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Mr David Bailey

Deputy Director, Head of Public Sector

Division National Accounts & Economic
Statistics Directorate

Office for National Statistics

Room 1.264, Government Buildings

Cardiff Road,

Newport NP10 8XG,

South Wales,

United Kingdom

Subject: Ex-ante advice on the classification of Companies House

Reference: Your letter of 26 June 2018, case 2017-70
Our discussion on 25 September 2018

Dear Mr Bailey,

Thank you for your ex-ante advice request on the classification of the Companies House dated 26 June 2018 and the discussion on this topic on 25 September 2018. After having closely examined the arguments in the documentation provided, Eurostat is now in a position to express a view on this matter.

1. THE CLASSIFICATION ISSUE

The issue is to analyse the decision taken by the Economic Statistics Classification Committee (ESCC) of the Office for National Statistics (ONS) concerning the statistical classification of the Companies House (CH) as a Central Government unit (S.1311). This decision has been questioned by the board of the CH. Therefore, the ONS requests Eurostat's opinion on the three following issues, whether:

- The charges on confirmation statements and incorporation levied by the CH should be considered as compulsory and unrequited and therefore as taxes;
- Eurostat agrees that even if the revenue from confirmation statements and incorporation was deemed to be from sale of a service, then the charges would not be considered economically significant under ESA 2010 and so CH would still be reclassified to Central Government subsector (S.1311);
- The activity of the CH should not be considered as a regulatory activity.

ONS considers that the CH is an institutional unit under government control as it satisfies the conditions set in ESA 2010 paragraphs 2.12 and 20.309 respectively. The CH is a profit making unit, which distributes its dividends to the owner (government) and therefore cannot be considered as a non-profit institution (ESA 2010 3.31).

Documentation provided

The ONS provided to Eurostat a copy of the following confidential documents:

- Classification case from ONS (case 2017-70) and supporting documents;
- Documents and arguments provided by the CH.

2. DESCRIPTION OF THE CASE

The Companies House (CH) is an executive agency of the Department for Business, Energy and Industrial Strategy (BEIS). The main statutory functions set out in the CH corporate framework document are the following:

- The incorporation of new companies and other entities, having the legal status of a limited liability partnership or company;
- The dissolution and striking off from the register of defunct companies and other entities;
- Ensuring compliance with the statutory information disclosure requirements of the Companies Acts and any other relevant legislation; and
- Making the information available for public inspection and use.

Any limited company/partnership has to register with the CH and has to file a minimum of two documents, namely: a confirmation statement and a set of annual accounts, together with the filing charge of £ 13 for an electronic filing and £ 40 for a paper filing. The charge covers also additional filings such as notices relating to secretaries' appointments, notices of a change in the registered office and notices of change of PSC details.

The non-observance of the filing requirement will trigger the CH inquiries to make sure if the company is still active, dormant or eventually defunct. If a company refuses to file, for several years, the CH starts the process of its strike-off and dissolution. A director refusing to comply with the filing obligation will be seen responsible for triggering an enforcement action. The sanction would likely result in the disqualification of the director, while the company will remain on the register.

2.1. CH funding

CH is mainly funded by the payments of the registered companies. Prices are fixed to cover the CH's costs plus a limited profit margin (maximum 3.5%). CH carries out its cost analysis, sets the level of fees to ensure they cover the costs and drafts the fees regulation for ratification by the Parliament, which has the final decision. The compulsory fees are bundled and cover several CH's activities such as registration, reminders for filing (sent out by CH if annual filing is delayed) or inquiries on documents delivered. Companies can choose extra treatment (i.e. fast registration, paper submission...) and incur higher payments.

In the past, the access for users was subject to a fee payment. Nowadays, access for users (households and corporations) to the regulatory information is free of charge and only legacy information is charged.

2.2. CH regulatory activity

The existence and maintenance of a public register is a regulatory function, including under European regulation. Limited liability companies that choose to be registered in the UK are required to comply with a statutory regulatory regime, a component of which includes delivering information for publication on a register. Without the Register, those companies could not comply with their legal obligations.

CH provides the service of supporting the companies to comply with their statutory obligations towards the register fixed by law. Such obligation includes the registration, the annual filing of information and the strike-off of defunct companies. This information is made available to the public.

The non-observance of the filing requirement will trigger CH inquiries to make sure that the company is still active, dormant or eventually defunct. If a company refuses to file for several years, CH starts the process of strike-off and dissolution. A director refusing to comply with the filing obligation will be seen responsible for triggering an enforcement action. The sanction would likely result in the disqualification of the director, while the company will remain on the register.

In addition CH checks e.g. company names (if already registered) and the appearance of potential directors with the Register of Disqualified Directors.

3. METHODOLOGICAL ANALYSIS

Classification decision of the Economic Statistics Classification Committee (ESCC)

The ESCC reached the conclusion that:

- The CH has to be considered as an institutional unit under public control;
- Revenues received by the CH should be considered as compulsory and un-requested and therefore as taxes;
- The activity of the CH cannot be considered as a regulatory activity.

Therefore, the ONS concluded that the CH should be classified in Central Government sector (S.1311).

