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Forgivable Loan Support for Small Business Company Directors

In our June 2020 report into the economic costs of the coronavirus pandemic, we identified significant gaps in UK government support, particularly for company directors of small businesses[1]. They had fallen 'between the cracks' because they were ineligible for the Self-Employment Income Support Scheme (SEISS).

For this subsequent report, we focus on two areas:

1. **Identifying the economic costs of the pandemic for company directors.** Our October 2020 survey of 343 small company directors demonstrates[2]:

- 80% have not accessed other sources of government support
- 62% of them had seen their income fall – and by an average of 68%
- 56% have cash flow concerns
- 27% expect to cease trading because of the pandemic

2. **Introducing loan 'forgiveness' as a targeted and proportionate policy for supporting company directors**. This is modelled on the United States government's principal wage subsidy scheme (Paycheck Protection Program). This US scheme works by asking small businesses to self-certify and provide financial information to banks. These banks then evaluate these loans against government eligibility criteria. Once the loan is agreed, this loan can be 'forgiven' (i.e. becomes a grant from the government) if it is used to subsidise wage costs.

Why is there a need to support company directors?

Working in sectors as diverse as the creative arts, finance or technology, company directors contribute £154 billion to the UK economy and help drive economic growth and entrepreneurial dynamism[3].

Nearly three-quarters (73 per cent) of company directors in our study have a degree and 76 per cent work in high value-add sectors (financial services, Information and communications and Professional, scientific and technical). Nearly half of the company directors are also from London and the South East regions of the UK.

'We serve the needs of larger businesses and thus improve their efficiency and productivity and help make them successful'[4].

They are not just solo company directors. One-fifth of our company directors employ others in their business.

What are the reasons for a lack of government support?

Despite claims that the UK government would do 'whatever it takes' to support UK businesses[5], none of the company directors in this report were eligible for SEISS.

One reason is that HMRC suggests that it is operationally difficult to identify if a company director's dividends are income from their company or from other sources[6].

Potentially, company directors could access the UK government's furlough schemes.

As employees of their business, company directors could use furlough payments because they often pay themselves a small monthly salary and augment this through dividend payments[7]. Consequently, they are eligible for small furlough payments of around £575 per month[8].

However, we found that only 20 per cent of company directors had accessed the furlough scheme. One disadvantage of this scheme – even as a 'flexible furlough scheme' – is that it makes it difficult for company directors to run their business because they often cannot work on a part-time basis.

'The Government didn't consider that a sole director of a Ltd company is the ONLY employee and, therefore, to generate any potential income they COULD NOT furlough'.

'I am in the Arts sector. Projects I'd worked on for years were cancelled overnight with no compensation…I have had to move out of my flat and my office. I am also still running the business every day, mostly unpaid, with less help as I now have fewer staff. I am exhausted.'

If the furlough scheme is unhelpful, company directors can potentially apply for small business grants or loans and seek to help with their cashflow by deferring tax and VAT payments[9]. Again, only 20 per cent of company directors had accessed these types of support.

'Lost income, lost clients, had to dismiss staff, had to put own money into business, haven't been able to take a salary, had to take out loans for first time ever, not knowing if I would be able to pay them back.'

How are company directors coping with the COVID-19 crisis?

Company directors have turned to their own savings to support their business activities. Four out of ten (41 per cent) used their own savings and nearly three out of ten (28 per cent) withdrew money from their business. This might be expected. Company directors often work on a freelance basis and build up cash reserves to fund fallow periods.

I worry about the future. I am using money saved for my pension to survive.

We aren't living any kind of life. We just exist. And I work to pay a government who have given me so little in my time of need after I have paid a high rate of tax for over 20 years.

However, the pandemic has seen the UK government take control of the economy. One indicator of the impact of government mandated control is that the average number of hours that company directors now work is 21 hours per week. Before the advent of the pandemic, they were working on average 40 hours per week. In effect, they have shifted from working full-time to working part-time.

62 per cent of them have seen their income fall and by - on average - 68 per cent. Nearly six out of ten of them have cash flow issues (56 per cent).

My business 'has earnt nothing since March…stressed and tearful and about to lose my car and home'

About a quarter of them (27 per cent) expect their business to close, with a further 23 per cent expecting their business to shrink. Only 5 per cent expect any business growth, with the remaining 45 per cent expecting their business to remain the same size.

Going to shut my business and try something else. I'm depressed, crying most days, extremely stressed.

