

PO - CH/NL/0227  
PART A

Part A.

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Begins: 4/1/88.

Ends: 14/1/88.



PO -CH /NL/0227



PART A

Chancellor's (Lawson) Papers:

REPLACING THE ADDITIONAL PERSONAL ALLOWANCE AND TAX RELIEF WITH INCREASED BENEFITS ON CERTAIN MAINTENANCE PAYMENTS

Disposal Directions: 25 years

*Philer*

18/9/95

PO -CH /NL/0227

PART A

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BF 8/1

FROM: J M G TAYLOR

DATE: 4 January 1988

MISS SINCLAIR

- cc PS/Chief Secretary
- PS/Financial Secretary
- PS/Paymaster General
- PS/Economic Secretary
- Sir P Middleton
- Mr Anson
- Mr Scholar
- Mr Culpin
- Miss Peirson
- Mr McIntyre
- Miss Hay
- Mr Cropper
- Mr Tyrie
- Mr Call
  
- Mr Isaac
- Mr C Stewart - IR
- Mr Mace
- PS/IR

JMGT  
TO  
SINCLAIR  
4 JAN

**REPLACING THE ADDITIONAL PERSONAL ALLOWANCE (APA) AND TAX RELIEF ON CERTAIN MAINTENANCE PAYMENTS BY INCREASED BENEFITS**

The Chancellor was grateful for your minute of 23 December.

2. He would be most grateful for the Chief Secretary's considered views, as soon as possible.

J M G TAYLOR

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FROM: J. ANSON  
7th January, 1988.

CHIEF SECRETARY

*by X below implies that  
there will be a delay before  
we get the CST's views.*

c.c. PPS  
Sir P. Middleton  
Mr. Scholar  
Mr. Culpin  
Mr. Turnbull  
Miss Peirson  
Mr. Gibson  
Miss Hay  
Mr. Call

**REPLACING THE ADDITIONAL PERSONAL ALLOWANCE (APA) AND TAX RELIEF  
ON CERTAIN MAINTENANCE PAYMENTS BY INCREASED BENEFITS**

The Chancellor has invited you to put forward your considered views on the problem discussed in Miss Sinclair's minute of 23rd December.

2. As Miss Sinclair mentions, there is not an exact fit between the beneficiaries of APA and OPB. The relative merits of the options for dealing with APA are therefore affected to some extent by whether a switch to OPB could be used at the same time to deal with the effect of withdrawing tax relief from maintenance payments to children of unmarried mothers.

3. Before offering a considered view you will want therefore to see the further submission mentioned in Miss Sinclair's paragraph 4, which I gather should be ready in the next two weeks or so. Mr. Scholar has confirmed to me that FP will at that stage pull together the two submissions on these two related topics.

4. In the meantime, perhaps I could offer one preliminary comment on the note by officials attached to the minute of 23rd December. That note focusses particularly on the loophole that two single people living together can draw two APAs. That is indeed an important loophole which needs to be corrected. But it seems to me that the

ANSON  
TO  
CST  
7 JAN

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"loophole" is wider than that. If the object of the APA is correctly described (in paragraph 2 of the main note) as "in recognition of the costs to taxpayers of bringing up children singlehanded", then it is a loophole to allow cohabiting couples to benefit from APA at all, even for one child.

5. On that approach, Option 2(a) would not go far enough, and the choice is between Options 2(b), 3 and 4. Of these, Option 2(b), which simply withdraws APA from cohabiting couples (using the same legal formulation as in social security legislation), would deal directly with the problem; but it has the disadvantage that the Inland Revenue would be directly involved on their own account in the disagreeable business of policing a cohabitation rule. Option 3, which enables the Inland Revenue to base the allowance on decisions already made by DHSS, has the merit of avoiding that. Option 4 (giving compensation through OPB) has the advantage of simplifying the tax system and applying cohabitation tests only to benefits where they are used already. But it has quite a long list of disadvantages set out in paragraph 16 of the note: in particular, the mismatch between APA and OPB produces a substantial number of windfall gainers; the sharp increase in OPB (from £4.90 a week to £12.30) would be awkward to defend, particularly when child benefit is being frozen; and 60,000 people would be brought into tax.

