QUOTED COMPANIES ALLIANCE

# Boosting growth in quoted companies

## Autumn Budget 2024 – Proposals for reform

Public markets are the best place for companies to source the funds to grow, operate transparently and distribute wealth widely. Small and mid-sized quoted companies represent 91% of the quoted company sector, employ 2.1 million people and contribute over £25 billion in annual taxation.

It is essential to ensure that public companies are able to operate in an environment where their potential is fulfilled, helping to ensure a healthy and resilient UK economy.

This paper puts forward several proposals that we believe should be included in the Autumn Budget on 30 October 2024. These solutions could have a significant impact on reinvigorating the UK's public equity markets by improving trading volumes, helping UK companies attract the best talent, enhancing investor appetite, increasing access to finance, and boosting corporate confidence.

## Key proposals for taxation reform

We call on the Government to:

1. **Confirm its commitment to maintaining business relief, recognising the vital role it plays in stimulating investment into growth companies on AIM and Aquis.**

2. **Simplify and update the Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCTs) to ensure that their scale and scope are sufficient to reflect the growth company ecosystem** through:
   - Streamlining the processing and eligibility criteria;
   - Reconfiguring or removing the seven-year rule; and
   - Updating the qualifying criteria.

3. **Simplify and update ISAs.**

4. **Scrap stamp duty on share trading for companies on the LSE Main Market outside the FTSE 100 to help boost investment into these businesses.**

5. **Rectify distortions in the tax system by levelling the playing field between debt and equity financing** by:
   - Introducing a £1.5 million upper limit to target the relief appropriately to smaller companies;
   - Allowing the relief to be applicable to both IPO and secondary fundraisings;
   - Allowing the relief to the extent that the equity finance supports business activities;
   - Allowing all types of fundraising costs associated with raising equity to be deductible; and
   - Allowing the tax relief for the costs of raising equity to be available in the year these were incurred.

6. **Carefully consider capital gains tax (CGT) reform and maintain the UK's attractiveness to high-growth companies by exempting gains made under employee share schemes from any CGT increase.**

7. **Update the qualifying limits of the Enterprise Management Incentive (EMI) scheme by:**
   - Increasing the gross asset test from £30m to £50m;
   - Increasing the employee limit from 250 to 350; and
   - Facilitating the transition from EMI to Company Share Option Plans (CSOPs).

8. **Modernise Share Incentive Plans (SIPs) and the Save As You Earn (SAYE) scheme in order to increase employee participation.**

## 1. Maintain business relief

Business relief is one of the most vital and cost-effective tax incentives offered by the UK Government. It channels billions of pounds into the UK's growth companies on AIM and Aquis so that they have the best chance of becoming the blue-chip stocks of tomorrow.

Business relief is a credible tax incentive that helps to correct a market failure by encouraging investment into smaller businesses that would otherwise be directed at larger, more liquid companies or remain unproductive as cash savings. It supports hundreds of companies operating across different, innovative sectors that, in turn, support hundreds of thousands of jobs across the UK.

### Proposal

The Government should confirm its commitment to maintaining business relief, recognising the vital role it plays in stimulating investment into the UK's growth companies.

### Explanation

Business relief has been fundamental in ensuring that smaller businesses do not face substantial barriers to capital raising, and that they have access to a diverse range of investors – both institutional and retail. It accounts for almost **£6.5 billion** of institutional investment into AIM companies, amounting to about **£1 in every £10 invested**[1] in qualifying AIM stocks and, in total, is estimated to have diverted around **£10 billion** into growth businesses. As a result of this, it helps to:

- Support growth and employment throughout the UK – AIM companies operate across nearly 40 sectors and support a substantial number of jobs outside of London and across the Midlands, North East, North West, Scotland and Wales.
- Incentivise long-term, productive investment – it is a major driver of long-term investment, with investors typically holding between 7-10 years, making it one of the most patient sources of capital, supporting companies regardless of market downturns. Without business relief, the typical investor would likely concentrate their wealth in cash, bonds or property.
- Enhance liquidity – it helps to ensure a broad mix of institutional and retail investment, helping to maintain an active secondary market that also underpins primary capital raising.
- Boost valuations – which makes UK companies less vulnerable to opportunist takeovers.
- Halt market exits – the above demonstrates to listed companies and those considering an IPO the value of AIM as well as Aquis, preventing further losses and potentially boosting admissions.

