

**TAX POLICY IN THE UK:  
AN EXAMINATION OF THE IMPLICATIONS OF BETTING TAX REFORMS FOR THE  
TAXATION OF UK EQUITY MARKETS.**

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**ABSTRACT**

In October, 2001, the UK Government abolished the tax on betting turnover which had existed since 1966 and replaced it with a tax on the gross profits of bookmakers. This paper examines the theoretical justification for this change, and investigates the effect of the change on Government revenue and on betting turnover. Implications of this tax change are considered with respect to financial markets more generally.

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**I. THE REFORM OF BETTING TAXATION IN THE UK: BACKGROUND**

The taxation of bookmakers was introduced in the UK in 1966, at a rate of 2.5% of turnover, and was increased to 5% eighteen months later. Although this was reduced by a percentage point in 1972, it continued to climb until it reached a peak of 8% before being trimmed back to 7.75% in 1992 and to 6.75% in 1996. The 1996 reduction was ostensibly in response to the introduction of the National Lottery, which was viewed as a danger to 'street-corner' betting establishments. Another critical change occurred in 1987, when the tax on wagers placed at the racetrack was abolished.

Deductions faced by bettors were generally levied by bookmakers at a higher rate than the betting tax rate, normally at 10% when the general rate was 8%, and 9% when it was 6.75%. The bookmaking establishments asserted that this premium was charged to cover payments to the Levy Board for managing the horse-racing segment, and also handling charges such as non-recoverable sales taxes in the form of VAT ('Value Added Tax').

The threat to the UK bookmaking sector from the National Lottery was exacerbated in the late 1990s by the growing use of home personal computers and the Internet for entertainment. The new technology led to the rise of on-line gambling, which posed a serious threat to the competitive position of 'bricks and mortar' gambling establishments.

In response to these pressures, the UK government instituted a radical reform of the taxation structure of UK bookmaking, switching from a tax on turnover (gross revenue) to a tax on 'gross profits' (net revenue), i.e. gross revenue from bettors minus payout to bettors. This reform was accompanied by a commitment from the major UK bookmakers to close down and repatriate to the UK all of their offshore operations, and to abolish deductions on bets placed with them. Specifically, the reform involved a switch from a tax on revenue, of 6.75 per cent, to a tax on the gross profits of bookmakers of 15 per cent. This switch represented about a halving of the effective rate of taxation faced by bookmakers.

A key economic rationale for the policy change is that a Gross Profits Tax (GPT) is generally more efficient than a revenue tax. Notably, the former is levied on price, whereas a revenue tax is levied on quantity. Consequently, a GPT provides firms with an incentive to reduce their margins and to concentrate on a low-price, high-revenue strategy, instead of a high-price, low-revenue strategy.

Economic theory predicts that this will result in a lower tax burden in sectors such as online betting, which are extremely competitive and thus have relatively low profit margins. Thus, a shift to GPT is expected to enhance the ability of British bookmakers to compete in a rapidly changing technological and global environment.

To summarize, the British government identified several challenges to the onshore British bookmaking industry, and therefore its own medium and long-term betting tax revenue base, from untaxed offshore competition and technological change. In response to this, a radical new betting tax structure was introduced in 2001, based on margins rather than turnover, designed to allow on-shore bookmakers to compete more effectively with off-shore rivals. The Gross Profits Tax was extended to pools duty in April 2002 and bingo duty in October 2003.

HM Customs and Excise (2003) published a review of the introduction of Gross Profits Tax – 'Report on the Evaluation of the Gross Profits Tax on Betting'. In that report, they concluded that the reform had been successful, and that in particular industry turnover had increased, although margins are now smaller - partly as a special consequence of the large-scale introduction of low-margin betting machines ('Fixed Odds Betting Terminals') into betting offices. The main impacts of the reform, summarized by the National Audit Office (2005) have been increased turnover (since the introduction of Gross Profits Tax stakes on betting quadrupled, from £7.1 billion in 2000-01 to £32.2 billion in 2003-04) and more choice for consumers.

