QUOTED COMPANIES ALLIANCE

Generating growth in quoted companies

Budget 2021: Proposals for taxation reform

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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 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 a tax deduction in the year the costs were incurred.
2. **Allow funds to invest in unlisted companies, such as those on AIM and the Aquis Stock 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, or 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. **Enact changes to research and development tax relief and discrimination**
7. **Modify the two risk capital schemes in relation to Enterprise Investment Schemes and Venture Capital Trusts to ensure they are fit for purpose in helping smaller companies attract crucial investment.**
8. **Undertake a review and consultation process to consider how the tax system can do more to encourage and assist businesses in their long-term sustainability objectives.**
9. **Establish a regional equity fund to draw greater public equity investment to businesses based in regions outside of London/the South East.**

10. Establish an enhanced COVID-19 relief for companies assisting with fighting the Covid-19 pandemic.

11. Preserve the current carried interest rules to protect private capital investment.

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.
   - **Publish the OTS's Strategic Vision and Agenda**
2. **Introduce a Tax Gateway which would allow small and mid-sized 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.**
7. **Improve efficiencies for mid-tier companies and groups in their liaison with HMRC by introducing an HMRC portal to allow for a single process and single point of contact when interacting with HMRC on all tax issues.**
8. **Reduce the SIP tax free period from five to three years to better reflect current employment trends.**

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).**

An introduction to the Quoted Companies Alliance

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

The contribution of those we represent to the UK economy is substantial. There are around 1,250 small and mid-sized quoted companies on the Main List of the London Stock Exchange and quoted on AIM and the Aquis Stock Exchange (AQSE), 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-sized 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 raise, 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-sized quoted companies often means that they are financially weaker than larger, more established companies. Attracting investment and raising money is therefore 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 in the UK due to the Covid-19 pandemic and the withdrawal from the European Union (EU) has exacerbated the regular issues for smaller companies and has acted as an impediment to their growth. It is increasingly important for small and mid-sized quoted companies to have a government that maintains its commitment to supporting them and ensuring that the UK's capital markets are fit for purpose and attractive to companies of all sizes. In turn, these companies will generate the economic growth required to provide economic stability, and to create jobs and wealth.

Recently, we welcomed Lord Hill's UK Listings Review, which sought to examine how we can encourage deeper capital markets and improve the flexibility and proportionality of our regulatory system in order to support growth and innovation.

However, more needs to be done.

It is now widely accepted that listing shares on UK equity markets has become less attractive for potential public companies. For the past twenty years, the total number of listed companies in the UK has fallen consistently. Since 2007, the number of companies quoted on the Main Market has declined by 25%[4] and the number of companies quoted on AIM has declined by 49%[5]. Studies, such as the *QCA/Peel Hunt Mid and Small-Cap Survey*, have suggested reasons for this decline, with many attributing this to a lack of tax incentives and the complexity of corporate tax[6].

The fact that the number of total quoted companies has been falling for so long is evidence that significant reform is not only necessary, but essential for the UK to cement its place as a global financial centre, particularly in the post-Brexit era.

Taxation will play a key role in this, and the system must be reformed on three central pillars: **competitiveness**, **simplicity** and **certainty**.

[4] Please note that these figures are gross and should be reduced by the number of investment companies that currently populate the market. Excluding these investment companies, the number of companies quoted on the Main Market has fallen by 60% since 1999. This compares with a 52% decline when financials are included. Furthermore, when looking below the largest 350 companies, the number of non-financial companies on the Main Market has fallen by 72% since 1999. By December 2019, the number had fallen to just 252. Further information can be found in a report by Hardman & Co. and the QCA here: https://www.theqca.com/article_assets/articledir_404/202121/Hardman-Insight-Are-public-market-closing-to-smaller-companies-May-2020.pdf

[5] Report by Hardman & Co and the QCA of May 2020: *Are the public markets closing to smaller companies – The evidence from the past 20 years in London*

[6] QCA/Peel Hunt Mid and Small Cap Survey, conducted by YouGov: *To be or not to be….a public company – the growing de-equitisation crisis.*

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 Non-Executive Directors (NEDs) of smaller companies with their shareholders through encouraging employee share ownership and creating additional incentives for 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. Finally, we 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. As we have now left the EU, these proposals will prove 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 as they lack the resource to tackle the large administrative burden. 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-sized 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

The withdrawal from the EU has presented the UK with significant economic challenge, but also opportunity. 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 the UK'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.

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[7].

However, there have been no corporate tax developments which have positively encouraged 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[8] 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.

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

[7] 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.

[8] 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 £443.2 billion[9] after nearly a decade of ultra-low interest rates. This means companies are more financially fragile and likely to face serious pressures when met by external or internal downturns.

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[10] (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."[11]

- **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.[12]

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.[13]

In its Capital Markets Union Action Plan[14], 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 EU.

It is therefore apparent that reliance on debt finance is not a long-term solution for small and mid-sized 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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[9] UK plc Debt Monitor (2018/19): https://insights.linkgroup.com/FormBuilder/_Resource/_module/sEWV08wDIE-hXLh5dNDWWQ/file/172_Debt-Monitor_0719_v7.pdf

[10] 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

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

[12] '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

[13] 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

[14] 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.

