PO-CH/NL/0341 PARTA

CONFIDENTIAL

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PO -CH /NL/0341

PART A

1988 CAPITAL DUTY AND UNIT TRUST INSTRUMENT DUTY

PO -CH /NL/0341

PART A

DD's 25 years N.A 3/3 10/11/95.

7-3-88

4368/24

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FINANCIAL SECRETARY TO THE TREASURY

FROM: **J J HEYWOOD**
DATE: **25 November 1987**

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Scholar
Mrs Lomax
Mr Culpin
Mr Tyrie
Mr Cropper
Mr Jenkins - OPC
Mrs Jackson - Bank
Mr Willis - IR
PS/IR

Ch/ Content to drop this starter?
JT 25/11

OK – but reconsider in a yr's time

STARTER 303: ABOLITION OF UNIT TRUST INSTRUMENT DUTY (UTID)

The Financial Secretary has read Mr Willis' submission of 24 November.

2. He is not inclined to pursue this starter. He thinks that there might have been a case for abolishing UTID if life assurance duty and capital duty could have been abolished at the same time.

3. But since it would seem odd to abolish life assurance duty in advance of the general review of the taxation of this sector, and since the EC issue makes abolition of capital duty look rather premature, the Financial Secretary does not think that the package is a starter.

4. His general impression, in any case, is that the financial services sector generally is, if anything, undertaxed at present.

J.H.

J J HEYWOOD
PRIVATE SECRETARY

PS/FST TO PS/CX 25 NOV

CONFIDENTIAL

FROM: R B WILLIS

Inland Revenue

Policy Division
Somerset House

1. MR CORLETT

24/11

24 NOVEMBER 1987

2. FINANCIAL SECRETARY

STAMP DUTY: ABOLITION OF UNIT TRUST INSTRUMENT DUTY: STARTER 303

The Chancellor asked for the abolition of unit trust instrument duty (UTID) to be included as a Budget starter. The attached paper considers this, together with the options for reducing or abolishing capital duty on the issue of new equity and the duty on life assurance policies. It has been prepared in consultation with FP, FIM and the Bank.

2. The paper's conclusions (paras. 20-24) are in summary:

a. UTID

the cost of abolishing UTID is relatively low (£30m or less in 1988-89) and could be justified if Ministers wish to give some modest encouragement to investment in Unit trusts. Managers of unit trusts would no doubt be grateful. There would however be little impact on the market for unit trusts or their competitors, and little if any discernible gain for

---

cc Chancellor
CST
PMG
EST
Sir Peter Middleton
Mr Scholar
Mrs Lomax
Miss Sinclair
Mr Ilett
Mr C J Riley
Mr Neilson
Mr Tyrie
Mr Cropper
Mr Jenkins (Parl. Counsel)
Mrs Jackson (Bank
Mr A Clarke (Bank)
Mr Isaac
Mr Corlett
Mr Beighton
Mr Calder
Mr Johnston
Mr Cleave
Mr Spence
Mr Gonzalez
Mr Pipe
Mr Pape
Mr Adderley
PS/IR
Mr Willis

WILLIS TO FST 24 NOV

investors. If the Budget has wider changes affecting unit trust investors there is unlikely to be much attention to the abolition of a minor duty. There is also the risk of claims from investment trust companies (and others) for a reduction in capital duty and from life companies for abolition of life assurance duty. If conceded these would increase substantially the cost.

Abolition of UTID is thus a lollipop which could be given to unit trusts in 1988 or reserved to sweeten a future Budget.

b. life assurance duty

there is no case for acting on life assurance duty ahead of the wider review of the taxation of life companies;

c. capital duty

abolition of capital duty would help reduce the costs of raising capital. The saving of 15 Stamp Office staff would be a welcome reduction, especially if there is no increase in the threshold for stamp duty on property. But the cost of over £m300 would obviously need to be considered in the wider context of the Budget package where there are other options - including the stamp duty threshold itself. The Bank's view is that capital duty should be abolished at a suitable time, and that 1988 could be the right time if there will be no change in the rate of stamp duty on shares. Others of us feel it would be premature to abolish capital duty when there is still the possibility of an EC Directive forbidding stamp duty on share transactions.

3. If abolition of UTID is made a firm part of the Budget package we should like to consult DTI officials, on a Budget Confidential basis, on three points:

a. would unit trust managers pass on the savings? UTID is a factor in the pricing formula for units. New rules for authorised unit trusts are currently being discussed by managers, the SIB and DTI. It is not clear whether they will result in abolition of UTID reducing the spread between bid and offer price, reducing managers' initial charges (typically 5%) or increasing profit for managers;

b. could fund managers ~~could~~ cope efficiently with abolition of UTID when they will be implementing the new rules and regulations devised by the SIB?

c. could we take the opportunity to rationalise the rules for managers' purchases of units so they are within the mainstream stamp duty and SDRT relief for market makers in shares - a change which would reduce the scope of the existing relief and halve the cost of abolishing UTID?

