



Inland Revenue

Savings and Investment Division
Somerset House

CF-PC

Prime Minister
I have obtained this from the Treasury following your query about the composite rate. The covering note summarises the issues, and the table the calculations.

FROM : J R STREETER
23 November 1988

- 1. MR O'CONNOR *23/11*
- 2. MR CORLETT *24/11*
- 3. MR ISAAC *(Marginal note on the ground)*
- 4. FINANCIAL SECRETARY

RECC 28/11

Approved

DETERMINATION OF COMPOSITE RATE FOR 1989/90

- 1. This note seeks your approval
 - a. to a determination of the 1989/90 composite rate for building societies, banks and local authorities at 21.75% (a drop of 1.5% from the current rate), and
 - b. for laying a Treasury Order to that effect (with accompanying Press Release) in the near future.

Background

2. The composite rate is the rate at which tax has normally to be accounted for on interest paid to individual investors by building societies, banks and local authorities. It is a final tax and cannot be repaid to those who are not otherwise liable. It has to be statutorily fixed each year. It is determined on

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| cc. Chancellor | Mr Isaac |
| Chief Secretary | Mr Corlett |
| Economic Secretary | Mr Davenport |
| Sir P Middleton | Mr Calder |
| Mr Culpin | Mr O'Connor |
| Mr Peretz | Mr Dearman |
| Mr Gilhooly | Mr Streeter |
| Mr Gieve | Miss Boland |
| Mrs Chaplin | Mr Willmer |
| Mr Tyrrie | Mr McCarney |
| | Mr Green |
| | PS/IR |

the basis of data for the preceding rather than the current year, and has to be, as nearly as maybe, revenue neutral (ie it should yield the same amount of tax as would be raised if those investors who were liable at basic rate suffered tax at that rate, and those who were not liable suffered no tax).

3. It is announced by Treasury Order, before, at the latest, 31 December preceding the relevant tax year starting the following 6 April. Thus the rate for 1989/90 has to be determined before 31 December 1988. The normal practice is to lay the Order earlier. Last year the Order was laid on 8 December and it is desirable to work to a similar timetable this year so that the institutions have as much advance notice as possible.

Parliamentary Procedure

4. The Order falls to be made by statutory instrument which is subject to the negative resolution procedure. It remains subject to this procedure for forty sitting days and under a House practice rule statutory instruments should, where practicable, not come into force before 21 calendar days after they have been laid.

Recommendation on 1989/90 rate

5. When banks were brought into the composite rate scheme in 1985, followed by local authorities in 1986, no data was available showing the ratio of taxpaying and non-taxpaying depositors in these institutions. Transitional rules were therefore included in the Finance Act 1984 which provided that the composite rate for the four years 1985/86, 1986/87, 1987/88 and 1988/89 should be calculated by reference to data relating only to building societies.

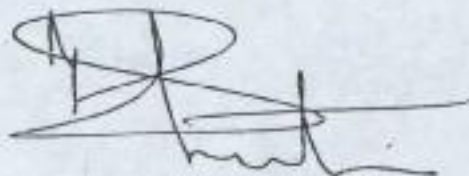
6. For 1989/90 and subsequent years the tax status of depositors in all the institutions covered by the scheme must be taken into account. Our Statistics Division has therefore extended the normal 4-yearly examination of building society accounts to include a sample of accounts held by other deposit-takers. The evidence supports a composite rate of 21.75 per cent for 1989/90 (a drop of 1.5 per cent from the 1988/89 rate of 23.25 per cent). Further details of the calculation are included in Annex A.

Court action by the Woolwich Equitable Building Society

7. Last year we warned that the Order determining the rate for 1987/88 might be challenged in the Courts. Following the successful challenge by the Woolwich Equitable Building Society of the Regulations which govern composite rate tax paid by building societies we assessed the possibility of a challenge to last year's Order as remote. The decision in favour of the Woolwich is subject to appeal by the Revenue. The possibility of a challenge against this year's Order remains but has not increased.

Summary

8. We seek your approval for
- a. composite rate for 1989/90 to be set at 21.75% (paragraph 6 and Annex A);
 - b. the laying of a Treasury Order as soon as possible (paragraphs 3 and 4);
 - c. the issue of the draft Press Release.



