

CONFIDENTIAL



FROM: E KWIECINSKI

DATE: 1 February 1983

NOTE OF A MEETING HELD AT H M TREASURY, 10.30am, 31 JANUARY 1983

Present at meeting: Financial Secretary  
Mr Munro/IR  
Mr French  
Mr F Martin

- 1) LIFE ASSURANCE: QUALIFYING POLICIES: INDEX LINKED PREMIUMS
- 2) SINGLE PREMIUM BONDS

The meeting had before it Mr Munro's submission of 25 January.

The Financial Secretary opened the discussion by commenting that given the Government's encouragement of such things as indexed gilts it seemed to make sense to permit private sector bodies to deal in indexed transactions.

Mr Munro commented that the Revenue had no objections in principle to the proposal put forward by the Life Offices Association. But there would be problems if one were to extend the provisions to allow the indexation of purchased life annuities and policies covered by the chargeable events legislation. Also the LOA had not demonstrated that there would be much of a demand for such policies, the same effect could be achieved by present policy holders exercising increased cover options on life cover only policies. Indexed premium policies would be more convenient and would probably allow an element of investment to be brought into the policies.

The Financial Secretary wondered whether the only reasons for not doing this were the length of the legislation (possibly 3 to 4 pages) and the fact that time was a bit short.

Mr Munro commented that there were other considerations. Such a measure would further entrench LAPR in the tax system. And depending on take up the provision could build up to a substantial cost to the Exchequer. Also it would be seen as setting a precedent for more general indexation provisions in the tax system.

In summing up the discussion the Financial Secretary commented:-

- 1) In principle he did not object to the idea of indexed linked premiums, (subject to any decisions on the future of LAPR).
- 2) But as there was no apparent urgency involved and the legislation would be lengthy, he did not think it was something for this year's Finance Bill.
- 3) The Revenue should write to the LOA informing them that Ministers had considered the matter and had no objections to their proposals <sup>in</sup> /principle, but that it was too late to do anything this year.

#### SINGLE PREMIUM BONDS

There was a brief discussion on the 1975 legislation on Single premium bonds.

The Financial Secretary was concerned at the charge which had been made in several letters to him that this Government's legislation on Second-hand bonds was much stricter than the Labour Government's legislation on single premium bonds.

Mr Munro commented that the Industry was much less sophisticated in 1975 than now, and that abuse through second-hand bonds was on a much larger scale. Having said that the best rejoinder to the charge of overt strictness this time was that the 1975 legislation had been too generous. It allowed profits to be siphoned from single premium bonds in the form of tax free loans, in the same way as with secondhand bonds, but in the latter case the problem was much more serious.

The Financial Secretary asked Mr Munro to send him a draft letter which could be used as a standard to refute the charges made by those making unfavourable comparisons between the 1975 and the proposed 1983 legislation.

  
E KWIECINSKI

Circulation:

Those Present

PS/Chancellor

PS/CST

PS/MST(R)

Mr Robson

PS/IR

CONFIDENTIAL



FROM: M E DONNELLY  
DATE: 1 February 1983

MR BROADBENT

cc Chancellor  
Chief Secretary  
Economic Secretary  
Minister of State (C)  
Minister of State (R)  
Sir D Wass  
Mr Bailey  
Mr Burgner  
Mr Morgan

ASSOCIATED BRITISH PORTS HOLDINGS

This note is to confirm the result of our telephone conversations during the course of this morning.

You informed me that Schrodgers had agreed a price of 112 pence per share with the underwriters. This was the maximum price within the range provisionally agreed at Friday's pricing meeting with the Secretary of State for Transport.

I informed you that the Financial Secretary was content for the sale to go ahead on the basis of a price of 112 pence per share. This is to be confirmed at 8.30am on 2 February.

*MED*  
M E DONNELLY



FROM: FINANCIAL SECRETARY  
DATE: 1 February 1983

CHANCELLOR

cc Chief Secretary  
Economic Secretary  
Minister of State (C)  
Minister of State (R)  
Mr French

REVIVING THE PRIVATE RENTED HOUSING SECTOR

I would like to add a further thought to my minute of 19 January on this subject. It is a purely political one.

In the last three constituency cases which I have dealt with where landlords have suffered grievous loss and frustration through the Rent Act, I have responded with the argument that Labour have cast a blight over repeal of the Acts, which is why we cannot do it. The landlords all think that this is a pathetic argument. Why not do it anyway they reply and let the landlords assess the risk of continuing to let! And indeed on this basis we will never repeal the Rent Acts, because however feeble Labour may seem there would always be the chance that they might win an election.

Moreover if we had adopted this attitude we would never have privatised nationalised industries, reduced the higher rates of tax, or "drawn the teeth" of CTT. (Though perhaps we have not done the latter. It would cost us £165 million to get back to the Healey 1974 position on CTT).

So we really must put in our manifesto - and do at the first chance after the election - the civilising of the Rent Acts. The excuses we have for not having done this so far looks threadbare. I fear it is another DOE failure to put alongside rates, LA over-spending, and Mr Livingstone.

NICHOLAS RIDLEY

BUDGET CONFIDENTIAL



FROM: E KWIECINSKI  
DATE: 1 February 1983

PS/CHIEF SECRETARY

cc PS/Chancellor  
PS/Economic Secretary  
PS/Minister of State (C)  
PS/Minister of State (R)  
Sir D Wass  
Mr Middleton  
Mr Kemp  
Mr Moore  
Mr Griffiths  
Mr Robson  
Mr French  
PS/C&E  
PS/IR

NCVO FISCAL WORKING PARTY REPORT 1982

The Financial Secretary has seen Miss O'Mara's minute of 31 January.

He agrees with the Chancellor that a number of the items should be considered in the context of the proposed "caring package" in the Budget.

The Financial Secretary suggests that items 3.2, 3.3, 3.5 and 5 in the NCVO report would seem to be <sup>comparatively</sup> easy to do and are worthy of fuller consideration.

*EW*  
E KWIECINSKI

1 February 1983

RESTRICTED



FROM: M E DONNELLY

DATE: 1 February 1983

MRS HEDLEY-MILLER

cc PS/Chancellor  
Mr Littler  
Mr Unwin  
Miss Court  
Mr Edwards

Mr Hancock - Cabinet Office

PS/Mr Hurd - FCO  
Mr Hannay - FCO

EC BUDGET - LETTER FROM NEIL BALFOUR MEP

The Financial Secretary has received the attached letter from Mr Balfour.

He has commented that this is a helpful letter. Mr Balfour's suggestion that the Government welcome this first move towards a Community Energy Policy in the 1983 Supplementary Budget has tactical advantages: and would certainly be a useful positive point for the Chancellor's 7 February press conference. But this would be going further than the Government has yet been prepared to commit itself; and the Secretary of State for Energy has expressed reservations about such a move.

The Financial Secretary would be grateful for advice, and a draft reply. He will of course be seeing Mr Balfour at the EDG Plenary Session in London tomorrow.

MED  
M E DONNELLY

From: Neil R. Balfour, M.E.P.



% 24 The Little Boltons  
London SW10 9LR.

## European Parliament

Tuesday 1st February '83

To: Financial Secretary  
Treasury.

Dear Nicholas -

Re: Community Budget Problem

I'm writing this in haste, as I know you will be impossible to take aside this pm, when you come to address the EDC and I want to put before you an idea which I think you may well be able to develop. [Incidentally, I mentioned it to Douglas Hurd yesterday at a meeting we had at the F.O. and I think he took it on board.]

① The Parliament is very keen to ensure that the 82/83 rebate NOT be treated as Our Money Back, but rather that it be given <sup>a</sup> [true Community look.

② The UK is presently completely naked in respect of its 1983 Contribution. It is



"uncovered" (as Douglas Hurd put it yesterday)  
for 1983, of which  $\frac{1}{2}$  has already gone,  
and for 1984 & beyond.

③ So why not call the Community's bluff  
(to the Parliament's) by going out of our  
way to make the presently proposed <sup>Special</sup> Energy  
measures a permanent, Community financed,  
Community Action or Policy? Insist that this  
will not be treated by H.M.G. as a 1982/83  
wonder, that it will not be seen as ~~as~~ a  
temporary measure, but rather as the  
beginning of a major new Community Initiative.

In this way, it seems to me, the E.C. will  
have to continue to make provision for this  
line in the future. By sending Nigel Lawson  
to report to a joint meeting of the Budgets &  
Energy Committees & by heralding this as  
a real Community dimension you will be able



(2.)

\* And with this in our pocket we could stop blocking (as I believe Michael Butler is advising HMGT to do) a NEVER AGAIN declaration by Council.

to shame the EC into converting what is at present an Ad Hoc measure into a permanent budget line!

It will tickle Davignon's fancy, because he gets a massive start to a Common Energy Policy — and his hands on a large whack of the budget.

It may look odd <sup>that</sup> for such a huge proportion of the EC Energy Policy should go to the one country which is the major producer of energy — but doesn't the CAP <sup>mostly</sup> get spent on the <sub>Country which is the</sub> largest producer of food?

I hope this may prove a fruitful line of discussion.

With all best wishes

Yrs. Neil.

I am bringing this round by hand this morning as I thought you should have this as soon as possible. Could your office please send me back

CONFIDENTIAL



FROM: M E DONNELLY  
DATE: 1 February 1983

MRS HEDLEY-MILLER

cc PPS  
Mr Littler  
Mr Unwin  
Miss Court  
Mr Edwards

EUROPEAN COMMUNITY. THE BUDGET PROBLEM: A POSSIBLE REAPPRAISAL OF TACTICS

The Financial Secretary was grateful for your note of 31 January covering Mr Hancock's draft paper.

He agrees with the general approach taken in Mr Hancock's paper; though he feels that it could spell out the timetable implications of decisions on longer term solutions more fully, showing clearly why further interim refunds will be necessary.

More generally the Financial Secretary has commented that the success of our tactics depends to a considerable extent on the public language we use about the Budget problem: we must try to sound more communautaire.

*MED*  
M E DONNELLY



FROM: M E DONNELLY

DATE: 1 February 1983

MR RIDLEY

cc Chancellor  
Mr Middleton

BRITOil AND THE METHODS OF DISPOSAL

The Financial Secretary has read your note of 24 January and Mr Rudd's comments on the Britoil flotation.

The Financial Secretary thinks that the problem with trying to apply the US system to the Britoil flotation would have been getting enough underwriters to form genuinely competing syndicates for such a huge issue. But he agrees that our system leaves much to be desired. It would be a good area for a professional external enquiry - a sort of mini Wilson Committee.

The Financial Secretary would like to discuss these issues further with yourself and Mr Middleton. This Office will be in touch to arrange a convenient time.

MED  
M E DONNELLY



FROM: M E DONNELLY  
DATE: 2 February 1983

MR BATTISHILL - IR

CORRESPONDENCE CASE KENNETH BAKER MP

The Financial Secretary is concerned about the questions raised by ... the attached correspondence case on the BSS. He has commented that this appears to be the sort of restriction which people see as pointless and which consequently creates bad feeling against the Revenue. The shares were fully paid up within the tax year. <sup>So</sup>there would seem a case for using some discretion in allowing the relief. He would be grateful if you would consider this in the context of the draft reply.

More generally the Financial Secretary would be grateful for your thoughts on this case in relation to the planned new provisions under the BES.

*ME*  
M E DONNELLY



Treasury Chambers, Parliament Street, SW1P 3AG

Kenneth Baker Esq MP

*Dear Kenneth*

... You wrote to me on 21 December enclosing this letter from your constituents Warner Bearman, Chartered Accountants, about the Business Start-Up Scheme. I am sorry that you have not had an earlier reply.

As you will recall, we introduced this generous new tax relief in 1981 to encourage individual investors to back new enterprises with which they are not connected. So it is a relief for outsiders, and we need to define who these are. There are two main rules: for the individual, he ceases to be an outsider when he owns more than 30 per cent of the issued ordinary share capital (there are some other variations); for the company as a whole, only 50 per cent of the issued ordinary share capital can qualify for relief.

In order to make the 50 per cent rule work fairly where investors subscribed for more than 50 per cent of the company's share capital, we need to ensure that claims are considered together. So relief is only given after the end of the year of assessment in which the shares are issued. But it is then given for that year. To avoid undue further complexity, we felt we had to restrict relief to shares that were fully paid-up. If we had not done so we would have needed further complex rules to cope with cases where different claimants had paid up differing amounts for similar shares in the same tax year, and also to deal with the case where subscriptions took place between different tax years. It would have been a difficult task to reconcile this with our objective of not giving relief before the company had actually received the money.

So the rule is that all shares must be fully paid-up. This was included in the Finance Bill as published on 3 April 1981, and the point was covered in an Inland Revenue Press Release on the same day - see the passage ... on page 5 of the copy attached. I am afraid therefore that I cannot agree with the contention of Warner Bearman that the legislation was in fact intended to give relief for partly paid-up shares. The intention of the legislation as approved by Parliament is quite plain. Accordingly, I do not see how the Inland Revenue could grant a concession which would run completely contrary to so clear an intention.

I have looked again at the point in the light of your comments, but I do not feel that the extra complexity necessary to deal with partly paid-up shares would be a particularly helpful addition to the legislation, nor likely in itself to attract further investment. If a company wishes to obtain investment qualifying for relief in defined slices, it can do this by issuing successive tranches of equity capital. And even if we were to change the rules, I am afraid that such a change would not be retrospective, and would therefore not help your constituents.

Although they have not obtained tax relief, nevertheless I wish your constituents well with their investment.

NICHOLAS RIDLEY



# INLAND REVENUE Press Release

INLAND REVENUE PRESS OFFICE, SOMERSET HOUSE, STRAND, LONDON WC2R 1LB  
PHONE: 01-438 6692 OR 6706

[3x]

3 April 1981

## BUSINESS START-UP SCHEME

1. In the course of his Budget Statement on 10 March 1981, the Chancellor of the Exchequer said:

"One of the biggest problems faced by people thinking of starting their own business is the difficulty of attracting sufficient risk capital to finance it during its critical early years. The amounts of additional money needed can be modest - at least as compared with the sums in which the big financial institutions commonly deal. But in individual cases they can be crucial. . . . I am, therefore, introducing an entirely new tax incentive to attract individual investors to back new enterprises. It is designed for the outside or minority investor in certain new small trading companies, as distinct from the owner of the business, his close family and associates. I am calling it the business start-up scheme".

Official Report 10 March 1981 col 781.

2. The detailed provisions for the business start-up scheme are provided by Clauses 50 to 63 of the Finance Bill, published today.

3. The main features of the scheme, as proposed in the Finance Bill, are:

- Relief will be based on the amounts which an individual subscribes for newly issued ordinary shares in new or recently formed companies.
- Relief will be given at the full marginal rate of income tax, including the investment income surcharge. It will be given on a total of up to £10,000 in any one year for shares issued to any one individual (subject to a de minimis exclusion of less than £1,000 invested in any one company).
- The relief will be given for additional investment by an "outside" investor. For this purpose, an "outside" shareholder may effectively own up to 30% of the company but he may not control it; and he may not be an employee or paid director of the company. More than one "outside" shareholder may claim relief for investment in any company; but relief

/will



will not be given on more than a total of 30% of the company's share capital. (Acting as a director will not, as such, disqualify a shareholder from claiming the new relief, provided that he does not draw fees from the company.)

- The investment must be for a genuine new business start-up. For this purpose, a "start-up" is defined to extend for the first 3 years of a company's business life; and it also includes the case where a self-employed man starts a business and subsequently (but within the initial 3 year period) incorporates. The relief is not available in respect of existing trades (more than 3 years old), or parts of existing trades, or for investment in new companies within a company group.
- To qualify for the relief, the company must exist to carry on one or more of certain genuine new qualifying trades. For this purpose, a qualifying trade is defined to exclude (broadly) dealing (including wholesale and retail distribution), leasing and financial activities and certain activities concerned with land (such as farming, forestry and other occupation of land on a commercial basis) which are "treated as" trades under special provisions in the Taxes Acts.
- The investment must be a bona fide commercial investment, for the purpose of a new qualifying trade, and not for reasons of tax avoidance.
- The investment must be maintained in the company for 5 years and, normally, the conditions satisfied to the end of that period. The investor does not have to wait until the end of the 5 years before he can claim relief; and may claim relief after the end of the year in which the shares are issued or (if later) after the company has been trading for a year.
- The scheme will run, in the first instance, for a period of 3 years, starting from 6 April 1981.

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For a synopsis of these features, see the NOTES FOR EDITORS on page 3.

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## NOTES FOR EDITORS

1. The Chancellor announced the business start-up scheme in his Budget Statement.
2. Its purpose is to encourage people to invest risk capital in new company trading enterprises.
3. The scheme will give relief from income tax on up to £10,000 subscribed for shares in a company in any one year.
4. The relief will be given at the individual's marginal rate of tax including the investment income surcharge.
5. The relief will be for an outside or minority investor in the shares of the company concerned.
6. The scheme will be for companies starting up a genuine new trade - and it will be available for the first 3 years of the trade. Certain kinds of trade are excluded.
7. The investment must be maintained in the business for at least 5 years.
8. There are rules to prevent the relief being used merely as a vehicle for tax avoidance.
9. The scheme will run for 3 years starting from 6 April 1981.

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DETAILS OF THE CLAUSES/

## DETAILS OF THE CLAUSES

CLAUSE 50 defines the relief.

Subsections (1), (2) and (3) provide that a taxpayer should get income tax relief, at his marginal rate, on the amount he subscribes for shares in a new qualifying company where the money is raised for a new qualifying trade. If the company has not begun trading, it must do so within 12 months.

Relief is given for the year in which the shares are issued, but not until after the end of the tax year in which the shares are issued, or if later, until the company has traded for 12 months; Subsections (3) and (4). The 12 month rule is eased if the company has had to go into liquidation before it has traded that long; (Subsection (6)). If after a claim has been allowed, the conditions cease to be satisfied within 5 years of the issue of the shares (the rest of the "relevant period"), the relief is withdrawn (Subsection (4) and (5)).

Subsection (7) settles the order in which the relief is given (after all personal allowances) and prevents relief being given in a PAYE coding. The relief is to be disregarded in calculating top slicing relief.

Subsection (8) provides for the year of assessment mentioned in the repayment supplement rules to be the year when relief may first be given, not the year for which the tax which is the subject of the relief was paid.

Subsection (9) provides that the new scheme should run for 3 years. Relief is given on shares issued in the year to 5 April 1982, 1983 or 1984.

CLAUSE 51 defines the limits of the relief.

Subsection (1) provides a "de minimis" rule - that relief will not be available for investments of less than £1,000 in any one company in any one year.

Subsection (2) provides that relief will be given on a maximum of £10,000 invested in any one year (whether in one or more than one company).

Subsection (3) introduces one of the main rules providing that relief is for additional investment by "outsiders" - rather than investment by proprietors in their own business. Relief may not be given on more than 30% of a company's share capital.

Subsections (4) to (7) provide for relief to be apportioned, where claims for a year would breach the 30% limit; for all interested parties to be heard on an appeal against an apportionment; and for all relief to be withdrawn if, exceptionally, a subsequent event causes the 30% limit to be breached.

CLAUSE 52 defines the "outside" investor qualifying for the relief - a UK resident individual subscribing on his own behalf and not connected with the company.

An individual is connected under Subsections (2) and (3) if he is an employee, or paid director of the company or of a company in partnership with the company, or a partner of the company: under Subsections (4) and (5), if he has more than 30% of the capital, including loan capital, or voting power: under Subsection (6) if he would be entitled to more than 30% of the assets in a winding up: and under Subsection (7) if he has effective control of the company.

Acting as a director will not, as such, disqualify a shareholder from relief, provided that he does not draw fees from the company.

As appropriate, the rights of an associate are attributed to an individual and what either is entitled to acquire is also taken into account. Subsection (8) contains rules about this. The existing definition of an "associate" is used, covering (broadly) close family and business partners.

Subsection (9) provides that these rules are not avoided by reciprocal arrangements.

CLAUSE 53 introduces the definition of a "business start-up" - "the new qualifying company".

Subsection (1) provides that it will continue to qualify as a "new" company for the first 3 years after it commences business.

Subsection (2) provides that the company must be resident in the UK and not resident elsewhere.

Subsection (3) provides that it must exist to carry on a new qualifying trade (defined in Clause 54).

Subsections (4) and (5) again provide safeguards for the case in which a company is wound up for bona fide reasons within the 5 year "relevant period".

||| Subsections (7) and (8) provide that the company must have only one class of share capital; the shares must be fully paid; and the company must be a single company unconnected with any other company.

CLAUSE 54 introduces the definition of a "new qualifying trade".

Subsections (2), (3) and (9) define what is meant by "qualifying" for this purpose. In particular, they exclude (broadly) dealing (including wholesale and retail distribution), leasing and financial activities and certain activities concerned with land (such as farming, forestry and other occupation of land on a commercial basis) which are "treated as" trades under special provisions in the Taxes Acts. They also exclude "hobby" trades - that is, those not carried on with a view to profit.

The remaining Subsections of Clause 54 define what is meant by a "new" trade. Subsection (4) provides that it must be a bona fide new venture. Subsection (5) provides nevertheless that a trade may continue to be treated as "new" for its first 3 years, even if (for example) it was carried on first as a self-employed business and subsequently by a company.

Subsections (6) to (8) are concerned with the situation where there is more than one trade essentially in the same line of business and under common ownership or control.

Take together, Subsections (4) to (8) provide (broadly) that a trade may be treated as a "new" trade for the purposes of the relief through the first 3 years of its existence; and that relief will not be available for an existing trade (more than 3 years old), or in certain special circumstances - for example, where such an existing trade may be reconstituted in a superficially changed form, or part of an existing trade may be set up as a new trade, or a single trade may be fragmented into a series of separate companies.

CLAUSE 55 provides rules for the occasion when a shareholder disposes of his shares within the 5 year "relevant period".

Subsection (1) provides that, where the shareholder sells the shares at an arm's length price, relief is withdrawn by reference to the amount which he receives for their sale. If he disposes of them by other than an arm's length bargain, the whole of the relief is withdrawn.

Subsection (2) provides for the occasion when the shareholder dies, without having disposed of the shares. In general, the relief is not withdrawn. However, relief is withdrawn in the case of the "death bed" purchase of shares 12 months or less before death.

Subsections (3) to (5) provide detailed rules for the identification of shares, where necessary on a disposal.

CLAUSE 56 provides for the case where a taxpayer subscribes for shares in a company, and then withdraws his capital in one form or another within the 5 year "relevant" period. Broadly, they provide that, where the transactions result in no net additional investment in the company, they do not yield an income tax advantage for the shareholder or a corporation tax advantage for the company.

Subsection (1) provides that relief will be withdrawn by reference to the amount which is effectively extracted from the company.

Subsections (2) and (3) define the various ways in which a shareholder may effectively withdraw funds from the company, directly or indirectly; and provide the necessary safeguards for the straightforward cases in which the shareholder merely receives the normal interest on a loan, normal dividend on his shareholding, or a normal commercial payment for goods supplied to the company; and Subsections (4) to (9) provide the detailed rules accordingly.

CLAUSE 57 provides further provisions against misuse.

Subsection (1) provides that relief will only be available if the shares are subscribed for and issued for bona fide commercial purposes, and not for tax avoidance.

Subsections (2) to (7) provide against further cases in which shareholders may extract capital in one form or another from the company; and, in particular, provide for the 30% limit (the rule limiting the scheme to "outside" equity investment) to operate effectively in this kind of situation.

CLAUSE 58 provides necessary practical adaptations in the case of married couples.

Subsections (1) to (4) provide for husband and wife to be treated as one: for the subscription of each to be relieved first against the income of the subscriber where separate assessment or wife's earnings election has been claimed: and for the 30% (Clause 51(3)) to be apportioned between them where necessary.

Disposals between husbands and wives, whilst they continue to live together, do not cause relief to be withdrawn; nor does a disposal on death to a surviving spouse (Subsections (5) and (7)).

Subsection (6) provides rules for the case where shares have not been transferred between husband and wife while living together, relief has been given to the partner who did not subscribe for the shares, the married couple separate or divorce and the subscriber then disposes of the shares. The relief is withdrawn from that individual.

CLAUSE 59 provides the detailed rules for making claims.

Subsection (1) provides that claims may be made after the end of the year when the shares are issued or (if later) the first 12 month's trading (Clause 50(3)(a) and (6)). There is a 2 year time limit for claiming.

Where more than one individual claims, the total claimed could exceed the relief available (because of the 30% rule in Clause 51(3)). Subsection (3) therefore provides for joint claims to be made (the 30% will then be apportioned under Clause 51(4)) and, where this is not done, for any potential claimant to be aware that a claim by someone else is being made.

Once claims have been allowed, if relief has been given on all the 30%, a later claimant will be unable to get relief unless (as Subsection (3) provides) any individual who has to give back some relief to accommodate him gives his consent.

The possibility that a claim for relief may later be allowed is not to be a ground for postponing payment of tax; and if the tax is not paid, interest is to run (Subsections (6) and (7)).

CLAUSE 60 contains rules regarding the withdrawal of relief should this prove necessary.

Where relief, though given, is later seen not to have been due, the taxpayer has in effect had a loan. Interest is therefore normally payable from the date the relief was given (Subsection (4)), but in certain circumstances not within his control, from a later date.

CLAUSE 61 contains information powers.

CLAUSE 62 provides for capital gains tax consequentials. The acquisition cost of the shares is reduced by the amount by which the individual's income was relieved, net of any relief withdrawn. Thus, for example, shares sold after the 5 year "relevant period" will be chargeable to capital gains tax on the basis that they had been acquired at a nil cost, and any loss on disposal will not be eligible (a second time) for income tax relief under Section 37 of the Finance Act 1980.

CLAUSE 63 is an interpretation Clause.

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FROM: M E DONNELLY  
DATE: 2 February 1983

MR EDWARDS

cc PS/Chancellor  
PS/Chief Secretary  
Sir D Wass  
Mr Littler  
Mr Unwin  
Mrs Hedley-Miller  
Miss Court

Mr Fitchew  
Mr Hall  
Mr Ingham  
Mr Peet  
Mr Towers  
Mr Ridley

BRUSSELS PRESS CONFERENCE: 7 FEBRUARY: SECOND DRAFT OF PREPARED STATEMENT

The Financial Secretary has read the second draft of this statement attached to your note of 1 February. He thinks it now reads very well.

The Financial Secretary had only two specific comments:

- in paragraph 6 classification of expenditure and the staging of grant payments are mentioned, but not really developed. Both these aspects could be referred to briefly later in the statement, if only to say that we broadly accept the European Parliament's views on them;
- the end of paragraph 14 is rather too technical and there is a danger that when translated into - say - Greek it may not be very comprehensible! If possible these points need to be spelt in extremely simple language.

Overall the Financial Secretary thinks that it may be helpful that the Commission's Green Paper will not have been published by 7 February, since it means we can keep our powder dry on that topic for another occasion.

MED  
M E DONNELLY



CONFIDENTIAL



FROM: M E DONNELLY  
DATE: 2 February 1983

PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary  
PS/Economic Secretary  
PS/Minister of State (C)  
PS/Minister of State (R)  
Sir D Wass  
Mr Bailey  
Mr Middleton  
Mr Kemp

SMALL FIRMS AND ENTERPRISE PACKAGE: MICHAEL GRYLLS MP

The Financial Secretary has seen your note of 26 January.