R WILLIS

CONFIDENTIAL

TABLE 1

UNIT TRUST INSTRUMENT DUTY (UTID) AND CAPITAL DUTY

PRESENT POSITION

	Revenue (£m)		Staff cost
	1988/89	1989/90	(1/4/87)
UTID	30	35	neg
Capital Duty	330	380	20

SUMMARY OF OPTIONS

	cost (-) / yield (+)		Staff effects	
	1988/89	1989/90	1/4/89	1/4/90
1. abolish UTID	-30	-35	neg	neg
2. abolish UTID and withdraw exemption for sales and purchases of Units	-15	-15	neg	neg
3. abolish UTID and capital duty	-360	-415	-15	-15
4. abolish UTID and reduce rate of capital duty to 0.5%	-190	-225	neg	neg

<u>Note</u>

These are illustrative figures. The yield from UTID could be considerably lower - perhaps as low as £m15 - if the slump in sales post-October continues into 1988-89. Yield from capital duty could similarly be effected by a down-turn in takeovers, rights issues and new listings.

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TABLE 2

ARGUMENTS FOR AND AGAINST UTID AND CAPITAL DUTY

For abolition	For retention
I. UTID	
double charge on creation of units and underlying shares, and in principle on transfers	maintains rough parity between unit trusts and investment companies
Unit trusts should be encouraged as a proxy for (and lead into wider share ownership by small investors	most transfers of Units free from duty in practice because of special relief for managers' dealings
DTI support	low profile of UTID
removes one of the obstacles to new types of funds	Regulatory power to take special cases out of UTID
simplification	part of package with capital duty, life assurance duty
II UTID AND CAPITAL DUTY	
reduces cost of raising capital	raises over £m300 a year with little fuss
lifts burdens on business	small cost compared with fees to advisers, underwriters etc on coming to the market
staff savings and simplification	

CONFIDENTIAL

ABOLITION OF UNIT TRUST INSTRUMENTS DUTY (UTID) AND CAPITAL DUTY

This note which has been agreed with Treasury and Bank officials:

i. describes unit trust instrument duty (UTID) and capital duty;

ii. considers the arguments for and against abolishing one or both taxes.

It does not describe in detail the possible effects on the administration of unit trusts and the possible (small) benefits to investors. It would be necessary to discuss these with DTI officials if detailed advice and estimates were required.

UNIT TRUST INSTRUMENT DUTY

2. UTID is charged at 0.25% on all property put into a unit trust, when the trust is set up or subsequently. It applies not only to traditional authorised unit trusts but to all the collective investment schemes within the wide definition in the Financial Services Act (eg unauthorised unit trusts, property unit trusts and single property schemes). However most of the yield comes from the authorised schemes.

3. UTID is broadly equivalent to the capital duty which investment companies and other companies pay at 1% when they issue shares. The difference between the rates is partly because the duties evolved from different origins, but has been justified by arguing that investors in a unit trust could bear more stamp duty than direct investors because:

a. the underlying assets of a unit trust bear duty on transfers in the usual way ie 0.5% on shares and 1% on real property; and

b. transfers of the units themselves are liable to 0.5% stamp duty or SDRT.

4. However there is a special relief for units sold back to the managers of unit trusts and then cancelled within 2 months. In practice this means the majority of transfers of units do not bear duty because they pass via managers who cancel the vendor's units and issue new units to purchasers.

CAPITAL DUTY

5. Capital duty had to be introduced in 1973 to meet an EC Directive which imposed a mandatory 1% tax on capital raised by companies. There is very limited room for manoeuvre on the scope of this charge. However unit trusts are specifically exempt.

6. Since 1985 member states have been free to reduce the rate of capital duty below 1% or abolish it altogether. Belgium has now a rate of 0.5%. We know of no other changes.

LIFE ASSURANCE DUTY

7. To complete the picture of stamp duties in this area we should mention the duty on life assurance policies. This is charged at 0.05% of the sum assured. It yields about £m60 a year.

ARGUMENTS FOR AND AGAINST UTID

8. The main arguments for abolishing UTID are:

a. unit trust holders bear, directly or indirectly, more duty than portfolio investors. There is a double charge on the creation of units because the shares underlying traditional (authorised) unit trusts have already borne capital duty;

b. in theory at least there can be a double charge (on the transfer of units and on transfers of the underlying assets) which breaches the principle of transparency we have accepted for CGT on authorised unit trusts;

c. it should reduce a bit the cost of investments in unit trusts and/or the spread between bid and offer prices; we cannot quantify the effects but £30m or so less would be taken out of the funds.

d. it would remove one of the sources of complaints from managers who want to create new types of unit trust eg to invest in property or money markets;

e. unit trusts will have in future to pay fees to the SIB for authorisation: Sir Kenneth Berrill expects managers to argue that the Government will be saving the cost of DTI's supervision and should therefore reduce its tax take;

f. simplification: it is a relatively cheap way to abolish a tax.

