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PART A

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PART A

BUDGET 1985 INDIRECT TAXES

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PO -CH /NL/0036
PART A

320.53

BUDGET SECRET

N/2

Copy no 23 of 24
SPARE

RECORD OF A MEETING HELD IN HM TREASURY AT 11.45 am ON 21 NOVEMBER 1984

Present: Chancellor
Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr A Wilson
Mr Battishill
Mr Monger
Mr Griffiths
Mr Peretz
Mr Cropper
Mr Lord

Mr Fraser)
Mr Knox) C&E
Mr Jefferson Smith)
Mrs Boardman)

The meeting considered Mr Knox's submissions of:-

(i) 19 November on "Extension of the VAT base";

(ii) 16 November on "Consumer Credit Duty";

(iii) 19 November on "Excise Duties and Car Tax".

The meeting followed the annotated agenda circulated under Mr Monger's minute of 20 November.

VAT

2. In reply to questions from the Chancellor, Mr Fraser said those areas of gambling not covered by the EC Sixth Directive (eg bingo halls) were already subject to VAT; and there was already a tax on the margin between buying and selling second-hand cars which was part of an established scheme.

3. The Minister of State said he had concluded that it would be wrong to look for any extension of the VAT base in the 1985 Budget. The Financial Secretary said that if there was to be any extension he felt it should fall on newspapers, magazines, and children's clothing. Other Ministers and advisers stressed the political difficulties of any extensionin foods, including tea and coffee.

4. The Chancellor recognised that any attempt to cast the net wider in the food area would be difficult, and could cause great demarcation problems. He concluded that an extension to tea, coffee and cocoa was the only real option on food. It should be retained as a Budget starter, though he was keenly aware of the lack of support for such a measure. No further work on other foodstuffs was required.

5. It was noted that a 1 per cent rise in the standard rate would yield £890 million gross, roughly the same as the package of extensions mentioned, and with roughly the same impact on the RPI (½ per cent). Mr Fraser said that this would be easier administratively for Customs and Excise than VAT extensions. On the other hand, the extra 1 per cent would not help mental arithmetic and there would have to be large scale relabelling in shops, and the gap between VAT and zero-rated goods would widen, which could encourage evasion.

6. It was agreed that this option should be retained as a possibility. It was also agreed that the aim should be to tailor the whole Budget package so as to hold the impact on the RPI to around ½ per cent the same rule of thumb as was adopted for the 1984 Budget.

7. The Chancellor said he did not wish to press for VAT on books, but VAT on newspapers and magazines, which had been

dropped from the 1984 Budget at a late stage, remained a possible starter. The Financial Secretary and Economic Secretary agreed.

8. The Chief Secretary said that it was not politically realistic to plan to tax newspapers, since backbenchers would not support it. So magazines and free sheets should also remain exempt this time around. The Minister of State agreed. Mr Cropper acknowledged that it might be difficult to handle in Parliament, but felt that the British people might actually enjoy seeing some of the national newspapers suffer, if not the regional press. Mr Lord felt it would be right in principle to put VAT on newspapers, but noted that criticism would affect the whole reception of the Budget.

9. The Chancellor noted that this raised difficult questions about the possibility of taxing free sheets. The Minister of State reported that the Newspaper Society certainly took the view that VAT on newspapers would seriously damage their competitive position with regard to free sheets.

10. The Chancellor said that he personally felt that taxing newspapers would be even tougher politically than taxing tea and coffee. But it should be left in as a Budget Starter for the time being. Although special taxation of free sheets had to be ruled out, primarily because it would be difficult to determine an equitable basis for the tax charge that would not be open to challenge under the VAT Sixth Directive, VAT on news services and newspaper advertising - a potentially bouyant source of revenue - should certainly be pursued.

11. The Chancellor said he was attracted by the option of VAT on children's clothing. Mr Fraser noted that the yields fell considerably, from around £220 million to around £60 million, if compensation were to be paid. But the

Chancellor argued that compensation would not be necessary, since those on supplementary benefit would receive it automatically and others did not need it. It was agreed that VAT on children's clothes should remain a starter, but that the option of VAT on children's footwear should be dropped.

12. It was agreed that there was no need yet to consult colleagues from other departments on the issues in this area, which were all, in principle, relatively straightforward.

Consumer Credit Duty

13. The Chancellor said that a Consumer Credit Duty looked very difficult without mortgages included, but that consumer credit duty on mortgage interest and mortgage interest relief would be seen as contradictory. If there was a front-runner, it was a half per cent across the board.

14. The Financial Secretary said that the banks were not placed to cope with this change in 1985. The Economic Secretary agreed, but said he was attracted in theory to the proposal, provided it included mortgages. Under new building society legislation, more people would borrow against mortgages, so such a duty was a necessity. The Chief Secretary said he was against the proposal and Mr Cropper agreed that it would be difficult. The Minister of State was attracted to the idea, but not for the 1985 Budget. Mr Cassell said that the banks' computers were already strained by adjusting to the composite rate and preparing to switch from banking to calender months.

15. The Chancellor said that he did not believe that the costs of a consumer credit duty would stick with the banks, but he agreed that this was an inappropriate time to impose

a measure of this kind upon them. He agreed with Mr Battishill that it should be a firm starter for the next Parliament.

Excise duties and car tax

16. The Chancellor thought that raising extra revenue from Excise duties, over and above revalorisation, should be seriously considered. Tobacco was the easy candidate. Mr Fraser said that the tobacco industry was not in a healthy state and he doubted whether they could take large increases in every Budget. The Minister of State said he had recently met with representatives of the tobacco industry and he felt that they could perhaps sustain one-and-a-half times revalorisation in 1985.

17. The Chancellor noted that wine was greatly under-taxed, although under EC rules tax on wine could not be raised without also raising tax on beer. Abolition of stock relief had been a major setback to the whisky industry, so the most that could be done in the case of spirits would be to revalorise. Mr Fraser agreed to explore ways of more than revalorising beer and wine, while leaving whisky and other spirits with simple revalorisation.

18. The Chancellor said that he wished to do no more than revalorise petrol, although he agreed with the Minister of State's suggestion that slight upwards rounding could yield a large amount of revenue.

19. It was agreed to leave car tax unchanged at 10 per cent in 1985.

PWO.

P WYNN OWEN

28 November 1984

cc Those present

BUDGET SECRET

CH/EX REF NO D/1
COPY NO 1 OF 23 COPIES

FROM: P WYNN OWEN
DATE: 7 December 1984

CORRIGENDUM TO A RECORD OF A MEETING HELD IN HM TREASURY AT 11.45AM ON 21 NOVEMBER 1984

Paragraph 10 of my record dated 28 November 1984 should be amended to read:-

"10. The Chancellor said that he personally felt that taxing newspapers would be even tougher politically than taxing tea and coffee. But it should be left in as a Budget Starter for the time being. VAT on news services and newspapers advertising - a potentially buoyant source of revenue - should certainly be pursued. On taxation of free sheets, he asked Customs and Excise to pursue option (c) in paragraph 10 of Annex 2 to Mr Knox's paper of 19 November on "Extension of the VAT base."

2. Sir Peter Middleton was not present at the meeting.

PWO.

P WYNN OWEN

7 December 1984

Circulation:

Chancellor
Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr A Wilson
Mr Battishill
Mr Monger
Mr Griffiths
Mr Peretz
Mr Cropper
Mr Lord
Mr Fraser (C&E)
Mr Knox (C&E)
Mr Jefferson Smith (C&E)
Mrs Boardman (C&E)

Budget Ref J10.
Copy No. 1 of 25.

NOTE OF A MEETING IN H.M. TREASURY AT

2.30 PM MONDAY 21 JANUARY

Those present

Chancellor of the Exchequer
Financial Secretary
Minister of State
Sir P Middleton
Mr Bailey
Sir T Burns
Mr Byatt
Mr Cassell
Mr Monck
Mr Battishill
Mr Monger
Ms Seammen
Mr Cropper
Mr Green - IR

NATIONAL INSURANCE CONTRIBUTIONS

The meeting discussed Mr Monck's submission of 18 January.

2. The Chancellor asked for views about the relative priority to be attached to reducing employers National Insurance Contributions as against raising tax thresholds. In discussion it was agreed that:-

(i) reducing NIC was presentationally attractive; the argument that raising tax thresholds helped employment was not making much headway.

(ii) large changes in tax thresholds would be needed to have significant supply side effects; this would take a number of years.

(iii) tax thresholds would be more helpful on the pay front.

MINUTES OF NICs MEETING 21/1

(iv) tampering with the insurance principle by divorcing employers and employees NIC's could set up pressures for the progressive elimination of employers NICs; though parity between employers and employees contributions might be a natural stopping point.

(v) while reducing the NIC rate was expensive, especially in gross terms, it might be worth using some of the fiscal adjustment to pay for a restructuring package.

3. The Chancellor said that, on economic grounds, there was not much to choose between reducing employers NICs and raising tax thresholds; both should probably feature in a balanced package.

Restructuring NICs

4. The Chancellor said he was still attracted to divorcing the employers NICs from the employees contribution and abolishing the upper earnings limit. But he still found the Byatt "twist" very unappealing largely because it involved a rise in the employers' marginal rate.

5. Turning to the options in Mr Monck's submission, the Chancellor said he did not want to pursue the idea of a payroll tax; it was clearly too late for this year. Ending the tax deductibility of employers NICs was also a non starter, since it has been suggested in the context of a payroll tax. In discussion, it was pointed out that ending tax deductibility would have advantages for companies temporarily going through a bad patch, but it would be particularly unpalatable to successful small businesses. It would create great upheaval, in return for a largely cosmetic reduction in the rate.

6. The Chancellor identified four options for restructuring employers NICs at the lower end of the earnings distribution:-

(i) turning the lower earnings limit (LEL) into a threshold.

(ii) leaving the lower earnings limit unchanged.

(iii) abolishing the lower earnings limit.

(iv) raising the lower earnings limit (but keeping it as a limit).

7. It was agreed that both (i) and (iii) would reduce the present bias in favour of part time work. But option (i) was very expensive and option (iii) would greatly increase administrative burdens especially on very small concerns. Exempting small companies from employers NICs altogether was unlikely to be workable; it would be expensive to take out any but the very smallest concerns, and the change would create its own distortions which could damage employment at the margin. Nor was raising the lower earnings limit (option (iv)) attractive. The lower earnings limit created a sharp jump in marginal employment costs. At its present level this mainly affected the choice between full time and part time employees. At a higher level it could distort full time employment patterns.

Further work

8. The Chancellor asked for further work on a package that would abolish the upper earnings limit, and both reduce the lower earnings limit and turn it into a threshold. This should look at the implications of:-

(i) a revenue neutral package.

(ii) no change in the employers marginal contribution rate.

(iii) a number of variants on (ii) with different net revenue costs, achieved by assuming different levels of the lower earnings threshold.

This work should look at the distributional effects on different kinds of firms and consider the administrative, legal and timing aspects.

Ruo.

pp MRS R LOMAX
22 January 1985

Distribution

Those present
PS/CST
PS/EST
Mr Littler
Mr Odling-Smee
Mr Lord
Sir L Airey - IR
Mr Isaac - IR
Mr Fraser - C&E

CH/EX REF NO F8
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NOTE OF A MEETING IN HM TREASURY
AT 2.15PM ON FRIDAY 1 FEBRUARY 1985

Those Present:

Chancellor
Financial Secretary
Sir P Middleton
Mr Bailey
Sir T Burns
Mr Byatt
Mr Monck
Mr Battishill
Mr Broadbent
Mr Cropper
Mr Cassell
Mr Short
Ms Seammen
Miss Noble
Mr Monger

Paper:

Ms Seammen's minute of 31 January.

RESTRUCTURING EMPLOYERS' NATIONAL INSURANCE CONTRIBUTIONS

The Chancellor said that he wanted to consider the various NIC options as potential claims on the fiscal adjustment, rather than as revenue neutral schemes. Costings were crucial; further work should assume full claw-back from the public sector. He noted that the employment effects were speculative; they were not for public consumption.

2. Ms Seammen's paper discussed four broad options. All include abolition of the upper earnings limit (UEL).

- Option 1: a linear taper.

- Option 2: a curved taper.

- Option 3: Mr Fowler's scheme with a £100 lower earnings limit (LEL).

- Option 4: using the proceeds of the abolition of the UEL to reduce the employers' marginal rate.

All four could in principle be done either on a revenue neutral basis or with an injection of cash, though there is little difference between options 1 and 2 on a revenue-neutral basis.

3. The Chancellor said he was strongly against schemes which required an increase in the employers' contribution rate. From the presentational standpoint there was a premium on simplicity. While options 1 and 2 did something to mitigate the distortions created by the LEL they were undeniably complicated. Options 3 and 4 did nothing on the LEL but they were very straightforward.

4. In discussion it was agreed that there would be strong pressure for option 3. It emanated from the King group and followed the Layard proposals. It had presentational attractions; it was best on short term employment and it would help full time youngsters. But it had substantial disadvantages. The higher LEL would create distortions at a more critical point in the earnings distributions. It would promote job splitting and evasion. And there would be pressure to make further increases in the LEL. Unless considerable sums were spent on the scheme it would also lead to a rise in the employers' marginal rate. It was agreed that the Treasury should resist this option; but strong arguments would be needed to win the day.

5. The real choice was between option 1 and 4. While option 1 looked more rational it simply replaced the "cliff-edge" by a series of little steps, each of which would create its own distortions. There might be continuous pressure to modify the scales. Option 4 did not address the LEL which is perceived as the major distortion in the current NIC system. And while

it reduced the cost of labour for those below the UEL, the benefits were spread rather thinly. But it might be easier to resist pressure for further modification; parity between the employer and employee contribution rates represented a natural stopping point.

6. The Chancellor commissioned:-

(i) further work on costings which would allow for full claw-back from public sector and make realistic assumptions about the scope for "fiddling" under option 3.

(ii) some succinct briefing outlining the pros and cons of options 1 and 4 and summarising the arguments against option 3. At this stage it would be wise to downplay the numbers in discussions outside the Treasury.

