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New Stamp Duty Reserve Tax regime for Unit Trusts and Open-ended Investment Companies

Initial guidance issued by the Inland Revenue: 1 September 1999

Purpose

Section 122 and Schedule 19 of the Finance Act 1999 introduce with effect from 6 February 2000 a new Stamp Duty Reserve Tax (SDRT) regime for surrenders and other transfers of units of unit trusts in place of the existing Stamp Duty charges. Corresponding changes will be made to the SDRT regime for transactions in shares in open-ended investment companies (oeics) using regulatory powers introduced in the same Section.

The Inland Revenue, jointly with the Association of Unit Trusts and Investment Funds (AUTIF) and other interested parties, has identified a number of key administrative areas arising from the new regime which affect the planning that the industry needs to carry out before 6 February 2000.

This guidance clarifies a number of administrative points and this information may be used for the planning of systems. It will form the basis of the formal guidance that the Stamp Office will issue in due course. While much of this document is expressed using the terminology of unit trusts, it can be taken as applying equally to oeics unless otherwise stated. References to numbered paragraphs are to the relevant Paragraphs of Schedule 19 Finance Act 1999.

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General description of the new SDRT regime

SDRT charging formula

1. The new regime generally imposes a 0.5% SDRT charge on the value of surrenders of units to the managers or trustees, which is potentially reduced by two ratios:
 - 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);
 - 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. The ratios are calculated for the whole unit trust. Under Paragraph 18 each part of an umbrella fund is to be treated as a separate unit trust in its own right, in the same way as each sub-fund within an oeic is treated as a separate oeic.
3. The following types of surrender are wholly or partly outside the scope of this general calculation:
 - Pro rata in specie redemptions (where the unit holder receives a proportionate share of each asset held in the fund) and certain transfers of units between unit holders (for example, where there is no consideration) are exempt and so fall outside the calculation;
 - Non pro rata in specie redemptions are excluded from the I/S ratio but may benefit from the reduction under the $N/(N+E)$ element of the calculation.

Unit trusts outside the scope of the charge

4. Surrenders of units in some unit trusts are totally excluded from the scope of the charge. This applies to unit trusts which can invest only in exempt investments, to pension fund pooling vehicles and certain other funds which are currently excluded by specific legislation from the definition of unit trust.
5. The treatment for oeics will be the same except that the rules will be adapted to reflect the fact that oeics have a different legal structure.

Transitional arrangements (period - 1 October 1999 to 5 February 2000)

6. Many of the general administrative procedures for Stamp Duty are changing from 1 October 1999 under provisions in Finance Act 1999. However, for unit trusts the rules in existence prior to that date are being retained until they become obsolete in February 2000. So transfers of units from a manager to a new unit holder will continue to be stampable at 50p rather than at £5, and the existing late stamping penalties will continue to apply. And, in the context of unit trusts - given the transition, any penalties sought under section 56(3) Finance Act 1946 (failure to keep appropriate records) or under section 17 of the Stamp Act 1891 (enrolling an instrument not duly stamped) will not exceed £10.
7. Equally, any instrument stamped under the existing rules remains potentially eligible for reclaims under section 54(4) of the 1946 Finance Act.

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Stamp Duty where units are given as consideration

8. The abolition of Stamp Duty on surrenders of units does not affect the Stamp Duty position on the conveyance on sale of property other than units where units are given as consideration. So, for example, where UK shares are sold to a unit trust on subscription for units, there is still either a Stamp Duty or an SDRT charge on the transfer of those UK shares.

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Points of clarification

9. The areas covered below in more detail are:
- Dividing line between the old and the new regime;
 - Tax calculation;
 - Exempt investments;
 - Wholly exempt unit trusts;
 - In specie redemptions;
 - Third party transfers;
 - Administration and payment;
 - Interest and penalties.

Dividing line between the old and the new regime

New regime

10. From 6 February 2000, under Paragraph 2 transfers or other surrenders of units to the manager or trustee are chargeable to SDRT, whether or not the unit or share is subsequently cancelled.

When surrenders ‘occur’

11. Surrenders will be taken to occur by reference to when they take effect; which for these purposes will be at the valuation point for which the deal is contracted. This means that the normal dealing record can be taken as the basis for the calculations. So if, for example, a notification (for a fund with daily dealings) was made on a Friday afternoon after that day’s valuation point, then the deal would be struck at the valuation point on the following Monday and this would be the effective date for the surrender. The same principle will also apply to funds which deal less frequently. So the new regime will apply to surrenders taking effect on valuation points on or after 6 February 2000.

