PO-CH/NL/0041

PART A

SECRET

(Circulate under cover and notify REGISTRY of movement)

PO -CH /NL/0041

PART A

1986 BUDGET TAX CHANGES

DDs 25 years 20/01/95 N.Az[illegible]

PO -CH /NL/0041
PART A

STARTS: 18-06-85

3.17

FROM: MRS R LOMAX

DATE: 18 June 1985

PSP

PSP

bf 25/6

cc Mr Farmer

PS/INLAND REVENUE

UNIT TRUST INSTRUMENT DUTY

The (unsigned) supplementary briefing on life assurance pipeline policies which was provided by someone in Revenue for the Chancellor's recent lunch for Save and Prosper referred to unit trust instrument duty. The Chancellor would be grateful for a note (which might start by explaining what it is!)

RL

RACHEL LOMAX

CONFIDENTIAL

FROM: J R CALDER
DATE: 2 August 1985

INLAND REVENUE
STATISTICS DIVISION
SOMERSET HOUSE

1. MR BLYTHE 2/8
2. CHANCELLOR OF THE EXCHEQUER

INCOME TAX HIGHER RATES

Mr Kuczys's minute of 30 July asked for the cost of raising the 60 per cent threshold from £28,900 to £32,600 in the revenue neutral régime with higher rates of 40%, 50% and 60% in my minute of 25 July.

The revenue cost would be £65 million in a full year at 1985-86 levels of income. Compared with the 1985-86 income tax system, there would be about 450,000 gainers and 100,000 losers. (The previous revenue neutral scheme had about 400,000 gainers and 150,000 losers). The attached graphs illustrate the gains and losses under the two schemes in cash and percentage terms at various levels of gross income for a married man with no allowances or reliefs other than the married man's allowance.

JRC

J R CALDER

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cc PS/FST
Mr Wicks
Mr Monger
Miss Sinclair
Mr Cropper
Mr Isaac
Mr Blythe
Mr Mace
Mr Calder
Dr Keenay
Mr Dodds

ANNEX

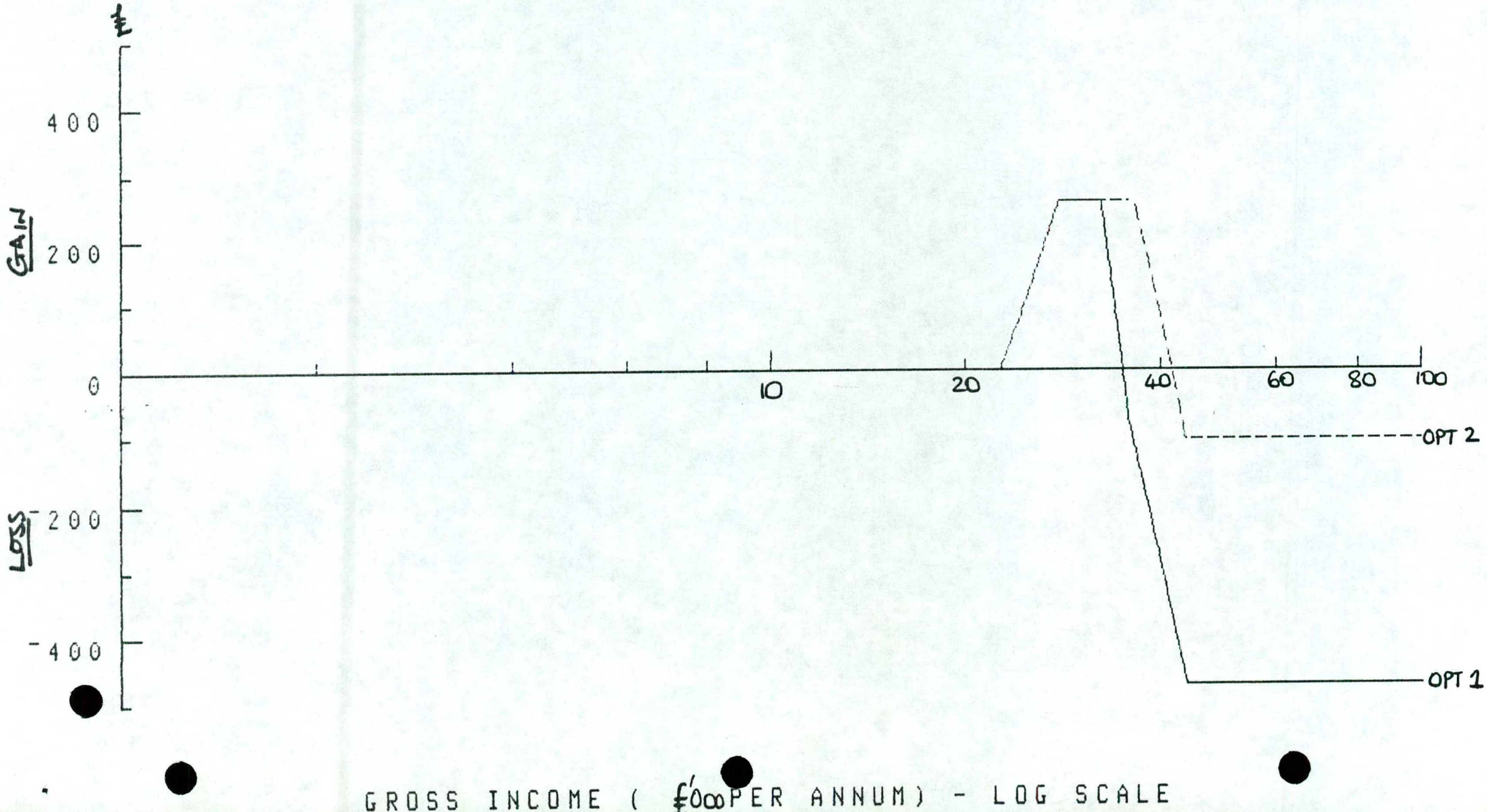
RATE BANDS per cent	Revenue-neutral Option 1 £	Option 2 £
30	0 - 16,200	0 - 16,200
40	16,200 - 24,400	16,200 - 24,400
50	24,400 - 28,900	24,400 - 32,600
60	over 28,900	over 32,600

FIG 1

GAIN/LOSS (IN CASH) COMPARED WITH PRESENT TAX REGIME

ARRIED MAN

OPT 1
OPT 2

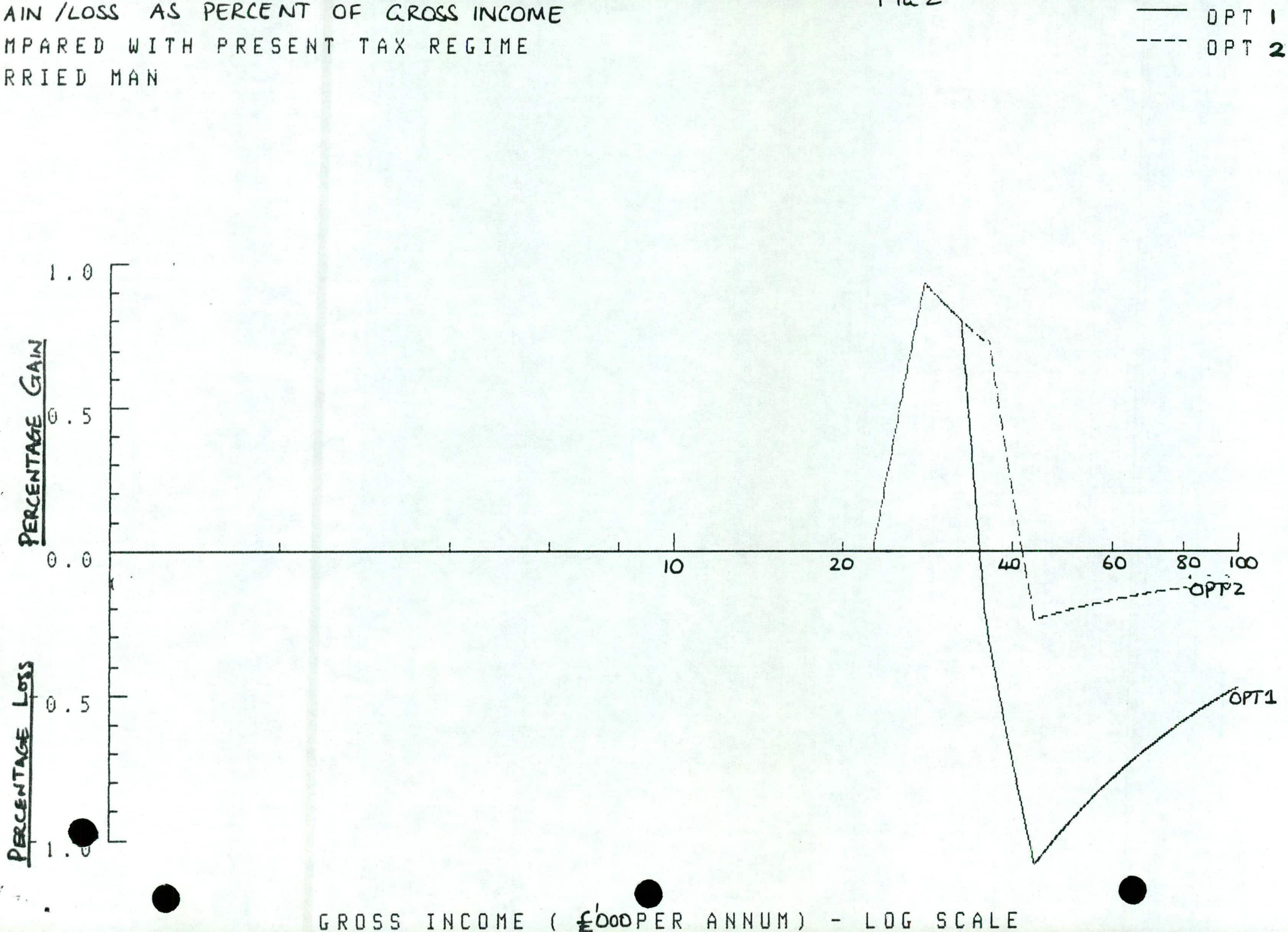


GAIN /LOSS AS PERCENT OF GROSS INCOME

OMPARED WITH PRESENT TAX REGIME

ARRIED MAN

FIG 2



FROM: A W KUCZYS
DATE: 30 July 1985

MR CALDER - INLAND REVENUE

cc PS/Financial Secretary
Mr Wicks
Mr Monger
Miss Sinclair
Mr Cropper
Mr Isaac (IR)
Mr Blythe (IR)
PS/IR

A

INCOME TAX HIGHER RATES

The Chancellor was grateful for your minute of 25 July, in which you set out a revenue neutral higher rate regime as follows:-

Bands of taxable income £	per cent
0 - 16,200	30
16,200 - 24,400	40
24,400 - 28,900	50
over 28,900	60

2. Starting from this new regime, the Chancellor has asked what would be the cost of then raising the 60 per cent starting point from £28,900 to, say, £32,600?

AWK

A W KUCZYS

CONFIDENTIAL

FROM: J R CALDER
DATE: 25 July 1985

INLAND REVENUE
STATISTICS DIVISION
SOMERSET HOUSE

1. MR BLYTHE 25/7
2. CHANCELLOR OF THE EXCHEQUER

INCOME TAX HIGHER RATES

1. Mr Kuczys's minute of 21 July asked what the 60% threshold would be under a revenue neutral measure which (i) reduced the existing 45% and 55% rates to 40% and 50%, respectively; and (ii) left the 50% threshold at its present level.

2. The new 60% threshold would be at £28,900 of taxable income compared with the existing £40,200. The structure of tax rates would be:

Bands of taxable income £	width £	per cent
0 - 16,200	16,200	30
16,200 - 24,400	8,200	40
24,400 - 28,900	4,500	50
over 28,900	..	60

3. About 400,000 single people and married couples would gain up to £260 per year compared with the current regime. These are taxpayers with taxable income between the present 45% threshold of £19,200 and £31,500 (£2,600 above the new 60% threshold). About 150,000 taxpayers with taxable income over £31,500 would lose up to £475 per year.

JRC

J R CALDER

cc PS/Financial Secretary
Mr Wicks
Mr Monger
Miss Sinclair
Mr Cropper
Mr Isaac
Mr Blythe
Mr Mace
Mr Calder
Dr Keenay
Mr Dodds

M10.36 **CONFIDENTIAL**

P/PTX/1

FROM: A W KUCZYS

DATE: 21 July 1985

MR CALDER - INLAND REVENUE

cc PS/Financial Secretary
Mr Wicks
Mr Monger
Miss Sinclair
Mr Cropper
Mr Isaac (IR)
Mr Blythe (IR)
PS/IR

INCOME TAX HIGHER RATES

The Chancellor has asked at what (lower) level of taxable income the top (60%) rate of income tax would need to start if -

(a) the present 40% and 45% bands were to be amalgamated into a single 40% band;

(b) taxable income between the enlarged 40% band and the start of the top rate were to be taxed at 50%; and

(c) the whole reform were to be revenue neutral.

AWK

A W KUCZYS

CONFIDENTIAL

FROM: J R CALDER
DATE: 28 June 1985
INLAND REVENUE
STATISTICS DIVISION
SOMERSET HOUSE

CHANCELLOR OF THE EXCHEQUER

INCOME TAX BANDS

1. Mrs Lomax's minute of 26 June asked for the cost of replacing the first four higher rate bands with a single band (of width £24,000) charged at 45%. The revenue cost would be £70 million.

2. There would be about 220,000 gainers but 700,000 losers. Losers would be taxpayers with taxable incomes between £16,200 (higher rate threshold) and £27,400. Those with taxable incomes above this would gain. The maximum loss would be £150 - for those in the present 45% band; the maximum gain would be £1,035 - for those at or above the present threshold for the 60% rate.

3. The number of two earner married couples who would find it beneficial to make the wife's earnings election would increase by 20,000 to 190,000. None of these new election cases would be gainers.

4. The change could be made revenue neutral if the 60% threshold were reduced by £4,500 - from taxable income of £40,200 to £35,700. The number of gainers would not be affected, but the average gain per gainer would be reduced and the maximum gain would be only £360.

Z Butt

for J R CALDER

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cc PS/FST
Mr Monger
Mr Cropper

Mr Isaac
Mr Blythe
Mr Walton
Mr Mace
Dr Keenay
Mr Calder
PS/IR

3.36

CONFIDENTIAL

FROM: MRS R LOMAX

DATE: 26 June 1985

cc PS/Financial Secretary
Mr Monger
Mr Cropper
PS/IR

MR CALDER - INLAND REVENUE

INCOME TAX BANDS

The Chancellor has been reflecting on the compression of the higher rate tax bands. He would like to know the cost of abolishing the first four higher rate bands and replacing them by a single band £24,000 wide at the rate of 45 per cent.

RL.

RACHEL LOMAX

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PRAYERS

C For Prayers.

Rvs 14/10

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

From: P Jefferson Smith

8 October 1985

C. As I read it this package might cause some annoyance to the tourism lobby, so Lord Young + Co might not be all that impressed. But the proposed changes are doubtless entirely rational. Any advice for the MST, or are you content for MST to deal with it as he sees fit? Rvs 10/10

MINISTER OF STATE

cc Chancellor
Chief Secretary
Financial Secretary
Economic Secretary
Sir P Middleton
Mr Monger
Mr Scholar
Mr Cropper
Mr Graham Parl. Counsel

VAT: HOTEL AND HOLIDAY ACCOMMODATION

1. The purpose of this submission is to report the results of a recent review of our treatment for VAT of hotel and holiday accommodation and to recommend certain changes in the law, to remove unfair competition and produce a useful revenue gain.

Present position

2. Schedule 6 Group 1 Item 1 to the VAT Act 1983 exempts:

"The grant, assignment or surrender of any interest in or right over land or of any licence to occupy land, other than -

[a list, of which the first item is -]

(a) the provision of accommodation in a hotel, inn, boarding house or similar establishment or of holiday accommodation in a house, flat, caravan or houseboat .

Note (1) "Holiday accommodation" includes any accommodation advertised or held out as such".

Internal circulation:

CPS	Mr Knox	Mr Howard	Mr P V H Smith
Mr Tracey	Mr Cockerell	Mr Wilmott	Mr Nissen

60/10/85

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The intention of this is to tax at the standard rate the provision of accommodation in hotels and similar establishments and of holiday accommodation. It was recognised at the planning stage of the tax that many people (such as retired people living in hotels, or low-paid workers in hostels) in fact reside permanently or semi-permanently in hotel-type accommodation and accordingly there is a special relief known as the "reduced value provision" (Schedule 4 para. 9 of the Act) which provides that where a supply of accommodation in a "hotel . . . or similar establishment" is made for a period exceeding four weeks the value for tax purposes from the 29th day is reduced so as to cover only the facilities provided other than the right to occupy the accommodation, subject to a minimum of 20%. At a standard rate of 15%, this means that an effective rate of 3% is payable after the first four weeks and represents a rough equivalent to the exemption under the main part of Item 1 for the rents paid by domestic tenants.

Outcome of Review

3. Our review identified three problem areas where the present law is unsatisfactory. First, contrary to the probable intention when the VAT legislation was first drawn up, it has been our practice, supported by the independent VAT Tribunals, to treat all accommodation in a "hotel . . . or similar establishment" as taxable under exception (a). This means that, as well as bedroom accommodation, we tax the letting of rooms in hotels for meetings and conferences, the letting of shop and casino premises in hotels, and the letting of sites for gaming and amusement machines in hotels and in those pubs which provide overnight accommodation. However because the "reduced value provision" also applies to non-bedded as well as bedded accommodation a very low rate of tax is charged and, unlike traders who make exempt lettings, hotels etc. suffer no restriction on their ability to deduct input tax connected with their letting activity. They are thus undertaxed compared with their non-hotel competitors.

4. Second, the "reduced value provision" applies not only to lettings of non-bedded accommodation of all kinds, but also to block bookings, by companies or tour operators, who take accommodation for, say, a summer season, and use it for successive groups of people each of whom stay less than four weeks. This interpretation of the law, although accepted by the VAT Tribunal, is quite contrary to what was intended, which was to relieve private individuals genuinely in long-term residence in hotels, of tax on the "residential" element of the services they received.

5. The third area of difficulty concerns service flats, many of them in London though some exist in provincial cities, which provide, with the exception of catering, virtually all the facilities of a good-class hotel plus added privacy, and which set out to attract tourists and other short-term visitors. They are directly comparable both with hotels and similar establishments and with holiday flats. However we have experienced great difficulty in maintaining taxation under either leg of exception (a). Our experience of appeal cases concerning holiday accommodation is that Tribunals are reluctant to look at the actual use to which accommodation is put and rely heavily on whether there is "holding out or advertising" as holiday accommodation. It is therefore simple for the operators of these flats to exclude "holiday" from their advertising without really diluting their message to "visitors to London", and our problems concern those who have done this. But we would not expect to succeed in maintaining before a Tribunal that accommodation of this kind to a transient population, even with facilities such as maid service, cleaning and porterage, could be regarded as a similar establishment to a hotel where no catering is provided.

The case for change

6. The case for action on all three points may be summarised as equity and simplicity of administration, though there is a small but worthwhile revenue gain from the package; and so far as the "reduced value provision" is concerned an amendment to the law would put right a patent wrong (see (b) below).

(a) Non-bedded accommodation All the lettings of land or premises mentioned in para.3 would generally be exempt if the premises in question were not in a "hotel . . . or similar establishment". In the case of commercial lettings therefore both landlord and tenant profit from a hotel letting to the detriment both of the revenue and of their counterparts in other premises. Whereas business tenants receiving exempt supplies of premises have to bear hidden tax in their rent because their landlord is unable to deduct as input tax the VAT he incurs, hotels suffer no such restriction, while most of their tenants, being fully taxable persons, are able to deduct as input tax the VAT they are charged. In these circumstances because of the reduced value provision even exempt tenants like banks and casinos may gain. Moreover there have been complaints on behalf of businesses which let premises for conferences, e.g. Wembley Conference Centre, that they are suffering unfair competition in respect of conferences staged in hotels.

One aspect of particular concern is vending, gaming and amusement machine site rentals. Because of the structure of this trade, those who raise the charge to tax are frequently not in a position to know whether the establishment concerned provides overnight accommodation or not. The uncertainty is bad taxation practice, is irksome to the traders concerned and this sector is of no revenue significance because of the input tax mechanism.

(b) The reduced value provision If there is no justification for treating some letting and leasing of property as standard-rated just because it is in a hotel, equally there is none for taxing these lettings at a low rate under a provision which was intended to provide an equivalent relief to that for domestic renting for private individuals who happen to reside in hotels. If it is accepted that the meaning of "accommodation" should be restricted to bedded accommodation for the purpose of liability to tax, then it would follow that it should be restricted in the same way for "reduced value" purposes.

Of greater revenue significance, however, is the abuse of the reduced value provision by foreign tour operators block booking. Parliament has decided that hotel accommodation shall bear VAT at the standard rate, and there is no reason why one tourist should pay less for his accommodation because he has booked with a foreign operator who does not account for UK VAT on his services, than another, who has booked his hotel himself or through a UK operator. There is no reason, again, why an operator, who does not in any real sense "occupy" the accommodation should benefit from a relief designed for individual long-term residents. We estimate a revenue gain of some £12 million in a full year at 1986-87 prices from restricting the reduced value provision to bedded accommodation supplied to an individual natural person.

(c) Short-term service flats Here the case in equity is at its strongest. These establishments are in fact used both by business and tourist visitors in the same way as a hotel or a holiday flat would be. They obtain an unfair advantage over their competitors in both these categories if they do not have to charge tax. Those establishments which do charge cannot understand why their competitors are "getting away with it". Many of these flats are in central London catering for wealthy foreign visitors. We estimate that redefinition of "holiday accommodation" to ensure that these places were included would bring in £1-2 million in a full year at 1986-87 prices.

Presentation of changes

7. We have considered whether the changes we seek could be brought about by administrative reinterpretation of the existing legal provisions. But as I have explained the line taken in the past by VAT Tribunals on our existing practice, unsatisfactory as we now believe it to be, makes it unlikely that we could make such a change stick within an acceptable timescale, since the few who actually lost by it would have an incentive to challenge us politically and in the courts. In any case, litigation could not tackle the problem of the reduced value provision. We therefore conclude that legislative action is necessary to deal with the problem as a whole. The changes on non-bedded accommodation in hotels and holiday accommodation could be made by an affirmative resolution Treasury Order (the first alone would only require negative procedure). However a Finance Bill clause (possibly about 5-6 lines) would be needed to prevent the reduced value provision from applying to block bookings.

8. While as I have indicated some sectors of the hotel and holiday trades would be adversely affected, this would be by no means universal. While some of the largest hotels or those which are part of VAT groups with other exempt activities, might as a result of exempting non-bedded accommodation become partly exempt and have to restrict their deduction of input tax, most hotels would remain unrestricted because of the generous de minimis provision for smaller businesses. And it is the large hotels which offer the most competition to proprietors of other shops, halls and conference venues. The change could therefore be presented as an end to distortion of competition in the treatment of property lettings. So far as the definition of holiday accommodation is concerned, the case for fairness is unarguable. It is possible that the tourism lobby might protest about the ending of the reduced value loophole, which they may see as a back-door way of having a reduced rate of VAT for overseas visitors. But the argument, which is persuasive, would be that there is no reason why some overseas operators should benefit to the detriment of British businesses.

9. We have also given some thought to whether before introducing such changes we should seek to consult affected trade interests. Here the arguments are more finely balanced. On the one hand we may be able to get the message over that we are trying to

simplify the operation of the tax and that many hotels will not be adversely affected by the change. On the other, the tourism lobby may well encourage the hotel industry to reopen its campaign for a general reduced rate of VAT, or one for overseas visitors, and on the holiday accommodation proposal it is unlikely that there is any representative body we could consult. On balance, while there is something to be said for prior consultation, we think it less likely to be productive than to delay or endanger the change.

EC Considerations

10. Under Article 13B(b) of the EC Sixth VAT Directive Member States are required to exempt, under conditions which they lay down, the leasing and letting of land. However the provision of accommodation, as defined in their domestic law, in the hotel sector or in sectors with a similar function, is to be taxed. Since we have a discretion how we define accommodation, there would seem to be no objection to our adopting revised definitions. It is in any case arguable that the intention of the Directive does not extend to non-bedded accommodation.

Revenue Effect

11. Taking the three elements of the package together, we would expect a revenue gain of about £13-14 million in a full year at 1986-87 prices.

Recommendations

12. The three elements of the package identified as a result of our review would, taken together, remove from the area of hotel and holiday accommodation anomalies which were not originally intended, which give rise to distortion of competition and added burdens on business as well as complicating the administration of VAT. Their removal will also yield modest but signficant extra revenue. Opposition should be divided and manageable. Accordingly we recommend that:

(a) the taxation of accommodation in hotels etc should be confined to bedroom accommodation and the other normal incidents of staying in a hotel;

(b) the reduced value provision for long stays should be similarly confined and should be restricted to stays exceeding 28 days by individual natural persons;

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(c) the definition of holiday accommodation should be extended in order to tax service flats catering for tourists and other short term visitors whether or not they are specifically held out as holiday accommodation.

On balance we advise against consultation with trade interests, but seek your agreement to the preparation of:

(i) an affirmative resolution Treasury Order for (a) and (c) to be laid in conjunction with

(ii) a 1986 Finance Bill clause for (b)

both to take effect from 1 November 1986 after the end of the 1986 holiday season.

PJS

P Jefferson Smith

cc: PS/Chancellor
PS/ C+E
Mr Jefferson Smith

PRIVATE AND CONFIDENTIAL

MINISTER OF STATE TREASURY

Treasury Chambers. Parliament Street. SWIP 3AG

17 October 1985

GOW → LORD YOUNG 17/10

Dear David,

VAT: HOTEL AND HOLIDAY ACCOMMODATION

You have kindly agreed to spare me half-an-hour of your time at 5.00pm on Tuesday, 5 November, to discuss possible changes to the VAT treatment of hotel accommodation.

This is a difficult and politically sensitive area and I enclose a submission from Customs and Excise which describes the position in some detail.

Yours ever,
Ian.

IAN GOW

Lord Young of Graffham
Secretary of State
Department of Employment
Caxton House
Tothill Street
LONDON SW1H 9NF

PRIVATE AND CONFIDENTIAL

VR20

CONFIDENTIAL

Can you advise on VAT starters referred to (we had it earlier)

FROM: MRS LOMAX
DATE: 23 October 1985

SIR P MIDDLETON Please advise Monck paper as sooner. See X

cc Sir T Burns
Mr Scholar

TAXES

The Chancellor was grateful for your minute of 22 October which he discussed briefly with you this morning (and may wish to return to at your next bilateral).

2. He has commented that this is a helpful pulling together of the threads, though he disagrees with it in some places (he is tempted to subtitle it "The Squirrel Report"!). He notes that you make no reference in your covering note to paragraph 17 (and the conclusion in paragraph 30(e)(i)). He also notes that there is no mention of the fact - very relevant to the comparison with employers' National Insurance contributions - that income tax cuts enable employers to pay less gross for an equivalent take-home pay.

3. On the major starters table, the Chancellor has noted that he will want to look at a package of measures on charitable giving, but this will need to go wider than VAT on charities, to cover, for example, the suggestions in the Ridley Report.

RL.

RACHEL LOMAX

24/10/87

pst

Table 4.2 Direct effects of changes in taxation

£million

WH Lane spoken - ? figs

	Effect in 1986-87: Changes from an indexed base(a)	Effect in 1986-87: Changes from a non-indexed base(a)	Effect in 1987-88: Changes from a non-indexed base(a)
INLAND REVENUE			
Income tax			
Increase in single allowance of £130 and married allowance of £200	Nil	-895	-1130
Increase in additional personal allowance and widow's bereavement allowance of £70	Nil	-10	-10
Increase in age allowance of £160 (single) and £250 (married) and income limit of £600	Nil	-115	-145
Increase in basic rate limit of £1000 to £17,200	Nil	-70	-115
Reduction of 1p in basic rate	-830	-830	-1245 (b)
Changes to further higher rate thresholds	+15	-35	-70
Abolition of higher rate relief limit for charitable covenants	Negligible	Negligible	-5
Relief for charitable donations through payroll deduction schemes	Nil	Nil	-20 (c)
Measures to counter avoidance and evasion by non-resident entertainers and sportsmen	Nil	Nil	+75 (d)
Fringe benefits - car and car fuel scales	Nil	Nil	+15
Changes to relief for overseas travel expenses	-10	-10	-5 (e)
Exemption for 1986-87 of July increase in social security benefits	-20	-20	Negligible
Changes in taxation of employee share acquisitions	Negligible	Negligible	Negligible (f)
Use of restricted shares in approved employee share schemes	Negligible	Negligible	Negligible (g)
Use of shares providing employee control in approved employee share schemes	Negligible	Negligible	Negligible
Exercise of options granted under approved savings-related share option schemes	Negligible	Negligible	Negligible
Worker co-operatives' use of redeemable shares in approved profit-sharing schemes	Negligible	Negligible	Negligible
Change in basis of assessment of enterprise allowance	Negligible	Negligible	-5
Exemption of pensions paid to victims of Nazi persecution	Negligible	Negligible	Negligible
Income tax and capital gains tax			
Tax relief for equity savings scheme	Negligible	Negligible	-25 (h)
Business Expansion Scheme- continuation beyond April 1987 and changes in coverage	Negligible	Negligible	+10 (i)
Income tax and corporation tax			
Refunds by occupational pension schemes	[+25]	[+25]	+125 (j)
Mines and oil wells capital allowances	Negligible	Negligible	-45 (k)
Changes in agricultural buildings allowance rules	Negligible	Negligible	Negligible (l)
Changes in capital allowance rules for leased assets	Negligible	Negligible	Negligible
VAT penalties, interest, surcharges and repayment supplement	Negligible	Negligible	Negligible (m)
Income tax, corporation tax and capital gains tax			
Charities: anti-avoidance measures	Negligible	Negligible	+20
Limiting scope of anti-bondwashing provisions	Negligible	Negligible	Negligible
Amendments to Accrued Income Scheme	Negligible	Negligible	Negligible

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

	Effect in 1986-87: Changes from an indexed base(a)	Effect in 1986-87: Changes from a non-indexed base(a)	Effect in 1987-88: Changes from a non-indexed base(a)
Income tax, corporation tax, capital gains tax and capital transfer tax			
Changes in relation to securities	Negligible	Negligible	Negligible
Corporation tax			
Reduction in rate of ACT to 29/71 times the amount of the dividend	-120	-120	-60 (n)
Reduction in small companies rate to 29 per cent	Negligible	Negligible	-20 (o)
Relief for single donations to charity by companies	Negligible	Negligible	-35 (p)
Loans by close companies	(q)	(q)	(q)
Transfer of losses on company reconstruction	Negligible	Negligible	+5 (r)
Corporation tax and capital gains tax			
Small part disposals of land	Nil	Nil	-5
Oil taxation			
Technical changes to remove anomalies	Negligible	Negligible	Negligible
Capital gains tax			
Indexation of annual exempt amount	Nil	Nil	-5
Restriction of holdover relief for dual resident trusts	Nil	Nil	+5
Capital transfer tax and inheritance tax			
Abolition of lifetime charge on transfers between individuals	-35	-35	-55 (s)
Indexation of chargeable rate bands	Nil	-20	-45
Stamp duties			
Reduction in rate on shares to 1/2 per cent from Autumn 1986	-70	-70	-75 (t)
Changes from 18 March 1986	+50	+50	+50
Other changes from Autumn 1986	+20	+20	+35
TOTAL INLAND REVENUE	-975	-2135	-2780

BUDGET SECRET
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BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

	Effect in 1986-87		Effect in 1987-88
	Changes from an indexed base(a)	Changes from a non-indexed base(a)	Changes from a non-indexed base(a)
CUSTOMS AND EXCISE			
Value added tax			
Increase in registration limits	Nil	Nil	Nil
Revised treatment of motoring expenses	Nil	Nil	+40
New rules on disaggregation of registrations	Negligible	Negligible	+20
Long term lettings of accommodation	Nil	Nil	+10
Reliefs for charities and the handicapped	-10	-10	-10
Excise duties			
No change in rate of spirits duty	-45	Nil	Nil
No change in rate of beer duty	-95	Nil	Nil
No change in rate of duty on cider and perry	-5	Nil	Nil
No changes in rates of wine and made wine duties	-30	Nil	Nil
Increases in rates of duty on light oil etc	+110	+380	+400
Increase in rate of duty on heavy oil for use in road vehicles	+30	+95	+105
No change in rate of fuel oil duty	-5	Nil	Nil
Abolition of duty on lubricating oils	-10	-10	-10
Abolition of duty on AVTUR	-10	-10	-10
Increase in rate of duty on gas oil	+25	+30	+30
Increases in rates of tobacco products duties	+175	+315	+335
TOTAL CUSTOMS AND EXCISE	? => +130	+790	+910

? [illegible].
this was scorecard neutral (nil rel to indexed base)

Vehicle excise duty			
No change in VED on car, light van and main lorry rates	-135	Nil	Nil
Increase in other VED rates	Nil	+5	+5
Changes in trade licensing arrangements	Negligible	Negligible	Negligible
Increased penalties for VED evasion	Negligible	Negligible	+10
Other			
Bus fuel grants	-5	-10	-10
TOTAL CHANGES IN TAXATION	-985	-1350	-1865

a. Estimates are rounded to the nearest £5million. 'Negligible' means less than £3million. Components may not sum to totals because of rounding. A detailed list of the proposals is contained in Annex [ ] with a description of the method of estimating the direct effects on revenue.
b. In addition there will be a £5million reduction in public expenditure on mortgage interest relief to those below the tax threshold.
c. This estimate is highly uncertain and depends on take-up.
d. The yield in subsequent years will be in excess of £100million.
e. The higher first year cost arises from the proposal to apply these improvements with effect from 6 April 1984.
f. Full year yield at 1986-87 income levels, £5million. This estimate is highly uncertain.
g. Full year cost at 1986-87 income levels, £10million. This estimate is highly uncertain.
h. This estimate is highly uncertain. The cost will build up over a period and will depend on take-up.
i. The scheme has a full year cost at current levels of investment of about £100million. The 1987-88 figure includes a small first year cost for continuing the scheme after April 1987.
j. The figure for 1987-88 includes a yield of £[70]million in corporation tax and income tax reflecting changed levels of contributions to or benefits paid from pension funds. [The overall yield including the charge on refunds may be about £[250]million in each of the following three years. These estimates are highly uncertain.
k. The cost will decline gradually in later years.
l. The cost will not exceed £5million in early 1990's. The long term cost will not exceed £20million.
m. The yield will build up over time to about £40million by 1991-92.
n. Increases subsequent liability to mainstream tax. The full year cost will be £10million.
o. Full year cost £35million.
p. Rising to about £70million, depending on take-up.
q. Without this measure the anomaly in the treatment of loans to participators in close companies could have led to widespread avoidance, costing tens of £million.
r. Rising to an eventual yield of about £50million a year.
s. The estimated eventual effect attributable to transfers in 1986-87 is £70million. If increased lifetime giving reduces the amounts in the death estates of donors, the CTT yield from those death estates will be reduced. But the effects are long-term and uncertain.
t. Duty on additional transactions expected to follow from the reduction in the rate is taken into account. The estimate is subject to a wide margin of error. The figure for 1987-88 takes account of a yield of £40million capital gains tax arising on the additional transactions.

