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PART F

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PART F

FINANCE BILL 1987

DD's 25 years NA 23/11/95.

PO -CH /NL/0008

PART F

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PART G

To go on NL/8

Part ~~B~~ F

Se

Finance Bill

Sheppards Moneybrokers Limited

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SML

FINANCIAL SECRETARY	
REC.	21 SEP 1987
ACTION	PS/IR
COPIES TO	PPS, Mrs. Lomax
	Mr. Cropper
	Mr. Perfect
	Mr. Scholar.

PGBW/AC

14th September 1987

The Hon. Peter Brooke, M.P.
House of Commons,
London SW1A 1AA

Dear Peter,

FINANCE BILL

First of all, thank you very much for sparing the time to come and have lunch with us last week. Not only was it a great pleasure to see you, but our guests much enjoyed the opportunity of meeting you. I have taken the liberty of suggesting to them that you might welcome further contacts with your constituents in a similar fashion!

As I mentioned to you, I would be most grateful if you could ask the Treasury Ministers if they would consider favourably two very minor changes in the next Finance Bill, which would make a very considerable difference to the Gilt-Edged Market, with, I hasten to add, no loss of income to the Revenue nor cause any great inconvenience to them.

The background is, I hope, quite simply stated. As I am sure you are aware, Gilt-Edged Market Makers need to borrow stock in order to be able to provide liquidity to the market and to effect timely deliveries of stock they have sold. They borrow from Stock Exchange Moneybrokers, who in turn borrow from Institutions. Most Gilt-Edged stocks are available from normal Institutional Lenders such as Banks, Insurance Companies and Pension Funds, in sufficient quantities to enable Market Makers to quote close and competitive prices in the knowledge that plenty of stock can be borrowed. The exceptions to this general availability are the low coupon stocks. These securities specifically appeal to the individual investor, not the Institutions and though the Building Societies used to be substantial holders of this type of investment, the alteration in tax treatment in February 1984 made them less attractive.

/Cont'd..

Though theoretically it might be possible to borrow low coupon stocks from the individuals who hold them, the physical, technical and legal problems are so great as to be almost insuperable, and the credit risks associated with this type of operation would not be acceptable in the Gilt-Edged Market. These problems would not arise if the Market could borrow stock held by Lloyd's and the stocks are normally controlled by Managers, so the tehnical and legal problems are largely mitigated. Having them available for lending would make a considerable improvement to the liquidity of the Gilt-Edged Market, and the ability of Market Makers to make competitive prices.

As you know, at present the arrangements for Revenue-approved stock lending are controlled under an extra statutory concession. Powers were taken in the Finance Act 1986 (Section 61) to give statutory cover to this concessional treatment of stock lending, but the regulations have not yet been made. So far the Revenue have not allowed Lloyd's members to participate in the concessional tax arrangements for stock lending because of technical difficulties which would arise in applying the Lloyd's tax legislation to stock out on loan across a year end.

Two small changes in primary legislation need to be made to correct this. First in relation to the Accrued Income Scheme it would have to be made clear that securities within its scope out on loan across a year end, would remain within the deemed transfer provisions of Paragraphs 24 and 25 Schedule 23 FA 1985. Second, in relation to capital gains tax, it would have to be made clear that securities within the scope of the Tax were, if out on loan across a year end, still to be brought within the valuation basis calculations of Paragraph 6(3) Schedule 16 FA 1973. Neither of these amendments, I understand would be particularly complicated nor would they involve any cost to the Exchequer.

We are all well aware that there could be more important matters in the Finance Bill which affect Lloyd's, and would in no way wish to suggest that the minor amendments we ask for had any influence or affect on other legislation which may be proposed. On the other hand, we believe that if stock could be made available from Lloyd's Syndicates at an early date, it would materially benefit the Gilt-Edged Market, on whose behalf I am writing.

I understand from Marcus Johnson, who you met at lunch, that Lloyd's would be quite happy to lend stock if they were assured that these amendments might be forthcoming. I quite appreciate that it might well be impossible to anticipate the budget by giving such an assurance, but obviously from the markets point of view if the lending could be expedited, it would be a great help.

/Cont'd...

As I said, I would be most grateful for any assistance which you could give us, and of course would be delighted to answer any questions which you, or the Treasury might have.

Yours

P.G.B. WILLS,
Chairman

HOUSE OF COMMONS
LONDON SW1A 0AA

17 September 1987

Dear Norman,

The enclosed is self-explanatory. I am assuming it should first go to you, but I am also sending a copy to Peter Lilley because of his relevant interests and responsibilities.

Yours ever
Peter

Peter Brooke

Norman Lamont Esq MP
HM Treasury
Parliament Street
LONDON SW1

7-2

FROM: MRS T C BURNHAMS
DATE: 16 SEPTEMBER 1987

1. MISS SINCLAIR

2. FINANCIAL SECRETARY

cc PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir Peter Middleton
Mr Scholar
Miss Evans
Miss Hay
Mr Michie
PS/IR
Mr Draper - IR
PS/C&E
Mr Wilmott - C&E

FINANCE BILL 1988: BUDGET STARTERS

We have started trawling Treasury Divisions, Department of Transport and the Revenue Departments for candidates for the Starters list. This submission explains the way information on Starters will be presented to Ministers.

Opening position

2. A full list of Starters with suppporting background information will be presented to Ministers in October. We have reviewed last year's arrangements and concluded that some improvements should be made to streamline procedures in order to facilitate updating and minimise delays. The revised procedure will also reduce the volume of paper it will be necessary to circulate. The summary sheet (Annex A) has been altered to allow all the relevant information to be presented in a clearer way. The reference sheet (Annex B) will be issued only once to provide background information and will not be updated unless the scope of the Starter changes significantly. The summary sheets will be recirculated at regular intervals and will show the latest position on each of the Starters.

3. In view of the heavy work programme which is anticipated for next year's Budget it will be even more important to ensure that we provide Parliamentary Counsel with an early and regular programme of work. To this end we and the Revenue Departments will be monitoring

progress closely in order to spot potential bottlenecks and to consider what action can be taken if work is getting behind schedule. Each proposed measure will be allocated to one of the following categories:

I	-	definitely included
I*	-	provisionally included
D	-	definitely dropped
D*	-	provisionally dropped
UCM	-	under consideration (at least one submission received by Ministers)
NSM	-	a first submission to go to Ministers

As work progresses on each Starter, it will be reclassified as appropriate.

Updating

4. For the last Budget, Ministers were presented with the first Starters list in October and this was revised on 3 occasions - in November, pre-Chevening and finally early in February. We intend to repeat this pattern. In addition the summary sheets will be updated and circulated at least every two weeks to replace earlier editions. Last year the Chancellor's meeting to review minor Starters was held on 18 December - we hope to bring forward the timetable this year and will advise on possible dates in our submission in mid-October covering the first Starters list.

Conclusions

5. We would welcome your agreement to the proposed arrangements for keeping Ministers informed about the progress of the Starters exercise.

Teresa Burnhams.

MRS T C BURNHAMS

-FORMA

Annex A

BUDGET STARTERS: SUMMARY SHEETS

1	2	3	4	5	6	7	8	9	Date 10	11
No	Description	Status	Date latest sub[mn]	Revenue £m cost(-)/Yield(+) 1988/89	1989/90	Staff Effect 1/4/89	1/4/90	Legislation Length	Target date for Inst to Counsel	Other Comments

Annex B

2-FORMf

Date of issue:

BUDGET STARTER: REFERENCE SHEET

TITLE

STARTER NUMBER: **CLASSIFICATION:**

Revenue £m* cost(-)/yield(+)			Staff effect*		Length of legislation*
1988/89	1989/90	(Full year)	1/4/89	1/4/90	

Minister in lead	Target date for instructions to Counsel	PCTA or equivalent resolution required

ORIGIN OF STARTER:

BACKGROUND AND COMMENTS:

OFFICIAL IN LEAD: **TELEPHONE**

OFFICIAL IN SUPPORT: **TELEPHONE**

FP CONTACT: **TELEPHONE**

***HEALTH WARNING** The data reports the position at the time of issue of each Reference Sheet and will be updated only if the scope of the Starter changes significantly. Latest information for all items can be found on the Summary Sheets.

4373/53

FROM: MISS S J FEEST
DATE: 17 September 1987

MRS T C BURNHAMS

cc PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir Peter Middleton
Mr Scholar
Miss Sinclair
Miss Hay
Mr Michie
Mr Draper IR
PS/IR
Mr Wilmott C&E
PS/C&E

FINANCE BILL 1988: BUDGET STARTERS

1. The Financial Secretary has seen your minute of 16 September and approves the proposed arrangements.

Susan Feest

SUSAN FEEST
(Assistant Private Secretary)

CONFIDENTIAL

Inland Revenue

Policy Division
Somerset House

From: P J A DRISCOLL
Ext: 6287
Date: 12 October 1987

1. MR MCGIVERN

2. FINANCIAL SECRETARY

FINANCE BILL 1988 : STARTER NO 205
CAPITAL ALLOWANCES: EXEMPT BODIES

1. The Government's proposals for privatisation of the water supply industry from 1989 onwards have highlighted the need to amend the capital allowances rules which apply where trade assets are transferred from a tax-exempt body to successor companies whose profits will be within the charge to corporation tax.

2. The problem concerns the base costs to be used for capital allowances purposes of assets taken over from the exempt body. If nothing were done the new water companies (PLCs) could get tax allowances worth hundreds of millions of pounds in excess of the values at which they take over the assets in question.

---

cc: Principal Private Secretary
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Miss Sinclair
Mr Michie
Mr Cropper
Mr Call
Mr Tyrie
Mr Jenkins, Parly.Counsel
Mr Painter
Mr McGivern
Mr Lawrance
Mr Beighton
Mr Pearson
Mr Reed
Mr Cleave
Mr P D Hall
Mr Bates
Mr Laffin
Mr Pascoe
Mr Huffer
Mr Elmer
Mr D Shaw (CD)
Mr Driscoll
PS/IR

3. There are two respects in which the existing tax rules could give a windfall advantage to successor companies. The first concerns "industrial buildings and structures", the second "machinery or plant". As it happens, we should in any event have been proposing remedial legislation in both areas in 1988 as part of our wider work in preparation for the consolidation of the capital allowances legislation (Starter No. 204). The proposal to privatise the water authorities makes such remedial legislation all the more desirable.

4. While we do not think you will wish to be concerned with the technical details of the problem - which is technically quite complex - it may be helpful to describe the way in which the existing law works and the anomalies it produces

A. Buildings and Structures

5. Where a person (A) acquires an industrial building or structure within 25 years from the date of its first use (50 years if it was constructed on or before 5 November 1962) from another person (B) who has already used those premises in a trade, A is able to claim writing down allowances on the "residue after sale". This figure is equal to the original cost to B less the industrial buildings allowances given to B (adjusted for any balancing charge or allowance) to take account of any depreciation in value during his ownership. However, if B is not chargeable to tax, no industrial buildings allowances will have been given and therefore the residue after sale (the amount on which A may claim allowances) is the same as the residue before sale, ie the original cost to B, which may be far more than the price A pays.

6. Present legislation deals with this problem where an industrial building is sold by the Crown (which is, of course, exempt from tax). It provides that the residue after sale is to be arrived at in the same way as if the

vendor had been a taxpayer. The result is that where the sale price is less than original cost of construction, tax allowances to the purchaser are limited to the price he pays. However, that provision does not apply in a case like water where the vendors, although exempt and responsible to the Secretary of State, are not, we are advised, regarded as equivalent to the Crown itself.

7. We see no merit in this situation which appears to arise purely fortuitously and not as a result of any conscious policy decision. The law deals with the particular case (sale by the Crown) but not with the (otherwise rare) general case of a sale by an exempt person. We think that Ministers will wish to remedy this longstanding anomaly now by simply extending the provision referred to to cover sales by all exempt bodies and not just by the Crown.

B. Machinery or Plant

8. A broadly comparable situation exists as regards machinery and plant. Where a person (C) succeeds to a trade previously carried on by a person with whom he is "connected" (D), then, in certain circumstances, C and D may jointly elect that capital allowances and balancing charges in respect of plant used in the trade shall continue to be computed as if there had been no change of ownership. The effect of such an election where the predecessor D was exempt would be that the successor C would be entitled to capital allowances on the whole of the original cost to D of the machinery and plant transferred. As with the anomaly described in paragraph 5 above, this result seems to flow from a simple lacuna in the law which fails to deal with the (admittedly uncommon) case where the predecessor is exempt from UK tax.

9. It would be quite straightforward to amend the law to prevent such joint elections where the predecessor is

exempt. The effect would be that the figure attributed to the assets transferred for the purpose of calculating the purchaser's allowances would be the lowest of market value, original cost and the consideration passing ie the "right answer".

C. Water Privatisation

10. If the two changes described in the preceding paragraphs were made in FB 1988 then the effect on the companies taking over the trading assets of the existing water authorities from 1989 would be that capital allowances would be available on the transfer value of assets which they had acquired in consideration for the issue of shares. Touche Ross, accountants acting for the Department of the Environment, have long been aware of the current anomalies and we have discussed with them on a contingent basis, how actual transfer values could be arrived at. It is agreed that if some satisfactory method could be devised of allocating expenditure between qualifying and non-qualifying assets and between buildings on the one hand and plant on the other (we are promised a paper in the next few weeks) historic cost net book values shown in the water authority accounts would provide the best answer.

Revenue Effects

11. While figures are uncertain, information supplied by Touche Ross suggests that the difference between "cost" and "historic cost net book value" would be of the order of £2bn. Since we are unaware of any other bodies that would be affected by the proposed changes we have used this figure as the basis of our "costing", which could be up to £160m revenue yield in 1991/92, depending on the dates of privatisation - about £700m in all, most of which would accrue over 10 years or so from 1991/92. This latter figure represents the value in terms of tax of allowances that would be denied to the water PLCs (who would presumably have tried to make use of them by way of group relief and other means). As more

data become available we shall try to improve the accuracy of our figures (which depends heavily on the "mix" of assets between "buildings" and "plant").

D. Case for Legislation in FB 1988

12. The two changes suggested are essentially technical and while they would not normally have merited action in a Finance Bill they represent the sort of tidying-up that would anyway have been proposed as part of our pre-consolidation exercise (see paragraph 13 below). They would be expressed in general terms and have no direct connection with the privatisation of the water industry. The amended law would be in place well ahead of the introduction of the water privatisation bill, envisaged for the 1988/89 Parliamentary Session - the first water PLC would be created late in 1989.

13. We shall be proposing other purely technical changes affecting the same (machinery and plant) legislation in a further note on the steps we think necessary to prepare the corpus (200 pages or so) of capital allowances legislation for consolidation (Starter 204). These include providing a time-limit for the elections referred to in paragraph 8 above and providing rules to deal with the case where the predecessor and successor companies make up their accounts to different dates. It would seem desirable to deal with all these matters together.

E. Summary and Conclusion

14. The law is defective in two particular respects. Until now we have regarded these defects as technical anomalies - the sort of weakness that would be remedied ahead of consolidation or when legislation otherwise came to be re-written. And indeed, that remains the case. At the same time, we thought that in view of

a. the significant sums of tax at stake; and

b. the connection with water privatisation;

you would want to consider these matters as a separate "Starter".

15. We do not think that there is really much argument about the merits of the case - the present position is not defensible on any basis and would give a pure windfall to the water PLCs on privatisation. Touche Ross, acting for the Department of the Environment, recognise this.

16. If you are content, we shall instruct Parliamentary Counsel to draft for the 1988 Finance Bill on the lines suggested. The changes would apply from (say) Budget Day 1988 (it may be desirable to have a common starting date for all pre-consolidation changes on which we shall be letting you have a separate submission).

17. This does not seem to be the sort of matter that needs to be kept confidential until Budget Day and on a practical level there would be some advantage if we could tell Touche Ross and the Water Authorities now what was proposed. This is because work needs to start very soon to identify and quantify assets on which capital allowances will be available post-privatisation. Only then will be it possible to devise the tax projections that will be needed for the privatisation prospectuses. It would be unfortunate if authorities were to waste money and resources on what would be a major task involving surveyors, engineers and accountants if the whole basis of the tax treatment were to be changed six months later. If we may tell Touche Ross that it is intended to legislate on these matters in 1988 we shall consider whether more general publicity would be justified later eg if you decided to announce consolidation of the capital allowances legislation.

18. Do you agree, please

a. that we should instruct Parliamentary Counsel to draft on the lines suggested; and

b. that we should tell Touche Ross and the Water Authorities Association what is proposed (reserving the question of wider publicity for a later opportunity)?

P J A DRISCOLL

2040/41/PP

CONFIDENTIAL

FROM: M F LYNE
DATE: 19 October 1987

FINANCIAL SECRETARY

cc. PPS
PS/CST
PS/PMG
PS/EST
Sir Peter Middleton
Mrs Brown
Miss Sinclair
Mr Michie
Mr Tarkowski
Mr Cropper
Mr Call
Mr Tyrie

FINANCE BILL 1988:
STARTER NO.205 CAPITAL ALLOWANCES: EXEMPT BODIES

Although we have been kept in touch with the Revenue's discussions on the capital allowances the Water Authorities will receive on privatisation, Mr Driscoll's 12 October submission was not cleared with us in advance, and you may wish to be aware of the implications for privatisation. We do not disagree with his recommendation.

2. As you know, it is difficult to extract full value for tax losses at the time of sale, and this proposal should, therefore, benefit the Exchequer overall. The proposal simply brings the treatment into line with the usual methods for calculating allowances available to a business in respect of assets acquired, which is clearly right.

3. There is no read-across to Electricity, since that industry already pays tax. (The anomalous position of the water industry is a hangover from their local authority past.)

4. This note has been agreed with PE and FP.

M F LYNE

3369/20

CONFIDENTIAL

JJ

PHP

FROM: J J HEYWOOD
DATE: 20 October 1987

MR DRISCOLL IR

cc Principal Private Secretary
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Miss Sinclair
Mr Lyne
Mr Michie
Mr Tarkowski
Mr Cropper
Mr Call
Mr Tyrie
Mr Jenkins OPC
PS/IR

FINANCE BILL 1988: STARTER No. 205
CAPITAL ALLOWANCES: EXEMPT BODIES

1. The Financial Secretary has now read your submission of 12 October together with separate advice from Mr Lyne.

2. He is content with what you propose.

JEREMY HEYWOOD
Private Secretary

CONFIDENTIAL

Inland Revenue

The Board Room
Somerset House
London WC2R 1LB

Ch
We have issued a
Jumbo needs for
late November &
January starters
AA

FROM: A J G ISAAC
21 October 1987

FINANCIAL SECRETARY

FINANCE BILL STARTERS

1. You will shortly be getting from FP Division the full list of Finance Bill Starters from all Departments. Perhaps I could add one comment specifically on the Inland Revenue items.

2. In drawing up the list, Mr Painter and I have been very conscious of the size of the tax package which is likely to emerge this year. Despite the desire each year to produce a short Finance Bill, the length has grown inexorably, especially during the 1980s - even in years when there were few major initiatives. There is a substantial risk therefore that in a year when there is to be a major reform of the tax system, we - that is Ministers, Parliamentary Counsel, Members, officials, representative bodies and taxpayers generally - shall all be heavily overburdened if a large number of the more technical and less strategic issues are tackled as well; indeed at worst, there must be the risk that with too large a Bill some of the more important items will not get the close attention which they will need.

---

cc Chancellor of the Exchequer
Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Scholar
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Isaac
Mr Painter
Mr Beighton
Mr Cleave
Mr Marshall
Mr McManus
Mr Shaw (CD)
PS/IR

3. We have therefore taken two steps to try to reduce this danger to a minimum. First, we have put in our suggested discard list a number of starters for which there is a good case in principle but to which we think a lower priority may need to be given. Some of these matters, eg the capital gains tax treatment of assets transferred on divorce, could possibly be desirable as sweeteners in a less busy year; others involve the potential loss of substantial sums of revenue and, if later on the risk of loss looms larger or nearer than it does today, we may suggest inclusion in the Bill after all. Clearly you will wish to examine our discard list to see whether, despite the question of priorities, we have put any item on it which you wish to keep in the reckoning for the Bill. At the same time we have kept in the starters list one or two items which you have said you will consider or which you have asked us to examine, eg

Starter 450: Tax appeals: NI General Commissioners

Starter 200: Close companies: apportionment of interest

where, when we come to report, we may well suggest holding over to 1989 any changes which in principle you would like to make.

Second, we are attempting to press ahead with all speed with all the items on the starters list. Some of them will inevitably take time while further work is done, or further information awaited, but wherever possible you will get our views in the next few weeks. The earlier that more detailed work can begin on those items to be included in the Bill, the easier it will be for all of us. As last year, therefore, in those cases where Ministers are unable to give us a final decision quickly, it will be very helpful if it is possible to give us a provisional decision on which we can be working.

C Isaac

A J G ISAAC

× you have now provisionally included it CCT group/business starter.

7-25

CONFIDENTIAL

Please keep handy

FROM MRS T C BURNHAMS
DATE: 22 OCTOBER 1987

MCS 22/10

1. **MR SCHOLAR**

2. **FINANCIAL SECRETARY**

cc Chancellor
Chief Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Mr Cassell
Miss Evans
Mr Cropper
Mr Call
Mr Tyrie

PS/IR
Mr Isaacs - IR
Mr Painter - IR
Mr Beighton - IR
Mr Shaw - IR
PS/C&E
Mr R Allen - C&E
Mr Jenkins - Parliamentary Counsel

1988 FINANCE BILL STARTERS

Attached is the first edition of the starters list for the 1988 Finance Bill, including

(a) an index of the starters by type of taxation;

(b) summary sheets listing the starters in numerical order with basic information on revenue and staff effects which will be revised as necessary

(c) reference sheets providing background information which will not be updated unless the scope of the starter changes significantly.

2. The summary sheets will be circulated on a regular basis - fortnightly at the early stages then subsequently weekly. Where the summary sheets contain no entry in the columns headed "Revenue cost/yield" and "staff effect", the numbers either depend on the final decision taken or estimates have not yet been possible.

Number of starters

3. There are currently 94 starters: 61 originating from the Inland Revenue; 23 from Customs; 7 from the Department of Transport and 3 from the Treasury. Of these 17 are task force measures. It is likely that further starters will be added. Each starter has been allocated a unique reference number which remains unchanged throughout the Budget exercise and which should be used on all relevant submissions and other papers.