The National Audit Office note also that most businesses and operations, including the biggest players, notably Ladbrokes, William Hill and Coral Racing, have repatriated their offshore businesses and thereby secured additional employment and business tax revenues within the UK. HM Customs & Excise predicted, prior to the 2001 tax reforms, that if no change was made to the structure or rates of betting taxation between a half and a third of the UK betting market would be lost to offshore operators (NAO, 2005, p.15).

Although general betting duty receipts fell in the immediate aftermath of the effective halving of the tax incidence, from £487m in 2000-01 to £304m in 2002-03, it began to rise thereafter, to £383m in 2003-04 (NAO, 2005). A comparison of the receipts between 2001 and 2004 shows that the latest figures are little changed from the earlier figures (2001- £474m; 2002- £291m; 2003 - £359m; 2004- £437m).

“...Customs considers that it is likely that revenue reduction under the old regime would have exceeded the decline recorded had no change been made as more and more businesses would have moved overseas.” (NAO, 2005, p. 18).

Given that the tax change was announced in April 2001, and that many betting companies reduced their rate of deductions in advance of the change, the temporary effect may be evident prior to October of this year. Indeed, there is evidence that the impact of the tax change implemented in October 2001 began to register five months before the actual implementation of the tax changes.

Overall, NAO (2005) provides an estimate that the total amount staked on all gambling in the UK rose from £27 billion in 2000-01 to £53 billion in 2003-04. Stakes less winnings paid out to bettors grew 20% from £6.9 billion in 1999-2000 to £8.28 billion in 2003-04.

## II. BETTING TAX: THEORETICAL ANALYSIS

In order to explore the effects of turnover and gross profit taxes, a formal theoretical model of the betting industry is proposed here. First, consider an industry characterised by an unspecified degree of monopoly power. The industry demand curve is given by  $Q = f(P)$  where  $Q$  is quantity and  $P$  is price.  $P$  is given by the proportion of a £1 stake that is retained by the bookmakers ( $0 \leq P \leq 1$ ) and  $Q$  is the number of £1 bets placed - in other words, the total turnover in the industry. The inverse demand curve is given by  $P = f^{-1}(Q)$ . Marginal costs are given by  $MC = g(Q)$ . In the absence of any tax, the equilibrium output,  $Q^*$ , will be at the point where the industry marginal revenue is equal to marginal cost. The equilibrium price,  $P^*$ , is then given by the inverse demand curve.

In this characterisation, a turnover tax is levied on  $Q$ , whilst a ‘Gross Profit Tax’ (GPT) would be levied on  $P$ . The impact of each tax on the model is as follows:

If a turnover tax is levied at a rate  $t$ , the industry demand curve is unchanged, but the marginal cost function is increased to:

$$MC = g(Q) + t.$$

Tax revenue,  $T_t$ , is given by:

$$T_t = t \times Q_t^*$$

If a GPT is levied at a rate  $r$ , the demand curve now becomes  $Q = f[P/(1-r)]$  and the inverse function is:

$$P = f^{-1}(Q) \times (1-r)$$

where  $P$  is the price received by the industry.

Equilibrium output,  $Q_r^*$ , is at  $MC = MR$  and the price paid by consumers,  $P_r^*$ , is determined according to the original inverse demand function. Tax revenue,  $T_r$ , is given by:

$$T_r = P_r^* \times Q_r^* \times r$$

The equilibrium of the model depends on the form of the industry demand curve and the extent of monopoly power in the industry.

For purposes of illustration assume a linear inverse demand function as follows:

$$P = a - bQ \quad \text{where } a \geq 1$$

Marginal costs are assumed to be constant (at least over the relevant region) and equal to  $c$ . The marginal revenue schedule will depend on the extent of monopoly power within the industry. Specifically, defining  $x$  as a coefficient of monopoly power, a general expression for marginal revenue is:

$$MR = a - 2bx \quad \text{where } 1 \leq x \leq 2$$

A value for  $x$  of two implies a pure monopoly, whilst  $x = 1$  implies perfect competition.