Other European countries 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-sized 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 across the UK's nations and regions, drive sustainable economic growth and support wider financial stability.

The UK should seek to celebrate and encourage the role of public companies and their significant contribution, both regionally and nationally, to the UK economy. It is estimated that the small and mid-sized quoted company community alone directly employs nearly 1.5 million people outside London and across the UK's nations and regions[15]. This demonstrates their potential importance in addressing regional inequality.

For a small or mid-sized company, the costs of raising equity represents 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 to target the relief appropriately to smaller companies

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 small and mid-sized 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 decisions in the early part of the 20th century, and it is clear that this policy position is inappropriate for modern

[15] Hardman & CO. and the QCA, May 2019, How small and mid-cap quoted companies make a substantial contribution to markets, employment and tax revenues, available at: 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

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[16]

Reporting accountants	£100,000 - £120,000
Company lawyers[17]	£120,000 - £180,000
Nominated adviser's lawyers	£40,000 - £60,000
Nominated adviser/broker corporate finance fee[18]	£100,000 - £250,000
Broker's commission[19]	3% - 4% of funds raised **or** 0.5% - 1% of funds not raised
Printing	£10,000
Registrars[20]	Minimum annual charge £4,000 - £5,000
Public relations	£36,000 - £72.000
London Stock Exchange AIM admission fees[21]	£11,250 + VAT - £126,000 + VAT

[16] Quoted Companies Alliance research conducted in February 2018.

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

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

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

[20] Excludes other charges such as the AGM.

[21] Fees for Issuers, 1 January 2020: https://docs.londonstockexchange.com/sites/default/files/documents/fees-for-issuers.pdf

Table 2 – Estimated Costs of Maintaining a Quotation on AIM[22]

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
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[23]	£8,700 - £105,000
London Stock Exchange AIM further issues fee[24]	£0 - £63,000 + 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

[22] Quoted Companies Alliance research conducted in February 2018.

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

[24] Fees for Issuers, 1 January 2020: https://docs.londonstockexchange.com/sites/default/files/documents/fees-for-issuers.pdf

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 smaller company sector, creating jobs and generating additional tax revenues.

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%[25].

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 £121 billion[26]. This has contributed significantly to employment growth and tax revenue for the Exchequer; the £33.5 billion contribution that the AIM companies make to UK gross domestic product is on greater than the architectural and engineering sector[27].

Business Property Relief (BPR) – as identified by the government's Patient Capital Review in August 2017[28] – continues to play an important role in 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 than 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

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[25] 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.

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

[27] 'Economic Impact of AIM' (June 2020): https://www.lseg.com/sites/default/files/content/LSE/2020/Economic_impact_of_AIM.pdf

[28] 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

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 is a vicious cycle which 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.

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 the AQSE, 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, and thus spreading their 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 which 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;[29]
- 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 investee companies would generate more employment and economic growth, which would increase tax revenue.

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.

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[29] This would capture 93% of most AIM companies and almost all AQSE companies.

C. Encouraging employee share ownership

Employee share ownership can offer substantial, mutual benefits to small and mid-sized quoted companies, members of the workforce and the economy as a whole. In difficult financial times, it also offers businesses the opportunity to incentivise employees but defer rewards to a later date, aiding cashflow and enabling reduced reliance on Government support or needing to reduce employee numbers to save costs.

For many small and mid-sized quoted companies, resources are scarce and share ownership legal requirements and tax rules are complex. With a clear lack of certainty in the economy at present, companies are being particularly careful with cash and spending. In the UK today, highly-skilled employees are in high demand, 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. Employee share ownership schemes therefore provide an alternative and cost-efficient way of recruiting, and more importantly, retaining staff when lucrative remuneration packages cannot be offered.

Studies and 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[30].

Workers with a meaningful economic stake will have a closer affinity for their business, benefitting directly from the additional value their company creates. This can lead to a more entrepreneurial workforce that actively seeks greater efficiencies and development, thereby raising productivity and improving product quality. This will support the company to deliver long-term value to all stakeholders by boosting employee motivation, satisfaction and productivity.

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

These factors support a stable, resilient economy, 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[31], 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

[30] 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

[31] 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.

The CSOP is a long-established discretionary tax-advantaged share scheme available for rewarding employees and full-time directors.

Companies may also qualify for one of the tax-advantaged all-employee share plans (SAYE Plans and SIPs), giving broader entitlements and tax advantages. However, the greater administration obligations and higher associated cost means multiple plans are not frequently used by smaller companies[32]. The cost per participant is significantly higher for SMEs. This was been recognised with the introduction of the EMIs.

CSOPs are used where it is not possible to qualify for EMIs. For example, where the business has grown such that the number of employees exceeds the 250 full-time employees limit or there has been a fund raising to take the gross assets over £30 million.

There is a significant cliff-edge, 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). For non-listed companies there are further restrictions, such as the type of shares that can be used.

