

**New Tax Measure to help researchers
acquiring shares in spin-out companies
created with universities and research
institutions**

Technical Note

Issued by Inland Revenue
2 December 2004



CONTENTS

	Page
Contact details	3
Introduction	4
Timetable	5
Background	5
Reason for Consultation	6
Proposed change - Outline	6
Definitions	8
Administration	9
Start date	9
Responses sought	10
Appendix 1: Suggested definition of Intellectual Property	11
Appendix 2: Examples	12
Appendix 3: The consultation process	14

Contact Details

Comments on this Technical Note and replies to any questions asked in it, should be sent:

by email to: Hasmukh.Dodia@ir.gsi.gov.uk

by fax to: 020 7147 2746 or 020 7147 2747

by post to: Hasmukh Dodia
Employee Shares & Securities Unit (ESSU)
Room 49, Ground Floor
1 Parliament Street
London SW1A 2BQ

telephone: up to 6th December 2004 020 7438 7504
from 7th December 2004 020 7147 2861

Comments should be sent by 10 February 2005

Responses to the Note, together with the names and addresses of respondents, may be published unless confidentiality is specifically requested. We will assume that if you are replying by email, any confidentiality disclaimer that is generated by your organisation's IT system is overridden unless you specifically include a request to the contrary in the main text of your submission to us. Please note that confidentiality cannot be guaranteed where a response includes evidence of a serious crime.

This document can be accessed from the Inland Revenue's Internet site:
<http://www.inlandrevenue.gov.uk>

© Crown copyright 2004.

Published with the permission of HM Treasury on behalf of the Controller of Her Majesty's Stationery Office.

The text in this document (excluding the Royal Coat of Arms and departmental logos) may be reproduced free of charge in any format or medium providing that it is reproduced accurately and not used in a misleading context. The material must be acknowledged as Crown copyright and the title of the document specified.

Any enquiries relating to the copyright in this document should be sent to:

HMSO
Licensing Division
St Clements House
2-16 Colegate
Norwich NR3 1BQ

Fax: 01603 723000

E-mail: hmsolicensing@cabinet-office.x.gsi.gov.uk

Introduction

- 1.** Universities and publicly funded not-for-profit Research Institutions (RIs) which own Intellectual Property (IP) often develop that IP further through companies created in association with the researcher from the institution who worked on the project. These companies are commonly referred to as spin-out or spin-off companies. In this Note the term spin-out will be used to describe them. Most RIs have in place an IP-sharing policy that acknowledges the researcher's contribution to the IP by sharing the benefit of it with the researcher through a share of royalties or, where the IP is developed through a spin-out, shares in that company.
- 2.** The shares in the spin-out company held by the researcher increase in value on introduction of the IP into the spin-out. Consequently, Part 7 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) (as amended by Schedule 22 of Finance Act 2003), which provides the rules for the taxation of employment related shares and securities, creates an immediate Income Tax and National Insurance (NICs) charge on the value of the benefit before cash is available to meet the bill. This has significantly reduced the creation of new spin-out companies.
- 3.** The combination of publicly funded institutions, IP-sharing agreements and charges arising before cash is available, all in a high-risk environment where many spin-outs fail, is unique to this sector.
- 4.** The Government has, therefore, decided to introduce legislation to provide a clear fiscal environment for the sector and ensure there is no long-term adverse effect because of this tax issue. The legislation will prevent an Income Tax and NICs charge arising on researchers on an increase in the value of the shares in the spin-out company due to the transfer of IP covered by the RI's IP-sharing policy.
- 5.** This Technical Note explains how the legislation in ITEPA will be modified in certain specified circumstances to remove this charge. Comments on

how we propose to draft the legislation will help us to ensure the measure delivers its objectives effectively.

Timetable

6. Responses to this Technical Note should be made by 10 February 2005.

The Government plans to publish draft clauses at the end of January 2005 prior to their inclusion in Finance Bill 2005 and early responses will be used to inform these.

