



TAXREP 49/13 (ICAEWREP 132/13)

ICAEW TAX REPRESENTATION

SUPPORTING THE EMPLOYEE-OWNERSHIP SECTOR

Comments submitted in September 2013 by the Tax Faculty of the Institute of Chartered Accountants in England & Wales (ICAEW) to HMRC in response to the consultation on supporting the employee ownership sector issued in July 2013

Contents	Paragraph
Introduction	1 – 3
Who we are	4 – 6
General points	7 – 15
Responses to specific questions	16 – 34
Ten Tenets for a Better Tax System	Appendix

SUPPORTING THE EMPLOYEE-OWNERSHIP SECTOR

INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation paper, published by HM Treasury in July 2013 at <https://www.gov.uk/government/consultations/supporting-the-employee-ownership-sector>
2. We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.
3. Information about the Tax Faculty and ICAEW is given below. We have also set out, in the Appendix, the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

WHO WE ARE

4. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 140,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
5. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
6. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including TAXline, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

GENERAL POINTS

7. ICAEW supports the egalitarian principles behind the concept of wider employee ownership, but to date there remain few examples of businesses where it has genuinely worked.
8. One of the principal difficulties with employee ownership occurs when one starts to consider how these changes of ownership, or growth, in the case of early stage business, are to be funded. Giving a majority stake of 51% or more to a large number of employees, typically makes external fund raising, for example via business angel, venture capital, or private equity ownership very difficult. For bank debt, or asset-based lending, there may also be issues relating to providing shares as security for lending to the company, if ownership is so widely spread.
9. Key to the success of these proposals will be to define the firms which will qualify. For example, is it the Government's intention to favour employees of support services businesses, which are typically grown without the need for significant external investment in plant and machinery, or research and development? Many businesses require long-term equity investment to enable the development of valuable intellectual property, for example via heavy investment in research and development. This form of investment cannot typically be financed by bank debt alone and usually involves external investors taking a majority stake in the business. This would seem to disadvantage the very sorts of businesses so vital to economic growth. Is there a danger that such a structure unfairly disadvantages manufacturing

companies and their employees, or indeed larger listed companies which rely on public and institutional shareholders to provide capital for growth?

10. Therefore, it is unclear whether it is the Government's intention simply to encourage employee ownership in companies with very low capital requirements, such as support services companies, or professional practices. We had understood that Graham Nuttall's intention was that this form of ownership should be an option in quite specific scenarios, but not to be limited by the capital requirements of the business. For example, a high growth business where the employees have all invested in the business (or are not paying themselves much) or where a proprietor is retiring and wants his loyal employees to be able to continue to run the company. This must be factored into any legislation.
11. In our view, the legislation needs to be tightly drafted to avoid firms simply adjusting their ownership structure to reduce their tax liability and then probably directly and indirectly their wages bill. Is it the Government's intention to confer competitive advantage on certain companies as a result of those companies having lower employment costs, by virtue of an employee ownership structure?
12. Any new relief should be clearly and simply understandable by the people who it is aimed at and not just to the accountants and lawyers who might advise them.
13. The suggestions in the consultation document raise a number of questions. These will need further consideration before implementation.
14. It is not clear from the consultation document how the share acquisition by the Employee Benefit Trust (EBT) itself is to be funded. Is it expected that the EBT will borrow funds or can it be funded by a contribution from the company? If it is to be funded by the company how is it expected that tax relief for the company will work? The existing rules will be inadequate to deal with this because under the current legislation, contributions by a company to an EBT only qualify for a corporation tax deduction when the employee is subject to income tax on the allocation or distribution by the EBT. In the circumstances outlined in this consultation, there will not be an income tax charge on the employee so legislation will be needed to ensure relief is available.
15. The proposals are complex so an advance clearance procedure should be out in place to confirm that HMRC is satisfied that the structures implemented are:
 - For the benefit of the trade
 - For the benefit of the employees
 - Are not caught by the transaction in securities legislation, and
 - That the price paid for the controlling interest will not be subject to adjustment by HMRC under any anti-avoidance principles.

This would protect the EBT and employees from the transferor of the controlling interest reducing the value of the business prior to, or at the time of, the transfer and ensure that the EBT is put in a position of owning a business which is a going concern.

16. Consideration should also be given to a requirement that the transferor retains a material (say 25%) stake in the company for a period of say two years after the transfer to ensure continuity of management.

RESPONSES TO SPECIFIC QUESTIONS

Learning about the sector

17. Questions 1 to 5 are not relevant for this response.

Q6 Are you a professional adviser? If so, do you see many indirectly employee owned companies? Do you think this number is likely to increase? What more could be done to increase the number? Will these reliefs help?

18. The advisers we have spoken to have said that they do not see many indirect employee companies, largely as a result of the tax issues associated with the transfer of ownership. The proposed reliefs will help shareholders of private companies that may not have family to take over the business and who want to pass it to the employees.

Q7 Did the Budget announcement raise awareness of the employee owned sector?

19. We are not aware that the Budget announcement has had any significant impact on the awareness of the employee owned sector.

Qualifying criteria and operation of the relief

Q8 Do you agree that the qualifying criteria should be expressed by reference to the proportion of shares with voting rights held by an employee benefit trust? Do you agree that the criteria should also look at the trust's entitlement to assets on liquidation or winding up?

20. The shares' rights should be measured with reference to voting rights and entitlement to profits and capital and to the rights on a winding up. This deters manipulation of the share rights in order to access the reliefs.

Q9 Can respondents suggest criteria by which to exclude companies which are already controlled by employees by reason of their shareholding in the company?