Classification

4. Each proposed measure has been allocated to one of the following categories

I	-	definitely included
I*-		provisionally included
D	-	definitely dropped
D*	-	provisionally dropped
UCM	-	under consideration (at least one submission received by Ministers)
NSM	-	a first submission to go to Ministers

Decisions have been taken already to definitely include 10 of the starters in the 1988 Bill and 4 further starters have been provisionally included. Of the remainder submissions have been made to Ministers in respect of 21 others.

Length of Finance Bill

5. At this stage it is not possible to give a reliable assessment of the length of the Finance Bill. Estimates for individual measures are still very tentative and in some cases no estimate is possible.

6. In the light of past experience we would expect the addition of new items and upward amendment of existing starters, throughout the various stages of the Finance Bill, to significantly increase the length of legislation estimated at the outset. If the Bill is not to become unmanageable, Ministers will need to be fairly stringent at an early stage with some of the lower priority items.

Handling

7. Inclusion of an item on the starters list does not, of course, imply policy approval. Separate submissions will be put to Ministers on each of the measures. It would be helpful if early decisions could be taken on any "free standing" proposals in order to try to avoid bunching at the drafting stage wherever possible. FP will monitor overall progress and advise if the timetable is beginning to look difficult. The Chancellor will be having an initial meeting on minor starters on 24 November.

MRS T C BURNHAMS

CONFIDENTIAL

Inland Revenue

Policy Division
Somerset House

FROM: L E JAUNDOO
DATE: 30 OCTOBER 1987
EXT : 6459

1. MR HOUGHTON
2. FINANCIAL SECRETARY

1988 FINANCE BILL STARTER NO. 251
INHERITANCE TAX: EXEMPTION FOR TRANSFERS TO POLITICAL PARTIES

1. The Chancellor has asked for the abolition of the £100,000 exemption limit on transfers to political parties to be included as a Budget Starter (Mr Kuczys' note of 17 July). This note discusses the background to the present limit, the likely impact of its removal and proposes Finance Bill legislation for its abolition.

Background

2. From 1894 to 1972 political parties enjoyed the same status as charities for Estate Duty. Gifts made one year or more before death were exempt as being for public purposes. Gifts made within a year or on death were however dutiable.

---

cc PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mr Scholar
Miss Sinclair
Miss Hay
Mr Cropper
Mr Jenkins (Parliamentary Counsel)
Mr Battishill
Mr Isaac
Mr Houghton
Mr Beighton
Mr Pitts
Mr Calder
Mr Lawrance
Mr Cleave
Mr Scott
Mr Spencer
Mr Furey
Mr Marshall
Mr Gonzalez
Mr Thompson
Mr Jaundoo
Mrs Evans
PS/IR

3. The Finance Act 1972 gave an additional special relief to charities - exempting from Estate Duty gifts within one year of death up to a limit of £50,000.

4. When capital transfer tax was introduced, the Finance Act 1975 doubled the exemption limit for charities to £100,000 and extended it to political parties. However, although the exemption limit for charities was progressively raised and finally abolished in 1983, the £100,000 limit for political parties still remains at the level set in 1975. The two exemptions have drifted apart, and the political parties' exemption is now so far behind that the limit set in 1975 would be £350,000 at today's prices.

The present pattern of giving

5. Very few gifts or bequests to political parties exceed £10,000, and we have not been able to identify a single case where tax became payable because the £100,000 exemption limit was exceeded.

6. When the charity exemption was limited there was pressure to extend it - but we are not aware of any similar upward pressure on the present exemption limit for political parties.

Likely effects of removing the limit

7. The present discrepancy between the limitless exemption for charities and the £100,000 limit for political parties appears to have arisen inadvertently. The abolition of the limit could therefore be presented as the removal of an anomaly by the restoration of the parity of treatment that existed for three-quarters of a century before 1972.

8. However, the proposal could prove unpopular with charitable bodies who might complain that it would undermine their position and encourage giving to political parties rather than to them. It may be argued that exemption for political parties ought to be less generous than that for charities. Donors tend to spread

their charitable giving over several charities but it would be a most unusual donor who left gifts to more than one political party. Such complaints of unfair advantage from charitable bodies can be met with the response that their exemption remains absolute and nothing is being taken from them.

Definition of a political party

9. At present a political party qualifies for exemption if, at the last general election before the gift, two members were elected to the House of Commons or one member was elected and at least 150,000 votes were given to candidates who were members of the party. This definition is substantively the same as that adopted in the Resolution of the House of Commons dated 20 March 1975 which governs financial assistance to opposition parties. We see no reason to change it.

Cost

10. Because the exemption limit is rarely if ever reached, the cost of abolishing it would be negligible in terms of the yield. Nor would abolition create any additional administrative costs.

Entry into force and length of legislation

11. We recommend that the abolition should apply to transfers on or after Budget Day, as was the case for relieving measures in previous years.

12. Subject to the views of Parliamentary Counsel, whom we have not consulted, we estimate that the change should take less than half a page.

Summary

13. The measure will represent the removal up of an anomaly which can be achieved at little or no revenue cost.

14. We seek authority to instruct Parliamentary Counsel to draft legislation with effect from Budget Day to remove the £100,000 exemption limit on transfers to political parties.

L E JAUNDOO

RESTRICTED

INLAND REVENUE
CENTRAL DIVISION
SOMERSET HOUSE

FROM: A J WALKER
29 MARCH 1987

PS/FINANCIAL SECRETARY

FINANCE BILL : LOBBY NOTES

I attach the Inland Revenue contribution to this year's lobby notes, which I understand Ministers wish to clear. The numbering is that in the second print of the Bill.

I should be grateful if you would let me know if the Financial Secretary is content with the notes on clauses for which he is responsible. I should likewise be grateful if PS/Economic Secretary would let me know if his Minister is content with the notes on his clauses.

A J WALKER

PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
Mrs Burnhams
Mr Isaac
Mr Painter
Mr Beighton
Mr Cleave
Policy Directors
Mr Willmer
PS/IR
Mr Walker.

INLAND REVENUE LOBBY NOTES 1988

* Indicates Inland Revenue issued press release on Budget Day
+ Indicates Inland Revenue issuing press release on 14 April

*Clause 22 sets the charge of income tax for 1988-89 and fixes the basic rate at 25 per cent.

*Clause 23 sets the basic rate limit at £19,300 for 1988-89 and fixes the higher rate at 40 per cent. It also sets the additional rate on income of discretionary and accumulation trusts at 10 per cent, and adjusts the rate at which tax is charged on trustees of maintenance funds for historic buildings in certain circumstances.

*Clause 24 sets the level of the main income tax personal allowances for 1988-89, and also abolishes the housekeeper allowance, dependent relative allowance, and son's or daughter's services allowance for 1988-89 and subsequent years.

*Clause 25 sets the main rate of corporation tax for the financial year 1988 at 35 per cent (unchanged).

*Clause 26 reduces the rate of corporation tax for small companies for the financial year 1988 from 27 per cent to 25 per cent.

*Clause 27 fixes at 25% the rate at which deductions are to be made from payments to subcontractors in the construction industry who do not hold exemption certificates. The change takes effect from 31 October 1988.

*Clause 28 reduces the rate of life assurance premium relief from 15 per cent to 12.5 per cent for policies taken out on or before 13 March 1984. (There is no relief for policies taken out or enhanced after that date). The change will take effect on 6 April 1989.

*Clause 29 alters the qualifying conditions for the additional personal allowance so that unmarried couples living together as husband and wife can qualify for only one allowance. The change applies from 1989-90.

XI

[Clause 30 in 2nd print of Bill to be amalgamated with clause 24]

Clause 31 changes the rules on tax allowances for British subjects living abroad and certain other non-residents with effect from 1990-91. Their entitlement to allowances will no longer be restricted by reference to the proportion of their total income liable to tax in the UK.

*Clause 32 abolishes the rule which deems a married woman's income to belong to her husband and taxes it as his. This takes effect from 1990-91.

*Clause 33 introduces seven new sections in place of the allowance provisions at present in S.257 of the Taxes Act 1988 from 1990-91:

Section 257 (new version) and Section 257A introduce a new personal allowance and a married couple's allowance, (which goes to married men in the first instance), each with higher levels for those aged 65-79 and 80 and over, subject to an income limit.

Section 257B allows a married man who is unable to make full use of married couple's allowance to transfer any unused part of it to his wife.

Section 257C provides for the new allowances to be indexed in line with increases in the retail prices index.

Section 257D provides transitional relief for couples where the husband has a small income in 1990-91. It ensures that the couple's allowances are not reduced below their 1989-90 level as a result of the change to Independent Taxation.

Section 257E provides transitional relief for certain husbands in elderly couples.

Section 257F provides transitional relief for men who are separated from their wives but wholly maintaining them by voluntary payments, (who can claim the married man's allowance at present).

*Clause 34 provides that, from 1990-91, where a husband and wife hold assets in their joint names the income is to be treated as divided between them in equal shares. If, however, one of the partners is entitled to the whole of the income from the property or they are entitled to it in unequal shares they may make a declaration to the tax office specifying their actual entitlement. Any income will then be taxed on the basis of their respective shares.

*Clause 35 and Schedule 3 make various amendments to the tax treatment of husbands and wives including amendments consequential on Clause 32 (introduction of Independent Taxation) and Clause 42 (residence basis for mortgage interest relief).

Clauses 36-40 reform the tax treatment of covenants and maintenance payments.

For non-charitable covenants made by individuals on or after 15 March 1988, there will be no tax relief for the payer, and no tax liability on the recipient.

For most new maintenance arrangements made from 15 March, the recipient will not be taxable on the payments. The payer will get tax relief, up to the difference between the married and the single person's allowance, for payments to his or her divorced or separated spouse. There will be no relief for other payments.

For existing maintenance arrangements, the present rules will continue to apply for 1988-89; but divorced or separated spouses will be exempt from tax on the first £1,490 they receive (Clause 37). From 1989-90 there will be special transitional rules limiting the relief for the payer, and the amount taxable for the recipient, to the 1988-89 level; and payments will be made gross (Clause 38). But payers will be able to elect to switch to the new rules (Clause 39).

*Clause 41 sets the 1988-89 mortgage interest relief limit at £30,000 (unchanged).

*Clause 42 introduces the residence basis for mortgage interest relief whereby the limit of £30,000 will be applied to the residence rather

than the borrower. The new basis will apply from 1 August 1988. Where loans are made before that date relief will continue on the present basis for the life of the loans in circumstances where greater relief is thus allowable. Further Inland Revenue Press Release on 22 March.

*Clause 43 abolishes relief for home improvement loans unless the loan was made before 6 April 1988.

*Clause 44 abolishes relief for interest on loans used to purchase a home for a dependent relative or former or separated spouse unless the loan was made and so used before 6 April 1988.

*Clause 45 sets the car benefit scale charges for 1988-89 at double the scale charges for 1987-88.

*Clause 46 exempts from income tax with effect from 6 April 1988 the provision for an employee of a car parking space at or near his place of work.

Clauses 47-49 exempt from income tax certain entertainment which an employee receives by reason of his employment from someone other than his employer. The exemption, which was announced in an Inland Revenue Press Release of 25 September 1987, applies from 6 April 1987.

+*Clause 50 and Schedule 4 extend the Business Expansion Scheme to investment in companies specialising in letting residential property on new-style assured tenancy terms.

+*Clause 51 places limits on the total amount of investment in a company which can qualify for tax relief in any 12 months period under the Business Expansion Scheme. This is £500,000 generally but £5 million for companies raising money for ship chartering or for private rented housing. The limits apply to shares issued after 15 March 1988. But where a company issued a prospectus before 15 March 1988 and issued the shares before 6 April 1988 the limit will be £1 million instead of £500,000.

+*Clause 52 allows investors in an approved Business Expansion Scheme fund to get tax relief by reference to the closing date for investment in the fund (rather than the date the fund invests the money). But investors will not be able to claim relief until the fund invests in companies and the usual conditions are satisfied. The change applies to funds closing after 15 March 1988.

*Clause 53 fixes 1 July 1988 as the start date for personal pensions. It also provides for the present retirement annuities tax regime to be extended until then.

+*Clause 54 allows DHSS 'minimum contributions' to a contracted-out personal pension scheme for a person who leaves an occupational pension scheme mid-way through a tax year to be backdated to the beginning of that year. It also allows members of contracted-in occupational pension schemes to contract out of SERPS through a special personal pension. The clause also exempts personal pension schemes from the additional rate tax which applies to the income of discretionary trusts. These provisions take effect from 1 July 1988.

*Clause 55 introduces new regulation-making powers for the transitional provisions to cover people who have a protected right to the pre-1987 occupational pension scheme tax rules.

*Clause 56 exempts from tax lump sum retirement benefits paid on the due date to people who defer retirement.

*Clauses 57 to 60 and Schedule 5 deal with the taxation arrangements for Lloyd's members. Clause 57 and Schedule 4 revise the administrative arrangements for taxing Lloyd's members. The change: takes effect for Lloyd's 1986 account, which closes at the end of 1988. Clause 58 amends the detailed tax rules for +he treatment of Lloyd's members' receipts from personal reinsurance policies against losses. Clause 59 modifies the 1987 legislation on Lloyd's reinsurance to close. It provides relief for those who leave syndicates, and simpler rules for those who remain in syndicates. These changes will take effect for the Lloyd's 1985 account, which closes at the end of 1987. Clause 60 makes consequential amendments.

*Clause 61 introduces a new capital gains relief for disposals of interests in oil licences relating to undeveloped areas. The new relief will apply to disposals past and future, wherever the consideration includes either an obligation to carry out a programme of drilling etc on the licence block concerned or another pre-development licence interest.

Clause 62 enables certain capital expenditure on drilling to be deductible in computing the chargeable gain on the disposal of interests in oil licences relating to undeveloped areas. Again this deduction will be available for disposals in the past as well as the future.

*Clause 63 provides the specialist definitions needed for clauses 61 and 62.

*Clause 64 and Schedule 6 reform the tax treatment of commercial woodlands. The occupation of commercial woodlands will be removed from the scope of income tax and corporation tax. Schedule B will be abolished as from 6 April 1988. With effect from 15 March 1988 (subject to transitional provisions extending to 5 April 1993) the right of occupiers of commercial woodlands to elect to be assessed to tax on their profits or losses under Schedule D will be abolished.

*Clause 65 provides that companies incorporated in the United Kingdom will be resident here for tax purposes. Under transitional arrangements, certain companies will not normally become resident for five years. The measure takes effect from 15 March.

+Clause 66 ensures that any benefit resulting from priority given to employees by virtue of their employment in applying for a public offer of shares will, subject to certain conditions, be exempt from income tax. The change takes effect from 23 September 1987.

+Clause 67 enables employees to borrow to purchase their option shares under the approved discretionary share option legislation without losing tax relief. The change takes effect from the start of the scheme concerned.

Clause 68 doubles the limit on charitable donations qualifying for tax relief under the payroll giving scheme from £120 a year to £240 a year from 6 April 1988.

*Clause 69 provides that, with effect from Budget Day, the cost of entertaining overseas customers will no longer be an allowable business expense for tax purposes.

*Clause 70 changes the tax relief for redundancy and other payments on termination of employment by increasing the amount payable tax free from £25,000 to £30,000 and abolishing "top slicing" relief for payments exceeding the tax exempt limit. The changes apply to lump sums paid in connection with terminations in 1988/89 and subsequent years.

*Clause 71 withdraws, with effect from 1988/89, the top-slicing relief which applies to the tax charged on premiums for leases and certain other payments.

+Clause 72 amends the definition of a recognised clearing system to include a system handling only foreign securities, and, as a consequence, extends the deduction of tax rules to collecting agents obtaining payment of overseas interest and dividends in the UK.

+Clauses 73-85 introduce changes to the rules in Section 79 of the 1972 Finance Act which apply to certain shares acquired by employees in that capacity outside an approved scheme. In most cases, the present charge to income tax on the whole of any increase in the value of such shares will be replaced with a new, more narrowly targetted charge that will arise only if manipulation of share values actually occurs. This relaxation will also apply to shares in qualifying subsidiary companies. These changes will take effect from 26 October 1987, when draft clauses incorporating the proposed changes were published for consultation.

*Clause 86 corrects a defect in the rules for calculating industrial buildings allowance following the sale of a building.

*Clause 87 introduces a two year time limit for elections under the capital allowance provisions relating to sales of assets between associated persons.

*Clause 88 corrects a number of defects in the special rules for calculating capital allowances on machinery or plant when a person succeeds to a trade previously carried on by a person with whom he is connected for tax purposes. The clause also introduces a two year time limit for elections under these provisions.

*Clause 89 amends the capital allowance legislation for safety expenditure at certain sports stadia to reflect an extension of safety certificate requirements to designated sports grounds. The change takes effect from 1 January 1988.

*Clause 90 abolishes the special capital allowance for expenditure at certain quarantine premises, with effect from 16 March 1988.

*Clause 91 ensures that capital allowances already given in relation to dwellings let under the assured tenancy scheme will not be withdrawn when the Housing Bill takes effect. The clause also provides

transitional arrangements for construction expenditure incurred before 15 March 1988 - up to 31 March 1992 where the land was acquired by an approved company before 15 March 1988.

+*Clause 92 and Schedule 7 change the base date for computing capital gains to 31 March 1982, with effect from 6 April 1988.

+*Clause 93 provides for capital gains of individuals to be charged at the rates that would apply if they were the top slice of taxable income, and for those of most trusts to be taxed at the basic rate.

+*Clause 94 adapts the rules for computing the gains of married couples to take account of the new capital gains tax rates. The Clause applies for 1988-89 and 1989-90; from 6 April 1990, married couples will, under Clause 96, be taxed separately, like two single people, on their gains.

+*Clause 95 charges the gains of accumulation and discretionary settlements at a rate equivalent to the sum of the basic and additional rates of income tax.

+*Clause 96 adapts the capital gains provisions for Lloyds underwriters to take account of the new capital gains tax rates.

+*Clause 97 contains detailed rules relevant to determining the rate of capital gains tax in certain special circumstances.

+*Clause 98 provides that Clauses 90-94 shall apply to disposals on or after 6 April 1988.

*Clause 99 provides for married couples to be taxed independently on gains on disposals on or after 6 April 1990, with separate annual exemptions.

*Clause 100 provides that if companies become non-resident they will normally have to pay tax on unrealised gains, except on assets of a branch or agency which remain here. The measure takes effect from 15 March.

*Clause 101 provides that when subsidiaries of resident United Kingdom companies become non-resident they may in certain circumstances elect to defer the charge under Clause 100 on foreign assets of a foreign trade.

*Clause 102 provides for the capital gains annual exemption for individuals to be £5,000 for 1988-89. Under existing law the exemption for most trusts is half that for individuals, and will therefore be £2,500.

Clause 103 extends capital gains retirement relief from 6 April 1988 to half of any qualifying business gains between £125,000 and £500,000.

Clause 104 withdraws the capital gains tax exemption for a home provided rent-free for a dependent relative. Relief will however continue where the home has been occupied by a dependent relative before 6 April 1988.

Clause 105 extends capital gains tax rollover relief to satellites, space stations and spacecraft from 28 July 1987, and to milk and potato quota from 30 October 1987.

Clause 106 provides that no capital gains indexation allowance shall be given on disposals on or after 4 July 1987 of shares in Building Societies and Industrial and Provident Societies.

*Clause 107 and Schedule 8 withdraw or restrict the capital gains indexation allowance on disposal of certain intra-group debts and shareholdings on or after 15 March 1988. This counters exploitation of the indexation allowance to create large artificial capital losses for tax purposes.

*Clause 108 reverses a recent Court decision to ensure that share exchanges by companies in the same group do not result in capital gains or losses being charged or allowed more than once.

+Clause 109 enables the tax treatment of losses incurred on the disposal of investments in a Personal Equity Plan to be altered, by Regulations. Such losses from disposals made on or after 18 January 1988 will not be allowable for capital gains tax purposes. (Earlier Inland Revenue press notice of 18 January 1988).

Clause 110 restores a part of the definition of an investment trust that was inadvertently repealed by the Finance (No 2) Act 1987, and provides that the repeal shall be treated as never having had effect.

+Clause 111 makes technical amendments to the capital gains indexation provisions. These amendments are consequential on Clause 89 and Schedule 7.

*Clause 112 ensures that the Inland Revenue will continue to have power to make an income tax assessment, on certain types of income assessable on the current year basis, in the course of the year in which the income arises.

*Clause 113 amends the obligation to notify the Revenue of additional liability to income tax for 1988/89 and subsequent years, so as to require notification of each source which has not been fully taxed; and amends the penalty for failure to notify, to a fully mitigable penalty of up to the amount of tax unpaid.

*Clause 114 amends the penalty for failure to notify the Revenue of liability to corporation tax, for accounting periods ending after 31 March 1989, to a fully mitigable penalty of up to the amount of tax unpaid.

*Clause 115 amends the penalty for failure to notify the Revenue of additional liability to capital gains tax, for 1988-89 and subsequent years, to a fully mitigable penalty up to the amount of tax unpaid.

Clause 116 puts a three year time limit on the information that the Revenue can require, in returns from an agent, of income received on behalf of clients; from a bank, etc of interest paid to depositors; and from a lessee, etc of details in connection with land.

*Clause 117 extends the list of persons that the Revenue can require to return details of fees and commissions paid, for payments made after 5 April 1988, to include Government Departments, public bodies, public authorities and local authorities.

*Clause 118 allows the Revenue to require returns of grants or subsidies paid out of public funds, which are paid after 5 April 1988, and of licences, in force after 5 April 1988.

*Clause 119 extends the Revenue's power to require a third party to provide access to documents relating to a person's tax affairs, in two ways; firstly, to the Department for National Savings; and, secondly, to documents relating to a person or persons whose true identity is not known to the Revenue, but only with the permission of the Board of Inland Revenue and an independent Special Commissioner, who must be satisfied that there are reasonable grounds for believing that something is seriously wrong with their tax affairs .

*Clause 120 extends the Revenue's information powers to allow the Revenue the same access to records held on computers as it is otherwise allowed to records held on paper.

*Clause 121 allows an employer to be charged interest on PAYE from 19 April following the tax year, and to be paid interest on PAYE repaid more than 12 months after the tax year. This will not come into force before 1992.