### Data and costings

The cost of business relief to the Exchequer is not especially high. It is estimated to cost £1.3 billion in 2023-24, amounting to just 0.048% of GDP according to HMRC[2]. However, this cost does not factor in the significant tax revenues generated by companies that are funded through investors motivated by business relief. These long-term investments help to drive tax revenues over the long-term and outstrip the one-off saving provided by business relief on death.

Please click here to see our full paper on the importance of business relief.

[1] It is expected that this figure is much higher as this does not include direct investments into companies, such as those made by individuals or founders, where business relief was a factor in the investment decision.
[2] Source: HMRC, 2022-23, Non-structural tax reliefs

## 2. Simplify and update EIS and VCTs

EIS and VCTs are two vital risk capital schemes that channel investment into both public and private companies whose scale means they might not otherwise attract it. The schemes are critical to maintaining support for early-stage companies, allowing these businesses to grow and plan for the future. The schemes also provide access for ordinary retail investors rather than simply the large investment houses and high-net-worth individuals, thereby spreading the wealth derived from the growth of these companies.

### Proposal

Conduct a review of the EIS and VCT schemes to ensure that their scale and scope are sufficient and that they reflect the growth company ecosystem. Areas for the review should include:

- Streamlining the processing and eligibility criteria – implementing a time limit on HMRC for the processing of applications, offering advanced assurance, making the system more transparent, amending the VCT UK permanent establishment requirement to align with the EIS approach, and allowing greater flexibility and access to the schemes.
- Reconfiguring or removing the seven-year rule – establishing alternative metrics to the seven-year rule in order to help determine a company's maturity more accurately, alongside removing the rule around acquisitions.
- Updating the qualifying criteria – updating and increasing the gross asset and full-time equivalent employee figures to better reflect the current nature of growth companies. A tapered application of the relief should also be available for companies who exceed the qualifying criteria to minimise the impact.

### Explanation

Whilst they provide vital capital for smaller companies, the schemes have significant limitations both in terms of their scope and scale that limit their effectiveness.

- Eligibility criteria – The complexity of the investment rules that provide HMRC with discretionary powers to be applied on a case-by-case basis has resulted in extremely lengthy delays in HMRC's processing of investment applications. This causes hold-ups and means unnecessary uncertainty and frustration for businesses at a critical point when they are trying to invest and expand. In addition, the current UK permanent establishment requirements create significant issues for start-ups and scale-ups, as well as their advisers and HMRC, when accessing EIS/VCT funding.
- Seven-year rule – this rule is unnecessarily restrictive given the time it takes some companies to bring some innovative ideas to fruition and is not an appropriate measure of commercial maturity. Furthermore, the rules around acquisitions are prohibitive and can result in issues for companies in terms of their ability to access finance.
- Qualifying criteria – it has been over a decade since the figures for gross assets and number of fulltime equivalent employees was updated. Whilst it is important that the schemes are appropriately targeted at higher risk, higher growth companies, these metrics no longer reflect the developments within, and the maturing of, the growth company ecosystem, meaning that many companies are currently facing a financing cliff-edge.

## 3. Simplify and update ISAs

The Government should introduce several measures to reform Individual Savings Accounts (ISAs) in order to make them more effective, appealing to investors and supporting of the UK economy. Firstly, ISAs would benefit greatly from simplification as it would not only make them more accessible to a broader range of individuals, including those with lower levels of financial literacy, but would also have the potential knock-on effect of increasing investment. Secondly, it has been some time since the ISA allowance was updated, which would naturally increase investment into UK plc.

### Proposal

The Government should seek to reform ISAs in the following ways:

a) Introduce a unitary ISA product, allowing Cash ISAs to be combined with Stocks & Shares ISAs; and
b) Increase the ISA allowance by increasing the limit from £20,000 to £30,000.

### Explanation

*a) Introduce a unitary ISA product*

The introduction of a unitary ISA product, allowing Cash ISAs to be combined with Stocks & Shares ISAs, would significantly simplify the regime. Merging these two features of current ISA products would not only reduce complexity through having various versions of ISAs, but it would also make it much easier for people to engage in investing.

In order for this to work, however, it will be important for platforms and services offering the unitary ISA to ensure appropriate communications so that individuals are able to get to grips with both types of products.