RL.

MRS R LOMAX

Distribution:
Those present

BOX.

CONFIDENTIAL

FROM: VIVIEN LIFE
DATE: 4 FEBRUARY 1985

MR CASSELL

c.c. PS/Chancellor
PS/FST
PS/EST
PS/Sir P Middleton
PS/Sir T Burns
Mr Monck
Mr Battishill
Mr Burgner
Mr Evans
Mr Lovell
Mr Monger
Mr Odling-Smee
Mr R I G Allen
Mr Robson
Ms Leahy
PS/IR
Mr Green/IR
Mr Beighton/IR
Mr Crawley/IR

NORTH SEA FISCAL REGIME

For the sake of accuracy, Inland Revenue have asked us to clarify one point in your minute of 1 February. In Para 8, while Department of Energy do see some interaction between most of the minor items and a reduction in E&A allowances, they do not see any such difficulty with the minor technical amendment to the OTA 1983 mentioned at para 4(iv) of the Steering Group Report.

Vivien Life.

VIVIEN LIFE

CONFIDENTIAL

BUDGET CONFIDENTIAL

FROM: MRS R LOMAX
DATE: 4 February 1985

CH/EX Ref No: F2

Copy No: 11 of 13 copies

SIR L AIREY - IR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Battishill
Mr Monger

GREEN PAPER ON PERSONAL INCOME TAX

Following his weekend discussion with the Prime Minister, the Chancellor is still in two minds about whether the proposed Green Paper on personal income tax reform would be a good idea. To assist him in coming to a view, he would be grateful if you could give some preliminary thought to the shape and content of such a paper.

RL.

MRS R LOMAX

BUDGET SECRET

FROM: MISS M O'MARA
DATE: 14 February 1985
CH/EX REF. NO. F40
COPY NO. 1 OF 16 COPIES

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mr Monck

Mr Battishill
Mr Monger
Mr Griffiths
Mr Cropper
PS/IR
PS/C&E

NOTE FOR THE RECORD

MEETING WITH MR RIDLEY: 1985 BUDGET

The Secretary of State for Transport called on the Chancellor this evening to discuss with him possible Budget measures which impinged on his Departmental responsibility.

VED

2. The Chancellor recalled that he had agreed with Mr Ridley earlier in the day that VED on cars and light vans should be set at £100.

3. He noted that the lorry package set out in Mr Ridley's letter of 22 January produced the equivalent of revalorisation of all the lorry rates by concentrating increases on the heavier rigid vehicles, leaving duty rates on articulated lorries unchanged. He said he would

be grateful if Mr Ridley could slightly alter his package to secure an additional £10 million from lorries (equivalent to 1½ times revalorisation), partly at least by making real increases on articulated vehicles, especially at the heavier end. He pointed out that he needed the additional revenue and that as he was only proposing revalorisation for the duty on derv, the road hauliers would have no cause for complaint on that score. Moreover, he believed it would be difficult politically if the package appeared to favour juggernauts.

4. Mr Ridley felt it would be difficult to implement a package of the kind the Chancellor had proposed. Juggernauts were already grossly over-taxed in relation to their track costs. He was willing to find another £10 million for the Chancellor but he did not believe he could increase the tax on heavier lorries. The industry had made a heavy investment in articulated lorries. These were the most efficient form of road haulage vehicle and the Government should not seek to discourage their use. He thought it might be possible to increase the tax on them by a very small amount but stressed that it was important not to get the tax system out of kilter, or there was a risk that the Government would lose the track costs argument entirely.

5. The Chancellor said that, given Mr Ridley's agreement to secure an additional £10 million, he was content to leave the decision on the shape of the package to him but emphasised that he would be grateful if he could increase the tax on articulated lorries to whatever extent he felt able to do so.

6. The Chancellor said that he was content with the remainder of the package which Mr Ridley had proposed but wondered whether there was a case for making no increase at all in the tax on pre-1947 cars in order to retain the good will gained in 1984. He noted that if the tax on cars and light vans were raised to £100, there should be a proportionate increase in the tax on pre-1947 cars to £67 but the revenue implications of forgoing any increase would be negligible. Nevertheless, he would not want to press this point if Mr Ridley felt strongly. Mr Ridley said that his initial reaction was to welcome the proposal and it was agreed that no change would be made, unless Mr Ridley informed the Chancellor to the contrary the following day.

CHANCELLOR OF THE EXCHEQUER

Shipping

7. The Chancellor said that it would be very difficult for him to make any concessions to the shipping industry this year. He pointed out that taxation was in any case not the real problem which the shipping companies faced, although they would, of course, be grateful for any relief which he might be able to offer. He suggested that only two of their proposals were worth further examination.

8. First, the industry had asked that the BES should be extended to shipping. However, despite initial sympathy for their case, he had concluded that there was no sensible way of extending the BES as they had requested. Mr Ridley expressed some disappointment and asked whether it would be possible to limit the extension to ships operating in the North Sea and to coasters etc. The Chancellor noted that the Financial Secretary had explored this area very thoroughly but agreed that it might be re-examined for 1986.

9. Second, the Chancellor told Mr Ridley on a personal basis that he was considering a concession on second-hand ships. He hoped it might be possible to extend the capital allowance treatment of new ships to second-hand ships at a reasonable cost but at present he thought it more likely that the measure would finally have to be ruled out.

10. Mr Ridley said that of the two proposals, he believed a concession on second-hand ships was politically the more important and he urged the Chancellor to concentrate on that, although he acknowledged it would meet opposition from DTI.

MOM

MISS M O'MARA

BUDGET CONFIDENTIAL

NOTE OF A MEETING HELD IN No.11 DOWNING STREET AT 4.10 pm ON TUESDAY, 12 FEBRUARY 1985

Those present:

Chancellor of the Exchequer
Financial Secretary
Mr Cassell
Mr Crawley - IR

Secretary of State for Energy
Minister of State
Sir Kenneth Couzens
Dr Myerscough

NORTH SEA FISCAL REGIME

Opening the meeting, the Chancellor said that he had to view changes in the North Sea fiscal regime against the background of a very tight budgetary situation. He pointed out that the North Sea oil industry had benefited substantially from the 1984 corporation tax changes, although clearly he had not been able to make this point publicly.

2. Turning to his specific proposals, the Chancellor noted that officials had undertaken an extremely thorough review of incrementals and the outcome had clearly indicated that there was no case for any Government action. On exploration and appraisal allowances, he drew attention to the direct link with his 1984 reforms. He thought there was a very strong case for saying that expenditure in this area should no longer be eligible for the Scientific Research Allowance (SRA) but should simply receive a 25 per cent reducing balance allowance. However, this expenditure had hitherto been eligible for the 100 per cent SRA and he was proposing to retain the SRA at 100 per cent for genuine scientific research. He therefore proposed that expenditure on exploration and appraisal should

receive a 25 per cent reducing balance allowance but that there should be immediate write-off if and when expenditure became abortive, or after five years if there had been no commercial decision to develop by then. He pointed out that his proposal on the SRA would in itself be of benefit to the oil industry.

3. On "New Brunswick", the Chancellor said he had been inclined to put this expenditure on a 25 per cent reducing basis too but that if the Secretary of State thought this was an issue to which the industry would attach importance, he would be prepared to agree that the existing revenue treatment should not be changed this year. Finally, the Chancellor mentioned that he was planning to remove PRT relief for onshore exploration and appraisal, pointing out that the onshore industry was very profitable so that the case for withdrawing the relief was very strong.

4. The Financial Secretary mentioned two further minor items. First, Treasury Ministers were planning to reduce relief for expenditure on extended production tests by any test income. He pointed out that only small sums were involved. Second, Ministers were proposing to make another technical change related to extended production tests. He pointed out that both the Chancellor's departments and the Department of Energy thought there were anomalies here which could be set right in the context of the other more general alterations to the regime.

5. The Secretary of State for Energy suggested that as a result of the falling dollar exchange rate and the changed prospect for the petrol and oil market in the UK, the tax burden on the North Sea oil industry had increased over the

past year. He believed that the industry had probably enjoyed a net benefit of around £55 million in 1984-85 as a result of the Budget changes. The Chancellor's proposals for 1985 would, however, amount to a net loss of £90 million. The Chancellor noted that the decline in the dollar exchange rate would, in fact, increase the industry's profits but the Secretary of State drew attention to the enormous losses suffered on downstream activities and Sir Kenneth Couzens suggested that as a result of higher profits, North Sea companies were now being pushed into the top PRT bracket. The Chancellor thought it important to consider the long-standing downstream problem separately, in the context of the industry's overall activities. He stressed that the North Sea fiscal regime was now a very favourable one, following the 1983 changes.

6. The Secretary of State for Energy noted that the Chancellor had made a very positive reference to incrementals in his 1984 Budget Speech. He therefore thought there was a need for some action this year. He believed it would suffice to say that extensive studies had been undertaken: as a result, the Government believed that no fiscal action was required at this stage, but it would continue to review the situation. The Secretary of State added that any relief would have to be targeted. All the major oil companies believed that it was possible to devise a relief of this kind and he therefore thought it would be a great tactical error to refuse to countenance any proposals which the industry might put forward. The Minister of State added that individual companies were even now examining the problem and the Secretary of State suggested that a statement on the lines he had proposed would cost the Government nothing.

7. The Chancellor noted that the UKOOA campaign on this issue had been a relatively small one. If officials had been able to devise a properly targeted relief for incrementals, he suspected that Ministers would probably have been prepared to introduce it but no satisfactory measure had come to light despite an extensive search. He noted he had promised in last year's Budget Speech that any action introduced in 1985 would be backdated to 1984. This undertaking could clearly not apply to any action taken in a subsequent year. He would think further about the point which the Secretary of State had put to him but he stressed that he did not want to mislead the industry by appearing to promise action where none was in prospect.

8. The Secretary of State for Energy emphasised that the industry was already nervous about a potential slide in oil prices. If it believed that the Government was attempting to reverse its fiscal stance for the North Sea, confidence could be badly shaken. The Chancellor replied that if there were a complete collapse of the oil price, the Government would clearly have to look again at the whole North Sea tax regime but naturally he could not commit himself to do so publicly. Meanwhile, he had to take his 1985 Budget decisions in the light of current conditions and the pressure for exemptions to the capital allowance regime which had risen on other fronts.

9. The Financial Secretary pointed out that the changes which Treasury Ministers had in mind would not have a large impact on the industry. The Chancellor commented that these

losses would be totally overshadowed by the benefits accruing to the industry from his 1984 corporation tax reforms. Over the period 1984-85 to 1988-89, these would reduce the industry's tax burden by £1.2 billion, compared with an annual average loss under Option B of £65 million.

10. Sir Kenneth Couzens pointed out that, unfortunately, last year's benefits had gone to the developed fields such as Forties and Brent, while the adverse changes now proposed were directed towards exploration and appraisal. The Chancellor explained that this was why he was prepared to introduce immediate write-off for abortive exploration and appraisal expenditure which in practice represented a significant concession. However, he stressed that he had to take some action on these allowances in order successfully to resist pressure from other industries, such as shipping, which were also seeking exemptions to the general capital allowance regime.

11. The Secretary of State for Energy noted that the figures which the Chancellor had quoted for the benefit to the oil industry of the 1984 corporation tax changes were higher than those which he himself had seen. He asked the reason for this. Mr Crawley explained that these were the figures which had emerged from the latest forecast. Part of the change could be accounted for by different estimates of company expenditure supplied to the forecasters by the Department of Energy. The Chancellor suggested that his officials should supply the Department of Energy with a detailed breakdown of the new forecast. Nevertheless, the Financial Secretary pointed out that the changes advocated by the Treasury and Inland Revenue had been proposed before the latest figures were available and the Chancellor noted that despite the changes now proposed, the North Sea fiscal regime was still a good one compared with that in place in other countries.

12. The Secretary of State said that following the Budget changes in 1983 and 1984, his concern was that the action proposed for 1985 might look like a reversal of policy. The Chancellor stressed that he had never claimed publicly that the 1984 changes would benefit the oil industry and that the action he was proposing for 1985 would clawback only some of the improvements in the regime. He had said last year that he would be examining the SRA and it had been clear from his remarks that any change would be bound to amount to a reduction in the relief. Sir Kenneth Couzens suggested that there would be greater value in continuing the allowance for exploration and appraisal at 100 per cent than maintaining a 100 per cent SRA. The Chancellor replied that this was perhaps an argument for reducing the SRA too.

13. Sir Kenneth Couzens referred to the weakness of sterling. He believed that this could in part be attributed to the fact that the markets had written down the value of the North Sea to the UK economy. He thought that the recent Sleipner announcement and the publicity given to the Ninth Round should have gone some way to counteract this. But it was also vital to rebuild the oil industry's confidence. The Department of Energy were therefore particularly concerned about the Chancellor's proposals on appraisal and exploration drilling, notwithstanding his concession on the immediate write-off of abortive expenditure. The Secretary of State stressed that this was highly marginal development where any adverse change in the tax regime could have a damaging effect.

14. The Chancellor doubted whether the changes he had in mind would have an effect on the behaviour of the companies concerned. He pointed out that these factors were much less important than others which the industry would be bound to take into account. The oil companies had enormous cashflows

at present. Their earlier experience of diversification had been an unhappy one, so they were likely to wish to continue to invest in oil and the UK tax regime was a particularly favourable one for them.

15. The Minister of State expressed his genuine concern about the effect of the proposed changes on the Ninth Round. The signs were that the industry was prepared to take a bigger risk on this occasion and that more small and medium-sized companies were involved. He therefore foresaw a real danger that a number would withdraw. The Chancellor emphasised that the major risk for such companies was that of drilling a dry well. In such cases, he was permitting immediate write-off.

16. The Secretary of State said that he would welcome a breakdown of the revised CT forecast. Once he had this, he would discuss with the Financial Secretary his response to the Chancellor's proposals. The Minister of State said that he would also like to look at the technical problems associated with writing-off expenditure immediately in the case of dry wells. He feared that in practice there could be some delay before the relief could be claimed.

