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PART A

1988 BUDGET DEPUTATION AND REPRESENTATION

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PART A

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1988 Budget Deputation

& Representation

Part A

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91?/088/alr

RB 4/1

1. MRS BURNHAMS
2. MISS SINCLAIR
3. MCU
4. ECONOMIC SECRETARY

FROM: MISS S WALLIS

DATE: 4 January 1988

cc PS/Chancellor 12/2
PS/CST
PS/FST
PS/Paymaster General
Mr A Wilson
PS/C & E
Mr J Fisher (C & E)

BUDGET DEPUTATION: THE BISCUIT, CAKE, CHOCOLATE AND CONFECTIONERY ALLIANCE

The Biscuit, Cake, Chocolate and Confectionery Alliance have sent in their representations for the Budget, and are asking for an opportunity to discuss them with Ministers.

The Alliance are not on the "Core List" of organisations that Ministers should see as a matter of course. They were not seen last year.

We and Customs see no advantage in you agreeing to a meeting this time round. We therefore suggest you turn down their request.

I attach a reply.

S Wallis

MISS S WALLIS

ENC

91●/089/alr

Treasury Chambers, Parliament Street, SW1P 3AG

Charles E Gillett Esq
President
The Biscuit, Cake, Chocolate and
 Confectionery Alliance
11 Green Street
London W1Y 3RF

January 1988

Thank you for your letter of 18 December to the Chancellor of the Exchequer.

As you can imagine, Treasury Ministers receive numerous requests for meetings from representative bodies before each Budget. I am sure you will appreciate they cannot see every organisation which requests a meeting. I am afraid, therefore, that it will not be possible for Treasury Ministers to see you in the run-up to the 1988 Budget.

I can assure you, however, that your representations will be carefully considered.

PETER LILLEY

13d

THE · BISCUIT · CAKE · CHOCOLATE & CONFECTIONERY · ALLIANCE

BR

HM TREASURY — MCU

RECD. 18 DEC 1987

ACTION Mrs Burnham Dep?

EST

REF No. 30062/8

PP – A Budget

The Rt. Hon. Nigel Lawson, MP,
Chancellor of the Exchequer,
The Treasury,
Parliament Street,
London SW1P 3HE

18th December 1987

Dear Chancellor,

Taxation on Food

The Biscuit, Cake, Chocolate and Confectionery industry welcomes the Government's statement on maintaining a zero rate of VAT on Food, and submits that the time has now come to revert to the situation when VAT was first introduced and restore zero rating to all the industry's products. The Food and Drink Federation opposes VAT on food and it is understood that the Snack Nut and Crisp Manufacturers Association and the Ice Cream Federation will also be making submissions concerning their products. The Government's defence of zero rating as an instrument of social policy would be immeasurably strengthened if in fact all food was zero rated.

There is no doubt that confectionery and chocolate biscuits are treated and regarded as food by both consumers and Government. The industry's products as a whole make a significant contribution to the diet reflecting the modern trend towards less formal eating habits. They are not a luxury. Manufacturers in the processed food sector, compete with one another for market share and those not subject to VAT have an unfair advantage. Also, the borderline between those products which are taxed and those which are not, is finely drawn and the cause of frequent differences of opinion which have to be resolved by VAT Tribunals and Appeal Courts.

It is accepted that removal of VAT from the industry's products would reduce Government revenue, but according to an Econometric Survey undertaken by the Department of Applied Economics at Cambridge University this would not be as great as expected since its removal would also boost industry, increase employment and reduce inflation. The Department's report and full details of the industry's case are enclosed.

It is submitted that both the economic climate and current developments within the European Commission towards completing the internal market provide a good opportunity for VAT to be removed from all food products.

/2...

11 GREEN STREET · LONDON W1Y 3RF · TELEPHONE 01-629 8971 · TELEX 24738 · FAX 01-493 4885
DIRECTOR J E NEWMAN DEPUTY DIRECTOR B H LAWSON

We would welcome the opportunity to present our case to you in person and look forward to meeting you in the New Year.

Yours sincerely,

Charles E. Gillett
President

THE BISCUIT, CAKE, CHOCOLATE & CONFECTIONERY ALLIANCE SUBMISSION ON VALUE ADDED TAX

CONFECTIONERY IS FOOD

1. SUMMARY

1.1 Food is not taxed in the UK.
Our products are food but are taxed.

Confectionery and chocolate biscuits are;

- Treated as food by consumers and categorised as food by the Government.
- Made from 'food' ingredients
- Provide a useful nutritional contribution.

1.2 Confectionery was originally exempt from VAT and only became subject to VAT because the government wished to gain revenue.

1.3 Treating confectionery as food will enhance the Government's policy on maintaining the zero-rating of food in the UK.

1.4 Although treating confectionery as food would reduce Government revenue, it would boost industry, increase employment and reduce inflation.

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CONFECTIONERY IS FOOD

2. INTRODUCTION: FOOD ISN'T TAXED IN THE UK

2.1 Zero-rating of VAT is permitted under European Community directives for clearly defined social reasons and, in the case currently being defended at the European Court of Justice, where the European Commission is challenging the UK's right to zero-rate various services, the zero-rating of food was quoted by the Commission's Advocate General to illustrate its proper application.

2.2 The UK Government has repeatedly committed itself to maintaining zero-rating for food as a major policy principle; but in fact the UK consumers pay some £625 million in VAT on food. This taxed food is eaten by adults and children, men and women, old and young, all social classes equally. Tax paid by consumers on the products of the BCCCA alone amounts to some £450 million. To continue to tax foods so widely used and interchangeable with other untaxed foods could be said to bring into question the validity of the UK's claim to be zero-rating food as an instrument of social policy.

2.3 When VAT was first introduced in 1973, no food was taxed; later certain foods were subjected to VAT to raise additional revenue.

2.4 This paper demonstrates that these foods subjected to tax, are interchangeable with other foods, and so should properly be treated as food. Therefore they can, and should, be included with food in the UK's "exemption with refund of the tax paid at the preceding stage", as permitted by the Sixth Directive (see Appendix I). A substantial proportion of the theoretically foregone revenue will be off-set by favourable cost and revenue consequences. There will be advantageous effects on the Retail Price Index via price reductions and other economic benefits.

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CONFECTIONERY IS FOOD

3. CONSUMERS

3.1 Consumers treat confectionery and chocolate biscuits as if they were any other food. After all, what else can you do with them except eat them?

3.2 They are eaten by all sections of the population

Expenditure on confectionery closely follows the pattern of population;

Socio-Economic Strata	Proportion of Population	Proportion of total Confectionery Expenditure
AB	17.0%	11.6%
C1	22.8%	24.3%
C2	27.7%	33.5%
DE	32.5%	30.6%

SOURCE: GORDON SIMMONS RESEARCH

3.3 Consumption is slightly skewed to the younger age group, but is still remarkably universal;

Age (Years)	Proportion of Population	Proportion of total Confectionery Expenditure
0-19	27 %	41 %
20-44	36 %	30 %
45 +	37 %	29 %

SOURCE: GORDON SIMMONS RESEARCH

3.4 They are eaten like other foods

According to the Household Food Consumption and Expenditure Survey 1985, there has been an increase in the number of meals taken at restaurants and snack bars and a decline at schools and places at work. This finding clearly demonstrates development of the snacking/convenience food market involving products made by Alliance members, together with many others.

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CONFECTIONERY IS FOOD

3.5 60% of the occasions when confectionery is eaten, it is part of a meal or eaten with other foods or drinks (source: British Market Research Bureau). Chocolate biscuits and confectionery are used frequently as alternatives 'desserts': alternative to similar products, like chocolate pudding and cakes. When asked, consumers listed alternatives to our product; ranging from fresh fruit to pizzas: all zero rated.

3.6 The BCCCA's products also fulfil a snack role, as part of the growing social trend towards informal eating. In this they play a similar role to yoghurts, cereals, meat pies, and desserts. A glance at, for example, a train buffet shows our products displayed in amongst fruit, sausage rolls, sandwiches and plain biscuits; none of which are taxed (See appendix III).

4. GOVERNMENT

4.1 All Key UK Government statistics treat taxed BCCCA products as food:

i)	Family Expenditure Survey	- Expenditure Surveys
ii)	Economic Trends	- Product surveys
iii)	Department of Employment Gazette	- Employment and R.P.I.
iv)	Overseas Trade Statistics	- Trade surveys.

4.2 In addition, no distinction is drawn between taxed and untaxed products in the 1984 Food Act and its associated regulations.

4.3 Differentiation between those products which are free of tax and those which are not leaves numerous anomalies and difficulties. A recent Court case (Commissioners of Customs and Excise v. Quaker Oats Ltd, before Mr. Justice Kennedy) on whether a certain chewy bar was or was not to be taxed involved subtle distinctions of an irrelevance to consumers - whether the manufacturing process was "baking" or some other - that would not have been out of place in a medieval scholastic debate. Customs and Excise themselves have in recent enquiry admitted the distortions of trade and difficulties of drawing a valid distinction.

THE BISCUIT, CAKE, CHOCOLATE & CONFECTIONERY ALLIANCE SUBMISSION ON VALUE ADDED TAX

CONFECTIONERY IS FOOD

5. THE NUTRITIONAL CONTENT

5.1 The chocolate, biscuit and confectionery produced by our industry are useful contributions to the nutrition of the British population. They provide;

22% of total carbohydrate
15% of total fat
7% of total protein
16% of total energy

(See Appendix II)

They have established themselves as a significant part of a healthy balanced diet.

5.2 A bar of milk chocolate, for example, provides more energy, more carbohydrate, more vitamin B2, more calcium and almost as much protein as a portion (2 slices) of wholemeal bread and butter.

6. INGREDIENTS

6.1 The nutritional content clearly comes from the ingredients used. The major items are sugar, glucose, syrup, wheat flour and other cereals, cocoa beans, eggs, butter, other dairy products, oils and fats, dried fruit and nuts. These are undeniably food and are purchased by the consumer free of any VAT.

6.2 So why is it that when our industry combines them into popular consumer products, they cease to be food and are penalised by a VAT surcharge?

6.3 Many consumers themselves make biscuits and confections similar to our products using the zero-rated ingredients. But they are penalised financially if they want to have the convenience and economy of large scale manufacture by our industry. This is not the case with other convenience foods, which are readily available and free from tax.

6.4 Further, these ingredients are common in foods which are not taxed. None of the major ingredients is used solely in chocolate biscuits or confectionery. Even cocoa beans are not unique to taxed products. For example, chocolate dessert pudding, milks, cooking chocolate and cocoa drinks are all free of tax.

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7. SO WHY IS CONFECTIONERY TAXED?

7.1 When VAT was introduced in the UK in 1973, the Chancellor explained why foods previously liable to purchase tax would now be zero-rated for VAT;

"There is one other tax which falls heavily on families with children... I refer to foods... which are at present charged to Purchase Tax - mainly all kinds of confectionery, and ice-cream, crisps, soft drinks and so on. The day has passed when these items can seriously be regarded as luxuries in the old sense of the word. They are bought by all sections of the community. I have decided they should be entirely relieved of tax - in other words zero-rated for VAT".

7.2 One year later, another Chancellor in another Government, searching for more revenue to replace that lost in some tax concessions, said:

"We must find the means of paying for this and I have decided to ... apply the standard rate of value added tax to confectionery ...".

7.3 A Conservative Chancellor felt that equity demanded zero-rating; A subsequent Labour Chancellor believed that the need to raise more revenue overrode that. Since then, all governments have justified this treatment of our products on revenue terms alone, and not denied the original argument in favour of zero-rating.

8. THE ECONOMIC CONSEQUENCES OF EQUITY

We have commissioned an independent economist to assess the consequences of zero-rating our products (see Appendix IV). The immediate loss of revenue to the government would be about £442m. However, the net cost would, our report shows, be only £244m, after allowing for the full financial ramifications.

8.2 The first effect of removing VAT from our products would be that we would reduce our prices by 13% (ie. 15%/115%). This would happen because we know that the money belongs to the consumer, not the industry. In addition, the market is highly competitive, and would force corresponding price reductions.

8.3 The direct results of this would be for sales of confectionery and chocolate biscuits to rise by 7.5% and other consumer expenditure by 0.12%. Meanwhile the Retail

Prices Index would fall by 0.2% as a result of our price reductions.

8.4 Employment in the industry and related sectors would rise by over 14,000. For the industry itself, the volume-led improvement in unit costs would improve competitiveness both at home in resisting further import penetration and abroad in the highly competitive export markets which already account for f.o.b. sales of £400 million per annum. The industry's ability to reinvest would also be greatly improved.

8.5 Virtually all the industry's raw materials are either controlled by the Common Agricultural Policy or originate in the developing countries of the third world. The increase in sales would assist in the task of reducing CAP surpluses in the best possible way by adding value to them, whilst the increase in demand for agricultural exports from the Third World would help their economies. For instance, the shea nut from Burkino Faso, used exclusively for its fat by the chocolate industry, is that country's largest export earner and represents some 10% of their exports.

8.6 The higher volume of demand released by the zero-rating would generate higher profits, which would themselves stimulate reinvestment and additional Corporation tax.

8.7 The net effect would therefore be a loss of revenue to the Government of £244m, but more than 14,000 jobs created, lower inflation, and additional investment in one of Britain's success industries.

THE BISCUIT, CAKE, CHOCOLATE & CONFECTIONERY ALLIANCE SUBMISSION ON VALUE ADDED TAX

CONFECTIONERY IS FOOD

9. CONCLUSION

9.1 The BCCCA believes that confectionery and chocolate biscuits should be zero-rated, because food is zero-rated and confectionery is food.

9.2 Treating confectionery as food would enhance the Government's policy on zero-rating food within the European Community.

9.3 Though this will reduce Government revenue, it will have highly beneficial economic effects. The Government should no longer justify an arbitrary and unfair tax on the basis of revenue requirements alone.

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APPENDICES

THE BISCUIT, CAKE, CHOCOLATE & CONFECTIONERY ALLIANCE SUBMISSION ON VALUE ADDED TAX

CONFECTIONERY IS FOOD

APPENDIX I

The impact of the Second & Sixth Directives of the European Community

The Effect of the Second and Sixth EEC Directives on VAT

1. It has been suggested that the combined effect of the 2nd and 6th EEC Directives on VAT prevent an extension of VAT exemptions. This claim is based on Article 28.2 of the Sixth Directive which reads:

> "Reduced rates and exemptions.... which are in force on 31st December 1975, and which satisfy the conditions stated in the last indent of Article 17 of the second Council Directive of 11 April 1967*, may be maintained until a date which shall be fixed by the Council...
>
> ... the Council shall review the above-mentioned reduced rates and exemptions every five years and, acting unanimously on a proposal from the Commission, shall where appropriate adopt the measures required to adopt the progressive abolition thereof".

* Article 17 provides that member states may maintain reduced rates and exemptions for clearly defined social reasons.

Whilst it appears from the Sixth Directive that only food (other than confectionery and the other items then excluded) is to be treated as exempt, it must be recognised that the exemption of confectionery was a reflection only of the VAT treatment accorded to it at that time; confectionery had, of course, previously been exempt from VAT in 1973.