Setting MR equal to MC, gives

$$Q^* = (a - c)/(2bx) \quad \text{and} \quad P^* = [a(x - 1) + c]/x$$

With a turnover tax at rate  $t$  we get

$$Q_t^* = (a - c - t)/(2bx)$$

and

$$P_t^* = [a(x - 1) + c + t]/x$$

With a GPT at rate  $r$ , marginal revenue is:

$$MR = (1 - r)(a - 2bx)$$

Equilibrium price and quantity are now:

$$Q_r^* = [(1 - r)a - c]/[2bx(1 - r)]$$

and

$$P_r^* = [a(1 - r)(x - 1) + c]/[x(1 - r)]$$

It follows that price and quantity are unchanged only for the case in which we assume there to be no monopoly power at all (that is,  $x = 1$ ). For any other value of  $x$ , equilibrium price and quantity changes when we move between revenue equivalent tax regimes.

The result is quite general from the model. In the presence of at least some monopoly power, a revenue-equivalent GPT will lead to a lower price and higher output. In economic terms, allocative efficiency is increased and welfare (or deadweight) losses are reduced. The greater the level of monopoly power, the greater will be the efficiency benefits of a gross profits tax, but in any case, a revenue-equivalent GPT is always at least as efficient as a turnover tax. The intuition behind this is that a GPT is levied on price whereas the current tax is levied on turnover. Consequently such a tax provides an incentive for firms to follow a low-margin/high-turnover strategy rather than the low-turnover/high-margin strategy encouraged by a turnover tax.

Thus, the efficiency implications of the policy shift to a GPT reduce to a standard comparison of commodity and ad valorem taxes. In these terms, the logic derived above indicates that a revenue equivalent ad valorem tax will result in lower prices and higher turnover in equilibrium than will a commodity tax.

The intuition behind this result is that an ad valorem tax (such as the GST) provides an incentive for firms that have some market power to adopt a low-margin/high-turnover strategy. This is in contrast to a low-turnover/high-margin strategy, which they are likely to adopt in the aftermath of implementation of a commodity tax (e.g., a standard tax on betting stakes).

In fact, the result that ad valorem taxes are welfare superior to commodity taxes generalises to a wide range of oligopoly markets in which this restriction does not apply (see, for example Skeath and Trandel, 1994; Delipalla and Keen, 1992). Further, empirical support for this hypothesis is provided in several studies of cigarette taxes in the U.S. and Europe, markets which are also likely to be characterised by inelastic demand. For example, Barzel (1976) and Johnson (1978) report that commodity taxes have a greater impact on cigarette prices in the U.S. than ad valorem taxes. This result was confirmed by Delipalla and O'Donnell (2001), using data from twelve European countries over sixteen years.

In summary, the available theoretical and empirical evidence suggests that a shift towards taxing net revenue, rather than gross stakes, will have a neutral impact, at worst, on allocative efficiency and economic welfare. The greater the level of monopoly power in the industry, the greater will be the relative efficiency benefits of the GPT.

To conclude, a GPT has considerable advantages over a turnover tax from the standpoint of economic efficiency. By construction a GPT is levied on *price* whereas turnover taxes are levied on *quantity*. Intuition suggests that the former provides firms with an incentive to concentrate on a low-price, high-turnover strategy, whilst the latter encourages a high-price, low-turnover strategy. The formal model introduced earlier confirms that, assuming the existence of some monopoly power, the equilibrium price will be lower and turnover higher under a revenue equivalent GPT. In economic terms, this suggests that a GPT is an allocatively more efficient and less distortionary means of taxing betting than a turnover tax.

