Tax credits on dividends for non-taxpayers

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Many Members have been contacted by constituents concerned about the impact of the Government's decision to abolish cashable tax credits reclaimed by non-taxpayers on their dividends from April 1999. This note provides some background on this issue, the impact that it has had on individuals, and the Government's reasons for withdrawing these credits.

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A. Introduction

Income tax on earned income is charged at three rates: the starting rate of 10%, the basic rate of 22%, and the higher rate of 40% for 2003-04. The 10% starting rate applies to taxable income up to £1,960. The basic rate is charged on taxable income earned in excess of this threshold, up to £30,500. Taxable income in excess of this threshold is charged the higher rate of 40%. Taxable income excludes personal allowances, which represent the amount of money someone may receive free of tax.

There are two rates of income tax on dividends: the ordinary rate of 10%, which is charged on income below the higher rate threshold, and the higher rate of 32.5% on income above that. Individuals who receive dividends are entitled to a tax credit of 10%, to set against their liability on tax on this part of their income. For lower rate or basic rate taxpayers the credit fully meets their tax liability; higher rate taxpayers pay an additional 22.5% on dividend income, to cover the difference between the higher and the ordinary rate.

All individuals receive a personal allowance – set at £4,615 for 2003-04 – which they can set against their liability to tax on all types of income – be it from earnings, dividends or savings. Two age-related additions are made to the allowance: the first, if someone is 65 or over, the second if they are 75 or over: these two allowances are set at £6,610 and £6,720 for 2003-04 respectively. These allowances are limited to the amount of someone's tax liability: individuals

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whose liability falls below the value of their personal allowance cannot claim the 'excess' of their allowance as a payment from the Inland Revenue.[1]

However, prior to April 1999 individuals whose incomes were too low to be charged tax *were* entitled to claim the value of the dividend tax credit from the Inland Revenue as a *cash payment*, in addition to their dividend cheque. Other shareholders who did not pay income tax on their dividend income – such as charities and investors holding their shares in a Personal Equity Plan (PEP) – were also entitled to redeem the credit in cash before April 1999. Cashable dividend tax credits were withdrawn as part of a wider reform in the way both dividends and company profits were taxed. This measure was announced in the July 1997 Budget, though at the time attention focused on the immediate withdrawal of dividend tax credits on dividends paid to pension funds.

Under the system of 'advance corporation tax' (ACT) companies had to account to the Inland Revenue for tax on the dividends they distributed charged at the ordinary dividend tax rate, as a pre-payment of their shareholders' income tax on dividends. Companies were entitled to set this deduction against their liability to corporation tax on their profits, which, generally speaking, they paid nine months after the end of their tax year. ACT was abolished in April 1999 and companies now pay corporation tax in quarterly instalments, the first of which they pay after the first six months of the year in question.[2] However, the tax credit on dividends continues to meet the liability of lower and basic rate taxpayers on their dividend income.

Whilst the removal of a tax concession for those whose income is already low may seem unfair, the Government has argued that the tax system which gave rise to cashable credits was inappropriate and restricted the ability of companies to make investment decisions on proper commercial grounds. The reform of which abolishing reclaimable credits was one part reduced the distortions created by the tax system in companies' investment plans, and, as a consequence, should benefit all shareholders – taxpayers and non-taxpayers. In addition, the system of tax credits was not designed as a form of income support for those on low incomes, which is how it operated when credits were claimed as a cash payment on top of a dividend.

The Government has also pointed to the introduction of the Individual Savings Account (ISA) in April 1999: a new type of savings vehicle with associated tax concessions. The account is free of income tax and capital gains tax, and is guaranteed to run for at least ten years.[3] For the first five years of the scheme a 10 per cent tax credit may be reclaimed on dividends for those who hold their equities in an ISA. As a consequence, non-taxpayers can receive the value of the tax credit by transferring their equity holdings to an ISA. In his 2001

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[1] For details see *Direct taxes: rates and allowances 2003-04*, Library Research paper 03/35 10 April 2003, available on the Library's site at: http://www.parliament.uk/commons/lib/research/rp2003/rp03-035.pdf

[2] Only large companies – those with taxable profits over £1.5 million – pay corporation tax by instalments. Separate arrangements cover small and medium sized companies.