2. As part therefore of the the move towards harmonisation of VAT it is entirely appropriate for chocolate biscuits and confectionery to be classified with other food and therefore exempt from VAT. The Government should discuss this change with the Commission as a part of its current policy to continue to treat food as exempt from VAT.

jc/bccca/11

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APPENDIX II

The Nutritional Contribution of BCCCA Products

The tables below illustrate the contributions of the major ingredients to nutrient intakes in the UK diet.

Carbohydrate

Total consumption		89.8 kg per person per year
BCCCA contribution		22.5%
Supplied by	sugar	11.0%
	glucose	2.7%
	flour	6.7%
	other	2.1%

Protein

Total consumption		24.7 kg per person per year
BCCCA contribution		7.0%
Supplied by:	flour	3.4%
	dairy products	1.8%
	cocoa	0.6%
	other	1.2%

Fat

Total consumption		35.4 kg per person per year
BCCCA contribution		15%
Supplied by:	oils and fats	9.3%
	cocoa butter	3.3%
	dairy fat	1.4%
	nuts	0.5%
	other	0.5%

Energy

Total consumption		754,150 kcals per person per year
BCCCA contribution		16%
Supplied by:	cocoa	3.3%
	oils and fats	2.1%
	dairy products	3.7%
	nuts	1.3%
	eggs	1.3%
	other	4.3%

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CONFECTIONERY IS FOOD

APPENDIX III

THE BISCUIT, CAKE, CHOCOLATE & CONFECTIONERY ALLIANCE SUBMISSION ON VALUE ADDED TAX

APPENDIX IV

The Economic Impact of Removing VAT on Confectionery - A paper by Dr. C.F. Pratten of the Department of Applied Economics University of Cambridge

1. SUMMARY

The main effects of removing VAT on confectionery are summarised in Table 1. The table shows the effects for a full year after full adjustment to the removal of VAT, and is based on 1986 prices and volumes.

The industry would pass on the reduction in VAT in full and the prices of confectionery would fall relative to the level with VAT in place, by 13 per cent. The effect on the RPI would be a fall of 0.2 per cent.

The volume of sales of confectionery would increase by about 7½ per cent in response to the reduction in the relative prices of confectionery. The reduction in VAT would lead to an increase in other consumers' expenditure of about 0.12 per cent. The effects on employment would be an increase in jobs of 14,250, and there would be a deterioration in the balance of payments of £138m. GDP would increase by 0.15 per cent.

Finally the effect on the PSBR would be a net reduction in government revenue of £241m. The direct reduction in VAT revenue would be £442m but £198m, 45 per cent of the initial loss of revenue, would be recouped.

THE BISCUIT, CAKE, CHOCOLATE & CONFECTIONERY ALLIANCE SUBMISSION ON VALUE ADDED TAX

Table 1. The Effect of Removing VAT on Confectionery

	Direct Effects	
(1)	Reduction in VAT Revenue (1)	£442m
(2)	Prices of Confectionery	-13%
(3)	The Retail Price Index	-0.2%
(4)	Volume of Sales of Confectionery	+7%
	Direct and Indirect Effects	
(5)	Other Consumers' Expenditure (2)	+0.12%
(6)	Employment	+14,250 jobs
(7)	Balance of Payments (1)	-£138m
(8)	G.D.P. at market prices (3)	0.15%
(9)	PSBR (1)	-£244m

Notes

(1) In terms of 1986 prices.

(2) Total consumers' expenditure (row 2 of Table 2) £234,167 less expenditure on confectionery (row 1) £3,390m = 230,777m. The direct effect on 'other consumers' expenditure' (row 11) £252m, less the reduction in sales of 'other food products' (row 10) £75m, plus part of the multiplier effects (row 13) £110m = £287m in all, as a percentage of £230,777m = 0.12 per cent.

(3) Other consumers' expenditure (note 2 above) £287m, plus increase in fixed capital expenditure (row 12), £25m, plus remainder of the multiplier effects (row 13 and note 2 above), £17m, plus expenditure on confectionery £221 = £550m, as a percentage of £374bn = 0.15 per cent.

THE BISCUIT, CAKE, CHOCOLATE & CONFECTIONERY ALLIANCE SUBMISSION ON VALUE ADDED TAX

2. METHODOLOGY AND ASSUMPTIONS

Removing VAT on confectionery would have a long chain of effects. It was decided that macro economic models would not provide a reliable method of tracing these effects because the models do not incorporate the distinctive characteristics of the confectionery industry. Instead the principal effects were estimated from information provided by firms in the industry and published statistics for the industry.

The estimates are for the effects of removing VAT on confectionery. They do not include the effects of increasing government revenue or borrowing to pay for the removal of VAT on confectionery. The estimates are intended as a basis for comparing the effects of removing VAT on confectionery with the effects of reducing other taxes. They are based on 1986 prices and volumes and they allow for full adjustment to the removal of VAT on confectionery. Full adjustment would take two to three years; it would take that long for the increases in profits to result in extra tax revenue.

The main assumptions made in order to make the estimates were that the following variables were not affected by the removal of VAT on confectionery:

(a) the exchange rate

(b) interest rates

(c) hourly wage earnings per person

(d) prices of the ingredients of confectionery and products (apart from the reduction in prices of confectionery flowing directly from the reduction in VAT).

(e) stocks and work in progress

(f) asset prices

The elimination of VAT on confectionery is assumed to apply to snack foods and ice cream. The estimates of the effects of the VAT changes on government revenue and expenditure given in Tables 1 and 2 are limited to the effects of the elimination of VAT on confectionery. The realism of the assumptions and the sensitivity of the estimates to change in the assumptions are considered later.

Table 2 gives the estimates of the effects of reducing VAT in more detail. First, the bases for the assessments of the effects on prices and sales of confectionery are described. The sources for the other estimates are given at the end of the table.

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SUBMISSION ON VALUE ADDED TAX

3. PRICES OF CONFECTIONERY

The confectionery industry is oligopolistic but it is competitive. There are several reasons for the effectiveness of competition in the industry. No one firm dominates the industry. Also the circumstances of the three leading firms in the industry differ and changes affecting the industry do not impinge on these firms in a uniform way. Such changes provide one or other of the firms with a temporary advantage with which it can increase its competitiveness. New products are introduced and changes made to existing products, some of these changes result in significant changes in market shares. The industry's customers include powerful retail groups.

The reaction of firms in the industry to the removal of VAT would be very visible. There would be pressure from large retailers, from 'own label' brands in some sectors of the trade and perhaps from the media for the industry to pass on the VAT reduction. There are strong grounds for expecting the removal of VAT on confectionery to be passed on in full in lower prices. Firms would expect prices to be cut and each firm would be reluctant to be left behind in the move to lower prices. This assessment of the price effects of changing VAT is supported by the record of the industry when dealing with earlier changes in indirect taxes and changes in the price of cocoa. Between 1972 and 1973 when purchase tax was removed the relative price of confectionery (the price of confectionery relative to the retail price index) fell by 10 per cent.

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4. SALES OF CONFECTIONERY

It is estimated that the reduction in prices of confectionery of 13 per cent would lead to a 7½ per cent increase in the volume of sales of confectionery. This estimate is based on estimates of the effects of past changes in prices made by firms in the industry. These price changes were in response to changes in indirect taxes and changes in the price of cocoa relative to other prices, or resulted from moves by firms to provide increased 'value for money' by increasing the size of chocolate bars. The relative reduction in confectionery prices between 1972 and 1973 was accompanied by an increase in consumption of confectionery of 11.6 per cent. Between 1973 and 1975 when VAT was imposed, the relative price of confectionery rose by 23.8 per cent and the volume of sales fell by 15.1 per cent. Although some part of these changes in the volume of sales are attributable to changes in stocks and real personal incomes, they suggest that the volume of industry sales is very responsive to changes in the prices charged by the industry. (1)

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(1) The increase in VAT in 1979 does not provide such a clear test of the effects of changes in indirect taxes because the increase in VAT applied to other consumer goods besides confectionery.

THE BISCUIT, CAKE, CHOCOLATE & CONFECTIONERY ALLIANCE SUBMISSION ON VALUE ADDED TAX

5. Table 2. The Initial Effects of Removing VAT at 15% on Confectionery in terms of 1986 output and prices.

(1)	Retail sales of confectionery and chocolate biscuits in 1986 (a)	£m	3,390
(2)	Total consumers' expenditure in 1986 (b)	£m	234,167
(3)	(1) as percentage of (2)	%	1.4
(4)	Consumers' expenditure on food in 1986 (b)	£m	32,340
(5)	(1) as percentage of (4)	%	10.5
(6)	Proposed reduction in VAT on confectionery (c)	£m	442
	The Direct Effects of Reducing VAT on Confectionery		
(7)	Prices of confectionery (d)	%	-13
(8)	RPI (e)	%	-0.2
(9)	Volume of sales of confectionery	% £m	+7.5 +221
(10)	Sales of other food products (f)	£m	-75
(11)	Other consumers' expenditure (g)	£m	+252
	The Second Round Effects		
(12)	Extra fixed capital expenditure (annual rates for 3 years by:		
	Confectionery manufacturers (h)	£m	+15
	Other firms (h)	"	+10
	Total	"	25
(13)	The multiplier effects of the first round increase in consumers' expenditure and the increase in fixed capital expenditure (i)	£m	127
	Employment effects		
(14)	Confectionery industry (j)	Number	+2,250
(15)	Firms supplying the confectionery industry and distributing its products (j)	Number	+6,000

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(16)	Other UK industries for direct increases in consumers' expenditure (j)	Number	+3,000
(17)	UK investment goods industries for increases in fixed capital expenditure	Number	+500
(18)	UK industries for the multiplier effects	Number	+2,500
(19)	Total		+14,250

Balance of payments effects

(20)	Increase in imports of confectionery (k)	£m	+15
(21)	Increase in imports of cocoa and other ingredients of confectionery (l)	£m	+40
(22)	Increase in imports for other consumers' expenditure (m)	£m	+53
(23)	Increase in imports of capital equipment (n)	£m	+10
(24)	Increase in imports to meet demand generated by multiplier effects	£m	+35
(25)	Total	£m	153
(26)	Increase in exports of confectionery products (o)	£m	+15
(27)	Net balance of payments effect	£m	-138

Effects on Taxation and Government Expenditure

(28)	Direct Loss of Revenue	£m	442

Increase in Tax Revenue or Lower Expenditure

(29)	Indirect taxes including VAT on additional other consumers' expenditure of £252m (p)	£m	50
(30)	Reduction in unemployment benefit and social security for jobs created (q)	£m	22
(31)	Taxes and national insurance contributions on the additional wages (r)	£m	29
(32)	Taxes on additional profits (s)	£m	20
(33)	Taxes derived from multiplier effects	£m	40

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(34)	Reduction in social security payments because of slower inflation (t)	£m	40
(35)	Total		201
(36)	Net effect on PSBR	£m	241

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SUBMISSION ON VALUE ADDED TAX

6. SOURCES OF ESTIMATES

(a) Retail sales of confectionery - The BCCCA

(b) Monthly Digest of Statistics, Oct. 1987

(c) VAT at 15 per cent on £m 3390 $\left(\frac{15}{115} \times 3390\right)$

(d) £442m as percentage of £3,390.

(e) £442m as percentage of £234,167.

(f) This is an estimate of the reduction in sales of other food products caused by the fall in the relative price of confectionery. It is difficult to assess the effects of price changes for confectionery on other food consumption. In relation to total food consumption the effects are much smaller than for consumption of confectionery and are, therefore, more difficult to isolate. There is evidence that changes in consumption of chocolate biscuits in response to changes in relative prices lead to opposite changes in the consumption of other biscuits.

(g) The savings ratio in 1986 was 9.1 per cent.[1] It is estimated that 10 per cent of the £442m reduction in VAT - £44m - would be saved. There are two reasons for expecting a low proportion of the tax reduction to be saved. The savings ratio for those benefiting from the reduction in confectionery prices is low because expenditure on confectionery is proportionately higher among low income groups. Also none of the reduction in taxes would be syphoned off into pension contributions.

(h) The estimates of the effects of increased demand on investment by confectionery manufacturing firms are based on estimated made by firms in the industry. The effects on the investment plans of firms vary. The elimination of VAT would cause some firms to initiate substantial investment projects. At the other extreme firms have enough capacity to meet the extra demand. In 1985 net fixed capital expenditure represented about 5 per cent of industry sales.[2] The estimated extra fixed capital expenditure of £15m a year by the confectionery industry represents 10 per cent of the increase in confectionery manufacturers' turnover.

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(1) Economic Trends, October, 1987.

(2) HMSO Business Monitor PA421, 'Ice-cream, cocoa, chocolate and sugar confectionery'.

THE BISCUIT, CAKE, CHOCOLATE & CONFECTIONERY ALLIANCE
SUBMISSION ON VALUE ADDED TAX

The increase in sales of 'other firms' would be £177m (the direct increase in 'other consumers' expenditure', £252m less the reduction in sales of other food products £75m). A part of these sales would be indirect taxes and some would be imports. The effect on fixed capital expenditure is estimated to be less than that for the confectionery industry, £10m. In addition the increase in sales of suppliers to the confectionery industry and of distributors of confectionery would result in some increase in investment which has not been estimated.

(i) The increase in consumers' expenditure of £398m (£442m less the increase in saving of £44m) and fixed capital expenditure of £25m would generate increased wages, salaries, profits and dividends which would lead to a further round of expenditure, here estimated at £127m, 30 per cent of the total increase in expenditure of £423m (£398m + £25m).

(j) For making the estimates of the employment effects of the VAT reduction it is assumed that confectionery manufacturers would benefit from significant scale effects and that the percentage increase in employment by the industry would be 60 per cent of that for the increase in output. Employment in the industry is estimated at 50,000; 60 per cent of 7½ per cent of 50,000 = 2,250. The scale effects relate to specialised production lines for confectionery products and for employees engaged in indirect or overhead functions. The estimated increases in sales of the confectionery industry and employment in the industry imply sales per employee for the additional employees of £65,800 per person.

Although the effect on employment of firms supplying the confectionery industry, which include cocoa and sugar processors, may be muted, the effects on employment with distributors would be substantial. In 1984 average sales per person engaged, including part-time employees, for confectionery, tobacco and newsagents shops was £21,000 a year.[1] An increase in sales of confectionery of £221m would imply an increase in employment of 9,600 with a sales per additional employee of £23,000 (to allow for an increase in sales per person between 1984 and 1986). In practice there would be some scale and capacity utilisation effects for CTN shops which would reduce these employment effects, and sales per employee for confectionery products sold through

(1) HMSO, Business Monitor, SDO25, Retailing p. 72.

supermarkets are higher than for sales through CTN shops. The increase in employment was estimated at 6,000 including part time employees.

The job creation effects of the increase in 'other consumers' expenditure £177m (row 11, £252m - row 10 £75m) would be less than for the increase in expenditure on confectionery, £221m. The increase is smaller, £177m compared to £221, and the indirect tax and import components would be greater.