8. Against abolition is:

a. the advantage it would give unit trusts over investment trusts (unless capital duty was also abolished - see below). Investment trusts could argue that they were facing unfair competition. We think they would not in practice lose business because they operate under very different regulatory regimes and their markets are by no means the same investors. But they would have a logical case.

b. the special relief unit trusts have already from stamp duty on transfers of units, which means most units are in practice bought and sold through fund managers, free from any tax on the transaction. Unit trusts have a good case for some relief from SD/SDRT in order to make a market in units, just as market makers in shares have stamp duty and SDRT exemptions. However market makers in shares have exemption only for their purchases, not their sales. Hence a sale and purchase of shares via a market maker bears one 0.5% charge while a sale and purchase of units via a manager often bears no charge at all.

c. special cases can be taken out of the unit trust regime by Regulation. Provision was made in the 1987 Finance Act to deal with investment schemes which come within the definition in the Financial Services Act but do not have the characteristics of a traditional unit trust.

d. the £m30 or so from UTID is easy (and relatively painless) revenue.

e. the life assurance companies could argue they had an equally good case for the abolition of life assurance duty. This will be looked at as part of the review of life assurance the Chancellor announced in 1987, and could be part of a wider package of reforms, although most European counties have a similar flat rate charge on life policies.

f. UTID is built into the DTI's (and now the SIB's) pricing formula. Removing it in 1988 would cause further disruption just as managers were trying to apply the new regime.

g. the saving is so small that, while fund managers will be pleased, individual investors will not notice the change. Indeed it is not clear that the benefit will be passed on directly.

h. there are negligible staff and running costs savings for the Stamp Office.

ARGUMENTS FOR AND AGAINST CAPITAL DUTY

10. For abolition there is:

a. it would reduce by about 1% the cost of new capital;

b. it would simplify the setting up of a company (consistent with the policy of reducing burdens on businesses);

c. it would leave unit trusts and investment trusts on a more or less equal footing.

d. 15 staff savings and simplification of stamp duties.

11. Against abolition there is:

a. the revenue of about £m300 a year from a tax which has a low profile with the general public;

b. the 1% rate is low compared with the total costs of raising capital, so the supply side benefits would be relatively small (and therefore expensive).

c. the deterrent effect of capital duty against securitisation of property: in order to exploit the lower rate of stamp duty on transfers of securities than on property the property has to be put into a company.

OPTIONS

12. We assume Ministers will not wish to act on life assurance duty in advance of the wide-ranging review of the taxation of life business generally.

13. There are then various permutations of action on UTID, on the special relief for fund managers and on capital duty. We consider below 4 main options.

(1) abolish UTID alone

14. This would be the most cost-effective option if Ministers wish to help unit trusts in particular. It would also be a small but welcome simplification of the stamp duties (albeit one with no staff savings).

15. There could however be complaints from investment trusts about unfair discrimination. Ministers would need to be ready to resist the investment trusts' arguments for a reduction in capital duty as well.

(2) abolish UTID and the special relief for transfers of units through managers

16. A package which abolished UTID and the stamp duty relief for transfers between unit-holders and managers would be cheaper and easier to defend to investment companies. However unit trust managers could protest that the Government was giving with one hand and taking away with the other. We can recommend this option as a low-cost way of abolishing UTID and tidying up the legislation, but cannot say the unit trust managers would applaud loudly.

(3) Abolish UTID and capital duty

17. This is the simplest package, and in some ways the most attractive, if the revenue cost can be afforded. There would be a welcome saving of 15 staff in Stamp Offices, and simplification of the stamp duty system. The costs of raising capital would be reduced, making equity more attractive relative to other sources of finance. The cost would need to be considered in the context of the wider Budget package.

18. Looking further ahead to the possibility of an EC directive which forbids taxes on transactions in securities Ministers could however be left with neither capital duty on the issue of shares nor stamp duty or SDRT on their transfer. There would be less room for manoeuvre in the Budget to achieve the desired spread of taxation.

(4) Abolish UTID and reduce capital duty to 0.5%

19. This is a compromise between options (3) and (1). UTID would go. Investment companies could be told they had gained both in absolute terms and relative to unit trusts from a reduction in the difference between capital duty and UTID (from 0.75% to 0.5%). All companies would gain from a small reduction in the cost of raising equity. But it is not cheap at some £m200 and does not save significant amounts of work in Stamp Offices.

SUMMARY AND CONCLUSIONS

UTID

20. The case for abolishing UTID is mainly that investment in a unit trust should bear no more duty, directly or indirectly, than investment in the underlying property. If this argument can be restricted to unit trusts, and the cost of up to £m30 can be afforded, there is no fiscal policy objection to abolishing the duty.

21. There is a general argument for removing duty in order to remove distortion between investment decisions. However we would not expect the abolition of UTID to have a major impact on the market for unit trusts or their competitors.

22. There are then three wider issues which may militate against action in the 1988 Budget:

   a. it is not obvious that the savings from abolition of UTID would be passed on to investors;

   b. abolition of UTID in the midst of all the other changes unit trusts are facing as a result of the DTI's and SIB's new regulatory regime might add to managers' administrative problems;

   c. although unit trusts would no doubt welcome the abolition of UTID there would be little if any obvious benefit for investors. If the Budget makes other, wider changes affecting investments in unit trusts (or the better of who have such investments) the abolition of a minor stamp duty could pass almost unnoticed. This obviously needs to be considered in the context of the overall Budget package, but Ministers might wish to consider keeping in reserve the abolition of UTID as a sweetener for a year when there is little else of benefit to unit trusts.

23. If Ministers decide to make abolition of UTID a firm proposal for 1988 we should like to discuss with DTI officials, on a Budget Confidential basis, the practical effects and the possibility of ending the special rules for unit trust managers by bringing them within the mainstream relief for market makers.

<u>Life assurance duty</u>

24. We recommend no change to the duty on life assurance policies ahead of the wider review of the taxation of life assurance.

