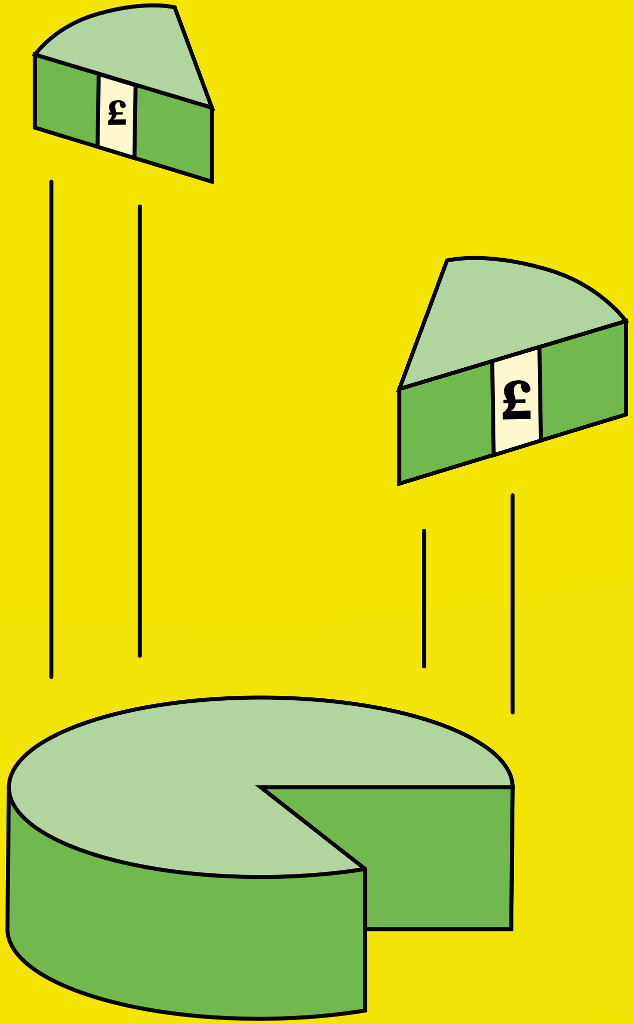
Beauhurst

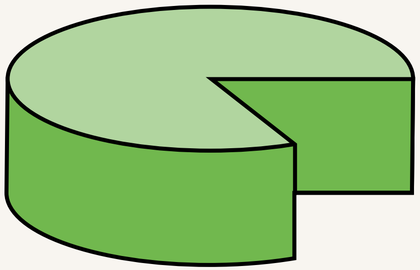
Balancing Risk & Reward

Quantifying the risk of Capital Gains Tax reform to the UK startup ecosystem



Contents

Introduction	**1**
Key findings	1
Introduction: What's the problem?	1
Short term	**3**
Companies would move elsewhere, putting jobs at risk	3
Fewer jobs would be created, talent would be harder to attract	4
Capital would go elsewhere	5
Long term	**6**
The pipeline of future investors would be depleted	6
Entrepreneurial spirit would decline dramatically	7
The UK would lose its startup crown, and struggle to compete with Europe	8
Our proposals	**9**
Recommendations	9
About Beauhurst	**10**
Appendix	**11**
The original blog: *"How changes to CGT threaten the future of UK startups"*	11



Methodology and demographics

Data for the research was collected by Beauhurst between the 4th and 15th February 2021. Data was collated and analysed on 16th February 2021.

A total of 471 individuals completed the survey, including:
- 362 founders of UK-registered companies
- 64 angel investors into one or more UK-registered companies
- 21 institutional investors into UK-registered companies (VC, PE, etc.)
- 24 professional advisors to UK-registered companies

Respondents had the option to answer the survey anonymously, or choose to give details on the companies they had founded. The option to participate anonymously ensured that respondents could voice their honest opinions, without hesitation.

217 respondents opted to submit the name of the UK companies they had founded, 150 of which have been classified as high-growth. Those named companies have collectively raised £1.6b in equity investment, with nine of them having raised more than £50m, and on track to reach billion-dollar valuations in the near future.

These companies span a range of industries, with 111 categorised as technology/IP-based businesses, 96 as business and professional services, 21 as industrials, and 14 as media.

Regardless of whether they submitted the survey anonymously, all respondents were questions relating to the number of people they employ, annual turnover, projections for future growth and strategic plans for the future.

Thank you to all of those who took the time to complete the survey, and shared it with their networks.

Key findings

If proposed CGT reforms come into effect:

85% **of founders would consider moving their companies abroad**

88% **of jobs would be at risk of moving abroad**

90% **of founders say it would be harder to attract top talent to their companies**

72% **of angel investors would be less likely to continue investing into UK companies**

80% **of founders would be less likely to engage in angel investing**

84% **of founders would be less motivated to build a large-scale business**

94% **of founders would consider starting their next company abroad**

Introduction: What's the problem?

Back in July 2020, Chancellor Rishi Sunak requested a review of Capital Gains Tax (CGT) by the Office of Tax Simplification (OTS). The aim was to 'identify opportunities relating to administrative and technical issues as well as areas where the present rules can distort behaviour or do not meet their policy intent'.[1] The results of this were published in November 2020, in the *Simplifying by design* report.[2]

To briefly summarise the 135 page document, the key proposals of interest to the UK's entrepreneurs and startup employees were:

- To tax the earnings they make when selling company shares at income rates of up to 45%, rather than the current rate of 20%
- To remove the remnants of Business Asset Disposal Relief (BADR), formerly Entrepreneurs' Relief, which allows entrepreneurs to be taxed at 10% on the first £1m of proceeds from share sales in their lifetime.

These lower rates of tax were first introduced in 1998 under Chancellor Gordon Brown, in the form of Business Asset Taper Relief. In the two decades since, they have incentivised founders for the risks they have taken to build a business. They have also incentivised startup employees, whose oft lower-than-market-rate salaries are commonly subsidised through an equity stake in the business via options share schemes. Finally, they've encouraged founders to reinvest in their business and, once they've exited, in the wider ecosystem by increasing their capacity to back other ventures as an angel investor.