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

Simple adjustments to the CSOP legislation would narrow the cliff. There could be some loss of tax and NI, compared to an option that does not qualify for tax advantages, but in practice smaller companies cannot afford the PAYE related costs of a non-qualifying plan. As a result, some slight adjustments to the CSOP rules may generate more economic growth, create some additional overall tax revenue and deter avoidance arrangements.

Suggested changes 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 additional 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 could grant Long-Term Incentive Plan (LTIP) awards with a lower entry cost (such as nil or nominal cost options), perhaps to meet shareholder requirements for less dilution 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, the AQSE 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.

[32] Indeed, participation in SAYE fell to about 310,000 in 2018-19; 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/894363/Table_3.pdf

- **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 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 an 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[33].

  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 25 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. This compares with the EMI individual limit of £250,000 (with a maximum total value of shares under option per company of £3 million).

  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-sized quoted companies as a means of incentivising their employees and improving productivity.

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-sized companies.

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

HMRC statistics show that the number of participants granted CSOP options has fallen from 415,000 in 2000-2001 down to only 30,000 in 2018-2019[34]. 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 from undertaking roles in smaller growth companies, which may, in turn, have an impact on the diversity of the pool of potential NEDs.

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. Research and Development Tax Relief and Discrimination

Much of the UK legislation relating to Research and Development Tax Relief has been formed as a result of EU directives to create a harmonisation in the tax treatment across the Union. The Small and Medium Enterprise (SME) Relief aspect to the regime is treated by the UK as a former member of the EU as State Aid and therein brings restrictions which are outside of the power of UK legislature. The State Aid requirements are part of the EU's non-discrimination requirements which prevent unfair competition across the Union and prevent Member State's governments assisting companies in that Member State above the assistance given to companies in other Member States.

The UK's departure from the EU removes the requirement for anti-discrimination so the UK Government is free to tailor the legislation and the level of relief to give the greatest benefit to UK companies that it sees appropriate and/or required.

The following could be considered:

1. A removal of the cap of relief which is due to be at three times the company's annual liability to PAYE taxes

[34] Available at
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/894365/Table_4.pdf

The legislation is designed to prevent offshore subcontractors carrying out R & D and therefore receiving tax advantaged funding for the work. This legislation will affect early-stage UK companies who do not have the funds for in house technical salaries but require the benefit of SME R & D relief to finance the work.

We would propose that legislation is amended to more tightly focus on the eligibility or otherwise of offshore subcontractor expenditure. More innovation will therefore take place in the UK.

2. Amend the size thresholds for companies accessing the SME relief

The definition of a large company is taken from EU directives and brings in quite a number of UK companies who are effectively SMEs but are managed independently although are part of larger groups mostly by way investment.

We would propose that the thresholds are raised to benefit these SMEs who are within these scenarios. Also, the size threshold for a group of companies and the definition of an independent carrying out R&D should be considered so that smaller companies in larger investment groups are not penalised after takeover by another company or group.

3. State Aid provisions

At present, SME tax relief is considered to be State Aid which affects R & D claims made where grants or other funding are received. This can in fact make some small levels of funding uncommercial due to the amount of R&D Tax relief that is lost.

We would suggest that SME claims are determined merely on the size of the company rather than include other funding received by the company. This will clearly improve the amount of entrepreneurial investment into scientific and technological innovation.

F. Extending EIS/VCT

Venture Capital Trusts (VCTs) and the Enterprise Investment Scheme (EIS) are two of the risk capital schemes designed to help small and mid-sized companies attract investment. Under these schemes, a company can raise up to £5 million over a 12-month period and a maximum of £12 million in the company's lifetime. A company can qualify, if at the time of investment, the company has:

- No more than £15 million in gross assets;
- Less than 250 employees; and
- It has not been more than 7 years since its first commercial sale[35].

The importance of the EIS/VCT schemes to smaller companies should not be underestimated.

Having access to finance and support is vitally important for small, early-stage companies in their growth and development. The reasons for seeking investment can be short-term, to boost cash-flow or for longer term expansion of headcount, capital goods, R&D or into new markets.

[35] There are different rules for both EIS and VCT eligible companies who are knowledge-intensive and carry out a significant amount of research, development or innovation. These companies can get more funding through the schemes.

EIS and VCT provide smaller companies in their early stages with crucial investment. Typically, these companies will struggle to attract the necessary investment due to their higher risk of loss of capital and lower liquidity. EIS and VCT help to ameliorate the funding limitations and boost the demand for shares in these companies. This is achieved through the provision of tax reliefs, which encourage investors to invest by compensating them for the added risk.

The aversion of risk and loss are particularly crucial factors in investor decision-making. This is achieved through EIS and VCTs as the tax reliefs mean that the value of an investment could fall considerably before an investor started to lose money. This assurance makes them more willing to invest.

A research report conducted by HMRC in 2016[36] exemplifies this point. The research indicated that over 60 per cent of investee companies reported that their investment would not have taken place without the tax-advantaged venture capital schemes. Furthermore, EIS and VCT were typically either the only source of finance or used alongside only one other source of finance in investee companies[37]. This demonstrates the considerable importance of these schemes, as well as the lack of other funding options for these companies.