On the question of what should be said to Michael Grylls the Financial Secretary considers that after the Budget we should have a reasonable tale to tell on:

- i) the Business Expansion Scheme;
- ii) deep discount and zero coupon bonds;
- iii) the generally downward trend in interest rates over the last year.

Mr Grylls will certainly be keen on the BES, and our encouragements to the longer term commercial paper markets, and this should be enough. Subject to the Chancellor's views, he would not propose to approach Mr Grylls again before the Budget.

*MED*  
M E DONNELLY

CONFIDENTIAL



FROM: M E DONNELLY  
DATE: 3 February 1983

PS/CHANCELLOR

cc PS/Chief Secretary  
PS/Economic Secretary  
PS/Minister of State (C)  
PS/Minister of State (R)  
Sir D Wass  
Mr Bailey  
Mr Monger  
Mr Mountfield  
Mr Kemp  
Mr Lovell  
Mr Culpin  
Mr Gordon  
Mr Robson  
Mr Traynor  
Mr Ridley  
Mr French

THE BRADFORD ENTERPRISE ZONE EXPERIMENT

The Financial Secretary has seen Roger Bright's letter of 26 January on this subject, and the Chancellor's comments in Miss O'Mara's note of 31 January.

The Financial Secretary agrees with the Chancellor that these proposals deserve study. He has noted that the major proposal is for a cut of 25 per cent in the rates in the "whole of the Bradford Enterprise Zone". This is clear evidence of the importance of high industrial rates as a deterrent to business; and it is a healthy development that at least one Council singles this factor out.

*ME*  
M E DONNELLY



FROM: M E DONNELLY  
DATE: 2 February 1983

MR RIDLEY

cc PPS  
PS/Chief Secretary  
PS/Economic Secretary  
PS/Minister of State (C)  
PS/Minister of State (R)  
Mr Kemp  
Mr R Allen  
Mr Hall  
Mr French  
Mr Harris  
Mr M Dobbs - Dept of Employment  
Mr A Jay

BUDGET BROADCAST

The Financial Secretary has seen your note of 31 January and the comments from the Minister of State (R) and the Chief Secretary.

The Financial Secretary feels that having an element of confidence and hope will be very important in this year's broadcast. The line could be something like: the tax cuts in this Budget are a sign that the reward of three years' hard slog are beginning to come through - the changed attitudes of management and unions; inflation and interest rates down etc. Now is the time to go ahead and soundly-based expansion will provide the jobs we need. . .

MEJ  
M E DONNELLY

CONFIDENTIAL



FROM: M E DONNELLY  
DATE: 2 February 1983

PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary  
PS/Minister of State (R)  
Mr Middleton  
Mr Moore  
Mr Kemp  
Mr R Martin - IR  
PS/IR

EMPLOYEE SHAREHOLDING

The Financial Secretary has seen your note of 1 February.

The Financial Secretary is content to extend the instalments period for options outside approved schemes to 5 years. His initial suggestion of 4 years was simply to keep the cost down and he is delighted to be argued off this parsimony.

*MEJ*  
M E DONNELLY

CONFIDENTIAL



FROM: M E DONNELLY  
DATE: 2 February 1983

PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary  
PS/Economic Secretary  
PS/Minister of State (R)  
Mr Middleton  
Mr Moore  
Mr Monger  
Mr Robson  
Mr French  
Mr Isaac - IR

INLAND REVENUE: WORK PRIORITIES

We spoke about the Chancellor's initial views on the Financial Secretary's note of 28 January.

The Financial Secretary agrees that Pre-Budget Work (section A) and major items for before the Summer Recess (item B) are progressing satisfactorily. He is grateful to the Revenue for the constructive work currently being done on all these issues.

On items C and D - the more general post election areas for work - the Financial Secretary agrees that, particularly in view of the sensitivity of some of these subjects, substantive comments on work priorities etc would best be kept for the post-Budget period, when a Ministerial discussion of these priorities might usefully be held.

In the meantime the Financial Secretary would hope to pursue some individual issues on which work is currently under way as and when time permits.

*MED*  
M E DONNELLY

RESTRICTED



FROM: M E DONNELLY  
DATE: 3 February 1983

MRS HEDLEY-MILLER

cc PS/Chancellor  
Mr Littler  
Mr Unwin  
Miss Court Mr Butt - UKREP  
Mr Edwards  
PS/Mr Hurd - FCO  
Mr Hancock - Cabinet Office

FINANCIAL SECRETARY'S DISCUSSIONS WITH EDG MEPs: 2 FEBRUARY

This note reports the main points of the Financial Secretary's discussions yesterday with members of the European Democratic Group at their plenary session in London.

The Financial Secretary briefly outlined the current position on the 1983 Supplementary Budget. He stressed the importance of resolving that problem quickly so that discussion could focus on the more important long term budgetary issues. The UK had been in the forefront of those states which wanted to respond constructively to the Parliament over the Budget. But it was now necessary for the Parliament to pass the 1983 Supplementary Budget, at its February session if at all possible.

In discussion, Robert Jackson foresaw two main problems, both of the longer term. One was whether the Parliament would not use its gains this year to demand that in future all UK Supplementary Measures were classified as non-obligatory; the second was that agreement over the classification of energy measures as non-obligatory but not affecting the 1984 assiette was unlikely to be renewed for 1985 and later. Things looked brighter on the additionality argument; Davignon was now talking about expenditure that was "new for the Community" and this <sup>was</sup> defusing criticism of UK programmes. The Budget Committee was also taking a less hard line on the "nie wieder" (never again) declaration that this should be the last special refund for the UK. It was being argued that this meant there should never again be a refund of this type. Nonetheless no serious thinking had been done about the need for UK refunds for the current year.

Mr Purvis stressed the importance of the Energy Programme. Expenditure on fast breeder reactors might be a good area for Community support. Mr Seligman stressed the need for a strong Council Presidency input on budgetary matters. Commissioner Tugendhat was seen as very much a British voice in these matters. Sir Fred Warner said they were grateful that the Government was paying so much attention to the views of MEPs. He hopes that if their advice diverged from that received from UKREP Brussels there would be a chance for further discussion. Other points made included the importance of maintaining good relations with the Germans, both at Government and Party level, to influence their MEPs; the small chance of any long term solution being agreed this year; and the need to continue to push for any common policies which might produce financial benefits for the UK.

Replying to points raised, the Financial Secretary said that the Group might like to talk to the Secretary of State for Energy on the detailed points raised about energy policy. He was in favour of using Community policies to aid the UK's budgetary problem in principle. But it had to be recognised that the scale of policies required did not make this a realistic solution by itself. He hopes the Government could maintain and build on its good relations with MEPs. It would be helpful if EDG members could continue to point out to other MEPs that the UK Budget problem was a symptom of the basic imbalance in Community financing due to agricultural spending. This was a problem which the Parliament had to face squarely.

#### Parliamentary Vote on 1983 SB

In informal discussions with MEPs later, the Financial Secretary found that there were some who considered that the Budget would not be passed by the Parliament at all, since it was so valuable a means of putting pressure on the Council. Some MEPs were apparently taking the line that rejection of this Budget - so forcing the UK to withhold - was the only way of ensuring that a fundamental reexamination of Community financing took place. The Financial Secretary was surprised that there was still some feeling that the 1983 SB might not be passed. He would be grateful for UKREP's assessment of the possible risks/<sup>that</sup> the 1983 SB might be rejected next week.



FROM: M E DONNELLY  
DATE: 2 February 1983

MR MIDDLETON

cc PS/Chancellor  
PS/Chief Secretary  
PS/Economic Secretary  
PS/Minister of State (C)  
PS/Minister of State (R)  
Mr Monck  
Mr Odling-Smee  
Mr Sedgwick  
Mr Johnson

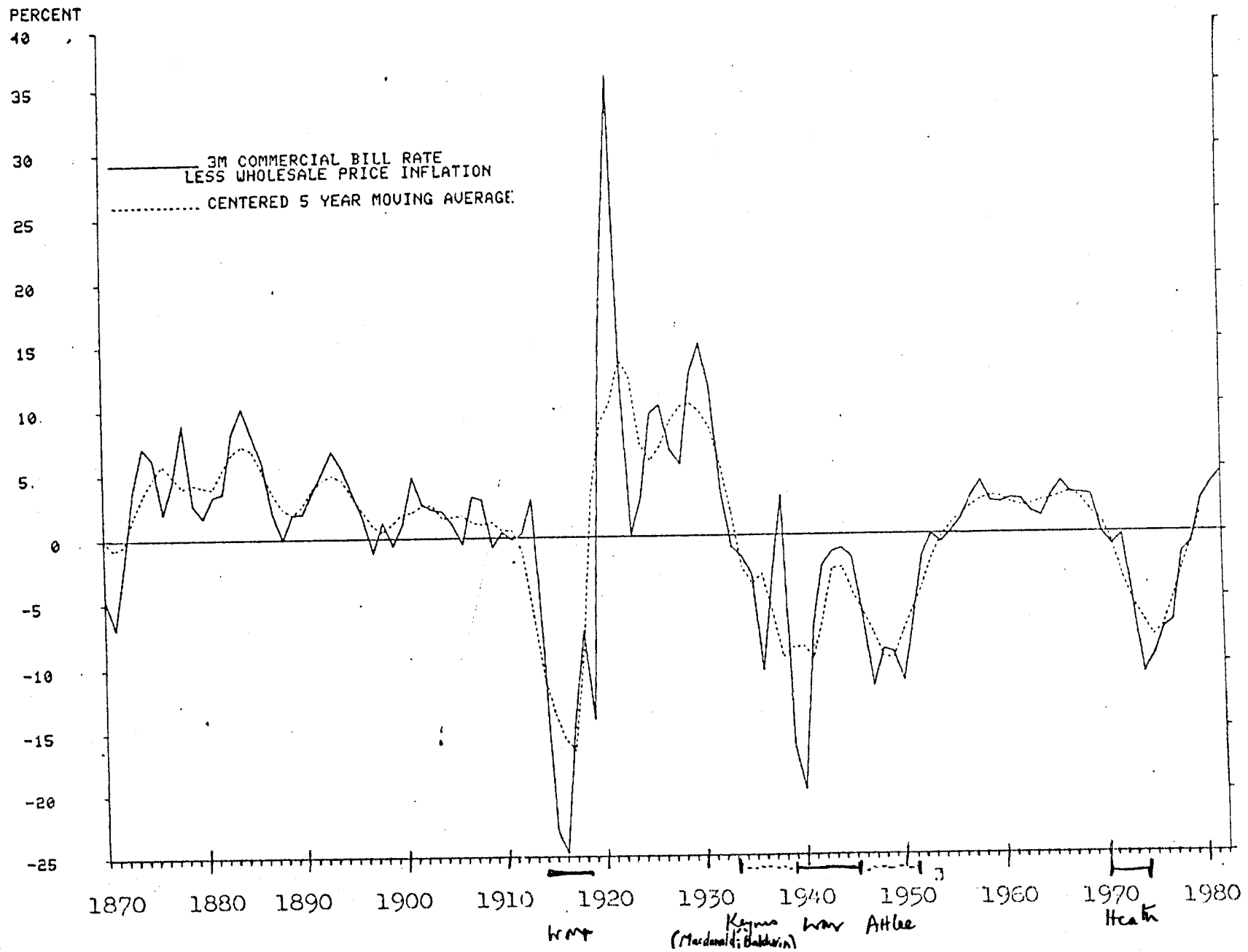
REAL INTEREST RATES

The Financial Secretary was grateful for the copy of the FEU note on historical trends in real interest rates. He found this a fascinating paper. His comments are summed up in his annotation to chart 3 (attached). This suggests that negative real interest rates flow from inflation and inflation follows from war or bad Governments.

MED  
M E DONNELLY



CHART III: REAL SHORT INTEREST RATE IN THE UK 1870-1982



CONFIDENTIAL



FROM: M E DONNELLY  
DATE: 3 February 1983

MR POTTER

cc PS/Chancellor  
PS/Minister of State (C)  
Mr Bailey  
Mr Gordon  
Mr Traynor

PRIVATE MEMBER'S BILL TO ABOLISH THE TRUCK ACTS

The Financial Secretary has read your submission of 2 February.

The Financial Secretary thinks that it would be better to adopt an attitude of benevolent neutrality towards the proposed Bill. The Bill has no real chance of getting through the House. And if we adopt a neutral position, this may provide some spur to TUC thinking in this area.

*ME*  
M E DONNELLY

CONFIDENTIAL



FROM: M E DONNELLY  
DATE: 4 February 1983

PS/CHANCELLOR

cc PS/Chief Secretary  
PS/Economic Secretary  
PS/Minister of State (C)  
PS/Minister of State (R)  
Sir D Wass  
Mr Burns  
Mr Middleton  
Mr Kemp  
Mr Moore  
Mr Griffiths  
Mr Ridley  
Mr Blythe - IR  
PS/IR

ANNUAL PAYE ACCOUNTING AND OPTIONAL NET OF TAX PAY

Paragraph 4 of your note of 1 February to PS/Economic Secretary asked about the status of these two proposals in relation to this year's Budget small business package.

The Financial Secretary has commented that on optional net of tax pay there is no requirement for legislation. Subject to the outcome of work currently being done by the Revenue, we could simply use the Budget speech or debate to commend this option to those whom it would benefit. It might only need the production of grossing up tables.

On the annual PAYE accounting proposal, with firms making monthly payments on account before settling accurately, the Financial Secretary wishes to have further discussions with Revenue officials.

He will make a final report on these two matters as soon as possible.

MED  
M E DONNELLY



FROM: M E DONNELLY  
DATE: 4 February 1983

CHANCELLOR

cc Minister of State (C)  
Minister of State (R)  
Sir D Wass  
Mr Wilding  
Mr Moore  
Sir L Airey - IR  
PS/IR  
Mr A Fraser - C&E  
Mr Gilbert - DNS  
(without attachment)

INLAND REVENUE EFFICIENCY PROGRAMME 1983

This note covers the Revenue's proposed Rayner scrutiny projects for 1983.

The Financial Secretary is content with the idea of studying the Superannuation Funds Office as the 1983 departmental scrutiny.

He has commented that this seems a very good candidate.

The Financial Secretary also thinks that the Capital Taxes Office would be a good candidate for the Multi-Departmental Review. But before deciding finally on this he would like to discuss with the Revenue the questions of the complexity of CTT on death, whether this could be studied, and if so how. There is also the question of its relationship with the Lord Chancellor's responsibilities.

The Financial Secretary aims to have an early meeting on this subject and report by 9 February.

ME

M E DONNELLY



FROM: FINANCIAL SECRETARY

DATE: 4 February 1983

MR MIDDLETON

PEPPER BONDS

An idea, following yesterday's meeting, on which I would be interested in your comments. - Let us take any bond which has a coupon of 4% or more and a life of more than 10 years. And which is issued at a discount. The interest shall be taxed through income tax in the hands of the lender and deductible for CT by the borrower.

Any capital gain or loss, after indexation relief, realised by the lender shall be changeable to CGT, whether he sells the bond or holds it to maturity. There shall be no relief for the borrower for the capital uplift.

- Questions
- 1) should not the interest be calculated on the value of the bond: ie apply the indexation multiplier to the 4% every year?
  - 2) what would this cost us in Revenue lost?
  - 3) I don't see opportunities for avoidance or arbitrage. Do you?

For my money I would rather go for indexed linked bonds, but it might be attractive (perhaps too attractive?) to allow Pepper bonds as well.

*N. Ridley*  
PP NICHOLAS RIDLEY

RESTRICTED



FROM: M E DONNELLY

DATE: 4 February 1983

MR WICKS

cc PS/Chancellor  
PS/Chief Secretary  
PS/Economic Secretary  
Sir D Wass  
Sir A Rawlinson  
Mr Bailey  
Mr Burgner

LEVEL OF SUBSIDY ON UK COAL PRODUCTION

This note is to record that, following the discussion between yourself Mr Burgner and the Financial Secretary, you agreed to provide a rough estimate of the current economic subsidy provided to coal in the UK. This would take account of such factors as the negative return on capital employed by the NCB and the implicit subsidy due to the Electricity industry buying coal at prices above world market levels.

MED  
M E DONNELLY

CONFIDENTIAL



FROM: E KWIECINSKI

DATE: 7 February 1983

MR BLYTHE/IR  
MR MONGER  
MR MOORE

cc PS/Chancellor  
PS/CST  
PS/EST  
PS/MST(R)  
Sir D Wass  
Sir A Rawlinson  
Mr Middleton  
Mr Kemp  
Mr Wilding  
Mr Robson  
Mr Aaronson  
Mr Ridley  
Mr French  
Mr Harris  
Mr Isaac/IR  
Mr Munro/IR  
PS/IR

NICIT, PENSIONS AND SAVINGS

... I attach the Financial Secretary's paper, "NICIT, Pensions and Savings".

He would be grateful for your comments in due course with a view to a further meeting after the Budget.

I will be in touch shortly to arrange the meeting.

*OK*

E KWIECINSKI

CONFIDENTIAL



NICIT PENSIONS AND SAVINGS

I have seen the papers on NICIT (Mr Blythe and Mr Monger of 19 January) and the papers on pensions Mr Munro of 21 January, <sup>and</sup> Mr Monger of 18 January. Both subjects relate quite closely to the husband and wife papers. Indeed all 3 subjects are inter-connected, and the whole is inter-connected with the poverty trap problem.

I think we must start from the basis that ITTA will be in place in a few years time. We should work on a NICIT scheme which takes account of that - indeed to function really well NICIT requires that everyone has the same personal allowance, and no other allowances. Transferable allowances would complicate NICIT, but I am not sure by how much.

NICIT must retain the contributory principle and we should really try and ensure that the yield of Social Welfare tax (SWT) covers the full cost of the State Pension, if not the remaining part of Social Security as well.

In order to get the highest possible thresholds for poverty trap reasons we must maximize resources. This can be achieved by going for the largest amount of SWT we dare raise eg by extending it to the elderly, and by saving as much on the reliefs as we can - by abolishing superannuation relief, LAPR, retirement annuity relief (dare I say it?) mortgage interest relief. This brings in the future of savings reliefs, as in my "holiday thoughts". I am sure it is right that all pensions above the State pension should be voluntary and that such tax relief as we must provide, be made available to all for their personal accumulation of a fund for their own enjoyment, or to buy themselves retirement annuities.

The position of the elderly will be radically altered as a result of all this. We have two ways of affecting it: either by setting the pension at a different level, or by altering their tax position. Paying SWT at a lower rate than the standard rate, would be a small



tax saving for them; we might need to look at the value/<sup>of</sup>Age allowances in order to adjust their SWT to the right level.

A scheme incorporating all of these elements might take the following form:-

1. Separate taxation of every individual in the land.
2. An exempt slice of personal allowance for everyone.
3. Social welfare tax at a low-ish rate for the first band of income. In Mr Blythes example:-  
25% on income between £1500 & £3000
4. Income tax graduated from then on, beginning in Mr Blythe's example with a 35% band from £3000 - £17000. It would be necessary to retain a wide "basic" rate band to limit administrative costs.
5. Everyone pays Social welfare tax (SWT), including pensioners (we might need to credit it for sick, unemployed?)
6. For married couples, part of the personal allowance would be transferable, as for ITTA. But if as a result no tax was paid by the transferring spouse, benefit entitlement would be less.
7. End, the graduated pension scheme, and buy out those who currently would be entitled to more than the minimum pension when they retire.
8. End tax relief for superannuation/<sup>contributions</sup>and all other savings related reliefs (LAPR etc)
9. Modify age relief for those over 65.
10. Adjust the retirement pension to the necessary level to compensate for 5 and 9 above.

11. It would be necessary for the Inland Revenue to maintain a contributions record for SWT since the contributory principle would

... this could be kept on computer?

Would the Revenue computers be able to handle this? ]

12. Mortgage interest relief, if it had to go on, would have to be handled by reducing all interest payments by the standard rate of tax and reimbursing the Building Societies - a sort of super-rough justice MIRAS.

13. All the minor personal allowances would have to be phased out or bought out. This would mean that there were no reliefs or allowances in income tax at all - except for the basic transferable personal allowances.

#### A. The Position of NI Pensioners

Under this scheme, an earning wife would become entitled to a pension, the level of which would be based on her payments of SWT (Social Welfare tax). If she didn't earn, she would have no pension. But when the couple retired, she could transfer part of her allowance to her husband, reducing the joint tax liability. She would not pay SWT because she would have insufficient income. She would "inherit" her husband's pension rights if widowed.

The extra SWT paid, by making pensioners pay it, (they do in Germany now) could be justifiable because people can live for between 1 and 30 years beyond retirement, to put it bluntly - "the more you live the more you should pay".

Equally SWT would be replacing a slice of income tax which pensioners currently pay. We could adjust both Age Allowance and the level of the Pension to produce the desired result, and one that we could afford out of the proceeds of SWT.

#### B. Saving for retirement

(Nearly) Everyone would have a NI pension - for 2 earner couples rather bigger than at present, (because non earning wives would have less than earning ones) they would have to save if they wanted

more. We would introduce personal portable pension schemes which would be available for everybody. The rules might be:-

- a) Tax deductible contributions allowed from employer up to the same amount as employee's contribution.
- b) The self employed, could match their personal contribution (non deductible with a similar, deductible contribution from their business.
- c) Funds to remain in Trust either for a period of say a minimum of 10 years or until retirement. But each trust to be decrete and personal and portable.
- d) While in Trust income to the fund to be tax free.
- e) If the fund on retirement is used to buy a retirement annuity the income from that to be taxable on the pensioner.
- f) If at any time after 10 years the capital is extracted it should bear some tax, probably: but full income tax rates could be too high. Perhaps a special 10% levy?

### C. Poverty, Unemployment traps

If the threshold (Mr Blythe's example) was £1500, with 25% SWT on the slice £1500-£3000, it would be less steep marginal taxation for a single person. For a married couple, the threshold would be £3000 if they both earn, and £2475 if a non-earning wife transfers her allowances to her husband. These are already better allowances than at present. They might be higher still if we could save on the graduated pension, and the savings reliefs. Child benefit would be in place to help where there were children. (Does this enable us to avoid the FIS problem?).

The other major area of difficulty, from Mr Mongers note, is Housing benefit. It seems to me that we would have to build in some sort of a taper to UHB to moderate the marginal tax rate it causes. This could perhaps be an area for a separate study?

D. The contributory principle

I think this must remain, the first question is to what do you contribute? Certainly the State pension. It would simplify things if unemployment, sickness, (and SB & the minor benefits) were not contributory, but Mr Monger can advise on that.

The second question is how much do you have to contribute? It could be measured in cash, in weeks, or in years of contribution. I prefer cash. If the maximum possible for a lifetime of contributions was £X, and in fact an individual had contributed £Y, he would be entitled to  $\frac{Y}{X}$  of the pension. [Or is this too simple?]

CONFIDENTIAL



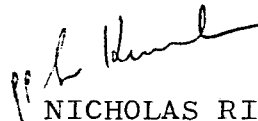
FROM: NICHOLAS RIDLEY  
DATE: 7 February 1983

CHIEF SECRETARY

cc Chancellor  
Economic Secretary  
Minister of State (R)  
Sir D Wass  
Mr Middleton  
Mr Moore  
Mr Robson  
Mr Chivers  
Mr Gordon  
Mr Godber  
Mr French  
Mr Graham - Parly Counsel  
PS/IR

CAPITAL ALLOWANCE FOR SELF-CATERING ACCOMMODATION

I have seen Mr Corlett's note to you of 3 February. I think this is going to throw up a lot of anomalies. Apart from those in Mr Corlett's note (particularly Caravans), there will<sup>be</sup> fury from the many individuals who own one, two or three cottages which they let out to self catering holiday families. These people have already been protesting strongly to us about their tax treatment - the IIS is their main complaint - so for them to be excluded because they have less than 10 units will infuriate them further. We would probably have to find some concession to placate them, say by treating the rents they receive as earned income.

  
NICHOLAS RIDLEY



FROM: M E DONNELLY  
DATE: 4 February 1983

PS/ECONOMIC SECRETARY

cc PS/Chancellor  
PS/Chief Secretary  
PS/Minister of State (R)  
Mr Moore  
Mr Griffiths  
Mr Robson  
Mr French  
Mr Graham - Parly Counsel  
Mr Battishill - IR  
Mr Corlett - IR  
PS/IR

SMMT SUBMISSION ON THE 1983 BUDGET: POSSIBLE SIMPLIFICATION  
MEASURES

CAPITAL ALLOWANCES FOR BUSINESS CARS (STARTER 171)

The Financial Secretary has read Mr Corlett's submission of 2 February.


He thinks that we should consider the question of capital allowances as part of the overall "motoring package" for the Budget. This would involve decisions on:

- (i) petrol
- (ii) VED
- (iii) car tax
- (iv) increase in car scales and petrol charge;
- (v) possible increase in £8000 limit?
- (vi) the level of capital allowances.

The Financial Secretary wonders whether removing the £8000 limit altogether and reducing the writing down allowance to 20%, might not be nearly neutral in its Revenue effects. If so it could be a neat way of dealing with all the complications. He would be grateful for Revenue comments on likely costing; and also whether

or not there would be any potential for staff savings.

The Financial Secretary would also be grateful if the Revenue would assess the effect of factors 1 to 4 along side his proposed changes so that an assessment can be made of the total effects on both the motorist and the car industry.

  
PP M E DONNELLY



FROM: M E DONNELLY  
DATE: 7 February 1983

MR HALLIGAN

cc Mr Lovell  
Mr Chivers

JAGUAR PRIVATISATION RECEIPTS

The Financial Secretary was grateful for your note of 3 February giving further details of the difference in likely receipts for the sale of Jaguar over the next three years.

The Financial Secretary has commented that if we did in fact want to sell relatively quickly the market could be told of these growth prospects, and they would surely be reflected in the current price, at least to some extent.

*MEJ*  
M E DONNELLY



CONFIDENTIAL



FROM: M E DONNELLY  
DATE: 7 February 1983

PS/INLAND REVENUE

cc PS/Chancellor  
PS/Chief Secretary  
PS/Economic Secretary  
PS/Minister of State (C)  
PS/Minister of State (R)  
Sir D Wass  
Mr Kemp  
Mr Moore  
Mr Robson  
Mr Ridley  
Mr French  
Mr Harris

QUERY FROM JOHN TOWNEND MP

In a recent meeting Mr Townend pointed out that the proprietor of a closed company borrowing money for the purpose of purchasing shares in his own company is allowed tax relief on the money he borrows. Mr Townend wondered why this concession could not be extended further in the unquoted company sector.

The Financial Secretary would be grateful for your comments on this suggestion.

*MED*  
M E DONNELLY



FROM: M E DONNELLY  
DATE: 7 February 1983

MR NEILSON

cc PS/Chancellor  
PS/Chief Secretary  
PS/Economic Secretary  
PS/Minister of State (C)  
PS/Minister of State (R)  
Sir D Wass  
Mr Bailey  
Mr Burgner  
Mr Morgan  
Mr R Wilson  
Mr Wicks  
Mr Grimstone  
Mr Halligan  
Mr S Thomas  
Mr Wood  
Mr Day  
Mr Wynn Owen  
Mr Ridley  
Mr Harris

#### RELATIVE VALUE OF PUBLIC SECTOR ASSETS

The Financial Secretary was grateful for your submission of 3 February.