6. Option 4 would also increase public expenditure by around £200 million. If that route were chosen, you would therefore have to decide whether to present it as a claim on the reserve or as justifying a similar increase in the overall planning total. Taking this increase in isolation, a case could be made for increasing the planning total, given the precedent of the switch from child tax allowances to child benefit. But you will need to look at it along with any other budget proposals which produce a switch between revenue and expenditure, eg on VAT refunds (in

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the light of the zero-rating infraction case) and student covenants. GEP will be putting this together in a submission when they have been able to clarify the position on the individual items.

7. This aspect need not necessarily be an overriding objection to Option 4 if the substitution of OPB proved a well-targetted and cost-effective way of replacing the APA and any other tax benefits which were being abolished at the same time. For APA alone, it is not and in my view Options 2(b) or 3 would be preferable; but you will want to await the further FP submission on the maintenance payments, and GEP's advice on the reserve treatment, before reaching a final conclusion.



J. ANSON



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Inland Revenue

The Board Room  
Somerset House  
London WC2R 1LB

*Ch/ To see also Mr Stewart's pgs, behind  
and Mr Anon's note, behind.  
You are waiting for comments  
from CST.*

*mainly -  
anti.*

FROM: A J G ISAAC  
8 January 1988

*file -  
put 1  
agree with  
Mr Isaac's  
conclusion.*

CHANCELLOR OF THE EXCHEQUER

MAINTENANCE PAYMENTS AND ONE-PARENT BENEFIT (STARTER 150)

ISAAC  
TO  
CH.  
8 JAN

1. Miss Sinclair's minute of 23 December promised that we should be sending you this submission from Mr Stewart on possible "fallback" options for the taxation of payments to children. FP will then be putting forward co-ordinated advice, bringing together the implications of the proposals affecting both the additional personal allowance (APA) and maintenance for children.
2. Very briefly, and trying not to pre-judge the fuller FP submission, I would add only a few personal comments.

cc Chief Secretary  
Financial Secretary  
Paymaster General  
Economic Secretary  
Sir P Middleton  
Mr Scholar  
Mr Culpin  
Miss Sinclair  
Mr McIntyre  
Mr Gibson  
Mr Cropper  
Mr Tyrie  
Mr Jenkins (Parl Counsel)

Mr Battishill  
Mr Isaac  
Mr Corlett  
Mr Lewis  
Mr Beighton  
Mr Calder  
Mr Mace  
Mr Davenport  
Mr Yard  
Mr J C Jones  
Mr Boyce  
Mr I Stewart  
Mrs Fletcher  
Mr C Stewart  
PS/IR

Maintenance payments

3. We have carried quite a bit further our contingency planning for possible tax relief "fallbacks" on maintenance payments. However, the outcome (recorded in Mr Stewart's note today) gives me little comfort. And I am conscious that, if the main OPB option which you tended to favour (his Option 1) is not acceptable, we face these unpalatable choices in any event - quite separately from your decisions on independent taxation and quite separately from your decisions on the other proposals on covenants.

4. I think it was one of the political advisers, at a recent meeting with the Financial Secretary, who suggested that the root of the problem here is that

- in the late 1970s a previous administration abolished the child tax allowances; and
- meanwhile, in the public perception, the original primary purpose of child benefits (negative taxation, or tax relief) has progressively been overshadowed by its secondary purpose (social security benefit).

5. As a result, we are dealing here with a succession of devices which seek to reintroduce through the back door the effect of child tax allowances for selected classes of taxpayer. The obvious unfairness and anomalies arise precisely because they generally exclude the main case - the married couple who stay married.\*

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\* As Mr Stewart says, however, the Law Society of Scotland has now written to us, raising points which imply that they think that the Sherdley principle can be extended under the existing law to include the married couple also. If they are right, we should in effect have open-ended child tax allowances for all - or at least for all those who can afford the legal costs.