17. The meeting closed at 4.55 pm.

MOM

MISS M O'MARA

Distribution

Those present
Chief Secretary
Minister of State
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Littler
Mr Bailey
Mr Monck
Mr Battishill
Mr Burgner
Mr Monger
Mr Robson
Mr Cropper
PS/IR

6.64

BUDGET SECRET

Spare

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COPY NO 11 OF 11 COPIES

cc PS/MST
Sir P Middleton
Mr Cassell
Mr Monger
Mr Battishill
Mr Griffiths
PS/C&E
Mr Wilmott (C&E)

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

PRIME MINISTER

I am writing to let you know what I have in mind for indirect taxes in the Budget.

2. Given the severe constraints in this year's Budget, I badly need to increase what little scope I have to raise thresholds by a further rise in indirect taxation. At the same time, it is clearly important to limit the effect of any increases in indirect taxes on the RPI. Accordingly, I have in mind a package that would raise in a full year some £300m over and above indexation, but would do so without a damaging effect on prices.

3. On the motoring taxes, I propose that the extra burden should fall on Vehicle Excise Duty. Nicholas Ridley and I have agreed that the duty on cars should be raised to £100. This is more than twice revalorisation, but it provides substantial extra revenue for a comparatively low RPI effect. We have also agreed that the increase in VED on goods vehicles should average out at 1½ times revalorisation. For petrol and derv I propose increases strictly in line with indexation, giving an extra 4.1p a gallon on petrol and 3.5p on derv. This should minimise both the impact on business costs and criticism of rising petrol prices by the rural motoring lobby.

4. For drinks, I have in mind an increase of 1½p a pint on beer, 6p a bottle on table wine, and 10p a bottle on fortified wine. These increases are about 1½ times revalorisation. For spirits, I propose an increase of only 10p a bottle, well below revalorisation, to recognise the difficulties on the Scotch whisky industry, a home producer of some importance to employment in Scotland.

5. As to tobacco, I intend to make an increase of 6p for a packet of 20 cigarettes. This is again about 1½ times revalorisation but will be generally accepted on health grounds. I would propose no increase in the duty on pipe tobacco or cigars, both of which are produced mainly in areas of high unemployment.

6. These increases would yield some £250m in a full year, over and above strict revalorisation. The RPI impact will be about 0.5 per cent, of which 0.4 per cent represents revalorisation and 0.1 per cent the additional revenues. This is less than the increase of about ¾ per cent produced by the last Budget (including the VAT changes) so that the effect of the proposals would be to produce a slight fall in the annual figure.

7. Finally, VAT. Whatever the long-term arguments for shifting more of the burden to VAT, I believe it would be wrong to make a big move in that direction this year. I therefore propose only to bring newspaper and magazine advertisements (but not newspapers and magazines themselves) into the tax. This would raise £50m in a full year, with no impact on the RPI. I am also seriously considering a small change in the VAT treatment of credit card companies which would increase revenue by up to £20 million a year.

I would be grateful to know if you would be content with these changes.

NL.

N.L.

26 February 1985

BUDGET CONFIDENTIAL

FROM: MRS R LOMAX

DATE: 11 February 1985

cc Sir P Middleton
Mr Cassell
Mr Monger
Mr Battishill
Mr Griffiths
Mr Cropper
Mr Lord
PS/C&E
Mr Knox - C&E

PS/MINISTER OF STATE

EXCISE DUTY OPTIONS: FORTIFIED WINES

The Chancellor has seen Mr Knox's note of 5 February and your note recording the Minister of State's views. While he thinks that the present distinction between Sherry and Port is indefensible and that there is therefore a case for not increasing the duty on Port at all since it is already over taxed, he is content on political grounds to accept the Minister of State's preferred course.

RL.

MRS R LOMAX

BUDGET SECRET

FROM: MISS M O'MARA
DATE: 11 February 1985

CH/EX REF NO F25
COPY NO 14 OF 15 COPIES

MR KNOX - Customs and Excise

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Battishill
Mr Monger
Mr Cropper
Mr Lord
PS/C&E

VAT ON NEWSPAPER ADVERTISING AND NEWS SERVICES

The Chancellor was grateful for your minute of 6 February. He has enquired what proportion of the total yield would come from classified advertising and what proportion from financial advertising.

MOM

MISS M O'MARA

BUDGET CONFIDENTIAL

NOTE OF A MEETING HELD IN No.11 DOWNING STREET AT 4.10 pm ON TUESDAY, 12 FEBRUARY 1985

Those present:

Chancellor of the Exchequer
Financial Secretary
Mr Cassell
Mr Crawley - IR

Secretary of State for Energy
Minister of State
Sir Kenneth Couzens
Dr Myerscough

NORTH SEA FISCAL REGIME

Opening the meeting, the Chancellor said that he had to view changes in the North Sea fiscal regime against the background of a very tight budgetary situation. He pointed out that the North Sea oil industry had benefited substantially from the 1984 corporation tax changes, although clearly he had not been able to make this point publicly.

2. Turning to his specific proposals, the Chancellor noted that officials had undertaken an extremely thorough review of incrementals and the outcome had clearly indicated that there was no case for any Government action. On exploration and appraisal allowances, he drew attention to the direct link with his 1984 reforms. He thought there was a very strong case for saying that expenditure in this area should no longer be eligible for the Scientific Research Allowance (SRA) but should simply receive a 25 per cent reducing balance allowance. However, this expenditure had hitherto been eligible for the 100 per cent SRA and he was proposing to retain the SRA at 100 per cent for genuine scientific research. He therefore proposed that expenditure on exploration and appraisal should

receive a 25 per cent reducing balance allowance but that there should be immediate write-off if and when expenditure became abortive, or after five years if there had been no commercial decision to develop by then. He pointed out that his proposal on the SRA would in itself be of benefit to the oil industry.

3. On "New Brunswick", the Chancellor said he had been inclined to put this expenditure on a 25 per cent reducing basis too but that if the Secretary of State thought this was an issue to which the industry would attach importance, he would be prepared to agree that the existing revenue treatment should not be changed this year. Finally, the Chancellor mentioned that he was planning to remove PRT relief for onshore exploration and appraisal, pointing out that the onshore industry was very profitable so that the case for withdrawing the relief was very strong.

4. The Financial Secretary mentioned two further minor items. First, Treasury Ministers were planning to reduce relief for expenditure on extended production tests by any test income. He pointed out that only small sums were involved. Second, Ministers were proposing to make another technical change related to extended production tests. He pointed out that both the Chancellor's departments and the Department of Energy thought there were anomalies here which could be set right in the context of the other more general alterations to the regime.

5. The Secretary of State for Energy suggested that as a result of the falling dollar exchange rate and the changed prospect for the petrol and oil market in the UK, the tax burden on the North Sea oil industry had increased over the

past year. He believed that the industry had probably enjoyed a net benefit of around £55 million in 1984-85 as a result of the Budget changes. The Chancellor's proposals for 1985 would, however, amount to a net loss of £90 million. The Chancellor noted that the decline in the dollar exchange rate would, in fact, increase the industry's profits but the Secretary of State drew attention to the enormous losses suffered on downstream activities and Sir Kenneth Couzens suggested that as a result of higher profits, North Sea companies were now being pushed into the top PRT bracket. The Chancellor thought it important to consider the long-standing downstream problem separately, in the context of the industry's overall activities. He stressed that the North Sea fiscal regime was now a very favourable one, following the 1983 changes.

6. The Secretary of State for Energy noted that the Chancellor had made a very positive reference to incrementals in his 1984 Budget Speech. He therefore thought there was a need for some action this year. He believed it would suffice to say that extensive studies had been undertaken: as a result, the Government believed that no fiscal action was required at this stage, but it would continue to review the situation. The Secretary of State added that any relief would have to be targeted. All the major oil companies believed that it was possible to devise a relief of this kind and he therefore thought it would be a great tactical error to refuse to countenance any proposals which the industry might put forward. The Minister of State added that individual companies were even now examining the problem and the Secretary of State suggested that a statement on the lines he had proposed would cost the Government nothing.

7. The Chancellor noted that the UKOOA campaign on this issue had been a relatively small one. If officials had been able to devise a properly targeted relief for incrementals, he suspected that Ministers would probably have been prepared to introduce it but no satisfactory measure had come to light despite an extensive search. He noted he had promised in last year's Budget Speech that any action introduced in 1985 would be backdated to 1984. This undertaking could clearly not apply to any action taken in a subsequent year. He would think further about the point which the Secretary of State had put to him but he stressed that he did not want to mislead the industry by appearing to promise action where none was in prospect.

8. The Secretary of State for Energy emphasised that the industry was already nervous about a potential slide in oil prices. If it believed that the Government was attempting to reverse its fiscal stance for the North Sea, confidence could be badly shaken. The Chancellor replied that if there were a complete collapse of the oil price, the Government would clearly have to look again at the whole North Sea tax regime but naturally he could not commit himself to do so publicly. Meanwhile, he had to take his 1985 Budget decisions in the light of current conditions and the pressure for exemptions to the capital allowance regime which had risen on other fronts.

9. The Financial Secretary pointed out that the changes which Treasury Ministers had in mind would not have a large impact on the industry. The Chancellor commented that these

losses would be totally overshadowed by the benefits accruing to the industry from his 1984 corporation tax reforms. Over the period 1984-85 to 1988-89, these would reduce the industry's tax burden by £1.2 billion, compared with an annual average loss under Option B of £65 million.

10. Sir Kenneth Couzens pointed out that, unfortunately, last year's benefits had gone to the developed fields such as Forties and Brent, while the adverse changes now proposed were directed towards exploration and appraisal. The Chancellor explained that this was why he was prepared to introduce immediate write-off for abortive exploration and appraisal expenditure which in practice represented a significant concession. However, he stressed that he had to take some action on these allowances in order successfully to resist pressure from other industries, such as shipping, which were also seeking exemptions to the general capital allowance regime.

11. The Secretary of State for Energy noted that the figures which the Chancellor had quoted for the benefit to the oil industry of the 1984 corporation tax changes were higher than those which he himself had seen. He asked the reason for this. Mr Crawley explained that these were the figures which had emerged from the latest forecast. Part of the change could be accounted for by different estimates of company expenditure supplied to the forecasters by the Department of Energy. The Chancellor suggested that his officials should supply the Department of Energy with a detailed breakdown of the new forecast. Nevertheless, the Financial Secretary pointed out that the changes advocated by the Treasury and Inland Revenue had been proposed before the latest figures were available and the Chancellor noted that despite the changes now proposed, the North Sea fiscal regime was still a good one compared with that in place in other countries.

12. The Secretary of State said that following the Budget changes in 1983 and 1984, his concern was that the action proposed for 1985 might look like a reversal of policy. The Chancellor stressed that he had never claimed publicly that the 1984 changes would benefit the oil industry and that the action he was proposing for 1985 would clawback only some of the improvements in the regime. He had said last year that he would be examining the SRA and it had been clear from his remarks that any change would be bound to amount to a reduction in the relief. Sir Kenneth Couzens suggested that there would be greater value in continuing the allowance for exploration and appraisal at 100 per cent than maintaining a 100 per cent SRA. The Chancellor replied that this was perhaps an argument for reducing the SRA too.

13. Sir Kenneth Couzens referred to the weakness of sterling. He believed that this could in part be attributed to the fact that the markets had written down the value of the North Sea to the UK economy. He thought that the recent Sleipner announcement and the publicity given to the Ninth Round should have gone some way to counteract this. But it was also vital to rebuild the oil industry's confidence. The Department of Energy were therefore particularly concerned about the Chancellor's proposals on appraisal and exploration drilling, notwithstanding his concession on the immediate write-off of abortive expenditure. The Secretary of State stressed that this was highly marginal development where any adverse change in the tax regime could have a damaging effect.

14. The Chancellor doubted whether the changes he had in mind would have an effect on the behaviour of the companies concerned. He pointed out that these factors were much less important than others which the industry would be bound to take into account. The oil companies had enormous cashflows

at present. Their earlier experience of diversification had been an unhappy one, so they were likely to wish to continue to invest in oil and the UK tax regime was a particularly favourable one for them.

15. The <u>Minister of State</u> expressed his genuine concern about the effect of the proposed changes on the Ninth Round. The signs were that the industry was prepared to take a bigger risk on this occasion and that more small and medium-sized companies were involved. He therefore foresaw a real danger that a number would withdraw. The <u>Chancellor</u> emphasised that the major risk for such companies was that of drilling a dry well. In such cases, he was permitting immediate write-off.

16. The <u>Secretary of State</u> said that he would welcome a breakdown of the revised CT forecast. Once he had this, he would discuss with the Financial Secretary his response to the Chancellor's proposals. The <u>Minister of State</u> said that he would also like to look at the technical problems associated with writing-off expenditure immediately in the case of dry wells. He feared that in practice there could be some delay before the relief could be claimed.

17. The meeting closed at 4.55 pm.

Distribution

MOM

MISS M O'MARA

Those present
Chief Secretary
Minister of State
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Littler
Mr Bailey
Mr Monck
Mr Battishill
Mr Burgner
Mr Monger
Mr Robson
Mr Cropper
PS/IR

BUDGET SECRET

FROM: P WYNN OWEN
DATE: 12 February 1985

Ch/Ex Ref No: F30
Copy No: 11 of 12 copies

PS/MINISTER OF STATE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Monger
Mr Battishill
Mr Griffiths
PS/C&E

TOBACCO PRODUCTS DUTY: MINOR PRODUCTS

At the Budget overview meeting on Monday, 28 January, it was decided that there should be no increase in duty for both pipe tobacco and cigars. The Chancellor would be grateful if the Minister of State could consider the presentation of this decision and let him have a note on how best to approach it.

Pwo.

P WYNN OWEN

BUDGET CONFIDENTIAL

FROM: P WYNN OWEN
DATE: 14 February 1985

PS/MINISTER OF STATE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Bailey
Mr Cassell
Mr Monck
Mr Battishill
Mr Monger
Mr Griffiths
Mr Romanski
Mr Robson
Mr Cropper
Mr Lord
PS/C&E

HEAVY FUEL OIL DUTY

The Chancellor has seen your minute of 11 February and Mr Romanski's note of 8 February. He agrees that the duty should be left unchanged.

