QUOTED COMPANIES ALLIANCE

Generating growth in quoted companies

Budget 2020: Proposals for taxation reform

March 2020

Contents

Key proposals for taxation reform

A future taxation system must be formed on three central pillars: **competitiveness**, **simplicity** and **certainty**. We have highlighted the following key points as essential to ensuring the three aforementioned pillars of the taxation system are achieved:

I. Competitive

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:
   - Taxing the difference where the exercise price is discounted from the market value at grant, but allowing the relief up to market value;
   - 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 defer income tax until the sale of the shares**.
5. **Modernise EMI by updating qualifying limits.**
6. **Exempt or zero-rate from VAT any small-cap investment research that has been paid for by an institution to a broker.**
7. **Encourage entrepreneurship through the maintenance of Entrepreneurs' Relief.**

II. Simple

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. Allow agents to register and de-register companies' employee share plans.
4. Remove the requirement to obtain HMRC approval of the form of HMRC standard joint NIC elections used for employee share schemes.
5. 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.
6. Ensure that anti-avoidance measures do not add to the complexity of the tax system.

III. Certain

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).
3. Clarify the implications of Brexit on the tax system.

An introduction to the Quoted Companies Alliance

We are the independent membership organisation that champions the interests of small to mid-size quoted companies.

The contribution of those we represent to the UK economy is substantial. There are around 1,250 small and mid-size quoted companies on the Main List of the London Stock Exchange and quoted on AIM and the NEX Exchange, totalling 93% of all UK quoted companies[1]. Collectively, these companies employ approximately 3 million people, representing 11% of private sector employment in the UK, and contribute over £26.5 billion annually in taxes (considering just Corporation Tax, Income Tax and National Insurance)[2]. The total market capitalisation of the small and mid-size quoted company sector in the UK is £428 billion[3].

Our principal aim is to create a proportionate regulatory and legislative environment whereby the needs and size constraints of these smaller companies are taken into account. Doing so will be a key component in stimulating the growth of these smaller companies, allowing them to fulfil their enormous potential, as well as the UK economy's as a whole.

We seek to identify the issues that matter to our members. We campaign, we inform and we interact to ensure that our influence creates impact for our members and that they develop the understanding and connections to keep their businesses ahead.

Our *Tax Expert Group*, supported by our *Share Schemes Expert Group*, has prepared these proposals for taxation reform. Our Tax Expert Group and Share Schemes Expert Group are committees that bring together experts on these issues for small and mid-cap companies. A list of Expert Group members can be found in Appendix E. Those highlighted in bold have played a particularly important role in formulating the proposals.

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[1] QCA/Hardman & Co., May 2019, How small and mid-cap quoted companies make a substantial contribution to markets, employment and tax revenues, https://www.hardmanandco.com/wp-content/uploads/2019/05/How-small-and-mid-cap-quoted-companies-make-a-substantial-contribution-to-markets-employment-and-tax-revenues.pdf
[2] Ibid.
[3] Ibid.

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Executive Summary

This submission seeks to highlight the main fiscal priorities for the Quoted Companies Alliance's membership ahead of the forthcoming Budget. We welcome the opportunity to communicate the key issues that affect our members, as well as to propose recommendations to make improvements.

Smaller, growing companies are key for the future health of the UK economy. The issues we highlight, and the recommendations we propose, are intended to ensure that the tax system gives smaller companies the appropriate platform they need to grow and thus deliver economic prosperity.

The growth nature of many small and mid-size quoted companies often means that they are financially weaker than larger, more established companies, which therefore means that attracting investment and raising money is often more regular and more complicated. Accordingly, it is vitally important that a tax system is built to allow growing companies access to capital.

The political and economic uncertainty that currently engulfs the UK has exacerbated issues for smaller companies, and has acted as an impediment to their growth. It is increasingly important for small and mid-size quoted companies to have a government that maintains its commitment to supporting them to generate the growth required to provide economic stability, and to create jobs and wealth. A future taxation system must be formed on three central pillars: **competitiveness**, **simplicity** and **certainty**.