The Financial Secretary agrees with Mr Grimstone's comment that although the results do need treating with caution it has been an interesting exercise. As one might expect a clear difference emerges between the performance of enterprises in growth and non-growth sectors of the economy. The only exception would seem to be BAE where one might have expected the figures to show a net surplus rather than a deficit on privatisation.

*MEJ*  
M E DONNELLY



FROM: M E DONNELLY

DATE: 9 February 1983

MR BRAY - IR

cc PS/Sir Lawrence Airey  
The Rayner Unit  
Mr Glassberg - IR

RAYNER SCRUTINY REPORT

The Financial Secretary has read Mr Bray's Rayner Scrutiny Report on Instructions to local Offices.

He found the report most interesting and congratulates Mr Bray on the work he has done. He looks forward to the Revenue's comments on the report.

The Financial Secretary's first response was that the Report suggests that the Revenue could perhaps find it worthwhile to employ a professional communications expert as a full time official. This might help to get over the very real problem that many staff - and tax payers - do not seem to understand Revenue literature.

*MEJ*  
M E DONNELLY

CONFIDENTIAL



FROM: M E DONNELLY  
DATE: 9 February 1983

PS/CHANCELLOR

cc PS/Chief Secretary  
PS/Economic Secretary  
PS/Minister of State (C)  
PS/Minister of State (R)  
Mr Middleton  
Mr Moore  
Mr Robson  
Mr Ridley  
Mr French  
Mr Blythe - IR  
PS/IR

HOUSE OF LORDS DECISION - WICK vs FIRTH, JOHNSON vs FIRTH

The Financial Secretary has seen Mr Blythe's note of 4 February covering Mr Driscoll's submission.

The Financial Secretary remains concerned about the political implications of this case. The Secretary of State for Education wants to use this decision to provide tax deductible school fees by the back door. But this is a political choice which should only be made after a formal proposal has been received from Sir Keith Joseph. It would not be right to allow such a major policy decision to be taken by default, through the actions of the House of Lords.

The Financial Secretary favours replying to Sir Keith Joseph along these lines.

*MEJ*  
M E DONNELLY



FROM: NICHOLAS RIDLEY  
DATE: 9 February 1983

CHANCELLOR

cc Minister of State (C)  
Minister of State (R)  
Sir D Wass  
Mr Wilding  
Mr Moore  
Mr Kingsley-Jones  
Sir L Airey - IR  
Mr Beighton - IR  
Mr Houghton - IR  
Mr Fraser - C&E  
Mr Gilbert - DNS

INLAND REVENUE EFFICIENCY PROGRAMME 1983

I have now discussed with officials the question of the Revenue's involvement in the MPO-led multi-departmental review of support services.

I think that at this stage we should limit ourselves to a fairly narrow review, starting with a look at the administrative processes within the Capital Taxes Office.

On the wider question of tax complexities for executors, I feel that this is clearly as much a legal as a taxation problem. I propose therefore to write to the Lord Chancellor in the near future, seeking his views on the desirability of either an inter-departmental review or a review by an outside body to study the problems facing executors on the death of the testator.

There are a number of related issues on which I will need to consult the Lord Chancellor, some related to taxation and others concerned with the administration of estates generally. I will send you copies of my correspondence with him.

NICHOLAS RIDLEY

RESTRICTED



FROM: M E DONNELLY  
DATE: 9 February 1983

PS/CHANCELLOR

cc PS/Chief Secretary  
PS/Economic Secretary  
PS/Minister of State (R)  
Mr Middleton  
Mr Kemp  
Mr Monck  
Mr Moore  
Mr Gordon  
Mr Pirie  
Mr Robson  
Mr Potter  
Mr Ridley  
Mr French  
PS/IR

MOVING FORWARD: SMALL BUSINESSES AND THE ECONOMY

The Financial Secretary has seen your note of 8 February, and a copy of the "Moving Forward" CPC booklet.

The Financial Secretary has invited Mr Bright and the other officers of the Conservative Smaller Businesses Committee to lunch on 15 February to "hear their views" in this area. He would be interested in any views on the booklet which colleagues might have which might be appropriate to pass on on that occasion. He would also be grateful for briefing from officials on points of interest arising from the booklet. Perhaps Mr Robson would take the lead in this.

*MED*  
M E DONNELLY



FROM: M E DONNELLY  
DATE: 9 February 1983

PS/CHANCELLOR

cc PS/Minister of State (R)  
Mr Moore  
Mr Robson  
Mr Gordon  
Mr Andren  
Mr Griffiths  
Mr Perfect  
Mr J Reed  
Mr French  
Miss Wheldon - Tsy Sols  
PS/IR

SECTION 482, ICTA 1970

The Financial Secretary has seen Mr Reed's submission of 7 February, and the Chief Secretary's response in Miss Swift's note of 8 February.

The Financial Secretary agrees with the Chief Secretary's views. Having abolished the Exchange Controls we cannot now covertly reimpose them through S482. The only way of preventing subsidiaries from going overseas is through "persuasion" - which usually means money. It might be worthwhile discussing this whole area with DoI.

*MEJ*  
M E DONNELLY



FROM: M E DONNELLY

DATE: 9 February 1983

CHIEF SECRETARY

cc Minister of State (R)  
Sir D Wass  
Mr Middleton  
Mr Moore  
Mr Robson  
Mr Pirie  
Mr French  
Mr Graham - Parly Counsel  
Mr Bryce - IR  
PS/IR

FOREIGN CURRENCY ACCOUNTS: NON DOMICILED UK RESIDENTS

The Financial Secretary has read Mr Bryce's submission of 7 February on the possibility on legislating in the 1983 Finance Bill on the CGT treatment of foreign currency bank accounts.

Although reluctant to add to the amount of legislation in this year's Finance Bill the Financial Secretary thinks that we should legislate on this question. To do so would be fiscal justice; and something of a counterbalance to the stopping of other tax loopholes elsewhere.

*MED*  
M E DONNELLY





cc PS/CST  
PS/EST  
- PS(MST(C))

FROM: FINANCIAL SECRETARY

DATE: 9 February 1983

PS(MST(R))

Sir D WASS

Mr LITTLE

Mr MUNN

Mrs Hadley-Miller

Miss COURT

Mr EDWARDS

Mr FITCHEW

PRIME MINISTER

1983 EUROPEAN COMMUNITY BUDGET REFUNDS

I went to Strasbourg yesterday for the latest in a series of lobbying discussions I have been having with MEPs and others about the Supplementary Budget for our 1982 refunds. I thought you would like to know the latest position.

The outlook is now more promising. The European Parliament's influential Budget Committee have not recommended any amendment to the draft 1983 Supplementary Budget agreed by the Council of Ministers in January. This contains provision for our agreed basic refund for 1982. The Parliament will debate this Budget on Thursday afternoon and on present plans will vote on it that evening. One can never count one's chickens, but my impression is that, although there will be some votes against it, mainly from the Socialist and Communist groups, the opposition will not be sufficient to block it.

All being well the Parliament should also give an opinion on the enabling Regulations for the UK's refunds. Provided that there is no further opposition in the Council, the way should then be clear for us to receive the main instalment of our basic refund by the 31 March deadline.

I am copying this minute to the Chancellor of the Exchequer, the Foreign and Commonwealth Secretary, and to Sir Robert Armstrong.

NICHOLAS RIDLEY

RESTRICTED



FROM: M E DONNELLY  
DATE: 9 February 1983

MR ROBSON

cc PS/Chancellor  
PS/Chief Secretary  
PS/Economic Secretary  
PS/Minister of State (R)  
Sir D Wass  
Mr Bailey  
Mr Middleton  
Mr Kemp  
Mr Lovell  
Mr Moore  
Mr Chivers  
Mr Gordon  
Mr Pirie  
Mr Turnbull  
Mr Andren  
Mr Battishill - IR  
PS/IR  
Mr Shilson - B of E

DISCUSSION WITH VENTURE CAPITALISTS - 7 FEBRUARY 1983

The Financial Secretary invited a selection of businessmen involved in Venture Capital to a meeting on 7 February. A list of those who ... attended is attached. Mr Andren and Mr Shilson (Bank of England) were also present.

The discussion ranged widely over the difficulties faced by those involved in Venture Capital. The more important ones with a Treasury interest are listed below.

Double charge to capital gains taxation

It was stressed that Venture Capital Funds (VCFs) received about 80 per cent of their funds from institutional investors. Some of these institutions were tax exempt. But all institutions investing through VCFs found themselves with an additional liability for capital gains tax, either on their profits or if they were exempt because the VCF itself had to pay such tax. This made a significant number of institutions unwilling to undertake investment.

## Tax relief for entrepreneurs and stock options

A number of those present argued that there was a case for giving more generous fiscal incentives to the entrepreneur involved in starting a new business. By its nature the Business Start-Up Scheme could not benefit the owner of a business. Those financing start-ups wanted the entrepreneur to have as large a financial stake as possible in his own business; they argued that anything which provided the entrepreneur with more money to use for this purpose would therefore have a positive effect overall. Two specific suggestions made were either to give the potential entrepreneur tax relief on interest payments on borrowed money; or to allow full tax relief on his or her losses.

There was also strong pressure from several of those present for improved tax treatment of stock options. It was suggested that a more generous regime could be limited to options in unquoted companies' stock.

## Innovation/R&D

It was suggested that the present BSS rules were too limiting in excluding non-trading companies engaged in R&D activities. There was also strong support for measures to encourage the formation of off-balance sheet development companies (ie unquoted companies) as a means of encouraging more R&D expenditure. It was suggested that the tax relief for R&D might be limited by making it contingent on the approval of projects by DOI under one of their innovation support schemes.

The Financial Secretary made clear that he could not comment in detail on the points raised in the discussion due to the proximity of the Budget. Some of the points raised (share options etc) are already under discussion. The Financial Secretary would be grateful if you would consider, in consultation with the Revenue, what can usefully be done to respond to the other points made by the Venture Capitalists. He would be grateful if the Bank of England could provide any further background on the US position in terms of support for R&D.

MED  
M E DONNELLY

Those present

David Cooksey	Advent Management Limited
Ronald Cohen	Alan Patricof Associated
Colin Clive	Thompson Clive & Partners
Gordon Dean	Electra Risk Capital
Tony Lorenz	Equity Capital for Industry
Charles Villiers	County Bank
David Prosser	National Coal Board Pension Fund
John Beevor	Midland Bank Industrial Finance
Mike Cumming	Barclays Development Capital Ltd
Tony Gray	Cogent Ltd



FROM: E KWIECINSKI  
DATE: 9 February 1983

MR C STEWART - IR

cc PS/Chancellor  
PS/Chief Secretary  
PS/Economic Secretary  
PS/Minister of State (C)  
PS/Minister of State (R)  
Mr Moore  
Mr Graham - Parly Counsel  
PS/IR

MIRAS: AMENDMENTS TO LEGISLATION (BUDGET STARTER 168)

The Financial Secretary has seen your note of 7 February.

He suggests that: 1) the known candidates such as, the Church of England Pensions Board and the Building Trust, should be allowed in from April 1983 by including them in this year's Bill.

and 2) the Revenue should take a power in the Bill to prescribe others as qualifying lenders, in future, by order.

This would mean that the known candidates would not have to wait until next year to come into the scheme.

E KWIECINSKI  
9 February 1983

RESTRICTED



FROM: M E DONNELLY  
DATE: 9 February 1983

MR UNWIN

cc PS/Chancellor  
Sir D Wass  
Mr Littler  
Mrs Hedley-Miller  
Miss Court  
Mr Edwards  
Mr Fitchew  
Mr Wicks  
Mr Peet  
PS/Mr Hurd - FCO  
Mr Hannay - FCO  
Mr Hancock - Cabinet Office  
Mr Butt - UKREP  
Mr Marsden - UKREP

FINANCIAL SECRETARY'S VISIT TO STRASBOURG: 8 FEBRUARY

This note reports on the main discussions which the Financial Secretary had during his visit to Strasbourg.

Meeting with Mr Tugendhat

Mr Tugendhat thought the outlook was "fair" for the 1983 Supplementary Budget to be passed by the Parliament on Thursday 10 February. Most political groups seemed either in favour of the Budget or, like the Socialists, resigned to its passing this time. But there was always the prospect of something unforeseen happening.

On the Commission's Green Paper on future own resources Mr Tugendhat accepted that the proposed financial equalisation mechanism could not by itself meet the UK's budgetary problems. Those who thought it could were arguing on an inexact parallel with the fiscal transfer system between German Länder. There, transfers were used to equalise the level of social services provided by individual states. But the proposed EC mechanism was rather designed to promote integration. To deal with the UK's problem it would have to be huge. The Financial Secretary suggested that the proposal for an agricultural mechanism looked more promising. There was a problem as to what you based the mechanism on - production, cost of surpluses, amount of land used etc. Mr Tugendhat suggested that one might start by deciding what proportion of the overall Budget should be raised

through this mechanism then work back to find a indicator which produced the right distribution of burdens between member states. What was important was that Parliament should not rule out this or any proposed financing change too quickly. If they did so the Commission would not want to <sup>it</sup> defy the Parliament by continuing to press ideas for reform that had already condemned.

#### Lunch with MEPs

The MEPs who attended are listed on the attached sheet.

The Financial Secretary said that he hoped the dispute over the 1983 SB. was now near to resolution. There had been give and take on both sides. It was now more important to focus on the need for longer - term solutions. No one dissented from this; and there was no further discussion of the 1983 SB. Herr Lange stressed that it was important for the Council and the Parliament - the two parts of the EC Budgetary Authority - to work closely together. He accepted that the UK had been placed in a position where remedial action was needed. But there could be no further supplementary measures of the type agreed for 1983 <sup>(though</sup> / he did not rule out the need for further transitional refunds in some form). A long - term solution was needed, and must involve reform of the CAP financing arrangements. Herr Bangemann said that the Parliament should be offered real political choices - eg between spending money on agriculture or on Community infrastructure such as a Channel tunnel. The Financial Secretary suggested that the Parliament would need to look critically at the amount of budgetary expenditure on agriculture in order to be able to consider rigorously the overall balance of the Community Budget.

Discussion then turned to the CAP. There was general sympathy for the UK's stand on the disproportionate amount of resources in the Budget being spent on agriculture. Mr Adonnino suggested limiting the intervention price guarantees to perhaps 7% of total production. No one objected in principle to the idea of CAP expenditure being financed more directly by the beneficiaries of it. But no specific proposals were put forward.

### Meetings with UK MEPs

Mr Adam (UK Socialist) said that he would be the rapporteur of the Energy Committee on the 1984 Budget. The Financial Secretary suggested that he might like to talk to Mr Lawson about the UK's position on the Energy Measures programme. Mr Adam agreed that this would be useful. He also asked about expenditure on ship building from the Regional Fund. This did not appear to have increased substantially over the past two years even though the shipbuilding industry had entered a grave crisis. The Financial Secretary agreed to check on the position here.

The Financial Secretary also spoke briefly with Mrs Castle.

The Financial Secretary met Sir Henry Plumb, leader of the EDG. Sir Henry was reasonably confident that the 1983 SB would be adopted on Thursday. He also raised the question of energy measures. He said he was unsure of the UK Government's position on this policy. The Financial Secretary again suggested that he get in touch with Mr Lawson.

### Meeting with Herr Lange

I spoke to Herr Lange about his planned visit to London to meet Mr Hurd, and if possible to make a brief call on the Chancellor. He is still keen to come. We agreed that I would telephone him on Thursday 17 February when he would have some firm dates for the visit, probably during the latter half of March.

### Further Action

The Financial Secretary would be grateful for a draft reply to send to Mr Adam on the shipbuilding point. He would also be grateful for your advice on how best to inform Mr Lawson of the interest among UK MEPs in the Energy Measures programme; and of the probability that this programme will become an increasingly important channel for future UK refunds.

MEJ  
M E DONNELLY



GUEST LIST FOR LUNCH ON TUESDAY 8 FEBRUARY 1983

Mr Christopher Lush CNG	United Kingdom Permanent Representative to the Council of Europe
Mr Nicholas Ridley MP	Financial Secretary
Mr Erwin Lange MEP	Chairman of the Budgets Committee (German Socialist)
Mr Ove Fich MEP	Member of the Budgets Committee, Socialist Group Spokesman (Danish Socialist)
M. Pietro Adornato MEP	Member of the Budgets Committee, EPP Group Spokesman (Italian EPP)
Mr Martin Bangemann MEP	German Leader of the Liberal Group
Mr Robert Jackson MEP	Member of the Budgets Committee, 1983 Budget Rapporteur (British EDG)
Mr Horst Langes MEP	Member of the Budgets Committee, (German EPP)
Mr Richard Butt	Financial Counsellor at the United Kingdom Permanent Representation to the EC
Mr William Marsden	Institutions and Press Counsellor at the United Kingdom Permanent Representation to the EC
Mrs Carla Barbarella MEP	Vice-Chairman of the Budgets Committee, Rapporteur for 1982 Budget and Spokesman for Communist Group (Italian Communist)

CONFIDENTIAL



FROM: M E DONNELLY  
DATE: 10 February 1983

CHANCELLOR

cc Chief Secretary  
Economic Secretary  
Minister of State (C)  
Minister of State (R)  
Sir D Wass  
Sir A Rawlinson  
Mr Middleton  
Mr Bailey  
Mr Judd  
Mr Burgner  
Mr Kemp  
Mr Monck  
Mr Wicks  
Mr Ridley  
Mr S Wood

SALE OF BP SHARES

The Financial Secretary has seen Mr Wicks' minute of 3 February, Sir D Wass' note of 4 February, your Private Secretary's note of 8 February and the Minister of State (R)'s comments in Mr Milner's note of 9 February.

In general terms the Financial Secretary is convinced that we should continue to sell BP shares, and not worry unduly about crossing the 25 per cent limit. On the question of timing the Financial Secretary also feels that a sale this year may not be advisable. A 1984 sale would come after the market had entirely digested Britoil and hopefully after a sale of BGC oil assets. A sale in the 1984-85 financial year might be a valuable offset to the PSBR in that year. Consequently the Financial Secretary would plan on selling 10 per cent of BP shares during the spring of 1984.

MED  
M E DONNELLY



FROM: M E DONNELLY  
DATE: 10 February 1983

PS/CHIEF SECRETARY

cc PS/Chancellor  
Sir A Rawlinson  
Mr Wilding  
Mr Burgner  
Mr Kemp  
Miss Brown  
Mr Judd  
Mr Perry  
Mr Allen  
Mr Robson  
Mr Norgrove  
Mr Potter.  
Mr Thomas  
Mr Harris

FINANCIAL SECRETARY'S SPEECH TO ACCOUNTANTS AND STOCK EXCHANGE AWARDS -  
14 FEBRUARY 1983

The Financial Secretary was grateful for officials' comments on the earlier draft of the speech, circulated on 8 February.

He has taken account of suggestions in producing the attached final draft. In the Chancellor's absence he would be grateful for the Chief Secretary's approval of the speech, by noon on Friday if possible.

MEJ  
M E DONNELLY

ACCOUNTANT AND STOCK EXCHANGE ANNUAL AWARDS

Draft Speech

I have never before connected St Valentine's Day with the accountancy profession. I esteem Accountants as much as anyone, but I never before seen the romantic side of their character. Perhaps it is that 9 months is the gestation period for Schedule D. More likely perhaps that the sensation of winning these awards is like falling in love. Certainly <sup>Grand Metropolitan</sup> <sub>PC Henderson Group</sub> and <sub>L</sub> have my sincerest congratulations on winning these much sought after awards. It is a considerable achievement and the competition was of a very high standard.

First I do want to commend the sponsors of these awards for their encouragement of better accounts. Accountancy like so much of human activity - including Government - is about the communication of information; information that is vital for success in this modern world.

High levels of inflation in the past have brought a new element into account; and although inflation is now more a spectre of the past than the future the search for ways of accounting for it goes on.

The accountancy profession has had a major debate about principles of inflation accounting for companies. This might become an easier problem to solve as we move forward in our search for fairer treatment of lending and borrowing. We have moved now to tax only capital gains that are real; and we are moving towards taxing only real interest, not the repayment of capital.

Indexed linked gilts have been de-restricted, and made available to the private sector. The principle of indexed lending and borrowing is beginning to interest mortgage lenders, insurance companies, and I hope soon industrial borrowers too. We are in the middle of a consultative exercise in our search for better tax treatment of deep discounted stocks. But there can be no purer, no more inflation proof lending instrument than that of indexed-linked paper. And the tax treatment of it is logical and fair.

We indexed capital gains, in order to stop applying tax to what was no more than the maintenance of the real value of capital. The correct tax treatment of lending and borrowing to allow for inflation will have an effect on company Balance sheets. This may help the accountancy profession to make progress in

search for inflation accounting.'

Some of the results are complex. The truth is that indexation is a complex thing, as accountants have found in their studies of inflation accounting for companies' accounts. The broad choice is either to have indexation and the complexity that goes with it, or neither. If we are to reduce the distortions and the unfairness of taxing paper gains and conventional interest payments, some complications necessarily follow.

Apart from being complex these changes are also novel. I am saddened by the critical and cautious response from the City and industry to the progress we are making, both on this front and on others. I hope the mood will change from concentrating on the complexities, to using the very real openings we have made - both for indexed borrowing and lending and for things like investment in new companies, and purchase of own shares. The wise investors are beginning to use these new opportunities. And I am sure that wise accountants will soon start advising their clients accordingly.

But whatever position one takes on inflation and indexation I do not think anyone would deny the need for clear, consistent, reliable and informative accounts of the sort which we are here to honour today. Informative accounts are necessary in order for <sup>the</sup> market to work properly and we are indeed grateful to the Accounting Standards Committee for the progress it has made in reducing the areas of difference and variety of accounting practice.

They are also necessary for good labour relations. At the very least the employees have a right to know how their company is faring. Many companies - quite rightly - take great trouble to communicate with their employees. They use their annual accounts as the basis <sup>of</sup> this information. Understanding what a company's accounts mean and how well a company is doing is vital. Financial involvement in the fortunes of a company can be equally vital as an incentive. We have taken a lot of measures both to clear the path, and to provide fiscal advantages for such schemes.

We are having some success. Since 1979 over 300 profit sharing schemes have been approved. 200 savings - related share option schemes under the 1980 Finance Act provisions have also received approval. A good step in the right direction:

90,000 new shareholders have come into existence.

A final word about Central Government itself. We are a rather odd fish. There is not the same distinction between current and capital spending in Government as there is in a business. Some of you (like me) may be old enough to remember the days when Government did try to distinguish between above and below the line expenditure. It wasn't very helpful. Mainly because Government is different to business; - concerned about levels of borrowing, of taxation, and the total financial pressures we put on the rest of the economy. So we do not really have a balance sheet at all. I hate to think what it would look like if we did! Our accounts are cash only with no accruals either way. I quite accept that for internal management purposes we need better information and the outcome of the financial management initiative will show whether to extend these principles further. Nevertheless we are trying to bring disciplines equivalent to those provided by commercial accounting into Government. Perhaps I might commend to you the recent Public Expenditure White Paper as an example of better presentation of these things.



So we do our best to follow the high standards set by Grand Metropolitan and PC Henderson in the presentation of accounts. I do congratulate them most warmly on their achievement, and hope they have a happy St Valentines' Day.

CONFIDENTIAL



FROM: E KWIECINSKI  
DATE: 10 February 1983

MR P J A DRISCOLL/IR

cc PS/Chancellor  
PS/CST  
PS/MST(C)  
PS/MST(R)  
Mr Robson  
Mr French  
Mr Blythe/IR  
Miss Hart/IR  
PS/IR

FLAT-RATE EXPENSES: SCHEDULE E

The Financial Secretary has seen your submission of 1 February.  
... I attach his initial thoughts on this. He would be grateful  
for your further comments in due course.

The Financial Secretary would eventually like a meeting to discuss  
this although he has commented that this is hardly something for this  
year's Bill.

*Ek*  
E KWIECINSKI

## FLAT RATE EXPENSES/SCH E

Starting from first principles, it should be for the employer to provide a tools or clothing allowance appropriate to his workers' needs. If the employer thinks these are justified and necessary, he will deduct them from gross pay before computing PAYE. If it were left at that the temptation would be for the employer to make the allowances artificially high in order to save the employee tax. So the concession must be limited. The limit would probably have to be £100 p.a to suit modern practice. In any event it is the job of management to argue the amount of the allowance with each of his employees (and their Trade Union if they must).

It ought not to be for the Revenue to argue with national Trade Unions: that limits a prerogative of management to control its own show (albeit only by a small amount)

What then happens if we were to say that henceforth the allowance must be agreed between management and employees in each particular case?

There would have to be a limit - the £100 referred to in Miss Hart's minute. But some employers might give less, or zero: in other words they might try and buy it out, thus reducing the loss of revenue. So it might not cost £600m net?

Could we find inducements to persuade employers to restrict it, or even give no allowance at all?

They would wish to avoid the complication, and the separate annual negotiation of the allowance as it is. We could add that we would pick on some and test the cases of individuals selected at random to see if they were justified - as under the option (e) proposed.

In short I am suggesting a mixture of option (b) and (e).



FROM: M E DONNELLY

DATE: 10 February

MISS COURT

cc Mr Heaver  
Miss Wright  
Mr Hayden

EXPLANATORY MEMORANDUM ON THE COURT OF AUDITORS 1981 REPORT

... The Financial Secretary has signed the attached memorandum put up under Mr Hayden's note of 7 February.

The Financial Secretary has asked for further details of any potential "nasties" in this document; particularly anything dealing with expenses of MEPs, fraud, gross extravagance etc.

Perhaps you could let us know of any such items in good time for the debate on the EC Budget.

*MED*  
M E DONNELLY

## EXPLANATORY MEMORANDUM ON EUROPEAN COMMUNITY DOCUMENT

Report by the Court of Auditors for the Financial Year 1981  
(Official Journal of the European Communities C344 31 December 1982)

Submitted by HM Treasury

February 1983

## SUBJECT MATTER

1. The European Court of Auditors was set up under the Treaty of 22 July 1975 and was formally inaugurated on 25 October 1977. The Court replaced the two former audit bodies of the Communities - the Audit Board and the Office of the ECSC Auditor. This is its fifth Annual Report but the fourth to be based entirely on its own work.
2. Under Article 73 of the Financial Regulation of 21 December 1977 the Commission is required to draw up a revenue and expenditure account for the Communities for the year ended 31 December and submit it to the Court of Auditors by 1 June the following year. The Court then has to transmit its comments to the Commission and the Institutions concerned by 15 July and they in turn are required to produce their replies by 31 October. The final report by the Court, including the replies, has to be submitted by 30 November to the authorities responsible for giving discharge to the Commission in respect of the implementation of the Budget.
3. Like its predecessors, the 1981 Report is divided into two parts. The first deals with the execution of the general budget of the Communities, including the budgets of the Parliament, the Council, the Commission, the Court of Justice, the Economic and Social Committee, the Office for Official Publications and the administrative budget of the European Coal and Steel Community (ECSC). It also deals with loans and borrowing operations under the EEC and EAEC Treaties.
4. Part II concerns the five European Development Funds. These Funds, which provide aid to developing countries, are managed by the Commission but do not form part of the general budget of the Communities.

