C·P·S POLICY CHALLENGE

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OWNERS ALL

A Proposal for

PERSONAL INVESTMENT POOLS

by

Philip Chappell and Nigel Vinson

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CENTRE FOR POLICY STUDIES

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This study was prepared by Philip Chappell and Nigel Vinson - co-authors of 'Personal and Portable Pensions for All' published by the CPS in April 1983 - as part of the programme of the Centre's Wider Ownership group. The two authors pay particular tribute to the members of that group, both for their informed comment and for their continuing determination to make wider ownership the cornerstone of an open society.

Philip Chappell has been a director of a City merchant bank for over 20 years, but emphasises that he writes in a personal capacity. He is also a director of other companies, and has many interests in the fields of education and the arts.

Nigel Vinson built up a most successful business as an inventor and entrepreneur - and won the Queen's award for technological innovation. He is a director of numerous companies, President of the Industrial Participation Association and Chairman of the Development Commission. A Founder Director of the Centre for Policy Studies , he was created a life peer in 1985 for his services to the welfare of small businesses.

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The Centre for Policy Studies, while delighted to publish these new proposals, wishes to emphasise that it never expresses a corporate view in any of its publications.

Introduction

'Sir,

A respect for property is only general among those who have some, or the reasonable prospect of acquiring some. Toxteths and Handsworths will recur so long as our society contains sizeable groups of people who know that their destiny is to look in upon its wealth always from the outside.

Yours faithfully,

David Green' (The Times, 17 September)

Few human aspirations are stronger than that of ownership. Nor will it be denied that ownership can confer independence and dignity. But it must be personal. Widely diffused, it serves as one of the principal foundations of an open and free society. Yet, in Britain today, ownership is concentrated in institutional hands and becoming more so, due in no small part to fiscal policies which favour such a trend.

The burden of this report - or 'Challenge' - is that the tax treatment of individuals and of financial institutions should be on an equal footing. Our major proposal is for Personal Investment Pools (PIPs) in which all can have the opportunity to participate.

We also present a list of other desirable tax reforms with the same intent, as parts of a long-term co-ordinated exercise with the goal of making everybody appreciate the importance of creating wealth and of the greatest possible diffusion of ownership.

Summary

Everybody favours the creation of wealth. What else can provide the means, not only for personal independence, but for defence, for welfare, for education - all the many indisputable needs of a modern society? But socialists argue that wealth should be garnered by the central authority, which alone can be trusted to control it and share it out equitably and impartially. We insist that the opposite is true.

Only if individuals participate directly in the creation of wealth can they understand the benefits which it brings to society at large. Ownership at second hand, whether through institutions or through the State is a sorry substitute. Institutionalised capitalism, because of its concentration of power and diminishment of individual enterprise, is just as much a betrayal of the open society as socialism itself. Diffusion of resources is a cornerstone of freedom, since it builds choice by the customer into the fabric of society. Such principles are all the more important to establish in a world of changing work patterns, new corporate structures and a growing service-based economy. Even if wider personal ownership will not of itself solve our economic difficulties, it is vital that it should be, and be seen to be, part of the basic framework of a wealth creating society.

A Government committed to the encouragement of enterprise and the principle of wider ownership might have been expected to introduce wider reforms. Much has indeed been achieved. Growing home ownership, abolition of truly penal taxes, greater employee participation and incentives to first time buyers in privatisation

sales are some of the many achievements of which this Government can justifiably be proud.

But there is a serious reservation. The concentration of ownership of wealth has increased and is still increasing. Given the fiscal bias in favour of institutions, this is scarcely surprising. This consideration leads us to our main proposal. Personal Investment Pools (PIPs) attempt to restore the balance by giving individuals and institutions equality before the taxman. Above all they provide means of spreading ownership far more widely - and who can reasonably object if in so doing they lead to fiscal equality?

A number of other reforms are also proposed, with the aim of ending other scandals of fiscal favouritism, encouraging the diffusion of wealth, and above all simplifying (and thereby accelerating) personal ownership.

People desire ownership, enjoy ownership and will vote for ownership. The single word captures the essence of the Tory alternative. We seek to make personal ownership a major theme for the next election. Industry Year 1986 is a good time to start.

1. Personal Ownership - why does it matter?

The case for wider ownership is simple: widest possible diffusion of wealth is not only the best safeguard of political freedom but also holds out the best promise of economic success.

