PO-CH/NL/0147

PART C

Part C.

CONFIDENTIAL

(Circulate under cover and notify REGISTRY of movement)

Begins: 15/9/87.
Ends : 14/12/87.

PO -CH /NL/0147

PART C

Chancellor's (Lawson) Papers:

PROPOSALS FOR WIDER SHARE OWNERSHIP

Disposal Directions: 25 Years

25/8/95.

PO -CH /NL/0147

PART C

MR 5/49

UNCLASSIFIED

FROM: N G FRAY
DATE: 15 September 1987

MR MOORE

REGISTER OF SHARES

The Chancellor has been and was grateful for your manuscript note in response to Jonathan Taylor's minute of 11 August.

N G FRAY

RJ8.36

CONFIDENTIAL

FROM: J M G TAYLOR
DATE: 16 September 1987

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr F E R Butler
Mr Cassell
Mr Monck
Mr D J L Moore
Mrs M E Brown
Ms Sinclair
Miss Leahy
Mr Cropper

Mr Jenkins - OPC
Mr Isaac - IR
Mr Lewis - IR
Mr Prescott - IR
PS/IR

SHARE ISSUES: TAXATION OF EMPLOYEE PRIORITY SHARES

The Chancellor has seen your minute of 14 September.

2. He is quite content to start with no limit. He has commented that we can always introduce one in the light of discussion in Committee (or indeed subsequently, in the light of events).

J M G TAYLOR

87. 2/90

WIDER SHARE OWNERSHIP COUNCIL

REG. OFFICE JUXON HOUSE, 94, ST. PAUL'S CHURCHYARD, LONDON EC4M 8EH Telephone: 01-248 9155

EXECUTIVE SECRETARY: 126 HAYES LANE, KENLEY, SURREY CR2 5HR

Telephone: 01-668 5923

Passed to for Nett.

As from: 10 Buckingham Place
London SW1E 6HX

Telephone: 01-828-9253

Confidential

CH/EXCHEQUER 21/9

REC.	21 SEP 1987
ACTION	MR ILETT
COPIES TO	PS/FST PS/PMG SIR P MIDDLETON MR CASSELL MR MONCK MR SCHOLAR MRS LOMAX MR BURGNER MR P GRAY MR CROPPER MR THRIE PS/IR MR P LEWIS-IR

16th September 1987

Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Building
Parliament Street
London
SW1

Dear Nigel,

I write firstly to thank you very much for coming to address our Forum. Your speech set the tone for the day and it proved to be a very good conference and forum.

Secondly, I write as requested to enclose details of a share scheme design which I have been working on. By amalgamating the best features of the existing types, it could:

1. Overcome the rights issue problem of the Finance Act 1978 schemes;
2. Reduce the future costs of tax relief for share schemes;
3. Coordinate executive and general employee facilities for share ownership in a single scheme;
4. Encourage business staff loyalty in the best possible way;
5. Make it simple to combine local profit-related cash incentive with group identity via a stake in group shares.

You may recall that I was a member of the wider share ownership committee set up by Sir Geoffrey Howe in 1975 and initially chaired by David Howell. I was at the time experimenting with the installation of share schemes in various companies, using Inland Revenue concessionary rulings for the deferment of employee income tax liability but needing Parliamentary sanction for actual tax relief. The committee's main need then seemed to be removal of the stigma of "employees selling shares at the factory gates". Hence the graduated tax scale, encouraging them to hold their shares at least until they obtained full tax relief, described in the Conservative Green Paper we produced in the spring of 1977.

The WSOC, at Maurice Macmillan's suggestion, had been an all-party body since its foundation in 1958. Thus in 1977 when the Lib-Lab pact was made, the Conservative Green Paper became the technical basis of a Liberal initiative for Labour legislation, but this legislation contained a technical snag. The idea of a reducing tax charge had been adapted from the American system of graduated vesting of employee shares, but in borrowing the idea we overlooked the fact that the Americans do not have rights issues.

In my experience, advising some 450 companies since 1977, the slow rate of introduction of FA 78 schemes is mainly due to the administrative complexity of a scheme which appropriates shares forthwith, then has a reducing tax liability and a major problem over rights issues, with small parcels of locked-in shares each having a separate tax status determined by their date of appropriation. By contrast a share scheme which starts with options is simple to administer, it makes shareholders only out of those who stay the course and it creates no hazards over rights issues. Moreover, we now know from experience that employees hold on to the great majority of shares if the scheme is designed well.

X I would not want to see the 1978 legislation repealed because it is all-party and because some firms have grown to like it, but in my view the attached model of a new scheme is much better. Why not let the two compete? I could follow up this individual letter with organised support from the WSOC, but would want to co-ordinate that with your need for consultation, confidentiality or whatever - if you like the idea.

Yours ever,

GC

George Copeman

Encs:

A Proposed

PROFIT-RELATED SHARE OPTION SCHEME

Objectives

To design an employee share scheme which:

1. Uses the existing legislation and the experience gained from working it;

2. Provides a single scheme for both management and general employees, encouraging companies to provide for both;

3. Minimises scheme administration and removes the rights issue problem;

4. Encourages employee job loyalty whilst allowing for mobility;

5. Can be coordinated easily with profit-related pay;

6. Encourages employees to hold on to shares whilst allowing for sales;

7. Can be based on group shares but related to local subsidiary or profit centre performance.

8. Can handle the individual's dilemma in a mobile society of how much provision for the future should be in risk capital, how much in pension;

9. Reduces the Revenue cost of employee share schemes;

Method

(a) Use the Finance Act 1984 as the provider of an option scheme;

(b) Allow for a category of 1984 Act scheme in which half the options granted each year must be on similar terms (Part A of the scheme) to all eligible employees, as defined in the Finance Act 1978. Within Part A, options could be exercised under the normal rules of the Finance Act 1984, except when a participant was also a member of a profit-related pay scheme with part of the bonus deferred to provide funds for exercising options, etc. Then, such options could only be exercised up to the amount of such funds available - as in a savings related share option scheme, where options can be exercised only up to the amount of savings and bonus or interest already accumulated.

(c) Allow companies with both a profit-related share option scheme (PRSO) and a profit-related pay scheme to designate a deferred proportion of PRP, which should be no greater than half of the excess of PRP above 5 per cent of pay. This proportion would be deferred for up to five years but usable earlier to exercise options under a PRSO or to pay additional contributions to a personal pension or to subscribe to a free-standing AVC. It would be important for the employer to be able to make this deferment of part bonus compulsory, to encourage its use for exercising options or supplementing pension, as appropriate. If not so used, the bonus would be payable in cash at the end of the five - year deferment.

(d) Resist the temptation to complicate the scheme by paying interest on deferred bonus. Inflation devalues an option price and a deferred bonus at a similar rate. The prospect of gain through exercising the option would be in lieu of interest.

(e) Allow an employer with a PRSO to set up or otherwise arrange a company - nominated PEP which would provide employees with facilities additional to those generally available to private citizens, in the same way that an SAYE contract for a savings related share option scheme is additional to the individual's entitlement to take out an SAYE contract at the Post Office. The manager of the company -nominated PEP, acting as agent for participants and receiving deferred bonus cheques from the company on their behalf, would be

company-sponsored special PEP should desirably be the same as the relevant share scheme annual limits.

Ten Advantages of the proposed scheme

1. It confines within one scheme the executive and general employee requirements for share facilities, on a 50:50 basis long known and used in the Investment Committee Guidelines, thus encouraging the use of both halves of the scheme together;

2. It reduces the income tax relief required on profit-related share schemes and it avoids loss of national insurance contributions;

3. It encourages company loyalty in the best manner, i.e. the financial reward for loyalty is highest when a company is prosperous and has a rising share price, but it falls to nothing when an option shows no gain;

4. It reduces share scheme administration costs (including administration for leavers) and it abolishes rights issue problems;

5. It allows a scheme to be designed to reward local performance, but it also provides a stake in group shares (as is becoming common in the US, where the original profit sharing provisions of Section 401 of the Internal Revenue Code are being adapted for this purpose);

6. It encourages company personal shareholding by allowing employees, via a personal equity plan, to go on holding shares with dividend tax and capital gains tax reliefs, and with professional aid in diversifying portfolios in due course;

7. It copes, via one scheme, with requirements for immediate cash incentive, medium-term share incentive via share ownership and longer-term security via portable pension top-up;

8. It ensures that only the employees of those units making significant profits and contributing capital, are able to take capital out of the business.

exercising the options at known option - grant prices, which could not give rise to initial valuation doubts. The company-nominated PEP should probably have a five-year bar against switching investments, so that employees acquired a significant stake in the employing company, but anyone wanting cash should of course be able to sell after one year.

(f) Require anyone departing from the company to leave any unused deferred bonus with the company until such date as he or she applied it to pension or was able to exercise relevant options or, if the options had been forfeited on leaving, until the end of the five-year deferment period. This would avoid paying a "premium" to leavers through the early release of their deferred bonus. It is suggested that the tax arrangements after departure could be for the deduction of basic rate, as in FA 78 share schemes. Deferred bonus should not, under a tax relieved scheme, be forfeitable on leaving the firm. Many companies are currently seeking deferred bonus systems as a golden handcuff for key staff, forfeitable on early leaving. Arguably the State should not recognise cash as a suitable golden handcuff, but share options are different. Their forfeiture protects the company against losing some of its capital to an early leaver.

(g) Allow employees a free choice at all times between waiting, if necessary, to apply deferred bonus to the exercise of options or alternatively applying it forthwith on a pre-tax basis to personal pension or AVCs. (The writer's enquiries show that job mobility in the business world results in relatively few people receiving a full pension, outside the main board who top themselves up.) A choice for employees would mean the company holding deferred bonus as a liability and deferring deductions from it pending employee decision. In the case of personal pension or AVC's, there would be full tax and NIC relief. In the case of exercising share options or if no decision was made and the employee collected the deferred bonus at the end of five years, there would be NIC deduction and half-rate income tax relief. In all cases corporation tax relief would be available when the deferred bonus was applied to a permitted use.

(h) Require that the limits on shares obtained under FA 78 and under the proposed profit-related share option scheme be combined into one total allowance for both schemes together and certified accordingly by auditors. The limits for a

9. Nevertheless, by overflow from one alternative choice to another, employees with a variety of backgrounds and needs are catered for more economically than by a set of separate schemes, each absorbing a certain proportion of resources regardless of need.

10. It creates competition between two types of profit sharing share scheme, allowing company choice and probably thereby causing the establishment of a greater total number of schemes.

GC

George Copeman
16 September 1987

CONFIDENTIAL

PS/FST will arrange

BF 21/9

Inland Revenue

Policy Division
Somerset House

Ok/Content?
25 17/9

FROM: M PRESCOTT
DATE: 17 SEPTEMBER 1987

I will send P/S a few minutes before PM finishes.

1. MR ISAAC 17.9

2. FINANCIAL SECRETARY

SHARE ISSUES: TAXATION OF EMPLOYEE PRIORITY SHARES

1. The Chancellor has agreed (Mr Taylor's note of 16 September) not to have a cap in these proposed provisions, at least initially, and you have agreed to the remainder of the proposals and recommendations in my note of 10 September. The next step is a Press Notice announcing the proposed legislation, and a draft is attached. May we know, please, if you are content with the draft, and for it to be issued?

2. The start date for the provisions will also be the date of the announcement. We suggest next Monday, 21 September. Are you content with this please?

3. We also assume that you are content for us to instruct Parliamentary Counsel on the draft legislation itself (which we expect to be quite short), for inclusion and publication in the Finance Bill in the normal way.

M. Prescott

M PRESCOTT

---

cc Chancellor
Chief Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Mr F E R Butler
Mr Cassell
Mr Monck
Mr D G L Moore
Mrs M E Brown
Ms Sinclair
Miss Leahy
Mr Cropper
Mr Jenkins (OPC)
Mr Battishill
Mr Isaac
Mr Easton
Mr Beighton
Mr Lewis
Mr German
Mr Cayley
Mr Prescott
Mr Peel
Mrs Eaton
Miss Green
Miss McFarlane
Mr Swann (SVD)
PS/IR

DRAFT

INLAND REVENUE

Press Release

INLAND REVENUE PRESS OFFICE, SOMERSET HOUSE, STRAND, LONDON WC2R 1LB
PHONE: 01–438 6692 OR 6706

[3x] September 1987

PUBLIC OFFERS OF SHARES: EMPLOYEE PRIORITY SHARES

The Chancellor of the Exchequer, the Rt Hon Nigel Lawson MP, today announced his intention to introduce legislation in the 1988 Finance Bill to ensure that, where certain conditions are met, there will be no Income Tax charge on the benefit which can arise from any priority given to employees in the allotment of shares in a public offer of shares. These provisions will take effect from today.

The text of the Chancellor's statement is as follows:

> "Directors or employees are sometimes allowed a priority allocation of shares when an offer of shares in their company is made to the public at a fixed price. This may confer a benefit on the employee or director where, as a result of such preferential treatment, he receives more shares than he would have done had he subscribed as an ordinary member of the public and the value of the shares at the date they are allotted to him exceeds the issue price which he paid. In the past, the Inland Revenue has not generally sought to assess such benefits. But they are now advised that the benefit in such cases is almost certainly taxable under existing law relating to the taxation of employment income.
>
> However, I do not believe that it is right to treat this particular benefit as though it was part of the employee's employment income, especially as the benefit will often be small or its precise nature and size difficult to determine. I therefore propose to introduce legislation in next year's Finance Bill to exempt such benefits from income tax, subject to certain conditions. Where the income tax exemption applies, any gains the employee realises on selling his shares will still be liable to capital gains tax in the normal way.
>
> The legislation will apply to offers that are made wholly or partly at a fixed price. The employee or director will be exempt from income tax on any benefit he derives from a priority allocation of shares in an offer of shares at a fixed price to the public, provided that the following conditions are met

- the priority allocation of shares to directors and employees does not exceed 10% of the total shares allotted at the fixed price in the share offer, and

- all of the company's directors and employees are offered priority on similar terms, so that no one person or group is picked out for particularly favourable treatment,

I propose that these provisions shall apply to any public offer of shares made on or after today, [ ] September 1987; and I have authorised the Inland Revenue to settle provisionally any liabilities arising on or after today on this basis until the legislation has been enacted."

Notes for Editors

1. Under present legislation, the amount that would fall to be taxed as income - under Schedule E - in these cases would be determined by reference to the extra number of shares received by the employee under the priority allocation, compared to a member of the public who had subscribed for the same number as the employee, and any difference between the value of the shares on the date they were allocated to the employee and what he paid for them. Any gain on subsequent disposal of the shares would be chargeable to capital gains tax in the normal way, with the acquisition cost treated as equal to the price paid plus the taxed benefit.

2. In practice, however, it may be difficult to determine the precise nature or size of the benefit in such cases, and the amounts will often be small. Nor at the time that the employee applies for shares will he know for certain whether or to what extent there will be a benefit at all. And, if there was a charge it would arise whether or not the employee had actually realised the benefit in question.

3. The 10% limit referred to in the Chancellor's statement is designed to ensure that exemption is confined to cases genuinely involving what is primarily an offer to the public, of which the priority allocation to the employees forms only a small part. The 10% limit will apply to the fixed price element so that where, as sometimes happens, part of the offer to the public is also by way of a tender, with a corresponding reduction in shares being offered at a fixed price, the maximum permissible number of shares under the employee priority fixed price allocation would reduce accordingly.

4. For the purposes of any CGT computation on a subsequent disposal, the shares will be treated as acquired at the price paid by the employee. For shares that exceed the proposed limit, there will be an adjustment to exclude from the capital gains charge any gains that were chargeable to income tax.

5. The proposed legislation will apply only to employee priority allocations under a fixed price offer. The exemption will not apply where the offer to the public is wholly by tender and the employees are entitled to subscribe for shares at a fixed price below the price for which shares are sold to members of the public in the tender. The benefit to the employees in such cases is and will remain taxable under the rules relating to the taxation of employment income.

6. The new provisions will have no application to any free shares an employee receives, at the time of the public offer, through an employee share scheme approved under the provisions of the Finance Act 1978; or to any shares an employee subscribes for on the same terms as an ordinary member of the public. In either case, there is no question of any income tax liability arising in relation to such shares.

CONFIDENTIAL

Inland Revenue

Policy Division
Somerset House

Ch.

1. Do you agree that there should be a similar terms requirement, + that ∴ the Press Notice should include the square-bracketed sentence?

FROM: M PRESCOTT
DATE: 18 SEPTEMBER 1987

1. MR ISAAC

2. PS/FINANCIAL SECRETARY

2. Should the letter to No 10 go from me, or do you want to write yourself? Are you content with the draft?

SHARE ISSUES: TAXATION OF EMPLOYEE PRIORITY SHARES

1. I understand that the statement and draft Press Notice about this, attached to my note of 17 September, is now to go out in the Financial Secretary's name, so some small changes to the draft are needed. A revised draft is attached. As I mentioned to you, however, we here have also spotted a couple of difficulties that need to be resolved.

2. The first of these is easy to deal with. On reflection, it struck us that the wording of the present draft in one or two places might just be misconstrued as meaning that the proposed exemption will apply only in cases where the employees receive a priority allocation of shares in their own company. But exemption will also apply where - as in the BP case - the priority allocation extends to employees of other companies in the same group as the company whose shares are being offered.

---

cc PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir Peter Middleton
Mr F E R Butler
Mr Cassell
Mr Monck
Mr D G L Moore
Mrs M E Brown
Ms Sinclair
Miss Leahy
Mr Cropper
Mr Jenkins (OPC)
Mr Battishill
Mr Isaac
Mr Easton
Mr Beighton
Mr Lewis
Mr German
Mr Cayley
Mr Prescott
Mrs Eaton
Miss Green
Miss McFarlane
PS/IR

One or two small textual changes are, therefore, desirable to make this clear and these are shown in the revised draft.

3. The more difficult problem concerns the proposed requirement that - for exemption to apply - all of the directors and employees concerned should be offered priority on similar terms,so that no one person or group is picked out for particularly favourable treatment. This requirement may help safeguard against abuse, especially as there is not to be a cap on individual benefits under the relief.

4. The problem, however, is that (as mentioned above) the employees concerned will sometimes include not just those of the company whose shares are being offered, but also those of other companies in the same group. The similar terms requirement therefore needs to apply on a group-wide basis. In the case of BP, however, only the UK employees (broadly, those working under a UK contract of employment and normally employed in the UK) will be eligible for the priority allocation. Overseas employees will not be eligible - even if they are employed by UK subsidiaries. (Conversely, UK employees of an overseas subsidiary will qualify). So, a similar terms requirement that applied to <u>all</u> employees in the issuing company's group would not be satisfied in the BP case, and they would not get the benefit of the proposed exemption.

5. One way round this might be a requirement that, if not all, then at least a specified minimum percentage of directors and employees in the group as a whole should be offered priority and on similar terms. An obvious break point would be a simple majority. But this would be no good for BP - their UK employees account for only about 23% of the group total. For this approach to work in the BP case (or other companies in a similar position), therefore, the percentage would have to be set at a very low such as to make it largely ineffective.

6. An alternative approach would be to adapt a provision that applies in the case of the two all-employee approved share

schemes, with a requirement that the offer should be on similar terms to all employees concerned, and not confined wholly or mainly to directors of companies in the group or to those employees of companies in the group who are in receipt of the higher or highest levels of remuneration. For this purpose, "wholly or mainly" is generally taken to mean more than half. The term "higher or highest remuneration" is, of course, relative and has to be interpreted by reference to the facts in each particular case.

7. This approach would help to deter companies from seeking to exploit the exemption by skewing things in favour of a perhaps quite small group of directors and higher paid employees. It would not exclude those on higher earnings from getting proportionately more shares under a priority allocation than those on lower earnings, but it would deter companies from extending the priority allocation only to that group. There is no doubt, however, that this would add a bit to the complexity of the provision, though probably not excessively so.

8. A third alternative would be to dispense with a similar terms requirement altogether, and simply rely on the proposed "10%" rule. The main argument for this is, perhaps, that while the second solution described above would deter companies from singling out directors and more senior people for special treatment, it would still allow them to confine the priority allocation to particular individuals or groups provided only that they were not mainly directors or higher paid people. So not an awful lot might be achieved in terms of trying to ensure that employee priority allocations were as broadly based as possible.

Point for decision

9. The choice, effectively, narrows down to that between dispensing with a similar terms requirement altogether, and having a requirement on the lines of that in the all-employee share scheme legislation which would at least discourage

selective priority allocations to directors and senior people. This is essentially a matter of judgment. It would undoubtedly simplify matters not to have a similar terms requirement. On the other hand the Financial Secretary may feel that it would be helpful to include such a requirement, if only for presentational reasons, even though in practice it might be of limited value in ensuring that priority allocations under the exemption were on an essentially all-employee basis. As you will see, I have included the point in square brackets in the revised draft, but this can simply be deleted if the Financial Secretary decides to dispense with the requirement altogether.

10. I also understand that the Chancellor wishes there to be a Private Secretary's letter to No 10 with a copy of the draft Press Notice, and a draft letter for this purpose is attached. I assume, incidentally, that this means that some slight slippage in the date for publication.

M PRESCOTT

REVISED DRAFT

INLAND REVENUE

Press Release

INLAND REVENUE PRESS OFFICE, SOMERSET HOUSE, STRAND, LONDON WC2R 1LB
PHONE: 01–438 6692 OR 6706

[3x] September 1987

PUBLIC OFFERS OF SHARES: EMPLOYEE PRIORITY SHARES

The Financial Secretary to the Treasury, the Rt Hon Norman Lamont MP, today announced the Government's intention to introduce legislation in the 1988 Finance Bill to ensure that, where certain conditions are met, there will be no Income Tax charge on the benefit which can arise from any priority given to employees in the allotment of shares in a public offer of shares. These provisions will take effect from today.

The text of the Financial Secretary's statement is as follows:

"Directors or employees are sometimes allowed a priority allocation of shares when an offer of shares in their company or another company in the same group is made to the public at a fixed price. This may confer a benefit on the employee or director where, as a result of such preferential treatment, he receives more shares than he would have done had he subscribed as an ordinary member of the public and the value of the shares at the date they are allotted to him exceeds the issue price which he paid. In the past, the Inland Revenue has not generally sought to assess such benefits. But they are now advised that the benefit in such cases is almost certainly taxable under existing law relating to the taxation of employment income.

However, the Government do not believe that it is right to treat this particular benefit as though it was part of the employee's employment income, especially as the benefit will often be small or its precise nature and size difficult to determine. We therefore propose to introduce legislation in next year's Finance Bill to exempt such benefits from income tax, subject to certain conditions. Where the income tax exemption applies, any gains the employee realises on selling his shares will still be liable to capital gains tax in the normal way.

The legislation will apply to offers that are made wholly or partly at a fixed price. The employee or director will be exempt from income tax on any benefit he derives from a priority allocation in an offer for sale of shares in his company (or another company in the same group) to the public at a fixed price, provided that the following conditions are met

- the priority allocation of shares to directors and employees does not exceed 10% of the total shares allotted at the fixed price in the share offer, and

- [all of the directors and employees concerned are offered priority on similar terms and the offer is not confined wholly or mainly to directors of companies in the group or to those employees of companies in the group who are in receipt of the higher or highest levels of remuneration].

We propose that these provisions shall apply to any public offer of shares made on or after today, [ ] September 1987; and I have authorised the Inland Revenue to settle provisionally any liabilities arising on or after today on this basis until the legislation has been enacted."

Notes for Editors

1. Under present legislation, the amount that would fall to be taxed as income - under Schedule E - in these cases would be determined by reference to the extra number of shares received by the employee under the priority allocation, compared to a member of the public who had subscribed for the same number as the employee, and any difference between the value of the shares on the date they were allocated to the employee and what he paid for them. Any gain on subsequent disposal of the shares would be chargeable to capital gains tax in the normal way, with the acquisition cost treated as equal to the price paid plus the taxed benefit.

2. In practice, however, it may be difficult to determine the precise nature or size of the benefit in such cases, and the amounts will often be small. Nor at the time that the employee applies for shares will he know for certain whether or to what extent there will be a benefit at all. And, if there was a charge it would arise whether or not the employee had actually realised the benefit in question.

3. The 10% limit referred to in the Financial Secretary's statement is designed to ensure that exemption is confined to cases genuinely involving what is primarily an offer to the public, of which the priority allocation to the employees forms only a small part. The 10% limit will apply to the fixed price element so that where, as sometimes happens, part of the offer to the public is also by way of a tender, with a corresponding reduction in shares being offered at a fixed price, the maximum permissible number of shares under the employee priority fixed price allocation would reduce accordingly.

4. For the purposes of any CGT computation on a subsequent disposal, the shares will be treated as acquired at the price paid by the employee. For shares that exceed the proposed limit, there

will be an adjustment to exclude from the capital gains charge any gains that were chargeable to income tax.

5. The proposed legislation will apply only to employee priority allocations under a fixed price offer. The exemption will not apply where the offer to the public is wholly by tender and the employees are entitled to subscribe for shares at a fixed price below the price for which shares are sold to members of the public in the tender. The benefit to the employees in such cases is and will remain taxable under the rules relating to the taxation of employment income.