[3] The scheme will be reviewed after seven years to decide on any changes come 2009.

Budget, the Chancellor announced that the annual subscription limit for ISAs would be maintained at £7,000 until April 2006, to give savers the chance to save more tax free.[4]

There has been considerable political pressure for the Government to retain reclaimable tax credits.[5] However, the Paymaster General, Dawn Primarolo, ruled out restoring these credits in December 1998,[6] and there has been no indication since then that the Government are willing to reconsider the issue. The remainder of this note sketches the background to the Government's decision, before looking the implications of this measure for non-taxpayers.

B. Abolishing tax credits on dividends: the July 1997 Budget

In his Budget speech on July 2 1997 Gordon Brown announced two changes in the taxation of company profits and dividends: first, a cut in the main rate of corporation tax from 33% to 31% to apply from April 1997, and second, the abolition of the tax credit on dividends paid to pension funds and companies. The Chancellor's rationale for the abolition of the tax credit was the following:

> Too often British companies have invested too little and too late in the economic cycle. Because I want companies to get the benefit now, the 2 per cent. corporation tax cut will apply from April 1997. This tax cut is the first component of this Budget's investment strategy. The second is a structural reform that will also encourage investment. The present system of tax credits encourages companies to pay out dividends rather than reinvest their profits. That cannot be the best way of encouraging investment for the long term, as was acknowledged by the previous Government. Many pension funds are in substantial surplus and at present many companies are enjoying pension holidays, so this is the right time to undertake a long-needed reform. The previous Government cut tax credits paid to funds and companies, so with immediate effect I propose to abolish tax credits paid to pension funds and companies.
>
> In all the consequential changes I will make, I have been, and I will be, fair. For PEP holders, for individuals who do not pay tax and for charities, tax credits will continue to be paid until April 1999. By that time, the introduction of the individual savings accounts will ensure that individuals have the opportunity to continue to be able to save with tax advantages. So they will continue to have favourable tax incentives to invest in equities. Basic and lower-rate taxpayers do not pay any extra tax on dividends that they receive and that will remain the position, and we shall ensure that higher rate taxpayers will pay no more than they do now on their dividends.[7]

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[4] *Budget 2001*, HC 279 March 2000 p 94. Further details on this savings account are given in a leaflet published by the Revenue: *ISAs, PEPs and TESSAs IR2008*, January 2002, available from its site at: www.inlandrevenue.gov.uk/pdfs/ir2008.pdf

[5] for example, "How tax shake-up of share dividends will hit income", *Sunday Times*, 20 December 1998; "Dividend tax credit move under fire", *Times*, 16 October 1999

[6] Inland Revenue press notice, *Payable tax credits on dividends paid to individuals*, 10 December 1998

[7] HC Deb 2 July 1997 cc 306-307

The argument that companies' investment decisions were distorted by the old system of dividend taxation is a long running one. Briefly, under this system the principal responsibility for paying tax on dividends lay with the company paying dividends. When a company issued a dividend during the tax year, it was required to make a part prepayment of corporation tax it would pay on its profits once its accounts for that year were completed.[8] Companies were entitled to set this 'advance corporation tax' (ACT) charge against their liability to corporation tax. This avoided company profits being taxed twice.

Dividend recipients received a 'credit' with their dividend – equal to the ACT charge – which they could set against their tax liability. In fact, the ACT charge was set equal to the basic rate of tax on dividend income (known as the Schedule F ordinary rate), so that for basic rate taxpayers, dividends were distributed tax paid. Dividend income in excess of the basic rate limit was charged the Schedule F higher rate – though higher rate taxpayers were entitled to use the tax credit to partly offset their tax liabilities. Following the March 1993 Budget the Schedule F ordinary rate was cut from 25% to 20%, along with the tax credit. The Schedule F higher rate of 40% continued to be charged on dividend income above this limit.[9]