6. Be that as it may, if you do not take the main OPB option, one possibility (Mr Stewart's Option 2) would be to end tax relief for maintenance payments to unmarried mothers, and offer no new compensation through the benefit system. This would leave unmarried mothers and their children to be picked up - as need be - by the existing safety net of income support. It is a political, not a technical, question whether that is a tolerable option. It is not something which I myself can recommend to you.

7. The remaining options (Mr Stewart's Options 3 to 5) imply preserving tax relief for payments to children and unmarried mothers in certain defined cases. Each of them implies - for the reasons outlined in paragraph 5 above - a major tax penalty on marriage - or on both marriage and families generally. They also look thoroughly messy and controversial to run in practice. I find it easy to understand why you described them at your recent meeting as "no solution".

8. Compared with the alternatives, Option 1 (to end tax relief for payments to children and unmarried mothers generally, but to provide compensation through OPB) does seem to me to have considerable attractions. It would be costly to enhance OPB solely for this purpose. But I do not think anyone would seriously suggest that, if you are going to enhance OPB, it would make sense to retain the APA. And if the APA goes, the "deadweight" cost largely goes with it.

#### Additional personal allowance

X 9. This leads on to APA, on which you have had the DHSS paper of 23 December. Arguably at some points it protests a little too much (it is after all a DHSS draft, though there have been long discussions with the Revenue). Maybe some of the points - for example, on encouragement of one-parent families - read a bit oddly against the background of the wider Budget proposals. But most of it is fair enough and DHSS do not of course yet know the wider background (though they will need to know more of it before too long).

10. A crucial question for APA is whether your objective is
- (a) just to eliminate the tax penalty on marriage as such (the case where two single people living together can each claim APA for each of two or more different children): what I might call the "narrower" objective; or in addition
  - (b) to simplify and rationalise the tax/benefit treatment of single parents, target APA more effectively on its original aim of single parents and in the process save Revenue staff: what I might call the "broader" objectives outlined in the original Green Paper.

Our best estimate is that there are up to 20,000 "couples" in category (a) - getting a "double ration" of APA and therefore enjoying more tax relief than a married couple with similar family responsibilities. There are 100,000 or so "couples" in category (b) - who are not enjoying more tax relief than a married couple with similar family responsibilities (the married man would get the married man's allowance), but who are getting APA though not in practice "single parents".

11. The proposal to enhance OPB and abolish APA would be the "broader" approach because couples in both 10(a) and (b) would lose APA and not qualify for OPB.

12. The position on "fallbacks" is somewhat less unhappy for APA than for maintenance payments. Subject to further work on the detail, we do not see quite the same order of problems in a rule which allows APA to continue, but disqualifies cohabiting couples. Such rules are inherently controversial and again it is probably realistic to accept from the outset that we would not be able to police them effectively. Unlike DHSS, we have no experience of them or appropriate administrative back-up. If we had to go down that route, there would be strong arguments for disqualifying only the most blatant cases, ie those in paragraph 10(a).

Conclusion

13. Overall, I see no reason to change the view (which I suggested at the time of your Green Paper) that the arguments for and against the conversion of APA into one-parent benefit (OPB) are quite finely balanced, if the APA proposal is taken in isolation. The question is how the balance of advantage shifts, if an enhanced OPB can also frank - as nothing else presently in sight can - the reform of maintenance payments.

14. This is, of course, why I have been so anxious that Ministers should take decisions on the APA and the maintenance proposals as a coherent package. As I see it, the OPB approach stands for both or falls for both.

C. J. C.

A J G ISAAC



FROM: J M G TAYLOR

DATE: 11 January 1988

*J.M.G. 13/11*

JMGT  
TO  
ISAAC  
11 JAN

MR ISAAC - INLAND REVENUE

cc PS/Chief Secretary  
PS/Financial Secretary  
PS/Paymaster General  
PS/Economic Secretary  
Sir P Middleton  
Mr Scholar  
Mr Culpin  
Miss Sinclair  
Mr McIntyre  
Mr Gibson  
Mr Cropper  
Mr Tyrie  
Mr Jenkins - Parl Counsel  
Mr Battishill - IR  
Mr Corlett - IR  
Mr C Stewart - IR  
PS/IR

**MAINTENANCE PAYMENTS AND ONE-PARENT BENEFIT (STARTER 150)**

The Chancellor has seen your minute of 8 January, and Mr Stewart's submission of the same date.