So far, they have been wildly successful, helping to grow our high-growth entrepreneurial ecosystem to a population of 40,000 businesses which collectively employ more than 3.5 million people. This is why we believe that these proposals to remove the incentive are potentially catastrophic for the UK economy.

We first made our opinions about these changes known in an article published in December which looked in detail at some of the potential adverse consequences of these proposals. We've included a copy of this article later in this report as background reading.

Off the back of this article we had many conversations with concerned people and organisations from across the ecosystem, from entrepreneurs and startup advisors, to angel investors, venture capitalists and think tanks.

1.https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/900220/CX_OTS_Letter_July_.pdf

2. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/935073/Capital_Gains_Tax_stage_1_report_-_Nov_2020_-_web_copy.pdf

Specifically, we've had some very fruitful conversations with our friends at Coadec and The Entrepreneurs Network, who are just as passionate about this issue as we are. In truth, we were amazed by the positive response we received to the article, both directly and indirectly via social media.

But, as a data company, we wanted to back the murmurings, feelings, and suspicions we were hearing with hard evidence and numbers. On the 4th of February, we launched a survey open to all founders of, advisors to, and investors in UK-registered companies.

"In this instance, the data is very stark: the findings presented in the following chapters are bleak, and should be cause for significant concern."

Almost 500 individuals completed the survey, including 362 entrepreneurs. Collectively, they've secured £1.6b of equity finance through the companies they've founded, with nine of the companies represented tipped to be future unicorns. And they're not just shiny fintechs and artificial intelligence startups; we received a significant number of responses from sectors such as industrials, media and business services. We believe, therefore, that these results are representative of the UK's 40,000 high-growth companies who collectively employ more than 3.5m people.

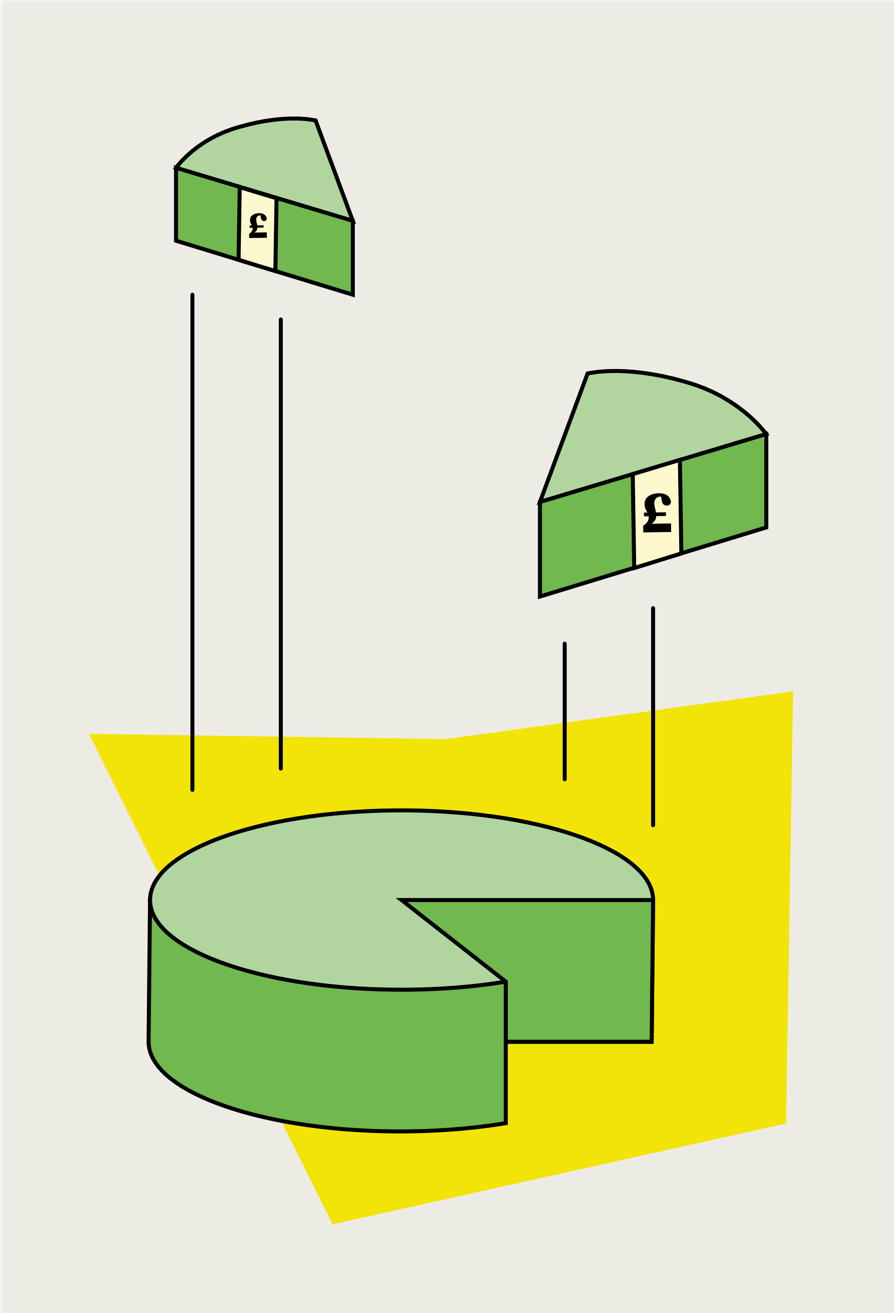
To be frank, the results are far more concerning than even we anticipated. They show the potential for a large and rapid loss of UK jobs through a combination of reduced business investment and an exodus of companies to more favourable jurisdictions. Up to 85% of companies representing almost 90% of jobs in the sector would actively consider moving abroad if the changes come into effect. In a world where remote working means that physical location is less important than ever, that can't be seen as an empty threat.