21. Possible criteria could include:

- Stipulating that the beneficiaries of the EBT to which the controlling interest is transferred amount to $\geq 75\%$ of the employees;
- Exclusion of EBTs with 5 or fewer members;
- Preventing the transferor (and his family members) from also being a participant in the EBT;
- Denying income tax and National Insurance relief where an individual together with his associates is a material ($>30\%$) beneficiary of the EBT;
- Denying income tax and National Insurance relief where the working time requirement is not met by the employee (25 hours per week or 75% of their working time).

Q10 Do you agree that a simple majority of voting power carried by the company's issued share capital (referred to here as '51 per cent') is an appropriate level of control? If not, please explain why not.

22. We agree $>50\%$ is an appropriate test for transfer of control as this is consistent with other legislative provisions and the accounting definition of control.

Q11 Is there a case for allowing the relief to other types of person liable to CGT, such as trustees? In what circumstances would those persons wish to dispose of a qualifying interest in a company to an employee benefit trust?

23. Yes, the relief should be extended to include trustees as some of the shares in family companies are often owned through a trust structure as a result of previous transfers on the death of shareholders and founders.

Q12 By how much would take-up of the CGT relief be increased if it were available to more than one transferor on the bases described?

24. It is not uncommon for private companies to be owned by a husband and wife. The relief should therefore be available to the transfer of a controlling shareholding by connected parties.
25. It should also be available in other cases where family companies have passed to the second and third generations. The shares may now be owned by the sons and daughters of the original founders (and their spouses) or their descendants. In such cases, the third or fourth generation of owners may not have any interest in what has become a large thriving company.
26. In our view, making the relief available in these other cases will increase the take-up of share ownership through EBTs, but be in line with the spirit of the intended legislation.

Q13 Should the CGT relief be available on disposals of unincorporated businesses, as well as disposals of ordinary share capital in a company? How would extending the relief in this way increase the likely number of qualifying disposals?

27. Practically the most efficient way for an unincorporated business to be transferred to its employees would be via a Limited Liability Partnership. The EBT would become a controlling partner in the EBT with proportional rights to votes, income and capital. This would avoid the EBT taking on the day to day management or unlimited liability for the business.
28. Structured this way, the relief could apply equally to disposals of controlling interests in sole trader businesses and partnerships as well as companies. This would extend employee ownership and participation in the businesses as many businesses are not incorporated and there is no reason why employees in these should be disadvantaged.

Q14 Would any other definition of ‘controlling interest’ be preferable in connection with the CGT relief?

29. A consistent definition of controlling interest should be applied across the reliefs to simplify implementation. Consequently we believe a ‘controlling interest’ should be determined as >50% of the voting rights and beneficial interests in the transferred business.

Q15 What do you see as the risks and advantages of the simple ‘51 per cent’ definition and any possible alternative definitions? How would the number of claimants vary with the possible definitions?

30. As with any numerical threshold there is a risk of companies structuring to meet the criteria. Anti-avoidance legislation may need to be considered to prevent the transferor retaining veto rights over key decisions so that de facto control is not transferred.

Q16 If the Government decides to extend the CGT relief to disposals of unincorporated businesses, how should a controlling interest in such businesses be defined so as to guarantee that an appropriate stake in the business is acquired by the trust?

31. For unincorporated businesses, a controlling interest should be determined as >50% of voting rights, capital and income distributions.

Q17 Should the CGT relief be available on disposals of unincorporated businesses, as well as disposals of ordinary share capital in a company? How would extending the relief in this way increase the likely number of qualifying disposals?

32. We do not have any data for the likely number of qualifying disposals that would result from a change in legislation.

Q18 How should the type of payments that qualify for the new exemptions be defined?

33. As the payments are to represent profits arising on an investment they should be akin to a dividend and taxed as such. The intention is that the 'bonus' is linked to the shares. Anti-avoidance rules will be needed to ensure that the reliefs are not used to substitute normal salary.

Q19 The Government expects that, in most cases, payments will be made directly to the employee from the employer company but it is aware that employers may seek to make different arrangements. The Government is considering whether the exemptions should apply where the payments are made by the employee benefit trust although it recognises this may involve more complex legislation. If the exemptions were limited to payments made by an employer company would this provide sufficient flexibility? How could the exemptions be effectively extended to payments made by trusts?

34. From a practical perspective we believe payments directly by an employer company would be simplest. Payments from the EBT would have funding issues as well as requiring a change in the disguised remuneration legislation such that the payments were 'approved arrangements'. There is also the income tax position of the trust on receiving dividends.

Q20 Do you agree that the proposed outline of the way the exemptions will operate is fair and straightforward for the employer to understand and implement?

35. It is our view that the proposals are far from clear. The companies and businesses that are most likely to benefit from this will struggle with these rules and how they interact with existing share scheme rules. The typical owner managed business wants its employees to participate in the success of the business without complex arrangements.

E anita.monteith@icaew.com

Copyright © ICAEW 2013
All rights reserved.

This document may be reproduced without specific permission, in whole or part, free of charge and in any format or medium, subject to the conditions that:

- it is appropriately attributed, replicated accurately and is not used in a misleading context;
- the source of the extract or document is acknowledged and the title and ICAEW reference number are quoted.

Where third-party copyright material has been identified application for permission must be made to the copyright holder.

icaew.com/taxfac

THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

In 1999, the Tax Faculty published The Ten Tenets for a better tax system. We have tested the proposals in this consultation document against our ten tenets and our conclusions are set out below.

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

The Ten Tenets are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see

<http://www.icaew.com/~media/Files/Technical/Tax/Tax%20news/TaxGuides/taxguide-4-99-towards-a-better-tax-system.ashx>).