2. He awaits the views of the Chief Secretary, especially on the maintenance payments angle. But he agrees with your conclusion.

*JMGT*

J M G TAYLOR

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SINCLAIR  
TO  
CH.  
13 JANFROM: MISS C E C SINCLAIR  
DATE: 13 January 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary  
Financial Secretary  
Paymaster General  
Economic Secretary  
Sir P Middleton  
Mr Anson  
Mr Scholar  
Mr Culpin  
Miss Peirson  
Mr McIntyre  
Mr Riley  
Miss Hay o/r  
Miss Evans  
Mr Cropper  
Mr TyriePS/Inland Revenue  
Mr Battishill  
Mr Isaac - IR  
Mr Corlett  
Mr Stewart  
Mr MaceMr C Jenkins  
-Parly Counsel**REPLACING THE ADDITIONAL PERSONAL ALLOWANCE (APA) AND TAX RELIEF ON CERTAIN MAINTENANCE PAYMENTS BY INCREASED BENEFIT**

My minute of 23 December covering the DHSS/Revenue/Treasury report on eliminating abuse of the APA advised you not to take decisions before you had seen the Inland Revenue's submission on "fallback options" for the taxation of payments to children. That advice is set out in the notes of 8 January by Mr Stewart and Mr Isaac. This note, agreed with the public expenditure side of the Treasury and the Inland Revenue, sets out the main issues which you will need to consider in relation both to scrapping the APA and tax relief on maintenance payments to children; and offers an FP view.

**Replacing the APA by benefit**

2. Replacement of the APA by enhanced One Parent Benefit was canvassed in the Green Paper on Personal Taxation as a way of

abolishing the present tax penalty on marriage whereby two people living together with children can each claim an APA. But there are a number of difficulties with this:

- (i) There is not an exact fit between recipients of APA and OPB.
- (ii) As a result, a general increase in OPB would benefit 150,000 people who do not currently get the APA.
- (iii) At the same time, certain groups (totalling at least 100,000) who get the APA - husbands with incapacitated wives, cohabiting couples with only one APA between them - would not qualify for OPB. (Miss Dyall's note of 8 October to the Financial Secretary suggested that the relief for incapacitated wives should be abolished for new claimants in any event.)
- (iv) Increasing the OPB (from £4.90 to £12.30) to compensate for withdrawal of the APA would add about £200 million to public expenditure - though the net cost to the PSBR, taking account of additional tax revenue from abolition of the APA, would be nearer £20-£30 million.
- (v) It may well be that OPB could not be increased before April 1989 at the earliest, subject to views of Counsel and whether such a large increase would require primary legislation.

3. These difficulties and others, such as increased costs for DHSS, are spelt out in the joint report by officials. We do not know Mr Moore's reaction: but he will be advised to resist this option. But the other possible solutions to the problem of abuse canvassed in the report (introduction of a cohabitation test for the APA; linking qualification for the APA to receipt of DPB/other benefits) are not attractive to the Inland Revenue and would reduce, or even reverse, the staff savings of 125 which they would secure if the APA were abolished.

### Taxation of payments to children

4. The problem here is that your decision to remove tax relief on payments to children - as a way of levelling the playing field between married and unmarried couples - could lead to reduced support for the children of unmarried mothers living alone (and for children being brought up by a third party on their own eg a widowed grandmother). As Mr Stewart's note of 8 January explains, this may be largely a political problem: in most cases need would be catered for by means-tested benefits. But to say that the problem is political does not make it any less of a problem.