### III. STAMP DUTY ON SHARE TRANSACTIONS

Stamp duty is a tax on share transactions in UK incorporated companies, payable whether or not the transaction takes place in the UK, and whether or not either party to the transaction is resident in the UK. It is not, however, chargeable on securities issued by companies incorporated overseas. Share transfers are normally charged at 0.5% of the price, unchanged since 1986, with no threshold, raising about £3 billion per year.

In key respects, this duty bears close similarities to the tax structure for betting prior to October 2001. Most pertinently, both taxes are taxes on turnover and act, under reasonable assumptions, to reduce efficiency in their respective markets. Moreover, both create inherent biases towards overseas rather than UK ownership. In the case of stamp duty, it is also likely to produce an associated downward impact on share prices. In the case of betting markets, the turnover tax was abolished in 2001, and replaced with a tax on the gross profits (net revenue) of bookmakers, thereby replacing a tax on the quantity of betting with a tax on the price of betting. This led to very significant increases in turnover, lower margins and greater market efficiency.

Stamp duty is chargeable on the purchase price of a share where there is a legal instrument of transfer. However, stamp duty depends upon there being a document which can be stamped, and is not therefore designed to deal with paperless transactions. There is also a stamp duty reserve tax (SDRT), therefore, on paperless transactions, introduced in 1986, and updated in 1996 to cater for electronic transfers, notably imposing an obligation on the operator of any Treasury approved electronic transfer system to collect SDRT on transfers going through that system. This is also charged at 0.5% on the amount or value of the consideration given for the transfer. A special rate of stamp duty at 1.5% was also introduced in 1986, in relation to the issue or transfer of securities into depository receipt schemes and clearance services. These are arrangements under which the shares themselves are held by a depository or nominee and interest in them are traded by investors. Trades in these derivative products (usually in the form of depository receipts) do not require a change in the registered ownership of the underlying shares and therefore would, without a special charge, evade stamp duty altogether. The 1.5% charge can therefore be viewed as kind of 'season ticket' or 'exit charge' levied on shares that are moving into an environment in which subsequent transfers of the receipts are not themselves liable.

Changes in stamp duty revenue can be caused by changes in share prices, quantities and turnover. As such, stamp duty revenues are sensitive to changes in any of these factors. This is an important issue in terms of sustainability of revenue, but just as critical are the implications of a chosen tax structure for economic efficiency and equity.

A simple but useful definition of a more efficient tax is one which helps direct resources to where they can be allocated to their best use. More generally, the shift from a tax on quantity to a tax on price serves to encourage the allocation of resources towards a low-price, high-turnover strategy compared to a high-price, low-turnover strategy. A simple but useful definition of an equitable tax is one which is 'fair' in terms of how and those on whom it is levied. In terms of the tax on betting considered above, a turnover tax was sub-optimal under reasonable assumptions compared to a tax on margins (a Gross Profits Tax), essentially because it tended to result in lower turnover and higher effective prices to consumers (and was hence less efficient than a GPT), and also because the turnover tax (unlike the gross profits tax) provided no direct link between a company's ability to pay (its gross profits) and the tax burden levied on that company.

Stamp duty on share transactions bears some similarities with the tax structure facing the betting industry prior to October, 2001. In particular, as a charge levied on transactions stamp duty might be expected to depress the rate of turnover in UK shares, which is in turn likely to have a depressing impact on the efficiency with which capital is allocated to companies, i.e. the allocation of resources to their most productive use. This is likely to be particularly burdensome in that stamp duty at 0.5% makes up a significant fraction of total

transactions costs, including for example commission and the spread. In summary, the overall effect is a tendency to reduce the return from, and market liquidity in, UK equities.

Economic theory also suggests that the price of UK shares in equilibrium should, other things equal, equal the post-tax return on other assets. For this reason, a transactions duty such as a stamp duty is likely to have the effect of reducing the level of share prices by an amount equal to the present value of the stamp duty payable on all future share transactions. There is also an equity consideration, in that stamp duty is likely to have a greater proportionate effect on turnover the lower relatively are other transactions costs, with differential impacts on different types of investors.