Pwo.

P WYNN OWEN

6.26

BUDGET SECRET

FROM: P WYNN OWEN
DATE: 14 February 1985

CH/EX REF NO F33
COPY NO 15 OF 15 COPIES

PS/MINISTER OF STATE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Battishill
Mr Monger
Mr Cropper
Mr Lord
Mr Graham (Parly Counsel)
PS/C&E
Mr Knox (C&E)

EXTENSION OF VAT TO NEWSPAPER ADVERTISING: METHOD AND DATE OF IMPLEMENTATION

The Chancellor has seen and was grateful for your minute of 11 February, giving the Minister of State's comments on Mr Knox's submission of 8 February.

He would also be grateful for the views of other Ministers and advisers.

Pwo.

P WYNN OWEN

BUDGET CONFIDENTIAL

FROM: P WYNN OWEN
DATE: 14 February 1985

PS/MINISTER OF STATE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Bailey
Mr Cassell
Mr Monck
Mr Battishill
Mr Monger
Mr Griffiths
Mr Romanski
Mr Robson
Mr Cropper
Mr Lord
PS/C&E

HEAVY FUEL OIL DUTY

The Chancellor has seen your minute of 11 February and Mr Romanski's note of 8 February. He agrees that the duty should be left unchanged.

PWO.

P WYNN OWEN

BUDGET SECRET

FROM: P WYNN OWEN

DATE: 14 February 1985

CH/EX REF. NO. F35

COPY NO. 7 OF 8 COPIES

cc Sir P Middleton
Sir T Burns
Mr R Allen
PS/IR

MR MONGER

INCOME TAX AND NICs AS A PERCENTAGE OF GROSS EARNINGS

Annex 3 to the Economic Strategy Paper for Cabinet on "The Tax Burden" had, in table 2, a column for those on half average earnings (Peter Short suggests that this means £92 per week). The Chancellor would be grateful if you could recast the final figure in the column, for 1985-86,for the double indexation of the basic rate tax threshold.

2. I should be grateful if you could provide this figure as soon as possible.

PWO.

P WYNN OWEN

Spare

FROM: MRS R LOMAX
DATE: 18 February 1985

CH/EX REF. NO. F44
COPY NO. 9 OF 9 COPIES

cc PS/Minister of State
Sir P Middleton
Mr Cassell
Mr Battishill
PS/C&E
Mr Wilmott - C&E

MR MONGER

INDIRECT TAXATION

The Chancellor has slightly amended the draft attached to your minute of 11 February. Could you please arrange to have it checked for factual accuracy - especially the references to the RPI.

RL.

MRS R LOMAX

DRAFT MINUTE FOR THE CHANCELLOR TO SEND TO
THE PRIME MINISTER

I am writing to let you know what I have in mind for indirect taxes in the Budget.

Given the severe constraints in this year's Budget, I badly need to increase what little scope I have to raise thresholds by a further rise in indirect taxation. At the same time, it is clearly important to limit the effect of any increases in indirect taxes on the RPI. Accordingly, I have in mind a package that would raise in a full year some £300m over and above indexation, but would do so without a damaging effect on prices.

On the motoring taxes, I propose that the extra burden should fall on Vehicle Excise duty. Nicholas Ridley and I have agreed that the duty on cars should be raised to £100. This is more than twice revalorisation, but it provides substantial extra revenue for a comparatively low RPI effect. We have also agreed that the increase in VED on goods vehicles should average out at 1½ times revalorisation. For petrol and derv I propose increases strictly in line with indexation, giving an extra 4.1p a gallon on petrol and 3.5p on derv. This should minimise both the impact on business costs and criticism of rising petrol prices by the rural motoring lobby.

For drinks, I have in mind an increase of 1½p a pint on beer, 6p a bottle on table wine, and 10p a bottle on fortified wine. These increases are about 1½ times revalorisation. For spirits, I propose an increase of only 10p a bottle, well below revalorisation, to recognise the difficulties on the Scotch Whisky industry, a home producer of some importance to employment in Scotland.

As to tobacco, I intend to make an increase of 6p for a packet of 20 cigarettes. This is again about 1½ times revalorisation but will be generally accepted on health grounds. I would propose no increase in the duty on pipe tobacco or cigars, both of which are produced mainly in areas of high unemployment.

Although these increases would yield some £250m in a full year, over and above strict revalorisation. The RPI impact will be only about 0.5 per cent, of which 0.3 per cent represents revalorisation and 0.2 per cent the additional revenues. This is less than the 0.75 per cent increase produced by the last Budget (including the VAT changes) so that the effect of the proposals would be to produce a slight fall in the annual figure.

Finally, VAT. Whatever the long-term arguments for shifting more of the burden to VAT, I believe it would be wrong to make a big move in that direction this year. I therefore propose only to bring newspaper and magazine advertisements (but not newspapers and magazines themselves) into the tax. This would raise £50m in a full year, with no impact on the RPI.

I would be grateful to know if you would be content with these changes.

(N.L.)

P24

BUDGET CONFIDENTIAL

CHANCELLOR OF THE EXCHEQUER

FROM: P WYNN OWEN
DATE: 18 February 1985

MR KNOX

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Battishill
Mr Monger
Mr Griffiths
Mr Cropper
Mr Lord
PS/C&E

VAT ON NEWSPAPER ADVERTISING

The Chancellor has seen and was grateful for your minute of 14 February.

PWO.

P WYNN OWEN

BUDGET CONFIDENTIAL

FROM: P WYNN OWEN
DATE: 18 February 1985

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Bailey
Mr Cassell
Mr Monck
Mr Battishill
Mr Monger
Mr Griffiths
Mr Robson
Mr Cropper
Mr Lord
PS/C&E

PS/MINISTER OF STATE

BUDGET 1985: MINOR OIL PRODUCTS

The Chancellor has seen your minute of 14 February and Mr McGuigan's minute of 12 February. He too agrees with the recommendations in paragraph 11 of Mr McGuigan's minute.

Pwo.

P WYNN OWEN

BUDGET CONFIDENTIAL

FROM: P WYNN OWEN

DATE: 20 February 1985

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mr Battishill
Mr Lankester
Mr Monger
Mr Griffiths
Mr Cropper
PS/IR
PS/C&E
Mr Knox - C&E

PS/MINISTER OF STATE

TAX ON CREDIT CARDS

The Chancellor has seen Mr Knox's minute of 19 February. He would like to know if the idea in paragraph 6 can be done for this Budget, and why it has not been done before, since it obviously seems right. He would be grateful if the Minister of State could look into this as a matter of urgency.

PWO.

P WYNN OWEN

6.40 SPARE

BUDGET SECRET

FROM: P WYNN OWEN
DATE: 21 February 1985

CH/EX REF NO F54

COPY NO 3 OF 3 COPIES

PS/MINISTER OF STATE

REVENUE FROM VAT ON NEWSPAPER ADVERTISING

The Chancellor has seen Mr Jefferson Smith's minute of 20 February and has commented that it must be right.

PWO.

P WYNN OWEN

BUDGET CONFIDENTIAL

RECORD OF A MEETING HELD AT 11.30am ON FRIDAY 22 FEBRUARY 1985
IN NO.11 DOWNING STREET

Those present: Chancellor of the Exchequer
Mr Knox, Customs and Excise
Lord Cockfield
Mr Fortiscue

Lord Cockfield thanked the Chancellor for seeing him to discuss the Chancellor's personal letter to him of 3 January concerning the VAT exemption limit. He had so far prevented the issue from coming before the Commission, but his control was limited. The initiative lay with the Commission services division who held the view that the UK had been put on warning a long time ago and had continued to increase the limit since. Legal services advised that the Commission's case was very strong. The Chancellor replied that the UK had only been put on warning very belatedly and since that date had merely increased the limit in line with the RPI. Lord Cockfield said that the Commission argued that the figure was already excessive, so uprating it each year did not improve the situation. If the limit were raised again, he very much doubted whether he could prevent the Commission from seeing the case. The previous week he had been on the losing side of an 11-3 Commission vote on infraction proceedings against the Germans for subsidising the Saar Railway. The new Commission was flexing its muscles very quickly.

2. The Chancellor said it was unthinkable that the VAT exemption limit should not be at least uprated in the Budget, though no final decisions had yet been made. If the Commission wished to declare war then let it do so. Both he and the Prime Minister felt very strongly on this issue. The UK had been

completely misled from an early stage by the Commission and could have revalorised the limit at an earlier date had it been forewarned. It had gained the impression from Mr Tugendhat in 1982 that there was no longer any need to worry. The Commission would do serious damage to its relations with the UK Government by seeking to enforce a measure which was contrary to present Government policies on small businesses, employment and the concept of "passport for a job". It was absurd to think that the village corner shop in the UK was competing with major continental stores.

3. Lord Cockfield noted that the Chancellor had deployed the political arguments from a UK perspective, but pointed out that the Commission had a duty to uphold the Treaty. Political arguments from the Germans on the Saar Railway had been totally overruled. On the continent enormous cross-border traffic meant that issues like this one could have wider ramifications.

4. The Chancellor said that he would be delighted if the Commission could propose an increase in the VAT exemption limit community-wide instead. Lord Cockfield said that, in his opinion, member states would not accept any increase. The Chancellor said the UK's record was a good one. It had fought the beer/wine infraction proceedings, lost, and implemented the decision in the very next Budget, although it was an absurdity in revenue terms. But this issue was of a completely different political order, with nationwide implications. Lord Cockfield said that he felt there was little more he could do.

5. The Chancellor asked about Commission initiatives on tax harmonisation. Lord Cockfield said that the Financial Secretary was right that the Commission's approach was fragmentary. He wanted to put together a paper on the whole issue of tax harmonisation The Chancellor said he assumed that nothing was proposed which would

affect the fundamentals of UK Corporate Tax Law. Lord Cockfield said that a lot was at stake. When the UK had chosen the imputation tax system this was partly done to suit Europe. Then the Germans had switched to withholding tax at the last minute and there was now deadlock because of a row between the Germans and Dutch. A uniform tax system would meet tremendous national resistance in the immediate future. Perhaps the UK had not recognised the consequences of its unqualified support for the free internal market.

6. The Chancellor said that there were much bigger impediments than taxation to the free operation of the internal market. Free movement of capital, which the UK supported and which was in the Rome Treaty, was a necessary prerequisite of the alignment of capital taxation. Lord Cockfield said that progress was needed on all fronts. M.Delors wanted "the abolition of fiscal frontiers" and to do that tax alignment was necessary. Each state had its own peculiar problem with the free internal market, but all were moving in the right direction. Though the last internal market council had caused some difficulties, it had made rapid progress on the initiative on standards.

7. The Chancellor noted that there were some issues which could be resolved by horse-trading and negotiation, but that there were other things of such importance that the Commission would simply have to leave them alone.

PWO.

P WYNN OWEN
28 February 1985.

Copies to: PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Mr Unwin
Mr Fitchew
Mr Monger
Mr Lord

PS/Customs and Excise
PS/Inland Revenue

12.26

BUDGET CONFIDENTIAL

FROM: MISS M O'MARA
DATE: 27 February 1985

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Minister of State
PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mr Battishill
Mr R I G Allen
Mr Robson
Mr Cropper
Mr Lord
PS/IR
Mr Green (IR)
Mr Crawley (IR)

OIL TAXATION

The Chancellor discussed briefly with the Financial Secretary this morning the outcome of Mr Walker's meeting yesterday.

2. In the light of that discussion, the Chancellor and Financial Secretary agreed that exploration and appraisal allowances should continue to get relief at the existing rates in line with the scientific research allowance but that no other changes should be made to the package the Chancellor had already proposed.

3. The Chancellor would therefore be grateful if Mr Cassell could produce a draft letter for him to send to Mr Walker. This should indicate that the Financial Secretary had reported the outcome of Mr Walker's meeting and that the Chancellor had decided to make a number of changes in oil taxation in the Budget which should then be listed. At its close, the letter, which should be copied to the Prime Minister, should draw Mr Walker's attention particularly to the SRA treatment of exploration and appraisal allowances which was now proposed.

MOM

MISS M O'MARA

CH/EX → PM 3/12/85
TAX CUTS: STRATEGY

SECRET AND PERSONAL

N436

PM 5/8

PRIME MINISTER

TAX CUTS: STRATEGY

A month or so ago we discussed the need to rebuild the shrinking constituency of those who want to see substantial cuts in personal taxes. I believe that we have made some headway here in recent weeks, but it has been particularly disturbing to sense these doubts amongst some of our own supporters, who should be the main proponents of the argument that without lower taxes we will never get an enterprising, vigorous and flexible economy; and that voters rightly want to keep more of their own money to spend themselves.

It is ironic, but we need to continually to <u>advocate</u> the case for lower taxes - not just with our colleagues in Cabinet, whose interest in lower taxes may conflict with their Department's pressures for higher public spending, but even with supporters inside and outside the House whose interest in tax cuts one might expect to be much more straightforward. I believe that we now have to step up our effort, to prevent erosion of our position, and to go on the offensive, with new arguments and fresh approaches.

Since our 1979 reduction in the basic rate of income tax we have put very large sums of money into threshold increases, taking people at the bottom end out of income tax altogether, reducing the numbers of people facing very high marginal tax/benefit withdrawal rates, and improving the rewards for those who work in relation to those who do not.

But the sheer cost of raising allowances with the present tax structure means that year by year we appear to be making painfully slow progress. This is, perhaps, a reason why our supporters lose enthusiasm for tax cuts. We need to think of imaginative ways of restoring their appeal.

This has been a major driving-force behind my personal tax Green Paper. Its proposals would distribute threshold increases more cost-effectively. From a given amount of tax relief more would go to one-earner couples where the wife is at home with the children - the group most affected by the why-work syndrome, and where the disincentive effect of taxation and benefit withdrawal is strongest. There would also be a step-increase in the single person's allowance - which, by taking many young people out of tax altogether, should help to reduce the numbers of young unemployed. The result would also be a fairer distribution in the tax burden on married couples at different points in their lives. Most women nowadays have paid jobs for a good part of their working lives. But the present tax system is hardest on married couples at just that time when they have the responsibilities of a young family and the wife is least able to work outside the home.