Clause 122 limits the total penalties that can be charged, where two or more tax-geared penalties are due in respect of the same tax, to the highest of those penalties.

*Clause 123 provides that if companies wish to migrate they must give the Inland Revenue notice of their intention and make suitable arrangements for payment of tax in respect of periods up to and including migration. This measure takes effect from 15 March. Chedule 10 part IV repeals Section 482 (1)(a) and (b) of the Income and Corporation Taxes Act 1970 which requires Treasury consent to migrate.

*Clause 124 provides for penalties for failure to comply with Clause 123. In some cases, persons other than the migrating company may be liable for the penalties.

Clause 125 provides that persons other than the migrating company may be liable for the unpaid tax.

Clauses 126 and 127 enable the introduction of General Commissioners of Income Tax in Northern Ireland and remove the fixed time limit for Commissioners to state a case. The changes from the existing arrangements take effect from a day to be appointed by the Lord Chancellor.

*Clause 128 increases the inheritance tax threshold from £90,000 to £110,000 and replaces the 4 rates of tax with a flat rate of 40 per cent. The changes take effect from 15 March 1988.

*Clause 129 abolishes the £100,000 limit on exemption for gifts to political parties made on or within one year of death with effect from

15 March 1988.

*Clause 130 is the Petroleum Revenue Tax half of the restructuring of the regime for Southern Basin and onshore fields developed after 1982, complementing the abolition of royalty for these fields. For chargeable periods from July 1988 onwards, it reduces the oil allowance available to these fields from 250,000 to 100,000 tonnes (and the cumulative limit from 5 to 2 million tonnes).

*Clause 131 extends relief against Petroleum Revenue Tax for the cost of operating and maintaining facilities such as platforms and pipelines where production from the principal field to which those facilities relate has ceased, but where they continue to be used by other fields under tariff arrangements.

* Clause 132 abolishes unit trust instrument duty with effect from midnight on 15 March 1988.

* Clause 133 abolishes capital duty with effect from midnight on 15 March 1988.

Clause 134 adds housing action trusts to the lists of local authorities, housing associations and other bodies which have reliefs from stamp duty for shared ownership leases and for sales of houses at a discount.

+Clauses 135 and 136 amend stamp duty and stamp duty reserve tax legislation to cater for shares in a UK and a foreign company which are offered for sale as pairs and can only be transferred in pairs. They provide relief from stamp duty on the issue of bearer shares in the UK company at the time of the public offer, and charge stamp duty and reserve tax on the foreign shares after the offer. The relief and, in most circumstances, the charges take effect from 1 November 1987 and 9 December 1987 respectively.

*Clause 137 and Schedule 9 remove certain tax obstacles to the conversion of building societies to company status under the Building Societies Act 1986.

CONFIDENTIAL

FROM: P TREVETT
DATE: 2 November 1987

PMG 3 - NOV 1987 - 13

HM CUSTOMS AND EXCISE
VAT CONTROL DIVISION D
ALEXANDER HOUSE 21 VICTORIA AVENUE
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TELEPHONE SOUTHEND-ON-SEA (0702) 348944 ext

PAYMASTER GENERAL

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary

Mr Scholar
Miss Sinclair
Mr Michie
Mr Cropper
Mr Jenkins (Parliamentary Counsel)

BUDGET STARTER NO 35 : AMENDMENTS TO SCHEDULE 1, VAT ACT 1983

1. Following our decision not to appeal the VAT Tribunal ruling in the case of Merseyside Cablevision Ltd, you gave your approval, Mr Judge's note of 4 September, for us to proceed with the necessary amendments to paragraphs 5(1) and 11(1)(b), and the repeal of paragraph 10, of Schedule 1. These amendments will fully align UK law with the provisions of the EC Sixth VAT Directive.

2. In consultation with other interested Divisions, we have almost completed our review of policy as regards voluntary and intending trader registration and expect to issue revised control, guidelines within the next month. A particular problem has been identified in the course of the review. Of late we have met an ever

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Internal Distribution

CPS
Mr Knox
Mr Finlinson
Mr Jefferson Smith
Mr Nissen
Dr McFarlane
Mr Keefe
Mr Tracey
Mr Taylor (VAD)
Mr Bazley
Mr Allen (DPU)
Mr Topping

increasing number of cases where traders, particularly in the building industry, have applied for, and in good faith have been allowed, obligatory registration by virtue of paragraph 1(b) of Schedule 1. The traders have declared that they are already making taxable supplies and that in the coming twelve months they expect to exceed the annual threshold. In such circumstances registration is approved unconditionally.

3. Subsequently, and normally as a result of an input tax credibility enquiry, it is found that at the time the application was made the trader was not in fact making taxable supplies so that registration by virtue of paragraph 1(b) was inappropriate. In the meantime, however, having obtained registration, the traders have been making claims for repayment of significant amounts of input tax. Investigation of the traders' activities has shown that some have made no taxable supplies since registration, while others have made only exempt supplies, e.g. short term leases of newly constructed buildings.

4. In such circumstances our practice has been to invalidate the registration ab initio, in order to safeguard the revenue against erroneous claims to repayment of input tax, on grounds that the trader was not making taxable supplies by way of business. This has led to several contentious and complex appeals (Merseyside Cablevision was one such case).

5. Invalidation of the registration of a trader who has made only exempt supplies is totally in accord with the principles of the EC Sixth VAT Directive. In cases where the trader has not made any taxable supplies, invalidation frequently results in the trader claiming that he still intends to do so. In such situations, application for intending trader registration should have been made in the first instance under paragraphs 5(1) or 11(1)(b) of Schedule 1. This application, before being allowed, would have been subject to the provision of objective evidence to support the declared intention of making taxable supplies, and to the trader's acceptance of the conditions regarding recovery of input tax repaid in the event of no taxable supplies, or only exempt supplies, being made. Nevertheless, and notwithstanding that the original application was incorrect, the Tribunals have contemplated whether in such circumstances the Commissioners, as an alternative to invalidation, ought to have substituted an intending trader registration for the original obligatory registration. Furthermore, the President has suggested privately that, under the present law, the trader having obtained registration,

cancellation of that registration should be from a current date. Whilst we do not agree with that view, the clear inference is that the Tribunal would confirm a trader's entitlement to repayment of input tax incurred during the period of registration, provided no exempt supplies had been made. A ruling on this basis would be most costly to the revenue. It would probably necessitate an appeal by us to the High Court to establish whether a registration could be invalidated ab initio, a point on which the law is at present silent.

6. In an endeavour to avoid such difficulties, and to put the matter beyond doubt, we believe that, as part of our revision of the voluntary and intending trader requirements, it would be prudent to introduce a new provision into Schedule 1 so that the position is clearly defined in law.

7. What we have in mind is that, where an obligatory registration is found subsequently to be incorrect, because at the time the application was made the trader was not making taxable supplies, the Commissioners will be required to reconsider the application under the amended provisions of paragraphs 5(1) and 11(1)(b) and, if satisfied, substitute an amended registration under either of those provisions from the original date of registration. If the Commissioners are not so satisfied as to the bona fides of the application, the registration would be invalidated ab initio. This we believe would be eminently fair both to the taxpayer and to the revenue, and is a necessary anti-avoidance measure forming part of the package amending the rules on voluntary and intending trader registration.

CAPITAL ASSETS

8. In the Budget starter, we have included the correction of a minor omission in the wording of paragraphs 1(5) and 2(3) of Schedule 1, as introduced by Section 14(2) and (3) of the Finance Act 1987. The purpose of the new paragraphs was to incorporate into UK law the requirements of Article 24(4) of the Sixth VAT Directive, namely that for the purposes of calculating turnover disposals of tangible or intangible assets shall be disregarded. Previously this requirement was catered for by an extra-statutory concession. Unfortunately, the reference in both paragraphs to "supplies of goods that are capital assets of the business" restricts the provision to tangible assets so that it does not fully meet the EC requirement. I am afraid that we failed to spot this inconsistency, which was

brought to our attention by the City of London Law Society on the day that the Bill received Royal Assent. We were unable, therefore, to introduce a Government amendment. Although in practice the error is unlikely to create difficulty, as traders operating around the level of the registration threshold are unlikely to have significant disposals of intangible assets, and administratively we have instructed our staff to treat the new provisions as applying to all capital assets, we believe that it would be prudent in this further revision of Schedule 1 to make the necessary amendment. Simple deletion of the words "of goods" in both paragraphs will do the trick.

9. We estimate that the further amendments proposed in paragraphs 8 and 9 above will take up an additional 6 lines of Finance Bill space. We would be grateful to know whether you are content with our proposals and that we can now complete our instructions to Parliamentary Counsel to draft the necessary clauses.

P TREVETT

DATE : 2 SEPTEMBER 1987

HM CUSTOMS AND EXCISE
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Paymaster General

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Mr Cassell
Mr Scholar
Miss Sinclair
Mr Michie
Mr Cropper
Mr Jenkins
(Parliamentary Counsel)

MERSEYSIDE CABLEVISION LIMITED

1. In my earlier notes of 10 July and 6 August, I said that we were seeking the advice of our lawyers on whether we should appeal the Tribunals Decision in this case. The advice we have now received is that, on balance and taking account of both EC and UK law, we should not.

2. There were 2 quite distinct and separate issues, which we had to consider when deciding whether to continue with an appeal. The first concerned EC law, where the Tribunal found that the relevant UK law, VAT Act 1983, Schedule 1, paragraphs 5 (1) and 11 (1)(b), was too restrictive in that it gave us a discretion to refuse registration, a discretion, which is not given in EC law. In the Tribunal's opinion, and under the provisions of the Sixth Directive, we are required to register a trader, where he so requests, subject only to our being satisfied that he is already making, or intends to make, taxable supplies in the course of his business. We are advised that this

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interpretation of EC law is correct. Indeed, it is very much in line with the opinion of the EC Commission that the Sixth Directive does not permit compulsory deregistration (Mr Howard's note of 4 February), which we were considering in the context of the small business review.

3. The second issue we had to consider was whether, at the material time, Merseyside Cablevision had established an intention to make taxable supplies. This is, in the opinion of our lawyers, debatable and, if the only issue in question, could justify an appeal. This is not, unlike the EC issue, a point of general applicability, but particular to the facts of this case. We, do not propose, therefore, to continue with our appeal.

4. A consequence of this case, which we believe would be confirmed by a higher court, is that our registration law has been shown to be not in accordance with EC law. Notwithstanding that our policy already follows the spirit of the Sixth Directive (my note 6 July), this could in future result in unnecessary appeals, where we have refused registration on a strict business test, and not because of the discretion given by our present law. We therefore recommend making the necessary amendments to paragraphs 5 (1) and 11 (1)(b) of Schedule 1 to the VAT Act 1983. We are also considering whether we should delete paragraph 10 of the same schedule. This paragraph gives us the power to deregister compulsorily traders, who are in default and trading below the registration threshold. We believe that this provision is also ultra vires in EC terms and is a provision which we seldom use.

5. We estimate, these amendments, will take up to 10 lines of Finance Bill space, and will be well received by outside bodies. For us they should have a negligible impact on our resources, perhaps an additional 1,000 new registrations a year, requiring 5 staff. The revenue implications are minimal.

6. We would be grateful to know whether you are content with our recommendations to amend Schedule 1 and that we now instruct Parliamentary Counsel to draft the necessary clauses.

P TREVETT

UNCLASSIFIED
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FINANCE BILL 1988

SUMMARY:
1. COMPLETE RE-DRAFT NECESSARY FOR FINANCE BILL 1988. FURTHER CUTS NECESSARY IN PUBLIC SECTOR DEFICIT. GOVERNMENT CONSIDERING OPTIONS.

DETAIL:
2. THE BUDGET COMMISSION OF THE SENATE ACCEPTED ON 31 OCTOBER THE JUDGEMENT OF AMATO, MINISTER FOR THE TREASURY THAT IN VIEW OF THE DETERIORATING INTERNATIONAL ECONOMIC SITUATION THE FINANCE BILL 1988 WOULD REQUIRE FUNDAMENTAL REVISION. THE COMMISSION NOTED THAT IT WOULD BE NECESSARY TO AVOID INFLATIONARY TENDENCIES, AND LIMIT FURTHER THE PUBLIC SECTOR DEFICIT. AUTHORITATIVE COMMENTATORS CLAIM THAT THE FIRST PRIORITY IS TO BRING THE DEFICIT BELOW 100,000 BILLION LIRE FROM THE PRESENT TARGET FOR 1988 OF 109,500 BILLION LIRE. THIS TASK WILL, ACCORDING TO AMATO, BE DIFFICULT TO AGREE WITHIN GOVERNMENT AND WITH BOTH SIDES OF INDUSTRY, 'BUT MUST BE DONE WITHIN THE COMING WEEK.

3. MOST AT RISK ARE THE PROPOSED REDUCTIONS IN PERSONAL TAXATION AND INCREASE IN FAMILY ALLOWANCES. DROPPING THESE WOULD SAVE 5,000 BILLION LIRE, BUT WOULD PROVOKE FIERCE OPPOSITION FROM TRADE UNIONS AND WITHIN GOVERNMENT. HOWEVER THE GOVERNMENT IS EXPECTED TO DROP THE PROPOSED 1 PERCENT INCREASE IN THE 9 PERCENT AND 18 PERCENT VAT RATES, AND TO REDUCE TO TWO THE NUMBER OF DIFFERENT VAT RATES AS REQUESTED BY THE EUROPEAN COMMISSION.

FCO PLEASE PASS TREASURY, BANK OF ENGLAND, DTI.

BRIDGES

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Board Room
H M Customs and Excise
King's Beam House
Mark Lane London EC3R 7HE

FROM: P JEFFERSON SMITH
DATE: 9 November 1987

ECONOMIC SECRETARY

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Mr Scholar
Miss Sinclair
Mr Cropper
Mr Jenkins
(Parly Counsel)

1988 FINANCE BILL: CUSTOMS AND EXCISE STARTER NO 32
VAT ON ROAD FUEL FOR PRIVATE USE

1. This item arises from Section 9 of the Finance Act 1986 which introduced a system of scale charges on road fuel bought by businesses but used for private journeys. In these circumstances, the business must account for VAT on a predetermined scale related to engine capacity, regardless of the actual level of private use. This avoids record-keeping and argument about the correct apportionment between business and private use. The measure took effect from 6 April 1987.

2. During the passage of the 1986 Finance Bill representations were made that the scale was too high, especially for small businesses, including farmers, and in particular that the total mileage, both business and private, of some small concerns is often less than that implied by the scale charge as applicable to private motoring alone.

Internal distribution: CPS
Mr Knox
Mr Allen
Mr E Taylor
Mr Elander

107/11/87

In correspondence with Members of Parliament, including Mr Tony Speller, the Paymaster General agreed that the scale charge would not be applied where the registered person claimed no input tax on any of his purchases of road fuel, whether for business or for private motoring. The decision to allow such a concession came too late to allow it to be included in the 1986 Bill and the concession has therefore operated on an extra-statutory basis.

3. The item was put forward as a starter for the 1987 Bill, but the Paymaster General decided that it should not be included. There was no pressing need to do so. The legislation would have come in the early months of operation of the new system, which we knew was not going to be universally well received. It was also recognised that the 1986 road fuel legislation might include other aspects which would be revealed after implementation as requiring amendment and these could be dealt with at the same time as this concession in a later Finance Bill.

4 The concession has not been well received because of its limited conditions. It can be used only by businesses which give up entitlement to input tax on <u>all</u> purchases of road fuel, which means fuel for any vans and lorries operated by the business as well as for cars. There have been a number of representations that this is unfair to a business which runs, say, a van for business journeys only and a car for both business and private journeys. Such attempts to widen the concession so that a business need forgo only the input tax on the fuel for the car and may continue to claim the input tax on the fuel for the commercial vehicle have been firmly resisted. This widening would be administratively difficult to operate and from our point of view much more difficult to control. It would probably lead to abuse and would militate against the main reason for introducing scale charges in the first place, which was to simplify this fairly complicated area of the tax. The concession was designed to help only those businesses with a low total mileage and we think this is now beginning to be understood, even though the resentment remains.

5. The revenue effect of the concession is difficult to estimate but will be very small in relation to the expected yield in a full year from scale charges of £50 million. The loss of the scale charge payment from such businesses will of course be largely offset by the amount of tax which would otherwise have been claimed on the business mileage. If this amount is high, it will not pay a business to take advantage of the concession, so the most likely beneficiaries will be those located in remote areas where both business and private motoring may be below average. A business with low private mileage and high business mileage would do better to ensure that the private petrol was not paid for by the business and avoid the scale charge in that way.

6. We have not as yet identified any other defects in the 1986 road fuel legislation so if the concession is given statutory cover in the 1988 Finance Bill, this will be the only amendment affecting the operation of the scheme. I recommended last year that it would be prudent to wait a year before legislating, and there now seems to be no particular reason for delaying further: but because the level of the scale charges has given rise to more complaints than we expected, and because the concession is considered to be too narrow, the item could be contentious. There continues to be a very high level of Ministerial correspondence on the scale charge system, which could even rise, as more and more businesses find themselves paying the charge. We would expect attempts in Standing Committee to widen the scope of the concession in the way referred to in 4 above. On the other hand, at the time the concession was first agreed to by Ministers, the Chancellor seemed keen that it should be made statutory as soon as possible: and now that all extra-statutory concessions are published, it is difficult to continue to operate them for very long on this basis without attracting criticism. However, this is scarcely an urgent candidate for Finance Bill space, and you may feel that legislation may once again be deferred.

P JEFFERSON SMITH

4373/30

FROM: MISS S FEEST
DATE: 9 November 1987

MR L E JAUNDOO IR

cc PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mr Scholar
Miss Sinclair
Miss Hay
Mr Cropper
Mr Jenkins OPC
Mr Houghton IR
PS/IR

1988 FINANCE BILL STARTER No. 251
INHERITANCE TAX: EXEMPTION FOR TRANSFERS TO POLITICAL PARTIES

1. The Financial Secretary was grateful for your minute of 30 October 1987 and agrees that Parliamentary Counsel should be instructed as suggested in your submission.

Susan Feest

SUSAN FEEST
(Assistant Private Secretary)

3769/043

RESTRICTED

papers pse pmp

FROM: P D P BARNES
DATE: 10 November 1987

ME JEFFERSON-SMITH-C&E

cc PS/Chancellor 2
Mr Scholar
Miss Sinclair
Mr Cropper

Mr Jenkins - Parly Counsel

Mr Knox - C&E
PS/C&E

1988 FINANCE BILL : CUSTOMS & EXCISE STARTER NUMBER 32

The Economic Secretary was grateful for your submission of 9 November, which he discussed with you this morning.

2. As he said at the meeting, the Economic Secretary would be grateful to see the correspondence on this from Mr Robin Maxwell-Hyslop MP before reaching a decision, but his initial preference was to accept your advice that this Starter should be dropped.

PB

P D P BARNES
Private Secretary

3318/038/AC

COVERING SECRET

FROM: MRS T C BURNHAMS

DATE: 11 November 1987

1. MISS SINCLAIR 12/11

2. FINANCIAL SECRETARY

cc Chancellor
Chief Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Mr Cassell
Mr Scholar
Miss Evans
Mr Cropper
Mr Call
Mr Tyrie
PS/IR
Mr Isaacs - IR
Mr Painter - IR
Mr Beighton - IR
Mr Shaw - IR
PS/C & E
Mr R Allen - C&E
Mr Jenkins - Parliamentary Counsel

1988 FINANCE BILL STARTERS

My minute of 22 October enclosed the first (and master) edition of the Starters list for the 1988 Finance Bill. I now attach the first amendments. These bring the position up to date as of Friday 6 November. Enclosed are:

(a) a new index for Inland Revenue

(b) updated summary sheets for Inland Revenue, Customs and Transport. Revisions are shown in bold type.

(c) a reference sheet for a new Inland Revenue starter no 260.

2. Most of the amendments relate to submissions going forward to Ministers and Ministerial decisions, but there are also some revisions to revenue/ cost estimates.

3. The current state of play is as follows:-

	TOTAL	I	I*	D	D*	UCM	NSM	UCM/NSM
IR	62	14	4	1	-	21	21	1
C/E	23	-	3	-	-	2	18	-
HMT/TRANSPORT	10	-	-	-	-	2	8	-

4. We are in regular contact with Parliamentary Counsel about the instructions for drafting which have gone forward; and every effort will be made to ensure that the steady flow which has been achieved will continue. Parliamentary Counsel has now received instructions in respect of 14 of the Starters and drafting has been completed on 4 of these.

5. In view of the sensitivity of starters 150 and 252 we have changed the classification of the summary sheets to secret. I should be grateful if copy recipients could reclassify the reference sheets for these two Starters accordingly.

Teresa Burnhams.