Background

7. RIs own any IP created by their employees in the course of their employment. They have “IP sharing policies” (sometimes also called “employee incentive or compensation schemes”) to reward employees who have created IP – the researchers – if it is subsequently exploited.
8. The form and timing of this reward varies. It may be cash representing a share of royalties received by the RI from licensing or selling the IP, to which the normal tax and NICs rules apply. Alternatively, it could be a transfer of value to the researcher via their ownership of shares in a spin-out company set up to further develop the IP to the point where it can be exploited commercially.
9. The current business model favoured by RIs can result in the transfer of share value under the IP sharing policy at about the time the company is formed. This means that Income Tax and NICs (including secondary NICs payable by the employer) arise at a time when the shares cannot be sold to generate funds to pay the tax.
10. Prior to the enactment of Schedule 22 RIs considered that shares awarded under their preferred business model, and any subsequent increase in value, including that caused by IP sharing, were subject to Capital Gains Tax treatment. This meant that any tax liability would not arise until the gains were realised. Were the spin-out company to fail there would be no liability. The Inland Revenue was not aware of this practice and had not

therefore challenged it. The new rules in Part 7 of ITEPA put the position beyond doubt. It is now clear that liability on the IP sharing element acquired by the researcher gives rise to Income Tax and NICs, not just Capital Gains Tax.

11. The problem with the timing of the tax and NICs charge, plus concern about the uncertainty and complexity in identifying the reward element, bound up as it is with valuation of the IP, has had a detrimental effect on spin-out activity. Spin-outs were declining in numbers before Schedule 22 was enacted, so we cannot be sure that this tax issue is the only reason for the decline. But feedback we have received from RIs indicates that it is a key issue.

Reason for Consultation

12. There are a number of issues in relation to how the legislation is to be framed on which input is directly sought from those involved in spin-out companies. Apart from any overall comments that observers may wish to make we are seeking technical observations in a number of areas. In this Technical Note questions have been inserted at the appropriate paragraphs (in bold), and are summarised at the end of the Note.
13. Draft legislation is not being published at the time of this Technical Note but early comments we receive will help us to deliver a more focused draft, which will be published at the end of January 2005.

Proposed Change Outline

14. The proposed Income Tax and NICs relief would mean that where
 - (a) Intellectual Property (IP) is transferred to a Spin-out Company by a Research Institution; and
 - (b) there is an IP sharing policy which applies to such IP; and
 - (c) an individual has worked on the creation of the IP while an Employee of, or a Research Student at, the Research Institution; and
 - (d) that individual holds or acquires shares which are employment-related securities in the Spin-out Company,

then market value of the shares (and of any benefit arising from the ownership of them) would be computed for the purposes of the Researcher's earnings from employment

- at the time of the transfer of IP or, if not more than 90 days later,
 - at the time the Researcher acquired his/her shares,
- as if the transfer had not taken place. This means there will be no Income Tax and NICs charge arising in respect of researcher shares due to the IP transfer.

- 15.** The measure is thus directly targeted at the researcher's position when IP is transferred into a spin-out company. It does not affect the position of the RI, except that there will be no employer's NICs to pay on the transfer of the IP. It will not affect their position for Capital Gains Tax or Corporation Tax. The spin-out company, and researchers' shares, remain within the scope of Part 7 ITEPA in all other respects.
- 16.** In particular, where shares in a spin-out are acquired by a researcher after other transactions have occurred, such as introduction of funding, there could still be a residual charge to Income Tax and NICs based on shares acquired at less than market value, even though the effect on value of the IP was being ignored.
- 17.** Some spin-out companies may issue restricted shares. Whilst there may be a charge at acquisition, under Chapter 2 of Part 7 of ITEPA there is also an Income Tax charge when the restrictions are lifted. As the proposed measure only provides Income Tax and NICs relief on any amount charged at acquisition the benefit of the new measure would be lost on any increase in value when the restrictions are lifted. But it is possible for employer and employee to elect that the effect of any restrictions should be disregarded so that Income Tax and NICs is charged on the full unrestricted value of the shares at acquisition.
- 18.** In order that researchers can get the full benefit of the proposed measure when restricted shares are acquired, the legislation will deem an election

under Section 431 ITEPA to have been made at the time the shares are acquired. This will prevent a charge to tax when the restrictions are lifted or the shares are sold, and enable the employee to enjoy the full benefit of the proposed relief. However, it is theoretically possible that situations could arise where the deemed election could produce an unwanted result where the shares acquired have a value apart from the IP. **We would welcome details of any instance where this approach might be insufficient in practice.**