I believe that the Green Paper proposals would be attractive to a wide range of political opinion, both within and outside the Party - and especially to women voters. The various tax penalties on marriage - all of which spring from the anachronistic rule that for tax purposes a married woman's income is treated as her husband's - arouse resentment among women right across the political spectrum, as I am sure you know from your own correspondence. All of them would go if the Green Paper proposals were adopted. You will recall that the Women's National Advisory Committee, in responding to Geoffrey Howe's earlier Green Paper, unequivocally supported the principle of mandatory independent taxation with a transferable option, arguing that the present system is anomalous, discriminatory against the family and inequitable as between husband and wife. Since I outlined my proposals in my Budget Speech there has been sustained and favourable interest both in the press and in the Party.

The high-tax, high-spending lobby would, of course, add up all the threshold increases and label the total the 'cost' of the Green Paper - ignoring the fundamental difference between tax reductions and expenditure increases. What we have to get over is that these are not 'costs' in the public expenditure sense, nor do they represent a new or additional commitment to cutting taxes. There is a world of difference between higher spending and allowing people to keep more of their own money. And we have already made it very clear that we intend to reduce personal taxes anyway, over a period of years. In last year's Green Paper, 'The Next Ten Years', we set out the scale of tax reductions which could be achieved if public expenditure is kept in check, up to 1993. These reductions would bring the (non-North Sea) tax burden down from its current 37½ per cent of GDP to as much as 6 percentage points below this level. By comparison, the illustrative figure given in the personal tax Green Paper is equivalent to only about 1½-2 per cent of GDP, assuming the proposals were introduced on a no-cash-loser basis. And a tax reduction of this size would still leave us above the tax burden we inherited in 1978/79.

If we can settle on, and publish, a strategy for substantial increases in thresholds along these lines we can then use the period between now and 1990, the earliest date on which any new system of thresholds could be implemented, to reduce the basic rate. Fiscal prudence must continue to constrain the pace at which we can move, but I believe our ultimate target should be the 25 per cent basic rate first advanced by Geoffrey Howe in 1979. Such reductions would be fully justifiable against the background of the raised and restructured thresholds in prospect. They would also help significantly to reduce the cost of the restructuring. And they would help all taxpayers - including those two-earner couples who do not stand to gain immediately from the Green Paper proposals themselves.

I believe that we should go for a two-pronged strategy on these lines. Without a clear prospectus for threshold increases we would be unable to build up support for reductions in the basic rate; and without basic rate reductions we risk losing the political initiative on our whole tax-cutting policy. Everyone knows what the basic rate of tax is: very few can tell you what their threshold is.

The essential first step is that you and I should together settle on a broad strategy - for both thresholds and the basic rate - on which we are agreed. Given the key political importance of all this and the substantial interactions between the tax structure and our social security and employment policies we will need next to secure the agreement of key colleagues - in particular Willie Whitelaw, Norman Fowler, Norman Tebbit and David Young - to what we have in mind, before Budget security considerations supervene. My aim would then be to publish the Green Paper itself on Budget Day - in the context of a fresh look at our overall economic strategy, and well clear of the publication of Norman Fowler's White Paper and Kenneth Baker's Green Paper on Local Government finance.

I hope we will be able to have a further talk about this at our meeting on Wednesday.

NL

3/12

CH/EX → PM
INDIRECT TAXES

Rec No 13 J

DR/17

BUDGET SECRET

NL/36

COPY NO 2 26 OF 6 .

26 Feb

PRIME MINISTER

I am writing to let you know what I have in mind for indirect taxes in the Budget.

I have reached the view that it would not be sensible to do more than revalorise the excise duties as a whole this year. There is no prospect of a major offsetting reduction in income tax. So I see little point in jeopardising the good prospect for a further significant reduction in inflation by adding unnecessarily to the RPI. But I think it is attractive to take the opportunity to reduce sharply the number of individual tax increases in the Budget, rather than simply uprating all the duties by the 5.7 per cent indexation factor.

As far as the motorist goes, I propose to put up petrol duty by 7½p a gallon and the duty on derv by 6½p a gallon. In each case this is about 2p a gallon more than revalorisation - but far less than most people are predicting. This will enable me to leave all the main VED rates unchanged.

Moreover, given the sharp fall in the oil price that has already occurred, and the slowness of the oil companies so far to reflect this in lower prices at the pump, there is no need for fuel duty increases of this order to be passed on to the consumer at all.

As Norman Fowler reminds me every year, there is considerable pressure on health grounds to increase the tax on cigarettes by appreciably more than revalorisation. I therefore propose an increase equivalent to approximately 11p on a typical packet of 20, with, as last year, no increase in the tax on pipe tobacco and cigars.

This will mean that there is no need for any increase at all in the duty on alcoholic drinks - for the first time since 1979. The prize here will be the absence of any increase in the tax on beer - which, you will recall, I had to put up by more than I would otherwise have done in 1984, to conform with the EC infraction judgement. The standstill on whisky will, of course, go down well in Scotland.

The overall impact of this package on the RPI, as conventionally calculated, will be to add about 0.5 per cent, entirely reflecting the effect of revalorisation. This is the same as last year's Budget, so there will be no change in the annual figure on this account.

I also propose to simplify the indirect tax system slightly by abolishing one or two of the minor oil duties and recouping the small loss of revenue from a 1½p increase in the duty on gas oil. This has been unchanged since 1980, leaving gas oil clearly under-taxed at the present time, relative to the rest of the EC. The duty on heavy fuel oil would once again remain unchanged.

So far as VAT is concerned, with the exception of one or two minor concessions to charities - relief on their newspaper advertising, and on medicinal products supplied to them - I am proposing to make no changes here, either to the rate or the base. However, I do intend to increase the VAT threshold to £20,500, in line with revalorisation, in spite of the Commission's contention (which we reject) that it is already higher than Community law allows.

I would be grateful to know if you would be content with these changes.

N.L.

26 February 1986

SPARE

6.66

BUDGET SECRET

FROM: P WYNN OWEN
DATE: 27 February 1985

CH/EX REF NO F 73
COPY NO 14 OF 14 COPIES

PS/MINISTER OF STATE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Battishill
Mr Monger
Mr Griffiths
Mr Cropper
Mr Lord
PS/C&E
Mr Jefferson Smith

EFFECT OF VAT ON NEWSPAPER ADVERTISING ON CHARITIES

The Chancellor has seen Mr Jefferson Smith's minute of 26 February and agrees with the recommendation in paragraph 10.

P WYNN OWEN

CH/EX REF. NO. M18
COPY NO. 1 OF 15 COPIES

FROM: MISS M O'MARA
DATE: 4 March 1985

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mr Battishill
Mr Monger
Mr R I G Allen
Mr Griffiths
Mr Halligan
PS/IR
PS/C&E

NOTE FOR THE RECORD

BUDGET REPRESENTATIONS: SECRETARY OF STATE FOR SCOTLAND

The Secretary of State for Scotland called on the Chancellor to discuss with him the Budget representations set out in his letter of 14 February.

2. Turning first to whisky, the Secretary of State referred to the difficulties which the industry had been experiencing. He appreciated that the Chancellor could not reintroduce stock relief but suggested that of all the proposals which the industry had put forward, the most reasonable was that on duty deferment. If the Chancellor could, for instance, extend the period from 4 to 6 weeks, he believed that would represent a substantial benefit.

3. The Chancellor drew attention to the cost of such a measure and the difficulty of drawing any dividing line. In the light of this, he explained that he had decided to increase

the duty on whisky by significantly less than the rate of inflation. His proposal, which he revealed to the Secretary of State in confidence, was to raise the duty by 10p per bottle. He appreciated that this would not compensate the industry for the loss of stock relief and noted that he would have preferred not to increase the duty on whisky at all but under EC rules he could not discriminate in its favour as compared with other spirits. The Secretary of State expressed his gratitude for this measure of relief which he regarded as fair.

4. Mr Younger referred to his concern about the impact on rural areas of any decision to switch from VED to an increased petrol duty. The Chancellor said that he had no intention of introducing such a change or even mentioning the possibility this year. Nevertheless, he was impressed by the case for such a switch and he believed that public opinion was gradually changing in its favour. He mentioned, in particular, the views which some backbenchers had recently expressed. He therefore hoped that it would be possible to make the change at some point in the future. The Secretary of State said that he himself believed there was a logical case for change and would certainly be prepared to work on public opinion.

5. Mr Younger then turned to the new capital allowance regime. He noted that agriculture and some other sectors suffered from the reduction in capital allowances but did not secure any benefit from the reduction in CT rates. The Chancellor said that he was well aware of this point. However, he noted that the unincorporated sector had benefited from the abolition of NIS in 1984 and he said he hoped that he might be able to do something for them in the 1985 Budget. He also referred to the problem of the dip in the investment profile which the CBI had identified in 1986-87. He noted that it should be possible to make a concession consistent with his 1984 reforms to ease this problem but he pointed out that it would carry quite a substantial cost in 1987-88. The Secretary of State agreed that a concession of this kind would be good for CBI morale but commented that the company sector was in fact faring quite well at present. The Chancellor noted that the only real issue of concern to the CBI was likely to be the level of interest rates.

6. The Secretary of State mentioned the proposal he had put to the Chancellor in November for extending deeds of covenant to 17 year old students. The Chancellor said that he had investigated this possibility thoroughly. He would have liked to have taken action but he feared he could see no way of doing so, given that deeds of covenant applied to children above the age of majority as defined by general law. He mentioned that he had written to the Secretary of State, explaining the difficulties in greater detail.

7. The Secretary of State also reinforced the views which he had expressed in his letter on any extension of the VAT base.

8. Finally, the Chancellor told the Secretary of State that he had decided not to act on the taxation of woodlands in the 1985 Budget. Mr Younger said that he was grateful for this decision.

MOM

MISS M O'MARA

BUDGET SECRET

FROM: P WYNN OWEN
DATE: 4 March 1985

CH/EX REF NO M8
COPY NO 12 OF 13 COPIES

APS/MINISTER OF STATE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Monck
Mr Battishill
Mr Griffiths
PS/C&E
Mr Knox (C&E)
Mr Jenkins (C&E)

BUDGET 1985: TOBACCO PRODUCTS DUTY

The Chancellor has seen Mr Jenkins' minute of of 25 February and your minute of 26 February. He is content with these minor decisions.

Pwo.

P WYNN OWEN

2.15

BUDGET SECRET

FROM: P WYNN OWEN
DATE: 4 March 1985

CH/EX REF NO M 7
COPY NO 11 OF 12 COPIES

PS/MINISTER OF STATE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Mr Battishill
Mr Monger
Mr Cropper
Mr Lord
PS/C&E
Mr Jefferson Smith (C&E)

REVENUE FROM VAT ON NEWSPAPER ADVERTISING

The Chancellor has seen Mr Ellis' minute of 27 February and agrees with the Economic Secretary. He has therefore amended Supplementary No 2 to Lord Beswick's PQ (see Mr Jefferson Smith's minute of 26 February) to read as follows:-

> "Tax yield from VAT on press advertising estimated at £50 million in a full year. This is a revision of a previous estimate of £25 million, in the light of more recent and detailed information, including the study by Price Waterhouse."

PWO.

P WYNN OWEN

BUDGET SECRET

FROM: MISS M O'MARA
DATE: 4 March 1985

CH/EX REF NO M13
COPY NO 25 OF 25 COPIES

MR MONCK

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Bailey
Mr Littler
Mr A Wilson
Mr Cassell
Mr Monger
Mr Battishill
Mr Odling-Smee
Mr R Allen
Mr Cropper
Mr Lord
Mr H Davies
PS/IR
Mr Green (IR)
Mr Beighton (IR)
Mr Crawley (IR)

BUSINESS TAXES AND CAPITAL ALLOWANCES FOR 1986-87

The Chancellor, Financial Secretary and Economic Secretary discussed with you and other officials this morning your minute of 1 March.

2. It was noted that two problems could be identified:-

(i) The dip in the investment profile which the CBI claimed would occur in 1986-87 as a result of the 1984 corporate tax changes;

(ii) The fact that the latest forecasts suggested that the 1984 changes in the corporate tax regime no longer appeared to be revenue neutral over the transitional period, although this shift from revenue neutrality had so far not been made public.

The first problem could be dealt with by announcing in the 1985 Budget that the reductions in capital allowances would be rephased so that a rate of 37½ per cent would apply for plant and machinery in 1986-87. This would be quite consistent with the philosophy underlying the 1984 change in the corporate tax regime. The second problem could be met by announcing a reduction in the CT rate in the 1986 Budget. But it was clear that no announcement in 1986 could ease the problem of the dip.

3. It was pointed out that the dip in the 1986-87 figures was based on crude CBI estimates. In practice, once all the 1984 Budget changes had been taken into account, the investment profile looked much smoother but it was plain that it was the CBI's approach which would influence companies' intentions and the forecast for 1986-87 looked particularly grim. It was suggested that it would be important to avoid any charge that the dip in investment that year was wholly attributable to changes in the corporate tax regime.

4. There were items in the 1985 Budget which would be unwelcome to the CBI and acting on the dip should defuse their opposition generally. Rephasing the capital allowances would also be of some benefit to the unincorporated and small unincorporated sectors. While rationally it should not have much effect on investment decisions and thus did not appear to be a cost-effective measure, it was suggested that the psychological impact would be much greater. Against that, a move to a 37½ per cent allowance could cost up to £½ billion in 1987-88, when the Government was likely to want all the fiscal room for manoeuvre it could secure.

5. The Financial Secretary and Economic Secretary in particular felt that depooling for short life assets should take priority over any action to ease the problem of the dip, especially in the light of its 1987-88 cost. The Chancellor confirmed

that he certainly intended to announce a move to depooling in 1986 if not in 1985. There was some discussion of whether an announcement of depooling should be deferred until 1986, if the Government decided to announce action on the dip in 1985 but it was generally felt that the sooner the announcement was made on depooling the better.