Old regime

12. A surrender which occurs before 6 February 2000 will fall under the old regime. So there will be the potential for a reclaim of Stamp Duty when an instrument in respect of it is presented for stamping.

13. It has long been the Stamp Office’s practice to stamp repurchase summaries where they are submitted in place of the individual instruments of surrender. In line with that practice, it will be acceptable for such a summary, relating to all remaining unstamped transactions as at 5 February 2000 to be prepared and submitted for stamping within 30 days of that date. Transactions covered by such an instrument will then be treated as falling within the old regime rather than the new regime. And such a procedure may be convenient for fund managers who wish to draw a clear line between transactions subject to the old and the new regimes.

Tax calculation

Value of surrenders

14. Paragraph 3 charges SDRT on 0.5% of

“whichever is the higher of:

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- (a) the price the unit might reasonably be expected to fetch on a sale in the open market at the time of surrender, and
- (b) its cancellation price, or if it is redeemed its redemption price, at that time, calculated in accordance with the trust instrument.”

15. In normal circumstances, the Stamp Office will accept that the cancellation price (or redemption price as appropriate) is no lower than the open market value, both in relation to authorised and unauthorised funds. In particular, the Stamp Office would always expect to be able to adopt this view in relation to an authorised fund operating properly within the relevant regulatory requirements.

Income and accumulation units in a unit trust

16. Paragraph 4 requires the SDRT calculation to be done separately for each “class” of unit, and there are provisions to ensure that any consolidations or subdivisions in the units are properly reflected.

17. For the purposes of this Paragraph, accumulation units are to be treated as being part of the same class of units as income units relating to the same pool of investments, with a conversion to the appropriate number of income units. So a fund with both income and accumulation units should calculate the liability to SDRT for a given charging period for the fund as a whole. Managers of funds with income and accumulation units will probably find it most natural to restate accumulation units in terms of notional income units for this purpose. A record of the conversion calculations will need to be kept for audit purposes.

18. But funds which have only accumulation units will of course have no need to restate them as notional income units.

19. Switches between income and accumulation units are not to be treated as surrenders under Paragraph 2 but as a type of consolidation or subdivision of units. A charge to SDRT does not arise on a switch between these types of units; accordingly, these switches should not be included in I or S as defined in Paragraph 4(3).

Classes of shares in oeics

20. Where there are income and accumulation shares of oeics, these are to be treated according to the same principles applying to income and accumulation units of unit trusts.

21. The SDRT liability of an oeic is calculated for the fund (or sub-fund) as a whole. So oeics, with more than one class of shares will need to express the number of shares of different classes issued or surrendered in a relevant two-week period in terms of one class of shares. This may be an actual or notional class, provided that the conversions are done on a consistent basis. A record should be kept of all conversion calculations.

22. As for unit trusts, switches between share classes within a fund will not be surrenders under Paragraph 2 and should also be excluded from I and S for the purposes of Paragraph 4.

Cancelled/altered deals

23. Taking the dealing record of the fund as the base record for SDRT calculations (both for the charging period and for the relevant two-week period) means, that some issues and surrenders will be included that are either cancelled altogether or are altered some time after they were first recorded in the dealing journal. This would include instances where an investor has exercised statutory cancellation

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rights, or where the deal is not completed as a result of a failed direct debit, or where a deal must be altered to correct an error.

24. To remove the need to revise computations in such cases, it will be acceptable for the purposes of Paragraph 4, for cancelled and altered deals to be included as amendments to issues or surrenders - whichever is applicable - in the charging period and relevant two-week period in which they occur provided this is done on a consistent basis. But if a fund wishes, it may of course carry out a full recomputation - again provided this is done on a consistent basis.

Reduction of tax charge where surrenders exceed issues

25. This operates on a 2 week rolling basis, so that the SDRT charge on the surrenders in week 1 is reduced if the aggregate number of surrenders in weeks 1 and 2 (S) exceeds the aggregate number of issues in weeks 1 and 2 (I) by multiplying the value of the surrenders in week 1 by the fraction I/S (Paragraph 4).