6. The new provisions will have no application to any free shares an employee receives, at the time of the public offer, through an employee share scheme approved under the provisions of the Finance Act 1978; or to any shares an employee subscribes for on the same terms as an ordinary member of the public. In either case, there is no question of any income tax liability arising in relation to such shares.

PSC type for my sig

DRAFT FROM PS/CHANCELLOR TO:

D R Norgrove Esq
Private Secretary
10 Downing Street

TAX TREATMENT OF PRIORITY EMPLOYEE SHARES IN A PUBLIC OFFER

You may like to be aware of the enclosed Press Notice which is to be issued very shortly and in which, as you will see, the Financial Secretary will be announcing the Government's intention to introduce legislation in next year's Finance Bill to deal with a problem that has arisen in this area. The draft Press Notice is I think self-explanatory. The problem is one that could arise in the context of either a private or a public sector flotation, and the proposed solution will help among other things to remove what might otherwise have been an obstacle to take up of shares by employees in future privatisations, including the forthcoming BP sale.

J M G TAYLOR

RJ8.52

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

21 September 1987

D R Norgrove Esq
10 Downing Street
LONDON
SW1

Dear David

TAX TREATMENT OF PRIORITY EMPLOYEE SHARES IN A PUBLIC OFFER

You may like to be aware of the enclosed Press Notice which is to be issued very shortly and in which, as you will see, the Financial Secretary will be announcing the Government's intention, of which the Chancellor has already informed the Prime Minister, to introduce legislation in next year's Finance Bill to deal with a problem that has arisen in this area. The draft Press Notice is I think self-explanatory. The problem is one that could arise in the context of either a private or a public sector flotation, and the proposed solution will help among other things to remove what might otherwise have been an obstacle to take up of shares by employees in future privatisations, including the forthcoming BP sale.

Yours sincerely

J M G TAYLOR
Private Secretary

cc PS/CST PS/FST.
PS/PMG
PS/EST
Sir P Middleton
Mr F E R Butler
Mr Cassell
Mr Monck
Mr D G L Moore
Mrs M E Brown
Ms Sinclair
Miss Leahy
Mr Cropper
Mr Jenkins - OPC
Mr Prescott - IR
Mr Isaac - IR
Mr Lewis
PS/IR

DRAFT

INLAND REVENUE

Press Release

INLAND REVENUE PRESS OFFICE, SOMERSET HOUSE, STRAND, LONDON WC2R 1LB
PHONE: 01–438 6692 OR 6706

[3x]

September 1987

PUBLIC OFFERS OF SHARES: EMPLOYEE PRIORITY SHARES

The Financial Secretary to the Treasury, the Rt Hon Norman Lamont MP, today announced the Government's intention to introduce legislation in the 1988 Finance Bill to ensure that, where certain conditions are met, there will be no Income Tax charge on the benefit which can arise from any priority given to employees in the allotment of shares in a public offer of shares. These provisions will take effect from today.

The text of the Financial Secretary's statement is as follows:

> "Employees or directors are sometimes allowed a priority allocation of shares when an offer of shares in their company or another company in the same group is made to the public at a fixed price. This may confer a benefit on the employee or director where, as a result of such preferential treatment, he receives more shares than he would have done had he subscribed as an ordinary member of the public and the value of the shares at the date they are allotted to him exceeds the issue price which he paid. In the past, the Inland Revenue has not generally sought to assess such benefits. But they are now advised that the benefit in such cases is almost certainly taxable under existing law relating to the taxation of employment income.
>
> However, the Government is committed to the encouragement of employee share ownenership and we do not believe that it would be right to treat this particular benefit as though it were part of the employee's employment income, especially as the benefit will often be small or its precise nature and size difficult to determine. We therefore propose to introduce legislation in next year's Finance Bill to exempt such benefits from income tax, subject to certain conditions. Where the income tax exemption applies, any gains the employee realises on selling his shares will still be liable to capital gains tax in the normal way.
>
> The legislation will apply to offers that are made wholly or partly at a fixed price. The employee or director will be exempt from income tax on any benefit he derives from a priority allocation in an offer for sale of shares in his

/company

company (or another company in the same group) to the public at a fixed price, provided that the following conditions are met

- the priority allocation of shares to directors and employees does not exceed 10% of the total shares allotted at the fixed price in the share offer, and

- all of the directors and employees concerned are offered priority on similar terms and the offer is not confined wholly or mainly to directors of companies in the group or to those employees of companies in the group who are in receipt of the higher or highest levels of remuneration.

We propose that these provisions shall apply to any public offer of shares made on or after today, [ ] September 1987; and I have authorised the Inland Revenue to settle provisionally any liabilities arising on or after today on this basis until the legislation has been enacted."

Notes for Editors

1. Under present legislation, the amount that would fall to be taxed as income - under Schedule E - in these cases would be determined by reference to the extra number of shares received by the employee under the priority allocation, compared to a member of the public who had subscribed for the same number as the employee, and any difference between the value of the shares on the date they were allocated to the employee and what he paid for them. Any gain on subsequent disposal of the shares would be chargeable to capital gains tax in the normal way, with the acquisition cost treated as equal to the price paid plus the taxed benefit.

2. In practice, however, it may be difficult to determine the precise nature or size of the benefit in such cases, and the amounts will often be small. Nor at the time that the employee applies for shares will he know for certain whether or to what extent there will be a benefit at all. And, if there was a charge it would arise whether or not the employee had actually realised the benefit in question.

3. The 10% limit referred to in the Financial Secretary's statement is designed to ensure that exemption is confined to cases genuinely involving what is primarily an offer to the public, of which the priority allocation to the employees forms only a small part. The 10% limit will apply to the fixed price element so that where, as sometimes happens, part of the offer to the public is also by way of a tender, with a corresponding reduction in shares being offered at a fixed price, the maximum permissible number of shares under the employee priority fixed price allocation would reduce accordingly.

/4.

4. For the purposes of any CGT computation on a subsequent disposal, the shares will be treated as acquired at the price paid by the employee. For shares that exceed the proposed limit, there will be an adjustment to exclude from the capital gains charge any gains that were chargeable to income tax.

5. The proposed legislation will apply only to employee priority allocations under a fixed price offer. The exemption will not apply where the offer to the public is wholly by tender and the employees are entitled to subscribe for shares at a fixed price below the price for which shares are sold to members of the public in the tender. The benefit to the employees in such cases is and will remain taxable under the rules relating to the taxation of employment income.

6. The new provisions will have no application to any free shares an employee receives, at the time of the public offer, through an employee share scheme approved under the provisions of the Finance Act 1978; or to any shares an employee subscribes for on the same terms as an ordinary member of the public. In either case, there is no question of any income tax liability arising in relation to such shares.

DRAFT

INLAND REVENUE

Press Release

INLAND REVENUE PRESS OFFICE, SOMERSET HOUSE, STRAND, LONDON WC2R 1LB
PHONE: 01–438 6692 OR 6706

[3x] September 1987

PUBLIC OFFERS OF SHARES: EMPLOYEE PRIORITY SHARES

The Financial Secretary to the Treasury, the Rt Hon Norman Lamont MP, today announced the Government's intention to introduce legislation in the 1988 Finance Bill to ensure that, where certain conditions are met, there will be no Income Tax charge on the benefit which can arise from any priority given to employees in the allotment of shares in a public offer of shares. These provisions will take effect from today.

The text of the Financial Secretary's statement is as follows:

> "Employees or directors are sometimes allowed a priority allocation of shares when an offer of shares in their company or another company in the same group is made to the public at a fixed price. This may confer a benefit on the employee or director where, as a result of such preferential treatment, he receives more shares than he would have done had he subscribed as an ordinary member of the public and the value of the shares at the date they are allotted to him exceeds the issue price which he paid. In the past, the Inland Revenue has not generally sought to assess such benefits. But they are now advised that the benefit in such cases is almost certainly taxable under existing law relating to the taxation of employment income.
>
> However, the Government is committed to the encouragement of employee share ownenership and we do not believe that it would be right to treat this particular benefit as though it were part of the employee's employment income, especially as the benefit will often be small or its precise nature and size difficult to determine. We therefore propose to introduce legislation in next year's Finance Bill to exempt such benefits from income tax, subject to certain conditions. Where the income tax exemption applies, any gains the employee realises on selling his shares will still be liable to capital gains tax in the normal way.
>
> The legislation will apply to offers that are made wholly or partly at a fixed price. The employee or director will be exempt from income tax on any benefit he derives from a priority allocation in an offer for sale of shares in his

/company

company (or another company in the same group) to the public at a fixed price, provided that the following conditions are met

- the priority allocation of shares to directors and employees does not exceed 10% of the total shares allotted at the fixed price in the share offer, and

- all of the directors and employees concerned are offered priority on similar terms and the offer is not confined wholly or mainly to directors of companies in the group or to those employees of companies in the group who are in receipt of the higher or highest levels of remuneration.

We propose that these provisions shall apply to any public offer of shares made on or after today, [ ] September 1987; and I have authorised the Inland Revenue to settle provisionally any liabilities arising on or after today on this basis until the legislation has been enacted."

Notes for Editors

1. Under present legislation, the amount that would fall to be taxed as income - under Schedule E - in these cases would be determined by reference to the extra number of shares received by the employee under the priority allocation, compared to a member of the public who had subscribed for the same number as the employee, and any difference between the value of the shares on the date they were allocated to the employee and what he paid for them. Any gain on subsequent disposal of the shares would be chargeable to capital gains tax in the normal way, with the acquisition cost treated as equal to the price paid plus the taxed benefit.

2. In practice, however, it may be difficult to determine the precise nature or size of the benefit in such cases, and the amounts will often be small. Nor at the time that the employee applies for shares will he know for certain whether or to what extent there will be a benefit at all. And, if there was a charge it would arise whether or not the employee had actually realised the benefit in question.

3. The 10% limit referred to in the Financial Secretary's statement is designed to ensure that exemption is confined to cases genuinely involving what is primarily an offer to the public, of which the priority allocation to the employees forms only a small part. The 10% limit will apply to the fixed price element so that where, as sometimes happens, part of the offer to the public is also by way of a tender, with a corresponding reduction in shares being offered at a fixed price, the maximum permissible number of shares under the employee priority fixed price allocation would reduce accordingly.

/4.

4. For the purposes of any CGT computation on a subsequent disposal, the shares will be treated as acquired at the price paid by the employee. For shares that exceed the proposed limit, there will be an adjustment to exclude from the capital gains charge any gains that were chargeable to income tax.

5. The proposed legislation will apply only to employee priority allocations under a fixed price offer. The exemption will not apply where the offer to the public is wholly by tender and the employees are entitled to subscribe for shares at a fixed price below the price for which shares are sold to members of the public in the tender. The benefit to the employees in such cases is and will remain taxable under the rules relating to the taxation of employment income.

6. The new provisions will have no application to any free shares an employee receives, at the time of the public offer, through an employee share scheme approved under the provisions of the Finance Act 1978; or to any shares an employee subscribes for on the same terms as an ordinary member of the public. In either case, there is no question of any income tax liability arising in relation to such shares.

---

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

22 September 1987

Dear Jeremy,

Tax Treatment of Priority Employee Shares in a Public Offer

The Prime Minister has seen the draft Press Notice attached to your letter to me of 21 September which deals with the tax treatment of priority employee shares in a public offer. The Prime Minister noted this without comment.

CH/EXCHEQUE

REC. 22 SEP 1987

ACTION CST PMG EST SIR P MIDDLETON

COPIES TO MR F E R BUTLER, MR CASSELL, MR MONCK, MR MOORE, MRS BROWN, MISS SINCLAIR, MR CROPPER, MR JENKINS - OPC, MR PRESCOTT IR

22/9

Yours,

David.

(DAVID NORGROVE)

PS/IR

J.M.G. Taylor, Esq.,
HM Treasury.

4374/31

CONFIDENTIAL

FROM: J J HEYWOOD
DATE: 23 September 1987

MR PRESCOTT IR

cc PS/Chancellor
Sir P Middleton
Mr Scholar
Mr D J L Moore
Mr Cropper
PS/IR
Mr. Culpin

TAX TREATMENT OF PRIORITY EMPLOYEE SHARES

1. You will by now have seen that the Prime Minister noted without comment Mr Taylor's letter to Mr Norgrove of 21 September to which was attached the draft Press Notice.

2. The Financial Secretary would like the Press Notice to be issued as soon as possible today. Could you arrange this?

JEREMY HEYWOOD
Private Secretary

b.f. with original note (2/10, I think)

Inland Revenue

Policy Division
Somerset House

FROM: M PRESCOTT
DATE: 29 SEPTEMBER 1987

FINANCIAL SECRETARY

PROFIT-RELATED SHARE OPTION SCHEME - PAPER FROM MR COPEMAN

1. Mr Copeman of the Wider Share Ownership Council wrote to the Chancellor on 16 September with some suggestions for what Mr Copeman has called a "profit-related share option scheme".

THE PROPOSAL

2. The paper is difficult to follow and there is also a lot of confusing detail. As we understand it, however, the key proposals are that

(a) companies with both an FA 1984 "discretionary" share option scheme and a PRP scheme would be required to extend (or would be permitted a variant on) the option scheme so that at least half the options granted under it each year were granted to all eligible employees of the company on similar terms;

(b) for an employee wishing to participate in both schemes, there would then be a clog on a designated

---

cc PS/Chancellor
PS/Paymaster General
Sir P Middleton
Mr Cassell
Mr Monck
Mr Scholar
Mrs Lomax
Mr Burgner
Mr Ilett
Mr P Gray
Mr Cropper
Mr Tyrie
Mr Isaac
Mr Lewis
Mr Beighton
Mr Corlett
Mr Munro
Mr Farmer
Mr Prescott
Mrs Eaton
Miss Green
Mr Fraser
PS/IR

proportion of his PRP - that designated proportion would normally have to be deferred for up to 5 years, but could be used earlier either to exercise options under the option scheme or to pay additional contributions to a personal pension or to subscribe to a free-standing AVC;

(c) any take-up of options by the employee under the option scheme would be restricted to the amount of his deferred PRP;

(d) the same rules to apply to individuals who left the company before 5 years - ie any unused deferred PRP to be withheld for the full 5 years unless used to acquire options or pensions;

(e) full CT relief for the company when deferred PRP was applied by the employee to a permitted use (exercise of options, pensions).

(f) allow shares acquired under the option scheme and funded out of deferred PRP to be held in a company-nominated PEP.

3. A number of the more detailed points are very unclear. For example, the suggestion concerning the "designated proportion" of PRP seems to be based on a misunderstanding about how the "5% minimum pool" rule will operate for PRP. In essence, however, the suggestion seems to be that the deferred proportion could be up to half the amount by which PRP exceeded 5% of pay. Similarly, it is not clear how exactly the proposed "all-employee rule" at (a) above would (or could) be made to work in practice, bearing in mind that "similar terms" does not exclude some employees (those who earn more or who have been with the company longer) from being granted options over more shares than other employees.

COMMENT

4. The WSOC is, of course, primarily concerned to encourage wider share ownership. They are also sceptical about PRP which they see as a diversion from wider share ownership and employee share schemes, as their Chairman (Mr Palamountain) made clear in his concluding remarks at the recent Forum which the Chancellor also addressed. The underlying aim of these proposals, therefore, seems to be that of using PRP to reinforce the share ownership objective, by linking the two.

5. There are a number of fairly weighty objections to these proposals. The most important are

(a) while PRP and the share schemes generally can complement each other, they do have essentially different objectives and it would therefore be wrong to make the availability of benefits under one conditional on the other. Most important, PRP is a tax relief for cash pay and it could defeat the pay flexibility objective of PRP if, as under this proposal, a part of PRP could only be used for specified purposes or had to be deferred. (Further, PRP schemes are available to uncorporated as well as to incorporated employers; share schemes are by definition available only to the latter)

(b) Ministers have repeatedly stressed the importance of allowing companies as much flexibility as possible both in framing their PRP scheme, and in the choice of share or share option scheme to suit their particular needs. This proposal could restrict companies' flexibility. Moreover, though the FA 1984 schemes are discretionary, there is nothing to stop a company having one on an all-employee basis if it wishes and some do - eg Rowntrees. Similarly, if in future an employee wishes to use part of his PRP to acquire shares under an FA 1984 option scheme in which he is

also a participant, he will be free to do so. In either case, however, it seems wrong actually to compel and restrict companies and their employees in this regard in the ways these proposals apparently envisage.

(c) there is a danger that this kind of linkage could actually be counter productive - ie it might discourage companies who have a share option scheme which they do not want to put on to an all-employee basis from introducing a PRP scheme, and companies that might otherwise have been prepared to introduce both schemes might decide instead to have only one or the other.

(d) linking schemes in this way would undoubtedly complicate the respective legislative provisions, and administration of them for companies and the Revenue alike. Moreover, PRP is still very new and now is certainly not a good time to start fettering it with new complications and restrictions.

6. In his letter, Mr Copeman says that he could mobilise WSOC support for the proposal if Ministers saw the attractions in it. Frankly, we doubt whether support from companies that participate in WSOC would in fact be all that great. For example, most company representatives participating in the recent WSOC Forum themselves seemed to see little attraction in this kind of compulsory linkage, even though a pre-Forum survey by WSOC of some companies had suggested that there might be some support for the idea. (On a related point, the WSOC also have long advocated making FA 1984 schemes conditional upon the company also having an all-employee FA 1978 profit-sharing scheme or FA 1980 savings-related share option scheme. Again, however, it was argued by most participants at the Forum that if companies wanted to make this kind of linkage they were already free to do so - but it should not be made compulsory).

7. Mr Copeman also mentions difficulty with FA 1978 schemes - which he stresses he wishes to retain - concerning rights issues. However, this is a narrow technical point and not one which in practice seems to be causing much of a problem. Briefly, the point is that under these schemes the shares have to be held in trust for a prescribed minimum period for the full relief from income tax to be available. Rules are therefore needed to ensure that the value of the shares remains locked-in to the trust for the required duration. However, a rights issue can involve some shift of value from existing shares to the rights shares with the result that some of the locked-in value would leak away if employees were free to dispose of their rights shares. The rules therefore provide that any rights shares must go in to the trust as well, when they will be deemed to have been acquired at the same time as the shares already in trust were acquired. But this can sometimes involve a complicated calculation if the shares already in the trust were acquired at different times and the value of the rights shares has, therefore, to be apportioned to different periods.

8. However, following consultation amending legislation was introduced in 1982 to help deal with this and related problems concerning rights issues, with a view to easing any administrative burden for scheme trustees. We believe that those changes succeeded because there have been virtually no representations on the point since then.

9. Mr Copeman's proposal to allow shares acquired under the option scheme to be held in a company-nominated PEP would entail a move away from the present rule that contributions to a PEP must be in cash. We believe this is unattractive for two reasons.

10. First, PEPs are intended to encourage wider, and deeper, share ownership. So there seems to be no reason in principle to facilitate the transfer of an existing shareholding into a PEP. Second, the transfer of a non-cash asset into a PEP would need to be deemed a disposal for CGT purposes if an undue tax break

for such transfers was to be avoided. This would add an unwelcome complication to what is intended to be a simple scheme for new investors.

11. Furthermore, the individuals who can currently participate in employee share schemes already enjoy significant tax benefits over those who cannot because, for example, their employer does not run a scheme or they are public servants. Mr Copeman's proposal to give members of profit-related share schemes an additional PEP entitlement would merely add to this unevenness.

CONCLUSION

12. Though they can complement each other, the objectives of the FA 1984 scheme are different from those of PRP (and indeed from the other approved share and share options schemes). It would, therefore, be wrong and possibly counter productive to impose compulsory linkages and conditionality of the kinds suggested by Mr Copeman - or even to suggest that the Government might one day favour them. That still leaves companies who wish to operate both a PRP and a share scheme in tandem perfectly free to do so - as indeed Mr Copeman himself seemed to acknowledge in his own address to the WSOC Forum.

13. We assume, therefore, that you will not want to pursue this suggestion. If you are content we will let you have a draft reply to Mr Copeman thanking him for the suggestion but explaining the difficulties that you see with it.

M Prescott

M PRESCOTT

Ch. Do you want IR to take this forward with DTI and the Association of Investment Trusts? See note at 1/10 end. 30/9

pp3. pl.

Inland Revenue

Policy Division
Somerset House

FROM: J H REED
DATE: 30 SEPTEMBER 1987

1. MR McGIVERN

2. CHANCELLOR OF THE EXCHEQUER

PURCHASE OF OWN SHARES RELIEF

Your private secretary's minute of 27 July to Mr Cropper asked for a more comprehensive review of the tax treatment of an investment trust buying its own shares before you replied to Sir Keith Joseph. You said you saw no argument in principle for the policy complained of and asked what would be the costs of changing it. You also asked whether investment trusts could solve their problem by buying each others' shares.

The proposal

2. The tax proposal (by Mr Griffin of GT Management plc) is that if an investment trust buys in its own shares this should not be treated as a distribution. He suggests that this might be subject to a limit of 10 per cent of their equity in any one year. The object of this proposal is to narrow discounts and so make investment trusts less attractive to predators.

3. You asked that the review should not be too comprehensive, so this note concentrates on the tax aspects of the proposal. It does not consider whether the present discount results from an "over-supply" of investment trust shares or whether the tax proposed would be effective in

---

cc Financial Secretary
Mrs Lomax
Mr Ilett
Miss Sinclair
Mr Cropper

Mr Painter
Mr Beighton
Mr McGivern
Mr Campbell
Mr Spence
Mr Templeman
Mr Gordon
Mr Cayley
Mr Creed
Mr Reed
Mr Huffer
PS/IR

narrowing discounts. Similarly, it does not look at whether there is a case on non-tax policy grounds for the Government to take action which would have the effect of reducing discounts.

The general tax position

4. In general, any distribution from a company in respect of its shares is taxed as income, except so much of the distribution, if any, as represents a repayment of share capital. So if a share was issued for £1 and the company buys it in for £1.60, the shareholder is treated as receiving income of £0.60 (and the company has to account for ACT on this). It is clearly necessary to have a general rule like this to prevent shareholders avoiding income tax by selling some shares to the company instead of receiving a dividend.

Relief for purchases by a company of its own shares

5. But in 1982 a special relief was introduced where an unquoted trading company buys in some of its shares. Subject to various conditions, the excess over the repayment of the share capital is treated not as income but as a capital gain (and the company does not have to account for ACT). The intention behind these conditions is to restrict the relief to cases where the main purpose of the purchase is either to benefit the company's trade (eg by buying out a dissident shareholder) or to enable the seller to pay inheritance tax.

6. The thinking behind the relief is that it is often very difficult for a shareholder to realise his investment in an unquoted company. If the other shareholders took sufficient dividends out of the company to buy out the shareholder they might face a large income tax bill. If they met this bill by taking out more dividends this would increase the income tax liability and could damage the company's ability to carry on its trade. An alternative way for the shareholder to realise his investment would be for the company to buy his shares.

But under the pre-1982 legislation this would have left him with an income tax liability (if he was a higher-rate taxpayer) and the company would have had to pay ACT. The purpose of the special relief is to allow the money to come out of the company to buy out the shareholder without imposing an income tax liability on any of the shareholders or an ACT liability on the company.

Case for extending the relief to investment trusts

7. These considerations do not apply to an investment trust. Its shares can easily be sold and if it chooses to buy them in it has no trade which could be damaged by a tax charge. So a different case would have to be found to justify extending the relief to investment trusts only.

8. It is interesting to compare the treatment of investment trusts with that of authorised unit trusts. It is of course normal for a unit-holder to sell his shares to the managers of the unit trust, who may then issue them to someone else or cancel them. The disposal by the unit-holder is subject to capital gains tax only (except in respect of accrued income) and the purchase by the managers is not treated as a distribution (so ACT is not payable). So the treatment is similar to that of a company which qualifies for the relief for the purchase of its own shares.

9. It is true that the unit-holders are taxed each year on the income accruing to the unit trust (whether or not it is distributed to them), and so it is not possible to avoid an income tax liability on the unit-holders by buying in units instead of distributing income. But although there is no equivalent rule for investment trusts there is another rule which produces a similar result. An investment trust is prohibited from retaining more than 15 per cent of the income it derives from shares and securities. It seems to follow that the balance of the income has to be distributed and is therefore taxed as income in the hands of its shareholders.

10. So in this respect the treatment of an investment trust and an authorised unit trust is broadly similar. But, as I have explained, the treatment of the purchase of own shares (or units) is different. Removing this difference could be seen as a justification for extending the special relief to investment trusts. On the other hand, the Stock Exchange provides a ready market for shares in investment trusts (which is not true of units in unit trusts) and a sale on this market is taxed in the same way as a sale of units to a unit trust. It follows that the difference in treatment under the present rules where an investment trust purchases its own shares could be seen as only a minor distortion in the operation of the financial markets.

11. There is also the question of whether the special relief should be extended not only to investment trusts but also to companies generally. As I have explained, the reason a purchase of own shares is normally treated as a distribution (except to the extent that it represents a repayment of share capital) is that otherwise shareholders could avoid income tax by selling some shares to the company instead of receiving a dividend. The scope for this is much less with investment trusts because of the requirement that they distribute at least 85 per cent of their income. Nevertheless, extending the relief to one set of quoted companies (investment trusts) would be likely to increase the pressure for its extension to others (eg, the McAlpines have long been pushing hard for this). Up to now Ministers have resisted this principally on the basis that lack of marketability remains central to the justification for the relief. Extending the relief to investment trusts, whose shares are marketable, would weaken this position.