Definitions

- 19. Spin-out company** will be the company into which the Research Institution (RI) has transferred the IP and in which the individual has acquired employment-related securities.
- 20. Intellectual Property** will be defined to include all those items that we have seen included in IP-sharing agreements (see Appendix 1 for an example). **Are there any items of IP that might be transferred that would not be included in such an IP sharing agreement?**
- 21. Research Institution** will be defined to include not only universities but also other educational, learning or research establishments whose activities are substantially publicly funded and who use IP-sharing agreements. However, the definition would not include any entity controlled or funded by a person who carries on activities for profit. **Is this definition likely to exclude any organisations that should benefit?**
- 22. Transfer** would include other forms of passing on IP besides outright sale, e.g. licensing.
- 23.** The definition of **Employee** would cover those actively engaged in the creation of IP through research, while employed by the Research Institution
- for a minimum of 25 hours per week, or if less
 - for three-quarters of their total working time.

Does this definition describe those employees who should be entitled to benefit from this measure?

24. A **Research Student** will be an individual who, although not employed by the Research Institution is working:

- for a minimum of 25 hours per week, or if less
- for three-quarters of their total working time.

within the Research Institution

A Research Student who is not employed by the Research Institution would need to be employed by the Spin-out Company to come within the ambit of the legislation in Part 7 in the first place. **Does this definition describe those research students who should be entitled to benefit from this measure?**

25. **Shares** would have their ordinary meaning. **Employment-related securities** would have the meaning as defined by section 421B(8) ITEPA 2003 for consistency.

26. The intention is that all the definitions will be capable of amendment by regulation to enable definitions to keep pace with sector developments.

Administrative and other points

27. There already is a duty to provide information on events relevant to the proposed new measure, such as the transfer of the IP, on Form 42. There would be an indication in the relevant places on this form to indicate where market value was affected by this measure. Either or both of the RI and the spin-out may be responsible for completing Form 42, although in practice only one of them would need to do so.

28. To monitor the use of the measure the Revenue is considering moving the tax affairs of all spin-out companies to a designated specialist office to provide consistent advice and treatment. Details will be provided in due course.

29. There will be anti-avoidance provisions to prevent the application of the provisions where the main or one of the main reasons of any arrangements is to avoid tax and/or NICs or where commercial organisations attempt to abuse the provisions for their employees.

Start Date and IP transfers to spin-outs after 2 December 2004

30. The Government intends to make the new measure effective from the date of the Pre-Budget Report announcement, 2 December 2004. This means that any transfers of IP that occur on or after that date may claim the benefit of the measure.

Responses Sought: Summary of Issues

The Inland Revenue will welcome comments on the proposed legislation and, in particular, on the issues highlighted:

- (a) Are there any items of IP that might be transferred that are not commonly included in IP sharing agreements?
- (b) Are there any instances when the interaction of this measure with the provisions in Chapter 2 Part 7 on restricted securities might cause any problems, particularly with regard to the proposed deemed election under section 431(1)?
- (c) Is the definition of research institution likely to exclude any organisations involved in spin-out activity where researchers share in IP?
- (d) Will the definitions of Employee and Research Student cover all those who should be entitled to benefit from this measure?

Appendix 1: Suggested definition of Intellectual Property

The definition of IP would be defined to include the items that universities themselves commonly include in IP-sharing agreements:

- (a) Patented inventions
- (b) Unpatented inventions
- (c) Know-how
- (d) Innovative ideas which might lead to (a) to (c) above
- (e) Trade marks for brand identity - of goods and services allowing distinctions to be made between different traders
- (f) Designs for product appearance - of the whole or a part of a product resulting from the features of, in particular, the lines, contours, colours, shape, texture, smell, or materials of the product itself or its ornamentation;
- (g) Copyright for material - literary and artistic material, music, films, sound recordings and broadcasts, including software and multimedia.

where inventions are either

- new products and processes or
- improved products and processes

that are capable of industrial or commercial application.

