QUOTED COMPANIES ALLIANCE

Quoted Companies Alliance

6 Kinghorn Street
London EC1A 7HW

T +44 (0)20 7600 3745
F +44 (0)20 7600 8288
mail@theqca.com

www.theqca.com

Ellen Milner
HM Revenue and Customs (HMRC)
3/63
100 Parliament Street
London, SW1A 2BQ

ellen.milner@hmrc.gsi.gov.uk

9 October 2013

Dear Sirs,

HMRC - Reform of close company loans to participators rules

Introduction

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

The Quoted Companies Alliance is a founder member of European**Issuers**, which represents over 9,000 quoted companies in fourteen European countries.

The Quoted Companies Alliance Share Schemes Expert Group has examined your proposals and advised on this response. A list of members of the expert group is at Appendix A.

Response

We welcome the opportunity to respond to this consultation.

1. **Do you agree these are the right primary objectives for rules governing the taxation of loans from close companies to their participators? Please explain your answer.**
2. **What, if any, other objectives do you think any reform should seek to address?**

A purpose of the rules for governing the taxation of loans from close companies to their participators must be to protect against the transfer of value outside the scope of income tax or national insurance as appropriate. Such rules must be one of the protections to ensure that closely held companies are not used for tax avoidance or abuse. The reason for targeting closely held companies might be that companies in the control of few people could be used as extensions of the individuals who control the company, with limited corporate governance or outside controls, to ensure that the property is fairly distributed and appropriately taxed.

The legislation, however, is not aimed only at that objective.

Public companies will tend to be regulated and scrutinised according to the Rules that govern the listing or trading of shares (as well as investor guidelines and similar) and the opportunities for abuse are limited.

Normally public companies publicly report details of directors' salaries and generally remuneration policies are published. Therefore, the loans to participators rules are inappropriate for such regulated public companies. It is unusual, but not that rare, for quoted companies to be close companies. It is also unusual for public companies to make direct loans, except for minor sums, to directors or participators due to various reasons and therefore funding would typically involve the use of an employee share trusts (EBTs). Please note that we are not suggesting that rules should not apply to ensure that an appropriate charge is made where loans are written off.

We believe that an unintended consequence of the taxation rules for loans to participators is that it discourages wider share ownership.

This response is made on behalf of those who are daily involved in employee share incentive arrangements and therefore the experience of loans to participators is predominately in the context of loans to directors, usually indirectly through an EBT to enable them to become shareholders. Such directors are usually participators by virtue of their office rather than by having a shareholding of more than 5% in the company.

Loans to such directors enable them to take up shareholding expected by investors, encouraged by corporate governance codes (to allow the alignment of the interests of shareholders and directors). (Part 7A Income Tax (Earnings and Pensions) Act 2003 also has an impact for loans through an EBT.) This tax treatment of such loans applies whether shares are awarded under an HMRC approved company share option plan (CSOP) or under a qualifying Enterprise Management Incentive (EMI) Scheme. In addition companies also make loans to EBTs to enable shares to be bought on the market and distributed to non-participators via share incentive plans, commonly, though not exclusively, under EMI or CSOP arrangements.

It should also be noted that commonly loans are made rather than gifts because public companies (but not other companies) are limited in their ability to fund the acquisition of their own shares unless the net assets of the company in question are not reduced (hence the need for a loan – section 682 Companies Act 2006).

3. **For each of the options, including the current regime as outlined in Chapter 3, please consider the following questions:**

a. Would the option be an appropriate and effective deterrent to extractions of value by participators from close companies? Please explain your answer.

- **Maintain the current regime**

This is currently a deterrent and due to the cost to the company anecdotal evidence suggests this charge will frequently discourage the commercial activities, for example for the benefit of employees. Whilst a statistic is given for the value of the outstanding loans (£1 billion), there is no indication as to whether this is increasing year on year or the levels of repayment, which might fairly indicate if the loans are relatively short term arrangements or permanent extractions of funds.

- **Increase the tax rate**

For genuine lost arrangements this merely increases the cash flow cost for UK companies that are currently struggling with fiscal challenges to the businesses. It would be a further deterrent to helping employees become shareholders.

- **Give a permanent annual charge on the amount at the end of the year**

The relevant point would be the rate of the annual charge. It is possible that some companies would find it easier to fund a 5% charge than a 25%, even if that were to be repaid after some years.

- **Give a permanent annual charge on the average amount outstanding**

This might reduce the opportunities to manipulate the amount outstanding and the change but increases the costs of compliance for companies.

b. Is the options itself robust against avoidance? Please explain your answer.

We have not seen loans to participators being used as part of an anti-avoidance arrangement; therefore it appears robust at present.

c. Does the option inhibit genuine commercial practice? Please provide any real-life examples you have as to why the option could create difficulties.

Please see the examples in the introduction as to why this prohibits genuine commercial activities to facilitate share ownership among employees and directors.

d. What do you think presents the fairest option, and why?