Effect of extending the relief to investment trusts

12. Looked at in isolation, investment trusts might well welcome the relief. It would make no difference if their CT liability is sufficient to absorb the ACT currently payable on a purchase of own shares. But if a purchase would otherwise

produce surplus ACT, which is quite likely given that they are required to distribute at least 85 per cent of their income, they would be better off if the relief were available.

13. But their shareholders might be worse off, and might therefore be reluctant to sell their shares to the investment trust. Assuming that the purchase of own shares would anyway have taken place, the effect of the proposed change would be as follows.

i. Exempt taxpayers (eg, pension funds, which hold perhaps 15 per cent of investment trust shares) can now reclaim the tax credit on the distribution: this would cease if the transaction no longer counted as a distribution.

ii. UK resident companies (such as insurance companies, which hold some 40 per cent of investment trust shares) would be liable to CT on the capital gains but at present pay no tax on the receipt of distributions (and these frank the ACT liability on their own distributions, and in some circumstances the company can obtain a repayment of the tax credit).

iii. A basic rate shareholder would gain no advantage and would be worse off if he had to pay capital gains tax.

iv. The only gainer would be someone who was liable to the higher rates of income tax, and then only if he paid less in capital gains tax than he would have paid in higher rate income tax.

14. Furthermore, instead of buying shares directly from its shareholders, the investment trust can buy them from a dealer in the usual way (ie, the investment trust pays ACT and the sale proceeds are taxed as a trading receipt of the dealer). This means that a higher rate taxpayer who prefers to pay

capital gains tax can achieve this if he sells to a market-maker who sells on to the investment trust.

15. So the present system generally appears more advantageous to the shareholders than one under which the special relief applied. Whether or not this is so in reality depends upon whether investment trusts do in practice buy shares direct from their shareholders. If not, the shareholders have nothing to lose from a change of system and the investment trust would gain to the extent that it avoided generating surplus ACT when it bought its shares from a market-maker (the latter would be unaffected by a change of system). In practice this gain to the investment trust would also benefit its shareholders by making the shares more attractive.

16. The evidence we are aware of suggests that there would be an overall advantage to investment trusts and their shareholders from extending to them the special relief. In recent years it has become common for investment trusts to be turned into authorised unit trusts with a view to liquidation over a period of time (which gives the shareholders flexibility over when they realise their investment and thereby give rise to a potential CGT liability). This suggests that the shareholders are attracted by the prospect of being able to realise a capital gain on the disposal of their shares. So they would presumably welcome the option of being able to do this directly by selling the shares to the investment trust (so avoiding the cost of unitisation) if they could get a good price (which would depend upon the extent to which the proposed change in tax law caused discounts to narrow).

17. We are not able to say very much about behavioural changes if the relief were extended to investment trusts. One possibility is that little would change because investment trusts and their shareholders would continue to find unitisation more attractive. At the other extreme, purchase of own shares might become widespread, discounts might be greatly reduced and unitisation might cease to be attractive. If you wish to pursue the idea, it might be sensible for us to

consult the DTI and, subsequently, outsiders (eg the Association of Investment Trusts) before reaching a decision.

Cost of extending the relief

18. There is unlikely to be a significant cost if behaviour does not change. So far as we are aware, investment trusts do not normally buy in their own shares. To the extent that they started to do so, this would cause the shareholders to realise accrued capital gains and some tax would be payable on these. In part this might replace capital gains tax which would otherwise have arisen from indirect liquidation through unitisation followed by sale of the units. But overall there would be no loss of capital gains tax; and to the extent that POS relief increased the price of investment trust shares, sale of the shares could lead to an increased CGT take.

19. The effect on tax payments by investment trusts is more difficult to estimate. It depends upon how they finance the purchase, whether by borrowing or by selling shares, and whether their dividend pay-out is reduced. But it seems unlikely that there would be a substantial net cost.

Length of legislation required

20. We have not yet worked out exactly what would be required - this could be the subject of a subsequent submission - but the legislation should not prove long or complicated.

Investment trusts buying each others' shares

21. You asked whether investment trusts could solve the problem of large discounts by buying each others' shares. We see no reason why this could not be done: it is not unusual for investment trusts to invest in other investment trusts (although perhaps usually within the same fund management group), and if done on a large enough scale this should in

principle increase the price of the remaining shares to the extent that this is a function of the underlying assets - although in practice some shareholders might be put off by this development. However, this would be a sound commercial decision if investment trusts really believe that discounts are unjustifiably large.

Reconstruction of investment trusts

22. You may have seen a report in the Press about a proposed reconstruction by Scottish National Investment Trust. Every ten existing shares would be replaced by a combination of four different types of share, which would have characteristics appealing to different categories of investor (eg one would produce income and another would produce capital gains). We are currently trying to find out more about the proposal. We shall make a submission about it in due course if there is anything significant to report. While this kind of proposal may be successful in reducing the discount, it involves setting a limited period to the life of the investment trust (in the present case, 1998). So even if the proposal works and is not objectionable as a tax avoidance device (which we shall consider) it may not be a wholly satisfactory solution to the problem of discounts.

Conclusion

23. A case can be made out for extending to investment trusts the relief for purchase of own shares, and this should not have a substantial cost. It could however give rise to pressure for similar treatment for other quoted companies. But we cannot be sure of its effect and we see advantage in prior consultation. This should make it easier to see whether the case for the change was strong enough to justify taking up Finance Bill space - but whatever the outcome you may not wish to legislate in the coming Bill, where space is already at a premium.

24. If you would like us to do some further work on the proposal, may we have your authority to seek the views of DTI on the non-tax aspects and, in the light of these, to consult the Association of Investment Trusts?

J H REED

CHANCELLOR

Mr Reed's analysis does not suggest that there is a very compelling case - at least on tax grounds - for extending the purchase of own shares relief to investment trusts. And it is interesting that the AITC has not, as far as we are aware, been pressing for the relief. The lack of marketability of shares has hitherto been the key test for relief. But there are some arguments the other way in this case.

E McGIVERN

4375/43

FINANCIAL SECRETARY TO THE TREASURY

FROM: J J HEYWOOD
DATE: 1 October 1987

MR PRESCOTT IR

cc PS/Chancellor
PS/Paymaster General
Sir P Middleton
Mr Cassell
Mr Monck
Mr Scholar
Mrs Lomax
Mr Burgner
Mr Ilett
Mr P Gray
Mr Cropper
Mr Tyrie
PS/IR

PROFIT-RELATED SHARE OPTION SCHEME - PAPER FROM MR COPEMAN

1. The Financial Secretary was grateful for your minute of 29 September. He broadly agreed with your view on the proposal.

2. Rather than writing to Mr Copeman, the Financial Secretary has agreed to meet him at 4.30pm on 12 October. He would be grateful if you could come along to that meeting.

JEREMY HEYWOOD
Private Secretary

THE FORTNIGHTLY

Number 55 2nd October 1987

THE STATE OF THE KINGDOM

The latest report from the OECD in Paris is that the United Kingdom is the only country in Europe which it is likely that unemployment is going to fall during the forthcoming year. Earlier this week while the Chancellor was making important statesman-like utterances at the World Bank and Fund Meetings in Washington, the Bank of England was having to "cap" sterling's rise against the D-Mark. Has it happened? Are we actually in the middle of the British economic miracle? The answer is; we are. It is an event of tremendous significance. And it transcends in importance the events of the present business cycle. This is part of a secular trend which could take us as a nation much further than we think.

The Problem With The Intellectuals

Why is it that there is such a reluctance to admit that the country is in fact doing better? Part of the answer is that the recovery is spotty. There are areas and industries where the re-invigoration has yet to reach. Because there is a deep seated tendancy in Britain to have sympathy with the underdog these under privileged groups have, rightly in a way, received much more than their fair share of attention. The media and the intellectuals in particular have been absorbed with if not obsessed by the problems of those left out of the main stream of today's prosperity. Hence the under estimation.

There is another reason for it. Big secular changes are difficult to perceive while they are actually happening. This is because events move faster than peoples' thinking. Intellectuals go on writing books, to explain a trend which in fact has changed. There have been some spectacular examples of this in the past. One of the most remarkable was the publication of a book by a certain Swiss Historian, Luthy, on "The State of France" in 1952. Monsieur Luthy spent some 600 pages explaining why France was in such a mess and would never really get out of it. It was convincing stuff, grounded as it was in a thorough understanding of French history. It was a collector's item. For just at the time it was published the French had, one can see now, broken decisively with the downwards trend which had lead them to defeat at the beginning of the Second World War. Some observers now trace the French recovery in the post war era right back to the early work done by civil servants and junior ministers in the Vichy Government of the war years. The top layer of Third Republic ministers having been put in jail, the administrators, those able "Inspecteurs de Finance" and the rest were left to take out of the bottom drawer of their desks, the plans for reconstruction

which they had long cherished but which they had been prevented from putting into effect by their political masters. Without masters, they could get on with the job. Hence the Rhone barrage, the rebuilding of the railways, the resuscitation of industry; all were planned for even before the guns were silent.

Whether or not this was really so, by the 60's when the cold war was holding sway it was clear to all who were unprejudiced that the French were on their way. As the British were prejudiced it took them another 10-20 years to believe what they could see with their eyes. But the trend has certainly changed.

Britain's New Direction

The parallel with Britain today is interesting. For this country has almost as deeply ingrained a record of failure since the war as the French had back in the 1950's. Every year Britain has slipped further and further behind in the economic race. Failure has become almost endemic. The problem has been that the British indentified success with achievements in areas which in any case were doomed. They measured their performance against industrial criteria which were as out of date as the industries themselves. Thus, as British ship building, steel making, coal-mining, machine tool production and the rest fell, so the performance of the country as a whole was down graded. Never mind that other newer industries were rising and taking their place. The latter were regarded as tinsel pretend-industries which didn't really count. And anyhow even if theydid count, the trouble was that there wasn't enough of the new to take the place of the old; as we know, unemployment rose horrifically because it was just not possible to close the gap in time.

In this situation very few experts took a hopeful view. Industrial Britain was collapsing and that was that. It is to Mrs Thatcher's credit that she never flinched. She took the role of De Gaulle. She knew she was right and that in the place of the old industry new activities would rise so long as the conditions were kept right for the latter's development.

The New Trend

Now the new trend has become firmly enough established to be visible to all. Up till the last election it was still possible for this government's opponents to argue that there wasn't a true recovery going on. What we were seeing was just a local bubble brought about by temporary expedience which would all burn off after the election was over and the natural downward trend had reassserted itself. We were still being promised doom and gloom. Furthermore it wasn't all that long ago that numbers of economists were prophesying the same sort of thing. This has now stopped. Except for a few totally devoted "flat-earthers" the vast majority have now agreed that we do indeed have a recovery in this country and that prosperity is spreading like the plague. The only thing that the disgruntled can do is to say that they disapprove of how we got here. Yes, they grudgingly admit, we are now better but what a terrible way to have achieved this modicom

of success. It is the last refuge of the intellectuals.

Labour's Conversion

Perhaps the most fascinating spectacle in this changing scene has been that of Labour and the Trades Unions. Mr Neil Kinnock has grasped the nettle. Labour can no longer hope to win an election by appealing to the disaffected in a country in which the numbers of the affected are growing so fast. What, as the Leader of the Opposition asks, do you tell a docker who is on £400 a week? Certainly not that you are going to free him from his misery. But the trouble is that Labour and even Mr Kinnock himself are so grounded in a past based on deprivation and envy that it will take a miraculous conversion to enable them to embrace the new society in which we live with any enthusiasm. They will always be wanting to wash their mouth out after speaking of Britain's prosperity. It is all too painful and foreign to them. This was why the Alliance in its brief moment of glory looked such a good bet. For here was a party that was both liberal and capable of understanding the present and the future. Its demise marks the final victory of the new conservatism.

Paradoxically it is amongst the Trades Unions that the most flexible minds are to be found. It is the Electrical and Engineering unions with their willingness to sign "no strike" deals that are embracing the future with fervour. They are realists. And realists are the ones who understand best what is happening in Britain today.

The Spread of Ownership

The greatest problem for the Left has of course been the phenominal spread of property ownership in this country. On the one hand there has been the purchasing of council houses and on the other the growth in private share ownership resulting from the privatisation issues. The BP issue looks as though it is going to be a mamoth success. Privatisation is no longer a gimmick or a side issue. It has become central to this government's achievements. It really has changed the attitude of the average man in the street towards property. Now that this new state of mind has been created, it is possible to build on it and to achieve a degree of public participation in the whole economic process undreamt of before. The only fly in the ointment is the City. It doesn't like this development and it is not set up to deal with it. What is going to happen is that organisations from outside the square mile are going to get into the mass distribution business. It is inevitable. It is their skills which are needed. And as Saatchi and Saatchi argue the skills of one area can equally well be applied to another. There's really no such thing as banking when it comes to giving the general public a service. Then, banking is just another service business. The business of investment when applied to the mass market falls into the same category. It requires a mass distribution skill. Marks and Spencers should take it on. Alternatively the General Post Office should be privatised and given the task. It is a pity in this connection that the Financial Services Act is so inward looking. It is conceived

I should be grateful for a note on X & Y. This is a v. important Issue.

as an instrument to control the City and to protect the average investor. The fact is that the average investor is being squeezed out of the City. What is needed is a piece of consumer based legislation which will produce a system of distribution which will give the average man in the street the service he deserves. As it is, the security markets are powerless to deal with the needs of the millions of new investors.

MULTIPLE APPLICATIONS AND ALL THAT

It is impossible not to feel that the hapless Mr Best would have done much better to have opted for trial in front of magistrates. They, bless their hearts, wouldn't recognise political pressure when they saw it and anyhow with a much more common sense perspective they wouldn't dream of handing out a custodial sentence for a matter like this. But leaving that aspect aside, why is it that the authorities have invoked the law at its most heavy handed to outlaw multiple applications for privatisation issues? What is so bad about them? This is a free society and it is meant to be a free market. The Government should be pricing its issues at a level which is attractive enough to get them sold but not so attractive as to constitute a giveaway. This is the judgement which confronts any issueing house with new shares to offer by way of subscription. There are no absolutely correct answers. Each case has to be judged on its merits. If the issuer feels he wants to price aggressively then he does so; if he feels nervous then he goes for bargain basement pricing. What has happened here is that the Government have taken to cheating. They want to ensure that their issues are a success and the only way to do this is to underprice them to an almost gross degree. But then they don't want to pay the penalty. So at that point they suspend the free market system and turn to rationing. You can have as many shares as you like so long as you only have one lot. People with two ration books are disallowed. Not just that; they are sent to jail. What is so extraordinary is that nobody has complained about this behaviour which is monstrous. The whole issue has got nothing to do with the protection of the individual shareholder or the private investor. The cheaper newspapers and indeed the posh ones who should know better have fallen for the government's policy, hook, line and sinker and they have been talking the usual kind of humbug. It is time that people came to their senses and thought the whole thing through again.

R.A.W. RUDD
8 BUCKINGHAM PLACE, LONDON SW1E 6HX
TELEPHONE: 01-828 8633, TELEX: 884466

VAT NUMBER: 381 8705 30

RJ8.73

CONFIDENTIAL

FROM: J M G TAYLOR
DATE: 5 October 1987

MR J H REED - INLAND REVENUE

cc Financial Secretary
Mr Lomax
Mr Ilett
Miss Sinclair
Mr McGivern
Mr Cropper
PS/IR

PURCHASE OF OWN SHARES RELIEF

The Chancellor has seen your submission of 30 September. He would be grateful if you could undertake some further work on the proposal, and is content for you to seek the views of DTI on the non-tax aspects and, in the light of these, to consult the Association of Investment Trusts.

J M G TAYLOR

Inland Revenue

Policy Division
Somerset House

FROM: M PRESCOTT
DATE: 5 OCTOBER 1987

1. MR LEWIS

2. FINANCIAL SECRETARY

BAT INDUSTRIES: FINANCE ACT 1984 SHARE OPTION SCHEME

1. The attached letter to the Chancellor from BAT Industries concerns a problem that has arisen with the operation of their Finance Act 1984 "discretionary" approved employee share option scheme. The point concerns the definition of "restricted shares" within the meaning of that Act and has implications for proposed arrangements under which some BAT employees would fund their exercise of options under the scheme. We accept that there is a valid point here, and that it represents a minor and unintended technical snag in the operation of the 1984 legislation. We believe, therefore, that a small change in the rules is needed to help ensure the smooth operation of the schemes. The problem will affect other companies with arrangements similar to BAT's - we have already had queries on the point from other sources, and the CBI have just raised it with us as well.

STATUTORY BACKGROUND

2. Under the 1984 legislation the shares to which the options relate must not be subject to any restrictions

---

cc PS/Chancellor
PS/Economic Secretary
PS/Pay Master General
Mr Monck
Mr Scholar
Ms Sinclair
Mr Cropper
Mr Tyrie
Mr Jenkins (OPC)
Mr Battishill
Mr Isaac
Mr Beighton
Mr Lewis
Mr Easton
Mr Prescott
Mrs Eaton
Miss Green
Miss McFarlane
PS/IR

which do not attach to all shares of the same class. The broad aim is to protect the position of employees by ensuring that they end up with a right to acquire genuine shares, not shares that are in effect second class because they are subject to various kinds of restriction. At the same time, this also prevents companies from being able artificially to pump value into shares acquired under the schemes by manipulating restrictions attaching to them. (You will recall that Section 79 FA 1972 is designed to counter this kind of abuse in the case of unapproved schemes, but those provisions do not apply to shares acquired under any of the Approved Schemes.)

3. The term "restriction" is widely-drawn so as to ensure that these aims are not frustrated by the imposition of restrictions that apply indirectly, to the employee himself, rather than being attached directly to the shares in question. For this purpose, therefore, a restriction includes "any contract, agreement, arrangement or condition by which [the option holder's] freedom to dispose of the shares ... is restricted".

THE PROBLEM

4. As BAT explain, a loan scheme is being set up to help the employees to fund the exercise of their options under the company's FA 1984 Scheme. Under the arrangement, Lloyds Bank - who also act as the company's Registrar - will lend employees the money to meet the subscription price. In return, and prior to the exercise, the employee will authorise the company's Broker to sell sufficient of the shares he acquires and to remit the proceeds of the sale to Lloyds in settlement of the outstanding loan and any charges.

5. In short, as a result of this arrangement the employee's freedom to dispose of some of the shares will be restricted - they will, thereby, be "restricted shares" within the meaning of the legislation. As the provisions stand, therefore, implementation of the BAT proposal would result in the

particular option holders losing their entitlement to income tax relief under the Scheme.

IS ACTION REALLY NECESSARY?

6. The problem with this particular arrangement arises because of the requirement to sell the shares to repay the loan. However, there may well be ways in which BAT (or any other company similarly placed) could, if they wished, arrange matters so as to avoid this result - in which case the problem could be avoided also. For example, it might be possible to arrange for the company itself to guarantee a loan on behalf of its employees, or for the employees to use some security other than the shares. But this may not always be possible or acceptable to the companies and/or employees concerned. Moreover, Ministers may feel that it would not be right to inconvenience companies and employees in this way to avoid what is after all an unintended hurdle in the legislation.

7. On a rather different tack BAT in their letter suggest certain technical arguments which, if accepted, might make it possible to regard the proposed arrangement as not being outside the legislation. We are quite satisfied, however, that the particular arguments mentioned simply cannot be sustained. In essence, the first of these arguments is that because some employees will not be using the loan arrangement, the scheme as a whole will still be one that enables employees and directors to acquire shares which satisfy the conditions for approval, including that the shares should be unrestricted. But this would be tantamount to saying that so long as the conditions for approval were satisfied at the time approval was given, any subsequent changes could be ignored - an obvious nonsense. The second argument is that there might be some room for interpretation whether the charge over the shares under this arrangement was in fact a restriction of the employee's freedom to dispose of them, and might rather be considered as a consequence at the exercise by him of his freedom to dispose of them. However, the wording of the legislation is quite

unequivocable on this, and in our view there is absolutely no doubt that under this proposed arrangement the shares would be restricted shares within the meaning of the legislation.

8. In brief, therefore, we believe that the only way to deal with the problem is to change the rules themselves. The case for action is strengthened by the fact that other companies are likely to be affected as well. As the first batches of approved FA 1984 options start to become exercisable (ie three years from the date of grant), many companies are likely to adopt proposals similar to BAT's. Many may already have set up such arrangements, unaware of this potential snag - this is all the more likely because arrangements of this kind are typically used by companies that have an unapproved share option scheme. Indeed, it is possible that some individual employees may even have entered into such loan arrangements privately, off their own bats. These too would be caught under the legislation as it stands - the shares would still be "restricted" regardless who makes or arranges the loan.

SOLUTION

9. This would be straightforward, and probably require only a small change in the rules. It would be necessary, in effect, simply to provide that shares acquired by an employee or director under an FA 1984 scheme were not to be regarded as restricted shares solely by virtue of any arrangement etc under which those shares were pledged as security for a loan used to finance the exercise of the option, or by which the shares were to be disposed of in repayment of such a loan.

10. On a point of detail, this would also require that the shares had actually been acquired by the employee. In the BAT case it is apparently the intention that the shares to be sold should be allotted directly to the Bank, and not the employees. However, we do not believe that this feature is essential to BAT's plans and we think it important in the proposed rule change to restrict the exemption to cases where the shares are

actually acquired by the employee. This scheme is, after all, designed to enable employees and directors to acquire shares and, though there is nothing to stop disposal immediately after acquisition, it does seem important - if only for presentational reasons - to continue to insist that the employee himself should have come to own the shares, if only for a fleeting moment.

11. The change itself would need to apply from 6 April 1987, the earliest date from which a tax relieved option under the FA 1984 scheme could have been exercised.

12. To help in the particular BAT case - where first exercise of options under the arrangement is imminent - there would also need to be an early announcement of the Government's intention to introduce legislation in next year's Bill.

RECOMMENDATION

13. We recommend that the rules should be changed as described at paragraphs 9-10 above to deal with this problem. The change itself would be quite small - say half a dozen lines of legislation. We would also recommend an early Press Notice announcing the intention to legislate.

14. If you are content to proceed on this basis we will submit a draft Press Notice for approval, and a reply to BAT.

M PRESCOTT

B·A·T INDUSTRIES

Windsor House 50 Victoria Street London SW1H 0NL Telephone 01-222 7979

Registered Office

URGENT

Our ref: XS29

24 September 1987

The Rt Hon Nigel Lawson, MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

Dear Chancellor

THE B.A.T INDUSTRIES "C" SHARE OPTION SCHEME

Shortly after the enactment of the Finance Act 1984, B.A.T Industries plc adopted a share option scheme which was approved by the Board of Inland Revenue under the provisions contained in Section 38 of and Schedule 10 to that Act.

In October 1984 the Board of B.A.T Industries plc resolved to grant options pursuant to the Scheme to approximately 10,000 Group employees to further the policy of wider share ownership enunciated by the present Government and embraced by B.A.T Industries plc. Those options become exercisable in October 1987 and it is in this connection that I am writing to you to point out an apparent contradiction between the policy of the 1984 Act and the Inland Revenue's application of Paragraphs 9 and 10 of the 1984 Act.

Paragraph 5 of Schedule 10 to the Finance Act 1984 permits an option to be granted to an eligible employee provided the aggregate value of shares over which an option is granted to a particular employee does not exceed the greater of £100,000 and four times the amount of his relevant emoluments. The policy adopted by this Board in 1984 was that options be granted to employees with an aggregate market value equal to one year's relevant emoluments. Inevitably, in order to fund the exercise of options employees will usually need to sell some shares to repay borrowings. As you will appreciate, this is the position for most optionholders, but it will be particularly the case when employees have few, if any, other liquid assets. Optionholders in that position will normally be able to raise a loan on security of the shares they are about to acquire. If they are prohibited from doing so, they will be unable to exercise their options and the aim of the scheme would, in large measure, be frustrated.

Lloyds Bank have offered to provide bridging finance. The arrangements would take the form of Lloyds Bank plc agreeing to advance to an optionholder sufficient monies to meet the subscription price and the optionholder would, at the same time, instruct the Company's broker to sell sufficient of the shares he acquires to repay the loan and to remit the proceeds of sale to Lloyds Bank plc in settlement of the outstanding loan.

/Continued .....

I understand that Technical Division of the Inland Revenue are of the opinion that such a scheme would cause the shares to be subject to a restriction as defined by Paragraph 10 of Schedule 10 to the Finance Act 1984. It seems that this would be the case even though B.A.T Industries plc were not party to any loan arrangements, whether arranged by the optionholder with Lloyds Bank or any other bank, which an optionholder may make. This would be the case whether the loan is secured either on the shares to be acquired as a result of exercise of the option or the proceeds of sale of such shares, or if the employee gives an instruction to sell any shares, as would be necessary to confer on the bank a reasonable degree of security. It also seems that the institution of such arrangements could result in the approved status of the scheme as a whole being withdrawn so that all optionholders may be subject to income tax charges on or as a result of exercise of the option.