5. The numbers who would be left worse off are likely to be extremely small. Payments made under existing maintenance orders would of course continue to attract relief. This leaves some 15,000 new cases generally each year. We know that over half of one parent families generally receive means-tested benefits; deserted mothers in receipt of income support will be fully compensated, while those on family credit would get extra benefit equal to 70 per cent of any cut in maintenance payments. For the rest, the vast majority would be taxpayers whose tax relief under the new arrangements would probably compensate for any cut in payments. The residual, belonging to neither of these categories, seems likely to be tiny. Nevertheless, opponents would be able to stir up public sympathy for such a group.

6. If tax relief on maintenance payments to children were abolished, parallel enhancement of OPB would meet the political problem. Mr Stewart's minute shows that other options, involving the retention of some form of tax relief for payments for children, would not deal satisfactorily with the present tax penalty on marriage and would leave scope for extension of "Sherdley". The choice is therefore between ignoring the political problem ie abolishing tax relief on all payments to children with no compensation for unmarried mothers living alone; or increasing the OPB.

### Public expenditure considerations

7. At current tax rates, the extra tax which will result from abolishing the APA is estimated at around £170 million in a full

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year. The extra tax from the maintenance proposals as a whole is estimated at something like £25 million in the long run, though there is likely to be a small revenue cost in the early years because of the transitional arrangements. The yield, in the longer run, from denying relief for payments to unmarried mothers and their children, should be about £10 million. But in the early years it will only amount to about £3 million a year. These tax yield figures need to be balanced against the additional cost - £200 million a year - of enhancing OPB.

8. ST consider that conversion of APA to benefit would be a disproportionate response to the abuse of APA, given that only around 5 per cent of APA recipients are unmarried couples claiming two APAs. It would mean tripling the amount spent on OPB from less than £200 million to £600 million, although this would be partly offset by a reduction in expenditure on means-tested benefits, leaving a net cost of £200 million. Taxation would increase by almost as much. There would be windfall gains for 150,000 non-taxpayers, worth £7.40 to £12.30 a week, costing about £60 million.

9. Enhancement of OPB could also increase pressure for higher child benefit, which could have more important consequences for public expenditure. The new OPB rate of £12.30 would look generous compared with child benefit at £7.25 (especially as lone parents get OPB on top of child benefit). A £1 increase in child benefit, to close the gap a little, would cost over £600 million. At the very least, such a large increase in OPB and the numbers receiving it would make reform of child benefit and OPB (and even restricting future increases below the rate of inflation) more difficult.

10. As far as maintenance payments to children are concerned ST feel that it would be wrong to increase a general benefit (OPB) to cope with a problem affecting only a very small minority: no-one is suggesting that sizeable numbers would be in real need as a result of the abolition of tax relief on payments to children.



11. ST believe that an increase in OPB to deal with these two tax problems would also send the wrong signal to DHSS about the Treasury's stance on benefits generally. The main aim is to contain the growth of the social security programme, particularly by persuading the Department to target assistance on those in need, especially in the child benefit/OPB area. An increase in non-means tested OPB, which would benefit people who did not receive the APA, and would add 350,000 (over 50 per cent) to the numbers receiving OPB, and would be a move in the opposite direction.

12. You will also want to reflect on whether you would wish to be in the position of demandeur with Mr Moore (though decisions at Chevening make this rather less of a problem than it might have been). But you will need to tell him about your proposal on maintenance payments to strengthen the case for enhancing OPB. He may well try to use the occasion to get your agreement to concessions in other areas.

#### Other considerations

13. Mr Isaac concludes in his note of 8 January that if the APA proposal is taken in isolation, the arguments for conversion to enhanced OPB are quite finely balanced. FP would agree: indeed if APA abuse was the only issue in the field there would be much to be said for Option 3 - linking qualification for APA to receipt of OPB or other similar benefits. But there is a wider argument for abolition of APA, namely simplification of the tax system. And the fact that enhanced OPB would also meet the political problem of unmarried mothers etc in the context of the maintenance proposals tips the balance in favour of increasing OPB, if you can accept the consequences for public expenditure outlined above.