Individuals whose incomes fell below the tax threshold were entitled to claim the tax credit as a cash payment from the Inland Revenue. Other categories of investor exempt from income tax - pension funds, institutional investors, charities – could do this as well. The cashable tax credit was a significant incentive for all non-taxpayers to prefer companies to pay out high dividends, rather than retaining their profits. Given the considerable size of institutional shareholdings, it has been argued that this incentive encouraged companies to focus on the short term, and that paying tax credits to non-taxpayers came at the price of under-investment by companies in research and development, affecting the long-term economic prospects of the whole economy. It is worth noting that this analysis was not universally accepted.[10]

During a debate on pensions in July 1997 the then Chief Secretary to the Treasury, Alistair Darling, summarised the case for ending the tax credit as follows:

> I want to explain our proposals. We believe that it is necessary to reform the system of tax credits because it contains a major distortion, under which shareholders are better off if companies pay out profits as dividends than if they retain them for reinvestment. It is right in principle to remove that distortion. The principle that underpins our changes to the corporation tax system is absolutely right. It is for the management of companies and the shareholders to make the decisions, not for the tax system to provide an inbuilt bias. In the United States, where a similar system exists,

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[8] Companies were normally required to pay corporation tax nine months after the end of their accounting period.

[9] Tax credits were calculated with reference to the principle that when a shareholder received a dividend, income tax at the ordinary rate had already been paid. If someone received a dividend cheque for £80, they also received a tax credit of £20. The value of the credit is 20% of a *notional* dividend (in this example, £100) one assumed the company would have made, if an ACT charge had not been paid; expressed as a formula, the calculation was: Value of Tax Credit (VTC) = 20 per cent of [Dividend payment + VTC].

[10] This issue is examined in more depth in a second note: "Advance corporation tax (ACT) and pension funds" SN/BT/581, 13 February 2004.

> pension funds take decisions on the economic merits. An important point to note is that they are as keen on the capital appreciation that then results as they are on dividends. Greater emphasis on capital growth is important. It will help companies and offer them high, long-term growth. It will ensure that they are not starved of capital by the tax system. Indeed, the importance of capital growth is something on which actuaries and others in this country might want to reflect further.
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> I was pleased to note that, after the Budget, the *Daily Telegraph* … said in its business section: "The quality of life in retirement ….. depends on the growth in the economy, reflected in the prices of shares where the contributor's money is invested. This is the point of the Brown Budget that the pension funds would do well to grasp." That is absolutely right, I want to emphasise that the reason we have taken this decision is right in principle. I wait to hear whether the Conservative party would repeal it were that party ever to return to power.
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> The American experiences is worth bearing in mind. The central thrust of the Budget is to create a climate in which the level of investment is raised. It is important to keep our eyes on that fact. Currently, the level of investment is lower than it should be at this stage of the economic cycle. I was interested in the speech delivered by Sir David Cooksey a few days ago, when he looked at some emerging US companies in 1975 and compared their position then with their current position. He noted that they had expanded dramatically, which is a common feature of the American economy. He said: "It is also notable that very few of those companies pay dividends to their shareholders who prefer to benefit from growth in capital value as the companies reinvest all of their profits in the business." He said that that contained a lesson which we should learn …
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> Our goal is a long-term one - to improve this country's investment performance. For many years, our performance has lagged behind that of our major competitors, and continues to do so despite the current recovery. That may be because, in the past, there was so much concentration on the short term. Investment for the long term and for better growth will greatly benefit companies and, therefore, pension funds, which will gain in the long term. Many of those who have commented on the impact of the corporation tax changes have ignored the long term. Indeed, that is far too common a tendency in Britain. The long term is the central point of the Government's economic strategy.[11]

Legislation to abolish reclaimable tax credits for non-taxpayers was included in the *Finance (No.2) Act 1997*.[12] Briefly, from April 1999 the tax credit is cut to 10%, and, in line with this, the rate of income tax on dividend income for both lower and basic rate taxpayers is cut to 10% as well (leaving them no worse off than before). The rate of tax for higher rate taxpayers is cut to 32.5%, to compensate them for the cut in the tax credit. Neither basic rate nor higher rate taxpayers enjoy the tax credit as a cash payment: the credit is only used to offset the income tax due on dividend income. That said, the cut in the dividend tax credit, and the associated