6. It was agreed that the decision whether to act on the dip was largely a matter of political judgement. The Chancellor said that he was inclined to announce a 37½ per cent allowance for 1986-87 in the Budget but before reaching a final decision would be grateful if Sir Terence Burns could indicate what effect this would have on the investment figures in the Treasury forecast.

7. There was also a brief discussion of capital allowances for shipping. It was agreed that a concession should be made on second-hand ships and that there was no need for a meeting with the Secretary of State for Trade and Industry on this subject. The Chancellor noted that to the extent that such a concession persuaded the industry to buy second-hand rather than new ships, it could actually save the Exchequer money.

MOM

MISS M O'MARA

BUDGET SECRET

Ref: M22
Copy: 1/18

NOTE OF A MEETING IN HM TREASURY
ON ~~FRIDAY~~ ~~1st~~ MONDAY 4th MARCH AT NOON

Those Present

Chancellor
Financial Secretary
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Battishill
Mr Monger
Mr Cropper
Mr H Davies
Mr Lord
Mr Isaac (IR)
Mr Houghton (IR)

CAPITAL GAINS TAX

The Chancellor said he was pleased with the way the CGT package had turned out. It deserved some prominence in the Budget Speech. The outstanding issue was the method of valuation to be used for arriving at notional 1982 values for pre-1982 asset holdings. The choice lay between a full Inland Revenue valuation for all assets, and a mixture of proper valuation for quoted shares and some proximate method, based on the RPI or other price indices, for other assets, including land and property.

2. In discussion it was noted that while an RPI valuation for shares would give much the same result as using market prices, a proximate valuation for quoted shares was not a practical option since it would not always be possible to establish when shares were acquired. A full valuation would involve additional taxpayer compliance costs, and 300 extra Inland

Revenue staff. But most of the additional staff cost would be incurred in respect of land and property, where taxpayers would typically have a financial interest in securing a proper valuation. The additional staff required by Inland Revenue would be mainly highly qualified professionals, who could be redeployed from the DLT Office, after abolition. Since additional staff of the same type would also be required in the late '80s, to cope with re-rating, using them for CGT valuation over the next few years made some sense from a management point of view.

The Chancellor said the decision was a fine one, but on balance he thought that the change should be made on the basis of proper valuation for all assets. He noted that the additional staff required would add to the problems of achieving Inland Revenue's manpower targets by 1988.

Capital Transfer Tax

3. The Chancellor said that the original decision to extend 100 per cent CTT relief to agriculture as well as business had been taken on Inland Revenue advice that it would be difficult to draw a clear distinction between the two; but the main purpose of extending the relief was to give extra help to business. The improvement in the CGT package and the decision to abolish DLT had however changed the picture. In discussion it was noted that extending CTT relief to agriculture would be difficult to defend in the context of a rather tight Budget, and it might be hard to present the CTT package convincingly as an enterprise measure.

4. It was agreed that there should be no improvement in the CTT relief for business and agriculture this year. Inland Revenue noted that they would lose 90 staff savings in consequence of this decision.

RL.

MRS R LOMAX

Distribution

Those present
Chief Secretary
Minister of State
PS/Inland Revenue

BUDGET CONFIDENTIAL

FROM: MISS M O'MARA
DATE: 5 March 1985

PS/FINANCIAL SECRETARY

cc Mr Cassell
Mr Battishill
Mr R Allen
Mr Robson
PS/IR
Mr Crawley (IR)
Miss Hill (IR)
Mr Graham (Parly Counsel)

ONSHORE OIL FIELDS: STARTER 138

The Chancellor has seen Miss Hill's submission of 1 March. He has commented that this seems the right approach but will surely need an amendment to the Budget Speech.

MISS M O'MARA

FROM: P WYNN OWEN

DATE: 5 March 1985

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Mr Cassell
Mr Battishill
Mr Monger
Mr Cropper
Mr Lord
PS/IR
PS/C&E

MR GRIFFITHS

TAXES ON NEWSPAPER ADVERTISING

The Chancellor has seen and was grateful for your minute of 27 February.

Pwo.

P WYNN OWEN

BUDGET CONFIDENTIAL

FROM: P WYNN OWEN

DATE: 7 March 1985

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mr Battishill
Mr Monger
Mr Griffiths
Mr Cropper
Mr Lord
PS/C&E
Mr Jeferson Smith - C&E

PS/MINISTER OF STATE

VAT ON IMPORTS: RELIEF FOR TEMPORARY IMPORTS

The Chancellor has seen your minute of 5 March and is content with the Minister of State's proposals.

Pwo.

P WYNN OWEN

CH/EX REF. NO. M28
COPY NO. 18 OF 18 COPIES

FROM: MRS R LOMAX
DATE: 7 March 1985

cc Chief Secretary
Minister of State
Economic Secretary
Sir P Middleton
Mr Bailey
Sir T Burns
Mr Cassell
Mr Monck
Mr Battishill
Mr Monger
Mr Cropper
Mr H Davies
Mr Lord
Sir L Airey - IR
PS/IR

FINANCIAL SECRETARY

CAPITAL ALLOWANCES

On further reflection the Chancellor has decided that he does not want to alter the phasing of capital allowances for plant and machinery to meet the CBI's concern about the dip.

2. He has also confirmed that he is content to maintain the oil exploration and appraisal allowance at 100 per cent, in line with the treatment of SRAs.

RL

MRS R LOMAX

BUDGET CONFIDENTIAL

cc PS/FST
Mr Monck
Mr Monger
Mr Lord
PS/IR
Mr Beighton - IR

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

11 March 1985

The Rt. Hon. Norman Tebbit MP
Secretary of State for Trade and Industry

Dear Norman

As I promised when we met, I have looked very carefully at the two taxation measures to encourage research, development and innovation about which you wrote to me on 22 February.

It seems that in the very large majority of cases it is possible to get immediate tax relief for R&D expenditure (whether by way of a deduction for revenue expenditure or through the scientific research allowance which, as you know, I have agreed to retain at 100 per cent for capital expenditure). But as you suggest, relief may not always be available until trading begins in the case of joint ventures such as those carried on by consortia or limited partnerships. However, there may often be other difficulties in the general law in setting up these arrangements and I therefore doubt whether to give tax relief for R&D before trading begins would by itself do much to encourage the growth of R&D activities here.

In any case, the change would have a substantial impact and cost in relation to the oil industry. Expenditure on oil exploration and appraisal qualifies for the scientific research allowance and I doubt whether it would be feasible to distinguish for this purpose such expenditure from expenditure on R&D. On this basis, the cost of allowing relief before trading begins would be around £25m a year, and I am afraid that I could not countenance such a significant increase in the level of the tax reliefs which the oil industry already enjoys. For Community reasons, it might also not be easy to limit any relief to R&D incurred in the United Kingdom.

Nevertheless, it might be useful for officials to continue to keep this point under review. Meanwhile I hope that the proposed extension of the Business Expansion Scheme to R&D companies will encourage individuals to invest in this area.

I have also carefully considered the possible exemption of hands-on venture capital companies from capital gains tax but there remain a number of difficulties. Under the scheme which the British Venture Capital Association have recommended, the treatment of the managers' rewards could be controversial since they do not appear to be prepared to settle for anything less than the tax treatment which can be secured from setting up offshore funds. In addition, their insistence that a proportion of funds must be available for investment overseas and in investments other than venture capital means that in practice we should be extending CGT exemption to funds only part (ie less than 50 per cent if BVCA had their way) of which was invested in small high technology companies in this country.

/

Like you, I certainly want to encourage institutional investors to invest more equity in unquoted trading companies. But I am not so far persuaded that this exemption is the most effective way of achieving that. You will have seen the recent criticism the Business Expansion Scheme has attracted through its use for property development companies and other low-risk activities. That provides a good example of the dangers of giving tax reliefs except where they can be targeted very closely indeed.

In particular the decision to retain the scientific research allowance and the extension of BES to R&D companies should help the presentation of your announcement about your Department's public expenditure support for R&D.

NIGEL LAWSON

BUDGET SECRET

FROM: MISS M O'MARA
DATE: 11 March 1985

CH/EX REF NO M39
COPY NO 14 OF 14 COPIES

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Minister of State
PS/Economic Secretary
Sir P Middleton
Mr Battishill
Mr Lovell
Mr Monger
Mr R I G Allen
Mr Halligan
Mr Cropper
PS/IR

CAR AND CAR FUEL SCALE CHARGES 1986-87

The Chancellor has seen your minute of 8 March and has agreed with the Financial Secretary that the Government should keep to a 10 per cent increase, as last year.

MOM

MISS M O'MARA

BUDGET CONFIDENTIAL

FROM: MISS M O'MARA
DATE: 12 March 1985

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Minister of State
PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mr Monger
Mr R I G Allen
Mr Cropper
PS/IR
Mr Bowman (OPC)

STAMP DUTY PACKAGE

The Chancellor has seen your minute of 8 March and agrees with the point the Financial Secretary has made.

MOM

MISS M O'MARA

BUDGET CONFIDENTIAL

FROM: MISS M O'MARA
DATE: 12 March 1985

cc Mr Cassell
Mr Battishill
Mr Watson
Mr R I G Allen
Mr Folger
Ms Seammen
PS/IR

MR MONGER

TAX AND NIC RELIEF

As I mentioned to you, the Chancellor would be grateful for a note, indicating the global amount of tax relief and NIC relief given to employees on average earnings or below, as a result of the Budget. He would also like to know how much employers will receive in NIC relief for the same group.

MOM

MISS M O'MARA

cc CST
FST
MST
EST
Sir P. Middleton
Sir T Burns
Mr Dailey
Mr Cassell
Mr Battishill
Mr Monger
Mr R.G. Allen
Mr Cropper
Mr Lord
Mr Davies
IR Sir L. Airey
Mr Isaac
Mr Blythe

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

12 March 1985

Andrew Turnbull Esq
10 Downing Street
LONDON
SW1

Dear Andrew

DRAFT GREEN PAPER ON PERSONAL INCOME TAX

As promised I attach two copies of the draft synopsis of the proposed Green Paper on personal income taxation, for discussion at the Prime Minister's bilateral with the Chancellor on Thursday morning.

Yours ever
Rachel.

MRS R LOMAX
Principal Private Secretary

DRAFT MINISTERIAL FOREWORD/INTRODUCTION

1. Last year I reformed the system of business taxation, setting the pattern for the next three years and beyond. In this year's Budget, I foreshadowed a programme for the reform of personal taxation.

2. My objective in both reforms is to create a tax structure that reflects the changing needs of the modern world and encourages the creation of wealth and jobs.

3. The Government is committed to reducing the burden of income tax. But changes in income tax are expensive and the money can only be found to the extent that it is not pre-empted by increases in public expenditure. It costs £1 billion to put the main personal allowances up by 5 per cent or to reduce the basic rate by 1 per cent. So it is vital to ensure that any resources that are available for reducing the burden of tax are put to the best possible use.

4. We need a tax system which is fair, comprehensible, and makes economic sense.

5. Measured against these criteria, the present system has a number of drawbacks:

- it discriminates in favour of two-earner families, at the expense of those where the wife stays at home to look after the children

- married women have no separate tax status; both their investment income and, normally, their earned income is aggregated with their husbands'

- low tax thresholds contribute to the poverty and unemployment traps - which are a disincentive to work

- it is complex and difficult for taxpayers to understand.

6. The Government can see considerable advantages in adopting a new system of personal taxation, based on a single transferable allowance for each taxpayer.

7. Under such a system everybody, man or woman, married or single, in or out of paid employment, would have the same standard tax allowance. Where one partner to a marriage is unable to make a full use of his or her tax allowance he or she would have the right (if they wish) to transfer the unused allowance to the other partner.

8. This reform would mean that <u>all</u> taxpayers would have exactly the same allowance. All <u>married couples</u>, whether one partner or both is earning, would have the equivalent of two allowances. The existing married man's allowance would disappear. The aggregation of husband and wife's income would go.

9. The single transferable allowance system offers three main advantages.

- it ends the present discrimination against the family where the wife works at home, which nowadays increasingly means discrimination against the family with young children

- unused allowances can be transferred within a marriage, ensuring that each taxpaying couple can take full advantage of them

- it gives married women equality and the right to privacy in their tax affairs, removing the anomalies created by the existing aggregation system.

10. It would, furthermore, enable the Government to raise tax thresholds both for families where the wife works at home and for young people and other low earners to a level that would be prohibitively expensive under the present system. For a given amount of tax relief it would take far more people out of the poverty and unemployment traps -and out of the tax net altogether - than is possible under the present system.

11. Transferable allowances would require changes to the way the tax system is run. These will be made possible by the computerisation of PAYE which is well under way; this is due to be largely completed by the end of 1987. It is essential to plan now for the tax structure that will be operated under a fully computerised system. The change to a new system can take place as soon as all the new facilities are available.

12. While this preparatory work is proceeding we are publishing this Green Paper to explain our proposals for reform in more detail. Subject to the outcome of the consultation period which will follow this Green paper, the Government propose to introduce the necessary legislation for a change in the system in 1987. New arrangements could be fully operational from April 1990.

13. Computerisation also opens up the possibility of other changes in the tax and benefit systems, which are discussed in the paper, and its Annexes.

REVISED OUTLINE OF GREEN PAPER

Chapter 1: The Objectives of Reform

Background: Reform of the Tax System

1.1 Government committed to tax reform.

1.2 1984 Budget achieved major reform of corporate tax system including substantial reduction in corporation tax rates; and dealt with distorting effects of capital allowances and stock relief.

1.3 1985 Budget sets in hand reform of personal income tax to reduce the tax burden and bring tax structure into line with reality of modern society. Green Paper outlines objectives and describes a system Government believes compatible with them. Outside comments welcome.

Objectives of Reform

1.4 Reform will have three specific aims

1.5 First: to provide a fairer system. To remove discrimination against couples with only one breadwinner. To remedy anachronistic treatment of married women (following 1980 Green Paper).