1. Ensuring the competitiveness of the tax system

In terms of ensuring the **competitiveness** of the UK's taxation system, it remains crucial that a regime is built that both incentivises and enables smaller, growing companies to raise sustainable, long-term capital more cheaply and efficiently. In order to do so, we propose measures to further align the interests of employees and NED's of smaller companies with their shareholders through encouraging employee share ownership and creating additional incentives for Non-Executive Directors (NEDs) that will result in improved levels of economic performance. We also seek to enhance the visibility of smaller companies and make it easier for them to raise capital and increase the liquidity in their shares through additional SME research and establishing a new BPR fund category. We also encourage the government to take note of other European countries and the merits of having a levelled playing field between raising debt finance and equity finance. Upon leaving the European Union, these proposals will be vital in supporting long-term economic stability and demonstrating that the UK is an attractive place to do business.

2. Creating a simple and reliable tax system

The UK's taxation system would benefit significantly from greater **simplification**. At present, the system is one of the world's most complex and new legislation continues to add length and complexity to the existing framework, which can be particularly onerous for smaller companies. In order to ameliorate these complexity issues, we propose that certain HMRC requirements are removed; smaller companies are exempted from the most burdensome reporting requirements; and modifications are made to employee share plans. All of this should be underpinned by the strengthening of the Office of Tax Simplification, so that it can play a greater role in not only assessing the impact of legislation on the **simplicity** of the taxation system, but also supporting the formulation of **simplified** tax policy. This will lower the costs of compliance for the smallest companies and remove barriers to them building their business and generating growth.

3. Creating a system built on certainty

Finally, we encourage the government to ensure that the tax system is underpinned by **certainty**. For the small and mid-size companies we represent, this remains crucial for them to effectively plan for their future development with confidence. A taxation system underpinned by **certainty**, which we believe can be achieved through establishing a binding ruling service and providing further clarification over transfer pricing, will allow companies to make long-term investment decisions that will help drive sustained economic growth.

I. Creating a competitive tax system

Leaving the European Union will present the UK with unprecedented economic challenges and 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 minimised.

We note that 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 growth companies is essential to increasing the UK's ability to boost its economic competitiveness.

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, growth companies to obtain the funding they need to grow.

A. Levelling the playing field between debt and equity

It is generally accepted that there is a need to address the preferential treatment of debt over equity as a source of finance for smaller, growing companies.

It is recognised that in recent years there have been legislative developments which have reduced the extent to which the corporate tax system encourages companies to raise debt finance over equity finance, including, since April 2017, a corporate interest reduction (CIR) regime which disallows interest-like expenses to the extent that the net tax-interest expense for UK companies exceeds the interest capacity[4].

However, there have been no corporate tax developments which have positively encourage companies to raise equity finance and there remains a significant and unwarranted corporate tax advantage in raising debt finance over equity finance.

In particular, it is noted that companies can generally claim corporation tax relief for costs incurred when raising debt finance but are unable to do so for equity.

As outlined in more detail at point (iii) below, it is considered that the bias against a company obtaining a corporate tax deduction for costs associated with raising equity capital is a remnant of early 20th century court decisions and is no longer appropriate in the context of the modern commercial environment.

In addition, in this regard there exists a clear distinction between the UK corporate tax system and the VAT system, since VAT case law[5] has confirmed that VAT on the costs of raising equity funding is deductible as input tax where it relates to taxable supplies made by the company.

It is considered that there is no policy reason for there to be an inconsistency between direct taxation and indirect taxation in this regard, and that this distortion in the tax system makes it more costly for smaller companies to raise the permanent capital they need to facilitate their growth.

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[4] 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.

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

Recent research by Link Asset Services illustrates that the debt of listed UK companies has risen to a record £390.7 billion[6] 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.

An 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, OECD work[7] (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."[8]

- **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.[9]

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.[10]

In its Capital Markets Union Action Plan[11], 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. Accordingly, the UK government should take steps to eliminate the debt bias and incentivise equity finance as a source of long-term, patient capital.