Applicable accounting rules

Based on the documents provided, Eurostat carried out its analysis on the three issues raised by the ONS, considering ESA 2010, in particular Chapters 3, 4 and 20, as well as the Manual on Government Deficit and Debt (MGDD 2016) in particular the Sections I.2.4 and I.2.8 as well as the Chapter I.6.

Analysis

3.1. The Companies House being a market regulatory body?

The CH main function is to incorporate and dissolve limited companies, register the information companies supply under statute, and to make that information available to the public.

The MGDD 2016 I.6.5.1 §30 states:

"Market regulatory bodies (also named authorities, agencies, regulators, etc.) described in this chapter are entitled by law with the powers to elaborate some regulations (norms, provisions, obligations, etc.). These regulations are legally binding and any actor on the market for a given activity is obliged to follow them, at the risk of possible prosecution (sanctions). Thus, market regulatory bodies exert decision-making on some key variables, influencing the way in which units carry out an activity and receive revenue from it."

In contrary to the foregoing, the CH is not entitled to set compulsory regulations for registered companies. It implements the regulatory decisions of the UK Parliament.

In addition I.6.5.1 §31 of the MGDD 2016 specifies, that:

"Market regulatory bodies may also be responsible for controlling norms, although this task could be delegated to a specialised unit without normative powers. In addition, market regulatory bodies may also exert ex-ante control on the agents wishing to take part in an activity in order to assess their competence, professional capacity (licenses, permits to operate) and provide some assurance to consumers on the professional expertise and qualification of the professional category (doctors, lawyers, etc.). [...]"

Some activities of the CH include control of a company name prior to registration of a company as well as checking potential directors against the Register of Disqualified Directors and their capacity to act as such. This cannot be assimilated to controlling norms. Moreover, this activity can only be considered as ancillary, compared to the main CH activity consisting of controlling the completeness of compulsory documents provided. As a consequence of the aforementioned, CH could not be considered as a regulatory body.

3.2. The CH's revenues being taxes or revenues from sales?

Taxes are defined as compulsory and unrequited payments levied by government on individuals or corporations (ESA 2010 4.77, 4.79 (d) and 20.165). They are compulsory because they are being due by each individual or corporation or at least by a defined group of individuals or corporations fulfilling certain conditions or willing to exercise a specific activity. They are unrequited as government does not deliver a specific service in line with this specific tax.

The MGDD 2016 I.2.4.8 specifies the borderline between taxes and sales of services:

"In assessing whether a unit is market or non-market, it is necessary to check whether a unit's income from non-government sources should be classified as sales or as something else. For example, payments made for permissions to carry out a given business or personal activity (usually evidenced by a license), should be treated as sales of services only if the

revenue is used to organise some proper regulatory function associated with the permission (such as checking the competence or the qualification of the person concerned, suitability or safety of the business premises, reliability or safety of the equipment employed, quality or standard of goods and services produced), and if the payments do not significantly exceed the cost of providing the services. However, the degree of obligations for the payers should also be considered, as there may be situations where the economic agents cannot carry out a given activity without holding a specific permission, so that the price should in no way influence the number of bid and asked permissions. Such payments should be treated as taxes if either of those conditions is not satisfied (see ESA 2010 4.79 (d)) and, therefore, the unit classified within general government or, in some cases, the payments rerouted via government since only government has the power to levy taxes."

Limited companies / partnerships will have to comply with the obligation to register and to deliver annual compulsory information to the CH. Each registered company / partnership has to pay an annual bundled fee. Without this fee the company confirmation statement is not accepted. The function of the confirmation statement being to provide an affirmation that the company has checked the accuracy and actuality of the information included in the register. If the information is incomplete or missing, the CH requests the missing information. A continued refusal of a still active company to comply with its statutory obligations will trigger enforcement actions and the sanction would likely result in the disqualification of the director, while the company will remain on the register. Thus, these payments should be considered as compulsory. Although the UK law gives the possibility to organise a business under conditions, which do not include a compulsory registration, all limited companies acting under this specific regulation have to comply with this obligation.

In order to assess whether the payments are required or unrequired, it is necessary to analyse the counterpart received by the registered corporation / partnership. The company / partnership receives a confirmation status and can act as a limited company. As a result, the shareholders benefit from the limitation of any risks associated to the business carried out to amount of the subscribed shares. However, this benefit results from law, not from the fact of being registered. In contrary, one of the statutory functions of the CH is to make this collected information available to the public for free. As such the CH delivers services to the whole community. Thus, the payments by the registered companies / partnerships should be considered as unrequired.

A further aspect is that the CH is an artificial monopoly, created by law, over the registration of limited companies / partnerships, which makes registration and filing compulsory for benefiting from this limited liability status. The compulsory element of the charges due to the monopolistic position of the CH and the tight link between the charges and the role of the CH may point to recognising the fiscal nature of the charges in national accounts.

Thus, the main portion of the revenues (> 75% are coming from confirmation statements and incorporations) should be considered as taxes and not being included in the calculation of the market / non-market test (ESA 2010 20.30 – 31).

