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FROM: NICHOLAS RIDLEY
DATE: 18 January 1983

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CAPITAL TRANSFER TAX

We need to decide the main changes to capital transfer tax to be made in the Budget. In considering my recommendations I have had three main factors in mind:-

i) we have done less to reduce the overall burden of CTT than we have done for most other direct taxes;

ii) despite the reliefs already available for businesses, the psychological impact of the tax still appears to be a disincentive to growth; and

iii) while the main cause of the continuing decline in let agricultural land is our failure to reform the tenure laws, a further shift in the balance in favour of let land would be an appropriate gesture.

These factors point to an increase in the threshold and rate bands and an improvement in the reliefs for businesses and agriculture. Compared with the cost of changing other direct taxes, the cost of even major improvements would not be substantial. I consider each in turn.

The rate Scale

Last year we indexed the CTT rate scale in broadly the same way as for the income tax personal allowances. Hence if we do no more, the threshold and rate bands will rise by some 6%. The full year cost to be shown in the FSBR will be £40m (£15m in 1983-84), but this figure is already in the forecasts so it does not affect the size of the fiscal adjustment. Nor of course does it affect the real burden of the tax. We should regard it as the base from which our decisions should be taken.

Last year we increased the threshold and bands all the way up the scale. But this was the first such adjustment. The only other change we have made to CTT was in 1980 when we increased the threshold to £50,000 without altering any other rate band. Our predecessors also made only one change which was largely weighted towards the bottom of the scale. The result is that, although the threshold is substantially higher in real terms than when the tax was introduced in 1975, the starting rates are so steep that above £80,000 the tax is heavier in real terms than on its introduction - indeed at some points the average rate of tax is some 10 percentage points higher now than then. Although international comparisons are particularly difficult for this tax, the burden is also high by comparison with other countries.

A particular area for consideration is the three top rates of 65%, 70% and 75%. Very few people pay at these rates, so that their significance is almost entirely political and not economic or social. I do not think we can remove them altogether; but I suggest that we should cut down the number of steps in the rate scale by charging only at multiples of 10% and, if we apply that principle to the top of the scale, the only rate above 60% would be at 70%, reducing the maximum rate by 5%.

Ideally I should like substantially to increase the threshold and to reduce the burden of the tax so that at no point does its real weight exceed that in 1975. But the full year cost of so doing would be well in excess of £100m so I fear that it must be rejected this year. I recommend instead a smaller increase in the threshold and a reduction in the burden all the way up the scale to bring it closer, though not down, to its 1975 real equivalent. This would cost £70m in a full year (£25m in 1983-84). If you considered that that was too much then on this occasion I think we ought to do no more with the treshold than round it up to the nearest convenient number. While I should like to see a real increase in it to keep the number of taxpayers and Inland Revenue staff to a minimum, given the concentration on the threshold in the past, I think that, if we cannot afford to do both, we should concentrate this year on those parts of the scale which have hitherto been left largely untouched. The cost of this alternative would be £45m in a full year (£15m in 1983-84).

... Table 1 attached shows the various scales I have considered. My preferred scale is scale H; my fall back scale is scale G. Table 2 shows the distributional effect of scales H and G and the graph (which is on a log scale) shows their effective rate compared with the 1975 and current scales indexed to date. This more detailed information is available for all the scales I have considered if you want it.

All these figures show only the rates on death. Any changes we make can be carried forward to the lifetime rate scale: the cost of changes to the latter will be within the margin of error of the estimates of changes to the scale on death. If the maximum rate on death is reduced from 75% to 70%, the maximum rate in life should drop correspondingly from 50% to 45%.

<u>Business and Agriculture</u>

One advantage of concentrating reductions in the rates further up the scale and not simply on the threshold is that it will be particularly helpful to those with significant interests in medium-sized businesses and to farmers who have tended not to benefit from all our measures for smaller businesses. But more than that is required. The Inland Revenue are keen to point out the extent to which businesses and farms are already favoured under the tax: for example on an estate containing only quoted securities worth £½m the tax would be £237,500, while if the estate comprised a business to the same value the tax would be only 37% thereof, £87,500, and even that would be payable by interest-free instalments which (depending on the discount rate chosen) is equivalent to a further reduction of 20-30%. I believe however that it is right that owners of productive assets should be subject to a far less onerous regime which recognises the very different nature and value to the economy of businesses and farms.