And that's just the impact on employment. The results also suggest that these proposals would cause a significant decline in angel and VC investment, not to mention a complete loss of drive for growth amongst entrepreneurs.
We'd suggest that adding these pressures into an ecosystem already struggling with the impacts of COVID and Brexit would be catastrophic for jobs, innovation and the economy.

At Beauhurst, we try to identify the silver linings where appropriate. But in this instance, the data is very stark: the findings presented in the following chapters are bleak, and should be cause for significant concern.

We hope that this warning does not go unnoticed, and helps to inform conversations around the future of Capital Gains Tax, in a way that supports the UK's entrepreneurs, world-class talent, and burgeoning high-growth ecosystem.

For the full background, see our original article "How changes to CGT threaten the future of UK startups" in the Appendix at the end of this report.



Short term impact

Companies would move elsewhere, putting jobs at risk

If these proposed changes come into effect, the UK would have the highest marginal rate of capital gains tax in Europe. We asked founders of UK businesses whether the implementation of these proposals would cause them to consider moving their company to another jurisdiction. Of the 362 founders surveyed, 85% said that they would actively consider moving abroad.

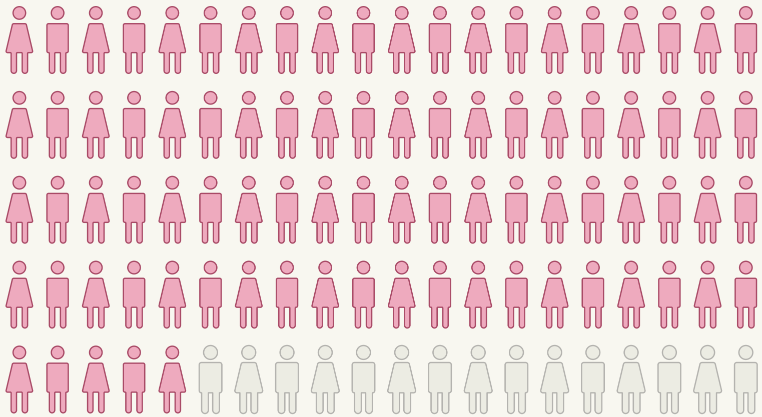
Moreover, we found that it was founders of larger companies that were more likely to look to move abroad. We asked respondents how many people they currently employ. Using this data, we've calculated that 88% of jobs at the respondent's firms would be immediately under threat of moving abroad.

One respondent suggested plans may already be underway – *"[I] know a bunch of very talented people already planning to move abroad if these proposals go through. This will result in serious long term harm to the U.K. economy."*

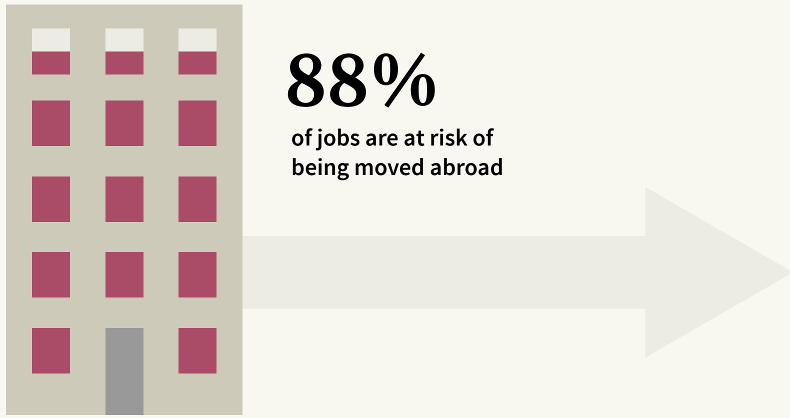
This is all the more concerning in the current climate. Given the issues that Brexit is causing for companies with an international presence or supply chain, as well as the move to remote work during the pandemic, there are already sufficient reasons for companies to consider moving jurisdiction. Increasing CGT and scrapping BADR could be the final straw for the UK's 40,000 ambitious companies and the 3.5m people who work at them.

> *"There is a point when the non-monetary upside to scaling a business can no longer make up for the personal financial shortfall. The proposed tax rate is past that point.*
>
> *If it no longer pays off to do business here, we will leave. We won't stop building companies, we won't stop scaling new tech. We'll just do it elsewhere."*
>
> **A founder**

85% of founders would consider moving their companies abroad if CGT proposals come into effect



88% of jobs are at risk of being moved abroad



Short term impact

Fewer jobs would be created, talent would be harder to attract

Our survey data shows that, under the proposed changes, the majority of founders would invest fewer resources into their business. More than nine in ten of our respondents said that they would invest less into growing their company, and this group almost unanimously said this decision would lead to fewer jobs being created in their businesses.

Under the current CGT and BADR policies, founders are incentivised to reinvest in their business, continuing to grow it and so creating more jobs, as the eventual return upon sale of the company is taxed at a lower rate than the income they could have taken out along the way.

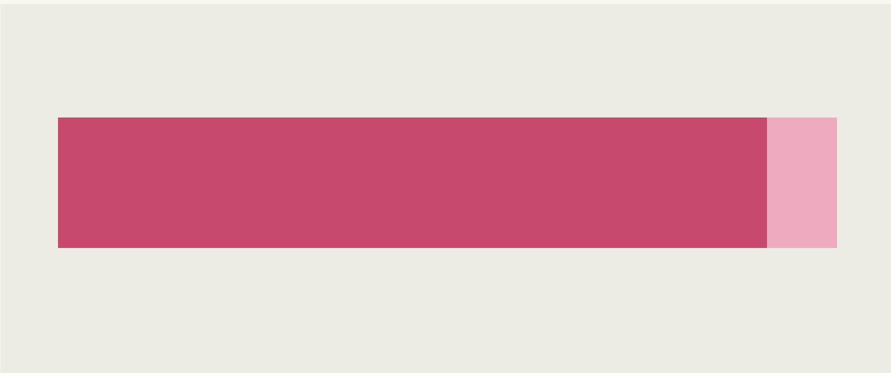
Under the proposed changes, founders would instead be incentivised to do the opposite; indeed, under certain scenarios they'd even end up paying more tax in total by scaling their business and exiting later, rather than taking an increased amount of cash out as salary or dividend sooner.

