HM Revenue and Customs
Employment Income Policy Team
Room 1E/08, 100 Parliament Street
London
SW1A 2BQ

By email: employmentincome.policy@hmrc.gsi.gov.uk 5 October 2016

Dear Sirs,

Re: BVCA response to HMRC consultation on tackling disguised remuneration

We are writing on behalf of the British Private Equity and Venture Capital Association ("BVCA"), which is the industry body and public policy advocate for the private equity and venture capital industry in the UK. With a membership of over 600 firms, the BVCA represents the vast majority of all UK based private equity and venture capital firms, as well as their professional advisers. Our members have invested over £27 billion in nearly 3,900 UK-based companies over the last five years. Companies backed by private equity and venture capital in the UK employ around 385,000 people and 84% of UK investments in 2015 were directed at small and medium-sized businesses.

Our feedback below is in response to the consultation document entitled "Tackling disguised remuneration". Our comments are relevant to the Close Companies' Gateway proposal.

The Close Companies' Gateway - Overview

We note that one of the government's proposals is to introduce a new "close companies' gateway to Part 7A.

We believe that the proposals are far too wide and that, if legislated in their current form, will catch numerous arrangements which should not come anywhere near the disguised remuneration ("DR") rules.

Our primary concern is therefore that the new rules go way beyond the original purpose of the rules which was to tackle genuinely "disguised remuneration" and instead could catch arrangements involving payments to current or former employees even where the capacity in which they receive those payments is clearly as shareholder rather than as employee.

Outline of Concerns

On our reading of the proposed new rules, there are a very limited number of conditions which must be satisfied before you pass through the proposed new gateway. These are set out below. Once you pass through the gateway, there are numerous heads of potential charge which can apply. These include a charge arising on any payment of money, as well as subsidiary areas of risk such as earmarking. Once you are in the ambit of the rules, you then have to delve through highly complex legislation in order to establish whether an exception is available. Even for those who are familiar with these provisions these rules are complex and the exceptions are not clear cut.

For this reason, we believe it is critical that you only pass through the gateway in limited circumstances. Otherwise, numerous scenarios which are entirely unrelated to remuneration

planning end up, potentially, exposed to PAYE charges or, at very least, will require complex advice around the existence or otherwise of exceptions.

The current gateway seeks to establish whether, in essence, the relevant arrangements are employment related. The new rules do not.

Instead, on our understanding of the new rules, you would pass through the gateway where: -

1. There is a relevant step involving an individual
2. That individual is a current or former employee/director who has, at any time, held a 5% interest in a close company
3. That close company is involved in the arrangements
4. The arrangements involve "payments, benefits or loans" to the individual

This gateway is therefore incredibly wide. Where you meet these conditions, it makes no difference that the payment is, clearly, nothing to do with employment and is being received in an entirely different capacity. It creates an irrefutable presumption that any payments which are made in these circumstances are employment related.

Examples of Concerns

1. Mr X is a shareholder in a close company. Many years ago he owned more than 5% of the company and was an employee. He hasn't been involved in an employment capacity for 10 years. He is told by the current majority shareholders that they have agreed to sell the company. Mr X receives some proceeds for his shares from the buyer of that company.

   On our reading of the provisions, this arrangement passes through the gateway test. Because it involves the payment of money from the buyer to Mr X (which is a DR head of charge) the sales proceeds are potentially re-characterised as remuneration.

   It may be that an exemption to charge, or potentially a credit against the charge, may be available in these circumstances. However, to pass through the gateway in the first place seems extremely odd and we assume would not be the Government's objective.

2. Mrs Y is an angel investor in a start-up company and holds a 15% stake. In order to protect her interests, as an investor, Mrs Y has a directorship in the company. The company is a close company. Several years later, Mrs Y is approached by the majority shareholders with respect to a sale of the company. Mrs Y eventually sells her shares to a third party and makes a capital gain. As part of the arrangements, each shareholder agrees to provide some money in a retention account against possible warranty claims.

   Again, on our reading of the provisions, this arrangement passes through the gateway test. Accordingly the payment Mrs Y receives on the sale of her shares is a 'payment' which is a potential charging provision. The retention of cash in the retention account potentially also creates an 'earmarking' thereby giving rise to a further possible head of charge. In each case, you then have to go through the legislation to see if an exemption applies. This is often not a clear cut analysis. On these facts the possible 'earmarking' could be particularly problematic.

Again, we assume it must be an unintended consequence that these type of arrangements pass through the gateway.

3. Private equity limited partnership holds a majority stake in a company. To protect its interests, one of its partners is appointed as a director to the board of the company. That company is close. The private equity fund decides to syndicate a part of its interest in the company to a co-investor and receives a payment from that entity.

   In this case, we have an individual who is a director of that company. That individual himself will not hold a 5% interest in the company. However that individual, together with the partners in the private equity partnership (who will be his associates), will hold a 5% interest. As such, there must be a material risk that this structure would pass through the gateway. If so, there must be a real risk that you have to consider all arrangements involving the fund, as to whether there is a charging provision under DR, even though the fund is comprised of entirely external investors and this arrangement has nothing whatsoever to do with an employment arrangement.

   Again, we assume this must be an unintended consequence.

There are multiple further examples of a similar sort but these examples, hopefully, provide an illustration of the extent of our concerns.

Why this matters to venture capital (VC) and private equity (PE)?

As you will know, a significant proportion of venture capital and private equity backed businesses will be treated as close companies. This results from the fact that VC and PE generally structure their investments through partnerships. Given that rights of one partner are aggregated with rights of other partners when considering the close company rules, many VC and PE backed companies are treated as "close" even where those companies are actually extremely large and are in reality owned by a number of unconnected investors in the fund.

Accordingly it is a misconception to believe that only relatively small, family backed, companies are close.

If these rules are implemented in their current proposed form, numerous transactions involving such companies will end up being treated as falling within the DR regime.

Recommendation

We strongly believe that the scope of the new gateway needs to be fundamentally redrawn. Unless there is something which asks you to consider whether the payment is "in essence" employment related, we really cannot see how these new rules can be made to work.

If, despite our strong recommendation, you chose to proceed with the rules in their current form, we would at least ask that there is a limited carve out from the presumption for PE/VC backed companies.

This could, for example, work as follows:-

If the conditions for the new gateway are satisfied; but

The only reason the company is close is because of the attribution of rights between partners in a PE/VC backed partnership. (This is a definition currently used in CTA 2009 at 376 (5)).

Then you do not pass through the new gateway and, instead, only fall within the DR rules if you pass through the existing gateway, but with the proviso that the VC/PE exemption does not apply if there is a connection between a relevant step and a tax avoidance arrangement. (This language mirrors similar language included in ITEPA in 554A (11)).

Extension to self-employment

Paragraph 6 of the Consultation proposes to extend the DR rules to self-employed individuals in partnerships. Investment managers frequently provide their services via limited liability partnerships of which they are members. These members receive fees (via the limited liability partnerships) from the collective investment schemes that they manage. We are concerned that the proposals in paragraph 6 of the Consultation could apply to sums received by investment managers. Given the extensive reach of the disguised investment management fee rules, more legislation in this area is unnecessary. Should the DR rules be extended to cover self-employment we recommend that a specific exclusion for investment managers be included.

We would be very keen to discuss the contents of this letter with you and look forward to hearing from you in order to establish whether a meeting of this sort is possible.

Yours faithfully,

David R. Nicolson
Chairman of the BVCA Taxation Committee