1.6 Second: simplification. Structure of system should be as simple as possible.

1.7 Third: to find cost effective answers to the problems caused by low tax thresholds. Consistent objective has been to increase income tax threshold. But very costly within present system. Reform needed so that, within limit of what can be afforded more can be done to reduce the burden of tax on the young and low paid, and to tackle the problems of the poverty trap and the unemployment trap.

1.8 Under the new system everyone would have a tax allowance in their own right; man or woman, married or single, in or out of paid employment. But tax system should continue to recognise the status of marriage, so unused allowances would be fully transferable within a marriage. Aggregation of husband and wife's income (investment as well as earned) would go. So structure will recognise each individual's right to independence and privacy in tax matters.

Chapter 2: The Case for Change and Proposals for Reform

Background

2.1 Structure of personal allowances has remained the same since the Second World War. Some of most important features of personal income tax system go back much further.

2.2 In brief:

Present structure

Single people: 1 personal allowance

Married men: approx 1½ the single person's allowance

Married women: wife's earned income allowance, equal to single personal allowance

Thus: single person: 1 allowance

one-earner couple: approx 1½ single allowance

two-earner couple: approx 2½ single allowance.

Wife's income aggregated with husband's income. Fuller details in Annex 1.

How the present structure originated

2.3 Before the War, there was an allowance for a single person, and an allowance of at least half as much again for a married man, who was expected to support his wife.

2.4 It was then unusual for a married woman to be in paid employment - only 10 per cent were in 1931 - but where she was in paid work, her husband got a small allowance to set against her earnings. This brought couple's total allowances up to roughly twice the single allowance.

2.5 In 1942 as part of the drive to encourage women to contribute to the war effort, the wife's earned income allowance was increased to the level of the single allowance. Wife's earned income allowance has remained at same level as single allowance ever since.

2.6 Married man has continued to get a higher allowance whether or not his wife is in paid employment. This gives the UK a system which, by international standards, discriminates in favour of two earner couples and against most one-earner couples. (See Annex 2 for international comparisons.)

<u>Social aspects</u>

2.7 Under present system:

- A married woman has no tax allowance of her own to set against her own income (wife's earned income allowance only available if she has earned income of her own, and even then theallowance belongs in strict law to the husband).

- Where wife has investment income of her own, couple may pay more in tax than two single people - a tax penalty on marriage.

- Because husband is nominally responsible for returning all couple's income and paying all the couple's tax, wife cannot have privacy in her financial affairs.

2.8 Major social and economic changes since the structure of allowances was fixed during the War. Very large proportion of women in paid employment. Now the rule rather than the exception for married women to go out to work except when they have young children. The great majority of women will be working at some point in their married lives; half of all married women already work outside the home, and the proportion is likely to go on rising.

2.9 It is right that everyone should have same tax allowance. All married women should have their own tax allowance - not just those who work outside the home. There is no reason to discriminate in favour of the married man whose wife goes out to work, as against single people and married couples where the wife works at home.

Traps

2.10 Low tax thresholds are one of the main causes of the poverty and unemployment traps. People most affected by these traps are married men on low earnings supporting families.* Traps wrong in themselves and bad for the economy.

2.11 Government has made progress, raising tax thresholds by [16] per cent in real terms, taking almost 1 million people** out of tax since 1978-79 (compared with indexation). But still too many people paying tax and in traps. New system will be more accurately targetted at those worst affected by low tax thresholds.

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* By historical accident, the present system does give relatively high tax thresholds already to married women supporting families: see Annex 1.

** Pre-Budget figures.

Proposals for reform

2.12 Government therefore proposing the system of single transferable allowances, which should correct many of the drawbacks of existing scheme.

2.13 Government's intention would be to phase in the new system over two years with no couples losing out in cash terms. The new allowance will be set at the level at which two such combined allowances currently given to a two-earner couple. Effects will be as follows.

- Single people will gain from increase in allowance. Helps young people looking for their first job. Unemployment worst among single youngsters.

- Married man who is sole earner will see a substantial increase in his tax threshold. This will reduce numbers of those most affected by poverty and unemployment traps.

- Two-earner married couples and married couples where the wife is the sole earner will keep the same total allowances in cash terms.

2.14 Phasing in such a change over 2 years would cost around £4.5 billion. But the effect would be to lift about 200,000 more tax units (mainly married couples) out of tax than would be the case if allowances were raised under the present system at a similar cost to the Exchequer. (Annex 3 shows how the change might be phased in; Annex 4 gives more details of the effects on couples in different circumstances.)

Aggregation of husbands' and wives' income

2.15 New system will also deal with widespread and justified criticism of present tax system among women. Aggregation of both earned income and investment income will be ended; and both partners in a marriage will have right to refuse transfer of any unused allowance. The rule which says that the income of a married woman living with her husband is deemed for income tax purposes to be his income and not her income will be ended. Husband and wife can have equal privacy and independence in tax matters.

2.16 Annex 5 gives more details of the treatment of investment income and discusses possible implications for other aspects of the income tax and for the capital taxes.

Particular groups

2.17 Annex 6 discusses how the new system will affect the elderly; Annex 7 looks at the position of single parents.

How the system will work

2.18 When it is fully phased in system will run broadly as follows:

(a) Before the start of the tax year a partner in a married couple who thinks he/she will have no income during that year may arrange for the tax office to give the whole of the unused allowance to the other partner, who will benefit through the PAYE code.

(b) If one partner thinks that he/she will only have modest earnings - eg from a part-time job - they may arrange for the tax office to transfer only part of the allowance.

(c) Otherwise each partner will get a single allowance.

(d) The position will be reviewed after the end of the tax year to ensure that the couple have received the right allowances.

Chapter 3: Practical implications of the change

3.1 Introduction of fully transferable allowances represents a major change in the tax system. Government have set in hand the planning for this change and, subject to the response to this Green Paper, intend to legislate during the life of this Parliament. Change will directly concern something like 1 million employers, 600 Tax Offices and [12] million married couples. Will also affect indirectly a further [9] million single people.

Computer support

3.2 To run smoothly, system of fully transferable allowances requires new administrative infrastructure in the Inland Revenue.

3.3 Government has already authorised the Revenue to go ahead with two major computer projects. A pilot system for computerisation of PAYE (COP) has been running live in the West Midlands for well over a year. COP system is now being extended across the whole country, region by region, and its installation beginning this year will be complete by late 1987 or early 1988. Procedures for taxing self employment income under Schedule D are also being computerised (CODA). This new system also will be in place by 1989.

3.4 Government has now authorised Inland Revenue to enhance this basic computer system by two further developments: an efficient data transmission network, enabling the 600 Tax Offices to exchange information quickly and economically with each other, and with the offices responsible for collection and enforcement; and also a computer based national index, which will maintain up to date records of each taxpayer, his or her employer (or self employment), together with the necessary information to connect the tax records of married couples.

3.5 This development will provide Inland Revenue with computer support it needs to run a fully transferable allowance system. The link can be created and maintained between the tax records of husbands and wives who (because they may have different employers) may be dealt with by Tax Offices hundreds of miles apart. For the great majority of couples these records are not linked at present. Computer system will also enable tax offices to handle the many more cases which will need to be reviewed after the end of the year.

3.6 Without these added facilities it would be almost impossible to run fully transferable allowances. First requirement is therefore that necessary computer support should be in place in the Revenue before the administrative action to change to the system of fully transferable allowances can begin.

3.7 The Revenue will be using the computer facilities in the COP and CODA systems, and the new integrated data network, to set up the new national index; and the index cannot therefore be completed until after the other facilities are in place (1989). This explains why changeover to the new system cannot begin until then.

3.8 Annex 8 looks in more detail at the administrative consequences of the change.

Chapter 4: Next Steps

4.1 This Green Paper outlines main features of the proposed reform to a system of fully transferable allowances.

4.2 In the long run computerisation in the Inland Revenue will open up wider possibilities for change. Government will be considering the case for changing from present cumulative PAYE to a system of non-cumulation and 100 per cent end year review, of the kind used by the USA and many other countries. This would imply major changes for employers, taxpayers and Revenue administration.

4.3 With wider computerisation of DHSS, Government will also be considering the case for closer integration between data bases for tax and social security, and the systems themselves.

4.4 Government not bringing forward any proposals for change in these wider areas at present. But implications need to be studied. Annexes 9 and 10 set out some of the issues for consideration. Full consultation before any decision is made. Important to note that move to fully transferable allowances does not prejudice any of these possible changes.

4.5 In shorter term, over the coming months Government will be working up the necessary detailed procedures to operate fully transferable allowances. Will want to discuss with, in particular, employers' representatives, what the reform would imply for changes in employers' payroll procedures.

4.6 The Government will welcome comments, both on the proposed reform itself and, in due course, on the detailed procedures.

4.7 Subject to that, the Government intend to legislate in this Parliament [1987?]. During [1988 and 1989] Tax Offices will be asking married couples for the information necessary to link their tax records, set up the national index, and to give them the appropriate allowances. The new system could come into operation in the 1990-91 tax year.

Summary of Annexes

Annex 1 **The present structure of personal income tax**

Explanation of the present system and personal allowances, including those for elderly people.

Annex 2 **International Comparisons**

Comparison of levels of personal allowances available to single people and married couples in [15] other countries. The UK is exceptionally generous in the scale of allowances given to two-earner couples but relatively much less generous to one-earner couples.

Annex 3 **Phasing in the new structure**

Text and tables to show how the new structure could be phased in, the consequences for different couples, and the costs to the Exchequer. A two-year phasing-in period could avoid losers in cash terms, at a total cost of £4.5 billion for the non-elderly.

Annex 4 **Distributional effects**

Text and tables to show the effects of the new system on different families at various income levels

Annex 5 **Consequences for investment income, other aspects of income tax and capital taxes**

Consequences of independent taxation for wives with investment income. Possible measures to counter artificial income splitting.

- Treatment of mortgage interest ceiling for married couples.
- Treatment of other limits for husband and wife.
- Implications for capital taxes.

Annex 6 **The Elderly**

To what extent should transferability extend to the age allowance; might age allowance be phased out as part of the change; and the distributional consequences of the options.

Annex 7 **Single parents**

Single parents currently receive an additional allowance equal to about half the single allowance; should this extra allowance be phased out as part of the change and/or converted into increased One Parent Benefit.

Annex 8 **Administrative consequences of fully transferable allowances**

- Staff costs of running the new system: would depend on the detail, but much less than under a manual system.

- Setting up costs.

  Capital costs of integrated data network national index - necessary in any event for efficient working of Revenue in 1990s.

Annex 9 **Administration in the longer term**

Computerisation opens up possibility of moving to taxation on a non-cumulative basis as in US. Would be attractive for small business.

Annex 10 **Integration of tax and social security**

Raises wider issues. Clarify possible objectives and how far they would be met by different schemes proposed. Explain administrative consequences.

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Annex 1 — The Present Structure of Personal Income Tax

1. The basis of the present system of taxing married couples is that the incomes of a husband and wife are added together and treated as the husband's and taxed at his marginal rate. He is formally responsible for handling the couple's tax affairs, claiming the allowances, and paying the tax.

2. The personal allowances are as follows:

- the married man's allowance (£3155 in 1984/85) can be set against any income of the couple;

- the wife's earned income allowance (£2005 in 1984/85) is technically an allowance available to the husband to set against his wife's earnings only; in practice, it is usually given against the wife's earnings directly under PAYE.

Because the married man's allowance can be set against any income of the couple, it is available against the wife's earnings if the husband has no income of his own. But the reverse does not apply: if the wife has no earnings, the husband cannot claim the benefit of the wife's earned income allowance.

3. Thus the total allowances available to couples in different circumstances are:

Both working	(3155 + 2005)	5160
Husband only working		3155
Wife only working	(2005 + 3155)	5160

The Elderly

4. People over 65 have higher tax allowances, if their income is below a certain limit (see paragraph 5 below):

single age allowance	£2490
married man's age allowance	£3955

The wife's earned income allowance for married women over 65 is the same as for younger people, £2005.

5. Age allowance is given in full up to income of £8100 - this limit applies to single people and to the joint income of a married couple. The allowance is then withdrawn by £2 for every £3 of income over that limit, until it is reduced to the same level as the corresponding basic allowance.

Wife's earnings election

6. Where husband and wife both have substantial earnings they may elect to have their earnings taxed separately. Each partner then gets a single allowance and his/her own set of tax rate bands. The election does not affect the investment income of the wife which remains aggregated with her husband's income.

Annex 2.

International Comparisons (DETAILS ARE SUBJECT TO CONFIRMATION).

1. Comparisons are very difficult to make, especially in such a confined area as the level of allowances available to single people and married couples. In many instances a comparison is impossible because the system provides allowances which vary with the size of earnings.

2. The comparisons which follow, so far as possible, give an indication of the ratio of allowances in three cases. These are:

	Single: Married One Earner	Single: Married Two Earner	Married: One Earner Married Two Earner
[UK	1 : 1·5	1 : 2·5	1 : 1·66]

[It has been assumed for a one earnier married couple that

a. the husband is the earner and

b. the wife has no income.

For all cases it is assumed the taxpayers have no children or other dependents.]

3. Denmark

1:2 1:2 1:1

Since 1983 a system of fully transferable allowances and independent taxation has applied. This does not extend to investment income which is aggregated with the income of the spouse with the highest earned income.

4. Ireland

1:2 1:2 1:1

Married couples can be taxed separately or jointly. The ratios given above are based on joint taxation which most married couples opt for. In addition to extra allowances with joint taxation a married couple also enjoy a special scale of rates with bands double that for single taxpayers so they usually pay less tax than a single person with the same size income.

5. Germany

1:2 1:2 1:1

In addition to allowances, married couples have the choice of separate assessment, where each are taxed as individuals, or income splitting. In the latter case the total income is divided by 2 and the tax calculated on that part. This is then multiplied by two to get the total tax due. This gives married couples an added advantage particularly where the incomes vary. Effectively any higher income which may be taxed at a higher rate is transferred to the lower income and taxed at a lower rate.