On top of this, nine in ten founders said the proposals would make it harder to attract and retain top talent to their company. Startups and fast-growing businesses are often unable to offer competitive market-value salaries to their employees, instead subsidising compensation with an equity stake in the company through the EMI options scheme. Increasing the tax rate on these options would make them substantially less valuable. Talent may therefore opt for a more secure and higher paying job in a more established and less innovative company, driving these individuals away from innovative roles that drive long-term economic and technological growth.

"I think the greatest impact would be in employee retention. Once an employee has joined a startup and realises how tough it can be, their vested options and the tax benefits they get from remaining with the company are one of the factors that contribute to them staying around."

A founder

91% of founders would invest less into growing their company



90% of founders say it would be harder to attract top talent to their companies

Short term impact

Capital would go elsewhere

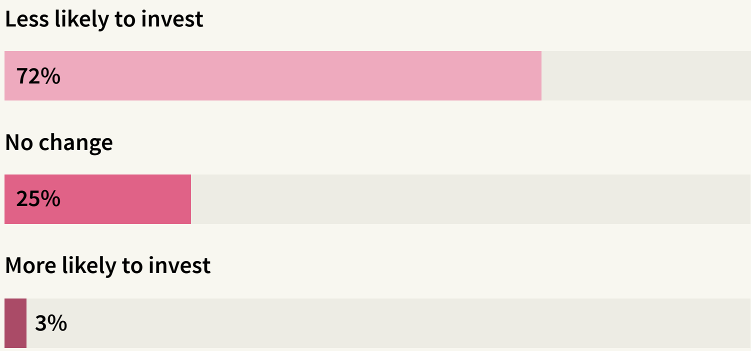
As well as the adverse effect on founders and employees, our survey shows that investment would also be negatively impacted if these proposals are introduced. Investors are an incredibly important facet of the innovation ecosystem—they provide the capital necessary to start and then grow.

An astounding 72% of angel investors and 67% of institutional investors said that they would be less likely to continue investing in UK businesses if the new proposals were implemented, as the potential for increased tax on the returns of these investments would render the risk/reward ratio unacceptable. Instead, many would focus on international opportunities when looking to deploy capital.

Ensuring tax shelters such as SEIS and EIS are maintained may help mitigate this risk, but they only capture some investments. And investors would still be put off by what they see as disincentivised entrepreneurs.

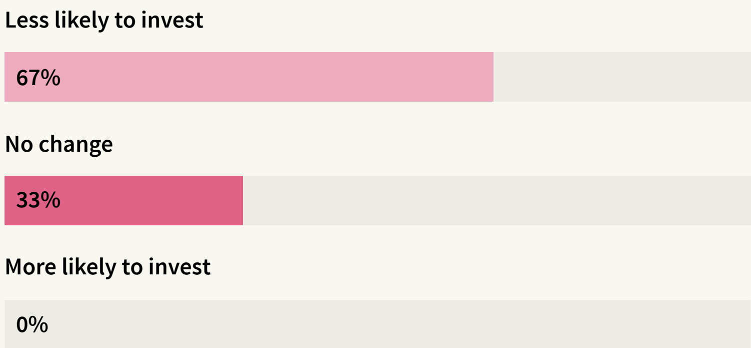
This initial decline in investment would also have a substantial knock-on effect. As one respondent explained, *"because companies would be less able to raise funds, they'd be less able to compete in a world market."*

72% of angels would be less likely to continue investing into UK companies



> *"If the proposals are implemented, the taxation of any gain would be too high to balance the risk of failure."*
>
> An angel investor

67% of institutional investors would invest less into UK companies



> *"Startup investing is super high risk. If the outcome is potentially reduced by higher taxes, I'd rather put my money into something safer, more stable, and not take that risk."*
>
> An angel investor

Long term impact

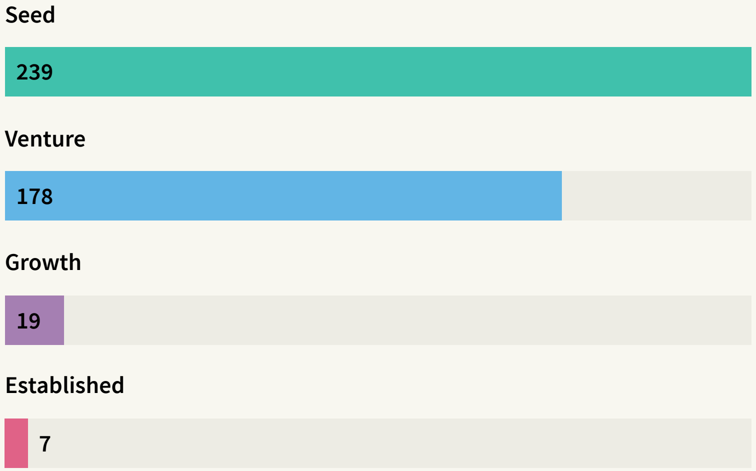
The pipeline of future investors would be depleted

It's not just current investors who would be dissuaded from backing UK companies if the changes come into effect; the future pipeline of angel investors would also be depleted. 80% of founders said that they would be less likely to engage in angel investing after exiting their company, as they would have less capital to invest in the first place, as well as the potential disincentivisation caused by higher tax rates on potential returns. One respondent summarised this effect perfectly: *"A higher tax bill means I will have less to invest."*

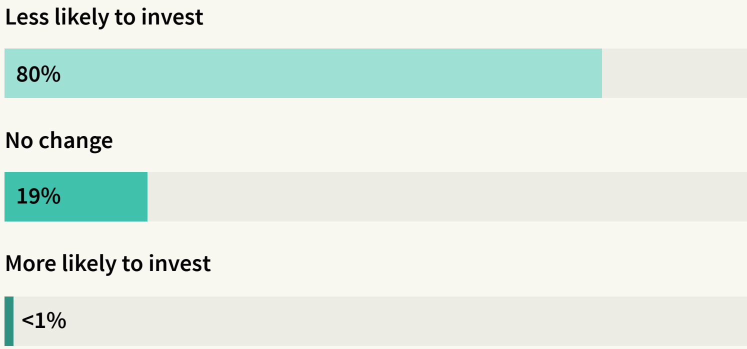
Of course, angel investors can come from all walks of life, and can invest with wealth generated through any means. But our data shows that the majority (53%) of angels fund their investments from the sale of shares in companies they have previously founded—i.e., their net proceeds from an earlier exit. If the majority of that 53% of angels choose to reduce investment, the UK's angel community will shrink substantially.