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Annex to Chapter 4

The Budget Proposals in Detail

Special small type?

Income tax

It is proposed -

to increase the single person's allowance and the wife's maximum earned income relief from £2,205 to £2,335 and the married allowance from £3,455 to £3,655

to increase the additional personal allowance and widow's bereavement allowance from £1,250 to £1,320

to increase the age allowance for the single person from £2,690 to £2,850, for the married from £4,255 to £4,505 and the age allowance income limit from £8,800 to £9,400

to increase the basic rate limit by £1,000 to £17,200

to reduce the basic rate from 30 per cent to 29 per cent

to retain the width of the 40 per cent band at £3,000, of the 45 per cent band at £5,200 and of the 50 per cent and 55 per cent bands at £7,900.

As a consequence of these changes, the structure of personal tax rates in operation in 1986-87 will be:

Bands of Taxable Income

£	Per cent
0-17,200	29
17,201-20,200	40
20,201-25,400	45
25,401-33,300	50
33,301-41,200	55
over 41,200	60

[To reduce to 29 per cent with effect from 6 November 1986 the rate of deduction on account of tax etc from payments to certain sub-contractors in the construction industry.]

It is also proposed -

to abolish the £10,000 limit on higher rate relief for covenanted donations to charities

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to introduce from April 1987 relief for charitable donations of up to £100 a year made through payroll deduction schemes

to introduce measures to counter tax avoidance and evasion by non-resident entertainers and sportsmen who derive income from the UK

to change on a revenue neutral basis, with effect from 1987-88, the present engine size breakpoints in the scales for taxing car and car fuel benefits in respect of company cars provided for directors and employees whose remuneration is at a rate of £8,500 a year or more, and to increase the new scale for car benefits by 10 per cent

to extend from 1984-85 the relief for overseas travel expenses incurred by UK employees working abroad and by expatriates working in the UK, and to extend to UK self-employed persons with businesses wholly abroad all of the reliefs for overseas travel and subsistence that are available to UK employees working wholly abroad.

to exempt for 1986-87 the increase in social security benefits payable from July 1986

to amend the tax charging provisions relating to directors' and employees' acquisitions of shares and interests in shares in their companies

to permit the use in approved employee share schemes of shares subject to restrictions on their retention by ex-directors and ex-employees

to permit the use in approved employee share schemes of shares of a class the majority of which is held by directors and employees and which gives them control of the company

to enable approved savings-related share option schemes to permit exercise of options within three years in certain circumstances

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to enable registered worker co-operatives to use redeemable shares in approved profit sharing schemes

to change the basis of assessment of the enterprise allowance from Case I to Case VI of Schedule D.

to exempt certain pensions paid to victims of Nazi persecution

Income tax and capital gains tax

It is proposed -

to introduce a new tax relief for individuals investing in equities

to extend indefinitely the duration of the Business Expansion Scheme, to introduce an exemption from capital gains tax on the first sale of qualifying shares and to make certain changes to the coverage of the scheme.

Income tax and corporation tax

It is proposed -

to amend the mines and oil wells capital allowances; in particular to change to percentage based writing down allowances on a reducing balance and incurred basis, instead of the existing output-related allowances

to amend the provision governing the agricultural buildings allowance

to amend the legislation relating to capital allowances on machinery or plant which is leased

to disallow deductions for VAT penalties, interest and surcharges and to disregard VAT repayment supplement

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to introduce a tax recovery charge on payments from over-funded occupational pension schemes to sponsoring employers

Income tax, corporation tax and capital gains tax

It is proposed -

to introduce provisions to counter abuse of the tax reliefs for charities

to remove certain securities within the Accrued Income Scheme from the scope of the anti-bondwashing provisions

to make minor amendments to the Accrued Income Scheme

Income tax, corporation tax, capital gains tax and capital transfer tax

It is proposed -

to make changes in relation to securities replacing special rules for Stock Exchange jobbers by rules for market makers

Corporation tax

It is proposed -

to introduce a relief from tax for single donations to charity by companies which are not close

to correct an anomaly in the taxation of loans to participators in close companies

to restrict the transfer of tax losses on a company reconstruction

Corporation tax and capital gains tax

It is proposed -

to exempt, with effect from 2 July 1986, gains on the disposal of any option or contract to acquire or dispose of gilt-edged securities or qualifying corporate bonds

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to amend the provisions dealing with small part disposals of land

Oil taxation It is proposed -

to clarify allocation of tariff charge in cases of fields in common ownership which received development consent on same day

to ensure that the onshore/offshore boundary for oil tax purposes coincides with the UK coastline

to provide an alternative basis for determining the market value of methane and certain other light gas

Capital gains tax It is proposed -

to increase the annual exempt amount in line with the increase in the retail prices index so that for 1986-87 an individual will be exempt on the first £6,300, and most trusts on the first £3,150, of capital gains

to amend the hold-over relief for gifts to dual resident trusts

Capital transfer tax and inheritance tax It is proposed -

to abolish the charge on transfers between individuals made on or after 18 March 1986 and more than seven years before the transferor's death, and to charge inheritance tax on other transfers on or after that date

to charge transfers made on or after 18 March 1986 but within seven years of the transferor's death according to the scale for transfers on death; the charge will be reduced in the case of transfers more than 3 years before death.

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It is proposed, for events on or after 18 March 1986 -

to reduce from ten to seven years the period for cumulation of a transferor's or settlor's previous chargeable transfers for the purpose of the rate of tax on transfers into trust and on property held in trust.

It is proposed -

to tax gifts with reservation of benefit made on or after 18 March 1986 in connection with the donor's death as if the whole of the gifted asset had remained in his estate until the reservation was finally given up

to increase the bands of chargeable value for transfers on deaths occurring on or after 18 March 1986, in line with the increase in the retail prices index as follows:

Band of chargeable value £000	Rate on death per cent
0- 71	0
71- 95	30
95-129	35
129-164	40
164-206	45
206-257	50
257-317	55
Over 317	60

to charge at half the death rates transfers (other than between individuals) not within 7 years of the transferor's death

[to extend the exemption for transfers of shares in a company to an employee trust]

Stamp duties

It is proposed with effect from 19 March 1986 -

to charge duty at a rate of ½ per cent on takeovers and certain other company reorganisations

to introduce a new exemption for company reconstructions

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to withdraw exemptions from sale duty for certain categories of loan stock

to withdraw the exemption from bearer instrument duty for bearer letters of allotment

to charge duty at 5 per cent on the conversion of shares into depositary receipts

It is proposed with effect from a date in the autumn:

to reduce the rate of duty on transfers of shares to ½ per cent

to impose a tax on certain share transactions which do not at present pay stamp duty

to withdraw the exemption from sale duty for letters of allotment and for purchases by a company of its own shares

to change the rate of duty on bearer instruments

Value Added Tax

It is proposed -

to increase the registration limit to £20,500 per annum and £7,000 per quarter

to make VAT relief available for distress alarms and lifts for the handicapped and their charities; non-classified advertising and medicinal products supplied to charities; video and refrigeration equipment used in medical applications by certain eligible bodies, including charities; welfare vehicles used by such bodies to transport the deaf, blind or mentally handicapped; and recording equipment used by charities for the blind.

to restrict the VAT provision relating to long stays in hotels by individuals (to take effect from 1 November 1986)

to change the law to counter tax avoidance by artificial disaggregation of businesses

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to use the Inland Revenue fuel benefit scale to assess VAT chargeable on fuel used for private journeys in business cars.

Excise duties It is proposed -

to increase the duties on cigarettes and hand rolling tobacco by 11.1p per packet of 20 cigarettes

to increase the duties on road fuels by 7.5p a gallon and on derv by 6.5p a gallon

to abolish the duties on aviation kerosene and lubricating oils

to increase the duty on gas oil by 1.5p per gallon

Vehicle Excise Duties It is proposed -

to increase from 19 March 1986 the rate of duty for hackney carriages of up to 20 seats to £52.50, and the additional payment for each additional seat to £1.05. The concessionary rates of duty for farmers' heavy goods vehicles over 7.5 tonnes, will be increased by varying amounts as a second stage in the process of bringing them into line with the proportion of average mileage covered by these vehicles on public roads

to increase from 1 January 1987 the rate of duty for trade licences to £70 for cars and £14 for motorcycles. The increase in trade licence rates will be part of a package of measures reforming trade licence arrangements, including widened availability and changes in the duration for which they are available to 6 months and 12 months. A new type of probationary trade licence is also to be introduced for new businesses and for businesses where there is a doubt whether there is sufficient business to justify a full licence.

to introduce a provision requiring a person convicted of using an unlicensed vehicle to pay twice the level of back duty owing, in addition to any fine.

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The Direct Effects of Changes in Taxation

Table 4.1 gives the direct effects of changes in taxation. The direct effect of a tax change is the difference between the yield of the tax which would arise on the basis of the rates of tax, allowances, etc prevailing before the Budget (the pre-Budget regime) and the yield after the changes proposed in the Budget (the post-Budget regime).

For Inland Revenue taxes (and VED) the difference in yield for each tax is generally calculated by applying the pre and post-Budget tax regimes to the same tax base. This base is the post-Budget base - that is the levels of income, profits etc forecast for future years on the assumption that all the measures proposed in the Budget take effect. In certain cases, however, the difference in yield also takes account of changes in taxpayers' behaviour arising from the tax change where these behavioural changes can be directly attributed to the change in tax. For example, the estimate of the direct cost of the cut in stamp duty rates allows for the expected increase in dutiable transactions.

For Customs and Excise taxes and duties, the calculation takes into account, where possible, the effect of the tax change on the pattern of consumers' expenditure and the resulting impact on other expenditure taxes but makes no allowance for secondary effects: in particular, it is assumed that total consumers' expenditure does not change. A fuller description of the methodology is in Economic Trends, March 1980.

Table [4.1] shows the expected change in receipts of tax resulting from the Budget proposals. Additional information is provided in footnotes to the table for those proposals where the effect on tax liabilities in the first complete year to which the change applies (full year effect) is substantially different from the effect on receipts in either 1986-87 or 1987-88; or where the impact of the proposal is expected to build up over a period of years.

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The direct effects shown in the third column of table [4.1] assume that the levels of allowances, rates of duty etc proposed in the Budget for 1986-87 continue to apply for 1987-88 and compare the effect on receipts in that year with allowances and rates of duty unchanged from their money levels in 1985-86 (the unindexed base).

The estimates shown in table [4.1] do not reflect changes in the tax base arising from changes in money incomes and in the general level of prices and other economic variables which may result from the proposed tax change. These secondary effects are, of course, taken into account in estimating the impact of the tax change in the PSBR. The base for the post-Budget forecast of each tax (given in table [6.8]) takes account of the effects, direct and secondary, of all the measures announced in the Budget.

CHANCELLOR OF THE EXCHEQUER
HONI SOIT QUI MAL Y PENSE

b/f 12/12

with minutes

SHOULD BE HERE TODAY
12/12
TONY L

CONFIDENTIAL

b/f 9/12 with minutes ~~Anna~~

R ask APS/MST for a record of X. Rno 8/11

~~b/f 27/11 pd~~ ~~b/f 6/11 for PPS~~ ~~PPS pl~~ ~~b/f 20/11 pd~~

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

From : P Jefferson Smith.
Date : 4 November 1985.

JEFFERSON SMITH → PS/MST 4/11

PS/t now 6/12 at 12 noon. h 28/11

Private Secretary to the Minister of State

cc PS/Chancellor ✓
Mr Monger

Fran: When will MST now meet Ld Young? Rno 27/11

PS/t, The meeting was cancelled. It is not yet known when it will take place. h 11/11

VAT on Hotel and Holiday Accommodation

X The Minister of State is to meet Lord Young tomorrow at 5 p.m.

As a result of an approach to us at official level, we understand that his officials will be advising him to oppose the long stay block booking change on the grounds that it will do some damage to our tourist industry.

The Minister of State may like to bear the following points in mind :

(i) The long stay relief was not intended to help the hotel or tourist industries; still less overseas tourists or tour operators; it was intended to minimise the VAT burden on retired people or young workers living permanently in hotel/hostel type accommodation.

(ii) The extent to which it has actually helped the hotel and tourist industries should not be exaggerated; the relief only applies to the accommodation charge (or four fifths of it to be precise). Board and other services separately charged for are taxed at full value. Moreover since the transport element of the holiday package is zero-rated, the block booking relief when it applies can hardly have more than a fairly marginal effect on the overall price.

Internal cc : CPS, Mr Wilmott, Mr Knox, Mr Tracey

CONFIDENTIAL

(iii) Also since it only applies from the fifth week of a contract onwards provided that there is no break in the occupancy of each room, it is rather capricious in its effect and discriminates in favour of package tourists accommodated in the bigger London hotels as against individual holiday makers or business visitors who of course do not stay for more than 28 days, at any rate in the same hotel.

(iv) It is onerous for hoteliers to operate because they have to keep detailed records of occupancy of each room under each contract.

(v) Parliament has decided that hotel accommodation should be taxed at the standard rate of VAT. It is contrary to normal taxation practice for holiday or business visitors to a country to get preferential treatment as regards the effective rate of tax on services consumed within the territory compared with that imposed on the resident population.

Finally if Lord Young is not responsive to these arguments, the Minister of State may like to explain that, while he will report Lord Young's views to the Chancellor, the matter is essentially one of sensible and even-handed tax administration for Treasury Ministers' decision rather than the withdrawal of an intended relief for the tourist industry.

P Jefferson Smith

b/f ~~20/12~~ b/f ~~17/12~~ b/f ~~16/12 pt~~ b/f ~~10/12 pt~~ b/f ~~13/1 pt~~ b/f ~~7/1 pt~~ b/f 16/1 pt

Note. Discussed X with PS/MST who agreed to keep me posted. R 6/12

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

From: P Jefferson Smith
5 December 1985

MINISTER OF STATE

cc Chancellor
Chief Secretary
Financial Secretary
Economic Secretary
Sir P Middleton
Mr Lavelle
Mr Monger
Mr Scholar
Mr Cropper

C. A political risk that this will be presented as – "Now, they are putting VAT on your holiday in the sun!" by the popular press.
Para 6 suggests there has been an own goal which should have been foreseen
But against a background of price-cutting in the industry and only £5 to 10 on a £300 holiday you may be able to get away with it. You may like to discuss with MST at Prayers.
R 5/12

Budget X

VAT : SALES OF HOLIDAY PACKAGES BY TOUR OPERATORS

1. The purpose of this submission is to seek your agreement to an announcement not later than in March 1986 that tour operators' margins on sales of overseas holiday packages will become chargeable with VAT at 15% from April 1988. The objectives of this are to avert EC infraction proceedings and to remove an unfair advantage in respect of package holidays taken abroad rather than the UK and to produce a modest revenue gain. Primary legislation would be needed in 1987.

Present Position

2. At present the typical overseas holiday package does not attract any UK VAT. We regard the package as made up of separate supplies. Supplies of hotel accommodation and catering in the overseas country are outside the scope of our VAT while supplies of transport to or from an overseas destination are within the scope of our tax but zero-rated. Any minor element in the package for insurance is exempt. Tour operators invariably recover all the UK VAT they incur

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Internal circulation:

CPS
Mr Howard
Mr P Jenkins
Mr Knox
Mr Cockerell
Mr Tracey
Mr P V H Smith
Mr E N Taylor

4.5/12/85

as input tax. The result is that in effect people who buy overseas holiday packages receive a supply which is totally free of UK VAT. This is a source of considerable criticism by many traders in the UK seaside resorts and tourist centres who claim that as well as suffering unavoidable climatic disadvantage they suffer unfair competition on the VAT front. It is only a partial answer to say that the overseas holidays bear the local taxes in force where they are enjoyed.

The EC Legislation

3. The EC Sixth Directive contains in Article 26 what is described as a "special scheme for travel agents". The first point to make is that in our terminology it is a scheme for tour operators - people who sell holiday packages as principals whereas travel agents normally act on a commission basis on behalf of the tour operators. The essence of the scheme is :-

(i) the holiday package is treated as a single taxable supply by the tour operator in the country where his business is located;

(ii) the value of that taxable supply is the tour operator's margin, that is to say the total amount paid by the traveller less the actual cost to the tour operator of supplies of goods and services bought in from other taxable persons for the direct benefit of the traveller;

(iii) the tour operator cannot deduct or recover any tax he incurs on any goods or services he buys in for the direct benefit of the traveller.

It is thus known as the margin scheme. It is designed to provide a simplified method of accounting for tour operators which ensures that no part of consumers' expenditure within the Community either escapes tax or is subject to double taxation. The tax revenue is distributed fairly between Member States according to where, on the one hand the goods or services are physically enjoyed and where, on the other, the tour operator resells them at a profit. The scheme only applies to holidays within the Community; those outside are zero rated.

The Reasons for not Adopting the Scheme in 1977/78

4. When the EC Sixth Directive came into effect from January 1978, we took the view that we had a derogation under the transitional provisions to continue with our existing treatment of holiday packages. Although the margin scheme, when described in broad outline, sounds simple enough, it is far from simple to operate in practice. The main difficulties lie in the fact that tour operators do not work on the basis of compiling a package for each individual traveller. They go in for block bookings. Some buy in their own aircraft rather than purchase seats from other carriers. In 1978 and subsequently we were concerned about the practical difficulties of operating the scheme and we preferred to wait and see how other Member States would operate it. Another consideration at that time was that the most popular destination was Spain and the scheme applied only to holidays taken in EC Member States. Moreover we were under pressure from the travel trade (ABTA) to concede as little as possible. They were particularly anxious that they should have adequate notice to prepare for such a scheme. Tour operators have to have their catalogues and brochures ready for travel agents and the public for the next holiday season before the existing one has finished. That in turn means much planning up to two years in advance of any particular holiday being taken. From 1977 ABTA have always been led to believe that a long lead-in period would be obtained if or when an Article 26 margin scheme was to be implemented in the UK.

Recent Developments

5. There have been a number of developments over the last year or so which have persuaded us that we ought now to make a commitment to implement Article 26. First the Commission has intimated that provided that Member States adopt the basic principles of Article 26 it is not worried over the details; Member States can operate the scheme in whatever way is administratively acceptable to them. Secondly the Commission has proposed in the draft 18th Directive that the existing transitional derogations relevant to Article 26 should

be ended. It is these which we claim as the justification for not having implemented the scheme at all. Finally and most importantly the Commission is threatening infraction proceedings against us in which it would claim that the transitional derogations did not in fact entitle us not to implement Article 26 with the result that we have been in breach of the Sixth Directive.

The Threat of Infraction Proceedings

6. The threat has arisen following a change in our law brought about by the Value Added Tax (Place of Supply) Order 1984. This measure was adopted because of complaints by UK organisers of educational holidays in the UK that they were suffering from unfair competition from promoters based in Europe who were escaping our VAT. I need not go into great detail on this but the Order attempted to alter the place of supply for these overseas-based promoters so that we could bring their supplies of UK holidays within the scope of our VAT. To the extent that these people were within the scope of Article 26 in their own countries, this could have involved an element of double taxation - tax on the full cost of the holiday in the UK, plus tax on the operator's margin in his own country. They therefore naturally saw our move as contrary to the Directive. There were complaints to the Commission which led to a letter from it alleging that UK was in breach of its Treaty obligations in not implementing Article 26 in the UK. Despite a lengthy defence of our existing position on Article 26 and an offer to limit the effect of the Order to taxing that part of the price paid for each holiday that had not borne tax in any other Member State, we have now heard that the Commission will be rejecting our response and is about to institute infraction proceedings by sending an Article 169 letter, the first formal step. We should be able to head them off if we undertake to implement the Article within, say, two years and if we offer in the meantime to relieve (extra statutorily) the double taxation which arises where a promoter's supply has been subject to an Article 26 charge in another Member State.

The Case Against Letting the Dispute go to the European Court

7. There are, as you will recall, several other VAT cases waiting to be brought before the European Court. Other Ministers are concerned lest an accumulation of weak cases come before the European Court. That would not help our stance in cases which are more important to us (eg. the one on our zero-rates). Our legal grounds for resisting the Commission on Article 26, while reasonably respectable, are not particularly strong. Moreover, the reason for our failure to implement Article 26 has been more a matter of administration than of principle, and in response to our submission on the draft 18th/19th Directives (Mr Knox 17 October) your predecessor indicated agreement that we should accept the principle of taxing gross margins on all holidays but resist the Commission's target date of 1 January 1986.

8. There is no real social or fiscal justification for not subjecting overseas package holidays to an element of VAT. The tax due on a £300 holiday would probably be in the range of £5-£10 and so we are not talking about any great increase in prices. We are still endeavouring to get from ABTA meaningful figures but our best guestimate at this stage is that the total extra revenue would be in the region of £25m p.a. That would be a useful gain.

9. As we see it, there are only two difficulties about accepting the need to implement Article 26. The first is that it will need special legislation to implement it - possibly a rather lengthy clause which might have to provide for subsequent regulations. This will involve greater complexity for ourselves and the tour operators. Fortunately, however, there are only some 600 of these and few of them can really be described as small businesses. The extra administrative burden will be limited accordingly. However the more important difficulty is that although the scheme will bite on holidays taken in other Member States and in the UK (although the effect in the UK will be very marginal because we already tax the full hotel accommodation element of UK packages), the margin for

?

holidays taken outside the Community will, in accordance with Article 26.3, be exempted with refund (ie. zero-rated in our terms). This is an unattractive aspect of the scheme because to the extent that the tax does put up prices of Community holidays people will be encouraged to go elsewhere. ABTA have in the past criticised this aspect of the scheme particularly, but Spanish, Portuguese and Greek membership of the Community greatly weakens the argument. However, while we might try to persuade the Commission and other Member States to amend Article 26.3, we doubt whether we would be successful. We could also ask the Commission whether they would allow us to tax the margin of non-Community holidays until discussions on the ending of the transitional derogations are completed. Nevertheless, we do not think that the administrative difficulties or the inability to tax non-Community holidays are sufficient justification for contesting the whole Article 26 issue in the European Court.

Possible Reactions

10. We think ABTA recognise that implementation of Article 26 must come some time. They may protest about the decision, but would probably reluctantly acquiesce. Other Government Departments will probably not feel strongly. The FCO will welcome the avoidance of another legal challenge by the Commission. The Department of Employment is the sponsoring Department for ABTA, and may be opposed, but would have to concede that there will be no great impact on employment in the UK. If there was an opportunity, you might like to sound out Lord Young at the meeting on hotels on Friday. Subject to this, we think we should consult the FCO and Department of Employment. The danger of this course is that if it delays things for more than a few weeks, the Commission are likely to lose patience and issue the Article 169 letter. But this is not a public step, and we think it is a risk that has to be run.

Conclusion

11. We, therefore, seek your authority:-

(i) to consult the FCO and Department of Employment, and provided they are not opposed:

(ii) to notify the Commission that the UK Government will be taking steps to implement Article 26 so as to tax the margin of holidays taken after 1 April 1988;

(iii) to prepare an announcement (possibly by an arranged PQ) that legislation for a margin scheme will be introduced in the 1987 Finance Bill after consultations between Customs and ABTA on the details, the effective date for the legislation being 1 April 1988; to give two clear years, the announcement should be made before the end of March 1986;

(iv) to discuss with the Commission, before the announcement is finalised, its attitude to bringing non-Community holidays within the ambit of the scheme either on a permanent or temporary basis.

P Jefferson Smith

Green Paper

REFORM OF PERSONAL TAXATION

NOTE BY THE CHANCELLOR OF THE EXCHEQUER

In my 1985 Budget speech I promised to publish a Green Paper on the reform of personal taxation, and outlined the approach I thought we should adopt (see annex 1). Since then a considerable amount of effort has gone into working out both the presentation and the details of this proposal. The result is incorporated in the attached draft Green Paper, which we are to discuss on 9 January.

The case for reform

2. Since 1979, we have made a lot of progress in reforming the tax system, with the aim of creating a simpler and fairer tax structure as well as one which will encourage enterprise and improve the prospects for growth and employment. But we have not yet tackled the personal tax system, which remains essentially as it emerged, forty years ago, after the war. I am convinced that the reform of personal income tax should be a major priority for the next Parliament. The computerisation of PAYE, now well under way, will provide an important opportunity for imaginative reform. And if we are to seize this opportunity, we must plan for it now.

3. I have benefited from the work done by Geoffrey Howe during his period as Chancellor. His Green Paper (The Taxation of Husband and Wife, Cmnd 8093) published in 1980, canvassed a number of options for the reform of personal allowances. Virtually everyone who responded to Geoffrey Howe's Green Paper - including the Conservative Women's National Committee, professional organisations such as the Law Society and the Chartered Accountants, as well as social and political commentators of all persuasions - agreed that the present system needs changing.

4. The response identified two main options: replacing the present married man's allowance by an increased level of cash benefits for those with children and other dependants, and a system of independent taxation with transferable allowances. Like my predecessor, I am convinced that the first approach, supported by

31/1/107

the Labour party and the SDP as well as the Child Poverty Action Group, would be quite wrong, economically and politically. It would mean a further large increase in social security benefits; and it would do nothing to raise tax thresholds, rightly identified as a priority by many of our own supporters. The alternative, independent taxation with transferable allowances, was supported by the WNAC and by the professional organisations. It would provide a system of personal allowances which would both recognise the independence of women, and the special status of marriage, bringing us much closer to best practice in other European and North American countries. It is an approach that is consistent with the importance which we as a party give to the family; as well as one that fits well with the philosophy of giving voters more freedom to spend their own money as they wish, and reducing, as far as prudently possible, the burden of taxation - especially on incomes.

<u>Transferable Allowances</u>

5. The case for adopting a system of transferable allowance is set out in detail in <u>Chapter 3</u> of the Green Paper. I attach particular importance to the following points:-

(i) Since 1979 we have devoted considerable resources to raising tax thresholds, while leaving the existing structure intact. A move to transferable allowances would target future increases in tax thresholds where they will do most good. <u>It would particularly benefit those groups who are most severely affected by the poverty and unemployment traps</u> - married couples where the wife is either not earning at all, or earns very little (typically because she works part-time). And, by combining it with a step increase in the single person's allowance, it would take many young people out of tax altogether, thereby helping to reduce the problem of youth unemployment.

(ii) A system of transferable allowances would be better attuned to the needs of couples over their working lives. Most women nowadays take paid work 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 responsibility of a young family and the wife is least able to take paid work. Transferable allowances would meet this problem, by giving everyone a tax allowance in their own right; and allowing them to transfer the balance to their spouse where they had insufficient income of their own to use it up.

(iii) My proposals would completely remove the many tax penalties on marriage, all of which spring from the anachronistic - and widely resented - rule that for tax purposes a married woman's income is treated as her husband's. They imply the independent taxation of investment as well as earned income.

6. Annex 2 of this note summarises the implications of my proposals for the different groups of taxpayers, highlighting in particular the effect on married couples at different points in their lives. Further detail is given in the annexes to the Green Paper itself.

7. I would also draw colleagues' attention to part II of the Green Paper which outlines the ways in which the proposed reform would allow us to simplify the host of minor personal allowances, including the highly complicated system of age allowance.

8. The move to transferable allowances will fit well with the major reform of social security outlined in Norman Fowler's White Paper - although some drafting changes will be required to bring the draft Green Paper fully into line both with the White Paper and, later, with whatever changes are made in the 1986 Budget.

The tax system in the longer term

9. Section III of the Green Paper discusses, without commitment, a number of other long term changes in the taxation system, such as a move towards self assessment and a non-cumulative system. It also fulfils my promise to examine the longer term relationship between the tax and social security systems - a subject of

considerable public interest. The draft rejects the idea of complete integration which, in my view, would mean a further and undesirable blurring in the distinction between the money people earn themselves, and the money they receive from the state. There is however a strong case for rationalising the two systems for reasons of efficiency and greater simplicity. Norman Fowler's proposed changes already go some of the way. While major progress must await computerisation in both the Inland Revenue and DHSS, we must show ourselves prepared to discuss the case for going further.

10. The remaining chapter in this Section considers the scope for integrating income tax and national insurance contributions. I see little practical merit in moving in this direction; it would destroy the contributory principle and create many losers, especially among the elderly.

Phasing in the new system

11. The Green Paper examines in some detail the practical consequences of moving to a system of transferable allowances. This is discussed both in Chapter 3 of the main text and in the annexes. The Green Paper figuring, which at this stage is purely illustrative, shows the implications of phasing in the reform over 2 years on a no cash losers basis.

12. I should stress that the Green Paper represents no new commitment to reduce taxation: it merely shows how part of the tax reduction programme outlined in the 1984 Green Paper ("The Next Ten Years: Public Expenditure and Taxation into the 1990s" - Cmnd 9189) might be put to best use. We have made it very clear that our policy is to reduce the overall burden of taxation in general, and of income tax in particular, as and when we have the scope prudently to do so. But colleagues will need no reminding that my proposals are contingent on there being scope for tax reductions.

13. It is difficult to estimate precisely what the tax reductions implicit in the Green Paper, on a no cash losers basis, would amount to. On the assumptions given in the Green Paper the figure comes out at £5.3 billion (or nearly £2¾ billion a year). This is

sensitive to a number of factors, in particular the level of inflation in the early 1990s (since "no cash losers" implies that the cost of statutory indexation would be appropriated towards the cost of the reform). Also important will be the level of the basic rate of tax by then. The following table indicates the sensitivity of the calculations to these assumptions.

Real loss of Revenue over a 2-year period

£ billions; total

		Basic Rate		
		25%	27%	30%
	0	4¾	5	5¼
Inflation	2½	3¾	4	4¼
(%p.a.)	5	2¾	3	3¼

14. As the table makes clear, the figure quoted in the Green Paper implicitly assumes zero inflation and a basic rate of 30 per cent. Other assumptions would result in a lower global figure.

15. Moving to transferable allowances will not necessarily imply a net reduction in the overall tax burden of the same magnitude; it would be in line with the policy we have consistently pursued since 1979 to finance income tax reductions in part by raising indirect taxation. Thus, despite the difficulties we have had in recent years, we have been able in the last three Budgets to reduce income tax by raising thresholds by £6½ billion, implying a real loss of revenue (ie. in excess of statutory indexation) of almost £3½ billion.

16. Of course the draft Green Paper represents no commitment to reduce even income tax by any particular amount by a particular date; implementation of these proposals would have to depend on overall economic constraints in the normal way, and would occur as and when the scope for it occurs. But - subject to these provisos - I see considerable political advantage in giving some indication of the Government's tax strategy for the medium term.

Conclusions

17. I believe that the proposals for personal income tax in this Green Paper will be attractive to a wide range of political opinion, both within and outside the party - and especially to women voters. The response to Geoffrey Howe's Green Paper showed that there is a substantial body of opinion in favour of radical reform of the personal tax system. Informed opinion is aware of the opportunities created by the computerisation of PAYE. Since I outlined my proposals in my Budget speech there has been sustained and favourable interest both in the press and in the party. I also hope that the Green Paper proposals will strengthen support for the reduction in the burden of taxation to which we are committed, by showing how the scope for tax reductions can be most effectively used to encourage enterprise and employment.

N.L.

EXTRACT FROM HANSARD, TUESDAY 19 MARCH, Vol 75, Col 794 - 795

TAX REFORM

Mr. Lawson: I now turn to taxation.

This Budget carries forward the theme of tax reform I set out last year. Reform designed to make life a little simpler for the taxpayer. And above all reform designed to improve our economic performance over the longer term, on which the jobs of the future will depend.

In my Budget last year I announced a radical reform of the corporation tax system. This had been preceded by the Green Paper on corporation tax issued by my predecessor in 1982.

I am satisfied that the right way to proceed with major tax reform is to issue a Green Paper first, as a basis for full and informed discussion, followed by legislation when the results of that discussion have been fully digested.

I therefore propose to issue a Green Paper later this year on the reform of personal income tax.

The computerisation of PAYE makes this the right time to review the system of personal taxation. Most of the work will be complete by the end of 1987 and the full range of facilities will be available by 1989. The Green Paper will therefore discuss a range of options opened up by computerisation, from non-cumulation to closer integration between the tax and benefit systems, and including in particular a reform of the present system of personal allowances.

It is the Government's firm policy to reduce the burden of income tax, but we need to make sure that the reliefs we can afford are concentrated where they will do most good.

The present structure of personal income tax is far from satisfactory. Too many young people start paying tax at too low a level, and too many families find themselves in the poverty and unemployment traps. The system discriminates against the family in which the wife stays at home to look after the children. It denies to the partners in a marriage the independence and privacy in their tax affairs which they have a right to expect.

There is therefore a strong case for changing to a new system of personal allowances more suited to today's economic and social needs. Under this, everyone, man or woman, married or single, would have the same standard allowance; but if either a wife or a husband were unable to make full use of their allowance, the unused portion could be transferred, if they so wished, to their partner.

This reform would produce a more logical and straightforward system. Far more people could be taken out of the poverty and unemployment traps, and indeed taken out of tax altogether, for a given sum of overall tax relief than is possible under the present system. It would end the present discrimination against the family where the wife feels it right to stay at home, which increasingly nowadays means discrimination against the family with young children.

Husbands and wives would each be taxed separately on their own income irrespective of the income of the other. The aggregation for tax purposes of a wife's earned income and investment income with her husband's would end, thus removing what has become an increasing source of resentment among women.

The Green Paper will set out full details of the proposals I have just outlined, as a basis for public discussion. After an appropriate period for consultation, it would be possible to legislate in 1987 and have a system on these lines in place by the end of the decade.

ANNEX 2

IMPLICATION OF PROPOSALS IN TAX GREEN PAPER FOR DIFFERENT GROUPS OF TAXPAYERS

This note summarises the implications of the proposals in the Personal Tax Green Paper for different groups of taxpayers.

2. The note looks at the following groups:

two earner couples;
one earner couples;
single people;
lone parents;
pensioners.

It considers the effect of transferable allowances on these groups, as well as the effect of the Green Paper proposals on disaggregation of investment income and capital gains.

TRANSFERABLE ALLOWANCES

3. Table 1 shows the effect of transferable allowances on various groups.

Two earner/one earner couples

4. These groups can be considered together because it is common for the same couple to move from being a two earner couple to a one earner couple, and back again. This reflects the growing number of married women in work who cease work on having children, but increasingly return to the labour force after a relatively short period of a few years.

5. In 1984, the latest year for which figures are available, married women represented 27 per cent of the labour force.

6. The proportion of married women in the labour force as a percentage of all married women rose from 38.1 per cent in 1966 to 49.4 per cent in 1983. The proportion of married women <u>of working age</u> in employment is higher, at 62.4 per cent.

