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PART C

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PART C

1986 BUDGET SPEECH

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PART C

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Budget
Speech

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BUDGET SECRET COPY NO. 16 OF 24.

THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

FROM: A J G ISAAC
DATE: 7 MARCH 1986

MR H J DAVIES

BUDGET SPEECH: TAXES ON INCOME

1. I attach some comments on your redraft of the old Section J in your minute of 6 March.

2. I hope that in the main they are self-explanatory, or explained in my marginal notes. However, I should perhaps say something on three points.

Page 3

3. I have reshaped this, with three thoughts in mind.

- First, and most important, I have to say again that it is dangerous to place too much emphasis on the benefits that transferable allowances will bring for families with children. If that is your primary objective, then you can achieve that more

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Cassell
Mr Monck
Mr Scholar
Mr Monger
Mr Odling-Smee
Mr Culpin
Miss O'Mara
Mrs Lomax
Mr Cropper
Mr Lord

Sir Lawrence Airey
Mr Isaac
Mr Battishill
Mr Mace
Mr Painter
PS/IR

effectively by the alternative approach (which many commentators and many in the Opposition would favour) of separate taxation and increased child benefit.

- Second, there are a number of inaccuracies, for example in dealing with aggregation.

- Third, on a lesser point, I do very much hope that you will avoid phrases such as

  "A wife's investment income is . . . considered by the taxman to be her husband's."

  It is one of the more common - and unpleasant - tricks of the commentators to blame "the taxman" for things which we are required to do under legislation introduced by Ministers and passed by Parliament. I know that is not your intention. But I hope that Treasury Ministers, of all people, will not be advised to encourage that habit.

The revised version owes a good deal to the old paragraphs 131 and 132.

<u>Page 5</u>

4. The paragraph on the "traps" here is awkward. If you need a paragraph on these lines (see my comments on page 3), it needs to come earlier. As now drafted, it reads as if <u>this year's</u> measures are intended as an interim ('meanwhile') measure to help with the traps. But the reduction in rate is clearly <u>less</u> effective for this purpose than an equal-cost increase in thresholds.

<u>Page 6</u>

5. The emphasis given here to the "first rate of tax" and the international comparisons could be another "own goal":

- Later on this same page you are announcing a reduction in the basic rate of tax, not a reduced rate band;

- As you go on to explain on the next page, the main benefit of the reduction in basic rate will go to middling incomes, where the present tax burden is (if anything) low by international standards.

- Two pages earlier in this draft, you are advocating a new system of transferable allowances, which would make it much more difficult and costly to introduce a reduced rate band for the 20 million or so people paying tax under PAYE.

A J G ISAAC

BUDGET SECRET

[courtesy to Sir G. Howe?]

[The response to the Green Paper on the Taxation of Husband and Wife, published in 1980, showed that] there are some features of the present system which are almost universally seen as unfair and indefensible. Married women naturally resent the rule that a wife's income is treated for tax purposes as her husband's; for it denies to the partners in a marriage that independence and privacy in their tax affairs which they have a right to expect. In addition, both married men and married women resent the tax penal~~i~~ties which, under the present system, discriminate against marriage and the family. Finally, the present system ensures that tax allowances are high when both husband and wife are earning, but low when there is only one earner. Just at the moment when a family's cash needs may be greatest, the tax system works against it.

The Green Paper I am publishing today describes a system which would correct these grave ~~thoughts~~ faults - but would at the same time recognise the way that a husband and wife share responsibilities within a marriage. The essence of the system is simple. Everyone - man or woman, married or single - would have a tax allowance in their own right - the same tax allowance. Where one partner in a marriage had little or no income of their own, and so could not make full use of their allowance, they could, if they wished, transfer the unused balance to their spouse. [[A system of this kind would be better attuned to the life cycle

It would end the rule by which the wife's is added to her husband's for tax purposes [that would be an end of 'aggregation'] of most families. It would end discrimination against married couples where, for whatever reason, the wife is not in paid employment.

SECTION J : PERSONAL TAX : TAXES ON INCOME

I now turn to income tax.

The Government's policy on income tax is clear; we want to reduce it. Lower personal taxation to restore work incentives has been a fundamental aim since 1979. In the long run this must mean both raising the starting point at which income tax begins to be paid and reducing the tax rates themselves. There is no inconsistency whatsoever between these two means to the same end.

Tax thresholds are important because of their impact on people at the lowest earnings levels - on people who are, indeed, on the threshold of the world of work, yet for whom the tax and benefit structure can together act as a powerful disincentive.

That is one reason why we have increased the ~~bottom~~ tax threshold by 20 per cent in real terms since 1978-79. As a result, the number of people paying any income tax at all is ~~X000,000~~ 1·4 million fewer than it would have been had thresholds merely been indexed in line with inflation.

? omit, as redundant.

[But raising tax thresholds cannot be the only answer to the problems of people in what are known as the poverty and unemployment traps. The reforms in the benefit system presented to the house last year by my Rt. Hon. Friend the Secretary of State for Social Services were another important step towards a more rational system with properly targeted benefits and decent rewards for work.

Note that the Green Paper is careful to relate this claim to tax and social security only – ie excluding student grants.

As a result, no families will face marginal tax rates above 100 per cent - a particularly wasteful and cruel feature of the previous system. The new Family Credit system will focus on <u>net</u> income, after tax, in indentifying a family's need for state assistance.]

There is a need, too, to reform our system of personal income tax if tax relief is to be targeted on those who most need it. I am publishing today, as I undertook to do in my Budget last year, a Green Paper on the reform of personal taxation.

Since 1979 we have reformed many aspects of the tax system to create a fairer tax structure, and one more favourable to enterprise, growth and employment. But we have not yet tackled the personal income tax system, which has remained essentially unchanged for over 40 years.

see revised draft — attached.

There are some feature of the present system which are almost universally seen as unfair and indefensible. It discriminates against families where the wife chooses to stay at home to look after the children, which increasingly means families with young children. Just at the moment when a young family's cash needs are greatest, the tax system works against it.

In addition, the existing arrangements deny to the partners in a marriage that independence and privacy in their tax affairs which they have a right to expect. The rule that a wife's income is - except for a few very high earning couples who elect for separate taxation - treated as her husband's for tax purposes is widely resented. A wife's investment income is, indeed, always considered by the taxman to be her husband's.

The Green Paper I am publishing today describes a system which would correct these two damaging deficiencies. The essence of the proposed arrangement is simple. Every adult, man or woman, married or single, would have a tax allowance in their own right - the same tax allowance. But where one partner in a marriage had little or no income of their own, and so could not make full use of their allowance, they could, if they wished, transfer the unused balance to their spouse.

~~The aggregation for tax purposes of a wife's unearned income with that of her husband would end. And the system would be better attuned to the life cycle of most families. The amount of tax-free income they were allowed would not, as now, fall when only one parent was in work.~~

The Green paper discusses how a system of transferable allowances could be introduced, probably over a period of years. No-one need suffer a cash reduction in their total tax allowances during the transitional period, and for most people allowances would rise in cash terms. The paper also examines the longer term future of the tax system and its relationship with social security benefits.

The Government will carefully consider the responses to the Green Paper before deciding how to proceed. I hope that there will be a good response from the general public, since these proposals would affect everyone. None of the changes described are possible until the system of tax collection has been computerised; that change will not be complete until the end of the decade. [~~But the Government's intention is to legislate in time to allow a new system to begin to be implemented as soon as the necessary programmes are in place.~~]

? omit: legislation in 1987 is now unlikely? ||

Omit: or bring in earlier. ~~not drafted,~~ see covering note.

* [Another benefit of transferable allowances, which goes directly to the heart of the income tax problem I was describing earlier, is that far more people could be taken out of the poverty and unemployment traps - and indeed taken out of tax altogether - for a given overall tax reduction than is possible today.]

But in the meantime we must work within the system we have. And we must work to improve it at the margin to the best of our ability.

I explained earlier that against the background of a sharp fall in the oil price and continued market uncertainties my room for manoeuvre was restricted. But I have sought to apply the money at my disposal to the best advantage.

? omit, see covering note

[It is instructive to look at the tax systems of our major trading partners. Three things stand out.

First, that the proportion of income of an average production worker taken in tax is higher in the United Kingdom than in the US, Japan, France or Germany. That is one important reason why we must get tax down to stay competitive.

Second, that our starting point for tax is in line with the average but,

Vl

Third, that our first rate of tax ~~is the~~ high~~est of the lot~~.

Against that background I have decided this year to increase tax thresholds in line with the statutory ~~inflation~~ ~~only~~. [The main personal allowances in 1986-87 will therefore rise by 5.7 per cent.] The single person's allowance will rise by £130 to £2,335 and the married man's allowance by £200 to £3,655. The single age allowance will rise by £160 to £2,850 and the married age allowance by £250 to £4,505.

indexation formula – that is, 5.7 per cent.

[because of rounding, the allowances do not increase by 5.7%]

In addition, I propose to lower the basic rate of income tax by 1p to 29pence in the pound.

Taken together these changes mean that a single person on average earnings will be £2.44 a week better off - a £1.69 more than under simple indexation.

A married couple on one and a half times average earnings will be £3.66 a week better off - £2.51 a week more than with indexation only.

[Inconsistent with Green Paper, which takes credit for 20% real increase in thresholds - and for the fact that young single people will benefit from the further increase in thresholds under transferable allowances]

Some 550,000 people on low incomes who would have paid tax if thresholds had not been increased will pay no tax at all in 1986-87. [~~But only about 20 per cent of these people are heads of households.~~]

The change in the basic rate means that the marginal tax rate is reduced for ~~14~~ some 20 million working taxpayers - 95 per cent of the total. And let us not forget that the basic rate is ~~also~~ the marginal rate for the vast majority of ~~unincorporated businesses and for most of~~ the 2½ million self-employed.

[the self-employed or the unincorporated businesses]

[the 2½ m is included in the 20 m]

The small companies rate of corporation tax is also aligned with the basic rate. I accordingly propose to reduce that rate for 1986-87 to 29 per cent, a further boost to small businesses.

I understand the concern shared by many who favour reductions in tax rates that basic rate changes give disproportionate benefits to the rich.

I think it right that we should give some relief to those on middling incomes, who have seen very little reduction in the burden of taxation in recent years - unlike those at the bottom end of the scale who have benefited both from the real rise in thresholds and from the reductions in National Insurance Contributions.

But different considerations apply to those on higher incomes. The burden of tax on the rich is largely determined by the structure of higher rates.

I have decided to increase the threshold for the first higher rate of tax by £1,000 to ~~its new indexed level~~ £17,200 - the level produced by the statutory indexation formula. But all subsequent steps on the scale will be lifted by £1,000 only, leaving the width of the bands the same. The effect of this is to limit the ~~cash~~ overall benefit to higher earners to almost exactly the amount they would have received from simple indexation of all thresholds and no change in the basic rate.
These changes will take effect under PAYE on the first pay day after [17 May]

I believe that in a year when the sums at my disposal are limited, this will be widely seen as an equitable and appropriate measure.

The basic rate cut I have announced is the essential next step on our road to a lower tax economy. It is, necessarily, a short step. But we are in no doubt about the overall direction of our tax strategy. And the pace of change will accelerate in the years to come.

FROM: A W KUCZYS

DATE: 7 March 1986

MISS HILL - Inland Revenue

cc PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Mr Cassell
Mr Monger
Mr Scholar
Mr Robson
PS/IR

BUDGET SPEECH: MR WALKER'S INTEREST

The Chancellor has seen your note of 6 March. He agrees with your recommendation to follow the normal procedure for showing the relevant parts of the speech to the Secretary of State for Energy. I have telephoned Mr Walker's office to tell them this is what we will do. Please could I have a draft letter to send to Mr Walker's office next week, to fulfill this remit?

AWK

A W KUCZYS

BT/37

BUDGET CONFIDENTIAL

FROM: A W KUCZYS

DATE: 7 MARCH 1986

MR BATTISHILL IR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Monger
Mr Scholar
Mr Cropper
Mr Lord
Mr H Davies
PS/IR

BUDGET DAY CHANGES

The Chancellor was grateful for your note of 27 February, which he had intended to raise at the last Overview meeting. He agrees with your conclusions at paragraph 9: there is no need to depart from the usual commencement rules this year. As to your paragraph 10 (a warning about future years), the Chancellor suggests that the Financial Secretary could make this point in his speech in the Budget Debate.

AWK

A W KUCZYS

COPY NO 11 OF 22

FROM: G W MONGER
DATE: 7 March 1986

MR H J DAVIES

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Cassell
Mr Monck
Mr Scholar
Mr Odling-Smee
Mr Culpin
Miss O'Mara
Mrs Lomax
Mr Cropper
Mr Lord

Sir L Airey
Mr Isaac - IR
Mr Battishill
Mr Mace

BUDGET SPEECH: TAXES ON INCOME

I attach suggested amendments to your draft dated yesterday. No doubt we shall be able to look more carefully at the detailed wording on the next round.

2. I also had a couple of more general comments. The draft begins by touching on the rates vs thresholds argument; then briefly mentions the Fowler reforms; then goes on to the Green Paper; and finally returns to rates vs thresholds and the main changes. I wonder whether it would be better to deal with the Green Paper first, and then rates vs thresholds separately. I also wonder if we need the Fowler detour which, as the detailed comments show, needs some amendment.

3. Secondly, we should perhaps consider whether more could be made of the effect of the Fowler changes on the balance of argument on rates vs thresholds. The two main points are:

- The benefit that allowance increases will give to those on the lowest incomes will be substantially reduced, since most of them will suffer as a result from withdrawal of means-tested benefits.

- Although threshold increases will still be more effective than rate reductions in dealing with the traps, the gap will narrow.

4. But I think it would be wrong, at least for the Budget speech, to make these points because:

a. They are complicated.

b. The social security changes do not happen until 1988.

c. Threshold increases <u>will</u> still be more effective in dealing with the traps.

d. It would cut across the presentation of the Green Paper.

I think we should stick to the line not that rate reductions are better but that we need both rate reductions and threshold increases.

5. Thirdly, I had some doubts about the last two paragraphs on page 7 because:

- The penultimate one seems as if it half accepts the concern about disproportionate benefits to the rich.

- Since 1979, the burden ot tax, as measured by the proportion of income taken by tax and NIC, has increased for those at the bottom of the scale.

- We do not want to present the basic rate reduction as helping only those with "middling" incomes. It also helps many below average incomes. Indeed I suggest that at the bottom of page 6 you give the comparison for the one earner married couple on ¾ average earnings instead of, or as well as, that for the couple on a 1½ ratio. (The gain for ¾ average earnings would be £2.05 a week, compared with £0.90 from indexation.)

Could you therefore redraft along the following lines:

"We have particularly helped those at the top of the income scale by the reduction in the top rates of tax, and we have particularly helped those at the bottom of the scale by the 20% real increase in thresholds since 1979. The reduction in the basic rate is designed to help those over a very wide range of incomes, from below average earnings to the top of the basic rate band.

As to those with higher incomes....."

G W MONGER

SECTION J : PERSONAL TAX : TAXES ON INCOME

I now turn to income tax.

The Government's policy on income tax is clear; we want to reduce it. Lower personal taxation to restore work incentives has been a fundamental aim since 1979. In the long run this must mean both raising the starting point at which income tax begins to be paid and reducing the tax rates themselves. There is no inconsistency whatsoever between these two means to the same end.

Tax thresholds are important because of their impact on people at the lowest earnings levels - on people who are, indeed, on the threshold of the world of work, yet for whom the tax and benefit structure can together act as a powerful disincentive.

That is one reason why we have increased the bottom tax threshold by 20 per cent in real terms since 1978-79. As a result, the number of people paying any income tax at all is ~~X00,000~~ 1·4 million fewer than it would have been had thresholds merely been indexed in line with inflation.

But raising tax thresholds cannot be the only answer to the problems of people in what are known as the poverty and unemployment traps. The reforms in the benefit system presented to the house last year by my Rt. Hon. Friend the Secretary of State for Social Services were another important step towards a more rational system with properly targeted benefits and decent rewards for work.

[True – but the numbers of those with higher rates below 100% will increase. Is this sentence needed?]

[This will be true of means-tested benefits generally]

[As a result, no families will face marginal tax rates above 100 per cent - a particularly wasteful and cruel feature of the previous system] The new Family Credit & Housing Benefit systems will focus on net income, after tax, in indentifying a family's need for state assistance.

There is a need, too, to reform our system of personal income tax if tax relief is to be targeted on those who most need it. I am publishing today, as I undertook to do in my Budget last year, a Green Paper on the reform of personal taxation.

Since 1979 we have reformed many aspects of the tax system to create a fairer tax structure, and one more favourable to enterprise, growth and employment. But we have not yet tackled the personal income tax system, which has remained essentially unchanged for over 40 years.

There are some feature of the present system which are almost universally seen as unfair and indefensible. ~~It discriminates~~ The tax system discriminates against marriage itself and in particular against families where the wife chooses to stay at home to look after the children, which increasingly means families with young children. Just at the moment when a young family's cash needs are greatest, the tax system works against it.

In addition, the existing arrangements deny ~~to the partners in a marriage~~ married women that independence and privacy in their tax affairs which they have a right to expect. The rule that a wife's income is - except for a few very high earning couples who elect for separate taxation - treated as her husband's for tax purposes is widely resented. A wife's investment income is, indeed, always considered by the taxman to be her husband's.

The Green Paper I am publishing today describes a system which would correct these two damaging deficiencies. The essence of the proposed arrangement is simple. Every adult, man or woman, married or single, would have a tax allowance in their own right - the same tax allowance. But where one partner in a marriage had little or no income of their own, and so could not make full use of their allowance, they could, if they wished, transfer the unused balance to their spouse.

Arrangements on these lines would give married women the opportunity for privacy & independence in tax matters & end the present discrimination against marriage

The aggregation for tax purposes of a wife's unearned income with that of her husband would end. And the system would be better attuned to the life cycle of most families. The amount of tax-free income they were allowed would not, as now, fall when only one ~~parent~~ partner was in work.

And, by giving a higher proportion of the benefit of an allowance increase to one-earner families, they would help those in the unemployment & poverty traps. One earner families are the largest group in the traps.

The Green paper discusses how a system of transferable allowances could be introduced, probably over a period of years. No couples ~~No-one~~ need suffer a cash reduction in their total tax allowances during the transitional period, and for most people allowances would rise in cash terms. The paper also examines the longer term future of the tax system and its relationship with social security benefits. The husband would!

The Government will carefully consider the responses to the Green Paper before deciding how to proceed. I hope that there will be a good response from the general public, since these proposals would affect everyone. None of the changes described are possible until the personal tax system ~~of tax collection~~ has been computerised. ~~that change will not~~ be complete until the end of the decade. But the Government's intention is to legislate in time to allow a new system to begin to be implemented as ~~soon as the necessary programmes are in place~~.

Changes on these lines could not be implemented before 1990. But, given the need for full public discussion, & for planning the new system well in advance, consultation needs to begin now.

Another benefit of transferable allowances, which goes directly to the heart of the income tax problem I was describing earlier, is that ~~far~~ more people could be taken out of the poverty and unemployment traps - and indeed taken out of tax altogether - for a given (increase in allowances) [~~overall tax reduction~~ than is possible today.

(Do you need this? If you do, do you have to say "at the margin"?])

But in the meantime we must work within the system we have. And we must work to improve it at the margin to the best of our ability.

I explained earlier that against the background of a sharp fall in the oil price and continued market uncertainties my room for manoeuvre was restricted. But I have sought to apply the money at my disposal to the best advantage.

It is instructive to look at the tax systems of our major trading partners. Three things stand out.

> <u>First</u>, that the proportion of income of an average production worker taken in tax is higher in the United Kingdom than in the US, Japan, France or Germany. [That is one important reason why we must get tax down to stay competitive] ?

[Economically dangerous. Incentives depend on the marginal rate, not the average rate discussed here].

Second, that our starting point for tax is in line with the average but,

[True as amended; but could lead to the reduced rate band argument].

Third, that our ~~first~~ Starting rate of national income tax is one of the highest of the lot.

Against that background I have decided this year to increase tax thresholds in line with inflation only. The main personal allowances in 1986-87 will therefore rise by 5.7 per cent. The single person's allowance will rise by £130 to £2,335 and the married man's allowance by £200 to £3,655. The single age allowance will rise by £160 to £2,850 and the married age allowance by £250 to £4,505.

In addition, I propose to lower the basic rate of income tax by 1p to 29pence in the pound.

Taken together these changes mean that a single person on average earnings will be £2.44 a week better off - a £1.69 more than under simple indexation.

A one earner married couple on one and a half times average earnings will be £3.66 a week better off - £2.51 a week more than with indexation only.

Some 550,000 people on low incomes who would have paid tax if thresholds had not been increased will pay no tax at all in 1986-87. But only about 20 per cent of these people are heads of households. The change in the basic rate means that the marginal tax rate is reduced for [14] million working taxpayers - 95 per cent of the total. And let us not forget that the basic rate is also the marginal rate for the vast majority of unincorporated businesses and for most of the 2½ million self-employed.

[14 may be too low. We will need to check].

The small companies rate of corporation tax is ~~the~~ (at present the same as) ~~also aligned with~~ the basic rate. I accordingly propose to reduce that rate also for 1986-87 to 29 per cent, a further boost to small businesses.

[not aligned in the sense of automatically the same].

I understand the concern shared by many who favour reductions in tax rates that basic rate changes give disproportionate benefits to the rich.

See minute

I think it right that we should give some relief to those on middling incomes, who have seen very little reduction in the burden of taxation in recent years - unlike those at the bottom end of the scale who have benefited both from the real rise in thresholds and from the reductions in National Insurance Contributions.

But different considerations apply to those on higher incomes. The burden of tax on the rich is largely determined by the structure of higher rates.

I have decided to increase the threshold for the first higher rate of tax by £1,000 to its new indexed level. But all subsequent steps on the scale will be lifted by £1,000 only, leaving the width of the bands the same. The effect of this is to limit the cash benefit to higher earners to almost exactly the amount they would have received from simple indexation of all thresholds and no change in the basic rate.

I believe that in a year when the sums at my disposal are limited, this will be widely seen as an equitable and appropriate measure.

The basic rate cut I have announced is the essential next step on our road to a lower tax economy. It is, necessarily, a short step. But we are in no doubt about the overall direction of our tax strategy. And the pace of change will accelerate in the years to come.

BUDGET SECRET

pvt

CHIEF SECRETARY TO THE TREASURY

FROM: **R J BROADBENT**

DATE: **7 March 1986**

PS/CHANCELLOR

cc: Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Cassell
Mr Monck
Mr Monger
Mr Scholar
Mr Culpin
Mr Pratt
Mr Cropper
Mr Davies
Mr Lord

PS/Inland Revenue
PS/Customs& Excise

BUDGET SPEECH (THIRD DRAFT): SECTIONS G TO J

The Chief Secretary has the following comments on the draft attached to your minute of 3 March.

Section ~~G1~~ F

Page 1, line 10, insert "and women" after the phrase "a level of pay which enables men".

Section ~~G2~~ G

On page 2, the Chief Secretary thinks it is worth saying that the increase in the VAT threshold is the maximum permitted under the existing EC rules.

Section H

On page 2, the Chief Secretary would redraft lines 19 - 21 to read as follows:

"this is only right because the company will have benefited from the tax relief previously given and needs to be recovered when money in the funds is no longer to be used for the purpose of paying benefits."

Section I

Towards the end of page 2, the Chief Secretary thinks it would be worth referring also to educational institutions, universities and research not associated with trade which all stand to benefit from more charitable giving.

Section J

The Chief Secretary thinks it is worth referring to the environmental advantages of lead free petrol.

R J BROADBENT
Private Secretary

Inland Revenue

Policy Division
Somerset House

FROM: C W CORLETT
7 March 1986

RP

PRINCIPAL PRIVATE SECETARY

BUDGET SPEECH : CHARITIES : PAYROLL GIVING

1. In the section of the speech dealing with charities, which Mr Monger sent you yesterday, an additional sentence is proposed, to deal with the Financial Secretary's point about the administrative difficulties in giving a general relief for one-off donations by individuals. The sentence is -

> "And, especially before computerisation, such a relief would carry a heavy staff cost."

2. We do not want to object to this insertion, if the Chancellor favours it. Certainly the administrative problem of end-year returns, claims and assessments was the main reason why a general relief for individuals was rejected.

---

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Mr Cassell
Mr Monger
Miss Sinclair
Mr Scholar
Mr Cropper
Mr Davies
Mr Lord
Mr Isaac
Mr Painter
Mr Stewart
Mr Cherry
Mr Cropper
Mrs Fletcher
Ms Tyrrell
Mr McManus
PS/IR
Mr Corlett

3. The awkwardness is in the reference to computerisation. While COP should in due course make it a little easier to handle repayment claims, the adminstrative difficulties and costs will still largely remain. This is because the computerised PAYE system will operate on the present basis that the majority of taxpayers should not have to make annual returns or receive assessments.

4. The reason for mentioning this is simply to warn that, if questions are asked immediately after the Budget, or when the pressures build up from employees of non-participating employers, no-one should be misled into concluding that once COP is in place relief for single donations by individuals would be an easy or cheap option.