*b) Increase the ISA allowance*

Increasing the ISA allowance by £10,000 from the current limit of £20,000 would produce substantial benefits. Whilst the level of investments into UK equities in ISA portfolios vary, increasing the overall allowance to £30,000 would inevitably result in a much-needed boost to investment for UK companies. This will also be boosted if the proposal to introduce a unitary ISA product is taken forward as it will encourage more funds into stocks and shares.

Given that the ISA allowance has been frozen at its current level of £20,000 since 2017/18, there is a strong argument that an increase is long overdue. An increased allowance would be a significant benefit for investors who have maxed out their allowances and now face significant levels of tax on investments held outside of ISAs.

It is estimated that increasing the existing allowance to £30,000 could mean capital gains savings of over £35,000 over a twenty-year period for taxpayers investing in stocks and shares (at an assumed CGT rate of 20%).

## 4. Scrap stamp duty for share trading outside the FTSE 100

The UK currently imposes a quadruple taxation on equities: dividend tax, capital gains tax, income tax and a transaction tax via stamp duty. This puts the UK at a competitive disadvantage; the US has no such charge, and the UK's stamp duty charge of 0.5% is the second highest in the world after Ireland, thus having a material impact on trading on UK equity markets.

### Proposal

Scrap stamp duty/stamp duty reserve tax on share trading for companies on the LSE Main Market outside the FTSE 100 to help boost investment into these businesses. This can be done by extending the growth market exemption that currently applies to AIM companies to all businesses on the London Stock Exchange's (LSE's) Main Market that sit outside the FTSE 100 (to be evidenced by CREST by way of a self-certification declaration).

### Explanation

In our view, removing stamp duty for share trading outside the FTSE 100 would:

- Increase the UK's international competitiveness – the US and Germany currently have no stamp tax on shares, in France and Italy the rate is 0.3%, and in Spain the rate is 0.2% (both France and Spain offer an exemption for companies with a market capitalisation under €1 billion). This would help to decrease the competitive disadvantage the UK has over other jurisdictions and direct capital into smaller, high-growth companies.
- Stimulate investment into smaller company stocks – over two-thirds of the companies on the Main Market have a market capitalisation of less than £1 billion, and nearly a quarter of the companies have a market capitalisation of less than £25 million[3]. This means that an exemption would stimulate investment into smaller companies that often struggle to attract the levels of institutional investment that larger companies can. This will help to improve trading volumes and thus liquidity in these stocks, as it has for AIM companies.
- Increase demand for UK shares and encourage retail investment – the current 0.5% charge on all transactions adds up and is a barrier to investors investing in equity who can opt for alternative investments, such as a bond or a unit trust. Removing the charge would encourage more retail investors to invest in equities, particularly those that are active traders.

### Data and costings

In 2023, the tax revenue generated from stamp duty was £3.3 billion, which equates to 0.3% of total UK tax revenue.

Given that the duty is based on the value of shares traded, this means that the amount of stamp duty collected will be highly concentrated within the largest companies. It is estimated that share trading in companies outside the FTSE 100 amounts to only about 15%[4]. Therefore, the initial loss of revenue to the Exchequer of scrapping stamp duty to all companies outside the FTSE 100 would be far less than the headline tax take: an estimated £650 million. We believe the initial direct impact on tax revenue would be more than offset by increases in other taxes. For instance, it is likely that revenues from capital gains tax, inheritance tax and corporation tax would grow as a result of increased economic activity.

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[3] Source: LSEG website, News and Prices, Reports, as of end July 2024
[4] Peel Hunt, Stamp Out Stamp Duty

## 5. Level the playing field between debt and equity financing

A current distortion exists in the tax system whereby there is differential tax treatment between debt and equity financing. This means that companies are incentivised to take on debt rather than to raise equity capital for their business. For smaller companies in particular, 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.

It has long been accepted that there is a need to address this preferential treatment of debt over equity as a source of finance. The EU, for instance, tabled a proposal for a debt-equity bias reduction allowance (DEBRA) in 2022, which introduces both a tax allowance on increases in equity and a limit on the tax deductibility of interest payments. In January 2024, the European Parliament adopted its (non-binding) resolution, with conversations ongoing to formally adopt the Directive.