26. Surrenders and issues which are not made entirely for money (e.g. in specie transfers, whether or not pro rata) are excluded from this fraction (Paragraph 4(5)), as are exempt transfers between unit holders (Paragraph 6(6)).

Reduction where some exempt investments are held

27. Where a fund holds some exempt investments (e.g. gilts, or foreign shares), Paragraph 5 provides further relief, based on the proportion of the fund held in exempt and non-exempt investments over the 2 week period.

28. The amount of SDRT due (after any reduction resulting from surrenders exceeding issues in the relevant 2 week period) is further reduced by multiplying it by the fraction $N/(N+E)$ where N and E are the average market values of the non-exempt and exempt investments over that 2 week period.

29. Cash or other funds held for day to day management are not classed as investments. So the fraction $N/(N+E)$ does not include cash either in the numerator or the denominator. This means, for example, that a fund holding only cash and UK shares will not qualify for this relief.

30. If the total investments in the fund are exempt (so that there are no non-exempt investments) in the particular 2 week period in point, then the fraction is zero and there will be no SDRT to pay on the surrenders in the week concerned.

Meaning of 'average values' for the $N/(N+E)$ calculation

31. Paragraph 5 defines N and E to be average values over the relevant 2 week period. It is clear that the differing nature of funds will mean that a range of approaches to measuring these averages may be appropriate in different cases. It is, therefore, not the intention to lay down a single rule. And a fund to which exceptional circumstances apply may seek to agree a bespoke arrangement with the Stamp Office. It will, in particular, be acceptable for funds to use any one of the following approaches (provided the approach chosen is operated for all transactions consistently):

- Averages of the values of N and E over all of the valuation points falling within the relevant two week period (including the individual values where there is only one such valuation point);

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- Averages of the values from valuation points at an equivalent time in each of the two weeks concerned - for example, an average of each Friday's valuation point;
- Averages of the values on the last business day of month 1 and the last business day of month 2 to be used to calculate a ratio $N/(N+E)$ which would be applied to all of the calculations relating to the two week periods ending in month 2.

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Exempt investments

32. The rules for determining when an investment is exempt are provided for by Paragraph 12 and differ for:

- Investments which are holdings in unit trusts or oeics; and
- Other (direct) investments.

33. Holdings in collective investment schemes are exempt only if the scheme is a bond or gilt fund (of the sort presently falling within section 101 Finance Act 1980). This includes funds which invest in foreign bonds as well as those investing in UK bonds, but is restricted to authorised funds.

34. Direct investments are exempt if they are neither:

- Investments the transfers of which would be liable to ad valorem stamp duty; nor
- Chargeable securities for the purposes of SDRT.

35. So, for example, gilts, commercial paper and other exempt loan capital are exempt whereas UK shares or interests in UK land are not.

36. One question which has arisen, is whether foreign shares would be exempt given that if someone were (exceptionally) to execute a transfer of such shares in the UK, that transfer would be stampable. This point was addressed by the Economic Secretary in the debate in Standing Committee on the provisions in the 1999 Finance Bill. At column 588 Mr Barry Gardiner (Brent, North) asked 'Will the pro rata relief for funds holding exempt investments ... apply to funds holding foreign shares?' And at column 594 Ms Patricia Hewitt replied 'In line with the purpose of pro rata relief in new schedule 1, the definition of exempt investment includes foreign shares'. Accordingly, the Inland Revenue's interpretation is that the exemption will apply where an investment is not of a type which would generally attract ad valorem stamp duty – such as shares in a foreign company which does not hold its register in the UK.

37. Derivatives are exempt investments only if they relate wholly to exempt investments. So, for example, an index tracking derivative would only be exempt if the index or indices concerned did not include any non-exempt investments.

38. Cash or other funds held for day to day management do not count as investments.

Wholly exempt unit trusts

39. The SDRT charge on surrenders applies only to those units which are chargeable securities. This means in particular (by virtue of Paragraph 12) that transfers of units in a fund which can invest only in exempt investments are always exempt. The requirement that this condition be a part of the terms of the scheme can be met either by its being incorporated in the trust deed or in the scheme particulars. In doing this, it will be acceptable for the condition to be expressed, by providing that the fund will invest only in the way described in section 99(5B)(b)(i) and (ii) Finance Act 1986, inserted by Paragraph 12(3).

