Quoted Companies Alliance

6 Kinghorn Street
London EC1A 7HW

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

www.theqca.com

Office of Tax Simplification
1 Horse Guards Rd
London
SW1A 2HQ

ots@ots.gov.uk

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To whom it may concern,

Capital Gains Tax review – call for evidence (Principles of CGT)

We welcome the opportunity to respond to your Capital Gains Tax (CGT) review on the principles of CGT.

The Quoted Companies Alliance *Tax Expert Group* and *Share Schemes Expert Group* has examined the proposals and advised on this response from the viewpoint of small and mid-size quoted companies. A list of Expert Group members can be found in Appendix A.

If you would like to discuss our response in more detail, we would be happy to attend a meeting.

Yours sincerely,

Tim Ward
Chief Executive

Respondents are encouraged to think broadly but asked particularly to consider the themes identified in the Chancellor's letter including:

- **Allowances, including the annual exempt amount, its level and the extent to which it distorts decision making;**

<u>General comments</u>

In relative terms, the allowance is a modest amount per person. This is recognised by the OTS as the consultation correctly points out that the majority of CGT is paid by a "relatively small number of taxpayers".

The QCA is of the opinion that there is little to no benefit in removing or even reducing the allowance, as the annual exempt amount is useful and appropriate, and in particular, for smaller employee share scheme gains.

There has been speculation about whether the Government might consider reducing the CGT annual allowance, with some indication it may be moved more in line with the dividend allowance. We are opposed to a reduction in the annual allowance as this would disproportionately impact employee participants in SAYE schemes and CSOPs and other small investors with comparatively small gains and low overall income, increasing the administration for HMRC and the individuals for both the returns and collection procedures.

That said, if the Government requires more austere measures, we would not be overly opposed to a freeze of the allowance of the current rate. A freeze of the allowance at the current rate for a short-term period would not engender too many complaints and would, in the future, serve as a useful way to retrieve more from CGT for HMRC.

- **Exemptions and reliefs, including how they fit together and the extent to which they incentivise some decision over others;**

<u>General comments</u>

Share Incentive Plans (SIPs), Save As You Earn (SAYE) schemes, Company Share Option Plans (CSOPs) and Enterprise Management Incentives (EMIs) all have special rules, which add to their complexity. Simplification of these rules, however, would increase unfairness and would reduce HMRCs tax take.

Similarly, the 10%, 18%, 20% and 28% rates of CGT, and the annual exemption, are not overly straightforward. However, issuing alternatives will only serve to create further complexities.

<u>SIPs</u>

SIPs are subject to rules under which qualifying employee shares are free from CGT while held in the SIP trust. Current employees can therefore leave their shares in the SIP trust for as long as they are employed and then sell them free from CGT (and from income tax and NIC if they have been held for at least 5 years). This relief encourages long-term, patient investment by and engagement of employees in their employing company/group.

One point that seems to create a lot of issues is that SIP leavers are deemed to withdraw their shares on the date they cease to be employed but often the plan administrator does not actually remove the shares from the SIP for some months. This creates PAYE/NIC issues if the employee leaves within 5 years and is not in the good leaver circumstances that are eligible for PAYE/NIC relief, but CGT would also be due on any growth in value from the date of the deemed withdrawal.

This could potentially be improved by requiring the employee to remove the shares within, say, six months of ceasing employment and applying tax at that point. Arguably a reduction from 5 to 3 years for the SIP maturity period might improve take up of SIPs and improve the broad base of employee participation in capital value creation.

<u>Business Asset Disposal Relief</u>

In respect of the exemptions and reliefs that may affect individual investors and employees, the QCA believes that Business Asset Disposal Relief (BADR) is a hugely important relief and should be maintained. BADR continues to be a highly effective and well targeted relief for small and mid-size quoted companies, which is used to encourage and reward individuals for enterprise. Well-targeted and cost-effective capital gains tax (CGT) reliefs encourage equity investment in 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. As such, it is especially important that BADR is maintained and can continue to play its part in encouraging innovation, growth and productivity within these companies.

As BADR plays important role in stimulating new investment in smaller, growing companies, including those quoted on AIM and the AQSE, we continue to support the availability of it. BADR helps smaller quoted companies attract the necessary talent and investment to grow and create more productive employment, which is essential for the UK's economic growth.

Given the positive role of this relief and its particular importance for employees, the QCA has previously made representations about the removal of the complex 5% holding requirements for employees that lead to unfair treatment if new investments or option exercises cause dilution or restructuring to enable the relief to continue. A simplification of this condition would better support employees seeking to participate in the growth of their business.

<u>Enterprise Management Incentive</u>

In a similar vein to BADR, we continue to support the Enterprise Management Incentive relief due to its significant and important influence on smaller quoted companies. EMI is a huge driver of growth for smaller companies. We believe that how the Government perceives EMI will be symbolic of whether the purpose of CGT reforms is to encourage enterprise or to raise taxes.

In an increasingly competitive world, growing companies will often struggle to compete with their larger, more established counterparts. This is particularly demonstrable in a growing company's ability to attract talent. Growth companies – who customarily have less cash available to them – are unable to compete against the salaries offered to employees of larger companies.

Historically, one way in which this is mitigated is through EMI. This scheme is used to level the playing field between growth companies and larger companies through enabling startups and growth companies to grant share options to key employees on a tax-advantaged basis. This allows these companies to attract and retain the best talent by compensating them for their smaller salary and higher risk employment choice.