5. In addition there are eight annexes. Annex I lists the allocation of responsibilities among Members of the Court of Auditors. Annex II lists the reports and opinions adopted by the Court during the 5 years to 30 November 1982. Annex III gives detailed information and statistics relating to the 1981 Community Budget and to the European Development Funds. Annexes IV to VIII contain the replies of the Institutions to the observations of the Court.

6. Part one is subdivided into 14 chapters, each of which deals with specific parts of the budget such as the Regional and Social Funds. At the beginning of each chapter is a summary of the principal comments made by the Court. There are nearly 90 of these principal comments ranging from criticisms of Financial Control systems to criticisms of the under-utilisation of payment appropriations.

7. Under Article 85 of the Financial Regulation it falls to the European Parliament, on a recommendation from the Council, to give a discharge to the Commission in respect of the implementation of the Budget. This is due by 30 April.

#### MINISTERIAL RESPONSIBILITY

8. Treasury Ministers are responsible for the Community Budget and matters concerning financial control generally, but other Ministers are concerned with the parts of the Report which concern their Departmental interests.

#### IMPACT ON UNITED KINGDOM LAW

8. The Report has no implications for UK law.

#### POLICY IMPLICATIONS

9. The Report has no direct implications for UK policy but is of importance for the development of financial control within the European Communities.

10. The Report is the main document which the Council takes into account in deciding whether and in what terms to recommend that the European Parliament grants discharge to the Commission in respect of the implementation of the Budget.

*Nicholas Ridley*

NICHOLAS RIDLEY  
Financial Secretary  
HM Treasury



FROM: E KWIECINSKI  
DATE: 10 February 1983

MR D NORGRÖVE

cc PS/Chancellor  
PS/Chief Secretary  
PS/Economic Secretary  
PS/Minister of State (C)  
PS/Minister of State (R)  
Mr Monger  
Mr Moore  
Mr Kemp  
Mr Mountfield  
Mr Ridley

PLAID CYMRU BUDGET REPRESENTATION

The Financial Secretary has agreed to meet a Plaid Cymru delegation to discuss their representation for this year's Budget. The meeting has been arranged for Thursday 17 February, at 2.30pm.

Those present will be, from the Plaid Cymru side: Mr Dafydd Wigley MP, Mr D E Thomas MP and their special adviser Mr I W Jones; and from the Welsh Office Mr Wyn Roberts MP.

... I attach a copy of Mr Wigley's letter to the Chancellor of 24 January. Mr Kemp minuted the Chancellor on this on 31 January.

I would be grateful if you could co-ordinate briefing for the meeting and arrange for official support.

I understand that Mr Roberts may be bringing an official from the Welsh Office.

*ck*  
E KWIECINSKI

10 February 1983





HOUSE OF COMMONS  
LONDON SW1A 0AA

CH/EXCHEQUER	
REC	25 JAN 1983
ACTION	MR KEMP <del>Mr. Deakin</del> 13/2
COPIES TO	CST, EST, MST(E), M&T(R), Mr MOORE, PS/R, PS/C+E.

24 January, 1983.

*WR*

26 JAN 1983

*Chancellor.  
Are you  
inclined to  
do this please?  
m*

Sir Geoffrey Howe,  
Chancellor of the Exchequer,  
11, Downing Street,  
London SW1.

Dear Chancellor,

Now that Budget day has been fixed for the 15 March, I write to ask if I and my colleague, Dafydd Elis Thomas, M.P. (together with one, or at the most two, advisors, could make representations to you or to one of your fellow-Ministers about the changes which we in Plaid Cymru would like to see in this year's Budget.

As you will know, I have over the last couple of years made numerous representations in writing on various points, but we have not troubled you in seeking meetings, although we did so with the last government. However, given the really severe effects of the recession on Wales - and I know that from your own family connections you will be aware of the effects that depression can have in Wales, - I would ask if it would be possible for us to have half an hour of the time of one of your colleagues during the next two or three weeks to make such representations?

*Specific?*

The areas which we would wish to cover would include broad economic tragedy with a view to reducing unemployment; capital programmes; health and social service spending priorities; transport spending; and the defence budget. We are not pressing for greater expenditure in all of these sectors, but we shall be pressing for different priorities and changes to present expenditure patterns.

However, I shall be very grateful if it is possible for you to agree in principal, and offer a time and date so that the necessary arrangements can be made. If it is helpful, our Secretary in Parliament, Miss Huws, (219-5021) will be willing to liaise with your Department concerning arrangements.

Many thanks.

Yours sincerely,

*Dafydd Wigley*

Dafydd Wigley  
Member of Parliament for Arfon.

CONFIDENTIAL



NOTE OF A MEETING HELD AT H M TREASURY, 10am WEDNESDAY 9 FEBRUARY 1983

Present at meeting: Financial Secretary  
Minister of State (R)  
Mr French  
Mr Martin  
Mr Crawley/IR  
Mr Stewart/IR

INTEREST RELIEF: EMPLOYEE BUY-OUTS: BUDGET STARTER 189

The meeting had before it Mr Stewart's submission of 28 January.

The Financial Secretary opened the discussion by commenting that he was sympathetic to the principle of encouraging employee buy-outs, although he was aware that any move in this area would be a further complication to the tax system. There were two possible routes to explore:-

1) the concept of "job ownership companies" as pioneered by Robert Oakshott and Jo Grimond. The Financial Secretary wondered how far the Department of Trade had progressed with their consideration of the Company law aspects of the scheme (para 8e) of Mr Stewart's note).

The Revenue agreed to follow this up with the DOT.

2) the taxation route: by extending to employee buy-outs the interest reliefs currently given on borrowings used to facilitate management buy-outs.

The Minister of State commented that at present it was quite possible for groups within management to organise themselves to take advantage of the reliefs available. The ordinary employee - The "small man" - was not being afforded these privileges, and he was concerned at this apparent discrimination.

Mr Crawley commented that so far the reliefs had been linked to persons acting in an entrepreneurial capacity. It would though be possible to extend the reliefs to employee controlled companies, if the provisions were fairly tightly drawn. He envisaged difficulties in defining an employee buy out situation although it would probably not be too difficult to find a suitable definition of employee control. Any legislation would be fairly lengthy and complex.

Ministers envisaged a scheme along the following lines:-

- 1) Relief would be given to full time employees of the company only.
- 2) Relief would be given on interest charged on original borrowings used for the buy out.
- 3) Relief would not be given for borrowings used for general share purchase by employees, but would be restricted to the employee buy-out situation.
- 4) The employees' total shareholding after the buy-out must be sufficient to control the company ie at least 51%.
- 5) The individual holding of an employee should be no more than X% (say 5%) of the employees' total shareholding.
- 6) There should be no money limit on the individuals' holding.

Ministers asked the Revenue to work-up a scheme along these lines and to send a further submission in due course.

Circulation:

Those present  
PS/Chancellor  
PS/Chief Secretary  
PS/Economic Secretary  
PS/Minister of State (C)  
Mr Robson  
PS/IR  
Mr Kemp  
Sir D Wass  
Mr Middleton  
Mr Moore

*SK.*  
E KWIECINSKI



NOTE OF A MEETING HELD AT 9.00AM ON 2 FEBRUARY 1983 IN THE  
FINANCIAL SECRETARY'S OFFICE, HM TREASURY.

Present: Financial Secretary  
Mr Driscoll )  
Mr Savage ) IR  
Mr Shute )  
Mr Brett )  
Mr Hoyes )  
Mr Groves )  
Mr Elsey ) CCSU  
Mr Bishton )  
Mr Sentinella )  
Mr MacPherson )  
Mr Hughes )

#### TAXATION OF CIVIL SERVICE ALLOWANCES

The Financial Secretary welcomed the Unions and invited them to explain their position on the taxation of the various allowances in question.

The Unions said that while they accepted that clothing and telephone allowances were taxable they did not concede that all the allowances paid on detached duty terms to peripatetics and others were taxable and were prepared to take test cases before the Commissioners if necessary. They were particularly anxious however to state their case for the tax liabilities of these allowances to be met by a composite global sum rather than grossing-up in individual cases. In their view this would save considerable administrative costs. They saw precedents for this method in the present sick pay arrangements in the Civil Service and the scheme applied to the expenses of part time office holders.

The Financial Secretary said that the Inland Revenue was responsible for administering the law laid down by Parliament and it was not possible for him as a Minister to intervene in their exercise of that responsibility. He thought it entirely proper for the CCSU to take test cases where necessary if there was genuine uncertainty over the

interpretation of the law and if no agreement could be reached. As for the administrative arrangements for collecting the tax, he was concerned that there should be equality of treatment for individuals throughout the United Kingdom and this could only be achieved by individual grossing-up. In addition such grossing-up by identifying individual costs might help Departments improve their efficiency.

The CCSU representatives pointed out that there were over 600 peripatetic posts in the Inland Revenue, DHSS, and Customs and Excise alone and again stressed the administrative problems of individual grossing-up. In particular while no Civil Servant should in theory be out of pocket in the long run, individuals might be out of pocket in the short term until they received the grossing-up element of their expenses, which might be at the year end. They stated that if it were possible to agree on a composite scheme they were of the opinion that it would be possible to avoid the need to take test cases before the Commissioners.

The Financial Secretary pointed out that he had a responsibility for the exercise of care in the spending of public money and that one could only be sure that the right amount of tax was paid over and collected through individual grossing-up. He pointed out that difficulties could arise through applying special schemes to Civil Servants that were not open to other employers. The Unions drew attention to the part time office holders' scheme and commented that individual grossing-up would, in their view, lead to no increase in revenue whilst increasing staff costs.

The Unions commented that the allowances paid to Civil Servants were not additional remuneration as might occur elsewhere but straightforward reimbursements made under very strict rules. The Revenue said that many reputable employers in the private sector applied similar strict rules to the reimbursement of expenses and that the Inland Revenue insisted on individual grossing-up in these cases. In addition the same rules were applied by the Revenue in judging whether detached duty allowances paid by outside industry were taxable as it was proposed to apply to the Civil Service.

The Financial Secretary concluded by saying that he thought that individual grossing-up was the correct procedure but that he appreciated that, as regards the taxation of these allowances, there may be difficulties as regards individual cases at the margins and these could, of course, be discussed with the Revenue. The CCSU agreed to contact the Revenue with details of the particular cases or instances where they felt that there was a particularly strong case to be made.

Circulation:

PS/Chancellor  
PS/Minister of State (C)  
Mr Robson  
Mr D Faulkner  
Mr M Williams  
Mr Driscoll) IR  
Mr Savage )  
PS/IR

CONFIDENTIAL



FROM: M E DONNELLY  
DATE: 11 February 1983

MR NORTON

cc Chancellor  
Chief Secretary  
Economic Secretary  
Minister of State (R)  
Sir D Wass  
Sir A Rawlinson  
Mr Wilding  
Mr Burgner  
Mr Kemp  
Mr Monger  
Mr Chivers  
Mr Pratt  
Mr R Williams  
Mr Hosker - T. Sols

DE LOREAN

The Financial Secretary was most grateful for your interesting report of 7 February giving further details of the role of the Government Directors on the De Lorean Board.

The Financial Secretary commented that in the private sector company directors are normally responsible to their shareholders. But in the De Lorean case (and also it would appear in the case of Lear Fan) the Government does not hold any shares, so the usual relationship cannot exist. He wonders whether in such cases we might somehow require the directors appointed by the Government to take explicit responsibility for the various financial guarantees which the Government will presumably have provided to the companies concerned. This might make the position of Government directors more analagous to their private sector equivalents.

MED  
M E DONNELLY

BUDGET CONFIDENTIAL



FROM: FINANCIAL SECRETARY  
DATE: 14 February 1983

CHANCELLOR

cc Chief Secretary  
Economic Secretary  
Minister of State (C)  
Minister of State (R)  
Sir D Wass  
Mr Burns  
Mr Middleton  
Mr Bailey  
Mr Kemp  
Mr Moore  
Mr Robson . *Mr Ridley*  
Mr Martin ) *Mr French*  
Mr Battishill )  
Mr Beighton ) IR  
Mr Blythe )  
Mr Painter )  
PS/IR  
PS/C&E

SMALL FIRMS, ENTERPRISE AND WIDER SHARE OWNERSHIP

We are meeting on Wednesday morning, 16 February, to discuss this ... package. I attach a table summarising the possible costs and a note giving the state of play on each of the items. I suggest that there are broadly three things we need to do.

First, we must spend some of the time on the Business Expansion Scheme which is the major innovatory item in the package. In particular, you will wish to discuss the questions which you raised on my minute of 31 January and which are noted in paragraph 3 of the note.

Second, we need to run through the items listed and where the work has been completed to confirm or to take decisions. On CTT we have agreed to defer our decision until we have a clearer picture of all the measures which might be held to help the better off. As the note records, we had provisionally agreed on a package under the wider share ownership heading. I am minuting separately on the questions which have been raised subsequently on whether something special should be done for executives in smaller firms and to deal with the



form of tax due under these schemes. For the remaining items the note indicates where work is still in progress and the only item on which it would now be useful to take a firm decision is the small one on Schedule D case V trading losses (paragraph 17 of the note). I will recommend on this before Wednesday's meeting.

Third, we need to consider whether we are satisfied with the shape and size of the package as a whole. I think it is attractive with a fair spread of useful items in it. The Business Expansion Scheme alone is a dramatic extension to what was already a generous relief and amounts practically to a new scheme which will I think be very welcome to the small business and enterprise lobby. The other two main items are CTT and wider share ownership. In addition to those we have a pretty useful list of medium to small items which should be welcomed.

Moreover, in looking at this package we must remember that there are other measures around potentially helpful to small firms and others. They will benefit from the NIS reduction. At the very least we shall want to revalorise the lower and upper small profits limits for corporation tax and, depending on which of the options we select from the paper which the Minister of State (R) will be putting to you, there might be something better on offer. Some of the options in the technology and innovation package and in the construction and tourism package (of which I am more doubtful) will also be helpful for some parts of the small/medium-sized company sector.



NICHOLAS RIDLEY

14 February 1983

SMALL FIRMS AND ENTERPRISE  
(including wider share ownership)

Note: All figures are of revenue costs. The only costs which would score as public expenditure are those for the Loan Guarantee Scheme.

Business Expansion Scheme

Cost: 1983-84 - neg?  
1984-85 - £10-100 million?  
Full year - ??

1. This is a major extension of the present Business Start-Up Scheme and will provide tax relief for new equity investment in qualifying unquoted trading companies - established and start-up.

2. The Revenue are advising further on the possible range of costs. But even then the estimate will be very uncertain, because of the difficulty of guessing the response to the new scheme. The 1983-84 costs will be nil if, for the transitional year, the present rule continues whereby applications are not allowed until after the end of the tax year. But if they were allowed from January 1984 there might be a significant cost. The Revenue will seek a policy decision on this.

3. Recommendations on the scheme's main features are in the Financial Secretary's minute of 31 January to the Chancellor. The Chancellor (Miss O'Mara of 3 February) has endorsed the broad approach, subject to:

- (i) advice on whether the exclusion of unquoted companies whose shares are quoted on the USM might introduce distortions and provoke protests (e.g. from the Stock Exchange);
- (ii) discussion of whether an investor who simply replaces an outstanding loan to a company with share capital should be eligible for tax relief - (paragraphs 19-23 of the FST's minute of 31 January).

4. The BES should be welcome to small and medium-sized unquoted companies; in particular it should enable them more easily to attract new equity to finance expansion and to improve their debt/equity ratios. The changes will also help to meet criticisms of the BSS by removing some of the complexities and restrictions in the present scheme.

5. Ministers have decided not to meet the CBI's proposals for Small Firms Investment Companies. As seen by the CBI, SFICs would have eased the problem of investors worried about being locked in to investment in small companies and have encouraged the institutions to invest through SFICs in the small firms sector. In response to that:

- i) we have agreed with Trade officials on a factual statement on the extent to which secondary markets in the private company shares can operation (Mr Robson's minute of 19 January to the FST). This demonstrates that there is more scope for such markets than the CBI suppose. The FST proposes that, subject to Lord Cockfield's agreement, more effective publicity should be given to the options available and that the possibilities should be stressed in the Budget debates;
- ii) in general there should be no tax constraints on institutions wishing to invest in small firms either directly or through approved investment trusts or authorised unit trusts. FP and Revenue will complete discussions by 11 February with some institutional investors to see whether there are any tax changes which might be made to stimulate more institutional investment, in particular through joint ventures. I held a meeting with the venture capital industry on 7 February, when some problems were raised which I will be following up.

Loan Guarantee Scheme

Cost: 1983-84 - £5 million (public expenditure)  
 1984-85 - £5 million (public expenditure)  
 Full year - -

6. Treasury Ministers have accepted that the scheme should run for the full 3 years, though not necessarily unchanged. An increase in the ceiling will be required. The point at issue is the guaranteed proportion: there is a good case for a reduction from the current 80 per cent to, perhaps, 70 per cent. A letter from DOI Ministers is expected shortly.

Corporation tax rates

7. Any real increase in the small profits limits for corporation tax, or any cut in the 40 per cent small company's rate, would be a significant element in the small firms package. This will be considered in the context of the main options identified for changes in corporation tax.

Capital transfer tax

Cost: 1983-84 - £34 million  
 1984-85 - £70 million  
 Full year - £90 million

(NB. These costs are additional to those arising from indexing the thresholds)

8. FST minuted Chancellor on 18 January, recommending a package of measures:

- (a) a new rate scale;
- (b) increases in business and agricultural reliefs;
- (c) a lengthening of the payment instalment period from 8 to 10 years.

On (a) and (b) the FST presents two options for change and favours the more generous in each case. The cost of the most generous package is shown above. The main beneficiaries would include owners of medium-sized businesses and farms; the measures would reduce the burden, alleviate the psychological disincentive of CTT on growth and ease cash flow problems. At the Chancellor's meeting on 4 February it was agreed to consider the package and options further in the light of other measures affecting the better off.

Wider share ownership

Cost: 1983-84	- £20 million
1984-85	- £35 million
Full year	- £40-45 million

9. The Chancellor (minute of 3 February) has agreed subject to overview of packages as a whole that:

- a) the limit on profit sharing schemes should be £1,250 or 10 per cent of salary, subject to a £5,000 maximum;
- b) the savings-related share option scheme monthly limit should be raised to £75;
- c) the instalment period for payment of tax on share options should be extended from 3 to 5 years.

10. The package as a whole offers increased incentive to employee shareholding. It does not reintroduce "top hat" schemes but it would give increased benefit to higher paid employees in particular. In response to the Chancellor's doubts a further paper is being circulated by the FST suggesting possible further measures.

Capital gains tax

11. A. Monetary limits

Cost: 1983-84	- nil
1984-85	- under £1 million
Full year	- under £1 million

Chancellor's meeting of 4 February approved FST's proposals to:

- (a) revalorise annual exempt amounts for individuals and for other trustees;
- (b) abolish small gifts exemption;
- (c) increase relief limit on small part disposals of land and residential letting reliefs limit to £20,000;
- (d) retain current chattels exemption at £3,000.

The CGT provisions for payment by instalments are now hardly used and, if CTT changes are made, the Financial Secretary has agreed that the CGT provisions may be dropped: if not, the £250,000 limit is to be removed.

#### B. Retirement relief

Cost: 1983-84 - nil  
 1984-85 - under £1 million  
 Full year - £1½ million

The Chancellor's meeting on 4 February approved FST's proposal to double present limit to £100,000. Relief provides assistance to unquoted trading sector.

NB. Although not part of the small firms and enterprise package there is also the decision to retain parallel pooling for shares, announced by PQ on 23 December 1982.

#### Zero and deep-discounted stock

Cost: not yet quantifiable.

12. A consultative document was issued on 12 January, requesting comments by 11 February. There is a commitment to legislate in 1983 at least to prevent avoidance. The document discusses options

and examines the possibility of an accruals system (spreading the taxation of the discount, and relief for it, over the life of the stock, rather than at redemption or earlier realisation). The implications of shelf issues of the definition of a "deep discount" are to be considered in the light of response to document. Firm options for change are not yet clear: cost will depend on take up. The FST will report further on the result of recent consultations.

#### VAT

Cost: 1983-84	- £5 million
1984-85	- £10 million
Full year	- £10 million

13. Ministers have agreed to increase in the VAT registration thresholds.

14. The EST is to discuss on 14 February the case for a consultative document on a move to annual accounting.

#### "Net of tax" pay tables

15. This would not require legislation or have a revenue cost. The object is to make it easier for employers to pay net of tax if they so wish and to commend the possibility in the Budget debate. The Revenue have reported (8 February) to the FST advising caution.

#### Schedule D/E

16. The Revenue are to discuss with the FST the possibilities, including issuing guidance to taxpayers, for clarifying the borderline between Schedules D and E.

#### Schedule D case V trading losses

Cost: 1983-84	- under £1 million
1984-85	- under £1 million
Full year	- under £1 million

17. The proposal is to allow losses of a trade carried on overseas to be carried forward for relief against future profits of similar activities in the UK. Revenue submission (22 December) recommended against action, but Chancellor asked (meeting 12 January) for the option to be kept on the table, as it would represent a concession to the Grylls Study Group and the IOD. A decision is now needed.

De minimis limit for assessment of apportioned income

Cost: 1983-84 - under £1 million  
 1984-85 - under £1 million  
 Full year - under £1 million

18. Income which is apportioned to the proprietor of a close company is not assessed if it is less than £200. Following the MST(R) note of 20 January the Chancellor (7 February) has decided to raise limit to £1,000.

Relief for interest - employee buy-outs

19. The proposal is to extend relief for interest to loans by employees to buy shares in an employee controlled company. Revenue submission (28 January) recommended against extension, but FST and MST(R) asked (meeting 9 February) for further Revenue note on how an employee controlled company could be defined and on options for limiting relief to actual buy-out situation. Cost very dependent on take up.

Close companies: ACT limit on loans

Cost: 1983-84 - under £1 million  
 1984-85 - under £1 million  
 Full year - under £1 million

20. The proposal is to increase the limit on loans for housing to employees in close companies which are exempted from ACT. Chancellor (1 February) has said that a change in the monetary limit should go hand-in-hand with the decision on the mortgage interest relief ceiling.



Tax treatment of interest paid by companies to non-residents

21. Consultative paper issued on 26 January, for comment by 22 February, seeking views on proposal for FB 1983 legislation (a) to enable UK companies to pay interest on Euro bonds to non-residents without deduction of tax; and (b) to make a minor relaxation of the conditions for relief for interest paid to non-residents. Cost difficult to estimate - perhaps up to £10 million eventually, but with negligible costs in 1983-84 and 1984-85.

Discounts on bills of exchange (acceptance credits)

Cost: 1983-84 - £1-2 million  
 1984-85 - £1-2 million  
 Full year - £1-2 million

22. Under present law, discount/<sup>on</sup> bills of exchange drawn under an acceptance credit facility can get Case I relief but subject to some restrictions (viz. that borrower is trading and that discount is on revenue account). FST has agreed to legislate in FB 1983 to remove these restrictions - in effect to allow relief for discount as if it were interest on ordinary bank borrowing.

SMALL FIRMS, ENTERPRISE AND- WIDER SHARE OWNERSHIP

Item	Revenue costs £m		
	1983-84	1984-85	Full year
1. Business Expansion Scheme (costs highly tentative)	under 1	10-100	10-100
2. Loan Guarantee Scheme	5 (pe)	5 (pe)	-
3. Corporation tax rates (figures are for revalorisation of small companies limits)	6	10	10
4. Capital Transfer Tax	34	70	90
5. Wider Share Ownership	20	35	40-45
6. Capital Gains Tax			
(a) monetary limits	-	under 1	under 1
(b) retirement relief	-	under 1	1-2
7. Zero and deep-discounted stock	na	na	na
8. VAT (registration thresholds)	5	10	10
9. "Net of tax" pay tables	na	na	na
10. Schedule D/E issues	na	na	na
11. Schedule D Case V trading losses.	under 1	under 1	under 1
12. De minimis limit for assessment of apportioned income.	under 1	under 1	under 1
13. Relief for interest - employee buy-outs.	under 1	2	5
14. Close companies - ACT limit on loans.	under 1	under 1	under 1
15. Tax treatment of interest paid by companies to non-residents.	under 1	under 1	10
16. Discounts on bills of exchange (acceptance credits)	1-2	1-2	1-2

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TOTALS	74-75	146-237	179-276
of which public expenditure	5	5	-

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CONFIDENTIAL



FROM: E KWIECINSKI  
DATE: 14 February 1983

PS/CHANCELLOR

cc PS/Chief Secretary  
PS/Economic Secretary  
PS/Minister of State (C)  
PS/Minister of State (R)  
Sir D Wass  
Mr Middleton  
Mr Moore  
Mr Lavelle  
Mr Robson  
Mr Fitchew  
Mr Kemp  
Mr Ridley  
Mr French  
Mr Harris  
Mr Beighton - IR  
PS/IR

CAPITAL TRANSFER TAX

The Financial Secretary has seen Mr Beighton's submission of 10 February and Miss Pollock's minute of 11 February.

He has commented that the main question is, how much can be afforded. He thinks that the most popular way to spend the money would be on the special reliefs. He would therefore still go for increases to 60 per cent and 40 per cent, plus Scale G (or Scale H if it could be afforded).

*CK*  
E KWIECINSKI

14 February 1983



FROM: NICHOLAS RIDLEY  
DATE: 14 February 1983

CHANCELLOR

cc CST  
EST  
MST(R)  
MST(C)  
Sir D Wass  
Mr Middleton  
Mr Bailey  
Mr Moore  
Mr Robson  
Mr French

EMPLOYEE SHAREHOLDING

You asked me to have another look at the package we have put together on employee shareholding and stock options to see what we could do to weight it rather more generously in the direction of stock options.

The package as it stands at present is -

- a. to raise the current £1250 limit for the 1978 profit sharing schemes to include an alternative limit of 10 per cent of salary, subject to an overall maximum of £5000;
- b. to raise the limit for monthly contributions under the 1980 savings-related share option schemes from £50 to £75; and
- c. to lengthen the instalments period for options exercised outside approved schemes from 3 years to 5 years.

I think we are agreed that it would be a mistake to go back wholesale to the 1972 relief, which made no charge to income tax or to CGT at the point of exercise of the share option, but which charged CGT on the gain at the point of ultimate disposal of the shares. Short of this, we have identified three basic choices -

- i. To go back to the 1972 relief, but limit it to smaller companies: we should probably have to draw the line at the quoted/unquoted point. Indeed it might be more saleable on the

basis of linking it to the Business Expansion Scheme - although there would need to be some awkward protective provisions. The cost is uncertain, but probably at present less than £m20.

ii. To charge the share option gain to CGT, rather than income tax, but continue as now to collect the charge at the point of exercise of the share option. Cost in the range £m30-60.

iii. To continue the present income tax charge on the exercise of the option, but to scale it down by charging only a proportion of the gain. For example, charging only 75 per cent of the gain would reduce the top rate of 60 per cent effectively to 45 per cent. Cost (on these figures) in the range £m15-25.

... I attach a table which puts these choices in context. Box 1 is the position in 1978/79 under the previous Government. Box 2 is where we are now, including an allowance for the benefit of the three-year instalment arrangement. Box 3 is the effect of the present proposal to move out to five-year instalments. Box 4 is my course (iii) above, including the extra benefit of retaining the existing three-year instalments. Box 5 is CGT rates, which could be charged either on exercise of the option (course (ii) above) or on ultimate disposal (course (i) above).