However I have been advised by solicitors that Paragraph 9 of Schedule 10, which provides that scheme shares must not be subject to any restrictions other than restrictions which attach to all shares of the same class, must be read in conjunction with Paragraph 6 of that Schedule. Paragraph 6 provides that the scheme must provide for directors and employees to obtain rights to acquire shares which satisfy the requirements of Paragraphs 7-11. As some eligible employees will not use any loan arrangement one must conclude that, notwithstanding the loan arrangements, the scheme still enables directors and employees to obtain rights to acquire shares which satisfy the requirements of Paragraphs 7-11 of Schedule 10.

I further understand that Technical Division's interpretation is open to doubt. A charge over the shares or their proceeds of sale given as security for a loan or an instruction to sell shares, is not a restriction on an employee's freedom to dispose of the shares or any interest in them or of the proceeds of their sale but is rather a consequence of the exercise by him of his freedom to dispose of the shares or an interest in them or their proceeds of sale.

Policy Division have indicated that they do not consider that a concession should be granted to alleviate the problems resulting from Technical Division's interpretation and that both Technical Division and Policy Division suggest that the optionholder must find an alternative method providing security for these loans. We have considered this and are advised by bankers that they would not grant loans without adequate security. This means that only wealthy individuals can, in reality, take up options with the benefits of the 1984 legislation. We cannot believe that this was the Government's intention.

/Continued .....

I also understand that Technical Division consider that the B.A.T Industries Share Option Scheme is unique in that it is being used to afford all employees the opportunity to acquire shares in the Company and not just the executives and that the problems I have described are problems for B.A.T Industries plc alone. I believe the contrary to be true and that the problems facing B.A.T Industries plc now will be faced by many companies in the coming months. As the B.A.T Industries Share Option Scheme has been regarded in the press as the ideal employee incentive scheme, and on the advice we have received, I find it difficult to accept the views of Technical Division and Policy Division that loans issued by banks under normal commercial practice, which enable employees to obtain shares, should be regarded in this way. I would therefore be grateful if you and your Board would reconsider the matter at your earliest convenience.

Yours sincerely

B P Garraway
Deputy Chairman

KE:ar:10ircops

Inland Revenue

Policy Division
Somerset House

FROM: D M GREEN
DATE: 7 October 1987

Thanks. 2. What is the answer to question 1? 13/7?

Ch/ The answer is that these figures are indeed in the THEB.

PRIVATE SECRETARY TO THE CHANCELLOR OF THE EXCHEQUER

TAKE-UP OF MEASURES TO PROMOTE WIDER EMPLOYEE SHARE OWNERSHIP

1. My minute of 6 July reported on the take-up of approved employee share schemes up to 30 June 1987. The attached Annex shows the position at 30 September 1987.

2. Of the 655 1984 schemes shown in table 4 as 'under consideration ' at the end of June, over three-quarters had already received their preliminary examination by the Revenue. Of the 336 1984 applications over 12 months old and listed as 'deferred or dropped', correspondence between the Revenue and the applicants is still in fact continuing on nearly 170.

D M GREEN

---

c PS/Chief Secretary
PS/Financial Secretary
Mr Scholar
Mr Neilson
Mr Cropper
Mr Lewis
Mr Lawrance
Mr Beighton
Mr German
Mr Willmer
Mrs Eaton
Miss Dougharty
Miss Green
PS/IR

ANNEX A

1. FA 1978 ALL-EMPLOYEE PROFIT SHARING SCHEMES : CUMULATIVE TOTALS

Date	Schemes submitted	Schemes deferred or dropped*	Schemes under consideration	Formally approved
March 1979	96			3
Sept	161			43
March 1980	228			117
Sept	277			161
March 1981	327			210
Sept	374			247
March 1982	400			278
Sept	443			310
March 1983	476	89	43	344
Sept	505	100	38	367
March 1984	552	107	53	392
Sept	591	109	49	433
March 1985	635	116	57	462
Sept	688	127	66	495
March 1986	733	135	66	532
Sept	778	141	53	584
March 1987	845	144	67	634
July 1987	900	147	76	677
Aug	905	146	76	683
Sept	920	152	76	692

2. FA 1980 ALL-EMPLOYEE SAYE-RELATED SHARE OPTION SCHEMES : CUMULATIVE TOTALS

Sept 1980	10			-
March 1981	82			22
Sept	142			89
March 1982	195			137
Sept	231			184
March 1983	267	12	40	215
Sept	308	17	36	255
March 1984	362	20	54	288
Sept	439	22	75	342
March 1985	516	27	86	403
Sept	573	43	61	469
March 1986	622	50	58	514
Sept	676	52	61	563
March 1987	728	56	54	618
July 1987	773	60	55	658
Aug	782	62	55	665
Sept	794	62	56	676

* This column includes all cases submitted more than 12 months earlier not yet approved.

3. FA 1978 AND 1980 ALL-EMPLOYEE SCHEMES : YEARLY TOTALS

Year to		Schemes submitted	Schemes approved
Sept	1979	161	43
Sept	1980	126	118
Sept	1981	229	175
Sept	1982	158	158
Sept	1983	139	128
Sept	1984	217	153
Sept	1985	231	189
Sept	1986	193	183
Sept	1987	260	221
		1,714	1,368

4. FA 1984 DISCRETIONARY SHARE OPTION SCHEMES : CUMULATIVE TOTALS

Date		Schemes submitted	Deferred or dropped*	Under consideration	Formally approved
Sept	1984	262	-	-	-
March	1985	1,125	7	916	202
Sept		1,649	58	701	890
March	1986	2,041	170	418	1,453
Sept		2,483	235	423	1,825
March	1987	2,959	266	489	2,204
July	1987	3,362	291	587	2,484
Aug		3,442	309	602	2,531
Sept		3,566	336	655	2,575

* This column includes all cases submitted more than 12 months earlier not yet approved.

ps3/30T

RESTRICTED

FROM: J M G TAYLOR
DATE: 12 October 1987

MR ILETT

cc PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mrs Lomax
Mr D J Moore

WIDER SHARE OWNERSHIP: HANDLING PROBLEMS

The Chancellor has noted the statement in Christopher Fildes' ... commentary, attached, that "neither he, nor shareholders, nor the Exchange itself can afford to hang around and wait for the new systems". He has also noted the suggestion in "The Fortnightly" that "what is needed is a piece of consumer-based legislation which will produce a system of distribution which will give the average man in the street the service he deserves. As it is, the security markets are powerless to deal with the needs of the millions of new ... investors." (Copy of relevant extract attached).

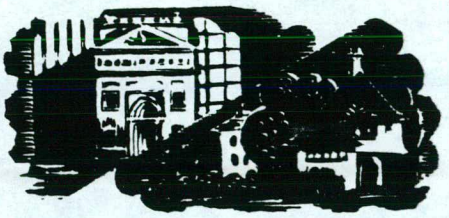
2. He would be grateful for a note on the points raised in these two pieces. He has commented that this is a very important issue.

J M G TAYLOR

Tell your budgie to lay off BP, but pass the form to your aunt

CHRISTOPHER FILDES

The Lord Chief Justice says: do not let your budgie stag the British Petroleum issue unless its teeth are unusually thick-skinned. Filling in application forms in the names of your pets can no longer be recommended, especially since the same effect can be achieved with perfect legality. That said, the Court of Appeal was able to release Mr Keith Best from prison by the skin of *his* teeth, taking the relatively merciful course of increasing his fine and completing the ruin of his career. The next man to put in half a dozen applications for a privatised stock will not, as the Court made clear, be treated so lightly. This still leaves the judges some gradations of punishment for those who, unlike Mr Best, have promoted specious plans for investing in bubbles, stolen millions from those to whom they stood in a relationship of trust, parted the inexperienced from their life savings, or robbed the poor-box. If five extra applications deserve a sentence of imprisonment, what do these crimes deserve? Transportation for life? (To Marbella?) Mr Best should now apply his training in the law (he is the author of *Write Your Own Will*) to the drafting of a Safe Stag's Guide. This would point out that, since it is an established principle of English law that a company and its shareholders are distinct legal entities, there is nothing to stop the would-be-stag from setting up half a dozen companies, each of which would fill in an application form. The simpler and more general practice is for a stag to encourage applications from his sisters and his cousins and his aunts, not to mention the butler, the bootboy and the upstairs maid. They must not, of course, apply applications on his behalf, as the forms now make clear – no more than one application for the benefit of any person. But if they apply on their own behalf, and if he finances their applications, and if they make a turn, shall their gratitude fail? The fault lies not in the stags but in the system, based on offering stock at a price which is, or is believed to be, below the price at which it can be sold in the market. Markets being what they are, this idea stimulates demand, but at this point the market mechanism is abandoned, and demand is met, not with supply, but with personal rationing. One citizen, one issue, one coupon, Mr Best – don't you know there's a war on? In the United States, home of popular capitalism, this nonsense is un-



known. New issues are sold, at a price struck at the last moment between willing buyer and willing seller, to groups of firms which expect to sell the stock on to their customers. No light-footed stags, and no heavy-footed policemen. As for the BP issue, encourage your aunt, but first put a green baize cloth over the budgie.

Unpopular capitalists

POPULAR capitalism and the BP issue will have been much on Nigel Lawson's mind as he prepared to take his bow at Blackpool. The trouble is that his new capitalists are not popular – not in that part of the City which blames them for its backlog of work, and now complains that the minimum application for BP is set so low as to encourage more of them in. The stock market in practice might have gone out of its way to discourage them. A firm of investment managers – not a member firm of the Stock Exchange, and with its own systems in good order – wrote to its private clients this week: 'Many purchases and sales of shares, normally settled about three or four weeks after the bargains of shares, are taking as many months, and more, to be settled. You may have difficulty withdrawing funds from your portfolio. . . .Although the Stock Exchange has announced that the situation is improving, we remain sceptical of its ability to solve the problems properly, at least until better settlement systems are installed. These are planned but are still some time away.' This is the kind of advertisement for popular capitalism which the Chancellor could have done without. Neither he, nor shareholders, nor the Exchange itself can afford to hang around and wait for the new systems. I expect that we shall soon see change and action.

Burnt pocket

THE Trustee Savings Banks were never exactly privatised, since (subject to various opinions in the House of Lords) they had never been exactly publicised. The objects of the TSB's £640 million share issue was to equip the company with some shareholders, and to give the investing public an encouraging dummy run for British Gas. The TSB already had a perfectly adequate amount of capital – unenterprising bank that it was, it had never discovered Brazil – and the £640 million has been burning a hole in its pocket ever since. Now the money has burnt through, and escaped in the direction of Hill Samuel. Hapless Hill Samuel, casting about in the marriage market – a saving bank is not exactly a smart match for an accepting house, but comfortable, and better than marrying a crook or the curate. The takeover is another step in the long and pointless process of making the Trustee Savings Bank more like other High Street banks, As if the other High Street banks were not far too much like one another already! As if there were something wrong with a bank which concentrated on its own, largely personal, not very grand customers! As if many of these customers needed a merchant bank! As if these were not stable and profitable customers whose merits the Big Four have belatedly recognised, the customers to whom the building societies want to sell banking services! As if the TSB had management to spare!

Adjustabuzz

Buzzings in the head are an occupational disease to those who return from international monetary meetings. They are caused by buzzwords. Gender-aware was this year's newcomer, alongside debt-distressed and structural adjustment. Chairman Barber Conable is nagging the World Bank into gender-awareness, and Mrs Conable is nagging Mr Conable. Officials unreliably assert that the Commonwealth has a study group on the role of women in structural adjustment, in which they encounter rigidities. The Chancellor, proclaiming his plan for exchange rate management, said that adjustment should be made by moving the midpoint within the confines of the existing range (otherwise known as the bands or goalposts) I remember this one from 20 years ago, when we last wrestled with the paradox of fixed but adjustable exchange rates, Mr Lawson has reinvented the Crawling Peg.

The Spread of Ownership

The greatest problem for the Left has of course been the phenominal spread of property ownership in this country. On the one hand there has been the purchasing of council houses and on the other the growth in private share ownership resulting from the privatisation issues. The BP issue looks as though it is going to be a mamoth success. Privatisation is no longer a gimmick or a side issue. It has become central to this government's achievements. It really has changed the attitude of the average man in the street towards property. Now that this new state of mind has been created, it is possible to build on it and to achieve a degree of public participation in the whole economic process undreamt of before. The only fly in the ointment is the City. It doesn't like this development and it is not set up to deal with it. What is going to happen is that organisations from outside the square mile are going to get into the mass distribution business. It is inevitable. It is their skills which are needed. And as Saatchi and Saatchi argue the skills of one area can equally well be applied to another. There's really no such thing as banking when it comes to giving the general public a service. Then, banking is just another service business. The business of investment when applied to the mass market falls into the same category. It requires a mass distribution skill. Marks and Spencers should take it on. Alternatively the General Post Office should be privatised and given the task. It is a pity in this connection that the Financial Services Act is so inward looking. It is conceived as an instrument to control the City and to protect the average investor. The fact is that the average investor is being squeezed out of the City. What is needed is a piece of consumer based legislation which will produce a system of distribution which will give the average man in the street the service he deserves. As it is, the security markets are powerless to deal with the needs of the millions of new investors.

3362/30

FROM: MISS S J FEEST
DATE: 14 October 1987

M PRESCOTT IR

cc PS/Chancellor
PS/Economic Secretary
PS/Paymaster General
Mr Monck
Mr Scholar
Ms Sinclair
Mr Cropper
Mr Tyrie
Mr Jenkins OPC
Mr Lewis IR
PS/IR

BAT INDUSTRIES: FINANCE ACT 1984 SHARE OPTION SCHEME

1. The Financial Secretary was grateful for your minute of 5 October.

2. He agrees the recommendations made in paragraphs 13 and 14 of the minute.

Susan Feest

SUSAN FEEST
(Assistant Private Secretary)

COMMERCIAL IN CONFIDENCE
UNTIL NOON ON 16 OCTOBER 1987

FROM: N J ILETT
DATE: 15 October 1987

PS/CHANCELLOR

c c PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mrs Lomax
Mr Neilson

WIDER SHARE OWNERSHIP : HANDLING PROBLEMS

I hope to let you have a note in reply to your minute of 12 October fairly shortly (I have been on leave for a few days). In the meantime, the Chancellor may like to know that Barclays are announcing their new retail stockbroking service tomorrow, 16 October.

2. Ministers know about the Barclays plans from the work we did to try to set up special share handling arrangements through Barclays for BP. In essence, investors will be the beneficial owners of shares registered in the name of a Barclays nominee. But we now have (under embargo until tomorrow) more details of how this will work. For an annual cost of £20, plus a minimum charge of £16 on each deal, Barclays will offer a no-frills dealing service. An advisory service will cost £60 a year. More details are attached.

N J ILETT

Inland Revenue

Policy Division
Somerset House

FROM: M PRESCOTT
DATE: 15 OCTOBER 1987

1. MR ISAAC 15.10

2. FINANCIAL SECRETARY

BAT INDUSTRIES: FINANCE ACT 1984 SHARE OPTION SCHEME

1. Further to the recommendation in my note of 5 October, which you have accepted (Miss Feest's note of 14 October) may we please know if you are content with the attached draft Press Notice, and for it to be issued? It is a bit late now for the Notice to be issued before the weekend, except on limited circulation, and we suggest therefore that it should be issued on Monday.

2. You will also want to reply to the letter of 24 September from BAT Industries, giving them the good news. We will let you have a short draft letter, to go out on Monday, covering a copy of the Press Notice.

M PRESCOTT

---

cc PS/Chancellor
PS/Economic Secretary
PS/Paymaster General
Mr Monck
Mr Scholar
Ms Sinclair
Mr Cropper
Mr Tyrie
Mr Jenkins (OPC)
Mr Battishill
Mr Isaac
Mr Beighton
Mr Lewis
Mr Easton
Mr Prescott
Mrs Eaton
Miss Green
Mr Willmer
PS/IR

DRAFT

INLAND REVENUE

Press Release

INLAND REVENUE PRESS OFFICE, SOMERSET HOUSE, STRAND, LONDON WC2R 1LB
PHONE: 01-438 6692 OR 6706

[3x]

October 1987

FINANCE ACT 1984 EMPLOYEE SHARE OPTION SCHEMES: RESTRICTED SHARES

The Financial Secretary to the Treasury, the Rt Hon Norman Lamont MP, today announced the Government's intention to introduce in the 1988 Finance Bill a small change to one of the detailed rules in the Finance Act 1984 approved employee share-option scheme, designed to help the smooth operation of such schemes. The rule concerned could in certain circumstances operate more restrictively than was originally intended, and the proposed change will enable employees or directors to enter into certain loan arrangements in relation to the scheme shares which they acquire on exercise of their options without that affecting their eligibility for income tax relief under the scheme.

The text of the Financial Secretary's statement is as follows

> "Under the 1984 legislation the shares to which the options relate must not be subject to any restrictions which do not attach to all shares of the same class. This protects the position of employees by ensuring that they acquire genuine shares and not ones whose value may be artificially manipulated because they are subject to various kinds of restriction. The legislation is widely drawn to include restrictions that might be applied indirectly to employees or directors themselves, rather than being attached directly to the shares.
>
> As the legislation stands, however, a loan taken out by option holders to fund the exercise of their options could also be caught - with a resulting loss of entitlement to income tax relief on the option gain. This could happen, for example, if the shares were pledged as security for a loan, or if the employee was committed to disposing of some of the shares to finance repayment of a loan - in either case, the employee's freedom to dispose of the shares would be restricted as a result of the loan arrangement.
>
> This was not how the Government intended that this particular provision should operate. We therefore propose to introduce legislation in next year's Finance Bill to correct the position, by ensuring that shares acquired by an employee or

/director

director under a Finance Act 1984 scheme will not be regarded as restricted shares solely by virtue of any arrangement by which they are pledged as security for a loan, or by which they are to be disposed of in repayment of a loan. This change will be deemed to have had effect from the start of the scheme".

Notes for Editors

1. Under the FA 1984 approved employee share option scheme, a company may grant options over shares to some or all of its employees and directors, up to a value of 4 times annual salary or, if greater, £100,000. Relief from income tax on the option gain is available provided that various qualifying conditions are satisfied, including a requirement that the shares to which the options relate are not subject to any restrictions that do not attach to all shares of the same class. The term "restriction" for this purpose is widely drawn, and Paragraph 10 of Schedule 10 to the Finance Act 1984 includes as a restriction any contract, agreement, arrangement or condition by which the option holder's freedom to dispose of the shares or their proceeds of sale is restricted.

2. Employees may sometimes not have sufficient funds of their own to finance the exercise of their options under the scheme, and they may therefore need to borrow the money for this purpose. Technically, however, if they pledged the shares to be acquired under their options as security for that or any other loan, or if they entered into a commitment to dispose of some of the shares to finance repayment of a loan, that would under the legislation as it stands represent a "restriction" on their freedom to dispose of the shares, and they would thereby lose their entitlement to income tax relief under the scheme. The change announced by the Financial Secretary will prevent that result.

Pl. amend, delete para nos., + narrow l.h. margin to 1".

C.

"OBSERVER" ARTICLE

1. I have marked PE's suggestions, and some from MOM, on the copy below.

2. The "Observer" asked for about 1500 words. The draft still stands at 1750. I have suggested some cuts in paras 6, 12, 13, and 22, which would bring it down to 1550.

AHH

16.10.

3696/012

PLP

RESTRICTED

FROM: MRS M E BROWN
DATE: 16 OCTOBER 1987

cc: Mr D J L Moore

MR HUDSON

"OBSERVER" ARTICLE ON PRIVATISATION

Some suggested amendments are shown on the attached copy of the draft article. I would add the following comments:

Transcribed onto copy below, APH

Para 3: Since British Steel is a privatisation candidate, it would be better not to draw attention to its lack of profitability not many years ago;

? Scale of turnround is the reason why it's a privatisation candidate.

Para 6: Important not to knock the past record of the nationalised industries, without acknowledging more recent improvements. Some remain in the public sector, and there are dangers in implying that they are being run inefficiently. The same point applies in para 8; — already redrafted by you.

Para 12 (third sentence): The Chancellor should not seem to speak on behalf of BT;

You took the relevant passage out yourself.

Para 16: Shares from the first Britoil tender were left with the underwriters. Better to focus on the loyalty bonus;

Para 22: It would be strange to make no reference to BP in this article. The lawyers are content with the suggested insert.

Mary Brown

MRS M E BROWN

Enc:

RM14.26

THIRD DRAFT OF "OBSERVER" ARTICLE ON PRIVATISATION

Privatisation has swept the world. The idea that was treated with suspicion and hostility when this Government introduced it in 1979 is now an integral part of the economic policy of all the seven leading countries that meet at the international summits. Dozens of others, all over the world, have followed suit - from Mexico to Malaysia, from Finland to the Philippines. And - indicative of Britain's pioneering role - the very word "privatisation" is used in almost every language, including Japanese.

2. The present Government's privatisation programme was originally conceived as part of a new approach to economic policy - that the way to achieve healthy growth was not ~~through the~~ by artificially boosting demand, ~~management of~~ as in the 1960s and 1970s, but by improving the working of the supply side of the economy. This meant enabling markets to work more freely. And one of the biggest impediments to ~~this~~ that was the vast block of nationalised industries.

3. Looking back to 1979, nobody could honestly say that the nationalised industries were one of Britain's success stories.

- Financially, they were a massive drain on the Exchequer. The total cost amounted to ~~over~~ nearly £3 billion a year. British ~~Steel~~ Coal alone cost the taxpayer ~~[£4 million a day]~~ £ X X million pounds a day. ~~[Or other examples.]~~

- Nor was this money well used. The industries' record on investment and productivity was poor. And their service to the customer was a byword for inefficiency and delay.

4. ~~Frankly,~~ the nationalised industries were something of a music hall joke - but one that ~~was doing immense damage to the economy~~ putting an ~~brake on~~ Re Germany ships could not afford. In 1979, they accounted for over one tenth of national output, ~~and~~ more than a sixth of total fixed investment, and employed some 1¾ million people. No ~~successful~~ country could ~~afford to have~~ be successful with such a large and essential sector of its economy so seriously underperforming.

5. Repeated attempts had been made to improve the performance of the nationalised industries. None had succeeded, because none had got to the root of the problem. It was not that the people working in the industries, at all levels, had lacked talent or dedication. But they were in an impossible position - expected to perform as businesses, but facing interference in their decisions from politicians and civil servants, and having to compete for finance with

other claims on public funds, such as defence or social security.

6. It was clear that these contradictions could not be resolved simply by a change of management at the top, or by tinkering yet again with the rules governing the industries. The problem was inherent in the structure within which they operated. As I said four years ago, "The business of Government is not the government of business." So the answer, wherever possible, was to set the businesses free.

7. Free, in particular, for management to manage without interference, or unnecessary restrictions, such as that which prevented Associated British Ports from developing the area around its docks until it was privatised. But by the same token, managers have to take full responsibility for their decisions, answering to their shareholders and - in some cases - to the regulatory authorities. They can no longer blame their failings on the Government. They are free to look to the capital markets for funds - but they have to convince the markets first that their businesses are worth investing in.

8. These benefits apply equally to all the companies that have been privatised. Those that are in direct competition with other businesses are exposed to the full play of market forces. Those that remain full or near

monopolies are regulated by new agencies whose specific job is to keep the companies up to scratch.

9. The acid test of the success of privatisation is the performance of the privatised businesses. ~~They have flourished~~. Most are reporting substantially higher profits, and higher orders. The example of Jaguar is particularly striking, with production, which slumped in the 1970s, at an all-time high, investment up massively, and 2000 new jobs. British Airways, a sorry case in the 1970s, now has a justifiable claim to be the "world's favourite airline".

10. The success of these firms does not only benefit their shareholders, of course. It benefits the whole economy. The orders generated create opportunities for other firms as suppliers, or sub-contractors. A successful firm will offer more lasting jobs than an ailing one. And the Exchequer benefits, through tax on the increased profits.

11. Among the privatised companies, British Telecom is currently attracting a certain amount of criticism, and inevitably some people are attributing the faults they see to privatisation. But in fact, BT is, on most indicators, a great deal more efficient than it was when it was part of the State sector. For example, in 1980, a quarter of a million people were on the waiting list for a phone; now, most new customers are connected within

8-10 days. ~~[Is this still true?]~~ BT is now making rapid strides to catch up on investment opportunities denied them before privatisation - last year ~~they commissioned~~ a new digital exchange was commissioned every working day.

MOM

12. What BT is experiencing is, in fact, the healthy pressures that come with being in the enterprise sector. Customers who were resigned to putting up with mediocre service from a nationalised industry expect more from the new BT - not least if they are shareholders themselves. I welcome that, ~~and so does BT.~~ And BT knows that more and more of its customers have a choice of telephone services. Mercury may not yet be competing on a very broad front - you cannot build up a complete alternative network overnight - but it is developing fast. Before privatisation, there was no competition at all. ~~[Is this accurate?]~~

MB

MB

APH: Omit to end of 13, to shorten?