In addition to enhancing a smaller company's ability to attract and retain talent, it also allows for greater employee ownership. This, in turn, allows for the greater representation of worker interests and voting rights.

<u>Investors' Relief</u>

Regarding Investors' Relief, we believe that it is a useful tool to help encourage investment and entrepreneurial activity in the UK. In particular, it is a good incentive for retail investors to participate in fundraisings where companies are issuing new shares. Having more attractive investment options for investors helps improve the chances of companies acquiring the capital that they need to grow and develop, which is particularly beneficial for smaller companies.

- **The treatment of losses with CGT, including the extent to which they can be used and whether the loss regime distorts decisions about when to buy or sell assets; and**

<u>General comments</u>

We believe that it is appropriate to maintain the capital loss regime as it is useful in mitigating against the lack of success which occurs for companies and individuals in their very early stages. However, any narrowing of the rules will have little to no effect on the majority of shareholders in small or mid-size quoted companies.

<u>Same day matching period</u>

We believe that consideration should be given to an extension of the same day matching period for acquisitions and sales. For instance, an extension of the period to 3-5 days would serve to avoid trivial gains or losses where shares cannot be sold all on one day due to the risk of flooding the market.

- **The interactions of how gains are taxed compared to other types of income, including how the boundary between what is taxed as gains rather than income works. Should there be difference regimes for short-term gains, compared to long-term gains?**

<u>General comments</u>

Firstly, it is important to stress our desire for the review process not to be an attempt to align the rate of income tax and capital gains tax to the higher levels of income tax. In our view, there is a direct link between the lowering of CGT rates and the increase in entrepreneurship experienced within the UK economy.

We believe that, if there is a return to previous levels of taxation on assets that have been created through an individual's own hard work, this would be especially detrimental. In particular, and given the current economic uncertainties created in respect of the Covid-19 pandemic, it is especially important that the economy's recovery is not stymied.

Finally, the notion of time-based capital gains is, in itself, something that would not seemingly prejudice the purpose of long-term investors and employee participation in terms of the rewards they receive in respect of the future growth of the company. Additionally, and given that the UK previously had Taper Relief, this change would seem unlikely to be subject to strong opposition from the business community.

Some of our members have considered similar approach to the US whereby gains on assets held for less than a year are reclassified as income. This rule would be much simpler. A return to a single headline rate that tapers over time is perhaps a simpler concept than the multitude of different rates and circumstances and rules that we now have. A return to a system that split business (lower tax rate) and non-business (higher tax rate) assets and a tapering rate to further reduce tax charge for longer asset holding could be welcome with shares acquired under an employee share scheme falling to be charged as business assets.

Section 431 elections – restricted securities

Regarding Section 431 elections, which have the effect of moving certain income taxable gains into the capital gains regime, we believe that this can be simplified by applying it by default to all employees and directors. Employees and directors should then be given the option to opt out, rather than having to opt into it. This should apply to all employees and directors, including previously non-residents selling their shares. Whilst this could potentially increase initial tax, it would potentially decrease income tax, and as such, will not be a loss to the Treasury. It would greatly simplify the process of acquiring and disposing of employee shares and minimise scope for administrative error.

5-year holding requirement for company share buybacks

Dispensing with the 5-year holding requirement to get share buybacks treated as capital if the purchase is of employment-related securities would aid simplification. That is, it would remove the need for companies to set up employee benefit trust schemes to store shares. This would prevent the need to set up employee trusts, which lead to complications with IHT, loans to participators, disguised remuneration and other complications.

Appendix A

The Quoted Companies Alliance *Tax Expert Group Expert Group*

Paul Fay (Chair)	Crowe UK LLP
Mark Allwood	Haysmacintyre
Paul Attridge	Bright Grahame Murray
Emma Bailey	Fox Williams LLP
David Blumenthal	Clyde & Co LLP
Edward Brown	Grant Thornton UK LLP
Tom Gareze	PKF Littlejohn LLP
Rachel Gauke	LexisNexis
Oliver Gutman	Shakespeare Martineau LLP
Yuri Hamano	BDO LLP
Daniel Hawthorne	Dechert
Hannah Jones	Deloitte LLP
Mark Joscelyne	CMS
Sabina Marguiles	LexisNexis
Zoe Peck	Mazars LLP
Dan Robertson	RSM
Matthew Rowbotham	Lewis Silkin
Ray Smith	Clyde & Co LLP
Andrew Snowdon	UHY Hacker Young
Peter Vertannes	KPMG LLP
Paul White	Druces LLP

The Quoted Companies Alliance *Share Schemes Expert Group Expert Group*

Fiona Bell (Chair)	RSM
Tristan Adams	Link Asset Services
Barbara Allen	Stephenson Harwood
Emma Bailey	Fox Williams LLP
Dave Bareham	Smith & Williamson LLP
David Baxter	Stephenson Harwood
Danny Blum	Eversheds Sutherland
Ian Brown	Slaughter & May
Michael Carter	Osborne Clarke
Sara Cohen	Lewis Silkin
Stephen Diosi	Mishcon De Reya
Suzy Giele	Lexis Nexis

Andy Goodman	BDO LLP
Ellisavet Grout	Travers Smith LLP
Juliet Halfhead	Deloitte LLP
Caroline Harwood	Crowe UK LLP
Lea Helman	Lexis Nexis
Stuart James	MM&K Limited
Liz Hunter	KPMG
Graham Muir	CMS
Isabel Pooley	Grant Thornton UK LLP
Jennifer Rudman	Prism Cosec
Richard Sharman	FIT Remuneration Consultants