#### IV. Stamp Duty: Theoretical Analysis

Standard economic theory predicts that the equilibrium price of a share should be equal to the expected present discounted value of future distributions after all taxes. A basic model is provided in Bond, Hawkins and Klemm (2004) which considers the special case where the dividend per share grows at a constant rate  $g$ , the discount rate  $r$  is constant. Here, the price  $P$  is given in the absence of transactions taxes by:

$$P = D/(1+r) + D(1+g)/(1+r)^2 + D(1+g)^2 / (1+r)^3 + \dots = D/(r-g)$$

- where  $D$  is the dividend per share paid at the end of the current period, and  $r-g$  is the dividend yield.

Assuming a rate of stamp duty,  $s$ , and a fixed number of transactions per period,  $t$ , the price  $P$  in the presence of stamp duty becomes:

$$P = D-stP/(1+r) + (D-stP)/(1+g)/(1+r)^2 + (D-stP)/(1+g)^2 / (1+r)^3 + \dots = D-stP/r-g = D/(r-g+st).$$

The impact on price implied by an unanticipated change in the rate of stamp duty,  $s$  to  $s'$ , assuming no effect on turnover, the discount rate or the growth of dividends, is given by:

$$(P' - P)/P = (s-s')t/(r-g+s't)$$

If stamp duty is abolished ( $s' = 0$ ),

$$(P' - P)/P = s(t/r-g),$$

- in which case the turnover assumption becomes redundant.

Essentially, the greater the reduction in the rate of stamp duty the greater is the predicted increase in the share price, other things equal, assuming that the turnover rate increases less than proportionately as the rate of stamp duty is reduced. Any increase in turnover will also serve at least in part to offset the rate cut, so that a cut in stamp duty by a 10%, for example, would reduce yield by less than 10%, even ignoring any extra tax raised as a result of a rise in share prices.

Another perspective on the efficiency of a particular capital tax is through its effect on the cost of capital. For a stamp duty, the effective average tax rate decreases as the underlying profitability of the potential investment project increases. This is in contrast to a corporation tax, where the tax rate increases as underlying profitability increases. Thus a corporation tax imposes higher tax rates than stamp duty on more profitable investment projects, while a stamp duty places lower tax rates on these projects. This implies that, for a given level of revenue, a stamp duty imposes a higher effective tax rate on marginal investment projects than a corporation tax. We assume here that both stamp duty and corporation tax are being levied on the same tax base. Because stamp duty has no investment allowances, it will also tend to impose a disproportionate burden on marginal investment projects compared to, say a corporation tax.

It can be argued that at least some of the desired impact on the financial asset prices can be achieved before the actual change and associated loss in Stamp Duty revenues, the extent of this being dependent upon the

degree of credibility with which the government's announcement is perceived by market agents, both investors and companies.

In terms of the government's tax revenues, the effect of the abolition of Stamp Duty on share transactions would be a tendency to increase fixed investment, leading to higher GDP and associated tax-take. In addition, there should be an indirect impact, via increased productivity and competitiveness, and a one-off increase in Capital Gains Tax receipts.

In terms of corporate control, what matters in efficiency terms is the impact of the tax on the realization of the merger or acquisition. The key issue here is that the current system encourages foreign takeover of UK firms since (as it is incorporated overseas) it only has to pay a one-off charge on the entire share capital of the UK firm, which is below the present value of the stamp duty saved. A UK takeover of a foreign firm is subject to opposite influences. For these reasons, there is likely to be a distorting effect on the pattern of ownership and control of UK firms. This could potentially take the form of emigration of UK incorporated companies.

In summary, stamp duty under reasonable assumptions imposes in terms of efficiency a sub-optimal tax structure for the stock market for UK listed companies, as did the betting tax structure which existed prior to October 2001 on betting companies. They are both taxes on turnover. Like the former betting tax regime, it also tends to encourage overseas rather than UK ownership, as part of the broader picture of avoidance-encouragement. The ways in which a Stamp Duty encourages investors to pursue an avoidance strategy range from a reduction in the total volume of trading to a splitting of trading into different markets, most notably OTC (and other 'Off-Exchange') derivatives and spread betting. The effect may be to reduce transparency and increase the incidence, and/or severity of, extreme price movements.