The payments due to the CH are presented as bundled fees, which include the filing of several documents. Therefore these payments do not cover the same activity for each transaction. As an example, one company presents only the registration of the annual filing and the annual set of accounts, while another company needs to submit also other information which is required, for the same amount.

In addition, the fact that registered companies / partnerships have to make the payments to the CH, while the public users can access the regulatory information for free, includes a distributive element and therefore satisfies the definition of taxes.

3.3. Should the payments made to the CH be considered as economically relevant?

An additional, however hypothetical, aspect is to determine whether the prices charged could be recognised as economically significant. ESA 2010 3.19 defines the notion of economically significant prices if the charges would not be recognised as taxes:

"Definition: economically significant prices are prices that have a substantial effect on the amounts of products that producers are willing to supply and on the amounts of products that purchasers wish to acquire. Such prices arise when both of the following conditions apply:

- (a) the producer has an incentive to adjust supply either with the goal of making a profit in the long run or, at a minimum, covering capital and other costs; and*
- (b) consumers have the freedom to purchase or not purchase and make the choice on the basis of the prices charged.*

ESA 2010 20.23 recalls the guidance on economically significant prices of ESA chapter 2 when output is sold to households and corporations:

"Economically significant prices normally result when two major conditions are fulfilled:

- (1) The producer has an incentive to adjust supply either with the goal of making a profit in the long run or, at a minimum, covering capital and other production costs, including consumption of fixed capital, by sales; and*
- (2) Consumers are free to choose on the basis of the prices charged."*

The MGDD 2016 I.2.4.1 gives further indications:

"ESA 2010 states that the distinction between market and non-market producers depends on whether or not prices charged for sales of goods and services are economically significant (see ESA 2010 20.19 and following paragraphs). A price is said to be economically significant when "it has a substantial influence on the amounts of products the producers are willing to supply and on the amounts of products that the purchasers wish to acquire." The capacity of producers and consumers to react to economic "signals" is fundamental as to assess market behaviour. Conversely, a price is said to be not economically significant when it has little or no influence at all on how much the producer is prepared to supply and have only a minor influence on the quantities demanded. It is thus a price that does not determine the observed levels of supply or demand."

The determination of the prices charged by the CH is based on an expected costs calculation plus a profit margin of maximum 3.5%. It is questionable whether CH is able to fix freely the prices directly. Most of the prices charged by CH are set through legislation by the Secretary of State¹ and are governed by a legislative framework.

CH might have an incentive to adjust supply with the objective to cover production costs and to meet the annual objective of a return on capital of 3.5% set by government. Registered companies are not free to choose the amounts charged once they have registered as a limited company / partnership as they are required by law to deliver regulatory information and pay the relevant charge. Finally the payments are not linked to the volume of output value, as those are fixed for the delivery of a bundled service, whether used or not by the registered company / partnership. As a consequence of the foregoing, the demand for CH services cannot be seen as linked to the prices charged and the user not having any choice than to registering with CH.

So, neither the CH has an incentive to adjust the supply of the services provided with the aim to increase its profitability nor the registered company / partnership has the choice to register with the CH based on the amounts charged after having taken the decision to be incorporated as a limited company / partnership. Therefore, the payments to CH (if not considered as taxes) cannot be considered as economically significant.

4. EUROSTAT'S VIEW

Eurostat agrees with the ONS analysis:

- That the CH cannot be considered a regulatory body because the regulatory activity represents only a minor part of CH's activity (MGDD 2016 I.6.5.1)
- that the payments made to the CH should be considered, most of the amounts charged, as taxes (ESA 2010 4.23 and 4.79, MGDD 2016 I.2.4.8).

In a purely theoretical consideration based on the assumption that payments are not taxes, Eurostat considers that the amounts charged by the CH could not be considered as economically significant (ESA 2010 3.19 and 20.23, MGDD 2016 I.2.4.1).

The activity of the CH includes some regulatory activity, which is however only limited. The main activity is to registering the documents legally required to be produced by each registered company / partnership. The latter cannot be considered as a regulatory activity.

The payments due to the CH for the annual filing and the registering of incorporations has to be considered as taxes, because the payment of the annual filing is compulsory. The amount charged makes no difference between the work to be carried out by the CH and the counterpart of the annual filing is a confirmation that the filing has been made. In addition, the whole public benefits for free from the general information made available by the CH.

As a consequence, Eurostat considers that CH should be classified within the general government sector (S.13).

¹ http://www.legislation.gov.uk/ukxi/2016/621/pdfs/ukxi_20160621_en.pdf

5. PROCEDURE

This view of Eurostat is based on the information provided by the UK authorities. If this information turns out to be incomplete, or the implementation of the operation differs in some way from the information presented, Eurostat reserves the right to reconsider its view.

In this context, we would like to remind you that Eurostat is committed to adopt a fully transparent framework for its decisions on debt and deficit matters in line with Council Regulation 479/2009, as amended, and the note on ex-ante advice, which has been presented to the CMFB and cleared by the Commission and the EFC.

Eurostat is therefore publishing all official methodological advice (ex-ante and ex-post) given to Member States on its website.

Yours sincerely,

(e-Signed)

Luca Ascoli
Acting Director