Appendix 2: Examples

The following examples indicate how the measure will apply in different spin-out scenarios. In each example, if any form of share-based reward or incentive other than that attributable to IP sharing flows to the researcher and/or other employees these will continue to be subject to the normal charging rules in ITEPA.

Example 1

Researchers at the University of Utopia, Thomas and Moore, have been conducting research in a specialist area. When it looks like there may be a commercial application, the University decides to set up a spin-out company to develop it further. It subscribes for 20 shares in the new company at par (£20). The University then transfers the IP as it then stands into the spin-out company, with a proviso that it reverts to the university if further development is not fruitful and the company becomes defunct. A further 30 shares are allocated to Thomas and Moore for which they pay £30. At the time of acquisition the value of the shares will be greater than the par value because they hold 60% of a company with access to the IP.

The starting point for the Income Tax and NICs charge is the difference between the price paid for the researcher's shares and the (possibly much higher) market value. The new legislation will deem the market value to be the value that the shares would have had if the IP had not been transferred, so there will be no tax or NICs charge in respect of the IP sharing.

Looking forward, if the spinout fails, then there is no Income Tax, NICs or CGT charge on the whole cycle flowing from the IP transfer. The IP, whether further developed or not, reverts to the university. If, on the other hand, development is successful, the gain on the shares held by Thomas and Moore will be within the normal rules for Capital Gains Tax.

Example 2

Plato is a researcher at the Republic University. He sets up a spinout company himself, paying for an initial 50 x £1 shares at market value of £50. Sometime later, after deciding that the invention is not yet developed sufficiently to licence, the University transfers the existing IP to the spinout. In exchange it receives 20 x £1 shares. At this time there is an increase in value of the original shares, which is chargeable under Chapter 4 of Part 7 of ITEPA. Following the change, the shares would be valued for Chapter 4 purposes as if the IP had not been transferred and there would therefore be no benefit to charge under Chapter 4.

Once the IP is in place, negotiations are concluded with venture capitalists. They introduce funds of £50,000 and subscribe for new

shares at their market value. They consider this to be £1000 per share, taking account of the value of the company complete with Plato, business plan and IP. So they receive 50 shares in return for their funds and the issued shared capital of the spinout company is 100 x £1 shares. If there is any increase in value of Plato's shares as a result of the funding support obtained this will be a normal commercial increase in value and will not therefore be chargeable under Chapter 4 of Part 7 of ITEPA.

Example 3

Samuel and Butler are researchers at the University of Erewhon. They have been conducting research into the development of new machines. When it looks like there may be a commercial application, the University decides to set up a spin-out company to develop it further. Venture capitalists are willing to invest £50,000 for a 50% stake in the venture; the University will licence the IP in return for a 25% stake; and Samuel and Butler will receive shares in the venture, in return for a payment of £25, and the waiver of their rights under the IP sharing agreement.

The shares are acquired by Samuel and Butler for £25. There are two scenarios:

- If the shares are acquired before the funding is provided by the venture capitalists then there will be no liability, as the company will have only a nominal value, ignoring the value consequent on transferring the IP.
- However, if the shares are acquired after the funding has been provided, or after other business development that could affect the share value has taken place, then the shares may have a considerable value and there could be a charge to tax and NICs, even having ignored the effect on value of the IP transfer to the company.

Appendix 3: about the consultation process – code of practice on written consultation

Consultation Criteria:

1. Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy.
2. Be clear about what your proposals are, who may be affected, what questions are being asked and the timescale for responses.
3. Ensure that your consultation is clear, concise and widely accessible.
4. Give feedback regarding the responses received and how the consultation process influenced the policy.
5. Monitor your department's effectiveness at consultation, including through the use of a designated consultation co-ordinator.
6. Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

The Inland Revenue confirms that, where possible, these consultation criteria have and will continue to be followed.