40. Where a unit trust invests in other funds, rather than directly in shares or bonds, the only funds that are treated as exempt investments are authorised funds within Paragraph 12(3).

41. Some unit trusts are specifically deemed not to be unit trusts at all for the purposes of Stamp Duty and SDRT and are therefore also excluded. Paragraphs 15 -17 refer to this; and preserve the pre 6 February 2000 position in that regard. In particular, this means that Pension Fund Pooling Vehicles are not subject to the new regime.

In specie redemptions

42. In specie redemptions are not subject to the reduction of SDRT in the I/S formula under Paragraph 4. Nor are they taken into account in calculating the formula.

43. Pro rata in specie redemptions are excluded from the charge on surrenders by Paragraph 7, but non-pro rata ones are chargeable.

44. The charge to SDRT on a non pro rata in specie redemption in a unit trust, that holds at least some exempt investments in the relevant 2 week period, will be reduced by the $N/(N+E)$ fraction under Paragraph 5.

45. The test for an in specie redemption to qualify for the pro rata exemption is that the unit holder must get a share of each asset that is proportionate to, or as nearly as practicable proportionate to, the unit holder's share. For this purpose practicability will be judged by reference to trading constraints beyond the control of the fund manager. In particular, the necessity to handle only deliverable lots in certain markets will be accepted as a practical constraint. It is however an all or nothing test in the sense that the whole value of the surrender is chargeable unless the condition is met.

46. Whether or not the in specie redemption is pro rata, the transfer of assets to the unit holder will be excluded from SDRT by section 90(1B) Finance Act 1986 inserted by Paragraph 11(4). Where the in specie transfer is carried out on paper, a fixed duty stamp of £5 will apply.

Third party transfers

47. There are two different types of ‘third party transfers’, which are mutually exclusive.
48. The first type is where the manager or trustee handles the transfer and alters the register or other records of the legal or beneficial ownership of the unit. Such a transfer counts, as both a surrender and an issue for the purposes of Schedule 19 and the trustee is liable for any SDRT due, just as for other surrenders, though Paragraph 6 provides various exceptions which are discussed below.
49. The second type of ‘third party transfers’ (which is understood to be rare) relates to the situation where the legal ownership of the unit remains with the same person (for example, a nominee common to both parties) and so the manager is not called upon to change the register or other records. In this situation there is no charge under Schedule 19, but instead there is a charge under section 87 Finance Act 1986 in the normal way for which the buyer is liable, subject to the reliefs provided by new section 90(1A) Finance Act 1999.
50. The remainder of this section is concerned with the first type, as it is only those which will affect trustees and managers as they operate the new regime.
51. In the straightforward case of a transfer, made for consideration between third parties, the surrender and issue are to be taken into account in the overall calculation along with other surrenders and issues and included in the I/S fraction; SDRT being charged on the surrender in the same way as in any other case.
52. These surrenders and issues are considered to ‘occur’ on the day that the register or other records are changed to reflect the transfer made, as it is not until then that the manager can be said to have accepted the transfer. This differs from the position for other surrenders where the manager is a party to a deal with the surrendering unit holder.
53. The value of the surrender for the purposes of the calculation is not directly related to the amount of consideration passing between the unit holders concerned. Rather, it is the market value of the unit concerned at the time. And any payment in respect of the SDRT required by the manager or trustee in connection with such transfers will depend on this figure. So in recognition of this, it will be acceptable for the value to be taken, as the redemption price at the time the unit holder sends the instruction authorising the manager or trustee to register or otherwise record the transfer; provided this is done promptly thereafter.

Exemptions

54. There are a number of situations in which surrenders under third party transfers are exempted from the SDRT charge by virtue of Paragraph 6. In such cases Paragraph 6(6) excludes both the surrender and issue from the I/S fraction in Paragraph 4.

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55. Third party transfers are exempt in this way if:

- There is no consideration in money or monies worth;
- The transferee is a charity;
- The transfer, were there to be a written instrument, is one to which the exempt instruments regulations or the Stamp Duty group relief provision would apply.

56. The final bullet point above does not mean that an actual instrument is required, or that the normal adjudication procedures relating to group relief claims have to be gone through. But the trustee will be liable for SDRT on transfers that are not exempt. Therefore, the manager will need to be satisfied (and on enquiry - satisfy the Stamp Office) about the facts behind any transfer where the parties involved suggest that such an exemption applies.