13. In short, the privatised companies are now an established part of a thriving, profitable British industry. Few people would now seriously suggest that they should be returned to State ownership. Who could argue that Jaguar would do better under the care of the Department of Trade and Industry than under its present management? Or that the Department of Energy should be dictating policy to Britoil? It is simply not the Government's job to build cars, or run an oil company.

14. Privatisation has transformed the efficiency and performance of several of the biggest businesses in this country. But from the outset, we have used it to fulfil another objective of equal importance: the extension of share ownership in this country.

15. To describe the way the nationalised industries used to be run as "public ownership" was a travesty. Most of the British people did not even realise that they nominally "owned" those businesses. They had no personal stake in them. ~~Certainly, nobody saw the slightest benefit from their supposed stake.~~ In contrast, ~~to this absurd position,~~ we set about creating what Geoffrey Howe described, in his first Budget Speech in June 1979, as "wider public ownership in the true sense of the term".

MB (I slightly prefer the original. AHH)

16. To encourage wider share ownership, we have devised a number of new approaches. Nearly five years ago, for the first sale of Britoil shares, I offered a loyalty bonus to small investors who held their shares for three years or more. Special facilities for the small investor have been a feature of ~~[Similar arrangements have been used in ~~most of~~ [all]~~ almost all the major share sales since then, along with unprecedented distribution of prospectuses and application forms, coupled with major advertising campaigns. Special incentives have also been given to encourage employees to buy shares, in every privatisation where a majority shareholding has been sold by stock market flotation.

APH/ MB (exception was RR)

17. The efforts to spread share ownership have been a triumphant success. A high proportion of employees took the opportunity to buy shares from the start - virtually all the staff in Cable and Wireless and Amersham International did so when they were privatised in 1981-82, and this pattern has continued. But the real breakthrough on wider share ownership came with the massive British Telecom sale in November 1984, when over 2 million people bought shares. More than double that number bought British Gas shares last year, ~~and over a million did so for British Airways only three months later.~~ Thanks largely to the privatisation issues, the number of shareholders in the UK has almost trebled, from under 3 million in 1979, to 8½ million ~~today~~ - one in five of the adult population, — by the beginning of this year. And since then, ~~that was before~~ British As the sales of British Airways, Rolls Royce, and BAA, have each ~~of which gains~~ has given a further boost to share ownership.

18. Privatisation has thus contributed to what is nothing less than a transformation in society. For decades, the proportion of shares held directly by the public fell, as institutional investors came to dominate the market. Shareholding was seen as the province of the rich, which reinforced the widely held convinction that Britain was permanently divided between "them and us".

19. Wider share ownership has done much to break down that divide. The benefits are clearest for employees, who are bound to perform better if they have a stake in

the company they work for. But beyond that, share ownership stimulates a closer and better informed interest in the performance of British industry, as more and more people have a personal financial stake in whether our leading companies are doing well or not, and why. That is of vital importance for our future economic success.

20. The new shareholders follow the prices of their shares in the newspapers, receive regular information about how ~~the annual reports of~~ the company is performing, can attend the annual meetings, if they wish, and know they will receive a dividend if the company does well. That is real ownership.

MN

1500

21. Privatisation has thus transformed the economic and social landscape of this country - a radical reduction in the public sector, boosting the performance of a large and vital part of industry, and the widest spread of ownership that we have ever seen. These were the objectives we set out to achieve, and they have been fully met. That should be more than sufficient to dispel the idea that privatisation was undertaken simply to raise money to swell the Government's coffers. Nothing could be further from the truth.

1600

22. What is true is that we have devised a variety of new techniques to improve the value we get from the sales. The 1985 Cable and Wireless sale pioneered competitive underwriting in London, which has reduced the

1622

cost of sales. ~~And~~ The BAA sale in July featured a unique combination of a tender and a fixed price offer, thus encouraging the general public to participate, while maximising the proceeds from institutional buyers. Both these innovations have been a notable success.

Given MB's suggestion below, I'd drop the ref. to BAA (though it's the only survival from the Grimstone draft!)

23. The privatisation programme goes on. Work is well under way on plans for water and electricity. More will follow. And as the privatised companies go from strength to strength, privatisation will be seen for what it is: an integral part of the revitalisation of the British economy, a revitalisation which is now as widely acknowledged throughout the world as are the merits of privatisation itself.

MB – see cover note.

In the current BP offer – not a "privatisation" ~~as such~~ but a sale of the Government's remaining shareholding – we are looking to institutional investors to pay the keenest possible price, in a tender, alongside our fixed price offer to the small investor.

BARCLAYSHARE PRESS BRIEFING

GAVIN OLDHAM, CHIEF EXECUTIVE

FRIDAY, 16TH OCTOBER 1987

I hope today to demonstrate clearly that Barclayshare really is "a better deal in stockbroking". As we said when Barclayshare's formation was announced in July last year, our objective is to set new standards in the provision of high quality stockbroking services for the personal customer and encourage wider share ownership.

We have spent a lot of time and money to develop our new Dealing and Advisory Service, whose implementation in the Barclays branch network is due to begin on Monday. We have been working on it for over 18 months due to the extensive programme of systems development which has involved approximately 45 man years.

In virtually every aspect of our new concept in retail stockbroking we will provide higher quality of service and added value which will give customers a better deal in stockbroking. And in closely combining these services to an optional new banking account, the Barclayshare Investor Account, we provide maximum benefit to the customer in linking broking and banking services.

Our new service is specifically for the Stock Exchange investor who prefers to take his or her own decisions on which shares to buy and sell. The service is offered in two versions, both of which feature the very significant added-value feature of portfolio administration and reporting. It is designed to comply with the new regulatory environment, working with the rules to introduce higher quality rather than avoiding their effect. The first action is therefore to complete an application form, which will be available in this brochure in all Barclays branches by March next year.

If you require the Dealing service, you will be sent a Dealing Card, a folder in which to keep investment documents such as contract notes and portfolio valuations, and a handbook on how to get the best out of the service. You will be able to place orders in a wide range of shares - all listed UK Equities, Gilts and Unit Trusts - over the telephone to the Barclayshare Centre or at any Barclays branch. No waiting for dealing limit checks: the system does that automatically. No need to confirm a telephoned deal in writing, if it is to the Barclayshare Centre. The contract note will be at your home address within 48 hours and settlement will take place on the due date, whether it is a purchase or a sale.

It's necessary to have a dealing account with Barclays in order to use Barclayshare's stockbroking services; but it's not necessary to move your main banking arrangements if you bank elsewhere. However, we are introducing a special Barclayshare Investor Account which pays high interest when in credit, has no bank charges, and on which you can borrow at very competitive rates if the loan is arranged in advance. Your bank statements show details of your transaction: the stock you sold or purchased, and a cross-reference to your contract note. You can also use your share portfolio as security against loans from Barclays Bank.

The key to Barclayshare's operation is the virtual elimination of paperwork associated with share dealing. With the backing of a sophisticated centralised computer system there is no need for stock transfer forms or dividend mandates, nor share certificates to check and keep on file since they are held centrally by Barclayshare using nominee registration.

But it's the portfolio administration and reporting features which really set Barclayshare apart from the competition for this service.

Just as with your bank account, you can simply walk into any branch of Barclays providing the service and request a summary of all your shareholdings valued at last night's closing price. No sweating over the newspaper, or reconciling your share certificates against your own records: all that is done for you by the fully automated Barclayshare system. Twice a year, as of 5 April and 5 October, you will receive a formal valuation, complete with the cost of your purchases and the current yield on the stocks.

And even that's not all, because as of 5 April you'll also receive a consolidated or "composite" Dividend Tax Voucher, which can be attached to a tax return to the Inland Revenue, if you have to submit one. There's no need to be concerned with individual slips of paper, which falls out of one's bank statement: that single summary is accepted by the Inland Revenue as a bona fide confirmation of tax already deducted on dividends.

It would be reasonable to think that such a comprehensive dealing service would cost the earth: or that it would only be available to the very wealthy. I am pleased to be able to inform you, however, that this is not the case: while the competition, including the other clearing banks, are busy raising their charges or suspending their services, our dealing commissions are set specifically with the active investor in mind: £16 minimum, and, on UK Equities a scale of 1.25% for the first £5,000, 0.75% for the next £10,000 and 0.5% for the remainder up to a maximum of £250. We also make a £10 charge half-yearly for the Dealing service, which covers for all the portfolio administration and reporting features.

Moving from the Dealing service to the Advisory service, our story of higher quality and added value continues. Advisory service customers

get all the Dealing service features, plus a really comprehensive set of advice features. We are particularly concerned about the availability of advice services to personal customers; more and more private client stockbrokers are pricing out this availablity and increasingly the only available source is the weekend press. We have taken a fresh look at providing advice, and have decided to positively offer a continuing flow of ideas each month to those customers requiring this service. However, we have taken careful steps to ensure that this advice is appropriate for the customer's individual circumstances.

We therefore ask a number of questions about your personal and financial circumstances when you apply for this service. This enables us to provide a personal portfolio guide, which provides a structure at various levels of total investment value to assist in the building of a portfolio of investments. This proposes a proportion of overall value to invest in UK Equities, Gilts and Unit Trusts, and a maximum unit holding for each investment type.

The guide is in the information pack sent to those applying for the service, which also includes their first copy of our monthly newsletter "Prospects". "Prospects" is sent to your home address, and it contains not only an overview of the market but also specific share recommendations under key numbers which relate to your portfolio guide.

There is also a digest of information : dividends coming up on leading shares, take-overs and right issues etc.

In addition our helpline at Watford, manned by qualified and experienced Account Executives who are equipped with screen information not only on the latest research available from BZW but also with the circumstances of individual customers, is available from 8.30 am to 5.30 pm each weekday.

The Advisory service is also sound value, as with the Dealing service: the same very competitive dealing commission rates and a quarterly subscription of just £15.

And we haven't stopped there in making stock market information available to the personal customer. As from November all branches will be equipped with "Teleshare", a new telephone information service which provides real time prices direct from the Stock Exchange. A special feature of these telephones is the provision of Bid and Offer prices, to provide realistic dealing estimates.

We are also carrying out a three month trial of the new Stock Exchange "Market Eye" screen in 30 leading branches to test their acceptability in the branch environment. With the great flexibility offered by telephone dealing, and with dealing access by terminal available from behind the counter in the bank branches, we do not rate the provision of a "transaction screen" on the counter such a high priority: but we do recognise a demand for continually up-to-date market price information presented in an easily understandable format. "Market Eye" does just that. More detailed information about this new service will be announced by the Stock Exchange next week.

As you can see, the service announced today represents a major step forward not just for Barclayshare but for the whole availability of retail stockbroking services. However we cannot just wave a magic wand and install it in every branch on Monday. During the next month, 90-100 leading branches at the rate of some 5 branches a day spread throughout the country will be fully equipped to provide the new stockbroking services. And an intensive staff familiarisation programme will enable the service to spread rapidly thereafter to encompass the remainder of Barclays 2000 main branches by next March.

There has been much comment recently in the press about the need for a major new initiative in retail stockbroking services. In particular a Mr Apfel from New York has been propounding the use of nominee registration, based on the clearing banks, to provide this important improvement of efficiency. We are pleased to say that this is one major initiative where the British, in the form of Barclays Bank, succeeded in grasping the nettle - two years ago. Barclayshare is therefore in a position to deliver what every active Stock Market investor wants: a better deal in stockbroking.

NEWS FROM

BARCLAYS

EMBARGO : NOT FOR PUBLICATION UNTIL 12 NOON, FRIDAY, 16TH OCTOBER 1987

BARCLAYSHARE LAUNCHES NEW SHARE DEALING AND ADVISORY SERVICE

Barclayshare, the retail stockbroking arm of Barclays Bank, today (Friday, October 16) announced details of a new national share dealing and advisory scheme designed to set new standards in the provision of high quality stockbroking services for private investors and encourage wider share ownership.

The phased introduction of the new service begins on Monday, October 19 when a two-tier service will be launched giving private investors a choice of opting either for a share dealing service coupled to portfolio administration and reporting, or having the added benefits of personalised investment advice.

Over the next month some five branches a day will begin to offer the new service and an intensive staff familiarisation programme will enable the service to spread rapidly thereafter to encompass the remainder of Barclays 2000 main branches by next March.

Announcing the service, Gavin Oldham, chief executive of Barclayshare, said: "In virtually every aspect of our new concept in retail stockbroking we will provide a higher quality of service and added value which will give customers a better deal in stockbroking".

Investors will be required to maintain an account with Barclays to pay for their share dealing, but it need not be their main banking account. They can choose to have either a normal cheque account or a special optional new account - the Barclayshare Investor Account - which pays interest on credit balances.

"The key to Barclayshare's operation is the virtual elimination of paperwork associated with share dealing," said Mr Oldham. "With the backing of a sophisticated centralised computer system there is no need for stock transfer forms or dividend mandates, nor share certificates to check and keep on file, since they are held centrally by Barclayshare using nominee registration".

The share dealing service offers the buying and selling of shares at best market prices covering all listed UK equity shares, government stocks and authorised unit trusts. An advanced telephone system has been installed to ensure swift response and customers will also be able to deal direct with Barclayshare by telephone any weekday between 8.30 am and 5.30 pm or through Barclays branches.

Portfolio administration features regular formal valuations, summaries available from the bank's branches and a consolidated or "composite" Dividend Tax Voucher at the end of each financial year. Settlement of share transactions is automatically routed to the customer's bank account on the due settlement day, so insulating the customer from the difficulties currently being experienced in market settlement. Dividends are also automatically credited.

Barclayshare's advisory service provides investors with all facets of the dealing operation plus personalised investment advice. As well as a portfolio guide recommending investment strategy, based on the investors personal and financial circumstances, there is also a regular monthly Barclayshare report called 'Prospects' giving specific share dealing advice.

With the portfolio guide referenced on Barclayshare's own computer, investors can quickly be given details of shareholdings, assessment of personal investment strategy, access to up-to-date stock market information and advice on specific shares using the research expertise of Barclays de Zoete Wedd, the Barclays Group investment bank.

The dealing commission rates are keenly competitive and apply to both services. There is a minimum commission rate of £16 (maximum £250) with rates of 1.25 per cent for UK equities deals up to £5000, reducing to 0.75 per cent for deals between £5001 and £15,000 and 0.5 per cent thereafter. A modest subscription is also charged, which recognises the many value-added features of the two services. For the dealing service it is £10 half yearly, and for the advisory service, £15 quarterly.

(Ends)

Note to Editors

Copies are available of a press release dated July 1986 which announced the establishment of Barclayshare, its objectives and provided background information about the establishment of the dealing and advisory service described above.

For further information contact:

Gavin Oldham
Chief Executive
Barclayshare Centre
Iveco-Ford House
Watford
Herts WD1 1SR
Telephone: (0923) 246353

Roger Sterba
Manager
Public Relations Department
54 Lombard Street
London EC3P 3AH

Telephone: 01-626 1567 ext 4374

PLEASE NOTE THAT THIS RELEASE IS EMBARGOED

3362/50

FINANCIAL SECRETARY TO THE TREASURY

pp3 pf

FROM: J J HEYWOOD
DATE: 19 October 1987

MR ILETT

cc PS/Chancellor
PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mrs Lomax
Mr Neilson

WIDER SHARE OWNERSHIP : HANDLING PROBLEMS

1. The Financial Secretary has seen your note to Mr Taylor of 15 October. He thinks this development is very good news indeed.

9.11

JEREMY HEYWOOD
Private Secretary

3369/05

FROM: J J HEYWOOD
DATE: 19 October 1987

MR PRESCOTT IR

cc PS/Chancellor
PS/Economic Secretary
PS/Paymaster General
Mr Monck
Mr Scholar
Ms Sinclair
Mr Cropper
Mr Tyrie
Mr Jenkins OPC
PS/IR

BAT INDUSTRIES: FINANCE ACT 1984 SHARE OPTION SCHEME

1. The Financial Secretary was grateful for your note of 15 October and has approved the press release for issue on Monday.

JEREMY HEYWOOD
Private Secretary

Windsor House 50 Victoria Street London SW1H 0NL Telephone 01-222 7979

Patrick Sheehy
Chairman
B·A·T INDUSTRIES p.l.c.

19th October 1987

The Rt. Hon. N. S. H. Lamont M.P.,
Financial Secretary to the Treasury,
The Treasury,
Parliament Street,
London. SW1P 3AG

Dear Mr. Lamont,

Following the letter from my colleague, Mr. B. P. Garraway, to the Chancellor on the subject of Share Options and the 1984 Finance Act, I am pleased to hear that we may shortly expect to receive a waiver from the impact of the provisions of that Act to allow us to offer share option holders a loan facility.

We have been in touch with the Revenue to ask when we can expect this waiver, but understand the matter is "now in the hands of the Minister". I appreciate that you will have many other important matters to consider but time is pressing for us, and no doubt many other companies in similar circumstances. The window when options may be exercised is a short one between late October and mid January and in order for us to let option holders know that there will be a facility for them to finance the exercise of their options we do need a response within the next few days. I would therefore be most obliged if you could find time to give this matter your urgent attention.

Yours sincerely,

P. Sheehy

RESTRICTED

FROM: N J ILETT
DATE: 20 October 1987

CHANCELLOR

cc: Financial Secretary
Economic Secretary
Sir P Middleton
Mr Cassell
Mrs Lomax
Mr D J Moore
Mr Neilson
Mr Cropper

WIDER SHARE OWNERSHIP : HANDLING PROBLEMS

Mr Taylor's minute of 12 October asks for comments on Christopher Fildes' article on "Unpopular capitalists" in The Spectator, 10 October, and on the suggestion in "The Fortnightly", which calls for a "piece of consumer-based legislation" to produce a system of distribution for retail investors.

2. The points these articles make are largely the same, though the suggestion for "consumer-based legislation" sounds a bit odd.

Problems of retail distribution

3. I think it is helpful to look at the problem of retail distribution of shares under three headings:

(i) Demand, and the readiness of institutions to take risks in providing for demand which has not yet emerged;

(ii) Physical infrastructure;

(iii) Legal infrastructure.

Demand

4. We have obviously greatly increased the demand for share ownership. The difficulty for the potential retail institutions is that, as yet, the extra share ownership is thinly spread and the trading habit is not well established. The most notable contribution to retail operations so far has been the Nat West counter screen operation. This only handles RLAs from the most

recent privatisation, for a limited period. And although I think it is theoretically two-way, in practice it is virtually exclusively used for selling and so reflects the post-privatisation demand which has clearly emerged. It would be tempting just to look at demand in terms of the chicken and the egg, so that, if we could get better retail systems established, people would come forward to use them. This is probably true up to a point, but institutions which decide to invest time and money in retail networks do so on the basis of a pretty considerable element of faith.

Physical infrastructure

5. Physical infrastructure is clearly a basic problem. Settlement difficulties and high commission charges apart, the traditional brokers were not equipped to handle either the scale of the new share ownership nor in many cases the type of potential customer we are now looking at. Key concepts are access and familiarity - within limits, these are probably more important than price. I do not think there is any substitute to friendly and easily accessible counters of one kind or another. I would personally be sceptical about using Post Office counters, even privatised, as "The Fortnightly" suggests, and not much more enthusiastic about Marks & Spencer. The obvious candidates are the clearing banks, and they are the people to push.

Legal infrastructure

6. Third, legal infrastructure. We have not identified fundamental problems. The Companies Act needs looking at, to make large share registers less unattractive to companies simply in terms of the weight and nature of communications between them and their shareholders; and we need to improve the relationship between companies/nominees/beneficial owners if nominee systems are to operate as well as they should. And technical changes to the stock transfer legislation and tax legislation are needed for dematerialisation of share certificates. We have this in hand. More on these points below.

7. These legal improvements are, however, essentially permissive. They remove inconveniences of various sizes. They do not in themselves encourage the growth of retail demand or of the machinery to meet that demand. Nor is it clear how they could.

8. The other piece of legal infrastructure is the consumer protection legislation. There, the Financial Services Act should represent an unambiguous improvement. If it does not, something has gone very badly wrong. We wait and see.

Retail market developments

9. Against this background, there are two main approaches in hand:

(i) The Stock Exchange's TAURUS system;

(ii) The use of nominee accounts, as now introduced by Barclayshare, advocated (separately) by Mr Apfel, and used by virtually all PEP managers to keep down costs.

TAURUS

10. TAURUS was first discussed, at least in public, in 1980/81. It is an all-singing, all-dancing system to carry everything electronically; trading, settlement, payment, and registration. So it gets around the present, very expensive and lengthy paper-handling system which has led to the settlement difficulty and, through its cost, must have substantially reduced the willingness of brokers to extend their client services down-market. But it does not simplify the procedures themselves; it just executes them more efficiently.

11. The Stock Exchange assure me that they are adapting TAURUS to fit the new wider share ownership world, and that it should be perfectly possible for at least reasonably small investors to have their own TAURUS sub-accounts via brokers at reasonable cost. But critics of TAURUS say that it is an obsolescent concept; it puts everybody's eggs in one basket, because it is a central system; and it is really designed for the old market. It operates off existing brokers and does not itself provide easier access - unlike Barclayshare. There are also the technical problems in getting it up and running. These reflect its size and scope and are not fully resolved. The timetable is supposed to be 1989, but the Exchange hope to bring at least parts into effect in 1988 so as to ease the settlement problems. This will require major legislation on stock transfer and tax earlier than we had firmly been told

(by the Exchange) to plan for. The DTI propose to use their Financial Markets (Clearing Systems) Bill to cover the stock transfer points, and the Revenue will be advising on technical implications for the Finance Bill.

12. In short, TAURUS is promising but unproven.

Nominees

13. You will be familiar with the Barclayshare system from the notes we produce in the context of BP, Mr Apfel's calls on the FST and EST, and Barclayshare's own annoucement last week. The nominee system is a development of the US system, where physical share certificates are very largely held by a handful of depositories and movements in beneficial ownership are recorded on computer. In theory, of course, there is no need to have physical certificates at all, and that is what TAURUS would achieve. In practice, a very large proportion of the costs which dematerialisation achieves can also be achieved by the combination of nominees and depositories, and this has the additional advantage that it can be achieved immediately, by organic growth through a number of different people offering these services, and on a decentralised basis.

15. I am pretty sure that Mr Fildes' oblique references to "things about to happen" refer to Mr Apfel and the Government's known interest in improving retail mechanisms. Mr Apfel knows how hard we tried to put something in place on these lines for BP, he has had a number of discussions with Treasury Ministers and officials, and he has developed a wide range of City contacts. See Mr Fildes' 12 October article on Mr Apfel, attached.

16. As noted, there are no legal barriers to the nominee system, but it would be sensible to legislate as soon as possible to give shareowners who hold via nominees the same rights as other small shareholders in terms of voting, access to company report and accounts etc. The Revenue is looking at the tax implications, which should mainly be technical. And it would sensible to continue to plan to use the privatisation programme to encourage nominee shareholding, in part to reduce settlement consequences, in part to encourage the development of more economic shareholding mechanisms.

Conclusion

17. Where do we go from here? On TAURUS, we can continue our dialogue with the Stock Exchange. Mr Apfel is, as Mr Fildes' second article explains, now working for the Stock Exchange for a few weeks, and he may try to produce something to bridge TAURUS and the nominee system. (I have been giving him some help in explaining UK regulatory practices, institutional peculiarities etc.) On nominees, if market circumstances allow, you plan to congratulate Barclayshare in your Stock Exchange speech next week, we can continue to use the privatisation programme, and we can look for other opportunities for encouraging the market to move in this direction. And we are discussing the legal infrastructure points with the DTI.

18. Finally, FIM will be producing a paper on "Whither wider shareownership", I hope by the end of the year, which will pull the main issues together. And measures for facilitating wider share ownership are now, of course, part of the supply side programme.

N J ILETT

Daily Telegraph

CHRISTOPHER FILDES

Awaiting the doctor's orders

22

DEMOLISHING the City's paper mountain starts at 10 o'clock this morning, when the Stock Exchange's doors swing round for Robert Apfel.

His arrival signals a wholly new approach to the machinery of share ownership — settlement, registration, custody, title. We can look forward to new systems, cheaper and faster. There will be much less paper, and much less of it will move about.

The system we have now is unchanged since before the Big Bang and for many decades before that. Trying to handle three times as much business and four times as many shareholders as before, the machinery has seized up, jammed with paper.

Share transfers are taking months to complete. Documents are piling up, and many must by now be lost, or stolen. Firms and their clients are at risk, and cannot even quantify that risk. Already we have seen a merchant bank, Kleinwort Benson, draw on its inner reserves to cover the cost of confusion in its back office.

Back office trouble is Robert Apfel's speciality. He is a consultant, based in New York, who advises banks and brokers on systems, and he can fairly claim to have given London early warning that its systems could not cope.

In this column on March 30 I recorded that warning, and on August 3 I set out his recommended routes down from the paper mountain. It was then clear that the Exchange could not get by on its mixture of pep talks, overtime working, spreading the blame, and waiting for its new computerised system to come over the horizon.

Now the Stock Exchange, much to its credit, has called Dr Apfel in as a matter of urgency. His brief is to find a way in which securities could be held in a central depository, rather than passing from hand to hand as they do now. This would require what he calls 'a nominee solution', by which the company actually holding the securities could do so as a nominee for the beneficial owners — who now own the securities directly.