C W CORLETT

BUDGET SECRET

COPY NO 1 OF 22 COPIES

PSY

FROM: H J DAVIES
DATE: 7 MARCH 1986

CHANCELLOR OF THE EXCHEQUER

PS/CST

cc PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr Cassell
Mr Monck
Mr Scholar
Mr Monger
Mr Odling-Smee
Mr Culpin
Miss O'Mara
Mrs Lomax
Mr Cropper
Mr Lord
Sir L Airey - IR
Mr Battishill - IR
Mr Mace - IR

BUDGET SPEECH: TAXES ON INCOME

... I attach a revised draft of this section which has benefited from suggestions made by the Chief Secretary, Financial Secretary, Messrs Cassell and Monger, and Mr Isaac on behalf of the Revenue.

2. I hope I have taken most of their detailed comments into account, but there are some more fundamental points you might wish to consider:

(i) Messrs Isaac, Monger and Cassell favour dropping the Fowler reference. It is square-bracketed in the text. The policy reasons for leaving it out are obvious; there is also a risk that it unbalances the draft. I do not feel strongly.

Worth 1 sentence at most

(ii) Mr Monger suggests that you might deal with the Green Paper on its own, and then come back to rates vs thresholds. I have preferred to try to integrate the arguments.

I agree

(iii) Mr Monger (and the Financial Secretary) think the draft concedes too much to the 'give-away to the rich' argument. I think you ought to take that head-on.

but so does MIB! (could use argument in PM minute -)

(iv) The Revenue are worried about the overseas comparisons, which they think may lead in the direction of a reduced rate band, rather than a lower basic rate.

yes - so if this is to be used, need to say why RR [illegible]

(v) The Chief Secretary thinks the basic rate change announcement ought to be more dramatic. YES!!

(vi) On a similar point, Sir Terence Burns has suggested that you might consider putting the upper rate threshold changes before the basic rate announcement, leaving your audience puzzled until the last about what you are up to. I think this goes too far in the 'rabbit' (out of a hat) direction and that the change should be embedded in a discussion of your overall tax strategy.

Yes, the HRB changes can be described very briefly — (£1000 on all the higher rate bands); & so can the net effect of these changes on HR taxpayers (1 sentence).

HJD

H J DAVIES

L Social security uprating decision (between Green Paper + main proposals?) - See below

SECTION J : PERSONAL TAX : TAXES ON INCOME

I now turn to income tax. L word of praise for Revenue staff (see Bartholomew - below)

The Government's policy on income tax is clear; we want to reduce it. Lower personal taxation t o restore work incentives has been a fundamental aim since 1979. In the long run this must mean both raising the starting point at which income tax begins to be paid and reducing the tax rates themselves. There is no inconsistency whatsoever between these two Both are means to the same end.

Tax thresholds are important because of their impact on people at the lowest earnings levels - on people who are, indeed, on the threshold of the world of work, yet for whom the tax and benefit structure can together act as a powerful disincentive.

That is one reason why we have increased the tax threshold by 20 per cent in real terms since 1978-79. As a result, the number of people paying any income tax at all is 1.4 million fewer than it would have been had thresholds merely been indexed in line with inflation.

and x % since last election alone

[But raising the present structure of tax thresholds can at best be only a very partial answer to the problems of people in what are known as the poverty and unemployment traps. The reforms in the benefit system presented to the house last year by my Rt. Hon. Friend the Secretary of State for Social Services were another important step towards a more rational system with properly targeted benefits and decent rewards for work.

[illegible] lighter touch.

As a result, no families will face marginal tax rates above 100 per cent - a particularly wasteful and cruel feature of the previous system. The new Family Credit and Housing

Benefit systems will focus on <u>net</u> income, after tax, in identifying a family's need for state assistance.]

We need to reform our system of personal income tax if tax relief is to be targeted on those who most need it. I am publishing today, as I undertook to do in my Budget last year, a Green Paper on the reform of personal taxation.

Since 1979 we have reformed many aspects of the tax system to create a fairer tax structure, and one more favourable to enterprise, growth and employment. But we have not yet tackled the personal income tax system, which has remained essentially unchanged for over 40 years.

Tribute to Sir G Howe.

The response to my predecessor GP "Husband and Wife" (1980) showed that

There are some features of the present system which are almost universally seen as unfair and indefensible. Married women naturally resent the rule that a wife's income is treated for tax purposes as her husband's. It denies to the partners in a marriage that independence and privacy in their tax affairs which they have a right to expect. The tax system discriminates against marriage itself and in particular against families where the wife chooses to stay at home to look after the children, which increasingly means families with young children. Just at the moment when a young family's cash needs are greatest, the tax system works against it.

The Green Paper I am publishing today describes a system which would correct these grave faults, but would at the same time recognise the way a husband and wife share responsibilities within a marriage. The essence of the system is simple. Every adult, man or woman, married or single, would have a tax allowance in their own right - the same tax allowance. But where one partner in a marriage had little or no income of their own, and so could not make full use of their allowance, they could, if they wished, transfer the unused balance to their spouse.

The system would be better attuned to the life cycle of most families. The amount of tax-free income they were allowed would not, as now, fall when only one partner parent was in work. And the aggregation for tax purposes of a wife's investment income with that of her husband would end. An tax penalties on marriage would go

The Green paper discusses how a system of transferable allowances could be introduced, probably over a period of years. No families need suffer a cash reduction in their total tax allowances during the transitional period, and for most people allowances would rise in cash terms. The paper also examines the longer term future of the tax system and its relationship with social security benefits.

The Government will carefully consider the responses to the Green Paper before deciding how to proceed. I hope that there will be a good response from the general public, since the changes it describes would affect virtually everyone. None of the changes described are possible until the system of tax collection has been computerised; that change will not be complete until the end of the decade. [But the Government's intention is to legislate beforehand.]

Another benefit of transferable allowances, which goes directly to the heart of the income tax problem I was describing earlier, is that far more people could be taken out of the poverty and unemployment traps - and indeed taken out of tax altogether - for a given overall tax reduction than is possible today. [One-career ? earner families, who would benefit most, are the largest group in the poverty and unemployment trap] C4 talk!

But in the meantime we must work within the system we have. [And we must work to improve it to the best of our ability.]

I explained earlier that my room for manoeuvre was restricted this year. That makes it all the more important to apply the money at my disposal to the best advantage.

[It is instructive to look at the tax systems of our major trading partners. Three things stand out.

First, that the proportion of income of a production worker on average earnings taken in tax is higher in the United Kingdom than in the US, Japan, France or Germany.

Second, that our starting point for tax is in line with the average but,

Third, that our starting rate of national income tax is [~~one of~~ the highest of the lot.]

if refers to 4 above.

Against that background I have decided this year to increase tax thresholds by 5.7 per cent, in line with inflation. The single person's allowance will therefore rise by £130 to £2,335 and the married man's allowance by £200 to £3,655. The single age allowance will rise by £160 to £2,850 and the married age allowance by £250 to £4,505.

In addition, I propose to lower the basic rate of income tax by 1p to 29pence in the pound.

lowest basic rate since the war (Tony's note)

Taken together the changes I have just announced mean that a single person on average earnings will be £2.44 a week better off - £1.69 more than under simple indexation.

[A one-earner married couple on three quarters of average earnings will gain £2.05 a week - 90 pence more than with indexation only.]

And a married couple on, in total, one and a half times average earnings will be £3.66 a week better off - £2.51 a week more.

Some 550,000 people on low incomes who would have paid tax if thresholds had not been increased will pay no tax at all in 1986-87. The change in the basic rate means that the marginal tax rate is reduced for some 20 million working taxpayers - 95 per cent of the total. And let us not forget that the basic rate is the marginal rate for the vast majority

we said 14 in your minute? (difference between tax units & individuals, presumably) of the 2½ million self-employed. / unincorporated businesses.

The small companies rate of corporation tax is at present the same as the basic rate. I accordingly propose to reduce that rate for 1986-87 to 29 per cent, a further boost to small businesses.

I understand the concern shared by many who favour reductions in tax rates that basic rate changes give disproportionate benefits to the higher income earners.

I think it right that we should give some relief to those on below average and middling incomes, who have seen very little reduction in the burden of taxation in recent years, and who, in proportionate terms, have benefited less from the rise in thresholds and the reduction in National Insurance Contributions than those at the bottom of the earnings scale.

It is because I want to concentrate the benefits on them, and not on the higher level of incomes, that I have decided to increase the threshold for the first higher rate of tax by £1,000 to £17,200, the level indicated by the statutory indexation formula. All subsequent steps on the scale will be lifted by £1,000 only, leaving the width of the bands the same. The effect of this is to limit the overall benefit to higher earners to almost exactly the amount they would have received from simple indexation of all thresholds and no change in the basic rate.

These changes will take place under PAYE on the first pay day after [17 May].

I believe that in a year when the sums at my disposal are limited, this will be widely seen as an equitable and appropriate measure.

The basic rate cut I have announced is the essential next step on our road to a lower tax economy. It is, necessarily, a short step. But we are in no doubt about the overall direction of our tax strategy. [And the pace of change will accelerate in the years to come.]

Or

[And I reaffirm here today the objective set by my predecessor to seek a basic rate of income tax no higher than 25 pence in the pound.]

BUDGET SECRET

COPY NO 15 OF 22 COPIES

FROM: H J DAVIES
DATE: 7 MARCH 1986

CHANCELLOR OF THE EXCHEQUER

cc PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr Cassell
Mr Monck
Mr Scholar
Mr Monger
Mr Odling-Smee
Mr Culpin
Miss O'Mara
Mrs Lomax
Mr Cropper
Mr Lord
Sir L Airey - IR
Mr Battishill - IR
Mr Mace - IR

BUDGET SPEECH: TAXES ON INCOME

... I attach a revised draft of this section which has benefited from suggestions made by the Chief Secretary, Financial Secretary, Messrs Cassell and Monger, and Mr Isaac on behalf of the Revenue.

2. I hope I have taken most of their detailed comments into account, but there are some more fundamental points you might wish to consider:

(i) Messrs Isaac, Monger and Cassell favour dropping the Fowler reference. It is square-bracketed in the text. The policy reasons for leaving it out are obvious; there is also a risk that it unbalances the draft. I do not feel strongly.

(ii) Mr Monger suggests that you might deal with the Green Paper on its own, and then come back to rates vs thresholds. I have preferred to try to integrate the arguments.

(iii) Mr Monger (and the Financial Secretary) think the draft concedes too much to the 'give-away to the rich' argument. I think you ought to take that head-on.

(iv) The Revenue are worried about the overseas comparisons, which they think may lead in the direction of a reduced rate band, rather than a lower basic rate.

(v) The Chief Secretary thinks the basic rate change announcement ought to be more dramatic.

(vi) On a similar point, Sir Terence Burns has suggested that you might consider putting the upper rate threshold changes before the basic rate announcement, leaving your audience puzzled until the last about what you are up to. I think this goes too far in the 'rabbit' (out of a hat) direction and that the change should be embedded in a discussion of your overall tax strategy.

HJD

H J DAVIES

SECTION J : PERSONAL TAX : TAXES ON INCOME

I now turn to income tax.

The Government's policy on income tax is clear; we want to reduce it. Lower personal taxation t o restore work incentives has been a fundamental aim since 1979. In the long run this must mean <u>both</u> raising the starting point at which income tax begins to be paid <u>and</u> reducing the tax rates themselves. There is no inconsistency whatsoever between these two means to the same end.

Tax thresholds are important because of their impact on people at the lowest earnings levels - on people who are, indeed, on the threshold of the world of work, yet for whom the tax and benefit structure can together act as a powerful disincentive.

That is one reason why we have increased the tax threshold by 20 per cent in real terms since 1978-79. As a result, the number of people paying any income tax at all is 1.4 million fewer than it would have been had thresholds merely been indexed in line with inflation.

[But raising the present structure of tax thresholds can at best be only a very partial answer to the problems of people in what are known as the poverty and unemployment traps. The reforms in the benefit system presented to the house last year by my Rt. Hon. Friend the Secretary of State for Social Services were another important step towards a more rational system with properly targeted benefits and decent rewards for work.

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Benefit systems will focus on net income, after tax, in identifying a family's need for state assistance.]

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There are some features of the present system which are almost universally seen as unfair and indefensible. Married women naturally resent the rule that a wife's income is treated for tax purposes as her husband's. It denies to the partners in a marriage that independence and privacy in their tax affairs which they have a right to expect. The tax system discriminates against marriage itself and in particular against families where the wife chooses to stay at home to look after the children, which increasingly means families with young children. Just at the moment when a young family's cash needs are greatest, the tax system works against it.

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Third, that our starting rate of national income tax is [~~one of~~] the highest of the lot.]
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<u>**Or**</u>

[And I reaffirm here today the objective set by my predecessor to seek a basic rate of income tax no higher than 25 pence in the pound.]

BUDGET SECRET

ypw?

FROM: M C SCHOLAR
DATE: 7 March 1986

PRINCIPAL PRIVATE SECRETARY

cc: Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr Culpin
Miss O'Mara
Mr Pratt
Mr Cropper
Mr H Davies
Mr Lord

BUDGET SPEECH

You asked for comments on the draft Budget speech. Mine are as follows.

Paragraph 2

I think we need now to demote uncertainty somewhat. It still will have an important part in the presentation, but we should substitute the fall in the oil price rather than uncertainty about it in this prominent position in the speech.

Paragraph 8

For "base" in line 5, read "pace".

Paragraph 11

In the anti-penultimate line, for "per year" read "per cent".

Paragraph 14

The fifth sentence should begin "Consumer spending is also likely......".

Paragraph 15

I think that it would be best to omit the last sentence.

BUDGET SECRET

Paragraph 16

If this is to be kept it would better read, "This damaging dispute at last came to an end, and we are now reaping the benefits from the way it was resolved: higher productivity in the coal industry; improved industrial relations; and wider benefits for the economy as a whole.

Paragraph 18

For "stabilised" substitute "been more stable".

Paragraph 20

I suggest an alternative version:

> "I do not share this defeatist view. Indeed, I believe that lower oil prices and our improved competitiveness offer us a unique opportunity; and that we are strongly placed to exploit this opportunity to the full."

If this is adopted there is a consequential in paragraph 28 (insert in first sentence "as I have said").

Paragraph 22

I doubt if our Saudi-bashing should be quite as barefaced as it is at the moment. I think it would be better not to refer to them explicitly. I suggest the following revised version of this part of the paragraph:

Paragraph 30

The last sentence might be expanded as follows:

> "Oil companies obviously suffer from the loss of income, and so - as I shall explain in a moment - does the Exchequer, through lower oil revenues."

Paragraph 31

I think that the thought in this paragraph survives into our new presentation. I suggest "continue to rise" for "survive" in line 2.

Paragraph 35

In line with what the Chancellor decided for the FSBR the last sentence should be deleted. In that case the paragraph had better run straight on into paragraph 36.

Paragraph 41

In line 6, substitute "months" for "weeks".

Paragraph 42

The complication described here is itself too complicated. I suggest instead something like "I come now to the public finances".

Paragraph 43

You will remember - some days ago - the Chancellor thought that we should put in the speech his expectation that the PSBR for this year will be undershot. If this thought survives you could make line 6 read "The PSBR remains at about £7 billion, the same figure - or perhaps a little below it - as I set out last year.

I suggest that we need a new paragraph, after para 43, which we might ask Mr Evans to draft, on the buoyancy of the non-North Sea oil revenues in 1985-86 and 1986-87.

Paragraph 45

I think that we should include some justification of the choice of $15 a barrel for the oil price. Perhaps something - after the first sentence - on the following lines:

I agree with those who think that the section on profit-related pay agreements is too prominent right at the beginning of the speech.

I find the second sentence on page 2 rather compressed. As an alternative could it say, "If the only element of flexibility is in the number of people employed, there is bound to be much unnecessary hiring and firing - and in practice this will often mean too many redundancies."

Section G2

At the end of the second paragraph delete "the small companay rate will be even lower at 30 per cent". This will now, presumably, come later, in the income tax section.

Section H

On page 4 would it be a good idea to add at the end of the sentence on the cost in 1987-87 as follows:

> "...£25 million in 1987-88. Its eventual cost is likely to be very much higher, if - as I expect - there is substantial take-up of this new scheme."

Section I

The second sentence seems rather wooden. What about an explanation on the following lines:

BUDGET - SECRET

Inland Revenue

Policy Division
Somerset House

Ch/ Content to accept this advice? Even if the answer has to be "no", Fowler may be mollified if you let him see the relevant passage from the speech. ([illegible] letter in the light of your response being long and negative [illegible] at present) KL. 7/3

Copy no 1 ... 01 . 12

FROM: N C MUNRO

7 March 1986

1. Mr Corlett I agree 7/3

2. Chancellor of the Exchequer

PERSONAL PENSONS : LETTER OF 5 MARCH FROM MR NORMAN FOWLER

1. Mr Fowler has asked you to think again about the timetable for tax legislation on personal pensions. He would like to see the legislation in this year's Finance Bill in case it proves possible for the new personal pensions to be introduced in Autumn 1987.

Present position

2. On the basis on a 1988 commencement date, you have agreed a 1987 package for pensions which includes:

- personal pensions

- possible changes in current law and practice, following a review which is now under way

- possible action against certain forms of loanbacks (eg pension mortgages

Does FST think this is on?

- possible changes in the retirement annuity regime, in view of the fact that professional people who are self-employed often have lower pension expectations than eg company directors.

---

cc Financial Secretary
Miss Noble

Mr Isaac
Mr Painter
Mr Beighton
Mr Corlett
Mr Lusk
Mr Munro
Mr McNicol
Mr Hinton
PS/IR

This advice stands well. FST [illegible] draft letter on your decision. I have [illegible]. The passage on the subject in the Speech needs to be 'beefed up', with mention of consultations [illegible] of grumbling [illegible].

PERS-PEN.SUB

Your intention is that such legislation should be preceded by detailed consultations, with a discussion document on most of these issues being published later this year.

Scope for legislation in 1986

3. There is clearly no prospect of implementing this package in the 1986 Finance Bill. Although work is well advanced on most of these issues, much more needs to be done before we would be able to report back to you fully. So any legislation this year would necessitate the dismantling of the package so that personal pensions could be dealt with separately.

4. On the other hand you will want to be as helpful as possible to Mr Fowler. But it would not be unfair to point out that his request comes very late in the day for action this year. Moreover, he has previously passed up two opportunities to make this suggestion:

- when the question was raised in MISC 111 last Autumn, he was asked to set out his views but failed to do so

- the publication of his White Paper in December last year offered another chance to press this point which he did not take up.

5. Nevertheless, even at this late stage it might - if Parliamentary Counsel could manage to fit in additional work - be possible to legislate on personal pensions this year. Such legislation would take the form of enabling provisions, to be followed at some later date by Regulations setting out the details of the new regime.

6. But it is far from clear that proceeding in this way would do much to mitigate the problems identified by Mr Fowler in his letter.

i. First, that pension providers will not be able to finalise their personal pension schemes until they know what the tax treatment is going to be.

This is true. But whatever legislation was included in this year's Bill would be unlikely to add much to what pension providers know already about the Government's intentions. And for consultations to proceed on a proper basis on the detailed Regulations would require a timetable not significantly shorter than the one you already envisage.

ii. Second, that the need for personal pension contracts to be approved by the Superannuation Funds Office may create a bottleneck in 1987-88.

We think this is unlikely. Given that the new contracts will closely resemble retirement annuity contracts (as is made clear in Mr Fowler's White Paper) we intend to adopt a "standard document" approach - as is currently the case for retirement annuities. Once a provider has agreed a standard document with us, he can make any number of contracts based on it without further reference to us. This, and the fact that retirement annuity contracts are very much simpler and shorter than pension scheme trust deeds, means that only a handful of staff are needed at the SFO to process retirement annuities.

7. We therefore doubt whether Mr Fowler's suggestion would give him the flexibility he desires. Providers will not be able to finalise their personal pension contracts until the complete legislation is on the statute book. But, on the basis of the information we intend to provide later this year, they will be able to do most of the necessary work on a provisional basis; subsequent changes are likely to concern matters of detail rather than fundamental principle. They should, therefore, be able to submit contracts for approval almost immediately after the detailed legislation has been settled.

Further considerations

8. Mr Fowler's proposed timetable would also pose problems of its own.

9. In the first place, it would necessitate a third tax regime for pension arrangments, at least for a period of time. This would be contrary to your wishes, and to the representations made by some professional pensions bodies. One advantage of legislation in 1987 is that it would enable us to revamp the current retirement annuities legislation so that it also covered personal pensions.
1988? This could still be done in 1987, of course, but it would mean legislating in successive years.

10. Second, one aspect of present law and practice to which Mr Fowler attaches considerable priority is the question of transferability between different types of pension arrangement. Because of the fundamental differences between defined benefit schemes (ie occupational pensions) and defined contributions schemes (broadly, money purchase arrangements) this is a highly complicated matter. In principle we are fairly confident that complete transferability will be possible. But we have not yet been able to follow through all the ramifications. Legislation on this question in 1986 is clearly out of the question. But until they know what is intended, potential providers will not be able to finalise their personal pensions contracts.

Conclusion

11. In short, we believe Mr Fowler has over-estimated both the difficulties likely to arise from the proposed timetable, and also the advantages which would flow from the timetable he proposes. And of course he is not aware that his proposal would raise new problems for us.

12. We therefore suggest that you should not accept his recommended timetable, although we think you should be able to reassure him that many of his anxieties are without foundation. I attach a draft reply for your consideration.

Nem.

N C MUNRO

Pl type.

PERSONAL PENSIONS LEGISLATIVE TIMETABLE : ~~DRAFT~~ LETTER FROM CHANCELLOR TO MR NORMAN FOWLER

This will need shortening & reading through when you decide what to do -

Thank you for your letter of 5 March 1986.

I am grateful for ~~your~~ confirmation that ~~my national insurance proposals are acceptable and~~ you are content with my proposals on the pension scheme surpluses.

Having looked at the matter very carefully I am afraid that

You also asked me to reconsider my timetable for the new tax regime for personal pensions, with a view to including legislation in this year's Finance Bill. I recognise the concerns which have caused you to make this request at this late date, ~~and I have no wish to appear unhelpful.~~ and, as you know, I share your desire to give personal pensions a good start. But ~~I have to say~~ legislation on personal pensions in 1986 would pose a number of difficult ~~issues for me.~~ problems. ~~And I am far from sure~~ however, nor am I convinced that it would ~~have the beneficial effects which you foresee.~~ be as helpful as you suggest.

Two main reasons why I originally favoured

My preference for legislation in the 1987 Finance Bill, preceded by detailed consultations ~~with interested parties later in this year,~~ ~~is~~ was because I ~~see~~ saw ~~the legislation on personal pensions~~ it as only one part ~~- albeit the most important -~~ of a pension package in the 1987 Budget which ~~will~~ would include a number of more or less closely related changes.

In particular, ~~arising out of~~ following the recent Rayner Scrutiny into the Supervision of Occupational Pension Schemes, I should like to consider the scope for more far-reaching changes in current Revenue law and practice than your proposals ~~in themselves~~ would require. Current Revenue practice is extremely detailed and complicated, and I frequently receive proposals that something more simple and straightforward should be introduced.

I also need to consider the present rules for retirement annuity contracts. Your own White Paper promised further study of ways of reconciling the different regimes that apply for retirement annuity arrangements and occupational pension schemes. As you know, there are ~~formidable~~ great ~~practicable~~ practical difficulties in ~~effecting~~ achieving a complete reconciliation. But one thing I am sure we would all like to avoid, if at all possible, is the creation of yet a third regime for provision for retirement.

There is no possibility ~~at all~~ of working up such a ~~that this~~ package ~~could be worked up~~ in time for this year's Finance Bill. ~~So~~ Any legislation this year would have to be confined to personal pensions alone, with a further tranche of legislation ~~in a later~~ next year. ~~I do not find this prospect attractive.~~ How we wish to do this, There is a real danger that, in legislating piecemeal on such an important subject, even with prior consultation, we would not get the provisions right. I should ~~not by choice want~~ be loath to introduce a substantial block of legislation this year, only to have to unpick it next year.

Nevertheless, ~~I might feel able set aside to overcome these misgivings~~ I might be willing to run this risk if I felt confident that legislation in 1986 ~~would~~ was needed to avert the problems you foresee with my timetable. ~~However, it may be that~~ Having looked at the question again, however, I think that the problems are less daunting than you fear.

was intended to

Your first concern is that pension providers will be unable to finalise their personal pension contracts until they know what the tax treatment will be. ~~Up to a point, I agree. But~~ It is already public knowledge that the regime for personal pensions will be broadly based on that which now applies for retirement annuities. The discussion document which ~~I intend will be issued by Inland Revenue~~ Revenue will be issuing later this year will give further details, in particular on how it is proposed to deal with the transferability point. This will enable providers to undertake most of the preparatory work necessary in drawing up personal pension contracts. Unless any subsequent changes arising from the consultations are fundamental (which I think unlikely), the final product

It is true that providers will not be able to finalise draft contracts until legislation is in place. But, on my proposed timetable, they should be in a position to do so very quickly thereafter.

will be different only on points of detail. ~~So, while I agree that providers will not be able to finalise their draft contracts until the legislation is in place, they should be able to do so very quickly immediately afterwards.~~

Revenue have assured me that they do not foresee any major administrative difficulties.