<u>Capital duty</u>

25. The main arguments for abolishing capital duty are to reduce the cost of raising equity, and to simplify the tax system (with savings of 15 Stamp Office staff). The Bank think it would be right to abolish capital duty at some time, and moreover that the 1988 Budget might be the right time if there is sufficient room for manoeuvre in the overall package (and there is no reduction in the rate of stamp duty on transfers of shares which would be their priority). However others of us do not feel 1988 would be a ripe time. There is still the possibility of an EC Directive on taxes or securities which will require the abolition of stamp duty on shares, and remove one major source of revenue from equities. Abolishing the other major source now could leave Ministers with no means to tax equities. And in the context of the wider

CONFIDENTIAL

Budget package we feel other options are likely to have priority for the £m300 or more of revenue from capital duty - including the option of reducing stamp duty on houses.

INLAND REVENUE
SOMERSET HOUSE
NOVEMBER 1987

MR 2/20

CONFIDENTIAL

FROM: J M G TAYLOR
DATE: 30 November 1987

PS/FINANCIAL SECRETARY

cc: PS/CST
PS/PMG
PS/EST
Sir P Middleton
Mr Scholar
Mrs Lomax
Mr Culpin
Mr Tyrie
Mr Cropper
Mr Jenkins - OPC
Mrs Jackson - Bank
Mr Willis - IR
PS/IR

STARTER 303: ABOLITION OF UNIT TRUST INSTRUMENT DUTY (UTID)

The Chancellor has seen your note of 25 November. He is content to drop this starter. He would like to reconsider it in a year's time.

J M G TAYLOR

BUDGET CONFIDENTIAL FROM: R B WILLIS

Inland Revenue

Policy Division
Somerset House

28 January 1988

1. MR CORLETT ~~~~ 29/1

2. FINANCIAL SECRETARY

I do not favour any change in the SD threshold this year. But it is worth looking again at the case for abolishing capital duty this year, & possibly UTD too, as part of a tax reform package. I shd be grateful for FST's urgent views. NL

PS. also let me have a note on the treatment of unit trusts & mutual life offices, looks in the light of this reform

WILLIS TO FST 28 JAN

STAMP DUTY: £30,000 THRESHOLD: STARTER 300

This note reports the latest forecasts of yield from stamp duty, and gives revised estimates of the cost of increasing the £30,000 threshold for transfers of land and buildings.

2. Your view in November was that there was a good case for doing nothing on stamp duty on land and buildings in 1988, although you wished to consider nearer the Budget the level of the threshold (Mr Heywood's minute of 23 November). You may wish to look again now, in the context of wider Budget changes, at the case for an increase in the threshold.

Chancellor	Chairman
Chief Secretary	Mr Isaac
Paymaster General	Mr Painter
Economic Secretary	Mr Corlett
Sir P Middleton	Mr Beighton
Sir T Burns	Mr Calder
Sir G Littler	Mr Gonzalez
Mr Anson	Mr Pipe
Sir A Wilson	Mr Adderley
Mr Byatt	PS/IR
Mr Scholar	Mr Willis
Mr Culpin	
Mr Sedgwick	
Mr Odling-Smee	
Miss Sinclair	
Mr Riley	
Miss C Evans	
Mr Hudson	
Mr Cropper	
Mr Tyrie	
Mr Call	

STAMP DUTY ON LAND AND BUILDINGS

3. The forecast of house prices now shows rather smaller increases in the next couple of years, as a result of which the forecast yield for 1989-90 is about £200 million lower than in my note of 10 November. The revised forecasts, and the effects of increasing the threshold to £40,000 or £50,000 are as follows:

TABLE 1: LAND AND BUILDINGS

	Revenue (£m) 1988/89	1989/90	Staff effect 1/4/89	1/4/90
present position	1,310	1,450	+10	+10
	Revenue effect (£m)			
increase threshold to £40,000	-310	-360	-10	-10
increase threshold to £50,000	-490	-570	-20	-20

5. The revenue cost in 1989-90 of a higher threshold is about 10% lower than before, corresponding to the lower forecast of yield. Apart from this, the arguments for and against an increase are unchanged from the paper we sent you in November. It is essentially a choice between, on the one hand, the tax revenue and, on the other, reducing the stamp duty paid by first-time buyers (and others) buying below the threshold and savings on Stamp Office staff and running costs.

6. There are no major operational pressures for an early decision. A straightforward increase in the £30,000 threshold could be implemented from Budget day provided we have a decision by, say, the end of February.

STAMP DUTY ON TRANSFERS OF SHARES

7. The forecasts of stamp duty and stamp duty reserve tax (SDRT) depend on the value of transactions. With the latest Treasury forecasts, showing much faster growth in turnover than previously assumed, the yield from stamp duty and SDRT would increase rapidly after 1988-89:

TABLE 2: SHARES

	£m
1987-88	970
1988-89	980
1989-90	1380

8. However these are highly uncertain forecasts and do not alter significantly the basis on which you decided not to change the rate of duty on shares in the 1988 Budget.

CAPITAL DUTY, UNIT TRUST INSTRUMENT DUTY AND LIFE ASSURANCE PREMIUM DUTY

9. The Treasury expect a massive decrease in the number and value of new equity issues. As a result the forecast yield from capital duty is much lower than the figures (over £m 300) previously expected.

10. Yield from unit trust instrument duty (UTID) and life assurance premium duty (LAPD) is also now expected to be lower.