On balance I do not favour course (i). There are arguments for looking particularly at the smaller company in this context, and larger unquoted companies have a case of sorts as well. <sup>However</sup> the quoted/unquoted line excludes some undoubtedly deserving cases of small high risk quoted companies from a very substantial benefit and I doubt whether in the end we should be able to hold the line. Course (ii) would be seen as too generous, particularly now that CGT is indexed.

Course (iii) seems better. The rationale - if one is needed - would be that these gains can be regarded either as income or as capital, depending on your point of view, and the right thing to do is to put

the effective charge somewhere in between.

For my own part, I would be happy to stick with the package as we have it - paragraph 2 above. These share options are not ungenerously treated we shall have more or less trebled the return on them (compare 1 and 3 in the table) since May 1979. It was in fact Patrick Jenkin (as the then Chief Secretary) who steered the 1972 reliefs through the House. Feelings ran quite high and he should therefore understand the sensitivity of the issue. I think the present package would go a long way towards satisfying him. Indeed I have discussed the problem with him, and he seems to be content that we are doing rather more than he expected.

But if you would prefer to move, further I am content. Of the three approaches I have set out, I would go for course (iii) above ie retaining the existing three-year instalments provision and charging 75 per cent of the gain - at the cost of a degree of further complication

*Nicholas Ridley*  
NICHOLAS RIDLEY

CONFIDENTIAL

Effects of various different tax charges on the gain on exercise of a share option

Share option gain	1			2			3			4			5		
	Income tax at 1978/79 rates			Current income tax rates, three year instalments			Current income tax rates, five year instalments			Current income tax rates, three year instalments, and charging only 75% of the gain			Current CGT rates		
	Tax Rate %	Tax £	Net Gain £	Tax Rate %	Tax £	Net Gain £	Tax Rate %	Tax £	Net Gain £	Tax Rate %	Tax £	Net Gain £	Tax Rate %	Tax £	Net Gain £
£10,000	83	8,300	1,700	53	5,300	4,700	48	4,800	5,200	40	4,000	6,000	7.2	720	9,280
£100,000	83	83,000	17,000	53	53,000	47,000	48	48,000	52,000	40	40,000	60,000	20.7	20,700	79,300
£m1	83	830,000	170,000	53	530,000	470,000	48	480,000	520,000	40	400,000	600,000	22.05	220,500	779,500

- Assumptions :
1. Option-holder's marginal rate of IT is the top rate.
  2. For columns 2, 3 and 4: 10 per cent return (post tax) on marginal extra investment.
  3. For column 5: Option exercised four years after grant, share value having doubled in the meantime; inflation at 8 per cent per annum (compounded over three years to 26 per cent); option holder makes no other capital gains in the year of exercise ie he has full use of his £5,000 CGT exemption.

CONFIDENTIAL



FROM: M E DONNELLY

DATE: 14 February 1983

CHANCELLOR

cc Chief Secretary  
Economic Secretary  
Sir D Wass  
Mr Burns  
Mr Littler  
Mr Middleton  
Mr Unwin  
Mr Evans  
Mr Kemp  
Mr Lavelle or  
Mr R I G Allen  
Mr Riley  
Mr Perfect  
Mr Ritchie  
Mr Ridley

COMPETITIVENESS

The Financial Secretary has seen Mr Peretz submission of 11 February, attaching a draft reply to Sir Terence Beckett's letter of 1 February.

The Financial Secretary is not happy with one phrase in line 7 of paragraph 3 of this draft. This is a reference to "lower inflation", in the context of wage restraint and improvement in productivity. What seems to be meant is lower wage settlements. These are not the same and it would be as well to refer specifically to "lower wage settlements" in that sentence.

*MEJ*  
M E DONNELLY



CONFIDENTIAL



FROM: FINANCIAL SECRETARY

DATE: 14 February 1983

CHANCELLOR

cc Chief Secretary  
Sir D Wass  
Mr Littler  
Mr Byatt  
Mrs Hedley-Miller  
Mr Unwin  
Mr Odling-Smee  
Miss Court  
Mr Edwards  
Mr Fitchew  
Mr Hall  
Mr Ridley.

COMMISSION GREEN PAPER

The analysis under cover of Mr Unwin's minute of 10 February is comprehensive, useful, and I am sure accurate. I do slightly quarrel with <sup>the</sup> tone. Although it is right to be cautious, and dismissive in private minutes, this sort of tone would be disastrous in public or in Council, let alone in the European Parliament.

Much of what we dislike has to go into the Green Paper to satisfy the ideals of MEPs, though neither the Commission nor MEPs, can believe they will get  $\frac{1}{4}$  of what they ask for. But they have to talk in the language of Community programmes and bigger budgets and more own resources, and we should not criticise them for that; just make sure it doesn't actually happen.

The only real lifeline to us is over the agricultural tax. The financial equalization programme is not meant to help us, and would not do so: although it might not hurt us either.

Shares in agricultural production must be the wrong basis for calculating the new own resources. As Mr Edward's calculations show, at best it can only bring back a third of our net contribution. It must be based on shares in overproducing. It is overproduction that causes the need for the Guarantee Fund and so overproduction must be the measure of the base for the new levy.

If NP = National Production )  
NC = National Consumption ) of common price products  
and CAP = Cost of Guarantee Fund

Then  $\sum (NP-NC) = \text{Community overproduction} = 0$   
each countries shares of 0 is =  $\frac{0}{NP - NC}$

[Some will be +, some negative, eg UK]

The Levy should be  $\frac{0 \times \text{CAP}}{NP - NC}$

I would prefer a measure based on farm land area - because this doesn't change with good and bad harvests like production. We could have a constant factor for each nation to apportion the cost of the Guarantee Fund. This would also put pressure on Countries to reduce their acreage of farm land, by taking land out of production - hopefully assisted to do so financially by the Commission.

What we should do is to put forward one of these variants on a levy on surpluses very forcibly.

I would welcome a discussion of all this if possible.

*N. C. Donnelly*  
pp NICHOLAS RIDLEY

CONFIDENTIAL



FROM: M E DONNELLY

DATE: 14 February 1983

PS/CHANCELLOR

cc Mr Littler  
Mr Unwin  
Mrs Hedley-Miller  
Miss Court  
Mr Edwards

COMMUNITY BUDGET NEGOTIATIONS REAPPRAISAL, FEBRUARY 1983

The Financial Secretary has seen the Cabinet Office paper written, for the Prime Minister's meeting at 4.00pm on 15 February to discuss the Budget negotiations.

He has commented that amongst the groups set out in paragraph 23 with whom we should have further bilateral discussions should be included the European Parliament. Given its assertion of its role in the Budgetary process it will be very important to remain in close consultation with MEPs throughout our discussions on a longer-term budget solution.

The Financial Secretary has commented on the Commission proposal to raise revenue related to agricultural indicators separately.

MED

M E DONNELLY



FROM: M E DONNELLY

DATE: 14 February 1983

MR EDWARDS

cc Mr Unwin  
Mrs Hedley-Miller  
Miss Court  
Mr Lennon  
Mr Peet

LETTER FROM STANLEY BUDD

... I have received the attached letter from Mr Budd, the Commission's representative in Scotland.

The Financial Secretary does not recall this precise figure; though he thinks it may be a misquote from a PQ answer. He would be grateful if you could ascertain where this figure comes from and also provide the correct figure. This might be included in a Private Secretary reply to Mr Budd.

MEI

M E DONNELLY

Commission of the European Communities

7 Alva Street Edinburgh EH2 4PH

Telephone: 031-225 2058

Press and Information Office open Mondays to Fridays  
9.00 a.m. to 1.00 p.m. and 2.00 p.m. to 5.00 p.m.

Representative for Scotland — Stanley A. Budd

3 February 1983

Mr. Martin Donnelly,  
Private Secretary to Hon. Nicholas Ridley, MICE MP,  
HM Treasury,  
Treasury Chambers,  
Parliament Street,  
LONDON SW1P 3AG.

Dear Mr Donnelly

In a television programme last week in which I took part with Mrs. Janey Buchan MEP and others, Janey quoted from what she claimed was a statement by Mr. Ridley that "the cost to Britain of membership since we joined, not since the Referendum, has been £1.7 million per day."

I do not remember reading this figure, although since I do not subscribe to Hansard I may have missed it. Is Mrs. Buchan quoting Mr. Ridley accurately? And might it be possible to spare me a copy of the full text? I would be grateful for any help you can give.

Yours sincerely

Stanley Budd

Stanley Budd

Cardiff Office:  
4 Cathedral Road Cardiff CF1 9SG  
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London W8 4QQ  
Telephone: 01-727 8090

BUDGET CONFIDENTIAL



FROM: E KWIECINSKI

DATE: 14 February 1983

MR M J G ELLIOTT/IR

cc CST  
Mr Robson  
Mr French  
Mr Graham (Parly Counsel)  
PS/IR

CGT MARKET VALUE RULES  
BUDGET STARTER No 144 (PART 1)

The Financial Secretary has seen your submission of 10 February.

He is sure that we should legislate this year to close the new loop-hole - but not of course to catch the Mr Baileys of this world.

He has commented that the new legislation may be different from that originally envisaged but we do nevertheless have a place for it in the Bill.

The Financial Secretary is keen to write to Mr McCrindle as soon as possible, otherwise he thinks the decision to legislate should be announced as soon as practicable.

  
E KWIECINSKI

- CONFIDENTIAL



FROM: M E DONNELLY

DATE: 15 February 1983

CHANCELLOR

cc Chief Secretary  
Economic Secretary  
Minister of State (C)  
Minister of State (R)  
Sir D Wass  
Mr Burns  
Mr Middleton  
Mr Byatt  
Mr Moore  
Mr Kemp  
Mr Barber  
Mr Griffiths  
Mr Powell  
Mr Ridley  
PS/C&E

LOWER OIL PRICES: POSSIBLE FISCAL ACTION

The Financial Secretary has seen Mr Cassell's note of 11 February.

He has commented that it would be interesting to see a similar piece by FEU on the effects of a rise in the oil price of \$5. Would tax reductions then be proposed; or would extra taxation be recommended to deal with the potential inflationary effects - as happened in 1974 and 1979. Overall the Financial Secretary thinks that oil price changes have little overall influence on the money supply; and steady control of the money supply should remain the object of policy.

ME  
M E DONNELLY

CONFIDENTIAL



FROM: M E DONNELLY

DATE: 15 February 1983

MR BATTISHILL/IR

cc Chancellor  
Chief Secretary  
Economic Secretary  
Minister of State (R)  
Mr Moore  
Mr Robson  
Mr French  
Mr Prescott - IR  
PS/IR

BUSINESS EXPANSION SCHEME: COST

The Financial Secretary was grateful for Mr Prescott's note of 11 February. He appreciates the difficulties involved in trying to estimate the costs of this scheme.

The Financial Secretary suspects that Mr Prescott may if anything has over estimated the likely cost of the scheme because of the time it is likely to take to get going, and because of the innate conservatism of many small businessmen. But of course the more the scheme costs the more effective it will be.

MEJ

M E DONNELLY



CONFIDENTIAL



FROM: M E DONNELLY

DATE: 15 February 1983

CHANCELLOR

cc Chief Secretary  
Economic Secretary  
Minister of State (C)  
Minister of State (R)  
Sir D Wass  
Sir A Rawlinson  
Mr Wilding  
Mr Le Cheminant  
Miss Kelley  
Mr Judd  
Mr Jones  
Mr Farrington  
Mr St Clair

PRIVATISATION OF HEAVY GOODS VEHICLE TESTING

The Financial Secretary has seen Mr Howell's letter of 9 February on the privatisation of heavy goods vehicle testing.

The Financial Secretary is not convinced by Mr Howell's criticism of Treasury concerns about this case. Indeed our intervention could be regarded as strengthening his hand in negotiating with Lloyds. So far the Department of Transport have only negotiated a very bad deal. Overall the Financial Secretary thinks that we need to delay a final decision until we have got the Bill dealing with Technical Redundancy, unless Mr Howell considers that he can get as good a deal from the trade unions now as he would get if that Bill were law.

*MEJ*  
M E DONNELLY

- CONFIDENTIAL



FROM: E KWIECINSKI  
DATE: 15 February 1983

PS/CHANCELLOR

cc PS/Chancellor  
PS/Economic Secretary  
PS/Minister of State (C)  
PS/Minister of State (R)  
Sir D Wass  
Mr Middleton  
Mr Moore  
Mr French  
Mr Isaac - IR  
PS/IR

**BUDGET PACKAGES: FAIRNESS IN TAXATION; ANTI-AVOIDANCE PROVISIONS**

The Financial Secretary has seen Mr Isaac's notes of 10 and 11 February.

He agrees with Mr Isaac that there should not be a "fairness in taxation package" as such, although he thinks several of the items may be worthy of inclusion in the Speech.

His specific comments are as follows:-

Item 197 (ICI scholarship case) - he thinks action should be taken to reverse the High Court decision.

Item 134 (car and fuel rate schedules) - he thinks the rate scales should be increased and he is awaiting a detailed submission from the Revenue, following his meeting of 14 February.

Item 110 (secondhand bonds) - we are committed to do this.

Item 144 (CGT non-resident trusts) - this was originally a relieving provision, which has been turned into a taxing provision. He thinks we should still do this.

Item 116 (deep discount bonds) - we should do this.

'Marks and Spencer' employees' houses - he thinks action should be taken to stop this device.

Double £25,000 loans - this should not be acted upon unless there is an increase in the £25,000 mortgage interest relief ceiling.

PAYE: tax borne by employers - He thinks that action on this is desirable, although final decisions should be subject to any mention of this in the Keith report and to the overall balance of anti-avoidance measures in the Budget.

[Item 134 and the last three items were discussed in Mr Driscoll's submission of 11 February (Taxation of Fringe Benefits) and at the Financial Secretary's meeting of 14 February.]

  
E KWIECINSKI

CONFIDENTIAL



FROM: E KWIECINSKI  
DATE: 15 February 1983

CHANCELLOR

cc Chief Secretary  
Economic Secretary  
Minister of State (C)  
Minister of State (R)  
Sir D Wass  
Mr Middleton  
Mr Moore  
Mr Robson  
Mr Griffiths  
Mr French  
Mr Hall  
Mr Strachen/C&E  
Mr O'Leary/IR  
PS/C&E  
PS/IR

KEITH COMMITTEE REPORT

The Financial Secretary has seen Mrs Strachan's and Mr O'Leary's joint submission of 14 February.

He has commented that the Report will need careful study and assessment. He is sure that there is little, if anything, that can be included in this year's Finance Bill - probably only the reform of the Special Commissioners already in hand. He thinks that to pick and choose among the rest of the Report's recommendations would be a great mistake. Indeed he suggests that the Report may need a special Bill of enactment, which may be easier than trying to enact certain measures in a Finance Bill.

On the other hand he does not think that publication of the Report should be delayed for too long, otherwise the Government may be accused of "concealing". Publication of the Report would not necessarily imply that the Government agreed with the Report's findings. The Financial Secretary thinks that the Report sounds useful and balanced but that there may be some stiff rearguard actions fought against some of the proposals for giving the Departments enhanced powers.

  
E KWIECINSKI



FROM: NICHOLAS RIDLEY  
DATE: 15 February 1983

CHIEF SECRETARY

cc Mr Driscoll - IR

BENEFITS IN KIND: CAR SCALES AND BR'S INTERCITY BUSINESS

I have seen the note by Simon Jenkins on this topic.

I don't believe there is any subsidy involved, as Simon Jenkins alleges. Nor do I believe people "clock up extra mileage" at the expense of the Railways. They clock up extra mileage to get over 18,000 miles and so halve their tax charge; but nothing would induce them to go by train anyway. It is no good for the travelling salesmen, and many businessmen, to go by train, because they don't have transport at the other end so they also lose flexibility. The car scales are a real muddle, I agree, but the loser is not the Railway, but the Revenue.

*Nicholas Ridley*  
pp NICHOLAS RIDLEY



FROM: M E DONNELLY  
DATE: 15 February 1983

MISS COURT

cc Mr Unwin  
Mrs Hedley-Miller  
Mr Edwards  
Mr Butt - UKREP  
Mr Marsden - UKREP

EUROPEAN PARLIAMENT: UK REFUNDS

The Financial Secretary was grateful for your draft letters to Messrs Lange, Notenboom and Adonnino. He has now written on the ... lines of your draft, slightly amended. I attach copies.

The Financial Secretary has commented that he would also like to thank Messrs Butt and Marsden for doing a splendid job throughout the refunds discussions.

*MED*  
M E DONNELLY



Treasury Chambers, Parliament Street, SW1P 3AG

E Lange Esq MEP

15 February 1983

*Dear Hen Lange*

I was so pleased to hear that the European Parliament approved the draft supplementary budget without amendment and adopted Opinions on the two Regulations. You were absolutely right in your prediction that they would.

I should like to thank you most sincerely for the constructive part you have played in the dialogue leading up to the budget approval. As you know we will be devoting all our energies to securing a permanent solution to the problems which have taken up so much time in successive years.

I hope that we shall be successful in getting you to come to London next month when we can resume our discussions. As you know I hope that the day you come will also be a day when the Chancellor is free to meet you. Douglas Hurd and I would both much value our discussions with you.

*With much respect  
Yours sincerely  
Nicholas Ridley*

NICHOLAS RIDLEY



Treasury Chambers, Parliament Street, SW1P 3AG

P Adonnino Esq MEP

15 February 1983

*Dear Signor Adonnino*

I was so pleased to hear that the European Parliament approved the draft supplementary budget without amendment and adopted Opinions on the two Regulations. You were absolutely right in your prediction that they would.

I should like to thank you most sincerely for the constructive part you have played in the dialogue leading up to the budget approval. As you know we will be devoting all our energies to securing a permanent solution to the problems which have taken up so much time in successive years.

I hope to visit Strasbourg again in May or June and look forward to seeing you again so that we shall be able to continue our exchanges on these subjects that are so important to the future of our Community.

*With my best wishes*

*Nicholas Ridley*  
NICHOLAS RIDLEY





Treasury Chambers, Parliament Street, SW1P 3AG

H Notenboom Esq MEP

15 February 1983

*Dear Mr Notenboom*

I was so pleased to hear that the European Parliament approved the draft supplementary budget without amendment and adopted Opinions on the two Regulations. You were absolutely right in your prediction that they would.

I should like to thank you most sincerely for the constructive part you have played in the dialogue leading up to the budget approval. As you know we will be devoting all our energies to securing a permanent solution to the problems which have taken up so much time in successive years.

I hope to visit Strasbourg again in May or June and look forward to seeing you again so that we shall be able to continue our exchanges on these subjects that are so important to the Future of our Community.

*With my best wishes*  
*Yours sincerely*  
*Nicholas Ridley*

NICHOLAS RIDLEY



FROM: E KWIECINSKI

DATE: 15 February 1983

MR FRENCH

cc PS/Chancellor  
PS/CST  
PS/EST  
PS/MST(R)  
PS/MST(C)  
Mr Moore  
Mr Robson  
Mr Ridley  
Mr Harris

CAPITAL GAINS TAX: WHAT NEXT?

The Financial Secretary has seen your minute of 10 February, and The Times article of the same date.

He does not think that "introducing a new higher index-linked exemption limit for CGT" is the answer. He thinks it would lose all the economic advantages for both the taxpayer and the Revenue. He thinks that the weakness of the Times article (as with the Government's other critics), is that it has no answer.

UK

E KWIECINSKI



NOTE OF A MEETING HELD AT HM TREASURY 10am, 14 FEBRUARY 1983

Present at meeting: Financial Secretary  
 MST(R)  
 Mr Robson  
 Mr Blythe )  
 Mr Driscoll) IR  
 Mr Savage )

#### TAXATION OF FRINGE BENEFITS

The meeting had before it Mr Driscoll's submission of 11 February 1983.

The Financial Secretary opened the discussion by commenting that the <sup>long</sup> term question of the taxation of Fringe benefits (reviewed in Mr Driscoll's major submission of January 1983) would need detailed consideration in meetings shortly after the Budget. Today's meeting would concentrate on specific items for this year's Bill.

#### 1) Car benefit scales for 1984/5

In discussion it was pointed out by the Revenue that a 20% increase in the scales would mean that eg the average higher paid employee paying tax at 30% and driving a 1600cc car would still pay less than £3 per week for his company car.

Mr Robson suggested that presentationally it would be better to concentrate on the actual cost to the taxpayer rather than on the percentage increase and the actual increase in the scales. He thought that more use should be made of the AA scales to show how low the charges would still <sup>be</sup> even after a 20% increase.

Mr Blythe recommended caution in making too direct a comparison with <sup>the</sup> AA scales. There was some danger that direct comparisons like this would lead people to believe that the Government viewed the AA scales as being the correct ones whereas Ministers' aims were simply to value the benefit of the company car more "realistically".

The Minister of State (R) thought it was important that the increase should be less than 20% this year to reflect the rapid reduction in the inflation rate.

The Financial Secretary agreed that politically such an approach might reduce any criticism of the increase although he reaffirmed his long term aim to remove the tax advantage currently enjoyed by recipients of company cars.

Ministers agreed that the Revenue should work on a new set of benefit scales for 1984/85 to reflect increases over the 1983/4 scales of more than 15%, but less than 20%.

2) Car fuel benefit scales for 1984/85

Ministers agreed on a similar increase in the scales as for the car benefits scales.

3) £8,500 threshold

Ministers agreed that the threshold should be left unchanged. The future of the threshold was for post-Budget long term consideration.

4) Beneficial loans - official rate

Ministers agreed that the rate (12%) should be left unchanged.

5) Beneficial loans - double £25,000 device

In discussion it was pointed out that it might appear a little provocative to deal with this if the £25,000 limit was left unchanged, although Ministers agreed that it would be desirable to stop this device.

Ministers agreed that a final decision on this should await the decision on the interest relief ceiling.

6) 'Marks & Spencer' device

Ministers agreed that this device should be stopped. Any legislation should take effect for 1984/85.

7) Directors' PAYE tax

Ministers agreed that action should be taken to resolve this problem, although the final decision should be subject to any possible mention in the Keith report, and to the balance of anti avoidance measures in the Budget.

8) Company cars - easement of potential double charge

Ministers agreed that this item should be placed on the Budget starters list.

9) Company Cars -easement for fire service cars

Ministers agreed that this item should be dropped for this year.

Conclusion

The Financial Secretary asked the Revenue to send a further note on car benefit and car fuel benefit scales (to be increased in the range 15% to 20% over the 1983/84 levels). He also asked the Revenue to send him a draft note to send to the Chancellor to reflect the decisions taken by Ministers at this meeting.

*W*  
E KWIECINSKI  
15 February 1983

Circulation:

PS/Chancellor  
PS/Chief Secretary  
PS/Economic Secretary  
PS/Minister of State (C)  
PS/Minister of State (R)  
Mr Moore  
Mr Robson  
Mr French  
Mr Blythe )  
Mr Driscoll) IR  
Mr Savage )  
PS/IR



FROM: M E DONNELLY

DATE: 15 February 1983

MR PIRIE

cc Chief Secretary  
Mr Middleton  
Mr Monck  
Mr Robson  
Mr French  
Mr Crawley - IR  
Mr Bridgeman - RFS

INDEX-LINKED MORTGAGES

The Financial Secretary has seen Mr Hawkins' letter of 7 February, covering a 1 page analysis of the relative attraction of index linked mortgages for borrowers and lenders. The Financial Secretary thinks that these calculations are not in fact correct. His own calculations are attached: he would be grateful for comments on them.

ME  
M E DONNELLY

Assume 10% interest, 7% inflation 3% real interest.

At present, on conventional mortgages, borrower pays 10% gross but each year the capital he has borrowed depreciates by 7% because it is not indexed. So he:-

	pays 7%	(interest less tax)
	Gains 7%	(depreciation of capital)
net payment:	<u>0</u>	

On Indexed Mortgage Borrowing

pays	3%
he gets tax relief of	1%
net payment	<u>2%</u>
he pays no capital back	0
so net cost to him	<u>2%</u>

Hawkins' calculations neglect the fact that capital is not indexed in conventional mortgages.

CONFIDENTIAL



FROM: E KWIECINSKI  
DATE: 16 February 1983

MR BRYCE - IR

CC PS/Chief Secretary  
Mr Moore  
Mr Robson  
Mr French  
Mr Graham - Parly Counsel  
PS/IR

CGT: PARALLEL POOLING

The Financial Secretary has seen your note of 15 February.

He has commented that in view of the wording of the 23 December announcement there should be no limitation on those who can elect for parallel pooling. But he adds that we should stand firm on the "irrevocable" nature of the election.

He suggests that he should also advise individuals against going down the parallel pooling route, perhaps in a speech or a PQ. He would be grateful for your comments.

A handwritten signature in cursive script, appearing to read "E Kwiecinski".

E KWIECINSKI



RESTRICTED



FROM: FINANCIAL SECRETARY

DATE: 16 February 1983

CHANCELLOR

cc Chief Secretary  
Economic Secretary  
Minister of State (R)  
Mr Robson  
Mr Gordon  
Mr French  
PS/IR

MEETING WITH SMALLER BUSINESS BUREAU

I had lunch with Messrs Loveridge, Bright, Colvin and Smith, the officers of the Conservative Small Businesses Committee yesterday. They, along with Brian Jenks, are coming to see you this afternoon.

They are likely to raise:-

- (i) the self-employed/employed problem. I hope that I was able to dampen their enthusiasm for the IOD £5000 personal allowance idea.
- (ii) simplification of the tax system for small business: especially VAT and PAYE annual accounting.
- (iii) concern that the Revenue Departments seem to treat all small businesses (including the honest ones) as if they were dishonest.
- (iv) CTT - and their suggestion that holdover relief should be given for unquoted company proprietors who pass their shares on to the next generation. They prefer this to a general easing of the CTT burden.

*M E Donnelly*  
pp NICHOLAS RIDLEY



FROM: E KWIECINSKI  
DATE: 16 February 1983

CHANCELLOR

cc Chief Secretary  
Economic Secretary  
Minister of State (C)  
Minister of State (R)  
Mr Kemp  
Mr Moore  
Mr Robson  
Mr Pirie  
Mr French  
Mr Stewart) IR  
Mr Crawley) IR  
PS/IR

MORTGAGE INTEREST RELIEF AT SOURCE

The Financial Secretary has decided that he should write to all MP's forewarning them of the change in mortgage interest tax relief ... arrangements. I attach, for your approval, a copy of the letter (with explanatory notes) which the Financial Secretary proposes to send.

I understand that you wouldlike to send a more personal letter to ... your Cabinet Colleagues. I attach a draft you may wish to use; this has been approved by the Financial Secretary.

*E Kwiecinski*  
E KWIECINSKI



Treasury Chambers, Parliament Street, SW1P 3AG

01-930 1234

CABINET COLLEAGUES

As you know, last year's Finance Act introduced new arrangements for giving tax relief for mortgage interest, which take effect in April. The change is entirely an administrative one, but it is nonetheless important. Most people with mortgages will come within the new scheme, and it will simplify the way in which they get their tax relief. It will also make a significant contribution to our drive for manpower savings in the Civil Service.

A first round of publicity about the scheme is already under way, and there will be a second round in April when the scheme comes into operation. As the change may give rise to enquiries from Members' constituents, Nicholas Ridley is writing to all Members to give them some explanatory notes about the new scheme. You may find it helpful to have the enclosed copy of his letter and enclosure, in case points are raised with you by constituents or on other occasions.