(k) Imports are estimated to take ten per cent of the increase in sales. Ten per cent of £221m = £22m at retail prices and £15m at import prices.

(l) UK confectionery manufacturers' sales would rise by £221m less imports of £22m, £199 at retail prices, equivalent to £133m at manufacturers' prices, plus exports of £15m - a total of £148m. The bought out materials and services content of manufacturers' sales is about 60 per cent, £89m. Of this total £40m is estimated to be imports.

(m) The increase in other consumers' expenditure, £177m would be met in part from imports. It is estimated that these imports would represent 30 per cent of this expenditure, £53m.

(n) It is estimated that 40 per cent of the increase in fixed capital expenditure would be imported. Forty per cent of £25m = £10m.

(o) There would be two positive effects of the reduction of VAT on exports of confectionery. The increase in the volume of sales to the home market would reduce costs and increase efficiency through scale effects and taking up spare capacity. This increase in efficiency would make the industry more competitive. Secondly, the increase in the profitability of the industry would enable some firms to step up their investment in marketing and gaining entry to overseas markets and retail outlets.

(p) Indirect taxes are estimated at 20 per cent of the increase in 'other consumers' expenditure.

(q) The estimated extra jobs attributable to the elimination in VAT is 14,250. It is assumed that unemployment falls by 60 per cent of 14,250, 8,550; the balance of jobs going to people who would not come off the unemployment register. The saving for unemployment benefit, etc., estimated at £50 a week per person taken from the unemployment register, would be £22m for 7,350 jobs.

THE BISCUIT, CAKE, CHOCOLATE & CONFECTIONERY ALLIANCE
SUBMISSION ON VALUE ADDED TAX

(r) Taxes and employees' and employers' national insurance contributions at 30 per cent of gross wages for 14,250 extra jobs at £130 a week would be £29m.

(s) The positive effect on profits of confectionery firms is likely to be large because of the scale effects referred to in (k).

	£m
Extra sales revenue of confectionery companies*	148
less: increased wages, national insurance contributions, etc. 2,250 jobs at £200 a week per person	23
purchases of materials and services 60 per cent of £148m	89
Balance, including increased profits	36

In addition to the increase in profits of confectionery companies, profits of other firms including distributors of confectionery, will increase with increases in sales generated by the reduction in VAT on confectionery.

(t) Slower inflation caused by the reduction in the price of confectionery, equivalent to a reduction of 0.2 per cent in the retail price index, would reduce the increase in social security benefits, £46bn in 1987/88 and national insurance contributions, £26bn in 1987/88.

* Extra retail sales of confectionery £221m less extra imports of £22m at retail prices, equivalent to £133m at manufacturers' prices, plus extra exports of £15m, £148m.

THE BISCUIT, CAKE, CHOCOLATE & CONFECTIONERY ALLIANCE
SUBMISSION ON VALUE ADDED TAX

7. CRITICAL ASSUMPTIONS AND THE SENSITIVITY OF THE ESTIMATES

The Assumptions

The first two assumptions made to estimate the effects of reducing VAT, that the change does not affect the exchange rate or interest rates are important for the results of the exercise. The assumption that the exchange rate would not be affected fits with the recent exchange rate policy. The authorities have sought to maintain the sterling exchange rate relative to the D.M., while allowing some flexibility in the Sterling/D.M. rate in response to falls in the $. Similarly, the proposed removal of VAT on confectionery would in practice be unlikely to lead to a change in interest rates.

The estimates indicate that the deterioration in the balance of payments brought about by the change in VAT would be of the order of £138m a year. Plainly such a change would tend to depress the sterling exchange rate. If it were assumed that the government replaced the lost VAT revenue on confectionery by issuing more bonds, the effect of the change would be to raise interest rates. These effects are difficult to estimate and simulations with different macro economic models give widely differing estimates of the effects.(1) In any case the purpose of the estimates described here is to provide a comparison with other forms of tax reduction. These would also lead to a deterioration in the balance of payments and an increase in borrowing or a slower repayment of debts.

The reduction in unemployment caused by the elimination of VAT would lead to a slight tightening in the labour market and hence upward pressure on wages. However, the effect of VAT reductions in indirect taxes to reduce wage increases via their effects to reduce the retail price index is recognised in macro economic models. 'It has long been known that cuts in expenditure taxes look very attractive options in most macro economic models'. The longer term benefit derives from the way in which lower expenditure taxes enhance the real wages of employees without raising production costs'.(1)

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(1) K.F. Wallis (Editor) 'Models of the UK Economy'. Oxford, 1986.

THE BISCUIT, CAKE, CHOCOLATE & CONFECTIONERY ALLIANCE SUBMISSION ON VALUE ADDED TAX

Sensitivity of the Estimates

Many assumptions are incorporated in the estimates and it is difficult to place ranges for the possible errors to the estimates. However, it is possible to consider the sensitivity of the estimates of tax revenue to changes in the assumptions and/or errors in the estimates.

The estimate that the reduction in VAT would be passed on in full is important for the result. Not only is the increase in consumers' expenditure on confectionery and other products dependent on this assumption, the £40m reduction in social security benefits also turns on the reduction in prices.

Government net revenue is less sensitive to the other estimates. For example, if confectionery sales were to rise by less than 7½ per cent in response to the reduction in prices of confectionery, other consumers' expenditure would increase faster and there would be little effect on tax revenue.

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(1) Andrew Britton, national Institute Economic Review, Feb. 1986, p. 87.

82/2/PAS/C7/35

pmp

FROM: MOIRA WALLACE
DATE: 5 JANUARY 1988

D BOARDMAN, C&E

cc PS/Economic Secretary
Miss Sinclair
Mr Michie
Mrs Burnhams

PS/C&E

DR PAISLEY'S BUDGET REPRESENTATIONS

I believe Mrs Burnhams mentioned to you that I received a call from Dr Paisley's office today. Dr Paisley would like to come with representatives from Gallahers to meet Customs officials, as in previous years. I promised that someone would get back to them, and I would be grateful if you could arrange for this to be taken forward. The person to speak to in Dr Paisley's office is Mr Dodds, and the phone number is Belfast (0232) 54255 or 58900.

MPW.

MOIRA WALLACE

35A/G/PC/8/5

pmp

pmp.

FROM: **MISS G M NOBLE**
DATE: 5 January 1988

ECONOMIC SECRETARY

c c PPS
PS/Sir P Middleton
Mr Scholar
Mrs Lomax
Mr Murphy
Mr Bridgeman BSC
Mr Watson BSC

REVIEW OF SCHEDULE 8 : REPRESENTATIONS FROM THE BSA

You have agreed to see the Building Societies Association tomorrow to allow them to make formal representations to you about the review of Schedule 8. I understand the team will be:-

Mr Tony Stoughton-Harris
(Nationwide Anglia)
Chairman of the BSA

Mr Frank Strickland
(North of England)
Deputy Chairman of the BSA

Mr Mark Boleat
Director-General of the BSA

Mr Ron Armstrong
Head of Legal Services, BSA

Mr John Spalding
Chief Executive
Halifax Building Society

Mr Alan Cumming
Executive Vice Chairman
Woolwich Building Society

Mr Peter Birch
Chief Executive Abbey National

2. You are, of course, well aware of the background to all this. I attach for reference the "shopping list" from the BSA's formal submission.

Opening remarks

3. I suggest you open the meeting by reminding the BSA that you said, when you announced the review of Schedule 8, that it had two aims: the first was to see whether the schedule could be redrafted to remove some of the problems societies had been experiencing using their new powers (basically to change the presumption at the margin) and the second was to consider in a more coherent way the various requests which societies had made for a substantive widening of their powers. On the first point, we are now clear that it is possible to use an affirmative order to restructure the schedule so that only those activities which are specifically prohibited would be ultra vires. This on its own would remove a lot of the irritating problems societies have had with the schedule. On the second point, you have considered the proposals the BSA have made. You are disposed to allow some widening of the powers. But the "shopping list" as a whole adds up to a pretty radical package and one which would effectively condense into one step the gradual phasing in of the powers which the architects of the Act had envisaged happening over 5-10 years. You are not certain yet that it is right to make quite such a large step in one go but are prepared to hear what the societies have to say. It would be useful in particular if they could give a better indication of their priorities. What items do they attach greatest priority to?

4. I gather the societies' representations will concentrate on the following items:-

i. **An increase in the £5,000 limit on unsecured loans**

The BSA have asked for £25,000. If you wish you could indicate you are disposed to make some increase in this limit, but would have reservations about asking the House to agree figures as high as £25,000. What sort of sum do they really need?

ii. **Insurance and stockbroking**

You could say that you could recognise that there are problems with the Financial Services Act. But that does not extend across the board. What are the points which really matter to societies in this area?

iii. **The need to increase the limit on class 3 assets from 5 per cent to the statutory maximum of 15 per cent**

You can say that you have some doubts about going quite so far in one go, both on presentational grounds (e.g. appearing to allow too rapid an increase in unsecured credit) and substantively (the limits provide some sort of brake on the speed at which societies move into the riskier new areas and force them to assess their priorities.) You could ask the societies to say what sort of figure they felt they could live with in the medium term if you felt you could not go to the statutory maximum at this stage.

iv. **Removing, or modifying the restriction on provision of services to individuals**

Here, you could simply point out that providing banking services to large businesses is a long way from building societies' conventional business ~~in the Act~~, and it is difficult to see where to draw intermediate line. What are the real arguments for moving into this area; what sort of business do societies really want to do?

5. Generally, I suggest you do not get drawn into detailed arguments, but make it clear that you are prepared to listen

carefully to their case and consider further before you make final decisions.

Timing

6. If the BSA ask about timing and press for a commitment to get the order presented in mid-February, I suggest you remind them that you made it clear at the start that you would ensure there were no unnecessary delays but that you were determined to take enough time to get the schedule right this time. You should say that is still your position. You recognise that there are implications for the societies' AGM's, but the BSA have put forward a much larger and more radical shopping list than expected; it raises important issues which needed careful consideration, there is a lot of detailed drafting still to be done, and with the best will in the world you cannot sensibly give a firm commitment that the order would be ready for introduction in mid-February.

G Noble

MISS G M NOBLE

Proposals

25. This section of the paper sets out the Association's specific proposals for Schedule 8. They are deliberately not couched in legal language, but rather the need for societies to be able to have the necessary powers in respect of the services is analysed. In summary, the Association proposes the following -

(a) So as to enable them to provide a comprehensive banking service, societies should be able to make unsecured loans up to £25,000, rather than the present limit of £5,000.

(b) The obstacles to societies playing a full part in EFTPOS developments should be removed.

(c) Societies should be able to offer ancillary banking services such as guarantees, indemnities, safe deposits and acting as company registrars.

(d) The limit on individual payment guarantees should be removed.

(e) Societies should be able to arrange credit without any restriction.

(f) Societies should be able to provide the full range of investment services including giving advice, acting as agents and providing a stockbroking service.

(g) Societies should have full fund management powers.

(h) Societies should be able to offer executorship and trusteeship services.

(i) Societies should be able to underwrite insurance through subsidiary or associated companies.

(j) The present restrictions on societies providing estate agency services should be removed.

(k) Societies should be able to offer services related to house buying and ownership, e.g. maintenance services.

(l) The restrictions of the management of land should be removed.

(m) Generally, restrictions to providing services to individuals only should be removed.

(n) The limit on class 3 assets shuld be increased as a consequence of the recognition that societies should be offering more services some of which will require significant capitalisation.

53/2/LPD/3746/054

cc PS/Chancellor PS/PMG, Mr Culpin, Miss Sinclair, Mr Cropper, Mr Tyrie, PS/C&E. Mr P.R.H. Allen - C&E

Treasury Chambers, Parliament Street, SWIP 3AG

PJ

P J Davis Esq
Chief Executive
Reed International Plc
Reed House
83 Piccadilly
LONDON
W1A 1EJ

5 January 1988

Dear Mr Davis,

Thank you for your letter of 18 December 1987 enclosing representations for the Budget from Reed International Plc.

I can assure you that your representations will be carefully considered in the run-up to the Budget. But, I am sure that you will understand that I cannot comment further at this stage.

As for the European Commission's proposals to "approximate" VAT rates, Nigel Lawson made it clear to the Council of Finance Ministers on 16 November that the United Kingdom would not permit to come into force any proposals which in any way conflict with pledges the Government has given concerning the UK's zero rates of VAT.

Yours sincerely

Peter Lilley

PETER LILLEY

FINANCIAL SECRETARY TO THE TREASURY

PMP

NOTES OF A MEETING HELD ON WEDNESDAY 6 JANUARY 1988 AT 3.00PM IN THE FINANCIAL SECRETARY'S ROOM, HM TREASURY

Those present: Financial Secretary

Mr J Nash)
Mr R Cohen) British Venture
Mr J Blake) Capital Association
Mr T Jenkins)

Julian Reed) Inland Revenue
Nigel Williams) Inland Revenue

Stephen Flanagan HM Treasury

BRITISH VENTURE CAPITAL ASSOCIATION BUDGET DEPUTATION

Mr Nash opened the meeting by thanking the Financial Secretary for his help on UK limited partnerships which he said were becoming the industry norm. He also referred to the excellent relationship with the Revenue over this. He commented that Section 79 was working well and that an outstanding job had been done by the working party.

Entrepreneur Scheme

2. Mr Nash then discovered the first of the BVCA's representations - an Entrepreneur's Scheme. He explained that the proposal was for a BES style relief for investment by an individual in a company for which he was a full-time employee. The reason for this scheme would be to encourage and attract good management. He felt there was an equity gap at the small end of the market ie. £50-£100,000.

3. Mr Nash felt the BES should be capped to a limit of £200,000 in order.

4. The Financial Secretary said this would kill most BES current schemes and they would become more like start up schemes. He asked either Mr Nash or Mr Cohen if his company were post BES investors?

5. Mr Cohen explained that both he and Mr Nash's company were pre-BES. They only get involved where a BES company has got into financial difficulties.

6. Mr Nash pointed out that if there was a cap on BES, his company would come into the schemes. At present, he did not see BES firms as competition, as BES firms tend to invest in businesses like Hotels rather than high technology. Mr Nash referred back to the BVCA's proposed entrepreneur scheme. He commented that the prospects of entrepreneurs investing in BES had been muted by Parliament. He, therefore, felt it was better to start a restrictive scheme than none at all.

7. The Financial Secretary said that such an entrepreneur scheme would create a problem of "round tripping" which would benefit the company but not the entrepreneur. He also pointed out there would be likely to be a substantial deadweight costs in respect of businesses that would have been set up anyway.

8. Mr Nash suggested there could be a test to ensure that there was a genuine 3rd party investor outside the entrepreneur.

9. Mr Cohen reiterated that the entrepreneur should be given the chance to invest and there should be incentive for management to issue to new companies: BES had already given incentives to passive investors and it was time to shift interest to the managers.

10. Mr Reed said he felt the deadweight problem was important as money would probably be spent on dull boring and unoriginal businesses.

11. The Financial Secretary also commented that the scheme might introduce the principle of insider investment, which would inevitably increase the pressure to extend relief to other insiders. He did, however, say that he would have another look at the idea.