### Proposal

The UK government should seek to rectify distortions in the tax system by levelling the playing field between debt and equity financing. To do this, the UK should provide a tax relief for the costs of raising equity up to a threshold level in order to appropriately target the relief at smaller companies. This could include the following elements:

1. Introduce a £1.5 million upper limit to target the relief appropriately to smaller companies;
2. Allow the relief to be applicable to both IPO and secondary fundraisings;
3. Allow the relief to the extent that the equity finance supports business activities;
4. Allow all types of fundraising costs associated with raising equity to be deductible; and
5. Allow tax relief for the costs of raising equity to be available in the year these were incurred.

### Explanation

Many countries that levy taxes on company profits treat debt favourably over equity, typically because they allow interest payments to be deducted from tax bills. This incentivises companies to borrow instead of funding themselves through equity, and is a disincentive to seeking a listing on a public equity market. It puts the UK at a competitive disadvantage compared to many other European regimes which provide some form of corporation tax relief for raising equity finance.

The OECD, which measures the debt-to-equity ratio of financial corporations across different nations, has shown that the UK (as of 2022) has a debt-to-equity ratio of 5.5[5]. This means that outstanding debt is 5.5 times higher than the market value of the outstanding equity, and is higher than other comparable jurisdictions such as France, Germany, Spain, Netherlands, Sweden and the US.

Countries with higher levels of debt are typically associated with slower levels of growth in addition to increased levels of financial risks and macroeconomic instability, whereas equity financing generally correlates to a positive growth effect.

The UK's reliance on debt finance is not a long-term solution. Making equity issuance costs deductible for corporation tax purposes would promote greater long-term stability and incentivise the use of the UK's capital markets.

[5] OECD, 2022, Financial corporations debt to equity ratio

## 6. Carefully consider CGT reform and maintain the UK's attractiveness to high-growth companies by exempting gains made under employee share schemes from any CGT increase

It is fundamentally important that the potential reform of CGT is carefully considered, and that the implications of raising its levels are fully assessed. We consider that a simple rise in CGT would reduce people's appetite to invest, result in individuals moving abroad, harm entrepreneurship and growth within the UK, and ultimately, could potentially raise less tax. For the growth of the economy, it is essential that business leaders are willing and able to invest in growing their business and hiring staff.

Employee share schemes help smaller UK companies compete for talent against large international employers. An increase in CGT could materially decrease the attractiveness of employee share ownership and seriously weaken the growth company ecosystem.

### Proposal

1. Gains made by employees on the sale of shares in their company or company's group should be exempt from any increase in the rate of CGT and/or benefit from a higher annual CGT exemption.
2. Business Asset Disposal Relief (BADR) should be preserved for sales of shares acquired by employees through EMI options.

### Explanation

Greater levels of employee share ownership can produce benefits for both employees and companies, including improved employee retention and motivation, helping to attract new talent, relieving pressure on cash flows, better company culture and increased productivity.

Coupled with the currently very low levels of annual capital gains tax exemption an increase in the rate of CGT without an exemption for employee share schemes would significantly reduce the number of employees prepared to make an investment in their employer, and use of the statutory tax-advantaged schemes EMI, CSOP, SIP and SAYE would decline or cease, meaning that staff feel less connected to their workplace and less invested in their company's success.

EMI, introduced by the Labour government in 2000, has been instrumental in supporting the UK start-up ecosystem. Gains made on the sale of shares acquired through EMI options currently benefit from BADR, which helps high-growth companies recruit and retain employees, particularly in the technology sector.

We have set out below some ideas for further improving the way in which EMI could help the UK's start-ups and scale-ups, facilitating the transition from EMI to CSOPs and for modernising the all-employee SIP and SAYE schemes.

## 7. Update the EMI qualifying limits

The Enterprise Management Incentive (EMI) scheme is a crucial scheme for high-growth start-ups and scale-ups that helps them to recruit and retain employees. Smaller companies often grant EMI options as they cannot afford to pay the levels of salary and bonus offered by larger companies. EMI is popular with employees, providing significant tax incentives in return for effectively making an investment in an early-stage employer. However, there are many high growth companies that are no longer eligible for EMI, for example due to employee numbers exceeding the 250 limit or a fundraising that causes their gross assets to exceed £30 million. This means that the cost of recruiting or retaining employees rises exponentially and so becomes dependent on their ability to obtain funding or generate sufficient cash flow to pay larger salaries (which can compromise their product by diverting R&D spend).