7. Over 80 per cent of women leave the labour market shortly before the birth of their first child, but return to paid employment at some point. The average length of time they spend completely out of the labour force is now some 3-4 years. However, most women, when they return to work, take part time jobs and indeed most of them subsequently remain in part time work. The proportion of women working part time is now 46½ per cent, compared with 40 per cent in 1977; and as much as 60 per cent of working married women are part-time. Of these part-timers, roughly 60 per cent earn <u>below</u> the £2,205 tax threshold.

<u>Regional variations</u>

8. Table 2 shows regional variations on the proportion of married women of working age who are either employed or seeking employment. On the whole this shows little significant difference between the various regions of England, but a noticeably lower proportion in Scotland and Wales.

<u>Effect of the proposed system of transferable allowances</u>

9. As noted above, many couples move from being two earner couples to one earner couples with the arrival of children; and return to being two earner couples as the children grow up. Transferable allowances are designed to recognise this typical cycle by removing the additional tax burden currently imposed at a time when many couples face heavily family commitments on sharply reduced gross family incomes.

10. As can be seen from Table 1, two-thirds of the 9.7 million married couples paying tax will be better off under transferable allowances. This is made up of all one earner couples and 40 per cent of two-earner couples. Two earner couples will be better off where the wife earns less than £2,205 pa (almost certainly because she is working part-time); or where the couple have elected for

separate taxation of earned income; or in the case of some higher rate taxpayers, where disaggregation leads to a lower rate of tax.

11. It can be seen from Table 1 that in no case will a working wife pay more tax as a result of transferable allowances. In fact, in all cases where earnings are above the tax threshold, a working wife as such could pay less tax than under the present system. This is because she will be entitled to an allowance some £635 above the present Wife's Earned Income Allowance. (But her husband will of course pay correspondingly more tax).

12. Because transferable allowances will improve the family's financial position either where the wife does not work at all, or where she earns very little, the relative financial advantage to the family of a married women taking a job will be less than it is now (because the couple's extra earnings would effectively be taxed at 30 per cent from the first pound). Although this would be a disincentive to some married women to go out to work it needs to be kept in perspective: for any wife contemplating earning above £2,205 a year the maginal rate of tax will normally be the same with transferable allowances as it is under the present system.

13. There are, moreover, many factors other than the present tax treatment which lead women to work outside the home and these are likely to remain important. Social attitudes are in practice crucial, and these have changed dramatically since the 1940s. This is suggested by experience in those countries (see Table 3) which have systems similar to transferable allowances - such as Scandinavia and Canada, where married women's propensity to take paid work has increased as fast as or even faster than in the UK, and where it is currently at an even higher level.

14. All single people paying tax will be better off under transferable allowances. About one-third of single people are under 25. Lower tax bills for this group (some will be taken out of tax altogether) should improve their employment prospects.

Lone parents

15. Lone parents will have their tax allowance reduced under transferable allowances, but the difference will be made up by increased one-parent benefit of equal value. Overall their position will be unchanged.

Taxpaying pensioners

16. Single pensioners (the largest group) will all be better off under transferable allowances.

17. Couples where the wife does not work or have her own pension will all be better off.

18. Couples where the wife works or has her own pension will either be better off, or in the same position, depending on the size of the wife's earnings.

DISAGGREGATION OF INVESTMENT INCOME

19. At present the wife's unearned income is added to the income of her husband and taxed at his marginal rate. It is proposed that following the introduction of transferable allowances, a wife's earned income should be taxed at her marginal rate. Couples will benefit where the husband's marginal rate of tax is higher than that of his wife (see Table 1).

SEPARATE TREATMENT OF CAPITAL GAINS TAX

20. Under the present arrangements, the gains and losses of each spouse are aggregated, and the couple are entitled only to one annual amount of tax free capital gains (currently £5,900). The Green Paper proposes that after the introduction of transferable allowances, each spouse should be entitled to an annual exempt amount, the unused part of which would be transferable to the other spouse. The provisions which allow the losses of one spouse to be set against the gains of another would be withdrawn.

EFFECT OF TRANSFERABLE ALLOWANCES

TABLE 1

Category	No of taxpayers in category	Present Position	Position under Transferable allowance	Better off/ Worse off
(a) Two earner couples				
1. Wife earning less than £2,205 pa.	1.8 million	Wife pays no tax, but couple cannot benefit from any unused portion of total allowances of £5,660 to which they are entitled.	Wife need pay no tax. Couple get benefit of £5,660 of allowances between them.	Couple better off. Wife's position the same.
2. Wife earning more than £2,205 pa.	3.1 million	Wife makes full use of £2,205 allowance to which she is entitled	Wife entitled to higher allowance (£2,830), but husband's allowance reduced as a result.	Position of couple unchanged. Wife better off.
3. Higher rate taxpayers * where couple have elected for separate taxation of earned income.	0.2 million	Wife and husband each have allowance of £2,205 pa.	Wife and husband each have allowance of £2,830 pa.	Both husband and wife better off off.
4. Higher rate tax payers * where couple have not elected for separate taxation.	0.2 million	Wife has allowance of £2,205, husband has allowance of £3,455	Wife and husband each entitled to allowance of £2,830.	Position of couple either unchanged or improved, if disaggregation leads to lower rate of tax. In either case, wife better off.

* These couples include some where the wife has unearned income taxed at her husband's marginal rate. In such cases the couple will be better off if the wife's marginal rate is lower than her husband's since the investment income will be taxed separately.

TABLE 1

Category	No of taxpayers in category	Present Position	Position under Transferable allowance	Better off/ Worse off
(b) **One earner couples** *	4.4 million	Couple have only married man's allowance £3,455	Couple get benefit of £5,660 allowances between them.	Couple better off.
(c) **Single people**	7.4 million	Have single person's allowance of £2,205	Gain allowance of £2,830	Better off.
(d) **Lone parents**	0.4 million	Receive single allowance plus additional personal allowance so effectively have married man's allowance of £3,455	Lose additional personal allowance but replaced by increased one parent benefit of equal value. Tax allowance falls to £2,830.	Position unchanged.
(e) **Pensioners** **				
1. Single	1.2 million	Have age allowance of £2,690 which tapers out when income over £8,800 falls to single allowance at income of £9,527.	Age allowance abolished but replaced by higher allowance of £2,830	Better off
2. Couples where only one partner has income	0.8 million	Man has age allowance of £4,255 which tapers out when income over £8,800 - falls to £3,455 when income £9,990 or over.	Each partner has own allowance of£2,830 - combined £5,660	Better off.
3. Couple where wife's earned income below £1,405	0.2 million	Have age allowance of £4,255 which tapers out when income over £8,800 - falls to married man's allowance at income of £9,999. Also have wife's earned income allowance against all of wife's earned income giving total allowances of £5,660	Each partner has single allowance so combined allowance £5,660.	Better off or unchanged depending on wife's earned income.
4. Couples where wife's earned income above £1,405	0.3 million	Have age allowance of up to £4,255 plus wife's earned income allowance of £2,205 giving maximum of £6,460.	Allowances protected to ensure no losses.	Better off or unchanged.

** Only 40% of pensioners pay tax.

PROPORTION OF MARRIED WOMEN OF WORKING AGE EMPLOYED OR SEEKING WORK - GREAT BRITAIN 1984

	%
Great Britain	62.4
North	61.8
Yorks and Humberside	62.8
East Midlands	64.0
East Anglia	60.0
South East	64.1
South West	61.5
West Midlands	61.1
North West	64.7
Wales	58.0
Scotland	57.6

TABLE 3

Denmark

1. Basic system: Fully transferable allowances for earned income; aggregation of investment income with the income of the spouse with the highest earned income.

2. Trends:

	Married women's participation rate*(%)	All women's participation rate**
1965	31.8	49.3
1970	49.0	58.0
1975	56.4	63.5
1979	60.9	69.9
1983	66.6	74.2

Sweden

1. Basic system: A married person whose spouse has little or no income is entitled to a tax credit which reduces as the spouse's income increases.

2. Trends:

	Married women's participation rate*(%)	All women's participation rate**
1965	42.8	54.1
1970	50.5	59.4
1975	57.6	67.6
1979	63.1	72.8
1983	66.9	76.6

Canada

1. Basic system: 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 spouse's income exceeds a set level.

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* Married women in the labour force as a percentage of all married women.

** All women in the labour force as a percentage of all women of working age. (Exact comparisons not available.)

2. <u>Trends</u>:

	Married women's participation rate*(%)	All women's participation rate**(
1966	not available	39.7
1970	not available	43.2
1975	40.9	50.0
1979	45.7	55.5
1983	50.5	60.1

<u>United Kingdom comparison</u>

<u>Trends</u>:

	Married women's participation rate*(%)	All women's participation rate**(
1966	38.1	52.9
1971	42.3	54.8
1981	47.2	60.7
1983	49.4	63.3

BUDGET

CONFIDENTIAL

From: SIR PETER MIDDLETON

Date: 22 October 1985

CHANCELLOR

cc Sir T Burns (without attachment)
Mr Scholar

TAXES

We had a brief discussion at our last bilateral about your plans for the forthcoming Budget. I do not think that they involve preparatory work at this stage in areas which are not already covered. But you might like to cast your eye over the attached list of possible starters in the tax field to see if there is anything which strikes you. The list deliberately avoids mentioning the specific issues which we discussed.

2. There will be plenty of time to discuss the balance of your budget - and there is not much point in doing so now in any detail. But you might be interested to know that we had a preliminary canter over the field at PCC last week on the basis of the attached paper by Mr Monck.

3. Industry was not regarded as a very suitable target for tax cuts - though there were some advocates. Their record on pay and the failure of the NIS/NIC changes so far to influence employer attitudes significantly did not make changes in this area seem very promising. If anything was done, the CT rate, by directing

214/10/87

help to the more successful, had a lot to be said for it. The main reason for contemplating industry - apart from responding to pressure from the CBI, Industry year etc - is that it does give a slightly better prospect for output and jobs than the alternative of personal tax reductions.

4. Persons were not regarded as much more deserving than companies. The prospect of a substantial increase - even before any tax reductions - in real personal disposal income in 1986 (as price inflation falls well ahead of the decline in earnings growth) was an argument against allocating a large slice of the fiscal adjustment to personal tax reductions: why reward those who are grabbing too much earnings growth with tax cuts on top? Against this, reductions in personal taxation had to be a high priority, both for political and longer term supply-side reasons. Although there would be the usual case for threshold increases, several people argued that we should think hard about a basic rate reduction this time: one reason was that this was an income tax measure which would reduce, and certainly not increase, the ultimate cost of the move to transferable allowances.

5. You will not be surprised to hear that many thought against this background that the best course might be to go for a lower PSBR and not take the full benefit of extra asset sales in the form of higher expenditure and lower taxes.

6. Finally, PCC thought it quite likely that higher public expenditure on special employment measures might again prove an unavoidable element in the Budget. But, with the Star Chamber straining for the extra £50 million or even £10 million of savings, an additional bid of this kind would damage the Treasury's credibility in the 1986 Survey!

P E MIDDLETON

MINUTES

NOTE OF A MEETING HELD IN HM TREASURY

ON FRIDAY 6 DECEMBER 1985

Those present
Chancellor
Financial Secretary
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Byatt
Mr Monger
Miss Sinclair
Mr Cropper
Mr Davies

Sir L Airey - IR
Mr Isaac - IR
Mr Battishill - IR
Mr Corlett - IR
Mr Houghton - IR

PREPARATION FOR THE 1986 BUDGET: DIRECT TAXES

The meeting followed the agenda set out in Mr Kuczys's note of 4 December.

Capital Transfer Tax

2. The Chancellor said he was most grateful to Mr Houghton for producing such a thorough set of papers in time for this meeting. He asked what was the new approach which Parliamentary Council had proposed, and Mr Houghton explained that it was based on the concept of an exempt transfer. The Chancellor also asked for an estimate of the cost year by year. Mr Houghton explained that estimating the cost of this proposal was very difficult. But in the first year (1986-87) the cost might be around £40 million, taking account of the spouse exemption. He undertook to do more work on how the cost would build up year by year over the following four years.

69/12/1024

3. Turning to the more detailed papers, the Chancellor said that, as far as trusts were concerned, he would prefer to see half the amount charged at the full rate - rather than having a special rate scale. Mr Houghton undertook to consider this. The Chancellor said that the Revenue's proposed treatment of protective trusts was satisfactory. He entirely accepted that it would be essential to "hold the line" on trusts, and that there would be pressure for relaxations for hard cases, which would have to be resisted. Mr Houghton argued that it would not be right to reduce the period of cumulation to less than 7 years (the same as the "protective period") and the Chancellor accepted this. The Chancellor said he would leave the question of an appropriate "taper" over the protective period to the Financial Secretary: his preference was for as smooth a taper as possible.

Capital Gains Tax

4. The Chancellor said he was persuaded by Mr Bryce's paper that there was no advantage in moving to an exemption based on disposals. The question then was whether to continue with indexation. He had been very disappointed by the continuing complaints about the complexity of indexation relief. He believed some people would prefer to see it go altogether.

5. The Financial Secretary argued that the CGT regime, though complex, was now rational. If, however, there were to be a change of approach, it might as well be a major one: with a significant reduction in the threshold, and in the rate. Sir Lawrence Airey said that, from an administrative point of view, he would welcome the demise of indexation; but he would be worried about the staff effects of a lower CGT threshold. Mr Cassell thought that indexation had been a great step forward, and would regret a "U turn". Sir Terence Burns said that, if the CGT threshold were to be reduced, the counterpart should be allowing carry forward of unused exemption. Mr Battishill thought that ending indexation

would receive a mixed reception. Mr Davies thought that those who were complaining about complexity did not seriously think the result would be an end to indexation.

6. Summing up this discussion, the Chancellor said that abolition of CGT indexation should not be pursued for 1986. More work needed to be done, in particular to assess the likely response to such a change from ordinary investors (as opposed to advisers who had an interest in making the present system appear complicated). But he remained very interested in ending indexation, and would like to return to this next year. The present arrangements tended to lock investors into pre-1982 assets, while the post-1982 regime was too favourable in comparison with income tax. So there was a good case for some toughening up of the post-1982 system combined with changes which would benefit pre-1982 gains.

7. As far as 1986 was concerned, the Chancellor was interested in "de-indexing" the threshold, rounding it up to £6,000, and freezing it at that level. He would want to reconsider the abolition of indexation next year on a more informed basis. Meanwhile, the Inland Revenue could go ahead with publication of their leaflet on the indexation rules.

Taxation of Savings

8. The Chancellor said that the Financial Secretary was now pursuing the "income tax approach", which was not necessarily related to retirement. This was a promising starter for 1986.

Taxation of Pensions

9. This was to be discussed at a meeting later that day.

Stamp Duty

10. The Chancellor said that it was not on politically to have a "handout" to the City in the next Budget. But Stamp Duty, at a rate of 1 per cent, had undesirable features. There was therefore a case for reducing the rate of Stamp Duty on share transactions to ½ per cent, balanced by an offsetting increase in tax elsewhere on the financial sector. The question was, what possible replacements were there?

11. Sir Peter Middleton and Mr Cassell pointed out that any tax - and some possibilities had been looked at before - would tend to be passed on to the investor. The Financial Secretary said that, in conjunction with Mr Isaac, he had looked at the possibility of a special income tax. There was nothing to report as yet. The Chancellor said he would be attracted by taxing intra-account dealings, and by charging entry into ADRs.

12. The Chancellor said that a reduction in Stamp Duty on share transfers should particularly benefit individuals. He asked whether it would be possible to impose a lower rate on individuals or to exempt them from stamp duty altogether. The Financial Secretary said that, in effect, this had been looked at 2 years ago when the proposal had been a sliding scale of stamp duty depending on the size of the bargain. Mr Corlett said that a number of practicalities would have to be considered - in particular whether the Stock Exchange computer could distinguish individuals' transactions. There might also be enforcement difficulties. It would help to be able to talk to one person at the Stock Exchange in strict confidence.

13. In conclusion, the Chancellor asked Mr Isaac to look at three areas:

(i) Imposing stamp duty on the entry into ADRs.

(ii) Exempting individuals from stamp duty on share transfers (in particular, what would this cost?).

(iii) Recouping this cost with an alternative tax, which would not have the effect of making the City uncompetitive.

AWK

A W KUCZYS

12 December 1985

Distribution

Those present
PS/Chief Secretary
PS/IR

URGENT Bf 12/12

MS to Rev with Ch Ex at prayers

MS

Would you like to send this to Ch. Ex. or have a word with him?

Friday Prayers.

Brooke → CH/EX 11/12

CHANCELLOR

cc PS/Customs and Excise PB 11/xii

Mr Jefferson Smith

Mr Tracey

+ Treasury Mins + CT

VAT on Hotel and Holiday Accommodation

The Customs submission of 8 October refers.

I met David Young last Friday to discuss this.

He has no objection to the recommendations at para 12(a) and (c) of the submission on, respectively, confining taxation to bedroom accommodation and extending the definition of holiday accommodation to tax service flats catering for tourists and other short-term visitors.

On recommendation 12(b) about restricting the benefit of the reduced value provision (the 28 day relief) to individuals, while he accepts that this would be entirely logical, he thinks that it would be fiercely attacked by the tourist lobby as an indication that Ministers were ambivalent in their attitude to the industry and its scope for job creation. I left David with the impression that we would be going ahead with this change but he gave no indication whether he would raise the matter with you.

He wondered whether consultation with the industry would not offer some scope for compromise. I see no real merit in consultation and there is no possibility of compromise other than a possible deferment of the effective date.

David was mollified to a degree when I revealed that we would also be making a change to the detriment of sales of overseas holiday packages (Customs submission of 5 December). An announcement of all the changes together would at least demonstrate that the Government was acting in an even-handed manner in correcting all the VAT anomalies affecting incoming and outgoing tourists and the hotel/travel trade businesses serving them. On the other hand the Department of Employment is now the sponsoring Department for ABTA and so the overseas holiday change is no great help to David personally.

I think that we should go ahead with all the changes suggested by Customs and make the announcement in the Budget Speech or Debate. You may like to write to David to tell him so. The one concession you could make if you wished would be to defer the effective date for the 28 day relief change until 1 November 1987; this would have the presentational advantage of bringing it more into line with the April 1988 date for the overseas holiday packages. However, I myself would be disinclined to do this. It is better to make a change of this kind when the industry is doing well. By 1987 exchange rate movements might have made the UK less attractive to overseas visitors.

Peter Brooke

VAT ON HOTEL + HOLIDAY ACCOMMODATION

11/S 12 DEC 1985 -17

CS

LORD YOUNG → BROOKE 11/12

SECRETARY OF STATE FOR EMPLOYMENT

Caxton House Tothill Street London SW1H 9NF

Telephone Direct Line 01-213 6460

Switchboard 01-213 3000

C/ to note.

PMo 13/12

The Hon Peter Brooke MP
Minister of State Treasury
Treasury Chambers
Parliament Street
London
SW1P 3AG

MINISTER OF STATE
REC. 12 DEC 1985
ACTION Mr Jefferson Smith
PS/Chancellor
PS/CST, PS/FST, PS/EST
Mr Monger, Mr Cropper
PS/C+E
Mr Tracey, Mr Wilmott
Mr Knox, MST

11 December 1985

Dear Peter,

Thank you for coming last Friday to discuss your proposals to tighten up VAT requirements in relation to hotels and short term service flats.

Although I have to agree that there is a strong equity argument for going ahead with this, I felt bound to point out the presentational difficulties in doing so which should not be lightly dismissed. As you know, we have gone to great lengths to demonstrate our support for tourism through the publication in July of "Pleasure Leisure and Jobs - The Business of Tourism" (which identifies a long list of Action Points to remove unnecessary obstacles to the industry's further growth) and by announcing increases in the funding of the British Tourist Authority and the English Tourist Board next year. This has gained us much goodwill. The action which you are now contemplating (even if justified) will inevitably detract from that. Perhaps therefore I could ask you to reflect further on these considerations? As you know I am prepared to live with the proposals on non bedded accommodation and short term service flats but I am most concerned about the ramification of the proposal concerning 'block bookings'. I am therefore grateful to you for agreeing to look again at this.

If it will help my officials will of course be willing to assist yours in these further deliberations in any way they can. I have in any case asked them to liaise with yours in the separate question of introducing VAT on the UK mark up on outgoing packages. As we mentioned on Friday this would not be welcomed by the travel trade (which I also sponsor) and I am not at all sure that it would be regarded even by the hotel industry as in any way offsetting the other proposals.

Yours,

David

ANNEX 7
INCOME TAX
HIGHER RATES

CONFIDENTIAL

FROM: R J EASON
DATE: 13 DECEMBER 1985

INLAND REVENUE
STATISTICS DIVISION
SOMERSET HOUSE

PS/CHANCELLOR OF THE EXCHEQUER

INCOME TAX HIGHER RATES

1. Given below are the costings of options for higher rates detailed in Mr Kuczy's minutes of 9 and 10 December plus two further options agreed on the telephone with Dr Keenay.

2. The options are set out below:

Rate (%)	Option A £	Option B £
30	0-16,200	0-17,100
45	16,201-32,400	17,101-34,200
60	over 32,400	over 34,200

Rate (%)	Option C £	Option D £
30	0-16,200	0-17,100
40	16,201-24,400	17,101-25,800
50	24,401-32,600	25,801-34,500
60	over 32,600	over 34,500

cc. PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Mr Cassell
Mr Monger
Mr Scholar
Miss Sinclair
Mr Cropper
Mr Isaac
Mr Blythe
Mr Calder
Mr Mace
Mr Eason
Dr Keenay

Option A, based on 1985-86 thresholds, gives a 45% band of the same width as the basic rate band. Option B is the same, but using thresholds indexed by 5½%, as in the Autumn Statement. Option C is the same as Option 2 in Mr Calder's note of 2 August. It gives a 40% band to replace existing 40% and 45% bands, and a 50% band, of the same width, to replace the existing 50% and 55% bands. Option D is the indexed version of Option C.

The indexed thresholds given in the Autumn Statement for 1986-87 are as follows:

Rate %	£
30	0-17,100
40	17,100-20,300
45	20,301-25,800
50	25,801-34,200
55	34,201-42,600
60	over 42,600

3. Exchequer Yield and Gainers and Losers

The yield to the Exchequer of the options and the number of gainers and losers are set out below.

Option	Yield (£m) 1986-87	Full Year	Gainers ('000)	Losers ('000)
A	160	290	10	1,220
B	50	90	140	960
C	60	110	330	900
D	-45	-85	560	110

Gainers and losers are calculated by comparing the options with liabilities under the indexed thresholds for 1986-87 given in the Autumn Statement. The sizes of the cash gains and losses for married men with no other allowances or ... reliefs are illustrated in the attached graphs.

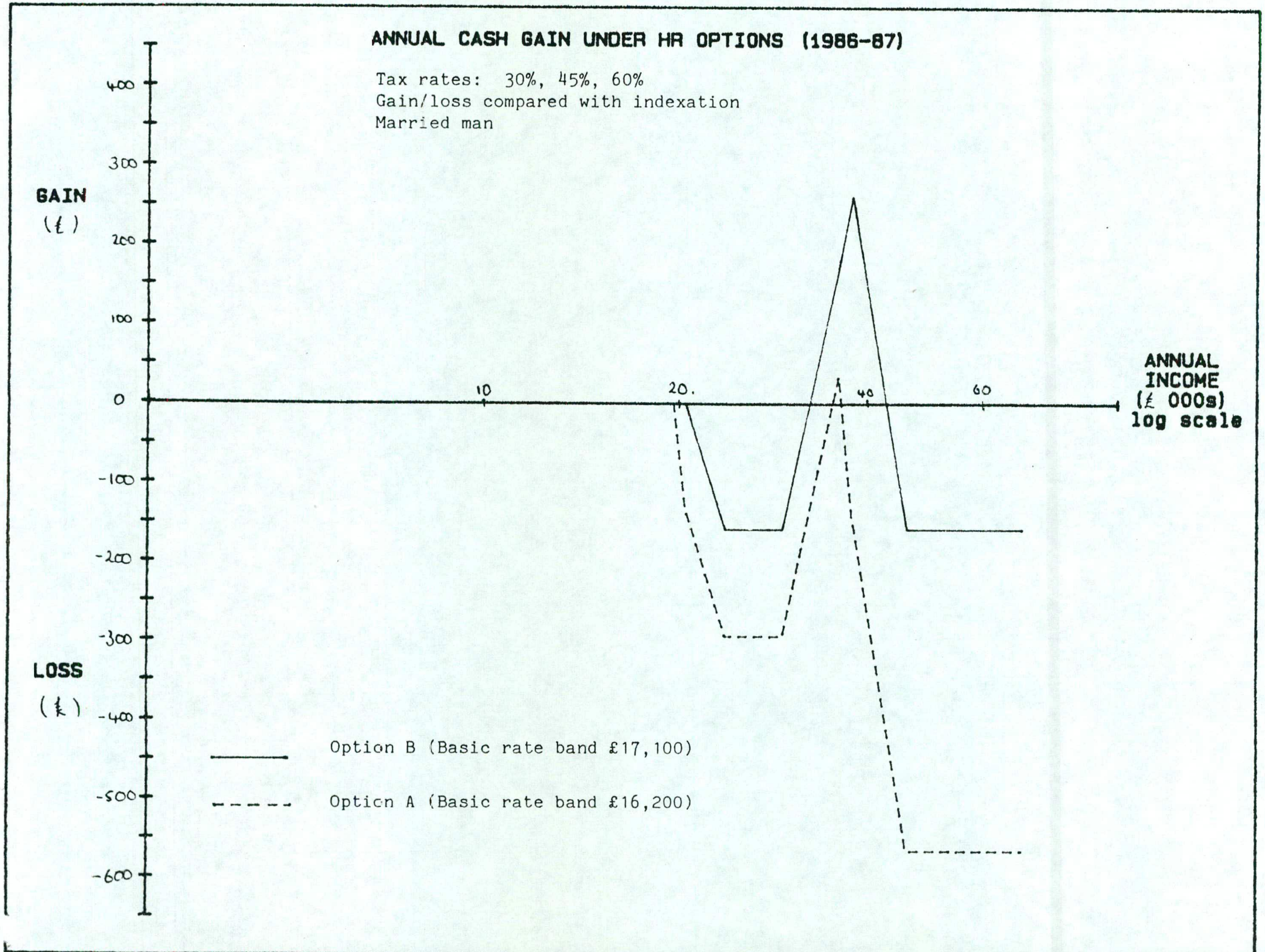
4. Taking option B as an example, the graph shows that taxpayers at existing (using indexed thresholds) rates of 40% and 45% would lose up to £160 per annum. These number

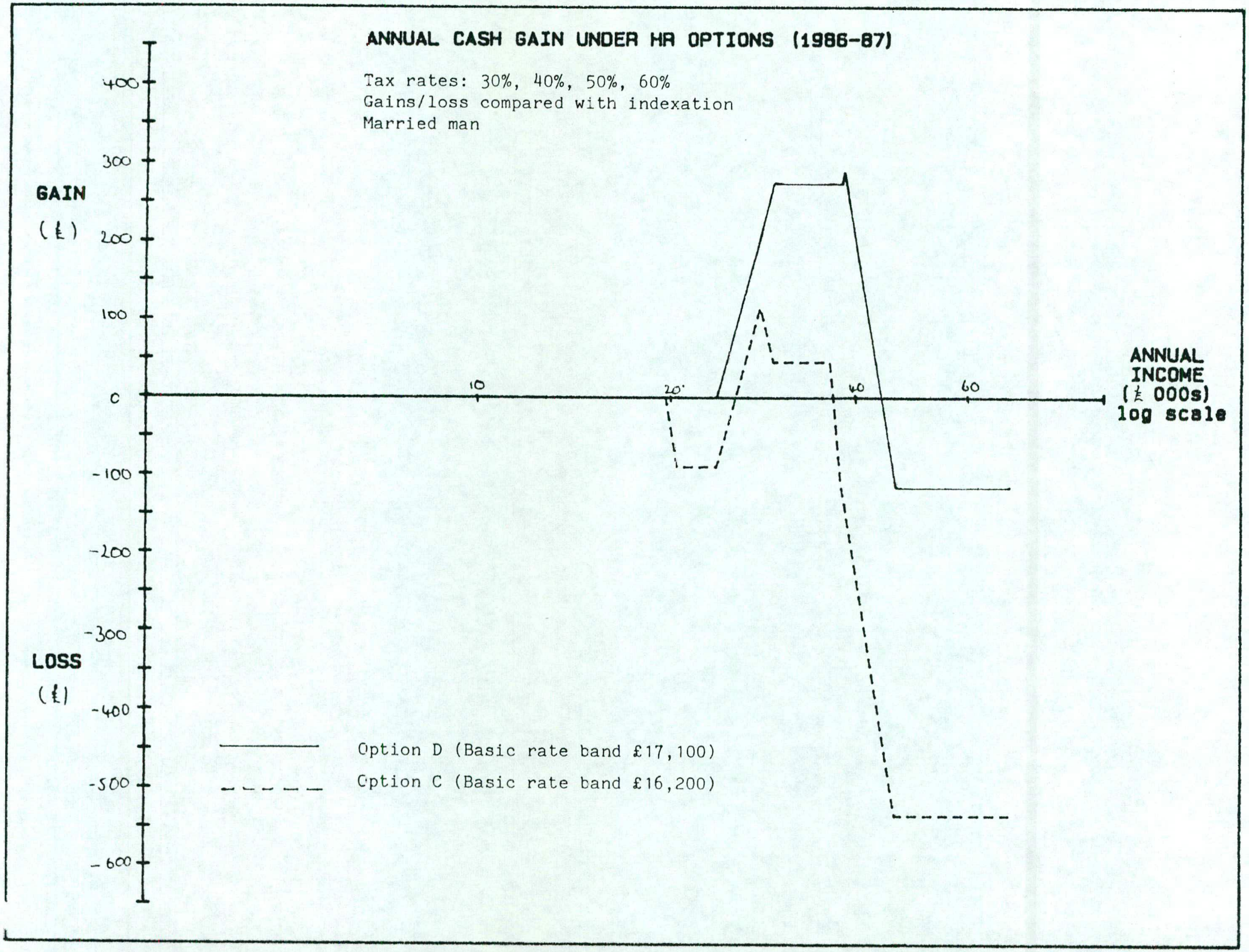
about 850,000 and the remaining 110,000 losers are at the 60% rate. They also would lose £160 per annum. However, those earning £34,200 taxable income (£37,855 for a married man with no other allowances or reliefs) would gain £260 per annum. This is the threshold where the existing rates would change from 50% to 55% and where, under option B, the 60% rate would start. Those with taxable income between £29,000 and £39,400 (£33,655 and £43,055 for married men) would all gain.

5. Option D is the only option with a cost, rather than a yield. Under it, the majority of higher rate taxpayers would not lose. Those with existing 40% rates would be unaffected. Those with 60% rates would lose, and the rest would gain. The maximun gain is £290 per annum for those with taxable income of £34,500, but all those at the 50% rate would gain at least £275 per annum.

6. Please let me know of any queries or of further information required.

R J EASON
13 December 1985


ANNUAL CASH GAIN UNDER HR OPTIONS (1986-87)
Tax rates: 30%, 45%, 60%
Gain/loss compared with indexation
Married man
GAIN (£)
LOSS (£)
400
300
200
100
0
-100
-200
-300
-400
-500
-600
10
20
40
60
ANNUAL INCOME (£ 000s) log scale
Option B (Basic rate band £17,100)
Option A (Basic rate band £16,200)


ANNUAL CASH GAIN UNDER HR OPTIONS (1986-87)
Tax rates: 30%, 40%, 50%, 60%
Gains/loss compared with indexation
Married man
GAIN
(£)
LOSS
(£)
400
300
200
100
0
-100
-200
-300
-400
-500
-600
10
20
40
60
ANNUAL
INCOME
(£ 000s)
log scale
Option D (Basic rate band £17,100)
Option C (Basic rate band £16,200)

CONFIDENTIAL

INLAND REVENUE
STATISTICS DIVISION
SOMERSET HOUSE

FROM: R J EASON

DATE: 19 December 1985

P/S CHANCELLOR OF THE EXCHEQUER

INCOME TAX HIGHER RATES

1. Following my submission of 13 December, I enclose details of further higher rate costings involving cuts in the basic rate. This note uses the same notation as that of 13 December in which the options were specified.

2. Costs

Costs of basic rate cuts, against an indexed 1986-87 base, are £975m in 1986-87 and £1,175 in a full year for each 1p cut. The costs of the 4 options, A to D, would therefore be as follows:

Exchequer Costs

	1986-87			Full year		(£m)
Basic Rate	30%	29%	28%	30%	29%	28%
Options						
A	-160	815	1790	-290	885	2060
B	- 50	925	1900	- 90	1085	2260
C	- 60	915	1890	-110	1065	2240
D	45	1020	1995	85	1260	2435

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cc. PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Mr Cassell
Mr Monger
Mr Scholar
Mr Sinclair
Mr Cropper
Mr Isaac
Mr Blythe
Mr Calder
Mr Mace
Mr Eason
Dr Keenay

3. Gainers and Losers

The table below gives the division of the expected 1.1m higher rate taxpayers into gainers and losers. In addition, about 19.2m basic rate taxpayers would gain from cuts in the basic rate.