MRS T C BURNHAMS

Classification

Each proposed measure has been allocated to one of the following categories

I	-	definitely included
I*-		provisionally included
D	-	definitely dropped
D*	-	provisionally dropped
UCM	-	under consideration (at least one submission received by Ministers)
NSM	-	a first submission to go to Ministers

INLAND REVENUE: INDEX

203 Business Expansion Scheme

204 Capital allowances: pre-consolidation amendments

205 Capital allowances: transfers by exempt bodies.

206 Capital allowances: fire safety etc

208 Capital allowances: enterprise zones

209 Capital allowances: assured tenancies

210 Exchange gains and losses

211 Abolition of relief for business entertaining of overseas customers

212 Small advertising gifts

213 In-year assessment on Schedule D income

214 LLoyd's: RIC leavers

215 Lloyd's Special Reserve Fund (SRF)

216 Lloyd's: reform of assessment and collection system.

217 Pension fund repayments

CAPITAL TAXES

250 IHT: rates and bands

251 IHT: exemption for transfers to political parties

252 CGT: main proposal

253 CGT: husband and wife

254 CGT: annual exempt amount

255 CGT: definition of an investment trust.

256 CGT: extension of rollover relief to satellites and spacecraft

257 CGT: capital losses on building society and co-operative shares.

258 CGT: indexation and groups.

259 CGT: intra-group share exchanges

260 CGT: milk and potato quota

STAMP DUTY

300 Stamp duty threshold

301 Stamp duty on shares

302 Stamp duty: Channel Tunnel

303 Abolition of Unit Trust Instrument Duty

OIL TAXATION

350 PRT: Expenditure claims during safeguard periods.

351 PRT: Variations in assessments or determinations

352 PRT: Expenditure relief - tariffing arrangements

353 Oil licence gains: work programme farm outs

354 North Sea Fiscal Regime Reviews

INTERNATIONAL TAXATION

400 Company residence and migration

MISCELLANEOUS

450 Tax appeals: General Commissioners for Northern Ireland

451 Tax appeals: place of hearing by General Commissioners

452 Keith Committee administrative improvements

453 Mr Monck's Working Group proposal

454 Shelters exercise

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 6 November 1987

1	2	3	4	5	6	7	8	9	10	11
No	Description	Status	Date latest subm	Revenue £m cost(-)/yield(+) 1988/89	1989/90	Staff Effect 1/4/89	1/4/90	Legislation Length	Date inst. sent to Counsel	Other comments
100	Income tax: allowances, thresholds & rates	UCM	14.7.87	Depends on decisions		Depends on decisions		2/3		Cost of 3.7% indexation of thresholds (£1060m in a full year) included in forecast.
101	Independent taxation of husband & wife	UCM	16.9.87	Nil	Nil	+110	+770	25	**3.11.87 (part)**	Implementation in 1990/91. Full year cost £700m.
102	Additional personal allowance: conversion to social security provision.	UCM	3.9.87	Depends on decisions		Depends on decisions		1/4		
103	Minor personal allowances - abolition	**I**	**9.10.87**	**+10**		**-75**	**-100**	A few lines		
104	Benefits in kind - misc.	UCM	**20.10.87**	Depends on decisions		Depends on decisions		Depends on decisions		

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 6 November 1987

1	2	3	4	5	6	7	8	9	10	11
No	Description	Status	Date latest submn	Revenue £m cost(-)/yield(+) 1988/89	1989/90	Staff Effect 1/4/89	1/4/90	Legislation Length	Date inst. sent to Counsel	Other comments
105	Benefits in kind - threshold	UCM	16.7.87	Depends on decisions		Depends on decisions		1/4		Cost & manpower effects depend on level of threshold and whether or not it includes car car fuel benefits.
106	Benefits in kind - car & car fuel benefits	I	22.10.87	Depends on decisions		Depends on decisions		Possibly up to 1/2		Changes to scale charges made by Treasury Order, but legislation may be necessary if changes to structure of car benefit scale to be made.
107	Benefits in kind - third party entertainment	I	16.7.87	Neg (-)	Neg (-)	Nil	Nil	6 (approx)		Exemption announced by FST on 25.9.87.

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 6 November 1987

1	2	3	4	5	6	7	8	9	10	11
No	**Description**	**Status**	**Date latest submn**	**Revenue £m cost(-)/yield(+)**		**Staff Effect**		**Legislation Length**	**Legislation Date inst. sent to Counsel**	**Other comments**
				1988/89	**1989/90**	**1/4/89**	**1/4/90**			
108	Benefits in kind - car parking	UCM	30.7.87	**Depends on decisions**		**Depends on decisions**		1/2 - 1		Estimates of cost, manpower & length of legn will need to be altered if car parking only partially exempted. Estimate of cost & manpower take into account that very little of charge is currently collected.
109	Benefits in kind - luncheon vouchers	NSM		Estimates not yet available						It is not certain that legislation would be required.

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 6 November 1987

1	2	3	4	5	6	7	8	9	10	11
No	**Description**	**Status**	**Date latest submn**	**Revenue £m cost(-)/yield(+)**		**Staff Effect**		**Legislation Length**	**Date inst. sent to Counsel**	**Other comments**
				1988/89	**1989/90**	**1/4/89**	**1/4/90**			
110	Amendments to PRP legislation	UCM/ NSM	3.9.87	Not known (probably negligible cost and manpower effect).					**22.9.87 19.10.87 (part)**	Ministers have approved drafting one item. Submissions on others will be made as soon as possible, when early reactions to the new legislation and Revenue's recent Guidance Notes can be assessed.
111	Review of S79 Unapproved employee share schemes.	I	22.7.87	Neg		Neg		5	4.9.87	**Draft clauses published 26.10.87.**
112	Employee priority shares in a public offer.	I	18.9.87	Neg		Neg		1/2	**Drafted**	

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 6 November 1987

1	2	3	4	5	6	7	8	9	10	11
No	Description	Status	Date latest submn	Revenue £m cost(-)/yield(+) 1988/89	1989/90	Staff Effect 1/4/89	1/4/90	Legislation Length	Date inst. sent to Counsel	Other comments
				Limit £30,000						
113	Mortgage Interest Relief Limit for 1988-89	UCM	23.9.87	Nil	Nil	Nil	Nil	Few lines		
				Limit £35,000						
				-230	-320	-12	-10			
				Limit £40,000						
				-400	-550	-25	-20			
114	Mortgage Interest Relief: Residence Basis	UCM	23.9.87	**Limit £30,000** April 1988 start				2 or 3		
				+10	+30	+25-30	+25-30			
				August 1988 start						
				+3	+20	+25-30	+25-30			
				Limit £35,000 April 1988 start						
				-220	-290	+25-30	+25-30			
				Alternative approach April 1988 start						
				-260	-285	+25-30	+25-30			

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 6 November 1987

1	2	3	4	5	6	7	8	9	10	11
No	Description	Status	Date latest submn	Revenue £m cost(-)/yield(+) 1988/89	1989/90	Staff Effect 1/4/89	1/4/90	Legislation Length	Date inst. sent to Counsel	Other comments
115	Mortgage interest relief: restriction of relief for home improvements	**UCM**	**27.10.87**	**+100**	**+250**	**-150**	**-200**	1		
116	FA 1984 Employee Share Option Schemes: Restricted Shares	I	5.10.87	Neg		Neg		8 lines	**Drafted**	
150	Maintenance payments and covenants.	UCM	24.7.87	Depends on decisions		Depends on decisions		Depends on decisions		
151	Personal pensions - delay in commencement date.	I	24.8.87	+10	+10	To be assessed		1	**21.10.87**	
200	Close companies - apportionment of interest	UCM	**5.11.87**	Neg	Neg	Neg	Neg			
201	CT rate for FY 1988	NSM		+10	+350	Nil	Nil	2 lines		

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 6 November 1987

1	2	3	4	5	6	7	8	9	10	11
No	**Description**	**Status**	**Date latest submn**	**Revenue £m cost(-)/yield(+)**		**Staff Effect**		**Legislation Length**	**Date inst. sent to Counsel**	**Other comments**
				1988/89	**1989/90**	**1/4/89**	**1/4/90**			
202	Small companies rate of CT for FY 1988	NSM		Neg	+25	Nil	Nil	4-9 lines		
203	BES	NSM		N/K		N/K		N/K		
204	Capital allowances: pre-consolidation amendments	NSM		Depends on decisions but should be very small.		Negligible		say 6-10		
205	Capital allowances: transfers by exempt bodies.	**I**	**12.10.87**	Nil	Nil	Negligible		1/2		Potential revenue saving long-term, say, £540m (net present value).
206	Capital allowances: fire safety etc	NSM		Depends on decisions		Negligible		Up to 1/2		
208	Capital allowances: enterprise zones	**UCM**	**21.10.87**	Depends on decisions		Negligible		Depends on decisions		

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 6 November 1987

1	2	3	4	5	6	7	8	9	10	11
No	**Description**	**Status**	**Date latest submn**	**Revenue £m cost(-)/yield(+)**		**Staff Effect**		**Legislation Length**	**Legislation Date inst. sent to Counsel**	**Other comments**
				1988/89	**1989/90**	**1/4/89**	**1/4/90**			
209	Capital allowances: assured tenancies	NSM		Depends on decisions		Negligible		Depends on decisions		Depends on developments in Housing Policy.
210	Exchange gains and losses	NSM		Depends on decisions		Negligible		say 20		Submission to Treasury Ministers by end-October 1987
211	Abolition of relief for business entertaining of overseas customers	UCM	16.7.87	N/K	N/K	Negligible saving		say 1/2		
212	Small advertising gifts	UCM	16.7.87	Increase to:		Negligible saving		Few lines		
				£15	Nil		-3			
				£20	Nil		-4			
				£25	Nil		-5			

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 6 November 1987

1	2	3	4	5	6	7	8	9	10	11
No	Description	Status	Date latest submn	Revenue £m cost(-)/yield(+) 1988/89	1989/90	Staff Effect 1/4/89	1/4/90	Legislation Length	Date inst. sent to Counsel	Other comments
213	In-year assessment on Schedule D income	NSM		+60 to 70		Saving of at least 40		say 1/2		This starter would avoid what would otherwise be a once and for all revenue cost of £m60-70 and a continuing staff cost of at least 40, if the Courts uphold the Special Commissioners decision.
214	LLoyd's RIC leavers	NSM		Probably negligible		Probably small		3/4		Cost and staff effects depend on details of relief.
215	Lloyd's Special Reserve Fund (SRF)	NSM		Neg	-3 to -20	Neg	Nil to + or - 10	Up to 1		Cost, staff effects and length of legislation all dependent on nature of change - for discussion with Lloyd's.

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 6 November 1987

1	2	3	4	5	6	7	8	9	10	11
No	**Description**	**Status**	**Date latest submn**	**Revenue £m cost(-)/yield(+)**		**Staff Effect**		**Legislation Length**	**Legislation Date inst. sent to Counsel**	**Other comments**
				1988/89	**1989/90**	**1/4/89**	**1/4/90**			
216	Lloyd's - reform of assessment and collection system.	NSM		Neg	Neg	Neg	-20 to -50	Up to 2		Staffing effects and length of legislation dependent on details of changes - for discussion with Lloyd's.
217	Pension fund repayments	NSM		[-100]		Nil		1/2		
250	IHT - rates and bands	NSM		-25	**-60**	Indexation alone will add to staff needs (increase of 20% in caseload)		1/2		Costs reflect effect of automatic indexation and are already assumed in the forecast.
251	IHT - exemption for transfers to political parties	**UCM**	**30.10.87**	Nil	Nil	Nil	Nil	1/2		
252	CGT: main proposal	UCM	1.7.87	Depends on decisions		Depends on decisions		Depends on decisions	**6.8.87 21.10.87 30.10.87 (part)**	

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 6 November 1987

1	2	3	4	5	6	7	8	9	10	11
No	Description	Status	Date latest subm	Revenue £m cost(-)/yield(+) 1988/89	1989/90	Staff Effect 1/4/89	1/4/90	Legislation Length	Date inst. sent to Counsel	Other comments
253	CGT - husband and wife	I*	6.8.87	Nil	Nil	Nil	Nil	Depends on decisions	**4.8.87**	
254	CGT - annual exempt amount	NSM		Nil*	-10*	No staff effect assuming revalorisation Staff addition if not revalorised as follows: Nil	+15	Few lines (in event of non-revalor isation)		
255	CGT - definition of an investment trust.	I	17.7.87	Nil	Nil	Nil	Nil	1	Drafted	
256	CGT - extension of rollover relief to satellites and spacecraft	I	24.7.87	Yield effect fluctuates from year to year - in some years nil, in others could be several million.		Neg	Neg	11 lines	Drafted	
257	CGT - capital losses on building society and co-operative shares.	I	18.6.87	Impossible to quantify. Revenue at risk if no action taken.		Neg	Neg	2-3 (might be shorter)	27.7.87	

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 6 November 1987

1	2	3	4	5	6	7	8	9	10	11
No	Description	Status	Date latest submn	Revenue £m cost(-)/yield(+) 1988/89	1989/90	Staff Effect 1/4/89	1/4/90	Legislation Length	Date inst. sent to Counsel	Other comments
258	CGT - indexation and groups.	I*	12.10.87	Substantial revenue at risk if no action taken.		Neg	Neg	Depends on decisions. Could be up to 2 pages.	4.11.87	
259	CGT - intra-group share exchanges	I*	21.9.87	Legislation is to prevent, for the future, both avoidance of tax and, in other cases, the charging of gains twice.		Nil	Nil	Up to 1/3	29.10.87	
260	**CGT: milk and potato quota**	I	23.9.87	**Neg**	**-5 or less**	**Neg**	**Neg**	1/2		**Relief announced 29.10.87.**
300	Stamp duty threshold:	NSM								
	(a) £30,000			Nil	Nil	+10	+10	Nil		
	(b) £40,000			-270	-360	-10	-10	1/3		
	(c) £50,000			-420	-580	-20	-20	1/3		
301	Stamp duty on shares	NSM		-480	-480	Nil	Nil	1/5		
302	Stamp duty - Channel Tunnel	I	21.9.87	Neg	Neg	Neg	Neg	1/3	27.10.87	

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 6 November 1987

1	2	3	4	5	6	7	8	9	10	11
No	**Description**	**Status**	**Date latest submn**	**Revenue £m cost(-)/yield(+)**		**Staff Effect**		**Legislation Length**	**Date inst. sent to Counsel**	**Other comments**
				1988/89	**1989/90**	**1/4/89**	**1/4/90**			
303	Abolition of Unit Trust Instrument Duty	NSM		-30	-30	Neg	Neg	1/3		Capital duty will also need to be considered
350	PRT: Expenditure claims during safeguard periods.	UCM	3.8.87	Neg	Neg	Nil	Nil	2		Review announced on 7.8.87
351	PRT: Variations in assessments or determinations	NSM		Nil	Nil	Nil	Nil	2		Designed to protect revenue
352	PRT: Expenditure relief - tariffing arrangements	D	21.10.87	?+5	?+10	Nil	Nil	4	—	**EST agreed that issues should be reviewed for FB 1989.**
353	Oil licence gains: work programme farm outs	I	20.8.87	Neg	Neg	Nil	Nil	2		

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 6 November 1987

1	2	3	4	5	6	7	8	9	10	11
No	Description	Status	Date latest submn	Revenue £m cost(-)/yield(+) 1988/89	1989/90	Staff Effect 1/4/89	1/4/90	Legislation Length	Date inst. sent to Counsel	Other comments
354	North Sea Fiscal Regime Reviews	NSM	21.7.87 (work programme only - no options for decisions)	N/K	N/K	N/K	N/K	N/K		
400	Company residence and migration	NSM		Without S482 the loss of revenue could be large (the amount must be speculative but could exceed £150m).		Nil	Nil	10-15		
450	Tax appeals - General Commissioners for Northern Ireland	I*	14.7.87	Nil		Nil		1-2 Short clause and schedule of repeals	**12.8.87 (part)**	Consultative document was issued seeking views by 20.11.87. Final decisions not likely until late December.
451	Tax appeals - place of hearing by General Commissioners	UCM	20.10.87	Nil		15-20* (Inspector level)		1		* No net saving saving from PES baseline; but avoids additional staff need.

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 6 November 1987

1	2	3	4	5	6	7	8	9	10	11
No	Description	Status	Date latest submn	Revenue £m cost(-)/yield(+) 1988/89	1989/90	Staff Effect 1/4/89	1/4/90	Legislation Length	Date inst. sent to Counsel	Other comments
452	Keith Committee administrative improvements	UCM	15.7.87	N/K	N/K	N/K	N/K	N/K		
453	Mr Monck's Working Group proposal	UCM	6.5.87	Nil	Neg	Negligible		2		
454	Shelters exercise	UCM	23.10.87	N/K	N/K	N/K	N/K	N/K		

CONFIDENTIAL

CUSTOMS AND EXCISE BUDGET STARTERS: SUMMARY SHEETS

Date 2 November 1987

1 No.	2 Description	3 Status	4 Date latest submn	5 Revenue £m cost(-)/Yield(+) 1988/89	6 1989/90	7 Staff Effect 1/4/89	8 1/4/90	9 Legislation Length	10 Date Inst. sent to Counsel	11 Other Comments
1	Duty rates	NSM	-	+610	+1530	Nil	Nil	2 pages and 12 pages of schedules		1988-89 revenue yield is based on revalorisation of 4%. 1989-90 yield assumes a further revalorisation of 5.2%.
2	Duty differential for unleaded petrol	NSM	-	Variable		Nil	Nil	5 lines		Revenue cost of £0.6M per 1p tax differential for every percentage point of unleaded petrol market share
3	Definition of process of rendering wine or made-wine "spark-ling"	NSM	-	Nil	Nil	Nil	Nil	10 lines		
4	Restructuring of wine and made-wine duties	NSM	-	Neg	Neg	Nil	Nil	2 pages		
5	Pool betting duty structure	NSM	-	Neg	Neg	Nil	Nil	31 lines		

CONFIDENTIAL

CUSTOMS AND EXCISE BUDGET STARTERS: SUMMARY SHEETS

Date 2 November 1987

1	2	3	4	5	6	7	8	9	10	11
No.	Description	Status	Date latest submn	Revenue £m cost(-)/Yield(+) 1988/89	1989/90	Staff Effect 1/4/89	1/4/90	Legislation Length	Date Inst. sent to Counsel	Other Comments
6	Phased abolition of matches and mechanical lighters duties	NSM	-	-6	-12	Nil	-9	10 lines		
7	Abolition of minimum duty charge for beer	NSM	-	Neg	Neg	Nil	Nil	20 lines		
8	Power to assess beer, wine and cider duties	NSM	-	Neg	Neg	Nil	Nil	5 lines		
9	Remission of duty on spirits for medical or scientific use	NSM	-	Nil	Nil	Neg	Neg	15 lines		
10	Oil duties relief	NSM	-	Nil	Nil	Nil	Nil	23 lines		
11	Relief from duty of goods for testing	NSM	-	Nil	Nil	Nil	Nil	10 lines		

CONFIDENTIAL

CUSTOMS AND EXCISE BUDGET STARTERS: SUMMARY SHEETS

Date 2 November 1987

1	2	3	4	5	6	7	8	9	10	11
No.	Description	Status	Date latest submn	Revenue £m cost(-)/Yield(+) 1988/89	1989/90	Staff Effect 1/4/89	1/4/90	Legislation Length	Date Inst. sent to Counsel	Other Comments
30	Keith review	I*	9.10.87	Neg	Neg	Nil	Nil	4-5 pages		Revenue cost of £5M in full year after 1990-91. PMG approval for most of the package. Outstanding items to be discussed.
31	Revalorisation of registration and deregistration thresholds	NSM	-	Neg	Neg	Nil	Nil	None	Not applicable	
32	Motor expenses	NSM	-	Neg	Neg	Nil	Nil	5-10 lines		
33	Value of used goods	NSM	-	Nil	Nil	Nil	Nil	6-7 lines		
34	Tax on supply to be liability of person completing the tax invoice	NSM	-	+5	+5	Nil	Nil	5 lines		Revenue yield likely to increase if loop-hole becomes more widely exploited
35	Amendments to VAT Act 1983 Schedule1	I*	2.9.87.	Neg	Neg	Nil	Nil	10 lines		
36	Computer evidence (Scotland)	NSM	-	Nil	Nil	Nil	Nil	1 line		

CONFIDENTIAL

CUSTOMS AND EXCISE BUDGET STARTERS: SUMMARY SHEETS

Date 2 November 1987

1	2	3	4	5	6	7	8	9	10	11
No.	Description	Status	Date latest submn	Revenue £m cost(-)/Yield(+) 1988/89	1989/90	Staff Effect 1/4/89	1/4/90	Legislation Length	Date Inst. sent to Counsel	Other Comments
60	Disclosure of importers' details	NSM	-	Neg	Neg	Neg	Neg	1 page		
61	Search of persons	I*	16.7.87.	Nil	Nil	Nil	Nil	35 lines		**Approval for search of persons only**
62	Penalty for customs fraud	UCM	17.9.87.	Nil	Nil	Nil	Nil	12 lines		
63	Prosecution time limits	UCM	17.9.87.	Neg	Neg	Neg	Neg	6 lines		
64	CAP warehouse approval and control	NSM	-	Nil	Nil	Nil	Nil	12 lines		

CONFIDENTIAL

BUDGET STARTERS: SUMMARY SHEETS

DEPARTMENT OF TRANSPORT

Date October 1987

1	2	3	4	5	6	7	8	9	10	11
No	Description	Status	Date latest sub mn	Revenue £m Cost(-)/Yield(+) 1988/89	1989/90	Staff Effect 1/4/89	1/4/90	Legislation Length	Date inst sent to Counsel	Other Comments
600	VED: powers to Combat Under-Licensing	NSM		Neg+		Neg		6-8 lines		
601	VED: Changes to recovery vehicle tax class	UCM	1.10.87	Nil		Nil	Nil	About ¼ page		
630	Dishonoured cheques provision to claim duty for the period a void vehicle excise licence was held by an Offender	UCM	28.10.86	Neg	Neg	Neg	Neg	1 page		
631	Vehicle registration and licensing minor amendments	NSM		Nil		Nil		½ Page		
632	Redefinition of 'Community Service Bus' (previously 'playbus') to make these vehicles	NSM								

CONFIDENTIAL

BUDGET STARTERS: SUMMARY SHEETS

DEPARTMENT OF TRANSPORT

Date October 1987

1	2	3	4	5	6	7	8	9	10	11
No	Description	Status	Date latest sub mn	Revenue £m Cost(-)/Yield(+) 1988/89	1989/90	Staff Effect 1/4/89	1/4/90	Legislation Length	Date inst sent to Counsel	Other Comments
	eligible for restricted HGV rate of VED			-£0.3m	-£0.3m	Nil		3-4 lines		
633	Change in criterion for concessionary rate for vehicles 'registered' pre 1.1.47 to manufactured pre 1.1.47	NSM		small		-	-	6-8 lines		
634	Ambulance and new welfare vehicle taxation classes	NSM		Neg Cost		Nil	Nil	1 page +4 lines		

Date of Issue: 6 November 1987

BUDGET STARTER: REFERENCE SHEET

TITLE: CGT: milk and potato quota

STARTER NUMBER: 260 **CLASSIFICATION:** B1

Revenue £m* cost(-)/yield(+) 1988/89	1989/90	(Full year)	Staff effect* 1/4/89	1/4/90	Length of legislation*
Neg	-5 or less	-10 or less	Neg	Neg	Up to 1/2 page

Minister in lead	Date instructions sent to Counsel	PCTA or equivalent resolution required
FST		No

ORIGIN OF STARTER: Inland Revenue

BACKGROUND AND COMMENTS:

At present CGT rollover relief is available for land but not for milk and potato quota. The FST announced on 29 October that relief would be extended to the quotas.

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FP CONTACT: R G MICHIE **TELEPHONE** 270 4922

* **HEALTH WARNING** The data reports the position at the time of issue of each Reference Sheet and will be updated only if the scope of the Starter changes significantly. Latest information for all items can be found on the Summary Sheets.