I have therefore looked closely at the proposals put forward by the Unquoted Companies' Group and a number of other representative bodies and have discussed it with them formally (as well, needless to say, as over lunch). In essence their scheme provides that, on the death of an owner of a business, or of shares in an unquoted company, no tax would be payable unless his heir sold the business or shares. When the heir himself died, the tax due on the first death would be forgiven altogether and the tax then becoming due would similarly be held over. This process would be carried on down the generations so that no tax would ever be paid so long as the business was run by the same family.

By the time it had been fully worked out, including its implications for agriculture, this scheme would be quite complex which is itself a reason for looking askance at it. But its major defect is that it would lock a family into its business, regardless of whether the younger generations were suitable to run it or not, and discourage the bringing in of outside equity or share ownership, or, if it prospered, the seeking of a Stock Exchange listing. So it would run counter to a lot of our other policies. One means of removing the locking-in effect would be to exempt businesses altogether - this would cost very little more than the holdover scheme. But even with a long qualifying period of ownership, there would be some people who would buy unquoted shares or agricultural land solely as a tax shelter, so I cannot recommend this either.

However I think we ought to do rather more to counter the belief that there is little point in expanding a business beyond a certain size because the CTT burden placed on the heirs would then be unmanageable. The Inland Revenue have shown in figures that this view is misplaced and our challenge to be given examples of cases where CTT has actually been damaging remains to be taken up. The feeling that it is a disincentive remains however among those to whom I have spoken so that the tax continues to be psychologically damaging, however unreasonable that attitude may be.

As a separate matter I think that we should make a gesture towards the difficulties faced by agricultural landowners. It is now, I believe, becoming more fully recognised that the major reason for the decline in let agricultural land and hence the drying up of openings for would-be tenant farmers is our system of land tenure, but (apart from some minor changes in Scotland to be introduced next month) there is nothing which can be done in this Parliament. Tax changes by themselves will have little effect on the problem, but they would act at least as a sign of good intent. Although in the longer term we should in my view be moving towards some recognition in the tax system that good estate management is closely analogous to the running of a business, a simple immediate step would be to increase the CTT relief we introduced in 1981.

You may recall that the main CTT business reliefs are:-

50% for owners of businesses, partners, and controlling shareholders; and

20% for minority shareholders in unquoted companies.

Similarly the CTT agricultural reliefs are:-

50% for agricultural land with vacant possession; and

20% for let agricultural land.

In each ase the lower level of relief recognises the lower value of minority shareholdings and of land subject to a lease.

My minimum recommendation in this area is that we should slant these reliefs by increasing both the 20% reliefs to 30%. The cost would be only £5m in a full year (£2m for businesses, £3m for agriculture) and £1m in 1983-84. But my preference would be to improve the reliefs as well as adding this slant by increasing the 50% reliefs to 60% and the 20% reliefs to 40%. The cost would then by £15m in a full year (£6m for businesses and £9m for agriculture) and £1½m in 1983-84. Table 3 shows the impact of relief at different levels on

There is one other point. Tax on businesses and on agriculture is payable by interest-free instalments over 8 years. I believe that we should ease the cash flow problems caused by taxing productive assets by increasing this period to 10 years. This would fit in with ten-year cumulation and, in the case of discretionary trusts, with the new ten-year charge to be introduced this April. In effect it would mean paying a little CTT every year and this could almost always be met out of income if the owners or trustees so wished. This would mean a lag in receipts of about £2½m a year, rising to £20m in the eighth year. By the tenth year the yield would be restored but lagged by a year. There would be no full year cost.

There is a corresponding facility to pay CGT and DLT by interest-free instalments. John Wakeham thinks we should make similar changes for DLT; we should also do so for CGT although the Inland Revenue are considering whether, following the changes made in the last two years in the treatment of gifts, there are any circumstances left in which the instalment provisions will apply. If not, they can be removed.