Higher Rate Taxpayers, 1986-87

(thousands)

Basic Rate Options	29p Gainers	29p Losers	28p Gainers	28p Losers
A	290	810	975	125
B	1100	-	1100	-
C	940	160	980	120
D	1100	-	1100	-

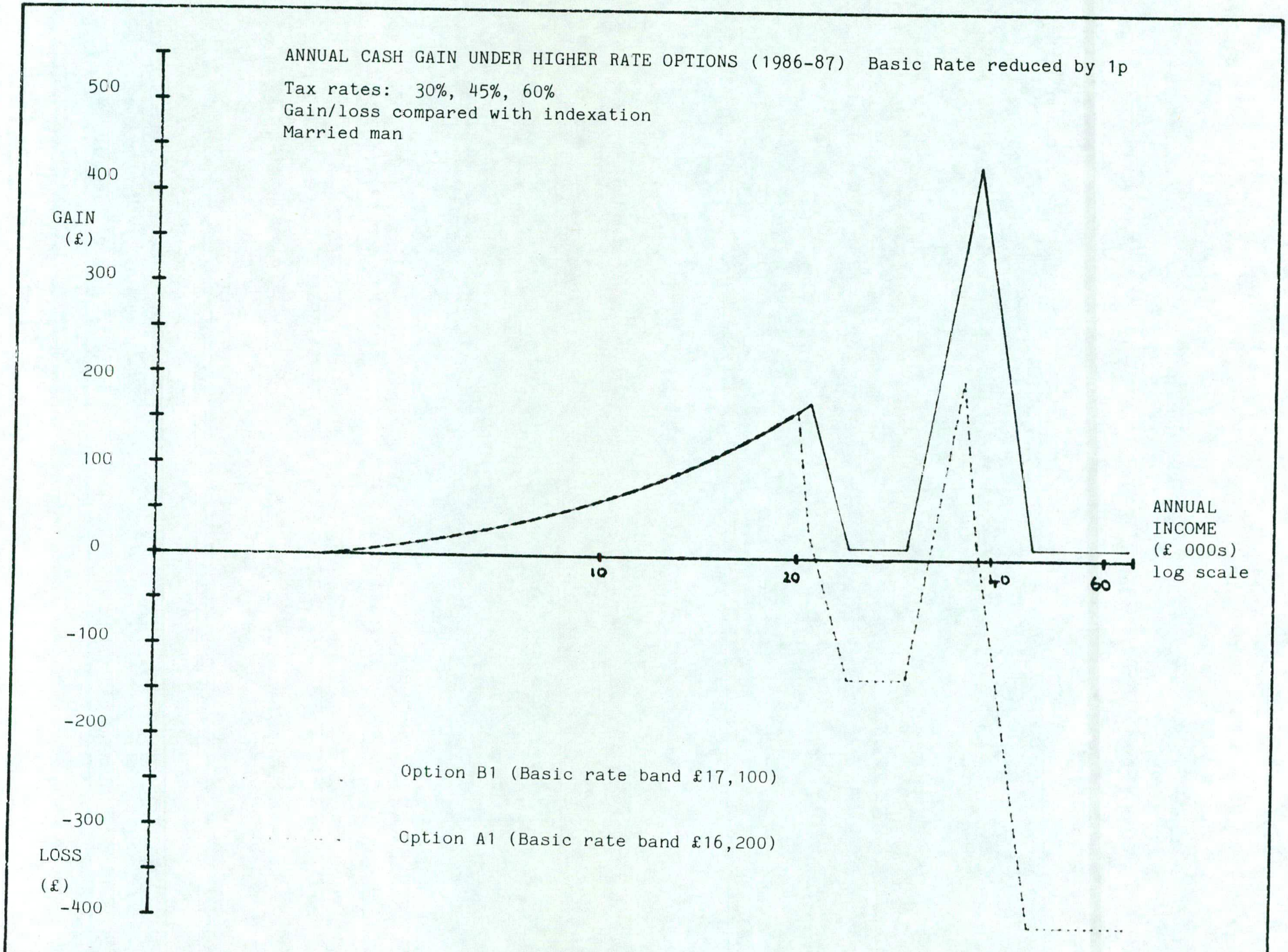
Both options B and D which are based on indexed thresholds give no losers.

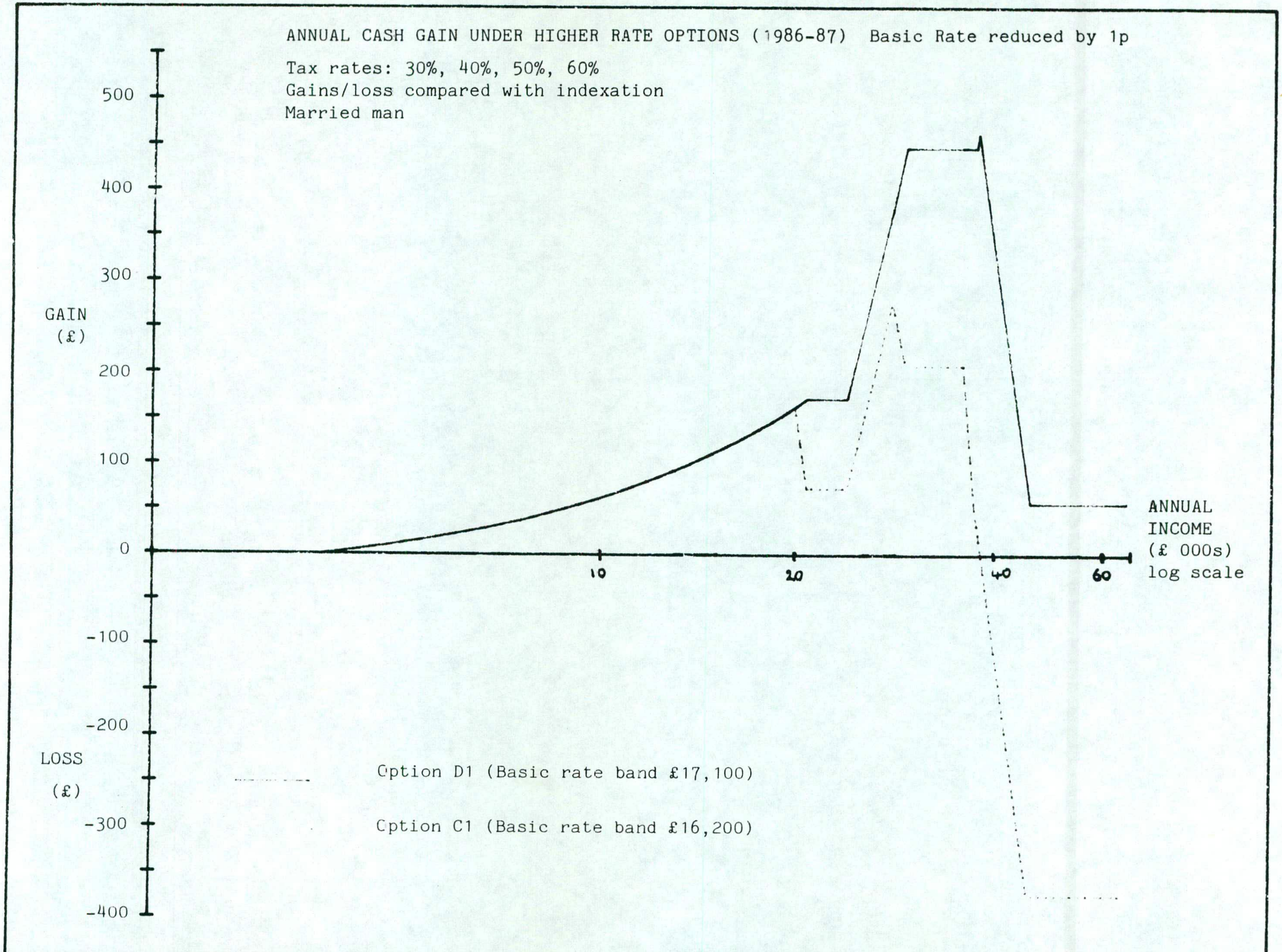
4. Gains and Losses

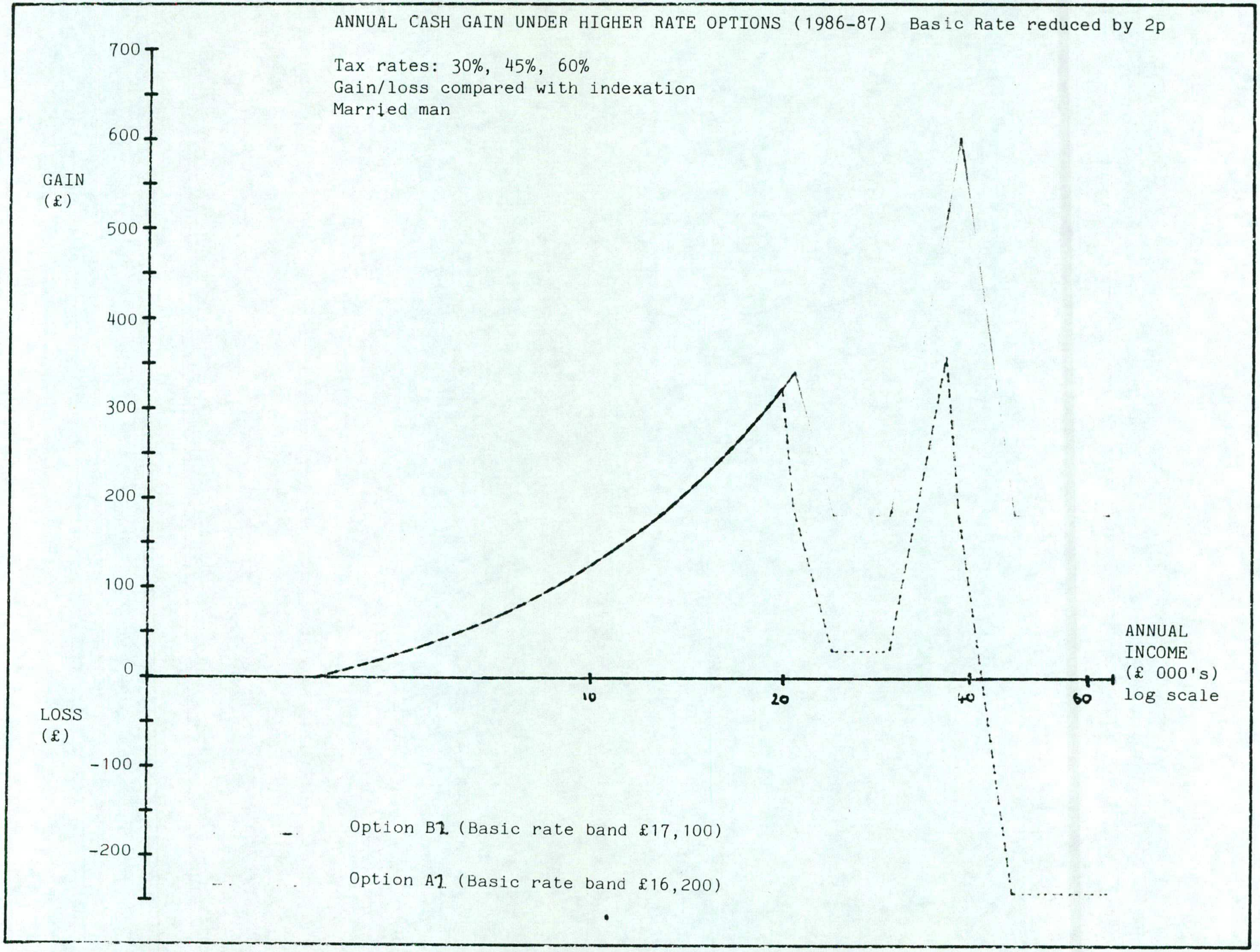
The attached graphs show the amounts gained or lost, compared with simply indexing allowances, by married men with no other allowances. Single people would gain or lose the same after adjusting for their smaller personal allowances (£2,335 compared with £3,655 after indexation).

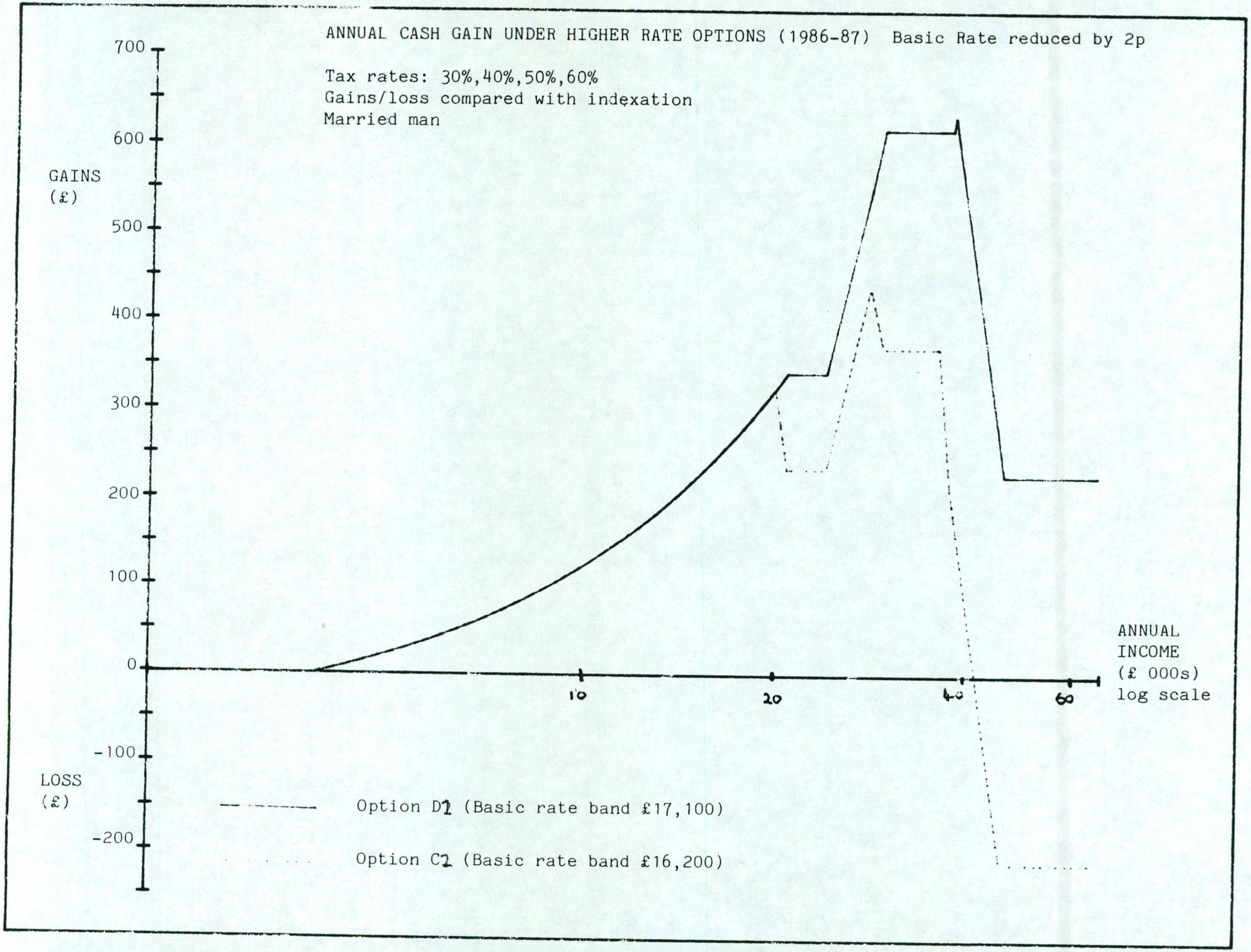
5. Please let me know of queries or further information required.

R J EASON


ANNUAL CASH GAIN UNDER HIGHER RATE OPTIONS (1986-87) Basic Rate reduced by 1p
Tax rates: 30%, 45%, 60%
Gain/loss compared with indexation
Married man
GAIN
(£)
500
400
300
200
100
0
-100
-200
-300
-400
LOSS
(£)
ANNUAL
INCOME
(£ 000s)
log scale
10
20
40
60
Option B1 (Basic rate band £17,100)
Cption A1 (Basic rate band £16,200)


ANNUAL CASH GAIN UNDER HIGHER RATE OPTIONS (1986-87) Basic Rate reduced by 1p
Tax rates: 30%, 40%, 50%, 60%
Gains/loss compared with indexation
Married man
500
400
300
GAIN
(£)
200
100
0
-100
-200
LOSS
(£)
-300
-400
10
20
40
60
ANNUAL
INCOME
(£ 000s)
log scale
Option D1 (Basic rate band £17,100)
Option C1 (Basic rate band £16,200)


ANNUAL CASH GAIN UNDER HIGHER RATE OPTIONS (1986-87) Basic Rate reduced by 2p
Tax rates: 30%, 45%, 60%
Gain/loss compared with indexation
Married man
GAIN (£)
LOSS (£)
700
600
500
400
300
200
100
0
-100
-200
10
20
40
60
ANNUAL INCOME (£ 000's) log scale
Option B1 (Basic rate band £17,100)
Option A1 (Basic rate band £16,200)


ANNUAL CASH GAIN UNDER HIGHER RATE OPTIONS (1986-87)   Basic Rate reduced by 2p
Tax rates: 30%, 40%, 50%, 60%
Gains/loss compared with indexation
Married man
GAINS (£)
LOSS (£)
700
600
500
400
300
200
100
0
-100
-200
10
20
40
60
ANNUAL INCOME (£ 000s) log scale
Option D1 (Basic rate band £17,100)
Option C1 (Basic rate band £16,200)

Approach to the 1986 Budget: Options for Personal Tax Changes

Introduction

1. This note considers a range of illustrative options for changes in personal allowances and the basic rate in 1986-87. It does not look at options for changes in the higher rate structure. The note examines how each option measures up to a number of standard target points, considers their distributional effects and describes the impact of each option on Inland Revenue manpower and the revenue cost of changing to transferable allowances.

Options Considered and Costs

2. The options are

Option	% increase over 1985-86 allowances	Reduction in basic rate	Revenue costs on top of statutory indexation* £ million 1986-87	Full Year
1A	5½ (Prices Indexation)	-	-	-
2A	7 (Earnings indexation)	-	220	275
3A	10 (£2 per week for married man)	-	710	900
4A	13	-	1200	1500
4B	7	1p	1200	1450
5B	10	1p	1725	2100
6A	19	-	2150	2700
6B	13	1p	2150	2650
6BX	7	2p	2150	2600

* Approximate and subject to change. Indexed levels of allowances and thresholds are as in the Autumn Statement. Costs are based on the latest information available and differ slightly from those in the Autumn Statement.

PREVIOUS DRAFT OF REVENUE PAPER

Allowances as a percentage of average earnings

16. The table below shows the personal allowances as a percentage of average earnings for 1985-86 and for each of the options.

Table 1

Allowances as a percentage of average earnings (all occupations)

	Single Allowance	Married Allowance
1985-86	21.2	33.3
Option 1A (5½%)	21.0	32.9
Option 2A (7%)[1]	21.2	33.3
Option 3A (10%)[2]	21.9	34.2
Option 4A (13%)[3]	22.4	35.1
Option 6A (19%)	23.6	37.0

1 Also Options 4B (7% + 1p off BR) and 6BX (7% + 2p off BR).

2 Also Option 5B (10% + 1p off BR).

3 Also Option 6B (13% + 1p off BR).

The earnings figures used here assume an increase of 7 per cent between 1985-86 and 1986-87 in line with the assumptions given to the Government Actuary for the Social Security uprating.

17. As the table shows, on the Autumn statement assumptions, it is necessary to go to at least Option 2A (7 per cent) to prevent allowance levels falling as a percentage of average earnings compared with 1985-86. At present both single and married allowances are at their highest level as a percentage of average earnings since 1977-78. Option 4A (13 per cent) would be sufficient to take the single allowance to its highest level since 1973-74 and the married allowance to its highest level since 1972-73. The peak reached in 1972-73 (and to a lesser extent in 1973-74 for the single allowance) is still some way off.

22. The table below shows how each option would reduce the number of taxpayers in 1986-87 compared with the number expected if allowances were left unchanged at their 1985-86 values.

Table 2

Taxpayers in 1986-87: reduction in number compared with no change in allowances

	Reduction 000s
Option 1A (5½%)	570
Option 2A (7%)	680
Option 3A (10%)	950
Option 4A (13%)	1210
Option 4B (7% + 1p off BR)	680
Option 5B (10% + 1p off BR)	950
Option 6A (19%)	1740
Option 6B (13% + 1p off BR)	1210
Option 6BX (7% + 2p off BR)	680

Poverty and Unemployment Traps

23. Annex 3 of the Treasury's Tax Issues paper considers in some detail the effects of income tax changes on the poverty and unemployment traps. On the basis of entitlement, about 450,000 working families are currently subject to combined marginal rates of tax and benefit withdrawal of over 70 per cent and may be regarded as being in the poverty trap. In practice the number with such high marginal rates is rather smaller than this because the take up of benefits is less than complete (for example it is estimated that only about half the families entitled to FIS actually claim it.)

Table 3

	Effect on 1988 Manpower Target
Option 1A (5½%)	+140
Option 2A (7%)	+ 90
Option 3A (10%)	- 25
Option 4A (13%)	-140
Option 4B (7% + 1p off BR)	+ 90
Option 5B (10% + 1p off BR)	- 30
Option 6A (19%)	-355
Option 6B (13% + 1p off BR)	-140
Option 6BX (7% + 2p off BR)	+ 85

27. Rather more than earnings indexation (Option 2A) is needed overall to achieve a neutral effect on our April 1988 manpower target. Although Option 2A is broadly enough to prevent any increase in the overall number of taxpayers between 1985-86 and 1986-87 (and hence to keep this component of our workload constant) the disproportionate rise in the number of higher rate taxpayers compared with the 1985 Budget estimate (see paragraph 21) means that there is an overall increase in our staffing requirement under Option 2A. Reductions in the basic rate have essentially no effect on our manpower requirement. (The small differences between the effects under some of the options when combined with a basic rate cut are due to differences in the expected number of wife's earnings elections under each option and hence in the number of higher rate taxpayers.) As the table shows Option 6A (19 per cent), for example, would reduce our 1988 manpower requirement by some 440 more than the equivalent cost Option 6BX (7 per cent plus 2p off BR).

24. Since they effectively reduce marginal rates for some taxpayers by 30 percentage points, increases in personal allowances are more effective in cutting the number of families in the poverty trap than reductions in the basic rate of tax. Under earnings indexation (Option 2A) there would be about 450,000 families with marginal rates over 70 per cent in 1986-87, the same number as at present. Option 4A (13 per cent) would reduce this by about 20,000 to 430,000 whilst Option 6A (19 per cent) would reduce it by about 40,000. Reducing the basic rate would not in itself cut the numbers of people in the poverty trap, though it would slightly reduce marginal rates for all 450,000 families affected.

25. About 2 million working families currently have replacement ratios over 70 per cent and may be said to be in the unemployment trap. By giving larger cash gains at lower income levels where replacement ratios tend to be relatively high, increases in allowances have a bigger impact on these families than cuts in the basic rate. Option 6A (19 per cent) would reduce the number of families with replacement ratios over 70 per cent by 230,000 whereas Option 6BX (7 per cent plus 2p off BR) would cut the numbers by 160,000.

Manpower Consequences

26. The table below sets out the effect on our 1988 manpower target of each of the options. The figures assume that COP is fully implemented by 1988 and take account of the effects of the estimated 4,000 savings from COP by then in local offices.

31. Amongst elderly taxpayers a much higher proportion (over 70%) would be better off with allowance increases than with basic rate reductions.

32. For illustration Chart 1 shows the percentage change in income net of tax under Options 6A (19 per cent), 6B (13 per cent plus 1p off BR) and 6BX (7 per cent plus 2p off BR) against income in £ per week for a married man. Chart 2 shows the similar picture for a single person. A feature which emerges from these charts is that Option 6B gives a greater proportionate increase to those with small incomes than to those with larger incomes. But under Option 6BX the largest proportionate increases go to those with the largest incomes.

Basic rate cuts combined with prices indexation

33. As paragraph 7 explains we have combined options involving a reduction in the basic rate with at least earnings indexation since this is necessary to maintain the position reached in 1985-86 on a number of target points. If Ministers wished, a basic rate cut could of course be combined with prices indexation of all the allowances and thresholds and this would cost some £220 million less in 1986-87 (£275 million in a full year) than the corresponding earnings indexation option. The table below sets out comparative figures.

Table 6

	Revenue costs on top of indexation £ million	
	1986-87	Full Year
Prices indexation + 1p off basic rate	980	1175
Earnings indexation + 1p off basic rate (Option 4A)	1200	1450
Prices indexation + 2p off basic rate	1930	2325
Earnings indexation + 2p off basic rate (Option 6BX)	2150	2600

for a net amount to be paid (many charitable covenants are of this kind) this would be unaffected by a change in the basic rate but the amount of income tax which can be recovered by the beneficiary would be reduced. So the beneficiary would be worse off, unless the covenantor took steps to increase the net payment.

37. If there is a change in the basic rate in 1986-87 a number of provisions will need to be reconsidered in the light of the new rate. These include the rate of tax deduction for subcontractors in the construction industry; the rate of life insurance premium relief and the additional rate for discretionary trusts. If it is decided that a reduction in the basic rate is a strong option for 1986-87 we will let Ministers have notes on the implications for these and some other items.

Effect on Cost of Transferable Allowances

38. Under Option 1A (statutory indexation) the cost of changing over to transferable allowances without losers would be £5.4 billion. The table below shows how this cost would vary for the other options.

Table 7	Effect on cost of changing to transferable allowances	Overall cost of changing to transferable allowances without losers
	£ million	£ billion
Option 2A (7%)	+ 50	5.45
Option 3A (10%)	+ 150	5.55
Option 4A (13%)	+ 250	5.65
Option 4B (7% + 1p off BR)	- 100	5.30
Option 5B (10% + 1p off BR)	+ 200	5.60
Option 6A (19%)	+ 750	6.15
Option 6B (13% + 1p off BR)	+ 400	5.80
Option 6BX (7% + 2p off BR)	- 250	5.15

39. For basic rate cuts combined with prices indexation the effect would be as follows

Table 8	Effect on cost of changing to transferable allowances	Overall cost of changing to transferable allowances without losers
	£ million	£ billion
Prices indexation + 1p off basic rate	- 150	5.25
Prices indexation + 2p off basic rate	- 300	5.10

CONFIDENTIAL

~~b/f with response (cob 8/1)~~ PA

1-✓for
2-TV for ✓
~~3-mp~~

FROM: P WYNN OWEN
DATE: 2 January 1986

b/f 9/1
PA

MR EASON - IR

cc: PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Mr Cassell
Mr Monger
Mr Scholar
Ms Sinclair
Mr Cropper

PS/IR

INCOME TAX HIGHER RATES

The Chancellor has seen and was grateful for your minute of 19 December.

Taking the 28% variant of all your options, the Chancellor would be grateful as soon as possible for this information recast in a more comprehensive form. That is, he would like to see both graphs and tables showing the gains (and losses) compared with the <u>status quo ante</u>.

The Chancellor has commented that the existing charts in your minute of 19 December are, surely, not even true gains and losses compared with indexation: under option B, for example, there must be people who <u>lose</u> compared with indexation of all higher rate bands; otherwise, there would not be a £50 million revenue saving.

Nigel Lawson

PP. **P WYNN OWEN**

BUDGET - CONFIDENTIAL

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

PW
Reply to be sent today.

15/1

Has MST replied.

From: P Jefferson Smith

13 January 1986

MINISTER OF STATE

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Mr Monger
Mr Cropper

14/1

VAT ON HOTELS : "BLOCK BOOKINGS" RELIEF : LETTER FROM LORD YOUNG (STARTER NO. 15)

1. I attach a draft reply to Lord Young's letter of 11 December.

2. You wanted to know how many hotels would be affected by the withdrawal of the long stay relief from block bookings by overseas tour operators and what would be the geographical spread of those hotels. You also wanted to know how much the withdrawal of the relief would cost each hotel or how much they would have to put up their prices.

3. Most of our VAT statistics are derived from the data which traders have to put on their returns. The returns, in the interests of reducing the compliance burden on traders to the minimum necessary, contain no breakdown of the total tax payable or as in this case the extent of the relief claimed. There is therefore no way of getting at accurate figures to answer the questions you have posed other than by expensive and time-consuming special visits by local officers to a structured sample of hotels, which we do not think you would want us to undertake. However, on the basis of such limited data as we do have and after discussion with the West End and Westminster Local VAT Offices, the best assessment we can make is as follows:

Internal circulation:

CPS
Mr Knox
Mr Wilmott
Mr Cockerell
Mr Tracey

(a) Number of hotels affected. Over 12,000 establishments are registered with the English Tourist Board, but a high proportion are not hotels. In the UK, there are about 4,700 VAT registrations under the hotel and other residential establishments trade classification. Only a very small proportion of hotels would be large enough (say 75-100 rooms or more) or located in the areas to which overseas tourists are attracted to have regular contracts with overseas tour operators sufficient to get continuous occupancy of the rooms concerned for periods in excess of 28 nights. The number of these is a guess, probably in the range of 250-500. This would suggest a cost of £25-50,000 per hotel, but these figures are too much of a guess to be suitable to quote to Lord Young.

(b) The Geographical Spread. We think overwhelmingly in London, in the WC, W and SW postcodes, with a few in places like Edinburgh, Stratford, York or Canterbury.

(c) Cost per hotel or increase in price. We are not in the main talking about the luxury class hotel but even so the hotels which are affected vary so much in size, tariff level and turnover that it would be meaningless to attempt an average cost per hotel. However from a number of fairly typical individual cases we have looked at it seems as though some 30-40% of turnover might come from block booking of rooms. Not all the block booked rooms would satisfy the continuity of occupation criterion. However for those that did the price per room (excluding breakfast) would in theory have to go up by about 12% after the 28th night. The VAT increase as a percentage of the total turnover of the hotels concerned might be in the region of 2%.

If, as we think, many hotels quote an average price per room to the tour operator reflecting both the absence of relief for the first 28 nights and the fact that continued occupancy will not be maintained for all rooms throughout the season, we would be surprised if that average price had to go up by as much as 5%. And as far as the individual overseas tourist is concerned, that increase is unlikely to represent more than an extra 2 or 2 1/2% on the total cost of his holiday including meals and travel (typically, the cost of accommodation is about one-fifth of the total cost of the vist). The impact on overseas tourists as a whole is even less, bearing in mind that total expenditure by overseas tourists in 1984 exceeded £4 1/2 billion.

4. You also asked whether there would be any gainers from the change. UK based tour operators such as British Airways, who cannot in practice benefit from the block booking relief because they have to charge UK VAT on the full price to their individual tourist clients, would benefit in the sense that they would in future compete with overseas based tour operators on equal terms. That is the theoretical position. Whether in practice they would gain any extra business is doubtful.

5. Finally our enquiries have established, that even for genuine long stay residents in hotels, the relief is often not passed on to the client. Moreover, some hotels simply do not bother with the relief because it is thought to be too complicated to operate. Taking all these points into account, we doubt whether, whatever the tourist lobby might say, many hotel businesses will be moved to protest at the loss of the block booking relief because it is a time-consuming and illogical way of helping the tourist industry even if that were its objective, which of course it is not.

PJ

P Jefferson Smith

DRAFT LETTER TO THE SECRETARY OF STATE FOR EMPLOYMENT

Thank you for your letter of 11 December asking me to look again at our proposal to end the so-called "block booking" VAT provision for hotels by confining the long stay relief to occupations by individual natural persons which was the original intention behind the relief.

I have indeed looked at the matter again and discussed your reservations with the Chancellor. While we understand the points you have made, there is never a right time to remove or restrict an unjustified relief. He has therefore decided to make all the VAT changes currently under consideration affecting UK and overseas holidays although there can still be discussion of the details on the margin scheme for the latter between officials.

This means that the block booking change will be announced in the Budget Speech or Debate and come into operation from 1 November 1986. This will defer the main impact of this change until the 1987 season and will give those hotels, overwhelmingly in London, which make a significant use of the relief plenty of time to make the necessary adjustment to their contracts and tariffs.

Although I regard this as an important and necessary change for VAT reasons, I think it is worth putting in perspective. It affects only those hotels of the right size, type and location to have regular contracts with overseas tour operators sufficient to get continuous occupancy of the rooms concerned for periods in excess of 28 nights. They are overwhelmingly in London (and in my constituency!) with a few outside in places like Edinburgh, Stratford, York or Canterbury. We think the extra VAT might be in the region of 2% of the total turnover of the hotels in question. Recent enquiries by Customs have indicated that some hotels do not bother with the relief because it is too complicated to operate; even when it is operated the benefit is not always passed on to the client. So I think the ~~burdens~~ burden of the change (you recall we estimated it at about £12 million) will be split between the hotels, tour operators and their clients. Against a perspective of total expenditure by overseas tourists in excess of £4 billion, the impact cannot possibly be significant. I think many in the industry, however much they may complain, will accept privately that it is a time-consuming and illogical way of helping tourism even if that had been the original objective.

I should be grateful if our exchanges could be given a suitable security classification in your Department until after the Budget.

PETER BROOKE

P MP

THE STOCK EXCHANGE

Sir Nicholas Goodison
Chairman

London, EC2N 1HP
Telephone: 01-588 2355
Telex: 886557
Telegrams: Stockex London EC2

15th January, 1986

C/ To note further Stock Exchange rep', received today.
R 16/1

Dear Nigel

In our annual comments on taxation in advance of the Budget, we concentrated on the abolition of transfer stamp duty as an over-riding priority.

There are a number of other changes which we would like to see and which are also important. These are set out in the attached note, a copy of which is being sent to the Inland Revenue.

I hope that these can be sympathetically considered when you are drawing up your Budget proposals.

Yours ever
Nicholas

The Rt. Hon. Nigel Lawson, M.P.,
Chancellor of the Exchequer,
11 Downing Street,
London,
SW1.

HM TREASURY – MCU
16 JAN 1986
ACTION FP – Mr Murray
cc CHX, CST, FST, MST, EST, Sir P Middleton, PS/IR, Sir T Burns, Mr Butler, Sir G Littler, Mr Anson, Mr Byatt, Mr Cassell, Mr Monck, Mr Lavelle, Mr Monger, Mr Scholar, Mr Culpin, Miss Sinclair, Mr Haigh, Mr Cropper, Mr Davies, Mr Lord
CHX
10/35/86

THE STOCK EXCHANGE

ADDITIONAL INLAND REVENUE SUBMISSION: 1985

In its annual submission on taxation, The Stock Exchange concentrated on the removal of transfer stamp duty on purchases of securities. The concentration on this aspect was deliberate. We wished to stress that this tax is the most significant barrier to the full development of London as a competitive international securities market.

There are, however, a number of other areas in which The Stock Exchange would like to see changes in order to help the liquidity, effectiveness and international competitiveness of the British securities market. These are set out below.

The Stock Exchange has in the past submitted detailed proposals on all of these to the Inland Revenue. The purpose of this note is to draw the Revenue's attention to them once again and to stress our continuing concern about them.

Capital gains tax

The Stock Exchange has in the past stressed its view that CGT hampers the development of wider share ownership. In 1982, some of the unfairness of the tax was removed by taxing only real, as opposed to inflationary, gains since that date. The price of this improvement was, however, a massive rise in the complexity of the tax through the indexation provisions. Furthermore some of the provisions themselves were unfair. The Chancellor made further changes to alleviate some of the unfairness and to simplify the system in the 1985 Finance Act.

The experience of the past few years illustrates quite clearly the dilemma posed by CGT: one has to choose between unfairness and simplicity on the one hand, greater fairness and Byzantine complexity on the other. Our view remains that to improve the liquidity of the secondary market, and thus to improve the effectiveness of the primary market in London, long-term CGT should be abolished.

Traded options

The Stock Exchange has made representations both to Government and to the Inland Revenue on the question of the segregated file. The changes we seek will help the traded options market in London to develop and to become the essential link within the European time zone of a growing international marketplace for options trading. Without these changes, options markets in other countries will reap the advantage.

Stock lending by pension funds

The NAPF and The Stock Exchange have each made representations in the past on this topic. Pension funds are effectively debarred from undertaking stock lending to market makers through Stock Exchange money brokers because of the tax imposition on such lending.

From the point of view of the millions of the funds' beneficiaries this represents a potential loss of income flow in retirement: current income from the lending could represent a significant increase in the funds' income earning capacity on their securities holdings.