[11] HC Deb 9 July 1997 cc 974-975

[12] Section 30(5),(6) of *Finance (No.2) Act 1997* specifically

reductions in the Schedule F rates, mean that, in effect, both basic and higher rate taxpayers face an unchanged tax structure in relation to their dividend income.[13] From this date the tax credit for shareholders with no income tax liability is abolished; this covers savers holding their shares in Personal Equity Plans, those with incomes below the tax threshold, and charities.[14]

Charities receive compensation for their loss of the tax credit over a five year period from April 1999. This compensation takes the form of a payment to a charity of a percentage of the dividends it receives, and is phased out as follows:

1999 – 2000	21 per cent
2000 – 2001	17 per cent
2001 – 2002	13 per cent
2002 – 2003	8 per cent
2003 – 2004	4 per cent[15]

C. The impact on non-taxpayers of withdrawing tax credits

Estimates for the numbers of non-taxpayers who receive tax credits, on the average amount of credit reclaimed, and the impact on Exchequer revenues from abolishing reclaimable credits were given in several written answers in June 1998:

> **Mr. Gibb:** To ask the Chancellor of the Exchequer how many individuals with no tax liability reclaimed a tax credit on dividends paid in (a) 1995-96 and (b) 1996-97; and what was the average amount re-claimed.
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> **Mr. Geoffrey Robinson:** The latest available information is derived from the 1995-96 Survey of Personal Incomes. It is estimated that some 630,000 non taxpayers made claims, averaging £75, for payment of the tax credit on dividends paid in 1995-96.
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> **Mr. Gibb:** To ask the Chancellor of the Exchequer, pursuant to his answer of 18 July 1997, Official Report, column 375, if he will provide a breakdown of the number of (a) non-taxpayers aged over 65 years and (b) all non-taxpaying individuals reclaiming tax credits on dividends in (i) 1995-96 and (ii) 1996-97, in the categories (1) under £20, (2) £21 to £50, (3) £51 to £100, (4) £101 to £200 and (5) over £200 reclaimed.
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> **Mr. Geoffrey Robinson:** The latest available estimates derived from the Survey of Personal Incomes cover dividends paid in 1995-96 and are given in the table.

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13 Inland Revenue Budget press notice REV2, 2 July 1997

14 In November 1997 the Chancellor announced that ACT would be replaced with a system of quarterly payments for corporation tax from April 1999, without any further significant change in the taxation of shareholders' dividends (HC Deb 25 November 1997 c 775). For further details on this reform see, Inland Revenue, *A modern system for corporation tax payments: outcome of consultation*, March 1998.

15 For comparison the tax credit had represented 25 per cent of the dividend prior to this reform.

Amount of dividends tax (£)	Number of non taxpayers aged 65 and over with claims (thousands)	Number of taxpayers with claims (thousands)
under 20	100	240
21-50	60	130
51-100	60	110
101-200	50	90
201 and over	30	60
Total	300	630

> **Mr. Gibb:** To ask the Chancellor of the Exchequer, pursuant to his answer of 18 July 1997, Official Report, column 375, what is the estimated saving to the Exchequer of abolishing the repayment of dividend tax credits in respect of (a) all non-taxpaying individuals and (b) non-taxpaying individuals aged over 65 years.
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> **Mr. Geoffrey Robinson:** It is estimated that abolishing payment of dividend tax credits in respect of all non taxpaying individuals will save the Exchequer about £50 million in a full year. About half of this relates to payments to non taxpaying individuals aged 65 and over. These estimates do not take into account any behavioural effects which might result from abolishing the payment of tax credits.[16]

These estimates were confirmed in a written answer given in April 1999:

> **Dr. Cable:** To ask the Chancellor of the Exchequer what are the projected revenue implications in 1999-2000 and 2000-01 of the abolition of dividend tax credits of non-taxpaying pensioners (a) on the assumption that savers fully switch into ISAs and (b) on the assumption that there is no switching.
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> **Ms Hewitt:** To correct a bias in the tax system against the retention of profits for investment, payable tax credits on dividends paid to individuals have been withdrawn from 5 April 1999. The potential revenue impact of withdrawing payable tax credits from non-taxpaying pensioners after 5 April is about £25 million a year. The effect will, however, be reduced to the extent that investors who switched their investments into PEPs before 5 April this year, or into ISAs after that date, or into interest bearing investments on which non-taxpayers can reclaim tax deducted at source on interest paid. As a result the effect could be very much less than £25 million a year.[17]