Capital Gains Tax

Following last year's major changes to CGT, I think we should leave the tax alone this year. The exempt amounts £5,000 for an individual, £2,500 for a trust) are now indexed and we should allow that to run through. I am also looking at those fixed money amounts which are not indexed to see if any should be updated this year. But none of this has any significance which needs to be examined in a Budgetary context, rather than in the detail of the Finance Bill.

Summary

Accordingly my recommendations are as follows:-

... i) we should introduce a new CTT rate scale H as shown in Table 1 attached or, if that is too expensive, scale G;

ii) we should not introduce a hold-over relief for productive assets;

iii) we should increase the 50% business and agriculture reliefs to 60% and the 20% reliefs to 40%: failing that the 50% reliefs should be left untouched but the 20% reliefs should be increased to 30%;

iv) we should increase the period over which tax can be paid by instalments from 8 years to 10; this should apply to CTT, DLT and - unless the provision is now all but otiose - CGT; and

v) we should allow statutory indexation to apply to the CGT exempt amounts but make no changes to the tax of Budgetary significance.

None of these changes would be at all complex; nor would they require lengthy legislation.

pp Eric Kwiatkowski
NICHOLAS RIDLEY
18 January 1983

TABLE 1

BOTTOM POINT OF BAND £'000

RATE %	NOW	INDEXED	SCALE F	SCALE G	SCALE H	SCALE B	SCALE C	SCALE D	SCALE E
30	55	59	65	60	65	60	60	75	100
35	75	80							
40	100	106	100	120	110	150		150	150
45	130	138					200		
50	165	175	150	180	175	250		225	200
55	200	212							
60	250	265	250	300	300	400	350	400	300
65	650	689	700					1,500	1,350
70	1,250	1,325	1,325	1,325	1,325			2,000	2,000
75	2,500	2,650	2,650					3,000	3,000
Cost full year		[£m40]	£m45	£m45	£m70	£m80	£m90	£m155	£m230
First year		[£m15]	£m15	£m15	£m25	£m30	£m35	£m 60	£m 90

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TABLE 2

TAX PAID ON AN ESTATE AT THE LOWER LIMIT OF THE RANGE

Lower limit of range of taxable estate	Number of estates in range	Indexed 1982/83	Scale H	Reduction £	%	Scale G	Reduction £	%
65	5,900	1,800	0	1,800	100.0	1,500	300	16.7
80	4,900	6,300	4,500	1,800	28.6	6,000	300	4.8
100	4,900	13,300	10,500	2,800	21.1	12,000	1,300	9.8
150	1,600	33,600	29,500	4,100	12.2	30,000	3,600	10.7
200	1,200	57,350	52,000	5,350	9.3	52,000	5,350	9.3
300	390	113,500	102,000	11,500	10.1	102,000	11,500	10.1
400	150	173,500	162,000	11,500	6.6	162,000	11,500	6.6
500	150	233,500	222,000	11,500	4.9	222,000	11,500	4.9
750	50	386,550	372,000	14,550	3.8	372,000	14,550	3.8
1,000	40	549,050	522,000	27,050	4.9	522,000	27,050	4.9
2,000	10	1,232,800	1,189,500	43,300	3.5	1,189,500	43,300	3.5
TOTAL	19,300							

TABLE 3

CTT LIABILITY ON SPECIMEN ESTATES ASSUMING VARIOUS LEVELS OF RELIEF
(1982/83 scale indexed by 6%)

Value of taxable estate qualifying for relief	No Relief	20% relief	30% relief	40% relief	50% relief	60% relief
£'000	£	£	£	£	£	£
65	1,800	0	0	0	0	0
80	6,300	1,500	0	0	0	0
100	13,300	6,300	3,300	300	0	0
150	33,600	20,300	15,050	9,800	4,800	300
200	57,350	38,100	29,100	21,000	13,300	6,300
300	113,500	78,750	62,350	47,350	33,600	21,000
400	173,500	125,500	101,500	78,750	57,350	38,100
500	233,500	173,500	143,500	113,500	84,250	57,350
750	386,550	293,500	248,500	203,500	158,500	113,500
1,000	549,050	419,050	354,050	293,500	233,500	173,500
2,000	1,232,800	952,800	812,800	679,050	549,050	419,050

In all cases where relief is available the tax due is payable by interest-free instalments.

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