11. The revised forecasts are as follows:

TABLE 3: OTHER DUTIES

£m

	Capital duty	UTID	LAPD	total
1987-88	240	30	70	340
1988-89	40	20	50	110
1989-90	55	25	55	135

12. We would not put a great deal of confidence in these forecasts. In particular the yield from capital duty is so far holding up well following the changes in the equity market. But the forecasts certainly make abolition of UTID or capital duty (or both) look more attractive.

13. The Chancellor has already indicated that abolition of UTID should be reconsidered next year.

14. Abolition of capital duty also seems likely to be a live issue for the 1989 Budget. The proposed exemption for building societies which is provisionally included in the 1988 Bill may well generate pressure (this year or next) for either a general relief for incorporations or for the outright abolition of the tax.

SUMMARY

15. The revised forecasts of yield from stamp duty do not affect significantly the arguments for and against a change in the 1988 Budget to the £30,000 threshold for land and buildings. It remains essentially a matter of judgement, in the context of the wider Budget package and arithmetic.

R B WILLIS

002/3651

BUDGET CONFIDENTIAL

? Arrived 5/2

FROM: A G TYRIE

DATE: 2 FEBRUARY 1988

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mr Cropper
Mr Call

Ch/ You have previous pps. on this.
AT 5/2

FST let me have them back — without [illegible] — for overview. N.

UNIT TRUST INSTRUMENT DUTY AND CAPITAL DUTY

I demur slightly from the Financial Secretary's conclusions on these in Mr Heywood's note of 3 February.

I think the case for getting rid of them is quite strong. We would obtain:

- Supply side benefits. Abolition would remove the small distortion in favour of loan capital in preference to equity capital in business start-ups. Abolition would thus remove a minor business burden and reduce the cost of new capital.

- Neutrality, by treating investment trusts and unit trusts equally.

- Simplification and staff savings.

In short abolition, albeit in a small way, would sit nicely with our overall tax objectives. We could claim that this budget got rid of a couple of minor taxes on enterprise/capital.

What's more, the revenue loss would probably be much smaller than the £300 million a year cited in Mr Willis' paper of

TYRIE TO CX

2[illegible] November. This is the forecast for the current, bumper year. I notice from Mr Heywood's minute that the forecast for 1988-89 has been reduced to only £40 million. Of course it may turn out to be more than that.

I don't think the argument that we must keep a taxable base in this area is very convincing. Even if the EEC did force us to abolish stamp duty on share transactions we would not be very upset.

pp A G TYRIE

FINANCIAL SECRETARY TO THE TREASURY

FROM: J J HEYWOOD
DATE: 3 February 1988

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Mr Scholar
Mr Culpin
Mr Ilett
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Battishill IR
Mr Isaac IR
Mr Painter IR
Mr Corlett IR
Mr Willis IR
PS/IR

Ch,
Agree with FST's advice:
OK.
– to retain cap. duty & UTID;
– to consider exempting (by regulation) the new money + conversion unit trusts from UTID;
– to examine all this after the Budget in the context of a gen. review of the taxation of savings?
4/2

Examine on cost, whether or not going with tax of bonds

CAPITAL DUTY AND UNIT TRUST INSTRUMENT DUTY (UTID)

The Chancellor asked for the Financial Secretary's views on whether capital duty, and possibly also UTID, should be abolished this year as part of a tax reform package (your minute of 1 February). The Financial Secretary originally concluded that action on capital duty in 1988 would be premature (my minute to you of 25 November, following Mr Willis' submission of 24 November).

PS/FST TO PS/CX 3 FEB

Capital Duty

2. The forecast yield from capital duty in 1988/89 has now been reduced from over £300m to £40m. Although officials stress that these figures are highly uncertain, it is likely that there will be some fall off in the number of new equity issues (and hence in the yield from capital duty) as a result of the stock market crash.

3. The Financial Secretary thinks that the reduced cost of abolishing capital duty - at least in the short-term - does change the arguments slightly. But he remains, on balance, opposed to abolition this year since:

(i) He doubts that capital duty hinders the raising of capital by companies, or distorts commercial decision making (by encouraging debt rather than equity financing);

(ii) It may be premature to abolish capital duty when there is still the possibility of an EC Directive forbidding stamp duty on share transactions;

(iii) Other countries levy capital duties, usually of 1%: we are not, therefore, uncompetitive in this area;

(iv) £40 million is still a substantial sum of money, and if new issues did not fall off by as much as forecast the cost of abolition would be more expensive still.

UTID

3. If capital duty were not abolished in 1988, the Financial Secretary thinks it would be difficult to abolish UTID since the Investment Trust industry would argue that this was a further discrimination in favour of unit trusts. The Financial Secretary thinks that the abolition of UTID might be held in reserve for 1989 when the unit trust industry may well need a sweetner.

4. However, the Financial Secretary does think that we need urgently to consider exempting the new money and currency unit trusts from UTID. The Revenue have said that this can be done

by regulation.

Conclusion

5. The Financial Secretary thinks there is a case for retaining capital duty and UTID at present. But he would be attracted to a coherent examination of all these duties (including life assurance duty) after the Budget in the context of a possible general review of the taxation of savings.

J.H.

JEREMY HEYWOOD
Private Secretary

ps3/77T BUDGET SECRET: TASK FORCE LIST

COPY NO. 28 OF 29.