Angels are a particularly important variety of investors, largely backing early-stage companies, before they have enough traction to win over institutional funds. Over 50% of all announced investments in 2020 that included the participation of angel investors, either individually or through a syndicate, were deployed to seed-stage companies.

Angel investments in 2020 by stage of evolution of invested company



80% of founders would be less likely to engage in angel investing if CGT changes come into effect



"When I sold my company, Entrepreneurs Relief allowed me to have the ability to, net of tax, invest into the next generation of founders. If my tax rate was 45% at exit, I would have likely invested in bonds and ETF's rather than risky, early-stage ventures. As it turned out, the companies I've backed as an early stage investor now employ over 2,500 people. Other ex-founder investors are rational too and quite likely would act like me. The butterfly effect of over-taxation would cost future jobs for sure."

A founder-turned-angel investor

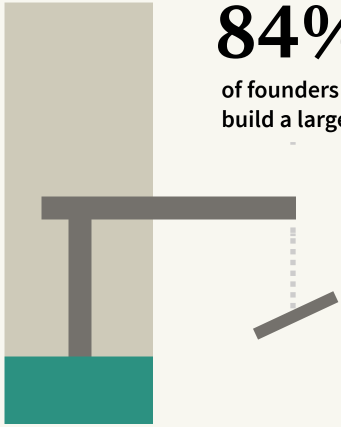
Long term impact

Entrepreneurial spirit would decline dramatically

The long-term effects of increasing capital gains tax and scrapping Business Asset Disposal Relief would be devastating for the UK's startup scene.

84% of the founders we surveyed would be less motivated to build a large-scale business if the changes come into effect. And that's a pretty big deal, considering that there are nine companies tipped to be future unicorns represented in our sample. All of these nine founders said they would feel less motivated to build a large-scale business—that could be the difference between a unicorn and, well, something far less valuable.

It's common for founders to start multiple businesses over their lifetime; we've identified 1,686 people who have founded two or more significant, high-growth UK companies in the past decade alone. But of the founders we surveyed, 68% said that they would be less likely to start another company if proposed changes to CGT came into effect.

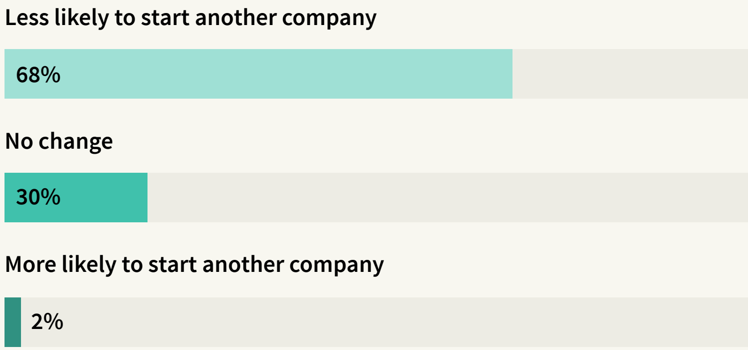


84%

of founders would be less motivated to build a large-scale business

> *"Innovation is the growth driver in the UK economy, this is driven by small company formation and growth, reducing the incentives to undertake this highly risky activity is counter productive to UK economic growth."*
>
> **A founder**

68% **of founders would be less likely to start another company if CGT changes come into effect**



> *"Startups are forming the next generation of technology companies, but the vast majority will not be successful. The government needs to take a more considered approach to tax reform, and ensure that high-risk activities are rewarded appropriately."*
>
> **Co-founder and Partner, Isomer Capital**

Long term impact

The UK would lose its startup crown, and struggle to compete with Europe

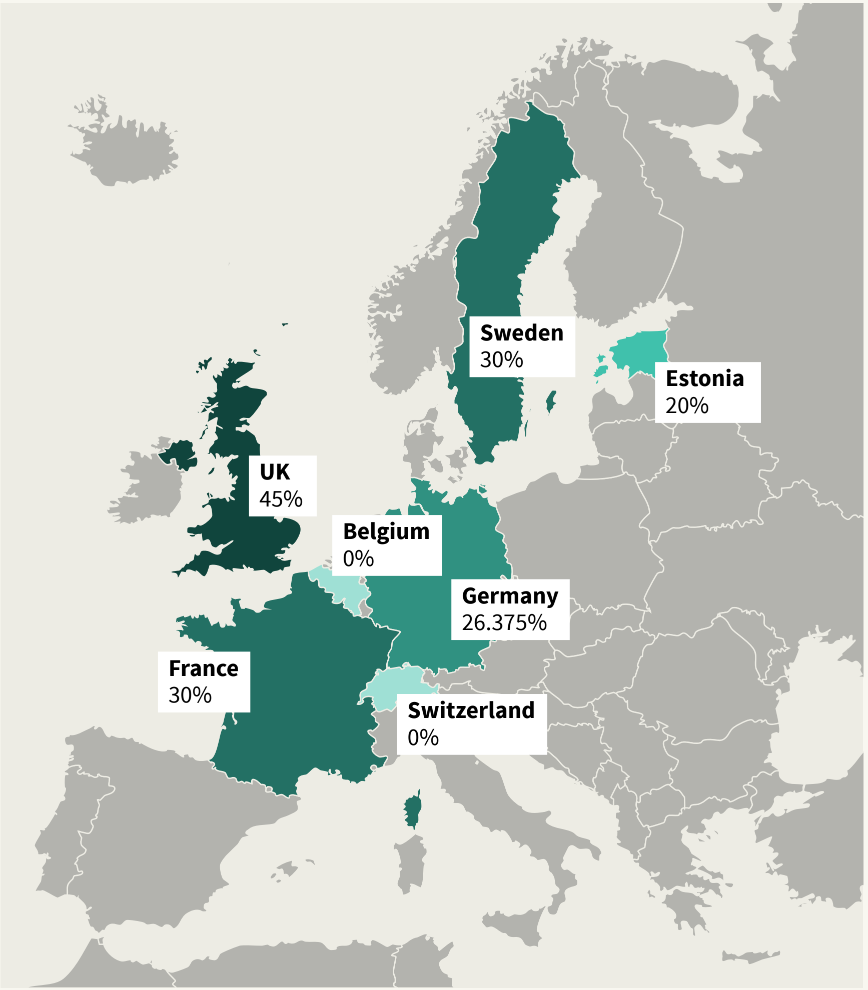
A staggering 94% of founders would consider starting their next venture abroad if these CGT changes come into effect. And they'd have plenty of locations to choose from, given that all other jurisdictions in Europe would have a lower marginal rate of capital gains tax than the UK. This spells real danger for the future of the UK's high-growth economy, which over the last decade, has proved to be the nation's innovation powerhouse.