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Administration and payment procedures

57. Regulations will be made to provide for the administration and enforcement of the new SDRT regime. As far as possible this will be done in a way that keeps in step with the existing SDRT regulations in SI 1986/1711. Fund managers and others may plan their systems on the basis that the following payment schedule and requirements for information in returns will apply.

Payment schedule

58. In keeping with the general pattern for SDRT a monthly return will be required on or before the prescribed 'accountable date'.

59. The return for each month will relate to surrenders occurring in the weeks for which the relevant 2 week periods end during that month. So the return for the first full month of the new regime, March 2000, would be of tax due on surrenders occurring in the period from Sunday 20 February to Saturday 18 March.

60. The 'accountable date' will be the 14th day of the following month (14 April in the example) and the SDRT will be due and payable on that date.

61. The trustee is liable for the tax in accordance with Paragraph 2(3). But the regulations will define the accountable person. This will be the manager in the case of a unit trust and the authorised corporate director in the case of an oeic. At any time, where there is no manager/authorised corporate director then the trustee of the unit trust or the oeic itself will be accountable.

Information required in a return

62. A monthly return will (after the initial return for February 2000) cover a 4 or 5 week period of surrenders and will comprise 4 or 5 subsidiary calculations. In order to carry out the calculation for a particular week (Wk1), for which it will also be necessary to take into account movements in the immediately following week (Wk2), the following information will be required:

- Number of units surrendered in Wk1 (excluding exempt third party transfers and all in specie redemptions) and the aggregate value, at the time of each surrender, of those units;
- Number of units surrendered in Wk2 (excluding exempt third party transfers and all in specie redemptions);
- Number and aggregate value of units surrendered due to non pro rata in specie redemptions in Wk1;
- Aggregate number of units issued in Wk1 and in Wk2 (excluding exempt third party transfers);
- The market value of the non-exempt assets (N) and the exempt assets (E) taken as a simple average of the respective valuations that represent the relevant two week period. (In order to ensure consistency the pattern of the valuation points to be used for this purpose should be stated on the first return. Should it be necessary subsequently to depart from the stated norm, the reason should be given on the relevant return);

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63. Whilst the following information will not form part of the calculation it will need to be declared on the return:

- Number of units surrendered as a result of pro rata in specie redemptions in Wk1;
- Number of units subject to exempt third party transfers in Wk1; the reason for the exemption (for example, nil consideration, charity transferee, group relief) will also need to be stated.

64. Where there is a charge to SDRT a return will be necessary. But where there is no charge to SDRT for a particular month (for example, where the funds in a unit trust are invested in wholly exempt investments) no return will be necessary.

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Interest and penalties

65. The interest rates which apply to SDRT in general will apply to tax charged under this new regime. These rates will be changed from their present level in October and will be set at the same rate as that for the new interest charge on Stamp Duty. The interest rates on any repayments of overpaid SDRT will be lower than the rate on any late or underpaid SDRT.

66. Penalties may arise where returns are late (i.e. submitted after the 'accountable date') or incorrect, as with the notification of other SDRT liabilities.

Late returns

67. Late returns will be subject to a fixed penalty of £100 unless there is a reasonable excuse for the lateness. The Stamp Office would not regard general difficulties in developing or operating computer systems as constituting a reasonable excuse, though serious equipment failure that was beyond the accountable person's control would be quite likely to do so.

68. If a return is submitted more than a year after the accountable date or, as a result of negligence, a return is incorrect there is a tax-geared penalty (up to the amount of the tax not accurately returned on time). It is the Inland Revenue's normal practice (as set out in leaflet SO14) to mitigate such penalties to reflect the readiness with which errors are disclosed and co-operation shown in correcting them.

69. In the early months of this new SDRT regime some managers may find it very difficult to submit fully accurate returns on time. But this does not of itself constitute negligence.

70. In particular, during these early months, the Stamp Office would not regard managers as negligent (and no penalties will be charged) where managers:

- Make as accurate a return as they reasonably can by the accountable date and pay SDRT in accordance with it on time;
- Indicate at the same time that there is some doubt as to the complete accuracy of the return and explain why;
- Provide any corrections as soon as they reasonably can and in any event within 3 months of the accountable date (recognising that interest will be payable - or refundable at a lower rate - on any such correction).