These are not new businesses prone to high closure rates[10]. Instead, they are established businesses, set up on average 12 years ago.

What is loan 'forgiveness'?

In the United States, the government backed wage subsidy scheme - Paycheck Protection Program – is open to all small businesses. It works by offering small business loans via the banking system. To get a loan, small businesses have to self-certify and provide financial information to support their loan claim. Banks subsequently process and award these loans. However, these loans become 'forgivable' (i.e. they become small business grants) if the small business owner uses these funds to pay employment costs and associated business expenses.

What are the benefits of loan forgiveness?

- *Shifts the administrative burden onto company directors*. HMRC have found it operationally difficult to distinguish the sources of dividend payments. Under a loan forgiveness scheme, the burden of proving that dividends are in fact company income shifts to the company director. Through self-certification and by providing appropriate financial information, they would have to demonstrate the veracity of their income sources. Banks – as the Business

Bounce Back loan scheme shows – have the capability and resources to assess and calculate loans.

- *Minimises fraud*. One of the advantages of SEISS is that there is a direct relationship between the applicant and HMRC. In contrast, the furlough uses agents. This may partly explain why SEISS fraud is around 1-2 per cent while fraud from the furlough scheme is around 5-10 per cent[11]. Using the banks as a key intermediary to check, assess and calculate loans provides safeguards against fraud by organised crime.
- *Minimises costs to the public purse*. These forgivable loans could be set so that they would be no more than current SEISS payments available to the self-employed. Interest rates may be commensurate with costs and risks associated with the scheme. Loans that become grants can be time limited and subject to eligibility criteria that balance the needs of company directors with that of the public purse. There are also longer-term advantages. The UK government has introduced SEISS and the furlough scheme because they recognise that government mandated interruptions to business activity have a serious impact on business revenues. Without such support, the alternative is that business will close in large numbers, retarding future economic recovery and increasing unemployment costs.
- *Closes a large gap in public provision*. The introduction of SEISS and the furlough scheme was quick and successful. Since then, there has been precious little policy evolution to account for evident support gaps. Although estimates vary, there are between 710,000-946,000 company directors who have no access to SEISS[12].
  There are also few practical differences between the work done by a company director and a sole trader. Yet, the sole trader is eligible for SEISS while the company director is ineligible.
  Going forward, the Chancellor of the Exchequer has signalled the importance of tax reform. One potential justification for these changes is the support provided through SEISS[13]. However, there are open questions about the natural justice of small business tax reform if company directors cannot access government support.

Interim studies of the US's loan forgiveness scheme have been favourable. It increased business survival rates, had positive employment impacts and monies were quickly disbursed through the banking system to businesses[14]. Another study found that although targeting was good, some firms used their loans to buffer their savings and to pay for or non-employment costs[15].

What needs to be done?

The situation faced by company directors is unjust. Compare the position of a graphic designer who is a sole trader with one that is a company director. Both the director and sole trader are likely to do identical work, often for the same client. But sole traders are able to access SEISS and can carry on working while the company director has no targeted support from the UK government. A loan forgiveness could resolve this inequity. Offering support now could pave the way for future inclusive tax reform.

We, therefore, call on the Chancellor of the Exchequer to examine a forgivable loan scheme to support company directors.

'Don't think I can write how I feel - watching friends that are self-employed and working getting money while I have been left to struggle.'

Author biographies

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[1] www.ipse.co.uk/resource/covid-19-report-2020.html

[2] For the October survey (22-30 October), 735 business owners were contacted, with 446 (61 per cent) completing the survey. This report focuses only on 343 respondents that were company directors and were still currently operating their limited company.

[3] Source: BEIS (2020) Business population estimates for the UK and regions 2020: statistical release (www.gov.uk/government/publications/business-population-estimates-2020/business-population-estimates-for-the-uk-and-regions-2020-statistical-release-html), Table 4; Burke, A., & Cowling, M. (2019) The relationship between freelance workforce intensity, business performance and job creation. *Small Business Economics*, 1-15; Burke, A. E. (Ed.). (2015) *The handbook of research on freelancing and self-employment*. Dublin: Senate Hall Academic Publishing.

[4] All quotes are taken from the comments of entrepreneurs who took part in the survey. We would like to thank them for their assistance. We would also like to thank Nicky Barneby for typesetting and producing this report and Paula Miners for her research assistance.

