



The British Private Equity and
Venture Capital Association
5th Floor East, Chancery House
53-64 Chancery Lane
London WC2A 1QS

Personal Tax Team
HM Treasury
1 House Guards Road
London
SW1A 2HQ

(email: employeeholdingvehicle@hmtreasury.gsi.gov.uk)

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Dear Sir/Madam,

New Employee Shareholding Vehicle Open Consultation

We are writing on behalf of the British Private Equity and Venture Capital Association (the “BVCA”), which is the industry body and public body advocate for the private equity and venture capital industry in the UK representing the interests of members of the industry. More than 500 firms make up the BVCA members, including over 250 private equity, mid-market, venture capital firms and angel investors, together with over 250 professional advisory firms, including legal, accounting, regulatory and tax advisers, corporate financiers, due diligence professionals, environmental advisers, transaction services providers, and placement agents. Additional members include international investors and funds-of-funds, secondary purchasers, university teams and academics and fellow national private equity and venture capital associations globally.

This letter has been formulated by the BVCA’s Taxation Committee, whose remit is to represent the interests of members of the industry in taxation matters. The BVCA welcomes the opportunity to submit comments on the new employee shareholding vehicle open consultation document published on 17 July 2014 (the “**Consultation**”).

Please find our comments set out below. We have not sought to provide a detailed response to each question in the Consultation but, rather, a general response on what we think is desirable and what not so desirable.

We would also be delighted to meet with you to discuss the use (and importance) of employee shareholding vehicles to businesses supported by the venture capital and private equity industry in more detail if that would be helpful.

Introduction

Employee shareholding is very important to the businesses supported by venture capital and private equity sponsors and considered essential in motivating employees (at all levels of seniority) over the long term and in aligning their interests with those providing the capital funding. Accordingly, we welcome the work of the Government and the OTS in supporting

employee ownership generally over the past few years. In particular, we welcome the proposal to introduce a new UK-based employee shareholding vehicle (“ESV”) and think that such a vehicle would be widely used by the sort of small and medium-sized enterprises supported by our industry provided that the legitimate safeguards discussed by you in the Consultation were not extended so widely that they limited the flexibility for use of the ESV to the extent that it became impracticable to use it in many commercial situations.

We agree with the OTS that current tax impediments discourage certain businesses from introducing employee shareholding arrangements using vehicles equivalent to EBTs and complicate the arrangements used by other businesses, with increased expense and administrative burdens.

Of the tax impediments discussed, the most problematic are inheritance tax, capital gains tax, tax on loans to finance EBTs and disguised remuneration. Removing stamp duty and stamp duty reserve tax charges would also be desirable to reduce the overall costs of running an ESV-based scheme.

Given these complications associated with using EBTs currently, it would obviously be desirable if a new, simple ESV were introduced.

Safeguards

We think that the factor that would be most likely to discourage the use of an ESV would be if the safeguards were cast so broadly that they imposed an impediment to genuine commercial transactions. The safeguards suggested by the OTS should be sufficient to protect the exchequer if the purpose of the ESV and the restrictions on its use were cast appropriately. In particular:

- a. UK residence – we agree with this;
- b. limiting beneficiaries to employees and former employees – we agree with this generally but not with the proposal to exclude directors or participators;
- c. limiting its purpose to encouraging or facilitating employee shareholding – we agree with this and consider that if this boundary is cast appropriately then other, more general safeguards should not be necessary;
- d. limiting property to fully paid non-redeemable ordinary shares or cash/other shares as a result of corporate transactions – we agree with this; and
- e. removing exemptions for breach of conditions, possibly with backdating – while we agree that it could provide an appropriate safeguard to remove exemptions from the date of a breach of conditions in appropriate non-trivial circumstances, we would be concerned if backdating such removal could be a risk other than in extreme circumstances, such as, where arrangements had been established with a view to using ESV status to circumvent the relevant tax rules where the general ESV purposes were not satisfied on establishment.

HMRC Safeguards

As stated, we think that the focus should be on setting the boundaries of when ESVs could be used effectively so that broad anti-avoidance protections will not be required.

- (i) Scope of permitted beneficiaries

Employee shareholding arrangements are important to the incentivisation packages for venture capital/private equity-backed businesses at all levels of employee seniority. Thus we think that it would be a serious impediment to the use of ESVs to exclude any class of employee, including directors or director-owners.

Existing EBTs are used as shareholding warehousing vehicles, so that share-based benefits can be allocated to employees (including directors), some of which may remain unallocated with the intention of allocating to future employees or, if not required, to existing employees (including directors) and some may be bought in from leavers and then reallocated. We cannot see why directors or director-owners should be excluded if the purpose of the ESV and the sort of property that it can hold and benefits that it can grant were properly scoped and the granting of benefits clearly led to the appropriate employment income tax consequences. Indeed, we consider that including such an exclusion would hinder the use of ESVs and therefore either discourage the implementation of employee shareholding arrangements that the Government is keen to encourage or lead businesses to continue using the unnecessarily complex and costly arrangements that are currently used and which the OTS recognise as undesirable.

(ii) Prescribed holding periods

The other safeguard that we think should be considered carefully is the extent of any minimum and maximum holding requirements. We agree that a minimum holding requirement would be desirable to support the aim of encouraging employee enfranchisement and alignment, but think that it should be relaxed in circumstances such as a disposal of the relevant company/group and for certain categories of leavers.

We think, however, that there should not necessarily be a maximum holding period for former employees, since this could lead to forced uncommercial disposals of illiquid shares. Rather, we think that people who have received their shares as employees should, subject to the leaver rules applied to the particular ESV, be able to retain their benefits after becoming former employees.

Conclusions

We support the proposal to introduce a simple, UK-based ESV. We consider, however, it very important that required safeguards are carefully considered so as not to discourage the use of such vehicles. In particular, we consider that the principal safeguard for the exchequer would best be achieved by carefully setting the boundary for the purpose of the ESV and the types of transaction into which it could enter.

We would be delighted to meet with you to discuss the use of employee shareholding arrangements in our industry further if that would be helpful.

Yours faithfully,



Steven Whitaker
Chairman of the BVCA Taxation Committee