Your second concern is about whether the Revenue will be able to cope with the influx of new applications for approval. ~~The fact that~~ Personal pension contracts ~~will~~ they will be broadly similar to retirement annuity contracts ~~will help them in this respect.~~ should be relatively simple to deal with. ~~These contracts~~ which ~~are~~ are very much ~~simpler and~~ more straightforward than ~~, for example, the trust deeds required for~~ occupational pension schemes. ~~They are therefore more easily and more quickly dealt with.~~ ~~Furthermore, I understand that~~ Retirement annuity contracts are approved on a "standard documents" basis - so that once the standard has been approved by the Superannuation Funds Office, any number of contracts based on it may be made without further reference to the Revenue. This ~~approach~~ means that - in contrast with the position for occupational pension schemes - only a very small number of SFO staff are required to process retirement annuity contracts. ~~In view of this, I think it is unlikely that the SFO will experience any major administrative difficulties.~~

Finally

WH

As you ~~yourself~~ recognise, legislation on personal pensions in the 1987 Finance Bill does not preclude a commencement date before April 1988. ~~In view of this, and in the light of the considerations I have already mentioned, I am afraid that I prefer not to depart from my present timetable.~~

In view of all this, I hope you will agree that the right course is to continue to aim for legislation in the 1987 Finance Bill.

NIGEL LAWSON

SPARE

BUDGET SECRET

CH/EX REF. NO. M28

COPY NO. 17 OF 18 COPIES

FROM: MRS R LOMAX

DATE: 7 March 1985

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

FINANCIAL SECRETARY

CAPITAL ALLOWANCES

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

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

RL

MRS R LOMAX

76/253

BUDGET CONFIDENTIAL

Sir PM

FINANCIAL SECRETARY TO THE TREASURY

FROM: H C GOODMAN
DATE: 7 March 1985

PS/CHANCELLOR

cc PS/CST
PS/MST
PS/EST
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Mr Battishill
Mr Monger
Ms Seammen
Mr Cropper
Mr Lord
Mr H Davies
PS/IR

Spare Ch/Ex

GREEN PAPER ON PERSONAL TAXATION

You asked for a speaking note for the Chancellor to use in his talk with the Prime Minister tonight on this subject. I attach a note which has been approved by the Financial Secretary.

2. You also asked for two tables. I attach one which sets out the distributional implications on a static basis and the other which shows the effect of phasing the introduction of fully transferable allowances.

Ch/Ex (very)

I have a ~~couple~~ few ~~of minor~~ points on the speaking notes. But is this the opportunity to grab tax issues away from Fowler. (& the Social Security White Paper)

If there is to be a move to change tax allowances [: then Ch/Ex ~~should~~ cf be in this Green Paper.

B.

Rm.

H C GOODMAN

BP 229

70/253

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Shd it not make a feature of the end of aggregation

Reform

Green Paper continues the programme of tax reform began last year.

Reducing Tax Burden

We must get tax thresholds up. We can change the system so that we use the resources which we have available more effectively than at present to help jobs and incentives.

The Proposal

I should like to move to a system which gives the same personal allowance to all taxpayers, but the unused part of the allowance should be fully transferable between the partners in marriage. We must end the present situation where a married couple with both partners at work get more than two single allowances. That in itself costs us something like £1½ billion and I know of no other country which is so generous to two-earner couples.

Effect on poverty and unemployment traps

how much this

Moving to fully transferable allowances is a very cost effective means of raising tax thresholds not only for young people and other low earners but more particularly for the low paid one-earner couple. It is for these people that the problems of the poverty and unemployment trap are most acute. Even if we made a broadly revenue neutral change to the new system at existing allowance levels, we could take some 200,000 one-earner couples out of tax. We would have to spend about £4 billion on raising the present allowance structure to achieve the same result. And the change would take about 25,000 married couples out of the poverty trap.

Transitional Period

We should in practice be able to do much better than this. By phasing the change in over two or three years we should be able to avoid making any two-earner couples worse off in cash terms and have an even larger effect on the unemployment and poverty trap for one-earner couples. At the same time we shall be pushing up the tax threshold generally.

Effect on Married Women in Work

The new system will not mean a reduction in the tax threshold for the married woman in work. Moreover we will give her a greater opportunity for independence and privacy in her tax affairs and end the present aggregation rule.

Longer Term Issues

Reshaping the personal income tax structure will take time. But the Green Paper can open up some other issues for discussion to respond in some way to the pressure for integration of tax and social security and look at other ways of running the tax system.

Mention [illegible] [illegible]

TABLE A

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Income of 1984-85

DISTRIBUTION EFFECTS OF A SWITCH TO FULLY TRANSFERABLE ALLOWANCES

AT 1984-85 LEVELS OF ALLOWANCES

NUMBERS OF NON AGED TAXPAYING UNITS[1] (thousands)

Income range (£)	LOSS more than £6.63pw	LOSS £6.63pw	LOSS less than £6.63pw	NO CHANGE	GAIN less than £4.93pw	GAIN £4.93pw	GAIN more than £4.93pw	Total
below - 5,000	0	0	100	3400	175	225	0	3900
5,000-10,000	0	750	550	3750	325	2375	0	7750
10,000-15,000	0	1650	400	600	175	1100	0	3925
15,000-20,000	0	750	100	100	50	250	25	1275
over 20,000	75	150	300	125	50	25	225	950
TOTALS	75	3300	1450	7975	775	3975	250	17800

(1) A taxpaying unit is defined as a single person or married couple with liability to tax either before or after the switch to fully transferable allowances.

TABLE 2

EFFECT OF FULLY TRANSFERABLE ALLOWANCES

After transition with no cash losers

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

42/253

7 MAR 1985 BUDGET CONFIDENTIAL

Sm PM

FROM: H C GOODMAN
DATE: 7 March 1985

PS/CHANCELLOR

cc PS/CST
PS/MST
PS/EST
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Mr Battishill
Mr Monger
Ms Seammen
Mr Cropper
Mr Lord
Mr H Davies
PS/IR

cc Mr Monck

REFORM OF PERSONAL TAXATION

I attach a revised draft of the introduction and synopsis of the Green Paper, which takes account of the Financial Secretary's comments on the draft submitted by Mr Mace on 5 March.

2. I have side-lined the major changes which include a re-ordering of the objectives, a revision of the historical section designed to insert the thought that the present system has developed from a series of changes rather than a set of coherent objectives and removal of some of the excesses of the sexist language.

3. One point, which concerns the Financial Secretary is the differential effect of the proposals on work incentives. He believes that it would be misleading to suggest an overall improvement in them, although the traps which face sole-earners are lessened in a cost-effective way.

HG

H C GOODMAN

BP277

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DRAFT MINISTERIAL FOREWORD/INTRODUCTION

Something general about the obvious flaws our tax system is in – debilitating, complex, costly etc.

1. Last year I reformed the system of business taxation setting the pattern for the next three years and beyond. In this year's Budget, I ~~announced~~ foreshadowed a programme for reform of the structure of personal taxation. ~~Goes~~ But personal tax affects lives of ~~so~~ many people, right to prepare to proceed after period of consultation.

2. My objective ~~in both~~ reform~~s~~ is a tax structure that reflects the changing needs of the modern world and, ~~so far as possible,~~ encourages the creation of jobs and, so far as possible, wealth. In the personal tax field, this means, in particular, a system of personal allowances which also improves ~~the~~ incentives ~~to work and~~ at all levels and distributes the burden of tax more rationally between different taxpayers.

[illegible]

3. The Government remain committed to reducing the burden of tax~~, as far as possible~~. But changes in the personal tax area tend to be expensive. ~~The priority remains to raise tax thresholds. Since 1978/79 we have raised tax thresholds in real terms by [16] per cent, but too many people on low incomes still pay tax.~~ Increasing tax thresholds is expensive - it costs nearly £200 million to put the main personal allowances up by 1 per cent. So it is ~~all the more important~~ vital to ensure that the money is spent where it is most needed.

4. I have therefore reviewed the personal tax system with ~~four~~ three objectives in mind.

2 - First, to ~~simplify the structure of the system~~ make it simpler. The present structure reflects a ~~series of~~ many different decisions taken for many different reasons over many years, not a set of coherent objectives.

3 - Second, to improve incentives. Too many people,

are given, and what exactly peoples rights and expectations within marriage should be. And the system should recognise the right to

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particularly those who ~~supporting families~~, find themselves in the unemployment or poverty ~~poverty~~ trap, where the combined effect of tax and loss of benefits means they are scarcely better off, and can even be worse off, if their earnings increase. When ~~Some of those who are~~ unemployed ~~can~~ find themselves better off without a job than when in work; ~~And young people looking for their first job come into tax at too low a level.~~

(1) - Third, to spread the burden in a more rational way. We need to be clear about the basis on which personal allowances ~~The present system discriminates in favour of married couples where both partners are in paid employment.~~

5\. It is possible to meet these criteria while recognising ~~- Fourth, to meet~~ some well justified criticisms of present structure of tax allowances, ~~the way married women are now taxed.~~ On the other hand ~~A married man and woman have a right to expect that the tax~~ system will continue to recognise ~~marriage and the special obligations that go with it. But each of them also has a right to expect the possibility of~~ independence and privacy in ~~their~~ tax affairs.

Tax it [illegible]

5\. I am therefore proposing that ~~to reform the personal income tax.~~ ~~Each~~ an every person, male or female, married or single, will have a right to the same tax allowance. Where one partner in a married couple is unable to make full use of his or her tax allowance he or she will have a right (if they wish) to transfer the unused allowance to the other partner. ~~Because we~~ ~~In order to recognise~~ Because we recognise marriage & the special obligations that go with it

6\. Thus, all taxpayers will have a single allowance. All married couples whether one partner or both is earning can have the equivalent of two allowances. The existing married man's allowance, as such, will disappear.

7\. This will be a major reform of the tax system. ~~The Green Paper explains the details. But,~~ In brief, ~~the~~ it

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reform will enable us to raise tax thresholds for the one earner family, and for young people and other low earners generally, to a level that would be prohibitively expensive under the present system. It will redistribute relief between two-earner couples, single earner couples, and single people. Whilst ~~continuing fully to recognise the obligations of marriage,~~ ~~the reform~~ this will also give married women the opportunity for independence and privacy which they have a right to expect, and end the so-called "tax penalty on marriage".

~~8. In the longer run, the current computerisation programmes in the Inland Revenue and the DHSS open up other possibilities, and the Government will be studying the case for them. The new structure of personal allowances will not stand in the way of further changes, if the case for them is made.~~

9. ~~Fully~~ Transferable allowances will require changes to the way the tax system is run. The first step, the computerisation of PAYE, is well under way and will be complete by the middle of 1988. ~~I have authorised~~ therefore the Revenue ~~to~~ will ~~bring in the necessary~~ plan for further information technology support immediately afterwards. Arrangements These ~~developments will enable~~ the information needed ~~by the Revenue~~ to operate transferable allowances will be assembled ~~to be set up and maintained~~. ~~As soon as all the new facilities are available the change to the new system can take place.~~

But we have to take supporting decisions now

10. While this preparatory work is proceeding we are publishing this Green Paper to explain our proposals for reform in more detail. Subject to the response to the Green Paper, the Government propose to introduce the necessary legislation for fully transferable allowances in 1987. ~~The Inland Revenue will be in touch with married couples during 1988/89 to gather the information needed~~

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~~to run fully transferable allowances, and~~ The new system will be introduced from April 1990.

11. Computerisation ~~was~~ also opens up the possibility of complementary changes in the tax and benefit systems, ~~[illegible]~~ which are discussed in the paper and its annexes.

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REVISED OUTLINE OF GREEN PAPER

Chapter 1: The Objectives of Reform

Background: Reform of the Tax System

1.1 Government committed to tax reform.

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

1.3 1985 Budget sets in hand reform of personal income tax to reduce the tax burden and bring tax structure into line with reality of modern society.

Objectives of Reform

1.4 Reform should have ~~four~~ 3 specific aims over and above the general aim of reducing tax burden.

1.5 First: simplification. Structure of system should be as simple as possible.

See Ch 5 Benefit Philosophy must come first in my view

1.6 Second: incentives: poverty and unemployment traps: interaction with the social security system. Consistent objective has been to increase income tax threshold. But very costly within present system. Reform needed so that, within limit of what can be afforded more can be done to reduce the burden of tax on the low paid and to tackle the problems of the poverty trap and the unemployment trap.

1.7 Third: discrimination between one-earner and two-earner couples. Improve effect of tax system on employment and labour market.

1.8 Fourth: aggregation of husbands' and wives' income. Re-examine and update way in which tax system treats husband

and wife. Wide range of options discussed in 1980 Green Paper.

1.9 New system should provide more privacy and independence for the partners within a marriage. Everyone should be entitled to a tax allowance in their own right. And allowance should be the same for everyone. But crucial that tax system should continue to recognise and reflect the <u>status of marriage</u>.

Chapter 2: The Case for Change and Proposals for Reform

Background

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

2.2 In brief:

Present structure

Single people:	1 personal allowance
Married men:	approx 1½ the single person's allowance
Married women:	wife's earned income allowance, equal to single personal allowance

Thus:	single person:	1 allowance
	one-earner couple:	approx 1½ single allowance
	two-earner couple:	approx 2½ single allowances.

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

How the present structure originated

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

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

2.5 During the War it was thought that further incentives were needed to encourage married women to take paid employment. So the wife's earned income allowance was increased in 1942 to the level of the single allowance. Wife's earned income allowance has remained at this ~~same~~ level since ~~as single allowance since the War.~~

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

~~**What is wrong with the present structure?**~~

2.7 It is right that ~~a~~ Everyone should have the same allowance. Attached to them as people. married woman should therefore have the same tax allowance as a single person. But ~~the original economic case~~ no longer need to ~~exists for a system that~~ discriminate~~s~~ ~~in~~ favour ~~of~~ the married man whose wife goes out to work, as against single people and married couples where the wife is not in paid employment. Cost is 1½b. could be better used + ~~more fairly used~~ This is fairer + simpler and ...

2.8 Major social changes since the structure of allowances was fixed in the 1940s. Now the rule rather than the exception for married women to go out to work except when they have young children. Half of all married women were economically active in 1979 and the great majority will be working at some point in their married lives. [Refine and update the figures.]

2.9 ~~Moreover, no longer labour shortage, but unemployment rising over past decade and~~ more.

Economic Aspects

~~2.10 Allowances for one-earner couples and single people are substantially less than they might otherwise be if two-earner couples did not retain the current married man's allowance - Cost of giving more than two single allowances to two-earner couples is £1½ billion.~~

Traps

2.11 Low tax thresholds are in part the cause of the poverty and unemployment traps. People most affected are married men on low earnings supporting families.* Traps wrong in themselves and bad for the economy.

2.12 Government has made progress, raising tax thresholds by 16 per cent in real terms, taking almost 1 million people** out of tax since 1978-79 (compared with indexation). But still too many people paying tax and in traps. ~~Reason more not taken out is partly that benefit of threshold increases not targeted at those most in need.~~ Can take more out with new system of allowances ∵ better targeted.

Social aspects

Put as before 2.7 as chapter + consider whether 1st sentence of 2.7

2.13 Present system ~~also~~ involves outdated approach to treatment of husband and wife which many find wrong and offensive. In present form, system treats husband and wife unequally. Thus

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

---

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

** Pre-Budget figures.

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

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

Proposals for reform

2.14 In brief, present system no longer applicable for the present day; and actually damaging. The Government is therefore proposing to reform the structure of personal allowances.

2.15 Reform will be based on two fundamental principles.

First: everyone should have a single personal allowance of their own to set against their own income.

Second: the tax system will continue to recognise the status of marriage. Where one partner in a married couple has insufficient income of their own to use up all their allowance they will, if they wish, be able to transfer any unused balance of the allowance to their partner.

2.16 Clear from this that Government have rejected ~~not followed~~ one of the approaches supported by some of those who responded to 1980 Green Paper. Suggestion was that tax system should give everyone a single allowance and take no account of marriage. Argument was that if an individual had certain defined responsibilities - eg caring for children - that should be recognised through social security benefits but there should be no allowance within tax system for a dependent wife or dependent husband. Such a scheme would inevitably leave worse off many families where one partner does not undertake paid work. But even leaving that aside, Government reject out of hand a system of taxation which paid no regard whatsoever to marriage.

Effects of the new structure

2.17 New structure reflects other approach favoured by many who responded to the Green Paper. Will ensure that all taxpayers, man or woman, married or single, can earn up to the same amount before they start paying tax. ~~Transferability means that~~ Where one partner in a married couple is not in paid employment or works only part-time, he or she may transfer any balance of their own allowance so that between them the couple get the same tax allowances as couple where both partners work. The system will no longer discriminate against couples where, for whatever reason, the wife is not in paid employment.

2.18 Government's intention is to phase in the new system so that no couples lose out in cash terms. Single allowance and transferable amount will be increased gradually so that two single allowances equal the allowances currently given to a two-earner couple. Effects will be as follows (using existing income and allowance levels for illustration).

- Single people gain £3.32 per week from increase in allowance. Helps young people looking for their first job.

Present values not 1990 money

- Married man who is sole earner sees a substantial increase in his tax threshold, which reduces numbers affected by poverty and unemployment traps. He would pay £11.57 per week less tax.

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

2.19 Annex 3 shows how the change might be phased in.

Diagram. Needs to make clear [illegible] Remember [illegible]

2.20 Even at existing allowance levels switch to fully transferable allowances would achieve (on broadly revenue neutral basis) same increase in tax threshold for one-earner married couple as spending about £4 billion on raising present structure of allowances. And effect on unemployment trap is twice as large as 10% real increase in present allowances (costing £1.7 billion). (Annex 4 gives more details of the effects on couples in different circumstances.)

Aggregation of husbands' and wives' income

2.21 New system will also deal with justified criticism of present tax system for husband and wife. Aggregation of both earned income and investment income will be ended. And because partner in a marriage will have right to refuse transfer of any unused allowance, system will allow both husband and wife to have privacy in their financial affairs. The rule which says that the income of a married woman living with her husband is deemed for income tax purposes to be his income and not her income will be ended.

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

Particular groups

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

How the system will work

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

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

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

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

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

Deadly boring. Shift. Annexe? Certainly after 4

Chapter 3: Practical implications of the change

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

Computer support

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

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

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

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

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

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

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

Chapter 4: Next Steps

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

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

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

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

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

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

4.7 Subject to that, the Government intend to legislate in this Parliament [1987?]. During [1988 and 1989] Tax

Offices will be asking married couples for the information necessary to link their tax records, set up the national index, and to give them the appropriate allowances. The new system will come into operation on 6 April 1990.

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Summary of Annexes

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

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

Annex 2 **International Comparisons**

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

Annex 3 **Phasing in the new structure**

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

Annex 4 **Distributional effects**

Text and tables to show the effects of the new system

- on single people and married couples
- at different income levels
- with different illustrative levels of allowances
- bringing out numbers of gainers and losers and size of gains and losses
- effect on poverty/unemployment traps.

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

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

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

Annex 6 **The Elderly**

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

Annex 7 **Single parents**

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

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

- Staff costs of running the new system: would depend on the detail, but much less than under a manual system.
- Setting up costs.
- Capital costs of integrated data network national index - necessary in any event for efficient working of Revenue in 1990s.

Annex 9 **Administration in the longer term**

Computerisation opens up possibility of running tax system in a different way: replace accurate withholding during the year with approximate deduction and end-of-year review for all taxpayers. Could be more taxpayer involvement, self-coding, or self-assessment. Would require tougher penalties. Could save Revenue staff. Further study underway.

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

Longer term possibility. Raises major issues of principle. Clarify possible objectives and how far they would be met by different schemes proposed. Explain administrative consequences.

[Will depend on DHSS Reviews.]

TABLE 1

EFFECT OF FULLY TRANSFERABLE ALLOWANCES

Assuming 1984-85 levels of allowance

	Amount of allowance: Before	Amount of allowance: After	Numbers (thousands)			Non-elderly
Single (7.8 million)	2,005	2,005	7,780	(100%)		No gain or loss
One-earner couples (4.4 million)	3,155	4,010	200	(5%)	taken out of tax	gain up to £4.93 per week
			4,000	(90%)	currently liable at the basic rate	gain £4.93 per week
			220	(5%)	currently liable at higher rates	gain over £4.93 per week
Two-earner couples (5.5 million)						
- wife earns less than £855	3,155 to 4,010	4,010	650	(12%)		gain up to £4.93 per week
- wife earns between £855 and £2,005	4,010 to 5,160	4,010	1,150(1)	(21%)		lose up to £6.63 per week
- wife earns over £2,005 - couple do not elect	5,160	4,010	3,300(1)	(60%)	currently liable at basic rate	lose £6.63 per week
			200	(4%)	currently liable at higher rates	lose up to £6.63 per week
- couple elect(*)	4,010	4,010	160	(3%)		No gain or loss

(1) In addition about 100,000 married couples with joint earnings between £4,010 and £5,160 where the husband earns less than £3,155 would be brought into tax (loss up to £6.63 per week)

(*) Couples with substantial earnings find it beneficial at present to take the wife's earnings election: each spouse gets a single person's allowance and their own set of rate bands. Electing couples would not lose from a change to fully transferable allowances (and might gain from separation of the couple's investment income).

TABLE 1A

Distribution of gains and losses at existing allowance levels

(1984-85 allowance levels)

Size of gain/loss		Number of taxpayers (thousands)	Per cent
Loss	£6.63 per week	3,300	19
	less than £6.36 per week	1,450	8
No change		7,940	45
Gain	less than £4.93 per week	850	5
	£4.93 per week	4,000	22
	Over £4.93 per week	220	1
	TOTAL	17,760*	100

	thousands	per cent
Total losers	4,750	27
No change	7,940	45
Total gainers	5,070	28
TOTAL	17,760*	100

* Including 100,000 two-earner married couples brought into tax

TABLE 2

EFFECT OF FULLY TRANSFERABLE ALLOWANCES

After transition with no cash losers

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

TABLE 2A

Distribution of gains after transition with no cash losers

(1984-85 allowance levels)

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

Table 3. Distribution of taxpayers by gross income

(thousands)

Gross Income	Single		Married One-earner		Married Two-earner	
below £5,000	3,500	(45%)	400	(9%)	100	(2%)
£5,000-£10,000	3,600	(46%)	2,400	(54%)	1,600	(30%)
£10,000-£15,000	600	(7%)	1,100	(25%)	2,200	(40%)
£15,000-£20,000	100	(1%)	300	(7%)	900	(16%)
over £20,000	80	(1%)	230	(5%)	640	(12%)
TOTAL	7,800	(100%)	4,400	(100%)	5,500	(100%)

CONFIDENTIAL

Sir Phy

FROM: A J G ISAAC

THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

6 March 1985

Bd/atte (& Green Pape) below

FINANCIAL SECRETARY

SELF ASSESSMENT FOR INCOME TAX

1. Thank you for showing me the papers attached to your Private Secretary's minute of 22 February, addressed to Mr Lord.

Procedure

2. If I may say so, I welcome the suggestion that Ministers might bring into consultation John Kay and the IFS, on the wider aspects of a possible move towards "self assessment". John Kay has an able team of economists at the IFS and, as Mr Lord says, there are not many academic commentators on fiscal matters of the quality we would like to see. (I might add that that is why we in the Revenue supported the setting up of IFS and have subsequently contributed to its financing and kept closely in touch with its work.)

3. By the same token, it might be helpful if you or we could have similar informal talks with a few others, such as Roger White and John Avery Jones. "Pre-consultation" of this kind can be helpful, not only in picking up good new ideas, but also in averting misunderstandings before they become public. (As you will see from the more detailed note attached there are a few misunderstandings in John Kay's note which it would be helpful to clear out of the way - not of course on the economic aspects but on the administrative aspects where - as John Kay himself recently emphasised to me - the IFS do not make any claim to a particular expertise).

c Chancellor of the Exchequer
Chief Secretary
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Monger
Mr Cropper
Ms Seammen
Mr H J Davis

Sir Lawrence Airey
Mr Green
Mr Isaac
Mr Rogers
Mr Gracey
Mr Painter
Mr Blythe
Mr Corlett
Mr Martin
Mr Mace
Mr Hudson
PS/IR

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4. I am not sure whether you have it in mind to talk to John Kay privately or to have us join you. We are entirely at your disposal, if you would like us to be present. And you may feel that a discussion would be less demanding of your time, and more productive in outcome, than a series of commentaries on each others papers.

Substance

5. If I may now turn to the substance, John Kay's note rightly draws attention to the interconnection between a number of current initiatives and future policy options. In particular, we are now engaged in, or have on the table

- computerisation (COP, CODA, CT, Collection, integrated data network).

- Keith (Schedule D compliance, CT compliance, information powers, interest and penalties).

- Reform of personal allowances (husband and wife).

- Reform of Schedule D (abolition of the "preceeding year" basis; consequential changes for Schedules A and B).