In the new market system, the increased number of market makers will stimulate the need for further sources of stock lending. The ability of the pension funds to perform that function would lead to a considerable improvement in the liquidity of the market, finer prices and a more competitive edge for London in international securities trading.

DM

SECRETARY OF STATE FOR EMPLOYMENT

Caxton House Tothill Street London SW1H 9NF

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CH/EXCHEQUER
REC. 15 JAN 1986
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SIR T BURNS
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MR CASSELL
MR BHATT
MR MONGER
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MISS SINCLAIR
MR CROPPER
PS/IR
MR ISAAC - IR

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON SW1

15th January 1986

Dear Nigel,

REFORM OF PERSONAL TAXATION

I would like to raise a couple of issues with you before we meet to discuss the Green Paper on Thursday.

I share your view that a system of transferable allowances would be desirable. It would remove distortions in the tax system which at present is biased against single earner families and discriminates against women. But I do have some doubts over the proposed implementation of the system.

The condition that there should be no losers in cash terms is not one we have applied in other areas, such as social security benefits. I am not myself convinced that it should be adopted for the reform of personal taxation.

I also share Norman Tebbit's doubts over revealing such a large potential tax giveaway. The ability of the Government to provide tax reductions on this scale should be specifically linked to responsible wage settlements and firm control of public spending. It would be helpful if the Green Paper could say more about the scope for actually making tax reductions.

At the same time, I particularly welcome the importance you attach to benefiting those groups most affected by the poverty and unemployment traps. As you know, I share your concern over incentives and unemployment. It would be helpful if you could indicate how much of the cost of the Green Paper goes towards helping those affected by the unemployment trap.

138/1/H

Finally while I recognise that transferable allowances are a desirable step of fiscal reform, I would put much more emphasis on concentrating the benefits of reducing taxes on the low paid. We should be aiming to release the low paid from tax altogether and should look at radical ways to achieve that aim.

I am copying this to the Prime Minister, Willie Whitelaw, Norman Tebbit, Norman Fowler, John Wakeham and Sir Robert Armstrong.

Yours,

David

CC PS/CHANCELLOR
PS/CST, PS/FST, PS/EST
MR MONGER, MR CROPPER,
PS/C&E
MR JEFFERSON SMITH.

Treasury Chambers, Parliament Street, SWIP 3AG

The Rt Hon Lord Young of Graffham P.C.
Secretary of State
Department of Employment
Caxton House
Tothill Street
LONDON SW1H 9NF

15 January 1986

C/ To note.
RO 16/1

Dear David,

Thank you for your letter of 11 December asking me to look again at our proposal to end the so-called "block booking" VAT provision for hotels by confining the long stay relief to occupations by individual natural persons which was the original intention behind the relief.

I have indeed looked at the matter again and discussed your reservations with the Chancellor. While we understand the points you have made, there is never a right time to remove or restrict an unjustified relief. He has therefore decided to make all the VAT changes currently under consideration affecting UK and overseas holidays although there can still be discussion of the details on the margin scheme for the latter between officials.

This means that the block booking change will be announced in the Budget Speech or Debate and come into operation from 1 November 1986. This will defer the main impact of this change until the 1987 season and will give those hotels, overwhelmingly in London, which make a significant use of the relief plenty of time to make the necessary adjustment to their contracts and tariffs.

Although I regard this as an important and necessary change for VAT reasons, I think it is worth putting in perspective. It affects only those hotels of the right size, type and location to have regular contracts with overseas tour operators sufficient to get continuous occupancy of the rooms concerned for periods in excess of 28 nights. They are overwhelmingly in London (and in my constituency!) with a few outside in places like Edinburgh, Stratford, York or Canterbury. We think the extra VAT might be in the region of 2 per cent of the total turnover of the hotels in question. Recent enquiries by Customs have indicated that some hotels do not bother with the relief because it is too complicated to operate; even when it is operated the benefit is not always passed on to the client. So I think the burden of the change (you recall we estimated it at about £12 million) will be split between the hotels, tour operators and their clients. Against a perspective of total expenditure by overseas tourists in excess of £4 billion, the impact cannot possibly be significant. I think many in the industry, however much they may complain, will accept privately that it is a time-consuming and illogical way of helping tourism even if that had been the original objective.

I should be grateful if our exchanges could be given a suitable security classification in your Department until after the Budget.

Yours ever

Peter

PETER BROOKE

CH/EXCHEQUER
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SECRET

PRIME MINISTER

REFORM OF PERSONAL TAXATION

I think it would be helpful to you and colleagues if I briefly set out my first reactions to Nigel's memorandum and Green Paper.

Carrying through these proposals will be a major element in the Government's programme over the next few years. We need to make sure that we get the details of these proposals right and that we are able to present them effectively. Clearly it will not be possible to complete this work in one discussion and I suggest that, as with the social security and local government finance proposals, there should be an opportunity for further meetings to enable us to go into the proposals in more detail.

There are one or two particular issues which we might cover. The Green Paper concentrates on the extra help going to families. We shall need to be able to demonstrate this and in particular the overall effect on family finances rather than just the effect of tax reductions. Now that we have a set of illustrative figures for the social security reform, we shall be able to look at the combined effect of the tax and benefit changes. This will enable us to see how the tax reforms affect poorer families as well as families in general. Similarly, we ought now to be able to show the effect on the poverty and unemployment traps of the tax reforms, on which Nigel rightly places so much importance. At the same time, we need to be able to explain why we have chosen transferable allowances rather than other ways of reforming the tax system e.g. by specifically recognising children again in some way.

We shall also have to consider the "no cash loser" basis in Nigel's proposals, as compared with the social security proposals. The presentation will not be easy.

SECRETARY OF STATE FOR SOCIAL SERVICES

There are two other social security aspects. First, I agree with Norman Tebbit that the Green Paper should deal in more detail with the case against full integration of tax and social security. My Green and White Papers have relied on Nigel's Green Paper to cover this issue. In developing this, we need to recognise the support amongst our own people as well as outside commentators for greater integration. We must therefore make the most of our moves to partial integration, as with family credit. Second, we need to consider very carefully before we convert another tax allowance - in this case the additional personal allowance for lone parents - into a cash benefit. As with the earlier conversion of child tax allowance into child benefi we shall be lowering the tax threshold. It would also add complication to social security at a time when we are trying to simplify it.

Finally, the presentation of the tax changes to married women will not be easy. Providing opportunities for tax privacy and equal treatment in investment income will be good news. But for women not in work, the picture would be different. Unlike now, they will have to declare every pound they earn on their return to work. And they will have no extra tax allowance, compared with women at home, to meet for example the costs of caring for children. We shall therefore have to convince people that the changes are not intended in any way to dissuade married women from returning to work.

I am copying this minute to Willie Whitelaw, Nigel Lawson, Norman Tebbit, David Young, John Wakeham and Sir Robert Armstrong.

NF

15 JANUARY 1986

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PREVIOUS DRAFT OF REVENUE PAPER

Approach to the 1986 Budget: Options for Personal Tax Changes

Introduction

1. This note considers a range of illustrative options for changes in personal allowances and the basic rate in 1986-87. It does not look at options for changes in the higher rate structure. The note examines how each option measures up to a number of standard target points, considers their distributional effects and describes the impact of each option on Inland Revenue manpower and the revenue cost of changing to transferable allowances.

Options Considered and Costs

2. The options are

Option	% increase over 1985-86 allowances	Reduction in basic rate	Revenue costs on top of statutory indexation* £ million 1986-87	Full Year
1A	5½ (Prices Indexation)	-	-	-
2A	7 (Earnings indexation)	-	220	275
3A	10 (£2 per week for married man)	-	710	900
4A	13	-	1200	1500
4B	7	1p	1200	1450
5B	10	1p	1725	2100
6A	19	-	2150	2700
6B	13	1p	2150	2650
6BX	7	2p	2150	2600
man option	5½	2p	1930	2325

* Approximate and subject to change. Indexed levels of allowances and thresholds are as in the Autumn Statement. Costs are based on the latest information available and differ slightly from those in the Autumn Statement.

larger option (VAT)	5½	3p	2895 − 675 = 2220	3485 − 925 = 2560

Table 7	Effect on cost of changing to transferable allowances	Overall cost of changing to transferable allowances without losers
	£ million	£ billion
Option 2A (7%)	+ 50	5.45
Option 3A (10%)	+ 150	5.55
Option 4A (13%)	+ 250	5.65
Option 4B (7% + 1p off BR)	- 100	5.30
Option 5B (10% + 1p off BR)	-	5.40
Option 6A (19%)	+ 500	5.90
Option 6B (13% + 1p off BR)	+ 100	5.50
Option 6BX (7% + 2p off BR)	- 250	5.15

39. For basic rate cuts combined with prices indexation the effect would be as follows

Table 8	Effect on cost of changing to transferable allowances	Overall cost of changing to transferable allowances without losers
	£ million	£ billion
Prices indexation + 1p off basic rate	- 150	5.25
Prices indexation + 2p off basic rate	- 300	5.10

ANNEX 1: DETAILS OF 1986-87 OPTIONS.

1986-87
Details of the Options*

	Percentage increase over 1985-86 allowances	Reduction in Basic Rate	Cost on top of indexation** 1986-87 Revenue £m	Full Year Revenue £m	Basic Single Allowance £/	Basic Married Allowance £/	Aged Single Allowance £/	Aged Married Allowance £/	Aged Income Limit £/
Option 1A (prices indexation)	5.5	-	-	-	2,335 (130)	3,655 (200)	2,840 (150)	4,495 (240)	9,300 (500)
Option 2A (earnings indexation)	7	-	220	275	2,365 (160)	3,705 (250)	2,850 (160)	4,505 (250)	9,400 (600)
Option 3A	10	-	710	900	2,435 (230)	3,805 (350)	2,920 (230)	4,605 (350)	9,600 (800)
Option 4A	13	-	1,200	1,500	2,495 (290)	3,905 (450)	2,980 (290)	4,705 (450)	9,800 (1,000)
Option 4B	7	1p	1,200	1,450	2,365 (160)	3,705 (250)	2,850 (160)	4,505 (250)	9,400 (600)
Option 5B	10	1p	1,725	2,100	2,435 (230)	3,805 (350)	2,920 (230)	4,605 (350)	9,600 (800)
Option 6A	19	-	2,150	2,700	2,625 (420)	4,115 (660)	3,110 (420)	4,915 (660)	10,200 (2,400)
Option 6B	13	1p	2,150	2,650	2,495 (290)	3,905 (450)	2,980 (290)	4,705 (450)	9,800 (1,000)
Option 6BX	7	2p	2,150	2,600	2,365 (160)	3,705 (250)	2,850 (160)	4,505 (250)	9,400 (600)
**Cost of indexation; and 1985-86 allowances			1,150	1,450	2,205	3,455	2,690	4,255	8,800

* Higher rate thresholds indexed

/ figures in brackets show increase over 1985-86 allowances

ANNEX 1

ANNEX 2: WEEKLY CASH GAIN COMPARED WITH 1985-86 £/WEEK

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ANNEX 2

WEEKLY CASH GAIN COMPARED WITH 1985-86 £ PER WEEK

		Multiples of average earnings					
Single		½	3/4	1	1½	2	5
Option 1A	5½%	0.75	0.75	0.75	0.75	3.36	9.77
Option 2A	7%	0.92	0.92	0.92	0.92	3.59	10.12
Option 3A	10%	1.33	1.33	1.33	1.33	4.13	10.92
Option 4A	13%	1.67	1.67	1.67	1.67	4.59	11.62
Option 4B	7%, -1p	1.53	2.06	2.59	3.65	6.88	13.40
Option 5B	10%, -1p	1.92	2.45	2.98	4.04	7.42	14.21
Option 6A	19%	2.42	2.42	2.42	2.42	5.59	13.12
Option 6B	13%, -1p	2.25	2.78	3.31	4.37	7.88	14.90
Option 6BX	7%, -2p	2.13	3.19	4.26	6.38	10.17	16.69

WEEKLY CASH GAIN COMPARED WITH 1985-86 £ PER WEEK

		Multiples of average earnings					
Married		½	3/4	1	1½	2	5
Option 1A	5½%	1.15	1.15	1.15	1.15	3.27	10.58
Option 2A	7%	1.44	1.44	1.44	1.44	3.65	11.15
Option 3A	10%	2.02	2.02	2.02	2.02	4.42	12.31
Option 4A	13%	2.60	2.60	2.60	2.60	5.19	13.46
Option 4B	7%, -1p	1.79	2.32	2.85	3.91	6.94	14.44
Option 5B	10%, -1p	2.35	2.88	3.41	4.47	7.71	15.60
Option 6A	19%	3.81	3.81	3.81	3.81	6.81	15.88
Option 6B	13%, -1p	2.91	3.44	3.97	5.03	8.48	16.75
Option 6BX	7%, -2p	2.14	3.20	4.26	6.38	10.23	17.73

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GAINS (+)/LOSSES (-) AT 1986-87 UEL

Tax and NIC — £ per week — 1986-87 compared with 1985-86

		Contracted in		Contracted Out	
		Single Person or earning wife	Married man	Single Person or earning wife	Married man
Option 1A	(5½%)	-1.05	-0.65	-0.67	-0.27
Option 2A	(7%)	-0.88	-0.36	-0.50	+0.02
Option 3A	(10%)	-0.47	+0.22	-0.09	+0.60
Option 4A	(13%)	-0.12	+0.79	+0.25	+1.17
Option 4B	(7%, -1p)	+1.52	+1.78	+1.90	+2.16
Option 5B	(10%, -1p)	+1.91	+2.34	+2.29	+2.72
Option 6A	(19%)	+0.62	+2.01	+1.00	+2.38
Option 6B	(13%, -1p)	+2.24	+2.90	+2.62	+3.27
Option 6BX	(7%, -2p)	+3.91	+3.92	+4.29	+4.40

ANNEX 3

ANNEX 4:
TAX AS %
OF INCOME

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ANNEX 4

TAX AS A PERCENTAGE OF INCOME

Single		Multiples of average earnings ½	3/4	1	1½	2	5
1978/79		17.1	22.4	25.0	27.7	29.5	50.5
1985/86		17.2	21.4	23.6	25.7	27.9	43.0
Option 1A	5½%	17.3	21.5	23.6	25.8	28.0	43.2
Option 2A	7%	17.1	21.4	23.6	25.7	28.0	43.2
Option 3A	10%	16.8	21.2	23.4	25.6	27.8	43.1
Option 4A	13%	16.4	21.0	23.2	25.5	27.7	43.0
Option 4B	7%, -1p	16.6	20.7	22.8	24.9	27.2	42.9
Option 5B	10%, -1p	16.2	20.5	22.6	24.7	27.1	42.8
Option 6A	19%	15.7	20.5	22.9	25.2	27.5	42.9
Option 6B	13%, -1p	15.9	20.3	22.4	24.6	26.9	42.7
Option 6BX	7%, -2p	16.0	20.0	22.0	24.0	26.4	42.6

TAX AS A PERCENTAGE OF INCOME

Married		Multiples of average earnings ½	3/4	1	1½	2	5
1978/79		9.5	17.4	21.3	25.2	27.2	48.8
1985/86		9.9	16.6	19.9	23.3	25.4	41.6
Option 1A	5½%	10.1	16.7	20.0	23.4	25.6	41.8
Option 2A	7%	9.8	16.6	19.9	23.3	25.5	41.7
Option 3A	10%	9.3	16.2	19.7	23.1	25.3	41.6
Option 4A	13%	8.8	15.8	19.4	22.9	25.2	41.5
Option 4B	7%, -1p	9.5	16.0	19.3	22.5	24.8	41.4
Option 5B	10%, -1p	9.0	15.7	19.0	22.3	24.6	41.3
Option 6A	19%	7.6	15.1	18.8	22.5	24.8	41.3
Option 6B	13%, -1p	8.5	15.3	18.7	22.2	24.4	41.2
Option 6BX	7%, -2p	9.2	15.5	18.6	21.7	24.0	41.1

ANNEX 5: TAX + NIC AS % OF INCOME

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how this taken out of the NIC taper?

ANNEX 5

TAX + NIC AS A PERCENTAGE OF INCOME

Single		½	3/4	1	1½	2	5
		Multiples of average earnings					
1978/79		23.6	28.9	31.5	33.3	33.7	52.2
1985/86		26.2	30.4	32.6	33.7	33.9	45.4
Option 1A	5½%	26.3	30.5	32.6	33.8	34.1	45.6
Option 2A	7%	26.1	30.4	32.6	33.8	34.0	45.6
Option 3A	10%	25.8	30.2	32.4	33.6	33.9	45.5
Option 4A	13%	25.4	30.0	32.2	33.5	33.8	45.5
Option 4B	7%, -1p	25.6	29.7	31.8	32.9	33.2	45.3
Option 5B	10%, -1p	25.2	29.5	31.6	32.8	33.1	45.2
Option 6A	19%	24.7	29.5	31.9	33.3	33.5	45.3
Option 6B	13%, -1p	24.9	29.3	31.4	32.7	33.0	45.1
Option 6BX	7%, -2p	25.0	29.0	31.0	32.1	32.5	45.0

TAX + NIC AS A PERCENTAGE OF INCOME

Married		½	3/4	1	1½	2	5
		Multiples of average earnings					
1978/79		16.0	23.9	27.8	30.8	31.4	50.5
1985/86		18.9	25.6	28.9	31.3	31.5	44.0
Option 1A	5½%	19.1	25.7	29.1	31.4	31.7	44.2
Option 2A	7%	18.8	25.6	28.9	31.3	31.6	44.1
Option 3A	10%	18.3	25.2	28.7	31.2	31.4	44.0
Option 4A	13%	17.8	24.8	28.4	31.0	31.2	43.9
Option 4B	7%, -1p	18.5	25.0	28.3	30.6	30.8	43.8
Option 5B	10%, -1p	18.0	24.7	28.0	30.4	30.6	43.7
Option 6A	19%	16.6	24.1	27.8	30.6	30.8	43.7
Option 6B	13%, -1p	17.5	24.3	27.7	30.2	30.4	43.6
Option 6BX	7%, -2p	18.2	24.5	27.6	29.8	30.0	43.5

4 The Budget Tax Proposals

4.01 The main tax changes proposed in the Budget are summarised below. A full list of changes is given in ~~the Annex to this Chapter~~. Table 4.1

Income Tax

4.02 The basic rate of income tax will be reduced to 29 per cent.

in line with the statutory indexation provisions (based on the increase of

4.03 Income tax personal allowances will be increased ~~by~~ 5·7 per cent ~~(the increase~~ in the RPI in the year to December 1985) ~~as provided for by statute)~~ This will mean that

the single person's and wife's earned income allowances will rise from £2 205 to £2 335

the married allowance will rise from £3 455 to £3 655

the age allowance will rise from £2690 to £2850 (single) and from £4255 to £45[illegible] (married) and the income limit from £8800 to £9400

the additional personal allowance and widow's bereavement allowance will rise from £1 250 to £1 320

4.04 Thresholds for the higher rates of income tax will be as follows:

Tax rate Per cent	£
29	0–17 200
40	17 201–20 200
45	20 201–25 400
50	25 401–33 300
55	33 301–41 200
60	over 41 200

Social Security uprating

4.05 The uprating date for Social Security benefits is being changed from November to April. As part of the transitional arrangements there will be an ~~interim~~ additional interim uprating in July 1986. Exceptionally, the Government has decided to exempt from income tax the amount of the increase payable in 1986–87 on retirement pensioners and linked long term benefits.

Visiting ~~Non-resident~~ entertainers and sportsmen

4.06 UK practice on the taxation of visiting entertainers and sportsmen will be brought into line with that in most other OECD countries by the introduction of deduction of tax at source, and other measures. The new arrangements will not come into effect until 1987–88.

Excise duties

4.07 The duties on cigarettes and hand rolling tobacco will rise by about 13½ per cent, equivalent to just over 11p on a packet of 20 cigarettes. Those on pipe tobacco and cigars will remain unchanged.

4.08 Duties on alcoholic drinks will remain unchanged.

4.09 Duties on road fuels will go up by a little more than 8 per cent or the equivalent of approximately 7½p on a gallon of petrol and 6½p on a gallon of derv.

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Vehicle Excise Duty 4.10 The duty on cars, light vans, motor cycles and most lorries will remain unchanged. The duty rates on buses, coaches and taxis will rise by 5 per cent.

Business Expansion Scheme 4.11 The Business Expansion Scheme ~~was due to come to an end on 1 April 1987~~. It is proposed to continue ~~it~~ indefinitely and to exempt new BES shares from ~~CGT~~ Capital Gains Tax on first sale. Certain low-~~rate~~ risk activities including those with high asset-backing are to be excluded. Certain forms of ship chartering are to be included. STET

Capital Transfer Tax 4.12 The lifetime ~~CTT~~ Capital Transfer Tax charge is to be abolished for all gifts between individuals made on or after Budget Day. There will, however, remain a tax on transfers made on death. Gifts made within seven years of death will be charged ~~at a~~ but with a taper~~ed rate~~ relief. To reflect its new structure, the tax will be known as the Inheritance Tax.

4.13 Under the new arrangements~~, and also to protect the lifetime charge~~, there will continue to be a charge on transfers involving and companies trusts. Provision will be made to charge gifts in relation to which the donor may continue to enjoy a benefit. The exempt amount and rate bands of the tax will be increased from Budget Day, as follows:

Bands of chargeable value £000	Rate on death per cent
0–71	0
71–95	30
95–129	35
129–164	40
164–206	45
206–257	50
257–317	55
Over 317	60

Personal Equity Plan

4.14 A new scheme known as Personal Equity Plans will be introduced to encourage individuals to invest directly in equities. Shares held in such plans will be free of any tax on both capital gains and dividend income. reinvested Investment of up to £2 400 will be permitted each year, and the shares will have to be held for a minimum period of not more than two years

Stamp Duty 4.15 The rate of Stamp Duty on share transactions is to be reduced in the Autumn from 1 per cent to ½ per cent. The scope of the duty will be widened to cover the following transactions (currently exempt):

Intra-account dealing—from Autumn

Takeovers including mergers—from 19 March

Loan Stock—from 19 March

Renounceable letters—partly from 19 March and partly from Autumn

Company purchase of own shares—from Autumn

A 5 per cent duty is being imposed where shares are converted into Depositary Receipts, from 19 March

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Employee Share Schemes

4.16 The following measures will be taken to encourage further the spread of approved employee share schemes:

—the extension of the present tax reliefs to shares which ~~have been~~ must be ~~granted to employees with the condition that they be [sold, returned to the employer, or otherwise~~ disposed of] when the employment ends.

—changes to enable employee controlled companies and worker co-operativies to take advantage more easily of existing schemes.

—more liberal regime for savings-related share options.

Pension Fund Surpluses

4.17 The present rules relating to pension fund surpluses will be clarified and revised as follows:

—pension funds' assets and liabilities will be valued, for tax purposes only, on standard assumptions ~~provided~~ advised by the Government Actuary;

—where such valuation shows an actuarial surplus of assets over liabilities of more than 5 per cent, the trustees shall be required to reduce it to not more than 5 per cent by ~~either~~ (i) an increase in pension benefits (within existing limits), or (ii) a contribution reduction or holiday by either employer or employee, or (iii) a refund to the employer, or (iv) by any combination of these measures, the choice of method being for the trustees to decide;

—where a refund is made to the employer, it will be subject to a ~~tax~~ charge in the ~~company's~~ employer's hands at a rate of 40 per cent.

—no refund will be permitted which would reduce the surplus to less than 5 per cent.

Charitable giving

4.18 Four new types of tax relief will be introduced:

—Companies—other than close companies—will for the first time be able to claim tax relief for single gifts to charity. The relief will be on single gifts up to a maximum equal to 3 per cent of the ordinary dividends paid by the company in the accounting period.

—The present annual limit of £10 000 on the amount of charitable giving through deeds of covenant for which an individual taxpayer may claim higher rate relief will be abolished.

—There will be a new scheme from April 1987 to encourage individuals to make donations to charity through deductions from their wages and salaries. Employees whose employers participate in the scheme will be able to get tax relief on donations of up to [£100] a year.

—VAT relief will be available on distress alarms and lifts for the handicapped and their charities, non–classified press advertising by charities, medicinal products supplied to charities, video and refrigeration equipment used in medical applications by certain eligible bodies including charities, welfare vehicles used by such bodies to transport the deaf, blind and mentally handicapped, and recording equipment used by charities for the blind.

4.19 Measures are also to be taken to prevent abuse of the tax relief for charities.

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Business taxation

4.20 The final stage in the business tax reforms introduced in 1984 will take effect on 1 April 1986 with the reduction in the main corporation tax rate to 35 per cent and (with a few mainly transitional exceptions) the full implementation of the standard reducing balance system of capital allowances. These reforms will be completed by updating the mines and oil wells capital allowances code, and adapting the system of allowances for agricultural buildings. In order to provide a full measure of tax depreciation for agricultural buildings and works with a short life, the taxpayer may choose to make balancing adjustments on their disposal or destruction.

Oil taxation

4.2~~1~~2 ~~The small companies' corporation tax rate will be reduced to 29 per cent. Unincorporated businesses will benefit from the reductions in basic rate to 29 per cent~~. Except for the updating of the mines and oil wells capital allowances code, no other changes are being proposed to oil taxation apart from technical changes to remove some anomalies.

Capital gains tax

4.2~~2~~3 The CGT annual exempt amount is to be increased in accordance with the statutory indexation provisions by 5·7 per cent from £5 900 to £6 300 in the case of individuals, and from £2 950 to £3 150 in the case of most trusts.

Car and car fuel benefits

4.2~~3~~4 The scales which determine the taxable cash equivalents of car and car fuel benefits in respect of company cars provided for directors, and ~~for~~ employees earning £8 500 a year or more, are to be changed from 6 April 1987. The present (1300cc and 1800cc) engine-size break points are to be aligned, on a revenue-neutral basis, with those (1400cc and 2000cc) ~~set out~~ proposed in the European Community Directive on car exhaust emissions. The resulting scale charges for car benefits (but not car fuel benefits) will be increased by 10 per cent for 1987–88. From April 1987 the car fuel benefit scale is to be used both for income tax purposes and to assess the VAT chargeable on fuel used for private journeys in business cars.

Value Added Tax

4.2~~4~~5 From 19 March 1986 the registration limits will become £20 500 per annum and £7 000 per quarter.

4.21 The small companies' rate of Corporation Tax will be reduced to 29 per cent. As a consequence of the reduction in basic rate, the rate of ACT will be ~~in~~ reduced to 29/71st of the distribution. To reinforce this link between the rates, the Finance Bill will contain a provision for the ACT rate to be adjusted automatically in line with future changes in the basic rate of income tax.

Table 4.1 Direct effects of changes in taxation

	£ million		
	~~Estimated effect on receipts in~~ 1986–87[a]		1987-88
	Indexed base	Non-indexed base	Non indexed base
INLAND REVENUE			
Income tax			
Reduction of 1p in basic rate	−830	−830	[ ] −1245
Increase in single allowance of £130 and married allowance of £200	Nil	−895	[ ] −1130
Increase in additional personal allowance and widow's bereavement allowance of £70	Nil	−10	[ ] −10
Increase in age allowance of £160 (single) and £250 (married) and income limit of £600	Nil	−115	[ ] −145
Increase in basic rate limit of £1 000 to £17 200	Nil	−70	[ ] −115
Changes to higher rate thresholds ~~(other than £17 200)~~ further	+15	−35	[ ] −70
Abolition of higher rate relief limit for charitable covenants	Negligible	Negligible	−5
Relief for charitable donations through payroll deduction schemes	Nil	Nil	−20
Changes in rules for the tax treatment of ~~non-resident~~ visiting entertainers and sportsmen	Nil	Nil	+75
Fringe benefits—car and car fuel scales	Nil	Nil	+15
Changes to relief for overseas travel expenses	−10	−10	−5
Exemption for 1986–87 of July increase in retirement pensions and linked long term benefits	−15	−15	Negligible
Changes in taxation of employee share acquisitions	Negligible	Negligible	Negligible
Use of restricted shares in approved employee share schemes	Negligible	Negligible	Negligible
Use of shares providing employee control in approved employee share schemes	Negligible	Negligible	Negligible
Worker co-operatives' use of redeemable shares in approved profit-sharing schemes	Negligible	Negligible	Negligible
Exercise of options granted under approved savings-related share option schemes	Negligible	Negligible	Negligible
Change in basis of assessment of enterprise allowance	Negligible	Negligible	−5
Exemption of pensions paid to victims of Nazi persecution	Negligible	Negligible	Negligible
Income tax and capital gains tax			
Tax relief for Personal Equity Plan	Negligible	Negligible	−25
Business Expansion Scheme—continuation beyond April 1987 and changes in coverage	Negligible	Negligible	+10
Income tax and corporation tax			
Refunds by occupational pension schemes	+20	+20	+120
Mines and oil wells capital allowances	Negligible	Negligible	−45
Changes in agricultural buildings allowance rules	Negligible	Negligible	Negligible
Changes in capital allowance rules for leased assets	Negligible	Negligible	Negligible
VAT penalties, interest, surcharges and repayment supplement	Nil	Nil	Negligible
Income tax, corporation tax and capital gains tax			
Charities: anti-avoidance measures	Negligible	Negligible	+20
Limiting scope of anti-bondwashing provisions	Negligible	Negligible	Negligible
Amendments to Accrued Income Scheme	Negligible	Negligible	Negligible
Income tax, corporation tax, capital gains tax and capital transfer tax			
Changes in relation to securities	Negligible	Negligible	Negligible

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Table 4.1 Direct effects of changes in taxation—*continued*

	£ million		
	~~Estimated effect on receipts in~~ 1986–87[a]		1987-88
	Indexed base	Non-indexed base	Non indexed base
Corporation tax			
Reduction in rate of ACT to 29/71 times the amount of the dividend	−120	−120	−60
Reduction in small companies rate to 29 per cent	Negligible	Negligible	−20
Relief for single donations to charity by companies	Negligible	Negligible	−35
Loans by close companies	Negligible	Negligible	Negligible
Transfer of losses on company reconstruction	Negligible	Negligible	+5
Corporation tax and capital gains tax			
Small part disposals of land	Nil	Nil	−5
Oil taxation			
Technical changes to remove anomalies	Negligible	Negligible	Negligible
Capital gains tax			
Indexation of annual exempt amount	Nil	Nil	−5
~~Reduction of period for cumulation of transfers to 7 years~~			
~~Taxation of gifts with reservation of benefits~~			
Restriction of holdover relief for dual resident trusts	Nil	Nil	+5
Capital transfer tax (inheritance tax)			
Abolition of lifetime charge on transfers between individuals and consequential changes	−35	−35	−55
Indexation of chargeable rate bands	Nil	−20	−45
~~Exemption for share transfers to employee trusts~~	~~Negligible~~	~~Negligible~~	~~Negligible~~
Stamp duties			
Other Changes from 19 March 1986	+50	+50	+50
Reduction in rate on shares to ½ per cent from Autumn 1986	−70	−70	−75
Other changes from Autumn 1986	+20	+20	+35
TOTAL INLAND REVENUE	−975 ~~−985~~	~~−2145~~ −2135	−2790
CUSTOMS AND EXCISE			
Value added tax			
Increase in registration limits	Nil	Negligible	Negligible
Revised treatment of motoring expenses	Nil	Nil	+40
New rules on disaggregation of registrations	Negligible	Negligible	+20
Revised treatment of hotels and tourism	Nil	Nil	+10
Reliefs for charities and the handicapped	−10	−10	−10
Direct exports	Nil	Nil	Nil
Transfer of import relief	Nil	Nil	Nil
Excise duties			
No change in rate of spirits duty	−45	Nil	Nil
No change in rate of beer duty	−95	Nil	Nil
No change in rate of duty on cider and perry	−5	Nil	Nil
No changes in rates of wine and made wine duties	−30	Nil	Nil
Increases in rates of duty on light oil etc	+110	+380	+400
Increase in rate of duty on heavy oil for use in road vehicles	+30	+95	+105
No change in rate of fuel oil duty	−5	Nil	Nil
Abolition of duty on lubricating oils	−10	−10	−10
Abolition of duty on AVTUR	−10	−10	−10

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Table 4.1 Direct effects of changes in taxation—*continued*

	£ million		
	Estimated effect on receipts in 1986–87		
	Indexed base	Non-indexed base	1987-88 Non-indexed base
Increase in rate of duty on gas oil	+25	+30	+30
Increases in rates of tobacco products duties	+175	+315	+335
Abolition of certain excise licences	Negligible	Negligible	Negligible
Northern Ireland betting and gaming	Negligible	Negligible	Negligible
TOTAL CUSTOMS AND EXCISE	**+130**	**+790**	**+910**
Vehicle excise duty			
No change in VED on car, light van and main lorry rates	−135	Nil	Nil
Increase in other VED rates	Nil	+5	+5
Increased penalties for VED evasion	Negligible	Negligible	+5
Other			
Bus fuel grants	−5	−10	−10
TOTAL CHANGES IN TAXATION	−985 ~~−995~~	~~−1360~~ −1350	~~−1885~~ −1875

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

PRIME MINISTER

BUDGET PROPOSALS

You already have my Budget proposals on indirect taxes. I still have to reach a final view on income tax, in the light of the latest economic forecast, which I shall want to discuss further with you when we next meet. This minute covers my remaining tax proposals, none of which depend on what is done on income tax. In addition, as you know, I am discussing with David Young a package of public expenditure measures to help the long-term unemployed, on which I hope to be able to report early next week. The cost of these will be met from the Reserve.

None of the measures described below will have significant effects on revenue next year. Taken together, they are more or less revenue-neutral. But overall they should help to encourage enterprise and improve the performance of the economy - and hence, of course, employment. In particular, I have been concerned to devise measures which carry further forward the themes of my previous Budgets.

Business and Enterprise

First, measures for business and enterprise. The Business Expansion Scheme is due to end next year and I have been reviewing its future with the help of a report from Peat Marwick. This report confirms that the BES has been an outstanding success in its aim of attracting new equity capital into unquoted companies, a high proportion of them new and small businesses. I therefore propose to continue the Scheme indefinitely. At the same time I feel I must take action to prevent abuse of the Scheme by excluding from its scope companies holding more than half their assets in the form of land and buildings and certain other activities which are threatening to bring the BES into disrepute (eg. investment in fine wines). These exclusions will serve to target the scheme more firmly on risk investment. I propose at the same time to improve the scheme further, by exempting BES shares issued after Budget Day from Capital Gains Tax on first sale.

My major proposal in this field is on Capital Transfer Tax. I intend to abolish the tax on lifetime gifts, which has had a particularly damaging effect in locking up assets and impeding the mobility of capital. You will recall the fierce attack we mounted on the taxation of lifetime giving when it was first introduced by Labour in 1974. This cost will be £35m in 1986-7 and £55m in 1987-8. The charge on death would of course remain, supported by a tapered charge on gifts made within seven years of death. In recognition of the radically changed nature of the tax I propose to rename it the Inheritance Tax. This will, in effect, be the fourth tax abolished since 1983. I believe this proposal will be warmly welcomed by all those who own and run family businesses.