CONFIDENTIAL

Inland Revenue

Policy Division
Somerset House

FROM: M J G ELLIOTT
DATE: 11 NOVEMBER 1987

1. Mr McGIVERN — See note at end. 11/11

2. FINANCIAL SECRETARY

FINANCE BILL 1988: STARTERS 211 AND 212
BUSINESS ENTERTAINING AND GIFTS

1. The Chancellor asked recently for confirmation that the removal of the special relief for the cost to businesses of entertaining overseas customers had been included as a starter for next year's Finance Bill. We had, indeed, included it in the list, together with another point which came up at the same time earlier this year. This note covers both points.

Summary

2. Since 1965, no deduction has been allowed in computing profits for tax purposes for any expenditure incurred by a business on entertaining or gifts except for

(i) the costs of the reasonable entertainment of an overseas customer

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c. Chancellor of the Exchequer
Chief Secretary
Paymaster General
Economic Secretary
Mr Scholar
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Jenkins (Parliamentary Counsel)
Mr Isaac
Mr Painter
Mr Beighton
Mr McGivern
Mr Lewis
Mr Cleave
Mr Calder
Mr Lawrance
Mr Pattison
Mr Yard
Mr Elliott
Mr Fitzpatrick
Miss Brand
PS/IR

2541 6412

(ii) expenditure on gifts which incorporate a conspicuous advertisement for the donor, up to a value of £10 per donee in any year.

3. Starter 211 is the proposal to remove the special exception for the entertainment of overseas customers, so that no business entertaining would be allowable for tax purposes. Starter 212 covers the possibility of an increase in the de minimis limit for promotional gifts from £10 to a larger figure - £15, £20, or £25.

Background and Starter 211

4. You will recall that these two points came up earlier this year when you were considering a possible consultative document on a package of measures centred on the tax treatment of third party entertainment and gifts provided for employees. The central items in the package - the exemption for third party entertainment received by employees and the exemption for third party gifts of £100 or less - have now been announced in Press Releases (25 September); the first is for legislation next year, the second is being dealt with by concession. It was decided, as you will recall, not to announce any other items at the same time, but to leave them for consideration as starters in the normal way.

5. On Starter 211, we understand that you and the Chancellor felt that, as part of the proposed package, it would be appropriate to remove the "overseas customer" relief. The arguments for doing so which it was proposed to advance in the consultative document were as follows.

6. First, the relief was introduced at a time (1965) when the balance of payments was seen as the most important constraint on improved economic performance, and the encouragement of exports was regarded as of paramount importance. The purpose of the relief was thus to encourage greater efforts on the part of UK exporters; but it was perhaps never particularly apt for that purpose because it

also applied to the entertainment of foreign suppliers by UK import agents.

7. Second, the relief has a lot in common with the Schedule E relief for foreign earnings which was largely withdrawn in 1984. That also was designed to help people "at the sharp end of exporting". Both these special reliefs had their origin at a time when marginal tax rates ran up to 83% for individuals' earned income, and up to 52% for companies. Since then, tax rates have been reduced as part of the Chancellor's overall policy to broaden the tax base, to remove complications which have outlived their original justification, and to reduce the extent to which business decisions are influenced (and at the margin sometimes distorted) by tax rather than strictly commercial considerations.

8. The draft document also made the point that the proposed reliefs for recipients of "third party" entertainment and gifts would be matched by the disallowance of relief to the provider who in future would receive no relief for any expenditure on entertaining or gifts (except small advertising gifts).

9. To these points one might add the consideration that abolition would result in a small but worthwhile simplification of the rules for business and the Revenue alike.

10. We believe that all these points amount to a convincing case for abolition. On the other hand, there can be little doubt that abolition would not be popular; in particular, we expect it would be criticized on the grounds that it would serve as a discouragement to exporters at a time when maximum effort is needed on the export front to assist the balance of payments (now in deficit on current account).

Transitional arrangements

11. The draft consultative document, which it was contemplated would be issued at the end of the summer, proposed that the relief should be abolished in respect of expenditure incurred after 31 March 1988 with transitional relief for expenditure incured after 31 March 1988 under contracts for the provision of entertainment entered into before the date the document was issued.

12. If the abolition of the relief were to be announced on Budget day - as we assume it would be - we suggest that it should take effect from midnight on that day, with transitional relief for expenditure incurred under contracts entered into before that time.

13. Potential Yield

I am afraid we have no information on which to base an estimate.

Starter 212

14. We have included Starter 212 because you were also interested, as part of the proposed gifts and entertainment package, in the possibility of increasing the £10 de minimis limit for promotional gifts - perhaps to £15, £20 or £25.

15. This limit was last increased - from £5 to £10 - in the 1985 Finance Bill. The increase, which was in line with inflation, was made as a small measure to help businesses. It seems to us that the case for increasing it again only three years later would be a difficult one to present. The exemption is intended only to cover small advertising gifts, e.g. pens, diaries, and calendars; and £10 seems reasonable in that context. No one has been asking for an increase; and it would be difficult to suggest that it was in any sense a quid pro quo for the abolition of the overseas customer entertainment relief, because there is no connection between the two. Revalorising the limit again in line with inflation would raise it to only £11 and clearly an increase of that

amount would not be worthwhile. Finally, comparisons could be drawn with the proposed concessionary relief for employees for gifts from third parties costing £100 or less, with the suggestion that that relief should also be given statutorily.

16. You may also want to keep in mind that Ministers ran into a fair amount of trouble in Committee on the occasion of the last increase to £10 in 1985. The Opposition suggested in particular that the cost of the increase - which we had suggested was negligible - might be much higher, and that is a potentially awkward line of argument because, despite our best endeavours, we really have no hard information to go on. The relevant Hansard extract is attached (to your copy only).

17. Our recommendation therefore is to leave this limit alone and to drop Starter 212. We should be grateful to know your views.

MJG

M J G ELLIOTT

Financial Secretary,

Starter 212 looks as if it might well be more trouble than it is worth, particularly in the light of the 1985 Committee Stage debate. The case for a further increase after only 2 years is not very strong.

Starter 211 would be fully in keeping with the Chancellor's tax reform policy and there seems to be a convincing case for legislation. But you will wish to consider the point in para 10 about the effect on exporters when the current account is now in deficit.

JMcG. 11/11

S211/2/Dk2

attention to the fact that the Government do not wish to damage friendly societies. Those are his words, and when *Hansard* is published tomorrow I am sure that we will read them as the words that he deployed.

If what he said is so, in the event that the societies can prove that the Government have incurred damage, will he reconsider the position? If the Government do not intend to impose damage, and the societies prove damage, surely the Minister cannot then turn a blind eye to it. He must be consistent. I merely ask that, if it can be proved that damage arises from the introduction of last year's changes, he will reconsider the position. That is a modest request.

Mr. Stewart: The hon. Gentleman will have to allow a hypothetical position to be debated on a real occasion in the future.

Question put and agreed to.

Schedule 8, as amended, agreed to.

Clause 41

BUSINESS ENTERTAINING EXPENSES

On proposed, That the clause stand part of the Bill.

Mr. Terry Davis (Birmingham, Hodge Hill): This is a short clause but it attracts my interest. I should be grateful if one of the Ministers would explain it to us. The clause is headed "Business entertaining expenses", but it appears to be about gifts. I sould like to know what gifts are called "business entertaining expenses" and what is the cost of the increase from £2 to £10.

Mr. Moore: I shall be delighted to explain. A not dissimilar question was imagined to have been asked in a Committee sitting in 1971. I start by referring to what my right hon. Friend who is now the Secretary of State for the Environment said in 1971 when he introduced the revaluation of this particular section of the Taxes Act from £1 to £2. He said:

"The clause has a misleading title."

He was right. It is misleading, so I shall first explain briefly what the clause seeks to do and then answer the point about cost.

Section 411 of the Income and Corporation Taxes Act 1970 disallows expenditure on business entertaining and gifts—that followed from the initial Act brought in by the Labour Government in 1965—as a deduction in computing profits for tax except for overseas trade customers. However since the legislation was first introduced in 1965, there has been an exception for small trade gifts below a de minimus limit. That exception was introduced by the Labour Government in 1965. The exception was intended to cover free samples and other promotional materials and small gifts such as calendars, diaries, pens, etcetera, bearing the donor's name or busines logo which are given to established customers, especially at Christmas. The limit was orginally set at £1 in 1965 and was increased to £2 in 1971—I referred to that Committee debate—and is being raised to £10, which will simply restore the value of the limit broadly in line with inflation. The cost is negligible, which puts it underneath our ability to determine the cost.

The relevant section of the Income and Corporation Taxes Act 1970 describes precisely the nature and the constraints surrounding the limitation introduced by the Labour Government in 1965. It states:

"an article incorporating a conspicuous advertisement for the donor, being an article–
(a) which is not food, drink, tobacco or a token or voucher exchangeable for goods..."

The second paragraph contains a description of the cost that was at that stage increased for £1 to £2.

The original exception was introduced by the Labour Government in 1965 in response to pressures from the printing and publishing trade because it saw it as part of its legitimate promotional business. The exception was to a very restrictive provision introduced to control business entertaining expenses other than for customers.

Mr. Terry Davis: How do the Government know that the cost is negligible? Surely they must have some measure of what it costs at present. We had a definition of "slight" during an earlier debate—it means less than £2 million. What does "negligible" mean? Is the list of gifts definitive? The Financial Secretary referred to a debate which took place in 1971 and to the speech made by his right hon. Friend who is now Secretary of State for the Environment. I was interested to read in the report of that debate that the Secretary of State omitted ash trays, which his right hon. Friend included in the list. What can be given as a gift? We know that tobacco, food and drink cannot–

Mr. Tim Smith (Beaconsfield): Diaries.

Mr. Davis: I did not hear what the hon. Member for Beaconsfield (Mr. Smith) said. If the hon. Gentleman would care to speak from a standing position—this is after all a Standing Committee—I should be delighted to listen to what he has to say.

Mr. Tim Smith: This is an intervention, is it not?

Mr. Davis: If the hon. Gentleman wishes to intervene, he should do so standing up.

The Chairman: I think that the Committee will be aware of my views about seated interventions. Hon. Members may get away with the odd one or two but after that, no.

Mr. Davis: I am anxious for enlightenment, and the hon. Gentleman to have some experience. I declare an interest and confess that I have been on the receiving end of some of these things in business. I never realised that the taxpayer was helping to pay for those diaries, calendars and pens—I think that pens were included in the list which the Financial Secretary gave us. However, what is the logic behind his list? Is there nothing else? He used the very loose word "etcetera". What else is included under that word? Surely he must have some idea of the cost. What is the logic behind the

[MR. TERRY DAVIS.]

list? Why are some things included and not others? If it is so reasonable to increase it from £2 to £10 in 1985, why have the Government not increased it since 1979? Why this year and why such a big increase?

After listening to the Financial Secretary, I should have thought that it would have been an annual event and that we would be asked to increase it in line with inflation every year or perhaps every couple of years. What has suddenly produced this clause in this Bill this year?

That was an intervention, Miss Fookes.

Mr. Moore: I will try to address myself to some of the points raised by the hon. Member for Birmingham, Hodge Hill (Mr. Davis). It is always a matter for debate as to how one defines what is negligible. I seem to recall the hon. Member for Hodge Hill asking me precisely the same question at some stage at night during last year's proceedings. I also seem to remember that I did not have the brief with me at that time but that I defined the sum to the Committee in Revenue terms as less than £1 million. I believe that that was the precise, normal nomenclature referred to for "negligible".

I accept that it is extremely difficult in such areas to establish the precise Revenue cost. This is the best estimate that the Revenue can give and, obviously, it is on that basis that I give it to the Committee.

The prescription of the list was introduced by the Labour Government to seek to help the very kind of small businesses that the hon. Member for Stoke-on-Trent, Central (Mr. Fisher) referred to in the debate in the House on the printing and publishing industry. The attempt was to try to ensure that genuine business promotion advertising was assisted. I could go a little further into the list but the hon. Member for Workington (Mr. Campbell-Savours) is dying to intervene.

Mr. Campbell-Savours: Just on this point, because I hope to catch your eye later, Miss Fookes.

The notes on clauses say that the gifts must incorporate an advertisement for the donor and must not consist of food. If they do not incorporate an advertisement, may I correctly assume that while they have been given by companies they do not attract tax relief? If they do not incorporate an advertisement yet are given in exactly the same way, would they not attract tax relief? Is that the position?

Mr. Moore: I referred carefully to the Income and Corporation Taxes Act 1970 definition of the prescribed nature not only of the gift but the amounts. Section 411(8) of that Act refers to

"a gift consisting of an articlee incorporating a conspicious advertisement"

not merely an advertisement but a conspicuous advertisement

"for the donor".

Apart from that, all it sought was to restrict

"food, drink, tobacco or a token or voucher exchangeable for goods".

I could go on extensively in trying to describe the list, but, clearly, the limitations are prescribed in the statute, and not only that. Obviously, they are limited by the cash amount.

The hon. Member for Hodge Hill asked why now? Why not between 1965 and 1971, when Government looked at the nature of the statutes and sought to revalue? There has been some modest pressure from, if I recall, the Institute of Chartered Accountants and the Law Society of Scotland on this issue. Essentially, this has been a continuing process when the small trades concerned with this matter press the Government from time to time to seek to revalue. All the Government seek is to revalue by the rate of inflation.

9.30pm

Mr. Campbell-Savours: May I bring two little experiences to this debate? When I was in business, I supplied a great number of business gifts to the trade and many of them were stationery items which we manufactured. Today, I telephoned the British Advertising Gift Distributors Association, and organisation called BAGDA, which I knew in its previous form in the 1970s and which has helped me in drawing the Ministers attention to several issues that I think that the Treasury has taken into account. I am told that 5 per cent. of all business gifts are over £10 in value. Half of the remaining number approximately 40 to 45 per cent.—are between £2 and £10 and the rest are under £2.

Therefore, nearly 50 per cent. of all business gifts fall within the £2 to £10 mark. They will all attract relief if they carry a logo.

Mr. Tim Smith: No.

Mr. Campbell-Savours: The hon. Member for Beaconsfield (Mr. Smith) says "No." Perhaps he would like to tell me where I am wrong, as the Minister told me that these articles were defined under corporation tax legislation, which provided that they attracted relief if they carried a logo of sufficient size.

Mr. Tim Smith: The Hon. Gentleman has overlooked the fact that that is not the only condition, and that food, drink and tobacco are exempted. One of the most popular gifts at Christmas is a bottle of Scotch. Even if that had a large logo printed on the label it would still not be allowable for tax.

Mr. Campbell-Savours: According to my information, that does not affect the majority of the trade, which is in hardware and not in drinks and food. In view of the secretary of BAGDA, whom I spoke to today, we are talking about a market of £200 million worth of products which are transferred in this way. Admittedly many of these products do not carry a logo, which is why I wonder why the hon. Gentleman intervened. Producers will simply put a logo on a product of up to £10 and find that they will then be able to establish tax relief. Was that taken into account when the calculation was done?

If that is the case, and only one half of the £200 million is in hardware, as against in wines, spirits and foods, we might be looking at a revenue consequence of £30 million or £40 million—the corporation tax that

would otherwise be payable on gifts which, under new arrangements, will carry a logo simply to ensure that the donor can claim corporation tax relief. That is a substantial amount of money. The Minister must assure us that that will not happen and that people will not switch to adding a logo and then claim full relief because of the existence of higher limits. If he cannot do that, there is a danger that the proposal could be far more expensive to the Revenue than expected.

Mr. Terry Davis: I should like to give the Minister time to reflect on the points made by my hon. Friend the Member for Workington (Mr. Campbell-Savours). To be fair to the hon. Member for Beaconsfield (Mr. Smith), he said not that most gifts consisted of bottles of whisky, but that the most popular was a bottle of whisky. I am sure that the hon. Gentleman speaks knowledgeably. A bottle of whisky may be more popular than a diary, calendar, pen or ashtray. I should like to know what thought the Government have given to the matter. It sounds as if they have given in to pressure from an important lobby of a particular section of the small business sector, without giving any thought to the logic.

Mr. Campbell-Savours: The BAGDA, which represents all these organisations, has never made any representations to the Treasury about raising the limit.

Mr. Davis: I thought that I heard the Financial Secretary say that he had had representations from the trade, but I do not suppose that he is allowed to say who, apart from the Institute of Chartered Accountants, have been lobbying him. There should be some logic behind these lists.

For example, it is illogical that it is wrong for a business to give a customer a packet of cigarettes advertising the company and bearing its logo yet if the company gives an ashtray, matches or a cigarette lighter, which will be covered by the £10 limit, the gift will be subsidised by the taxpayer. It does not seem to be in the public interest to encourage the distribution of glossy sexist calendars displaying the company's name yet not to subsidise the distribution of books—I shall not name my favourite author.

I do not understand the logic of the provision. The gifts are not restricted to materials printed and published in this country. They can be produced abroad so that an overseas printer benefits.

It is not good enough for the Government to say that they have listened to submissions from an unknown representative or representative body of a particular section of small business and to increase the limit from £2 to £10. I do not oppose the increase. I want to understand whether the Treasury has any logic. I begin to think that, again, there is no logic in the provision.

Must the gift be an item? A company may decide to distribute tickets to a sporting event that it has sponsored. A company such as Canon may give out tickets to football matches in the Canon league.

Mr. Campbell-Savours: They do.

Mr. Davis: I am not sure whether that is a good thing for the taxpayer to subsidise or whether it qualifies for tax relief. Perhaps the Minister will explain. Such a gift could be held to advertise a company's products.

The Minister says that the provision is designed to help small businesses. He has confirmed that his definition is the same as it was in the early hours of the Finance Bill Comittee last year. To the Government, "negligible" means less than £1 million and under £2 million is "slight" Those are the small businesses that the Minister wants to help. We shall pursue that implication on other matters such as the production of Cyprus sherry by a well known co-operative producer.

When I see Ministers I shall raise those sorts of figures as "negligible" and "slight" in terms of subsidies to businesses. We have had it from the Minister that that interpretation can be given from the representations received from small businesses. But why only some small businesses? Why exclude tobacco, drink and especially food? What about small restaurants?

The clause is titled "Business entertaining expenses" so why not encourage business men to entertain their customers to breakfast at a charge of less than £10? Why should a business man not buy his customer a traditional breakfast on British Rail for £5.50 plus gratuity? That would fall within the £10 limit. I am a great admirer of British Rail breakfasts and it would be a good way of winning orders.

You and I, Miss Fookes, remember the long hours of the Standing Committee on last year's Finance Bill. In the hot, early hours of the morning we were told about fiscal neutrality. We have not heard much of that cliché this year. I do not believe that the words "fiscal neutrality" have dropped from the lips of a Treasury Minister since Easter.

I am puzzled. I thought that fiscal neutrality would be pursued year in, year out, Finance Bill after Finance Bill. I believed that fiscal neutrality was the name of the game and that last year was just the first instalment. But what is fiscally neutral about diaries, pens, glossy sexist calendars and ashtrays?

I see no logic in the measure. I do not admire much about the Chancellor of the Exchequer but I thought that he was at least trying to be neutral and that he would not interfere and make value judgments about whether a diary was better than the Bible. But that is what he is doing because a gift must bear the company's logo.

I question whether such gifts are of value to the economy. What about the tremendous waste of physcial resources? In the Houses of Parliament in the new year there are dozens of calendars – not sexist ones – diaries and even pens in waste paper baskets. We are inundated with them, all subsidised by the taxpayer.

In business it was even worse. We could not raffle the gifts because there are too many so we distributed them round the office. I question whether such gifts are necessary and question the logic of them.

Mr Harry Cohen (Leyton): My hon. Friend is making some good points. Taxpayers subsidising advertising in this way is a serious matter and should be opposed. Taxpayers' money should be spent in better ways. Does my hon. Friend agree that what is happening here is subsidisation of advertising generally? Is there not something immoral in that? Saatchi and Saatchi are dead keen to keep the

[HARRY COHEN]

Conservative party's advertising budget, so they might make sure that they give lots of gifts to Conservative Members of Parliament and Cabinet Ministers. So there is double immorality – the immorality of promoting the Conservative party, and getting tax relief for doing it.

Mr Davis: My hon. friend tempts me to stray out of order but I shall not succumb.

My hon Friend is somewhat mistaken. Advertising is a normal legitimate business expense, which is deducted in the calculation of profit. I see the logic in saying that if an item is advertising a company it would be classed as advertising, rather than as a gift. But that is different from business entertaining. Here we are dealing with "Business entertaining expenses", that is the title of the clause. If it was a diary, a pen or a calendar – like the ones we all see in garages; I always look at them when I collect my car – that is advertising a company's products, not a business entertaining expense.

May I put a further point to the Financial Secretary, which I think he did not mention in his explanation of the clause. There is one other constraint on the tax relief. It is not a limit of £2 to be increased by this Government to £10 on an item; the limit is on the value of gifts that a business can give a customer or recipient.

Mr Moore: An item.

Mr Davis: So it is an item. I therefore withdraw the point. I understood that the restriction was on the recipient as well; one could give several items, but they should not add up to more than £10. If the Financial Secretary says that I am wrong, I shall accept what he says.

Mr Moore: I did not read the relevant part. of the 1970 Act. It says:

"the cost of which to the donor, taken together with the cost to him of any other such articles" –

so it does circumscribe in that respect –

"Given by him to that person in the same year, does not exceed £2".

So it is the item and the recipient, with the figure proposed to be £10.

Mr Davis: What the Financial Secretary is now telling me is what I understood before. A business can give a customer items which add up to £10. No single item is to exceed £10. The restriction would not affect two calendars or two diaries. The business could give a diary, a calendar, an ashtray, a cigarette lighter and boxes of matches, provided that they did not amount to more than £10 to that recipient from that donor.

Mr. Moore *indicated assent.*

Mr. Davis: The Financial Secretary nods, so I have understood correctly. What records are companies supposed to keep?

Mr. Moore: I shall try to cover as many of the points as I can. It was not the Chancellor who sought to circumscribe this area with a moral code which, interestingly and amusingly, was introduced through "fiscal neutrality" and in other ways by the hon. Member for Birmingham, Hodge Hill (Mr. Davis). I shall go back to the beginning, although I had assumed that Opposition Members were aware of the legislation that they introduced, and of the reasons for it.