With reference to criterion 1, the consultation period for this document is 10 weeks, from 3 December 2004 to 10 February 2005. This is because the legislative process does not allow for the normal 12-week period.

If you have any complaints about any element of the consultation process leading from the issue of this document, please contact:

Up to 14 December 2004

Steve Webster
Inland Revenue
Room 35
New Wing
Somerset House
Strand
London WC2R 1LB

Tel: 020 7438 6535 Fax: 020 7438 6431

From 15 December

Inland Revenue
Room3/37
3rd Floor
1 Parliament Street
London
SW1A 2BQ

Tel 020 71472382 E-mail: Steve.Webster@ir.gsi.gov.uk

PARTIAL REGULATORY IMPACT ASSESSMENT (RIA)

**New Tax Measure to help researchers acquiring shares in
spin-out companies created with universities and research
institutions**

Purpose and intended effect of the measure

The policy objectives

1. To help the creation of certain spinout (sometimes referred to as 'spin-offs') companies by providing statutory certainty of the tax treatment of shares held by researchers involved in them.
2. The measure is aimed at researchers in universities and publicly funded not for profit research establishments who benefit under the establishment's Intellectual Property (IP) sharing policy when the IP they create is transferred to a spinout company for further development. In this RIA we will use the term Research Institution (RI) to describe the target population.
3. The certainty will be provided by deeming the Intellectual Property (IP) transfer to have no effect on the market value of the shares held by the researchers for the purposes of the rules that tax employment-related securities.
4. The Technical Note which this RIA forms part of, sets out the detail of the measure. It is intended that the measure will take effect from the date of the Pre Budget Report announcement, 2 December 2004. The purpose of this RIA is to invite comment on the impact of the proposed legislative solution.

Background and introduction

5. Academics, etc employed by RIs often work on research that may have a commercial application. Stand-alone companies are often set up between a RI, researchers and a funding partner to further develop IP to the point where it is ready for commercial exploitation. These are commonly referred to as "spinout" companies.
6. IP created by employees of RIs is the property of the employing entity. The employing organisations generally have policies in place under which they agree to share any income or gains generated by the IP with the employees who created it. They can do this either by making cash payments to the employees or by using shares in a spinout company set-up specifically to further develop the IP. The latter path facilitates innovation as it means that the further development of the IP within the spinout company will continue to benefit from the researcher's input.
7. Schedule 22 of Finance Act 2003 reformed the rules on the taxation of employment-related securities and shares to bring parity between earnings taken in cash or by means of shares and other securities. Before this legislation came into force the view taken by the RI sector was that shares held by their employees in spinout companies were subject only to capital

gains tax when the shares were sold. The Revenue was not aware of this view and had not therefore challenged it.

8. Schedule 22 Finance Act 2003 made it clear that shares or securities held by RI employees in spinout companies are "employment-related". Any discount at the time the shares are acquired or any later increase in value over and above normal commercial growth (for example, such as that following the transfer of IP to the spinout) is subject to income tax and National Insurance Contributions (NICs) in the same way as cash payments under the IP sharing policy.

The issue

9. The structures typically adopted by RIs' spinouts trigger income tax charges when the IP is transferred into the company. However, this is usually at a time when the employee has no funds to pay any tax charges. The barrier this creates has been cited by the sector as one of the main reasons for the downturn in recent spinout activity.

10. The UK technology transfer sector has strong potential to contribute to UK innovation and enterprise. Consequently, the downturn in activity has a potential knock-on effect to the UK's long-term economic performance.

11. Evidence gathered by the Universities Companies Association (UNICO), a professional association involved in the university IP transfer sector, indicates that the impact of Schedule 22 has caused a severe decline in spinout activity. Spinouts were declining in numbers before Schedule 22, so it is not clear the tax issue is the only reason for the decline. Therefore, **we would welcome figures on the number and nature of spinout companies that did not proceed because of the Schedule 22 issue.**

Options

12. **The do nothing option** – To do nothing risks the freeze in RI spinout activity continuing, to the detriment of innovation and long-term economic performance in the UK.