- Non-cumulative basis for PAYE (leading to 100 per cent end of year review; other policy options).

- Self assessment.

6. A succession of recent minutes from Somerset House

have mentioned the ways in which a number of these initiatives and options are inter-related and - in particular the reform of Schedule D lies quite early on the critical path towards a system of self assessment and a simple Keith style system of Schedule D compliance and an efficient system for transfer of allowances between husband and wife. We are seeing if we can summarise this complex web of relationships in a simple and helpful way, in one paper.

7. The main thrust of John Kay's paper is on reform of PAYE. The central analysis is familiar to all of us. Our present PAYE is essentially a "non-assessment" system. It does a specific job really rather efficiently; and it succeeds in getting 5 out of 6 of its customers tax affairs right during the year, so that they are neither out of pocket during the year nor facing a tax demand after the year end. Two of three taxpayers do not have to fill in a tax return or indeed take any other action over their tax affairs; many taxpayers never see a tax return for many years at a stretch, and only a small minority need an end year assessment. This would all have to change under self assessment. But the present system is inflexible towards some kinds of policy change, making it difficult for Ministers to take up some potential options, if they so wish, without a very heavy staff cost. No system could afford the cost of handling individual taxpayers affairs before the year and during the year (like PAYE) and also after the year end.

8. In the attached note I add some comments on particular points in John Kay's note (including the staff costings, where he clearly has not stopped to check his arithmetic).

A J G I.

A J G ISAAC

PAYE REFORM AND SELF ASSESSMENT

End of year review or self assessment

1. On a fundamental point, John Kay shares our conclusion that the really important question is whether:

(a) You aim to get taxpayers affairs right during the year, or

(b) you settle for a more rough and ready deduction system during the year, and review all taxpayers affairs at the year end.

If you settle for (b), then it is to some extent a secondary question whether the end-year assessment is done by the Revenue or by the taxpayer (with a subsequent check by the Revenue - perhaps on a sample basis) John Kay goes even further than we, when he says "who does the arithmetic....is of very little* importance.

2. As you know, the Americans seem to be coming round to the same conclusion.

Prior conditions, and simplification

3. Of the main pre-conditions, before we could in practice move towards a system of end-year review and, possibly, self assessment, John Kay

- endorses the need for a more effective and automatic (non-discretionary) compliance regime (Keith); and
- notes, but naturally does not discuss, the need for computer support.

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* Our emphasis: see also paragraphs 15 and 16 below.

4. He goes on to say

> "The commonly expressed view that self assessment is only possible if the system is simplified is almost the opposite of the truth."

5. We need to be a little more precise about what we mean by "simplification".

6. First, self assessment shifts responsibility from the Revenue authorities to the individual taxpayer. It is therefore essential to simplify the tax system, in so far as it affects the work that the ordinary individual taxpayer has to do, in order to work out his tax liability. For example, we have no doubt - and as you know the management consultants whom we have employed have no doubt - that simplification of Schedule D is a prior condition for (inter alia) self assessment. If John Kay disagrees with that, we think he is wrong.

7. Second, a system of 100 per cent end-year review (with or without self assessment) requires the Revenue to have each year information about all income (employment income and investment income) of all taxpayers. John Kay is right in saying that this does allow the Revenue to do some complex things which would be very expensive if not impossible under the present system. In particular

- once the computer has to calculate tax on each taxpayer's total income there may be little additional marginal cost in incorporating complex progressive income tax rate schedules; clawback; transfers of allowances and so forth.

- Once every taxpayer has to make a tax return, there may be little additional marginal administrative cost in new allowances - for gifts to charities and so forth; however, there is an important qualification to this - see paragraph 17 below.

- Again, once the Revenue has details of all taxpayers total income, the same base can be used - if a future Government so wishes - and other taxes, such as a local income tax.

(On a point of detail, John Kay illustrates this point by reference to capital gains tax; this is a surprising example, because CGT is already handled on a basis of end year review.)

<u>Costs for taxpayers</u>

8. John Kay rightly notes that a non-cumulative system would commonly have a cost for individual taxpayers, who would have too much tax deducted during the year. He suggests that there would be a benefit for taxpayers if we (he claims, like other countries) deferred collection of underpayments until subsequent years. In practice, however, the United States insists on collecting tax underpayments on the nail.

9. John Kay rightly emphasises the importance of private sector compliance costs. However, we do not know what he can have in mind, when he suggests that private sector PAYE compliance costs for the United States are lower than here. It may be that he was thinking only of employers. And employees, however, we know that in the United States 40 per cent of taxpayers have to seek professional assistance in completing their tax returns (compared with perhaps 10 per cent here). There everyone has to complete a tax return every year; whereas here only one person in three has to complete a return in any year, and some people may have to complete a return

no more than two or three times in their working lives.* Any system of 100 per cent end year review requires the great mass of ordinary employees to take on a new job of filling in an annual tax return.

Employers costs

10. John Kay suggests that, under a non-cumulative system, the Revenue should provide each taxpayer with a "coding card", which the taxpayer should hand to his employer. This is, of course, the suggestion which we ourselves put to employers' representatives in 1971. I have to say that the employers flatly rejected this, as imposing an intolerable administrative burden upon them. The administrative cost would be higher under a system of transferable allowances between husband and wife, because of the increased number of coding changes. As you know, our present thinking is more in the direction of a US style system of "self coding". This is one of the points on which consultion with employers would be essential.

11. For the longer term future, John Kay talks of possible "smart" cards, helping with the payment of benefits. This is an obvious possibility and, as you know, the DHSS papers for Misc 111 discuss the possibility of cards being used to pay benefits through a cash dispenser in the local post office. The same technique could be attractive for payments of credit under any tax credit scheme but it would of course emphasise the extent to which such credits would be in the nature of "benefits" rather than "tax relief".

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*An IFS publication last year said that all PAYE taxpayers filled in a tax return once every 3 years. In fact we abandoned this some years ago in the interests of staff savings.

Costs for Revenue

12. Something has gone very wrong with John Kay's manpower costs. He quotes a figure of 10,000 staff for the present PAYE "movements"; the most up to date figure is about half that amount. He says that an extra one hour spent on end-year review for each PAYE taxpayer under self assessment would cost 1,250 staff; even on the most favourable basis*, the cost, as a matter of simple arithmetic, would be ten times that amount.

13. More important, John Kay over states the amount of information that the Revenue authorities either need or receive under the present system. For example, he seems to believe that we already have full information about taxpayers' total income and their marital status.

14. Under an end-year review or self assessment system John Kay says that

> "It seems self-evident that [getting a tax return from individual taxpayers] is more efficient [than getting information from the payers of income - employers, banks etc, etc]; and that [once one has a system of end of year assessment] the additional cost of universal returns would be small".

15. The first statement is very doubtful and the second certainly untrue. Getting information from the individual taxpayer means - for the foreseeable future - getting him to fill in a piece of paper; and then feeding information from that piece of paper into the computer. There are two heavy costs in this process.

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* Assuming that the one hour includes all "overhead" costs such as getting the post to the desk of the right allocation officer, typing, filing, management supervision etc.

1. It is administratively costly to handle paper and to feed information manually from paper into the computer.

2. An individual's tax return is not always the most accurate source of information about his income (The United States taxpayer compliance measurement system estimates that one-fifth of employees understate their income by $100 or more; this is a good deal better than their experience on (eg) self employed income; even os the information which they now get from payers of income enables them to correct the taxpayer's return, and demand additional tax, in some 3 million cases a year).

16. For this reason, as you know, the United States are hoping by the end of the decade to dispense with paper returns from something like two-thirds of all individual taxpayers; and assess taxpayers on the basis of information provided in computer-usable form by the income payers. The Japanese already dispense with paper returns from 90 per cent of taxpayers.

17. Even in the interim, the United States system depends heavily on simplifying the tax affairs of large numbers of small taxpayers (for whom the theoretical complexity of the US tax system - noticed in paragraph 7 above - is in practice successfully by-passed.) This is done by the Zero Bracket Amount (ZBA), which gives the invidividual a large increase in his effective tax threshold, provided he does not itemise a claim for a complex variety of special reliefs. This paves the way for the simple, machine readable, tax return 1040EZ.

<u>The Schedular System</u>

18. John Kay mentions the attractions of abolishing

the schedular system. Again, it can be helpful to be precise about what one means here. For example, the rules for taxing employment and self employment income can never be precisely the same: you cannot deduct the greengrocer's income tax when buying a pound of apples from him; nor can you apply the same expenses rule to the man who is paid to do a specific job and the man who has to make up his own mind how he wants to run his business. It does not much matter whether you can call the separate rules "Schedule E" and "Schedule D", or use some other name. The important thing is to move all the schedules on to a common basis for the year of assessment and for payment of tax. It is this which opens up the prospect of "total income assessing" in which one single assessment can comprise all the income of a taxpayer for the fiscal year and all the tax payable on it - and the possible option of eventual "self assessment".

201/2

COPY NO 1 OF 20.

PRINCIPAL PRIVATE SECRETARY

FROM: N MONCK
DATE: 7 March 1986

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Kemp (profit sharing only)
Mr Odling-Smee
Mr Scholar
Mr Culpin
Miss O'Mara
Mr Shaw
Mr G White (profit sharing only)
Mr Pratt
Mr H Davies
Mr McManus - I/R

BUDGET SPEECH: SECTION G1

... I attach amendments.

2. On profit sharing I agree with the Financial Secretry about the prominent placing. But I understand you wish to keep it here and have suggested some amendments to make it clearer that any benefits will not be short-term. I have also added a passage on the broad requirements of profit sharing agreements which would produce the benefits we are after. Mr Davies agrees that amendments of the kind I have suggested are desirable, though he has not seen the detailed text.

3. The amendments on the remaining paragraphs reflect the decisions reached yesterday. I have left the order as it was. I understand Lord Young's presentation is likely to be in terms of "enterprise, jobs and further help for the long-term unemployed".

4. Your text does not give public expenditure costs at the end of the bit about each measure, but only total figures at the end. This departs from the pattern last year but the individual figures are smaller and I assume that you want to refer only to the totals.

5. I have also assumed that some grounds for optimism about employment, irrespective of new measures, which were in the second draft of the speech ~~which~~ will either appear elsewhere or strike you as too weak. They were: the demographic improvement, the better prospect for manufacturing (and hence for people who claim benefit if unemployed) and evidence of increased labour market flexibility.

NM

N MONCK

FROM: **H J DAVIES**
DATE: 7 MARCH 1986

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Monck
Mr Scholar
Mr Culpin
Mr Cropper
Mr Lord

BUDGET SPEECH (THIRD DRAFT) : SECTIONS G TO J

I have the following comments on the draft.

G1. Help for the unemployed

(i) Page One lines 13-15. The current formulation is a bit long and rather complicated. I suggest '...ensures that British industry can hold its own against our major overseas competitors.'

(ii) Page One, second large para. I would drop 'faster than is consistent with low unemployment and' in the second sentence and put a sentence making the same point - 'It is excessive pay rises that cause companies to shed labour.' after 'British economy.' in line 9.

(iii) Page Two. I have discussed this with Mr Monck. My comments are incorporated in his.

(iv) Pages Three-Four I would promote the Enterprise Allowance Scheme in the order, since its size is to be doubled, against the more modest increase in the Community Programme. Put it first after profit sharing.

G2. Business and Enterprise

(i) Page One, line seven, drop 'finally'. At the end of the paragraph there is a problem, since on the new plan the small company rate will come down to 29p, but we do not wish to announce it as this point in the speech. I think the reference should be dropped altogether.

(ii) Page Two last paragraph. I wouldn't thank Peat's for their report. First, they were handsomely paid for it and, second, it did not seem to me to be very good. We scarcely used it in making decisions. I think one brief reference will suffice.

(iii) Page Three. There are a lot of 'I proposes' in the BES section. I suggest dropping 'And I propose to' in line 14 of the paragraph and running the two sentences together linked by 'but'.

H. Savings and Investment

(i) Page Two, lines 3 & 4. Not 'based' on a 'basis' I think. Perhaps 'based on conservative actuarial and funding principles.'

(ii) Page Three line 17. Drop 'entirely'. Same word in the sentence twice.

(iii) Page Four I think the description of the PEP is not quite right. As I understand it capital gains on disposals may be taken out free of tax after the end of the minimum holding period. Dividends would need to be reinvested for the minimum period before they can come out free of tax. The third sentence of the first complete para. does not make this entirely clear. I suggest saying '[18 months], thereafter all capital gains on disposals will be entirely free of tax. Dividends on plan shares will also be free of tax if they are reinvested within the Plan.'

HJD

H J DAVIES

RR7.17

FROM: MRS R LOMAX
DATE: 10 March 1986
REF NO:- 36J
COPY NO:- 8 OF 11

MR MUNRO - INLAND REVENUE

cc PS/Financial Secretary
Mr Cassell
Miss Noble
Mr Isaac - IR
Mr Corlett - IR
PS/IR

1 - JK
2 - R - I have also spoken to Clive.
3 - Pup.
Rs 10/3

PERSONAL PENSIONS: LETTER TO MR FOWLER

The Chancellor was grateful for your minute of 7 March. He agrees with your advice, and has dispatched a slightly amended version of the draft letter you provided to Mr Fowler.

2. He would be grateful for the Financial Secretary's view on whether action against certain forms of loanbacks (eg. pension mortgages) will be on for 1987.

3. The Chancellor has also suggested that the passage on personal pensions in the Budget speech should be beefed up, mentioning consultation, and giving evidence of positive enthusiasm for personal pensions. I would be grateful if Mr Corlett would submit a further draft by close on Tuesday 11 March.

Rs.

pp RACHEL LOMAX

BUDGET CONFIDENTIAL

FROM: P WYNN OWEN
DATE: 10 MARCH 1986

MR CAYLEY - IR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Mr Monger
Mr Cropper
Mr Lord
PS/IR
Mr Battishill - IR
Mr Taylor Thompson - IR

VICTIMS OF NAZI PERSECUTION; FOREIGN DIVIDENDS: BUDGET DAY PRESS RELEASES

The Chancellor has seen your minute of 25 February to the Financial Secretary and Ms Life's minute of 28 February. He would be grateful if you could use "Nazi" rather than "National Socialist" throughout the text of the Press Release.

Rwo.

P WYNN OWEN

BUDGET SECRET

FROM: MRS R LOMAX
DATE: 10 March 1986 PN

REF NO 30J

COPY NO 42 OF 43

MR SCHOLAR

cc Index plus Sections A-F, K, L

Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr F E R Butler
Sir G Littler
Mr Cassell
Mr Monck
Mr A Wilson
Mr H P Evans
Mr Monger
Mr Odling-Smee
Mr Culpin
Miss O'Mara
Mr Pratt
Mr Cropper
Mr Lord
Mr H Davies
Sir L Airey (IR)
Mr Isaac (IR)
PS/IR
Sir A Fraser (C&E)
Mr Knox (C&E)
PS/C&E

cc Section C only

Mr Robson
Mr Haache

Sections B, C and D only

Mr Peretz
Mr C Kelly
Mr Riley
Mr Walsh

Section E only

Mr Turnbull
Miss Peirson
Mr Riley

Section F only

Mr Shaw

Section K only

Miss Sinclair
Mr Lewis (IR)
Mr Mace (IR)
Mr McManus (IR)

BUDGET SPEECH (THIRD DRAFT): SECTIONS A-F, K, L

The Chancellor has now worked on the remaining sections of the Budget Speech (Sections A-E, K, L) and amended the section on Help for the Unemployed (now Section F) in the light of comments received on Friday.

2. I should be grateful if the following people would be responsible for checking and co-ordinating factual comments on the following sections:-

Section B (the economic background):	Mr Evans
Section C (oil):	Mr Evans
Section D (monetary policy):	Mr Cassell

CHANCELLOR OF THE EXCHEQUER

Section E (public sector borrowing): Mr Cassell
Section F (help for the unemployed): Mr Monck
Section K (income tax): Mr Monger

All other comments should come direct to this office.

3. Could I please have all comments, in writing, by close of play on Tuesday 11 March.

RL

RACHEL LOMAX

1986 BUDGET SPEECH

Index

A. Introduction

This year's Budget has inevitably had to be framed in the unprecedented context of a dramatic fall in the world oil price.

But the Government's objectives remain unchanged: the conquest of inflation and the creation of an enterprise culutre.

Not least because this is the only route to more jobs.

So my Budget today will carry forward the themes of my two previous Budgets, and sow some seeds for the future.

But first let me record a word of appreciation to the staff of the Inland Revenue and Customs and Excise, who have to cope each year with implementing the tax changes in the Budget and Finance Bill.

People in both Departments are currently under heavy pressure of work, particularly those who are also adapting to reorganisation and change.

Their hard work should not go unrecognised, and the House will, I know, join me in thanking them.

In the course of my speech I shall begin by reviewing the general economic background to the Budget, and go on to deal with the specific issue of oil.

I shall then discuss monetary policy and the fisal prospect, both this year and next.

I shall then turn to the question of direct help for the unemployed.

Finally, I shall propose some changes in taxation designed to assist in achieving the economic objectives I have already outlined.

As usual, a number of press releases, filling out the details of my proposals, will be available from the Vote Office as soon as I have sat down.

B. The Economic Background

I start with the economic background.

The strength and durability of the current economic upswing continues to confound most of the commentators.

We can now look back to very nearly five years of growth at around 3 per cent a year.

Even more important, 1985 was the third successive year in which we secured the elusive combination of steady growth and low inflation - the first time this has been achieved since [the 1960's].

During 1985 as a whole, output grew by a further 3½ per cent, the highest rate of growth in the European Community, and higher than the United States, too.

Within that total non-oil exports grew by x per cent, to reach yet another all-time record.

Despite a marked slowdown in the growth of world trade from the heady pace of 1984, the current account of the balance of payments was in surplus for the sixth year in succession - this time by some £3 billion.

Inflation ended the year at around 5½ per cent and falling.

Employment continued to rise, though still not fast enough to reduce the appallingly high number of people out of work.

I shall have more to say about that later.

Manufacturing industry, the subject of so much ill-informed comment, had another successful year, with its output up by 3 per cent, its productivity by 4 per cent, its investment by 5 per cent, and its exports by 6 per cent.

As the London Business School recently observed, looking at Britain's performance over the past six years as a whole, "There has been no previous five year period in history over which manufacturing industry has been so successful in holding its market share, and in keeping pace with world output".

At the heart of this success lies a remarkable turn-around in productivity.

In the six years prior to 1979, Britain's annual rate of growth of manufacturing productivity, at 1 per cent, was the lowest of all the major industrial nations.

In the six years since 1979, our annual rate of growth of manufacturing productivity, at $4\frac{3}{4}$ (CHECK) per cent, has been second only to that of Japan.

Looking ahead, I expect 1986 to be a further year of steady growth with low inflation.

Indeed, with output forecast to rise by 3 per cent, and inflation to fall to 4 per cent, 1986 is set to register our best overall performance for a generation.

The pattern of growth should also show a satisfactory balance, with exports and investment expected to grow rather faster than consumer spending - as indeed they have during the sustained upswing as a whole.

But the uncertainties inherent in all these forecasts, good though their track record has been, is reinforced by constant reminders that we live in an uncertain and turbulent world.

One particular difficult aspect of this is the febrile and volatile nature of the world currency markets.

There has been some improvement here.

The so-called Plaza Agreement between the Group of Five Finance Ministers last September has undoubtedly led to a more sustainable pattern of exchange rates worldwide.

Since Plaza, the dollar has fallen by some (16) per cent against the other major currencies as a whole, with the pound moving up by (6) per cent, the Deutschemark by (24) per cent and the Yen by (34) per cent - an outcome very much in line with what those of us who were party to the agreement intended.

This process will be assisted further if the passage of the Gramm-Rudman amendment succeeds in securing its objective of a much-needed reduction in the United States budget deficit.

Meanwhile, the Plaza Agreement has already succeeded in reducing, at least for the time being, the dangerous protectionist pressures that were building up in the United States.

Provided we are not over-ambitious, I believe that the Plaza accord is something we can usefully build on.

But the most dramatic development on the world economic scene, and one of considerable importance to this country, has of course been the collapse in the price of oil.

It is to that I now turn.

C. Oil

I presented my Budget last year at the end of a 12-month coal strike.

I observed at the time that it was a remarkable tribute to the underlying strength of the British economy that it had been able to withstand so long and damaging a strike in such good shape.

We now have to face a challenge of a very different kind.

Since the turn of the year the price of oil has almost halved, and with it our North Sea oil tax revenues and earnings from oil exports.

Not surprisingly, perhaps, this initially caused a fair amount of turmoil in the financial markets, with sterling falling by some 6 per cent.

I decided to respond with an immediate one per cent rise in short term interest rates in early January, but to resist the for a time very strong, but to my mind unjustified, pressure to raise them still further.

That pressure now appears to have subsided.

There has been some speculation that the turbulence in the oil market, which from time to time has fed through into the financial markets, has been deliberately exacerbated by some leading OPEC countries in an attempt to scare the United Kingdom into cutting back its own oil production and thus, in effect, becoming a country member of the cartel.

It has even been suggested that the decision to hold a meeting of OPEC Ministers to coincide with today's Budget is part of that same process.

I have to say that, if any such tactics are indeed being employed, those employing them are wasting their time.

There is no question whatever, and never has been any question, of the UK cutting back its oil production in order to secure a higher oil price.

In the first place, the whole outstanding success of the North Sea has been based on the fact that it is the freest oil province in the world, in which decisions on levels of output are a matter for the companies and not for the Government.

And in the second place, we are not only a major oil producer; we are also a major oil consumer: there is no UK national interest in keeping oil prices high.

I am aware that a recent Report, which attracted a certain amount of publicity at the time, predicted that

> "as the oil revenues diminish the country will experience adverse effects which will worsen with time"

of a most alarming nature.

Had the authors of that Report known at the time that half the oil revenues would disappear within a matter of months, their conclusions would no doubt have been even more apocalyptic.

As the House knows, I believe their analysis to have been profoundly mistaken.

But certainly it is going to be put to the test sooner than anyone expected.

The United Kingdom is likely to remain an oil producer, of a gradually diminishing volume of oil, for the next 25 years or so.

If we can survive unscathed the loss of half our North Sea oil revenues in less than 25 weeks, then the prospective loss of the other half over the remainder of the next 25 years should not cause us undue concern.

It is, of course, true that in relative terms we do lose from the collapse of the oil price.

That is to say, the really big gains will be made by the major non-oil-producing countries such as Germany and Japan, where growth will be boosted and inflation, already low, is likely to fall virtually to zero.

But the oil price fall will be beneficial for the industrialised world as a whole, and even for the United Kingdom the gains will at least offset the losses.

To be precise, I expect that the levels of economic activity and inflation will not be very different from what they would have been without the oil price collapse.

If anything, they will be slighly better.

And what of the balance of payments?

Thanks to the abolition of exchange control in 1979, we have been able to use a good part of our earnings from North Sea oil since then to build up a massive stock of overseas assets.

Our net overseas assets have in fact risen from £12 billion at the end of 1979 to almost £100 million at the end of last year.

This is a far bigger total than any other country in the world, with the inevitable exception of Japan.

The earnings from those assets will be of increasing value to our balance of payments in the years ahead.

So, too, should be an improvement in our manufacturing trade balance.

For while the British economy as a whole may do only a little better than break even as a result of the oil price collapse, there will be considerable differences within the economy.

And the major gainer will be manufacturing industry, which is already benefiting from both lower oil prices and a lower exchange rate against its major competitors.

This provides British manufacturing industry with an outstanding opportunity both to increase its exports and reduce import penetration in the home market.

It has no excuse for not seizing that unique opportunity.

But it will only be able to do so if it is capable of controlling its labour costs.

Both the opporunity, and the responsibility to see that it is not thrown away, rest fairly and squarely on the shoulders of British management.

Meanwhile, despite the massive fall in oil prices, I expect the current account of the balance of payments to remain in sizeable surplus this year, by some £4 billion.

If manufacturing industry is the main gainer from the halving of the oil price, the main loser is the Chancellor of the Exchequer.

Clearly, what is good for the British economy is not always good for the Chancellor.

I can live with that.

But it does mean that North Sea oil revenues, which totalled £12 billion last year, 1984-85, and are likely to amount to £11 billion this year, 1985-86, are expected to plummet to £6 billion next year, 1986-87 and perhaps some £4 billion in 1987-88.

(CHECK ALL FIGS)

A loss of £5 billion between this year and next.

This has obvious implications for the Budget.

But the important fact is that we have been able to take the unprecedented collapse in the oil price in our stride.

We have been able to so, first, because of the underlying strength of the economy in terms of growth, inflation and the external account.

And, second, by virtue of the reputation we have earned over seven years for sound and prudent financial management.

D. Monetary Policy

The framework within which that sound and prudent financial management has been pursued, and will continue to be pursued, is the Government's Medium Term Financial Strategy.

As usual, I am extending it forward a year.

At the heart of the MTFS lies the objective of steadily reducing the growth of total spending power in the economy, as measured by GDP in cash terms, over a period of years, at a pace that will gradually squeeze inflation out of the system while at the same time leaving adequate room for real growth.