Not everyone agrees, however. Socialists argue that more central ownership of wealth makes for impartiality and equality. Others take a feudal view - that individuals cannot be trusted to make their own decisions and must be protected from their follies: this leads to a cryptic form of socialism, masquerading as benevolent paternalism. Fortunately, the voices of individuals, eager and able to reassert their right to personal ownership, are heard throughout history. Diffusion of ownership does more than diffuse wealth: it spreads initiative, spreads the power of patronage, and strengthens the foundations of a free and open society. The opportunity for political interference with the decisions of individuals is diminished.

The efforts of the present Government in encouraging wider ownership have indeed produced successes: more people own their own houses; more people now own shares; more people have some form of participation in their employers' successes. But despite this the concentration of ownership continues to grow: wealth is becoming more institutionalised, not less. On the most optimistic assumptions, a mere 6% of UK residents have direct personal shareholdings, compared to 25% in the USA, and up to 35% in Hong Kong.

Many studies tell the same story. For example, the London Business School's Financial Outlook (March 1985) suggests that between 1980 and 1988 (after eight years of Conservative government) the proportion of net financial assets held by the personal sector in pension funds and insurance companies will have grown from 44.3% to 69.7%. Of quoted equities, less than 20% **are now held by individuals and each year up to £4bn - or a** further 2% - passes from individuals to institutions. Privatising Telecom may have introduced 1 million new shareholders (though their loyalty may be fragile and due only to the special incentives for first-time buyers); but small shareholders own only 13% of Telecom.

Total personal wealth may indeed be growing but the proportion of that total held at second-hand is also growing. The result is a diminishment of personal liberty and of decision -making in one of the most important fields of human activity. Only a major initiative can change things if ownership is ever to become a real expectation for the many instead of a preserve of the few.

No one questions the importance of providing for retirement in our society. But over-generous provision distorts flows of saving, attitudes towards investment, patterns of ownership. It will be argued that institutions which inevitably dominate retirement funds are only conduits for wealth which belongs to individuals; thus UK Limited will be said not really to be owned by the City or by pension funds, but by the members of those funds. But individuals have limited access to that wealth, even on their sixty-fifth birthday or whenever; and wealth, we believe, motivates in proportion to its accessibility.

Can it be right that a polity which seeks to encourage a culture of enterprise should channel so large a proportion of the rewards of that enterprise to the years of one's retirement? Success breeds success. A man who is free to chose the time, or times, of gaining access to the wealth he has created is able and likely to build further success with it.

No doubt everyone owns something - many much more than they realise: but, if a feeling of direct participation and involvement in the wealth of the nation is to be restored, only <u>direct</u> ownership will answer.

2. The barriers to Personal Ownership

This process of institutional concentration should not surprise us given the barriers to personal ownership which remain in place e.g.

a) an income tax rate levied at up to 60% (better than 98%, but still offering too many opportunities for tax minimisation schemes *via* institutions)

b) undue preference given to one particular form of ownership - housing - through mortgage relief

c) the complex monstrosity of capital gains tax

d) roll-over provisions within authorised investment or unit trusts

e) favourable treatment for retirement provision - albeit with many restrictions

f) stamp duty charged only on houses and equity capital, assets whose ownership should surely be encouraged

g) gross interest and other tax benefits available only on National Savings

h) Capital Transfer Tax still a barrier - rather a battered one - to wealth distribution

i) High costs for smaller market transactions

And there are many other barriers. Everyone will have their own list. A Government wholeheartedly committed to policies of wider ownership would have dismantled more of them. The 1986 Budget is the last opportunity for new reforms to have any impact on electoral attitudes.

3. Equality for Personal Ownership - a fair demand

With the emphasis now given to the importance of the individual and the encouragement of enterprise, some modest bias in favour of personal ownership might be thought not out of place. At the very least demand for equality of tax treatment between the individual and the institution is fair and reasonable.

Two routes are possible:

a) remove all tax privileges from financial institutions

b) extend equality of tax treatment to all savers

The former route may have the philosophical, but the latter route has all the practical and political advantages. Fiscal equality:-

+ facilitates the next stages of tax reform, which is seen to be more and more desirable
+ pre-empts the arguments of institutions, anxious to preserve their privileges and adept at arguing the disadvantages - without mentioning the benefits - of tax changes
+ gives everybody the satisfaction of feeling that they are winners
+ places the emphasis on taxing consumption rather than saving
+ encourages new creators of wealth in today's society

No one should object to others being given privileges which they enjoy themselves (even if they thereby cease to be privileges!). The present oligarchy of asset-owners must acknowledge that the popular demand for, and political advantages of, wider ownership necessitate an alteration in its favour.