We must also consider all of the budding entrepreneurs across the rest of the globe who see the UK as a good place to do business.

Some of the UK's top startup success stories have been founded by foreign-born entrepreneurs, including Transferwise, Revolut and Deliveroo. If capital gains tax is indeed brought in line with income tax, then international talent will undoubtedly be less likely to start and scale businesses in the UK.

94% of founders would consider starting their next company abroad if CGT changes come into effect

Capital Gains Tax in select European countries after proposed changes



Recommendations

In light of these survey results, we are resolute in our belief that the OTS proposals would be catastrophic for entrepreneurs, ambitious UK companies and the wider economy. There may still be a case for making changes to the wider capital gains tax regime—we're only experts in our entrepreneurial niche—but applying these to entrepreneurs and their employees risks a mass exodus of jobs, investment and tax revenues. However, rather than merely offer criticism, we'd like to proffer some recommendations of our own.

Firstly, it's worth reiterating that the OTS does have some good points in its proposals, especially around the abuse of Business Asset Disposal Relief by individual consultants. Some people are indeed gaming the system in order to extract rolled-up retained earnings at a low tax rate, and this does need to be addressed.

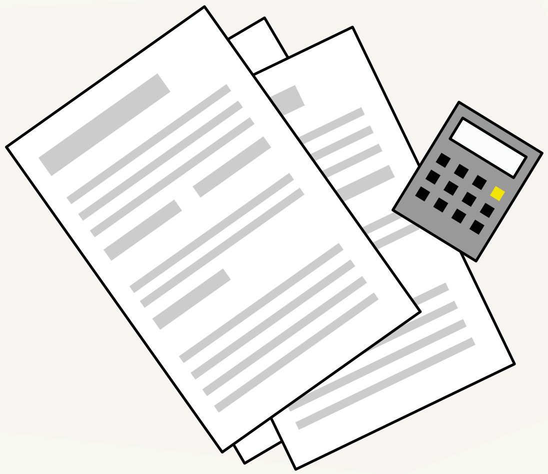
The case for a carve-out

But we disagree with a number of points on a fundamental level. In the opening section of the *Simplifying by design* report, the OTS states that focus groups showed 'a range of opinion on whether there needs to be a tax incentive to encourage risk taking or entrepreneurship and whether such an incentive can be sufficiently targeted not to lead to unnecessary distortions.' Let there be no confusion on our part here: we are categorically in favour of tax incentives in this arena; and we do believe that these can be easily targeted to avoid unnecessary distortions. If successful, entrepreneurs contribute far more than their 'fair share' to the economy through both employment and tax, and to society more generally through, for example, the development of novel technologies. But few get to that point. All entrepreneurs (as well as the people they employ) take on significant personal and financial risk in growing a business from scratch. And it's that high risk, high reward dichotomy that separates capital gains from income, and makes a tax incentive so important. Our survey results in this area show how strongly entrepreneurs feel about this philosophy and what the practical impact of taking away this incentive would be.

If the government is intent on implementing these proposals, our view is that it must—at the very least—provide a carve-out for entrepreneurs.

What a carve-out should look like

Such a carve-out should look to maintain the current rates of CGT for genuine entrepreneurs and their share-incentivised employees: 10% on the first £1m of gains during their lifetime and 20% thereafter, with no upper limit.



The basis for determining eligibility for this carve-out would be the existing BADR scheme, tweaked and improved to ensure it's only used by genuine entrepreneurs.

"It's that high risk, high reward dichotomy that separates capital gains from income, and makes a tax incentive so important."

BADR is a good starting point because it has some important restrictions on who can access the relief. Specifically, it requires shares to be held for over two years prior to sale which incentivises longer-term growth. In addition, it already captures shares issued via options under the Enterprise Management Incentive (EMI) scheme, which helps entrepreneurial companies attract and retain talent.

To ensure a carve-out protects genuine entrepreneurs who are generating broad economic value by creating jobs, we recommend adding in a new restriction around the size of the company. As a starting point, we'd suggest a requirement for the company to have averaged more than five full-time PAYE employees over the two years prior to the sale of shares in question.

Further, the Enterprise Investment Scheme (EIS), which offers tax relief to investors in early-stage businesses, has some additional rules which we think are valuable. One of these is the requirement for businesses to have a permanent establishment in the UK. Again, this ensures any tax incentive is granted solely to those generating real economic value for the UK.

Finally, to prevent abuse of the system, we propose that HMRC run an authorisation scheme similar to the EIS approval process. Through this, HMRC would validate that a sale of shares is eligible for carve-out tax relief, rather than leaving it to a self-declaration.

We believe that a carve-out such as this would allow the UK's entrepreneurial ecosystem to continue flourishing and, ultimately, generate far more value for the UK economy than it costs. This carve-out would need a name. Luckily, one became free a year back when BADR was introduced: Entrepreneurs' Relief.