Within the MTFS, the central role is played by monetary policy, for it is above all by controlling the growth of money in the economy that the Government is able to influence the growth of money GDP.

Last year I set target ranges of 3 to 7 per cent for narrow money and 5 to 9 per cent for broad money, or liquidity.

Over the 12 months to mid-February, the targeted measure of narrow money, MO, grew towards the bottom of its range, but that of broad money, £M3, at well above the top of its range.

In my speech at the Mansion House last October, I explained why this was so, and how monetary policy would henceforth be conducted.

Consistent with that, I shall be retaining the same two target aggregates for next year.

For narrow money, the target range for 1986-87 will be that indicated in last year's MTFS, namely 2 to 6 per cent.

For broad money it will be 11 to 15 per cent.

This reflects the well-established demand, at a time of low inflation and significantly positive real interest rates, to hold a higher proportion of savings in liquid form.

It is thus wholly consistent with a further decline in inflation, which it is the Government's firm intention to achieve.

In operating policy, it will of course continue to be necessary to have regard to a range of other evidence about monetary conditions, of which the most important is the exchange rate.

The only effective instrument of monetary policy is the level of short-term interest rates.

There is thus necessarily some difference in status between the targets for narrow and broad money.

Further details are given in the Red Book.

The House will, I know, be glad to learn that that is all I propose to say about monetary policy today - except to repeat what I said at the Mansion House, that the acid test of moentary poilicy is its success in reducing inflation.

The proof of the pudding is in the eating.

I shall be giving a fuller exposition of the Government's monetary policy, and how it is conducted, at an early date.

[Consider "standard" insert on interest rates and pay, as explanation (in part) of why ours are so high]

E. Public Sector Borrowing

Monetary policy must always be supported by an appropriate fiscal policy.

That means, in plain English, keeping public sector borrowing low.

The outturn for the public sector borrowing requirement in 1984-85, which had to bear the bulk of the cost of resisting the coal strike, was (£10 billion), or just over 3 per cent of GDP.

(CHECK ALL FIGS)

In my Budget last year I planned to reduce it substantially in 1985-86, to £7 billion, or 2 per cent of GDP.

In the event, despite the loss of £2 billion of North Sea oil revenue, this year's PSBR looks like turning out at a little under £7 billion.

This successful outcome, which represents this first substantial reduction in the PSBR as a proportion of GDP since 1981-82, is attributable to two factors.

First, public expenditure has been kept under firm control.

Not only is the outturn likely to be well within the planning total, but 1985-86 will mark the first year in which public spending has fallen in real terms since (DATE).

And the second factor behind the successful PSBR outturn for 1985-86 is that the £2 billion shortfall in oil revenues has been more or less fully offset by the increased buoyancy of non-oil revenues, reflecting a healthy economy and an increasingly profitable corporate sector.

The buoyancy of non-oil tax revneues is likely, on the forecast of the economy I have already given, to continue in 1986-87.

What is harder to assess at the present time is the likely outturn for oil revenues, depending as it does on the average price of North Sea oil over the coming year.

The figure of £6 billion which I mentioned earlier is based on an average price of \$15 a barrel.

This is close to the average price over the past month of \$xx a barrel.

Last year's MTFS indicated a PSBR for 1986-87 of £7½ billion, or 2 per cent of GDP.

Some would argue that, in the light of the significant increase in projected privatisation proceeds, I ought to aim well below that.

Others would claim that, since the sharp drop in oil revenues far exceeds the rise in privatisation proceeds, a higher figure would be appropriate.

As last year, my judgement is that the wisest course is to stick broadly to our pre-announced figure.

But given the uncertainties over the oil price, I have decided, within that framework, to err on the side of caution, and provide for a PSBR of £7 billion, or $1\frac{3}{4}$ per cent of GDP.

Needless to say, this does not enable me to reduce taxation on anything like the scale foreshadowed in last year's MTFS.

Indeed, given the £5 billion loss of oil revenues I would have had to increase taxes in this year's Budget had it not been for our success in restraining public expenditure coupled with the continued vigour of the non-North Sea economy.

As it is, I am able this year to accommodate a relatively modest net reduction in the burden of taxation, of a little under £1 billion.

F. Help for the unemployed

I turn first to the continuing problem of high unemployment.

It is a problem that can be solved - and there is no secret about how.

The solution to the problem of unemployment - and it is the only solution - requires progress on two key fronts.

The first is a sustained improvement in the performance of business and industry, and thus of the economy as a whole.

That is what every aspect of the Government's economic policy has been designed to assist, and it is already achieving impressive results.

The second is a level of pay which enables workers to be priced into jobs instead of pricing them <u>out</u> of jobs, and which in particular ensures that British industry can hold its own against our major industrial competitors.

It is here that Britain's failure lies.

For the plain fact is that labour costs per unit of output in British business and industry continue to rise faster than is consistent with low unemployment and faster than our principal competitors overseas.

Productivity is, indeed, rising quite rapidly.

But pay is rising faster still.

It is this - and not our alleged dependence on oil - that constitutes the Achilles heel of the British economy.

And I have to say that, in a free economy, the responsibility for putting this right lies fairly and squarely on the shoulders of British management.

For - as the CBI has frankly and commendably acknowledged - it is the responsibility of employers and management to control industry's cost structure in general and its wage costs in particular.

In the new and improved climate of industrial relations, and with inflation falling and set to fall further, there can be no excuse for failure to discharge that responsibility.

I have, however, considered whether there is anything further Government can do to assist this over the longer term.

The problem we face in this country is not just the level of pay in relation to productivity, but also the rigidity of the pay system.

If the only element of flexibility is in the numbers of people employed, then redundancies are inevitably more likely to occur. One way out of this might be to move to a system in which a significant proportion of an employee's remuneration depends directly on the company's profitability per person employed.

This would not only give the workforce a more direct personal interest in their company's success.

It would also mean that, when business is slack, companies would be under less pressure to lay men off; and they would in general be keener to take men on than to pay costs were fixed, irrespective of company profitability.

The development of profit-sharing agreements of this kind is clearly in industry's own interest, and most emphatically in the best interest of the unemployed.

It may well occur without any prompting from Government.

But I recognise that there is a great deal of inertia to overcome.

It might, therefore, make sense to offer some temporary measure of tax relief to the employees concerned to help get profit sharing agreements of the right kind off the ground, and to secure the benefits they could eventually bring if they really caught on.

The broad characteristics of such agreements are clear.

As I have already said, a significant share of employees' remuneration needs to vary with profit per person employed.

The agreements need to cover the great majority of employees in a business or profit centre.

And of course employees must not restrict the scope for employers to take on more labour.

But the operation of such a relief, and the precise definition of qualifying agreements, is a matter of some complexity.

I am keenly aware of the practical difficulties.

The Government therefore proposes to discuss with employers and others to see if a workable scheme can be defined which offers the prospect of a worthwhile and broadly-based take up.

If these preliminary discussions produce a sufficiently encouraging response, we would then propose to embark on wider consultation based on a consultative document setting out a detailed scheme for consideration.

The earliest opportunity for legislation would be next year's Finance Bill.

Meanwhile, there is more we can do of an immediate nature to help the unemployed.

In my Budget last year I announced the Government's intention to launch a new two-year Youth Training Scheme, leading to a recognised vocational qualification.

The new and expanded YTS will duly come into operation next month.

It will be a giant step towards our objective of ensuring that no youngster under the age of 18 need be unemployed.

I also announced in last year's Budget a substantial expansion of the Community Programme to help the long-term unemployed - those who have been out of work for over a year, or, in the case of those between 18 and 24, for more than six months.

The Community Programme, which offers work for up to a year on projects of benefit to the community, is currently providing almost 200,000 places.

I have agreed with my Rt. Hon. and Noble Friend the Secretary of State for Employment to provide the funds to raise the eventual target for this year to 250,000 places.

At the same time, the average wage limit for the Community Programme will be raised to £67 a week as from next month.

Last November my Rt. Hon. and Noble Friend announced two new pilot schemes to provide further help for the long-term unemployed. These new initiatives, which began in January, are a counselling scheme open to all the long-term unemployed in the pilot areas, and the Jobstart scheme, which provides a grant of £20 a week for six months for those long-term unemployed who take a job at less than £80 a week. The pilot schemes are already proving effective, and I have accordingly decided to provide the funds to extend both these imaginative new initiatives nationwide.

This means that every single one of the long-term unemployed throughout the country will be called to interviews to be helped in finding a job.

I shall also be providing the resources to launch a new scheme - the New Workers Scheme - to help 18-20 year olds to find a job.

This will provide for a payment of £15 a week for a year to any employer taking on an 18 or 19 year old at not more than £55 a week or a 20 year old at not more than £65 a week.

The New Workers Scheme should provide a worthwhile incentive for employers to create jobs for young people.

Finally, I have agreed to a substantial enlargement of the proven and highly successful Enterprise Allowance Scheme, which makes payments of £40 a week for up to a year to assist unemployed men and women to set up in business on their own account.

Funds will be provided that will enable the annual rate of entry to the Enterprise Allowance Scheme to be increased from its present rate of 64,000 to 100,000 by April 1987.

At the same time I propose to improve the tax treatment of payments made under this scheme.

The total public expenditure costs of the measures I have outlined comes to £195 million in 1986-87 and £290 million in 1987-88.

These gross costs will, however be partly offset by savings on social security benefits, leaving a net public expenditure cost of £100 million in 1986-87 and £165 million in 1987-88.

These sums will be financed from the Reserve, and there will therefore be no overall addition to planned public spending.

K. Income Tax

Finally, I turn to income tax.

In my Budget speech last year I undertook to issue a Green Paper on the reform of personal taxation.

As the House is aware, I am publishing the Green Paper today.

It discusses a range of options which will in due course be opened up by the computerisation of PAYE, from the relationship between income tax and employees' national insurance contributions to closer integration of the tax and benefit system.

In particular, however, it outlines a possible reform of the present system of personal allowances.

The responses to my predecessor's 1980 Green Paper revealed widespread dissatisfaction with the existing arrangements, but - inevitably - no clear consensus as to what should replace them.

Married women increasingly resent the fact that a wife's income is treated for tax purposes as that of her husband, depriving her of the independence and privacy she has a right to expect.

There is growing complaint, too, of the way in which, in a number of respects, the present system penalises marriage itself.

And it cannot be right that the tax system should come down hardest on a married couple just at the time when the wife stops work to start a family.

Yet that it what happens at the present time.

The alternative system set out in the Green Paper, of independent taxation with allowances transferable between husband and wife, would remedy all these defects.

To be acceptable, however, it would need to be accompanied by a substantial increase in the basic tax threshold.

The Government is committed to reducing the burden of income tax, and the proposal in the Green Paper suggests one way of doing that which would achieve a number of other worthwhile objectives - including the ability to take more people out of the unemployment and proverty traps for a given amount of tax relief than is possible under the present tax system.

Given the timetable of computerisation, none of this could possibly be implemented until the 1990s.

But we need to start planning for the 1990s today.

The Government will therefore carefully consider the responses to today's Green Paper before taking any decision on how to proceed.

Meanwhile, I have to set the tax rates and thresholds for the coming year.

But first I have two minor proposals to announce, both of which I hope the House will welcome.

First pensions paid by the German and Austrian Governments to victims of Nazi persecution are free of tax in both Germany and Austria.

In this country, however, the tax relief on such pensions is set at 50 per cent.

In future, I propose that pensions paid to victims of Nazi persecution should, here as in Germany and Austria, be free of tax altogether.

Second, the House will be aware that, as from next year, social security benefit upratings will be moved to April, to coincide with the tax year.

To bridge the gap between the November 1985 and April 1987 upratings my Rt Hon friend the Secretary of State for Social Services proposes to have a special transitional uprating in July, the details of which he has recently announced.

The increases have been widely criticised as derisory.

I wholly reject that allegation.

They are fully in line with the rise in the cost of living over the relevant period; and to suggest that pensioners and others would sooner have high inflation and high upratings than low inflation and correspondingly low upratings is sheer poppycock.

But I do accept that it could be confusing for many old-age pensioners and widows in particular to undergo a further mid-year tax recoding.

I have therefore decided that, for pensioners and widows, the benefit increases payable in July will be exempt from income tax in 1986-87.

The cost of this will be £15 million.

Since we first took office in 1979, we have cut the basic rate of income tax from 33 per cent to 30 per cent and sharply reduced the penal higher rates we inherited from Labour.

We have increased the main tax thresholds by some 20 per cent more than inflation - and 12 per cent of that 20 per cent has been achieved during the present Parliament.

It is a good record, but it is not good enough.

The burden of income tax is still too great.

Noting could be further from the truth than the claim that we have a choice between cutting tax and cutting unemployment.

The two go hand in hand.

It is no accident that the two most successful economies in the world, both overall and specifically in terms of job creation, the United States and Japan, have the lowest level of tax as a proportion of GDP.

Reductions in taxation motivate new businesses and improve incentives at work.

They are a principal engine of the enterprise culture, on which our future prosperity and employment opportunities depend.

The case for higher tax thresholds is well understood.

In my two previous Budgets I have raised the married man's allowance to its highest level in real terms since the war, and higher as a proportion of average earnings than in either Germany or the United States.

But we should not overlook the need for rdeductions in the basic rate of tax, too - which is also the starting rate of tax.

The basic rate of tax is the crucially important marginal rate of tax for 95 per cent of all employees and over 90 per cent of all self-employed and unincorporated businesses.

Clearly, given the massive fall in oil revenues, this is not a year for substantial reductions in income tax of any kind.

But provided the economy continues to grow as it has been, and provided we continue to maintain firm control of public expenditure, the scope should be there in the years ahead.

Meanwhile, I propose for 1986-87 to raise all the main thresholds and allowances by the statutory indexation figure of 5.7 per cent.

The single person's allowance will therefore rise by £130 to £2,335 and the married man's allowance by £200 to £3,655.

Similarly, the single age allowance will rise by £160 to £2,850 and the married age allowance by £250 to £4,505.

The age allowance income limit becomes £9,400. (CHECK)

I propose to raise all the higher rate thresholds by exactly £1,000.

Thus the first higher rate of 40 per cent will be reached at a taxable income of £17,200, in line with statutory indexation, and the top rate of 60 per cent will apply to taxable income above £41,200 - some £x,yoo less than statutory indexation.

I now turn to the basic rate.

Given the very limited scope this year, I can do no more than reduce it by a penny, from 30 per cent to 29 per cent.

But this still represents the first cut in the basic rate of income tax since 1979.

And so long as this Government remains in office, it will not be the last.

I also propose a corresponding cut in the small companies' rate of Corporation Tax from 30 per cent to 29 per cent.

The combined effect of the various income tax changes I have just announced is to concentrate the benefit, modest as I readily concede it to be, on those in the middle, who have benefited least from the tax changes we have been able to make so far.

Thus the gain for those at the top of the income scale is more or less confined to what they would have received under simple indexation alone.

By contrast, the married man on average earnings will be some £2.60 a week better off, an improvement of £1.45 a week over simple indexation alone.

The income tax changes I have announced today will take effect under PAYE on the first pay day after 17 May.

Their cost is considerable: some £2 billion in 1986-87, of which over half represents the cost of indexation.

Seven years ago, when my predecessor cut the basic rate of income tax to 30 per cent, he added:

> "Our long-term aim should surely be to reduce the basic rate of income tax to no more than 25 per cent."

I share that aim.

L. Conclusion

In this Budget, Mr Deputy Speaker, I have reaffirmed the prudent policies that have brought us three successive years of steady growth with low inflation, and the prospect of a fourth ahead of us.

I have described how we can take in our stride the dramatic collapse in the oil price, and benefit from its consequences.

In collaboration with my rt hon and Noble Friend the Secretary of State for Employment, I have announced a further substantial battery of measures to help the unemployed.

I have proposed a radical and far-reaching new scheme for tax-free investment in equities, so that we may truly become a share-owning democracy, and abolished outright a fourth tax.

I have announced the most substantial package of assistance to charitable giving ever, and proposed the first cut in the basic rate of income tax for seven years.

Building as it does on the achievements of the recent past, this Budget is a safeguard for the present and a springboard for the future.

I commend it to the House.

Gl. **Help for the unemployed**

I turn first to the continuing problem of high unemployment.

It is a problem that can be solved - and there is no secret about how.

The solution to the problem of unemployment - and it is the only solution - requires progress on two key fronts.

The first is a steady improvement in the performance of business and industry, and thus of the economy as a whole.

That is what every aspect of the Government's economic policy has been designed to assist, and it is already achieving impressive results.

The second is a level of pay which enables men to be priced into jobs instead of pricing them out of work, and which in particular ensures that labour costs per unit of output in British industry at the very least rise no faster than those of our major overseas competitors.

It is here that our failure as a nation lies.

For the plain fact is that labour costs per unit of output in British business and industry continue to rise faster than is consistent with low unemployment and faster than our principal competitors overseas.

Productivity is, indeed, rising quite rapidly.

But pay is rising faster still.

It is this - and not oil - that constitutes the Achilles heel of the British economy.

And I have to say that, in a free economy, the responsibility for putting this right lies fairly and squarely on the shoulders of British management.

For - as the CBI has frankly and commendably acknowledged - it is the responsibility of employers and management to control industry's cost structure in general and its wage costs in particular.

I have, however, considered whether there is anything further Government can do to assist this.

The problem we face in this country is not just the level of pay in relation to productivity, but also the rigidity of the pay system.

If the only element of flexibility is in the numbers of people employed, then redundancies are inevitably more likely to occur. One way out of this is to move to a system in which a significant proportion of an employee's remuneration depends directly on the company's profitability per person employed.

This will not only give the workforce a more direct personal interest in their company's success.

It also means that, when business is slack, companies will be under less pressure to lay men off; and they will at all times be keener to take men on, since the immediate cost is less and will build up only as the company's profits improve.

The development of profit-sharing agreements of this kind is clearly in industry's own interest, and most emphatically in the best interest of the unemployed.

It ought to occur without any prompting from Government.

But I recognise that there is a great deal of inertia to overcome.

It might, therefore, make sense to offer some temporary measure of tax relief to the employees concerned in order to help get profit sharing agreements of the right kind off the ground.

The operation of such a relief, and the precise definition of qualifying agreements, is a matter of some complexity.

I am keenly aware of the practical difficulties.

The Government therefore proposes to embark on discussions with employers and other to see if a workable scheme can be defined which offers the prospect of a worthwhile and broadly-based take up.

If these preliminary discussions produce a sufficiently encouraging response, we would then propose to embark on wider consultation based on a consultative document setting out a precise scheme.

The earliest opportunity for legislation would be next year's Finance Bill.

Meanwhile, there is more we can do of an immediate nature to help the unemployed.

In my Budget last year I announced the Government's intention to launch a new two-year Youth Training Scheme, leading to a recognised qualification.

The new and expanded YTS will duly be launched next month.

It will mean that no youngster under the age of 18 need be unemployed. ((CHECK WHAT I SAID LAST YEAR))

I also announced in last year's Budget a substantial expansion of the Community Programme to help the long-term unemployed - those who have been out of work for over a year, unless they are between 18 and 24, when they qualify if they have been out of work for more than six months.

The Community Programme, which offers work for up to a year on projects of benefit to the community, is currently providing almost 200,000 places.

I have agreed with my Rt. Hon. and Noble Friend the Secretary of State for Employment to provide the funds to continue the expansion of the Community programme, so that it will be providing 250,000 places by the end of this year.

Last November my Rt. Hon. and Noble Friend announced two new pilot schemes to provide further help for the long-term unemployed. These new initiatives, which began in January, are a counselling scheme open to all the long-term unemployed in the pilot areas, and the Jobstart scheme, which provides a grant of

£20 a week for those long-term unemployed prepared to take a job at less than £80 a week. The pilot schemes have already proved their worth, and I have accordingly agreed with my Rt. Hon. and Noble Friend to provide the funds to extend both these new initiatives nationwide.

I have also agreed to provide the resources to launch a new scheme - the New Workers Scheme - to help 18-20 year olds to find a job. This will provide for a payment of £15 a week to any employer taking on an 18 or 19 year old at not more than £55 a week or a 20 year old at not more than £65 a week.

Finally, I have agreed to a substantial enlargement of the proven and highly successful Enterprise Allowance Scheme, which makes payments of £40 a week for up to a year to assist those among the unemployed who set up in business on their own account.

Funds will be provided that will enable the annual rate of entry to the Enterprise Allowance Scheme to be doubled from its present rate of 64,000 to 130,000 by next January.

At the same time I propose to mitigate the tax treatment of payments made under this scheme.

The total public expenditure costs of the measures I have outlined comes to £200 million in 1986-87 and £350 million in 1987-88.

These gross costs will, however be partly offset by savings on social security benefits, leaving a net public expenditure cost of £105 million in 1986-87 and £210 million in 1987-88.

These sums will be financed from the Reserve, and there will therefore be no overall addition to planned public spending.

E. Public Sector Borrowing

Monetary policy must always be supported by an appropriate fiscal policy.

That means, in plain English, keeping public sector borrowing low.

The outturn for the public sector borrowing requirement in 1984-85, which had to bear the bulk of the cost of resisting the coal strike, was (£10 billion), or just over 3 per cent of GDP.

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In my Budget last year I planned to reduce it substantially in 1985-86, to £7 billion, or 2 per cent of GDP.

In the event, despite the loss of £2 billion of North Sea oil revenue, this year's PSBR looks like turning out at a little under £7 billion.

This successful outcome, which represents this first substantial reduction in the PSBR as a proportion of GDP since 1981-82, is attributable to two factors.

First, public expenditure has been kept under firm control.

Not only is the outturn likely to be well within the planning total, but 1985-86 will mark the first year in which public spending has fallen in real terms since (DATE).

And the second factor behind the successful PSBR outturn for 1985-86 is that the £2 billion shortfall in oil revenues has been more or less fully offset by the increased buoyancy of non-oil revenues, reflecting a healthy economy and an increasingly profitable corporate sector.

The buoyancy of non-oil tax revneues is likely, on the forecast of the economy I have already given, to continue in 1986-87.

What is harder to assess at the present time is the likely outturn for oil revenues, depending as it does on the average price of North Sea oil over the coming year.

(oil revenues in '86-7)

The figure of £6 billion which I mentioned earlier is based on an average price of \$15 a barrel.

This is close to the average price over the past month of \$xx a barrel.

Last year's MTFS indicated a PSBR for 1986-87 of £7½ billion, or 2 per cent of GDP.

Some would argue that, in the light of the significant increase in projected privatisation proceeds, I ought to aim well below that.

Others would claim that, since the sharp drop in oil revenues far exceeds the rise in privatisation proceeds, a higher figure would be appropriate.

As last year, my judgement is that the wisest course is to stick broadly to our pre-announced figure.

But given the uncertainties over the oil price, I have decided, within that framework, to err on the side of caution, and provide for a PSBR of £7 billion, or $1\frac{3}{4}$ per cent of GDP.

Needless to say, this does not enable me to reduce taxation on anything like the scale foreshadowed in last year's MTFS.

Indeed, given the £5 billion loss of oil revenues I would have had to increase taxes in this year's Budget had it not been for our success in restraining public expenditure coupled with the continued vigour of the non-North Sea economy.

As it is, I am able this year to accommodate a relatively modest net reduction in the burden of taxation, of a little under £1 billion.

F. Help for the unemployed

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I turn first to the continuing problem of high unemployment.

It is a problem that can be solved - and there is no secret about how.

The solution to the problem of unemployment - and it is the only solution - requires progress on two key fronts.

The first is a sustained improvement in the performance of business and industry, and thus of the economy as a whole.

That is what every aspect of the Government's economic policy has been designed to assist, and it is already achieving impressive results.

The second is a level of pay which enables workers to be priced into jobs instead of pricing them <u>out</u> of jobs, and which in particular ensures that British industry can hold its own against our major industrial competitors.

It is here that Britain's failure lies.

For the plain fact is that labour costs per unit of output in British business and industry continue to rise faster than is consistent with low unemployment and faster than our principal competitors overseas.

Productivity is, indeed, rising quite rapidly.

But pay is rising faster still.

It is this - and not our alleged dependence on oil - that constitutes the Achilles heel of the British economy.

And I have to say that, in a free economy, the responsibility for putting this right lies fairly and squarely on the shoulders of British management.

For - as the CBI has frankly and commendably acknowledged - it is the responsibility of employers and management to control industry's cost structure in general and its wage costs in particular.

In the new and improved climate of industrial relations, and with inflation falling and set to fall further, there can be no excuse for failure to discharge that responsibility.

I have, however, considered whether there is anything further Government can do to assist this over the longer term.

The problem we face in this country is not just the level of pay in relation to productivity, but also the rigidity of the pay system.

If the only element of flexibility is in the numbers of people employed, then redundancies are inevitably more likely to occur. One way out of this might be to move to a system in which a significant proportion of an employee's remuneration depends directly on the company's profitability per person employed.

This would not only give the workforce a more direct personal interest in their company's success.

It would also mean that, when business is slack, companies would be under less pressure to lay men people off; and they would in general be keener to take ~~men~~ workers on than to pay costs were fixed, irrespective of company profitability.

The development of profit-sharing agreements of this kind is clearly in industry's own interest, and most emphatically in the best interest of the unemployed.