I shall also be proposing a number of smaller measures to help business, including the extension and improvement of the Loan Guarantee Scheme, under which the Government guarantees bank loans to small and new businesses. In addition, I am planning to announce that we will embark on very preliminary discussions with employers and others about the feasibility of devising incentives for profit-sharing agreements in industry, perhaps through some temporary measure of tax relief, as a means of increasing the flexibility of the labour market.

As last year, I propose to increase the scale charge for assessing the taxable benefit of company cars by 10 per cent. At the same time, in response to representations from the motor industry, I shall be changing the engine scale break points to come into line with the break points in the new European Community directive on exhaust emissions. The fuel scale will remain unchanged but, as from April 1987, it will also be used to assess the VAT due on petrol used by registered traders and their employees.

I should also like to rectify an anomaly in the taxation of overseas entertainers and sportsmen visiting the UK. In virtually every other major country - including the US, Germany and France - a tax is imposed on visiting British entertainers and sportsmen. There is no reason to give foreign visitors here more favourable treatment than British visitors receive abroad. If the necessary legislation can be drafted in time, I propose to impose a witholding tax of 30 per cent on the earnings of these people. The change will bring in extra revenue of up to £100 million in 1987-8. No doubt there will be complaints (although most of the tax will be at the expense of Revenue authorities overseas) but there is an indisputable case for taking this action and the best time to do so is now.

Savings and Investment

There is clearly a very strong case for reducing - if not abolishing altogether - the Stamp Duty on equities to coincide with the Stock Exchange's Big Bang in October. With no tax at all on share transactions in New York and only half a per cent in Tokyo, the current rate of duty of 1 per cent threatens to make London uncompetitive in the fast developing world market for financial services. If London cannot win a major share of the global securities market its present world pre-eminence in other financial services will be threatened. I would therefore like to cut the rate to ½ per cent in October. But I believe it would be politically awkward in the present climate of opinion about the City to reduce the overall contribution which financial services make to the Exchequer. I therefore propose to recoup the entire cost of the rate reduction by applying the duty to other transactions which currently escape it, such as intra-account transactions and takeovers and mergers. There will also be a special rate of 5 per cent on the conversion of UK shares into American Depository Receipts, the method increasingly used to escape Stamp Duty and transfer dealings abroad.

This change will have the incidental benefit of reducing the cost of share dealings by individuals. But I am anxious to find more immediate ways of promoting our policy of encouraging direct share ownership by individuals. I therefore intend to propose a radical new scheme under which individuals can invest up to £2,400 a year in equity shares to be held in a special account known (unless I can think up a better name) as a Personal Equity Plan. While in the Plan investments will be entirely free of all capital gains tax and income tax on dividends. They need be held only for a short qualifying period (under two years) before they can be withdrawn tax-free. The cost will be negligible in 1986-7, and about £25 million in 1987-8. The cost in later years will depend on take-up, but it is bound to rise. I am sure that over time this measure will dramatically extend share ownership in Britain, just as the rather different <u>Loi Monory</u> has in France.

I plan to announce in the Budget Speech my intention to introduce in next year's Finance Bill provisons which will, in effect, give personal pensions the same highly favourable tax treatment as is enjoyed by other funded pension schemes. I shall reiterate the assurance I gave last year, that I have no plans to change that favourable tax treatment in any way. But I do need to clarify the Revenue's discretionary rules for dealing with the growing problem of pension fund surpluses. As inflation has fallen and the climate for investment has improved, many pension funds have become heavily, and undesirably, over-funded. This is now attracting some attention in the press. Excessive surpluses are a clear abuse of the tax privileges enjoyed by the funds. Nor are they in the interests of pension fund members who are denied the higher benefits or lower contributions they might otherwise enjoy. At the same time the Revenue is having to use its discretionary powers to turn down many of the increasing number of requests for refunds from companies which, in the 70s, had to top-up funds which were then in deficit.

The result is an inevitably arbitrary state of affairs which is causing dissatisfaction all round. I therefore propose clear and objective legislation under which funds with surpluses of more than 5 per cent (calculated on standard published guidelines, based on the most conservative funding and actuarial methods) will be required to eliminate their excess over a period of years. How they do so will be entirely a matter for the trustees: they can choose to increase benefits, or reduce contributions, or make a refund to the company. But if there is a refund, there will be a tax of 40 per cent on the company (not the pension fund) to recover at least part of the tax relief it will have obtained on its contributions, and to discourage abuse of this tax relief through "parking". These changes should bring in an extra £20 million in 1986-7 and £120 million 1987-8. In devising this scheme, I have had the benefit of the advice of the Government Actuary.

Charities

Finally, I have decided to make major changes in the tax treatment of charities. Charitable giving substitutes private action for State action and we have already done much to encourage it. I have been urged by many colleagues to do more. I have three proposals: first, I intend to abolish the upper limit on relief at the higher rates of tax on charitable covenants, while at the same time stopping the abuse of the tax system by certain sorts of private charity. Secondly, I propose to allow companies, other than close companies, tax relief on one-off gifts up to a maximum of 3 per cent of their dividend payments. Thirdly, I shall propose a new scheme of payroll giving under which, if employers agree, employees can have charitable donations of up to £100 a year deducted from their pay, and get tax relief on them. These new measures will of course be in addition to the present tax relief for covenants by both companies and individuals. They should in time lead to a substantial increase in charitable giving. The cost will be negligible in 1986-7 and about £60 million in 1987-8 in gross terms, partly offset by a yield of around £20 million from the anti-abuse measures.

As I told you last week, I also wish to make a number of minor but carefully chosen concessions to charities on the VAT front.

I would be glad to know if you are content with this package of measures.

Rachel Lomax

N.L.

5 March 1986

(approved by the Chancellor & signed in his absence)

Revenue Effects of Budget Changes

Cost-/Yield+	1986-87	1987-88 £m
Business and Enterprise		
Business expansion scheme	neg	+10
Capital transfer tax	-35	-55
Car and fuel benefits	neg	+15
Overseas entertainers	nil	+100
Savings and investment		
Stamp Duty	neg	+10
Personal Equity Plan	neg	-25
Pension fund surpluses	+20	+120
Charities		
Package of reliefs	neg	-60
Anti-abuse measures	neg	+20
VAT concessions	-10	-10
Total	-25	+125

Memo

Loan Guarantee Scheme (+additional expenditure)	nil	10

pmp.

~~DRAFT MINUTE FOR CHANCELLOR TO SEND TO THE PRIME MINISTER~~

PRIME MINISTER

BUDGET PROPOSALS

You already have my Budget proposals on indirect taxes. I still have to reach a final view on income tax, in the light of the latest economic forecast, which I shall want to discuss further with you ~~tomorrow.~~ (when we next meet.) This minute covers my remaining tax proposals, none of which depend on what is done on income tax. In addition, as you know, I am discussing with David Young a ~~modest~~ package of (public expenditure) measures to help the long-term unemployed, on which I hope to be able to report early next week. ~~They would~~ The cost of these will be met from the Reserve.

2. None of the measures described below will have significant effects on revenue next year. But overall they should help to encourage enterprise and improve the performance of the economy - and hence, of course, employment. (In particular,) I have ~~also~~ been concerned to devise measures which carry forward the themes of my previous Budgets. ~~that foster private initiative and responsibility. I see this as an important way of winning the argument against those who think instinctively in terms of State action and higher public spending.~~

Taken together, they are ~~[illegible]~~ more or less revenue-neutral.

Include

Business and Enterprise

3. First, ~~the~~ measures for business and enterprise. The Business Expansion Scheme is due to end next year and I have been reviewing its future with the help of a report

from Peat Marwick. This report ~~shows~~ confirms that the BES has been an outstanding success in its aim of attracting new equity capital into unquoted companies, a high proportion of them new and small businesses. I therefore propose to continue the Scheme indefinitely. At the same time I ~~shall~~ feel I must take action to prevent abuse of the scheme by excluding from its scope companies holding more than half their assets in the form of land and buildings ~~or investing in other assets likely to rise in value over time. These exclusions will~~ and certain other activities which are threatening to bring the BES into disrepute (eg investment in fine wines). These exclusions will start to target the scheme more firmly on risk investment. I ~~therefore~~ propose at the same time to improve the scheme further, by exempting BES shares issued after Budget Day from Capital Gains Tax on first sale.

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5. I shall also be proposing a number of smaller measures to help business, including the extension and improvement

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of the Loan Guarantee Scheme, under which the Government guarantees bank loans to small and new businesses. In addition, ~~[After consultation with David Young and Paul Channon~~ I am planning to announce that we will embark on very preliminary discussions with employers and others about the feasibility of devising incentives for profit-sharing agreements in industry, perhaps through some temporary measure of tax relief, as a means of increasing the flexibility of the labour market.]

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stet

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~~VAT threshold (despite OC pressure)~~

Savings and Investment

6. ~~Both Paul Channon and the Governor have argued strongly that I should give a high priority this year to cutting~~ There is clearly a very strong case for reducing - if not abolishing altogether - the Stamp Duty on equities to coincide with the Stock Exchange's Big Bang ~~next~~ on October. ~~There is a formidable case for doing so.~~ With no tax at all on share transactions in New York and only

half a per cent in Tokyo, the current rate of duty of 1 per cent threatens to make London uncompetitive in the fast developing world market for financial services. If London cannot win a major share of the global securities market its present world pre-eminence in other financial services will be threatened. I would therefore ~~intend~~ like to cut the rate ~~on share transactions (but not on houses, which would be too expensive this year)~~ to ½ per cent in October. But I believe it would be politically ~~unwise~~ awkward ~~it would be wrong - particularly~~ in the present climate of opinion about the City ~~-~~ to reduce the overall contribution which financial services make to the Exchequer. I therefore propose to recoup ~~all~~ the entire costs of the rate reduction by applying the duty to other transactions which ~~now~~ currently escape it, such as intra-account transactions and takeovers and mergers. There will also be a special rate of 5 per cent on the conversion of UK shares into American Depository Receipts, the method increasingly used to escape Stamp Duty and transfer dealings abroad.

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? vet 15 Transfer

8. I plan to announce in the Budget Speech my intention to introduce in next year's Finance Bill provisions which will, in effect give personal pensions the same highly favourable tax treatment as is enjoyed by ~~post-occupational~~ other funded ~~pensions~~ pension schemes. I shall reiterate the assurance I gave last year, that I have no plans to change ~~the~~ that favourable tax treatment in any way. But I do need to clarify the Revenue's discretionary rules for dealing with the growing problem of pension fund surpluses. As inflation has fallen and the climate for investment has improved, many pension funds have become heavily, and undesirably, over-funded. This is now attracting some attention in the press. Excessive surpluses are a clear abuse of the tax privileges enjoyed by the funds. Nor are they in the interests of pension fund members who are denied the higher benefits or lower contributions they might otherwise enjoy. At the same time the Revenue is having to use its discretionary powers to turn down many of the increasing number of requests for refunds from companies which, in the 70s, had to top-up funds which were then in deficit.

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11. I would be glad to know if you are content with this package of measures.

about £60m in 1987-88, in gross terms, partly offset by a yield of around £20m from the anti-abuse measures.

£

around £60m

Chanc. I think the reforms of the 22 cost, not the 32 cost. In any case I'd give gross cost of reliefs, then state that stopping abuse will offset £Xm of this.

RR3.75

BUDGET CONFIDENTIAL

FROM: MRS R LOMAX
DATE: 28 February 1986

MR CASSELL

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr Monck
Mr Peretz
Mr Scholar
Mr Monger
Mr H Davies
Mr Isaac - IR
Mr Corlett - IR
PS/IR
Mr Walker - B/E

STAMP DUTY: ADR RATE

The Chancellor was grateful for your minute of 27 February. He agrees with the recommendation to set the ADR charge at 3 per cent.

AwK

pp RACHEL LOMAX

FROM: A W KUCZYS
DATE: 10 March 1986

PS/ECONOMIC SECRETARY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Monck
Mr Peretz
Mr Scholar
Mr Monger
Miss Sinclair
Mr H Davies
Mr Draper (IR)
PS/IR

STAMP DUTY PACKAGE

The Chancellor has seen Mr Draper's minute of 6 March. He would be grateful for the Economic Secretary's views.

2. As to the question of a name, he is inclined to prefer simply "Transactions Tax". But it will not warrant a separate line in the FSBR, so we will have to say "Stamp Duty (including Transactions Tax)".

3. The Chancellor has also asked where we are on the original idea - raised last year - of changing from Stamp Duty to Transactions Tax anyway?

AWK

A W KUCZYS

BUDGET SECRET

Ref No 52J
Copy No 17 of 19

FROM: A W KUCZYS
DATE: 12 MARCH 1986

PS/ECONOMIC SECRETARY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Monck
Mr Peretz
Mr Scholar
Mr Monger
Miss Sinclair
Mr H Davies
Mr Draper IR
PS/IR

STAMP DUTY PACKAGE

The Chancellor was grateful for your minute of 10 March, and Mr Corlett's and your minutes of 11 March. I understand it was agreed at this morning's meeting of Ministers and Advisers that the name for the new tax should be: Stamp Duty (Reserve Tax).

AWK

A W KUCZYS

LP5.22

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

21 March 1986

The Editor
Official Report
House of Commons
LONDON SW1A OAA

Dear Sir,

The Chancellor of the Exchequer much appreciated the prompt and very largely accurate production of the Budget Statement in Hansard the following day. But he has asked me to write to you to draw your attention to a few errors in the initial Hansard text and to ask for them to be corrected in the bound volume. The errors are:-

(i) Column 169, line 40 - "revenues" is incorrectly spelt.

(ii) Column 168, line 31 - "£11.5 billion" should read "£11½ billion".

(iii) Column 175, line 35 - "2.5 per cent" should read "2½ per cent".

(iv) Column 180 - the heading should simply read "TAXES ON SPENDING", with "PERSONAL TAXES:" deleted.

I should be grateful for confirmation that the Bound Volume of the Official Report will be amended accordingly. Many thanks for your help.

Yours faithfully,

Philip Wynn Owen

P WYNN OWEN
Assistant Private Secretary

Already done. PT up-date Ch's copy of the brief (PWP'd this am)

NB

BUDGET BRIEF RECIPIENTS

FROM: S R KEMP
DATE: 21 March 1986

Done 27/3.

BUDGET BRIEF: CORRIGENDA

I attach individual, corrected pages for briefs A1, B1, B3 (2 pages), B7, B8, B10, B11, E3, F1, G1, J4, K5 (2 pages), L2, M2, M3, N7, P2, Q2 (3 pages), Q4 (3 pages), Q8, T2 and T3 (3 pages). Please substitute these pages for the equivalent ones in the Brief circulated on 18 March. Corrections are sidelined.

2. In addition, I attach:

(i) a new brief on National Savings, E1A, covering an announcement made by the Economic Secretary on 20 March.

(ii) 6 pages of J3, updated to take account of the 1984 Family Expenditure Survey, which has only just become available.

S R Kemp

S R KEMP

RR7.41

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

21 March 1986

A R Jay Esq
33 Mount Avenue
LONDON
NW5

Dear Peter

Once again I have to thank you for your invaluable help in putting together the Budget broadcast - last minute changes and all. I was generally very happy with the end product and I hope you were too. I really am most grateful.

Yours ever
Nigel

NIGEL LAWSON

506/8

RESTRICTED

b/f 24/3 pl

FROM: B O Dyer
DATE: 21 March 1986

01-233 4749

PS/ECONOMIC SECRETARY

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
Mr Culpin
Mr Draper - IR

Note
Spoke to C about point below. R 24/3

BUDGET RESOLUTIONS : MONDAY 24 MARCH 1986

At the conclusion of the Budget Debate, at 10pm on Monday, the Chair will put the question on the 'Amendment of Law' Resolution. Once that has been agreed, he will then put successively the questions on each of the remaining Ways and Means Resolutions, and the Procedure motion, without further debate (under SO No.114). The Chair will also indicate those Resolutions on which a Division is desired.

2. Any question of procedural propriety in withdrawing the three Resolutions and tabling an Amended Resolution, in respect of 'Stamp Duty', is a matter for the Chair. The fact that the Amended Resolution was accepted on the 'Table' today indicates that the House Authorities, and by implication the Chair, endorse the procedure adopted.

3. I will confirm the foregoing with the Table Office when they open for business on Monday morning; and, in the light of what they say, will let you have a further note, if necessary.

B. Dyer

B O DYER
Parliamentary Clerk

506/7

PWP

CONFIDENTIAL

Note: Told B.Dyer of C's comment. Asked him to report back Monday am.

Ro 21/3

I don't believe this is necessary; but X would help. [Y would not.]

FROM: B O DYER
DATE: 21 March 1986

01-233 4749

C, All these suggestions are in hand, apart from the highlighted section. Brian is offering X and Y, with a steer to Y so as to protect you from any "points of order" when the resolutions are put after your speech at close on Monday. EST would not, I should think, be over the moon about this. But it would ensure you a quiet passage. Any views?

Ro 21/3

MR WYNN-OWEN

STAMP DUTY : BUDGET RESOLUTIONS

My understanding is that the Economic Secretary has agreed to the withdrawal of three 'Stamp Duty' Resolutions, and that an amended Resolution on 'Loan Stock' should be tabled to appear on Monday's Order Paper.

2. As you know, I am concerned that we do our best to avoid the Chancellor (who is winding up Monday's debate) becoming the focus of 'points of order' as a result of this late change. I am sure that the proposal to provide some explanation by way of an + arranged PQ today, together with a letter to the Opposition, will be helpful in this respect. But I doubt that this, in itself, will be sufficient to forestall 'points of order' on Monday. It is of course a matter for Ministerial judgement, but I wonder whether it would be helpful, in this context, to try and X persuade the Chairman of Ways and Means to draw the attention of the House to the amended Resolution at the commencement of Public Business on Monday; or, alternatively Y if the Economic Secretary were to make a short explanatory statement?

3. Murdo Maclean and the Leader of the House are aware of the position (and in contact with the EST's Office); and no doubt they will be putting forward their own views in due course, as to how this might best be handled.

B. Dyer

B O DYER
Parliamentary Clerk

+ Might there not be advantage in having a short press release also? The Written Answer to the arranged PQ may not appear in Hansard until Tuesday.

R.

CONFIDENTIAL

10 DOWNING STREET

From the Private Secretary

5 March 1986

Dear Rachel

BUDGET PROPOSALS

The Prime Minister is content with the Budget proposals set out in the Chancellor's minute to her of today.

CH/EXCHEQUER

REC.	- 5 MAR 1986
~~ACTION~~	PS/FST
COPIES TO	Sir P. Middleton
	Mr Scholar
	Mr Monger

5/3

Yours ever

Tim

pp DAVID NORGROVE

Mrs Rachel Lomax,
H M Treasury

CONFIDENTIAL

dnd

UK Budget 1986

A pretty rough 'n' ready effort.

MESSEL

L. Messel & Co.,

UK BUDGET - MARCH 1986

CONTENTS

Editors: Michael Howell/Louise Havergal
Head of Research: Peter Jones
Economics Partner: Tim Congdon

18th March 1986

"A BUDGET FOR LOWER INTEREST RATES"

It is almost a "Budget for Everyone", but clearly it is a Budget that is **very good** for financial markets. Both gilts and equities stand to make **immediate gains**, with the balance slightly in favour of **gilts**, initially. Looking longer term gilts may be concerned about the Budget's longer-term **inflationary** consequences, but equities will definitely gain from the moves to encourage **wider share ownership** and to **reduce dealing costs**. The fall in stamp duty could boost equity turnover by almost **70%** in the medium-term.

The **generous £M3 target range** of 11-15% will allow **significant falls in interest rates** over coming months, while the low **3½%** end-year **inflation** must **improve sentiment** toward financial assets.

The Budget has improved the outlook for the **cyclical consumer stocks**, eg. **Stores**, and for **Construction** and other areas of capital spending. Prospects for the stable consumer group are mixed, but sentiment towards **Brewers** should improve noticealy. Apart from short-term relief from the **financial** sector following no "financials tax", there is little positive news for the sector. Similar comments apply to **Oils**, although the proposed "Personal Equity Plan" should make these high yielders attractive.

STOCK RECOMMENDATIONS

The objective of these recommendations is to secure outperformance to the market over next 3 months.

Company	Price (p) (Relative)	Price Range (Rel. to All Sh)	Reasons for Recommendation
MAIN BUYS			
Bass	755 (95)	755-472 (95-59)	*Benefit from sector strength.*
Scottish & Newcastle	209 (26)	209-125 (26-16)	*Benefit from sector strength.*
ASDA-MFI	148 (19)	166-128 (21-16)	*Significant non-food interests.*
Harris Queensway	254 (32)	168-288 (28-45)	*Most "durable goods"-related stock.*
First Leisure	427 (54)	430-228 (54-29)	*Benefit from sector strength.*
Bunzl	613 (77)	618-404 (78-50)	*Quality packaging company.*
Sedgwick	378 (48)	412-335 (52-42)	*Under-rated.*
Storehouse	340 (43)	333-277 (42-35)	*Benefit from sector strength.*
MAIN SELLS			
British Aerospace	558 (70)	586-295 (74-37)	*Dependent on tight public spending.*
Plessey	228 (29)	224-116 (28-15)	*Dependent on tight public spending.*
Ferranti	154 (19)	184-104 (23-13)	*Dependent on tight public spending.*

MAIN POINTS

* Mr. Lawson's third budget is in the same style as his first two. Significant tax cuts of almost £1b announced, despite £5½b loss of North Sea revenues. Mr. Lawson confirms his reputation as a radical supply-sider rather than a genuine "sound money" man.

* PSBR control dependent on continuing tight reign on public expenditure. Very good January and February PSBR figures suggest that public expenditure in 1985/86 lower than expected. The Chancellor is hoping that this continues into 1986/87, so that PSBR stays at £7b, below expectations despite the tax cuts and loss of North Sea revenue.

* Sterling M3 target re-introduced, but target band of 11-15% growth is generous. If bank lending averages 1¼bn a month zero net gilt sales will be required to attain the middle of the target range. The resulting possibility of large interest rate cuts in coming months will combine with over-supply of housing finance (note strong competition between banks and building societies at present) to generate boom in mortgage lending in late 1986.

* Further interest rate cuts will follow any cuts this week and single figure base rates are likely later this year.

* The ½% point out in Stamp Duty will boost equity turnover significantly. We estimate turnover could rise by a total 70% over the medium-term with the first year impact being 25%. Prices will also benefit from this growth by as much as 3%.

* Prospective boom in mortgage lending and measures to promote "popular capitalism" will be well received by equity market. Cut in stamp duty also helpful for equities, although ½% stamp duty on loan stock and letters of allotment seems inept and misjudged. No support for development of commercial papers and bond markets.

* £7b PSBR in 1986/87 and sterling M3 target of 11-15% imply low level of gilt funding. If bank lending to private sector is £12b, net gilt **redemptions** of £1b possible. This seems bullish for gilts, and maybe attainable given the recent squeeze on public spending, but the markets may be nervous about the long-run inflationary consequences of Mr. Lawson's adventurism.

* Growth forecasts for 1986 of 3% seems plausible, but suggestions of 4% increase in consumption, and 5% increases in exports and investment, may raise eyebrows. L. Messel & Co's forecast of consumption growth is more cautious, but the coming boom in housing finance will be supportive.

	Forecasts for 1986	
	H.M. Treasury (March 1986)	L. Messel & Co. (March 1986)
GDP	+3%	+3¼%
Consumers' expenditure	+4%	+3%
Fixed investment	+5%	+4%
Stockbuilding	Nil	+£¾b
Current account	+3½	+£3b
Retail price index (4th qr. to 4th qtr)	+3½	+4%

All figures at 1980 prices except for current account (outturn prices) and retail price index.

ECONOMIC SUMMARY

A TYPICAL LAWSON BUDGET

Mr. Lawson is temperamentally a tax-cutting supply-sider, not a sound money man. In his first two Budgets he cut taxes, despite the risk of a large fall in oil prices and the long period of time before the next general election. It seemed a risky approach and the financial markets, particularly gilt investors, did not like it. The oil price has now fallen sharply and wiped out £5½b. of potential revenue in 1986/87 - but Mr. Lawson is still cutting taxes! How has he achieved this apparently remarkable jest? Do the numbers really add up or is the Chancellor taking unnecessary risks?

The key to reconciling tax cuts of £1b. with a PSBR estimate of £7b. and a £5½b. slump in North Sea revenues is very tight control of public expenditure. In the Budget speech Mr. Lawson said that expenditure would be "within" the planning total envisaged for 1985/86. Presumably, "within" means "beneath", an interpretation which agrees with his further statement that public expenditure will be lower in real terms in 1985/86 than in 1984/85 (even when the cost of the miners' strike is subtracted from the 1984/85 total). Mr. Lawson is hoping and assuming that expenditure control will be as vigorous in 1986/87 as in 1985/86. If it is not, his fiscal arithmetic may prove over-ambitious and unreliable.

Nevertheless, the Budget speech contained the standard phrases about sound money and the overriding priority of reducing inflation. Sterling M3 has been restored as the aggregate in which the broad money target is expressed, while the analytical basis of the medium-term financial strategy - that fiscal policy must be consistent with the monetary targets - has been reiterated. In fact, the monetary aspects confirm the adventurism which seems to be part of Mr. Lawson's style. The target bond for sterling M3 is growth of between 11% and 15%, which should present few problems for the monetary managers in the Bank of England. Loan demand from companies will be very weak in the second quarter (after the bunching of investment ahead of the 1st April change in capital allowances), while the banks at present cannot find enough personal sector borrowers to take up all the credit facilities available. The message must be substantial interest rate cuts in April/May, which will prompt a boom in mortgage lending in the summer and autumn.

This boom will contribute to another rise in consumer expenditure. The Treasury is predicting that consumption will be 4% higher in 1986 than in 1985, a rather more optimistic assessment than most economic forecasters'. Nevertheless, consumption will not - in the Treasury's view - be the most dynamic components of demand. That accolade instead goes to exports and investment which are both expected to advance by 5%. The growth of gross domestic product as a whole will be held back to 3% by a forecast 6% increase in imports.

The relaxed sterling M3 target and recent vigorous control of public spending imply early interest rate cuts, while the required level of official gilt sales will be modest by the standards of recent years. The gilt market should therefore respond favourably. This will provide a good background for equities, which in any case have their own grounds for celebration in the cheerful forecasts for economic growth and the measures to encourage wider share ownership. Despite the silly ½% stamp duty of loan stocks and other instruments, and the inept levy of ADR conversion, Mr. Lawson's third Budget will be popular in the City.

Tim Congdon

SUMMARY: BUDGET IMPACT BY EQUITY SECTOR

SECTOR	COMMENT
CAPITAL GOODS	
- Construction & Related Materials	*Positive: Good news from lower interest rate prospects.*
- Technology	*Neutral/Negative: Tight public spending.*
- Mech Engineering & Motors	*Neutral/Positive: Boost from lower interest rate.*
CONSUMER GROUP	
- Brewers & Distillers	*Positive: No increase in duties.*
- Food Manufacturers	*Neutral*
- Food Retailers	*Neutral/Positive: For non-food demand within supermarkets.*
- Health & Household	*Neutral*
- Leisure	*Positive: Benefit from more discretionary spending.*
- Newspaper & Publishing	*Neutral: Good for advertising revenue.*
- Packaging & Paper	*Neutral*
- Stores	*Positive: A better than expected budget for the consumer.*
- Tobacco	*Negative: For Rothman and Imperial from sharp increase in duty.*
OTHER GROUPS	
- Chemicals	*Positive*
- Telephone Networks	*Neutral: Benefit from increased discretionary spending.*
- Oils	*Neutral: But high yielders should gain.*
FINANCIAL GROUP	
- Banks	*Netral/Positive: No tax on banks.*
- Insurance	*Neutral for brokers: Negative for life: Slightly negative for composites.*
- Merchant Banks	*Neutral: Stamp duty on mergers unlikely to curtail corporate activity.*
- Financial Service Companies	*Neutral/Positive: From lower stamp duty.*

The PSBR

The final outturn in 1985/86 should be noticeably less than the £7b. estimate made in March last year, but the winter fall in oil prices will severely impair the government's financial position in 1986/87. The 1985 *Autumn Statement* failed to confirm the £7½b. PSBR target for 1986/87 set out in the Budget. Moreover, it did not contain any update of the government's receipt and expenditure in 1986/87. The government's receipt and expenditure plans from the 1985 *FSBR* are shown in Table 1. L. Messel & Co.'s view is also given.

The £11½b. forecast for North Sea oil revenues made in the last Budget can, clearly, no longer be maintained. Oil revenues were estimated to raise £11½b. in 1985/86 as well in the last *Autumn Statement*. Accounting for the six-month lag in PRT payments, 1985/86 oil revenues were generated in a period in which the North Sea oil price averaged $27.40, the pound/dollar exchange rate averaged $1.24 (i.e. a sterling oil price of £22 a barrel) and production was 2.6m. barrels a day. The relevant period for PRT revenues in 1985/87 is October 1985 to September 1986. In the first five months of this period the oil price averaged $26.0 a barrel at $1.43, a sterling oil price of £18. With June Brent currently trading at $12.00 a barrel the outlook seems set for further deterioration. However, according to the Royal Bank of Scotland oil index, production is now running at a higher level of 2.7m. barrels a day.

Table 1 The government's plans for 1986/87 (in £b.)

	As projected in March 1985	L. Messel & Co. estimate
Receipts		
Taxes on expenditure, income and capital	120½	117
(of which, North Sea)	(11½)	(5)
National Insurance contributions	26	26½
Interest, accruals adjustments, etc.	12	13
Total	159	157
Expenditure		
Central government expenditure	139	141
Debt interest	18	19
National accounts adjustment, etc.	7	7
Total	164	165½
Public corporations' borrowing	-1	-1
Implied fiscal adjustment	3½	-
PSBR	7½	8½

N.B. Constituent items may not sum to totals due to rounding to nearest £½b.

Source: *Financial Statement and Budget Report*, March 1985 and L. Messel & Co. estimates.

Non-North Sea tax receipts were forecast to raise £109b. in the 1985 Budget compared with the £101b. estimated for 1985/86 in the last *Autumn Statement*. Our own forecast for non-North Sea tax receipts in 1986/87 is £3b. higher at £112b. The difference can largely be attributed to the impact of non-oil companies' profits growth on corporation tax receipts as well as rapid earnings growth

The general government expenditure totals include asset sales which are treated as negative government expenditure. Asset sales were scheduled to raise £2b. in 1986/87, according to the 1985 *FSBR*. This was revised upwards to £4¾b. in the last *Autumn Statement*. Our forecast therefore implies that general expenditure (excluding asset sales) should be around £5b. higher than anticipated a year ago. We also assume that the government continues to overshoot its target for debt interest payments.

PSBR 1986/87 - the problem areas

In this section we examine the outlook for three of the more troublesome areas of the government's financial arithmetic. We may then have a clearer idea if a PSBR of £7b., is to be attainable.

i. North Sea oil revenues

Not surprisingly,oil revenues are forecast to be sharply lower in 1986/87 than the £11½b. outturn estimated in the current financial year. The government's tax take from the North Sea is forecast to be £6b. in 1986/87 and around £4b. a year thereafter. The Chancellor's forecast for 1986/87 assumes that the dollar oil price averages $15 a barrel for the rest of 1986 and into 1987.

The Budget forecast emphasises the sensitivity of North Sea oil revenue projections to changes in the pound/dollar exchange rate and production levels. In the matrix below we estimate the level of oil revenues which would accrue in a full year at various levels of sterling against the dollar. Production is assumed to be 2.7m. barrels a day, a little higher than the 2.6m. figure recorded in the last twelve months.

Government revenue from the North Sea in 1986/87

£/$ exchange rate \ Oil price, per barrel	$9	$12	$15	$18	$21
1.20	4.7	6.7	8.6	10.6	12.6
1.30	4.2	6.1	7.9	9.8	11.5
1.40	3.8	5.6	7.3	9.0	10.6
1.50	3.5	5.1	6.7	8.2	9.8
1.60	3.2	4.7	6.2	7.7	9.1

All figures in box in £b.

Notes: 1. The above figures assume average output at around 2.7m. barrels per day and operating costs of £1,500m.

The level of oil companies' investment spending is also relevant for oil revenues because capital expenditure (including exploration) is deductible partly from royalties and in full from PRT payments.

ii. Special asset sales

The £4¾b. target for special asset sales in 1986/87 announced in the *Autumn Statement* should be attained. There is a £1,205m. final call on British Telecom shares in the first week in April and the first cash call on British Gas may raise up to £3,000m. Other offers for sale could include the £600m. sale of the British Airports Authority and the £300m. sale of the Royal Ordnance Factories. The government also plans to sell off the British Shipbuilders warship yards for £200m. Meanwhile, uncertainties over US anti-trust legislation prompted the government to postpone indefinitely its planned privatisation of British Airways.

Table 3 The asset sales timetable £b.

1986/87		1987/88	
BL Trucks	0.1	British Gas (2nd call)	2.5 - 3.0
BT (3rd call)	1.2	British Airports Authority	0.6
British Gas (1st call)	2.5 -3.0	Rolls Royce	0.4
Royal Ordnance	0.3	Thames Water	0.8
National Bus Co.	0.2	Other Water Authorities	0.5
Unipart	0.1	Short Bros.	0.1
Warship yards	0.2	British Airways (?)	0.9
Total	4.6 - 5.1		5.8 - 6.3

Monetary policy

Sterling M3 rose by $14\frac{3}{4}$% in the twelve months to mid-February. It grew at annualised rates of 13% and $6\frac{3}{4}$% in the last six and three months respectively. The narrower measure, MO, grew by only $3\frac{1}{2}$% in the last twelve banking months. The government has recently preferred to target the MO measure of money supply in favour of sterling M3. However, City analysts have tended to take MO less seriously. Not only is it demand determined, and not a leading indicator of economic activity, but also it responds to technical changes. For example, the greater use of cash dispensers encourages individuals to hold less cash.

In his 1985 Mansion House speech the Chancellor announced that the 5% to 9% target range for sterling M3 in 1985/86 would be suspended (n.b. not *abandoned*). Overfunding the PSBR as a method of monetary control was discontinued.

Sterling M3 grew rapidly in 1985 as it was boosted by heavy bank lending to the corporate sector. Bank lending to companies seemed set to continue at a brisk pace in the first quarter of 1986 ahead of the final scaling-down of capital allowances on 1st April. However, lending was only modest in the January and February banking months and sterling M3 recorded gains of only 0.1% and 1.0% respectively.

In 1986/87 monetary trends should be reasonable. Any lending surge ahead of 1st April which might influenced the March and April money numbers should be followed by a lull in loan demand in the rest of the financial year. Furthermore, the lower corporation tax rate announced in the 1984 Budget favours equity finance compared to bank borrowing, as the value of tax relief on interest payments is lower at a 35% corporation tax rate than at a 52% corporation tax rate.