We hope that these recommendations, and the data included in this report, are useful contributions to the conversation around capital gains tax. As always, we love to hear your thoughts and feedback. If you'd like to discuss the issues raised here in more detail, then please don't hesitate to get in touch.

info@beauhurst.com
@Beauhurst
company/beauhurst
beauhurst

About Beauhurst

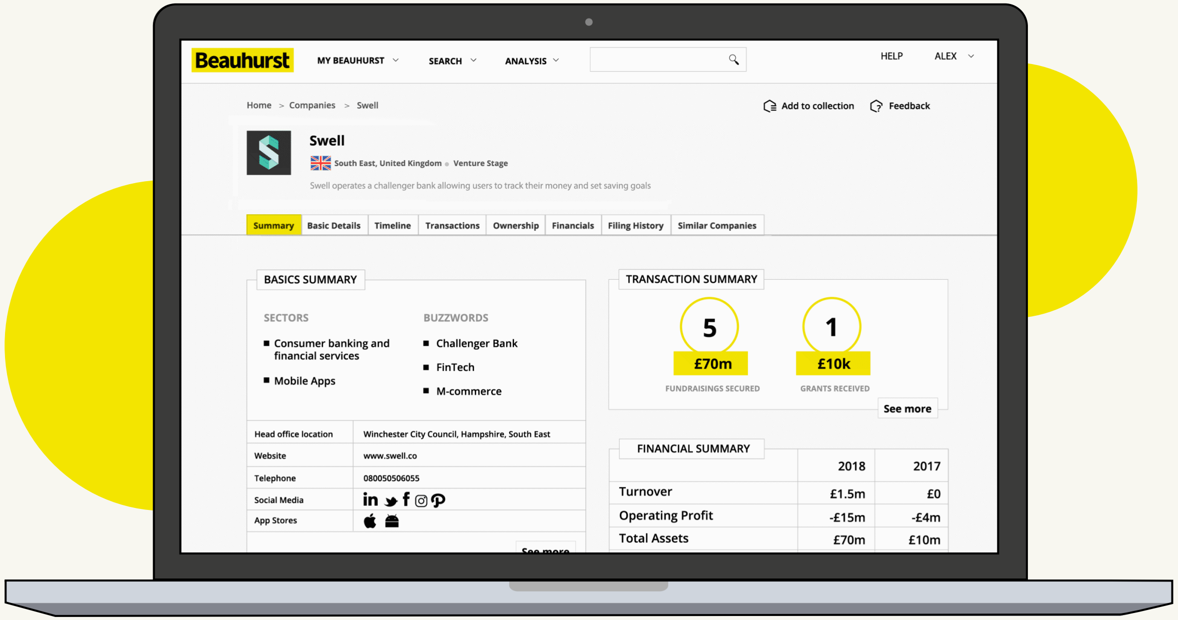
Beauhurst is the leading data provider on high-growth businesses in the UK.

Our platform is trusted by thousands of business professionals to help them find, research and monitor the most ambitious businesses in Britain. We collect data on every company that meets our unique criteria of high-growth; from equity-backed startups to accelerator attendees, academic spinouts and fast-growing scaleups.

Our data is also used by journalists and researchers who seek to understand the high-growth economy, and powers studies by major organisations—including the British Business Bank, HM Treasury and Innovate UK—to help them develop effective policy.

For more information and a free demonstration,
visit beauhurst.com

info@beauhurst.com
@Beauhurst
company/beauhurst
beauhurst



"Having Beauhurst is like having your own extended team doing the data work for you, allowing me to do all the meaningful insights myself so that I can better (and more efficiently) support our community of SMEs. It's a huge time saver – once set up, deep data analysis that previously would take me weeks now only takes hours".

Andrew Waterworth, Industry Engagement Manager at the Royal Society of Chemistry

Appendix

The original blog: *"How changes to CGT threaten the future of UK startups"*

We first published an article on this matter back in December 2020 outlining the negative ramifications of the OTS proposals. As mentioned in the Introduction, we received an overwhelming response to this. For those of you who are not familiar with the explanations for our concern, we've included the full article below.

The Office of Tax Simplification (OTS) recently published their first report reviewing Capital Gains Tax (CGT) titled *Simplifying by Design*. The Chancellor called for the review in July, primarily to look at the administrative difficulties associated with the tax. A second report is due to be published: the first looks at the principles of the tax, the second will look at technical and administrative issues.

As supporters of the entrepreneurial ecosystem, we always try to monitor the policy environment for entrepreneurs (and for startups and scaleups) and, wherever possible, provide data relevant to policy and interventions. We have not previously, however, objected outright to proposed changes, especially where data is lacking.

But *Simplifying by Design* makes recommendations for changes to CGT under four main categories, one of which we think will have profound—and adverse—impacts on entrepreneurs and the businesses they run. Therefore, in a change from our usual broadcasting, we're taking the opportunity today to elaborate on how and why this change is a catastrophically bad idea.

Simplifying by Design suggests that the Government should consider *"whether employees and owner-managers' rewards from personal labour (as distinct from capital investment) are treated consistently and, in particular consider taxing more of the share-based rewards arising from employment, and of the accumulated retained earnings in smaller companies, at Income Tax rates"*.

To translate: tax capital gains, including those generated by entrepreneurs from their own businesses, at income tax rates.

If implemented this would raise basic rate taxpayers' CGT from 10% to 20%, and higher and additional rate taxpayers' CGT from 20% to 40% and 45% respectively. The OTS also recommends reducing the tax-free annual allowance for CTG, currently at £12,300, to between £2,000 and £4,000.

Finally, the OTS recommends replacing Business Asset Disposal Relief (formerly Entrepreneurs' Relief) with a new, more restrictive scheme focussed around retirement. Business Asset Disposal Relief currently allows entrepreneurs to pay a lower CGT rate of 10% on the first £1m of proceeds from sale of their own company shares over their lifetime in recognition of the risk they have taken in building a business.