14. The Inland Revenue and FP consider that the present position on tax relief for payments to children is totally unsatisfactory. Following Sherdley, relief is available for everyone except the married couple who stay married; and there is a real risk that the Courts might extend the Sherdley decision to cover married couples also - in effect, restoring child tax allowances. Any half-way house on tax relief for children would be equally

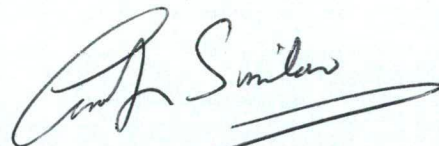
unsatisfactory: it would still discriminate against marriage and, wherever the boundary is drawn, new anomalies would be created which would lead to continuing pressure to extend the relief. The logic of the present position on child tax allowances is that there should be no tax relief for the support of children: your Budget proposal would, at long last, put that logic into law.

### Conclusions

15. Tax policy considerations point to abolishing both the APA and tax relief on payments to children. You could do both and avoid public expenditure complications if you decided to ignore losers. But this would be virtually impossible in the case of the APA: the Green Paper has already trailed the possibility of compensating losers via the benefit system if the APA were to be abolished. And in the case of payments to children, FP and the Revenue do not think you can ignore the consequences of your proposals for unmarried mothers on de minimis grounds. Your maintenance proposals will be contentious anyway. It would seem ill-advised to rouse the one-parent family lobby as well.

16. Because there would be so few losers, ST do not see abolition of tax relief on maintenance payments as a good reason for increasing OPB. In their view, this consideration would not therefore help to outweigh the disadvantages of converting APA into benefit.

17. FP think that on balance it is worth enhancing OPB - despite the drawbacks - because it would allow you to abolish both the APA and tax relief on payments to children. Other options would not.



CAROLYN SINCLAIR



FROM: FINANCIAL SECRETARY  
DATE: 14 January 1988

CHANCELLOR

cc Chief Secretary  
Paymaster General  
Economic Secretary  
Sir Peter Middleton  
Mr Anson  
Mr Scholar  
Mr Culpin  
Miss Peirson  
Mr McIntyre  
Miss Sinclair  
Mr Cropper  
Mr Tyrie  
Mr Isaac IR  
Mr Corlett IR  
PS/IR

*Ch/ You have the other  
pps. for tomorrow's meeting  
2/ 14/1*

**REPLACING THE ADDITIONAL PERSONAL ALLOWANCE (APA) AND TAX RELIEF  
ON CERTAIN MAINTENANCE PAYMENTS BY INCREASED BENEFIT**

I have had a quick look at this very complicated and difficult set of issues, in advance of your meeting tomorrow. I think it raises very awkward questions of tax and benefit policy.

2. There seem to me to be two ways of looking at these questions. On the one hand, a wide-ranging radical package could add another significant element of simplification to a Budget that is perhaps less strong on that than we would have liked. On the other hand, a narrower set of measures would be less radical but better targetted.

**A. RADICAL PACKAGE**

3. A package of measures could be constructed and presented coherently as a significant tax reform along the following lines

- (i) Abolition of tax relief for maintenance payments to children;

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(ii) Abolition of the Additional Personal Allowance (APA);

(iii) Compensatory increase in One Parent Benefit (OPB).

4. The main public argument or justification for this package would be that it would deal with the anomalous arrangements under which support for some children is presently available in the tax system. Relief has been creeping back into the system piecemeal since child tax allowances were abolished, and in such a way that there is discrimination against married couples. The increase in OPB would be a targetted compensation for one parent families which had previously been helped through the tax system by the APA and/or by tax relief on maintenance payments for their children. Seen in this context, I believe this package could form an important element in the wider tax reform Budget.

5. We would also, of course, claim credit for removing the tax penalty on marriage caused by the "abuse" of APA. More generally, the APA was originally intended to provide help for those bringing up children on their own. But, it is now being used increasingly for different purposes - for reducing the tax bills of cohabiting couples with children. This is another argument in favour of radical reform.

**B. NARROWER APPROACH**

6. One difficulty with the radical package is the fact that raising OPB is not a well-targetted, cost-effective or self-evidently appropriate quid pro quo for dealing with the "abuse" in either:

(i) the double APA; or

(ii) the tax relief on Sherdley and cohabiting maintenance payments.