Our main proposal - the creation of Personal Investment Pools (PIPs for short) - adopts this approach. It can be seen to follow logically from the Centre's paper in 1983 on ' Personal and Portable Pensions - For All' (PPPs), which was one of the main catalysts for a better understanding of pension provisions, and for changes in legislation. A shopping list of further proposals is in the Appendix. All our proposals have the same theme - equalising tax treatment, and simplifying and widening personal ownership.

4. Personal Ownership through PIPs - our detailed proposal

With PIPs any individual would have the right to set aside any part of his annual income, and to designate any of his existing assets within an approved range, into a segregated personal pool - which they would enter free of all tax. Such a segregation would not be automatic, total or compulsory. Once within the pool, assets would be entitled to gross fund status (i.e. recovery of tax deducted at source and exemption from gains tax), giving them equal status to retirement provision and to some forms of insurance-related savings. But there would be important differences:-

a) withdrawal of the savings from the pool would be permitted at any time but would attract income tax (even though true equality with pension provision, which offers the ultimate tax privilege of commutation, ought to allow some tax free lump sum extraction);

b) a personal pension effectively ends when a pension right is determined and suffers the disadvantage that the personal ownership of assets held for retirement cannot be maintained once retirement has begun: a PIP could continue indefinitely during an individual's lifetime and would form part of his estate. Special provision would enable a limited range of 'heritage assets' (i.e. those deemed to be of national importance) to be passed on, free of tax, by way of inheritance, provided that they were retained within the PIP ring-fence;

c) Gains Tax, if it survives, would <u>not</u> be levied on assets, either within the pool, or on entry to, or withdrawal from, the pool;

d) the range of assets authorised for inclusion within a PIP should be as wide as possible. Initially we suggest that this should cover any assets held with a view to receiving an income return e.g. property (other than principal residence), bank or building society deposits, investments in listed or unlisted securities, but not physical and collectable objects such as stamps or pictures. We recognise that such an approach offers a bias in favour of one class of wealth creation, but our definition covers the most substantial proportion of assets which are currently influenced by fiscal policy. As the arrangements became established, the definition of authorised assets might be widened;

e) assets within a PIP would be held by an authorised depositary but, to minimise costs, the administration must be made as simple as possible and changes of assets within the pool must be easy to effect;

f) personal assets could continue to be held outside a PIP but would not qualify for the more favourable tax treatment on entry that PIP offers. Individuals might in some cases believe that the penalty on withdrawal from a PIP outweighed the advantages of accumulating assets within a PIP.

The artificial restraints of the Business Expansion

Scheme can be abandoned and, in particular, the flexibility of PIPs would allow investment in companies in whose management an individual or his close relations were involved. By enabling assets to enter the pool free of CGT the 'locked in' status of many individuals who made gains between 1965 and 1982 (often representing no more than inflation) would be freed.

By this one major reform the creation of personal assets becomes achievable by all, and their owners are put on an equal footing with institutions whether in unit or investment trusts, in retirement funds or insurance company bonds. We visualise that many individuals whose wealth is now more or less inaccessible due to the restrictions of their retirement provision may prefer the greater flexibility of a PIP for some part of that wealth. Criticism of the dominance of retirement provision as the main source of long term capital will no longer be valid so soon as individuals have a genuine, unbiased, choice for whatever part of their savings that they wish.

<u>PIPs provide an opportunity to encourage enterprise and risk, to put ownership by individuals and institutions on an equal basis, and to demonstrate that the accumulation of wealth through earning and saving is just as possible as through inheritance</u>.

5. Personal Investment Pools - a practical example

Our investor decides to start his PIP early. Teenage odd jobs provide a piggy bank of savings which by age 17 provides £500, enough to buy 200 shares in Telecom (Britain's largest company) at the local share shop. Re-investment of income, some capital gains and some other early savings, have generated £5,000 in his PIP by the time of his marriage, when it is liquidated (and income tax paid) to provide towards house purchase.

Four years later a legacy (from the sale of a relative's former council house) is not immediately spent but re-establishes his savings pattern in a PIP; half of it goes into a building society, the other half into equity ownership, which he manages shrewdly as his business skills develop. He adds £250 p.a. to his PIP out of his gross salary; his employer is also providing £500 p.a. savings in an employee share participation scheme.