In the context of the Budget I am concerned to ensure that, so far as possible, there is no confusion in the minds of the five - six million owner-occupiers concerned. On the one hand, the effects of the new scheme will be to reduce net pay (from the first pay day on or following 6 April) because the tax relief due will be given direct by deduction from the mortgage payments rather than through PAYE. On the other hand, there may be improvements in net pay as a result of my Budget. The effects of the latter are likely to be felt in pay packets rather later - say May. The main risk therefore is that some people might think that the reduction in net pay as a result of the new mortgage interest relief scheme had something to do with the Budget. The publicity campaign in early April referred to above, as well as publicity on the Budget measures themselves, will be designed to minimise this risk. But I thought you might like to be aware of the point, as it underlines the need to get the message on the new scheme over as clearly as possible.

GEOFFREY HOWE



Treasury Chambers, Parliament Street, SW1P 3AG

TO ALL MEMBERS OF THE HOUSE OF COMMONS

As you will know, the Finance Act 1982 introduced new arrangements for giving tax relief on mortgage interest at source. The new scheme starts in April, and most people with mortgages will be affected.

The change is entirely an administrative one. Until now, borrowers have been getting their tax relief for mortgage interest either through PAYE or their tax assessments. From April, most borrowers will get their tax relief instead by making lower mortgage payments to their lender. At the same time, they will find their tax payments going up because the relief is no longer given through PAYE. The net effect will be to leave borrowers in broadly the same position as before; but the new system will be simpler for them because it will not be necessary to adjust their PAYE code numbers to give them the correct relief whenever interest rates change.

I emphasise that there is no change in the entitlement to mortgage interest relief for taxpayers. But the change may well prompt enquiries from your constituents. I have therefore had some notes prepared for Members which I hope will help you to answer some of these questions. I enclose some copies which you may find helpful at Surgeries or with correspondence. If you would like more copies the Vote Office have a supply.

Sometimes taxpayers will wish to raise more particular questions about their own circumstances. In that case, I am sure that either the taxpayer's own tax office or his lender (depending on the nature of the question) will be happy to try and clear the point up. And of course do write to me in cases of difficulty.

NICHOLAS RIDLEY

## MORTGAGE INTEREST AND TAX RELIEF : THE NEW ARRANGEMENT

From April 1983 most borrowers will be getting their tax relief on their mortgages in a new and simpler way. Instead of getting that relief in their PAYE codings or tax assessments, as they do at present, most borrowers will get tax relief at the basic rate by making lower mortgage payments to their lender. The borrower's payments will go down because tax relief at the basic rate (at present 30 per cent) will be taken off the interest part of the mortgage payment. But because the borrower will no longer be given an allowance for the interest in PAYE codings or assessments, the amount of tax he/she pays will go up. The change is administrative. It does not affect the tax relief rules or the amount of the relief, only the way in which it is given. Borrowers entitled to relief will still get all the relief which is due on their interest payments.

### Why is the change being made?

The main reasons are to make the system simpler and more efficient. The present system worked well when interest rates remained fairly stable, but frequent changes in interest rates have made it difficult to give the correct relief through PAYE, and taxpayers often overpay or underpay tax. With the new system, the right amount of relief can be given at once, even if interest or tax rates change, without involving the tax office. This is better for the borrower and has the added benefit of enabling administrative savings in the Inland Revenue - about 1,000 staff by April 1984 - from which taxpayers generally should benefit.

### Is everyone affected by the change?

Although most borrowers will be affected, some will be outside the scheme. For example, some borrowers whose loans are above the tax relief limit of £25,000 will find that their

relief will still be given by their tax office. This is because their lender has exercised its option to keep loans above the tax relief limit outside the scheme. And although the major lenders are within the scheme, some lenders - mainly those bodies for whom mortgages form a small part of their business, and private lenders - will remain outside. Borrowers with those lenders will, of course, continue to get their tax relief through their PAYE codings or assessments as they do now.

Will borrowers still get the higher rate tax relief to which they are entitled?

Yes. Because only basic rate relief can be given under the new system, those entitled to relief at the higher rates will continue to get that relief through their PAYE codings or tax assessments. The mortgage interest paid will, of course, still be taken into account in determining whether a taxpayer is in fact liable to tax at the higher rates.

Does the scheme only affect mortgages?

No. Improvement loans which qualify for tax relief can also come within the scheme. Improvement loans from building societies and local authorities come in automatically but other lenders are able to choose whether to bring in their new improvement loans. Existing improvement loans from those lenders will stay outside the scheme. The scheme also applies to loans used to purchase an annuity by a borrower who is over the age of 65.

Will borrowers be obliged to pay more?

No. At present, except for endowment mortgages, the net cost of a mortgage gradually increases, because as the capital debt is paid off, the interest element in the monthly

payments goes down and so the tax relief also goes down. When the new scheme is introduced, some lenders, notably the building societies and local authorities, are likely to propose a change in the way borrowers pay back their loans, so that future net payments remain constant, except when interest or tax rates change. Compared with the present pattern, the borrower's payments would be slightly higher in the early years and slightly lower in later years. The legislation permits the lender to propose this change, but it also gives existing borrowers the right, if they wish, to keep their payments at a lower level (the amount they would have had to pay at the beginning of 1983/84 if the lender had not proposed the change).

Lenders who wish to propose this change have to notify individual borrowers, and the borrower will then be able to see how it affects his own mortgage and what his options are.

Are option mortgages affected by the change?

Yes. The Option Mortgage Scheme comes to an end on 31 March 1983. Those with an option mortgage will no longer get a subsidy but they will normally get the benefit of tax relief whether or not they pay tax. After March, an option borrower will become like, and have the same rights as, any other borrower.

How will people know whether they are affected?

Borrowers should hear from their lenders, who will tell them whether and exactly how their payments are affected.

Why are PAYE codes for 1983-1984 being reduced to recover mortgage interest relief for 1982-83?

Allowances for mortgage interest relief in PAYE codes for 1982-83 were originally calculated on the basis of building society interest rates in force at the time. But during the course of the year these interest rates have been reduced. This means that the original estimates of relief in PAYE codes are now too high, and insufficient tax will be deducted during 1982-83. The purpose of the adjustments to 1983-84 codes is to recover the excess relief. An important benefit of the new system of giving relief is that for most borrowers this kind of adjustment will not be necessary in future years, because the relief will be given in the calculation of the mortgage payments and not through PAYE.

Why were PAYE codes for 1982-83 not adjusted when interest rates changed?

If codes had simply been reduced, there would have been a disproportionately heavy tax deduction on the first pay day after the change, because the normal effect of the cumulative tax tables is to apply a changed code retrospectively, from the preceding 6 April. If reduced codes had instead been operated on a special non-cumulative basis, there would still have been some excess relief to be recovered at the end of the year; and the non-cumulative basis would have denied adjustments later during the year in favour of (for example) taxpayers with periods of low or no earnings.



CONFIDENTIAL



FROM: E KWIECINSKI  
DATE: 16 February 1983

MR CORLETT/IR

cc PS/Chancellor  
PS/CST  
PS/EST  
PS/MST(R)  
PS/MST(C)  
Sir D Wass  
Mr Middleton  
Mr Moore  
Mr Robson  
Mr Hopkinson  
Mr Godber(o/r)  
Mr Ridley  
Mr French  
Mr Graham (Parly Counsel)  
Mr Battishill/IR  
PS/IR

ASSURED TENANCIES ALLOWANCE

The Financial Secretary has seen your submission of 15 February.

A meeting to discuss this has been arranged for tomorrow (17 February) in the Financial Secretary's room at the Treasury.

The meeting will discuss:-

- a) the extension of the assured tenancies allowance to shared ownership (Miss Rutter's minute of 16 February refers).
- b) the DOE's approval of partnerships.

The Financial Secretary's general comment is that we should resist any extension of the assured ten-ancy scheme.

If the DOE cannot be persuaded to stop approving partnerships, he would be inclined to introduce amending legislation to disallow partnerships add individuals from claiming the capital allowance.

On the two "defects" - he thinks you should go ahead and draft correcting provisions, although he has commented that it remains to be decided whether or not they will be included in this year's Bill.

*CK*

FROM: S WEBB  
DATE: 16 February 1983

FINANCIAL SECRETARY

*allowed by  
Financial Secretary.*

cc PPS, *Chief Secretary*  
Economic Secretary  
Minister of State (C)  
Minister of State (R)  
Sir D Wass  
Mr Littler  
Mr Bailey  
Mr Unwin  
Mr Byatt  
Mr Burgner  
Mr Christie  
Mr Mountfield  
Mrs Hedley-Miller  
Miss Court

## COMMUNITY DEMONSTRATION PROJECTS IN ENERGY

1. Mr Lawson's letter of 15 February seeks agreement to the level of funding of Community Demonstration projects in Energy.

### Background

2. Demonstration projects are an intermediate stage between Research and Development and the commercial launching<sup>of</sup> a new technology. In 1978 the Community introduced schemes to support demonstration projects in the field of alternate<sup>mecus</sup> energy sources (eg coal and solar heating) and energy saving. Some 205<sup>was</sup> committed up to the end of 1982. Although some UK projects attracted Community support, the scheme has not been to our net benefit overall.

### Current Proposals

3. The draft regulations, due to come before<sup>of</sup> the Foreign Affairs Council next week, provide for continuation<sup>of</sup> the existing schemes and their extension into the new fields of wind and wave power. They are intended to last for five years.

### "Ceilings"

4. Following the difficulties between the Council, Parliament and Commission last summer, formal financial ceilings in this area

can no longer be set. We have, however, been concerned that without some figure in the Regulations, the programme would grow uncontrollably. It is a fashionable area of non-obligatory expenditure where we are especially vulnerable to the Parliament driving up the level of expenditure (as they did in the 1983 Budget). The UK has therefore taken the lead in pressing for an "indicative figure" to be included in the Regulations. Other countries, and the Commission, have accepted this in principle but a figure has still to be settled. The smaller countries and the Commission have pressed for figures in the region 600-800 mecu over 5 years; the French, Germans and UK have supported a much lower figure of 200 mecu, although there are indications that the other two are moving upwards.

#### Treasury Position

5. On the merits of the programme, we agree with the Department of Energy that there should be a modest reduction in the level of expenditure in this area (continuing the present level would point to 400-450 mecu over 5 years). The original pressure of the energy crisis has eased and we doubt whether there are sufficient worthwhile projects to warrant an increased rate of spending.

6. The dilemma we face is that we need to get a "ceiling" into the regulations in order to have any real prospect of expenditure control subsequently; but to secure agreement to a "ceiling" we may have to give ground somewhat towards the position of the smaller countries on the figures. There are also risks in getting isolated too much, when other countries are linking their attitude on this issue to others such as the Coal Package where we are seeking UK benefit.

7. Mr Lawson's letter seeks agreement to a step by step approach to try to secure agreement to a ceiling in the regulations at the lowest level. This has been discussed by officials and we are broadly content, although it is important that our negotiators should not <sup>have</sup> complete discretion. I think that the figure of 450 mecu is the very furthest we should go.

Recommendation

8. I recommend that you agree to the proposals in Mr Lawson's letter. Since we have been asked to give agreement during the course of this afternoon, your Private Secretary might so inform Mr Lawson's office. In doing so I suggest he stresses the importance of concerting with the French and Germans privately to obtain agreement to the lowest possible figure commensurate with getting a ceiling into these Regulations.

9. A draft reply on these lines is attached.

*Webb*  
PPS WEBB



FROM: M E DONNELLY  
DATE: 16 February 1983

MRS HEDLEY-MILLER

cc PS/Chancellor  
Mr Littler  
Mr Unwin  
Miss Court  
Mr Edwards

UK SUPPLEMENTARY MEASURES: PUBLICITY INVOLVING MEPs

The Financial Secretary would be grateful for a progress report on the position in ensuring good publicity for those capital projects which have been allocated to the UK Supplementary Measures Programme.

In particular he would be grateful for ideas as to how MEPs might be closely involved in completed projects. Possibilities might include:

- i) following up the Chancellor's earlier suggestions for European logos or plaques marking completed projects with some EC financing content ;
- ii) arranging for selected groups of MEPs to see projects in the regions currently under construction;
- iii) perhaps arranging for Mr Dankert to inspect or even open some project when he is here on his official visit later this spring.

*MED*  
M E DONNELLY



FROM: M E DONNELLY  
DATE: 16 February 1983

MR PEET

cc PS/Chancellor  
Mr Littler  
Mr Unwin  
Mrs Hedley-Miller  
Miss Court  
Mr Edwards  
Mr Lennon  
Mr Shore  
PS/Mr Rifkind - FCO  
Mr Fry - FCO

EC BUDGET: HOUSE OF COMMONS DEBATE

The Financial Secretary has seen your note of 15 February on the wording of the Motion for Monday's Debate.

The Financial Secretary has discussed the wording of the Motion with Mr Rifkind. Both Ministers agree that the Motion should read as originally agreed between the Financial Secretary and Mr Hurd; that is the version in paragraph 2 of your note. This makes no specific reference to the question of increasing own resources.

*MED*  
M E DONNELLY

CONFIDENTIAL



FROM: M E DONNELLY  
DATE: 16 February 1983

MR ROBSON

cc PS/Chancellor  
PS/Chief Secretary  
PS/Economic Secretary  
PS/Minister of State (R)  
Sir D Wass  
Mr Bailey  
Mr Middleton  
Mr Kemp  
Mr Lovell  
Mr Moore  
Mr Chivers  
Mr Gordon  
Mr Pirie  
Mr Turnbull  
Mr Andren  
Mr Battishill - IR  
PS/IR

#### DISCUSSIONS WITH VENTURE CAPITALISTS

The Financial Secretary was grateful for your note of 15 February setting out the position on the points raised at his meeting of 7 February with Venture Capitalists.

The Financial Secretary had the following comments on your note:

#### Double Charge to Capital Gains Tax

The Financial Secretary was interested to learn that Coopers did not consider the problem of paying double CGT to be a substantive one. He looks forward to reading Mr Moore's report on this point.

The Financial Secretary will aim to deal with the investment inhibitions mentioned in your paragraph 6 whenever he meets the institutions involved.

#### Tax Relief for Entrepreneurs and Stock Options

The Financial Secretary agrees that the complaint about stock options has been covered in recent Ministerial discussions.

Innovation/R&D

The Financial Secretary would be grateful if the points in your paragraph 14-18 could be put in the form of a letter for him to send to David Cooksey of Advent Management Ltd who put the argument that R&D pure and simple should be given BSS treatment.

MED  
M E DONNELLY



CONFIDENTIAL



FROM: NICHOLAS RIDLEY  
DATE: 17 February 1983

CHANCELLOR

CC CST  
EST  
MST(R)  
MST(C)  
Sir D Wass  
Mr Middleton  
Mr Moore *Mr. Kemp.*  
Mr Robson  
Mr Hopkinson  
Mr Godber (o.r)  
Mr Ridley  
Mr French  
Mr Graham (Parly Counsel)  
Mr Corlett  
Mr Battishill/IR  
PS/IR

FAMILY POLICY GROUP: EXTENSION OF ASSURED TENANCIES CAPITAL  
ALLOWANCE TO SHARED OWNERSHIP PROPERTIES

I have discussed with the Revenue earlier today the question of Shared Ownership, on which you want to send your FPG colleagues a note (Miss Rutter's minute of last evening).

Extending capital allowances into this type of house purchase is fraught with difficulties. Under the tax rules as they stand, the best advice we have suggests that only in the exceptional case would a builder constructing <sup>a</sup> property for shared ownership be able to persuade the courts that he was investing in property, rather than trading in it. At the margin, of course, there will always be room for dispute. But the builders will want certainty on the tax position before they venture into share ownership projects - certainly on any scale.

So if we went down this road, we would have to legislate. Legislation would need to provide that, whatever the position is under general tax law, certain shared ownership transactions were specifically to be treated as investments (and not as trading activities) for tax purposes. Entitlement to capital allowances would then follow automatically. And any profit a builder made on selling a property (albeit in stages) would count as a capital gain (and attract capital gains tax) rather than as income (subject to income tax or

corporation tax).

We would have to ring-fence the transactions, <sup>we</sup> were prepared to see being treated as investments. We could not, for example, allow a builder to construct a property, retain only a small proportion for rent and that only for a short period before he "sells" it - and thereby secure, first, highly generous capital allowances and, second, favourable CGT treatment. Otherwise the relief will just be used by builders building for sale <sup>to make</sup> ↑ a large profit.

I am asking the Revenue to consider what might be reasonable minimum conditions which a shared ownership transaction might have to meet in order for the builder to be treated as a landlord rather than as a trader. We may, for example, need to prescribe that a certain proportion at least of the property is rented, that this rental element is retained by the builder for a minimum period and that the property is held separately from the builder's normal trading stock.

I suggest that, if you agree, I should discuss this with John Stanley as soon as possible. But I must say that, if we were to proceed in this area we would have to put together what might be some quite tricky and lengthy legislation in what is now a very short time. For my part, I am dubious of its value.

pp *Nicholas Ridley*  
NICHOLAS RIDLEY

CONFIDENTIAL



FROM: E KWIECINSKI

DATE: 18 February 1983

MR BATTISHILL/IR

cc PS/Chancellor  
PS/Chief Secretary  
PS/Economic Secretary  
PS/Minister of State (C)  
PS/Minister of State (R)  
Mr Moore  
Mr Robson  
Mr French  
Mr Lusk )  
Mr Corlett) IR  
Mr Bryce )  
PS/IR .

#### TAX TREATMENT OF SELF CATERING INDUSTRY

At the Financial Secretary's meeting yesterday the proposal to give capital allowances for expenditure on self catering accommodation was discussed.

The proposal being considered would give allowances for those with ten or more units of self catering accommodation. The Financial Secretary was not attracted to extending capital allowances in this way. He recognised that the proposal raised a number of quite complicated questions and that the resulting legislation would almost certainly need to be complex. You agreed to send him a detailed submission on the probable form that such a scheme would take, which would include a critique of the problems inherent in such a scheme.

The Financial Secretary saw some political difficulty in only giving capital allowances to those with more than ten units and felt that there would be pressure from those with fewer units for some other special tax reliefs.

He would be inclined to give some special tax relief to those who are too small to benefit from capital allowances. He suggested that the same definition (yet to be decided) of a self catering unit used for the purposes of the capital allowances proposal should be used to give special relief to those with less than ten units.

The suggested <sup>special</sup> reliefs were:-

a) Any person involved in self catering would be given an earned income allowance of say, £1000 per self catering unit, for up to 9 units.

and/or

b) they would receive Capital Gains Tax roll-over relief for up to nine self catering units.

The Financial Secretary asked the Revenue to consider these proposals and submit a paper in due course.

  
E KWIECINSKI



FROM: E KWIECINSKI

DATE: 18 February 1983

PS/CHIEF SECRETARY

cc Mr Robson  
Mr Culpin  
Mr French  
Mr Robertson/IR  
PS/IR

COUNTRY LANDOWNERS ASSOCIATION  
TAX RELIEF FOR CONSERVATION

The Financial Secretary has seen Mr Robertson's minute to the Chief Secretary of 16 February.

He has commented that such policy issues should be discussed between outside bodies and ministers, and not with officials alone.

He thinks that we should always be prepared to see them and tell them directly if we are not going to meet their points.

He suggests that the Chief Secretary should say that he (the Financial Secretary) will see them after the Budget.

E KWIECINSKI



Note of a meeting held at 2.30pm 17 February in the Financial Secretary's room: Plaid Cymru Budget Representation

Those Present: Financial Secretary  
Parliamentary Under Secretary of State - Welsh Office  
Dafydd Wigley MP  
Dafydd Elis Thomas MP  
I W Jones  
Mr Allen - Treasury

The Financial Secretary thanked the Plaid Cymru representatives for coming, and inviting them to set out their views on what the Budget should contain.

Plaid Cymru provided the attached memorandum setting out their proposed Budgetary strategy. They stressed the need to take measures to combat unemployment. There should be a public investment programme with a gross cost of £2000million in Wales. Since this would reduce unemployment its net cost would be considerably less. The extra cost should be met partly by the PSBR and partly by increasing direct taxation. Exchange control should be reintroduced and imports of manufactured goods restricted. Basic income tax thresholds should be raised, to £2,500 for a single person and £3,500 for a married couple. This would return them to the same proportional level of average earnings as in 1972/73. A double rate of VAT should be introduced. Social benefits should be generally improved. Pensions increases should be implemented 3 months after the Budget announcement. The 5% abatement/invalidity benefit and unemployment benefit should be immediately restored. Mr Thomas MP suggested that restoring maternity Benefit to its 1969 level in real terms, an increase from £25 to £120, would be a clear vote catcher for the Government.

Mr Wigley stressed the need to an expansion of Regional Policy measures. Mr Roberts pointed out that over 90% of the Welsh population already lived in Assisted Areas. Mr Wigley said the recession had undermined the effectiveness of regional policy measures. If the private sector was not providing sufficient investment then the public sector had to make up the difference. There was

in any case a need for improvement in the transport infrastructure in Wales.

The Financial Secretary thanked Plaid Cymru for outlining their budget proposals. He said that the details contained in their Memorandum would be considered, along with other representations which the Government had received. But it had to be recognised that the cost of doing everything that Plaid Cymru had asked for would be massive. If they so wished he would be happy to have their proposals costed as a package. He could not of course comment in detail on the proposals put forward. The resources available were limited by the need to avoid putting excessively heavy financial pressures on the rest of the economy. A major contribution to cutting unemployment was through individuals setting up small businesses which expanded. The Government aimed to create a climate favourable to this. He thanked the Plaid Cymru representatives for putting their proposals so clearly.

The meeting ended at 3.15pm.

MED

M E DONNELLY

17 February 1983

Circulation:

Those present  
PS/Chancellor  
PS/Chief Secretary  
PS/Economic Secretary  
PS/Minister of State (C)  
PS/Minister of State (R)     Sir D Wass  
Mr Kemp  
Mr Monger  
Mr Moore  
Mr Mountfield  
Mr Norton  
Mr Richardson  
Mr Norgrove

P L A I D C Y M R U

MEMORANDUM TO THE CHANCELLOR OF THE EXCHEQUER FOR THE 1983 BUDGET

(Presented on 17 February 1983 to Nicholas Ridley MP, <sup>FINANCIAL</sup> ~~Chief~~ Secretary to the Treasury, on behalf of Plaid Cymru, by Dafydd Elis Thomas MP and Dafydd Wigley MP, together with Cllr Haydn Edwards, Mr Geraint Davies and Mr Ieuan Wyn Jones)

(1) Budget Strategy

We contend that the major objective of the Budget in 1983 must be to overcome the tragic unemployment which in Wales has now reached 17.5%. There needs to be created in Wales as a matter of urgency at least 100,000 jobs by specific Government action as a first step which will lead in due course to the virtual elimination of the current level of 180,000 unemployed. With 40,000 young persons under 20 years of age unemployed in Wales, a large part of this strategy must be geared at these, with a particular emphasis on support for training and apprenticeships.

- (2) We assert that it is unacceptable, socially and economically, that the brunt of the present recession should be borne by the 20% of the working population who are least able to secure for themselves a job. We would dispute, in view of the success of Sweden, Norway and Austria in keeping unemployment under 4%, that the present level of joblessness in Wales is inevitable.

But if the recession is indeed inevitably going to impact on Wales to such a grim extent as being suffered at present, it should be borne in a more equitable manner and the budget strategy should therefore aim at both reflating the economy to create growth and jobs, and at sharing out the burden of the residual depression on a fair basis.

- (3) The private sector, despite having been given incentives in the 1979 Budget to trigger growth, shows no sign of any significant



expansion. In the light of our experience over the past four years, it is our belief that we cannot rely on the private sector to provide many of the jobs so desperately needed. We say therefore that the strategy of getting the people of Wales back to work must rest on a massive public sector initiative. We call for increased public spending in Wales which will directly create jobs and which will also stimulate the private sector out of its present lethargy.

- (4) Put another way, we say that economic sense and social justice dictates that rather than incur an average cost of £5,000 per unemployed person per annum, the central Government should pay a little more - perhaps £6,000 or £7,000 per annum, in order to pay these persons for doing worthwhile work, rather than for doing nothing.
- (5) In order to achieve the numbers of jobs need in Wales, we assess that we need an increased public investment programme of the order of £2,000 million. Clearly this cannot be achieved at a stroke, but there needs to be a fundamental change in the Government's thinking. Given that such a programme will reduce unemployment, and consequently achieve off-setting savings the net cost to the Exchequer will be considerably less.
- (6) This additional net public expenditure which we seek, in order to put Wales back to work, can be met partly from a greater Public Sector Borrowing Requirement, which we believe the overall economy can well bear; and partly from an increased level of taxation. We believe that some additional direct taxation may be justified as a means of spreading the burden of the recession more equitably through the community, rather than the bottom 20% in the labour market bearing the whole burden. This additional taxation should be borne in proportion and the ability to bear it - with those on highest incomes rating the greater share.
- (7) In parallel with the change of economic policy, we urge that the Government reconsider the question of exchange control, which was lifted in 1979. Last year the UK had a net capital outflow of

£8 billion, compared to some £2 billion the previous year and a net balance three years ago. This represents the equivalent of one million jobs exported, and this cannot be allowed to continue. Likewise, we believe that there will have to be some restriction on imports of manufactured goods, which should be phased in harmoniously with a reduction in the depletion rate of offshore oil.

(8) Direct taxation

There needs to be a shift in the balance of impact of income tax away from those on lowest incomes and particularly to end the invidious/<sup>poverty</sup>trap which the present system creates. It is ridiculous that persons barely above the supplementary benefit level should be subject to income tax, and this is equally true of pensioners with the smallest of incomes over and above state pension levels. We call for a substantial raising of the income tax thresholds, to £2,500 for a single person and £3,500 for a married couple. This is in fact to reattain the same proportional level of average earnings as was the case in 1972-73, and can only be seen as an interim step towards a more radical reform.

(9) We believe that the bands of taxation over and above the standard rate of tax should be continued with a progressive 5% bandwidth through to a top level of 90% tax (compared to the present 60%), consolidating unearned income surcharge to give a maximum top rate of 97.5%.

(10) We further believe that there should now be a move towards a wealth tax, paid on net assets excluding the value of a lived in first home, on a sliding scale between  $\frac{1}{2}$ % and  $2\frac{1}{2}$ %. This proposal should be considered side by side with moves away from domestic rates, and whereas the whole change may not be achievable this year, a declaration of intent should be made with the objective of phasing in such change over a two year period of time.

(11) Indirect Taxation

We recognize arguments favouring the reduction of indirect taxation relative to direct taxation on the basis that

(a) It may trigger demand and create jobs,

(b) in practice (if not necessarily in theory) it has an anti-inflationary effect,

(c) it is socially more acceptable.

There may however be limits on the extent to which this may be achieved simultaneously with massive increased spending programmes. We would however urge consideration of a greater division in VAT between a "standard rate" and a "luxury rate".

- (12) Excise duties should increase by the present rate of inflation; petrol duty should be increased by less than the rate of inflation in recognition of its effects on other costs, and of price rises which have recently taken place.