The unique nature of EIS and VCTs encourages long-term investment from the outset, helping to push back against short-termism. Not only this, but the schemes have also manifested investment in a wide range of companies, not only in different sectors, but also throughout the UK. Accordingly, these schemes have helped to balance the nation's economy and fit with the Governments levelling up agenda.

The implications and reach of EIS and VCT are significant for the UK economy, helping it to achieve economic growth. EIS, for instance, has provided funding worth £15 billion to nearly 30,000 businesses[38], whilst VCTs are estimated to have created 27,000 jobs since they were first launched[39]. Additionally, the venture capital schemes have helped broaden and diversify wealth as they have improved accessibility for investors and thus increased the shareholder base.

Other positive impacts of the schemes include[40]:

- Around three-quarters of EIS investees and two-thirds of VCT investees attributed an increase in sales to the investment they received.
- Over half of EIS and VCT investee companies said that productivity had increased as a result of their investment.
- Over three-quarters of investee companies said they had undertaken some form of innovation due to the EIS or VCT investment, including the development of new products and services.
- Over 70 percent of investee companies said that their company had grown in terms of numbers of employees, with median growth in number of employees increasing by 33 per cent.

Notwithstanding the positive implications of the schemes, there are some issues that limit their effectiveness.

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[36]HMRC Research Report, February 2016, available at: https://www.researchgate.net/publication/292747571_The_Use_and_Impact_of_Venture_Capital_Schemes#pf9
[37]Ibid.
[38] Enterprise Investment Scheme Association, 2018, available at: https://eisa.org.uk/wp-content/uploads/2018/08/Grow-your-business-with-the-Enterprise-Investment-Scheme-2-ilovepdf-compressed.pdf
[39] Venture Capital Trust Association, March 2018, https://www.vcta.co.uk/submission-to-the-treasury-select-committees-sme-finance-enquiry
[40]HMRC Research Report, February 2016, available at: https://www.researchgate.net/publication/292747571_The_Use_and_Impact_of_Venture_Capital_Schemes#pf9

Understandably, the Government must ensure that EIS and VCT investments are appropriately targeted and that the schemes operate effectively. That said, the continuation of the effective supply of capital is essential for closing the funding gap in the smaller company space. Any changes to the incentive's frameworks could have a significant effect on AIM and individual companies' ability to raise money. Following the review into EU State aid rules and the Patient Capital Review, the Government made considerable changes to the schemes in 2015 and 2017 respectively, which produced some negative consequences.

Some of the issues in relation to the EIS and VCT schemes in their current format are outlined below:

1. HMRC delays

The changes made in 2015 and 2017 have increased the complexity of the VCT investment rules that provided HMRC with discretionary powers that are applied on a case-by-case basis. This has resulted in lengthy delays in HMRC's processing of VCT investment applications, known as advanced assurance.

In the 2017 Budget, it was announced that the target for processing applications was 15 days, however, research conducted by the Venture Capital Trust Association found that the average time for clearance was 64 days, with some taking up to six months[41]. Correspondingly, these delays are preventing the effective delivery of finance to smaller companies, resulting in serious issues for the companies themselves.

It is not uncommon for a company to have to wait a considerably long time for a HMRC response on EIS or VCT queries causing them to lose out on crucial investment. It is frequently the case that investments worth millions of pounds are simply waiting for clearance from HMRC. Given that the vast majority of EIS/VCT eligible companies are typically reliant either solely on the schemes, or one other source of finance[42], this can be hugely detrimental for a company and its operations.

In the worst instance, companies have either withdrawn their IPO or delisted due to their inability to gain access to finance.

2. 7-year rule

The introduction of the 7-year rule in 2015 has cause significant detriment to companies. The rule is unnecessarily restrictive and means that potential investee companies trading for over 7 years are often unable to secure funding without the tax-advantaged schemes.

The issues with the 7-year rule are particularly pronounced for companies that have separate divisions. In this instance, a newly or recently established division of the company may be eligible for EIS/VCT, but because the company operates under one corporate entity and has another division that made its first commercial sale more than 7 years ago, it will not be eligible. Similarly, there is a possibility that an EIS/VCT eligible company that is still within the 7-year rule will undertake an acquisition of a non-eligible EIS/VCT company outside of the 7-year rule making it ineligible for the schemes.

[41] Venture Capital Trust Association, March 2018, available at: https://www.vcta.co.uk/submission-to-the-treasury-select-committees-sme-finance-enquiry

[42] HMRC Research Report, February 2016, available at: https://www.researchgate.net/publication/292747571_The_Use_and_Impact_of_Venture_Capital_Schemes#pf9

3. Funding gap

Despite the positive implications of ensuring investments are targeted at higher risk, higher growth companies, a significant funding gap still prevails. Once a company exceeds the thresholds making them ineligible for EIS/VCT investments, the company will likely find itself unable to attract investment because they are still too small and too high risk. There is evidence of companies increasing their market capitalisation and displaying impressive share price performance as a result of EIS/VCT and then being unable to locate investment once outside of the eligibility criteria. Ineligible companies will often find that they need more scale to find investors but cannot scale without significant investments from institutions that would have been provided by EIS/VCT.