### Proposal

The EMI scheme should be updated to increase its qualifying limits. The gross assets test was last updated in 2002, meaning it is outdated and no longer fit for purpose. The employee number criteria was set in 2008 in relation to the EU requirement to satisfy state aid rules, and now the UK is no longer restricted by the EU it should set its own definition. Therefore, we believe the qualifying limits should be updated as follows:

- The gross assets test should be increased from £30 million to £50 million;
- The employee number should be increased from 250 to 350; and
- The rule causing EMI options to disqualify, when CSOP options are granted, to be abolished.

In addition to this, the company's employee numbers and gross assets can change regularly. In order to simplify the scheme, a fixed period of qualification should be implemented whereby a company qualifies for, say, a 12-month period before being assessed again.

### Explanation

For smaller companies that are eligible to use the scheme, EMI plays a significant role in helping these companies make new appointments, retain current employees, and ultimately assist with their growth and development. Continued access to these schemes remains crucial for the UK's growth company ecosystem (including start-ups and scale-ups), which helps to fuel the UK economy.

There have been substantial developments in the nature of growth companies since the criteria were last updated, and these limitations are inhibiting companies who outgrow the current thresholds yet remain young in their growth cycle. Many small-cap companies who currently exceed the limits face significant barriers to the retention and recruitment of key employees without access to EMI. This restricts their ability to grow and create positive outcomes for wider society and the economy.

There is also a longstanding argument that once a company outgrows EMI, the costs of designing, implementing and maintaining an SAYE, SIP or CSOP plan would be difficult to justify for these companies. For instance, the requirements of these three schemes are much less flexible than EMI scheme and the implementation of a SIP or SAYE will likely require companies to employ an administrator/savings provider.

Even where companies are prepared to take on the additional cost and administrative burden of operating a CSOP, one particular barrier to transition from EMI options to CSOP options is the fact that any CSOP options granted to employees with subsisting (unexercised) EMI options will count towards the individual EMI limit (currently £250,000) and should this be exceeded, the CSOP grant will count as a disqualifying event of the pre-existing (and often more valuable) EMI options.

## 8. Modernise the SIP and SAYE schemes

The all-employee SIP and SAYE schemes help companies recruit and retain staff, as well as helping to encourage a savings attitude and improve financial awareness in companies where they are used. However, there are issues that currently exist in allowing them to fulfil their full potential. For instance, there are administrative burdens and costs, publicity around them is limited and they are fairly restrictive in terms of those that participate in them. We raised these concerns in HM Treasury's consultation on the non-discretionary tax-advantaged share schemes, but no update has been provided.

### Proposal

In order to increase participation in both schemes, we propose that SIP/SAYE plans can be modernised by:

1. Reducing the holding period for full tax-advantaged vesting from five years to three years for SIPs.
2. Allowing greater flexibility in determining what constitutes a "good leaver" for SAYE.
3. Permit flexibility for the use of free shares for different categories of employees, such as new joiners and lower paid employees (rather than all employees having to be offered free shares at the same time).
4. Enabling company contributions and auto-enrolment for SAYE.
5. Revisiting the definition of "employee" to include more workers in employee share schemes (both for tax and Companies Act/Financial Services purposes).
6. Removing the company law condition requiring net assets and/or distributable reserves for PLCs before giving financial assistance in connection with employees' share schemes.
7. Removing the loan to participators (s455) tax liability for companies when lending in connection with employee share schemes and clarification that a gift by the company is not a distribution.

In addition to the above, the Government and other non-governmental groups should be encouraged to raise awareness of the benefits and SAYE and SIP through greater publicity and communication campaigns.

### Explanation

There are multiple barriers that exist that prevent smaller companies from using the SAYE scheme and SIPs. For instance:

- There are high costs, administrative and time burdens associated with their implementation, particularly for smaller companies which will incur a disproportionate cost per employee.
- There are limitations to rolling the schemes out to employees in overseas jurisdictions.
- There are issues for companies with regard to having sufficient distributable reserves to implement.
- Low levels of liquidity and poor share price performance can inhibit the take up of the plans.
- For SIPs, the requirement for the length of time for employment reduces participation.

We believe, therefore, that the above proposals would produce benefits to both employees and companies and increase participation in the schemes.

Further details are included in our response to HMT's consultation.