7. If the aim were to tackle either (i) or (ii) in isolation then I think we would all agree that an increase in OPB would look inappropriate.

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8. As far as (i) is concerned a central political motivation is to stop co-habiting couples claiming two APAs. But this is a relatively "small" problem: perhaps at most 20,000 couples are actually claiming double APA out of 480,000 APA recipients in total. Would it be appropriate to increase OPB by a substantial amount for hundreds of thousands of people (there are currently 640,000 and the numbers would rise if we increased OPB) for the sake of cracking this small nut? Would it not be more logical to stop APA abuse directly by limiting its scope rather than by abolishing APA for everyone and then being forced to raise OPB to compensate those we do not wish to suffer?

9. Equally, in order to compensate the very small number of unmarried mothers who might lose from the abolition of tax relief for maintenance payments (probably much less than 7,500 each year), is it right to contemplate a net public expenditure cost of £200m pa?

10. If this line of argument has any force, I think one is driven to a rather messy combination of Option 2(a) in the joint DHSS paper and Option 4 in Mr Stewart's submission. This would:

- (i) Retain the APA but limit couples living together with two or more children to one APA between them;
- (ii) Allow tax relief for maintenance payments to children to continue, but only where the child was not living with, or in the custody of, the payer. This would be subject to a ceiling of £1370 on the relief;
- (iii) Leave OPB unchanged.

11. Under this proposal, the unmarried cohabiting couples with children would get the same amount of tax relief (and benefit) as the married couple. There would be neither a tax incentive for such couples to get married nor a disincentive. The "abuse" of APA would go. Unmarried couples would not be able to covenant income to each other; and if cohabiting would get no maintenance relief.

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C. ARGUMENTS AGAINST THE RADICAL PACKAGE

12. It seems to me that the main criticisms of the tax reforming package as a whole are that:

- (i) The proposition that abolition of either the APA or the tax relief for maintenance payments to children might sensibly be bought out by a rise of £7.40 per week in the OPB looks distinctly odd;
- (ii) It offers some Revenue staff savings, but at the price of pushing up DHSS administrative costs (though overall there would be net administrative savings of roughly £0.75m p.a.);
- (iii) The large increase in OPB would be in stark contrast to our recent freezing of child benefit. The difference between the total child benefit available to the one parent family (£12.30 + £7.25) and that due to the married mother (£7.25) might lead to strong pressure for higher child benefit;
- (iv) It would generate 120,000 or so losers - the cohabiting couples who would lose from the abolition of the APA but would not be entitled to OPB as a result of the cohabitation rule;
- (v) It would give large windfall gains to 150,000 non-taxpaying recipients of OPB (at a cost of £60m);

13. I would comment on three of these criticisms. First, as regards (i), the key question is whether the prize of abolishing both the APA and tax relief for maintenance payments to children is sufficient to justify the increase in OPB. In my view, the £7.40 per week increase looks much more reasonable when viewed against the two-fold simplification.

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14. I do not see (iii) as a major obstacle. We would argue that:

(a) OPB is being increased to compensate for the loss of APA and maintenance relief;

(b) OPB is narrowly targetted on one-parent families, not on children generally. (Child benefit of course is a universal benefit);

(c) Married recipients of child benefit will gain from independent taxation.

15. Finally, on (iv), I am sure that many of these "losers" will gain from other aspects of the Budget package.

**D. ARGUMENTS AGAINST THE NARROW PACKAGE**

16. The limited package is not without problems either. In particular:

(i) It could not be regarded as much of a simplification of the tax system and would not save Revenue staff;

(ii) It would mean the Revenue getting involved with assessing whether couples are "living together as husband and wife" for the purposes of restricting double APA claims and maintenance relief.

**E. SHOULD THE TAX SYSTEM FAVOUR MARRIAGE OR BE NEUTRAL TO IT?**

17. A central question which has to be faced in all of this is whether we want a tax system which positively encourages people to get married. We have, of course, already built into the new personal tax system the Married Couple's Allowance and we will have to defend it. However, the proposal to abolish the APA goes a step further. It would result in married couples with

**CONFIDENTIAL**

children getting more tax relief than unmarried cohabiting couples with children. Do we actually want the tax system to go beyond neutrality in this way?

