10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

18 July 1989

CORRESPONDENCE WITH SIR EMMANUEL KAYE

We spoke this morning about a letter the Prime Minister had received from Sir Emmanuel Kaye concerning the treatment of minority holdings in unquoted companies for inheritance tax and capital gains tax purposes. I now enclose the relevant extract from Sir Emmanuel's letter, and would be most grateful if you could arrange for the preparation of a draft reply for the Prime Minister to send him. If at all possible, it would be helpful to have this by close of play on Thursday 20 July. Apologies for the tight deadline.

PAUL GRAY

Steven Flanagan, Esq.
Financial Secretary's Office
HM Treasury

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The Unquoted Companies' Group

Founded in 1968 to study the contribution made to the economy by the unquoted sector

Date: 17th July, 1989

Please reply to:
Sir Emmanuel Kaye C.B.E.
Hart House
HARTLEY WINTNEY
Hampshire
RG27 8PE

Tel: (025 126) 3773

The Rt. Hon. Mrs. Margaret Thatcher M.P
10 Downing Street
LONDON SW1A 2AA

My dear Prime Minister,

Elizabeth and I are greatly looking forward to the pleasure of seeing you and Denis at Glyndebourne. As you know, I treat such events as purely social and relaxing occasions but on this visit I should much appreciate your advice on a Revenue/Treasury matter, particularly as you are First Lord of the Treasury! Therefore, I thought I should put you in the picture beforehand.

You will recall that the Chancellor's 1988 Budget abolished, for Capital Gains Tax purposes, pre-1982 inflationary gains and raised the rate of CGT from 30% to 40%. Accordingly, it became necessary to establish 1982 valuations for unquoted shares for CGT purposes.

Sir Anthony Jacobs, Chairman of the British School of Motoring, pointed out that there was an anomaly in the valuation of minority unquoted shares, which were subject to a heavy discount. In other words, a majority holder was given a proportionate valuation whilst the small shareholder was clobbered. I can best illustrate this by an example:

In the case of a company worth £200,000 in April, 1982, with two shareholders - one with 90% and one with 10% - the 90% stake would be valued at £180,000 but the 10% would be valued at £20,000 less a discount of 75%, or at only £5,000.

In his representations Sir Anthony had the support of some 200 major unquoted companies and he understands that some 90 MP's have written on this matter to Treasury Ministers. All suggestions made by Sir Anthony Jacobs and by The Unquoted Companies' Group to remedy this anomaly have so far been rejected.

There is a further, even more serious, anomaly. If, for instance, two of the shareholders in the £200,000 company were husband and

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wife, each with 30%, for Inheritance Tax purposes if one of them died the two holdings would be added together and valued as a majority holding. Thus, in my example, the two holdings would be 60%, or valued at £120,000 so that on the death of one Inheritance Tax would be payable on £60,000.

But if one of the spouses sold the 30% holding to a third party then, for CGT purposes, it would be valued as a minority holding subject to a discount of about 60%, or at only £24,000, and CGT would be levied on the difference between £24,000 and the sale proceeds.

The Revenue answer is that for Inheritance Tax purposes the holdings of spouses are added together to prevent avoidance by the splitting of holdings. Be that as it may, the effect remains that holdings of spouses are penalised by being valued at full value for Inheritance Tax and a very low value for Capital Gains Tax.

It appears that the Revenue recognise this contradiction by having had an unpublished practice of agreeing to treat spouses' holdings as one for the purposes of CGT if they employed the device of permitting one spouse to sell to the other one day before the sale to a third party (although this was not clear from the original legislation and seemed to invite "Furniss v. Dawson" treatment). In May this year the Revenue disclosed this practice by publishing a statement to this effect, on which publication they are to be commended.

However, all this is grossly unfair on those couples who were unaware of the unpublished practice and who sold their holdings to third parties between April 1988 and May 1989. Consequently, Sir Anthony Jacobs and I on behalf of The Unquoted Companies' Group, saw the Chairman of the Board of Inland Revenue, Sir Anthony Battishill, and explained that we are therefore seeking a Revenue concession that all such holdings of husband and wife since April, 1988 should be added together for CGT purposes. We gathered from Sir Anthony Battishill that such an Extra Statutory Concession by the Revenue was feasible provided the Treasury agreed. You will have noted that the Revenue publication establishes the practice of spouses selling to each other one day before a third party sale for all future years, whereas what we are seeking is a concession limited to one year only.

