

Stamp duty reserve tax - Schedule 19: a discussion paper

November 2007



HM TREASURY



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Schedule 19:
a discussion paper**

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HM Treasury contacts

This document can be found on the Treasury website at:

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For general enquiries about HM Treasury and its work, contact:

Correspondence and Enquiry Unit
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 4558

Fax: 020 7270 4861

E-mail: ceu.enquiries@hm-treasury.gov.uk

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ISBN 978-1-84532-364-6

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INTRODUCTION

BACKGROUND

Context

1.1 In October 2006 KPMG and the Investment Management Association (IMA) published a report *'Taxation and the Competitiveness of UK funds'* and in December 2006 the then Economic Secretary announced the creation of a joint Treasury, IMA and HMRC working group to consider its recommendations. This consultation document concerns the report's findings on Schedule 19 Finance Act 1999 (Schedule 19), the Stamp Duty Reserve Tax (SDRT) legislation that applies to collective investment schemes.

1.2 The report argued that Schedule 19 is one factor that is encouraging funds to domicile abroad. The report emphasises two issues:

- that the tax is complicated to calculate and therefore a burden on funds to administer (requiring bespoke systems to comply); and
- that, given its complexity, explaining the tax to potential investors acts as a disincentive to invest in UK funds.

1.3 Following discussions with the joint working group, at PBR 2007 the Government announced its intention to consult on two options for the reform of Schedule 19. Both options aim to make the legislation simpler for funds to administer and easier for investors to understand, thus tackling both of the issues raised in the original KPMG / IMA report.

Rationale and application of Schedule 19

1.4 When UK shares are traded, SDRT is charged to the purchaser on the transaction. In the case of collective investment funds, where an investor leaves the scheme and 'surrenders' their units in the fund, the fund manager can (under FSA regulations) retain the surrendered units for up to two weeks to issue to new investors.

1.5 This means that, when investors leave a fund and new investors join and provided these new investors arrive within the two-week window, no disposal of shares and no subsequent re-purchase takes place on the open market. In these cases, without Schedule 19 no SDRT would be payable. Schedule 19 therefore is that part of SDRT legislation that makes a charge to tax on such transfers of units, and therefore of interests in the underlying shares, within collective investment schemes.

1.6 The charge is a flat rate of 0.5 per cent on the value of units surrendered on a weekly basis. It is subject to two proportionate reductions to the extent that:

- the redemptions lead to a reduction in the size of the fund¹; and

¹ If more units are surrendered than issued during the two week period, which consists of the week the surrender occurs and the following week, then the liability is reduced by multiplying it by the ratio I/S (where I and S are the numbers of units issued and surrendered in the two week period).

- the fund contains securities that would not themselves be subject to Stamp Duty, such as bonds or overseas equities².

1.7 Given the concerns raised by the IMA / KPMG report and in subsequent working group discussions on complexity of administration and investor perception, the Government has decided to seek a revenue neutral reform of Schedule 19. The Government has considered abolition of Schedule 19, but does not consider this to be a viable option, having weighed up the loss involved for the Exchequer compared to the amount abolition might save the industry in terms of administrative and compliance costs. The purpose of this consultation is to seek views regarding two proposed options to simplify the SDRT regime for collective investment funds.

Point for discussion:

1. The Government would welcome comments on the need to tackle the burden imposed by the Schedule 19 regime and the potential disincentive to investors it produces.
2. The Government welcomes views from interested parties on whether the aspects of the proposals are likely to reduce administrative costs, how those might arise, and any evidence that may be helpful in providing a quantitative estimate of these savings.
3. Estimating the compliance savings and costs generated by the proposed reforms is complex. The Government is seeking evidence from the industry to aid with quantifying these.

² If a fund has investments in exempt assets, the liability is (further) reduced by multiplying it by the ratio $N/(N+E)$ (where N and E are the average market values of the non-exempt and exempt assets of the fund over the two week period).

2

ISSUES FOR CONSULTATION

PROPOSALS FOR CHANGE

Current position

2.1 There are over 2000 collective investment funds in the UK, managed by around 150 investment managers. The total value of assets under management is circa £450 billion, of which, around 40 per cent is UK equities³. The Exchequer revenue from Schedule 19 was £70 million in 2005 – 2006.