It may well occur without any prompting from Government.

But I recognise that there is a great deal of inertia to overcome.

It might, therefore, make sense to offer some temporary measure of tax relief to the employees concerned to help get profit sharing agreements of the right kind off the ground, and to secure the benefits they could eventually bring if they really caught on.

The broad characteristics of such agreements are clear.

As I have already said, a significant share of employees' remuneration needs to vary with profit per person employed.

The agreements need to cover the great majority of employees in a business or profit centre.

And of course employees must not restrict the scope for employers to take on more labour.

But the operation of such a relief, and the precise definition of qualifying agreements, is a matter of some complexity.

I am keenly aware of the practical difficulties.

The Government therefore proposes to discuss with employers and others to see if a workable scheme can be defined which offers the prospect of a worthwhile and broadly-based take up.

If these preliminary discussions produce a sufficiently encouraging response, we would then propose to embark on wider consultation based on a consultative document setting out a detailed scheme for consideration.

The earliest opportunity for legislation would be next year's Finance Bill.

Meanwhile, there is more we can do of an immediate nature to help the unemployed.

In my Budget last year I announced the Government's intention to launch a new two-year Youth Training Scheme, leading to a recognised vocational qualification.

The new and expanded YTS will duly come into operation next month.

It will be a giant step towards our objective of ensuring that no youngster under the age of 18 need be unemployed.

I also announced in last year's Budget a substantial expansion of the Community Programme to help the long-term unemployed - those who have been out of work for over a year, or, in the case of those between 18 and 24, for more than six months.

The Community Programme, which offers work for up to a year on projects of benefit to the community, is currently providing almost 200,000 places.

I have agreed with my Rt. Hon. and Noble Friend the Secretary of State for Employment to provide the funds to raise the eventual target for this year to 250,000 places.

At the same time, the average wage limit for the Community Programme will be raised to £67 a week as from next month.

Last November my Rt. Hon. and Noble Friend announced two new pilot schemes to provide further help for the long-term unemployed. These new initiatives, which began in January, are a counselling scheme open to all the long-term unemployed in the pilot areas, and the Jobstart scheme, which provides a grant of £20 a week for six months for those long-term unemployed who take a job at less than £80 a week. The pilot schemes are already proving effective, and I have accordingly decided to provide the funds to extend both these imaginative new initiatives nationwide.

This means that every single one of the long-term unemployed throughout the country will be called to interviews to be helped in finding a job.

I shall also be providing the resources to launch a new scheme - the New Workers Scheme - to help 18-20 year olds to find a job.

This will provide for a payment of £15 a week for a year to any employer taking on an 18 or 19 year old at not more than £55 a week or a 20 year old at not more than £65 a week.

The New Workers Scheme should provide a worthwhile incentive for employers to create jobs for young people.

Finally, I have agreed to a substantial enlargement of the proven and highly successful Enterprise Allowance Scheme, which makes payments of £40 a week for up to a year to assist unemployed men and women to set up in business on their own account.

Funds will be provided that will enable the annual rate of entry to the Enterprise Allowance Scheme to be increased from its present rate of 64,000 to 100,000 by April 1987.

At the same time I propose to improve the tax treatment of payments made under this scheme.

The total public expenditure costs of the measures I have outlined comes to £195 million in 1986-87 and £290 million in 1987-88.

These gross costs will, however be partly offset by savings on social security benefits, leaving a net public expenditure cost of £100 million in 1986-87 and £165 million in 1987-88.

These sums will be financed from the Reserve, and there will therefore be no overall addition to planned public spending.

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G. Business and Enterprise

I now turn to the taxation of business and enterprise.
While the measures I have just announced help the unemployed directly, in the long run what really matters is the creation of a climate in which business and enterprise flourish.
For it is business and enterprise, not Government, who create jobs.

The new and improved system of business taxation which I introduced in my 1984 Budget is finally reaching the end of its transitional phase and comes fully into force next month.
From then on the United Kingdom will have, at 35 per cent, the lowest rate of Corporation Tax of any major industrial nation - with the small company rate even lower at 30 per cent.

This year I have only two minor amendments to make.
First, I propose to ensure a full measure of depreciation for tax purposes of short life agricultural buildings and works, by introducing balancing adjustments on the disposal or destruction of such buildings.
The change will only be made at the taxpayer's option.
Second, I propose to reform the mines and oil wells allowances broadly along the lines of the proposals published in last July's consultative document.
The overall net benefit to the industries concerned will amount to £45 million in 1987-88.
Otherwise I propose only minor technical changes to the taxation of North Sea oil; but I am continuing to keep the economics of incremental investment under review.

I need to set the 1987-88 car and fuel benefit scales for those whose employers provide them with the use of a car.
At the same time the motor industry have represented to me that the discrepancy between the engine size break points in these scales and the break points in the new European Community directive on car exhaust emissions is potentially damaging to their international competitiveness.

Accordingly I propose, from April 1987, to change our break points to those in the new directive.
At the same time, as last year, I propose to increase the (restructured) car scale by 10 per cent.
This will still leave the scale level well short of the true value of the benefit.
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.
This will be simpler and more equitable than the present system, and will also bring in an extra £40 million of revenue in 1987-88.
I propose to increase the VAT threshold to £20,500 from midnight tonight.
[Insert here brief passage on relief for o/seas travel expenses]

[I also propose to rectify an anomaly in the taxation of international entertainers and sportsmen.
When British entertainers or sportsmen work overseas, the tax authorities there normally levy a withholding tax on their earnings.
But at the present time we levy no tax on the earnings of foreign entertainers and sportsmen in the UK.
I believe that, in future, we should fall into line with most of the rest of the world.
Accordingly, I propose to introduce a withholding tax of 30 per cent - the same rate as applies in the United States - on the earnings of overseas entertainers and sportsmen in the UK. This should yield £125 million in 1987-88.]

As the House knows, I have been reviewing the future of the Business Expansion Scheme, which is due to come to an end, unless renewed, in April 1987.
I have been assisted in this review by the independent report commissioned by the Inland Revenue from the consultants Peat, Marwick and Mitchell.
I would like to thank Peat's for their very full report, which the Inland Revenue will be publishing today (CHECK).
I am placing a copy in the Library of the House.

It is quite clear - and this is confirmed by the evidence in the Peat Marwick report - that the Business Expansion Scheme, which my predecessor introduced in 1983 as an improvement on the (?) 1981 Business Start-up Scheme, has been an outstanding success.
It has fully achieved its aim of attracting new equity capital into unquoted companies.
It has been attracting well over £100 million a year, a high proportion of which has gone into new and small businesses.
Well over half the companies involved raised sums of less than £50,000 each.

I therefore have no hesitation in proposing to extend the life of the Business Expansion Scheme indefinitely.
But at the same time, despite the exclusions of farmland and property development in my two previous Budgets, I am concerned that too much BES money is being diverted from the high risk areas for which the scehme was always intended into areas where the risk is very much less.
Accordingly, I propose, from now on, to exclude from the scheme all companies holding more than half their assets in the form of land and buildings.
I also propose to exclude companies whose main purpose is to invest in objects, such as fine wines, whose value may be expected to rise over time.
And I propose to include within the ambit of the scheme companies engaged in ship chartering.
I propose to take power to make further changes in the ambit of the scheme by Order.
Finally, having taken steps to target the Business Expansion Scheme more carefully, I propose to improve it.
BES shares issued after today will be entirely free of Capital Gains Tax on their first sale.

And as a further measure of help for small and new businesses, the Loan Guarantee Scheme, under which the Government guarantees 70 per cent of qualifying bank loans, will also be extended, in this case for a further three years.
My hon Friends will be glad to learn that the premium will be reduced from 5 per cent to 3 per cent.

My last proposal in this section concerns Capital Transfer Tax, which ever since its introduction by the Labour Government in 1974 has been a thorn in the side of those owning and running unquoted family businesses, and as such has had a damaging effect on risk-taking and enterprise within a particularly important sector of the economy.
In addition to statutory indexation of the threshold and rate banks, I propose this year to reform the tax radically.

In essence, the Capital Transfer Tax is two taxes, as its two separate scales imply: an inheritance tax and a lifetime gifts tax.
We have had an inheritance tax in some shape or form ever since Lord Harcourt introduced the Estate Duty in [18??].
But the lifetime gifts tax which the Labour Government introduced in 1974, in the teeth of wholehearted Conservative opposition, is an unwelcome and unwanted impost.
By deterring lifetime giving, it has had the effect of locking in assets, particularly the ownership of family businesses, often to the detriment of the businesses concerned.

Accordingly, I propose to abolish entirely the tax on lifetime gifts to individuals.
As with the old Estate Duty, there will be a tapered charge on gifts made within seven years of death; and the regime for trusts, which is needed as a protection for the death charge, will be kept broadly unchanged.
The cost of abolishing the tax on lifetime giving will be £35 million in 1986-87 and £55 million in 1987-88.

In recognition of the radically changed nature of the tax I have decided to rename it the Inheritance Tax.
My two previous Budgets abolished three unnecessary taxes.
The abolition of the tax on lifetime gifts adds a fourth.

H. Savings and Investment

I now turn to the taxation of savings and investment.

In my 1984 Budget I introduced a major reform of the taxation of savings and investment designed to improve the direction and quality of both.

Today I propose to carry this reform further forward.

The Social Security Bill now before Parliament proposed important and far-reaching changes in pension provision, notably by encouraging the growth of personal pensions.

These changes will come into force in 1988, and accordingly I intend 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 occupational pensions.

And as I made clear last year, I have no plans to change that favourable tax treatment in any way.

But I do need to deal with the growing problem of pension fund surpluses.

The dramatic improvement in the financial climate compared with a decade ago, most notably as a result of the sharp fall in inflation, has seen many pension funds become heavily overfunded.

This presents a double problem both aspects of which the Inland Revenue is at present having to deal with through the exercise of its discretionary powers.

In the first place, excessive surpluses represent the potential abuse of a tax privilege intended to encourage the provision of pensions, and for no other purpose.

Accordingly, the Revenue uses its discretionary powers to require from time to time that surpluses be diminished.

But at the same time it is having to use those same discretionary powers to turn down many of the increasing number of requests for refunds it receives from companies which, in the 'seventies, had to top up funds which were then in deficit.

The result is an inevitably arbitrary state of affiars which is causing dissatisfaction all round.

I therefore propose to replace these discretionary arrangements with clear and objective legislation.
Standard published guidelines, based on a conservative funding and actuarial basis, will determine for tax purposes the amount of surplus in any fund.
Where that surplus is 5 per cent of total assets or less, no action will be taken.
But where the surplus is in excess of 5 per cent the fund will be required to eliminate that excess.

There are, basically, three different ways in which an excessive pension fund surplus can be reduced: by higher benefits, or lower contributions, or by a refund to the company - or, indeed, by some combination of these.
It will be entirely a matter for the trustees of the funds concerned which route is chosen.
But to the extent that the money is refunded to the company, the company will be liable to a special tax of 40 per cent of the amount refunded.
Only in this way is it possible to ensure that at least some of the tax relief previously given is recovered when money in the funds is no longer to be used for the purpose of paying benefits.
The effect of these new arrangements is likely to be a yield of £25 million in 1986-87 and £140 million in 1987-88.
The exempt amount for Capital Gains Tax in 1986-87 will be £6,300, in line with statutory indexation.

Next, Stamp Duty.
I have no change to propose in the stamp duty on houses and other property.
But despite the all-round reduction in Stamp Duty to 1 per cent which I made in my 1984 Budget, there is a formidable case this year for a further reduction in the rate of stamp duty on share transfers.
The City of London is the pre-eminent financial centre of Europe.
The £xyz million it contributes to our invisible exports is but one measure of the benefit this confers on the British economy.
But competition in financial services nowadays is not continental, but global.

The City revolution now under way, due to culminate with the ending of fixed commissions - the so-called Big Bang - on 27 October, is essential if London is to compete successfully against New York and Tokyo.

And if London cannot win a major share of the global securities market its present world pre-eminence in other financial services will be threatened.

Successful competition depends on a number of factors, but one of the most important is the level of dealing costs.

The abolition of fixed commissions will certainly help.

But with no tax at all on share transactions in New York, and roughly ½ per cent in Tokyo, London will still be vulnerable.

I therefore propose to reduce Stamp Duty on share transactions from 1 per cent to ½ per cent as from 27 October, the date of the Big Bang.

And I propose to recoup the entire cost of this by bringing into tax a range of financial transactions which are at present entirely free of Stamp Duty.

Thus in future the new ½ per cent rate of Stamp Duty will also apply to loan stock, transactions unwound within a Stock Exchange account, renounceable letters of allotment, the purchase by a company of its own shares, and takeovers and mergers.

There will also be a special rate of 3 per cent on the conversion of UK shares into American Depositary Receipts (ADRs).

Some of these changes will take effect immediately: others will be delayed until the Big Bang.

This further halving of the stamp duty on equities should enable London to compete successfully in the worldwide securities market.

It will also provide a further fillip to wider share ownership in the UK.

Just as we have made Britain a nation of home owners, it is the long-term ambition of this Government to enable the British people to become a nation of share-owners, too; to create a people's capitalism, in which more and more men and women have a direct personal stake in British business and industry.

Through employee share schemes, in which this year I propose to make a number of minor improvements, for the benefit of worker co-operatives and others, and through the massively successful privatisation programme, much progress has been made.

But not enough.

Nor, I fear, will we ever achieve our goal so long as the tax system continues to discriminate so heavily in favour of institutional investment at the expense of direct share ownership.

Accordingly, I propose to redress the balance by introducing a radical new scheme to encourage direct investment in UK equities.

With effect from 1 January 1987, anyone will be able to invest up to £200 a month, or £2,400 a year, in stocks and shares to be held in a special account known as a Personal Equity Plan.

Once the shares have been retained for a minimum period of [18 months], thereafter all dividends on the shares, and all capital gains on disposals, will be entirely free of tax, provided only that they are reinvested within the Plan.

The new Personal Equity Plans will have to be administered by authorised dealers in securities.

But it will be the investor himself who chooses what share to buy, and retains the ownership of them until such time as he chooses to sell them.

The cost of this measure will be around £25 million in 1987-88.

I am confident that this radical new scheme will, over time, bring about a dramatic extension of share ownership in Britain.

Although wholly different in structure from the Loi Monory in France, I expect it to be every bit as successful in achieving its objective.

I am sure the whole House will welcome this substantial package of measures to reform the taxation of savings and investment.

BUDGET - SECRET

I. **Charities**

I now turn to the tax treatment of charities and charitable giving.

In almost every facet of the nation's affairs it becomes increasingly clear that private action is more effective than State action.
This is particularly well illustrated by the success of charitable organisations up and down the land in the fields of education, social welfare, medicine, the arts and the heritage.
This Government has already done a great deal to assist charities, both through the tax system and in other ways.
I believe the time has come to take a further step forward.
The fundamental question is whether any further fiscal relief should be given to the charities themselves, through relief from VAT, or to the act of giving.

In the light of representations from the Charities VAT Reform Group, I am prepared this year, exceptionally, to make a number of specific concessions on this front.
I propose to relieve charities from VAT on most of their press advertising; on medicinal products where they are engaged in the treatment or care of people or animals, or in medical research; on lifts and distress alarm systems for the handicapped; on recording equipment used by charities for the blind; and on welfare vehicles used by charities to transport the deaf, blind or mentally handicapped.
The cost of these reliefs is some £10 million.

But in general I am convinced that the right way to help charities is not by relieving the charities themselves from VAT, but by encouraging the act of charitable giving.
I say this for two principal reasons.
First, it is clearly better that the amount of tax relief is related to the amount of support a charity is able to attract, rather than to the value of goods and services it happens to purchase.

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And, second, whereas a £ of VAT relief is worth precisely that, a £ of tax relief on giving is likely to generate more than a £ of income that goes to charity.
My principal proposals therefore relate directly to the act of giving to charity.

First, I propose to abolish altogether the upper limit on relief at the higher rates of income tax on charitable covenants.
At the same time I propose to act to stop the abuse of the tax system by certain sorts of private charity.

Next, companies.
It is widely believed that corporate giving to charity would be very much more generous than it is at present if tax relief did not depend on the company entering into a four-year covenant.
Accordingly, I propose to allow companies (other than close companies) to enjoy tax relief on one-off gifts to charity up to a maximum of 3 per cent of the company's annual dividend payment to its share-holders.
There will, of course, continue to be no limit on the amount a company can covenant to charity.

I do not propose to enable individuals to enjoy a similar relief for one-off donations.
Many charities have made clear to me their fear that to do this would weaken them by reducing the binding force of covenants.
Instead, I propose to encourage individual giving to charity by a different means, that of payroll giving.
From April 1987 it will be open to any employer to set up a scheme under which employees can have charitable donations of up to £100 a year deducted from their pay, and get tax relief on it.

All in all, the proposals I have announced today add up to a very substantial package of assistance to charities and charitable giving.
Their cost to the exchequer will be £xx in 1986-87 and £yy in 1987-88.
Their effect will build up over time, but the additional annual charitable giving they stimulate should be [at least twice that amount].

J. **Personal Taxes: Taxes on spending**

Finally, I turn to the taxation of spending and income.

So far as the indirect taxes are concerned, the overriding question this year is how much I should recover from the oil consumer the tax revenues I have lost from the oil producer, as a result of the massive fall in the oil price.

So far this year the price of petrol at the pump has fallen by roughly x pence a gallon.

Had the oil companies not used the collapse in the oil price to increase their profit margins, but had kept their margins unchanged, the price fall at the pump would have been around y pence a gallon by now.

There is clearly scope, therefore, for a sizeable increase in petrol tax this year, and many people have been urging me to do just that.

I have concluded, however, that at the present time, while I must certainly maintain the real value of the revenue I get from the motorist, I will not increase it.

But I do believe it makes sense to look again, in the light of the radically changed circumstances, at the relative weight of petrol tax and Vehicle Excise Duty.

Accordingly, I propose to increase the duty on petrol by an amount which, including VAT, would - if it were wholly passed on to the consumer - raise the price at the pump by sevenpence halfpenny a gallon.

This is twopence more than is needed to keep pace with inflation, and that twopence engables me to keep the real burden on the motorist unchanged by leaving Vehicle Excise Duty at last year's level of £100 for cars and light vans.

Moreover, given the fat that has accumulated in the oil companies' margins, there is clearly no need for the pump price of petrol to go up at all.

In the same way, I propose to increase the duty on derv by an amount which, including VAT, would - if it were wholly passed onto the consumer, which it should not be - raise the price at the pump by sixpence halfpenny.

This will enable me to avoid any increase this year in the Vehicle Excise Duty on lorries, too.

So far as the other oil duties are concerned, I have one or two changes to make.
Not to the duty on heavy fuel oil, which will remain unchanged as it has done since 1980.
But I propose to increase the duty on gas oil, which by European standards is very lightly taxed in this country, by a penny-halfpenny a gallon.
And I propose to abolish altogether the duties on aviation kerosene, or Avtur - which at present is taxed for domestic flights only - and on lubricating oils.
All these changes in duty will take effect from 6 o'clock this evening.

Finally, so far as oil products are concerned, I am anxious to do what I reasonably can to assist the introduction of lead-free petrol.
I have therefore decided to create a duty differential in its favour to offset its higher production costs.
My officials will be discussing with the oil companies how this can best be achieved in time for next year's Budget.

In the light of the representations I have received on health grounds, I have decided to increase the duty on cigarettes by appreciably more than is needed to keep pace with inflation.
I therefore propose an increase in the duty on cigarettes and hand-rolling tobacco by the equivalent, including VAT, of approximately elevenpence on a packet of 20 cigarettes.
This will take effect from midnight on Thursday.
As last year, I propose no increase at all on the duties on cigars and pipe tobacco.

Finally, drink.
As the House will recall, I was obliged in 1984 to increase the duty on beer by slightly more than I would have wished as a consequence of the judgement against the UK in the European Court of Justice.

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Accordingly, I propose no increase at all in the duty on beer this year - for the first time since 1979.
Nor do I propose any increase in the duties on cider, table wine, sparkling wine, fortified wine or spirits.
This last decision will, I hope, be particularly welcome in Scotland.

I now turn to Value Added Tax.
The House will, I am sure, be glad to know that I have no changes to make other than those I have already announced in relation to charities.

The changes I have announced in the excise duties will, all told, raise an extra £795 million in 1986-87, which is the exact amount needed to keep pace with inflation.
The overall impact effect on the RPI, if all the increases are fully passed on, will be one half of one per cent.
This has already been taken into account in the forecast I have given the House of 4 per cent inflation by the end of the year.

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K. Income Tax

Finally, I turn to income tax.

In my Budget speech last year I undertook to issue a Green Paper on the reform of personal taxation.

As the House is aware, I am publishing the Green Paper today.

It discusses a range of options which will in due course be opened up by the computerisation of PAYE, from the relationship between income tax and employees' national insurance contributions to closer integration of the tax and benefit system.

In particular, however, it outlines a possible reform of the present system of personal allowances.

The responses to my predecessor's 1980 Green Paper revealed widespread dissatisfaction with the existing arrangements, but - inevitably - no clear consensus as to what should replace them.

Married women increasingly resent the fact that a wife's income is treated for tax purposes as that of her husband, depriving her of the independence and privacy she has a right to expect.

There is growing complaint, too, of the way in which, in a number of respects, the present system penalises marriage itself.

And it cannot be right that the tax system should come down hardest on a married couple just at the time when the wife stops work to start a family.

Yet that it what happens at the present time.

The alternative system set out in the Green Paper, of independent taxation with allowances transferable between husband and wife, would remedy all these defects.

To be acceptable, however, it would need to be accompanied by a substantial increase in the basic tax threshold.

The Government is committed to reducing the burden of income tax, and the proposal in the Green Paper suggests one way of doing that which would achieve a number of other worthwhile objectives - including the ability to take more people out of the unemployment and proverty traps for a given amount of tax relief than is possible under the present tax system.

Given the timetable of computerisation, none of this could possibly be implemented until the 1990s.

But we need to start planning for the 1990s today.

The Government will therefore carefully consider the responses to today's Green Paper before taking any decision on how to proceed.

Meanwhile, I have to set the tax rates and thresholds for the coming year.

But first I have two minor proposals to announce, both of which I hope the House will welcome.

First pensions paid by the German and Austrian Governments to victims of Nazi persecution are free of tax in both Germany and Austria.

In this country, however, the tax relief on such pensions is set at 50 per cent.

In future, I propose that pensions paid to victims of Nazi persecution should, here as in Germany and Austria, be free of tax altogether.

Second, the House will be aware that, as from next year, social security benefit upratings will be moved to April, to coincide with the tax year.

To bridge the gap between the November 1985 and April 1987 upratings my Rt Hon friend the Secretary of State for Social Services proposes to have a special transitional uprating in July, the details of which he has recently announced.

The increases have been widely criticised as derisory.

I wholly reject that allegation.

They are fully in line with the rise in the cost of living over the relevant period; and to suggest that pensioners and others would sooner have high inflation and high upratings than low inflation and correspondingly low upratings is sheer poppycock.

But I do accept that it could be confusing for many old-age pensioners and widows in particular to undergo a further mid-year tax recoding.

I have therefore decided that, for pensioners and widows, the benefit increases payable in July will be exempt from income tax in 1986-87.

The cost of this will be £15 million.

Since we first took office in 1979, we have cut the basic rate of income tax from 33 per cent to 30 per cent and sharply reduced the penal higher rates we inherited from Labour.

We have increased the main tax thresholds by some 20 per cent more than inflation - and 12 per cent of that 20 per cent has been achieved during the present Parliament.

It is a good record, but it is not good enough.

The burden of income tax is still too great.

Noting could be further from the truth than the claim that we have a choice between cutting tax and cutting unemployment.

The two go hand in hand.

It is no accident that the two most successful economies in the world, both overall and specifically in terms of job creation, the United States and Japan, have the lowest level of tax as a proportion of GDP.

Reductions in taxation motivate new businesses and improve incentives at work.

They are a principal engine of the enterprise culture, on which our future prosperity and employment opportunities depend.

The case for higher tax thresholds is well understood.

In my two previous Budgets I have raised the married man's allowance to its highest level in real terms since the war, and higher as a proportion of average earnings than in either Germany or the United States.

But we should not overlook the need for rdeductions in the basic rate of tax, too - which is also the starting rate of tax.

The basic rate of tax is the crucially important marginal rate of tax for 95 per cent of all employees and over 90 per cent of all self-employed and unincorporated businesses.

Clearly, given the massive fall in oil revenues, this is not a year for substantial reductions in income tax of any kind.

But provided the economy continues to grow as it has been, and provided we continue to maintain firm control of public expenditure, the scope should be there in the years ahead.

Meanwhile, I propose for 1986-87 to raise all the main thresholds and allowances by the statutory indexation figure of 5.7 per cent.

The single person's allowance will therefore rise by £130 to £2,335 and the married man's allowance by £200 to £3,655.

Similarly, the single age allowance will rise by £160 to £2,850 and the married age allowance by £250 to £4,505.

The age allowance income limit becomes £9,400. (CHECK)

I propose to raise all the higher rate thresholds by exactly £1,000.