### Regional Policy

(13) (a) Social benefits

We urge that pension increases be implemented sooner than the November date which is customary; we cannot accept that a six month delay is inevitable; we urge that this be cut to a three month period. We also press that the 1983-84 increase be at least as high as the highest twelve month moving inflation rate levels recorded during the past 18 months. The retiring age for men should be reduced to 60, as for women.

(b) Invalidity benefits

We call for the immediate restoration of the 5% abatement in invalidity benefit; which at a cost of £50 million per annum, is overdue. We also call for the ending of the "invalidity trap" so that invalidity pensioners with permanent illness or disablement qualify for the long term rate.

(c) Unemployment benefit

We likewise call for the restoration of the 5% abatement in unemployment benefit which is overdue since these benefits are now taxable.

(d) Supplementary benefits

With over 300,000 persons estimated to be on supplementary benefit in Wales, there is a need to re-assess its adequacy to meet everyday costs.

(e) Blind Persons Allowance Benefit

An allowance, at approximately the same level as Mobility Allowance should be introduced, since blind people have been badly neglected over recent years. The cost would be only some £100 million per annum.

(f) Invalid Care Allowance and the HNCIP

This should immediately be made available to married or cohabiting women who look after a disabled person, since the present policy discriminates on grounds of sex. The Housewives Non-Contributory Invalidity Pension should have the "household duties test" ended.

(g) Maternity Benefit

The value should be restored to its 1969 level in real terms, which would require an increase from £25 to £120.

(h) Child Benefit

There are strong arguments for child benefit to be increased substantially, as a non-means tested benefit that provides finance to the mother. We propose that this be increased to £7.50 per child. We would offset this increase in expenditure by the elimination of the married man's additional tax allowance.

(j) Death Grant

The fundamental principle that the state bears all the basic costs of a funeral should be accepted, with the grant being consequently increased to £250.

(k) VAT on Disablement Charities

There should be no VAT charged on recognised disablement charities.

(14) Other Action

Finance must be made available for young people with no inherited wealth or property, to enter the agriculture industry, and we propose a state funded land bank to help such people to buy their farms, and capital availability to county councils to re-establish small-holdings for renting to such persons.

(15) The water rating system should be changed and an announcement made at Budget time that the Government will introduce legislation during the coming year that will give a more equitable basis of domestic charges, and a rebate system for those on pensions or low incomes.



NOTE OF A MEETING HELD AT H M TREASURY 12.30PM, 16 FEBRUARY 1983

Present at meeting: Financial Secretary  
Mr Driscoll/IR  
Sydney Chapman MP  
Mr Alex Gordon )  
Mrs Elizabeth Layton ) RIBA  
Mr John Arnold )

### CONTINUING PROFESSIONAL DEVELOPMENT IN THE CONSTRUCTION INDUSTRY

The Financial Secretary invited Mr Gordon to open the discussion.

Mr Gordon commented that there was a need in today's rapidly changing technological society for training courses to be encouraged. CPD had been very active and their courses were worthwhile but they feared that the situation was stagnating. He highlighted what he saw as an anomaly in the present tax system whereby training costs incurred by employers were deductible for tax purposes whereas those incurred by employees on their own behalf were not.

The Financial Secretary commented that he supported CPD. However he was concerned that giving relief to individuals for CPD in the construction industry would only be the tip of the iceberg because other industries and employees generally would want the same reliefs. It would be very difficult to hold the line for genuine study courses or to discriminate <sup>in</sup> between good and bad courses.

Mr Gordon commented that the Institutions could monitor and approve bone fide courses. Also employers would not waste time and money on sending their employees on useless courses. He suggested that Section 192 ICTA 1970 should be amended to allow as deductible, expenses incurred on all courses reported to the Institute. The Institute could then decide which courses to approve: this could either be restricted by limiting the number of courses to the mandatory ones required by professions or to those recognised by the institution.

The Financial Secretary pointed out that it was for Parliament alone to decide who should receive tax reliefs. Any monitoring or approving would have to be done on Parliament's behalf by the Inland Revenue and he was loathe to increase the Revenue's discretionary powers in this area.

Mrs Layton commented that there was at present a parlous lack of further education among employees, which is why CPD were looking at the disincentives on self improvement.

Mr Driscoll suggested that extending tax reliefs was not the best way to encourage this.


The Financial Secretary agreed and added that the constant narrowing of the tax base with special reliefs reduced the scope for general tax reductions for the bulk of ordinary taxpayers.

Mr Driscoll asked the delegation if they had considered what form any new clause in the Finance Bill would take or indeed if they had produced a draft clause.

Mr Gordon commented that they had not.

Mr Chapman made a plea for special treatment for the construction industry.

In summing up the discussion the Financial Secretary concluded that giving tax reliefs in this area was neither desirable nor effective. He suggested that the employers should do more themselves to encourage their employees' further education. He also suggested that subsidies for this type of activity would probably be more effectively targetted through a grants system rather than through taxation reliefs.

  
E KWIECINSKI

Circulation:

Mr Driscoll - IR  
PS/IR

RESTRICTED



FROM: M E DONNELLY  
DATE: 18 February 1983

MR RIDLEY

cc PPS  
MCU

TREATMENT OF LETTER FROM RICHARD NEEDHAM MP

I have now checked on the handling of the Richard Needham MP letter.

The problem arose because this letter was originally classified by MCU as a Budget representation. It was not therefore singled out from the 100-150 other Budget representations that are currently being received each week.

The letter was sent to this Office to receive a formal acknowledgement as a Budget representation on Monday 14 February. These representations do not have high priority and there is currently a two-three day processing period. As soon as this letter came into the Inner Office it was identified and passed on to you.

I have discussed with the Ministerial Correspondence Unit how to prevent letters of such sensitivity being treated in this run of the mill way. In future they will vet all Budget representations more stringently.

As a fall back I have arranged for all Budget representations from MPs to be double-checked as soon as they arrive in this Office.

This should prevent similar problems recurring.

ME  
M E DONNELLY



CONFIDENTIAL



FROM: M E DONNELLY  
DATE: 17 February 1983

MR WALTON

cc PS/Chancellor  
PS/Chief Secretary  
PS/Economic Secretary  
PS/Minister of State (R)  
Mr Moore  
Mr Robson  
Mr Griffiths  
Mr Ridley  
Mr French  
Mr Battishill)  
Mr Corlett ) IR  
Mr Driscoll )  
PS/IR  
PS/C&E  
Mr Howard - C&E

SMMT SUBMISSION ON THE 1983 BUDGET: CAPITAL ALLOWANCES FOR BUSINESS CARS (STARTER 171)

The Financial Secretary was grateful for your note of 15 February.

In the light of your comments on the capital allowance ceiling and rate of writing down allowances, the Financial Secretary thinks we do not need to abolish the £8,000 limit. He would be grateful for your assessment of the Revenue implications of increasing this limit to cover the main cars in ordinary use, which would involve increasing it to perhaps £10,000. But he still sees advantage in reducing the writing down allowance to 20 per cent. This brings in some revenue and discourages company car ownership. But given the other likely Budget measures there seems little danger of criticism that the motorist is being too hard done by.

He would be grateful for an assessment of the implications of measures on the above lines.

MED  
M E DONNELLY



FROM: E KWIECINSKI

DATE: 21 February 1983

cc Minister of State (R)  
Mr Robson  
Mr Corlett - IR  
PS/IR

PS/CHANCELLOR

MONARCH AIRLINES LTD: BUDGET REP

The Chancellor asked (your minute of 15 February) whether the point made by Monarch Airlines in their letter of 4 February is of sufficient generality to need to be taken into account on deliberation on corporation tax.

... The Financial Secretary entirely agrees with Mr Corlett's note of 18 February (copy attached, top copy only).

A handwritten signature in dark ink, appearing to be "EK", written in a cursive style.

E KWIECINSKI

MONARCH AIRLINES: POSITION OF LESSEES IN THE  
EVENT OF A REDUCTION IN THE RATE OF CORPORATION TAX

1. The value of a capital allowance - like any other tax relief - is determined partly by the rate of tax on the profits or income against which it runs. The higher the rate of tax, the greater the "value" of the capital allowance. It follows that, other things being equal, the higher the rate of tax, the greater the amount of the investment incentive element in a capital allowance which can be passed through by a lessor to a lessee in the form of lower lease rentals.

2. Lease rentals are arrived at on the basis of assumptions as to the rate of corporation tax at which the lessor will be able to utilise the first year allowances. If the rate of corporation tax is reduced, there is less benefit to be fed through to the lessee, and the rentals must be increased accordingly. For a lessee to ask for compensation on such a reduction, is rather like a claim for compensation for the fact that a reduction in basic rate reduces the value of mortgage interest relief.

3. In any case, a revision clause for a change of corporation tax rate is standard in tax-based leases. Lessors could not afford to write such leases on any other terms. In our cross-border leasing clause last year, we specifically allowed lease rentals to be varied as a result of a change in the rate of corporation tax.

4. The proposal has no merit whatsoever.



FROM C W CORLETT X

INLAND REVENUE  
POLICY DIVISION  
SOMERSET HOUSE

18 FEB 1983

18 February 1983

1. MR BATTISHILL *AB*
2. FINANCIAL SECRETARY

MONARCH AIRLINES LIMITED: BUDGET REPRESENTATIONS

1. The Chancellor has asked (Miss Rutter's minute of 15 February) whether the point made by Monarch Airlines in their letter of 4 February is of sufficient generality to need to be taken into account in deliberation on corporation tax.

... 2. I attach a short note, which you may want to send the Chancellor. There is no merit in the proposal put forward by Monarch.

*CW*  
C W CORLETT

*Monarch are apparently saying the  
Chancellor should not cut Corporation tax rates  
because there would then be less tax relief to  
pass through to tax-exhausted companies in leaving  
debts. So the tax-paying companies must suffer!  
This is pretty cheeky!*

*AB*  
18/2

X/11 cc Minister of State (R)  
Mr Robson

Mr Battishill  
Mr Corlett  
Mr Skinner  
Mr Elmer

PS/IR X

COMMERCIAL IN CONFIDENCE



FROM: M E DONNELLY

DATE: 22 February 1983

CHANCELLOR

cc CST  
EST  
MST(C)  
MST(R)  
Sir D Wass  
Sir A Rawlinson  
Mr Wilding  
Mr le Cheminant  
Mr Mountfield  
Mr Judd  
Mr St Clair  
Mr F K Jones  
Mr Farrington  
Miss J Kelley  
Mr Harris

PRIVATISATION OF HGV

The Financial Secretary has seen Miss Kelley's note of 21 February.

He remains uneasy about the line proposed. Lloyds would be having their cake and eating/<sup>it</sup>if the Government pays all costs and Lloyds then take any subsequent savings. We even have to pay redundancy costs if Lloyds slim down the work force. And if they prove unable to run the operation it returns to the Government.

For the reasons already set/<sup>out</sup>by Mr Howell the Financial Secretary would be prepared to take these risks. But in addition the prospect of having to pay 80% of redundancy pay to staff who are not actually losing their jobs is insufferable and indefensible. We need an accurate analysis of what the Government's liabilities would be if the Public Services (Transfer of Functions) Bill was already law. The Department of Transport should not be allowed to concede any terms more favourable than these in their negotiations; and indeed be ready to break off negotiations if the HGV staff demand further concessions.

The Financial Secretary would be grateful if /<sup>officials</sup> could undertake such an analysis. He recommends that paragraph 6 of the draft letter

attached to Miss Kelley's note be amended to make the above point.  
The 5th sentence would then read:-

"We agree that if the unions, and staff involved, are unwilling to go except on better terms than they could expect to get under the prospective Transfers of Functions legislation, Ministers would need to consider whether it is sensible to go on with the transfer."

MED  
M E DONNELLY



FROM: E KWIECINSKI

DATE: 22 February 1983

NOTE OF A MEETING HELD AT HM TREASURY, 10am 18 FEBRUARY 1983

Present at Meeting: Financial Secretary  
Mr Driscoll - IR  
Mr G Turnbull)  
Mr A Fraser ) SMMT  
Mr H Cownie )

SMMT'S BUDGET REPRESENTATION: CAR BENEFIT SCALES

The Financial Secretary invited Mr Turnbull to open the discussion.

Mr Turnbull commented that this was a very important issue for the car industry. The SMMT were concerned that further increases in the car benefit scales could change the structure of car sales in the UK. Any further increases in the scales would cause people to move down to smaller cars, which would favour importers. He felt there was a misconception that the company car was a pure perk whereas in most cases it was a genuine and essential tool of the trade.

The Financial Secretary commented that the tax charge on the individual for his company car was still very low compared with the actual cost of running a car. He would be interested to hear from the SMMT what level they thought the car scales would need to be to cause the individual to buy his own car rather than accept a company car and pay the tax charge. He thought we were very far from this level.

Mr Turnbull disagreed and commented that people were already asking for smaller cars to reduce their tax burden. Often companies wanted their employees to drive larger cars for prestige reasons and in these cases the employees sought recompense from their employer for the increased tax charge. This added to industry's costs.

The Financial Secretary accepted that industry's costs might possibly be affected by increases in the scales, although he commented that this was a separate argument which should be considered in the context of costs to industry and costs of motoring generally.

Mr Driscoll pointed out that the aim of the car scales was simply to tax the benefit to the employee.

He commented that with a differential scale of car benefits there would always be some people wanting to reduce their tax bills by taking smaller cars.

Mr Turnbull commented that the SMMT would have preferred a single rate for all types of car although they recognised that this might be politically unacceptable. What the SMMT wanted this year was a moratorium on any further increases, or at worst for any future increases to be restricted to the rate of inflation.

In concluding the discussion the Financial Secretary summarised the SMMT's arguments as follows:-

- a) that perpetual annual increases in the car benefit scales would cause structural change to the car market; and that
- b) the structural change would be that people in seeking to reduce their tax bills would trade down to smaller cars. Such a change would disadvantage the UK industry;
- c) at some point the levels of taxation would put extra costs on industry.

The Financial Secretary's response to b) and c) was that we were nowhere near the level of tax charge that would cause these things to happen. He assured the SMMT that it was not the Government's intention to follow a course of perpetual annual increases.



Finally he commented that the Government needed to assess the real benefit of a company car for the individual so that a realistic tax charge could be made on it. He asked the SMMT to supply information on the costs of motoring etc to help the Government decide what a realistic charge should be.

EK.

E KWIECINSKI

Circulation:

Chancellor  
Chief Secretary  
Economic Secretary  
Minister of State (C)  
Minister of State (R)  
Mr Kemp  
Mr Moore  
Mr Robson  
PS/IR  
Mr Driscoll/IR

CONFIDENTIAL



FROM: E KWIECINSKI

DATE: 22 February 1983

MR D M WILLIAMS

cc PS/Chancellor  
PS/MST(C)  
Mr Le Cheminant  
Mr Robson  
Mr Porteous  
Mr Driscoll/IR  
PS/IR

#### TAXATION OF CIVIL SERVICE ALLOWANCES

The Financial Secretary and the Minister of State (C) held a meeting today to discuss the taxation of certain civil service allowances. (Mr Porteous' note of 21 February served as an agenda for the meeting.)

Ministers made the following decisions:-

1) Telephone Rental and Connection Costs

Ministers agreed that taxation and ERNIC should go ahead on this item on the basis of an annual taxable allowance of £100.

2) Clothing allowance

Ministers agreed that taxation and ERNIC should go ahead on these allowances on the basis of grossing up each allowance by  $\frac{10}{7}$ .

3) Nothern Ireland Ferry Costs


Ministers agreed that Treasury and Revenue officials should discuss this question further.

4) Detached Duty

The Financial Secretary suggested that consideration should be given to the possibility of introducing a new taxable annual detached duty allowance as an alternative to the detailed grossing up of allowances. He envisaged that such a new taxable allowance would cover the subsistence and travelling expenses of persons on detailed duty.

The Minister of State(C) commented that officials should continue to search for the most administratively simple and economic way of dealing with the problem.

You agreed to send a note commenting on Ministers' suggestions; and also a draft note for Ministers to send jointly to the Chancellor to enable him to respond to No.10's letter of 14 February.

  
E KWIECINSKI



FROM: M E DONNELLY

DATE: 22 February 1983

MR BATTISHILL - IR

cc PS/Chancellor  
PS/Chief Secretary  
PS/Economic Secretary  
PS/Minister of State (R)  
PS/Minister of State (C)  
Mr Kemp  
Mr Moore  
Mr Ridley  
Mr French  
PS/IR

RICHARD PAGE MP : SUMMARY OF BSS PROBLEMS

seen

The Financial Secretary has/the Summary of Problems produced by Mr Page MP attached to Mr Harris note of 21 February.

The Financial Secretary would be grateful for elucidation of Mr Page's points 5 & 6; and whether we can do anything to help. He also/wonders whether there might be further scope for a reduction in the period of which shares must be held (Mr Page's point 4).

*ME D*  
M E DONNELLY



FROM: NICHOLAS RIDLEY  
DATE: 23 February 1983

CHANCELLOR

cc Chief Secretary  
Economic Secretary  
Minister of State (R)  
Minister of State (C)  
Sir D Wass  
Mr Middleton  
Mr Moore  
Mr Kemp  
Mr Robson  
Mr French  
Mr Graham (Parly Counsel)  
Mr Driscoll - IR  
PS/IR

BENEFITS IN KIND

The Minister of State (R) and I have discussed the Inland Revenue's submission of 11 February which contains a list of measures for possible inclusion in this year's Budget. The measures are summarised in the checklist in the submission with details in the series of Annexes. This note sets out my recommendations and incorporates one or two revised figures. You may like a discussion sometime in the next few days.

A. Car and Fuel Benefit Scales  
For 1984/85

The Revenue favour an increase of 20 per cent in the car scale in line with that announced in each of the last three years. They argue that many people are anticipating an increase of that size and that while there would be grumbles the scales are so far short of realistic levels that a 20 per cent increase could be justified. The Minister of State (R) and I agree that the scales are still nowhere near realistic levels but we both think that an increase for this year of a little less than 20 per cent would deflect criticism from those who argue that we are moving too quickly towards our eventual target. The following table shows the scales proposed for 1983/84 together with a 20 per cent increase and my recommended scale:-

	<u>1983-84</u>	<u>+ 20%</u>	<u>Recommended 1984-85 Scale</u>	<u>% increase</u>
Up to 1300cc	325	390	375	(15.4)
1301-1800cc	425	510	500	(17.6)
Over 1800cc	650	780	750	(15.4)
<u>Original Market Value</u>				
£14,000 - 21,000	950	1140	1100	(15.8)
Over £21,000	1500	1800	1750	(16.6)

The cash breakpoints relating to luxury cars (£14,000 and £21,000 for 1982-83) could be increased by about 14 per cent to £16,000 and £24,000 respectively. Broadly speaking the aim is to ensure that the same groups of cars fall into each band each year and the Revenue will be sounding out (British) manufacturers in the next week or so to see whether breakpoints at these levels would achieve that objective.

The car fuel scale for 1983-84 (the first year) follows the first three points of the car sales. Between March 1982 and January 1983 the price of a gallon of 4 star petrol has risen by about 8 per cent. The car fuel scales are a very blunt instrument, but any employee who doesn't want to pay tax on the scale charge can reimburse his employer or refuse the perk in the first place. I think the car fuel scale should increase in line with the car scales:

	<u>1983-84</u>	<u>Proposed for 1984-85</u>
Up to 1300cc	325	375
1301-1800cc	425	500
Over 1800cc	650	750

### Presentation

It is perhaps unfortunate that scales are expressed in terms of notional additions to income rather than in terms of tax. For 1983-84 the average company car driver (driving a 1600cc car and paying tax at 30 per cent) will pay just over £2.44 a week for the benefit of having the car available for his private use and double that if he also has free petrol. On my proposed scales he will pay £2.88 in 1984-85 (assuming

no reduction in the basic rate) an increase of 44p a week (88p if he gets petrol too). For the average tool of the trade driver the total tax charge for a car with petrol will be only £2.88 a week! I think that in both your Budget Speech and subsequent debates the emphasis should be on these tax figures rather than on the income figures in the tables or on the percentage increase.

B. Threshold and "Official Rate"  
for Beneficial Loans

Both the Minister of State (R) and I think that the £8,500 threshold and the "official rate" should remain as they are. There is no need to announce either decision in your Budget Speech.

C. Anti-Avoidance Measures

The Revenue's note deals with three anti-avoidance proposals all of which we agree ought to be adopted, subject firstly to the overall balance of your Budget - goodies v nasties - and secondly to the way they interact with other areas for decision.

The double £25,000 device is basically offensive but its removal could be controversial unless it were linked with an increase in the £25,000 ceiling for mortgage interest relief. If we do decide to increase the ceiling then the stopping of this loophole could be seen as a perfectly natural concomitant. For this reason, I think we should defer a decision on whether to act against the avoidance device until we have decided what to do about the ceiling.

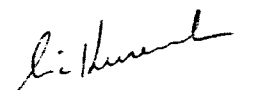
The "Marks and Spencer" device should be stopped. It is quite wrong that a director should be able to occupy a £400,000 company house rent free or at a nominal rent and either pay tax only on the derisory amount prescribed by the existing law or not at all. The Chairman of Marks and Spencer is on record as saying that these arrangements were entered into because Company law prevented them making interest free loans to directors. It seems right therefore to treat the transactions as if they were in fact interest free loans. At the same time, while the overall tax loss cannot be enormous - the Revenue estimate about £ml - the impact on individuals

could be considerable - the example in the Revenue's note would involve the director paying about £30,000 extra in tax. For that reason, I should favour an announcement in your Budget Speech of the intention to act with legislation in this year's Bill but a starting date of 6 April 1984. That would give those affected a chance to reorganise their affairs.

The problem of directors' PAYE tax borne by the company is part of the overall problem of the non-application and late payment of PAYE. Since their submission of 11 February the Revenue have done some more work aimed at quantifying the existing tax loss. They now think that it is perhaps of the order of £m10 (not the £m30 - £m50 given in their earlier paper) involving between 15,000 and 20,000 cases. While the practice is undoubtedly spreading and even the reduced tax loss is not negligible it might look odd to tackle this aspect of the problem in isolation. Subject to your views and those of Treasury Ministerial colleagues, I think it might at this stage be best to note this as a strong candidate for future action when we have had a chance to consider what the Keith Committee report has to say about the problem of late payment of directors' PAYE tax and the possibility of charging interest (it does not specifically mention the point which is the subject of this paragraph) and to look more generally at the whole question of interest on unpaid PAYE tax.

D. Company Cars - Easement of  
Potential Double Charge

Legislation would remove the need for an extra-statutory concession. It is a small point but I favour action if space in the Finance Bill permits.

  
NICHOLAS RIDLEY



CONFIDENTIAL



FROM: NICHOLAS RIDLEY  
DATE: 23 February 1983

CHANCELLOR

cc Minister of State (R)  
Minister of State (C)

#### TAXATION OF CIVIL SERVICE ALLOWANCES

The Minister of State (R)'s minute of 22 February goes in a rather different direction to mine of 22 February. I am concerned to move in a direction of making perks taxable, and encouraging the payment of salaries and allowances which after tax provide sufficient net remuneration to "recruit and retain" employees. I am worried about finding devices to make allowances non-taxable: that will simply encourage the private sector to follow our example. If telephone and protective clothing allowances can be regarded as non-taxable in the way MST(R) suggests, it is an invitation for every private sector employer to give his employees £200 odd in tax free allowances - cost to the Revenue £150m!

The same is true of detached duty and travelling allowances. The 12 months rule is indeed nonsense - but I suspect it should be reduced to 2 weeks rather than extended to 18 months! If an employee is required to do work which causes him to have higher living expenses, then his gross remuneration should be big enough for his net to allow him to afford to live in the manner to which he is accustomed. The 12 month rule costs us dear already in the private sector - most building workers get a fat tax free allowance (called "lodging and subsistence") under it, whether they live at home or not.

Similarly, with travelling across the Irish sea: rather than finding a way of making the cost of this non-taxable by obliging the employee to return, I would rather pay him enough gross (via the allowance) so that after tax, he is able to travel or not as he wishes. Otherwise we reopen the can of worms about home to work travel being taxable.

What is necessary for the 12 month rule is to scrap it, and have a rule that allows travelling and subsistence to be tax free only in the performance of duties, and from the place of work.

This is not very helpful in the context of this incident: but the ramifications for the rest of the work force are terrifying if we are not very careful.

A handwritten signature in black ink, appearing to be 'NR', with a small dot below the 'R'.

NICHOLAS RIDLEY



FROM: M E DONNELLY

DATE: 23 February 1983

MR CRAWLEY - IR

cc Mr Middleton  
Mr Robson

TAX TREATMENT OF DEEP DISCOUNT STOCK

The Financial Secretary was grateful for your note of 21 February.

He is content with the draft note to Chancellor. He wishes to add an extra longer-term option at the end of the note. This would not be designed for inclusion in this years Finance Bill, but as a "think piece" to stimulate internal discussion. I attach a draft of what the Financial Secretary has in mind. He would be grateful for your quick comments (by telephone) on the proposal outlined.

MED

M E DONNELLY

Option (d) A fourth option would be to apply capital indexation to deep discount stock and treat it as an indexed stock, but with a redemption price; which may turn out to be either higher or lower than the price at which a similar indexed stock would be redeemed.

There would be no need to stipulate a minimum rate of interest. But any interest paid would be taxable in the normal way.

At any time that such a bond was redeemed or sold Capital Gains Tax would apply to the difference between the sale price (or the redemption price) and the issue price, suitably increased by the CGT indexation allowance. For the lender this would be quite straightforward. But for the borrower it would be necessary, for tax symmetry, to index his "loss" and to allow him to set any indexed loss against other Capital Gains he may have.

These would be major innovations, which could have repercussions in practice on CGT legislation generally, even if kept discrete to this particular type of bond in the legislation.

of  
I would be glad of the Revenue's views on this, fourth, option: and I realise that it is a major step with considerable ramifications. I include it in this paper because I think it is the way we ought to be moving; if it gives rise to some discussion when we meet to settle this matter, the issues will emerge more clearly.



FROM: M E DONNELLY

DATE: 23 February 1983

MS LOW

cc Chief Secretary  
Minister of State (R)  
Mr Bailey  
Mr Lovell  
Mr Bolt  
Mrs Imber

PRIVATE SECTOR FINANCE FOR INDUSTRIAL AND COMMERCIAL DEVELOPMENT

The Financial Secretary was grateful for your note of 22 February.

He assumes that by "future income stream" in paragraph 3 you mean in practice the rent. The drawback with this approach is that if a property cannot be lent its rent is effectively 0; and therefore looking at its future income stream is of no help. Such properties are only of value as stock to someone hoping to make a profit from them when times improve. That is their only value/<sup>to</sup> the Government. The only way to discover this stock value is to put them up for sale and accept the highest bid.

In principal therefore the Financial Secretary sees no reason not to sell <sup>to</sup> properties for whatever price we can get. But in practice due/the presentational problems caused by appearing to sell properties "cheap" he accepts that some external price guideline is necessary. He would welcome your suggestion as to how best to calculate such a minimum sale price.

MED  
M E DONNELLY

CONFIDENTIAL



FROM: M E DONNELLY

DATE: 24 February 1983

SIR L AIREY

INLAND REVENUE'S: POWERS TO LITIGATE AND EXECUTIVE FUNCTION

The Financial Secretary has been following the recent correspondence in the Financial Times on Parliament and the Revenue. The most recent letter on this subject is from Mr J Emmerson and appeared in the Financial Times of 23 February.