By age 50, now on a salary of £15,000, his accumulated pension rights are valued at £60,000, his house (now free of its mortgage) at £55,000 and his PIP and other savings at £25,000; he has become a working capitalist and has a substantial stake in our society.

Many choices, therefore, are now open to him. He has the opportunity, and the resources, to establish his own business, perhaps through a buy-out of management. Or he may think that his accumulated pension rights by now suffice for his basic needs, and decide to use his future savings - perhaps through a personal pension - in a more adventurous investment policy. In this example he liquidates his existing PIP investments (without any tax penalty) and decides to support his nephew's newly-set-up industrial cleaning business, buying 30% of the equity. He is able to help and advise his nephew on a part-time basis, to the extent that ten years later the enterprise becomes a quoted company, capitalised at £500,000 and employing 100 people.

At 60 our investor retires, having achieved prosperity almost without realising it. He distributes £25,000 to each of his own three children to start their own PIPs in the next generation.

Of course in the real world there are failures as well as successes. But should we not at least encourage personal enterprise by providing some such tax framework for success?

Personal Ownership - The costs

Our case for fiscal equality is based both upon broad social arguments for personal freedom, and on the evident justice of the proposition that personal wealth creation should be entitled to the same tax treatment as institutionalised saving. If we cannot afford the former, perhaps we are being too generous to the latter.

But no one can propose tax reforms without being challenged on their costs - although calculating the cost to the Revenue of extending fiscal privilege is inevitably more uncertain than calculating the benefits of securing equality by the withdrawal of privileges. Our proposition depends upon three specific arguments:-

a) new personal saving with PIPs will, to a great extent, be a substitute for existing savings. A restructuring of the savings market, rather than any increase in its total, is the most likely consequence. If there is no net savings increase, the fiscal cost will be nil; if savings do increase there is a wider effect on many economic factors, such as interest rates;

b) attitudinal changes to wealth creation will stimulate activity and create increased taxable capacity;

c) PIPs are not seen as ideal for all savings, since the benfit of gross fund status within the pool is offset by the penalty of tax payment on eventual withdrawal. PIPs offer accessibility of assets and deferral of tax - but <u>not</u>, in the long run, a reduction in the tax base.

Some estimates of costs, however, have to be made. Given existing allowances and exemptions, a flow of £4 billion into PIPs in a single year would result in a loss to the Revenue of £1 billion. Pre-empting for the sake of PIPs a modest portion of what is hoped to be available for tax reduction is surely not out of the question. If it is feared that the net savings flow into PIPs would be even greater, then a policy of gradual implementation could be followed, with an annual individual limit. The essential point is that we should acknowledge and welcome the principle now.

There will be those who will argue loudly that we cannot afford PIPs. But can we afford not to recognise the injustices of the present system and the consequences of further concentration of wealth?

7. Conclusion

Critics of these proposals will argue that they provide a licence to minimise tax for those best able to take advantage of them, or that they provide freedom of choice to those with insufficient skill or judgement, or that the costs are virtually incalculable. We urge the contrary view. Any such disadvantages should be balanced against the much greater supply side benefits of a widely based revival of a personal capital ownership.

For wider personal ownership and, consequent upon it, greater individual commitment to success, is essential if we are to create wealth as a nation, thereby laying a foundation for increased employment, and for adequate resources to pay for welfare. The Government should acknowledge the disadvantages - the dangers indeed - of the present concentration of wealth, and make wider ownership a basic theme of the 1986 Budget and a major part of the platform for the next election.

Appendix

Personal Ownership - some further proposals

1 Stamp Duty. This should ideally be abolished, since it now applies only to the wrong assets. But if abolition is regarded as too expensive, why should gilt-edged and similar securities be exempt? Fiscal equality requires its extension to transactions in such securities. At least this would enable the rate to be reduced to a trivial percentage and might result in recognition of its absurdity.

2 Employee ownership. Incentives should be offered to financial participation by employees wherever practicable. The number and importance of company-wide schemes for share participation is growing. We suggest that no executive option scheme should be introduced unless an adequate participation scheme for all employees was already in being. Option schemes themselves may well have become over-generous in the light of inflation, widely extended as they are beyond the high-technology, high-risk companies for which they are principally suitable. It would certainly be more reasonable if the exercise price for a tax-exempt option scheme was escalated annually at least by the RPI plus a percentage to allow for the gap in equity yield.

Companies should open share-shops for employees on company premises. Employee-held shares should be transferable as simply and easily as possible - free of stamp duty.