9.45 pm

The nature of the problem was an attempt by the then Labour Government in 1965—continued by successive Labour and Conservative Governments—to inhibit, contain and control what might be called "entertaining", so that a business could not legitimately claim an entertainment expense other than for an overseas customer.

In the process of doing so, the Labour Government of 1965 were persuaded, essentially by the printing and publishing industry, that there were legitimate advertising promotional activities that were part and parcel of their business. I could go through the list of ashtrays and other items, and go into the details of numbers of gifts and firms involved in what is a substantial industry made up of small units. The Government were persuaded at the time to make a specific exception relating to business. The morality, or immorality, of having a moral code was therefore not developed by the present Chancellor, nor by a Conservative Government.

It was determined in 1965 that the arrangment should be circumscribed in two essential respects: the first related to the nature of the product and what I might call moral decisions were made at the time about food, tobacco or vouchers that could effectively be exchanged for money. Secondly, a limit was imposed on the amount of money used for any recipient.

The present Government, wisely or unwisely, have not sought to challenge that moral dilemma. The arrangement has continued and has not been challenged, even when the Government last sought, in 1971, to upvalue the cash limit in line with the rate of inflation. There may be room for further debates, or for a debate on the need for moral judgment. The Government are not seeking to enlarge an areas that might be called "entertaining" as opposed to promotional advertising.

I cannot debate with the hon. Member for Workington (Mr. Campbell-Savours) the data he has received and his own experience of the size of the industry concerned. All that I can say is that it has been suggested to me that his figures may be somewhat too large. If, however, we are wrong, and there has been a sizeable increase in such business activities we would have to come back to the Committee next year or some other year and admit that the figure had increased. There would be greater tax revenues, in consequence of increased business revenue.

I recognise the need for debate. I apologise if I did not make it clear that this year the only pre-Budget representations that we received on the need for this revaluation came from the Institute of Chartered Accountants and the Law Society of Scotland. In the past there have been regular representations from the trade associations representing calendar and diary manufacturers,, campaigning for the limit to be increased in line with inflation.

I apoligise to the hon. Member for Hodge Hill because I am leaving the area of "fiscal neutrality". But I am entering the area of absolute equity. I wrote down what he, rightly, said. He said that advertising is a normal business expense, and that all that the Government are seeking to do, within the context of the existing code, is to ensure that the revaluation—which I agree is somewhat outdated—is covered by an increase to £10, which reflects simply the effect of inflation.

This is a modest step, and it acknowledges a legitimate business activity within a tightly circumscribed entertainments expenses limit. It excludes and would exclude the tickets referred to by the hon. Member for Hodge Hill. Those would be regarded as entertainment and would not come within the regulations.

I hope that hon. Members will acknowledge that the provision offers some assistance to a large number of reasonably-sized British firms.

Mr. Campbell-Savours: The Minister has skilfully skirted around the important issue that I raised, that those companies will now put a logo on items costing up to £11. Earlier I quoted a figure of £30 million to £40 million but I had failed to take into account the fact that only half the gifts cost between £2 and £10, so I am now changing the figure for that potential revenue loss to between £15 million and £20 million in the current financial year, when the changes are to be made. It would be a perfectly legitimate business practice to stamp the company's name on an item and so ensure that the company retains corporation tax relief.

The Minister is responsible for Treasury officials. Did his officials take the facts into account when they made their recommendations to him and submitted the representations from calendar and diary manufacturers? I maintain that they were remiss in not identifying the amount, because if I am right, it will prove that they were negligent, and the Minister is directly responsible for them.

Between now and Report the Minister should examine what I have said and if there is any danger that the revenue loss could be between £15 million and £20 million at a time when many needy areas could make good use of that £20 million, he should consider deleting the clause on Report. I am well aware that it has implications for some visitors to the United Kingdom, but the Government defined their policy not on the basis of this measure of revenue loss, but on the basis of its being a negligible loss. Had the Government known that the potential for revenue loss was between £15 million and £20 million, they would never have put the clause in the Bill. That is why they should establish before Report whether there is any value in what I am saying. If the Government can prove that I am wrong, the measure should stay in the Bill, but if I am right, they must defend making such a tax concession which would be indefensible in current circumstances.

I spoke to a representative of BAGDA this morning who said that although the tax concession was beneficial, it was not important or crucial. I am sure that the Minister understands the distinction. It was not he who said that industry would simply purchase gifts that included a logo; I said that myself. If I were in business today and involved in that business, that is what I would do. A manufacturer must maximise his production and distribution within the existing tax and legislative framework. Any business man who wants to get into that business and is now selling products costing between £2 and £10 to customers who cannot claim tax relief is mad if he does not include a logo and so ensure that he avoids corporation tax liability. In his company's interests it is better that he does not pay that tax, as companies take into account the possible tax consequences when making their decisions.

Mr. Terry Davis: I do not intend to detain the Committee for long, but I want to record my disappointment that the Government have not only abandoned fiscal neutrality without a whimper, but have abandoned their aims of being a reforming Treasury team.

What a timid reply the Financial Secretary gave! He simply took the list of items bequeathed to him, not by the last Labour Government, but by the Labour Government of 1965, and accepted what had gone before. Those glad, confident days of 1984 have gone and the Government are back to the old business of updating, indexing and increasing in line with inflation.

The Financial Secretary was mistaken on one small point. It was not the Government who increased the limit from £1 to £2 in 1971. The record shows that the amendment was moved by a Conservative Back Bencher, Mr. Piers Dixon, who represented Truro at that time. It was accepted by the Conservative Government but this is the first time that any Government, either Conservative or Labour, has given way to that lobby. Indeed, what lobby? We are told that it is only the Institute of Chartered Accountants and the Law Society of Scotland.

I must also express some disappointment at the Minister's wriggling about the statistics. He told us that he knows how many items are given, he knows how many firms there are in the business but he cannot quantify the effect on the Inland Revenue of this increase from £2 to £10.

Finally, in 1965 the Labour Government stopped tax relief for business entertainment. Is the Minister telling us that that has had a harmful effect on the business entertainment industry? If not, why mess about with this tax relief?

Mr. Moore: I apologise for having neglected to answer one point. The hon. Member for Birmingham, Hodge Hill (Mr. Davis) when he checks the record will know the answer anyway. Companies must disclose details of all expenses claimed as a deduction for tax so that the Inland Revenue can be satisfied that expenses are deductible.

All I can say to the substantive point—I acknowledge it as such—made by the hon. Member for Workington (Mr. Campbell-Savours) is that the figures and the suggestions that he gave were outside the knowledge of the Inland Revenue. In my limited experience the Inland Revenue has considerable practical knowledge in most areas of business. However, the figures he raised were substantially different from anything that we have heard. Of course I shall look at the matter carefully. He would not wish

[MR. MOORE]
me to do other than listen with great care to what he says and the information that he has been given by outside organisations. I shall not make any commitment but I shall look at it seriously, because it is a different dimension to the size of the negligible amount of theoretical tax cost—not tax loss because it is an expenditure of legitimate businesses that we see in the context of that clause. I shall of course consider it on that basis.

Question put and agreed to.

Clause 41 ordered to stand part of the Bill.

Clause 42

BUSINESS EXPANSION SCHEME

Mr. Roger Freeman (Kettering): I beg to move amendment No. 139, in page 41, line 29, at end insert—

"(1A) for the purposes of this Schedule a company shall not be excluded from being treated as raising money for research and development merely because it intends to use or uses that money wholly or partly for research and development which it pays another person to carry out on its behalf and for the purposes of the new sub-paragraph (4) of paragraph 2 to this Schedule inserted by sub-paragraph (3) below research and development carried on for four months for and on behalf of the company first above mentioned shall be deemed to have been carried on by the company itself."

I have no direct interest to declare in the effects of the clause. However for the last 20 years, both as a chartered accountant and as an investment banker, I have been involved with research and development projects. I therefore have a close personal and professional interest in the clause.

The clause extends the scope of the business expansion scheme. My amendment seeks to widen it further by permitting the business expansion scheme reliefs to apply not only to companies which carry out their own research and development but to those which commission third parties to carry out that research and development. I believe that that is a sensible addition to the provisions in the clause.

I very much welcome the business expansion scheme. It has now been running for a full two years. It started in 1983. I welcome the restrictions in the scheme which have been introduced in successive Budgets, but I particularly welcome the extension in the clause of the BES to research and development projects because it constitutes a breakthrough—I am sure that many of my hon. Friends will agree with me—in tax legislation. For the first time, tax relief is given not just for a commercial trade that is being undertaken but for pure research and development. Although certain conditions are attached in the clause which I fully accept and which my amendment does not touch, it represents an important first step.

I hope that perhaps next year the Committee will return to the extension of the business expansion scheme still further, possibly to qualifying research and development partnerships. This is neither the time nor the place to describe their virtues but is the next logical step.

There are a number of reason why amendment No. 139 should be considered and I should like to outline them briefly to the Committee. When a research and development project is undertaken by a newly formed company, in some cases that research must be contracted out to third parties

10 pm
Sitting suspended for a Division in the House.

10.15 pm
On resuming—

Mr. Freeman: I was about to give the Committee valid reasons why a small research and development company—a possible beneficiary of the clause—might wish to contract out research and development work to a third party and why the benefits of the clause should not be denied to such a company.

First, a small company formed by two or three individuals may wish to capitalise on an idea that has been worked on in a university or is a product of its own pure research. It may wish to continue a project over a period of years, with the assistance of funds from institutions and, through the business expansion scheme, from individuals, and may have to rely on third parties to do so. That is already a common occurence.

Secondly, a company may wish to avoid duplicating the efforts of a university or research body. For example, in my constituency the research body for footwear and allied trades has conducted research benefiting the footwear industry for many years. It is therefore logical for small firms to contract out specific items of research and development work to that body. It is surely sensible to argue that a small company seeking the benefits of the business expansion scheme provisions in the clause would not wish to reinvest the wheel or to undertake part of a complicated research and development project requiring the expertise of a third party. Rather, it would wish to contract the work out.

Finally, many projects require expensive facilities – for example, laboratories and facilities to carry out operational research in the testing of new products. Small companies often cannot afford those facilities and therefore have to consider contracting out.

I accept some of the tightly-drawn provisions that the Government have included in the clause. In addition to denying business expansion scheme relief to companies that mainly or substantially contract out research and development work, it specifies that the research and development company must be new, that later trade must result – that seems a sensible provision – that it must carry on the work for at least three years and that certain R and D activities should be excluded.

I accept most of those tight and sensible provisions and I accept the need for the Revenue to draw up such provisions, but I would be grateful if the Financial Secretary would at least volunteer to monitor the effects of the clause to ascertain how the prohibition of the contracting out of R and D work to third parties hampers or harms the excellent and valid reasons for introducing the clause.

Mr Moore: I welcome the general support expressed by my hon. Friend the Member for Kettering (Mr.

3770/016

PWP.

FROM: G R WESTHEAD
DATE: 12 November 1987

MR M BROWN - C&E

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Mr Scholar
Miss Sinclair
Mr Mitchie

Mr Knox - C&E
Mr Nash - C&E
Mr Wilmott - C&E
Mr Allen - C&E
Mr Helsdon - C&E
Mr Railton "

SEARCH OF PERSON : FINANCE BILL STARTER NO.61 CLASSIFICATION C

Subsequent to your minute of today's date, I attach a copy of the letter sent by the Economic Secretary to Lord Caithness attaching draft letters for Lord Caithness to send to Lord Monson and Lord Harris about Customs and Excise's search powers.

Guy Westhead.

GUY WESTHEAD
Assistant Private Secretary

3770/018

Treasury Chambers, Parliament Street, SW1P 3AG

The Earl of Caithness
Home Office
50 Queen Anne's Gate
LONDON
SW1H 9AT

12 November 1987

Dear Lord Caithness,

CRIMINAL JUSTICE BILL:
SEARCH OF PERSON POWERS OF CUSTOMS AND EXCISE

Following the Committee stage debate on the amendment proposed by Lord Monson, I have been considering with Customs and Excise what aspects of his proposals, if any, we could accept in principle and how we might progress them. As you know, Customs were in any case reviewing their personal search powers in the light of the Keith Committee recommendations, and the Lords debate has caused us to crystallize our thoughts.

There are several aspects of Lord Monson's amendment that I am happy to take on board, but I question whether the CJB is the right place to enact them, because:

(a) the drafting will be quite tricky and not something on which I would like to rush Parliamentary Counsel;

(b) amendments to Customs powers as a result of the Keith Committee have up to now been made in Finance Acts; and

(c) the Government line in this area possibly stands a better chance of being upheld in the Commons than in the Lords.

I have consulted Nigel Lawson, who has agreed to cover the subject in the Finance Bill. Our aim should therefore be to forestall any further consideration in the CJB.

Two of the "safeguards" that we can accept from Lord Monson's shopping list are outlined in the attached draft letter that you may like to use. They are current administrative practice in Customs, but

it will do no harm to spell them out in law. There is a further safeguard we can accept. This is that suspects should be informed of their appeal rights. You may prefer not to offer this from the start, in order to have something to concede in discussions with Lord Monson. But I leave the decision to you.

The draft also explains our objections to his other major safeguards, to add to the cool reception you gave them in Committee.

I also attach a draft letter to Lord Harris to answer his questions about the Keith Committee recommendations.

You are a better judge than I of how to defuse the search of person issue with your fellow peers. If you consider that a meeting with Lord Monson would be useful, I would be very willing to be present as would Customs officials.

Yours sincerely,
Guy Weatherall
(Assistant Private Secretary)

PETER LILLEY

[Approved by the Economic Secretary and signed in his absence to avoid delay]

DRAFT LETTER FROM LORD CAITHNESS TO:

LORD MONSON

During the debate on Customs' powers of personal search on 3 November I undertook to write to Lord Harris of Greenwich about the recommendations of Lord Keith's Committee on the enforcement powers of the Revenue Departments, and to comment on the current review of these powers and procedures. I attach a copy of my letter, which I hope will re-assure you that most of the safeguards which your amendment sought to achieve are already in place, and that the relevant PCEA Codes of Practice are indeed incorporated into Customs' procedures.

I think there are three aspects of your amendment on which we can favourably consider legislating:

(a) that each sex shall be searched only by an officer of the same sex;

(b) that intimate searches shall normally be carried out only by a medical practitioner; and

(c) that suspects should be informed of their appeal rights.

My Treasury colleagues are also considering the Keith Committee recommendation for a power to detain suspects, short of arrest.

There are, however, three aspects of your proposal which would, in our view, seriously hamper Customs' efforts to counter smuggling.

Firstly, the involvement of Senior Executive Officers (SEOs) in authorising searches. Outside normal office hours, staff at SEO level are on call, but are not themselves on duty at the smaller ports and airports. They currently authorise all intimate searches, but to extend the range of functions requiring

change the order

their involvement would be expensive in resource terms, could seriously delay passengers required to wait while the SEO is contacted, and goes beyond what PCEA demands of the police.

Secondly, a requirement always to disclose to the person searched the grounds for suspicion, rather than merely the offence suspected and the nature of the proposed search (which are already disclosed), would severely undermine Customs' use of intelligence. Customs are placing increasing emphasis on intelligence and information in seeking specific targets or 'profiling' potential smugglers. This is essential to the best use of manpower and other resources, but depends critically on confidentiality. Apart from the undesirability of potential smugglers knowing the extent of the information, Customs have to protect their sources from the vicious and resourceful criminals involved in organised smuggling.

Thirdly, Lord Keith's Committee has accepted that section 164 should continue in its present scope in regard to all forms of search, including intimate search. Where the officer has evidence that there are Class B drugs (such as cannabis) or other valuable items such as gemstones carried illegally, it would be unhelpful if the law offered no power for a doctor to recover them. [I would add there are close links between the drugs trade and covert movement of valuables such as gemstones, and since the passage of the Drugs Trafficking Offences Act, the incentive to smuggle such goods has been increased.]

3

Finally, a few words about the publication of search statistics. I gave some figures in the debate, but Customs have only recently started keeping records that would permit the statistical analysis required by your amendment. In particular, they are unable to confirm or deny the figure of 11-12000 strip searches that you quoted. Until the first batch of the new statistics has been collected and analysed it is too early to predict what they will show, but I have no doubt that Customs will be as ready to divulge them as they have in the past. I feel it would be better to let the new system bed down before considering a formal statutory requirement to publish.

Customs have already adopted most of the safeguards you seek and my Treasury colleagues will be considering how best to legislate. They have assured me that they have taken careful note of your proposals, and will consider how far they might incorporate elements of them in the Finance Bill, which is the traditional vehicle for changes to the revenue departments' enforcement powers. In the circumstances, I hope you will be content to let the matter rest in the context of the Criminal Justice Bill.

DRAFT LETTER FROM LORD CAITHNESS TO:

LORD HARRIS OF GREENWICH

I undertook during the debate on Customs' powers of personal search on 3 November to write to explain the way and extent to which the recommendations of Lord Keith's Committee on the enforcement powers of the Revenue Departments in this area have been implemented, and to comment on the review of search of person powers now being conducted.

Lord Keith's Committee looked at the full range of Customs and Excise powers. The recommendations made in respect of VAT (Volumes 1 & 2) have largely been implemented in various Finance Acts, but the Government has yet to complete its consideration of the Customs, Excise and Car Tax recommendations.

In their recommendations the Committee accepted that Customs' powers of search of person (including intimate search) now contained in section 164 of the Customs and Excise Management Act should be retained. While recognising that the safeguards for personal search in the PCEA were not capable of direct extension to section 164, the Committee recommended firstly that:

> "Suitably adapted provision be made as to detention for the purpose of undertaking a search, records of personal search and levels of Departmental authority along PCEA lines."

The ~~public safeguard~~ which safeguard the public elements of this recommendation have already been incorporated into Customs practice administratively, as I explain below.

Customs officers are bound by section 67(9) of PCEA to have regard to relevant provisions of the Codes of Practice issued by Order under that section. The Codes are incorporated in their standing instructions, but do not in themselves have the status of primary legislation.

PCEA safeguards are not always suitable for direct translation. For example, the CEMA search power is not exercised in a public place, and is deployed against types of concealment different from the weapons and tools for theft envisaged by the search power contained in section 1 PCEA. However I

understand that Customs have administrative procedures for authorisation of searches which equal (or exceed) the stringency of Police controls.

Customs' suspects also have the right of appeal to a JP or superior officer which is not paralleled by the PCEA provisions. Customs formerly took the view that this right need be specifically notified only if the person to be searched objected, but since June of this year, they have instructed officers to advise all persons who are to be searched of this right. A printed notice of rights for display in search rooms is also under consideration to reinforce the oral explanation.

The Keith Committee also recommended a clear power to detain persons for search, similar to that in section 1 PCEA. Customs' experience has been that passengers rarely attempt to leave before any search needed for clearance of themselves and their luggage is completed. In such rare cases a power of arrest for hindering the officer would be already available. The need for this further detention power is therefore still under consideration.

The third Keith recommendation reflects long-standing Customs practice. No person of the opposite sex is permitted to be present during a search of any sort, except where a woman suspect consents to be searched intimately by a male medical practitioner. And all intimate searches are conducted by a medical practitioner, unless a Senior Executive Officer considers that a lay search is unavoidable. No incidents of lay intimate search are known.

Customs have therefore already acted upon almost all Lord Keith's recommendations and in doing so have provided many of the safeguards sought by the amendment we debated. Of the points of difference, three are those recognised and accepted by Lord Keith's Committee - that there should remain a contingency provision for intimate search other than by a medical practitioner; that such search need not be preceded by arrest; and that the Customs power should not be confined to Class A drugs.

Lord Monson's amendment has however raised other points which are not the subject of recommendation by the Committee:

(a) that all strip searches should be authorised at SEO level. This goes further than the comparable police power and would present a staffing problem for customs, whose SEOs are not always readily available, particularly at nights and weekends;

(b) that Customs should disclose to the suspect the grounds for search and hand them a copy of the search record. This would generate a lot of paper, and more worryingly would give real assistance to criminals by revealing the extent and sources of Customs' information; and

(c) that statistics should be published. Procedures have only recently been introduced to collect statistics centrally, and it would be preferable to allow the new system to bed down before considering whether they should be published.

Customs procedures are being reviewed in the light of recent media comment and my Treasury colleagues are considering the need to take up the Keith recommendations in legislation. They will consider most carefully the substance of Lord Monson's amendment and the extent to which elements of it might be incorporated in the changes to the law that they intend to make.

HM CUSTOMS AND EXCISE
CUSTOMS DIRECTORATE
DORSET HOUSE, STAMFORD STREET
LONDON SE1 9PS
01-928 0533
GTN 2523

CONFIDENTIAL

FROM: MARTIN BROWN
DATE: 12 November 1987

cc. PS/Chancellor
PS/CST
PS/FST
PS/PMG
Mr Scholar
Miss Sinclair
Mr Mitchie

ECONOMIC SECRETARY

SEARCH OF PERSON: FINANCE BILL STARTER NO 61 CLASSIFICATION C

I understand that you now have the Chancellor's approval to legislate in the Finance Bill. This note considers further the content of that legislation, and suggests how to defuse the Lords' Criminal Justice Bill issue by presenting the commitment to Lord Monson.

Our note of 5 November contained at Annex C an explanation of the amendments we wished to make to section 164 of our Management Act. In summary, these provide:

(a) that a person be searched only by a person of the same sex, except that intimate searches shall be performed only by a doctor or nurse, who may be of either sex;

(b) a distinction between rub-down searches (prior appeal only to superior officer) and strip or intimate search (prior appeal to JP or superior officer); and

(c) that a suspect may be detained for the purpose of search.

Internal circulation: CPS, Mr Knox, Solicitor, Mr Nash, Mr Wilmott, Mr Allen, Mr Helsdon, Mr Railton

In the light of the Lords debate, we can add another item that is already our administrative practice and was recommended by the Keith Committee:

(d) to inform suspects of their right of appeal before they are searched.

Proposals (a) and (d) in fact cover three of the safeguards in Lord Monson's amendment, and a commitment to them in principle could well smooth the further passage in the Lords of the Criminal Justice Bill. The attached redraft of a letter that Lord Caithness may like to send to Lord Monson is phrased so as to accept his three safeguards while firmly clocking on the head the ones that would cause us real problems.

I also attach a redrafted letter for Lord Caithness to send to Lord Harris about his specific interest in the Keith Committee recommendations; and a covering letter you might use to brief Lord Caithness himself. Lord Caithness is anxious for an early response, as Report Stage of the CJB starts on Tuesday.