13. **The non-statutory route** – Inland Revenue has been working with sector representatives and two structural solutions have been developed to ensure that an income tax charge does not arise unless and until the venture is successful. This has allowed some spinout activity to resume. **We would welcome figures on the number of spinout companies formed since April 2003 and an indication of the number that have used the two models.**

14. While the sector accepts that these solutions provide a level of certainty in terms of tax treatment, they argue that an income tax and NIC liability arising on the value of the shares when the spinout company is sold or listed does

not make them attractive to the researchers whose expertise is critical to the venture.

15. Feedback is that RIs consider it important to be able to use simple corporate structures that ensure the researchers commitment to the venture through share ownership, whilst avoiding the need for complex share acquisition agreements. They also suggest valuation of IP is a difficult and costly process that places an additional financial burden on those involved in the spinout activity at a time when funds are limited.

16. **The legislative option** – This option would ensure that those researchers who are involved in the development of IP in a RI spinout are not hampered by the tax rules with regard to the transfer of the IP and its effect on their employment related securities. To do this effectively the measure would need to recognise the unique IP sharing arrangement present in RI spinout companies and limit the scope of the measure to that transaction.

17. To achieve this aim a Finance Bill provision would deem the market value of the shares held by the researcher in the spinout to be unaffected by the transfer of the IP into the company. This would ensure no income tax and NICs charge arises under Schedule 22 in relation to the IP transfer event.

18. The statutory provision proposed would provide tax certainty, reduce the need for costly professional advice on share valuation and the income tax and NICs implications of IP transfer arrangements and give the sector the flexibility it needs to adopt structures that meet the commercial considerations of the business. It recognises the unique arrangement present in RI spinouts and is therefore limited to that sector and to the IP transaction within it that causes the value to flow to the employee. If some other employment-related event increases the value of the researcher's shares that increase will be liable to income tax and national insurance contributions, as it would in any other company where employees hold such securities.

Business sectors affected

19. The proposed measure is targeted at employees of RIs who acquire employment-related shares in spinout companies, into which the RI transfers IP. As the nature of the IP can be very wide ranging it is unlikely it will favour or impact on a particular business sector/activity. Given the nature and purpose of spinout companies, it is most likely all spinout companies affected will be small in size, with less than 50 employees.

20. We understand universities create the majority of the spinouts, and the number of spinouts created by other RIs is very small. **We would welcome information about companies set up by other RI organisations and how IP transfer is achieved by these organisations.**

21. The Higher Education Business Interaction Surveys 2002 to 2004 show 203 spinouts were established in 1999-00, 248 in 2000-01 and 213 in 2001-02. An informal UNICO survey has indicated 172 university spinouts for the year to April 2003 and estimated a lower figure of around 90 post-April 2003.

There is, however, no data available that shows how many researchers are involved in spinout companies in which they have share ownership. **We would welcome firmer figures on the number of spinouts undertaken since April 2003 in the university and wider sector and how many researchers are involved with these.**

Equity and fairness

22. This measure is intended to remove a unique barrier that is currently slowing down the creation of new RI spinout companies. It will level the playing field in this respect between RI spinouts and other new business start-ups, which do not face the same problems that flow from the IP sharing policy agreements.

23. We do not consider the proposed measure to have any Human Rights Act (HRA) consequences.

Benefits

Economic Benefits

24. This measure should help to restore the confidence of RI and RIs' researchers to re-engage in spinout activity and take forward research that may have the potential to foster innovation and growth in the economy. Although a significant number of spinout companies may not be successful because of other factors, this measure will ensure that the first hurdle of setting up a spinout and engaging the essential input from the RI researchers is overcome.