This issue has been exacerbated by the Woodford UCITS fund debacle, where piecemeal publications on liquidity management from the regulator has resulted in small and mid-cap institutions going up the market-cap, creating significant challenges for companies in the funding gap to find suitable investors.

It is essential that these issues are addressed. Facilitating access to finance and providing support for smaller, early-stage companies should be a focal point of the Government's growth strategy. The effective supply of capital is essential for small and mid-sized companies and addressing the funding gap will be key to realising the future potential of the UK economy.

The tax-advantaged venture capital schemes are an integral part of facilitating this for smaller companies, helping them to raise capital to fund their growth. It remains crucial that the provision of tax reliefs for investors are maintained and strengthened in order to encourage investment in companies which would otherwise struggle to raise capital due to their higher-risk nature.

We outline below some potential solutions/improvements to the current system:

1. Streamlining of the processing/eligibility criteria

Given that, in their current format, the EIS and VCT processing and eligibility criteria is particularly opaque, we recommend a further streamlining of these processes. A streamlining of the processes would help to reduce the extent to which the delays can hinder, or even stop the IPO and/or secondary fundraise process. This would ensure that EIS and VCTs are more effective in being able to invest in smaller companies, enabling them to scale-up and employ more people.

HMRC have previously attempted to address the advanced assurance applications by encouraging firms to self-approve investments on the basis of professional advice. However, this did not remove the disproportionate penalty of disqualification of an entire fund for a non-qualifying investment. This meant that companies were still wary of proceeding with investments without having received formal assurance from HMRC.

In March 2018, HMRC announced that they were publishing revised guidance for advanced assurance, stating that, provided all reasonable steps have been taken to ensure an investment would be qualifying, HMRC will not withdraw a funds status.

HMRC's changes to the advance assurance process have been helpful, but more still needs to be done. In order to ensure that the self-approval system is efficient, with the removal of subjectivity and inconsistencies in the application of the rules, HMRC needs to provide greater clarification and make the system more transparent.

2. Reconfiguring the 7-year rule

As a result of the issues that the 7-year rule gives rise to, we propose reconfiguring the rule in two ways. Firstly, we propose that there needs to be greater flexibility on the rule, with a revision back to the pre-2015 rules on acquisition finance. That is, to allow the EIS/VCT tax breaks for acquisition financing, so long as the combined entities are below the specified size and the spirit of the combined entity remains entrepreneurial and/or knowledge intensive. As alluded to above, this has historically created significant issues for companies and their ability to gain access to finance. Making the rule less restrictive and allowing a company to remain eligible for EIS/VCT when it has undertaken an acquisition of an older entity would serve to ameliorate these issues.

Secondly, we propose that the Government and HMRC consider amending the 7-year rule in determining a company's maturity. At present, a company's lifespan is used to determine its maturity, and once it has surpassed 7 years since it conducted its commercial sale, it is determined to have fallen out of scope of EIS/VCT eligibility. In place of this rule, we propose that the Government and HMRC instead determine a company's maturity on the basis of less artificial metrics. This would help to ensure a more accurate reflection of a company's maturity.

3. Addressing the funding gap

Historic changes, such as increasing the annual cap for investment into qualifying companies from £2 million to £5 million, the increase in gross assets limit for companies eligible for investment from £7 million to £15 million and the increase in the maximum number of employees allowed from 50 to 250 in 2012-13, have produced significant benefits for investee companies. Namely, these changes have increased the extent of long-term investments as they enabled investors to follow a company to later stages in its business cycle. This has allowed investors and companies to remain together for important expansion projects. Not only this, but it has also meant that investors have been able to invest in a wider range of companies, helping them to diversify their portfolios and spread their risk. It has also helped to fill gaps in access to finance for smaller, innovative companies in niche sectors.

In order to reflect the maturing of the market and growth company eco-system, we urge the Government, at a minimum, to periodically assess the qualifying limits. The number of growth companies in their early stages of development finding themselves outside the criteria for EIS and VCTs has increased. As such, we are of the opinion that the criteria are outdated and not fit for purpose. The qualifying criteria 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 force them outside of eligibility for EIS/VCT investment, but also outside of being able to attract other investment.

Therefore, we urge the Government to update the current limits in gross assets and number of employees in order to address the funding gap. This would serve to markedly increase a company's ability to retain investment, which is so crucial during their early stages.

G. Tax relief/incentive for sustainability improvements

Recent years have seen an increased focus in society on environmental issues. In November 2020 HMRC published its own 2019-2020 sustainability report which included a commitment to become carbon neutral by 2040. We also note that the Government previously published the Greening Government Commitments setting out the actions the UK government departments and their agencies will take to reduce their impact on the environment in the period 2016 to 2020.

Many businesses see sustainability as a key issue. As well as playing their part as responsible corporate citizens, many businesses see sustainability as a key factor in creating long term value, have specific sustainability objectives and programmes, and often issue reports to update interested parties on progress on these. Key issues may include the reduction of carbon footprints, reduced consumption of energy, water and other resources, minimising waste, recycling, ensuring compliance with environmental legislation and regulation, education of staff and others. Many businesses have strategies which go further than this, for example, addressing how a business can do more to support and engage with its local communities.