J R STREETER



**INLAND
REVENUE**

Press Release

INLAND REVENUE PRESS OFFICE, SOMERSET HOUSE, STRAND, LONDON WC2R 1LB
PHONE: 01-438 8692 OR 8706

[3x]

November 1988

**COMPOSITE RATE FOR BUILDING SOCIETIES, BANKS AND LOCAL
AUTHORITIES ETC FOR 1989-90**

A Statutory Instrument was laid before the House of Commons today fixing at 21.75 per cent the rate at which building societies, banks, local authorities and other deposit-takers will account for tax on interest paid in 1989-90 to individuals resident in the United Kingdom.

The Statutory Instrument, which has the title "The Income Tax (Reduced and Composite Rate) Order 1988" will be published on

Copies will be obtainable from HMSO.

Notes for Editors

The composite rate is a fixed rate of tax on interest which is not repayable. It is set (on the basis of a periodic statistical survey of depositors) at a level which will achieve revenue neutrality - that is, a rate which will result in the same amount of tax in total becoming payable as would be payable if tax were charged on investors according to their own individual tax rates.

The 21.75 per cent rate now determined for 1989-90 is a reduction of 1.5 per cent from that for 1988-89.

S T A T U T O R Y I N S T R U M E N T S

1988 No.

I N C O M E T A X

The Income Tax (Reduced and Composite Rate) Order
1988

<u>Made</u>	<u>1988</u>
<u>Laid before the House of Commons</u>	<u>1988</u>
<u>Coming into force</u>	<u>6th April 1989</u>

The Treasury, in exercise of the powers conferred on them by section 483 of the Income and Corporation Taxes Act 1988(a), hereby make the following Order:

1. This Order may be cited as the Income Tax (Reduced and Composite Rate) Order 1988 and shall come into force on 6th April 1989.
2. The Treasury hereby determine that the rate which, under the provisions of the said section 483, shall for the year 1989-90 be the reduced rate (for building societies) and the composite rate (for deposit-takers) shall be 21.75 per cent.

1988 Two of the Lords Commissioners of Her Majesty's Treasury

(a) 1988 c.1.

EXPLANATORY NOTE

(This note is not part of the Order)

By virtue of the Income Tax (Building Societies) Regulations 1986 (S.I. 1986/482; amended by S.I. 1987/844 and S.I. 1988/1011) a building society is required to pay to the Inland Revenue in respect of payments of dividends and interest an amount representing income tax on certain sums calculated in part at the basic rate and in part at "the reduced rate".

Under the provisions of section 479 of the Income and Corporation Taxes Act 1988 ("the Act") a deposit-taker on making payments of interest in respect of a relevant deposit is liable to account for and pay an amount representing income tax on such payments. The amount is calculated by applying "the composite rate" determined in accordance with section 483 of the Act.

Section 483 of the Act provides that the Treasury shall by order made by statutory instrument determine a rate in each year of assessment which for the following year of assessment shall be the reduced rate (for building societies) and the composite rate (for deposit-takers). This Order determines the rate at 21.75 per cent. for the year 1989-90. The rate for the years 1985-86 and 1986-87 was 25.25 per cent. (S.I. 1984/1674 and S.I. 1985/1836), for the year 1987-88 24.75 per cent. (S.I. 1986/2147) and for the year 1988-89 23.25 per cent. (S.I. 1987/2075).

CONFIDENTIAL

EVIDENCE ON A REVENUE-NEUTRAL RATE FOR COMPOSITE INTERESTAssembly of New Evidence

1. The rate to be set for 1989-90 is the first one which is not exempted (by ICTA Section 48 3(4)) from having to take account of the inclusion of bank depositors within the scope of composite rate, which took effect from 1985-86.
2. To enable bank composite rate interest to be included in the calculation of what level of composite rate produces revenue-neutrality, a Composite Rate Statistical Investigation has been carried out. The savings institutions, including banks, drew a sample of their composite rate accounts, and supplied to the Inland Revenue the names and addresses of the account holders, and the amount of interest paid and credited in the year to April 5 1987. Most of them managed to meet the due date for doing so, the end of June 1987. By the end of January of this year, almost all the details of sampled investors had been supplied; the tax district most likely to deal with their affairs had been identified and had been asked to provide tax or income information relevant to the calculation of what proportion of their interest would be liable to tax in the absence of a composite rate system.
3. The sample of accounts with which tax districts were asked to deal numbered about 86,000. They responded well, supplying details for about two thirds of account-holders by the end of July. However, locating the right tax district from the name and address supplied by the savings institutions was not straightforward in the case of a substantial minority of account-holders. For many, no record was traceable. Such account-holders could not be assumed to be non-taxpayers simply because no tax record could be traced, and they were, if necessary, asked to complete a return of income.