Thus the first higher rate of 40 per cent will be reached at a taxable income of £17,200, in line with statutory indexation, and the top rate of 60 per cent will apply to taxable income above £41,200 - some £x,yoo less than statutory indexation.

I now turn to the basic rate.

Given the very limited scope this year, I can do no more than reduce it by a penny, from 30 per cent to 29 per cent.

But this still represents the first cut in the basic rate of income tax since 1979.

And so long as this Government remains in office, it will not be the last.

I also propose a corresponding cut in the small companies' rate of Corporation Tax from 30 per cent to 29 per cent.

The combined effect of the various income tax changes I have just announced is to concentrate the benefit, modest as I readily concede it to be, on those in the middle, who have benefited least from the tax changes we have been able to make so far.

Thus the gain for those at the top of the income scale is more or less confined to what they would have received under simple indexation alone.

By contrast, the married man on average earnings will be some £2.60 a week better off, an improvement of £1.45 a week over simple indexation alone.

The income tax changes I have announced today will take effect under PAYE on the first pay day after 17 May.

Their cost is considerable: some £2 billion in 1986-87, of which over half represents the cost of indexation.

Seven years ago, when my predecessor cut the basic rate of income tax to 30 per cent, he added:

"Our long-term aim should surely be to reduce the basic rate of income tax to no more than 25 per cent."

I share that aim.

L. Conclusion

In this Budget, Mr Deputy Speaker, I have reaffirmed the prudent policies that have brought us three successive years of steady growth with low inflation, and the prospect of a fourth ahead of us.

I have described how we can take in our stride the dramatic collapse in the oil price, and benefit from its consequences.

In collaboration with my rt hon and Noble Friend the Secretary of State for Employment, I have announced a further substantial battery of measures to help the unemployed.

I have proposed a radical and far-reaching new scheme for tax-free investment in equities, so that we may truly become a share-owning democracy, and abolished outright a fourth tax.

I have announced the most substantial package of assistance to charitable giving ever, and proposed the first cut in the basic rate of income tax for seven years.

Building as it does on the achievements of the recent past, this Budget is a safeguard for the present and a springboard for the future.

I commend it to the House.

BUDGET CONFIDENTIAL

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

Mr Walters

Pl check with IR, FP and HE that there are no problems here: I wdnt expect there to be.

MLS 11/3

A W Kuczys Esq
Private Secretary to
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

10 March 1986

CH/EXCHEQUER
REC. 10 MAR 1986
MR SCHOLAR
PS/CST, PS/EST
SIR P MIDDLETON
MR F.E.R. BUTLER
MR MONCK
MR CASSELL
MR GILMORE
MR MONGER
MR REVOLTA
PS/IR

Dear Tony,

CHANCELLOR'S BUDGET STATEMENT

We discussed the possibility of the Chancellor including in his Budget Statement a brief reference highlighting the decision to extend BES to ship chartering. My Secretary of State suggests that the Chancellor might refer to this in the following way:-

> "I have decided to bring ~~ship chartering~~ chartering of UK-registered ships within the scope of BES. This will provide new opportunities for successful investment in both new and secondhand tonnage in the hard pressed coastal, short sea and off shore trades."

I have explained to Philip Wynn-Owen that we shall also be submitting a Press Notice, to be issued as part of the Budget pack, drawing attention to the extension of BES to ship chartering. In view of this, I do not think there is any need to take forward the possibility of a reference to shipping in the Financial Secretary's wind up speech.

I am sending a copy of this letter to Vivien Life.

Yours Sincerely,

Jon.

J CUNLIFFE
Private Secretary

BUDGET CONFIDENTIAL

BUDGET SECRET Copy No. 1 of 12

Inland Revenue

Policy Division
Somerset House

FROM: C W CORLETT
11 March 1986

PRINCIPAL PRIVATE SECRETARY

PERSONAL PENSIONS : BUDGET SPEECH

As requested in your minute yesterday. I attach a beefed-up passage on personal pensions, in the form of a revised paragraph H2.

C W CORLETT

---

cc Financial Secretary
Mr Cassell
Mr Scholar
Miss Noble
Mr Isaac
Mr Painter
Mr Munro
Mr Lusk - SFO
Mr Hinton
PS/IR
Mr Corlett

Cy

You have the annotated version of it.

We've promised to send a draft para to Fowler's office.

R

Ref No 41 J

Copy No 22 of 24

FROM: MRS R LOMAX

DATE: 11 MARCH 1986

SIR PETER MIDDLETON

cc Chief Secretary
Financial Secretary
Economic Secretary
Ministry of State
Sir T Burns
Mr F E R Butler
Mr Cassell
Mr Monck
Mr H Evans
Mr Odling-Smee
Mr Scholar
Mr Turnbull
Mr Culpin
Miss O'Mara
Miss Peirson
Mr Riley
Mr Powell
Mr Pratt
Mr H Davies

PSBR IN 1985-86 AND 1986-87

The Chancellor has seen Miss Peirson's minute of 10 March summarising the current best forecast of the PSBR in 1985-6 and 1986-7. In view of this, he has decided to publish figures for the PSBR in both years rounding to £7 billion: in unrounded terms, he would like to show £6.8 billion for 1985-86, and £7.1 billion for 1986-87. He has confirmed that the forecasts should assume oil prices of $15 a barrel.

Rl.

RACHEL LOMAX

COPY NO / of 7

FROM: A M W BATTISHILL
DATE: 11 March 1985

MRS LOMAX

cc PS/Financial Secretary
Mr Monger

Mr Painter - IR
Mr Wilmott - C&E

BUDGET SPEECH: SECTIONS H-M (FIFTH DRAFT)

I have the following points which might just squeeze within your requirement for comments of substance.

H. Tax Reform

Paragraph 23. The figure in brackets should be £155 million; and it would be better to talk of "the three reforms" (to distinguish them from the indexation of the exempt amount which is not included in that figure).

J. Business Taxation

Paragraph 2. Insert at the end of this paragraph:

> "Details of some minor matters left over for this year's Finance Bill are given in the Red Book."

This provides useful cover for a number of minor matters which are not otherwise mentioned - in particular, the £15 million cost of dealing with the date expenditure is incurred for capital allowance purposes (included within the Budget arithmetic).

Paragraph 13. The 1985-86 figure should be £30 million not £35 million.

Paragraph 23. Coupon stripping. The Chancellor is right that this was not separately identified in the scorecard though it is mentioned in the note to bondwashing (item 12). The cost in 1985-86 and in a full year is negligible. But, strictly speaking, it ought to be included in the list of minor starters. The scorecard arithmetic would not be affected.

Paragraph 24. North Sea. Is the omission of any reference to incremental investment deliberate?

Paragraph 26. VAT on imports. Mr Monger will let you have a suitable reference to Customs & Excise, after speaking to them.

K. Personal Taxation : taxes on spending

Paragraphs 10 to 12. These are on the long side and interrupt the rapid delivery of the tax sections. Tempting though it is, I wonder whether the second half of paragraph 11 and the quotation from Mr Gladstone will take many tricks either in the House or with the radio audience?

Paragraph 17. Three lines from the bottom the figures are £60 million, not £70 million and £190 million, not £195 million.

Paragraph 12. The figure in brackets should be £1½ billion (actually £1.59 billion). I am sending you a separate note on the date of the PAYE changes.

AMWB

A M W BATTISHILL

FROM: E P KEMP
11 March 1986

MR KUCZYS

cc Mr Battishill

BUDGET SPEECH - TRIBUTE TO THE STAFF

You asked me for comments on the three paragraphs towards the bottom of page 1 and the top of page 2 of the draft of the Budget speech which you showed me.

2. At the end of the day this is very much down to the Chancellor's judgment. Arguably it would be nice to recognise the hard work which Customs and Excise and Inland Revenue people undoubtedly put in to preparing and implementing Budgets. But there are three points which need to be considered going in the opposite direction, thus :-

a. The fact remains that Inland Revenue staff, as represented by IRSF members, are a bit unpopular at the moment, through the political funds episode. You will have seen the leader in today's Guardian. Ministers are under some pressure on this matter, and Mr Tebbit, I understand, takes this issue very personally. The Chancellor needs to consider how far a tribute to staff could be seen as condoning this vote. (You will have seen that Mr Luce had a slightly hard time in the House on the subject yesterday).

b. Second, there is the question of the pay negotiations we are now entering into. The Inland Revenue Staff Federation are among the consortium who have bid for £10 per week plus 10 per cent on top, or around 17 per cent all in. I do not have to say this is far too high and we are going to have to turn them down and come back with something very much lower. I am concerned at the argument that might be put forward by the IRSF and by the main Customs and Excise union (the Society, also a member of the consortium) that a tribute of this order implies endorsement of the worthwhileness of the people involved, and hence some kind of backing to their claim.

c. Finally, although in a sense it is right and proper that in the Budget speech the Chancellor should single out Customs and Excise and Inland Revenue staff, the whole of the Civil Service are, arguably, working just as hard, one way or another, coping in their various ways with the various things which the Government ask them to do. It is not just people in these two Departments who are "currently under heavy pressure of work, particularly those who also adapting to reorganisation and change". It is just possible that a particular tribute to Customs and Revenue staff could be taken amiss elsewhere.

3. None of these are clinchers and as I say it is entirely down to the Chancellor's judgment, but he may like to consider these arguments.

E P KEMP

28/3062

COPY NO 4 OF 5. COPIES

Personal Copy Mr Lomax.

BUDGET - SECRET

FROM: DAVID PERETZ
11 March 1986
Mr Odling-Smee
cc Mr Walsh

MR CASSELL

BUDGET SPEECH (3RD DRAFT)

When we discussed this this morning, I said I would let you have some drafting suggestions in writing. My suggestions are as follows.

2. At the top of page 2 of Section C I do not greatly like the personalising of these decisions, but more important I think something should be said to explain why a 1% rise was justified, but no more. I suggest something like:-

"I decided that it was right to respond with an immediate 1% rise in short-term interest rates in early January. This increase was required to keep financial conditions on track, in view of the fall in sterling. The fall was not, however, sufficient to justify any further rise, and I decided to resist the, for a time, very strong pressure to raise interest rates still further."

3. I agree it would help in the monetary policy section to give a little more of an international dimension. It will also help to make the section sound more statemanlike, and less technical. I suggest adding a short passage after the last paragraph on page 1 of Section D, on the following lines:-

"Our experience, which has been shared by the other major industrial countries, has demonstrated the worth of a firm monetary framework for policy in getting inflation down, and providing the basis for sustainable growth. One result which we are now beginning to see is that as inflation comes down, worldwide, nominal interest rates too begin to fall. Other countries ~~too~~ have also shared our experience that it can be misleading to concentrate on any one single indicator of monetary conditions. The pace of financial innovation has complicated monetary management in most countries.

Last year I set target ranges of 3-7% for narrow money and 5-9% for broad money. Over the 12 months to mid-February ...".

4. There is no need to refer specifically to M0 and £M3.

5. The paragraph at the bottom of page 2 ought at least to mention institutional developments. For example it might say:-

> "This reflects the well-established trend, at a time of rapid institutional developments, low inflation and significantly positive real interest rates, for a higher proportion of savings to be held in liquid form."

6. I do not like the sentence on page 3 about the only effective instrument of monetary policy being the level of short-term interest rates. First, it is not that it is the only effective instrument, but that it is the only one normally useable within the year. Second, I do not much like the reference to "the level" of interest rates, partly because I think it is very often the relative level, vis-a-vis rates abroad that matters; and partly because the instrument consists not of the level, but of making changes in short-term interest rates. It is a difficult sentence to get right, but perhaps it might say something like:-

> "Short-term interest rates represent the only effective instrument by which monetary policy can be operated during the year."

7. I would then be inclined to spell out the thought in the following sentence a little, if it is to be retained at all in the speech, perhaps on the following lines:-

> "This means there is necessarily some difference in status between targets for narrow and broad money. For whereas changes in short-term rates have an unambiguous effect on narrow money, their effect on broad money is less certain and slower acting. So a rise in the growth rate ~~for~~ of broad money outside its target range can be a trigger for action on interest rates, but that action may not have the effect of getting broad money growth back within its range within the target period."

8. As I said this morning, my own inclination would then be to finish this section of the speech more or less at that point,

with a concluding paragraph saying something like:-

> "The House will, I know, be glad to learn that is all I propose to say about monetary policy today. Further details are as usual given in the Red Book."

It seems to me that to refer forward to yet another major speech on monetary policy not to be made to the House of Commons would act as simply a red rag to the Treasury Committee, if not to the House as a whole.

DLP

D L C PERETZ

RR7.22

BUDGET SECRET

REF NO. 425

COPY NO 15 OF 17

[redacted]

FROM: MRS R LOMAX

DATE: 11 March 1986

MR MUNRO - INLAND REVENUE

cc PS/Financial Secretary
Mr Monger
Mr Scholar
Miss O'Mara
Miss Sinclair
Miss Noble
Mr Cropper
Mr H Davies
Mr Loades - GAD
Mr Isaac - IR
Mr Corlett - IR
PS/IR

PENSION SCHEME SURPLUSES:
EFFECT OF BENEFIT IMPROVEMENT UNDER NEW REGIME

The Chancellor was most grateful for your minute of 10 March. He has noted in particular your conclusion that the fact that modest benefit improvements can be combined with a contribution holiday means that only grossly over-funded schemes will be <u>obliged</u> to make any refund to the employer. He thinks this is a very important point for the Budget briefing.

RL

RACHEL LOMAX

BUDGET SECRET

COPY NO. 16 OF 18
REF NO. 46 J
FROM: MRS R LOMAX
DATE: 11 MARCH 1986

MR CALDER (Inland Revenue)

cc: PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Odling-Smee
Mr Scholar
Mr Monger
Miss Sinclair
Mr Pratt
Mr Wilmott (C&E)
Mr Isaac (IR)
Mr Battishill (IR)
Mr Painter (IR)
PS/IR

DIRECT EFFECT OF BUDGET CHANGES: FSBR TABLE 4.1

The Chancellor was most grateful for your minute of 11 March. In the light of your misgivings, the lateness of the day, and the very minor difference in practice between columns 1 and 2, the Chancellor is prepared to stick to the column 1 presentation agreed at his meeting, and already incorporated in the Red Book proofs.

RL

RACHEL LOMAX

Rf475
11 of 12

cc CST
EST
Sir P.Middleton
Mr F.Butler
Sir T.Burns
Mr Cassell
Mr Scholar

BUDGET SECRET

PRIME MINISTER

1986 BUDGET: MTFS

My two previous minutes set out my Budget tax proposals with the exception of those for income tax, which we agreed at our meeting on 5 March.

I have since agreed a package of employment measures with David Young, on which I have minuted you separately.

This leaves the question of the PSBR and monetary targets for 1986-87.

<u>Public Sector Borrowing</u>

The latest indications are that this year's PSBR will come out slightly below the £7 billion forecast in the last Budget (and still more below the figure forecast last Autumn). A substantial shortfall on oil revenues has been more than made up by the buoyancy of other tax revenues and an expected small underspending of the Reserve. We have thus achieved this year a significant step down in the PSBR, the first since 1981-82, reducing the PSBR as a proportion of GDP from over 3 per cent to just 2 per cent.

Last year's MTFS envisaged a PSBR of £7½ billion for 1986-87 (after allowing for a "fiscal adjustment" of £3½ billion). Since then we have added £2½ billion to expected receipts from privatisation, offsetting a similar addition to gross expenditure plans. We have had to revise down our forecast of oil revenues by over £5 billion (on an assumed oil price averaging $15 a barrel for the financial year 1986-87). But other tax receipts are forecast to be significantly higher than was expected a year ago. So the reduction in total government tax revenues is rather less than £3 billion.

At unchanged tax rates, therefore, we would foresee a PSBR of around £6 billion. The Budget package that we have agreed would come to just under £1 billion, raising the PSBR to £7 billion or 1¾ per cent of GDP.

In view of all the uncertainties I think it is wise to err on the side of caution and aim for a borrowing figure below the £7½ billion envisaged a year ago. It is important that the Budget should be seen by the markets as sound and responsible. I think that a PSBR of £7 billion would be so regarded, and indeed should leave us with some room for manoeuvre if, for example, there were a further weakening in oil prices later in the year.

For the remaining years of the MTFS period, I plan to show a path in which the PSBR falls slightly further to 1½ per cent of GDP by 1988-89. (Each ¼ per cent of GDP is approximately £1 billion.)

Monetary Targets

For the monetary targets in 1986-87 I intend to stick to MO and £M3. In view of its past behaviour, a case can be made for dropping £M3 altogether. As you know, £M3 has for some years shown a tendency to grow more rapidly than money GDP, partly in response to financial liberalisation, and partly because high real interest rates have increased the demand for broad money as a medium for saving. £M3 growth has regularly exceeded our expectations, without adverse consequences for inflation. This year has been no exception. A year ago we set a range of 5 to 9 per cent growth for 1985-86; in the 12 months to February the actual growth of £M3 has been nearly 15 per cent. And yet all the indications are that inflation is set to fall further over the coming year.

After careful consideration, however, I have concluded that dropping £M3 would risk giving the wrong signal about our attitude to liquidity. But I cannot risk a repetition of this year's experience.

We must set a range for 1986-87 that is both credible and achievable. I have decided that this should be 11-15 per cent, to allow for a continuation of the recent velocity trend. In view of all the uncertainties about broad money, however, I do not propose to show ranges of £M3 growth for the years beyond 1986-87.

The choice of target range for MO has been much easier. Its growth over the past 12 months has been 3½ per cent, towards the bottom of the 3-7 per cent range set a year ago, and I am reaffirming for 1986-87 the 2-6 per cent range indicated in last year's MTFS. As in the last two years, I shall be publishing illustrative ranges for MO for the whole MTFS period.

The presentation of monetary policy has undoubtedly suffered from the continuing problems with £M3, and the market's reluctance to accept MO as a substitute. I have sought to re-establish the credibility of the MTFS by giving a slightly more prominent role to money GDP in explaining the Government's strategy. This has no real operational significance, but it is a useful way of making the point that, whatever the problems with particular monetary aggregates, the Government remains committed to reducing the growth in money incomes, as a means of achieving a further reduction in inflation.

This approach has been fully discussed with the Bank who support these recommendations.

NL.

N.L.

COVERING BUDGET SECRET Budget ref:- M47 COPY No .... OF 9

FROM: A W KUCZYS

INLAND REVENUE
CENTRAL DIVISION
SOMERSET HOUSE

12 MARCH 1985

2541-7221

PS/CHANCELLOR (MRS LOMAX)

BUDGET SPEECH : SECTIONS H TO M (5TH DRAFT)

When we spoke last night I gave you the more important of our comments on the Chancellor's redraft of the final sections of the Speech. For the record, I attach a note of these plus our drafting amendments which we did not bother with last night.

AWK

A W KUCZYS

cc Mr Battishill
Mr Monger

Sir Lawrence Airey
Mr Green
Mr Isaac
Mr Painter
Mr Walton
Mr. Kuczys.

SECTION H

Paragraph 7 line 3 delete "the family", insert "families". In the next line, delete the comma. (The thought is that the sentence is not true of all families with one breadwinner - eg where the wife is the breadwinner.)

Paragraph 8 amend the second and third sentences as follows -

"but the computerisation of PAYE is well under way and the full range of facilities should be available by 1989. It is essential therefore to lose no time in preparing for the changes we wish to make once computerisation is in place."

Amend the last two sentences as follows -

"In the light of ... implementation by April 1990. The Green Paper will ... ranging from non-cumulation to a closer integration between the tax and benefit systems.

Paragraph 9 line 4 before "reform" insert "fundamental".

Paragraph 13 line 3 before "private" insert "bona fide".

Paragraph 19 amend the second sentence as follows -

"This provision, introduced to discourage the short-term conversion of income into capital, required complex identification rules for shares. This has the unfortunate effect of greatly complicating life for all taxpayers."

Line 12 delete "tomorrow" insert "6 April". Remove the square brackets around the last few words.

Paragraph 21 line 1 "indexation" is mis-spelt.

Paragraph 22 line 5 delete "Together" insert "Combined".

Paragraph 23 delete "builds up to [£m150]" substitute "is £m155".

Paragraph 25 line 6 delete "still". Line 7 delete "registered by" substitute "sent to".

Paragraph 26 line 2 delete "one third" substitute "over 40%". Delete the reference to removing legislation from the Statute Book (we are minuting on this).

Paragraph 27 line 2 "reform" is mis-spelt.

Paragraph 29 redraft as follows -

"This is a particularly complex tax, introduced in response to soaring land values and high inflation. Evidence suggests that the tax discourages the bringing forward of land for development. The disincentive effects will grow as the gap ...".

(The point is that DLT is not designed to deal with soaring land values etc; and the present reliefs for house builders act to exclude most house building land from the tax.)

Paragraph 31 delete the square brackets.

SECTION J

Paragraph 2 line 2 delete "company" substitute "business".

Paragraph 4 We would urge that this paragraph be kept.

Paragraph 5 Amend the first sentence as follows -

> "During the course of last year's debates it was announced that expenditure on new ships would continue to be eligible for free depreciation within the overall context of the new system."

Paragraph 9 The figures are "under 2 million" and "2½ million".

Paragraph 10 The problem here is that it is wrong to imply that we are putting the self-employed on the same footing as employees. Our suggestion is: delete all of paragraph 10 after the first sentence, and substitute -

> "While the National Insurance Contributions paid by the self-employed as a whole pay for the greater part of their benefit, the entitlement to benefit of any individual does not depend on his paying Class 4 contributions."

In paragraph 11, delete the first sentence and substitute -

> "In recognition of this, from 6 April ...".

You said you did not think the Chancellor would be happy about this, and might raise it at the Overview Meeting.

Paragraph 14 line 1 delete "the year".

Paragraph 15 line 1 after "implement" insert "many of".

Penultimate line, delete "otherwise".

why? Paragraph 18 last line delete "these", insert "profit-sharing". (As the sentence stands it is not true.)

Paragraph 19 lines 8 to 10 delete "the rules ... presently the case." Substitute -

> "The new partnership will be taxed for its first 4 years on the profits actually arising in those years."

(You said you did not think the Chancellor would like this wording, and we will look at it again.)*

Paragraph 23 line 2 delete "similar" insert "complimentary".

Paragraph 24 line 5. The Chancellor asked for a sentence -

> "Since the 1983 Budget, 19 development projects have received approval, and exploration and appraisal activity has reached record levels [with 182 new well starts in 1984 alone (40% higher than in any previous year)]."

You confirmed that the Chancellor had consciously decided to omit a reference to incremental investment in existing fields, in the interests of brevity.

SECTION L

I think it would be better if the heading read "PERSONAL TAXATION : DIRECT TAX" rather than "INCOME TAX".

Why?

Paragraph 3 line 6 delete "any" insert "significant".

Paragraph 7 lines 8 to 11. Redraft as follows -

> "The tax thresholds we have in this country are too low, whether compared with our principal competitors or with our own not so distant past. They discourage young people starting work, and they are a major cause ...".

Paragraph 11 line 1 delete "thresholds" insert "allowances". Line 3 delete "the threshold"; after "1985-86"say "they will be some 20% higher ...". Over the page the square brackets can come out. But after "out of tax altogether" we must say "compared with no increase at all". Otherwise the sentence is untrue.

Paragraph 12 The date is 17 May, and the cost is £1.6 billion.

SECTION M

Paragraph 7 line 4 "lowest" should be "lower". (The very lowest-earning pay no NIC at all.)

---

* We have looked at this again this morning. An alternative suggestion is -

> In the 4th line on the 2nd page, at end insert "which may be".
>
> In the 6th line, insert "broadly" before "apply".

BUDGET CONFIDENTIAL

FROM: R I G ALLEN
DATE: 12 MARCH 1985

PRINCIPAL PRIVATE SECRETARY

cc PS/Financial Secretary
Sir P Middleton
Mr Monck
Mr Cassell
Mr Monger
Mr Folger
Mr H Davies

PS/IR

BUDGET SPEECH: SECTIONS H-M (FIFTH DRAFT)

Could I add a further (late) comment on the discussion of SLAs in the draft of Section J attached to your minute of yesterday.

2. First, the draft says that "the new structure of capital allowances enables the generality of plant and machinery to be written off over a period that is in fact less than their useful life". This is not the line which has usually been adopted in public, namely that the 25 per cent regime will strike a fair average for most industries and companies.

3. Second, SLAs emerge rather as the centrepiece of the business tax section. Would it be worth quoting the cash benefit to business (£100m in 1988-89 and £300m a year in the early 1990s) in what is currently a slightly flat passage? (A footnote in Part 4 of the FSBR gives the latter figure.)

4. It can also be argued that a figure should be given against the decision to retain 100 per cent SRAs for "traditional" scientific research (paragraph 3). I would incline against this, however, for three reasons:

   i. The cost of the concession is very difficult to evaluate because, under the old regime, many businesses claimed qualifying expenditure on research and development as plant and machinery rather than as SRA (where both allowances were at 100 per cent, the distinction did not much matter);

BUDGET CONFIDENTIAL

ii. The bulk of SRAs went to North Sea companies, a fact which may not be presentationally helpful;

iii. Many businesses will not see the continuation of SRAs for traditional scientific research as a "concession" at all.