Given the importance of sustainability to society generally, we believe the UK tax system could do more to encourage sustainability. This may include, for example, a sustainability tax credit system (perhaps akin to research and development tax credits), enhanced tax deductions for relevant expenditure, the re-introduction of an improved system of enhanced capital allowances for energy efficient expenditure, etc.

We appreciate that this is a potentially wide ranging and difficult topic, and the need for the Government to ensure that any additional tax reliefs are properly focused. We would therefore suggest undertaking a review with business on how the tax system could do more to encourage sustainability, including a consultation process so that businesses of all size can contribute to the discussion.

H. Regional equity fund

It is well established that the UK is one of the most regionally unequal countries in the developed world.

The QCA believes both a symptom and cause of this is the matching disparity in terms of access to finance, and in particular, a lack of public equity investment in the regions.

It has long been acknowledged that the UK's distribution of equity investment has featured a significant imbalance. Predictably, London in particular and the South East claim a large proportion of the public equity markets attention while regions in the North of England fall far behind.

There are some hubs outside of London that are worth noting, Cambridge and Oxford are focal points, centred around their world leading universities and Manchester is an area of some activity in the North. Even when these areas are considered the gap remains extremely wide.

The 2020 budget established plans to "level-up" the UK's regions that have fallen behind due to Covid-19. These plans are focused on large infrastructure investment in the North, improving physical and digital infrastructure and building homes.

Covid-19 will continue to have implications. Analysis by the IFS indicates that most of the regions that were worse off prior to COVID would likely have not been the worst impacted by the pandemic[43].

The impact of the pandemic is likely to be that areas that were not thought of as deprived in 2019 may have been pushed towards greater difficulty. This means that the long list of regions for Government to focus on may have become longer.

There will also have to be a particular focus on the regions that fall into the deprived categorisation pre-COVID that have suffered greatly as a consequence since. Coastal towns that relied heavily on tourism and hospitality and were therefore severely impacted by lockdowns and restrictions on travel and leisure will need extra attention.

The recent Comprehensive Spending Review addresses some of these issues and provided greater detail regarding the approach to the levelling up agenda. The "Fairer, Faster, Greener" Strategy also added an emphasis on supporting private investment. One of the means of supporting private investment will be via a new infrastructure bank. The plan to allow this bank to provide support by offering debt, equity, and hybrid products is very welcome.

It is clear that the regional inequalities have become so marked because of long standing factors. Long term solutions are therefore essential. The CSR identifies one of the issues has been an inconsistency of government investment. This is unsurprising as successive governments of different political persuasions, have had to respond to the fluctuations of their own budgets and the government's debt.

The QCA believes one of the key ways to make the plans for most effective is to ensure the right balance between debt and equity investment.

Specifically, a strategy that would be more effective in the long term would be to encourage a greater involvement of equity investment from retail investors. Research conducted by YouGov for the QCA in 2020 showed the vital role retail investors played in the recovery of the stock markets during the pandemic. This research shows retail investors tend to take a long-term positions and therefore will form an important base for investment which is ideal for growing companies[44].

Currently the plan for the bank to "co-invest alongside private sector investors including banks, institutional investors, sovereign wealth funds, pension funds and global infrastructure investors" does not mention retail investment. The bank should also seek to find innovative ways for retail investors to play a role in the programme.

The Patient Capital Review in 2017 established that the UK had untapped potential in fostering growth companies and identified a lack of patient equity investment as the key area for improvement.

[43] Alex Davenport and Ben Zaranko, October 2020, Levelling up: Where and how, available at: https://www.ifs.org.uk/publications/15055

[44] QCA Research Report Retail Investment in Small and Mid-Sized Quoted Companies, 2020, https://www.theqca.com/article_assets/articledir_418/209186/QCA%20Retail%20Investment%20in%20Small%20and%20Mid-Sized%20Companies%20Research%20Report%202020.pdf

The QCA is proposing that a new fund is created to draw greater public equity investment to businesses based in the Northern regions of the UK.

The Government should employ a similar approach as the Life Sciences Equity Programme where government takes an equity stake in businesses that have growth potential in the regions. The program should provide additional incentives and support for these businesses to float their stocks.

I. 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 the Enterprise Management Incentive (EMI) 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 no longer 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 pushes them outside the limits of the current thresholds whilst they are still in a developmental phase. As a result, these companies are failing to attract and retain the best talent, which is so crucial for their growth in their early years.

We urge the Government to update EMI by making the following changes:

1. Limits such as the number of employees and gross assets can change daily. A simplification would be to fix the limit as applicable for, say, a 12-month or 18-month period during which the SME could continue to qualify.
2. Share valuations of non-quoted shares for EMI options have been agreed for the longer period of 120 days as a result of Covid-19. A simplification would be to allow values to be agreed for 12 months (this is the US tax approach) or at least six months for all plans. This helps growth companies making multiple annual awards as their employees grow and should save review time for HMRC.
3. Remove the requirement to report an EMI option within 92 days. There is no longer the approval process difference between EMI, CSOP and SAYE that was the original justification for the additional requirement and the grants may be reported on the annual returns through the normal online portal. Whilst there is a reasonable excuse provision, the removal avoids companies making genuine mistakes needing to rely on this. In addition, it saves HMRC time dealing with errors.