[5] The Chancellor of the Exchequer, Rishi Sunak (17 March, 2020) said: 'We will support jobs, we will support incomes, we will support businesses, and we will help you protect your loved ones. We will do whatever it takes.' (www.gov.uk/government/speeches/chancellor-of-the-exchequer-rishi-sunak-on-covid19-response).

[6] Treasury Secretary, Jesse Norman in answer to a Parliamentary Question on the 5th November, 2020 said: 'Under current reporting mechanisms it is not possible for HM Revenue and Customs (HMRC) to distinguish between dividends derived from an individual's own company and dividends from other sources, and between dividends in lieu of employment income and as returns from other corporate activity. This means, unlike announced support schemes which use information HMRC already hold, targeting additional support would require owner-managers to make a claim and submit information that HMRC could not efficiently or consistently verify to ensure payments were made to eligible companies for eligible activity. This is about identifying what is operationally feasible, managing technical complexities and fraud risks, and ensuring that other forms of support the Government has already committed to are delivered in a timely way'.

[7] The standard set up is for company directors is to pay themselves a PAYE of £719 per month and supplement this by drawing dividends from their business when they are in profit. Two main reasons for this are it helps smooth out income fluctuations over the year and it is tax efficient. However, tax efficiency is neither tax avoidance nor evasion. Despite calls for tax reform (e.g. Freedman, J. and Crawford, C. (2010) 'Small Business Taxation' (http://eureka.sbs.ox.ac.uk/3368/1/WP0806.pdf)), successive UK governments have used the tax system to incentivise business owners to set up as limited companies. Indeed, over the period 2010-2020, the number of UK companies has increased by 63 per cent.

[8] A monthly PAYE salary of £719 equates to a furlough payment (at 80 per cent) of £575 per month.

[9] The UK government offered a wide range of business support options such as a small business grants of up to £10,000 and business bounce back loans. There are also a range of national and sectoral support available. For example, the Scottish government have had schemes for the newly self-employed and for the arts sector. Many company directors were ineligible for the small business grant because they did not pay small business rates relief. There are also issues with taking up business bank loans. Although the terms and conditions of these loans are relatively favourable - relative to standard business term loans, many small businesses do not favour taking on loans, particularly in an uncertain business climate. Indeed, Greene (2020) shows that around 50 per cent of UK small businesses are permanent non-borrowers (Greene, F. J. (2020) *Entrepreneurship: Theory and Practice*, Macmillan: London).

[10] ONS (2020) show that the only 42.5 per cent of new businesses survive for five years (Source: https://www.ons.gov.uk/businessindustryandtrade/business/activitysizeandlocation/bulletins/businessdemography/2019#the-south-

west-continues-to-have-the-highest-five-year-survival-rate, Figure 2).
[11] National Audit Office (2020) Implementing employment support schemes in response to the COVID-19 pandemic, Figure 16.
[12] It is difficult to estimate precisely the number of company directors who fall between the cracks of existing government support. BEIS (2020) suggest that at the start of 2020, there were 945,545 limited companies with no employees (i.e. solo company directors). They define these in their methodology as 'Companies with only one PAYE employee on the IDBR are counted in the "with no employees" category, rather than the "1 employee" category, as the employee is treated as being equivalent to a "working proprietor' (BEIS (2020) Business population estimates for the UK and regions, 2020, methodology & quality note, p.6.). The IFS (2019) estimated that there were 1.8 million UK company directors in 2015-16 of which 470,000 were sole company directors and 1.3 million were a director of two-director company (Cribb, J., Miller, H., & Pope, T. (2019) *Who are business owners and what are they doing?* (No. R158). IFS Report). Meanwhile, IPSE have estimated that there were 710,000 company directors who were ineligible for SEISS support (https://www.ft.com/content/79ff5bd9-11aa-4790-bf71-0620023dee0f).
[13] HM Treasury press notice, Chancellor outlines new coronavirus support measures for the self-employed, 26 March 2020.
[14] Bartik, A. W., Cullen, Z. B., Glaeser, E. L., Luca, M., Stanton, C. T., & Sunderam, A. (2020). *The targeting and impact of Paycheck Protection Program loans to small businesses* (No. w27623). National Bureau of Economic Research.
[15] Granja, J., Makridis, C., Yannelis, C., & Zwick, E. (2020). *Did the Paycheck Protection Program Hit the Target?* (No. w27095). National Bureau of Economic Research.