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

[7] 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

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

[9] '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

[10] 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

[11] 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

It is considered that the UK government could begin to address the issue as follows:

1. Provide tax relief for the costs of raising equity up to a threshold level.

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.

For a small or 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

The measure should 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.

(iii) Allow the relief to the extent that the equity finance supports business activities

It is understood that the principal reason that the costs of raising equity are not currently deductible is due to the UK's longstanding policy that "capital costs are not deductible for corporate tax purposes (see BIM42510).

However, the bias against "capital" within the corporate tax code derives from court decision in the early part of the 20th century, and it is not clear that this policy position remains appropriate for modern business taking place in the 21st century, especially where the funds raised are deployed to support the active business activities of the fund-raising company.

In particular, it is noted that both the Loan Relationship code (s.293(3) CTA 2009) and the Intangible Asset code (see CIRD10120) explicitly ignore the significance of "capital" in establishing whether an item of expenditure is deductible for corporate tax purposes. These two regimes, established in 1996 and 2002 respectively, demonstrate a more modern approach to corporation tax, and it is considered that the UK should seek to move away from an anachronistic bias against companies incurring expenditure for the purposes of raising "capital".

For policy reasons, it would be important to target the relief to issuances where funds will be employed in a business, but this should be a straightforward legislative measure. For example, a "wholly and exclusively" style rule could be adopted to ensure that no corporate tax relief is available where funds raised are ultimately received solely/mainly by existing shareholders.

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

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[12]

Reporting accountants	£100,000 - £120,000
Company lawyers[13]	£120,000 - £180,000
Nominated adviser's lawyers	£40,000 - £60,000
Nominated adviser/broker corporate finance fee[14]	£100,000 - £250,000
Broker's commission[15]	3% - 4% of funds raised **or** 0.5% - 1% of funds not raised
Printing	£10,000
Registrars[16]	Minimum annual charge £4,000 - £5,000
Public relations	£36,000 - £72.000
London Stock Exchange AIM admission fees[17]	£10,000 + VAT - £112,000 + VAT

Table 2 – Estimated Costs of Maintaining a Quotation on AIM[18]

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

12 Quoted Companies Alliance research conducted in February 2018.

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

14 Varies depending on market capitalisation/size of the company.

15 Varies depending on market capitalisation/size of the company.

16 Excludes other charges such as the AGM.

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

18 Quoted Companies Alliance research conducted in February 2018.

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[19]	£7,900 - £75,000
London Stock Exchange AIM further issues fee[20]	£0 - £56,000 + VAT
Share option service	£15,500

We acknowledge a potential concern 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, we do not consider that this is a significant risk area, as we are not aware that the corporate tax deductibility of the costs of raising debt finance has led to professional cost inflation.

In particular, 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.

(v) 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.

(vi) 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.

(vii) 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.

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

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

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%[21].

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.

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, AIM has supported over 3,800 companies raise £113 billion.[22] 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.[23]

Business Property Relief (BPR) – as identified by the government's Patient Capital Review in August 2017[24] – 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.

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[21] 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.

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

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

[24] 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

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.

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;[25]
- 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 and with some lack of certainty in the economy at present, companies are being particularly careful with cash and spending. Many such companies also operate in economic sectors where highly-skilled employees are in high demand, such as software and computer gaming development, meaning 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.

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

Employee share ownership schemes therefore provide an alternative and cost-efficient way of recruiting and retaining staff when lucrative remuneration packages cannot be offered.

This can generate better outcomes for companies. Studies, as well as anecdotal evidence, indicate that higher levels of employee share ownership tend to result in enhanced levels of economic performance – both in terms of turnover and profitability – particularly for smaller, growing companies.[26]

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.

Both companies and employees 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.

Greater financial awareness and opportunities for personal development also can be seen to flow from enhanced employee ownership.

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.