4. Review and simplify the excluded activities for EMI options in Schedule 5 ITEPA. For example, hotels and residential care homes have been excluded on the basis that they may be capital intensive businesses, but as they have suffered due to Covid-19 this might be reviewed. Computer software and game development companies find the limitations imposed by the restriction on licensing are out of line with common practices where, for example, businesses with intellectual property are bought by other growth businesses such that the exemption for such IP created 'in-house' will not apply.
5. Increase the gross assets test to £50m and employee numbers to 350 (which would help many hospitality businesses with high staff levels that are suffering from the combination of Brexit hampering recruitment and Covid-19, recruit the staff they need). The criteria for EMI – which was set in 2000 – is outdated and no longer fit for purpose.

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

J. Preserving the current carried interest rules to protect private capital investment

The Labour Party's announcement that, if the party wins the next general election, it will target the carried interest rules and seek to tax carry as income instead of at capital gains tax rates is likely to reignite the debate and may cause the government to reflect on the current position on carried interest in the Budget. It is essential that any consideration of change in this area should take into account the potential impact on the availability of funding for small and medium sized businesses. Private capital plays a vital role in the growth of a company until it is of a size and scope to become quoted on public markets. In fact, 9 in 10 UK businesses receiving private equity or venture capital investment in 2020 were small and medium sized businesses[45].

Contrary to what Labour argue, the UK's carried interest regime does not create unfairness in the tax system but derives from the deliberate treatment of carry as longer-term investment returns (and not therefore regular income) in order to incentivise executives to invest their own money and take on risk for the long term. The implications of The Labour Party's proposal for the asset management industry are potentially very significant because for additional rate taxpayers, treating carried interest as income would cause it to be taxed at 45%, as opposed to 28% under the current rules. Any adverse change would inevitably impact on small and medium sized companies which may struggle to attract the same level of private investment in the absence of the tax incentive.

In the UK, following substantial tax reform in recent years, we now have amongst the highest rates in the world on carried interest. Any proposals for change need to take careful account of the international competitiveness of the UK's regime and the impact of investment being diverted elsewhere at a time when small and medium sized companies need it most.

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[45] BVCA, September 2021, *Investing with integrity: Supporting businesses through the pandemic*, available at: https://www.bvca.co.uk/Portals/0/Documents/Research/2021%20Reports/BVCA%20Investing%20with%20Integrity%20-%20September%202021.pdf

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[46].

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-sized 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[47] 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[48] has noted, the OTS's remit continues to be largely limited to only being able to assess existing law and not propose 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.

It would be helpful both for the Treasury and the tax profession if the OTS's vision and five-year plan were published. This would then allow the Chancellor to stand beside the body and cooperate in terms of future legislation. The tax profession would be also more able to assist the OTS in the future if its plans and strategy were available for consideration.

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

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

[48] 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

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.

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-sized quoted companies

New tax rules aimed at reducing tax avoidance have disproportionately affected small and mid-sized quoted companies, despite being targeted at larger listed, multi-national companies.

Legislation is often drafted in a way that compels small and mid-sized 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.

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

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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 an overly 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 advisers. 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-sized 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-sized 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, in turn, uses up HMRC staff time to correct.

The company itself must register a plan (whether it operates a formal share scheme or not) 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.

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-sized 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. This 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. The 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. HMRC portal

Many mid-tier companies and groups experience practical difficulties when dealing with HMRC. HMRC staff are of course busy and remote working in the last year has made reliance on electronic communication more important than ever. Different queries from a business, say on payroll taxes, corporate taxes or tax payment allocations, can make it necessary to liaise with different parts of HMRC. It is often difficult for taxpayers to liaise directly with relevant specialists in HMRC, and the HMRC employees taking calls cannot be expected to have the skill set to deal with every query that comes in. Furthermore, when a business has to phone back to HMRC it is highly unlikely that the same HMRC employee will answer the call or have a detailed understanding of what was discussed in a previous call. For these reasons, relatively minor issues such as having a tax payment reallocated to a different period can become unnecessarily complex and time consuming for businesses.

For larger businesses the Customer Compliance Manager (CCM) system provides a single point of contact for the business within HMRC. The CCM who can then liaise as necessary with other teams within HMRC to coordinate matters and involve the relevant HMRC specialist and ensure that matters are progressed. We appreciate that it is not practical to have a CCM for all mid-tier tier companies and businesses.

We would however suggest that HMRC looks to introduce an electronic portal system for its dealings with mid-tier businesses. The portal would act as a single communication channel where a business can raise queries with HMRC (on any tax) and HMRC could respond and/or raise its own queries with the business. It would enable both the taxpayer and HMRC to liaise as necessary within their respective organisations and reply using a single communication channel. It would enable dialogues to be tracked and monitored so that all communication between HMRC and the taxpayer is in a single place and the status on a particular issue can be seen immediately by both HMRC and the taxpayer. The system would add further benefit to the Making Tax Digital project.

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

Overall, 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-sized 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 despite being intended primarily for major multi-national and larger listed companies.