2.2 As set out in paragraphs 1.4 to 1.6, Schedule 19 makes an SDRT charge on collective investment funds where there is effectively a transfer of underlying shares to a different investor. The current formula for calculating the amount of SDRT payable on the surrender of units in a fund takes as its starting point 0.5 per cent of the value of the unit, which is then multiplied by two fractions I/S and $N/(N+E)$, where:

- I is the number of units issued by the fund managers in the relevant two week period;
- S is the number of units surrendered to the managers in the relevant two week period;
- N is the average market value of the non-exempt investments over the relevant two-week period; and
- E is the average market value of the exempt investments over the relevant two week period.

2.3 Fund managers must ensure that the Schedule 19 calculation is performed weekly and submit returns on a monthly basis. Where a fund has invested in another fund, the fund manager must also determine, in order to make the calculation, whether the units in that fund are exempt investments or non-exempt investments for the purposes of the $(N/(N+E))$ formula. This involves obtaining information from a third party, i.e. the manager of the other fund,

2.4 The proposals in this document have been drawn up following discussions with industry representatives where concerns were raised about the complexity of the calculation and the perception of the tax to potential new investors. They take into account the Government's principles of equity and simplicity for the tax system and are intended to simplify the regime for funds and potential investors.

2.5 Two options are considered in this paper. The first is to make a charge on funds based on the value of assets under management, the second is an amendment to the requirements of the current regime but similar in that it would be based on the value of surrenders over the year.

2.6 The options reflect the Government's desire to maintain the competitiveness of the UK asset management industry, while recognising the need for investors in different circumstances to be subject to similar tax treatment. Both proposals will be developed to be broadly revenue neutral, although it is recognised that there will be distributional effects associated with any change.

³ Based on ONS and IMA data.

2.7 For example, funds with low investor turnover may see their liability increase as a result of either of the changes set out below or vice versa. Similarly, while the overall proportion of UK equities held in the industry is 40 per cent, funds with a higher proportion in their portfolio may see an increased tax liability. The Government is keen to understand how these proposed reforms will affect an individual fund's tax liability.

Reform option 1 – an alternative charge

2.8 This option would seek to replace Schedule 19 with an alternative charge, based on the value of relevant assets under management. This would change the nature of the tax from a transactions tax to an asset-based tax, making a charge on the funds on an annual basis at a small percentage of the value of assets they have under management. An initial estimate is that this rate could be set at 0.05 per cent but the Government will be gathering evidence for finalising the rate during the consultation⁴ with the aim of making it revenue neutral as noted above.

2.9 The Government proposes that the charge would be based on the value of relevant assets averaged (daily) over the year. By using an average, volatility in the stock market would be accommodated making it fair across taxpayers.

2.10 Funds would still be required to identify exempt and non-exempt investments, as they currently do in relation to Schedule 19. The difference is that the charge would be calculated as a simple percentage of the value of those assets, rather than basing it on the net issues and surrenders.

2.11 Similarly, the Government proposes that the charge would be collected at the end of the fund's accounting period (although see note below on transitional issues).

2.12 A single, simpler, yearly return would be required. This is likely to require the details of the fund, the value of the relevant assets, the tax due and a signed declaration from the authorised signatory. The Government will consider the compliance regime for this option during the course of the consultation.

2.13 The main benefit of this option would be simplification. The calculation would be based on information that funds usually collate in the normal course of their business. Funds would need to differentiate between exempt and non-exempt investments but they would not have to perform the calculation to make the relevant reductions currently required. This option would also reduce the number of returns from the current 12 per year to just one.

2.14 The simplicity of this regime would also mean that potential investors would find it easy to understand, therefore addressing the investor perception problem. As mentioned in paragraph 1.2, one of the issues with the current regime is the difficulty fund managers have in explaining the charge to potential investors.

2.15 The charge would no longer be a tax on transactions so this option would require considerable legislative changes to give HMRC the powers to collect the tax. These legislative changes may take longer to develop and introduce than the changes required under Option 2. Similarly, the distributional effects must also be considered (as mentioned in 2.7). The move to an assets based regime would entail considerable changes in different funds' liabilities that must be considered carefully.

⁴ This estimate is calculated on the assumption that 40 per cent of funds under management are UK equities.

2.16 The other major change that this entails is that there would no longer be a tax on the transfer of equities. The Government however, believes this option would be an appropriate proxy, simplifying the regime while not putting investors within collective investment funds at an advantage compared to those investors buying UK equities directly. The transitional costs of moving to this regime could outweigh the benefits of doing so and the Government seeks industry's view on this.

2.17 Also to be considered is the transition to a new regime. Subject to the outcome of the consultation the Government would aim to publish draft clauses in Budget 2008. As well as legislative changes this option would require systems changes within both HMRC and possibly funds making implementation later with this option compared to option 2 below.