## **V. ALTERNATIVES TO STAMP DUTY**

Hawkins and McCrae (2002) mention five possible alternatives to stamp duty. These will be considered in turn.

### **1. Wealth tax.**

A wealth tax might be charged on the average value of a share over a given period, and changes in such, unrelated to actual trading in the share. Ignoring any implementation costs and difficulties, such a tax would have an advantage over a Stamp Duty in that it would not have a negative impact on the volume of transactions or on market liquidity. It does not resolve other distortionary effects of Stamp Duty, however, notably on merger and acquisition activity. In particular, a wealth tax would be chargeable on investments in UK companies by UK residents, but is not chargeable if these residents decided to invest in an overseas company, even if the majority of the company's activities take place in the UK.

### **2. Exemption for merger and acquisition activity.**

There is currently a 1.5% stamp duty charge on issue of depositary receipts, which has a clear impact on a UK company which acquires an overseas company and compensates the original shareholders through the issue of depositary receipts backed by shares in the new UK-based group. Exempting these receipts from the charge would ensure that the equity of overseas shareholders is not open to UK stamp duty. This would in principle address one of the issues creating a current bias towards overseas incorporation, although it is unclear in theory what would be the relative impacts on UK equity turnover and levels of avoidance of abolishing this particular distortion as against implementing a revenue-equal cut in the general rate of stamp duty.

### **3. Buying out the present value of future stamp duty revenues**

This alternative takes the form of the Government capitalising the value of future tax payments into a single payment to Government. This could be made compulsory or voluntary. If compulsory, there is a potential danger in the effect on company cash flows which could prove problematic to its practical implementation; if voluntary, it might have to be set at a level significantly below the expected present value of future tax liabilities, partly because of the signal such an announcement might give that the burden of stamp duty was likely to fall in any case. Assuming the immediate practical difficulties of implementation can be resolved, such an alternative would ultimately prove less distortionary than the current system of continuing Stamp Duty, and

after the transition period tend to increase share prices and UK equity turnover, and clearly to reduce levels of avoidance.

#### 4. Replacement with income tax.

Replacement with a general increase in personal taxation, including income taxation, would have a less distortionary impact on financial transactions, and is likely therefore to lead to an increase in share prices and UK equity turnover. It is unclear, however, how equitable could be considered a tax levied outside the financial sector to meet the cost of any reduction in the burden of Stamp Duty.

#### 5. Replacement with corporation tax.

A movement away from Stamp Duty to a corporation tax has parallels with the movement away from the turnover tax on betting to that of a Gross Profits Tax in October, 2001. In particular, the gross profits tax is a tax levied on the profit earned by the bookmaker on the basis of his transactions, and as such is a tax on profit, or margin, as opposed to quantity. The tax change led to a significant increase in turnover (see above) and gross profits, led to a significant growth in lower-margin activity, and significantly reduced avoidance and led to a marked movement of operations on-shore from overseas. In economic terms, the movement from a turnover tax to a Gross Profits Tax has generated less market distortion and greater efficiency and liquidity. Likewise, economic theory suggests that a movement away from Stamp Duty to corporation tax has a tendency to increase efficiency, notably through reduced distortion to merger and acquisition activity and greater liquidity of the main market in shares of UK incorporated companies. The increased turnover has served in the case of betting markets to offset in large part the immediate impact on tax revenue. Likewise, any increase in turnover generated by the movement to corporation tax is likely to help limit any revenue cost of the change.

### **VI. SUMMARY AND CONCLUSIONS**

In the 2001 Budget, the Chancellor of the Exchequer announced a change to the structure of the taxation of betting in the UK. The change was from a tax on betting turnover to a tax on the margins or 'gross profits' of bookmakers, i.e. the difference between bookmakers' receipts from bettors and the amount paid out to bettors.