He will work together with the Exchange, evaluating various ways of doing this, and has been asked to give his preferred solution by the end of this month.

What he has in mind is a co-operative system, held together by the Exchange, but with major contributions from financial institutions, incldiug the High Street banks and the brokers.

"We'd seek to immobilise securities at the source", he says. "Right now the sources are the banks and brokers. We want them to turn to their customers and say: Please let us have your certificates."

Banks and brokers already have their own nominee companies. Dr Apfel wants these companies to hold the securities, giving the customers a proper and legally binding receipt. The banks and brokers in their turn would deal with a central nominee service company, established by the Stock Exchange.

The Exchange would keep track of what the banks' and brokers' nominee companies own. A bank in turn would keep track of its millions of individual customers, logging the securities it holds for them, just as it logs the cash it holds for them.

"Keeping track of its customers is what a bank does for a living", says Dr Apfel: "it's simply moving knowledge and experience from one commodity to another." He has already been talking to the investment banking companies of the Big Four, and in the next three weeks they will be seeing more of him.

It is important, he says, to give the different parts of his structure reasons to work together: "It's going to require that all parties up and down the line see what's in it for them."

There is, naturally, a common interest in seeing the present mess tidied up, cutting down the risks and costs which it generates, and giving London as smooth and efficient a settlement as, say, Copenhagen's. (The efficient Danes have a central register of stock ownership and an almost paperless system). Reform will appeal to patriotism and also to profit.

He argues, in general, that making more use of nominees will turn brokerage into a more profitable business. So indeed it should, given that, under the old system, a share passing from one owner to another requires nine handling operations which between them cost £100.

In particular, he wants to upset the conventional wisdom of the securities business, which says that the only good customer is an active customer — constantly buying and selling, and as constantly paying commission.

There are other ways for banks and brokers with efficient nominee companies to make money. Efficiency will let them provide new services to the companies whose securities they hold for their customers, and to do so profitably.

They could undertake, for a suitable fee, to distribute dividends. They could receive payments for new issues, and part-payments when the stock is being sold by instalments. It cost British Gas £700,000 just to write to all its shareholders telling them not to vote Sir Ian MacGregor on to the board — surely they could undercut that?

All the banks have their own departments which act as companies' registrars. At the moment they are, almost certainly, cost centres. They could become profit centres.

At Merrill Lynch, the Western world's biggest broking firm, even the mailing room is a profit centre. Merrill has four million retail customers. It sends them the reports and accounts and other paper from the companies in which they hold shares — and it charges the companies.

The prize is far bigger. The Big Bang, which changed so much, has yet to change stock market attitudes to ordinary investors, or the economics of handling their business. It is not surprising that a government which believes in popular capitalism, and has pointed millions of new capitalists into the stock market's way, is now pressing for change.

The Chancellor a month ago put the City on notice: "The growth in small shareholdings is not an irksome problem, as some still seem to see it, which will soon go away. The City needs to find ways not only of overcoming the present settlement problems but, with imagination, of cutting dealing costs, and making it easier for the small investor to buy and sell shares — and in general to develop a far more vigorous retail business than at present exists. it is abundantly clear that the market is there."

So it is. Soon, with a fair wind for the Stock Exchange and Robert Apfel, the systems will be there too.

1987

ps3/72T

RESTRICTED

1. AH - to be found (spk. to Ch/Ex)

2. PMP

FROM: J M G TAYLOR
DATE: 21 October 1987

MR ILETT

cc Financial Secretary
Economic Secretary
Sir P Middleton
Mr Cassell
Mrs Lomax
Mr D J L Moore
Mr Neilson
Mr Cropper

WIDER SHARE OWNERSHIP: HANDLING PROBLEMS

The Chancellor was grateful for your minute of 20 October (and for your earlier minute of 15 October).

2. He has commented that the passages in your note of 20 October on physical aspects and nominees are relevant to the passage in the Stock Exchange Speech, as originally conceived. It is clear that he will now need quite a major section on the markets in that speech.

J M G TAYLOR

Inland Revenue

Policy Division
Somerset House

FROM: M PRESCOTT
DATE: 21 OCTOBER 1987

1. MR ISAAC

2. FINANCIAL SECRETARY

UNAPPROVED EMPLOYEE SHARE SCHEMES: REVIEW OF SECTION 79 FA 1972

1. The draft Clauses to replace Section 79 are now almost finished, and ready for publication. These are attached (top copy only), together with the draft of a Press Notice and of a suggested covering note summarising the responses to the earlier Consultative Document and explaining the Government's proposals.

2. The draft Clauses will take up about 5 printed pages of the Finance Bill itself. They have been seen by, and take account of comments from, the outside Practitioners assisting with the Review. (The Practitioners were generally very complimentary, and had only minor points of detail). They also embody all of the proposals set out in my submission of 17 July, and approved by you (Mr Heywood's note of 22 July), with two small exceptions

---

cc PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Monck
Mr Scholar
Mr Lomax
Mr Moore
Ms Sinclair
Mr Cropper
Mr Jenkins (OPC)
Mr Isaac
Mr Beighton
Mr Lewis
Mr Easton
Mr Lawrance
Mr Prescott
Mr German
Mrs Eaton
Mr Swann (SVD)
Miss Green
Mr Williams
Miss McFarlane
PS/IR

- Section 79 at present applies only if the shares in question are those acquired in respect of an office or employment within Case I of Schedule E and, though not mentioned in its Report, the Group had originally thought it might make sense to extend the scope of the provisions to include acquisitions in respect of offices or employment within Cases II and III as well. (Broadly, Case II applies where the person is not resident in the UK, or is resident but not ordinarily resident, and charges to income tax those emoluments of the chargeable period in respect of duties performed in the UK; Case III deals with people who are resident in the UK and who remit earnings from abroad here). On closer analysis, however, we have concluded that extension is not really necessary and indeed that there could in practice be difficulty in applying the provisions in such cases; moreover, we shall not be creating any obvious opportunities for abuse by continuing to exclude Cases II and III.

- We had originally suggested that the proposed relaxation in respect of "stand alone" subsidiaries should only be available if, in addition, the shares in question were held by someone who was a full-time employee or director of that subsidiary, and of no other company in the group. This would be consistent with the idea of seeking to "incentivise" those individuals whose commitment etc was to that particular subsidiary, rather than to the group as a whole. However, this would involve an extra layer of complexity because in addition to the main rule it would then also be necessary to have rules to deal with the situation where the individual concerned changed from qualifying to non-qualifying status, or vice versa. Bearing in mind that this would be an extra restriction in the provisions, and that the Group only ever saw it as an "optional" extra anyway, we concluded that the best course was to drop it.

3. As you know, the Unquoted Companies Group have a particular interest in the outcome of this review because of the way that Section 79 can at present impact adversely on unapproved employee share schemes involving subsidiaries. That was why we suggested that one of the outside Practitioners on the informal Working Group assisting with the Review should be nominated by the UCG - and they duly nominated Mr Tony Wakeford. As I have mentioned to your Private Secretary, Mr Wakeford has apparently already on a confidential basis disclosed to members of the UCG the broad outline of the proposals in the draft Clauses as they apply to subsidiary companies, and he has confirmed that the UCG are likely to be generally content.

4. The operative date for the proposed new regime has still to be decided. We have framed the transitional provisions so that people with shares subject to the existing regime can get the benefit of the new more relaxed regime as soon as possible (provided the qualifying conditions are satisfied) while retaining adequate safeguards against manipulation. We therefore believe that the operative date could reasonably and safely be the date when the draft Clauses themselves are first published, and we recommend accordingly.

5. The draft cover note is, I think, self-explanatory. As you will see, we are inviting comments by the end of December - which would still leave plenty of time to incorporate any changes in time for the Finance Bill. Of course, that will be a busy period for Parliamentary Counsel - and ourselves - and we shall therefore do what we can to encourage people to respond as quickly as possible. We propose, for example, to write directly to the main representative bodies with the draft Clauses, and also to offer them a meeting if they wish to discuss any comments they may have.

6. Finally, I think it would be much appreciated if - on publication - the outside Practitioners were to receive a short letter from you thanking them for their services, and if you are content I will let you have a draft.

7. May we know, please, if you are content with the draft Press Notice and covering note, and for these and the draft Clauses to be published. If you are content, we suggest publication next week - on, say, Monday 26 October.

M. Prescott

M PRESCOTT

DRAFT

INLAND REVENUE

Press Release

INLAND REVENUE PRESS OFFICE, SOMERSET HOUSE, STRAND, LONDON WC2R 1LB
PHONE: 01-438 6692 OR 6706

[3x] October 1987

UNAPPROVED EMPLOYEE SHARE SCHEMES - REVIEW OF SECTION 79, FINANCE ACT 1972

With the approval of Ministers, the Inland Revenue today published draft legislation incorporating the Government's proposals for change following the review of these wide-ranging anti-avoidance provisions announced by the Chancellor of the Exchequer earlier this year. Major changes are proposed, designed to help companies and their employees by targeting the provisions as narrowly as possible on the particular kinds of abuse at which this legislation is aimed. The Government proposes to introduce these changes in the 1988 Finance Bill and is now inviting views of interested parties on the draft Clauses. The changes will apply to relevant shares acquired on or after today; there are also transitional arrangements to enable shares at present subject to Section 79 to get the benefit of the new provisions as soon as possible provided the qualifying conditions are satisfied.

Note for Editors

1. A copy of the draft legislation is attached, together with a short covering note explaining the Government's proposals.

2. Section 79 Finance Act 1972 contains wide-ranging anti-avoidance provisions relating to unapproved employee share schemes. The review was announced by the Chancellor of the Exchequer on 17 March 1987, when a Consultative Document was also issued and views were invited on ways of simplifying and improving the provisions, consistent with their underlying purpose. The review was undertaken by the Inland Revenue with the assistance of a small informal group of outside practitioners who have expertise in this area.

3. Comments and suggestions on the draft legislation are invited as soon as possible, and not later than 31 December 1987.

DRAFT

REVIEW OF SECTION 79 FINANCE ACT 1972: UNAPPROVED EMPLOYEE SHARE SCHEMES

EXPLANATORY NOTE AND DRAFT CLAUSES ISSUED BY THE INLAND REVENUE

1. Earlier this year the Chancellor of the Exchequer announced a review of these wide-ranging anti-avoidance provisions. A Consultative Document was issued and views were invited on ways of simplifying and improving the provisions, consistent with their underlying purpose. The Chancellor also announced that the review was to be undertaken by the Inland Revenue with the assistance of a small informal group of outside practitioners who have expertise in this area.

2. Ministers have now considered the conclusions of the review and have drawn up their proposals for change. In essence, these are designed to help companies and their employees by targeting the provisions as narrowly as possible on the particular kinds of abuse at which the legislation is aimed.

3. These proposals are contained in the attached draft Clauses which the Government propose to introduce in the 1988 Finance Bill and on which views of interested parties would be welcome.

BACKGROUND - PRESENT PROVISIONS

4. Section 79 brings in to income tax certain benefits relating to shares acquired by employees in that capacity and outside an approved scheme. The main - growth in value - charge applies to employee-acquired shares whose value is capable of being artificially manipulated to the benefit of the employees, either because the shares are subject to certain restrictions or because they are of a class that is not widely available other than to the employees. The charge - to income tax - is on the whole on the growth in value of the shares over the period to the 7th anniversary of their acquisition or, if earlier, to the date when

the shares are disposed of or the restrictions are lifted. A second charge applies to various other special benefits which employee shareholders might receive from the company in respect of their shares, and which for various reasons would not otherwise be within the normal charge to income tax. In both cases, Section 79 is founded on the view that these benefits are in reality part of the emoluments of the individual's office or employment, akin to his other remuneration, and that they should be taxed as income accordingly.

RESPONSES TO EARLIER CONSULTATIVE DOCUMENT

5. The decision to review Section 79 was universally welcomed in the responses, as was the setting up of the informal Working Group to assist with the review.

6. In almost all responses the need for some kind of anti-avoidance provision in this area was accepted, implicitly or explicitly, albeit with strong reservations about Section 79 in its present form. Most respondents were in favour of continuing to base the provisions on objective and clear-cut rules, rather than seeking to replace them with provisions designed to operate only in cases that were motivated by avoidance or abuse. It was generally accepted that the operation of provisions based on some kind of motive or main purpose test would - in the very nature of such tests - be more subjective, and less certain in their effect.

7. There were two major concerns in the responses. First, there was strong criticism of the present growth in value charge because of the way that it applies to all of the growth in value of the shares concerned - ie including any normal growth reflecting the company's underlying performance - and not just growth that is due to manipulation of the employee shares. Second, responses showed that many groups of companies want to be able to motivate employees of a subsidiary company by allowing them to acquire shares in that company, rather than the parent company, without bringing the shares within the ambit of these provisions - which will usually happen at present. It was suggested that such a

facility would be particularly relevant in cases where the subsidiary operated more or less independently of other companies in its group. Most respondents also acknowledged, however, that there were special problems in the case of shares in a subsidiary company because of the considerable additional scope for abuse (by artificially shifting value into the subsidiary) that existed in such circumstances, even if the shares were not restricted or of a special class, and that safeguards were therefore needed.

PROPOSED CHANGES

8. In the light of these responses, and advice from the informal Working Group assisting with the review, major changes are now proposed.

9. The first of these concerns the growth in value charge and cases where value is shifted preferentially into the employee shares by removing or varying some restriction that attaches to them, or by adding some new right to them. As mentioned above, at present, if the shares are subject to certain kinds of proscribed restriction, or are unrestricted but certain other tests are not satisfied, there is a charge on the whole of the growth in value over the relevant period and not just on any "artificial" growth resulting from manipulation of the restrictions etc. Indeed, the growth in value charge would still apply in such cases even if there was no manipulation at all.

10. One possible solution - mentioned in the previous Consultative Document and supported in some responses - might be to replace the growth in value charge by an immediate charge, at the time of acquisition, based on the difference between the value of the shares ignoring the effect of any restrictions attaching to them and the price paid for them by the employee. This would, however, have a number of major drawbacks. Most important, it could result in the employee being taxed on a benefit that he did not receive - ie where the "offending" restriction was not in the event subsequently lifted or varied. To avoid this happening there would need to be some kind of arrangement for deferring or

repaying the charge, but that would be administratively unwelcome and would add to the complexity of the provisions. Moreover, even with such an approach there would still need to be a second charge to deal with cases where value was shifted into the employee shares by attaching some new or enhanced right to them some time after they were acquired by the employees.

11. The Government therefore proposes a simpler and more straightforward approach under which there would be a charge only if, when, and to the extent that value was actually shifted preferentially into the employee shares as a result either of lifting or varying a restriction attaching to the shares, or of attaching some new or enhanced right to them. (The provisions would also need to cover changes in the value of employee-held shares brought about indirectly, by subjecting the non employee-held shares to some new or increased restriction or loss of rights). The measure of the charge - to income tax - would be the difference in the value of the shares immediately before and after the change. But the charge would not apply if the employees themselves held only a minority of the shares whose value was increased by the change in question. Nor would it apply in cases where, though the individual concerned still owned the shares in question, he had long since ceased to be an employee of the company or of another company in the same group.

12. The second main change concerns employee shares in a subsidiary company. The Government accepts that there can be a genuine problem here for groups of companies that want to motivate the employees and directors of a subsidiary company by allowing them to acquire shares in that company, rather than, for example, in the parent company. This is likely to be particularly relevant in the case of "stand alone" subsidiaries whose trading and other activities are largely independent of other companies in the same group. As recognised in responses, however, extra safeguards would be needed because of the numerous ways - in themselves quite legitimate - in which value could be shifted into a subsidiary company and, thereby, into a minority holding of employee shares in such a company.

13. One possibility considered in the review was that of confining the relaxation to "stand alone" subsidiaries, strictly defined. But there are limitless ways in which value can be shifted between companies of the same group and such an approach would therefore in practice require complex provisions, with extensive and very detailed rules, tests and definitions. There would also be considerable resource cost for the Inland Revenue - and probably for companies as well - in monitoring adherence to such tests. In theory, an alternative approach might be to apply a charge only in cases where there was artificial growth in value of the employee-acquired shares in the subsidiary due to value shifting from elsewhere in the group. However, such an approach would simply not be practicable because it would be necessary to distinguish artificial from normal growth in the value of the subsidiary's shares, and that in turn would involve having to examine the motives underlying virtually every transaction between the subsidiary concerned and other companies in the same group.

14. The Government therefore proposes a more pragmatic solution, designed to avoid the difficulties with either of the above approaches while at the same time seeking to incorporate reasonable safeguards against abuse. These proposals are designed to meet the main concern in representations - subsidiary companies which are operating more or less independently of their group.

15. In brief, it is proposed that where a subsidiary is a qualifying company for this purpose, any selective lifting of restrictions or adding of new rights to the employee shares in that subsidiary would trigger the proposed new charge described at paragraph above, as with employee-acquired shares in any other company. But there would be no other charge. Where the subsidiary was not a qualifying company for this purpose, however, a growth in value charge on broadly the present lines would continue to apply instead, with the charge arising 7 years after the date of acquisition or, if earlier, on disposal.

16. A qualifying subsidiary for this purpose would be a company whose trade and activities were wholly or mainly independent of

other companies in the same group, and where any transactions that did occur with other group companies were essentially on an arm's length basis and such that they did not entail any significant transfer of value to the subsidiary company. Eligibility would be determined largely on the basis of self-certification - by the directors of the subsidiary's ultimate parent company, with a supporting auditor's report - that these conditions had been satisfied for the year in question. The draft Clauses also include provisions to cater for cases where the subsidiary in question changes status, from qualifying to non-qualifying or vice versa.

AMBIT OF PROVISIONS

17. It is proposed that this should remain unchanged, with the provisions applying to shares acquired by employees and directors in that capacity and not as part of an offer to the public.

18. One issue that was considered carefully in the review was the suggestion in some representations that in certain circumstances individuals who are or who become an employee or director of the company might nevertheless be regarded as having acquired their shares in the company in an essentially proprietorial or entrepreneurial role, and that in such cases these provisions should not apply. A particular example of this is shares acquired by employees in the course of a management or employee buy-out of their company.

19. However, the Government believes that it is in practice extremely difficult to draw this kind of distinction. Nor in the Government's view would it provide sufficient justification for saying that shares whose value was artificially and preferentially enhanced by manipulation of restrictions or rights should be given privileged treatment merely because those shares were acquired by the individual not only as an employee but in some other capacity as well. It should be stressed, however, that under the proposed changes there would be a charge only if, when and to the extent that the value of the employee shares was actually manipulated and there is therefore no reason why, for example, an employee buy-out

as such should be adversely affected under the proposed new regime.

OTHER MATTERS

20. The draft Clauses also cover various more detailed points, including definitional and procedural matters.

21. As will be seen, the intention is to incorporate all of these changes into new free-standing provisions, rather than to proceed by way of statutory amendments to the existing provisions. This, it is hoped, will help make the legislation itself compact and easier to follow - something which many respondents also attached importance to.

22. It is proposed that the changes should apply to relevant share acquisitions made on or after [-] October 1987. There are also transitional arrangements designed to ensure that, where the necessary conditions are satisfied, shares at present within the ambit of the existing provisions can get the benefit of the proposed new regime as soon as possible.

COMMENTS

23. Comments and suggestions are invited on the draft Clauses as soon as possible, and not later than 31 December 1987.

24. Respondents are asked to address their comments in writing to Inland Revenue Policy Division (1/4), Room 46, New Wing, Somerset House, London WC2R 1LB.

Inland Revenue
October 1987

CONFIDENTIAL

CH/EXCHEQUER

REC.	22 OCT 1987
ACTION	MR ILETT
COPIES TO	CST FST SIR P. MIDDLETON SIR G. LITTLER MR CASSELL MRS LOMAX MR CROPPER

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

21 October 1987

Dear Alex,

PURCHASE OF SHARES

One or two people mentioned to the Prime Minister when she was in Dallas that the rules for buying shares on margin or by the use of borrowed money were now more restrictive than they had been in 1929. It was also suggested however that the rules in the UK now were less restrictive than those in the US. The Prime Minister would be grateful to have a short note on the present position both in the US and the UK and it would be useful for this to cover the futures markets as well as the securities markets.

I am copying this letter to John Footman (Bank of England) and Tim Walker (Department of Trade and Industry).

Yours,

David.

D. R. Norgrove

Alex Allan, Esq.,
H. M. Treasury.

3369/31

RESTRICTED

FROM: J J HEYWOOD
DATE: 22 October 1987

PS/CHANCELLOR

cc PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mrs Lomax
Mr Ilett
Mr Cropper

WIDER SHARE OWNERSHIP : HANDLING PROBLEMS

The Financial Secretary has seen Mr Ilett's minute of 20 October.

2. In paragraph 5 Mr Ilett suggests that the clearing banks are the "people to push". The Financial Secretary would add that the building societies are also important here:

(i) It is building society investors we are after;

(ii) They have the same sort of retail networks as the banks;

(iii) Very few societies have gone down this route, though the Bradford and Bingley PEP has shown what can be done.

JEREMY HEYWOOD
Private Secretary

RESTRICTED

RJ4.14

RESTRICTED

FROM: J M G TAYLOR
DATE: 23 October 1987

PS/FINANCIAL SECRETARY

cc PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mrs Lomax
Mr Ilett
Mr Cropper

WIDER SHARE OWNERSHIP: HANDLING PROBLEMS

The Chancellor has seen your minute of 22 October. He agrees with the Financial Secretary's view that the building societies are also important here.

J M G TAYLOR

3369/52

CONFIDENTIAL

FROM: J J HEYWOOD
DATE: 23 October 1987

MR PRESCOTT IR

cc PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Monck
Mr Scholar
Mrs Lomax
Mr D J Moore
Ms Sinclair
Mr Cropper
Mr Jenkins OPC
Mr Isaac IR
PS/IR

UNAPPROVED EMPLOYEE SHARE SCHEMES: REVIEW OF SECTION 79 FA 1972

1. The Financial Secretary was most grateful for your submission of 21 October.

2. He is content with the two small policy recommendations. He also agrees that the operative date should be the same as the date on which the draft clauses are published.

3. The Financial Secretary would be content to write to the outside Practitioners. Could you supply a draft, names and addresses?

4. The Financial Secretary is happy with the draft Press Notice and covering note and with the date for publication of 26 October.

5. One final point; could you supply a short line on what the proposals in their present form allow that was hitherto not permitted? (ie. What is the main bull point?)

JEREMY HEYWOOD
Private Secretary

Imperial Chemical Industries PLC

Imperial Chemical House
Millbank London SW1P 3JF

Telephone 01-834 4444

From A. W. Clements

The Rt Hon Nigel Lawson, MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON SW1P 3AG

27 October 1987

Dear Chancellor,

FINANCE ACT 1984
EMPLOYEE SHARE OPTION SCHEMES: RESTRICTED SHARES

I was delighted to receive a copy of the Inland Revenue press release dated 19 October. I should like to record my appreciation of the very sensible step which the Financial Secretary, Norman Lamont, announced therein.

The proposed legislation will remove considerable fear for a number of employees about the possible effect of paragraph 10, Schedule 10, Finance Act 1984 and, if I may say so, the Government is to be congratulated on acting so speedily once the problem was identified.

Yours sincerely

Alan Clements

Registered in England No. 218019 Registered Office Imperial Chemical House Millbank London SW1P 3JF

Inland Revenue

Policy Division
Somerset House

FROM: M PRESCOTT
DATE: 2 NOVEMBER 1987

PS/CHANCELLOR

FINANCE ACT 1984 EMPLOYEE SHARE SCHEMES: RESTRICTED SHARES

1. You asked - via PS/FST - for an acknowledgment to Mr Clements' letter to the Chancellor of 27 October, and a draft is attached. As I mentioned in my submission to the Financial Secretary of 5 October, while it was BAT Industries who first raised this potential difficulty with us we were aware that a number of other companies might be affected as well. ICI was obviously one of them.

M PRESCOTT

---

cc Mr Prescott
Mr N Williams
PS/IR

Re-type/sig

DRAFT FROM CHANCELLOR TO

A W Clements Esq
Finance Director
Imperial Chemical Industries PLC
Imperial Chemical House
Millbank
LONDON
SW1P 3JF

FINANCE ACT 1984 EMPLOYEE SHARE OPTION SCHEMES: RESTRICTED SHARES

Thank you for your letter of 27 October. I am glad that we were able to deal with this problem, and I appreciate your kind words about the speed with which we acted are appreciated.

NIGEL LAWSON

cc Mr Prescott - IR

pmp

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

2 November 1987

A W Clements Esq
Finance Director
Imperial Chemical Industries Plc
Imperial Chemical House
Millbank
LONDON
SW1P 3JF

Dear Mr Clements

FINANCE ACT 1984 EMPLOYEE SHARE OPTION SCHEMES: RESTRICTED SHARES

Thank you for your letter of 27 October. I am glad that we were able to deal with this problem, and I appreciate your kind words about the speed with which we acted.