FROM: J M G TAYLOR

DATE: 1 February 1988

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Sir A Wilson
Mr Byatt
Mr Scholar
Mr Culpin
Mr Sedgwick
Mr Odling-Smee
Miss Sinclair
Mr Riley
Miss C Evans
Mr Hudson
Mr Cropper
Mr Tyrie
Mr Call

Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Corlett - IR
Mr Willis - IR
PS/IR

STAMP DUTY: £30,000 THRESHOLD: STARTER 300

The Chancellor has seen Mr Willis's minute of 28 January.

2. He does not favour any change in the SD threshold this year. But it is worth looking again at the case for abolishing capital duty this year, and possibly UTID too, as part of a tax reform package. He would be grateful for the Financial Secretary's urgent views on this.

3. He would also be grateful for a note on how the CGT treatment of unit trusts and mutual life offices looks in the light of CGT reform.

JT

J M G TAYLOR

JMGT TO PS/FST 1 FEB

CONFIDENTIAL

Inland Revenue

FROM: R B WILLIS
Policy Division
Somerset House

PPS p!

BF 19/2

12 FEBRUARY 1988

1. MR CORLETT 12/2

2. MR ISAAC 12.2

3. FINANCIAL SECRETARY

FIM advice still awaited. 1 sec.

WILLIS TO FST 12 FEB

UNIT TRUST INSTRUMENT DUTY AND CAPITAL DUTY

The overview meeting on 8 February decided that further consideration should be given to the abolition of unit trust instrument duty (UTID) and capital duty.

2. The options are to abolish

a. UTID; or

Chancellor	Chairman
Chief Secretary	Mr Isaac
Paymaster General	Mr Painter
Economic Secretary	Mr Corlett
Sir P Middleton	Mr Beighton
Sir T Burns	Mr Calder
Sir G Littler	Mr Gonzalez
Mr Anson	Mr Haigh
Sir A Wilson	Mr Pipe
Mr Byatt	Mr Adderley
Mr Scholar	Mr McManus
Mr Culpin	PS/IR
Mr Sedgwick	Mr Willis
Mr Odling-Smee	
Miss Sinclair	
Mr Riley	
Miss C Evans	
Mr Hudson	
Mr Cropper	
Mr Tyrie	
Mr Call	
Mr Unwin (C & E)	
Mr Knox (C & E)	

b. UTID and capital duty

(Abolishing capital duty while retaining UTID would be both illogical and, I think, impossible to defend).

ABOLITION OF UTID

3. The main argument against abolishing UTID alone is that it would give unit trusts an advantage over investment trusts and life assurance companies.

4. The answer to life assurance companies might be that duty on their policies will be considered in the review of the taxation of life assurance announced last year.

5. Finding an answer to investment trusts is harder. After looking again at the differences between them and unit trusts the only realistic option seems to be to say that:

a. investment trusts are subject to capital duty like any other company; and

b. capital duty has been a significant source of revenue; but

c. the possibility of reducing (or abolishing) capital duty will be reviewed.

6. Whether or not this would mollify the investment trusts is a matter of judgement. And it would reduce the newsworthiness of abolishing capital duty in 1989.

ABOLITION OF CAPITAL DUTY AND UTID

7. FIM are advising on the market implications and costs of this. I would add only one comment to my previous notes; this is on the forecasts of revenue costs.

8. The forecast yield from capital duty was reduced to £35m in 1988-89 and £55m in 1989-90 on the basis of forecasts of equity issues provided by the Treasury. This seemed to us inconsistent with the actual receipts from capital duty since October (although those will not fully reflect the effects of the Stock Exchange crash).

9. We understand the Treasury have now revised upwards the forecasts of equity issues. We will let you have corresponding revised figures for capital duty shortly. But we would expect a figure around £100 million a year.

10. This is of course not an argument of principle against abolishing duty. But I think you would need to be ready to defend giving up prospective yields of £m100 or so.

R B WILLIS

This underlines the point I made at the Overview meeting that the costings depend on a (necessarily speculative) guess by Treasury officials about the future levels of Stock Exchange activity over the next 12 months or so.

C.E.P.
12.1

FINANCIAL SECRETARY TO THE TREASURY

1989 starts. N.

FROM: FINANCIAL SECRETARY
DATE: 15 February 1988

OK: we will drop these now & reinstate them as

CHANCELLOR

FST TO CX 15 FEB

UNIT TRUST INSTRUMENT DUTY AND CAPITAL DUTY

I just want to stress a few points on this.

(a) If we abolish UTID but not Capital Duty the Investment Trust industry will howl in protest. There will be a wholly disproportionate fuss!

(b) Therefore I think we need to abolish both or neither in 1988.

(c) On Capital Duty we are hampered by not having a credible forecast for receipts in 1988/89 and 1989/90. If the cost of abolition (in the year after a major stock market crash) is as high as £100 million I do not think it is worth contemplating.

(d) For £100 million we will be buy ing very few benefits. We are not uncompetitive internationally; the distortion in favour of debt-financing will not be removed by this minor measure; the staff savings will be of second-order.

(e) Officials are preparing a substantial paper on the future of all the stamp duties over the summer. I would prefer to consider the future of capital duty in that context, the future of UTID in the context of a review of the different savings media, and the life assurance duty in the context of the review of life assurance taxation.