Successive governments have supported employee ownership and HMRC currently offers four types of direct, tax-advantaged employee share scheme[27], 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 employees and full-time executives, as well as in small and mid-sized companies that do not qualify to grant EMI options (for example, where the company is still developing its trade or where the company has grown such that the number of employees exceeds the 250 full-time employees limit).

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[26] 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

[27] 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.

Companies may also qualify for one of the tax-advantaged all-employee share plans (SAYE Plans and SIPs), however, in practice, multiple plans are not frequently used by smaller companies.[28] This is probably due to the proportionately greater administration obligations and higher associated costs of all-employee and multiple 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 qualify for, or has outgrown, an EMI. If the company qualifies, a CSOP can be governed by a relatively simple set of rules compared with SIPs and SAYE and can be more easily administered in-house.

There is a significant cliff, however, between what a company's offering under the flexible EMI regime and the more restrictive CSOP. This is due to (1) the individual limits on the share value under option (less than one-eighth of an EMI plan) and (2) the circumstances when tax-advantages are available under CSOP (an all or nothing regime applies).

Larger companies could compensate by offering SIP and SAYE participation but mid-size companies are disadvantaged due to the additional costs. The cliff between plans expands and prejudices employees of growth companies curtailing opportunities to expand and to attract and retain talented employees.

Some relatively small changes to the CSOP legislation would narrow the cliff and while there could be some loss of tax and NI, it could create some small additional revenue and deter avoidance arrangements.

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).** This would create a partial but manageable liability to income tax and NIC in 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.

  Smaller listed companies preferring to grant Long-Term Incentive Plan (LTIP) awards over the full value of shares, perhaps to meet shareholder or best practice demands, would be able to use a CSOP. One of the main reasons for this is that LTIPs use fewer shares to provide the same reward. This helps smaller listed companies whose shares have lower liquidity and maintains the attractiveness of smaller companies being listed on AIM, NEX Exchange or the full list. It would be hugely beneficial from a corporate point of view if CSOPs could be structured in the same way as LTIPs.

  Such a change need **not** mean any additional costs to HM Treasury if it generates 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 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

[28] 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

reflects their commercial objectives and incentivises their employees. It is also worth noting that employees categorised as Millennials and Generation X have a shorter term view and could be deterred from saving/investing by longer periods.

In practice, many SMEs would opt for at least 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 creates cost reductions by virtue of the simplification for both the company and HMRC in terms of its monitoring/reporting costs.

- **Remove all leaver and other early exercise requirements.** The removal of the three year holding period delivers and additional simplification so that the legislation could remove the complex leaver and corporate event early exercise provisions.

- **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[29].

  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.

  The individual limit for CSOP has remained unchanged, at £30,000 per eligible employee, since 1996. As 24 years have elapsed (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 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-

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

2001 down to only 40,000 in 2016-2017.[30] 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 are an important part of corporate governance for listed companies. NEDs taking shares align their interests with those of shareholders, and often agree to accept a portion of their remuneration in shares. Income tax plus national insurance (both employer and employees) arises upon issue of the shares. This comes at a time when the non-executive director will not have the cash to pay the tax and may, therefore, deter many good potential NEDs, perhaps from minority groups, from undertaking roles in smaller growth companies.

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. Modernising EMI by updating qualifying limits

The UK is currently one of the world's leading locations for startups and growth companies. However, 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, or the Enterprise Management Incentive scheme. 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 startup'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.

Recently, however, the number of startups and growth companies in early stages of development finding themselves outside the criteria that would allow them to qualify for the EMI scheme has increased. The criteria for EMI – which was set in 2000 – is outdated and not fit for purpose. The criteria to qualify for the scheme fails to reflect the developments within, and the maturing of, the growth company ecosystem which has occurred in recent years. Companies frequently find that their growth and success inevitably

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

pushes them outside the limits of the current thresholds whilst they are still in a development phase. As a result, these companies are failing to attract and retain the best talent, which is so crucial for their growth and development in their early years.

