BVCA Funding the future

Mr John Whiting
The Office of Tax Simplification
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Sent by email to: ots-ess@ots.gsi.gov.uk

14 December 2012

Dear Mr Whiting

Unapproved employee share schemes: Request for evidence on PAYE deadlines and penalties

As stated in our letter of 9 November, the provisions where a share is a deemed readily convertible asset (RCA) unless the employing company would be entitled to corporation tax relief can be problematic for private equity fund structures.

Shares issued in an investee company may in reality be illiquid, but the company cannot obtain corporation tax relief because i) the majority of the shares in that company are held by a PE fund and ii) there is a corporate general partner ("GP") within that fund structure, such that the GP could be deemed to effectively "control" the board of the investee company. If the "control" test is met (or if it is prudently considered to be met) the shares in the investee company could be deemed RCAs such that the company is required to collect any income tax via PAYE on any undervalue when those shares are issued to the employees.

This is an anomalous situation where the shares may be illiquid securities that are prohibited from being sold/transferred except in very limited circumstances.

Complying with the deadline to pay PAYE (by the 19th of the following month) is rarely an issue. Rather, it is the calculation of PAYE which is problematic. Although it is necessary to calculate PAYE on a 'best estimate' basis, in practice, this poses difficulties. The valuation for tax purposes of a private investee company is a subjective and can be a difficult exercise, often requiring the work to be undertaken by an independent and professional valuer. The costs of such a professional valuation could be significant, particularly for a small private company, but also for larger companies.

Obtaining a professional valuation does not necessarily eliminate the risk of a challenge by HMRC that PAYE has not been calculated on a best estimate basis. If the valuation is successfully challenged by HMRC, then the failure to apply PAYE on a best estimate basis may give rise to additional income tax liabilities if the employee does not make good the amount to the employer within 90 days ('Payments by employer on account of tax where deduction not possible' - s222 ITEPA 2003). This is an unsatisfactory outcome for taxpayers since there is a high degree of subjectivity in ascertaining a valuation of a private company. We would request greater certainty in the process for tax payers.

If you would like to discuss this further then please do not hesitate to contact me on Kathleen.Russ@traverssmith.com and 0207 295 3230.

Yours sincerely,

Kathleen Russ
on behalf of the BVCA Taxation Committee