(f) Therefore, I continue to think that 1988 - a year of personal tax reform - is not a suitable occasion to contemplate the abolition of a handy set of revenue-raisers.

NL

NORMAN LAMONT

BUDGET CONFIDENTIAL

FROM: J M G TAYLOR
DATE: 16 February 1988

PS/FINANCIAL SECRETARY

UNIT TRUST INSTRUMENT DUTY AND CAPITAL DUTY

The Chancellor has seen the Financial Secretary's minute of 15 February.

2. He agrees that we should not pursue these further in the 1988 Budget. They should be reinstated as 1989 starters.

J M G TAYLOR

B/G/MAD/1322/16

CONFIDENTIAL

FROM: MRS R LOMAX
DATE: 23 February 1988

CHANCELLOR

Prayers

Ch
Worthy, but not a high priority if size of package is being trimmed.
AA

cc: Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Sir A Wilson
Mr Byatt
Mr Scholar
Mr Culpin
Mr Peretz
Mr Sedgwick
Mr Odling-Smee
Mr Riley
Mr Cropper
Mr Tyrie
Mr Call
Mr Battishill, IR
Mr Unwin, C&E
Mr Willis, IR
PS/IR
PS/C&E

LOMAX TO CX 23 FEB

CAPITAL DUTY AND UNIT TRUST INSTRUMENT DUTY

You asked for advice on the market implications and costs of abolishing capital duty and unit trust instrument duty. This note reflects consultation with the Bank and Inland Revenue.

Capital duty

2. As noted in Mr Willis's submission of 24 November, capital duty was introduced in 1973 to meet an EC directive which imposed a mandatory 1% tax on capital raised by companies. The duty, which is paid by the company, most commonly arises on the formation of a company, an increase in its capital by the issue of new equity for cash, and on some takeovers (typically those where there is a significant cash element). Loan stock (other than convertibles) is excluded, as it is from stamp duty on share transfers. There is very limited room for manoeuvre on

the scope of the charge, but since 1985 Member States have been free to reduce the rate or abolish the duty altogether.

3. Abolition would directly reduce the cost of issuing equity capital. It would also remove one source of bias against equity, compared with debt finance and bank borrowing. (As you know, corporation tax still discriminates against equity, despite the 1984 reforms, which makes the additional discrimination implied by capital duty all the more difficult to justify). Some redress in the balance of tax advantage in favour of equity would come particularly well at a time when the balance of capital issues may be swinging towards debt, for market reasons.

4. The principal argument against abolition has always been the cost. Prior to the stock market collapse, this was put at £300 million: as noted in Mr Heywood's minute of 3 February, more recent estimates are lower, reflecting the subdued level of new equity issues now expected. But the figure quoted in that note, £40 million, looks too low. Inland Revenue's current best guess, based on the latest Treasury forecast, is around £90 million, rising to perhaps £100 million in 1989-90, and £105 million in the following year.

5. Needless to say there are massive uncertainties. But it seems safe to assume that the cost of abolition would not be anything like £300 million, next year at least. New issues (which are the major, though not the only, element in the capital duty tax base) rose to unprecedented levels in the last two years - from just under £6 billion in 1985-86 to £11 billion in 1986-87, and something like £15 billion in the current financial year. Even so, the yield of capital duty was just under £200 million in 1986-87, and is expected to be £295 million in 1987-88.

6. The stock market crash has already had a drastic effect on the new issue market: new equity issues fell to under £¼ billion a month in December and January, compared with a monthly average of over £2½ billion in the third quarter. While the new issues market appears to be recovering slowly, the queue

is a shadow of its former self, many issues are still being pulled just ahead of time and the market is still looking very vulnerable to further upsets. There is certainly no reason to expect a sharp recovery. But a yield of capital duty of £40 million in 1988-89 would imply no recovery at all from present levels - which in turn would imply a level of new issues close to the average for the early 1980s. A more prudent assumption, for score-card purposes, might be that the level of new issues will recover to around £5½ billion a year (ie close to the average for the mid-1980s) and that, as long as share prices remain depressed, a higher proportion of takeovers will attract capital duty. This scenario is broadly consistent with the Revenue's latest forecast of £90 million.

7. It is sometimes suggested that capital duty is de minimis, relative to the other costs of making a new issue. This is not the case. While the duty is a rather minor element in the (very high) cost of small equity issues, it does represent a high proportion of the costs of larger issues. And it is a significant reason why issuing costs for shares are higher than for bonds.

8. The most systematic recent evidence on issuing costs comes from a pre-Big Bang survey by the Bank of England, covering the period 1983-85. This suggested a wide spread of new equity issue costs, depending on the size, nature and method of issue. The cost of small issues (less than £10 million) is dominated by accountants and legal fees, advertising and distribution costs, which are largely invariant to the size of issue, and which can push up total issue costs to around 10 or even 20 per cent of funds raised. But the survey suggested that typical expenses of a £100 million rights issue were very much lower, at just over 3 per cent, with capital duty the largest single item after issuing house fees of around 2 per cent. The average cost of rights issues of £10 million or more was 3.9 per cent in 1985, and there is no reason to suppose that this figure has come down significantly since Big Bang. By comparison the costs of making a bond issue in either the London domestic market or the Euro-sterling bond market seem to range from about ¾ per

cent (for a domestic placing) to around 2½ per cent in the Eurobond market (though effective launch costs may be lower than this).

