Press Release

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UK SHAREHOLDERS' ASSOCIATION ENTERS DEBATE ON CGT PROPOSALS

The UK Shareholders' Association has entered the debate over coalition government proposals to boost its income from capital gains tax. In a letter to George Osborne, the Association's chairman, Martin White, has urged the chancellor –

- not to raise the rate of CGT without the reintroduction of full indexation to offset inflation;
- to ensure that extra administration costs are taken into account before making any reduction in the CGT tax free allowance.

Pointing out that proposals currently being floated are likely to drive more individuals into spread betting and away from direct investment in company shares, Martin White observes that this will foster a gambling mentality which is quite the opposite of the '*patient mindset which the country needs to adopt in relation to wealth creation*'. As a major attraction of spread betting for some is the tax advantages it enjoys, incurring neither stamp duty nor any CGT at all, this would be wholly counter-productive for reducing the fiscal deficit.

Martin White, an actuary by profession, suggests that the government should test the reality for savers by asking the unit trust industry to provide data on the real returns it has delivered over periods of 10, 20 and 30 years. He strongly suspects these to show '*significant capital gains in nominal terms, but that after adjustment for inflation (they) will be small and frequently negative*.'

The UK Shareholders' Association, which earlier this year published *Responsible Investing – for the Individual and Society* which seeks to create a wider understanding of the communal benefits of individuals investing directly in shares, regards any tax of the inflationary element of apparent gains is asset values as '*wealth confiscation and bad long term policy (because) governments should not profit out of the misery of inflation*.'

The letter to the Rt Hon George Osborne MP, Chancellor of the Exchequer, reads as follows:

Dear Chancellor,

Taxing the inflationary element of gains is wealth confiscation and bad long term policy; governments should not profit out of the misery of inflation.

First of all, please accept my congratulations on assuming your office in the new coalition government. Congratulations also for setting up a new office for budget responsibility. I am writing as a director of the UK Shareholders' Association, a body set up to represent the interests of private investors generally and to work towards better governance of UK companies. An important principle for us is that decisions relating to the tax regime should be taken after very careful thought as to the long term implications and any unintended consequences.

The UK Shareholders' Association understands the pressure for changes to align income tax and capital gains tax. However, we cannot emphasise too strongly the need to reinstate comprehensive indexation allowances to avoid taxing inflation, and thereby avoid expropriating the savings of pensioners and modest investors.

In our opinion it is also highly desirable that an exemption is retained for those living off savings who may be forced to realise a capital gain due to takeovers. Reducing the annual exemption will raise the tax take and bring more people into the CGT net; it will be unpopular and will increase compliance and collection costs. But we recognise that popularity is the least of your current concerns. Our overriding concern, which we believe to be a totally legitimate concern even in the current crisis, is the deep unfairness relating to inflation.

It is for governments to set tax rates. And the 18% rate was obviously not going to be sustainable. But the CGT changes introduced by the last government were particularly penal to long term investors because of the removal of the incentives to hold investments for long periods and amounted to a breach of trust. These allowances had been introduced as an alternative to indexation of capital gains, and fairness requires that their removal should be accompanied by the full reintroduction of indexation. We wrote to Alistair Darling [1] prior to the pre-budget review last year to emphasise our deep concern about the past and future impact of inflation on savings.

CGT is not simple to calculate, and one of the benefits of the annual allowance is that it cuts down administration for investors and HMRC, and takes many investors outside CGT. The complexity of indexation is a price well worth paying for fairness, but if you wish to avoid this complexity a form of rough justice might be achieved by, for example, tapering the rate such as 40% for assets held for less than one year, down to nil for assets held for 10 years or more.

Without a "rough justice" solution of this type, we would urge the reintroduction of full indexation in the calculation of capital gains. Anything else would be essentially dishonest. This should include the ability to carry forward indexed losses. Governments should not profit out of the misery of inflation.

Before final decisions are made on this matter, we strongly urge that the position of a typical long term investor be tested for fairness. Please ask the unit trust industry to provide data on the real returns it has delivered in terms of unit prices over periods of 10, 20 and 30 years (dividend income having been distributed and taxed) – our strong suspicion is that there have normally been significant capital gains in nominal terms, but that after adjustment for inflation the capital gains will be small and frequently negative.

In summary, we urge the following:

- Do not raise the rate of CGT without reintroducing full indexation to reflect inflation from date of purchase of the asset, and carry forward of indexed losses.
- If you are minded to reject this argument, first consider very carefully the impact of inflation on ordinary investors such as long term holders of unit trusts.
- A tapered rate, reducing with length of holding, may be a practical alternative.
- The extra administration costs resulting from a reduced annual allowance should be taken into account before setting the level of the allowance. The allowance should

[1] http://www.uksa.org.uk/UKSA_Press090_Capital_Gains_Tax.pdf

only be reduced if you are confident that there will be an adequate net benefit after the extra administration costs.

We would further note that raising the rate of capital gains tax without mitigation to reflect inflation is likely to encourage more people to engage in (untaxed) spread betting, thus encouraging a gambling mentality which is at odds with the patient mindset which the country needs to adopt in relation to wealth creation.

Yours sincerely, Martin White, Chairman, UK Shareholders' Association

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For further information contact Eric Chalker on 020 7620 0907, or ec.office@btinternet.com

Martin White may be contacted after 18.30 on 07946 472 981, and at any time on chairman1@uksa.org.uk.

Roger Lawson is no longer a contact for the UK Shareholders' Association.

About the UK Shareholders' Association (UKSA)

UKSA is the leading independent organisation which represents the interests of private shareholders in the United Kingdom. We campaign to protect the rights of shareholders in public companies, and to promote improved standards of corporate governance. Our campaign activities, regional meetings for members, analyst-style meetings with company directors and the resources of our website, all help to promote the interests of private investors and savers generally, as well as our members. UKSA is a not-for-profit organisation primarily financed by its members.