

EXETER CITY COUNCIL

SCRUTINY COMMITTEE - ECONOMY 9 SEPTEMBER 2004

THE IMPLICATION OF THE FINANCE ACT 2003 ON THE DEVELOPMENT OF KNOWLEDGE BASED BUSINESSES

1. PURPOSE

- 1.1 To inform Members of the implications of the Finance Act 2003 on organisations/businesses which allow and encourage employers to create companies who in turn are shareholders in the “spin out” venture.

2. BACKGROUND

- 2.1 The focus of the Regional Economic Strategy is to raise productivity, particularly by capitalising on opportunities for innovation and enterprise. Improved productivity is essential for the retention and creation of employment and the attractiveness of investment. As the draft Exeter and Heart of Devon Economic Development Strategy points out, enterprise ranges from the establishment of a small locally based rural business to a new science based spin out from the University.
- 2.2 The universities of Exeter and Plymouth are both represented in the sub-region and are central to the encouragement of enterprise and innovation, as demonstrated, for example, in the development of the Innovation Centre at the University of Exeter and the University’s involvement in spinning out companies. The City Council has been proactive in working with the University on these and other initiatives related to promoting business development through innovation.
- 2.3 The sub-regional strategy identifies the importance to the local economy of raising the proportion of knowledge-based jobs in the sub-region. Increasing the numbers of businesses created, and their growth, is fundamental to this. As in other universities one key source of the development of such businesses is the directly spun out companies emanating from the activities of university employees.
- 2.4 The University of Exeter, amongst others, has recently highlighted the difficulty caused by Schedule 22 of the Finance Act 2003, which has imposed a new tax liability on academics who take a stake in a business set-up by their university, to commercialise research they had produced. Previously an academic in this situation would have been liable to Capital Gains Tax only after selling their shares, and a form of tapered relief could reduce the levy to as little as 10%. The Finance Act 2003 now means that they have to pay Income Tax instead, based on the value accrued to their shares as a result of their investment. The charge falls due before the academic has necessarily sold any of their stake. The long term benefits of such a great deal of investment locally and nationally into providing university spin-out companies may be adversely affected by this direct disincentive for the initiation of ideas in order to commercialise them.

3. ISSUES RAISED

- 3.1 Although the number of spin-outs per year from the University of Exeter is around four companies, any one of these could be subject to significant growth and create new quality employment for the economy of the city and the sub-region.
- 3.2 Such businesses are high risk in the eyes of potential investors and often depend on personal investment by the initiator to take them through the early stages of development. There is some evidence that this new financial directive is discouraging this stage. It would require additional expense by the university or some other body at this stage to offset the loss of this personal input.
- 3.3 The change in regulation also affects all companies/organisations who have employees with shareholdings, as the Inland Revenue will also treat the parent organisation as the first port of call when taxing any increase in value in the shares held by employees. A recent article in the Financial Times has highlighted how this serves to “disincentivise” universities from being as proactive in spinning out companies where academic employees or their families have a shareholding.

4. RECOMMENDED that:-

- 4.1 Members support the university in lobbying for a change to this requirement of the Finance Act 2003, which is a disincentive to the creation of employment through the commercialisation of innovative ideas.

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Local Government (Access to Information) Act 1985 (as amended)
Background Papers used in compiling the report:- None