when the Exchequer has serious need for receipts, owing to an uncommercial approach to the tax dispute resolution;
- Increased legal/professional costs to both the Exchequer and UK taxpayers generally; and
- Uncertainty and frustration for taxpayers, some of whom have chosen to base their operations outside of the UK based on the approach of the tax authorities, which is one factor in assessing business decisions.

We welcome the apparent change in emphasis in HMRC's Dispute Resolution/Litigation & Settlement Strategy, with the recognition that not all disputes are black and white and that settlement without litigation can benefit the Exchequer as well as business.

We understand that HMRC's Dispute Resolution/Mediation Pilot is likely to apply to only the largest cases. The QCA's members are small and mid-cap quoted companies who often "give in" to HMRC on disputes because they don't have the resources of HMRC or of bigger corporates to fight cases through litigation. Ultimately this can damage the UK economy because the entrepreneurial flair is stunted and/or activities are based outside the UK.

QCA Proposal:

We would recommend a formal update to the Litigation & Settlement Strategy to confirm this approach. Also, we would recommend that HMRC is charged with adopting a culture that seeks to promote the UK as a business friendly jurisdiction, which adopts a collaborative and more certain business approach. This should help attract and retain more businesses in the UK, which in turn would help to stimulate growth and employment.

APPENDIX A: QCA COMMENTS ON CONSULTATIONS

1. **QCA Response to HM Treasury's and the Department of Business, Innovation and Skills's *Financing a Private Sector Recovery* (Business Finance Green Paper)**

Much of the content of the QCA's Budget Representations has come from the QCA's response to HM Treasury's and the Department of Business, Innovation and Skills's *Financing a Private Sector Recovery* consultation. In our response, we highlighted three areas from which to stimulate the small and mid-cap quoted company sector, including investor enablement, improving access to non-bank finance, greater transparency and incentivising investors and stakeholders.

To read the full response, please visit: http://www.theqca.com/about-us/responses/30701/qca-response-to-hm-treasuryand39s-and-bisand39s-consultation-on-financing-a-private-sector-recovery.thtml

APPENDIX B: MEMBERS OF THE QCA SHARE SCHEMES COMMITTEE

Nicholas Stretch (Chairman)	CMS Cameron McKenna LLP
Fiona Bell (Deputy Chairman)	Memery Crystal LLP
Martin Benson	Baker Tilly
Danny Blum	Eversheds LLP
Chris Browne	KPMG LLP
Sara Cohen	Lewis Silkin
Christopher Connors	Charles Russell LLP
Michael Deeks	Olswang LLP
Amanda Stapleton	Mazars LLP
Jared Cranney	Interior Services Group plc
John Daughtrey	Equiniti
James Dean	Osborne Clarke
David Ellis	BDO LLP
Matthew Findlay	Hewitt New Bridge Street
Philip Fisher	PKF (UK) LLP
Amanda Flint	BDO LLP
Jeremy Glover	Stephenson Harwood
Paula Hargaden	Burges Salmon
Colin Kendon	Bird & Bird
Michael Landon*/Nigel Mills	MM & K Limited
Peter Mossop	Sanne Group
Robert Postlethwaite/Stephen Chater	Postlethwaite & Co
Nick Wallis	Smith & Williamson Limited
Kate Jalbert	Quoted Companies Alliance
Tim Ward	Quoted Companies Alliance