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Prime Minister (2)
Treasury have clarified their explanation for the tax treatment of the BT vouchers.
AT 20/9

FINANCIAL SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Andrew Turnbull Esq
Private Secretary
10 Downing Street
LONDON

19 September 1984

Dear Andrew,

BRITISH TELECOM: SHARE INCENTIVES

Thank you for your letter of 6 August.

You asked us to spell out more fully the tax treatment of the vouchers. To answer the Prime Minister's question first, grants or gifts from the Government are generally speaking treated in the same way as grants or gifts from anybody else for tax purposes. This is a point which the Courts have established, and I am sorry if our earlier note did not make it clear.

The vouchers represent value received in the hands of the share subscribers. Since this value has not come out of the assets of BT it does not fall within the ambit of the legislation which applies to the distribution of either income or capital by a company. Nor does the voucher fall to be taxed as a receipt of income. It does not for example represent a payment for services rendered, nor is it akin to other types of income such as rent or interest. In the Inland Revenue's view, the voucher is a capital receipt and is to be taken into account in calculating the eventual gain on the shares. This follows from the provisions of Section 42 of the Capital Gains Tax Act which provides that any part of expenditure on an asset met directly or indirectly by the Crown or by any Government shall reduce the acquisition cost of that asset for the purposes of calculating any capital gain on its subsequent disposal.

In your letter you also raised the question of whether the value received in the Vouchers could simply be exempted from Capital Gains Tax. This would require legislation.

On the face of it, there is something to be said for exemption if only because, as you say, liability to CGT is unlikely to arise in practice for the majority of small subscribers - mainly because of the annual exemption limit (currently £5,600). It might help in a small way to simplify matters administratively. And, presentationally at least, it might make the shares that bit more attractive and so contribute to the overall success of the flotation.

There are, however, a number of counter arguments.

a. Exemption would provide little or no additional incentive for small investors, precisely because they are likely to be out of the CGT net anyway. So in practice it would benefit the larger investor, because they will tend to be the CGT payers, whereas the aim is to try to get in more small investors.

b. Exemption would represent a departure from the normal tax rules and, as such, from the Government's general approach to privatisations that there should, as far as possible, be parity of treatment with comparable transactions in the private sector.

c. We estimate that the cost of exemption would be up to £2 million.

For all these reasons, the Financial Secretary thinks that it would be better not to exempt the value represented by the vouchers.

I am copying this letter to Callum McCarthy and Neil McMillan.

Yours sincerely,

Helen Goodman

H C GOODMAN
Private Secretary

POST + TELECOM: Future d.... : Pt 8

CONFIDENTIAL

10 DOWNING STREET

From the Private Secretary 21 September, 1984

British Telecom: Share Incentives

The Prime Minister has seen your letter to me of 19 September and has noted the fuller explanation which you provided on the tax treatment of the vouchers.

I am copying this letter to Callum McCarthy (Department of Trade and Industry) and Neil McMillan (Mr. Pattie's Office).

ANDREW TURNBULL

Ms. Helen Goodman,
H.M. Treasury

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Key

FILE

10 DOWNING STREET

From the Private Secretary

6 August, 1984

BRITISH TELECOM: SHARE INCENTIVES

The Prime Minister saw the note attached to your letter to me of 1 August and queried the basis of taxation for the voucher. She understands that the logic for bringing the value of the voucher within the scope of CGT is that it is not a distribution by BT but a grant or gift from the Government; and that as such it is closer in nature to a capital rather than an income transaction. She wonders why, if it is a grant or gift from HMG, it is subject to any form of taxation.

I assume that as there will be a maximum value per person of £72 a year, mostly in the hands of small investors, virtually none of the value will in practice give rise to CGT charge. In these circumstances would there be merit in exempting it from the start? I would be grateful if you could spell out a bit more the thinking behind the tax treatment proposed.

I am sending a copy of this letter to Callum McCarthy (Department of Trade and Industry) and to Neil McMillan.

(A. Turnbull)

Miss F.P. Bogan,
HM Treasury

Fed 1580

10 DOWNING STREET

Prime Minister (2)

In coming to the view that the voucher is not subject to income tax, but only CGT, Inland Revenue took the following steps

(i) is it a distribution by BT: no this a gift from Government

(ii) As a gift does it have more the characteristics of income or capital; answer more like capital therefore treat under S. 42 of the CGT Act 1979.

AT

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I think it is a ridiculous decision. If it is a gift - you surely do not go on to ask its cap/inc. characteristics

FINANCIAL SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

1 August 1984

Andrew Turnbull Esq
10 Downing Street
Whitehall
London SW1P 3AG

Dear Andrew,

BRITISH TELECOM: SHARE INCENTIVES

At the Prime Ministers' meeting on Monday, the question of the tax treatment of the proposed BT share purchase inducements was raised. The Financial Secretary has asked me to send you the attached short note which sets out the position.

The main points are:-

- the rental voucher will not be taxed as income;
- both the rental voucher and the share bonus will be taken into account for the purpose of assessing capital gains tax, in ways which reflect the different nature of the two inducements.

I am sending copies of this letter to Callum McCarthy and Neil McMillan.

yours sincerely

FP Bogan.

MISS F P BOGAN
(Assistant Private Secretary)

BRITISH TELECOM: PRIVATISATION

Telephone Bill Vouchers

1. Each share subscriber will be eligible to receive a voucher (worth about £18) for each £250 worth of shares purchased up to a maximum of 12 vouchers. One voucher at a time will be accepted by BT against quarterly telephone bills.

2. The Government will reimburse BT for an amount equivalent to the face value of the vouchers, and this will form a trading receipt chargeable to Corporation Tax in BT's hands.

3. Since the incentive is being provided by the Government and not out of BT's own assets, it will not be treated as income in the subscriber's hands (unlike, for example, a dividend paid out of BT's profits). It is however akin to a discount on the purchase price of the shares. As a result, the face value of the vouchers will be treated as reducing the acquisition cost of the shares for capital gains tax purposes - this will have the effect of increasing the amount of any gain chargeable to CGT on subsequent disposal by the shareholder.

Loyalty Bonus

4. Subscribers will be able to opt to receive, in respect of the first £5000 worth of shares originally purchased, a bonus of 1 share transferred from the Government's holding for every 10 which the subscriber holds, if the shares are held for three years. This option will be an alternative to the rental voucher. For example, if 5000 shares are purchased for £10,000, the bonus after three years would be 250 shares.

5. The tax treatment here is again straightforward. For purposes of determining any charge to CGT on subsequent disposal, the shareholder will be deemed to have acquired the bonus shares at their market value when they were transferred to him. There are no other tax implications.