From the point of view of quoted companies, none of the options are fair and consideration should be given to a suitable exclusion of the application for quoted companies (including where shares are traded on AIM or ISDX). As regards other companies, the fairest option is one where a full refund is available; but, in practice, smaller companies may find it fairer to fund 5% annually than 25% as an upfront charge.

e. How do you think the option affects administrative burdens for business? Would the administrative burdens be proportionate?

Each option gives administrative burdens simply by adding additional rules and compliance and additional accounting and/or legal costs to ensure that the company does not go outside the rules.

f. How could the option better meet the policy objectives or be improved?

If the policy objective is to deter commercial loans to participators then, from our experience in talking to companies, the current arrangements do this. It deters, so that loans are made if necessary and with the hope of repayment. If the true policy objective is to prohibit such loans where used for tax avoidance, then to match the higher rates of tax would achieve this, but would prohibit many genuine loans for the benefit, ultimately of non-participators via EBTs. Therefore there needs to be targeted exceptions to allow for commercial arrangements.

g. Do you think the suggested rates of tax are appropriate? Why (not)?

Comments have been made above relating to the rates.

h. Please identify and explain what you consider to be the strengths and weaknesses of the option.

See the response to a. above.

4. The options do not form an exhaustive list – we would welcome alternative proposals or suggestions as to how the options or current regime could be improved. Are there any other options that may be more appropriate? In setting out your answer please make reference to the points above.

In seeking to target the deterrent without affecting commercial arrangements for the benefit of non-participators or participators holding less than, say, 5% of the issued share capital, we suggest considering an increase to the tax rate, whether in a repayable form or as a permanent annual charge. However, we believe that specific arrangements should be carved out, e.g., loans to participators in quoted or otherwise regulated companies, loans to employees purely to enable them to acquire shares in the company and loans to employee share trusts where such loans are used to facilitate or enable the acquisition of share by or for the benefit of employees and their close family relatives (see the definition of employees' share scheme in section 1166 Companies Act 2006).

5. Are there any interactions which HMRC should be considering: in particular are there any specific interactions which would render any of the options ineffective or inappropriate?

HMRC should note that, for benefits for employees, there will be alternative ways to ensure that tax arises. For example, loans to participators who are employees might be charged annually if no interest is payable as a beneficial loan and, if the loan is written off, not only would there be no repayment of the tax paid by the company but the individual would be taxable. Further, where funding arises via an employee benefit trust, there is already legislation in Part 7A of ITEPA to ensure tax arises where appropriate.

6. Do you think any of the reform options impact upon individuals or households? Please explain your answer.

The remuneration of directors of early stage or small and mid-size quoted companies tends to reflect the current stage of development of that company, and therefore may not be paid large salaries. Yet directors of quoted companies are normally expected to buy shares in their company at their own expense. If they cannot acquire some support by way of loan from a company or employee benefit trust, then individuals and their families would experience some level of hardship trying to fund acquisitions through personal savings or bank loans.

7. Do you think any of the reform options raise questions about equality? Please explain your answer.

No.

8. How effective is each of the options at reducing administrative burdens for business? Please explain your answer.

All of the options impose administrative burdens on the company. See 3e above.

9. What other (positive or negative) impacts do you think each of the reforms may have? Please explain your answer.

As mentioned in our Introduction, we believe that the taxation rules for loans to participators have a negative effect on wider share ownership and in particular employee owned or controlled companies.

If you would like to discuss any of our response further, we would be happy to attend a meeting.

Yours faithfully,

Tim Ward
Chief Executive

APPENDIX A

Quoted Companies Alliance Share Schemes Expert Group

Fiona Bell (Chairman)	RM2 Partnership Limited
Barbara Allen	Stephenson Harwood
Emma Bailey	Fox Williams LLP
Martin Benson	Baker Tilly
Danny Blum	Eversheds LLP
Anika Chandra	Stephenson Harwood
Sara Cohen	Lewis Silkin
Karen Cooper	Osborne Clarke
Jared Cranney	ISG plc
Rory Cray	FIT Remuneration Consultants
Vanessa Cundy Cooper	KPMG LLP
John Daughtrey	Equiniti
MattheW Findley	Pinsent Masons LLP
David Firth	Penna Consulting PLC
Philip Fisher/ Andy Goodman	BDO LLP
David Fuller	CLS Holdings PLC
Mark Gearing	Field Fisher Waterhouse
Paula Hargaden	Burges Salmon
Colin Kendon	Bird & Bird LLP
Michael Landon	MM & K Limited
Robert Postlethwaite/ Stephen Chater	Postlethwaite & Co
Andrew Quayle	Olswang
Richard Sharman/ Amanda Stapleton/ Amanda Flint	Grant Thornton UK LLP
Nicholas Stretch	CMS Cameron McKenna LLP
Mia Thursby-Pelham	PricewaterhouseCoopers LLP
Nick Wallis	Smith & Williamson Limited
Matthew Ward	Hewitt New Bridge Street