Subsequent reports by HM Customs & Excise and the National Audit Office have concluded that tax reform had been successful, and that in particular industry turnover has increased significantly, and that there has been a significant repatriation on-shore of overseas bookmaking operations.

This evidence is in line with a theoretical modeling of the taxation of betting, which shows that under reasonable assumptions a shift from a tax on turnover to a tax on margins leads to greater allocative efficiency, more economic welfare, and will lead to increased output and lower prices. In economic terms, this suggests that a GPT is a less distortionary means of taxing betting than a turnover tax.

Indeed, a convenient assessment of the effectiveness of a new tax policy is its performance with respect to four key criteria - efficiency, fairness, international competitiveness, and the maintenance and sustainability of government revenue.

In terms of efficiency, a switch to a 'Gross Profits Tax' from a turnover tax represents an improvement under reasonable assumptions because it encourages a low-price, high-turnover strategy instead of a high-price, low-turnover strategy. This is because a GPT is by construction levied on price whereas turnover taxes are levied on quantity. In terms of international competitiveness, economic theory predicts that a 'Gross Profits Tax' will result in a lower tax burden in sectors such as online betting, which are extremely competitive and thus have relatively low profit margins. A shift to GPT enhances, therefore, the ability of British bookmakers to compete in a rapidly changing technological and global environment, as well as encouraging the big operators to repatriate their offshore businesses, thereby also securing additional employment within the UK. This also seems to meet the criterion of 'fairness' in that those who earn a greater level of gross profits pay more tax and vice-versa, a tax base which would seem more equitable than linking tax to a measure such as turnover. In terms of the maintenance and sustainability of government revenue, it is possible to argue from economic theory that government revenue may be less stable and predictable with a GPT than with a turnover tax, insofar as gross profits may be less stable and predictable than turnover. Even if this were the case in the short-term, by removing some of the risk from industry and enabling it to compete more effectively with overseas competition, a GPT may protect long-term tax revenue. In fact, the available evidence indicates that the tax base has been secured by the

move to GPT insofar as it is reasonable to conclude that revenue reduction under the new tax system is less than would have occurred had no change been made, in part because more businesses would have moved overseas and overseas-based business by the big bookmakers would not have been repatriated.

Stamp duty on share transactions can be argued to have clear parallels with the turnover tax on betting which pre-existed the switch to a Gross Profits Tax in 2001, notably in that it is a tax on turnover, and is sub-optimal in terms of allocative efficiency. Moreover, it creates an inherent bias towards overseas rather than UK ownership, and is likely to depress turnover as compared to a tax less firmly or exclusively based on quantity. There are also parallels in its impact on avoidance and implications for the sustainability of Government tax revenue.

Alternatives to the current stamp duty regime include a wealth tax, charged on the average value of a share over a given period, and changes in such, an exemption from charges on merger and acquisition activity, notably by a UK company of an overseas company; a one-off conversion charge based around the present value of future stamp duty revenues; and a switch to corporation tax.

Each of the alternatives to stamp duty has potential difficulties of its own. Even so, a movement towards replacing stamp duty with a wealth or a corporation tax has clear parallels with the switch from a turnover tax on betting to a tax on the gross profits of bookmakers in October, 2001. In particular, economic theory suggests that the switch from a turnover tax to a Gross Profits Tax generates less market distortion and greater efficiency and liquidity, and practical experience has borne out the key theoretical predictions. Likewise, economic theory suggests that a movement away from Stamp Duty may have a tendency to increase efficiency, notably through reduced distortion to merger and acquisition activity and greater liquidity of the main market in shares of UK incorporated companies.

On the basis of this theory and evidence now available with respect to the tax changes to betting introduced in 2001, there would therefore seem to be a prima facie case for further investigation into the implications of Stamp Duty on share transactions for the structure and efficiency of UK equity markets.

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