Approved Share Option Schemes

12. Mr Nash explained that the BVCA think the present limit of four times salary is restrictive and should be increased to six

ti[illegible]s salary. He pointed out that the present system meant that if an employee joins a smaller firm and therefore receives a smaller salary, he will be allowed less options.

13. The Financial Secretary emphasised that he was in favour of options but he pointed out that there was evidence that remuneration in a number of large companies consisted of large amounts of options.

14. Mr Nash suggested that the scheme be limited to unquoted companies or for a limited amount of money. He explained that companies often offer options when they bring in a new management team.

15. The Financial Secretary agreed that the Government could be more generous on unquoted companies. He did point out, however, that there was no great pressure for change in the limits and no real evidence to suggest that the present limits were preventing the scheme from achieving its aims. However, he agreed to take a further look at the proposal.

16. Mr Blake pointed out that the BVCA would be happy to meet with officials to discuss any complex technical points.

17. After the meeting the Financial Secretary spoke to Officials and he thought the Entrepreneur Scheme could be a possibility for this year's finance bill. He also said he was interested in the BVCA's proposals on share options in relation to unquoted companies. He asked for notes on both subjects.

Susan Feest

SUSAN FEEST
(Assistant Private Secretary)
7.1.1988

cc PS/Chancellor
Mr McGivern IR
Mr J Reed IR
Mr N Williams IR
Mr S Flanagan
PS/IR

FROM: MRS T C BURNHAMS
DATE: 6 JANUARY 1988

PS/CHANCELLOR 12/2

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Cassell
Mr Monck
Mr Scholar
Mr Culpin
Miss Sinclair
Miss Evans
PS/IR
Mr Marshall - IR
PS/C&E
Mr R Allen - C&E

Thanks. JM.

BUDGET REPRESENTATIONS

... As requested I attach a matrix covering the first batch of representations from the main organisations. A summary was attached to my minute of 14 December. As I am sure you will appreciate the matrix can only provide a snap shot of the main points made by the organisations and other less important or more technical points cannot be included.

Teresa Burnhams

MRS T C BURNHAMS

	ASSOC OF CORPORATE TREASURERS	BRITISH CASINO ASSOC	COUNTRY LANDOWNERS ASSOC	BUSINESS IN THE COMMUNITY
PERSONAL TAX			Increase Reliefs	
STAMP DUTY			Increase threshold to £40,000 on land sales and change threshold to allowance	
CGT			Increase reliefs and reduce rates	
IHT			Reduce burden	
CT	Increase relief			
CAPITAL ALLOWANCES				1st £30,000 of capital investment allowable as revenue cost in 1st yr
BES				
VAT				
EXCISE DUTY				
BETTING AND GAMING		Duty to be paid on profits net of expenses. Relief on bad debts		

	CBI	SCOTTISH LANDOWNERS FEDERATION	IOD TECH REPS
PERSONAL TAX	Reduce top rate to 50% , lower tax for low paid, intergra- tion of tax, NICs and benefits	Reduce rates	Abolish PIID threshold tax relief for private health schemes, no increase in car scales
STAMP DUTY			
CGT	Rebase to 1982	General reduction	Reduce rate to below IT and CT rates, exempt pre 82 assets held for 10 or 20 years
IHT	Reduce burden to benefit small firms	General reduction	Business and agricultural relief on gifts, limit of 50% tax on gifts made between 3-5 years before death
CT	Lower rate to encourage increased investment and wider set-off of losses. Improve double taxation relief and allow pool- ing of overseas tax.		Ease rules for losses and group relief, apply sm bus rate to first £100,000 of profits for all
CAPITAL ALLOWANCES			
BES	Extend scheme		
VAT	Bad debts relief		Extend cash accounting, introduce bad debt relief
Excise Duty			
BETTING AND GAMING			

	LAW SOCIETY OF SCOTLAND	~~NUM~~ NFU	TOBACCO ADVISORY COUNCIL
PERSONAL TAX	Extend relief for covenants to students under 18, increase minor personal allow. increase PIID threshold		
STAMP DUTY	Abolish		
CGT	Abolish, rollover relief for milk quotas, transferable allowances for spouse	No CGT if asset held for 7 years	
IHT			
CT			
CAPITAL ALLOWANCES		100% allowance on 1st £10,000 of investment in plant & M/C or 25% write-down allow. on straight-line basis. 10% Agricultural Building Allowance	
BES			
VAT			
EXCISE DUTY			Limit increase in tobacco duty to rate of inflation
BETTING AND GAMING			

	INST OF TAXATION	INST OF CHARTERED ACCTS	ROYAL INSTITUTE OF CHARTERED SURVEYORS
PERSONAL TAX	Reform schedular system to allow wider offset of losses	Reduce tax rates and steep tax progression. Review of tax returns time limits	
STAMP DUTY	Reinstate relief for reconstructions and de-mergers		Less regressive on residential property
CGT	Extend retirement relief to cover the disposal of business assets	Simplification	Indexation of pre 82 gains
IHT	Improve business and agricultural property reliefs		Reduced burden when death occurs after less than 7 years
CT	Extend time limit for group relief claims	Removal of close company legislation	
CAPITAL ALLOWANCES			
BES			
VAT			
EXCISE DUTY			
BETTING AND GAMING			

	MANAGERIAL, PROFESSIONAL & STAFF LIAISON GROUP	INTERNATIONAL CHAMBER OF COMMERCE	LANDOWNERS GROUP
PERSONAL TAX	Shift burden from direct to indirect taxation, married person's allowance		
STAMP DUTY			
CGT		Greater alignment with IT, relief for capital losses from intra group lending	Reduce rates to 25% abolish indexation and introduce taper from 3rd to 6th year with no charge after 7 years
IHT			Reduce rates
CT		Tax relief for losses incurred on repayment of foreign currency borrowing	
CAPITAL ALLOWANCES			Reduce capital taxes
BES			
VAT			
EXCISE DUTY			
BETTING AND GAMING			

	CHARTERED ASSOCIATION OF CERTIFIED ACCTS	INST OF CHARTERED ACCTS OF SCOTLAND	AA
PERSONAL TAX	Less harsh penalty regime, reduced burden generally	Eased retirement relief rules for F/T Directors relief for farm losses due to economic and climatic factors	
STAMP DUTY			
CGT	Simplication and less harsh penalty regime	Independent taxation and review of contingent rights	
IHT			
CT	Less harsh penalty regime		
CAPITAL ALLOWANCES			
BES	Carry back relief to be increased to £20,000		
VAT	Extension of registration period		
EXCISE DUTY			Freeze petrol duty and VED
BETTING AND GAMING			

	BRITISH INVISIBLE EXPORTS COUNCIL	BRITISH VENTURE CAPITAL ASSOCIATION	ASSOCIATION OF BRITISH INSURERS
PERSONAL TAX		Increased incentives for entrepreneurs, higher limits for share option schemes	tax exemption for insured pension schemes
STAMP DUTY	Abolition on Securities transactions		
CGT		Remove CGT on sale of equity	Increase relief
IHT			
CT	Aggregation of overseas taxes for credit against UK tax, rollover relief for balancing charges on ship's sales		Improve tax treatment of exchange losses and double taxation relief
CAPITAL ALLOWANCES	Allowances for shipping		
BES			
VAT			
EXCISE DUTY			
BETTING AND GAMING			

912/068/alr

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

Major General W D Mangham CB
The Brewers' Society
42 Portman Square
London W1H OBB

6 January 1988

Dear General Mangham

Thank you for your letter of 11 December, which enclosed your representations for the Budget.

I would be delighted to meet a deputation from the Brewers' Society again this year. I have asked my office to be in touch with the details.

Yours sincerely
Nigel Lawson

NIGEL LAWSON

From Major General W D Mangham CB

The Brewers' Society

42 PORTMAN SQUARE · LONDON W1H 0BB

TELEPHONE · 01-486 4831 (16 LINES)
FAX · 01 935 3991 · TELEX · 261946

MANGHAM → CH/EX 11/12

The Rt Hon Nigel Lawson MP
The Chancellor of the Exchequer
H M Treasury
LONDON
SW1P 3AG

11 December 1987

Dear Chancellor,

The Chairman of the Society, Mr Anthony Fuller, would be very pleased if he and I could come and see you, preferably in the first half of January, to discuss the position of the industry and the treatment of beer in the forthcoming Budget.

I enclose a short paper outlining some of the areas of concern within the industry.

I look forward to hearing from you.

BR

HM TREASURY – MCU
RECD. 14 DEC 1987
ACTION Mrs Branhams PP

cc CHX, CST, EST, PMG, EST, Sir P Middleton, Sir T Burns, Mr Cassell, Mr Monck, Mr Scholar, ~~Mr Corlin, Miss Sinclair~~, RIG ALLEN, CE

CHX
2964/87

Yours sincerely,

David Mangham

Director

THE BREWERS' SOCIETY

BEER DUTY

The Beer Market

1. There has been a very small improvement in the demand for beer during the last twelve months. Sales in the year to 31st October 1987 are expected(1) to be about 62.0m. hl, an increase of only 0.6% on the figure for the previous year. Home production (including foreign brands) brewed under licence in the UK) was 59.6m. hl in the year to 31st October 1987 an increase of 0.3%.

2. The poor summer weather has clearly not helped, and the market has also been influenced by a number of demographic factors, to which attention has been drawn in previous submissions.

3. The decision by the Chancellor not to increase duty in the last two budgets has been very welcome, and without it the present level of the market would not have been sustained. In fact, most of the improvement in volume followed last year's Budget. In the seven months from April to October, sales were 1.1% higher than in the equivalent period in 1986.

Price of Beer

4. In the late summer and early autumn, there was a spate of press reports pointing to numerous increases in beer prices. This is of course a period when prices may be increased, coming as it does just after the period of peak demand.

5. Members of the Society have been made aware of the comments made by the Chancellor in respect of brewers' price increases following the duty stand-still. On average, wholesale beer prices rose between September 1986 and September 1987 by 3.8%. The RPI increased by 4.2% during the same period. The position is therefore much less startling than was represented in the media. It reflects the fact that there have been some cost increases in beer production and distribution, even though these did not occur in respect of the duty element. Net of duty the average increase was, at 5.2%, within a single point of the RPI.

6. Average data on retail prices is difficult to establish. Brewers only set retail prices in their managed houses, and these account for only 20% of the total market for beer or 24% of the market for beer consumed on the premises. The retail price also reflects the "package" of drink and amenity which the consumer is purchasing. Very substantial investment has been made in improving the amenity in on-licensed outlets, and the "package" offered to - and indeed demanded by - the consumer is very different now from what it was a generation ago. These improvements

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(1) From data supplied to the Society by its members.

n amenity would inevitably be reflected in price, even at a time of zero inflation. Nevertheless, this total package is commonly provided at moderate rates. In a recent survey carried out by the Society, it was established that the ratio between the price of beer in pubs and similar outlets and the price of beer in off-licences was much lower in the UK than in any comparable country.

Duty on stronger beers

7. The present straight line duty structure was introduced in 1974, and made it possible for brewers, without incurring any fiscal penalty, to use the technique known as high gravity brewing in the production of beer. This technique is a modern development which enables highly efficient use to be made of brewing plant and conserves energy. It uses worts of a higher original gravity than is intended for the finished product. After fermentation, the resulting beer is conditioned and then liquor (purified and de-oxygenated water) is added under very strictly controlled conditions to bring the beer down to the target original gravity.

8. From calculations made by the Society, virtually half of the beer produced in the UK is brewed using this technique. If recent proposals(2) to increase the duty on stronger beers were adopted, a brewer could be faced with two choices in respect of beers currently produced by the high gravity technique:-

- He could continue to use the technique but pay more duty per hectolitre on a beer of the same target O.G. than a brewer not using such technique; or

- He could install new capacity to brew the required volume of beer at its target original gravity. In this connection, it should be observed that the industry is sometimes thought to have excess capacity but most of this concerns the production of ale/stout, and lager capacity is often under pressure. High gravity brewing is used more for lager than for ale, and so its restriction by fiscal means would in many cases give rise to a need for additional brewing and conditioning capacity. This would have cost dis-benefits due to increased energy wastage and the cost of financing the new plant.

9. An equally important objection to the introduction of higher rates for stronger beers is that it would affect the duty relationship between beer and wine in force since the European Court decision, in a manner adverse to beer. This would be unfair to the many moderate drinkers who enjoy strong beers such as barley wine and premium lager, and to the producers of those products - who are very largely home-based, compared to wine producers, who are not.

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(2) By a Working Group of the Home Office Standing Conference on Crime Prevention.

10. It would not, however, be likely to help to deal with the problem of drink abuse amongst the young, which is the purpose for which the recommendation has been made, because the 18-25 age group is well known to have the highest discretionary income amongst all drinkers.

The 1030° Base

11. It has been suggested that there would be social benefits in removing the 1030° duty base for beer, i.e. in changing the duty formula so that worts below 1030° were charged at the standard per degree rate and not at a minimum rate applicable to an O.G. of 1030°. This could of course stimulate the production of lower strength beers.

12. The Society would not wish to resist any Government measures which are likely to inhibit the misuse of alcohol, but it is most important that any reform should not be harmful to the quality, and hence the reputation, of British beer. Many brewers believe that it is not possible to produce an adequate quality in beers such as ale, stout and lager with worts of less than 1030°, because, amongst other things, they do not allow sufficient reproduction of the yeast to develop the traditional flavour components. Simply removing the 1030° base could well induce brewers under competitive pressures (including those from continental brewers exporting to the United Kingdom) to produce what purported to be normal beers at increasingly low gravities. This could have a very harmful effect on the public perception of the quality of British beer.

13. If it is wanted to stimulate the production of low strength beers, the Society would strongly suggest that the 1030° minimum duty should be retained except in one respect. This is as follows:-

1. There should be a new low flat rate of duty for beer with an O.G. below 1030° and an alcoholic strength by volume exceeding 1.2% and not exceeding 2.2%.

2. Beers in this category should be referred to as "reduced strength" beers, and it should be obligatory for these words to form part of the product name, e.g. "reduced strength bitter" or "reduced strength lager".

14. The Society envisages that duty would be collected on the wort in the present manner, and that "reduced strength" beers would qualify for a partial refund of duty analogous to the complete refund of duty for beers in which the alcohol is removed to below 1.2%. It is therefore very much hoped that this arrangement could be introduced without a substantial administrative burden for either the excise control or the brewer. It is also believed that the proposed arrangement would be entirely compatible with the existing practice of labelling non-dutiable "beers" as "low alcohol" or "alcohol free", as the case may be, where, by reason of the labelling system, the public are well aware of what they are buying.

Mixed alcoholic beverages

15. Last year, H.M. Customs & Excise issued a discussion paper on the restructuring of the wine/made-wine duties. It may be helpful for the Society to restate its views on the issues raised in the discussion paper. They are as follows:-

- We would support the introduction of a new duty band for mixtures of wine and beer with fruit juices etc.

- We accept the suggestion that the upper limit for this band should be 5.5% alcohol by volume.