Another salient feature of bank lending in recent months is slack lending to the personal sector. This has taken the form of both weak credit card business and the failure of banks to establish a significant share of the home loan market. The latest quarterly analysis of lending by the clearing banks reports arise in lending for house purchase of only £395m. in the three months to mid-February compared with £829m. in the previous quarter. The increase in other personal lending was also lower at £449m. compared with a £539m. rise in the three months to mid-October.

When the sterling M3 target was withdrawn, it was 5% to 9%. The new target will be for generous growth of 11-15%. This will allow significant falls in interest rates in coming months

Table 4 Required gilt sales in 1986/87

£M3 growth \ PSBR - in £b.	7.0	8.0	9.0	10.0	11.0
5%	8.0	9.0	10.0	11.0	12.0
7%	4.1	5.1	6.1	7.1	8 1
9%	1.0	2.0	3.0	4.0	5.0
11%	-1.0	-	1.0	2.0	3.0

Figures in the box above show official net gilt sales (in £b.). For example, net gilt sales of £4.0b. would be required to maintain 9% sterling M3 growth if the PSBR were £10b. in 1986/87.

Real Economy

The Treasury also released its latest economic forecast for 1986. Its overall forecast for GDP growth is unchanged at 3% and consumers' expenditure is still expected to grow by 4%. However, the Chancellor was keen to emphasise that the fall in oil prices will be more than compensated for by non-oil export growth. Exports are now expected to rise by 5% in 1986 compared with 2% projected in the 1985 *Autumn Statement*. The Treasury also expects faster investment growth than it projected last Autumn. Stockbuilding is forecast to be flat.

The forecasts for the UK current account surplus and retail price inflation were broadly unchanged.

The Treasury's Budget forecasts for 1986 are summarised in the table below and compared with the *Autumn Statement*. L. Messel & Co. 's view is also given. We are more optimistic about GDP growth and stockbuilding than the Treasury. However, we envisage slower growth in general government consumption and less consumer spending. Otherwise, our view is reasonably in line with the Treasury.

Forecasts for the UK economy

	Forecasts for 1986		
	H.M. Treasury November 1985	H.M. Treasury March 1986	L. Messel March 1986
Output and expenditure at 1980 prices:			
Gross domestic product	+3%	+3%	+3¾%
Consumers' expendiuter	+4%	+4%	+3%
General government consumption	+½%	+1%	+½%
Fixed investgment	+3½%	+5%	+4%
Exports	+2%	+5%	+3%
Imports	+4%	+6%	+4½%
Stockbuilding	+£1b.	-	+£¾b.
Cuurent account	+£4b.	+£3½b.	+£3b.
Retail price index	+3¾%	+3½%	+4%

Note: The Treasury's g.d.p. forecast is an average measure. L. Messel & Co.'s forecast refers to the output based estimate.

Source: *Autumn Statement* November 1985, *FSBR* March 1986 and L. Messel & Co. estimates.

Lower oil prices will help the corporate sector. In particular, manufacturers and export related businesses which benefit from lower input costs and sterling weakness on the foreign exchanges. Companies may use their financial strength to extend export credit and finance e overseas acquisitions, which would be reflected in a strong current account position. Once puzzler at present is that, despite their high liquidity, companies are not increasing investment rapidly.

Another salient feature of the Treasury's and our own forecasts for 1986 is the expectation of some stockbuilding revival. So far stockbuilding has been depressed despite the corporate sector's healthy cash flow. However, this may partly reflect companies preference for investment expenditure ahead of the abolition of first-year allowances on 1st April 1986.

EQUITY STRATEGY

The Budget is bullish for both gilts and equities, but probably contains more for gilts initially. However, equities will definitely gain from any falls in interest rates and must gain longer-term from the moves to widen share ownership and reduce dealing costs.

We therefore recommend staying fully invested in equities with a new emphasis towards the interest-rate sensitive and capital spending areas of the market.

Our estimates suggest that the reduction in Stamp Duty will boost London equity turnover by around 70% over the medium-term. This alone would increase it to the equivalent of nearly 40% of market capitalisation which compares with 50% for the New York Stock Exchange, 44% for Tokyo, and a staggering 80% for Hong Kong and NASDAQ in the US. Lower commission charges can only help even more. Moreover the improvement in turnover will also help prcies.

We have recommended "basic industry" sectors in recent weeks. These have outperformed the market but should have further to go given the forecast for manufacturing industry of 3% growth for 1986. We had suggested a move later in the year towards the cyclical consumer stocks (stores, textiles, newspapers and leisure) and capital spending stocks (mechanical engineering, electricals and miscellaneous industrials). We would now look to move into these sectors sooner than before.

We continue to believe that money should be taken out of the stable consumer area (tobaccos, foods, brewers, health and packaging) with a probable exception of brewers short-term. Both financials and oils stand to gain little directly from the budget although sentiment towards financials will benefit from the absence of a financial services tax.

Our specific sector recommendations would now look to increasing weightings in stores building and construction, mechanical engineering and banks and brewers short-term.

The following pages contain more specific sector comments and stock recommendations.

UK EQUITY MARKET WEIGHTINGS & DYNAMICS

18th MARCH 1986

FT Group	Equity Sub-Sectors	All Share Index (% breakdown)	Latest Turnover (1)	Activity Ratio (2)	L. Messel & Co. Recommendations	Portfolio (% breakdown) current	(-3 mths)	Gain/loss on All Share Index 1 mth %	3 mths %	12 mths %
1.	**Capital Goods**	**17.9**	**25.3**	**1.41**	---	**22%**	**(18)**	**2.5**	**6.0**	**2.7**
2.	Building Materials	2.8	3.3	1.18	overweight	-		2.7	3.5	20.4
3.	Contrac. & Construc.	1.4	2.3	1.64	neutral+	-		1.5	1.1	26.6
4.	Electricals	0.6	0.7	1.17	overweight	-		1.6	5.9	2.5
5.	Electronics	4.8	7.4	0.62	overweight	-		0.4	3.1	-19.3
6.	Mech. Engineering	3.2	5.1	1.59	overweight	-		5.1	5.2	6.4
8.	Metals & Metal Form.	0.4	0.6	1.50	neutral+	-		6.5	11.9	36.0
9.	Motors & Distrib.	1.4	3.6	2.57	neutral+	-		0.8	15.6	13.4
10.	Other Ind. Mtrls.	3.3	2.3	0.70	overweight	-		4.0	11.1	7.1
21.	**Consumer Group**	**34.1**	**39.6**	**1.16**	---	**27%**	**(33)**	**-0.2**	**1.5**	**3.6**
22.	Brewers & Distill.	5.1	11.3	1.36	neutral-	-		-3.9	-5.3	17.7
25.	Food Manufacturing	4.1	4.0	0.98	neutral-	-		-1.1	-1.1	0.2
26.	Food Retailing	3.4	3.1	0.91	neutral+	-		-4.4	-6.5	2.5
27.	Health & Household	5.3	4.7	0.89	neutral+	-		2.0	9.5	17.7
29.	Leisure	2.3	2.8	1.22	neutral-	-		2.5	3.7	6.7
32.	Publishing & Print	0.7	1.7	2.43	underweight	-		-0.9	2.7	2.5
33.	Packaging & Paper	1.1	1.1	1.00	overweight	-		-0.8	3.7	10.6
34.	Stores	7.6	7.4	0.97	underweight	-		0.6	1.1	16.7
35.	Textiles	1.2	3.3	2.75	underweight	-		8.1	19.5	24.8
36.	Tobacco	3.2	11.3	1.36	neutral	-		1.9	4.7	-5.7
41.	**Other Groups**	**17.8**	**10.9**	**0.61**	---	**20%**	**(17)**	**2.4**	**0.6**	**-3.5**
42.	Chemicals	4.1	3.5	0.85	overweight	-		4.9	10.0	-4.5
44.	Office Equipment	0.5	0.5	1.00	overweight	-		-9.8	0.4	6.0
45.	Shipping & Transport	1.2	0.9	0.75	underweight	-		1.7	3.6	11.4
47.	Telephone Networks	7.1	7.4	0.62	neutral+	-		2.3	-4.6	5.7
48.	Miscellaneous	5.0	6.0	1.20	overweight	-		2.2	-2.4	-5.1
	Oil & Gas	**8.2**	**6.0**	**0.73**	---	**7%**	**(7)**	--	--	--
51.	Oil	8.2	6.0	0.73	underweight	-		-5.9	-12.3	-23.1
61.	**Financial Group**	**15.4**	**12.0**	**0.78**	---	**17%**	**(18)**	**-0.8**	**-1.3**	**3.2**
62.	Banks	4.1	3.3	0.67	neutral+	-		3.5	0.1	8.4
65.	Insurance (Life)	2.5	4.2	0.67	neutral+	-		0.6	-1.8	11.7
66.	Insurance (Composite)	2.8	4.2	0.67	overweight	-		1.1	0.5	16.7
67.	Insurance Brokers	1.0	4.2	0.67	overweight	-		-11.6	-8.9	-15.8
68.	Merchant Banks	0.8	3.3	0.67	neutral	-		1.9	6.7	18.0
69.	Property	2.9	2.3	0.79	neutral+	-		-7.2	-4.2	-9.6
70.	Other Financial	1.4	2.3	1.64	neutral	-		0.5	-1.3	-8.6
	Miscell. Sectors	**6.5**	**6.3**	**0.96**	---	**7%**	**(7)**	--	--	--
71.	Investment Trusts	4.6	3.1	0.67	neutral+	-		-2.4	-3.4	-8.8
81.	Mining Finance	1.1	1.4	1.27	neutral+	-		-1.8	-7.1	-22.8
91.	Overseas Trading	0.8	1.8	2.25	neutral+	-		-3.5	-5.3	-8.5
99.	All-Share Index	100.0	100.0	1.00		100.0		10.0+	19.1+	26.4+

* - Change since last issue + - absolute change

Major points
- Maintain underweight in "Cyclical Consumer" Stocks.
- Increase weightings in "Basic" and "Capital Spending" Industries.
- Continue overweight in Financials.
- Reduce overweight holdings of Banks and Health and Household.

Notes -
(1) Latest account figures 28.02.86
(2) Ratio of turnover to market cap. at annualised rate. Values in excess of 1 show "above average" activity and can explain short-term relative strength or weakness.
(3) Telephone Networks and Electronics, Tobaccos and Brewers, and the Insurances are all reported as single sectors.

MARKET BACKGROUND

Indices 17.3.86	Year Ending	% changes in Profits (All Sh)	% changes in Erngs (500 Sh)	% changes in Divs (All Sh)	Actual Tax Charge (Industrials)	PER Actual Tax (500 Share)	Yield (All Sh) %	Index Change (% +/-) Period	Index Change (% +/-) All-Sh	Index Change (% +/-) FTSE
All-Share	1984	+26	+29	+18	34.5%	13.9+	3.84+	1m	+10.9	+10.5
791.4	1985(e)	+10	+10	+12	35.0%	14.0*	3.90*	3m	+18.1	+17.6
FTSE	1986(f)	+19	+18	+15	36.0%	11.9*	4.49*	12m	+26.4	+25.0
1622.6	1987(f)	+15	+14	+15	36.0%	10.4*	5.16*			

FT All Share range, 1981/86: 753-266 **FTSE 100 range,** 1981/86: 1550-607 *+ current value* ** prospective*

NB. Profits earnings and dividends are all in a 'real time' rather than 'reported basis', and are adjusted for new capital issues.

Recent Movements: UK equities after an initial splutter have been one of the strongest of the world markets so far in 1986. Prices are 18% up on 3 months ago and 11% up on the last month. A new All Time High of 1624.5 was established for the FTSE100 on March 12th.

The market rise has been broadly based: the ratio of all rises to falls has averaged 2.5 to 1 through March to date, while only 4 of the 34 constituent sectors of the FTA All Share index are not at their own All Time Highs.

Turnover has continued at a high level, although it is below its mid-February peak in both volume and nominal terms. The current rating on the FT482 (Industrials less Oils) is 13.4x on prospective 1986 earnings growth of 19%: this is equivalent to assuming compound eps growth of just over 8% pa. in perpetuity.

The strongest of the larger market sectors over the last three months have been Chemicals (lower oil prices and sterling), Tobaccos ((Imperial bid), Other Industrial Materials (BTR rerating), Health & Household (sector growth prospects) and Electronics (recovery hopes).

Prospects: The only argument for selling the market is sentiment based, namely that such a strong rise must encourage some profit-taking. On fundamentals the market looks fairly valued assuming a 15% rise in prospective 1986 dividends. This figure which 3 months ago would have looked optimistic may even be a little on the low side given the "excessive" level of dividend cover currently carried by industrial companies.

Dividend cover is currently 2.7x (net), compared with its 20 year high of 3.2x reached in 1977, a year when inflation averaged 16% and the high inflation psychology was firmly embedded. Given such high cover against a "low" inflationary background there is a strong case for larger payouts, even if earnings prove to be below expectations, while the proximity of a General Election and continued takeover activity may encourage some companies to boost dividends.

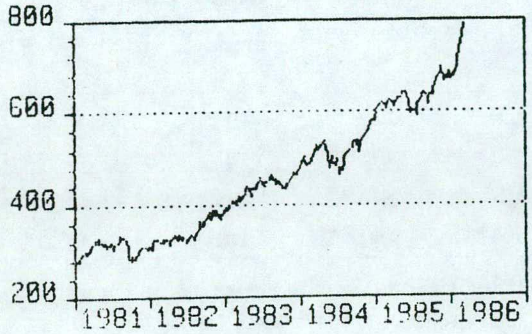
Lower transactions costs for equity dealing should substantially boost equity turnover and also lead to higher equity prices. Our research suggests that the 0.5% point fall Stamp Duty will lead to a rise in the volume of equity transactions of around 20% in the first year, followed by further rises that will total almost 70% after 5 years.

This rise in turnover will be supported by the extent to which dealing commissions also fall after Big Bang and also by the new tax on transfer of equities into ADRs. Equity prices should also benefit. Using our discounted earnings model, the 0.5% reduction in Stamp Duty should itself boost equity prices by around 2.5% in a full year.

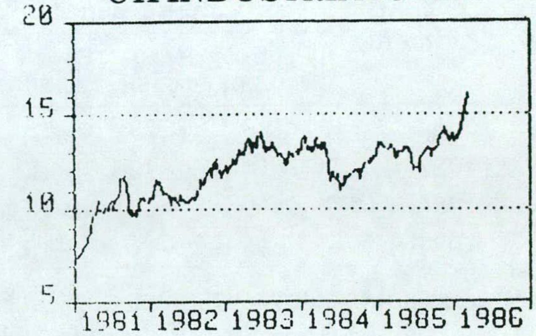
A final bullish factor must be interest rates. Prospective UK real interest rates at 8.5% 6 months ahead are well above comparable major World rates which average 4-4.5%. Sterling must now be less vulnerable to volatile oil prices, while the Chancellor's generous sterling M3 target for 1986/87 makes lower rates much more likely.

CHARTS

FTA ALL SHARE INDEX

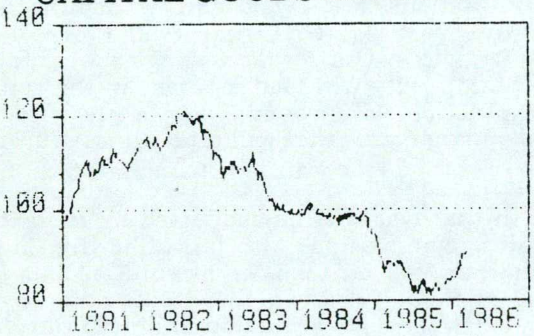


UK INDUSTRIALS PER

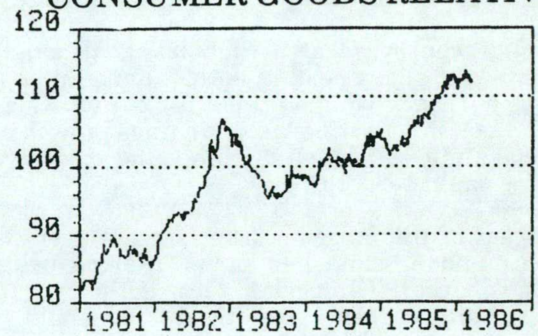


MAIN SECTORS RELATIVE TO FT ALL SHARE

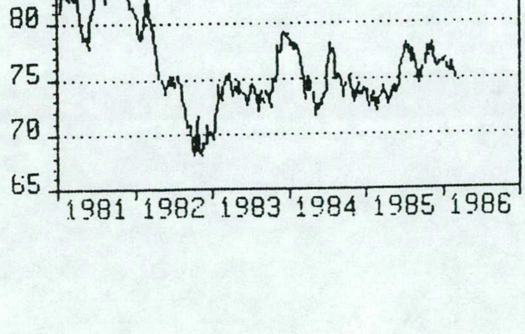
CAPITAL GOODS RELATIVE



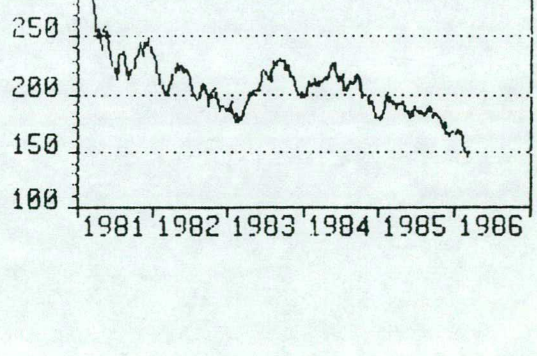
CONSUMER GOODS RELATIVE



FINANCIALS RELATIVE



OILS RELATIVE



CAPITAL GOODS & TECHNOLOGY

Capital goods in general should **benefit** from the better economic environment confirmed by the Budget and the prospects for significant falls in interest rates. However, certain areas of the group depend upon already tight public sector spending which could easily be cut further.

The fiscal impact of the Budget is not unexpectedly **neutral** for the **building sector**. Yet the monetary implications on top of an already bullish mortgage market must unpin good volume growth. Lower interest rates will boost prospects for housebuilders, where we are buyers of **C.H. Beazer Holdings** and **Wilson Connolly**. We would also look to buy leading building material producers that are closely geared to the housing cycle: examples are **BPB, Tarmac, Meyer International** and **RMC Group.**

Longer-term we expect a public expenditure outlook in 1987 that will be of more direct assistance to the construction industry..

A **neutral/positive** outlook is expected for **Mechanical Engineering.** Lower interest rates and faster investment spending will clearly help the sector in general, but particularly the medium to smaller sized companies. Of the majors **Hawker Siddeley** will gain, but **British Aerospace** with its dependence on the public sector may lose out relatively.

Similar comments apply across the Electronics and Electricals sectors. Those companies geared toward the private sector will be the winners e.g. **BICC,** while those dependent on MOD contracts could suffer e.g. **Plessey, Ferranti.**

In Miscellaneous industrials the impact for Christies and Transport Development Group is probably adverse. The abolition of Capital Transfer Tax on lifetime gifts is likely to stem the flow of death duty related estate disposals. This is likely to impact on the flow of goods into the salerooms and limit the number of house sales which have been death duty dictated. However whilst demand remains excellent prices should be pushed higher if supply declines markedly

Fuel costs represent some 25% of T.D.G.'s running costs in the haulage operations: if the 6.5p increase in the derv price is passed on much of the advantage taken by the company via lower fuel prices will be negated and profits could fall short of our earlier expectations.

In more general terms the Chancellor's proposal to make pension scheme overfunding subject to statutory liquidation criteria may affect those companies that have yet to address the problem. In short, pension overfunding of less than 5% (Govenrment Actuary's assessment) is ignored but amounts in excess of 5% must be dealt with and any liquidations will be subject to tax. This will be of particular interest to manufacturing companies which have substantially reduced their workforces.

CONSUMER GROUP

Cyclical consumer stocks (stores, textiles, newspapers and leisure) stand to gain most from the Budget. Lower basic taxation and the prospect of lower interest rates, much lower inflation and a plentiful supply of mortgage finance augur well.

Personal tax cuts of £1bn. net underpin an upgrading in our forecast of consumer spending volume growth from 2.7% to nearly 3.5% for 1986 with further strong growth expected in 1987. We are buyers of **Harris Queensway**, for its gearing to the durable goods cycle, **Freemans, Storehouse, Next, Grattan, GUS** and **Burton Group**.

The advertising and leisure sectors should also benefit from more discretionary spending: our favoured stock is **First Leisure Corp.**, although Grand Met should be considered for its leisure interests.

The impact on the stable consumer group (brewers, foods, health and tobacco) is mixed. Brewers clearly stand to gain from no rise in duties (we recommend **Bass, Scottish & Newcastle** and **Whitbread**), but **Tobaccos** will lose out from higher duty which pushes up the price of the typical branded cigarette to 149p from 138p per packet. This will lead to an acceleration in the rate of decline in the UK market from ½% in 1985 to 2-3% in 1986. Big loosers are **Imperial and Rothmans. BAT Industries** absent from the UK market is of course unaffected. Packaging should gain in general from more consumer spending: Bunzl and Bowater are our buy recommendations.

The impact on Foods is mixed. No clear benefit for Manufacturers is partly offset by a small boost to those Retailers with exposure to non-food interests and higher margin foods, while the prospect of lower interest rates will help those facing the capital cost of physical expansion; stocks we like are **ASDA-MFI, Bejam, Kwik Save** and **Tesco**.

OILS & COMMODITIES

The Budget impact on the oil sector's fundamentals is **neutral.**

Chancellors Nigel Lawson stated that the UK oil sector would be free from government directive and gave the assurance that UK oil output would not be restricted to support World oil prices. However, this had already been discounted and any surprise should have been further mitigated by the Chancellor's emphasis that the UK is not a major oil producer.

The net effect of the Budget to the motorist is **neutral in real terms;** however, the Chancellor has offset a slightly faster increase in petrol duties than implied by indexation with no increase in vehicle excise duty.

The **7.5p average rise in petrol duty** is above the 5.4p required by RPI inflation but well below the figures suggested before the Budget. Moreover, as the Chancellor noted given the impact that lower oil prices have already had on refining margins relative to pump prices there is a good chance that petrol prices will see no net rise.

In the context of the currently very profitable downstream market this extra duty will have **no significant impact**. The other tax changes proposed by the Chancellor that relate to the sector also appear to have no major impact. We maintain our cautious stance towards the sector: **BP** and **Shell** are holds.

The one tax change that could influence sentiment towards oil is the proposal to allow private investors to invest $2400 annually tax free into a Personal Equity Plan. This will clearly encourage funds towards high Yielding equities: the prospective yield on BP is 9.8%, on Shell it is 7.1% and on Britoil 10.6%.

The two major Mining Finance companies **Cons. Gold** and **RTZ** may not benefit directly from the Budget but they will get some boost to their sizeable construction materials division from the improved outlook for the UK building sector.

FINANCIALS

The main point for financials must be the absence of any specific bank tax or more general financial services tax.

This non-negative news will allow a further rise in the Banks sector which will come on top of last week's sudden re-rating. This push to prices will allow the Banks to achieve the pre-results rating that we had originally expected.

Thus apart from a short-term rise we are **neutral** towards the sector on a 6-12 month view. Of the major stocks **Barclays** is currently on our "buy list". Barclays through its newly formed securities arm should benefit from the significant increase in equity turnover that we expect following the cut in Stamp Duty.

Although the Budget left Insurance Brokers unaffected, the sector still remains attractive. **Sedgwick** and **Willis Faber** are our major buys.

Life assurance operations will, however, feel some direct impact. First the proposed changes to CTT as applied to lifetime gifts could have an adverse effect on some tax avoidence products marketed by life companies. This therefore could detract from the attractions of single premium poilicies, one of the major growth areas of recent years.

Second, the proposed "Personal Equity Plan", a tax free scheme to encourage wider share ownership, could affect the marketing of savings plans and endowment policies.

In general terms the Budget impact is **slightly negative** and we would look to reducing overweight holdings in the sector. Similar comments must apply to those Composites that have major life interests.

The Budget impact on Merchant Banks and Financial Service companies is broadly **positive.** The imposition of a 0.5% Stamp Duty on mergers should not hit Merchant Banks' business, while the lowering of Stamp Duty on equity transactions should improve prospects for those that are geared towards broking.

L. MESSEL & CO.
RESPONSIBILITY BY SECTOR

DEPARTMENTAL HEADS (01) 377 0123
Peter Jones(Research) Ext. 4158 **Jonathan Carr(Sales)** Direct 480 8045

Sector	Analyst(s)	Extension	Specialist Salesmen	Direct Line
Economics	Tim Congdon Christopher Wickham	4561 4598	- -	- -
Portfolio Strategy	Michael Howell	4145	-	-
Building Materials	Simon Brown	4282	Gareth Pocock	480 8067
Electricals/ Technology	Keith Hodgkinson Denis Gross Chris Will	4449 4500 4560	Roger Goodwin	480 8042
Brewing/Distilling/ & Hotels	Philip Shaw James Riding	4238 4235	David Baggs Tim Bates Robin McKelvey	480 8051 480 8052 480 8059
Food Manufacturing	Tim Potter	4208	Robert Cathery	480 8009
Food Retailing	Tim Kirkwood Mark Josefson	4448 4450	Geoff Bowman Michael Rice	480 8064 480 8038
Health & Household	Stewart Adkins	4565	Mark Donati Charles Greenwood	480 8039 480 8035
Packaging & Paper Publishing & Printing	Tony Willis	4566		
Stores	Tim Kirkwood Richard Clarke	4448 4111	Geoff Bowman Michael Rice	480 8064 480 8038
Tobacco	Chris Alexander	4443	Richard Boxhall	480 8048
Oils	David Oswald Chris Firmin	4231 4232	Nick Thorniley	480 8054
Financials Banks Fin Services/Misc Fins Insurance	 Chris Davis Wayne Gerry Kevin Phillips	 4525 4520 4236	 Charles Wood James Kentish Barnes	 480 8032 480 8034
Investment Trusts	David Thomas Pam Sawyer	4037 4219	David Carleton Paget David Thomas	480 8036 480 8037
Mining Finance/ Mining	Euan Worthington David Morgan Peter Miller Richard Harris Jane MacKelvie	283 8711 " " " "	Jeremy Mainwaring-Burton Nick Panitza John Sibbald	283 8711 283 8711 480 8080
Misc.Messel Cos. & Small Cos.	Chris Radmore Ronnie Dunbar	4249 4165	- -	- -
European Equities	Melinda Diamond Simon Miller	4230 4237	Peter Streatfield Christian Englehart	480 8079 480 4078
Technical Analysis	David Sowray David Beach	4428 4412	David Hunter	480 8084
Financial Futures	-	-	Malcolm Robertson	480 8053
Traded Options	Keith Williamson	4033	Geoffrey Chamberlain Lesley Powell	480 8062 480 8057
Convertibles	-	-	Nick Forde	480 8041
Bids & Deals	-		Nick Coombes	480 8058

Craig

Could you please check the industry figure in £24 billion.

CX concerned at coincidence of same no. for aid (revised to 1133) and industry – in his list as 1133.

Please report answer to Private Office. Ta.

Hurl.

INDUSTRY
1133 — 400m
[illegible]

Do not use £24b breakdown

Hattersley wrote to CST claiming.

SUNDAY 23 MARCH 1986

OBSERVER

Paper tigers make economies 19

Katharine Whitehorn's implication (last week) that although a Civil Service run on managerial lines had been mooted before 1979, little had been done until Margaret Thatcher brought in Lord Rayner's potent efficiency unit takes me back well over 40 years.

I was part of a team introduced into the War Office by Leslie Hore-Belisha to probe its business efficiency, and by the end of the 1939-45 War our recommendations had achieved among other improvements annual savings of over a million pieces of paper.

S. B. Townsend,
SW13.

■ I am afraid that Katharine Whitehorn vastly exaggerates the size of the Business Statistics Office at Newport. Even at its pre-Rayner peak it was only about a tenth of the size quoted and its numbers are now well under a thousand.

But it is the context of this mistake which is more serious than the error itself; it gives a picture of vast numbers of low-ranking number-crunchers when the reality is that the Business Statistics Office has a relatively small staff of dedicated professionals who perform a very valuable function.

It has become fashionable to regard the collection, analysis and dissemination of statistical data as a second-rate activity compared with policy formulation and Katharine Whitehorn faithfully records this attitude. However, I believe that a change in official views towards the value of statistical collection is now detectable: that sound policies need to be based on sound information.

J. B. Mayers,
John Bradwell Associates,
SE22.

■ Katharine Whitehorn's article was both readable and informative but I can only hope that her reference to 'Norman Fowler's . . . attempt to stop young people enjoying their unemployment by the seaside' was meant ironically. In Milton Keynes (no 'Costa del Dole' here) over 700 young people found themselves faced with eviction and homelessness as a result of this DHSS cost-cutting exercise.

The 'ultimate shame' is not that these regulations were overturned in the courts but that having thus been declared illegal, they were instantly reintroduced in an act of arrogant disregard of public opinion and the rights of homeless people. While the DHSS mandarins debate the finer points of 'elegant mid-field play' versus 'goal scoring,' 700 people in Milton Keynes once again await eviction.

Miles Sibley,
Milton Keynes Housing
Aid Centre.

The Mail

Sick note 18 MP

A FAVOURITE Westminster dinner table question at the moment is: what is the biggest employer in Europe after the Russian Army?

Answer: our National Health Service which employs 796,000 — up 68,000 on the total Mrs Thatcher inherited in 1979.

The answer highlights the problem confronting the Tories when their private polls show massive disenchantment with their handling of the NHS.

The solution some Ministers are suggesting is an election promise of a privatisation programme for the NHS involving the sacking of an army of bureaucrats.

What none of these Tories mentions is that it was the *last* Tory government which introduced the paper pushers into what until then had been an efficient service.

LT3.10

BUDGET SECRET

REF NO 66J

COPY NO 17 OF 18

cc CST
FST
MST
EST
Sir P Middleton
Mr F E R Butler
Mr Anson
Mr Monck
Mr Burgner
Mr Monger
Mr Shaw
Miss Sinclair
Mr Butler

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

PRIME MINISTER

CIVIL SERVICE MANPOWER

Following my earlier minutes to you about my Budget proposals, I thought you might like a brief note on the effect of the Budget on Civil Service manpower numbers.

As last year, the most significant effect arises from the Department of Employment measures, which will require about 2,000 extra staff at April 1987 and April 1988. The largest single item is the nationwide extension of the counselling initiative and Jobstart allowance pilot schemes for the long-term unemployed, where there will be a continuing requirement, after an early peak, of about 1,000 staff. In addition, there will be an increase of 300 in the staff dealing with fraud, and a number of other more modest additions.

There will be no extra staff required in Customs and Excise. In the Inland Revenue, there will be a small reduction in 1986-87, thanks in part to a new simplified procedure for reporting benefits in kind; but in 1987-88, as the extra staffing requirements for a number of Budget measures come through, there will be a net increase of 300 staff.

On the face of it, the increases for the Department of Employment measures mean that the Government's overall manpower targets for both 1 April 1987 and 1 April 1988 will be breached. But, as John MacGregor pointed out in his minute to you of 7 March, it will in any case be necessary to look at the overall position after the Budget and make a reassessment, as part of the 1986 Public Expenditure Survey.

N.L.

14 March 1986

Penhaligon

PST: this inflation point.

How true

Year to January 1986 : Consumer price inflation

UK	5.5 %
US	3.9 %
Japan	1.4 %
W. Germany	1.3 %
France	4.2 %
Italy	8.8 %

Budget brief says:

"UK inflation remains above that of all our major competitors except Italy"

(ie. Penhaligon broadly right)

Inland Revenue

Policy Division
Somerset House
FROM: M PRESCOTT
26 March 1986

26/3

1. MR ~~LEWIS~~

3. FINANCIAL SECRETARY

b/f with FST's response

TAXATION OF LUMP SUMS FROM EMPLOYMENT

1. Following your recommendation that the defect in this legislation should now be corrected for the future (Ms Life's note to PS/Chancellor of 25 March) we need to consider the timing of an announcement and, linked to this, the "operative date" for the proposed changes.

2. We are putting this note to you now in case you feel the change should take effect from 6 April, the start of the next tax year. If so, we would need to act quickly.

Procedural

3. The legislation itself will be introduced as a new clause at Committee Stage. Because we shall be tightening up the existing legislation, there will also need to be a Ways and Means Resolution taken on the floor of the House before the new clause can be considered in Committee.

---

cc. PS/Chancellor of the Exchequer
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Mr Scholar
Mr Peretz
Mr Monger
Miss Sinclair
Mr Cropper
Mr Lord
Mr Graham (OPC)
Mr Dyer (Parliamentary Clerk)

Mr Isaac
Mr Painter
Mr P Lewis
Mr P Hall
Mr Northend
Mr R H Allen
Ms Tyrrell
Mr Prescott
Mr Wilcox
PS/IR

4. Before then there will need to be an announcement about the decision to legislate. This could be done by way of an arranged PQ. There will also need to be an Inland Revenue Press Notice to draw attention to the announcement, and to explain the position in respect of past cases and invite supplementary claims for relief from taxpayers concerned. (As previously proposed, we would also write simultaneously to all of the main representative bodies).

Trigger and Operative Date

5. The legislation (Section 187 ICTA) operates by treating the lump sum as being income received at the time of the event (e.g. the termination of employment) in respect of which it is paid. The proposed revised treatment will therefore simply apply to payments in respect of "events" occurring on or after the operative date.

6. As regards the operative date itself, there are then three possibilities, viz

(a) 6 April 1986

(b) the (subsequent) date on which the decision to legislate is announced

(c) the date of enactment of the Finance Bill.

7. Presentationally, it would look very odd to correct the defect but for this not to apply until enactment of the Bill. Though the scope for doing so in practice might be limited, this would be tantamount to inviting people to make hay while the sun shone. We assume, therefore, that to prevent this you will agree that the choice narrows down to (a) and (b) above.

8. There are two main arguments in favour of (a) - 6 April.

9. First, there is the general argument that if it is thought desirable to correct this defect in the legislation, it must follow that it is also desirable for the correction to apply sooner rather than later.

10. Second, there is a technical argument which also bears on the length of legislation that will be needed. The top slicing reliefs that we shall be amending apply for a given year of assessment. Where there are two or more lump sum payments in the same year of assessment, the rules provide for the top slicing reliefs and thresholds to be applied to the aggregate amount of these payments. Unless the operative date was 6 April, therefore, the present aggregation rules will not work where one payment was made after the operative date and was subject to the revised basis, and another was made before the operative date and was subject to the previous basis. We should therefore need additional rules to cover this (admittedly fairly rare) eventuality, and this would mean rather longer legislation than the few lines which we think (and subject to the views of Parliamentary Counsel) is all that would otherwise be needed.