To obtain Ministerial agreement I wrote to Mr. Norman Lamont on 22nd June, 1989 (copy enclosed). Unfortunately, the two dates we had arranged to meet since then have both been postponed by the Treasury, although another is in the offing. I have always been received with courtesy and interest by Treasury Ministers and had hoped to have spoken to Mr. Lamont on this subject before now but that, of course, has not proved possible and I have so far not obtained any assurance that this one year concession to bridge the gap will be forthcoming.

With kindest regards,

Yours very sincerely,

Emmanuel

The Unquoted Companies' Group

Founded in 1968 to study the interests of the unquoted sector

Date: 22nd june, 1989

Please reply to:
Sir Emmanuel Kaye, CBE,
Hart House,
HARTLEY WINTNEY,
Hampshire, RG27 8PE

The Rt. Hon. Norman Lamont, MP
Financial Secretary
H. M. Treasury
Parliament Street
LONDON SW1P 3AG.

My dear Financial Secretary,

I have come across a situation which bears upon our previous exchanges on the valuation of shares as at 1982 - but could also give rise to something which, if I may say so, you should take action upon.

The recently published Statement of Practice, no: SP5/89, which deals with the valuation of holdings at 31 March 1982, if they have subsequently been united, on the basis of the aggregate percentage they represent - e.g. a wife giving away a minority interest to her husband, to add to his minority interest, just before sale so that he sells a majority interest and his base value at 1982 is calculated as if it were the value of a majority holding - makes public something the Revenue have apparently been practising for some time. And yet my enquiries show that the Revenue practice was not known of, even in some of the major accounting firms, let alone among laymen.

This is very serious. It means that people who did know of the Revenue practice could organise themselves so as to obtain one base value calculation, while those who did not, and failed to do the very simple (almost artificial) thing of having a gift between spouses just before sale, could only get another. This is desperately unfair.

I suggest that the only way to correct this for people who did not know of the Revenue's unpublished practice is to add to the law - unless it can be done by Statement of Practice or by Extra Statutory Concession - a provision which is effective from 6th April 1988 (since the Revenue were operating that practice during the last tax year) and, at least for

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husbands and wives, operates to give them (whether one of them actually made a gift to the other or not) a greater valuation of their holdings as at April 1982 in the event of a subsequent disposal.

With kind regards & looking forward to your reply.

Yours sincerely,

Emma.

BRIEF

1. In 1988, capital gains tax was confined to gains since 1982: earlier gains were exempted. To measure post-82 gains, it is necessary to value assets at 1982.

2. For holders of shares, what matters is what the individual - shareholding was worth in 1982 - not the value of the company. When shareholders come to sell, their CGT is on the gains on their particular shares, not the increase in value of the company. Value is determined on what shares would have fetched in the open market in 1982. The approach used is the same as that for other tax purposes - inheritance tax, Schedule E benefits, etc.

3. A minority shareholding will be worth significantly less than a straight proportion of the value of the company. This is because the shareholder cannot control how the company is run.

4. Shareholdings in private companies have typically been split into minority holdings to give tax advantages - lower values for inheritance tax etc. The corollary is that these lower values will be reflected in the new 1982 CGT baseline. There have been a lot of representations that, one way or another, shareholders ought to be able to aggregate their holdings for 1982 valuations. The Financial Secretary has had many meetings with lobbyists. It would be very difficult to justify making a change of this kind without doing the same for valuations for other tax purposes - where the change would work heavily against taxpayers (leading to higher values and hence more tax) and be very unwelcome.

5. The law does allow husbands and wives to arrange for their shares to be aggregated for valuation purposes, by one spouse transferring his/her shares to the other before sale. This is the strict effect of the law: there is no room for argument or interpretation. But having had the odd enquiry, the Revenue thought it helpful to publicise the position in a Statement of Practice in May 1989. There is no question of the Revenue "concealing" an unpublished practice in an area where there is legal doubt: the position stems from the wording of the law.

6. Sir Emmanuel suggests there should be a special concession for married couples who did not appreciate what the law meant, and sold shares between April 1988 (when the new 1982 baseline came into being) and May 1989, and might have arranged their sale differently had they fully understood things. Other correspondence suggests Sir Emmanuel himself is in this position: he sold Lansing Bagnall recently, and it appears that shares were held by both him and his wife. Had he and his tax advisers asked the Revenue, they would have been told what the legal position was. It would be novel to make a concession for taxpayers who might have arranged things differently if they had fully understood the law or had better tax advice.