Yours sincerely

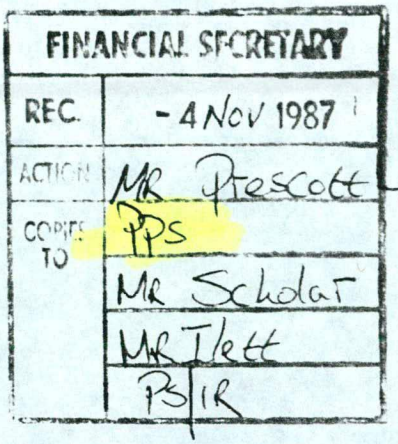
NIGEL LAWSON

WIDER SHARE OWNERSHIP COUNCIL

JUXON HOUSE, 94 ST. PAUL'S CHURCHYARD, LONDON, EC4M 8EH *TELEPHONE:* 01-248 9155 *TELEX:* 887521

As from: 10 Buckingham Place
London SW1E 6HT

Telephone: 01-828-9253



2nd November 1987

Rt Hon Norman Lamont MP
Financial Secretary to the Treasury
Treasury Chambers
Whitehall
London
SW1

Dear Mr Lamont,

At the recent meeting of our Industrial Committee, following on the Forum, it was decided to ask you to consider the following specific recommendations on important matters of detail concerning employee share schemes, in the hope that you will be able to take appropriate remedial action in the Budget and Finance Bill, next year:

(a) Removal of the restriction on part-time employees joining in a share option scheme under the Finance Act 1984

The Council recommends that the 20 hour minimum limit for part-time employees (other than directors) in a 1984 scheme should be removed when 50% + 1 of the employees take part in the scheme; this would spread employee share ownership more equitably and motivate the growing part-time work-force.

(b) Employee Benefits Trusts

(i) Payments by a company to an employee benefits trust should be clearly tax deductible for the company.

(ii) In the case of an approved benefits trust borrowing funds for the acquisition of shares in the company half the interest paid to a person who carries on a business which includes the lending of money in the course of that business shall be exempt from taxation in the hands of the lender.

The first of these recommendations has been discussed in detail by us with Rowntrees and Freemans. We think their case is strong for removing the 20 hour minimum limit on part-time employees under the Finance Act 1984, subject to the safeguard we suggest, which is one you have previously used in relation to employee benefits

trusts. Moreover, as the majority of part-time employees are female, it does appear that the Finance Act 1984 as it now stands offends against the spirit of the equal opportunities legislation.

As for the second recommendation, enclosed for convenience is a copy of the Clifford Chance draft which would put into British law the US tax reliefs for ESOPs, also a commentary on this. We commend for your consideration such a step, or alternatively, a simple statutory confirmation of corporation tax relief for profits used to finance the company's shares when applied to an employee benefits trust, subject of course, to safeguards against double tax relief.

You will appreciate that employee benefit trusts are important to family owned companies. The case for them can be summed up in the observation that the date when a block of shares becomes available (e.g. through the death of a member of the controlling family) cannot be guaranteed to coincide with the requirements of shares for use in employee share schemes. There needs to be a warehouse (the employee benefits trust) to take up and hold a block of shares, when it becomes available, and retail it to the managers and other employees on a motivational basis, i.e. when they have "earned" the shares, as measured by the performance of the company.

Yours sincerely,
Geo Copeman

George Copeman
Chairman of the Industrial Committee

Encs:

ESOPs

(Employee Share Ownership Plans)

IN THE UK

DRAFT LEGISLATION

NEW CLAUSE - APPROVED EMPLOYEE SHARE TRUSTS

The provisions of Schedule 1 to this Act shall have effect to provide for tax reliefs in relation to employee share trusts.

SCHEDULE 1 - APPROVED EMPLOYEE SHARE TRUSTS

Part 1 - Approval of Trusts

1. (i) On the application of a body corporate (in this Schedule referred to as "the company concerned") which has established an employee share trust, the Board shall approve the trust -

(a) if they are satisfied that the conditions in sub-paragraphs (2) to (5) below are fulfilled in relation to the trust; and

(b) unless it appears to them that there are features of the trust which are neither essential nor reasonably incidental to the purpose of providing for employees and directors benefits in the nature of shares or interests in or rights to acquire shares.

(ii) The trust must be constituted under the law of a part of the United Kingdom.

(iii) The trustees must, in relation to the trust, fall to be treated under section 52 of the Capital Gains Tax Act 1979 as resident and ordinarily resident in the United Kingdom.

(iv) The terms of the trust must be embodied in an instrument which provides -

(a) for the application by the trustees of monies given or lent to them in the acquisition of shares in respect of which the conditions in paragraphs 4 to 7 below are satisfied (in this Schedule referred to as "qualifying shares");

(b) for the shares so acquired by them to be held upon trusts which do not permit any of the property subject thereto to be applied otherwise than for the benefit of employees, directors and former employees and directors of the company concerned and companies under its control or for charitable purposes.

(v) The trust instrument must contain such provisions as will ensure that benefits from the trust are not conferred wholly or mainly on directors or those employees who are in receipt of the higher or highest levels of remuneration.

(vi) An application under sub-paragraph 1 above shall be made in writing and contain such particulars and be supported by such evidence as the Board may require.

2. (i) If, at any time after the Board have approved a trust -

(a) there is any contravention of the terms of the trust, or

(b) the Board cease to be satisfied as mentioned in paragraph 1 above, or

(c) the trustees or the company concerned or any company under its control fail or fails to furnish any information which they are or it is required to furnish pursuant to paragraph 8 below,

the Board may withdraw the approval with effect from that time or from such later time as the Board may specify.

(ii) If an alteration is made in the terms of the trust at any time after the Board have approved it, the approval shall not have effect after the date of the alteration unless the Board have approved the alteration.

3. The shares must form part of the ordinary share capital of -

(a) the company concerned; or

(b) a company which either is or has control of a company which -

(i) is a member of a consortium owning either the company concerned or a company having control of that company; and

(ii) beneficially owns not less than three-twentieths of the ordinary share capital of the company so owned.

5. The shares must be -

(a) shares of a class quoted on a recognised stock exchange, or

(b) shares in a company which is not under the control of another company; or

(c) shares in a company which is under the control of a company (other than a company which is or would if resident in the United Kingdom be a close company within the meaning of section 282 of the Taxes Act) whose shares are quoted on a recognised stock exchange.

6. (1) The shares must be -

(a) fully paid up; and

(b) except in the case of shares in a workers' co-operative, not redeemable; and

(c) not subject to any restrictions other than restrictions which attach to all shares of the same class or a restriction authorised by sub-paragraph (2) below.

(2) Except as provided by sub-paragraph (3) below, the shares may be subject to a restriction imposed by the company's articles of association -

(a) requiring all shares held by directors or employees of the company or of any other company of which it has control to be disposed of on ceasing to be so held; and

(b) requiring all shares acquired, in pursuance of rights or interests obtained by such directors or employees, by persons who are not (or have ceased to be) such directors or employees to be disposed of when they are acquired.

(3) A restriction is not authorised by sub-paragraph (2) above unless -

(a) any disposal required by the restriction will be by way of sale for a consideration in money on terms specified in the articles of association; and

(b) the articles also contain general provisions by virtue of which any person disposing of shares of the same class (whether or not held or acquired as mentioned in sub-paragraph (2) above) may be requird to sell them on terms which are the same as those mentioned in paragraph (a) above.

7. (i) Except where the shares are in a company whose ordinary share capital consists of shares of one class only, the majority of the issued shares of the same class either must be employee-control shares or must be held by persons other than -

(a) persons who acquired their shares in pursuance of a right conferred on them or opportunity offered to them as a director or employee of the company concerned or any other company and not in pursuance of an offer to the public; and

(b) trustees holding shares on behalf of persons who acquird their beneficial interests in the shares in pursuance of such a right or opportunity as is mentioned in sub-paragraph (a) above; and

(c) in a case where the shares fall within sub-paragraph (a) of paragraph 5 above, companies which have control of the company whose shares are in question or of which that company is an associated company within the meaning of section 302 of the Taxes Act.

(ii) For the purposes of this paragraph, shares of a company are employee-control shares if -

(a) the persons holding the shares are, by virtue of their holding, together able to control the company; and

(b) those persons are or have been employees or directors of the company or of another company which is under the control of the company.

8. The Board may by notice in writing require any person to furnish them, within such time as the Board may direct (but not being less than thirty days), such information as the Board think necessary for the purposes of their functions under this Schedule, including in particular information -

(a) to enable the Board to determine -

(i) whether to approve a trust or withdraw an approval already given; or

(ii) the liability to tax, including capital gains tax, of any beneficiary under a trust; and

(b) in relation to the administration of a trust and any alteration in the terms of a trust.

Part 2 - Tax Reliefs

Schedule D deduction of payments to trustees

9. (i) Any sum expended by the company concerned or a company under its control in making a payment to the trustees of an approved trust shall be included -

(a) in the sums to be deducted in computing for the purposes of Schedule D the profits or gains of a trade carried on by that company, or

(b) if that company is an investment company within the meaning of section 304 of the Taxes Act or a company in the case of which that section applies by virtue of section 305 of that Act, in the sums to be deducted as expenses of management in computing the profits of the company for the purposes of corporation tax,

if, and only if, one of the conditions in sub-paragraph (2) below is fulfilled.

(ii) The conditions referred to in sub-paragraph (1) above are -

(a) that before the expiry of the relevant period the sum in question is applied by the trustees -

(i) in the acquisition of qualifying shares;

(ii) in the payment of interest on a loan which falls within paragraph 11 (1) below; or

(iii) in paying off such a loan; and

(b) that the sum is necessary to meet the reasonable expenses of the trustees in administering the trust.

(iii) For the purposes of sub-paragraph (2) (a) above, "the relevant period" means the period of nine months beginning on the day following the end of the period of account in which the sum in question is charged as an expense of the company incurring the expenditure (or such longer period as the Board may allow by notice in writing given to that company).

(iv) For the purposes of this paragraph, the trustees shall be taken to apply sums to them in the order in which the sums are received by them.

(v) Where a company incurs a loss in a trade in a period of account in which one or more sums deductible under this paragraph are charged as its expenses, subsections (2) and (3) of section 177 of the Taxes Act (set off of losses against total profits) shall have effect in relation to so much of the loss as does not exceed the sum or sums which are so deductible as if the time specified in the said subsection (3) were a period of three years ending immediately before the period of account in which the loss is incurred.

Pension scheme surpluses

10. Schedule 12 to the Finance Act 1986 (pension scheme surpluses) shall have effect as if the permitted ways of reducing or eliminating such an excess as is mentioned in paragraph 6(2) thereof included -

(a) making a payment to the trustees of an approved trust which has been established by an employer; and

(b) transferring qualifying shares to such trustees.

Loans to trustees

11. (i) Sub-paragraphs (2) and (3) below apply to a loan to the trustees of an approved trust, the proceeds of which are, before the expiry of the period of six months beginning on the day following the day on which the loan is made, applied -

(a) in the acquisition of qualifying shares; or

(b) in paying off another loan which would have fallen within this sub-paragraph had that other loan not been paid off.

(ii) Where the loan is made by a person who carries on a business which includes the lending of money, and is so made in the course of that business, tax shall not be chargeable in respect of one-half of any interest paid to him by the trustees on the loan.

(iii) Where the loan is made by a close company, section 286 of the Taxes Act (loans to participators etc) shall not apply to the loan.

Capital gains tax roll-over relief

12. (i) Sub-paragraph (2) below applies where an individual disposes of qualifying shares to the trustees of an approved trust and, before the expiry of the period of six months beginning on the day following the date of the disposal, the consideration which he obtains for the disposal is applied by him in the acquisition of shares which are listed in the Official List of The Stock Exchange (in this paragraph referred to as "listed shares").

(ii) The individual shall, on making a claim as respects the consideration which has been so applied, be treated for the purposes of the Capital Gains Tax Act 1979 -

(a) as if the consideration for the disposal of the qualifying shares were (if otherwise of a greater amount or value) of such amounts as would secure that on the disposal neither a gain nor a loss accrues to him, and

(b) as if the amount or value of the consideration for the acquisition of the listed shares were reduced by the excess of the amount or value of the actual consideration for the disposal of the qualifying shares over the amount of the consideration which he is treated as receiving under sub-paragraph (a) above;

but neither sub-paragraph (a) nor sub-paragraph (b) above shall affect the treatment for the purposes of the said Act of the trustees or of the other party to the transaction involving the listed shares.

(iii) Where sub-paragraph (2)(a) above applies to exclude a gain which, in consequence of Schedule 5 to the Capital Gains Tax Act 1979 (assets held on 6th April 1965), is not all chargeable gain, the amount of the reduction to be made under sub-paragraph (2)(b) above shall be the amount of the chargeable gain, and not the whole amount of the gain.

(iv) The provisions of the Capital Gains Tax Act 1979 defining the amount of the consideration deemed to be given for the acquisition or disposal of assets shall be applied before this paragraph is applied.

Inheritance tax relief

13. (i) Where -

(a) the value transferred by a transfer of value made by an individual is attributable to qualifying shares which become subject to an approved trust, and

(b) the transfer of value is not an exempt transfer by virtue of section 28 of the Inheritance Tax Act 1984 (employee trusts),

the value transferred shall be treated as reduced by one-half.

(ii) for the purposes of sub-paragraph (1) above, the value transferred by a transfer value shall be calculated as a value on which no tax is chargeable.

(iii) Where the value transferred by a transfer value is reduced under Chapter I of Part V of the Inheritance Tax Act 1984 by reference to the value of any relevant business property, the value to be reduced under sub-paragraph (1) above shall be the value as reduced under that Chapter (but subject to sub-paragraph (2) above).

Dividends

14. Dividends on qualifying shares held by the trustees of an approved trust shall be exempt from income tax.

Distribution of shares

15. (i) Where the trustees of an approved trust acquire qualifying shares and, before the expiry of the period of ten years beginning with the day after the date of their acquisition, those shares are deemed to be disposed of by the trustees by virtue of section 54(1) of the Capital Gains Tax Act 1979, any gain accruing to the trustees on the disposal shall not be a chargeable gain.

(ii) For the purposes of sub-paragraph (1) above, shares which were acquired at an earlier time shall be taken to be disposed of before shares of the same class which were acquired at a later time.

Workers' co-operatives

16. (i) Where, for the purpose of securing (and maintaining) approval of its employee share trust in accordance with Part I of this Schedule the rules of a society which is a workers' co-operative or which is seeking to be registered under the industrial and provident societies legislation as a workers' co-operative contain -

(a) provision for membership of the society by the trustees of the trust,

(b) provision denying voting rights to those trustees, or

(c) other provisions which appear to the registrar to be reasonably necessary for that purpose,

those provisions shall be disregarded in determining whether the society should be or continue to be registered under the industrial and provident societies legislation as a bona fide co-operative society.

(ii) Schedule 9 to the Finance Act 1978 (profit sharing schemes) shall have effect as if the persons who may be members of a co-operative society as mentioned in paragraph 18 (a) thereof included the trustees of its approved trust.

Employee share schemes: material interest test

17. In applying section 285(6) of the Taxes Act for the purpose of determining whether an individual has a material interest in a company for the purposes of Schedule 9 to the Finance Act 1978, Schedule 10 to the Finance Act 1980 and Schedule 10 to the Finance Act 1984, and for the purpose of determining whether interest on a loan is eligible for relief under section 75 of the Finance Act 1972 by virtue of paragraph 9 of Schedule 1 to the Finance Act 1974, there shall be disregarded -

(a) the interest of the trustees of a trust approved in accordance with Part I of this Schedule in any shares held by them; and

(b) any rights exercisable by those trustees by virtue of that interest.

Part 3 - Interpretation

18. In this Schedule -

"approved trust" means a trust approved in accordance with Part 1 of this Schedule;

"the company concerned" has the meaning assigned to it by paragraph 1(1) above;

"control" shall be construed in accordance with section 534 of the Taxes Act;

"qualifying shares" has the meaning assigned to it by paragraph 1(4)(a) above;

"recognised stock exchange" has the same meaning as in the Corporation Tax Acts;

"the trustees", in relation to an approved trust, means the trustees for the time being thereof;

"workers' co-operative" means a registered industrial and provident society, within the meaning of section 340 of the Taxes Act, which is a co-operative society and the rules of which include provisions which secure -

(a) that the only persons who may be members of it are those who are employed by, or by a subsidiary of, the society and those who are the trustees of its approved trust or of a profit sharing scheme which it has established and which is approved in accordance with Part 1 of Schedule 9 to the Finance Act 1978; and

(b) that, subject to any provision about qualifications for membership which is from time to time made by the members of the society by reference to age, length of service or other factors of any description, all such persons may be members of the society.

19. In this Schedule "the industrial and provident societies legislation" means -

(a) the Industrial and Provident Societies Act 1965, or

(b) the Industrial and Provident Societies Act (Northern Ireland) 1969,

and "registrar" has the same meaning as in each of those Acts and "co-operative society" has the same meaning as in section 1 of those Acts.

20. For the purposes of this Schedule a company is a member of a consortium owning another company if it is one of a number of companies which between them beneficially own not less than three-quarters of the other company's ordinary share capital and each of which beneficially owns not less than one-twentieth of that capital.

APPROVED EMPLOYEE SHARE OWNERSHIP PLANS ("ESOP"s)

Structure of proposed Legislation

PART I: APPROVAL OF TRUSTS

Paragraph	Outline	Remarks
1. Approval of trusts	(1) On the application of a body corporate which has established an employee share trust complying with Part I of this schedule, the Board must approve the trust unless it appears to them that it contains features which are neither essential nor reasonably incidental to the purpose of providing for employees and directors benefits in the nature of shares or interests in shares. (2)-(3) The trust must be constituted under the law of a part of the United Kingdom; its terms must be embodied in an instrument complying with sub-paragraphs (4) and (5) below; and its trustees must be resident in the United Kingdom for the purposes of the Capital Gains Tax Act 1979. (4) The trust instrument must provide for the application by the trustees of monies	The whole of Part I of the proposed schedule is based closely on Finance Act 1978 for approved profit-sharing scheme trusts. (Cf. paragraphs 1, 3 and 4 Schedule 9 Finance Act 1978.)

given or lent to them in the acquisition of shares in respect of which the conditions in paragraphs 4 to 7 below are satisfied and for the shares so acquired by them to be held upon trusts which, either indefinitely or until the end of a period (whether defined by a date or in any other way), do not permit any of the trust property to be applied otherwise than for the benefit of employees, directors and former employees and directors of the company concerned and companies under its control or for the benefit of charity.

(5) The trust instrument must contain such provisions as will ensure that benefits are not conferred wholly or mainly on directors or on the highest paid employees.

(6) An application must be in writing and contain any particulars required by the Board.

2. Withdrawal of Approval

(1) The Board may withdraw approval of a trust if they cease to be satisfied as mentioned in paragraph 1(1) above; or if there is any contravention of the terms of the trust; or if the company concerned fails

to provide information requested.

(2) If the trust is altered after it has been approved, the approval will not have effect after the date of the alteration.

3. Appeals

The company concerned may appeal to the Special Commissioners against the Board's failure to approve the scheme or an alteration to it, or against withdrawal of approval.

4. Conditions as to shares

The shares must form part of the ordinary share capital of the company concerned, a company which has control of it, or a company which either is or has control of a company which is a member of a consortium owning the company concerned or a company controlling it and beneficially owns not less than three-twentieths of the ordinary share capital of the company so owned.

The conditions for the shares, and the permissible restrictions, are drawn in identical terms to paragraphs 5 to 8 Schedule 9 Finance Act 1978.

5.

The shares must be of a class quoted on a recognised stock exchange, in a company which is not under the control of another company, or in a company which is under the control of a company (other than one which is or would if

resident in the United Kingdom be a close company) whose shares are quoted on a recognised stock exchange.

6. (1) The shares must be fully paid up, not redeemable and not subject to any restrictions other than those which attach to all shares of the same class or one authorised by sub-paragraph (2) below.

(2) The shares may be subject to a restriction imposed by the company's articles of association requiring all shares held by directors or employees of the company or any other company which it controls to be disposed of on ceasing to be so held, and requiring all shares acquired, in pursuance of rights or interests obtained by such directors or employees, by persons who are not such directors or employees to be disposed of when they are acquired.

(3) A restriction is not authorised by sub-paragraph (2) above unless any disposal required will be by way of sale for a consideration in money on terms specified in the articles, and the articles also contain general provisions by virtue of which any

person disposing of shares of the same class may be required to sell them on the same terms.

7. (1)-(2) Except where the shares are in a company whose ordinary share capital consists of shares of one class only, the majority of the issued shares of the same class either must be employee-control shares or must be held by persons other than those who acquired them as directors or employees, trustees holding shares on behalf of persons who acquired their beneficial interests in them as directors or employees and, where the company is under the control of another company and is not quoted on a recognised stock exchange, companies controlling it or associated companies.

8. Information

The Board may require any person to furnish information for the purposes of operating the approved share trust legislation.

Cf. section 53(7) Finance Act 1978.

PART II: TAX RELIEFS

Paragraph	Outline	Remarks
9. Schedule D deduction of payments to trustees	(1) Qualifying payments made by the company (or a company under its control) to the trustees are deductible for the purposes of Schedule D in computing its trading profits if it is a trading company, or as expenses of managements if it is an investment company (sections 304 and 305 Taxes Act 1970).	The same, confirmatory provision as in section 60 Finance Act 1978 for approved profit sharing scheme trusts. Deduction under general principles might be subject to modification by evolving case law.
	(2) Payments qualify if they are applied in acquiring qualifying shares; or in paying interest on a loan applied in acquiring such shares; or in repaying such a loan; or in meeting the trustees' reasonable administration expenses.	This confirms that relief extends to payments, both interest and redemption, on loans to the ESOP.
	(3) Payments must in each case be so applied not later than nine months after the end of the period of account in which they are charged as an expense of the company making them (or such longer period as may be allowed by the Board).	

(4) Payments made to the trustees are treated as applied by them in the order in which they are received.

(5) If a company incurs a trading loss in the period of account, so much of the loss as does not exceed the amount deductible under this section may be set against its profits of preceding accounting periods ending within the three years immediately prior to that period under section 177(2) Taxes Act 1970.

Cf. section 177(3A) Taxes Act 1970 (capital allowances).

10. Pension scheme surpluses

The permitted ways of reducing or eliminating a pension scheme surplus for the purposes of paragraph 6(3) Schedule 12 Finance Act 1986 include a payment of money or a transfer of qualifying shares to the trustees of an approved trust established by the employer in question.

This new relief enables a tax-efficient transfer of pension surpluses to ESOPs and reflects a successful relief for ESOPs in the USA.

11. Loans to trustees

(1)-(2) Where a person who carries on the business of making personal loans makes a loan to the trustees in the ordinary course of that business, and the money lent is applied by the trustees within six months thereafter in the acquisition of qualifying shares, tax is not chargeable in respect of

This relief enables the lender to advance loans at normal rates for what will often be an equity risk. Again, an effective relief in the USA.

one-half of any interest on the loan received by that person and paid by the trustees.

(3) Where a close company makes a loan or advances money to the trustees, and the money so lent or advanced is applied by them within six months thereafter in the acquisition of qualifying shares, section 286(1) Taxes Act 1970 does not apply to the loan or advance.

This removes a technical barrier to "close" companies lending directly to the ESOP - and most private companies are "close".

12. Capital gains tax roll-over relief

(1) Where an individual disposes of qualifying shares to the trustees and within six months thereafter applies the consideration for the disposal in the acquisition of quoted shares listed in the Official List of The Stock Exchange, he may elect that for the purposes of capital gains tax the consideration for the disposal should be treated as being of such amount as to result in neither a loss nor a gain accruing to him.

This extends the existing business asset relief to cover the sale of shares to the ESOP trust. (Cf. section 115 Capital Gains Tax Act 1979 - replacement of business assets).

(2)-(4) Where such an election is made, the consideration for the acquisition of the relevant quoted shares is treated as reduced by the excess of the actual consideration

		for the disposal over the amount of the consideration treated as received.	
13.	Inheritance tax relief	(1)-(3) To the extent that, for the purposes of inheritance tax, a transfer of value made by an individual in transferring qualifying shares to the trustees is not an exempt transfer by virtue of section 28 Inheritance Tax Act 1984, it is treated as reduced by one-half.	This extends the scope of the existing business property relief, to include disposals of shares to the approved trust (Cf. section 104 Inheritance Tax Act 1984 - business property relief).
14.	Dividends	Dividends on qualifying shares held by the trustees are exempt from income tax.	This new relief provides the same protection for ESOP income as is afforded to approved FA'78 scheme trusts by section 53(6)(a) Finance Act 1978. (Cf. also section 21(2) Finance Act 1970 - retirement benefits schemes).
15.	Distribution of shares	(1) If, on a distribution of qualifying shares to beneficiaries, the trustees make a disposal for capital gains tax purposes, or are treated by section 54 Capital Gains Tax Act 1979 as making such a disposal, any gain accruing to them is not a chargeable gain. This relief only applies if the distribution of the shares takes place not more than ten	This new relief provides the same protection against capital gains tax as is provided by section 53(6)(b) Finance Act 1978 to FA'78 scheme trusts - but only for 10 years, as compared with the 18 months for FA'78 scheme trusts.

years after their acquisition by the trustees.

(2) Shares acquired at an earlier time being taken to be distributed before shares of the same class acquired at a later time.