2.18 The Government proposes that the introduction of the alternative charge could be staggered by making the annual return coincide with a fund's normal accounting period but welcomes comments on this. One option would be to apply the new regime to the fund's first annual accounting period beginning after Royal Assent to Finance Act 2009.

Points for discussion

4. Do you support the introduction of an annual charge on the average value of assets instead of the current Schedule 19 regime?
5. The Government seeks views from the industry on whether an alternative charge could be calculated from information already collected in the normal course of a fund's business.
6. Would the introduction of an annual charge on the value of relevant assets under management be easier for funds to administer compared to the current Schedule 19 regime?
7. The Government also seeks information on the costs for funds of administering and complying with an alternative charge of the type described in this document, particularly in comparison to the costs of administering and complying with the current Schedule 19 regime.
8. The Government would welcome comments on the possible distributional effects of changing to an alternative charge of the kind described in this document (as set out in paragraph 2.7).
9. Would the information required for an alternative charge be collected in the normal course of a fund's business?
10. The Government would welcome comments on how funds would prefer the transition from the current regime to an annual charge.
11. The Government also seeks information from individual funds on the transitional costs they perceive of moving to an assets based regime.
12. The Government would welcome views on the estimates of the running costs of an alternative charge regime compared to the current regime.
13. Does industry see any unintended consequences of a move of an alternative charge, positive or negative?

Reform option 2 – a reformed Schedule 19 process

2.19 A second option that the Government is seeking industry's views on is a simplification of the current Schedule 19 arrangements.

2.20 As highlighted above, the current regime uses a calculation that requires funds to set up bespoke systems or processes to obtain the required data and submit a return on a monthly basis. The second option for reform would simplify this calculation, basing it on the value of surrenders only, and lowering the rate of charge. Similar to the alternative charge an annual return to HMRC would be required rather than a series of monthly returns.

2.21 The benefits of this option are similar to option 1 above. Funds would not have to collect the data specifically required for the current regime, but rather use information already available. Furthermore, simplifying the calculation would also enable the tax to be charged on an annual basis, therefore reducing the number of returns from 12 to one. As with option 1, the Government believes this option would also be simpler for fund managers to explain to potential investors.

2.22 Under option 2 it is proposed that the formula would be adjusted to consider the surrenders of units rather than both issues and surrenders. This formula would be applied annually, based on the average value of assets over the accounting period. The Government proposes that the formula would take the form:

- rate $\times S \times N/(N+E)$ where;
- S is the annual value of units surrendered;
- N is the average market value of the non-exempt investments held; and
- E is the average market value of the exempt investments held.

2.23 As this option is a modification of the existing SDRT provisions, the Government is minded to adapt the current compliance regime as necessary to apply to this option.

2.24 Based on the current size of the industry and the need to make the option revenue neutral an initial estimate of the rate is 0.155 per cent⁵. As with option 1 above, this rate should not be regarded as final and the Government will be gathering evidence for setting the rate during the consultation.

2.25 Within this option the Government will also consider making units held in collective investment schemes themselves exempt. This would eliminate the problem that fund managers have in establishing whether units held in other collective investment schemes are exempt or non-exempt investments, an issue highlighted by the FSA report on funds of alternative investment funds.

2.26 This option would not require such substantial legislative or system changes as option 1 and so could potentially be implemented more quickly than the alternative charge.

⁵ Estimate provided by the IMA

2.27 Also to be considered is the transition to a new regime. The Government proposes that this could be staggered by making the annual return coincide with the fund's normal accounting period but welcomes comments on this. The Government is minded to bring this option into effect for the fund's first fund accounting period starting after Royal Assent to Finance Act 2008.

Points for discussion

14. Do you support amendments to the current Schedule 19 regime to base it on the average value of surrenders over the year?
15. The Government seeks views from the industry on whether an alternative charge could be calculated from information already collected in the normal course of a fund's business.
16. Would the amendments to the Schedule 19 regime outlined above be easier for funds to administer compared to the current regime?
17. The Government also seeks information to quantify the costs to individual funds of administering and complying with an amended Schedule 19 regime, of the type described in this document, particularly in comparison to the costs of administering the current Schedule 19 regime.
18. The Government would welcome comments on the possible distributional effects of amending the current Schedule 19 regime in the way described in this document (as set out in paragraph 2.7).
19. Would the information required for an amended Schedule 19 regime be collected in the normal course of a fund's business?
20. The Government would welcome comments on how funds would prefer the transition from the current regime to an amended Schedule 19 regime.
21. The Government also seeks information from funds on the transitional costs they perceive of moving to an amended Schedule 19 regime.
22. The Government also seeks information on the transitional costs of moving to an assets based regime.
23. Does industry see any unintended consequences of this change, positive or negative?