If you agree our policy recommendations at (a) - (d) above, we suggest you write to Lord Caithness, and that your private secretaries discuss whether Lord Caithness sees value in a meeting with Lord Monson and his co-signatories of the amendment (before or after Lord Caithness sends the suggested letter).

We would be glad to attend further meetings with you and/or Lord Caithness, and in the light of your decision on the Finance Bill content we will start to instruct Parliamentary Counsel.

MARTIN BROWN

DRAFT LETTER TO LORD CAITHNESS

CRIMINAL JUSTICE BILL:
SEARCH OF PERSON POWERS OF CUSTOMS AND EXCISE

Following the Committee stage debate on the amendment proposed by Lord Monson, I have been considering with Customs and Excise what aspects of his proposals, if any, we could accept in principle and how we might progress them. As you know, Customs were in any case reviewing their personal search powers in the light of the Keith Committee recommendations, and the Lords debate has caused us to crystallize our thoughts.

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(a) the drafting will be quite tricky and not something on which I would like to rush Parliamentary Counsel;

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(c) the Government line in this area possibly stands a better chance of being upheld in the Commons than in the Lords.

I have consulted Nigel Lawson, who has agreed to cover the subject in the Finance Bill. Our aim should therefore be to forestall any further consideration in the CJB.

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I also attach a draft letter to Lord Harris to answer his questions about the Keith Committee recommendations.

You are a better judge than I of how to defuse the search of person issue with your fellow peers. If you consider that a meeting with Lord Monson would be useful, Customs officials will be glad to support you.

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Finally, a few words about the publication of search statistics. I gave some figures in the debate, but Customs have only recently started keeping records that would permit the statistical analysis required by your amendment. In particular, they are unable to confirm or deny the figure of 11-12000 strip searches that you quoted. Until the first batch of the new statistics has been collected and analysed it is too early to predict what they will show, but I have no doubt that Customs will be as ready to divulge them as they have in the past. I feel it would be better to let the new system bed down before considering a formal statutory requirement to publish.

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In their recommendations the Committee accepted that Customs' powers of search of person (including intimate search) now contained in section 164 of the Customs and Excise Management Act should be retained. While recognising that the safeguards for personal search in the PCEA were not capable of direct extension to section 164, the Committee recommended firstly that:

> "Suitably adapted provision be made as to detention for the purpose of undertaking a search, records of personal search and levels of Departmental authority along PCEA lines."

The public safeguard elements of this recommendation have already been incorporated into Customs practice administratively, as I explain below.

Customs officers are bound by section 67(9) of PCEA to have regard to relevant provisions of the Codes of Practice issued by Order under that section. The Codes are incorporated in their standing instructions, but do not in themselves have the status of primary legislation.

PCEA safeguards are not always suitable for direct translation. For example, the CEMA search power is not exercised in a public place, and is deployed against types of concealment different from the weapons and tools for theft envisaged by the search power contained in section 1 PCEA. However I

understand that Customs have administrative procedures for authorisation of searches which equal (or exceed) the stringency of Police controls.

Customs' suspects also have the right of appeal to a JP or superior officer which is not paralleled by the PCEA provisions. Customs formerly took the view that this right need be specifically notified only if the person to be searched objected, but since June of this year, they have instructed officers to advise all persons who are to be searched of this right. A printed notice of rights for display in search rooms is also under consideration to reinforce the oral explanation.

The Keith Committee also recommended a clear power to detain persons for search, similar to that in section 1 PCEA. Customs' experience has been that passengers rarely attempt to leave before any search needed for clearance of themselves and their luggage is completed. In such rare cases a power of arrest for hindering the officer would be already available. The need for this further detention power is therefore still under consideration.

The third Keith recommendation reflects long-standing Customs practice. No person of the opposite sex is permitted to be present during a search of any sort, except where a woman suspect consents to be searched intimately by a male medical practitioner. And all intimate searches are conducted by a medical practitioner, unless a Senior Executive Officer considers that a lay search is unavoidable. No incidents of lay intimate search are known.

Customs have therefore already acted upon almost all Lord Keith's recommendations and in doing so have provided many of the safeguards sought by the amendment we debated. Of the points of difference, three are those recognised and accepted by Lord Keith's Committee - that there should remain a contingency provision for intimate search other than by a medical practitioner; that such search need not be preceded by arrest; and that the Customs power should not be confined to Class A drugs.

Lord Monson's amendment has however raised other points which are not the subject of recommendation by the Committee:

(a) that all strip searches should be authorised at SEO level. This goes further than the comparable police power and would present a staffing problem for customs, whose SEOs are not always readily available, particularly at nights and weekends;

(b) that Customs should disclose to the suspect the grounds for search and hand them a copy of the search record. This would generate a lot of paper, and more worryingly would give real assistance to criminals by revealing the extent and sources of Customs' information; and

(c) that statistics should be published. Procedures have only recently been introduced to collect statistics centrally, and it would be preferable to allow the new system to bed down before considering whether they should be published.

Customs procedures are being reviewed in the light of recent media comment and my Treasury colleagues are considering the need to take up the Keith recommendations in legislation. They will consider most carefully the substance of Lord Monson's amendment and the extent to which elements of it might be incorporated in the changes to the law that they intend to make.

CONFIDENTIAL

FROM: P TREVETT

DATE: 13 November 1987

HM CUSTOMS AND EXCISE
VAT CONTROL DIVISION D
ALEXANDER HOUSE 21 VICTORIA AVENUE
SOUTHEND-ON-SEA X SS99 1AJ
TELEPHONE SOUTHEND-ON-SEA (0702) 348944 ext

Economic Secretary

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Mr Scholar
Miss Sinclair
Mr Cropper
Mr Jenkins
(Parliamentary Counsel)

FINANCE BILL 1988

SELF BILLING : LIABILITY OF SUPPLY TO BE THE RESPONSIBILITY OF PERSON ISSUING THE TAX INVOICES : STARTER NO 34

1. Your approval is sought for this minor starter to remove a weakness in the law that has already given rise to a loss of tax, and which could prove to be a vehicle for tax avoidance. The purpose of this measure would be to provide that where a taxable person issues himself with a tax invoice, in place of the supplier, he would be responsible for the liability of the tax on that supply.

Internal distribution

CPS
Mr Knox
Mr Finlinson
Mr Jefferson Smith
Mr Nissen
Dr McFarlane
Mr Holloway

Background

2. When a supplier of goods or services makes his supply it is normal for him to issue a tax invoice to his customer. The problem we have encountered concerns a procedure known as 'self billing'. Under this procedure the supplier does not issue a tax invoice, but instead the customer makes out the tax invoice, sending a copy to the supplier. The tax invoice is, of course, the customers evidence for entitlement to recover input tax and on which the supplier must account for output tax. The use of self billing is a long standing commercial practice which precedes VAT and was allowed to continue on the introduction of the tax.

3. We have always had control problems with self billing in ensuring, for example, that a suppler accounts to us for the output tax paid to him by the customer and that a customer keeps an up to date record of the VAT status of his suppliers, ie whether they are still registered for VAT. This year we have encountered a new problem in the construction industry, where self billing is used extensively.

The problem

4. It is now common practice to include in new houses items such as washing machines, refrigerators (white goods), fitted carpets etc, all of which are liable to VAT at 15%. The new house is zero rated, but to ensure that VAT is paid on these items of normal consumer expenditure the law provides that the housebuilder cannot take deduction of input tax when they are included in the sale of a new house. In one particular case a major national building company self billed for such consumer items, showing the tax liability to be at the zero rate. The practical effect of this was that whereas the customer should have self billed and paid the supplier for the cost of the goods plus non recoverable 15% VAT, he has only billed and paid for the cost of the goods plus zero rate VAT. The result has been a tax loss of some £250,000.

Legal position

5. Under section 2(3) of the VAT Act 1983 the responsibility for the tax on any supply is the liability of the person making the supply. The building company argued, and our legal advisers support his view, that the liability for the tax on which he had self billed rests with his suppliers. Although we have the power to assess the suppliers (sub contractors) the exercise would not be practicable, nor cost effective, as this

builder employs many hundreds, if not thousands of sub contractors. We are unable to assess the trader as he has not underdeclared his output tax, nor overclaimed his input tax.

6. A trader is allowed to provide himself with, in effect, a tax invoice (which determines the tax point or time of supply) under section 5(4) of the VAT Act, but although regulation 2(3) of the VAT (General) Regulations 1985 stipulates the content of the document, it does not enable us to hold the trader (self biller) concerned responsible for the correct tax liability of the supplies involved. Furthermore, although we impose conditions on traders approved for self billing, we have no vires for doing so. Correct liability is not one of those conditions and even if it were it would be seen as overriding primary legislation and therefore be ultra vires.

Conclusion

7. Although we have no indication that the practice is widespread in the industry, we consider that it would be prudent to block this loophole by placing the responsibility for correct liability of a supply firmly on the shoulders of the self-billng customer. In addition, the burdens of VAT accounting on small businesses should further be reduced by this move. This is because the self-biller is usually a large company with expert accounting staff well versed in the areas of complicated liability, whereas his suppliers are frequently smaller businesses with few, if any accounting staff.

8. We would be grateful to know whether you are content that we now instruct Parliamentary Counsel to draft the necessary clause for inclusion in the 1988 Finance Bill. We estimate that this legislation will take some 5 lines of Finance Bill space.

P TREVETT

3770/038

FROM: G R WESTHEAD
DATE: 16 November 1987

MR TREVETT - C&E

cc PS/Chancellor 2
PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Mr Scholar
Miss Sinclair
Mr Cropper
Mr Jenkins (Parly Counsel)

PS/C&E

FINANCE BILL 1988 :
SELF BILLING : LIABILITY OF SUPPLY TO BE THE RESPONSIBILITY OF PERSON ISSUING THE TAX INVOICES : STARTER NO 34

The Economic Secretary has seen and was grateful for your minute of 13 November. He is content for Parliamentary Counsel drafting to proceed on this starter.

Guy Westhead

GUY WESTHEAD
Assistant Private Secretary

FROM: J S BEASTALL
DATE: 17 November 1987

FINANCIAL SECRETARY

cc Chancellor
Chief Secretary
Paymaster General
Economic Secretary
Mr Anson
Mr Kemp
Miss Sinclair
Mr Hurst
Miss G C Evans
Mr Shore
Mr Cropper

Miss Wheldon (T.Sol.)

FINANCE BILL: STARTER NO 650
AMENDMENT OF PUBLIC ACCOUNTS AND CHARGES ACT 1891

This submission seeks your agreement to include a short amendment to the above Act in next year's Finance Bill.

2. The relevant provision of the 1891 Act is Section 2(3) ... (attached). This empowers the Treasury to direct, by means of a Minute laid before Parliament, that certain receipts shall be appropriated in aid of expenditure instead of being paid into the Consolidated Fund. Over the years Section 2(3) has been interpreted, despite certain misgivings, to mean that a Treasury Minute was only necessary to appropriate receipts in aid of expenditure in cases where an Act of Parliament expressly identifying receipts directed that they were to be paid into the Consolidated Fund. As a result, the Treasury has not laid Minutes before Parliament to appropriate in aid other classes of receipts.

3. However we have recently had legal advice that a Treasury Minute under Section 2(3) applies to other classes of receipts as well, because the 'catch all' provision in Section 1 of the ... Civil List Act 1952 (also attached) requires all (or nearly all) Crown receipts to be paid into the Consolidated Fund. The National Audit Office take the view that there is a pressing need to secure legal authority for any appropriation in aid of these other receipts.

4. One solution would be to lay Treasury Minutes for all the categories of receipts affected. We do not advocate this for two reasons. First, it would involve a very major exercise for

departments and Treasury expenditure divisions to identify all the classes of receipt affected and then agree the drafting of the Treasury Minutes needed. Second, additional Treasury Minutes would continue to be needed whenever it was wished to appropriate in aid a new class of receipt, however small.

5. Instead, we favour the more radical solution of removing altogether the need for Treasury Minutes authorising appropriations in aid. We would argue that they serve no useful purpose. They do not enhance Parliamentary control of expenditure because Parliament approves all appropriations in aid year by year in the Supply Estimates. Nor do they assist Treasury control, which is also exercised through the approval of the Estimates. Doing without Treasury Minutes in these circumstances would produce a small, but welcome, saving in administrative effort.

6. Subject to the views of Parliamentary Counsel, the clause we need would probably amend Section 2(3) to provide for Parliament to be informed of Treasury agreement to receipts being appropriated in aid through the presentation of Estimates, rather than Treasury Minutes. The National Audit Office has confirmed that it would be content with this.

7. The clause would be short and uncontroversial. We suggest that it deserves priority because now that the irregularity has been discovered we can expect NAO criticism if we do not take an early opportunity of rectifying matters.

JSB

J S BEASTALL

and be it enacted by the Queen's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows:—

Payment of hereditary revenues to the Exchequer.

1. The hereditary revenues which were by section one of the Civil List Act, 1937, directed to be carried to and made part of the Consolidated Fund shall, during the present reign and a period of six months afterwards, be paid into the Exchequer and be made part of the Consolidated Fund.

Annual payment for the Queen's Civil List.

2.—(1) There shall, during the present reign and a period of six months afterwards, be paid for the Queen's Civil List the yearly sum of four hundred and seventy-five thousand pounds.

(2) In respect of any period during which the Duke of Cornwall for the time being is a minor, the sum payable under the preceding subsection shall be subject to a reduction of an amount equal to the net revenues of the Duchy of Cornwall for the year, less—

(*a*) for each year whilst he is under the age of eighteen years, one equal ninth part of those revenues,

(*b*) for each of the last three years of his minority, thirty thousand pounds,

and the net revenues of the Duchy up to the amount of the reduction to which the said sum is subject by virtue of this subsection shall be at the disposal of Her Majesty.

(3) In respect of any period during which the Duchy of Cornwall is vested in Her Majesty, the sum payable under subsection (1) of this section shall be subject to a reduction of an amount equal to the net revenues of the Duchy for the year.

Provision for His Royal Highness the Duke of Edinburgh.

3. There shall be paid to His Royal Highness the Duke of Edinburgh during his life the yearly sum of forty thousand pounds.

Provision for Her Majesty's younger children.

4.—(1) There shall be paid to the trustees hereinafter mentioned as a provision for the benefit of the children of Her present Majesty, other than the Duke of Cornwall for the time being, yearly sums of the following amounts, that is to say—

(*a*) in respect of each such child who either attains the age of twenty-one years or marries, ten thousand pounds in the case of a son and six thousand pounds in the case of a daughter, and further

(*b*) in respect of each such child who marries, fifteen thousand pounds in the case of a son and nine thousand pounds in the case of a daughter,

to commence from the date of his or her attaining that age or marrying (whichever is the earlier) in the case of a sum falling

(4) Where by any Act heretofore passed, or any bond or other instrument now in force, any payment is required or secured to be made to the Receiver-General of Inland Revenue, or to his account, the Act, bond, or instrument, shall be construed as requiring or securing the payment to be made to the account of the said Commissioners, or to a collector of Inland Revenue, or other person authorised to receive money on behalf of the said Commissioners.

Issues from Exchequer and appropriations in aid.

2.[1] Whereas it is expedient to give statutory authority to the practice with respect to issues from the Exchequer and appropriations in aid—

(1) Where an Act authorises any sum to be issued out of the Consolidated Fund of the United Kingdom of Great Britain and Ireland towards making good the supply granted to Her Majesty for the service of any year, every sum issued in pursuance of that Act shall be applied towards making good the supply so granted at the time of such issue.

(2) All money directed by or in pursuance of any Act (whether passed before or after this Act), or by the Treasury, to be applied as an appropriation in aid of money provided by Parliament for any purpose, shall be deemed to be money provided by Parliament for that purpose, and shall, without being paid into the Exchequer, be applied, audited, and dealt with accordingly, and so far as it is not in fact so applied shall be paid into the Exchequer.

(3) Where any fee, penalty, proceeds of sale, or other money of the nature of an extra receipt is, by virtue of this Act, or of any other Act (whether passed before or after this Act), or otherwise, payable into the Exchequer, the Treasury may by a minute to be laid before Parliament direct that the whole or any specified part thereof shall be applied as an appropriation in aid of money provided by Parliament for the service mentioned in the minute.

[*S.* 3 *rep.* 14 *Geo.* 6. *c.* 6 (*S.L.R.*)]

Commutation of annuities for railways under 52 & 53 Vict. c. 66. 53 & 54 Vict.

4. Whereas by the Light Railways (Ireland) Act, 1889, and the Acts amending the same, the Treasury are authorised to pay for the purpose of light and other railways in Ireland annual sums not exceeding in the aggregate [2twenty-five] thousand pounds a year in addition to the residue, if any, for the time being remaining unappropriated of the sum of forty thousand pounds a year, mentioned in the ninth section of the Tramways

[1 Ext. by annual Appropriation Acts.]
[2 Substituted 56 & 57 Vict. c. 50, s. 1.]

4374/51

CONFIDENTIAL

FROM: J J HEYWOOD
DATE: 17 November 1987

PS/CHANCELLOR

Ch/ Agree with FST's views?
JF 19/11
Agreed.

cc PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Monck
Mr Scholar
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Jenkins OPC
PS/IR

FINANCE BILL 1988: STARTERS 211 AND 212
BUSINESS ENTERTAINING AND GIFTS

The Financial Secretary has considered Mr Elliott's submission of 11 November.

2. He thinks we should definitely press ahead with the removal of the special relief for the cost to businesses of entertaining overseas customers (Starter 211).

3. As for the annual limit for promotional gifts, the Financial Secretary is inclined to drop this Starter (212). There is no pressure for an increase, and the last time the issue was raised in the House it proved unexpectedly sensitive. Given the need to keep the number of minor starters down to the absolute minimum, he would recommend leaving this alone.

J.H.

JEREMY HEYWOOD
Private Secretary

FROM: B H KNOX
DATE: 18 NOVEMBER 1987

Board Room
H M Customs and Excise
King's Beam House
Mark Lane London EC3R 7HE

pwp

Economic Secretary

cc Chancellor
Chief Secretary
Financial Secretary
Paymaster General
Miss Sinclair
Mr Michie
Mr Jenkins,
Parliamentary Counsel

FINANCE BILL 1988: CUSTOMS AND EXCISE STARTER NO. 33

1. This starter is intended to transfer the effect of an Extra-Statutory Concession (ESC) to legislation. The ESC modifies the requirement in the VAT Act 1983 Schedule 4 that goods which form part of the assets of a business which are transferred or disposed of shall be valued for VAT purposes on the original purchase price, so that the value is reduced for used equipment or used goods. The effect is that a credit is given for the input tax deduction to reflect the period of genuine business use before disposal.

2. To transfer the ESC to legislation would require an amendment to the VAT Act 1983 which would amount to prescribing what the value should be for the VAT treatment of disposal of used goods from a business. We had chosen as our route an amendment to Schedule 4 prescribing that value as "the open market value" at the time of disposal. We are reluctant to recommend pursuing this course now as we have been challenged in the VAT Tribunal on the use of this wording in our VAT law in the case of Naturally Yours Cosmetics. The issue has been referred to the European Court of Justice. Similarly, in the Boots PLC case, we are in the throes of agreeing in the High Court further questions on the same issue also to go to the European Court. In the light of the eventual judgment of the Court, we may very well have to change the terminology in the VAT Act.

Internal distribution: CPS, Mr Fotherby, Mr Allen, Mr Jefferson Smith, Mr Cockerell, Ms French

3. The ESC does what we want and we have been under no pressure to remove it - other than in the interests of good housekeeping - and we propose therefore not to continue with this Starter until we have the benefit of the ECJ ruling, which is not expected before the Budget 1988. We would welcome your agreement to drop this starter from the 1988 list.

Bryce Knox

B H KNOX

3741/014

FROM: P D P BARNES
DATE: 19 November 1987

MR KNOX - C&E

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Mr Scholar
Miss Sinclair
Mr Michie
Miss Evans
Mr Jenkins - OPC

Mr Jefferson-Smith - C&E
Mr Cockerell - C&E
Mr Allen - C&E
Miss French - C&E
PS/C&E

FINANCE BILL 1988 : CUSTOMS AND EXCISE STARTER NO.33

The Economic Secretary was grateful for your submission of 18 November.

2. The Economic Secretary agrees with your advice that starter 33 should be dropped from the 1988 list.

P D P BARNES
Private Secretary

CONFIDENTIAL

Inland Revenue

Policy Division
Somerset House

From: M A KEITH
Ext: 6287
Date: 20 November 1987

1. MR McGIVERN (Seen in draft & approved)

2. FINANCIAL SECRETARY

FINANCE BILL 1988 : STARTER NO.204
CAPITAL ALLOWANCES : PRE-CONSOLIDATION

1. This note suggests that Starter No.204 should be dropped but identifies four minor pre-consolidation items which might otherwise have had a place in the pre-consolidation package but which we suggest you will wish to consider for legislation in 1988; that is because they affect the capital allowance provisions which will be changed next year as a result of the (agreed) Starter No.205. Mr Driscoll's note of 12 October dealt with the particular problem for capital allowance purposes where trade assets are transferred from a tax-exempt body to companies within the charge to corporation tax (Starter 205) and paragraph 13 of that note referred briefly to these other technical changes.

---

cc: Principal Private Secretary
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Miss Sinclair
Mr Michie
Mr Cropper
Mr Call
Mr Tyrie
Mr Jenkins, Parliamentary Counsel
Mr Painter
Mr McGivern
Mr Lawrance
Mr Beighton
Mr Pearson
Mr Cleave
Mr P D Hall
Mr Laffin
Mr Calder
Mr Pascoe
Mr Elmer
Mr D Shaw (CD)
Mr Keith
PS/IR

2. The Law Commission, with our support, are preparing to consolidate the 200 or so pages of capital allowances legislation but drafting cannot now begin before April 1988 at the earliest. In the expectation that a Capital Allowances Consolidation Bill would be presented during the 1988/89 Parliamentary Session and become law ahead of publication of the 1989 Finance Bill, we were proposing to invite you to agree that Finance Bill 1988 should be used to make a series of pre-consolidation amendments. These would be mainly technical in nature to put right in advance of consolidation various defects, anomalies etc in the existing law that have emerged in practice.