- We think it is most important that the duty burden of products in this band, which will be in strong competition with beer (which is itself a low strength alcoholic beverage) should not be such as to favour these new products compared to beer.

16. Subject to this, we do not believe there should be any carbonation limit (or special additional rate applicable to products over a specified level of carbonation).

AGT/ps
December 1987

RJ8.62

UNCLASSIFIED

FROM: J M G TAYLOR

DATE: 8 January 1988

MRS BURNHAMS

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Monck
Mr Scholar
Mr Culpin
Miss Sinclair
Miss Evans
PS/IR
Mr Marshall - IR
PS/C&E
Mr R Allen - C&E

BUDGET REPRESENTATIONS

The Chancellor was grateful for your minute and enclosure of 6 January.

J M G TAYLOR

3977/56

FROM: P J CROPPER
DATE: 8 January 1988

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mr Tyrie
Mr Call

CONSERVATIVE WOMEN'S BUDGET RECOMMENDATIONS

These came in five minutes ago.

P J CROPPER

✓ Done.

Thanks. PS [illegible] conservative [illegible] Budget [illegible] (Ideal [illegible] submissions from representative gps!)

Conservative Women's National Committee
32 Smith Square Westminster London SW1P 3HH
Tel. 01-222 9000 Telex 8814563 Fax. 01-222 1135

PROPOSALS SUBMITTED TO THE RT HON NIGEL LAWSON, MP
CHANCELLOR OF THE EXCHEQUER, FOR THE 1988 BUDGET
BY THE CONSERVATIVE WOMEN'S NATIONAL COMMITTEE

In our Budget Submissions this year, we urge the Chancellor of the Exchequer to look at five matters which we feel need his urgent attention.

CH/EXCHEQUER
REC. 11 JAN 1988
ACTION MRS T. BURNHAMS
COPIES TO PS/CST PS/FST PS/PMG PS/EST SIR P. MIDDLETON SIR T. BURNS MR CASSELL MR MONCK MR SCHOLAR MR CULPIN MISS SINCLAIR MISS EVANS PS/IR PS/C&E

1. The Taxation of Married Women
2. Mortgate Interest Relief
3. Tax Relief for Carers
4. Child Benefit
5. Work Place Nurseries

1. The Taxation of Married Women

The CWNC agrees with the Chancellor when he says, as he did at the 1987 Party Conference, that the tax treatment of married women is no longer acceptable and will have to change. The number of speakers at Blackpool who called for the reform of the tax system relating to husband and wife indicated that there is a considerable amount of interest and no shortage of strong feelings about this issue. Although the response to the 1986 Green Paper on the reform of personal taxation was disappointing, the CWNC supports the Chancellor's resolve to reform the taxation of husband and wife. The Chancellor has an excellent record on tax reform and we believe that the taxation of married women is an area which provides an opportunity to keep up the drive towards a simplified, fairer and more modern tax system.

The basic approach to the taxation of married women has been the same since the beginning of the last century; it is clearly no longer relevant to the needs of modern society. The CWNC would ask the Chancellor to reform this arcane system in such a way that gives women independence and privacy in their tax matters, that removes the distinction between couples where the wife is working, who receive a higher combined allowance than couples where the wife does not work, and that removes the tax penalty on marriage whereby a married women, unlike a single woman, has no allowance of her own to set off against savings income.

./.

2. Mortgate Interest Relief

The CWNC asks the Chancellor to remove the tax penalty on marriage whereby a married couple are entitled to tax relief on the interest on a mortgage up to £30,000, whereas two single people living in the same property can each have tax relief on interest payments on the mortgage, up to £30,000, on that property.

The CWNC is in favour of tax relief on mortgage interest payments which is helping more than 8 million people buy their own homes. However, we believe that there is a strong argument for resolving a tax anomaly which makes it more profitable for two people to live together rather than as a married couple. For this reason, we would ask the Chancellor to re-consider the possibility of allocating tax relief to the property and not to the individual.

3. Tax Relief for Carers

The CWNC welcomes the extension in 1986 of Invalid Care Allowance to married women. This move, for which the CWNC had been calling for many years, represented a very large improvement in the provision made for the care of elderly and disabled people in the community.

It is thought that at least 1.25 million people in Britain are caring for a dependent relative at home, the majority of them caring for an elderly person. Three out of four carers are women. We would call upon the Chancellor to recognise the good and compassionate work done by the many people in Britain who look after elderly or disabled dependents, by considering the introduction of tax relief for all carers.

4. Child Benefit

The CWNC is a strong supporter of Child Benefit which we believe is the key benefit provided for the family. We argue that it should be given very high priority in our welfare system and we therefore welcomed the commitment in the 1987 Manifesto that 'Child Benefit will continue to be paid as now, and direct to the mother' (or caring parent). We strongly ask the Chancellor not to overlook the significance of this commitment.

We hope that the recent announcement that Child Benefit is to be frozen at £7.25 a week does not indicate that this important payment is to be undermined. We would ask the Chancellor to ensure that there is no further erosion of Child Benefit.

./.

5. Work Place Nurseries

The CWNC urges the Chancellor to give further consideration to our representations of tax relief for work place nurseries as we submitted in 1987:-

The CWNC asks the Chancellor to reconsider the confirmation that a place for one's child in a work place nursery is a tax assessible benefit.

Whilst not wishing to encourage mothers to work outside the home whilst their children are too small, the CWNC stresses that some women need to work, i.e. single parents, those whose special skills are needed by employers and those who wish to maintain skills, perhaps by working part-time. The fact that employers are prepared to provide work-place nurseries, often at considerable expense, shows the value they place on the work of these women.

The work place nursery is clearly an excellent form of provision existing in line with the required working hours and giving the child access to the parent whenever necessary, it therefore, seems strange not to give encouragement for such a provision, especially since there is a shortage of high quality nursery provision in the country.

By taxing a parent on the cost of a place the total cost is put out of reach of many women. The resulting danger is that those who need to work will put their children in less good provision, some will be prevented from working and may have to rely on state benefits and some whose skills would be of real value to the economy will be discouraged from working at all. To maintain that some women should not have a provision which is not available to all is not usually an argument put forward by the Conservative Party.

January 1988

913/001/alr

1. MRS BURNHAMS
2. MISS SINCLAIR
3. [redacted]U
4. FINANCIAL SECRETARY

FROM: MISS S WALLIS
DATE: 11 January 1988

cc PS/Chancellor 12/2
PS/CST
PS/EST
PS/Paymaster General
Mr A Wilson
PS/IR
Mr D Shaw (IR)
PS/C & E
Mr J Fisher (C & E)

BUDGET DEPUTATION: THE BURMAH OIL PUBLIC LIMITED COMPANY

The Burmah Oil Company have sent in their representations for the Budget, and are asking for an opportunity to discuss them with Ministers.

2. Burmah Oil are not on the "Core List" of organisations that Ministers meet as a matter of course. They were not seen last year.

3. We and the Revenue see no advantage in you agreeing to a meeting this time round. We therefore suggest you turn down their request.

4. I attach a reply.

S Wallis

MISS S WALLIS

ENC

912/002/alr

Treasury Chambers, Parliament Street, SW1P 3AG

R N A Wood Esq
The Burmah Oil Public Limited Company
Burmah House
Pipers Way
Swindon
Wiltshire
SN3 1RE

January 1988

Thank you for your letter of 17 December to the Chief Secretary setting out your representations for the Budget and asking for an opportunity to discuss them with Ministers.

As you can imagine, Treasury Ministers receive numerous requests for meetings from representative bodies before each Budget. Ministers try and see as many organisations as possible, but as I am sure you will appreciate, they cannot see every organisation which requests a meeting. I am afraid, therefore, that it will not be possible for Treasury Ministers to see you in the run - up to the 1988 Budget.

I can assure you, however, that your representations will be carefully considered.

NORMAN LAMONT

Burmah

The Burmah Oil Public Limited Company

Burmah House
Pipers Way, Swindon, Wiltshire SN3 1RE
Telephone Swindon (0793) 30151
Telex 449221
Telegrams Burmoilo Swindon Telex

CHIEF SECRETARY
REC. 21 DEC 1987
ACTION MCY
COPIES TO for FST reply

The Rt.Hon. John Major, M.P.,
Chief Secretary to H.M. Treasury,
Treasury Chambers,
Parliament Street,
LONDON, SW1P 3AG

17th December 1987

Dear Chief Secretary,

<u>Advance Corporation Tax</u>

I was glad of the opportunity to talk to you on 8th December following the Westminster Industrial Briefing. In particular, I mentioned the concern that we have at Burmah in respect of the current Advance Corporation Tax (ACT) legislation. As with a number of UK based international companies, the low proportion of our UK earnings to our total earnings results in insufficient full mainstream tax with which to offset our ACT liability on dividends.

We would appreciate a review of the ACT system so that, without reducing the Treasury's source of revenue, we do not continue to incur an inequitable fiscal penalty. This letter outlines the present inequalities and our proposal.

The "big bang" was a manifestation of the changing way in which world capital markets are operating. It was required to enable the UK to preserve its position as a country having one of the world's leading capital markets. Recent press commentary in connection with the first anniversary of the "big bang" indicates that the UK has succeeded in this.

BR

HM TREASURY – MCU
REC'D 22 DEC 1987
ACTION Mrs Bonham FP. A Budget rep?
cc IR
FST

Over the years, the UK has been active in promoting double taxation agreements and in putting into effect unilateral reliefs which would reduce the burden of international double taxation in order to benefit the UK by encouraging foreign trade and investment. These measures have been aimed at the position of UK persons, whether corporate or individual, making investments overseas. To an extent also they have encouraged the development of the UK by attracting foreign capital to this country.

The developments of recent years introduce a new facet to the pattern of international investment so that it is now more probable that a group based in one country and investing in other countries worldwide, may itself have a substantial body of shareholders in many countries throughout the world as well as in its home country.

The UK tax system is now tending to discriminate against such companies and their shareholders. This is because ACT must be paid when the company pays a dividend to the shareholders. Although double taxation treaties may provide for some repayment of the ACT to some shareholders, there is usually a withholding tax in such cases with 15% being the most usual rate for portfolio investors.

Foreign shareholders in non-treaty countries recover none of the ACT and it would not normally be available for credit in their home country.

Notwithstanding any repayment to its shareholders, the company is treated as having made an advance payment of corporation tax with the intent that the ACT should be credited against the UK corporation tax liability arising on this income in due course. The aim is to avoid the economic double taxation of shareholders.

Where, however, the company has substantial investments overseas, this aim is not achieved. Instead, the holding company, although in principle subject to UK tax on dividends received from its overseas subsidiaries, will in fact have no further UK liability because credit for double taxation relief will fully cover the UK liability. Thus, the ACT paid in respect of the dividend paid on to the shareholders imposes another layer of UK tax on top of the foreign tax already suffered.

If the shareholder is resident outside the UK, it is likely that he will then be subject to further tax in his country of residence and the intent of the imputation system is totally frustrated. The effect will be to discourage non-UK investors from taking shareholdings in UK companies with international operations, compared with countries which have more beneficial tax regimes. The UK is also ruled out as a location for the holding company and headquarters of newly-emerging international groups.

Thus, if the UK wishes to maintain and improve upon its position as a leading centre of the capital markets, a reform of the ACT system is required.

We, therefore, propose that a special category of company be introduced which for convenience I have designated as an International Trading Company (ITC). A company would qualify for this status if it was a UK holding company for a group, more than 50% of whose turnover was earned by subsidiaries or permanent establishments outside the UK.

The ITC would be able to elect that ACT should not be paid in relation to the whole or any part of its dividends. The dividend voucher would make it clear that no tax credit attached to the appropriate part of the dividend. This would eliminate the double taxation of income arising outside the UK and passing through the UK to a non-resident shareholder.

At the same time, the possibility of preventing the double taxation of dividends paid out of UK profits would remain available because the ITC could still choose to pay ACT, but there would be no avoidance of liability on profits actually arising in the UK, since full mainstream tax would still be paid. Of course, the full mainstream tax rate is slightly higher than the ACT rate.

I would be pleased to discuss this proposal in more detail with you or with your colleagues.

Yours sincerely,

Roger Wood

R.N.A. Wood
Group Finance Director

913/003/alr

1. MRS BURNHAMS CB 11/1
2. MISS SINCLAIR CWS 11/1
3. MCU
4. FINANCIAL SECRETARY

FROM: MISS S WALLIS
DATE: 11 January 1988

cc PS/Chancellor 12/2
PS/CST
PS/EST
PS/Paymaster General
Mr A Wilson
PS/IR
Mr D Shaw (IR)
PS/C & E
Mr J Fisher

BUDGET DEPUTATION: THE ASSOCIATION OF INDEPENDENT BUSINESSES (AIB)

The Association of Independent Businesses have sent in their representations for the Budget, and are asking for an opportunity to discuss them with Ministers.

2. The AIB are not on the "Core List" of organisations that Ministers see as a matter of course. They were not seen last year.

3. We and the Revenue Departments see no advantage in you agreeing to a meeting this time round. We therefore suggest you turn down their request.

4. I attach a reply.

S Wallis

MISS S WALLIS

ENC

913/004/alr

Treasury Chambers, Parliament Street, SW1P 3AG

David Selby Esq
Chairman
Association of Independent Businesses
Trowbay House
108 Weston Street
London SE1 3QB

January 1988

Thank you for your letter of 16 December to the Chancellor of the Exchequer setting out your representations for the Budget and asking for an opportunity to discuss them with Ministers.

As you can imagine, Treasury Ministers receive numerous requests for meetings from representative bodies before each Budget. Ministers try and see as many organisations as possible, but as I am sure you will appreciate, they cannot see every organisation which requests a meeting. I am afraid, therefore, that it will not be possible for Treasury Ministers to see you in the run-up to the 1988 Budget.

I can assure you, however, that your representations will be carefully considered.

NORMAN LAMONT

Association of Independent Businesses

Trowbay House, 108 Weston Street, London SE1 3QB
Telephone: 01-403 4066

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1P 3AG

16th December 1987

Dear Chancellor,

BUDGET REFORMS: THE WAY AHEAD

The Association's Tax Committee has now finalised its proposals for the 1988 Budget and these are enclosed for your consideration.

"Buget Reforms: The Way Ahead" was today discussed at the Department of Employment with John Cope, the Small Firms Minister. Whilst these discussions proved most constructive nevertheless there remain some outstanding matters which we would very much like to discuss in person with you and your officials at Treasury Chambers.

I do hope that you find this submission helpful in your deliberations as you begin to draw up tax priorities for 1988 and I look forward to hearing from you about the possibility of a meeting in the near future.