11. Given your concern to avoid retrospection, however, this in turn means that with an operative date of 6 April there would need to have been an announcement about the proposed legislation before then. Because of the Easter recess, an arranged PQ announcing the decision would have to be put down by this evening at the latest, and answered tomorrow (Thursday). The Revenue Press Notice would also need to issue on Thursday. (Drafts of both are attached in case they are needed).

12. We assume you will consider that this would be rushing things too much just for the sake of slightly tidier and shorter legislation. Moreover, you will now also want to consider what if any action is needed on golden "hellos" and "handcuffs" (Mr Kuczys's note of 25 March), but clearly this is not something on which we could hope to prepare considered advice within the next few hours!

13. On the other hand, we think there is a strong case for an early announcement (i.e. after the Recess) about the decision to legislate and for the operative date to be the date of that announcement.

Points for decision

14. Do you agree, please

(a) that the operative date for the legislation should not be 6 April, and

(b) while the announcement should be deferred until you have considered the position on golden hellos and handcuffs, there should be an announcement as soon as possible and with the operative date tied to this?

M. Prescott

M PRESCOTT

DRAFT

Draft Parliamentary Question

To ask Mr Chancellor of the Exchequer if he has any plans to amend the legislation for taxing ex-gratia lump sums paid to individuals on the termination of their employment.

Draft Answer

The Inland Revenue have been advised that the effect of the legislation governing the tax treatment of such payments where they exceed £50,000 is to give more relief than was originally intended when these rules were amended in 1982, or than the Revenue have hitherto believed the legislation permitted. The Government therefore proposes to amend the rules for the future so that they accord with our original intentions, and the necessary provision will be introduced at Committee Stage of the Finance Bill. We propose that the corrected rules should apply to lump sums paid in respect of a termination of employment, or such other event which gives rise to a charge to tax under Section 187 of the Taxes Act 1970, occurring on or after [6 April 1986].

This also means that tax relief given on any lump sums exceeding £50,000 paid since 6 April 1982 will have been calculated incorrectly. As a result anyone who has paid tax on such a lump sum may now be entitled to a repayment of tax. The Inland Revenue Press Release issued today, of which copies are available in the Library, explains fully what steps a taxpayer should now take to claim a repayment.

DRAFT

INLAND REVENUE

Press Release

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

[3X] March 1986

TAX TREATMENT OF LUMP SUMS PAID ON TERMINATION OF EMPLOYMENT

In reply to a Parliamentary Question the Financial Secretary to the Treasury, the Rt Hon John Moore MP gave the following written answer:

"The Inland Revenue have been advised that the effect of the legislation governing the tax treatment of such payments where they exceed £50,000 is to give more relief than was originally intended when these rules were amended in 1982, or than the Revenue have hitherto believed the legislation permitted. The Government therefore proposes to amend the rules for the future so that they accord with our original intentions, and the necessary provision will be introduced at Committee Stage of the Finance Bill. We propose that the corrected rules should apply to lump sums paid in respect of a termination of employment, or such other event which gives rise to a charge to tax under Section 187 of the Taxes Act 1970 occurring on or after [6 April 1986].

This also means that tax relief given on any lump sums exceeding £50,000 paid since 6 April 1982 will have been calculated incorrectly. As a result anyone who has paid tax on such a lump sum may now be entitled to a repayment of tax."

---

1. Certain ex gratia and compensation lump sums - including redundancy payments - received by employees are only taxable under the special rules in Sections 187 and 188 (including Schedule 8) of the Income and Corporation Taxes Act 1970.

2. Under these rules only lump sum payments in excess of £25,000 are taxable and, with effect from 6 April 1982, the rules were amended with the intention that these payments should be taxed as follows:

/First

First £25,000	- exempt
Next slice, between £25,000 and £50,000	- tax reduced by 50%
Next slice, between £50,000 and £75,000	- tax reduced by 25%
Excess over £75,000	- taxable in full

3. The Inland Revenue are now advised, however, that the effect of the legislation as amended in 1982 is to provide the following treatment:

First £25,000	- exempt
Next slice, between £25,000 and £75,000	- tax reduced by 50%
Next slice between £75,000 and £100,000	- tax reduced by 25%
Excess over £100,000	- taxable in full

4. Legislation will be introduced at Committee Stage of the Finance Bill to correct the position for the future in respect of lump sums paid in respect of a termination of employment, or other event which gives rise to a charge to tax under Section 187 of the Taxes Act 1970, which occurs on or after [6 April 1986].

5. As it is not proposed that the correction should be retrospective in its effect, this means that the tax relief given on any lump sums exceeding £50,000 paid between 6 April 1982 and 6 April 1986 will have been calculated incorrectly. As a result, anyone who has paid tax on such a lump sum may now be entitled to make a supplementary claim for relief and to receive a repayment of tax.

6. Tax Offices will repay tax, together with a repayment supplement where due, in any such case they themselves are able to identify where tax has been calculated and charged on the previous, incorrect, interpretation of the law. However, Tax Offices may not always be able to identify cases where a repayment is due. Consequently, anyone who believes that he may be entitled to a repayment should make a supplementary claim for relief to his current Tax Office, giving his current tax reference together with details of the lump sum when it was received, the name, address and, if known, the tax reference number of the employer at that time. Supplementary claims may be made at any time within a period of 6 years from the end of the tax year in which the lump sum was received.

Notes for Editors

1. Certain ex gratia and compensation payments such as redundancy payments and "golden handshakes" are not taxable under the general Schedule E rules because they are not emoluments from the employee's office or employment. Since 1960, however, they have been taxable under the special rules in what are now Sections 187 - 188, and Schedule 8 Income and Corporation Taxes Act 1970.

/2. These

2. These special rules were simplified in 1981 (Section 31, FA 1981) and further changes were introduced the following year in Section 43 FA 1982.

3. Section 42(8) of the Taxes Management Act 1970 provides that where (as in this case) relief is given only on the basis of a claim by the taxpayer, and it subsequently emerges that an error or mistake has occurred, the taxpayer is entitled to make a supplementary claim within the time allowed for making the original claim. The time limit is six years which means, for example, that the deadline for a supplementary claim in respect of a lump sum received in 1982/83 - the first year to which the current rules applied and thus the earliest year for which incorrect relief could have been given - would be 5 April 1989.

I THANK YOU
FOR BOTH
CH/ER HAS SEEN
~~RECEIVED YOU~~
AND WAS GRATEFUL
FOR . . . .
ONLY RECEIVED
TODAY.

2796/37

CONFIDENTIAL

FROM: P J CROPPER
DATE: 26 March 1986

CHANCELLOR

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Mr T Sainsbury
Mr P Lilley

Sir P Middleton
Sir T Burns
Miss O'Mara
Mr Lord
Mr Davies

PS/IR
PS/C & E

BUDGET DEBATE

Brief round up of the final day of the Budget Debate.

PJC

P J CROPPER

BUDGET DEBATE

MONDAY 24 MARCH

Chancellor of the Duchy of Lancaster: Labour's spending plans: Inflationary dangers.

Mr John Smith (Monklands East): British Leyland. Aldington Report. "Golden Hellos managed to avoid any action in the Budget." Lack of training and of expenditure on R & D. Disappearance of regional aid.

Mr Leon Brittan: Welcome for measures on charities and profit sharing. Applauded PSBR of £7 billion. Recorded his conversion to the idea that cutting the rate was right. Unhappy about the monetary policy parts of the Budget. "Excessive interest rates and frequent changes in them are damaging to industry." "The moment is approaching very rapidly - if it has not already arrived - when we should fully join the European Monetary System."

Mr J Enoch Powell: Discussed the structure of the balance of payments. Danger of fixing the exchange rate.

Sir William Clarke: Welcomed training measures. Not certain that a 5% surplus in a pension fund is high enough for safety. Chancellor should have concentrated on raising thresholds, not cutting the rate. Warm welcome for PEP.

Mr David Penhaligon: Welcomed charity measures. Unit labour costs. Dangers inherent in holding down public sector wages relative to private sector. We believe that the country could run "a slightly bigger PSBR". "We believe that the 1p off income tax is a mistake." We shall vote against it tonight. CTT lifetime abolition was wrong.

Mr Michael Heseltine: Not self-evidently right to cut basic rate by 1p. Dangers of depending on asset sales for financing. Welcomed enterprise measures, and wider ownership encouragement. Concern about unemployment. PSBR could have been £7½ bn.

Mr Robert Sheldon (Ashton under Lyne): Unemployment. CTT "disgraceful". Will the Chancellor abolish CGT next? The Chancellor under-rates the importance of oil.

Mr Michael Morris: Welcomed PEP and 1p off the rate. Welcomed job clubs and other employment measures.

Mr Douglas Hoyle (Warrington North): Chancellor could have used £1 billion to stimulate employment on infrastructure. Government has no strategy for industry.

Mr Ian Gow: Tribute to consistency on MTFS. Praise for PEP scheme.

Mr Donald Stewart (Western Isles): Tax increase on petrol will hit Scotland. Welcomed action on charities, but not PEP. Welcomed increase on cigarettes. A disgrace to abolish lifetime CTT. The 1p off could have been better used on schools, hospitals etc. I will vote against 1p cut.

Sir Julian Ridsdale: Surprised that Alliance oppose tax cuts. Urged a generous Christmas bonus this year.

Mr Eric Heffer (Liverpool Walton): Enough has been done for the rich.

Mr Tony Baldry: Dangers of excessive pay awards. Welcome for profit sharing. Importance of technology.

Mr Reg Freeson (Brent East): Inner city decay, infrastructure, construction industry work. "Ways could be found to increase investment in rented housing ....".

Mr Richard Ryder: Examples of Socialist governments in other countries that have had to face reality.

Dr Jeremy Bray (Motherwell): Where is the Government's exchange rate policy?

Mr William Powell: Welcomed PEPs, abolition of lifetime CTT. Training in Britain is still very poor.

Mr Nicholas Budgen: Regret that the Chancellor has effectively abandoned the principle of fiscal neutrality. Agrees that we need monetary discipline, but not within EMS.

Mr Terry Davis (Birmingham, Hodge Hill): The Budget is clever, skilful and ingenious. But not good. There is no logic in the existing pattern of vehicle excise duties. PEP scheme really for the people with existing portfolios. Chancellor should have raised thresholds, or cut NI contributions. We would have increased child benefit and pensions by £3 billion and recouped from the rich. £100 million for job creation totally inadequate. "The debate has been overshadowed by the Chief Secretary's claim to have costed the Labour programsmme at £24 billion....".

Chancellor of the Exchequer: Quotes from R Hattersley's Jimmy Young interview. Case for rates rather than thresholds this year. Charity measures. Employee schemes. PEP. Favourable climate for industry.

PJC

P J C

26 March 1986

RT8.46

FROM: A W KUCZYS
DATE: 25 March 1986

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Mr Scholar
Mr Monger
Mr Peretz
Miss Sinclair
Mr Cropper
Mr Lord
Mr Isaac - IR
Mr Lewis - IR
Mr Prescott - IR
PS/IR

TAXATION OF LUMP SUMS FROM EMPLOYMENT

The Chancellor has seen your note of today, and is content with what the Financial Secretary now proposes. But if there is to be legislation in the Finance Bill, we must urgently consider whether there <u>is</u> any tightening up we wish to do on the "hellos/handcuffs" point.

AWK

A W KUCZYS

Inland Revenue

Policy Division
Somerset House

FROM : B O'CONNOR
26 March 1986

1. Mr Pitts

2. Economic Secretary

The draft letter has been cleared with both Treasury and Bank of England. As a holding matter, it lets the banks off the hook until we can be sure what the legal effect of the fiduciary deposit arrangements is. It also gives us longer to consider what, if anything, need be done should they be found to be within CRT.

26/3

COMPOSITE RATE TAX : OVERSEAS DEPOSITS

Further to our notes of 14 March and 18 March and, as we explained briefly at our meeting this morning, we have now been told that the Swiss fiduciary deposits placed with banks in the United Kingdom exceed £20 billion. We now understand that they are largely dollar deposits although some are in sterling and other currencies.

The Swiss banks are alleged to have declined to support these deposits with any sort of even minimal documentation confirming the non ordinarily residence of the individual depositors. Rather than face this trouble the deposits, it is said, will be removed from London and placed elsewhere. In the short time available we have been unable to assess the reality of this threat which the Bank of England are looking into. But it does seem possible that, even if they are placed initially outside the UK, some or all will still eventually reach here by a circuitous route.

---

cc. PS/Chancellor
PS/Financial Secretary
Sir P Middleton
Mr Cassell
Mr Peretz
Mr Hall
Miss Sinclair
Mr Walsh
Mr Monger

Mr Battishill
Mr Pitts
Mr Parker
Mr Templeman
Mr Cleave
Mr Streeter
Mr O'Connor
PS/IR

Our major difficulty at the moment is the uncertainty about the precise legal nature of these deposits. Until this is determined we cannot assess which of various possible solutions might be appropriate. We are seeking urgent advice from a Swiss lawyer or other expert in Swiss law. This will inevitably take some time. Meanwhile we understand Swiss banks are becoming edgy and some withdrawal of funds from London has taken place. This will build up as we approach 6 April when the composite rate legislation takes effect for foreign currency deposits. It is therefore vital, particularly with the intervention of Easter, that we make an interim statement tomorrow.

As you agreed the most appropriate way of doing this is by means of a letter from this Department to the British Bankers' Association who raised the issue with us. We have prepared the attached draft and should be grateful for your approval.

B O'CONNOR

N L Dellow Esq
Assistant Secretary
British Bankers' Association
10 Lombard Street
London EC3V 9EL

I refer to the meeting on 21 March with representatives of your Association about Swiss fiduciary deposits.

As you know the legal nature of these deposits is uncertain and we are seeking further advice. Pending clarification we propose to regard a Swiss fiduciary deposit placed with a bank in the United Kingdom as not a relevant deposit for the purposes of Schedule 8 to the Finance Act 1984. This means that interest on such a deposit will not be subject to composite rate tax.

When the status of these deposits has been determined we shall contact you again about the treatment of interest thereafter.

027/2768

CONFIDENTIAL

FROM: JILL RUTTER
DATE: 26 March 1986

PS/FINANCIAL SECRETARY

cc:

PS/Chancellor
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Mr Scholar
Mr Monger
Mr Peretz
Miss Sinclair
Mr Cropper
Mr Lord

Mr Isaac - IR
Mr Lewis - IR
Mr Prescott - IR
PS/IR

TAXATION OF LUMP SUMS FROM EMPLOYMENT

The Chief Secretary has seen your minute of 25 March to PS/Chancellor. He is content with the Financial Secretary's revised approach.

JILL RUTTER
Private Secretary

CONFIDENTIAL

2386/120

R P

FROM: MRS K S MEASON
DATE: 27 March 1986

MR O'CONNOR IR

cc: PS/Chancellor
PS/Financial Secretary
Sir P Middleton
Mr Cassell
Mr Peretz
Mr Hall
Miss Sinclair
Mr Walsh
Mr Monger
Mr Pitts
PS/IR

COMPOSITE RATE TAX : OVERSEAS DEPOSITS

The Economic Secretary has seen your minute of 26 March and the attached draft letter, with which he is content.

KSM

MRS K S MEASON

FROM: A B MURRAY

DATE: 27 March 1986

1. MCU
2. FINANCIAL SECRETARY

cc PS/Chancellor
PS/CST
Mr Judge

PETERBOROUGH CITY COUNCIL: LETTER ABOUT UNEMPLOYMENT AND THE BUDGET

I attach a draft reply for you to send, which draws on advice from LG.

Andrew Murray

A B MURRAY

DRAFT REPLY TO:

Councillor Edward Connolly
Chairman, Unemployment Sub-Committee
Peterborough City Council
Town Hall
Peterborough
PE1 1HG

You wrote to the Chancellor of the Exchequer on 14 March about unemployment in Peterborough, and the Budget.

As you will have seen, the Budget included a number of measures to help the unemployed, both directly through additional expenditure focussed on the young and long-term unemployed, and indirectly through measures designed to encourage enterprise and initiative. In total, an extra £195 million will be spent in 1986-87 - in addition to the almost £2 billion already being spend on employment measures - to expand the Community Programme and Enterprise Allowance Scheme, to develop last year's pilot schemes into the Restart programme for the long-term unemployed, and to introduce the New Workers Scheme. This additional expenditure in 1986-87 will be within the existing public expenditure planning total.

In addition the tax reduction and reform in the Budget - notably the reduction in the income tax basic rate, and the abolition of the charge on lifetime gifts between individuals, as well as measures aimed specifically at business such as the improvement and extension of the Business Enterprise Scheme and Loan Guarantee Scheme - will stimulate enterprise and thus help the growth of new jobs.

You asked in particular for additional finance for local authorities themselves to spend on unemployment measures. However, the government's policy is to hold public expenditure broadly level in real terms, so that, as the economy grows, the burden of taxation can come down, improving efficiency, motivation and employment. Local authority spending is a major part - about a quarter-of planned public expenditure, and so continued restraint is necessary if our objectives are to be achieved.

JOHN MOORE

Councillor Edward Connolly,
Chairman,
Peterborough City Council,
Unemployment Sub-Committee
Peterborough City Council
Town Hall
Peterborough PE1 1HG
Telephone (0733) 63141
MDX 12310 Peterborough

City of Peterborough

BR

4 MAR 1986

FP

When calling or telephoning please ask for Members' Secretary

Telephone direct (0733) 317 327
Our ref EC/CJW
Your ref

Date March 14th, 1986.

Right Hon. Nigel Lawson M.P.,
Chancellor of the Exchequer,
11 Downing Street,
LONDON.

FST
15590/86

Dear Lord Chancellor,

Re: Peterborough Unemployment

At the meeting of this Authority's Unemployment Sub Committee held yesterday, Thursday 13th March 1986, the attached report was received, setting out the latest unemployment figures for the City of Peterborough. This Council has been concerned with the level of unemployment in the city for some time, hence the establishment of our Unemployment Sub Committee in the first place, which from the beginning of the next Municipal Year, will become a full Standing Committee. However, even so, our Members were shocked and horrified to discover the real extent of unemployment in what is, essentially, an expanding New Town. Peterborough is not usually considered to be an unemployment black spot in the manner of a Liverpool or the North East of England, and yet, the following extracts from the figures do I feel speak for themselves;-

(i) 40% of unemployed men in the city have been out of work for more than one year.

(ii) 25% of unemployed men have been out of work for two years or more.

(iii) Just under 40% of our unemployed are in the age bracket of 16 to 25 years.

In preparing your Budget on Tuesday, the Unemployment Sub Committee would urge you to re-think your policy of tax cuts, and would ask you to release additional finance to local authorities to enable them to tackle the real problems of unemployment, which as you can see, is becoming more and more widespread in this country. It goes without saying that tax cuts are meaningless for those without work, and I would put it to you that more benefit can be gained through allowing this local authority more resources to tackle what, as you can see from the report, is a real problem through the provision of real jobs.

In our efforts to approach the problem of unemployment we have adopted a caring and positive attitude and we would urge you to do the same when you make your Budget Speech on Tuesday.

Yours faithfully,

Edward Connolly

EDWARD CONNOLLY

Chairman - Unemployment Sub Committee

Enc:

UNEMPLOYMENT SUB-COMMITTEE

13th March 1986

UNEMPLOYMENT IN PETERBOROUGH

The following report outlines the latest unemployment figures (January 1986) for Peterborough produced by the Research Unit of Cambridgeshire County Council based on Department of Employment statistics in the ERSC archive at Essex University.

Table 1 gives a breakdown of unemployment by ward, in terms of actual numbers and unemployment rates. The table shows wide differences in total unemployment across the District, from 5.5% in Wittering to 34.1% in Central. The figures show that the highest rates are in the urban wards of Central, East and Ravensthorpe, whilst the rural wards such as Glinton, Newborough and Northborough have the lowest rates of unemployment. The lowest urban wards are Stanground, Werrington and West. Female and male unemployment rates generally follow a similar pattern with male unemployment usually a few percent higher than the female. In the case of East Ward male unemployment is almost twice that for females.

However there seem to be two major exceptions to this generalisation. Paston appears to have an exceptionally low unemployment rate for an urban ward at the moment, yet in previous years this ward had one of the highest rates. This sudden change in figures is now being investigated by the County Council, to find the reasons for it.

The second exception is Wittering where male unemployment is apparently very low and female unemployment is very high. This may be a quirk due to the R.A.F. base, but again earlier figures were more in line with the general pattern. It should also be noted that the figures for the north western part of the district are affected by the fact that some people will choose to register at Stamford and so may not be included in these figures.

TABLE 1: UNEMPLOYMENT BY WARD

Ward	Nos Unemployed			Male Rate %	Female Rate %	Total Rate %
	Male	Female	Total			
Barnack	61	31	92	7.5	6.5	7.1
Bretton	361	186	547	16.3	13.3	15.1
Central	834	263	1097	37.8	26.1	34.1
Dogsthorpe	527	207	734	20.5	13.4	17.8
East	666	203	869	30.4	17.2	25.8
Eye	99	53	152	13.8	12.4	13.3
Fletton	412	223	635	16.4	14.1	15.5
Glinton	62	41	103	6.1	7.1	6.5
Newborough	29	22	51	4.7	7.6	5.6
North	292	116	408	16.2	10.4	14.0
Northborough	45	33	78	5.6	7.3	6.2
Orton Longueville	511	201	712	18.1	10.8	15.2
Orton Waterville	285	122	407	17.4	13.0	15.8
Park	259	178	437	11.8	13.3	12.4
Paston	103	47	150	7.0	6.2	6.7
Ravensthorpe	630	230	860	24.6	14.3	20.6
Stanground	261	139	400	9.6	7.9	8.9
Thorney	52	26	78	7.5	7.0	7.4
Walton	416	215	631	19.6	16.1	18.3
Werrington	252	169	421	8.6	9.3	8.9
West	326	183	509	9.2	7.9	8.7
Wittering	19	86	105	1.3	17.6	5.5
Total	6502	2974	9476			

Source: Cambridgeshire County Council January 1986.

Table 2A looks at how long people have been out of work. 40% of unemployed men have been out of work for more than a year, but only 25% of women are in the same position. Sadly 25% of men and 12% of women have been out of work for 2 years or more.

More detailed figures show that the older urban wards north of the river (Central, Dogsthorpe, East and Ravensthorpe) have the highest proportions of people who have been out of work for over a year. It is the rural wards (Eye, Northborough, Wittering and Thorney) which have the lowest. However, it should be noted that Barnack with a high proportion, and Park with a low proportion, are exceptions to this trend. Nevertheless the suggestion is that it is in those areas with the highest rates of unemployment that people generally have most difficulty in getting jobs, although there are considerable variations between the patterns for men and women.

TABLE 2A LENGTH OF TIME OUT OF WORK

Time Unemployed	Males		Females		Total	
	Number	%	Number	%	Number	%
Under 1 Year	3858	59.3	2242	75.4	6100	64.4
1-2 Years	989	15.2	366	12.3	1355	14.3
2-5 Years	1307	20.1	303	10.2	1610	16.9
5 Years +	348	5.3	63	2.1	411	4.3
Total	6502	100	2974	100	9476	100

Source: Cambridgeshire County Council January 1986.

Table 2B shows the age of those who are out of work. Just under 40% of the unemployed are 16-25 years old. Since this age group makes up only 24% of the potential workforce, this highlights the fact that it is still the young who are more likely to be out of work. It is also worth noting that half the women out of work are under 25, but only 1 in 3 of men are.

In general in most wards the proportion of the unemployed who are under 25 is fairly close to the average. However, young men make up a particularly high proportion of those out of work in Orton Waterville (41%) and the same is true of young women in Central (61%). Conversely in Newborough only 20% of men and 32% of women out of work are under 25. A low proportion of the women out of work are young in Glinton, Barnack and Thorney as well.

It does seem that those urban wards with high unemployment rates also have the highest proportions of the unemployed who are young, while the rural wards with the lowest unemployment rates have the lowest proportions, although there are considerable variations between the patterns for men and women.

TABLE 2B: UNEMPLOYMENT BY AGE GROUP

Age	Males		Females		Total	
	Number	%	Number	%	Number	%
Under 25	2203	33.8	1462	49.2	3665	38.6
25-44	2659	40.9	1054	35.4	3713	39.2
45-54	852	13.1	296	9.9	1148	12.1
Over 55	788	12.1	162	5.4	950	10.0
Total	6502	100	2974	100	9476	100

Source: Cambridgeshire County Council January 1986.

Table 3 compares the rates of unemployment in October 1982 with the 1986 figures. Unfortunately in most rural wards a direct comparison is not possible, but in general the overall rate of unemployment has risen with the largest increases in Central and Walton. Leaving aside the surprising drop in Paston mentioned earlier, the most stable wards in unemployment terms are Stanground, Dogsthorpe and Bretton. Indeed in Stanground, Bretton and Park male unemployment has actually fallen over the three years, while Central, Walton and the Ortons have seen the greatest increases. In all wards the rate of female unemployment is catching up with the male rate and in a few cases even overtaking it. Central, Walton and Park have shown the largest increases over the period and East, Ortons, Dogsthorpe and Stanground the smallest.

TABLE 3: UNEMPLOYMENT RATE BY WARD 1982 and 1986

Ward		1982 Rate %		1986 Rate %	
		Male	Female	Male	Female
Bretton		18.1	10.4	16.3	13.3
Central		32.6	14.9	37.8	26.1
Dogsthorpe		20.4	12.2	20.5	13.4
East		27.6	16.7	30.4	17.2
Fletton		16.4	10.4	16.4	14.1
North		15.4	7.2	16.2	10.4
Orton Longueville		)	)	18.1	10.8
Orton Waterville		)13.5	)10.2	17.4	13.0
Park		12.6	7.1	11.8	13.3
Paston		22.3	16.9	7.0	6.2
Ravensthorpe		21.7	12.2	24.6	14.3
Stanground		10.3	6.3	9.6	7.9
Thorney		5.6	4.7	7.5	7.0
Walton		13.7	7.8	19.6	16.1
Werrington		5.7	3.8	8.6	9.3
West		8.1	5.9	9.2	7.9
*Rural Central:	Eye	)	)	13.8	12.4
	Glinton	)	)	6.1	7.1
	Newborough	) 7.7	) 5.7	4.7	7.6
	Northborough	)	)	5.6	7.3
*Rural West:	Barnack	)	)	7.5	6.5
	Wittering	) 1.5	) 1.4	1.3	17.6

Source: Cambridgeshire County Council, 1982, 1986.

* The 1982 definitions on the left do not exactly correspond to the ward boundaries used in 1986 so direct comparisons are not possible.

CITY PLANNING OFFICER

Inland Revenue

Policy Division
Somerset House
FROM: M PRESCOTT
8 April 1986

P 8/4

1. MR LEWIS

2. FINANCIAL SECRETARY

TAXATION OF LUMP SUMS FROM EMPLOYMENT

1. We shall shortly be submitting advice about golden hellos and handcuffs. But in the meantime we propose to get ahead in preparing the New Clause which you have now agreed should be introduced at Committee Stage to correct the defect in the "handshakes" legislation. As noted in my original submission of 12 February, however, there is a related bit of tidying up in the handshakes legislation which we said would be worth tackling at the same time, and on which we undertook to provide a further note if you did decide to legislate on the main defect.

<u>The problem: aggregation rules</u>

2. This concerns the operation of the "top slicing reliefs" (Schedule 8, ICTA 1970) where the individual concerned receives two or more lump sums in respect of different offices or employments with the same employer.

3. For obvious reasons, the legislation provides that exemption from tax altogether on the first £25,000 (Section 188, ICTA) is available only once, and for all time, in

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cc.	
PS/Chancellor of the Exchequer	Mr Isaac
PS/Chief Secretary	Mr P Lewis
PS/Economic Secretary	Mr Easton
PS/Minister of State	Mr Northend
Mr Monger	Mr O'Brien
Miss Sinclair	Mr Prescott
Mr Cropper	Mr R H Allen
Mr Lord	Mr Wilcox
Mr Graham (OPC)	PS/IR

respect of payments to an individual from the same employer. For this purpose, "employer" is defined so as to link together all "associated" employers. Thus, for example, the parent of a group and its subsidiaries will be deemed to be one employer for the purposes of determining how many tranches of £25,000 are available. So, if someone who was a director of the parent and also of a couple of the subsidiaries got the sack from all three posts, and received a separate handshake in respect of each termination, he nevertheless would get only one amount of £25,000 exempt from tax. And this is true even if he loses one directorship and gets one handshake in one year, loses the second directorship and gets a second handshake in the following year, and so on.

4. On the other hand, payments from different employers can each qualify for exemption of the first £25,000. Thus, someone who had two or more directorships with unrelated companies and who got a handshake in respect of both of them would be entitled to the £25,000 exemption in respect of each payment.

5. The exemption of the first £25,000, therefore, applies to each employer regardless of the year in which payments are assessed. By contrast, the "top slicing reliefs" (i.e. tax on next £25,000 reduced by 50%, and on next £25,000 after that by 25%) operate by reference to years of assessment. So, if someone receives two or more handshakes in the same year (whether or not from the same employer) he nevertheless gets only one set of top slicing reliefs in that year.

6. What this means, however, is that if he receives one payment in one year, and another in the following year then he will be entitled to two separate lots of top slicing relief, one in respect of each payment. In the case of the chap who is receiving these payments from different employers, this result is at least consistent with the treatment that applies to the first £25,000 of such payments - see paragraph 4 above.

7. But, in the case of the chap who is getting two or more payments from the same employer, we end up with the anomalous

result that the payments from that employer are aggregated for the purposes of Section 188 but not for the purposes of Schedule 8; that is to say, while we allow only one tranche of £25,000 tax-free, we nevertheless allow two or more sets of top slicing relief.

8. This is illogical, and was unintentional. It is a loophole which could be easily exploited, by the simple expedient of arranging as regards people in this situation for the terminations of employment etc, and the associated handshakes, to be staggered. Though the number of individuals who might stand to benefit will be very small, the tax saving for any one individual could be substantial - even after the main defect has been corrected, the saving could theoretically be as much as £18,750 for each handshake deferred.

9. Linked to this is another minor defect in the aggregation rules - in this case, as they apply where there are two or more payments to the same person in respect of the same employment and for the same year. The legislative provision in question achieves the required result as regards half-rate relief but not, on a technicality, as regards quarter-rate relief. As a result, it might be possible for someone to get quarter-rate relief on more than the £25,000 maximum in a particular year.

Comment

10. The main defect in the top slicing relief itself could be corrected without tackling these weaknesses in the aggregation rules as well and it is not absolutely essential to deal with them now. So far as we know, neither of them is yet being exploited - possibly because they have not yet been spotted. Moreover, they could only be exploited anyway where a particular set of circumstances apply, and in practice these might arise only rarely. In short, these are the kind of technical points which in normal circumstances we would be recommending should be put right in due course, but with which we could continue to live for the time being if necessary.

11. The difference here, of course, is that as a result of action to correct the main defect, there may be more interest than otherwise in probing these provisions for other weaknesses that can be exploited. There is too the risk that these weaknesses in the aggregation rules will be spotted sooner or later anyway, and that groups of companies in particular might seek to exploit them - e.g. by trying to engineer multiple payments by creating multiple employments for senior employees within the group. It would also of course be rather embarrassing if, having corrected the main defect this year, we then had to act again next year to deal with these other defects - especially as in each case it is the "big fish" who stand to gain from exploitation of these loopholes.

12. Subject to the views of Parliamentary Counsel, we do not think that this would mean adding much in length to the legislation that is needed to correct the main defect. Ideally, in order to keep things as simple as possible, the amended rules would apply from 6 April 1986. But you have already decided that in order to avoid any retrospection the amendment correcting the main defect should apply from the date the decision to make the amendment is announced. This would, therefore, also be the start date for the revised rules here as well.

RECOMMENDATION

13. On balance, we think it would be wise to deal with these two aggregation points at the same time as dealing with the main defect, and we recommend accordingly. May we know, please, if you agree?

M. Prescott

M PRESCOTT

2816/009

CONFIDENTIAL

FROM: VIVIEN LIFE
DATE: April 1986

28

MR PRESCOTT

cc: PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Mr Scholar
Mr Peretz
Mr Monger
Miss Sinclair
Mr Cropper
Mr Lord
Mr Graham (OPC)
Mr Dyer (Parliamentary Clerk)
PS/IR

TAXATION OF LUMP SUMS FROM EMPLOYMENT

The Financial Secretary has read your minute of 26 March.

2. He agrees that the operative date for legislation should not be 6 April and that the announcement should be deferred until you have considered the position on golden hellos and handcuffs.

3. He has commented that in considering the position of golden hellos etc he will need clear advice as to what steps could be taken to clarify the legislative position. When it comes to making an announcement he would want to try, for the sake of clarity, to combine the publication of the new clause, the answering of the PQ and the issuing of the Press Release at the same time.

VL

VIVIEN LIFE

CONFIDENTIAL

RP

FROM: P J CROPPER
DATE: 10 April 1986

PS/CHIEF SECRETARY
PS/FINANCIAL SECRETARY

cc PS/Chancellor

TAX ADVISERS

Could I ask the Private Secretaries to the Chief Secretary and the Financial Secretary to give me an agreed list of times when their Ministers could meet the Carmichael/Chown/Sutherland group to discuss the Budget.

2. I suggest it should be at least ten days after publication of the Finance Bill, but before the Bill goes into Committee upstairs.

3. I suggest 5.30 pm for a drink.

4. I would ask you to give me a choice of three dates if you possibly can - avoiding, obviously, 2nd Reading and Committee of the Whole House.

P J CROPPER

cc FST
Mr Cassell
Mr Monck
Mr Odling-Smee
Mr Bredenkamp
Mr Monger
Mr Cropper
Mr Battishill - IR
Mr Isaac - IR
Mr Calder - IR
Mr Wilmott - C&E

RP

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

The Rt Hon The Lord Young of Graffham
Secretary of State for Employment
Caxton House
Tothill Street
London SW1H 9NF

21 April 1986

Dear David

Thank you for your letter of 26 March enclosing cuttings from the Wall Street Journal of the day before.

Needless to say, we do have well worked estimates of the likely effects of tax reductions on revenue, taking supply side and other indirect effects into account. It is obviously true that tax reductions have beneficial effects on the working of the economy and indeed that is the main reason why they are central to our policy. The question in practice is how great we can safely assume these effects to be, especially in the first few years. Their size and timing are much more uncertain than the Wall Street Journal allows. What is quite clear is that tax cuts reduce tax revenues in the short run, and even a temporary move towards a higher Budget deficit would have obvious risks. It therefore seems right to reduce taxes gradually on realistic estimates of supply side effects and to make further cuts taking advantage of greater supply side effects as and when these effects occur.

The plain fact is that the Wall Street Journal has long been committed to (and is now almost the last bastion of) the extreme "Lafferite" proposition that tax reductions increase tax revenues even in the short term. This has already been disproved in the context of the much more dynamic US economy, as the size of their Budget deficit bears eloquent witness.

Yours

Nigel

NIGEL LAWSON