9. There is no reason to suppose that abolishing capital duty would have a very large effect on new issue activity. But although share prices and total funding requirements are the main factors driving the volume of new issues, the relative costs of equity compared with debt finance and the rate of return on liquid assets do play a significant part at the margin. It might also be that some companies would be slightly more inclined to finance takeovers with cash. But the main effect would probably be to reduce the cost of issues that would have taken place anyhow, with the benefit spread between the company and its shareholders. This would include a reduction in the costs of setting up new companies, and "going public", thus lifting one "burden on business". (In practice, public companies have normally been exempt from capital duty on privatisation, and it has already been decided that building societies will also have exemption, on conversion to plc's.) Abolition might just conceivably be justified on wider share ownership grounds too, in the sense that it would cut costs at a particularly favourable point for attracting new individual shareholders.

10. Whether the prospect of an EC initiative to abolish stamp duty changes the balance of the argument is debatable. The timing, and still more the precise nature, of any EC directive in this area is still very uncertain. And it could be that the abolition of stamp duty (and with it, presumably, bearer duty and the ADR charge) would make it more, not less, difficult to retain capital duty.

Unit Trust Instrument Duty

11. If capital duty goes there would be a good case for getting rid of UTID at the same time. Unit trusts are exempt from capital duty and UTID - a charge of ¼% on all property put into a unit trust, when the trust is set up, or subsequently - is broadly equivalent to the capital duty which investment companies and

others pay (at 1%) when they issue shares. (The difference on the rates of duty has been justified by the fact that unit trusts pay stamp duty on transfers of both the underlying assets and the units themselves - though in practice special reliefs apply.)

12. Abolition of UTID is estimated to cost only £20 million in 1988-89: this allows, broadly, for the effect of the stock market crash, and compares with a total annual yield of about £30 million in each of the last two years, and £18 million in 1985-86. It would remove a minor irritant, at a time when unit trust managers are feeling beset by the DTI and SIB's new regulatory regime: it would also mean further administrative change, but few taxpayers would object to the abolition of a tax, even a small one, on these grounds.

13. It may in any event become a bit more difficult to defend UTID following the new wide definition of collective investment schemes in the Financial Services Act. The definition covers some odd schemes which Ministers have decided should be excluded by Regulations. The Revenue will also be advising that authorised unit trusts which invest in money markets will have to be excluded from UTID, if they are to operate competitively. If the door to exemptions is opened in this way, other fund managers can be expected to press for similar treatment.

14. We would need to consult DTI to establish the precise impact of abolishing UTID on the pricing of units. Whatever the details, however, the fact is that abolition will put unit trust managers in a better position to reduce their charges to investors, which can only be welcome at a time when the costs facing small investors are rising.

<u>**Conclusions**</u>

15. The cost of abolishing both capital duty and UTID is likely to be of the order of £100 million or a bit more over the next year. The removal of two slightly anomalous taxes would lighten the burden on financial activities which are of some economic

(or social) benefit: raising capital, forming and floating new companies, and providing a home for the savings of small investors. Whether you can afford £100 million or so - and in this area - depends of course on the overall shape of the Budget package. But if you are looking for taxes to abolish, these two seem reasonable candidates.

16. I ought to add that if you are minded to reinstate these starters, Revenue will need a very early decision.

RL.

RACHEL LOMAX

FROM: J M G TAYLOR

DATE: 16 February 1988

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Sir A Wilson
Mr Byatt
Mr Scholar
Mr Culpin
Mrs Lomax
Mr Sedgwick
Mr Odling-Smee
Mr Ilett
Miss Sinclair
Mr Riley
Ms C Evans
Mr Hudson
Mr Cropper
Mr Tyrie
Mr Call
Mr Unwin -C&E
Mr Knox - C&E
Mr Battishill - IR
Mr Isaac -IR
Mr Painter - IR
Mr Corlett - IR
Mr Willis -IR
PS/C&E
PS/IR

Ch
I discover we had stood FIM down. I have now reactivated them & asked for urgent advice.
AA
(lost costings as at X)

Thanks.

UNIT TRUST INSTRUMENT DUTY AND CAPITAL DUTY

The Chancellor has concluded that the abolition of Unit Trust Instrument Duty (UTID) and Capital Duty should not be pursued further in the 1988 Budget. They should be reinstated as 1989 starters.

J M G TAYLOR

42aG/NH/1123/2

BUDGET CONFIDENTIAL

FROM: N J ILETT

DATE: 7 March 1988

MISS HAY

cc Mr Scholar
Mr Culpin
Mrs Lomax
Mr J G Taylor
Mr P S Hall

CHANCELLOR'S LETTER TO LORD YOUNG: CAPITAL DUTY AND UNIT TRUST INSTRUMENT DUTY

Herewith a paragraph for the letter or aide-memoire for the Chancellor's pre-Budget communication to Lord Young.

> "I have decided to abolish the 1 per cent duty payable on the formation of a company or an increase in a company's capital (capital duty), and the ¼ per cent duty on all property put into a unit trust (unit trust instrument duty). These decisions will obviously be welcome to industry. I shall make it clear that I expect the benefits of UTID abolition to reach investors. Abolition will take effect at midnight on Budget day, so unit trust managers will have to move pretty sharply to adjust their systems".

N.

N J ILETT