Yours Sincerely

David Selby

DAVID SELBY FCA
Chairman
Tax Committe
Association of Independent Businesses

BR

HM TREASURY – MCU	
RECD.	18 DEC 1987
ACTION	Mrs Barnhams EP
	FST
	30034/87

BUDGET REFORMS: THE WAY AHEAD

Submission to the Chancellor of the Exchequer for the 1988 Budget

Tax Committee
AIB
108 Weston Street
London SE1 3QB

December 1987

CONTENTS

SUMMARY OF MAIN RECOMMENDATIONS

1 The tax rates for Inheritance Tax are far too steep in the initial stages. These should be reduced and a nil rate band to apply to £250,000

2 Unused Inheritance Tax relief to be made available to the surviving spouse

3 Full relief on Capital Gains Tax for pre-1982 inflation

4 Automatic rollover relief for all assets until cashed

5 Abolition of stamp duty on share transactions and property transfers

6 Companies to be given access to past tax paid

7 Reintroduction of the Employer's Upper Earnings Limit for National Insurance Contributions

8 Reduction in Employer's National Insurance Contributions

9 Regionally adjusted National Insurance Contributions

10 Lifting the restrictions on investors in the Business Expansion Scheme to include directors and employees

11 Extend the Business Expansion Scheme to the corporate sector giving Corporation Tax relief to the large company which invests in a small business

12 An improved and less expensive Small Business Loan Guarantee Scheme

13 VAT registration threshold raised to £50,000

14 Extended VAT relief for bad debts

15 A raised tax allowance on meal vouchers to £1

16 Refunds of pension scheme surpluses into a company's balance sheet to be taxed at 30% for small businesses

RT A: CAPITAL TAX REFORMS

Passing on the Family Business: Reforms to Inheritance Tax

We all know that Inheritance Tax can be avoided by giving away assets to individuals in one's lifetime, provided one lives for at least seven years after making the gift. But if one gives away substantial parts of one's business during one's lifetime this will affect one's income and one's control of the business. The problem that if one does not do this one's beneficiaries may need to sell the business on one's death in order to pay Inheritance Tax.

Many believe that Inheritance Tax only applies to the wealthy. In fact it can apply to fairly modest estates. For example, the Inheritance Tax payable on the death of an individual with assets valued at £100,000 is £3,000, assuming no lifetime gifts have been made. Therefore, anyone who owns his own home, has some savings or investments is almost certainly a potential Inheritance Tax payer. For larger estates there will be an expectation of an Inheritance Tax liability but its full impact may be underestimated. Inheritance Tax on an estate of £500,000 is £204,000, an overall rate of 40.8%.

The following reforms are needed:

- The rates of tax are far too steep in the initial stages. Above £330,000 this is 60% which is excessive bearing in mind that it is quite common now for a house in the South East to be worth £220,000. The nil rate band should apply to £250,000 and thereafter should be graduated much less steeply.

- The tapered relief for gifts where the person dies more than three years after the date of the gift, but still less than seven, is totally inadequate. Indeed in the majority of cases it works out at effectively nil. The relief should be an appropriate percentage of the value of the gift. This would make sure that the relief had some benefit in most circumstances; at present the opposite is the case.

- Further relief should be introduced on assets which are difficult to realise, especially shares in unquoted trading companies. Such shares should be left out of account and be totally free of tax until the owner actually realises them for cash.

- Unused Inheritance Tax Relief should be made available to the surviving spouse on death.

Taxing Inflationary Gains - Reforms to Capital Gains Tax

We welcomed the 1987 provisions extending imputation to the tax on companies' chargeable gains. This measure will eliminate and reduce the double taxation of companies' gains. However, there is still no adjustment for that part of any gain which arises because of the inflation which took place between April 1965 and March 1982, seventeen years during which prices generally rose by 547%. Many assets are held by families over a long period of time and an asset worth £5000 in 1965 was likely to be worth £27,300 in 1982, making a purely paper profit of £22,300 which is still taxable on realisation. The resultant liability can amount to a confiscatory levy of 27% of the current value.

The following reforms are therefore needed:

- the gross inequity implicit in the non-indexation of capital gains tax base values between 1965 and 1982 requires urgent attention

- if full relief for pre-1982 inflation is not given companies should be given the same annual exemption as individuals

- capital gains should be taxed less heavily than income and certainly not more heavily as is the present situation

- retirement relief to be indexed annually in line with inflation and in the case of husband and wife partnerships retirement relief extended to both spouses where one qualifies for the relief

- rollover relief is far too restrictive. If an asset is sold at a gain in order to purchase another asset or pay IHT the rollover relief should be automatic.

Stamp Duty

- stamp duty should be abolished. The half percent duty on share transactions should be abolished as should the one percent duty on property transfers. The latter measure should be a great help to workers moving house to take on a new job.

P[illegible] B: COMPANY TAX REFORMS

The Save Up and Then Spend Business Tax Regime

There is a real need for a new business tax regime to replace the present corporation tax system to allow businesses to grow from their retained earnings by giving them access to tax paid. We have called this new regime by its most obvious name "The Save Up and Then Spend" business tax regime.

The scheme is designed specifically to allow businesses to expand from the most obviouse source of finance - their own retained earnings. The scheme would work in the following way:

- tax would be computed on profits as currently calculted with additional reliefs given for increases in stocks and work in progress and increases in trade debtors less trade creditors

- tax to be capable of being refunded for up to seven years to allow any additional reliefs should they not be accommodated in the current year's profit

- tax to be paid in the normal to the Inland Revenue or purchase made of a Treasury Bond redeemable against proof of expansion and if held unreedemed for a period in excess of seven years surrendered to the Treasury

The purpose of this new tax regime is to produce a system which does not drain profits from the company that needs the extra liquidity to finance expansion. The system, however, does tax profits that are not so used for expansion. The details on whether a company qualifies as an expanding company and thus able to access past tax paid, would be produced by the company's accountant and approved by the Revenue. Badges of expansion would be announced in advance and the most obvious one we foresee would be an increase in the number of employees thus the system is directly linked to job creation.

Other Business Tax Reforms

Capital Allowances

The share of total tax receipts paid by British companies has risen by 50% since 1979. The most rapid growth in companies' tax bills has come since 1984 when the Government abolished stock relief and phased out capital allowances. Whilst the 1984 measures were balanced by a reduction in the corporation tax rate nevertheless the combination of changes has been far from neutral and the impact has been to raise companies' tax burden. In order to redress this imbalance we would like to see the following measures:

- Introduce 100% capital allowances for the first £50,000 of capital expenditure including buildings in any one tax year for independent businesses.

- Retain first year allowances at 50% on plant and machinery indefinitely.

- Allowances for industrial buildings to be included at 50%.

The Small Companies Rate

- Reduce this further in line with any reduction in the basic rate of income tax

- Increase the qualifying threshold to £250,000.

Employers' National Insurance Contributions

- The removal of the Upper Earnings Limit on employers' NIC has imposed an unncessary cost on employers. It is of the utmost urgency that the limit is reintroduced.

- There is a strong case for applying part of any scope for tax reductions to reducing the employers' NIC rate by 1%.

PART C: COMPANY FINANCE REFORMS

Reforms to Fill Up the Equity Gap

The Business Expansion Scheme: Lifting the Restrictions

Among the aims of the Business Expansion Scheme are to increase the net supply of equity funds to unquoted firms, to encourage investment in high risk/high growth situations, to create employment and to encourage wider share ownership. These aims are worthy but are not being fulfilled because of the restrictions attached to the scheme.

The scheme takes the form of tax relief on certain kinds of investments (fully paid up new ordinary shares with no preferential rights), in certain kinds of companies (UK incorporated and resident and unquoted), in certain kinds of trade ("qualifying trades") made by certain kinds of individuals (beneficial owners of the shares who are "unconnected" with the company) or certain, carefully specified new institutions, (Approved Investment Funds under BES).

Only if <u>all</u> the criteria are met can the benefits of the BES be realised.

In order to realise the full potential of the Business Expansion Scheme the following reforms are needed:

- employees, directors and their families to be allowed to invest in their own companies through the BES and to claim the relevant tax relief

- extending the BES benefits to the corporate sector by giving corporation tax relief to a company that invests in a qualifying business under Business Expansion Scheme rules. We have called this form of investment "the Corporate Investment Scheme (CIS)".

The Loan Guarantee Scheme: Improving Its Impact

We support the concept of a loan guarantee scheme as a potentially cost effective means of increasing bank lending to small firms which have viable projects but lack proven track records or sufficient personal security. Between 1 June 1981 and 31 May 1984 the Department of Trade and Industry issued over 15,000 loan guarantees in respect of £500 million of bank lending representing about 4% of total bank lending to small businesses. Over half of the guarantees issued went to new businesses, and around 43% went to manufacturing businesses. The scheme has so far produced 45,000 jobs.

Despite the popularity and job creation success of the scheme the Department of Trade and Industry alarmed at the failure rate for the first cohort of loan guarantees amended the scheme by reducing the Department's guarantee from 80% to 70%; by insisting that the borrower pay an annual premium of 2.5% and that in addition to paying this premium applicants with personal assets (including their own homes) who were unwilling to provide security for a commercial loan would not be eligible under the scheme.

The overall impact of these changes has been to reduce the demand from small businesses for guaranteed loans. This significantly reduced the level of activity is making the LGC redundant by requiring banks to apply the same criteria for LGS borrowers as for more traditional business loans.

The following reforms will bring back the scheme to its original conception and will increase the flow of funds to the small business sector:

- guarantee to cover loans of up to £150,000 to any one borrower. This is currently limited to £75,000

- further reduce the premium charged for the guarantee portion to a token 1%

- borrowers need not pledge all available personal assets on a normal commercial loan before applying for a guaranteed loan.

PART D: TAX REFORMS AND THE INNER CITIES

The fiscal regime can contribute greatly to the debate on the regeneration of the inner cities and we have a series of reforms which we feel will make a major contribution in this area.

Regionally Adjusted National Insurance

The National Insurance system can be used to concentrate regional aid in areas most in need and to relate it to the rate of unemployment. "Travel to Work Areas" would be the basis for deciding the amount of preference. For example, as a travel to work area moved into a level of high unemployment all employers should receive a rebate on their National Insurance Contributions in respect of any additional labour they take on.

Wage Subsidies for the Long Term Unemployed

A special employment measure to be introduced for the Long Term Unemployed operated through the independent business. Where an employer takes on someone who has been unemployed for one year or more such an employer should be given a subsidy of a 50% grant of up to 1.5 times the average national wage. The employer must show that the labour taken on was additional to that which he had employed on average.

Income from Land and Property to be Treated Favourably

In order to encourage the letting of properties such as houses, flats, factories or shops in inner city areas, there is a case to be made for reducing the impact of taxing the income from such lettings. Perhaps only three fifths of the income from such property should be assessed for tax purposes.

Along with our long standing support of the rates reform proposals, especially regarding the Uniform Business Rate (which should produce a diversion of £700 million from the South to the North), these proposals will make a valuable contribution to a solution of the inner cities problem.

PART E: VALUE ADDED TAX REFORMS

Net receipts of VAT in 1986/87 were £21,423 million, an increase in real terms of 7.4% over the previous year. This healthy state of affairs regarding VAT revenue comes in the wake of the Council of the European Communities' directive aimed at a common system of Value Added Tax and approximation of VAT rate to coincide with the onset of the internal market in 1992. We are concerned about more immediate reforms which are needed to the presen VAT regime as it affects UK small businesses and set out our VAT reforms below:

- In order to relieve the burden on business start ups the registration threshold for VAT should be raised from its miniscule £21,300 to a more substantial sum, namely, £50,000

- The unfair position regarding VAT for traders who do not receive payment should be rectified and the trader should be given full VAT relief for VAT which he has not received if it turns out that a debt is effectively bad after 18 months

- Traders with a turnover below £2 million per annum to qualify for cash accounting method for VAT receipts

PART F: OTHER TAX REFORMS

Pension Scheme Surpluses

- Refunds of surpluses into a company's balance sheet should not suffer tax at 40% on the premise that this would have been the average tax offset gainable from the original contribution inputs. We propose the lowering of the 40% in the case of small companies to a more reasonable figure of 30%.

Age Allowance

- We welcomed the increased Age Allowance for those aged 80 or over in the Finance Act 1987. However, the retention of the income limit of £9,800 is disappointing. There is little justification for restricting Age Allowance simply by reference to a person's income. Age Allowance should be available according to age, and age alone.

Raising the Tax Allowance on Meal Vouchers

- It is clear that the current 15p tax free allowance on meal vouchers is linked to conditions from the past and has no real relevance to today's commercial environment. For small businesses wishing to gain the commercial advantages of a serious work-meal allowance, meal vouchers are an obvious choice because they are the only efficient alternative to an inhouse facility. We believe an increase inm the allowance to a realistic level of £1 would not only be fair but would also serve as a positive benefit to small businesses.

CC PPS
CST
PMG
EST
MR Scholar
Miss Sinclair.

FINANCIAL SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

D R L Duncan Esq
Director
Charterhouse Development Capital Limited
7 Ludgate Broadway
London EC4V 6DX

12 January 1988

Dear Mr Duncan

Thank you for your letter of 14 December on behalf of the Charterhouse Development Capital Limited. I apologise for the delay in replying.

I can assure you that your representations will be carefully considered in the run-up to the Budget. However, I hope you will understand that it would be inappropriate for me to comment further at this stage.

Yours ever

Norman Lamont

NORMAN LAMONT

53/2/LPD/3747/040

FROM: P J WALES
DATE: 12 January 1988

MR JEFFERSON-SMITH

cc PS/Chancellor 2
PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Miss Sinclair
Mrs Burnhams
Mr Michie

PS/C&E

WINE AND SPIRIT ASSOCIATION : 1988 BUDGET REPRESENTATIONS

The Economic Secretary has agreed to meet Mr Gent (Wine and Spirit Association of Great Britain and Northern Ireland) on Thursday 4 February at 3.00pm to discuss their 1988 Budget Representations.

2. I would be grateful if you could arrange for briefing to reach this office by close of play 2 February.

Peter Wales

P J WALES
Diary Secretary

FROM: MRS T C BURNHAMS
DATE: 14 JANUARY 1988

1. MISS ~~SINCLAIR~~ 15/1

2. **CHANCELLOR OF THE EXCHEQUER**

Many thanks. I shd be grateful if X cd come forward in time for FES.

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Monck
Mr Scholar
Mr Culpin
Miss Evans

PS/IR
Mr Marshall - IR
PS/C&E
Mr R Allen - C&E

1988 BUDGET REPRESENTATIONS

... I attach a summary of the representations received in December.

... 2. Representations were received from 51 organisations and I attach a summary of the main points made by the more important organisations together with a matrix. I also attach a list (annex A) of the subjects raised in correspondence from members of the public either directly or through their MPs and by the less important organisations (these are listed in annex B).

3. Tobacco duty continues to be the most popular subject for correspondence and in December the number supporting the BMA's campaign for substantially increased duty outnumbered the pro-tobacco lobby by about 3 to 1. Interest in the abolition of CGT and increased spending on the NHS also continues. In addition there appears to be a campaign to increase concessions for unleaded petrol by environmentalist groups.

4. There is a significant increase in Budget representations this year compared to last. The position to date is as follows compared to a similar time last year:

Representations from	1987	1988
MPs	50	291
Organisations	52	128
Members of the Public	198	310

The increase in correspondence with MPs is particularly striking.

X 5. A further summary will be submitted in February.