3. Pre-consolidation legislation is best left until the latest possible Finance Bill before a consolidation bill is introduced, to ensure that all necessary amendments are picked up; many of these will be identified by the draftsman in the course of drafting the consolidation bill. It is now clear that a Capital Allowances Consolidation Bill will not be ready for introduction until 1989 and would not be introduced until after Finance Bill 1989 has had its second reading in the House of Commons. This points very strongly therefore to deferring the general package of pre-consolidation measures to the 1989 Finance Bill.

4. The four items we have identified as candidates for Finance Bill 1988 relate to the special provisions in the machinery or plant code dealing with the situation where a person succeeds to a trade previously carried on by a person with whom he is "connected". Those provisions enable the parties to elect jointly that capital allowances should continue to be calculated as if there had been no change. It is proposed to amend the relevant legislation (Starter 205) to prevent such elections where the predecessor is a tax-exempt body, otherwise the company acquiring the trade could obtain excessive capital allowances.

5. The four changes we propose in this area are to provide a time-limit for the elections; to make it possible for an

election to be made where a partnership is involved; to prohibit elections where either party is not chargeable to UK tax on the profits of the trade; and to provide rules to overcome computational difficulties that arise when the parties are assessed on different bases. These are highly technical points which are described in more detail in the Annex to this submission, with a note in each case of the remedy proposed. They should be non-controversial and would have negligible implications for the Exchequer, Inland Revenue manpower and taxpayer compliance costs.

6. We have not consulted Parliamentary Counsel over the likely length of legislation needed but have assumed it would be about one page. It would seem desirable to deal with these 4 changes and those required for Starter No.205 together in 1988, rather than taking two bites at the same legislative cherry (next year for Starter 205 and again in a later package of pre-consolidation measures for the four other items).

Conclusion

7. If you are content -

a. Starter No.204 can be dropped, and

b. we shall proceed to instruct Parliamentary Counsel to draft for the matters described in the Annex.

M A KEITH

ANNEX

CAPITAL ALLOWANCES : SUCCESSIONS TO TRADES BETWEEN CONNECTED PERSONS

1. General

Where a person succeeds to a trade previously carried on by a person with whom he is "connected" there is a special provision (paragraph 13 of Schedule 8 Finance Act 1971) enabling the parties to elect jointly that capital allowances and balancing charges in respect of machinery or plant used in the trade shall continue to be computed as if there had been no change of ownership. A comparable provision exists (paragraph 4 of Schedule 7 Capital Allowances Act 1968) where an industrial building or structure passes between any taxpayers who are "connected" or "under common control". In each case the effect of an election is to allow the person acquiring the assets to "stand in the shoes" of the person disposing of them with the result that no balancing adjustment is made at the time of change, the successor's allowances are calculated by reference to the tax written down values at that time and the calculation of any later balancing charge takes account of allowances given to the predecessor.

2. Time Limit for Elections

a. The Problem In neither case does the statute provide an explicit time limit for the election so that there is doubt as to when such an election may be made. In practice elections are permitted up to the time when the relevant assessment becomes final and conclusive.

b. Proposed Solution Amend paragraph 13 of Schedule 8 Finance Act 1971 - and the comparable provision in paragraph 4(1) of Schedule 7 Capital Allowances Act 1968 - to require elections to be made within two years of the date of the transactions referred to.

c. Considerations Clarification will help taxpayers and tax advisers to know what is required for a valid election to be accepted. In most other cases where a right of election exists a time limit - generally a two year limit - is provided for in the statute.

d. Exchequer effect Negligible.

e. IR Manpower and

f. Taxpayer Compliance Negligible, but increased certainty will help.

3. **Application to Partnerships**

a. The Problem Existing law precludes an election on most successions to a trade where a partnership is involved. There is no reason in principle for partnerships to be excluded. In practice elections are admitted where there is some degree of continuity - at least one person in common before and after the change.

b. Proposed Solution Legislate to give effect to the current practice for partnerships.

c. Considerations The current practice gives a sensible result. It would seem absurd to consolidate legislation which was to be immediately over-ridden in practice.

d. Exchequer effect Nil. Gives statutory effect to current practice.

e. IR Manpower and

f. Taxpayer Compliance Negligible.

4. Application to Non-Residents/Exempt Bodies

a. The Problem Paragraph 13 of Schedule 8 was intended to achieve broadly the same result under the new system of capital allowances for machinery or plant introduced in 1971 as paragraph 4 of Schedule 7 Capital Allowances Act 1968. But, unlike the 1968 legislation, it does not include a provision prohibiting an election where one of the parties is not resident in the UK and is not trading in the UK through a branch. We have managed so far to maintain the line that this legislation cannot apply for instance where the successor is outside the UK tax net but the position is far from clear. If there were a successful challenge in a case where the price received by the predecessor exceeded the tax written down values of the assets transferred, no balancing charge could be made to recover in effect the excess capital allowances given to the predecessor.

Starter 205 deals with the separate problem where the predecessor is exempt from UK tax and which water privatisation would highlight. Correction of that defect alone would leave open the possibility (admittedly unlikely) of an election where the successor is an exempt body.

b. Proposed Solution Legislate to prohibit an election where the profits of the trade of either party are not within the charge to UK tax.

c. Considerations This tightening of the rules is unlikely to excite much resistance. Like Starter 205 we do not think there can be much argument, if any, about the merits of the case.

d. Exchequer effect No evidence of exploitation of these potential loopholes but blocking will reduce the risk of tax loss.

e. IR Manpower and

f. Taxpayer Compliance Negligible.

5. **Basis Periods**

a. The Problem Computational problems arise whenever the parties to an election are assessed on different bases, in particular where the predecessor is on a preceding year basis and the successor on a current year basis. For example, suppose that an individual (A), who has been in business for many years and makes up his accounts to 31 December, transfers the business on 31 December 1986 to a person with whom he is connected (B) and they jointly elect under these provisions. The capital allowances for A's final year 1986/87 (on a preceding year basis) should take account of expenditure incurred in the year ended 31 December 1985. Allowances for B's first year 1986/87 (on a current year basis) will take account of expenditure incurred in the period 1 January 1987 to 5 April 1987. Thus the whole of 1986 strictly falls out of account for capital allowance purposes.

In practice account is taken of expenditure incurred and of any disposal value received during the gap (1986) in calculating capital allowances for the predecessor's final year.

b. Proposed Solution Legislate to provide for the transfer of assets to take place at a price which will not give rise to a balancing adjustment on the predecessor.

c. Considerations The practice achieves a reasonable result but a simple statutory rule is needed before the legislation is consolidated.

d. Exchequer effect Nil.

e. IR Manpower and

f. Taxpayer Compliance Negligible.

CONFIDENTIAL

H.M. CUSTOMS AND EXCISE
KING'S BEAM HOUSE, MARK LANE
LONDON EC3R 7HE
01-~~626 1515~~ 382 5101

1. Mr Knox 20/4

2. Economic Secretary

FROM: W F McGUIGAN
DATE: 20 NOVEMBER 1987

cc Chancellor
Chief Secretary
Financial Secretary
Paymaster General
Mr Culpin
Miss Sinclair
Mr Michie
Mr Cropper
Mr Jenkins (Parliamentary Counsel)

STARTER NO 10: EXCISE : OIL DUTIES RELIEFS

Summary

1. As Ministers told the Commons in response to Finance Bill debates in 1985, extra statutory concessions (ESC's) are reviewed each year to allow consideration of them as candidates for legislation. Hydrocarbon oil ESC's account at present for more than a quarter of Customs and Excise non-VAT concessions (6 out of 19), and some have been in effect for many years. This starter proposes a short enabling provision allowing statutory effect to be given to the desired concessions through Commissioners' regulations. A convenient opportunity to make such regulations will arise in the course of 1988/89, since the general control regulations for hydrocarbon oil are then due to be consolidated, with a variety of amendments. This starter was also considered last year, but dropped for lack of space.

Internal Distribution:

CPS
MR KNOX
MR JEFFERSON SMITH
SOLICITOR
MR NISSEN
MR BREUER
MR ALLEN
MR BERRY
MR GAW
MR BOARDMAN
MS NOONAN

Background

2. The hydrocarbon oil legislation provides for duty to be charged at full rates on oils for use as road vehicle fuel, chiefly petrol and derv (19.38 pence and 16.39 pence per litre respectively). Much lower effective rates are charged on gas oil and fuel oil (1.1 pence and 0.77 pence per litre respectively) and other oils such as lubricating oil bear an effective nil rate of duty. For historical reasons, the lower and nil effective rates of duty are achieved in law by allowing an appropriate rebate against the full rate of duty at the time the oil is delivered for dutiable consumption. The governing legislation, the Hydrocarbon Oil Duties Act 1979, also provides for a number of reliefs from these lower "rebated" rates of duty, for example for oil used by approved persons for industrial purposes (other than as fuel or lubricant).

3. The 1979 Act was a consolidation measure, and retains much of the particularity of the previous legislation, dating back to 1952 and 1960. The relief provisions spell out in detail whether reliefs can be given by remission, or repayment, or both, and to whom repayments may be made. Unfortunately, these provisions do not always meet current trade needs or administrative practice, particularly since the 1985 Oil Warehouse Review (OWR), which markedly reduced the number of bonded warehouses for hydrocarbon oils.

4. There is also a range of circumstances where on grounds of equity or to conform to an international obligation it is desirable to remit or repay a duty charge but legal provision allowing this is absent. The more recent legal codes governing tobacco products duty, wine and made-wine duties and excise warehousing make general provision, in addition to any specific reliefs, for relief from duties to be allowed in cases prescribed by regulations, but there is no such provision in the 1979 Hydrocarbon Oil Duties Act.

Existing ESC's

5. The 6 extant concessions for hydrocarbon oil are as follows:

a) duty credit on waste etc oil delivered to refiners for recycling (No 8 in Customs and Excise Notice 748)

b) duty repayment on duty-paid oil deliveries to home waters relief use (No 9)

c) allowing fairground showmen to use rebated oil in the engines of their immobilised vehicles to generate electricity for fairground use (No 10)

d) relief for aircraft fuel loaded in the UK to complete an inward international airline journey (No 11)

e) duty repayment on duty-paid oil deliveries to bonded users/ distributors (No 12)

f) duty repayment on duty-paid oil delivered to a refinery for use as fuel (No 13).

Further details, together with the reasons for the concessions and an estimate of their individual cost, if any, are at Annex A.

6. Use of concession No 11 by piston-engined aircraft is now negligible, and if there are no presentational reasons internationally for maintaining it, it may prove possible to cancel it. Concession No 8 is also likely to be recast, to limit its general scope to repayments at rates not exceeding the relevant rebated rate of duty. Otherwise, the concessions are set to continue.

Legislation

7. The enabling provision we seek would permit the Commissioners to provide by regulations for the remission or repayment, in whole or in part of any of the duties charged under the Hydrocarbon Oil Duties Act 1979 in such cases and subject to such conditions as might be prescribed by or under the regulations. For completeness, petrol substitutes duty and road fuel gas duty,also charged under the 1979 Act, should also be covered. We have not consulted Counsel, but on the basis of similar existing provisions we estimate the length of legislation required to be up to five lines in the section and between a quarter and a half page in a schedule.

Compliance costs

8. The proposal involves no extra administrative costs for the trade.

Caveat

9. A possible disadvantage of legislating is that it would give the motor industry a debating point if, as seems likely, it again seeks relief from duty on petrol used for research and testing.

Conclusion

10. I would be grateful for your agreement in principle to include amending legislation in the 1988 Finance Bill, and for authority to instruct Parliamentary Counsel to draft.

W F McGUIGAN

HYDROCARBON OIL ESC's AT 1 OCTOBER 1987

Description of concession and Number in Notice 748 list	Why needed	When introduced	Approx Annual cost
8. Recycling of waste oil When hydrocarbon oil delivered from a refinery for home use on payment of duty has been produced wholly or in part from oil on which duty has previously been paid and not repaid, Customs and Excise may allow such credit of duty as they deem to have been previously paid.	To prevent double taxation when the recycled oil is charged to duty on removal from the refinery.	1947, but regularised as an ESC in 1982.	£250,000 credit but duty charged on removal exceeds credit allowed.
9. Hydrocarbon oil, duty paid, for use in home waters Provided Customs and Excise are satisfied that heavy oil has been delivered on board a vessel for use as fuel on a voyage in home waters, they may repay any duty which they are satisfied has been paid and not repaid on the quantity of oil so delivered, subject to the conditions which would apply if the oil concerned had been delivered from a refinery or warehouse without payment of duty.	The law permits repayment only to owner of ship, not to his oil supplier.But for the concession, more warehouses would need to remain bonded to supply duty-free oil just for this purpose.	1985 in conjunction with Oil Warehouse Review (OWR).	£1 million gross but nil effective revenue cost.
10. Hydrocarbon oil for fairgrounds etc Fairgrounds etc showmen may use rebated hydrocarbon oil in the engines of their vehicles to generate electricity provided	Licensed vehicles, even when used off the roads, normally	1963	About £700,000

the vehicle is immobilised by disconnection of the propellor shaft, and the fuel is supplied from a tank entirely separate from the vehicle.	bear the full rate of duty on their fuel, and the law requires showmen to pay back "an amount equal to rebate" on rebated oil so used. For these vehicles, in these circum-stances, that would not be equitable.		
11. Hydrocarbon oil for aircraft of overseas airlines Excise duty need not be paid on hydrocarbon oil loaded in the UK by aircraft of overseas airlines and used to complete their inward international flights.	To meet an international obligation, and secure valuable reciprocity for UK air-lines abroad. UK law makes no provision for remitting the duty charge in these circumstances.	1972	Nil as regards aviation kerosene (jet fuel), duty-free since 1986, but may be residual benefits for some piston-engined aircraft using aviation spirit (avgas). Negligible cost.
12. Hydrocarbon oil delivered duty-paid to bonded distributors and bonded users When duty paid oil is delivered to a bonded distributor or bonded user approved to receive that kind of oil duty free, Customs and Excise may repay the duty	Law makes no provision for such repayment. But for the concession, more ware-houses would	1985 in conjunction with OWR.	About £200,000 gross but nil effec-tive revenue cost.

to the supplier, subject to the same conditions as apply to duty-free deliveries.	need to remain bonded just to supply duty-free oil for these purposes.		
13. **Hydrocarbon oil delivered duty-paid for refinery boilers** When unused duty-paid hydrocarbon oil has been delivered to an approved refinery for use as fuel to produce energy, Customs and Excise may repay to the supplier the duty paid, and not repaid, on the delivery.	The law allows supply of oil duty-free for this purpose, but makes no provision for relief by repayment. But for the concession, more warehouses would need to remain bonded just to supply duty-free oil for this purpose.	1985 in conjunction with OWR.	Not exceeding £100,000 gross, but nil effective revenue cost.

1777.54

RESTRICTED

FROM: CATHY RYDING
DATE: 20 November 1987

1. MR C W KELLY
2. ECONOMIC SECRETARY

cc: PPS
Sir P Middleton
Sir G Littler
Mr Cassell
Mr Scholar
Miss Sinclair
Mr Peretz
Mr Watts
Mr Kelly
Mr Cropper
Parliamentary Counsel
Mr Jenkins T Sol
Mr Dancy B/E

1988 FINANCE BILL: TREATMENT OF GILTS REDEMPTION MONEYS AND SMALL ESTATES (STARTERS 651 AND 652)

This minute seeks your agreement to two minor Finance Bill starters. The starters are quite separate, but both would simplify current procedures at the Registrar's Department of the Bank of England in relation to gilt edged stock. The more important concerns redemption moneys; the other, small estates of deceased stockholders. It would be helpful to have your decision in principle (subject to space) ahead of the Chancellor's meeting to review minor starters next Tuesday.

Gilts Redemptions Moneys

Background

2. The Bank's present practice for paying gilt redemption money follows the prescriptions of the Finance Act 1921 and the Government Stock (Redemption) Regulations 1924. Three months or so before the redemption date a form is issued to the sole or first named holder on each account and a notice to other holders; the form has to be signed by all the holders and returned with the certificate. Once

the signed form and certificate are received and found to be in order, the Bank can make payment on the due date. If they are not returned, the Bank are unable to make any payment and the Government retains use of the redemption money.

3. There are two main problems with the current procedure. The first is that it is administratively cumbersome and time-consuming for the Registrar's Department: all returned forms have to be examined, and there is further clerical effort if the form is not returned properly completed or when certificates are mislaid. It may also involve inconvenience for the stockholder (for example when the signatures of all the joint holders of a stock are required).

4. The second problem arises when the stock holder is known to the Bank to have died. Until evidence of title has been properly established, unclaimed redemption moneys are retained by the authorities without payment of interest (for which there is no legislative provision). This has led to a number of understandable complaints from heirs. In response to such cases, a grace and favour practice has developed which may be ultra vires. When the Bank learns that there may be significant delay in establishing title, they usually offer to reinvest the redemption money in another gilt of the correspondent's choice under an indemnity; this practice is long-standing and normally good for customer relations. But as well as having no statutory cover (which could bring Accounting Officer problems), it also risks the possibility of complaint and even legal liability for the Bank (eg in respect of an investment challenged by a beneficiary under a will for yielding what he regards as an insufficiently favourable return). These issues were explained at some length by Mr Richardson's submission of 9 April - copy attached (top only); your predecessor agreed that existing practice should continue for the time being, and that further work should be done to resolve the problem.

Proposals

5. To combat the administrative drawbacks the Bank have proposed a new streamlined procedure. Under the new payment system proposed, the Bank would write to the sole or first named holder on each account and also to any joint holder notifying that a warrant for the redemption moneys would be sent to the sole or first holder's registered address unless contrary instructions were given. This would bring the arrangements for the payment of redemption money onto the same footing as for gilts dividends, and would be in line with the practice of a number of commercial registrars. The Bank also intend to insert a new paragraph on new stock certificates indicating that under the new procedures, the certificates of title would cease to be of value after the redemption date.

6. To combat the second problem (where the Bank knows the stockholder to have died) we propose that the Bank be given the power if they wish to place the redemption money due to a deceased stockholder on deposit in an interest bearing account. This power would probably only be exercised by the Bank in respect of larger holdings and probably only after a prescribed period of delay. It would be broadly equivalent to the powers already enjoyed by the DNS (under NSSR Regulations 1976 s45(3)) in respect of redemption moneys from gilts held on the NSSR. The legislation proposed would therefore ensure that in these circumstances stockholders and heirs were accorded similar treatment, wherever their gilts were registered. If you agree with this proposal we will submit further recommendations on how the details of the deposit scheme would work in practice.

Assessment

7. The administrative proposal should make life easier for stock holders; they would need do nothing to receive their redemption money. If stockholders wanted a different kind of payment they

would simply return the form to the Bank - as they have to do now before receiving payment. The only right they would lose would be the removal of the option to have payment in cash over the counter at the Bank of England (an option that is rarely if ever exercised).

8. One concern, however, is what happens to gilt holders who have changed addresses and have failed to notify the Bank. The Bank say that the proposed procedures are exactly the same as those currently employed for gilts dividends (although some dividends are paid directly into holders bank accounts) and are in line with the practice of a number of commercial registrars. The Bank claim that when problems have arisen with misappropriation of gilts dividends (and there have not been many of these) they have always successfully contested that the fault lay with the banks who cashed the warrant. They have been able to do this because of a provision in the legislation covering dividend payments that "posting equals delivery". This provision is also included in the existing legislation for gilt redemption moneys and the Bank propose that any new legislation should continue this protection.

9. The main advantage of the second proposal is that by putting the Bank's activities on a secure legal footing it resolves any potential Accounting Officer difficulties. As things stand at the moment, the expenditure may be ultra vires, despite the fact that it has been going on for some sixty years. The expenditure is improper and would leave the Accounting Officer (in this case Sir P Middleton) exposed to adverse criticism from the NAO. We have no reason to believe that the NAO would take action in the short run providing we propose to act at the first opportunity to put this expenditure on the correct basis. This presents a strong case for inclusion in this year's Finance Bill.

10. The new procedures would enable the Registrar's Department to save perhaps 6 posts at an annual costs of £60K or so. The benefit of this saving should accrue to the Treasury's PES. Against this would be the loss to HMG of the interest-free benefits of redemption money that is currently unclaimed or awaiting probate. How much

would be foregone here is difficult to estimate, since the amount of capital unclaimed varies with the age and type of stock involved. Experience over the last eighteen months shows that the amount outstanding after one month has varied from £280K to £8.1m (or from 0.03% to 1.3% of the stock's total capital value); and after six months from £80K to £2.3m (0.01% to 0.4% of capital value). However we do not think that it would be reasonable to abandon the reforms to preserve uncovenanted benefits of somewhat dubious validity.

11. The legislative changes needed would be technical and non-controversial, and fairly short (ie a couple of clauses and some new regulations). We recommend accordingly.

Small Estates

12. A second issue concerns small estates. When the owner of a small (less than £5000) holding of gilts dies, the Director of National Savings has discretion to dispense with the sight of a Grant in dealing with the holding - provided the stock is held on the NSSR. The Chief Registrar has no such powers in respect of small holdings registered at the Bank. In such cases, the Chief Registrar's normal practice - when the stock is an NSSR stock - is to transfer the holdings to the NSSR so that it can be dealt with by the DNS. If the stock is not on the NSSR, other procedures are followed involving in some cases Statutory Declarations, and in others bankers' indemnities.

13. Current procedures thus cause duplication of effort in the Bank and at the NSSR. As well as saving administrative time, more discretion for the Bank would benefit the heirs to small holdings, insofar as the procedure for establishing legal title would be simplified. Over a sample twelve month period the Bank dealt with 2500 small estates, a quarter of which were transferred to the NSSR.

14. The Bank have therefore proposed legislative provision to allow them to dispense with the exhibition of a Grant where the owner of a small holding dies and place the stock at the disposal of the person to whom it seems that legal title will pass; and to give them an appopriate indemnity on the lines given to the NSSR.

15. We support the administrative streamlining proposed. The legislation needed would be short (one clause) and non-controversial. The measure is desirable but not essential, and could well have to yield priority if space problems becomes acute. We meanwhile recommend it for inclusion in the Bill.

Summary

16. We would be grateful for your agreement that, subject to the availability of space, measures to simplify the Bank's payment of gilts redemption moneys and to streamline the handling of small estates be included in the 1988 Finance Bill; and that work should be set in hand with Parliamentary Counsel accordingly.

Cathy Ryding

CATHY RYDING