There are two issues arising out of this and other correspondence which the Financial Secretary would like to discuss with you. The first concerns the Revenue's discretion in pursuing litigation. It currently has very wide powers indeed to commit public funds through appealing against decisions on Revenue matters taken by lower courts. The second concerns the question of responsibility for the Revenue's executive discretion. This is of course the responsibility of the Chairman of the Board rather than Treasury Ministers. Again, questions of accountability arise.

These points might be discussed in the context of the letter from one of the Financial Secretary's constituents sent to you on 23 February.

MED

M E DONNELLY

CONFIDENTIAL



FROM: NICHOLAS RIDLEY  
DATE: 24 February 1983

CHANCELLOR

cc CST  
EST  
MST(R) mst(c)  
Mr Middleton  
Mr Moore  
Mr Kemp  
Mr Robson  
Mr French  
Mr Stewart/IR  
PS/IR

INTEREST RELIEF EMPLOYEE BUY-OUTS: BUDGET STARTER 189

Tax relief is already available for interest on loans for investment in a close company if the borrower has at least a 5% shareholding in the company or works for the greater part of his time in the management of the company. There have been representations, in particular from the National Freight Consortium, that this relief should be extended to cover the case of the "employee buy-out" where the company is not close but is controlled by its employees (as NFC itself now is).

I think it very important to be seen as benevolent, even to promote, employee buy-outs in the present political and industrial climate.

We have also been asked - by Patrick Jenkin among others - to extend the relief to employees of close or unquoted companies generally who borrow to buy shares in their company. I think that would be going too far; it would be difficult then to resist relief for employees of quoted companies and perhaps also some alternative relief for people who are not employed by companies. That could be costly and would lead to an increase in borrowing. But I would like to meet the rather special case of the employee buy-out, where interest relief for employees could help to get the scheme off the ground. The Revenue have suggested the outlines of a possible scheme (Mr Stewart's note of 18 February); relief would be given if the shares were in an employee-controlled company and were bought not later than (say 6 or 12 months after the company became employee controlled. There is inevitably some arbitrariness about the definition; it would cover

those who bought shares as part of the original buy-out process (but not future employees who bought shares later on and who would be much more difficult to distinguish from the employees of any other company).

I recommend that we go ahead with a scheme on these lines. The cost would be very small (perhaps £m2 in a full year).

*Nicholas Ridley*  
PR

NICHOLAS RIDLEY



CONFIDENTIAL



FROM: FINANCIAL SECRETARY

DATE: 24 February 1983

CHANCELLOR

cc Chief Secretary  
Economic Secretary  
Minister of State (C)  
Minister of State (R)  
Sir D Wass  
Mr Middleton  
Mr Moore  
Mr Monck  
Mr Robson  
Mr Turnbull  
Mr Ridley  
Mr French  
Mr Crawley - IR  
PS/IR

#### TAX TREATMENT OF DEEP DISCOUNTED STOCK

Last June we lifted the embargo on the issue of loan stock at a "deep" discount by companies. The Revenue issued a Press Notice to clarify the tax treatment of such stock under present law, and we said we would review the tax arrangements with a view to legislation this year for a more satisfactory regime. A consultative document was issued in January on the options for legislation, including the possibility of an accruals basis of taxation on US lines.

A deep discount stock is rather like a conventional stock but with the "interest" accruing annually reinvested automatically and paid on maturity of stock. Responses to the consultative document show a variety of views about the most suitable tax treatment. A number of respondents have urged options which would involve major asymmetry between the tax treatment of the lender's gain (taxation on a capital basis) and the borrower's outgoings (to be relieved on an income basis). I think we must continue to resist them. It would be equivalent to an interest subsidy and would be open to exploitation and "round tripping" at very considerable cost to the Exchequer. But a number of the most influential respondents (including the CBI, the Accepting Houses and the Clearing Banks) have suggested as a possible compromise that the borrower should be allowed relief for the discount annually on an accruals basis, while the investor should be taxed on the accrued income when he sells or redeems the stock. This would have some cost to the Exchequer, since borrowers would tend to get relief for the discount

earlier than investors paid their tax on it. In effect, it gives the investor a degree of tax deferral while his accruing "interest" is reinvested. But, although it involves some asymmetry in the timing of the relief as compared with taxation of receipts, it is not open to the same objections of principle and cost which are involved in capital/income asymmetry. Subject to further work on the detail, this is the solution I would recommend. It is clear that an accruals basis of taxing the investor annually would be unattractive to investors, and would lead to pressure for alternative options to be made available at the same time, thus complicating the tax regime and leading to possible confusion in the market.

If we take this route, companies wishing to issue stock will have a choice between -

(a) conventional stock - with annual interest allowed against income for the borrower and taxed as income of the lender;

(b) indexed stock - There are two options here:-

(i) if the capital is indexed, the indexation is a capital gain for the investor (but benefits from the indexation allowance) and is not allowable against income for the borrower. Real interest actually paid is treated as income.

(ii) Alternatively if the interest rather than the capital is indexed, it is treated as income in the hands of the lender, and the borrower can get full tax relief.

Companies are already free to issue indexed bonds on these terms (as was made clear in the Revenue Press Release last June).

(c) deep discounted stock - with the borrower getting relief against income annually for the discount as it accrues, and the investor being taxed on his accrued income on sale or redemption. (The treatment of any capital gain or loss element in a sale, and the basis for calculating the accrued income, needs to be settled but that is a matter of detail).

My only concern is whether the markets will find the three options outlined above wide and attractive enough. I have considered a further option. This would be to apply capital indexation to deep discount stock and treat it as an index stock, but with a redemption price; which may turn out to be either higher or lower than the price at which a similar index stock would be redeemed. There would be no need to stipulate a minimum rate of interest. But any interest-paid would be taxable in the normal way. At any time that such a bond was redeemed or sold CGT would apply to the difference between the sale price (or the redemption price) and the issue price, suitably increased by the CGT indexation allowance. For the lender this would be quite straightforward. But for the borrower it would be necessary, for tax symmetry, to index his "loss" and to allow him to set any indexed/<sup>loss</sup> against other Capital Gains he may have.

The above option raises fundamental issues concerning CGT indexation of capital losses; and runs the risk of making this whole area seem too complicated to the City. So I would not recommend that we proceed with it at this time. But subject to further discussion and Revenue comments, it is an option we might keep in the locker to be brought forward later. And it would be a logical step forward towards greater indexation of the tax system.

Overall therefore, I think options (a), (b) and (c) provide company treasurers with a useful range of possibilities. But we will need to ensure that they are fully aware of them. I have in mind the issue of a simple leaflet about the different options and their tax treatment, once the legislation on deep discounted stock has been enacted - or even announced.

At your meeting on 24 January you decided provisionally against withdrawing the present tax exemptions for gilts, including the income tax exemption for the discount on low coupon issues but thought that they should be looked at further in the light of the response to the consultative document. Although a number of respondents have referred critically to the gilts treatment, this has not been the major theme of the responses. I suggest that we let matters rest on the provisional decision at least for this year.

*I confer to a certain "unease" about this position.*

If you agree we will now work these plans up ready for the Budget,  
and where necessary the Finance Bill. You may wish to discuss  
the whole question at a meeting, which I would welcome,

A handwritten signature in black ink, consisting of a stylized 'N' and 'R' followed by a checkmark-like flourish.

NICHOLAS RIDLEY



FROM: M E DONNELLY  
DATE: 24 February 1983

MR MIDDLETON

FINANCIAL TIMES 23 FEBRUARY: LETTER FROM E J HEMBREY

The Financial Secretary wishes to draw to your attention the letter from Mr E Hembrey in yesterday's FT.

He has commented that Mr Hembrey has highlighted the point about the favourable treatment of borrowers under the present system which we have frequently discussed. It would be useful if, say, Gordon Pepper were to write to the FT commenting and expanding on this point.

Perhaps you might consider mentioning it to him when a suitable occasion arises?

MEJ

M E DONNELLY

FINANCIAL TIMES 23-2-83

### But what of the borrowers?

From Mr E. Henbrey

Sir,—It has been reported (February 15) that the Financial Secretary to Her Majesty's Treasury recently told a City audience that consideration of the index-linked taxation of interest is now high on the Government's list of priorities.

What a lovely thought for lenders! But what of the borrowers? The debate on the tax treatment of deep discounted stock demonstrates the Government's predilection for symmetry. How will corporate treasurers, mortgage borrowers, et al, face up to the limitation of deductibility of interest to the real interest element in their total interest outgoing?

E. J. Henbrey  
40 Corringway,  
Ealing, W5



FROM: M E DONNELLY

DATE: 24 February 1983

MR PERETZ

cc PS/Chancellor  
PS/Chief Secretary  
Mr Kemp  
Mr Allen  
Mr Hall  
Mr Perfect  
Mr Ridley  
Mr Harris - or

FINANCIAL SECRETARY'S PRESS HANDOUT IN WALES - 25 FEBRUARY

... I attach the final draft of the Financial Secretary's press release for use in Wales tomorrow.

It would be helpful to have any comments by 3.00pm this afternoon.

MED  
M E DONNELLY

[PRESS RELEASE]

It is important that we put yesterday's trade figures in a proper perspective. The UK balance of payments position remains strong. In 1982 we earned a current account surplus of £4.7 billion following a surplus of £ 6 bn in 1981. The figures announced yesterday received a lot of attention, but it is always unwise to read too much into one month's figures. They always get revised but they rarely get repeated. A more reliable guide to recent trends is provided by the figures for the last three months together. Over this period the current account was over £1,200 million in surplus. Export volumes were  $2\frac{1}{2}$  per cent higher than a year earlier, while import volumes were little changed. There have not been many occasions in the last 30 years when we could have said that.

Other indicators underline the fact that financial conditions remain sound. Public spending and borrowing are under firm control and will remain so. Public expenditure is well within levels set in earlier plans. And the Government deficit as a percentage of GDP is one of the lowest among industrialised countries. Monetary policy is also on course. The growth of the main monetary aggregates are all well inside their target range. Fiscal and monetary discipline are yielding encouraging results. Unit labour costs are rising by only about 5 per cent a year - below the rate in most of our major competitors. Inflation has fallen dramatically faster than even we expected, to around 5 per cent



the lowest level for thirteen years. This is the performance of a sound economy.

This Government has no intention of deviating in the battle to ensure a return to sustainable growth. This is the only way to provide more lasting jobs. Too often in the past politicians have sought the electorally attractive option of reflation and cast aside monetary and fiscal prudence for the mirage<sup>of</sup> political gain. I think most people would see it in a "mirage". If we were to cast away responsibility before an election, it would be more likely to damage us than assist us. So that is not our way. I want both the people and the financial markets to know it. We have earned their confidence and are determined through our actions to retain it.



FROM: E KWIECINSKI  
DATE: 25 February 1983

PS/CHANCELLOR

CC PS/Chief Secretary  
PS/Economic Secretary  
PS/Minister of State (C)  
PS/Minister of State (R)  
Mr Kemp  
Mr Moore  
Mr Robson  
Mr Pirie  
Mr O'Hare - IR

MORTGAGE INTEREST RELIEF AT SOURCE

The Financial Secretary has seen Mr O'Hare's note of 23 February.

He has commented as follows:-

On page 3 paragraph 2 he suggests deleting from the last sentence:  
"...and costly for the Revenue."

On page 3 paragraph 3 he suggests deleting the phrase, "...and much recoding work for the Revenue...".

He is otherwise now content with the revised question and answer leaflet and would be grateful for the Chancellor's agreement that he can start sending it (under cover of the agreed letter) to all Members of the House.

  
E KWIECINSKI



FROM: M E DONNELLY  
DATE: 25 February 1983

PS/CHIEF SECRETARY

cc PPS  
PS/Economic Secretary  
PS/Minister of State (C)  
PS/Minister of State (R)  
Mr Wilding  
Mr Bailey  
Mr Christie  
Mr Mountfield  
Mr Chivers  
Mr Morgan  
Mr Pirie  
Mr Wicks  
Mr R Wilson  
Mr Perry

C&AG BILL: MMC PROGRAMME IN 1983

The Financial Secretary has seen your note of 24 February to Mr Burgner. He thinks that to announce the 1983 MMC Programme during the Committee Stage of the C&AG Bill would be seen as an insult by the backers of the Bill. He would therefore counsel holding up an announcement until the Report Stage of the Bill.

*MED*  
M E DONNELLY



FROM: E KWIECINSKI  
DATE: 25 February 1983

PS/CHANCELLOR

CC PS/Chief Secretary  
PS/Economic Secretary  
PS/Minister of State (C)  
PS/Minister of State (R)  
Mr Kemp  
Mr Moore  
Mr Robson  
Mr Pirie  
Mr O'Hare - IR

MORTGAGE INTEREST RELIEF AT SOURCE

The Financial Secretary has seen Mr O'Hare's note of 23 February.

He has commented as follows:-

On page 3 paragraph 2 he suggests deleting from the last sentence:  
"...and costly for the Revenue."

On page 3 paragraph 3 he suggests deleting the phrase, "...and much recoding work for the Revenue...".

He is otherwise now content with the revised question and answer leaflet and would be grateful for the Chancellor's agreement that he can start sending it (under cover of the agreed letter) to all Members of the House.

E KWIECINSKI



FROM: M E DONNELLY  
DATE: 25 February 1983

MR G SMITH

cc PS/Chancellor  
PS/Chief Secretary  
PS/Economic Secretary  
PS/Minister of State (C)  
PS/Minister of State (R)  
Sir D Wass  
Mr Burns  
Mr Middleton  
Mr Byatt  
Mr Christie  
Mr Kemp  
Mr R I G Allen  
Mr Fitzgerald - IR  
PS/IR

#### RELATIVE BURDEN OF TAXATION ON PERSONAL AND COMPANY SECTORS

In answer to a Supplementary Question from Mr Robin Cook yesterday the Financial Secretary stated:

"It has been conceded many times...that [personal] taxation has increased under this Government. However the counterpart to that is that taxation upon companies and industries has been greatly reduced." (Hansard 24 Feb col. 1045)

The Financial Secretary would be grateful if you would provide figures showing:

- i) the relative burdens of taxation in absolute and percentage terms on the company and personal sectors since this Government took office; and
- ii) how the current relative distribution of taxation compares with the position under the previous Government adjusted for inflation etc.

It would be helpful to have this information by close on Monday  
28 February.

ME)  
M E DONNELLY

TAX COMPARISONS

	78-79	78-79 [regime indexed]	82-83	
CT	3.9bn	5.8bn	5.45bn	<i>- I.R. Figures</i>
NIS		<i>CV. rough fig.)</i>	<i>(not yet published)</i>	
employers NIC				
TOTALS				



Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon George Younger MP  
Secretary of State for Scotland  
Scottish Office  
Whitehall  
LONDON  
SW1

Dear George

SCOTTISH TRANSPORT GROUP: PRIVATISATION

I have seen your paper E(DL)(83)1 setting out your conclusions on privatisation of the Scottish Transport Group.

I am rather disappointed with your proposals. I agree that the study undertaken by the British Linen Bank is unsatisfactory. It falls well short of an acceptable analysis of the position and leans too easily towards the view that nothing can be done because it is all too (politically) difficult. This is not a judgement that I see as being appropriate for the bank. It is one for us; and there is nothing in the bank's report which sways me from my view that we should press ahead with privatisation.

I do not agree with the view that privatisation means 'the complete withdrawal of bus services from the Highlands, from Dumfries and Galloway, and from large parts of North East Scotland'. This confuses the question of ownership with that of subsidy. If the local authorities (or the Scottish Office) are willing to pay for loss making services (and there may well be a case for them to do so) then a private operator will be just as able to run them as STG. Insofar as privatisation enhances efficiency, costs will actually be reduced. A more detailed, and more professional, study by one of the major merchant banks with experience of privatisation would also point the way to resolving the other technical difficulties misleadingly raised by the Linen Bank.

Clearly the political considerations will have to be handled carefully. But it would be wrong to adopt a negative approach in contrast to our very clear platform of privatising existing public sector operations on which we are making good progress elsewhere. I am not proposing any fundamental change, and certainly not an announcement, before an election. But we must get ahead, to ensure that we can move forward speedily in the next Parliament.

Mr Morgan  
Mr Hurst  
Chancellor  
CST  
EST  
West of  
West (R)  
Su Dumas  
Mr Bailey  
Mr Banger

22 February 1983

Mr Farrington  
Mr Broadbent  
Mr R Harris



David Howell is of course pushing forward work on NBC. I think it would be helpful to discuss the two bus companies together since, as you acknowledge in your paper, many of the same considerations apply in both cases. Providing David is reasonably confident of being ready to bring forward his paper during March, I suggest we should defer discussion until then. The Chancellor, as Chairman of E(DL), is content to defer a meeting for this short period, so that both industries can be considered alongside each other.

I am copying this letter to members of E(DL), Sir Robert Armstrong and Mr Sparrow.



NICHOLAS RIDLEY



3 H Roked  
PS / Monceller  
PS / CST  
PS / EST  
PS / MGT (R)  
PS - Dixon  
Mr Bailey  
Mr Middleton  
Mr Kemp  
Mr Howell  
Mr Moore

Treasury Chambers, Parliament Street, SW1P 3AG.

Mr David Cooksey  
CBI  
Centre Point  
103 New Oxford Street  
LONDON  
WC1A 1DU

24 February 1983

Mr Charles

Mr Gordon

Mr Paine

Mr Turnbull

Mr Andrew

Mr Battersby / IR

*Dear Mr Cooksey*

BUSINESS START-UP SCHEME (BSS)

PS / IR

Following our meeting on 7 February I have been looking into the points you raised on R&D. It might be helpful if I set the position out.

If a company engages in research and development before commencing to trade, it is not dis-qualified from the BSS scheme provided it does commence trading within 12 months (or 2 years if the Inland Revenue use their discretion to agree to an extension - which it normally would do in a bona fide case). Similarly, where a company has started to trade and undertakes expenditure on R&D which is ancilliary to its trading activity, that would not disqualify the company.

In both cases, relief could not be given until after the end of the year of assessment in which the shares were issued or after the company had completed 4 months trading, whichever was the later. The purpose of this 4 month rule is to ensure that the company is actually engaged in a qualifying trade. The alternative would be to give relief when the investment was made and then claw it back if the company did not begin to trade. This would be a more cumbersome procedure, and more resented.

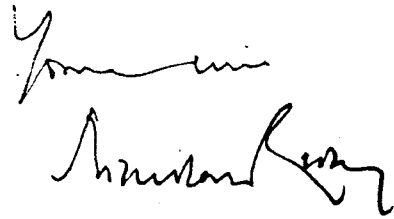
Research and development is not an activity which, on its own, amounts to trading. For there to be a trade goods or services must be supplied for a reward. If the relief was not linked to trading, there would be no way of distinguishing hobbies etc from genuine commercial activities, and no guarantee even in the genuine case that any trading activity would result (eg flies crawling up the wall!)

Of course, there could be a company whose trade was the supplying of R&D services - eg on a commission basis. Provided that all the other rules were satisfied, such a company would, prime facie, qualify under the BSS. In practice companies carrying on this kind of trade may not be very common.

Discussion two linked proposals came up. They were, first, tax relief should be given for off-balance sheet development companies and, second, that relief should be available for companies not qualified for DOI support under one of the department's innovation schemes. The common thread was that in both cases the relief proposed took the form of BSS relief for equity investment by the proprietors.

As you will appreciate, this goes to the heart of the BSS which is a scheme for equity investment by outsiders, designed to help fill the equity gap in small firms by encouraging outside investors to take up shares. Extending it to proprietors would not be consistent with this key objective.

So overall the position is not too bad. But if you have any ideas to suggest I am sure you will let me know because I accept the need for help in this area.



NICHOLAS RIDLEY



CC Chancellor  
 CST  
 EST  
 MST(R)  
 Mr Moore  
 Mr Robson  
 Mr French  
 Mr Prescott  
 Mr Balfourhill } IR  
 PS/IR

Treasury Chambers, Parliament Street, SW1P 3AG

The Deputy President  
 Institute of Taxation  
 39 Melville Street  
 EDINBURGH  
 EH3 7JL

24 February 1983

Dear Mr Voge

PURCHASE OF OWN SHARES

Thank you for your letter of 10 February with the Institute's further comments on the POS legislation. I fear I must again take issue with you on certain points.

For the reasons given in my earlier letter, I do not agree that it would be sufficient to have a test of "bona fide commerciality" of the kind in Section 460, instead of the present benefit to the trade test. Nor can I agree with you when you say that the inference to be drawn from my remarks in Committee is that the "trade benefit" arises when money is attracted to the company in the first place, and that what happens thereafter is of no concern to the company.

My remarks in Committee were, of course, clearly confined to the situation where the shareholder wants to quit entirely. In these circumstances he is by definition a "reluctant" shareholder, and he could, in frustration, become dissident or sell his shares to third parties including trade competitors. It is accepted, therefore, that when a shareholder wants to leave altogether, the repurchase is likely to "benefit" the trade in the sense that the trade could be damaged if the repurchase did not take place. And, as experience has so far borne out, there is no real difficulty with the trade benefit test in the great majority of complete buy-outs. The result is that, for this category, a test on Section 460 lines would probably not have a significant effect on the "pass" rate.

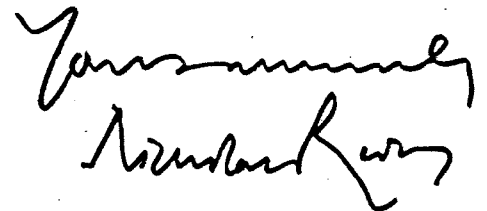
Where a Section 460-type approach would make a difference is in the area of partial buy-outs. I think it is entirely reasonable that, in circumstances where a shareholder wants to stay in the company but take cash out, the company should be required to show that its trade has benefited. If the legislation followed the approach recommended by the Institute, it would not be hard to envisage circumstances where a shareholder could take out cash which he would normally receive by way of dividend (or further dividend) free of income tax, whilst nevertheless retaining the major part of his investment in, and influence on, the company. That said, however, it is recognised that

All be circumstances where a partial buy-out would benefit  
company's trade, and as I said in my earlier letter, the Revenue  
cleared schemes for partial buy-backs.

Accidentally, it is not right to say that there is no effective appeal  
where where the Revenue has not given clearance. In these circumstances  
it is open to a company which thinks it has a good case to go ahead  
with partial buy-out and, if the proceeds are treated by the  
Revenue as a distribution, to appeal to the Commissioners against  
the resulting assessment.

With regard to the 5-year test, I take the point of your example.  
Nonetheless, for the reasons I have given, we thought that a minimum  
period of ownership condition was necessary as an additional safeguard  
against abuse, and also was consistent with the aim of encouraging  
investment on a reasonably long-term basis.

I am grateful to the Institute for the interest they have taken  
in these provision, and I shall certainly continue to bear your comments  
in mind. But, as I said in my earlier letter, fears that the benefit  
to the trade test might prove unduly restrictive have not been  
borne out by experience and I suspect that the Institute's preferred  
approach, and that of the Government, will not be too far apart  
in terms of practical results.



NICHOLAS RIDLEY



CC Mrs Hedley-Milla  
Mr Bokkrell  
Mr Peck  
Miss Court  
Mrs Wright  
Mr Salvason

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Francis Pym MP MC  
Secretary of State for Foreign  
& Commonwealth Affairs  
Foreign and Commonwealth Office  
Downing Street  
LONDON  
SW1

25 February 1983

*Dear Secretary of State*

EC ECONOMIC REPORT AND REVIEW 1982-83: PARLIAMENTARY SCRUTINY

The House of Commons Select Committee on European Legislation on 8 December 1982 recommended that European Community document 10337/82, the draft of the Commission's Annual Economic Report and the background document 10480/82 Annual Economic Review, should be further considered by the House in the context of a future debate on economic affairs. Since then the Annual Report has been adopted in final form by the Council and has also been recommended for debate with document 10337/82.

Unless you or your colleagues see any difficulty I propose that as in previous years we should include these documents in the UK Budget debate. I would not expect them to give rise to any particular comment or controversy.

I am copying this letter to the Lord President of the Council, Members and Secretaries of OD(E) and L Committees and Secretary of the Cabinet.

*yours sincerely*

*Nicholas Ridley*

FP NICHOLAS RIDLEY

(Approved by the Financial Secretary  
and signed in his absence)



CC PS/Chancellor  
PS/CST  
PS/EST -  
PS/MST(C)  
PS/MST(R)  
Sir A Rawlinson  
Mr Moore  
Mr Robson  
Mr Culpin

Treasury Chambers, Parliament Street, SW1P 3AG

Mr D Green - IR  
PS/IR

Lord Bellwin  
Parliamentary Under Secretary  
of State  
Department of the Environment  
2 Marsham Street  
LONDON  
SW1

28 February 1983

*Dear Lord*

INLAND REVENUE RAYNER SCRUTINY: VALUATION OFFICE VISITS TO THE PUBLIC

I have recently been considering with my officials the recommendations in a Rayner Scrutiny Report on visits made to the public by Revenue officials. One of the areas under scrutiny was visits made by Valuation Officers.

The report looks at the visits which staff make to domestic properties following notice from a rating authority of changes which may have rating consequences. At present, notices are followed up with an inspection visit in every case, but Section 21 of the Local Government Act 1974 will often apply to postpone any alteration to the Valuation List until a general revaluation.

The recommendation is that for all domestic properties the Valuation Officer should work from plans deposited with the local planning authority, rather than from inspection visits, to provide the basis for his revised valuation. The proposal, if fully implemented, might save some 250 staff as well as travelling expenses.

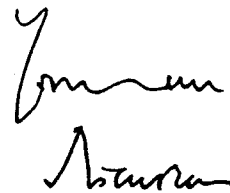
I am of course wholly in favour of making savings, but I have some doubts about whether the results of working entirely from plans would be satisfactory. Also I would be reluctant for us to go forward at this time. First, until we reach our final decision on the future of domestic rating as a whole and on the terms of our reply to the Select Committee on the Environment, I think it would be best not to tinker with the system. Secondly, I am also rather concerned about the proliferation of plans. The scrutiny envisages changes in the planning legislation and the Building Regulations to provide that plans deposited with local planning authorities should also be sent to the Valuation Officer. A possible alternative would

the authorities to pass a copy of plans to him. (I gather this could be implemented by the Department of the Environment issuing a guidance note to the local planning authorities.) Either way it will be resented by many of those putting forward plans for planning permission.

In the circumstances I think the best way forward might be for the Revenue to test the proposal with a pilot study in selected rating areas before any decision is taken on whether or not to implement it. Results from plans would be compared with the valuations actually made by the Valuation Officer. The cases covered by Section 21 - if it survives - might at least prove a promising area for achieving some savings.

Local Authorities will have to be brought in on the pilot study in order for the Valuation Officer to have access to plans. For this reason I do not think we should aim to start the study in advance of the main decisions on rates. Again we do not want to add gratuitously to the existing public unrest about rates while there is still so much uncertainty about their future. However I should like to have your views as both the pilot study and the recommendation, if implemented, could have repercussions for your Department.

I know that your officials are looking at the other Rayner Scrutiny on "Rating Procedures", but there too I do not think we should publicise the recommendations in any form, before we announce our course for the future of rating. These have, of course, become tied up with the problem of finding the manpower for a revaluation of non-domestic property.



NICHOLAS RIDLEY