MRS T C BURNHAMS

Society of Motor Manufacturers	26.11.87
Association of Independent Investment Managers	27.11.87
Chartered Institute of Management Accountants	30.11.87
TUC (tech reps)	30.11.87
The Stock Exchange	30.11.87
Association of British Chambers of Commerce	1.12.87
Wine and Spirit Assoc of GB & NI	2.12.87
Adam Smith Institute	2.12.87
Union of Independent Companies	4.12.87
National Union of Seamen	8.12.87
British Vehicle Rental and Leasing Association	8.12.87
National Chamber of Trade	9.12.87
Engineering Employers' Federation	10.12.87
General Council of British Shipping	10.12.87
Apex	10.12.87
Wider Share Ownership Council	11.12.87
City Capital Markets Committee	11.12.87
Unquoted Companies' Group	14.12.87
UK Onshore Operators Group	14.12.87
Association of Independent Business	16.12.87
Road Haulage Association Limited	17.12.87
The National Trust	17.12.87
Imperial Tobacco	17.12.87
British Retailers Association	18.12.87
Federation of British Electrotechnical and Allied Manufacturers Association	18.12.87
The Brewers Society	22.12.87
The Small Businesses Bureau	22.12.87
Motor Agents Association	22.12.87
Barclayshare	23.12.87
Joint Taxation Committee of Construction Industries Groups	23.12.87

The Society of Motor Manufacturers

Recommend -

- Replacement of schedular system
- Abolition of restriction on write down allowance
- Reduction in administrative burden for VAT on imports
- VAT to be repayable on vehicles used for R + D
- Restoration of 100% capital allowances
- Abolition of car tax
- No further increases in taxation of company cars or fuel
- Lower VED for commercial vehicles.

The Association of Independent Investment Managers

Support exemption of long term gains from CGT, a taper of CGT over 7 years or a flat tax rate at the standard rate for a shorter period.

The Chartered Institute of Management Accountants

Recommend -

- Abolition of 25% reducing balance basis for CT write down allowances in favour of a straightline system.
- Removal of 27% restriction on ACT offset against CT
- CGT tapering relief up to 5 years
- Abolition of S482 + 483 of 1970 Taxes Act
- Relief for exchange rate fluctuations
- Increase PIID limit to £25,000.

TUC - tech reps

Recommend -

- Increased coverage of Pay and File system (including unincorporated businesses)

- Increase PIID threshold to £10,000 and index
- Tax exemption for childcare facilities
- Tax concessions for secondments to community organisations.

Main representations support increased personal allowances or a reduced IT band.

The Stock Exchange

Support abolition of Transfer Stamp Duty and CGT and fiscal neutrality for all forms of savings. Suggest tax relief of £500 pa for PEPs, extension of 28 day rule to 90 days and PEPs to include gilt-edged stock or unit trusts.

Wine and Spirit Association of GB and NI

Support reduction on duties of wine exceeding 15% alcoholic strength by 10% and freeze on duty of other wines and spirits.

Association of British Chambers of Commerce

Support -

- Abolition of Stamp Duty on share transfers
- Abolition of CGT
- Local enterprise funds to be given BES treatment for tax purposes.

Adam Smith Institute

Recommend -

Abolition of Stamp Duty, Inheritance Tax and CGT.

- Reduction in income tax with 3 bands of 25%, 30% and 40% with indexed thresholds
- Phased reduction of Corporation Tax to basic rate over 4 years
- Reduction in NICs and eventual phasing out
- Indexation of excise duties with immediate 10% addition to tobacco duty.

Union of Independent Companies

Propose -

- Interest subsidy to ensure real rate of interest no more than 6%
- Increase to £25,000 maximum for Government's Loan Guarantee Scheme
- Nil rate band of CT on 1st £20,000 of taxable profits for small companies
- Reduction in small business rate of CT to 25%
- Full holdover of IHT on gifts of shares in unquoted companies to FT employees of 5 years standing
- Reduction of IT basic rate to 25p and top rate to 50p
- Abolition of married man's allowance, increase in single allowance transferable to spouse
- Increase in NICs thresholds
- Restriction of MIR to basic rate
- Interest on loans for manufacturing investment to be paid net of tax.

National Union of Seamen

Support no extension of VAT to marine fuel oil and shipboard stores.

British Vehicle Rental and Leasing Association

Propose -

- Abolition of restriction on Capital Allowance on private cars
- Increase in depreciation allowances to 25% on straight line basis or 30% on reducing basis
- extension of depooling option to private cars

- Abolition of restrictions on deductibility of lease rentals on private cars.
- Increase in car scales restricted to RPI
- Abolition of car tax.

National Chamber of Trade

Propose -

- Increase in VAT threshold to £100,000
- Increase in PIID threshold to £15,000
- LVs to be tax free up to £1.50
- Tax relief for small firms who set up investment reserves for development
- Extension of 4% write down allowances to retail stores and service buildings.

Engineering Employers' Federation

Propose -

- 100% tax relief for investment expenditure
- CGT taper up to 6 years.

General Council of British Shipping

Request rollover relief for balancing charges when money obtained from sale of ships is reinvested in shipping.

Apex

Propose -

- Allowances for employers who invest in training

- Lower employer's NICs
- Investment allowances for new forms of equipment and technology.

Wider Share Ownership Council

Support income tax relief deducted at source for PEPs.

City Capital Markets Committee

Suggest non-residents who place funds for management in UK should not be liable to UK tax.

Unquoted Companies Group

Support abolition of Inheritence Tax on unquoted companies and general reduction in IHT rates and increased reliefs.

UK Onshore Operators Group

Support reintroduction of PRT relief for onshore exploration.

Associations of Independent Business

Propose -

- Reduced rates of IHT with nil rate up to £250,000
- Unused IHT relief transferals to surviving spouse
- Full CGT relief on pre 82 gains
- Automatic rollover relief for assets until liquidated
- Abolition of Stamp Duty on shares and property transactions
- Reintroduction of UEL for employers' NICs and regionally adjusted contributions

- Less restrictions on BES
- Improved Loan Guarantee Scheme
- Increase VAT threshold to £50,000
- VAT relief for bad debts.

Road Haulage Association Limited

Support -

- Reduced VED for hauliers
- Reduced fuel tax
- Increased spending on roads
- Abolition of rebated automotive fuel and concessionary VED for farmers.

The National Trust

Support increased incentives for charitable donations including a more effective payroll - giving system based on the US model.

Imperial Tobacco

Advocate freeze on tobacco duty

British Retailers Association

Support -

- Harmonisation of duty rates on sparkling and still wines
- Extension of duty deferment by 4 weeks
- Harmonisation of deferment periods for VAT and Duty
- Removal of requirement for bank guarantees
- Removal of restrictions on tobacco clearance before Budget.

Federation of British Electrotechnical and Allied Manufacturers Association (BEAMA)

Recommend -

- Less restrictions on removal of double taxation
- No CGT on pre 82 gains
- Less restrictive rollover relief
- Restoration of 100% capital allowance
- ACT should be available for offset at full CT rate on all profits

The Brewers Society

Oppose higher duty for stronger beers. Propose new flat rate duty for beer below 1030° and alcoholic strength by Volume exceeding 1.2% but below 2.2%.

Support new duty band for mixtures of Wine or beer with fruit juice.

The Small Business Bureau

Propose -

- Reduced IT and CT for small firms
- Graduated rate of CT
- The introduction of an enterprise bond to be offset against taxable income
- Increase limit of Loan Guarantee Scheme
- Increase BES relief to £250,000
- Tax relief for individuals investing in their own businesses
- Relief for self-employed investing in own business against previous tax paid
- Abolition of CGT on gains on unquoted shares
- Abolition of IHT on transfer of shares in unquoted companies or 100% Business Property Relief and extension to minority holdings

Motor Agents Association

Recommend -

- Phased removal of car tax over 3 years
- Abolition of non-deductibility of VAT on cars purchased by companies
- No increase in car benefit scales
- Alter tax breaks to take account of different engine capacity of diesel vehicles
- Abolition of limit on write down allowance for cars or raise limit to £15,750
- Reduce small business rate of CT
- Concessions on IHT.

Barclayshare

Propose -

- Abolition of CGT
  or independent taxation of husbands and wives
- Abolition of Stamp Duty on shares
- PEPs-relief for dividends on UK shares up to £500 pa.

Joint Taxation Committee of Construction Industries Group

Propose -

A VAT

1. Reduction in burden on housing repairs, maintenance and improvements - low rate for work on residential property.

2. Right of option for tax on property transactions otherwise exempt from VAT.

3. Lower threshold of £10,000 for small businesses in construction industry.

B. Direct Taxes to help Urban Renewal

1. Extension of BES for investment in approved projects

2. CT relief for projects similar to BES relief for individuals

3. Reduced NICs for employee's on approved projects

4. Accelerated Industrial Building Allowances on approved projects.

C. IT

Integration of IT + NICs. Review of Schedule E. Indexed limit on pension lump sums. MIR to £40,000 and indexed to house prices.

D. Benefits in Kind

Raise threshold to £15,000

E. Stamp Duty

Raise transfer duty threshold to £60,000. Abolition of Capital Duty.

F. CT

Simplify by abolition of Schedular system and revision of groups' legislation.

G. Capital Allowance

Extend to commercial building.

441/008/AC

	SOCIETY OF MOTOR MANUFACTURERS	ASSOC OF INDEPENDENT INVESTMENT MANAGERS	CHARTERED INST OF MGT ACCTS.
PERSONAL TAX	No further increases in tax of company cars or fuel		Increase PIID limit to £25,000
STAMP DUTY			
CGT		Exemption of long-term gains. CGT tapered over 7 years or flat rate (same as IT standard rate) for shorter periods	Relief tapered over 5 years
IHT			
CT	Abolition of restriction on write down allowance. Replace schedular system		Abolition of 25% reducing bal. basis for write down allowances replaced by straightline system. Removal of 27% restriction on ACT offset against CT. Relief for exchange rate fluctuations. Abolition of S482 + 483
CAPITAL ALLOWANCES	Restoration of 100% Allowances		
BES			
VAT	Reduce administrative burden for VAT on imports. Repayment of VAT on vehicles used for R + D		
EXCISE DUTY	Abolish car tax		
BETTING AND GAMING			
VED	Lower VED for commercial vehicles		

	TUC	STOCK EXCHANGE	WINE AND SPIRIT ASSOC OF GB AND NI
PERSONAL TAX	Increased personal allowances or reduced IT band. Tax exemption for child care facilities. Increase PIID threshold to £10,000 and index	Fiscal neutrality for all savings. Tax relief for PEPS	
STAMP DUTY		Abolish for share transfer	
CGT		Abolish	
IHT			
CT			
CAPITAL ALLOWANCES			
BES			
VAT			
EXCISE DUTY			Reduce duty on wine exceeding 15% alcoholic strength by 10%. Freeze other duties on drink
BETTING AND GAMING			

	ASSOC. OF BRITISH CHAMBERS OF COMMERCE	ADAM SMITH INSTITUTE	UNION OF INDEPENDENT COMPANIES
PERSONAL TAX		3 Bands - 25%, 30% and 40% indexed threshold on IT	25% basic rate. 50% top rate. Restrict MIR to basic rate. Abolition of MMA. Transferable single allowances
STAMP DUTY	Abolish on share transfers	Abolish	
CGT	Abolish	Abolish	
IHT		Abolish	Hold over of IHT on gifts of shares in unquoted companies to employees
CT		Phased reduction over 4 years to match basic IT rate	Interest subsidy. Nil rate up to £20,000 tax profits for small companies. Small bus rate 25%
CAPITAL ALLOWANCES			
BES	BES treatment for Local Enterprise Funds		
VAT			
EXCISE DUTY		10% immediately on tobacco and indexation	
BETTING AND GAMING			

	NATIONAL UNION OF SEAMEN	BRITISH VEHICLE RENTAL AND LEASING ASSOC	NATIONAL CHAMBER OF TRADE
PERSONAL TAX		Increase in car scales restricted to RPI	Increase PIID threshold to £15,000
STAMP DUTY			
CGT			
IHT			
CT			Tax relief for small firms who set up investment reserves for development
CAPITAL ALLOWANCES		Abolition of restriction on private cars. Increase depreciation allowance to 25% on straightline basis	Extension of 4% write down allowances to stores and service buildings
BES			
VAT	Against extension to marine fuel oil and shipboard stores		Increase threshold to £100,000
EXCISE DUTY		Abolish car tax	
BETTING AND GAMING			

	ENGINEERING EMPLOYERS' FEDERATION	GENERAL COUNCIL OF BRITISH SHIPPING	APEX
PERSONAL TAX			
STAMP DUTY			
CGT	CGT tapered over 6 years	Rollover relief for balancing charges when money reinvested in shipping	
IHT			
CT	100% relief for investment expeniture		Relief for investment in training and new forms of equipment and technology
CAPITAL ALLOWANCES			
BES			
VAT			
EXCISE DUTY			
BETTING AND GAMING			

	WIDER SHARE OWNERSHIP COUNCIL	CITY CAPITAL MARKETS COMMITTEE	UNQUOTED COMPANIES GROUP
PERSONAL TAX	IT relief at source for PEPs	Non-residents who place investment funds for UK mgt to be exempt from UK IT	
STAMP DUTY			
CGT			
IHT			Reduce rates and increase reliefs. Abolish for unquoted companies
CT			
CAPITAL ALLOWANCES			
BES			
VAT			
EXCISE DUTY			
BETTING AND GAMING			

	UK ONSHORE OPERATORS GROUP	ASSOCIATION OF INDEPENDENT BUSINESS	ROAD HAULAGE ASSOCIATION
PERSONAL TAX			
STAMP DUTY		Abolish for shares and property transactions	
CGT		Relief for pre 82 gains. Automatic rollover relief for assets until liquidation	
IHT		Reduce with nil rate up to £250,000. Unused relief transferable to surviving spouse	
CT			
CAPITAL ALLOWANCES			
BES		Less restrictions	
VAT		Increase threshold to £50,000. Relief for bad debts	
EXCISE DUTY			Reduce fuel duty. Abolish rebated automotive fuel for farmers
BETTING AND GAMING			
VED			Reduce VED for hauliers. Abolish concessions for farmers
PRT	Reintroduce relief for onshore exploration		

	NATIONAL TRUST	IMPERIAL TOBACCO	BRITISH RETAILERS ASSOCIATION
PERSONAL TAX	Increased incentives for charitable donations		
STAMP DUTY			
CGT			
IHT			
CT			
CAPITAL ALLOWANCES			
BES			
VAT			
EXCISE DUTY		Freeze tobacco duty	Harmonise duty on sparkling and still wines. Extend duty deferment by 4 weeks
BETTING AND GAMING			

	BREAMA	BREWERS SOCIETY	SMALL BUSINESS BUREAU
PERSONAL TAX			Reduced rates. Introduction of enterprise bond to be offset against tax income. Relief for self employed investing in own business
STAMP DUTY			
CGT	Abolish for pre 82 gains. Less restrictive rollover relief		Abolition for unquoted shares
IHT			Abolition for shares in unquoted companies
CT	Less restrictions on removal of double taxation. ACT to be available for offset at full CT rate on all profits		Reduce rate for small firms. Graduated rate of CT
CAPITAL ALLOWANCES	Restore 100% allowance		
BES			Increase relief to £250,000 Extend to corporate venturing
VAT			
EXCISE DUTY		Against higher duty for strong beers. New flat rate duty for beer and duty band for mixtures of wine or beer with fruit juice	
BETTING AND GAMING			