6. France

1:2	1:2	1:1

The French have a family quotent system under which income of the family (including children) is aggregated and then divided by a certain coefficient. The tax is calculated on that reduced amount and then multiplied by the same coefficient to get the total tax due. For a husband and wife only, the coefficient is 2 and the effect is therefore similar to the German splitting system. The ratios above are not based on allowances but on the effect of this system on the zero rate band only. Allowances, or expense deductions, have maximum or minimum values, but vary with a. the size of income and b. the type of job. So a comparison of allowances alone is not possible.

7. Italy

Taxpayers are allowed tax deductions as opposed to personal allowances. A husband and wife are assessed separately, although an additional tax deduction is available to them if one spouse has taxable income not exceeding a specific level. Tax deductions vary with income levels so a comparison is not possible.

8. Luxembourg

1:1.78	1:2	1:1.12

A husband and wife are assessed jointly. One tax scale applies to all taxpayers but a married couple's tax is calculated by applying the table to only half their income and then multiplying the result by 2. As the table includes a zero rate band, this is effectively doubled for married taxpayers. (This same method also applies to a single taxpayer who has been divorced less than 5 years at the start of the tax year - so in the ratios shown such a person is equivalent to a one earner married couple.)

Broadly, allowances to set against income are doubled for two earner married couples. The ratios given include minimum special expenses and employment income allowance.

9. Belgium

A comparison cannot usefully be made because allowances for employment income vary with income up to a maximum level. Furthermore the tax position of married couples varies depending upon the size of their total net income.

10. Netherlands

Allowances vary and are broadly dependent upon 1. age, 2. size of income and 3. whether or not the taxpayer lives with someone (not necessarily a spouse). A comparison is not therefore possible.

11. USA

1:1.6	1:>1:6 (2.5 max)	1:>1 (1.55 max)

Married couples can be taxed separately but in practice most opt for joint taxation. This is generally more beneficial, a different scale of tax rates then applies with wider bands, which includes a larger zero rate band than available to single taxpayers and marrieds taxed separately. One and two earner couples filing joint returns both receive double the exemption given to a single taxpayer. In addition, two earner couples, taxed jointly, get an extra exemption equivalent to 10 per cent of the lesser of $30,000 or the amount of the lower earning spouse's earned income. (Hence the variation in rates.)

12. Japan

Individuals are taxed separately but a special exemption is available for a spouse who has no income, or income which does not exceed a specified level. In addition, there are basic allowances which vary with the level of income, so a comparison is not possible.

13. Sweden

1:1	1:2	1:2

Individuals pay both National Income Tax (at progressive rates) and Local Income Tax (at a flat rate which can vary from area to area).

A personal deduction is given to all taxpayers but can only be set against local income tax. Husband and wife are taxed separately although the unearned income of both is aggregated with that of the spouse with the highest earned income. The tax calculated on the unearned income is then split between the spouses in proportion to the amounts of their respective unearned income.

All taxpayers benefit from a zero rate band on National income tax upon which the above ratios are based. There is no special treatment for a dependent spouse.

14. <u>Greece</u>

1:1.24 1:2 1:1.6

Spouses are taxed separately although a husband is entitled to an allowance for a wife provided her income is less than a specified level. He is also entitled to a tax reduction for his wife but only if she has no taxable income. If allowances or tax reductions cannot be used in full by the husband, they are transferred to the wife.

The ratios provided take into account the basic personal allowance, the maximum value of the general employee's allowance, (this allowance will vary with income) the zero rate band effect and converting the tax reduction for a one earner family into an allowance taking the lowest rate of tax only. (11 per cent.)

15. <u>Canada</u>

1:1.87 1:2 1:1.07

Husband and wife are taxed on an individual basis, but a married person supporting a spouse is entitled to a further allowance over and above that available to single taxpayers. This further allowance is reduced $ for $ if the supported spouses income exceeds a set level.

16. <u>Australia</u>

1:1.6 1:2 1:1.25

Husband and wife are taxed separately. A spouse is entitled to a tax rebate only where he/she maintains the other spouse.

Where the supported spouse has income above a specified amount the rebate is reduced by $1 for every $4 by which the spouse's net income exceeds that amount.

The tax scale of rates includes a zero rate band. The first tax rate above this is 30 per cent. The ratios therefore take into account the maximum value of the tax rebate at the 30 per cent rate to a one earner couple.

17. <u>New Zealand</u>

1:1 1:2 1:2

A husband and wife are taxed separately. The only basic allowance given for all taxpayers is a standard deduction for employment expenses. Otherwise taxpayers receive tax rebates against income. The 'principal income earner' rebate is available to most individuals and varies with income.

A special rebate was also available for a dependent spouse but this was abolished with effect from 1 April 1983.

The ratios given above are based on the entitlement to the 'principal income earner' rebate and will only hold good if it is assumed that the income of the single taxpayer and that of each married taxpayer is identical.

18. It would be wrong to attempt to draw any worthwhile conclusions from a limited comparison of this kind. In the majority of cases, the effect of any one country's tax system on married or single people is far more complex than the outline above demonstrates.

Where comparisons of this sort are made, it may well be the case that other features of the tax system provide additional tax advantages to married couples which are not reflected within the narrow confines of the allowances given.

ANNEX 3: PHASING IN THE NEW STRUCTURE

1. Aim will be to phase in fully transferable allowances over [two year] period avoiding cash losers amongst two-earner couples.

2. But this will involve substantial forward commitment of resources (£4.5 billion at current prices and income levels). Precise way in which system would be phased in would therefore need to be considered in light of economic circumstances at the time.

3. Phasing in over two years enables the cost to be spread.

4. For illustration, at 1984-85 allowance levels, a possible two-year phasing in scheme would be

Year 1

(i) Reduce married man's allowance to £2,855.

(ii) Raise single allowance and wife's earned income allowance to £2,305.

(iii) Introduce transferable component of £1,200 within wife's earned income allowance. (The married man's allowance is, under present rules, already available to set against a wife's income if the husband has insufficient income of his own.)

Year 2

(i) Raise single allowance to £2,580.

(ii) Convert wife's earned income allowances into a single allowance.

(iii) Replace married man's allowance by single allowance of £2,580.

(iv) Make single allowance fully transferable between spouses.

[5. Position of elderly would need special consideration in light of decision about future of age allowance.]

Annex 4

FULLY TRANSFERABLE ALLOWANCES: DISTRIBUTIONAL EFFECTS

1. The attached tables show the detailed effect of introducing fully transferable allowances.

TABLE 2

EFFECT OF FULLY TRANSFERABLE ALLOWANCES

After transition with no cash losers

Non-elderly

	Amount of Allowance Before	After	Numbers (thousands)		Amount of cash gain
Single (7.8 million)	2,005	2,580	680 (9%)	taken out of tax	up to £3.32 per week
			7,000 (90%)	currently liable at basic rate	£3.32 per week
			100 (1%)	currently liable at higher rates	over £3.32 per week
One-earner couples (4.4 million)	3,155	5,160	620 (14%)	taken out of tax	up to £11.57 per week
			3,580 (81%)	currently liable at basic rate	£11.57 per week
			220 (5%)	current liable at higher rates	over £11.57 per week
Two-earner couples (5.5 million)					
- wife earns less than £2,005	3,155 to 5,160	5,160	1,800 (33%)		up to £11.57 per week
- wife earns over £2,005					
- couple do not elect	5,160	5,160	3,300 (60%)		no gain
- couple liable at higher rates but do not elect	5,160	5,160	200 (4%)		gain depends on split of income between husband and wife.
- couple elects	4,010	5,160	160 (3%)		at least £6.63 per week

TABLE 2A

Distribution of gains after transition with no cash losers

(1984-85 allowance levels)

Size of gain	Number of taxpayers (thousands)	Per cent
No gain/loss	3,300	19
Taken out of tax	1,300	7
Total gainers remaining in tax	13,060	74
	17,660	100

Annex 5	<u>Consequences for investment income, other aspects of income tax and capital taxes</u>
Annex 6	<u>The Elderly</u>
Annex 7	<u>Single parents</u>
Annex 8	<u>Administrative consequences of fully transferable allowances</u>
Annex 10	<u>Integration of tax and social security</u>

Still in preparation; dependent on decisions.

Annex 9 Administration in the Longer Term

1. Chapter 4 of the Green Paper explained that work is in hand on a study of how the tax system might be run in the longer term. This annex sets out some of the possibilities under consideration.

2. There are basically three stages in the work of calculating and settling tax bills:

(a) Before the year - coding, to give taxpayers their personal allowances and to make other adjustments;

(b) During the year - taking account of changes in personal circumstances, job changes, and fluctuating income;

(c) At the end of the year - calculation of any repayment due or tax still owed, and settling the balance.

3. Changes could be made to any or all of these stages. Some could be made independently; others only make sense in conjunction with changes to other parts of the tax system.

Before the year

4. The most likely change here would be a move from Revenue-coding to self-coding by taxpayers.

5. This would save work for the Revenue. By the same token, it would impose a burden on taxpayers, and would make life more difficult for employers who would receive coding notices piecemeal from their employees instead of in a batch from the tax office.

6. The first question to consider is how well taxpayers could cope with self-coding under the present system. Some simplification would certainly be desirable and perhaps essential. And particularly if coupled with a change to non-cumulation (see paragraphs 8 to 10), self-coding would mean that many taxpayers would have paid too little or, typically, too much tax by the end of the year.

7. Self-coding would inevitably mean more work for the Revenue in reviewing cases at the end of the year. It would be for consideration whether this would require returns from all taxpayers or whether, as information technology develops, the information provided by income payers would be enough in many cases (see 13 below).

<u>During the year</u>

8. The key question here is whether to retain the present system of cumulation or to move to non-cumulation.

9. A change to non-cumulation would have these advantages.

(a) Some employers, particularly those whose payrolls were not computerised, might find non-cumulation simpler to operate during the year, but this could be offset by any extra work from self-coding (see paragraph 5 above).

(b) Non-cumulation for IT could help to make it easier to integrate tax and NIC deductions into a single set of tables.

(c) Non-cumulation could mean an end to the current staff-intensive system for handling taxpayers moving from one employer to another.

10. The central disadvantage of non-cumulation is that it will not produce the right result for a high proportion of taxpayers. Of itself, non-cumulation would tend to mean that taxpayers would overpay tax - the person with breaks in employment will lose the benefit of some of his personal allowances, and the person who receives a bonus may find himself paying higher rates for the week in question.

After the end of the year

11. Either of the preceding changes would inevitably mean more work in sorting out cases after the end of the year. This extra work could either be done entirely by the Revenue, as happens at the moment, or there could be a move to self-assessment.

12. The Revenue could assess all taxpayers on the basis of information provided by the taxpayer. All taxpayers would therefore have to fill in returns, which the Revenue would process. There would be perhaps 20 million returns to handle, and millions of assessments and repayments to follow.

13. The paper mountain which that would generate would be reduced sharply, as technology develops, by an alternative approach. Information could be provided by income payers - employers, banks, companies paying dividends etc - on electronic tape. The Revenue would assess on the basis of this information, and fewer taxpayers would have to fill in returns.

14. Self-assessment would take a good deal of work from the Revenue, at the cost of putting the work on the taxpayer. A number of important changes would have to be made before self-assessment could be introduced. Some

simplification to the tax system would be needed, to ease the actual process of self-assessing. In particular, the basis of assessment for Schedule D would have to be brought into line with that for income from employment.

15. Under a non-cumulative system, and a fortiori under self-assessment, a compliance regime with more effective and automatic penalties would be required, to ensure that taxpayers met their obligiations.

16. A switch to the sort of system described in this Annex would have four main advantages.

(a) The new system might be run by fewer staff.

(b) The marginal extra staff cost of running transferable allowances within such a system might be small.

(c) Small (non-computerised) employers might be able to calculate the deductions for tax and NIC from one table.

(d) The way might be opened to further policy options.

The main possible disadvantages are that there would be extra compliance requirements for taxpayers and on balance possibly, for some employers. Taxpayers could also often pay too much tax during the year, though in expectation of an eventual repayment.

BUDGET CONFIDENTIAL

FROM: MISS M O'MARA
DATE: 13 March 1985

MR DRAPER - INLAND REVENUE

cc
PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Sir P Middleton
Mr Cassell
~~Mr Battishill~~
Mr Monger
Mr R I G Allen
PS/IR
Mr Corlett (IR)
Mr Bowman (Parly Counsel)

STAMP DUTY PACKAGE

The Chancellor has seen your minute of 12 March and would like to include in the Budget Speech the statement that he is "removing 13 pages of unnecessary law" as a result of the package.

MOM

MISS M O'MARA

BUDGET CONFIDENTIAL

FROM: MISS M O'MARA

DATE: 15 March 1985

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mr Battishill
Mr Monger
Mr R I G Allen
PS/IR
Mr Corlett - IR
Mr Bowman (Parly Counsel)

MR DRAPER - INLAND REVENUE

STAMP DUTY PACKAGE

The Chancellor has seen your minute of 12 March and agrees that the net figure of 5 pages is not large enough to warrant inclusion in the Speech.

MOM

MISS M O'MARA

BUDGET CONFIDENTIAL

FROM: P WYNN OWEN
DATE: 18 March 1985

APS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Minister of State
PS/Economic Secretary
Mr Culpin
Mr Halligan
Mr Cropper
Mr Lord
Mr H Davies

PRESS NOTICE: TAX REFORM

The Chancellor has seen Mr Halligan's minute to you of 14 March covering a draft press notice on tax reform. He has decided that this press notice should be dropped.

Pwo.

P WYNN OWEN

BUDGET CONFIDENTIAL

FROM: P WYNN OWEN
DATE: 18 March 1985

MR MONGER

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Mr Cassell
Mr Battishill
Mr Watson
Mr R I G Allen
Mr Folger
Ms Seammen
Mr Matthews
Mr Cropper
Mr H Davies
PS/IR

TAX AND NIC RELIEF

The Chancellor has seen your minute of 13 March. He wonders whether your note might be useful for briefing purposes.

PWO.

P WYNN OWEN