25. The impact of the measure on RIs and spinouts is to remove a tax hurdle that they face under the existing rules. This means RIs and RI spinouts in the future will experience reduced professional advisors costs, as the tax position relating to impact of IP transfer on employment related securities will be certain. They will not have to consider alternative structures to defer the tax charge until the spinout is successful, nor will they have to seek an Inland Revenue Code of Practice 10 clearance to be certain of the tax position. It will also remove the need to obtain a valuation at an early stage of the spinout company for income tax purposes. **Comments are welcome on the average savings in terms of professional advisory costs.**

Social & Environmental Benefits

26. It is not considered that this proposal is likely to have any direct social or environmental impacts.

Costs

Economic Costs

27. The Exchequer income tax and NICs cost of the measure are considered to be negligible.

28. The likely costs involved with complying with the measure will include the researchers and RIs familiarising themselves with how the measure will operate. They will also need to satisfy themselves that their activity is within the scope of the exemption. There may be initial advisory costs associated with doing this. It is difficult to ascertain a figure for these costs and it may be tied with other costs incurred on setting up the spinout company. Most universities involved in spinout activity have dedicated offices to help and advise academics in creating spinout companies and therefore any initial one-off costs may be absorbed by the university providing the IP.

Comments are welcome on whether generally the originating institution funds the initial spinout start-up costs or the researcher. Also it would be helpful if you could give

- **an indication of the average time needed/cost attached to achieve familiarisation with how the measure will operate**

and

- **whether adviser costs will be incurred in the future to establish the income tax and NICs position relating to the RI researchers employment related securities. And if yes, an estimate of the average likely cost.**

Social & Environmental costs

This measure has no social or environmental costs.

Small Business impacts

29. Spinout companies mostly fall into the micro-business category. It is unlikely that a spinout company will have more than 50 employees at the start of its lifecycle when the IP is transferred because at this point it is primarily a vehicle for researchers to further develop IP. Only once the IP is developed to a point where it has a commercial value is the spinout likely to expand and diversify into product manufacture. The impact of the measure will be to facilitate the creation of the RI spinout companies, by removing a unique barrier encountered by RIs setting up spinouts. The spinout company will not thereafter directly benefit from the measure.

Competition assessment

30. This measure has a potentially positive impact on the competitive process. The operation of the tax system has presented a barrier in a very discrete and narrow area relating to IP transfer, that we understand is unique to the RI sector. This barrier to entry for prospective spinouts has made it difficult for them to compete with other companies, who may be pursuing an innovation in the same niche areas. Removing the barrier creates a level playing field between spinouts and other business forms, which ensures that spinouts can contribute to the competitive process in markets where innovation is often the main form of competition.

31. It might be claimed that other companies designing, developing and commercialising new technology would be disadvantaged, by not being able to access the measure. However, we understand that these companies do not have the same practices of sharing IP in the way RIs do with their employees and so there is no equivalent barrier.

Securing compliance

32. It is envisaged that existing administrative processes will be used to identify spinout companies in order to deal with them in one location. This will enable the Inland Revenue to monitor the take up and effectiveness of the measure and ensure that it is not being abused. In turn the spinout companies will benefit from consistent advice and staff accustomed to their particular circumstances. We do not envisage that this will impose any additional compliance costs on RI or companies.

Consultation

33. We will be informally consulting on the detail of the design and effect of the proposal with a range of sector representatives. We have published a Technical Note to explain how the proposal will work and invited comments in the Note to be made within ten weeks of publication of that Note.

34. The period of consultation is shorter than the Cabinet Office guidelines, which suggest a minimum of twelve weeks. This is because the draft legislation needs to be ready for publication of the Finance Bill, a process that does not allow in this instance for the usual consultation period.

Monitoring and evaluation

35. RI spinouts and researchers will report to the Revenue the acquisition of employment related securities that make use of this measure. This will provide the necessary information to help determine whether the measure is effective in returning activity to the RI spinout sector.

Contact point

by email to: Hasmukh.Dodia@ir.gsi.gov.uk

or by post to

UP TO 6 DECEMBER 2004

Hasmukh Dodia
Employee Shares & Securities Unit (ESSU)
Room 138, New Wing
Somerset House
Strand
London WC2R 1LB

Telephone: 020 7438 7504 Fax: 020 7438 7260

FROM 6 DECEMBER 2004

Hasmukh Dodia
Employee Shares & Securities Unit (ESSU)
Room 49, Ground Floor
1 Parliament Street
London SW1A 2BQ

Telephone: 020 7147 2861 Fax: 020 7147 2746 or 020 7147 2747