The rationale for abolishing reclaimable tax credits for non-taxpayers could be put as follows: the tax credit ensures that tax is not paid twice on profits distributed as dividends: once by the company in the form of corporation tax, and once by the dividend recipient. If the latter is not liable to pay income tax there is no double taxation. By allowing tax credits to be claimed as cash payments, the old system could be thought to be doing something for which it was never

[16] HC Deb 1 June 1998 cc 87-88W

[17] HC Deb 13 April 1999 c 118W

intended: supplementing the income of non-taxpayers.[18] An analogy might be made with personal tax allowances, as those whose incomes fall below their allowances cannot receive the remainder of the allowance in the form of a benefit payment. From this perspective, one might say that a tax credit on dividends enjoyed by non-taxpayers was, in fact, a contradiction in terms. Moreover, the provision of the tax credit only benefited non-taxpayers holding equities, and one might suggest that it is fairer to offer help to all savers on low incomes.

Whatever the merits of the arguments for abolishing tax credits, there has been considerable political pressure for the Government to retain them. At the Report stage of the Finance Bill in June 1998, the then Paymaster General, Geoffrey Robinson, promised to consider this:

> We are looking at alternatives, as we did when we went into the consultation period following the initial ending of tax credits, and deciding which way to go on company taxation policy overall with regard to ACT. I can give no commitment today and I have not brought a solution to the House; we would not be having this sort of debate if I had. I am aware also of the growing anxiety among poorer non-taxpayers who have been hit by the measure, so I know that we need to make our position utterly clear as quickly as possible. I am working to that end.[19]

However, on 10 December 1998 Dawn Primarolo, now Paymaster General, stated in a written answer that "having listened carefully to all interested parties, the Government confirm the arrangements set out in the July 1997 Budget for phasing out payable credits in order to correct a bias in the tax system against the retention of profits for investment. Individuals have time to consider their investments before the new rules take effect - for example, they can move to tax-favoured investments should they wish to do so."[20] Subsequently the issue has been debated on a number of occasions: for example, in an Opposition day debate in January 1999,[21] and during the Committee stage of the Finance Bill in June 1999.[22] However, the Government has not given any indication since then that it would consider restoring cashable tax credits on dividends.[23]

D. Provision of tax credits for equities in ISAs until 2004

In his July 1997 Budget the Chancellor also announced the Government's plans to introduce a new tax-privileged savings vehicle, the Individual Savings Account (ISA), from 6 April

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[18] It is worth noting that in October 1999 the Government introduced the Working Families Tax Credit (WFTC) for people on low incomes to replace in-work social security benefits; in contrast with this aspect of dividend taxation, the WFTC – and its successor, the working tax credit – *have* been designed to supplement low incomes. For details on Government policy in this area see, *Budget 2003* HC 500 April 2003 pp 90-1.

[19] HC Deb 30 June 1998 c 175. A new clause tabled by the Opposition to cancel the abolition of tax credits for non-taxpayers was put to the vote, and negatived, by 284 votes to 171 (HC Deb 30 June 1998 cc 159-180). The *Finance Act 1998* received Royal Assent on 31 July.

[20] HC Deb 10 December 1998 c 296W

[21] HC Deb 18 January 1999 cc 629-671

[22] The Opposition tabled a new clause (NC 4) to restore tax credits for non taxpayers, though this was negatived on a division: SC Deb (B) 22 June 1999 cc 720-736.

[23] The Government reiterated its position in answer to a PQ in July 2002 (HC Deb 18 July 2002 c 467W).