3

NEXT STEPS

How to Respond

3.1 The consultation will run until 25 January 2008. Comments should be received by this date and sent to the following address:

By email to: Schedule19@hm-treasury.gov.uk

Or by post to: Corporate Taxation (Schedule 19 consultation)
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

3.2 All responses will be acknowledged but it will not be possible to give substantive replies to individual representations.

3.3 The Government intends to hold consultation meetings with the sector. These will be set up in due course.

3.4 For queries please contact Dominic O'Connell on 020 72706042 or email the address above.

Publication of responses

3.5 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA) and the Data Protection Act 1998 (DPA).

3.6 If you would like the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances.

3.7 An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

3.8 The Department will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

3.9 The Government will publish a summary of responses in accordance with Cabinet Office guidelines.

Legislative Timetable

3.10 The precise nature of any legislative changes required will be determined by the response to the consultation.

Impact Assessment

3.11 An impact assessment has been produced to accompany this consultation document, and is attached at the back of this document.

3.12 This consultation is being conducted in accordance with the Cabinet Office Code of Practice on consultation. This can be found at <http://www.berr.gov.uk>.

3.13 For any queries or complaints regarding the consultation process should be addressed to:

Duncan Calloway
Better Regulation Unit
HM Revenue and Customs
100 Parliament Street
London, SW1A 2BQ
Email: Duncan.Calloway1@hmrc.gsi.gov.uk

Summary: Intervention & Options

Department /Agency: HM Treasury	Title: Impact Assessment of Reform of Schedule 19 (SDRT)	
Stage: Consultation stage	Version: 1	Date: November 07
Related Publications: Stamp Duty Reserve Tax: Schedule 19 discussion paper		

Available to view or download at:

<http://www.hm-treasury.gov.uk>

Contact for enquiries: Dominic O'Connell

Telephone: 020 72706042

What is the problem under consideration? Why is government intervention necessary?

SDRT - Schedule 19: Schedule 19 was introduced in 1999. It makes a Stamp Duty Reserve Tax (SDRT) charge on the transfer of units within collective investment funds. This means there is an SDRT charge on the transfer of ownership of the underlying shares where otherwise there would be none since they are not sold on the open market.

In October 2006 KPMG and the Investment Management Association (IMA) published a report 'Taxation and the Competitiveness of UK funds' and in December 2006 the Economic Secretary announced the creation of a joint IMA, Treasury and HMRC working group to consider its recommendations. The report concluded that Schedule 19 is one factor encouraging collective investment funds to domicile abroad and for the Government to do nothing would leave this disincentive in place. This was for two reasons, a) the charge was difficult and time consuming to administer and b) it acts as a disincentive to investors. The proposed reforms aim to address these problems.

What are the policy objectives and the intended effects?

The objective of either of the proposed reforms is to reduce the compliance burden of the current Schedule 19 regime as well as simplify the application of the tax to make it easier for potential investors to understand, at negligible cost to the exchequer.

What policy options have been considered? Please justify any preferred option.

Abolition - This would mean a direct loss to the Exchequer of £70 million based on 2005 - 06 receipts and more for future years.

Alternative charge - a charge on funds based on the value of assets under management. The aim of this change would be to reduce the compliance costs for funds by changing the basis of the calculation as well as removing the need to perform it on a weekly basis.

Simplify the existing regime - the requirements of the calculations will be adjusted to make it simpler for funds to apply. This would fit more into the present legislation but again reduce compliance costs and remove the need to perform it on a weekly basis.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

The Government intends to monitor the effects of the any final reform package on an ongoing basis.

Ministerial Sign-off For consultation Impact Assessments:

Signed by the responsible Minister:



..... Date: 06 November 07

Summary: Analysis & Evidence

Policy Option:	Description:
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C O S T S	ANNUAL COSTS	Description and scale of key monetised costs by ‘main affected groups’ The Government expects there to be some transitional costs as funds amend their processes. The consultation asks for comment on the scale of these for funds. There is also a one-off cost for HMRC to amend their systems / processes	
	One-off (Transition) Yrs £ tbc		
	Average Annual Cost (excluding one-off) £ tbc		
	Total Cost (PV) £ tbc		
	Other key non-monetised costs by ‘main affected groups’ None		