We urge the Government to update EMI by increasing the current limits from £30 million in gross assets to £100 million, as this would markedly increase a growing company's ability to attract and then retain the best talent and compete against larger companies. An increase would also serve to ensure that the qualifying limits are positioned in line with inflation having not been adjusted since 2000, as well as reflect the maturing of the UK's startup and growth company ecosystem.

As a result of the UK's imminent withdrawal from the EU, the Government is presented with an opportunity to update the qualifying limits. Upon exit, the UK will cease to be bound in the longer term by state aid rules, thus enabling the Government to update the limits.

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 [31] 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.

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).[32] 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.

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

[32] "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

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.

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.

G. Encouraging entrepreneurship through the maintenance of Entrepreneurs' Relief

Entrepreneurs' Relief 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 Entrepreneurs' Relief is maintained and continues to play its part in encouraging innovation, growth and productivity within these companies.

In recent years, we have welcomed the changes to Enterprise Management Incentives (EMI) implemented in the Finance Act 2013 regarding 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 the 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 the Autumn Budget 2017.

These measures are, on balance, 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 due to the important role it plays in small and mid-size quoted companies, helping them to attract the necessary talent and investment to grow and create more productive employment, which is essential for the UK's economic growth.

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.[33]

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[34] 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[35] 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.

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

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

[35] 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 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.

In our experience, HMRC use the powers s168(1)(b) very infrequently meaning that "medium sized" groups currently fall into a limbo category where they may be compelled by HMRC to operate transfer pricing, though in practice are seldom required to do so.

(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. 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.

Many practical difficulties have been ironed out as a result of HMRC interaction by professional advisers when preparing returns and notifying option grants, as required. However, companies cannot ask their advisers to register and close plans, which frequently leads to errors by the company's staff, which uses up HMRC staff time to correct.

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 in Appendix C.

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.

D. 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 where using HMRC's standard form of elections [https://www.gov.uk/guidance/transfer-employers-national-insuarnce-to-employees]. 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.

E. Simplifying 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.

F. Ensuring that anti-avoidance measures do not add to the complexity of the tax system

On aggregate, we support measures aimed at reducing opportunities for tax avoidance and evasion. It is important that a fair taxation system is maintained in order to ensure that everyone pays their fair share of tax. Small and mid-size quoted companies are willing to pay their fair share of taxation to contribute to society and the economy.

That said, anti-avoidance and evasion measures must be implemented carefully and methodically, taking into consideration the impact that they have on adding further layers of complexity to the taxation system. In particular, the Government must bear in mind that anti-avoidance measures often disproportionately affect smaller quoted companies in spite of being intended primarily for major multi-national and larger listed companies. As a result of anti-avoidance legislation, small and mid-size quoted companies are often subject to sizeable and disproportionate compliance costs that significantly impacts their ability to grow and develop. In addition, these measures also create a considerable administrative burden for smaller quoted companies. Typically, these companies do not have the same level of resources or in-house tax departments available to them as larger companies. As such, smaller companies find themselves in situations where they are compelled to pay advisors to do the work for them, which adds further to the compliance costs.

Furthermore, the introduction of new, or consolidation of existing, anti-avoidance measures and powers has to be carefully considered so as to ensure that a situation does not materialise where there is an unnecessary burden placed on companies. That is, if new and existing measures are introduced and emboldened, a situation may arise whereby the costs and burdens placed on companies significantly outweigh the perceived value gained as a result of implementing further measures. Any proposals to implement additional measures must undergo thorough cost-benefit analysis and consider the cost/benefits relating to smaller companies specifically.

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 clearance/ruling process along similar lines to those provided in the Netherlands and Luxembourg. 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. It would of course be conditional on taxpayers making full disclosure of all relevant facts. It could be introduced on a paid-for basis and thus provide a small revenue-raising mechanism.

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. We understand, for example, that the Netherlands have recently amended their own ruling processes.

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 a limbo position of not knowing for certain whether or not transfer pricing adjustments may ultimately be required.

The result is that such companies may feel 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, and the associated tax cost of modifying the current position is likely to be small.