18. We also need to bear in mind that:

- (a) Post-Budget, divorced and separated couples will still get tax relief on maintenance payments (up to a ceiling), payments which will be used partly to help with the costs of bringing up children. So with divorced, separated and married couples looked after by the tax system why do we turn our backs on the children of unmarried couples?
- (b) Whilst the OPB increase will compensate many single parent families it will not compensate specifically cohabiting couples. Thus the unfavourable tax treatment accorded to unmarried couples with children will be left uncompensated in the "least bad" case where the couple have a stable relationship and are living together as a family.

19. Taken together the tax and benefits system will impell people wanting children either to get married or to live apart.

**DECISION**

20. What your meeting tomorrow will have to decide is whether the more radical tax reforming package is really worth the substantial public spending cost which is avoided by going down the messier (for the Revenue) and more limited route I have suggested as a possible alternative. I think that despite the rough edges and the number of objections, there are arguments for the radical approach. The APA is the sort of relief we ought to phase out in a reforming Budget.

A.H.

**NORMAN LAMONT**



CONFIDENTIAL

FROM: P J CROPPER  
A G TYRIE

DATE: 14 January 1988

CHANCELLOR

*NB of Tyrrie done!*

cc Chief Secretary  
Financial Secretary  
Paymaster General  
Economic Secretary  
Sir P Middleton  
Mr Scholar  
Mr Culpin  
Mr Gilmore  
Mr Anson  
Miss Peirson  
Miss Sinclair  
Mr Burr  
Mr MacIntyre  
Mr Battishill IR  
Mr Isaac IR  
Mr Corlett IR  
Mr Mace IR  
Mr C Stewart IR

**REPLACING THE ADDITIONAL PERSONAL ALLOWANCE (APA) AND TAX RELIEF ON CERTAIN MAINTENANCE PAYMENTS INCREASED BENEFITS**

Following a marathon three hour meeting this morning with the FST, Cropper and Tyrrie now think they know where they stand on this very difficult set of issues.

1. The Married Couple's Allowance is at the heart of our chosen scheme of Independent Taxation. It represents a discrimination in favour of marriage and against the co-habiting couple. So be it. We see no great political difficulty in sustaining that discrimination.

2. We feel quite differently when children come on the scene. Looked at from their point of view, it would be undesirable if their (unmarried) parents were placed at an avoidable disadvantage compared with the (married) parents next door, because the difference would come through in the childrens' welfare.

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3. At present the APA serves to equalise the position of these two "families". (In some cases it is abused, by two cohabiting couples each claiming an APA: that must be stopped, see below.)

4. It is very attractive from a tax reform angle, to abolish the APA and replace it with a benefit. One of the present proposals is to increase the One Parent Benefit. That would be a quite legitimate switch in the case of the single parent living alone with his or her child or children.

5. But the OPB only goes to single parents, by definition. It does not go to the cohabiting couple with children. So the cohabiting couple with children lose by APA abolition and do not gain from the OPB increase.


6. It is not easy to justify a system which would discriminate against cohabiting couples with children, vis a vis married couples with children.

7. Furthermore we see distinct disadvantage in a reform which leaves unaffected the single parent with children, while disadvantaging the cohabiting couple with children. That way, we would be encouraging unmarried parents to live apart. Even though one may deplore couples with children living together out of wedlock, it is much worse (for the children) if they live apart out of wedlock.

8. We are not sure there is any way out of this impasse except by retention of the APA. [Tyrie is still trying and may minute you later in the evening.]

9. In that event the Inland Revenue would have to be asked to police a system which will stop cohabiting couples getting two APAs - much as they will dislike the job.

10. The other clutch of problems involving Sherdley, and the Super-Sherdley that may come along in its wake, will have to be dealt with by corrective legislation.

  
P J CROPPER

  
A G TYRIE