B E N E F I T S	ANNUAL BENEFITS	Description and scale of key monetised benefits by ‘main affected groups’ The consultation seeks views from funds on the expected fall in compliance costs for the industry. There may also be some reduction in admin burdens (see section on evidence base below). The possible disincentive to invest in UK funds would also be removed.	
	One-off Yrs £ tbc		
	Average Annual Benefit (excluding one-off) £ tbc		
	Total Benefit (PV) £ tbc		
	Other key non-monetised benefits by ‘main affected groups’ None		

Key Assumptions/Sensitivities/Risks At this stage there are several uncertainties which are the subject of the consultation. The Government welcomes comments and evidence from interested parties to aid with the analysis used in the impact assessment.

Price Base Year	Time Period Years	Net Benefit Range (NPV) £ tbc	NET BENEFIT (NPV Best estimate) £ tbc
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What is the geographic coverage of the policy/option?		UK	
On what date will the policy be implemented?		tbc	
Which organisation(s) will enforce the policy?		HMRC	
What is the total annual cost of enforcement for these organisations?		£ tbc	
Does enforcement comply with Hampton principles?		Yes	
Will implementation go beyond minimum EU requirements?		Yes/No	
What is the value of the proposed offsetting measure per year?		£ 0	
What is the value of changes in greenhouse gas emissions?		£ nil	
Will the proposal have a significant impact on competition?		No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium Large
Are any of these organisations exempt?	No	No	N/A N/A

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)	
Increase of £ tbc	Decrease of £ tbc	Net Impact	£ tbc

Key: Annual costs and benefits: Constant Prices

(Net) Present Value

Evidence Base (for summary sheets)

Compliance savings and costs

There are two options for discussion during the consultation which have been developed in discussion with the industry. The first is to charge funds, annually, on the value of assets under management. The second is to adapt the current Schedule 19 legislation to make the calculation simpler (by removing the 'issues' element), and again charging annually. Both options have the same aims and benefits set out below but will have very different transitional costs and distributional effects. Any changes will be broadly revenue neutral but are intended to simplify the process for funds in complying with the legislation, and improve the competitiveness of the UK by removing a potential disincentive to invest in UK funds.

Informed by discussions with the industry, the Government expects either of the reforms to reduce compliance costs associated with Schedule 19 for funds for the following reasons.

- Funds will not have to run bespoke systems, instead making the tax calculation from data that is collected in the course of their normal business.
- The proposals will consider a suggestion to exempt units in collective investment schemes themselves, eliminating a particular compliance cost for 'Funds of Funds'.

The Government will be gathering evidence to quantify these costs during the consultation.

There will be some transitional costs of compliance for fund managers to familiarise themselves with any new regime. Funds may also have to change some existing systems and processes to comply with the new regime. Again, further information to quantify these costs will be sought during the consultation.

Administrative burdens and costs

The Government expects some reduction in admin burdens as measured by the Standard Cost Model (SCM), for example, funds will submit one SDRT return a year instead of the present 12. In addition, funds will no longer have to perform the calculation on a weekly basis from data which must be collected solely for calculating their Schedule 19 liability.

Using the SCM, the annual administrative burden savings are taken as a simple product of a) the number of funds affected and b) an estimate of the cost savings per fund. The latter is calculated according to the size of the firm and whether key operations are handled in-house or outsourced (for further information on the Standard Cost Model approach to estimating the administrative burdens see www.hmrc.gov.uk/better-regulation/kpmg.htm).

The industry reports significant compliance costs associated with Schedule 19 (as well as acting as a disincentive to invest) which are not picked up in the SCM. These have been discussed with the industry and the options set out in the consultation document reflect these discussions. Further information is sought from funds during the consultation to quantify these.

HMRC costs

There will also be a cost incurred by HMRC for the transition to a new regime. This is not expected to be high but further work will be undertaken during the consultation.

The changes are not expected to increase HMRC running costs compared to the current regime but there will be a transitional cost mentioned above.

The Government anticipates that in total these one-off costs should be negligible for HMRC.

Competition Assessment

The proposals are targeted at reducing Administrative and Compliance burdens on UK Funds. Any such reductions will act to improve the efficiency of the UK's Fund Management industry, acting to increase competition within the wider European Market.

At this stage, the scale of this improvement is yet to be ascertained; however, relative to the total size of funds under management it is likely to be small.

Small Firms ImpactThe proposals affect firms of all sizes and so the overall savings in administrative burdens reported above will be shared by small and large firms alike.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No

ISBN 978-1-84532-364-6



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