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 through the following means:

1. Raising the threshold at which the transfer pricing rules apply.

This would have the effect of relieving the burden of operating transfer pricing on many groups where the potential tax risk that they represent to the UK Exchequer is modest.

2. Introducing legislation stating that a transfer pricing direction will only be issued to "medium-sized" groups where arrangements have been entered into those that have a tax avoidance motive.

This would ensure that the existing legislation is not targeted at groups operating on a wholly commercial basis.

3. Confirm the circumstances in which HMRC will seek to issue a direction to "medium-sized" groups to operate transfer pricing policies.

There is currently no substantive guidance provided by HMRC on the circumstances in which a direction to operate transfer pricing will be made (See INTM412070).

Updating HMRC's guidance in this area would give "medium-sized" groups a clear understanding of how and when HMRC will seek to apply their existing legislative powers.

4. Confirm that a "medium-sized" group is not required to compile contemporaneous evidence to support transfer 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.

This would give groups of this size comfort that they do not need to incur significant transfer pricing costs ahead of a direction being received and will not be adversely affected by the failure to do so.

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 D. They illustrate the complexities and costs incurred by small and mid-size quoted companies.

C. Clarifying the implications of Brexit on the tax system

Brexit has been one of the most significant impediments to small and mid-size quoted companies being able to plan ahead effectively and with certainty. In a survey conducted in July 2019[36], our members indicated that preparations for Brexit in the three years since the referendum had resulted in time being taken away from their business priorities. In addition to this, it has become evident that our members do not believe that the information that the Government has provided to help companies prepare for Brexit has been adequate.

In order to ameliorate these issues and uncertainties, we urge the Government to provide clarification on how the UK's withdrawal from the EU will impact business and smaller quoted companies in particular. It

[36] https://www.theqca.com/news/briefs/187266/survey-brexit-hasa-negative-impact-on-turnover-growth-for-small-and-midcaps.thtml

would be beneficial for companies to understand how Brexit will impact the tax system, as well as which EU Directives will be maintained and which ones will be terminated and when.

This will enable companies to manage and navigate the likely impacts of Brexit with an increased level of confidence and certainty. This is especially important for small and mid-size quoted companies who are typically more susceptible to political and economic fluctuations.

Appendix A: European regimes for tax relief for the costs of raising equity[37]

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

[37] 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?
		net equity has given rise to a surplus (upon which 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).

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

Country	Is there any corporate tax relief for flotation costs?	Are the costs of issuing new equity generally deductible for corporation tax purposes?
		depreciation is deductible for corporate income tax purpose; • Interest charge deduction is subject to a cap (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

Country	Is there any corporate tax relief for flotation costs?	Are the costs of issuing new equity generally deductible for corporation tax purposes?
Portugal	Yes. Pursuant to Portuguese GAAP, which follows IAS, such costs do 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.	Yes. Any administrative and similar costs incurred are tax deductible on the basis that such costs are necessary 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	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).

Country	Is there any corporate tax relief for flotation costs?	Are the costs of issuing new equity generally deductible for corporation tax purposes?
	economically justified (Article 252, Item 1).	
Serbia	Yes.	Yes.
Spain	Yes. 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.	Yes. 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. <u>NOTE:</u> 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.

Country	Is there any corporate tax relief for flotation costs?	Are the costs of issuing new equity generally deductible for corporation tax purposes?
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 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) [38]

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) [39]

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[40]	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**

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

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

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

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

Company A

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 B

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

Company C

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 D

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 E

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 E: Expert Group members

Quoted Companies Alliance *Tax Expert Group*

Those highlighted in bold have played a particularly important role in formulating the proposals.

Paul Fay (Chair)	**Crowe UK LLP**
Mark Allwood	Haysmacintyre
Paul Attridge	**Beavis Morgan LLP**
Emma Bailey	Fox Williams LLP
Alex Barnes	Memery Crystal
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

Quoted Companies Alliance *Share Schemes Expert Group*

Those highlighted in bold have played a particularly important role in formulating the proposals.

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