Taken in isolation, and couched in terms of creating equality between income tax payers and CGT payers, these changes may seem innocuous, indeed fair. But we believe they will have some serious unintended consequences for entrepreneurs, particularly those who lead fast-growth companies.

To understand why, we must consider how these entrepreneurs make money. Typically, they do so differently to a regular employee: through exit events (sale of their shares in the company they founded) rather than salary—an event that is a capital gain. These events are few and far between—often only when the company is sold, although occasionally through an earlier 'secondary' sale of shares along the way.

An entrepreneur's income is, therefore, extremely lumpy, and—crucially—will likely occur almost entirely in one single tax year.

The current differences between income tax and CGT rates and reliefs accommodates this distinction well; its removal will lead to three main negative impacts—discouraging entrepreneurship in the UK; discouraging growth of entrepreneur-led companies; and discouraging investment into high-growth businesses.

Discouraging entrepreneurship as a career in the UK

1. Entrepreneurs will be taxed more heavily than employees

Entrepreneurs will pay top levels of marginal rate of income tax on the majority of their income since it occurs largely in a single tax year. This compares unfavourably to employees who are paid standard salaries. Take the following comparison which, for simplicity, ignores inflation and assumes current income tax arrangements stay in place:

An employee earning £80k per annum for ten years—£800k of gross income:

> *£80k p/a gross is £55,042 p/a net.*
> *Total net earnings over ten years are therefore £550,420.*
> ***Effective tax rate of 31.2%.***

Entrepreneur taking £30k per annum salary for ten years, then selling the company for £500k—£800k of gross income:

> *£30k p/a gross is £24,042 p/a net.*
> *Net earnings from salary over the first 9 years is £216,378.*
> *Year ten income is £530k gross; £292,042 net (44.9% overall tax rate after accounting for National Insurance).*
> *Total net earnings over ten years are therefore £508,420.*
> ***Effective tax rate of 36.4%.***

The entrepreneur ends up with a significantly higher effective tax rate despite risking ten years of their life building a business rather than taking a job somewhere. That is clearly the wrong signal to be sending.

2. There will be a perceived 'nationalisation' of entrepreneur-led companies

Any capital value created by an entrepreneur above £150k will eventually (on realisation) be taxed at the top marginal rate of income tax—currently 45%. In effect, this gives the Government a risk-free stake of up to 45% in all private entrepreneur-led companies. Or, to put it another way, it's the equivalent of the Government taking 45% of an entrepreneur's equity stake in their company into public hands. Again, we'd argue that is not the right signal to be sending at a time when private-sector led economic growth is critical.

3. The UK will be poorly positioned compared to international comparables

Implementing these proposals would give the UK the highest marginal CGT rate of any European country at 45% – beating Denmark's current 42% – and higher too than the US. Many of the fastest-growing companies have no need to be legally or even physically located in the markets they are targeting; the entrepreneurs behind them even less so. Disadvantageous tax regimes for entrepreneurs compared to similar jurisdictions will drive entrepreneurs and their current (and future) companies abroad.

Discouraging growth of entrepreneur-led companies

1. It promotes payment of dividends (or salary) over reinvestment for growth

Entrepreneurs in profitable companies are faced with a constant decision as to whether to re-invest profits for company growth—often a risky move, certainly with no guarantees of return—or take dividends. As it currently stands the tax system incentivises entrepreneurs to re-invest, as capital growth is taxed at a lower rate than dividends. Under these new proposals, capital growth is taxed at a higher rate than dividend income. Entrepreneurs will therefore have no incentive to take the riskier reinvestment route. Indeed, dividends aside, it's even the case that an entrepreneur would be better off taking cash out as salary (removing it from the company's investment pool) rather than reinvesting for capital growth. Not only is this less risky than reinvestment, but they'll also benefit from an overall lower rate of tax (see example above).

In short, these proposals take no account of an entrepreneur taking the decision to reinvest for tomorrow rather than reward themselves today. They forget that foregone dividends or salary is a risky capital investment.

2. It will make it harder for entrepreneurial companies to attract and retain talent

Many entrepreneurial companies use equity options to attract key talent. This offsets the fact that they can't compete with large, established organisations on salary alone, and ensures incentives are aligned between entrepreneurs and employees at these organisations. Most such options are issued under the Enterprise Management Incentive scheme under which employees have their gains on shares acquired through options taxed at capital gains tax rates, including benefitting from Business Asset Disposal Relief.

These proposals would massively increase the tax rate on such gains. That means that such options will become far less valuable as an incentive, risking both talent attraction and retention, and therefore slowing growth.

Discouraging investment into high-growth businesses

It will remove significant amounts of angel investment capital from the ecosystem

A large proportion of seed capital in the UK comes from angel investors who have made their cash by building and selling their own business. A massive tax hike on these sales will remove a significant proportion of discretionary seed capital from the ecosystem in short order. The same can be said for serial entrepreneurs—with less net proceeds post-sale of a company, it's less likely they'll be in the financial position to start their next company.

The desirability of the circular nature of entrepreneurial capital has been well-studied—it's circulating not just capital but also expertise back into the ecosystem. These proposals would significantly depress this much sought after feedback loop.

So what's the answer?

We are not the first to raise objections to these proposals. Lord Leigh, founder of Cavendish Corporate Finance penned an open letter to the Chancellor calling on him to *"ensure that the entrepreneurial spirit in this country is recognised and encouraged, by keeping capital gains taxes at an appropriate level"*. The Centre for Policy Studies' Tom Clougherty said it *"would deter investment and punish saving".*

Whilst we sympathise with the rationale behind some of the changes, particularly the (ab)use of the system by sole contractors to extract rolled up retained earnings at a low tax rate, we feel this one-size-fits-all change would have a significant adverse impact on the entrepreneurial ecosystem just at the time it is needed to power growth. The right thing to do is to ditch the change—at least where entrepreneurs and their businesses are concerned.

Beauhurst

Authors Toby Austin, Henry Whorwood, Hannah Skingle, James Richardson
Design Ella Halmari