The Government should encourage all listed companies to introduce share schemes by illustrating the success of those who have already done so. It is still only a small minority of companies who have introduced them. A professional study of both the qualitative and financial impact of employee participation might well provide additional arguments. The success of National Freight is very telling evidence that the greatest spur to a more positive attitude in the work place is personal involvement in the success of an enterprise.

3 <u>Statutory requirements</u>. One of the barriers to wider ownership is the cost imposed on the company in supplying information to shareholders in a form which is needlessly elaborate and detailed - at least for the majority of personal shareholders. Many companies may not welcome small personal holdings purely on the grounds of the cost of servicing them. A simplified form of reporting, more in the style of employee reports, should be authorised, provided that full statutory accounts were available on request. Our proposal for reinvestment facilities for dividends would also reduce costs of servicing small shareholders. The new rules for simpler prospectuses for new issues should be extended, so that the full requirements of the Companies Act could be met by a prospectus available to Stock Exchanges, professional investors and journalists, or on request - without the necessity of a general publication.

4. <u>Dividend reinvestment</u>. Our proposals on PIPs, and our wish to encourage the smallest investor, lead naturally to advocacy of schemes for dividend reinvestment. The fiscal rules in Britain for such schemes have been frequently changed. Nevertheless they offer the single simplest mechanism for an individual to enhance the value of his asset without burdensome transaction costs. We recommend that they should be available for

dividend and interest payments on all investments, including Government bonds. Oddly, a British investor in an overseas company (e.g. in Canada or Australia) which offers reinvestment does obtain the tax benefits. The administration of reinvestment can be greatly simplified (we have seen examples of an Australian company which sends out a simple statement in lieu of a dividend cheque) and could be still further simplified if the company's registrar was allowed to retain share certificates and despatch consolidated share certificates only on request.

5. Transaction costs and regulation. Perhaps the greatest single disincentive to the ordinary investor is the complexity and cost of each transaction in quoted securities. The so-called City Revolution will do nothing to correct this and is widely seen as favouring the big investor in the big companies. The retailing revolution which has so reduced costs to the housewife, translated to the securities market, would be just as beneficial to the individual investor. To buy shares should be made as easy as to buy groceries. Technological advances have made it possible for a share shop to buy and sell securities as an instant transaction - without all the present complexities of agency arrangements, contract notes, transfers, etc., all of which add to costs. While regulation of markets may well be important, it can impose unnecessary burdens: and we see no case for insisting that transactions should be executed on the Stock Exchange. The Securities and Investment Board (and the market operators whom they regulate) must accept the challenge of producing simplified procedures and de-regulating transactions which are below an agreed level.

6. Small business and start-ups. Our proposals so far have done no more than create an equilibrium between the individual and the investor. PIPs in effect would take the place of schemes such as the B.E.S. But we would like to go one stage further. We suggest giving a positive fiscal incentive to the individual investor wishing to make direct personal investment in a small business or start-up situation. We therefore propose that any such investment (broadly defined along B.E.S. lines, but abandoning the restraints on family links or personal involvement) would be made through a PIP in the way we had explained, but would be taxable at only half-rate as and when withdrawn from the pool. If the proceeds of sale are reinvested within the pool, a credit would be marked against future withdrawals.

7. Government exemptions. It is offensive that the Government, as a taxing authority, should be able also to claim fiscal privilege for its own borrowing programme. In particular, National Savings, with their gross interest payments and tax free status, create a market distortion. These exemptions should be ended. (In the present position of an over-funded Borrowing Requirement, there are also wider economic arguments for reducing the inflow into National Savings.)

8. Capital Gains Tax. As it stands, CGT is extraordinarily complex and a great barrier to personal ownership due to the inflexibility which it causes. A prime advantage of PIPs will be that assets held within the pool can be bought and sold free of this tax. Ideally CGT should be abolished altogether; but at the very least the iniquity of taxing gains between 1965 and 1982 which do no more than represent inflation should be recognised and

remedied.

As soon as practicable, CGT should be restricted to gains realised within one year of purchase; and such gains should be taxable at the full Income Tax rate providing a parallel with assets held within a PIP.

9. Capital Transfer Tax. Encouragement of wider ownership should lead to the replacement of CTT (which extracts tax from the donor) by an inheritance tax whereby an acquisition of assets through inheritance by a given individual would be taxed only if his cumulative life-time total exceeded a basic exemption figure of say £100,000. Surely it is preferable for the millionaire to make 100 gifts of £10,000 each and thus disperse wealth?