16. Workers' co-operatives	(1)-(2) A co-operative may, without prejudicing its registration, permit the trustees of an approved trust to be a member with limited rights, and may adopt an approved FA'78 share scheme.	This new provision permits a co-operative to use an approved trust, and reflects FA'78 which has been extended to co-operatives.
17. Material interest test	Shares held by an approved trust will be disregarded for the purposes of excluding from participation in an approved FA'78 scheme a person with a material shareholding in a close company.	This provision reflects the relief afforded to FA'78 schemes.

PART III: Interpretation

Paragraph	Outline	Remarks
18. Interpretation	This section defines "approved trust", "the company concerned", "qualifying shares", and "the trustees" by reference to the relevant provisions of the preceding sections or the Schedule, as well as any other expressions requiring a particular definition.	Cf. section 61 Finance Act 1978.

Inland Revenue

Policy Division
Somerset House

FROM: N WILLIAMS
DATE: 5 November 1987

1. MR PRESCOTT

2. PS/FINANCIAL SECRETARY

LETTER OF 2 NOVEMBER FROM WIDER SHARE OWNERSHIP COUNCIL

1. Mr Copeman has written to the Financial Secretary asking him to consider two specific recommendations concerning employee share schemes in the hope that action on them can be taken in next year's Budget and Finance Bill.

2. The FST is seeing Mr Copeman next Monday to discuss his ideas for a "profit-related share option scheme". Full briefing for that is contained in Mr Prescott's note of 29 September.

3. Of the two points raised in Mr Copeman's latest letter the second and more significant is essentially the same package of measures already presented by Job Ownership Ltd in their letter of 10 October ie proposals for tax reliefs based on the ESOP legislation in the United States. What is now happening is that the same proposal is being presented in various different guises. In short, JOL have, on this issue, joined forces with New Bridge Street Consultants, who are linked with Clifford Chance, who have drafted the clause which in this instance is being put forward by the Wider Share Ownership Council.

---

cc PS Chancellor
Mr Scholar
Mr Ilett

Mr Isaac
Mr Lewis
Mr Beighton
Mr Farmer
Mr Prescott
Mrs Eaton
Mr Williams
PS/IR

Mr Prescott's note of 29 October therefore deals fully with all the ESOP proposals contained in both the JOL letter and now in this draft clause accompanying Mr Copeman's letter.

4. Mr Copeman's second point concerns the restriction that the approved Finance Act 1984 'discretionary' share option scheme may only include employees who serve at least 20 hours a week.

5. When the scheme was introduced, Ministers decided that only those employees who made the most substantial contribution to the company's success should be allowed to participate. Because of the generous benefits available a restriction was imposed to exclude part-time employees. To allow part-timers access to the schemes would leave scope for an employee to fulfil the scheme qualification for more than one employing company and thereby benefit from more than one scheme. In fact a relaxation has already been made since the minimum qualification limit was reduced from 25 hours to the present 20 (in the case of employees who are not directors) as a result of an amendment at Report Stage in 1984.

6. Although the CBI have included this point in their Technical Budget Representations this year, apart from Rowntree Mackintosh and Freemans (both referred to by Mr Copeman) there has been very little pressure on this point. The subject was debated in Finance Bill Committee earlier this year when the then Chief Secretary responded along the lines of paragraph 5. The FST also wrote to a number of MPs who had raised the subject in the summer, prompted by directors of Freemans, and also to the Freemans' Company Secretary (copy of letter attached).

7. In short, the WSOC suggestion that the limit should be removed when 50% + 1 employees take part would not deal with

the fundamental objections against removing the restriction. Twenty hours per week strikes the right balance, but there are bound to be criticisms wherever the limit is set.

N. Williams

NIGEL WILLIAMS

Encl.

PS49/4176/87

PLEASE DO NOT REMOVE THIS COPY

FINANCIAL SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

E F T Cribb Esq
Company Secretary
Freemans Plc
139 Clapham Road
LONDON
SW9 9HR

22 July 1987

Dear Mr Cribb

You wrote on 11 June to the former Chief Secretary, John MacGregor, about the participation of part-time employees in Finance Act 1984 approved share option schemes.

I am afraid that there is little I can usefully add to John MacGregor's very clear statement of the Government's position. I doubt therefore whether a meeting would be useful at this stage. The essential point is that we believe there must be some restriction on who may participate in these schemes, given the very generous tax reliefs involved. Wherever the line is drawn, some will fall on the wrong side, but we consider as a matter of judgement that the 20 hours condition strikes a reasonable balance.

Nevertheless I have noted very carefully your comments. We are fully aware of the importance of part-time employees to the economy generally and will certainly be willing to look at this question again in future years.

Yours sincerely

NORMAN LAMONT

859/5

CONFIDENTIAL

papers pse (X).

MR PRESCOTT - IR

FROM: J J HEYWOOD

DATE: 9 November 1987

cc PS/Chancellor
PS/Paymaster General
Mr Cassell
Mr Monck
Mr Scholar
Mrs Lomax
Mr Burgner
Mr Neilson
Mr Call
PS/IR

MEETING WITH MR COPEMAN (WIDER SHARE OWNERSHIP COUNCIL)

The Financial Secretary was grateful for your minute of 29 September and for Mr Williams' note of 5 November. As you know the Financial Secretary has now spoken to Mr Copeman about some of the latter's proposals. Mr Copeman produced the attached paper which I circulate for those who have not seen it.

2. At the meeting with Mr Copeman the main point of discussion was Mr Copeman's proposal for a "Profit-Related Share Option Scheme". (Your note of 29 September covers the ground).

3. Mr Copeman made various points:

(i) It was better to design employee share schemes around share options rather than (as in the 1978 scheme) around immediate appropriation of shares because with options there were fewer problems with rights issues, early leavers and so on. You pointed out that we had had virtually no representations on the rights issue point since amending legislation was introduced in 1982.

(ii) Given his preference for option schemes he wanted to see a refinement of the 1984 Discretionary Share Option Scheme. (See paragraph 2 of the attached paper).

(iii) The "problem" however with an all-employee option scheme along the lines he was proposing was that employees would not be able to exercise their options when they were entitled to, because they would not have the resources. Mr Copeman's solution was to utilise the PRP scheme. PRP used to subscribe shares would attract a higher rate of tax relief than PRP taken in the normal way. Employees would therefore use PRP to finance the option exercise under Mr Copeman's scheme. The Financial Secretary pointed out that this would completely change the PRP scheme which was supposed to be complementary to employee share ownership (encouraging pay flexibility) not an integral and rigid component of a new scheme. The Financial Secretary also said that people would under existing law be able to use their PRP to exercise options if that was the way they wanted to use it.

4. Mr Copeman went on to suggest various extensions of his scheme having outlined the above key features. For instance:

(i) To encourage retention once the options had been exercised he thought the shares could be placed in a PEP. You pointed out that this breached a fundamental principle of PEPs - that existing shareholdings could not be transferred into a PEP.

(ii) There should be some relaxations in the field of employee benefit trusts.

Conclusion

5. The Financial Secretary thanked Mr Copeman for drawing to his attention these "imaginative" proposals but said that he remained sceptical. He asked Mr Copeman to keep him in touch with any further thoughts he might have on this subject.

J.H.

JEREMY HEYWOOD
Private Secretary

SIX KEY OBJECTIVES FOR EMPLOYEE SHARE OWNERSHIP

by George Copeman

1. **Motivate employees with the prospect of making personal capital when the company's capital value grows, as indicated by a higher share price.**

Best done via an option scheme because the option lapses if the employee leaves within three years. Capital rewards go to those who stay long enough to contribute to capital-building. Also options are simple to administer. There is no share ownership until the option is exercised and then it is ordinary share ownership, with no restrictions or special tax liabilities, so there are no rights issue or capital restructuring difficulties.

2. **Encourage managements to include all employees in their share schemes, subject to a minimum service qualification.**

Best done by adapting FA84 so that an option scheme can have two parts, one discretionary and the other on similar terms, granting share-for-share in the two parts, equally. The stimulus to do this could be simple. For example, the present limit on option grant is four times pay, in a discretionary scheme. This could be reduced to three times pay where the general employees were excluded and increased to six times pay where they were included, on the following simple basis: total options that could

be held by any individual would be three times pay unless the following conditions applied, when they could be six times pay:

(a) options worth no more than three times pay have been granted in the previous three-year period; and

(b) "similar terms" options have been offered to all eligible employees at least once during the previous three years - minimum eligibility group being five years' service and 12 hours per week.

3. **Motivate employees in the similar terms part to earn, in bonus, the extra money to trigger their options and pay for exercising them.**

Best done via a kind of profit-related pay, based on local performance, though the scheme may use group shares. To encourage PRP it should be provided that part of PRP may be used to subscribe shares under option and that these options can only be exercised up to the value of PRP set aside. The money used to subscribe shares would have better tax relief than the money taken in instant cash. The shares could go only to those parts of the business which made significant profits.

4. **Encourage employees to go on holding shares after exercise of option, but also build a mixed portfolio.**

Best done via a kind of personal equity plan, with switching facilities that are operable after an initial period of holding, so that employees do not end up with all their eggs in one basket.

5. **Motivate employees to provide for their future security as well as to take the risk of making future gain.**

Best done by specifically arranging for profit-related pay to include a facility for channelling part of bonus into personal pension or free-standing additional voluntary contributions, as a third alternative to cash and shares.

6. **Encourage family controlled companies to protect their future and motivate their employees through share ownership.**

Best done via an option scheme which prevents early leavers from taking out any capital, but operated in conjunction with an employee benefits trust which can acquire a block of former family shares and grant options on them.

In short, by these six inter-linked facilities, encourage managements to run well motivated businesses that have profit-related reward in cash, shares and pension top-up, meeting the needs of employees at all ages and stages, and in total providing incentive for the flexible part of pay to build up, in many companies, to at least 20 per cent of total pay.

G.C.
Nov. 87

4373/41

FROM: J J HEYWOOD
DATE: 10 November 1987

MR WILLIAMS IR

cc PS/Chancellor
Mr Scholar
Mr Ilett
Mr Prescott IR
PS/IR

LETTER OF 2 NOVEMBER FROM WIDER SHARE OWNERSHIP COUNCIL

The Financial Secretary was grateful for your note of 5 November.

2. The Financial Secretary is not attracted to either of these WSOC proposals.

JEREMY HEYWOOD
Private Secretary

3730/002

FROM: N J ILETT
DATE: 11 November 1987

PS/CHANCELLOR

cc: PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mrs Lomax
Miss Noble
Mr Hall
Mr Cropper

THE PURCHASE OF SHARES ON BORROWED MONEY

I attach a note in reply to the Prime Minister's question (No.10's letter of 21 October) about the rules for buying shares on borrowed money in the USA and the UK. This is very largely based on work by Mr Hall, and has involved discussions with the Bank and the DTI and enquiries instituted by the Bank with other bodies. In present circumstances, this has inevitably taken a little time.

2. The note concludes that, on the specific points raised with the Prime Minister in Dallas, US rules are certainly stricter than they were in 1929 and that UK rules are arguably less strict than present US rules, though this difference may be more of form than substance.

3. I also attach a draft letter to No.10.

N J ILETT

D R Norgrove Esq
10 Downing Street
LONDON SW1

PURCHASE OF SHARES

Thank you for your letter of 21 October. I enclose a note by Treasury officials on the rules for buying shares on margin or by the use of borrowed money in the UK and the USA. The DTI and the Bank of England have assisted in the research reflected in this note.

I am copying this letter to John Footman (Bank of England) and Tim Walker (Department of Trade and Industry).

(PRIVATE SECRETARY)

THE PURCHASE OF SHARES, FUTURES AND OPTIONS ON MARGIN AND WITH BORROWED MONEY

Introduction

There is a basic difference between the US and the UK approaches to the rules for buying shares on borrowed money. In the US, the Federal Reserve and other authorities impose rules on lenders which govern, among other things, the terms on which they may lend to finance share purchase. The UK authorities do not control the end-use of the money banks lend to their customers. That is left to the banks to decide for themselves and to regulate by their internal systems, though supervisors obviously take an interest in banks' policies.

US rules

2. We cannot readily provide an authorative account of US regulations and practices in 1929, but it is clear that US rules have been tightened very significantly since that time. US regulations in 1929 permitted some banks and securities houses to lend investors 90% of the market value of securities purchased with the loan and deposited as collateral, provided investors put up a further 10% in cash or other securities. Other institutions worked on the more prudent basis of a cash margin of around 50%. If the market value of the collateral rose, the investor's ability to raise funds to buy more securities rose correspondingly. This facilitated the development of "pyramiding" (the progressive expansion of investors' balance sheets) and added to instability when the bear market came.

3. Under present Federal Reserve regulations, equities purchased with a bank loan and deposited as collateral for that loan are valued at 50% of market value, and the cash/other securities margin requirement is also 50%. These rules are much the same whether the lending is by banks or securities houses. In some circumstances, notably when stock prices are falling, exchanges may impose additional margin requirements; this has been done in recent weeks. There have also, of course, been a host of other regulatory changes since 1929, notably the enforced separation of banking and securities business under the Glass-Steagall Act.

UK practice

4. Historically, lending to finance securities purchases has been on a much lesser scale in the UK than the US, reflecting among other things a lower level of participation in the market by individuals.

5. The Stock Exchange imposes tight rules on lending by its member firms' to clients; in particular, collateral must have a market value of 33% above the loan and the lender can sell the collateral as soon as the borrower fails to maintain this margin. But Exchange officials say such lending has declined since 1974. In addition the Stock Exchange account system allows for credit until account day - which can be up to 3 or even 4 weeks after the bargain is struck. But brokers may insist on immediate payment when they deal with a new customer or are otherwise uncertain of his standing.

6. UK clearing banks leave lending decisions to their managers. Generally, they do not encourage lending for securities purchases or lend on the collateral of the securities purchased (privatisations may be an exception, and it is conceivable that the securities financed with one loan may be accepted for collateral elsewhere). At least some banks have central rules requiring the market value of securities put up as collateral to exceed the value of the loan by 25% (ie less than the Federal Reserve requirement in the US).

Avoidance

7. There is some scope in both the UK and the USA for individuals to obtain loans without disclosing (or by concealing) their purpose, eg by using automatic overdraft facilities attached to "gold" credit cards. We doubt this is on a significant scale in overall market terms, but some individuals will make substantial use of such devices.

Terminology

8. Margin in the sense used above means that collateral required on loans to finance equity purchases must have market value in excess of the value of the loan, at least initially. In short, the value of the collateral (other of course than cash) is

discounted. "Margin" is used in a different sense in the futures and options markets, where investors deposit cash margins with their brokers as an insurance that they will fulfil their contracts. In difficult times investors may make losses in excess of the margins which then constitute debts to their brokers.

Futures and Options

9. Financial futures and options markets did not exist in 1929. Investors can gear much more highly in these markets than in "traditional" security markets.

10. For futures, the margin requirements vary considerably, and depend on the underlying investment, the current price volatility of that investment and also the particular exchange on which the contract is traded. Buyers and sellers must deposit margins with brokers, and exchange rules require brokers to collect margins promptly and in full and to pass them on to the exchanges. Additional margin is required daily if prices move against market players, so brokers usually hold further sums of clients' money in a special account to meet these margin calls. Our information is that brokers and banks are unlikely to lend clients money to meet their margin calls.

11. There are also major variations in practice in the case of options. But in some cases (e.g. purchases of options on the Chicago Mercantile Exchange) there is no margin because the nature of the instrument traded implies a pre-determined, limited risk which is covered by the premium paid at the time of purchase.

12. Margins on the futures and options markets are generally lower than the "discount" margins in the equities markets, although they have been raised considerably over the last 3 weeks in the financial futures and options markets in response to events.

13. There have been cases over the last 3 weeks where banks, securities houses and brokers both in the UK and the USA have allowed clients to over-extend themselves in the futures and options markets. These clients became unable to meet increased calls for margin, so their broker had to meet the bill for the losses sustained in the markets. In the UK the two most prominent cases

mentioned in the Press have concerned A J Bekhor (a private client broker not linked to a major finance house) and County Nat West Securities. On the information we have, Press accounts are reasonably accurate. At the least, such incidents reflect grave errors of judgement by managers; and they probably also indicate deficiencies in systems. In the first instance, it is for the institutions themselves to take corrective action. But supervisors will be taking a close interest.

Conclusion

14. The Prime Minister's interlocutors in Dallas were certainly correct in saying that US rules have been tightened since 1929. Arguably, US rules on lending for equity purchases are tighter than UK rules because US rules are imposed by statutory authority and require higher "discount" margin than UK banks and securities houses seem to expect. On the other hand, UK banks are more reluctant to lend on the collateral of the shares purchased, and we are told that UK Stock Exchange members now do relatively little lending to their customers. Arrangements in financial futures and options markets vary between markets but in this area there are no substantial differences of approach between the USA and the UK.

FIM(2)
HM TREASURY
12 NOVEMBER 1987

4374/41

FROM: J J HEYWOOD
DATE: 16 November 1987

MR FARMER IR

cc PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Monck
Mr Cassell
Mrs Lomax
Mr Burgner
Mr Scholar
Mr Ilett
Ms Sinclair
Mr Cropper
PS/IR

EMPLOYEE STOCK OPTION PLANS (ESOPs)
LETTER OF 19 OCTOBER FROM JOB OWNERSHIP LTD

The Financial Secretary has read Mr Prescott's submission of 29 October. He has decided that he will meet JOL again this year.

2. I shall let you know when this meeting will take place and would be grateful if you could provide official support for that meeting together with Mr Ilett.

JEREMY HEYWOOD
Private Secretary

Christopher Morgan & Partners
15 JOHN ADAM STREET, LONDON WC2N 6LU
TELEPHONE: 01-930 7642 TELEX: 8812128 MORGAN G FAX: 01-839 3579

STRICTLY PRIVATE AND CONFIDENTIAL

The Rt. Hon. Norman Lamont, MP
Financial Secretary
H.M. Treasury
Parliament Street
London SW1

18 November 1987

Dear Mr. Lamont

I read in the Financial Times today of your concern regarding Advisers' ability not only to attract small shareholders but to retain them.

One of the problems is that to try and become an "Adviser" you have to be a member of the club, which personally I find rather offensive.

Might I suggest that the next privatisation issue should be looked at from a marketing standpoint, rather than taking a straightforward financial approach?

My own consultancy does not blow its own trumpet, preferring to blow that of its clients. However, we are in charge of marketing for the largest broker to private investors in the U.K. (Alexanders Laing & Cruickshank). We marketed the financial futures exchange (LIFFE) from scratch. This year we marketed the French capital markets worldwide, and, I might add, with some effect. The City of London would have been preferable, but frankly nobody there listened.

If you could spare some time to listen to our ideas, I am sure that we could contribute to your objective.

Yours sincerely

A.C. Morgan
Senior Partner

42aG/NH/3774/35

FROM: MARTIN HURST
DATE: 14 December 1987

1. MRS LOMAX ✓
2. FINANCIAL SECRETARY

I don't see a strong case for repeating a special survey but you may wish to discuss

RL 14/12.

cc PS/Chancellor
PS/EST
Sir Peter Middleton
Mr Cassell
Mr C D Butler
Mr Peretz
Mr Scholar
Mrs Brown
Mr Ilett
Mr Griffiths
Mr Courtney
Mr Neilson
Mr Corlett - IR

WIDER SHARE OWNERSHIP SURVEY

When Treasury Ministers commissioned the joint survey (with the Stock Exchange) on share ownership which was published in March of this year, the question whether the survey should form part of a regular series was left open. This submission considers whether we should commission a further Survey in time for next year's Budget. It would be necessary to tell NOP (who did last year's survey) that we want another one before Christmas. The Stock Exchange have informally stated their willingness to participate on the same basis as last time.

2. A new survey would probably cost in the region of £25,000, of which we would pay half. We already have £25,000 in the Treasury's Budget for 1988-89 to cover the costs of a survey. While payment on a survey in January/February 1988 would be due in 1987-88, EOG would be content for us to bring forward this expenditure since it would help relieve pressure on running costs in 1988-89.

Likely Results

3. Our best guess is that a new survey would show a marginal fall in share ownership over the previous year. Surveys conducted

39/139/14

by Financial Research Services (FRS) show that between February-March and September of this year share ownership, if anything, fell slightly (from 7.2 million to 7.04 million). The February-March FRS figure may have been somewhat inflated by the inclusion of British Airways "stags". An estimate of the extent of this bias can be found by adding to the pre-Gas FRS figure of 5½m the estimated 1½ million new share owners which (according to the Treasury/Stock Exchange survey) were due to the British Gas privatisation. This suggests that the bias is small and that the pre BA figure, at around 7 million, was very similar to the September figure. This conclusion is strengthened by results from Dewe Rogerson (DR) surveys which show a small fall from 9.6 million to 9.4 million, although this source is less reliable.

4. Since September, share registers in privatised companies have continued to contract, albeit slowly, and it is probable that the slump in equity prices, plus the payment of the BT loyalty bonus (qualification date 30 November) and the second issue of Gas vouchers (31 December) will, if anything, have caused a reduction in share ownership from the September level. But evidence from a survey commissioned by Valin Pollen conducted in the immediate aftermath of the equity price crash suggested that few, if any, share owners were contemplating selling as a result of the crash.

Alternative Sources Of Information

5. A new Treasury/Stock Exchange survey is not, of course our only source of information on recent trends in share ownership. There will be three reasonably sound alternative sources. These are the General Household Survey (GHS), the 1987 version of which includes questions on shareownership on a definition comparable with last year's Treasury/Stock Exchange survey for the first time; the regular FRS and Target Group Index (TGI) surveys run by NOP and by the British Market Research Board. Of these:

6. - The GHS survey is published by the OPCS, and thus produces quotable figures for share ownership. But even on the most optimistic estimates it will not produce any results before the summer and then only for calendar 1987 (by quarters). 1988 data will not become available until mid-1989. The figures produced are on the same definition as the Treasury/Stock Exchange survey.

This is also the survey which Gordon Brown is always quoting: and which we say is not a good indicator of absolute levels.

- The FRS survey produces the most up-to-date data, available about a month after the end of each quarter. But the figures for share ownership are consistently lower than those produced by other surveys, due to differences in the questions asked and in the context of questioning. However, the FRS probably gives an accurate indication of the changes that have taken place since the HMT/Stock Exchange survey. FRS figures are not quotable for copyright reasons. We do not currently have access to FRS data but could subscribe for around £500.

- The TGI survey has around a four month lag from sampling to production of data. By Budget time the latest TGI data available will be for September 1987. It provides figures each quarter which are comparable with Treasury/Stock Exchange figures (rather than the GHS which only provides quarterly figures once a year) but once again these are not quotable. We already have access to TGI data through the Department for National Savings.

7. In conclusion, FRS data could probably provide a good idea of movements in share ownership since the crash by the time of the Budget, and a publicly quotable figure comparable with the Treasury/Stock Exchange survey should become available from GHS by the summer.

Pros and Cons

8. The main aim of the 1987 Treasury/Stock Exchange survey was to establish an authoritative figure for share ownership as it then stood, given the conflicting estimates then being published. In this respect it was undoubtedly a success. Providing an update of this authoritative figure would be the main justification for spending £25,000 of our and the Stock Exchange's money on

commissioning a new survey. But expenditure on a new survey is less justifiable this year, given the use of and payment for the GHS survey to inquire about share ownership.

9. Quotable figures at Budget time could only be obtained with a new survey. But on other grounds the case for a survey is fairly weak. As argued in para 2, the level of share ownership now is probably not very different from the figure found in the 1987 survey. The firm base of this survey plus estimates from FRS of the magnitude of changes since then will thus probably give us a reasonable idea of post-crash share ownership by the time of the budget. Taken together with the existence of share ownership questions in the GHS, which will provide authoritative, if somewhat dated, quarterly figures for calendar 1987 by (we hope) late summer 1988, the need for a new survey is less obvious than it was last year.

10. It would be prudent to assume that any survey by HMT will become public knowledge, whether or not we like the results. A survey showing a small fall in share ownership might usefully demonstrate the robustness of share ownership in the face of severe shocks. But we cannot be sure of obtaining this result. Share ownership could fall further over the next few months due to selling as a result of the fall in equity prices, and the BT and BGC bonuses mentioned in para 2. And any survey is subject to sampling error. We would estimate this danger to be small, but not insignificant.

11. Finally, our own survey would provide some information on issues such as multiple privatisation holdings, which is not available elsewhere. Such information is of use to us and to the Revenue, but would not alone justify commissioning a special survey.

Timing

12. If we do want to commission a new survey, in time to have results available for Budget, we would need to tell the Stock Exchange and NOP before Christmas.

Summary

13. A new survey costing around £25,000, divided between the Treasury and the Stock Exchange and commissioned before Christmas would provide information by the time of the Budget. Our best guess is that it would reveal a small fall in share ownership over a year ago. But there must be a possibility that the survey would show a larger fall than we anticipate, which would be a particular embarrassment if we had sponsored the survey.

14. There is a relatively cheap alternative source of information from the FRS but this would not be publishable and would be less detailed. The GHS survey results, which are publishable and which have already been paid for, will only become available in early summer at best, and may, by then, be somewhat out of date.

Martin Hurst

MARTIN HURST