12/7

R I G ALLEN

Budget ref:- M44

409.31

COPY 1 of 7 COPIES

BUDGET SECRET

FROM: J ANSON
12 March 1985

PRINCIPAL PRIVATE SECRETARY

cc Sir Peter Middleton
Mr Bailey
Mr Monck
Mr Battishill
Mr Scholar

BUDGET SPEECH: FOURTH DRAFT (of 8 March)

At PCC this morning I queried the last sentence in Section F, paragraph 10: "within the unchanged cash limits set for the coming year".

2. I have now checked with Mr Scholar that the increase in the Community Programme <u>does</u> involve a change in a cash limit. The sentence is therefore not correct as it stands. The message it is intended to convey would however still be conveyed if the word "unchanged" is omitted.

(J ANSON)

BUDGET SECRET

Ref 485
9 of 10

cc CST
Sir P. Middleton
Mr F. Butler
Mr Monck
Mr Scholar

BUDGET SECRET

PRIME MINISTER

BUDGET PROPOSALS: EMPLOYMENT MEASURES

I promised to let you know the main lines of the agreement I have reached with David Young on a Budget package of public expenditure measures to help the unemployed.

Last year I announced the new 2-year Youth Training Scheme and a substantial expansion of the Community Programme. These measures were financed by an addition to the planning total. This year, as I mentioned to you, it is essential to keep the measures to a level that can be financed from the Reserve. We cannot allow a further increase in the public expenditure planning total.

The package I have agreed is based on the proposals put forward by David Young at your meeting last November. Its main components are:

(a) an increase in the 1986 expansion target for Community Programme places: by Christmas we will have almost twice as many places as we had before the 1985 Budget. At the same time, the average wage limit for the CP will be raised to £67 a week as from next month;

(b) nationwide extension of David's imaginative initiatives for helping the long-term unemployed - counselling and the £20 Job start allowance. This means that every single one of the long-term unemployed will be called to interviews and offered help towards finding a job. The evidence of the pilots suggest that many of those who are on the register, but ought not to be, sign off when called up for an interview;

(c) a New Workers Scheme to help create jobs for 18-20 year olds - a successor to Alan Walters' Young Workers Scheme. This will pay £15 a week to any employer taking on an 18 or 19 year old at not more than £55 a week or a 20 year old at not more than £65 a week;

(d) an enlargement of the Enterprise Allowance Scheme for the unemployed who wish to set up on their own. The annual rate of entry will rise from 64,000 now to 100,000 by April 1987 and there will be more training for those on the scheme. The tax treatment of the Allowance will also be improved.

As I told you last week, I shall also be announcing an extension and improvement of the Loan Guarantee Scheme.

The gross expenditure additions to David's programme will be £190 million in 1986-87 and £280 million in 1987-88. After allowing for an offsetting reduction in social security spending the net public expenditure cost will be £100 million in 1986-87 and £165 million in 1987-88. These will be charged to the Reserve so that there will be no increase in the planning total.

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

NL.

N.L.

BUDGET SECRET

Copy No. 1 of 7

Inland Revenue

Policy Division
Somerset House

FROM: C W CORLETT
12 March 1986

PRIVATE SECRETARY TO THE CHANCELLOR OF THE EXCHEQUER
(Mr Kuczys)

Recd

PERSONAL EQUITY PLAN : BUDGET SPEECH

1. As I mentioned to you, we wondered whether the section on PEP might be beefed up a bit. I attach a shot by Mr Beighton, Mr Munro and myself.

2. I leave it to you to do what you want with it.

CWC

C W CORLETT

cc

Mr Isaac
Mr Beighton
Mr Painter
Mr Munro
Mr Corlett
PS/IR

A
B
C
D
E
F
G
H
I
J
K
L

2-25

BUDGET CONFIDENTIAL

Rup

MWS 12/3

FROM: D N WALTERS
DATE: 12 MARCH 1986

1. MR SCHOLAR

2. PS/CHANCELLOR OF THE EXCHEQUER

cc PS/Chief Secretary
PS/Financial Secretary
Sir Peter Middleton
Mr F E R Butler
Mr Monck
Mr Cassell
Mr Gilmore
Mr Monger
Mr Revolta
PS/IR

CHANCELLOR'S BUDGET STATEMENT

John Cunliffe's letter of 10 March suggested a form of wording for inclusion in the Budget Statement to highlight the decision to extend BES to ship chartering. The letter also explained that the Department of Transport intend to issue a press notice as part of the Budget package drawing attention to this extension of BES and went on to suggest that, in view of this, there was no need for the Financial Secretary to make reference to the subject in his wind-up speech. I have spoken to FP, HE and the Inland Revenue about the terms of Mr Cunliffe's letter. There are no voices of dissent or objection. The Inland Revenue have suggested, however, that the first sentence of the paragraph for the Statement might be amended to highlight the fact that the extension is restricted to UK registered ships. Hence:

"I have decided to bring chartering ~~by~~ of UK registered ships within the scope of BES."

2. If you agree the amendment, you may care to speak to Mr Cunliffe to advise him of the small change. However, I see no need for a formal reply.

Ch/ This arrived too late to incorporate in the version of the speech you were working on. But, if you agree, this can be picked up next time round

CWK 12/3

D N Walters

D N WALTERS

BUDGET CONFIDENTIAL

FROM: H J DAVIES
DATE: 12 MARCH 1986

CHANCELLOR

cc Mr Monck

BUDGET SPEECH: PROFIT SHARING

You asked for a shortened version of the passage on profit sharing in the current draft of the Budget Speech.

2. I attach a revised draft which sticks quite closely to the existing form of words, but cuts out some of the qualifications in the middle. In the light of the press notice I think it would not be unreasonable to shorten your reference to this seminal proposal in the speech itself.

HJD

H J DAVIES

Ch/

This arrived too late for the last draft. Nick wasn't very keen on it. But you may like to see it - in case you are looking for cuts

RC

14/3

DRAFT PASSAGE FOR BUDGET SPEECH: PROFIT SHARING

I have, however, considered whether there is anything further the Government can do. The problem we face is not just the level of pay in relation to productivity, but also the rigidity of the pay system.

If the only element of flexibility is in the numbers of people employed, then when business drops off redundancies are inevitable. One way out of this is to move to a system of profit sharing.

If the pay of a significant proportion of the workforce depends on the company's profitability individual employees will have a more direct personal interest in their company's success.

When business is slack, companies will be under less pressure to lay men off; and in good times they would be keener to take men on.

proportion of employees and where a significant proportion of their remuneration is profit linked.

The design and definition of profit sharing arrangements which merit tax relief are matters of some complexity. I am keenly aware of the practical difficulties.

The government therefore proposes to hold preliminary discussions with employers and others to see if workable schemes can be defined which offer the prospect of a worthwhile and broadly based take up.

If these preliminary discussions are encouraging then the government would prepare a consultative document setting out the details of a scheme of tax relief. ~~The earliest opportunity for legislation would be next year's Finance Bill.~~

FROM: MRS R LOMAX
DATE: 12 March 1986

REF NO 55J
COPY NO 24 OF 26

MR SCHOLAR

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Cassell
Mr Monck
Mr H P Evans
Mr Odling-Smee
Mr Culpin
Miss O'Mara
Miss Peirson
Mr Riley
Mr Pratt
Mr Cropper
Mr H J Davies
Mr Lord
PS/IR
PS/C&E

1986 FSBR: SECOND DRAFT

This minute records the Chancellor's principal comments on the second draft of the Red Book, attached to your minute of 10 March.

Chapter 1

2. The Chancellor was content to include Table 1.2 at the end of Chapter 1. The term "central privatisation proceeds" should however be replaced by "privatisation proceeds". He also suggested reordering public sector receipts, to put income tax first.

3. The Chancellor made a number of suggestions about the placing of Table 1.1: it might go between paragraphs 1.04 and 1.05 or (as a fallback) right at the front before paragraph 1.01 or - just possibly - between paragraphs 1.07 and 1.08.

4. The Chancellor had the following comments on the text:

- Paragraph 1.04: the Chancellor has asked whether it is true that taxes are on a declining path as a percent of GDP. (He accepts that they certainly ought to be, but he would like to see the figures.)

- Para 1.05: redraft penultimate sentence as follows: "Investment and exports are forecast to grow more rapidly".

- Paragraph 1.07: redraft first sentence as follows: "Chapter 5 describes the public expenditure measures announced in the Budget, designed to help the unemployed".

- Paragraph 1.08: redraft second, third and fourth sentence as follows: "The public expenditure measures will be financed from the Reserve and thus do not add to the public expenditure planning total. Taxes are reduced by almost £1 billion. The public sector borrowing requirement is set at some £7 million - $1\frac{3}{4}$ per cent of GDP". In the next sentence insert "slightly" before "below the level indicated in the MTFS".

Chapter 2

5. The Chancellor had the following drafting points:-

- Paragraph 2.02: in the final sentence replace "enhancing" by "thus promoting".

- Paragraph 2.06: in the first sentence replace "consistent with" by "that will bring about". In the final sentence replace "This should be consistent with" by "This is consistent with".

- The Chancellor preferred version B of the charts on money GDP growth, inflation and output growth.

- On Table 2.1, the Chancellor has suggested tagging footnote 1 on to the end of what is now footnote 2, and reordering the footnotes accordingly.

- Paragraph 2.08: redraft the first sentence as follows: "While firm monetary policies must be supported by low public sector borrowing in the medium term, there is some scope for varying the balance between fiscal and monetary policy, especially in the short term."

- Paragraph 2.09: redraft first sentence as follows: "Until recently the authorities also sought to control the growth of broad money and liquidity by overfunding ie. selling more debt than needed to fund the public sector borrowing requirement".

- Paragraph 2.12: in the first sentence, insert "(principally non-interest bearing)" between "those" and "assets". Insert the following at the end of the first sentence: "In practice, however, there is no single measure of narrow money that meets all these criteria". Redraft final sentence as follows: "The same developments have distorted non-interest bearing M1, which continues to be affected by short term variations in the boundary between interest bearing and non-interest bearing accounts."

- Paragraph 2.13: redraft first two sentences as follows: "M1 covers only a narrow range of transactions balances. It has however demonstrated a relatively stable velocity trend over a long period and responds in an unambiguous manner to changes in interest rates." Redraft second half of the next sentence as follows: "... but this has been occurring at a fairly steady and predictable pace". In the next sentence replace "it" by "MO".

- Paragraph 2.14: at the end of the first sentence replace "unlike the experience of the 1970s" by "in contrast with experience in the 1970s". In the third sentence delete "wholly".

- Paragraph 2.15: redraft first sentence as follows: "As in the past two years the Government is setting targets for the year ahead, 1986-87, for MO, as a measure of narrow money, and for £M3, as a measure of broad money".

- The Chancellor has asked that Chart 2 be rescaled to make the graphs shallower; the scale for the MO panel should show 10 and 15 rather than 13.

- Paragraph 2.13: in the first sentence the reference should be to "short term interest rates"; redraft the end of this sentence as follows: "... their targets, together with other relevant evidence, especially the exchange rate".

- Paragraph 2.19: delete the last two sentences. The Chancellor thinks these are too much geared to recent events, and too much in contrast with his 1985 Budget Speech (to which he still adheres).

- Paragraph 2.20: redraft the second sentence as follows: "Experience has shown that a change in short term interest rates is unlikely to alter the growth of £M3 significantly, within the target period." At the end of the final sentence insert "in these circumstances" between "range" and "would not be".

- Paragraph 2.23: add the following to the end of the first sentence: "slightly below the level indicated in last year's MTFS"; and add the following to the end of the final sentence: "as set out in the Autumn Statement".

- Paragraph 2.24: replace "small" by "slight" in the first sentence.

- Paragraph 2.26: redraft final sentence as follows (if true): "It is assumed that there is no major change in either the sterling exchange rate index or the sterling/dollar exchange rate from year to year".

- Paragraph 2.29: the Chancellor suggests expanding the final sentence to include a comment on the growth of non North Sea taxes in relation to money GDP.

- Table 2.5: the Chancellor was somewhat irritated to discover that the figures in the columns do not add up: he asked whether anything can be done, while leaving the PSBR line intact.

- Annex Paragraph 2A.2: redraft first sentence as follows: "The growth of MO is expected to be towards the bottom of its target range in 1985-86".

- Annex Paragraph 2A.3: redraft the second half of this sentence as follows: "and the range set for 1986-87 is considerably higher than the illustrative range in last year's MTFS".

Chapter 3

6. The Chancellor suggests printing the summary on a page by itself.

7. He had the following drafting comments:-

- Paragraph 3.08: the Chancellor wonders whether we want to include the final sentence of this paragraph at all; if we do, "significantly" should be deleted.

- Paragraph 3.09: redraft second sentence as follows: "This has been associated with a continuing weakness in primary product prices (see Chart 3.1)".

- Chart 3.2, footnote 2: replace "centrally planned economies" by "the Communist bloc".

- Paragraph 3.12: in the first sentence replace "maintain" by "restrict".

- Paragraph 3.13: redraft final sentence as follows: "This forecast assumes that prices will average $15 a barrel - rather below, in real terms, the level between 1974 and 1976".

- Table 3.1 and Chart 3.3: the Chancellor has noted that neither the Table nor the Chart make it clear that the 1986 (and in one case 1987) figures are merely forecasts. They should. In Chart 3.3, he would like a fine horizontal line drawn at zero.

- Table 3.2: the row showing the weights in 1984 should be printed in italics. There should be a note explaining that the 1986 figures are forecasts.

- Paragraph 3.21: in the penultimate sentence, the Chancellor has commented that yields on 20 year gilts are surely now in single figures; if so, both the text and the chart should make this clear.

- Paragraph 3.25: redraft final sentence as follows: "They are thus consistent with the slower growth of nominal incomes and fall in inflation contained in this forecast".

- Table 3.3: the Chancellor wonders whether it is really necessary to talk about "relative actual unit labour costs"; or to make it clear that the 1985 figure is only an estimate.

- Paragraph 3.28: redraft fourth sentence as follows: "The fall in oil prices on its own worsens the terms of trade in goods by 3 per cent."

- Table 3.4: the Chancellor has noted that the column of figures for the terms of trade are quite different from the earlier draft, and appears to bear little relation to the preceding text. He would be grateful for an explanation. He has noted that there is a footnote missing to this table.

- Table 3.6: the Chancellor has observed that it was agreed that these charts would not extend to 1987, and that 1986 would be very clearly shown as a forecast (if at all).

- Paragraph 3.34: in the third sentence replace "increase" by "rise sharply". The last two sentences should be run together, inserting "and" between the two.

- Table 3.5: the Chancellor has suggested a new version of this table which distinguishes between oil and non-oil balances, providing a breakdown of the latter into manufacturing, other goods and invisibles. For the total, figures after allowing for special factors should be shown in brackets.

- Chart 3.7: once again, the Chancellor would like the hatching for 1986 to be different, to indicate that it is a forecast.

- Paragraph 3.36: the Chancellor would like to quote the UK stock of net overseas assets in 1979 in terms of £billion.

- Paragraph 3.43: delete the final sentence. The Chancellor has commented that this section does not elsewhere look ahead to 1987-88 and the wording implies that the growth in the GDP deflator depends exclusively on oil prices.

Chapter 4

8. Throughout this section the Chancellor would like to replace the subheadings (for income tax, social security uprating etc). by side-headings.

9. He had the following drafting comments on the text:-

- Paragraph 4.05: delete the third sentence, and redraft the following sentence as follows: "Exceptionally the

Government has decided to exempt from income tax the amount of the increase payable in 1986-87, to retirement pensioners and widows."

- Paragraph 4.08: redraft as follows: "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.

- Paragraph 4.10: redraft as follows: "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 on first sale. Certain low risk activities, including those with high asset backing, are to be excluded." The Chancellor thinks there should also be some reference to ship chartering.

- Paragraph 4.11: delete the first part of the first sentence, starting with "The lifetime CTT charge is to be abolished for all gifts ..."

- Paragraph 4.12: the Chancellor thinks it would be worth considering including a table here setting out the new rate bands.

- Paragraph 4.13: redraft first sentence as follows: "It is proposed to launch a new scheme, known as Personal Equity Plans, to encourage individuals to invest directly in equities." In the next sentence delete "reinvested"; and add the following to the end of the final sentence: "... of not more than two years".

- Paragraph 4.14: redraft the beginning of the first sentence as follows: "The rate of Stamp Duty is to be reduced ...". There should be some mention in this paragraph of the different start dates for the various components of the Stamp Duty package.

- Paragraph 4.15: delete the first half of the sentence, and redraft as follows: "The following measures are proposed to further encourage ..."

- Paragraph 4.16: add the following to the end of the second indent "the choice of method being for the trustees to decide;" The Chancellor has noted that the passage in brackets is out of place. In the third indent, insert "to the employer" after "refund"; and replace "employers' hands" by "companies' hands".

- Paragraph 4.19: in the first sentence replace "disappearance of first year and initial capital allowances" by "full implementation of the standard reducing balance system of capital allowances".

- Paragraph 4.20: delete the reference to oil taxation, and replace by "the small companies corporation tax rate will be reduced to 29 per cent".

- Paragraph 4.21: in the first sentence delete "to maintain its value".

Chapter 5

10. The Chancellor has discussed this chapter with the Chief Secretary, who will be approving the draft.

Chapter 6

11. The Chancellor has noted that there is a problem with the tables in this section, as a result of the decision not to allocate the Reserve. He thinks that the answer is to summarise all the information about the public sector borrowing requirement in 1985-86 in a single table; drop the final column of the existing Table 6.1; and drop the rows relating to the central government and local authority etc borrowing requirements from Table 6.2, 6.3 and 6.4 (so that they end at the expenditure total.

12. The Chancellor had the following drafting comments on the text:-

- Paragraph 6.02: redraft the first sentence as follows: "Table 6.1 shows the sectoral composition of the PSBR in 1985-86". Delete the rest of this paragraph.

- Paragraph 6.03: add the following to the end of this paragraph "borrowing for the eleven months to February totalled £[ ]billion". The Chancellor also suggests adding something about the uncertainty assigned to the individual components of the PSBR.

- Paragraph 6.04(ii): delete the references to National Insurance contributions and gross trading surpluses; the Chancellor was surprised by the absence of any reference to Corporation Tax in this section.

- Paragraph 6.04(iii): redraft as follows: "A shortfall of around [ ] is expected in the planning total outturn." Delete the rest of this passage. The Chancellor thinks it is wrong to single out teachers' pay for special mention - especially since we did not forecast a teachers' pay settlement of this size a year ago.

//

CHANCELLOR OF THE EXCHEQUER

- <u>Paragraph 6.05</u>: redraft the first sentence as follows: "The PSBR in 1986-87 is forecast to be [ ], or $1\frac{3}{4}$ per cent of GDP, slightly below the projection for 1986-7 in the 1985 MTFS."

- <u>Paragraph 6.05(i)</u>: in the second sentence delete "but partly the higher dollar/sterling exchange rate".

- <u>Paragraph 6.05(ii), second indent</u>: redraft as follows: "A rise of [ ] in income tax receipts: the buoyancy from the real growth in earnings is only partly offset by the Budget measures". The Chancellor attaches particular importance to deleting the heretical reference to earnings uprating.

- <u>Paragraph 6.06</u>: replace by something along the following lines: "Table 6.2 to 6.4 show forecasts of revenue and expenditure for central government, local authorities and public corporations respectively in both 1985-86 and 1986-87. Expenditure for 1986-87 is understated since the Reserve has not been allocated." This paragraph might be sidelined "Government transactions by sector".

- <u>Paragraph 6.07</u>: end this paragraph after the first sentence.

13. The Chancellor has noted that Annex 6a will need amending to make it consistent with what has gone before.

RL

RACHEL LOMAX

RR7.23

BUDGET SECRET

REF. NO. 495
COPY NO 21 OF 23

FROM: MRS R LOMAX
DATE: 12 March 1986

MR LEWIS - INLAND REVENUE

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Mr Cassell
Mr Scholar
Mr Monger
Miss Sinclair
Miss Noble
Miss O'Mara
Mr Culpin
Mr Cropper
Mr Lord

Sir L Airey - IR
Mr Isaac - IR
Mr Battishill - IR
PS/IR

CHANGE IN THE SOCIAL SECURITY UPRATING DATE

The Chancellor was most grateful for your minute of 11 March, which he found very helpful.

2. On the defensive briefing (why are unemployment benefit and supplementary benefit, the other taxable benefits, not also being exempted?), the Chancellor would like to use the first two paragraphs, but not the rest.

RL.

RACHEL LOMAX

BUDGET SECRET

REF. NO. 505

COPY NO 22 OF 24

FROM: MRS R LOMAX

DATE: 12 March 1986

PS/FINANCIAL SECRETARY

cc Chief Secretary
Economic Secretary
Minister of State
Mr Cassell
Mr Kemp
Mr Monger
Mr Scholar
Miss Noble
Miss Sinclair
Mr Cropper
Mr H Davies
Mr Lord

Mr Isaac - IR
Mr Corlett - IR
Mr Munro - IR
Mr Hinton - IR
PS/IR

Mr Johnston - Government Actuary
Mr Loades - GAD

PENSION SCHEME SURPLUSES

The Chancellor has seen Mr Hinton's note to the Financial Secretary of 11 March, recording the Government Actuary's view that the valuation guidelines for schemes with index-linked pensions should indicated a net yield of 2½ per cent. The Chancellor thinks the Government Actuary has a good point. But he thinks it is worth asking the Government Actuary to consider whether he is sure that 2 per cent would not be the right figure for guaranteed index-linked schemes.

RL.

RACHEL LOMAX

CONFIDENTIAL

From: K F MURPHY
Date: 12 March 1986

PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary
PS/Financial Secretary
Mr Cassell
Mr Monger
Mr Scholar
Miss Sinclair
Mr Culpin
Mr Cropper

Mr Isaac - IR
PS/IR

GREEN PAPER: BUDGET DAY PRESS RELEASE

I understand that it was decided at Prayers this morning that the press release on the Green Paper should take the form of the Chancellor's foreword plus the final paragraph of Mr Hudson's draft indicating where comments should be sent. Sir Peter Middleton has commented apropos of paragraph 5 of Mr Hudson's covering note, that he thinks that this should be a Treasury press release rather than an Inland Revenue one.

K F Murphy

K F MURPHY
Private Secretary

FROM: P WYNN OWEN
DATE: 12 March 1986

PS/MINISTER OF STATE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Sir P Middleton
Mr Cassell
Mr Monger
Mr Scholar
Mr Dyer
Miss Sinclair
Mr Romanski
Mr Cropper
PS/C&E
Mr Knox - C&E
Mr Jefferson Smith - C&E

VAT: CHANCELLOR'S 1985 BUDGET UNDERTAKING

The Minister of State, Sir Peter Middleton, Mr Monger, Mr Cropper, and Messrs Knox and Jefferson Smith of Customs met with the Chancellor at 3.30 pm on 11 March 1986 in No.11 Downing Street.

2. They considered Mr Jefferson Smith's minutes of 3, 7 and 11 March, your minutes of 5 and 10 March and Mr Monger's minute of 7 March.

Letting of sports and similar facilities

3. It was decided the Custom's proposal could well be interpreted by critics as breaking the Chancellor's VAT pledge in the 1985 Budget. Given that local football and cricket teams who hire pitches every fortnight throughout a season would be subject to VAT for the first time, the outcry might well be substantial.

4. It was decided that between Easter and the Finance Bill Standing Committee action should be taken to restore the status quo prior to the South Glamorgan decision, but nothing beyond that, by way of tidying up or extending the VAT boundary, should be done.

The hotels package

5. Mr Jefferson Smith identified the four elements of the hotels and holiday package:

(i) Abolition of the long stay relief for block bookings by overseas tour operators;

(ii) confining the taxation of hotel accommodation to bedrooms;

(iii) bringing furnished service flats effectively competing as part of the hotel sector into the tax net;

(iv) taxation of tour operators' margins on overseas travel (to be announced as part of the 1986 package for 1988).

6. Of these, (i) could be defended by explaining that it was simply a question of valuing something which was already taxed. Item (ii) looked like a relief, but perversely brought in revenue by restricting the amount businesses could deduct. So it was clearly not an extension. Item (iv) could be defended on the grounds that the UK would otherwise be subject to EC infraction proceedings which it would doubtless lose.

7. The only potential problem lay with item (iii). Strictly speaking, this might be seen by some as contrary to the strict wording of the 1985 Budget pledge. But it could be presented as removing a very clear anomaly on the VAT borderline and rectifying a matter which caused considerable complaint from the hotel industry. The Chancellor's 1985 pledge was made in terms of extensions to major items such as food, children's clothes etc. which were subject to great public discussion in the run up to the 1985 Budget. It was absurd to read the 1985 Budget pledge as wholly excluding any tidying up of the VAT borderline. There was unlikely

to be much political difficulty from the owners of furnished service flats, since this would necessitate their revealing the extent of their operations. It was therefore decided to go ahead with this measure, since it would prove to be a good test case of the interpretation of the 1985 Budget pledge.

Rc.

P WYNN OWEN