1999.[24] When the abolition of tax credits was debated in Standing Committee in July 1997, the then Economic Secretary to the Treasury, Helen Liddell, noted that savers on low incomes would have sufficient time to take advantage of the new ISA:

> The suggestion that we are removing tax credits for administrative ease is not true … We are getting rid of tax credits because they are a distortion in the system and not the best way in which to ensure long term growth of the economy … [The purpose of clause 30] is to implement the removal of tax credits for non taxpayers by 1999 to allow people to make the appropriate changes to their personal savings portfolios and to allow them to move into the similarly tax-advantaged commodity of individual savings accounts.[25]

At first it was envisaged that ISA holders would be able to invest up to a £5,000 each year within an overall investment limit of £50,000 – and that savers using existing tax-protected schemes – TESSAs and PEPs – would only be entitled to transfer their holdings into an ISA *within* this £50,000 limit.[26] In the event the Government withdrew this retrospective element of the proposals.[27]

ISAs include three components: cash (including National Savings); life insurance; and stocks and shares. Initially it was proposed that individuals would be entitled to subscribe up to £5,000 a year, of which no more than £1,000 could be held in cash and £1,000 in life insurance, though in the scheme's first year of the scheme the annual limit would be £7,000 of which no more than £3,000 could be cash and £1,000 life insurance.[28] However the annual limits set for the first year of the scheme have been extended, and in his 2001 Budget, the Chancellor confirmed that the £7,000 overall limit and £3,000 cash limit would be retained until April 2006.[29]

Savers may withdraw their funds from an ISA at any point - there is no statutory lock-in period - though once they have subscribed the maximum annual amount to their ISA, no further subscriptions will be allowed that year, regardless of how much is withdrawn. ISAs are completely free of income tax and capital gains tax. A 10 per cent tax credit will be paid for the first five years of the scheme on dividends from UK equities: that is, until 5 April 2004. This will apply to equities in the stocks and shares component of the new savings account, and to equities which back policies in the life insurance component.

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24 HC Deb 2 July 1997 c 306

25 Standing Committee A 22 July 1997 c 344 (the debate itself covers cc 326-347)

26 Inland Revenue, *The new Individual Savings Account*, 2 December 1997

27 The Chancellor Gordon Brown announced this change in his March 1998 Budget speech (HC Deb 17 March 1998 c 1102).

28 Inland Revenue Budget press notice IR2, 17 March 1998

29 *Budget 2001*, HC 279 March 2000 p 94. For details on Government policy in this area see, HM Treasury, *Delivering savings and assets: the modernisation of Britain's tax and benefit system #9*, November 2001.

The legislation to introduce ISAs is in sections 75-78 of the *Finance Act 1998*. The provision of the 10 per cent tax credit was mentioned by Helen Liddell, then Economic Secretary, during the Committee stage of the Finance Bill in June 1998:

> The clause will do two things. First, it will allow tax credits on dividends paid on UK equities between 6 April 1999 and 5 April 2004 to be paid to investors where the equities are held in either a PEP or an ISA. Many members of this Committee also served on the Finance Committee that considered our first Budget of July last year.
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> We discussed at length our corporation tax measures which were designed, as those hon. Members will know, to change the previous rules that allowed profits to be paid out as dividends rather than to be retained for the good of the business. That practice distorted behaviour and affected investment. As I have said, it is important to ensure that there is a high level of investment and stability in the economy. As part of those measures, the payment of tax credits on equities held in PEPs would have ended from 6 April 1999.
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> However, we have recognised the importance of ensuring that PEP investors in equities had time to adjust their investments in light of the changes. That is why we have proposed a five-year period in which the tax credit will still be paid. But we do see the need for a specific time period. In the Committee of the whole House, the Opposition tried to cause confusion where there was no confusion. They tried to suggest … that the five-year payment of tax credits would guarantee tax relief for ISAs for only five years. Let me confirm what was clearly stated in the Budget day press release: the five-year payment of tax credit is in addition to the 10-year guarantee of tax relief for ISAs.[30]

At the time several commentators argued that this did not provide adequate compensation to pensioners who are non-taxpayers; the following example is taken from *Saga* magazine:

> At the moment fund managers running PEPs and ISAs can reclaim the tax credits on dividends paid into those funds. They will still be able to reclaim the tax credits from next April but, as the credit will have been reduced from 20% to 10%, the tax relief will be halved. And in April 2004, this concession will disappear and no refunds of credits will be paid into PEPs or ISAs whatsoever. Even when the tax refund is halved from April there will be little advantage for basic rate taxpayers to invest in an ISA or to leave money in a PEP as the charges will eat away most of the tax gain.[31]

In summing up a debate on this issue in January 1999, the then Economic Secretary, Patricia Hewitt, argued that the Government's strategy to help pensioners on low incomes was both comprehensive and effective, even though the continuation of tax credits on dividends to non-taxpayers was not part of it:

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[30] SC Deb (E) 4 June 1998 cc 533-523

[31] "Tax changes punish the poor", *Saga*, July 1998

My hon. Friend the Member for Harrow, East (Mr. McNulty) … reminded the House of the package of benefits that the Government have put in place for elderly people, including the cut in VAT on fuel … the minimum income guarantee … the minimum tax guarantee … free eye tests; the national concessionary fares scheme; and the investment in the NHS that will make such a difference to elderly people in particular. The hon. Member for Banbury (Mr. Baldry) … asked … how taxing non-taxpayers would help. Let me make it quite clear - we are not taxing non-taxpayers. We are removing a repayable tax credit that was covered by ACT. The abolition of ACT necessitates the abolition of the repayable tax credit … We are helping pensioners and business. We are raising the pension with the minimum income guarantee and cutting corporation tax to its lowest-ever rate. That is why I ask the House to reject the Opposition motion …[32]

More recently there has been some interest in whether the Government might continue to pay a tax credit on dividends paid into an ISA beyond 2004. The fund management industry is reported to have been lobbying strongly for this change.[33] The issue was raised in Treasury Questions on 27 March 2003, when the Paymaster General noted that "the removal of tax credit as part of the reform of corporate tax in 1997 was part of a long-term plan to tackle the distortions in investment", going on to observe "ISAs [will] retain the 10 per cent. protection until April 2004." Jim Cousins MP then asked Ms Primarolo whether the tax credit might be maintained after this date:

Mr. Jim Cousins (Newcastle upon Tyne, Central): Will my right hon. Friend consider extending the ISA tax credit beyond 2004? It is a difficult time for people who have equity ISAs and it is the wrong moment to encourage them to switch to bond funds. In all other respects, I support my right hon. Friend in taking a long-term view of shareholder value that does not depend on the volatility of asset values in the stock market at any given time and does not encourage financial engineering.

Dawn Primarolo: As my hon. Friend is aware, the 10 per cent. of payable tax credit for ISAs was a transitional measure to allow investors to adjust their portfolios. I listened carefully to his comments on what might happen in future, although he would not expect me to announce anything from the Dispatch Box now. However, I shall certainly reflect on his concerns.[34]

In November 2003 the issue was raised in a written answer in the Lords:

Lord Taylor of Warwick asked Her Majesty's Government: Why they are ceasing the 10 per cent tax relief on stocks and shares ISAs from April 2004 when they are seeking to encourage savings.

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[32] HC Deb 18 January 1999 cc 670-671. The motion moved by the Conservative Party - which proposed that all non taxpayers should be entitled to receive a 10% tax credit on dividends after April 1999 - was rejected by 336 votes to 166. For details of the Government's strategy to help pensioners see, *Budget 2003* HC 500 April 2003 pp 112-5.

[33] "ISA campaign stepped up", *Financial Times*, 8 November 2003

[34] HC Deb 27 March 2003 cc 447-8

> **Lord McIntosh of Haringey:** The removal of the ISA and PEP payable tax credit is part of a package of reforms of the corporation tax system announced by the Chancellor of the Exchequer in his July 1997 Budget. This package included reductions in the rate of main corporation tax and small companies tax. After 5 April 2004, PEP and ISA investors will still pay no income tax on their investment returns or capital gains tax on any long-term capital appreciation.[35]

No further announcement on this issue has been made to date.[36]

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[35] HL Deb 4 November 2003 cc 94-5WA

[36] No mention was made of maintaining the credit in the *Pre-Budget Report* in December 2003 (Cm 6402 para 5.69).