As a result of anti-avoidance legislation, small and mid-sized 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. By definition, these companies do not have the same level of resources as larger companies and typically lack in-house tax departments. As such, smaller companies find necessary to pay advisers 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 must 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, it is possible the costs and burdens placed on companies significantly outweighs the increased tax revenue from these measures. Any proposals to implement additional measures must undergo thorough cost-benefit analysis and consider the cost/benefits relating to smaller companies specifically.

H. Reducing the SIP tax free period from five to three years

The tax-free holding period for all Share Incentive Plan (SIP) shares should be reduced from five years to three years in order to aid simplification and better reflect current employment trends. Making such a reduction to the holding period will not only simplify the scheme considerably, but it will also make it more attractive.

A reduction to the holding period was recommended by the Office of Tax Simplification's (OTS's) review of tax advantaged employee share schemes in 2012[49]. The OTS concluded that the number of different holding periods can cause confusion and lead to a disconnect between the holding period and when the full tax relief can be realised. This confusion arises as a result of the inconsistency between the minimum holding period and the required holding period for tax. While the minimum holding period for free and matching shares is three years, the tax relief is not available until the shares have been held for five years. This creates issues with communicating this to employees both on launch of the scheme and at the maturity stage. As a result, this confusion has the effect of reducing the attractiveness of the scheme.

Furthermore, the five-year period also causes issues as it is difficult for employees to understand the calculation of the taxable value associated with leaving the scheme where some shares have been held for less than three years and other shares have been held between three and five years.

Finally, the five-year period is inconsistent with most current remuneration practices. For instance, the holding period for SIPs is longer than the typical holding period for CSOPs, and SAYE also allows participants to exercise after three years. It is a commonly held belief that the five-year period is too long, with many suggesting that it makes it difficult to maintain a retentive effect with a clear line of sight for employees. This significantly reduces the attractiveness of the scheme.

Aligning all the holding periods to three years would therefore make the SIP scheme much simpler, remove confusion and increase its attractiveness.

[49] Office of Tax Simplification, March 2012, *Review of tax advantaged employee share schemes: Final report*, available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/198444/ots_share_schemes_060312.pdf

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 plan for their future development effectively and confidently. Where uncertainty exists in a tax system, companies are far more likely to defer, or abandon altogether, plans to invest for growth

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 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, following its departure from the EU, 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.

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-sized 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 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 C. They illustrate the complexities and costs incurred by small and mid-sized quoted companies.

Appendix A: European regimes that apply tax relief for the costs of raising equity[50]

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

[50] 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).

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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. NOTE: 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) [51]

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) [52]

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[53]	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**

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

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

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

Appendix C: The difficulties faced by small and mid-sized quoted companies applying transfer pricing rules

Company A

Number of Employees: 500
Turnover: £100m
Market Cap: £40m

Company A'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 B

Company B 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 C

Company C, 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 D: Expert Group members

Quoted Companies Alliance *Tax Expert Group*

Those highlighted in bold have played a particularly important role in formulating this year's proposals.

Paul Fay (Chair)	**Crowe UK LLP**
Mark Allwood	Haysmacintyre
Zoe Andrews	Slaughter & May LLP
Emma Bailey	Fox Williams LLP
Edward Brown	Grant Thornton UK LLP
Fiona Cross	Beavis Morgan
Tom Gareze	PKF Littlejohn LLP
Rachel Gauke	LexisNexis
Oliver Gutman	Shakespeare Martineau LLP
Yuri Hamano	BDO LLP
Daniel Hawthorne	Dechert
Catherine Heyes	PKF Littlejohn
Hannah Jones	Deloitte LLP
Mark Joscelyne	CMS
Sabina Marguiles	LexisNexis
Zoe Peck	Mazars LLP
Dan Robertson	RSM
Matthew Rowbotham	Lewis Silkin
Andrew Snowdon	UHY Hacker Young
Peter Vertannes	KPMG LLP
Paul White	Druces LLP
Jonathan Woodall	Travers Smith 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**
Jennifer Rudman (Deputy Chair)	**Equiniti**
Tristan Adams	Link Asset Services
Barbara Allen	Stephenson Harwood
Emma Bailey	Fox Williams LLP
David Baxter	Stephenson Harwood
Danny Blum	Eversheds Sutherland
Ian Brown	Slaughter & May
Michael Carter	Osborne Clarke
Sara Cohen	Lewis Silkin
Louise Delamere	Bright Grahame Murray
Stephen Diosi	Mishcon De Reya
John Dunlop	DAC Beachcroft
JD Ghosh	MM & K Limited
Suzy Giele	LexisNexis
Andy Goodman	BDO LLP
Kathy Granby	Lewis Silkin
Elissavet Grout	Travers Smith LLP
Juliet Halfhead	Deloitte LLP
Caroline Harwood	BDO LLP
Lea Helman	LexisNexis
Catherine Heyes	PKF Littlejohn LLP
Liz Hunter	KPMG LLP
Stuart James	MM & K Limited
Graham Muir	CMS
Isabel Pooley	Grant Thornton UK LLP
Neil Sharpe	Mishcon De Reya