	MOTOR AGENTS ASSOCIATION	BARCLAYSHARE	JOINT TAX COMMITTEE OF CONSTRUCTION INDUSTRY
PERSONAL TAX	No increase in car benefit scales	PEPs-relief upto £500 pa	Integrate IT + NICs. Review limit on pension lump sums. Increase MIR to £40,000 and index. Raise PIID to £15,000
STAMP DUTY		Abolition of duty on shares	Raise transfer duty threshold to £60,000. Abolish Capital duty
CGT		Abolish, or independent tax of husbands and wives	
IHT	Further concessions		
CT	Abolition of limit on write down allow. for cars, or increase limit to £15,750. Reduce small bus rate		Simplify by abolition of Schedular system and revision of groups legisation
CAPITAL ALLOWANCES			Accelerate Industrial Building Allowances on approved projects. Extend to commercial buildings
BES			Extension for approved projects. Extension to corporate ventures
VAT	Abolition of non-deductibility on company cars		Reduce burden on repairs + maintenance. Lower threshold to £10,000 for small bus in construction industry
EXCISE DUTY	Phased removal of car tax		
BETTING AND GAMING			

Increase Tobacco Taxation	69
Abolish or reduce CGT	38
Increase public spending rather than tax cuts	36
End penalty on marriage for MIR	24
Freeze tobacco taxation	21
More tax concessions for the elderly	15
Support independent taxation	14
Concessions for unleaded petrol	7
Increase higher rate tax	6
Abolish or reduce Inheritance Tax	5
No increase in alcohol taxation	4
Increase tax on alcohol	3
Reduce tax on aviation fuel	3
Reduce goods subject to VAT	3
Lower the tax burden	3
Abolish MIR	3
Reintroduce 100% 1st year Capital Allowances	3
Increase Personal Allowances	2
Increase VAT threshold	2
Further relief for cars	2
Increased relief for the disabled	2
Increase threshold for stamp duty on houses	1
Abolish VED and increase tax on petrol	1
MIR - regional differentials	1
Increased relief for 1 parent families	1
VAT concessions for the British Legion	1
Extend VAT base	1
Tax relief for private education	1
Reduce CT for small firms	1
Expand BES	1
Non tax deductibility for advertising	1
Child benefit to continue to be tax free	1
Abolition of Stamp Duty on shares	1
VAT bad debt relief	1
Improve Mines and Oil Well Allowance	1
Tax on horse-owners	1
Reform of ACT	1
Relief for gifts to universities	1

ANNEX B

LIST OF OTHER ORGANISATIONS

The Association of Anaesthetists

The Chest, Heart and Stroke Association

Imperial Cancer Research Laboratory

Kings College School of Medicine and Dentistry

University of Leicester, Department of Chemistry

Cambridge/Essex/Herts Branch of Country Landowners Association

The Health Education Authority

City of Newcastle upon Tyne

Frenchay Health Authority

British Lung Foundation

University of Edinburgh Development Fund Campaign

City of London Health Department

UK Coordinating Committee on Cancer Research

The Agricultural Engineers Association

Trimite Limited

Burmah Oil Plc

Merrydown Wine Plc

The Federation of Associations of Specialists and Sub Contractors

British Aggregate Construction Materials Industries

Engineering Employers' West Midlands Association

SBCI Savory Milln

ps7/26L

UNCLASSIFIED

FROM: MRS JULIE THORPE
DATE: 14 January 1988

EST

PS/ECONOMIC SECRETARY

cc PS/Financial Secretary
PS/Paymaster General
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Monck
Mr Culpin
Miss Sinclair
Mr R I G Allen
Mrs Burnhams
PS/C&E

THE BREWERS' SOCIETY: BUDGET REPS

The Chancellor has agreed to see the deputation from the Brewers' Society to discuss their Budget representations on Tuesday, 26 January at 9.30am.

2. The Chancellor would like the Economic Secretary to attend the meeting along with someone from Customs. Please could Customs let me know who will be attending the meeting in due course.

3. I would be grateful if Mrs Burnhams could co-ordinate the briefing to reach this office by close of play on Friday, 22 January.

Julie Thorpe.

MRS JULIE THORPE
Diary Secretary

913/017/alr

1. MRS BURNHAMS
2. MISS SINCLAIR
3. MCU
4. FINANCIAL SECRETARY

FROM: MISS S WALLIS
DATE: 15 January 1988

cc PS/Chancellor 12/2
PS/CST
PS/FST
PS/EST
PS/Paymaster General
Sir A Wilson
PS/IR
Mr S Shaw (IR)

BUDGET DEPUTATION: THE AMERICAN COMMUNITY SCHOOL

The American Community School have sent in their representations for the Budget, and are asking for an opportunity to discuss them with Ministers.

2. The American Community School are not on the "Core List" of organisations that Ministers should see as a matter of course. They were not seen last year.

3. We and the Revenue see no advantage in you agreeing to a meeting this time round. We therefore suggest you turn down their request.

4. I attach a reply.

S Wallis

MISS S WALLIS

ENC

913/020/alr

Treasury Chambers, Parliament Street, SW1P 3AG

G E Speed Esq
Academic Director
The American Community School Limited
"Heywood"
Portsmouth Road
Cobham
Surrey KT11 1BL

January 1988

Thank you for your letter of 4 January setting out your representations for the Budget and asking for an opportunity to discuss them with Ministers.

As you can imagine, Treasury Ministers receive numerous requests for meetings from representative bodies before each Budget. Ministers try and see as many organisations as possible, but as I am sure you will appreciate, they cannot see every organisation which requests a meeting. I am afraid, therefore, that it will not be possible for Treasury Ministers to see you in the run-up to the 1988 Budget.

I can assure you, however, that your representations will be carefully considered.

NORMAN LAMONT

American Community School

The American Community School Ltd
'Heywood', Portsmouth Road,
Cobham, Surrey KT11 1BL

Telephone Cobham (0932) 67251
Telex [illegible] ACS G

Accredited by The New England
Association of Schools and Colleges

Mr Norman Lamont MP
House of Commons
LONDON
SW1A OAA

BR

HM TREASURY MCU
REC'D 12 JAN 1988
Mrs [illegible] FP
cc IR
FST
1065/88

4th January 1988

Dear Mr Lamont

I enjoyed the opportunity of meeting you and hearing your most interesting talk to the recent dinner meeting of The Enterprise Club.

I had wished to raise a question on behalf of our School during the question and answer session following your talk, but alas there were more questions than time, due to the pending vote in the House.

However, I would still like to bring our concern to your kind attention. In the past, the vast majority of our students' fathers were employed by a few select multi-national companies. Most had their school fees paid for by their companies. Because of various tax benefits (50%, then 25% of personal income only taxed, no tax on scholarships, etc.) our tuition charges represented only a small portion of an individuals total cost to his company and wasn't a problem.

Now, however, the situation has altered considerably. The vast majority of our students are from families employed by small companies or self-employed. Fewer companies pay school fees on their behalf. All the tax benefits have been phased out or withdrawn. Consequently, our fees now represent a major burden to the small company and/or the individual employee.

Yet, at the same time, we are a vital and very important part of the total British effort to attract foreign investment. Without international schools such as ours to provide continuity of education, many employees would not accept a UK assignment nor self-employed persons set-up business here. We are a net importer of currency, we help attract investment to the UK and we save the State the expense of providing educational facilities for 1500 students, yet our corporate users and parents receive no tax break for their additional cost!

We request on behalf of ourselves and other international schools a tax concession on school fees to be incorporated in the coming Spring Budget.

Contd./...

We would be pleased to have the opportunity to meet with you to discuss our proposal at a time and place convenient for yourself. If you have the time we would like to invite you to the school to see our facilities.

Thank you for your kind consideration of the above.

Yours sincerely

G E SPEED
Academic Director

53/2/LPD/SETS/009

pmp

ECONOMIC SECRETARY TO THE TREASURY

FROM: P J WALES
DATE: 18 January 1988

MRS T BURNHAMS

cc PS/Chancellor 2
PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Sir P Middleton
Miss Sinclair
Mr Saunders

PS/C&E

BRITISH MEDICAL ASSOCIATION (BMA) : BUDGET REPRESENTATIONS

The Economic Secretary has agreed to meet a delegation from the BMA on Thursday 4 February at 10.30 am, to discuss their 1988 Budget Representations.

2. I would be grateful if you could co-ordinate the appropriate briefing, in consultation with ST2, to reach this office by close of play 2 February.

Peter Wales

P J WALES
Diary Secretary

53/2/LPD/3748/008

Treasury Chambers, Parliament Street, SW1P 3AG

Patricia Langley
British Medical Association
BMA House
Tavistock Square
LONDON
WC1H 9JP

18 January 1988

Dear Patricia

I refer to our telephone conversation on Friday 15 January.

I am writing to confirm that the Economic Secretary will be delighted to meet a delegation from the British Medical Association on Thursday 4 February at 10.30am to discuss their 1988 Budget Representations.

I would be grateful if you could let me know the names of the BMA delegation in due course.

Yours Sincerely

Peter Wales

P J WALES
Diary Secretary

913/023/alr

Dmp

1. MRS BURNHAMS TB 19/1
2. MISS SINCLAIR Ss 19/1
3. MCU
4. ECONOMIC SECRETARY

FROM: MISS S WALLIS
DATE: 18 January 1988

cc PS/Chancellor 12/2
PS/CST
PS/FST
PS/Paymaster General
Sir A Wilson
PS/C & E
Mr J Fisher (C & E)

BUDGET DEPUTATION: THE PET FOOD MANUFACTURERS' ASSOCIATION (PFMA)

The Pet Food Manufacturers' Association (PFMA) have sent in their representations for the Budget, and are asking for an opportunity to discuss them with Ministers.

2. The PFMA are not on the "Core List" of organisations that Ministers should see as a matter of course. They were not seen last year.

3. We and Customs see no advantage in you agreeing to a meeting this time round. We therefore suggest you turn down their request.

4. I attach a reply.

S Wallis

MISS S WALLIS

ENC

913/024/alr

Treasury Chambers. Parliament Street. SW1P 3AG

T Bell Esq
Chairman
The Pet Food Manufacturers Association
6 Catherine Street
London WC2B 5JJ

January 1988

Thank you for your recent letter to the Chancellor of the Exchequer setting out your representations for the Budget and asking for an opportunity to discuss them with Ministers.

As you can imagine, Treasury Ministers receive numerous requests for meetings from representative bodies before each Budget. Ministers try and see as many organisations as possible, but as I am sure you will appreciate, they cannot see every organisation which requests a meeting. I am afraid, therefore, that it will not be possible for Treasury Ministers to see you in the run-up to the 1988 Budget.

I can assure you, however, that your representations will be carefully considered.

NORMAN LAMONT

13d

6 Catherine Street,
London WC2B 5JJ
Telephone 01-836 2460
Telex 299388
Fax 01-836 0580

The Pet Food Manufacturers' Association

PFMA

BR

HM TREASURY
-6 JAN
Mrs Burnhams FP
cc CE.
EST

The Rt.Hon. Nigel Lawson MP
Her Majesty's Treasury
Parliament Street
London SW1P 3AG

8 January 1988

Dear Chancellor,

We are writing to ask you in your forthcoming Budget to correct a VAT anomaly that adversely affects half the households in Britain, that of petfoods and VAT.

Currently the UK is one of a few European countries where prepared petfoods are not treated in the same way for VAT purposes as other animal feeds and human foods. The Pet Food Manufacturers Association believes that there are compelling reasons why this opportunity should be taken to rectify this anomaly and to ensure that for VAT purposes, as is the case for many other legislative purposes, prepared petfoods are treated in the same way as animal feeds and human foods.

<u>Equal treatment with competitors</u>

Currently petfood is in a unique position because it falls into two categories of foodstuffs, neither of which attracts VAT. The two categories are:

1. Animal feedstuffs - Prepared petfoods are classified as animal feeds for purposes of legislation on labelling, additives and contaminants.

2. Family foods - Petfoods are subject to the same legislation as human foods for weights and measures, product liability and trade descriptions.

Given these circumstances, prepared petfoods should be treated in the same way as their direct competitors ie. other animal feedstuffs and human foods. Equal treatment will, we believe, produce important social benefits as well as helping an important UK industry.

It is clear that animal feeds and human foods are direct competitors to prepared petfoods, but each have severe drawbacks if they are used in the feeding of pet animals, which their tax treatment encourages. Prepared petfoods provide a fully balanced diet which is frequently not available from human food scraps or animal feeds designed for another purpose.

For all pet owners - 49% of British households - petfoods are a real basic necessity in that they have no choice as to whether the pet is fed or not. Prepared petfood is a regular, significant item in the household shopping basket, purchased in an identical manner to all other food items, usually at the same time and place.

Benefits for the elderly, children and the disabled

The role of the pet animal in society is very important. The growth in pet ownership has brought important benefits to many of the most disadvantaged in society - particularly the elderly, those living alone, families with small children and the disabled.

Almost half the households in Britain own a pet and a high proportion of pet owners (85%) are in lower income groups. The elderly and those living alone often rely on the companionship and protection of a pet animal. Pets frequently provide the main motivation for the maintenance of independence in the elderly, with important consequences for society and the social services.

The educational benefits of pet ownership to families with small children are well recognised. Pet ownership encourages a sense of responsibility and caring amongst children. Pets are the focus of a valuable hobby, including training and breeding animals.

Pet ownership has particular benefits to the disabled and those with medical and psychological problems. Pets have considerable physical and psychological benefit in hospitals and day care centres, easing stress and aiding recovery. Stroking and fondling a pet has a soothing effect, easing stress and even lowering high blood pressure.

Pet animals, of course, help people in practical ways - for example, guide dogs for the blind, hearing dogs for the deaf and search and rescue dogs.

An unfair VAT burden is falling most heavily on those least able to afford it, since most pet owners are in lower income groups, families with children, the elderly and the disabled.

Encouragement of pet ownership

The development and popularity of convenient prepared petfoods has been crucial to the expansion of pet ownership, with its attendant benefits. In view of this - and the widespread benefits to be gained as a result of responsible pet ownership - pet ownership should be encouraged rather than hindered, as is presently the case as a result of the anomalous VAT treatment of prepared petfoods.

The additional burden of VAT means that pet ownership can be denied to those that could most benefit from it. In addition, the discrimination against petfoods can also deny to the pet animal the guarantee of adequate nutrition.

Increased pet ownership among groups such as pensioners, the disabled and those living alone will have beneficial effects on the ability for people to be cared for within the community. Reduced costs will encourage the keeping of companion animals within residential institutions such as hospitals, homes for the elderly and prisons - with considerable psychological and physical benefits to all those that come into contact with them.

Unfair discrimination

Finally, we would emphasise that it is the unfair discrimination aspect of this problem that we are concerned about. The setting of individual VAT rates is rightly a matter of Government policy.

We would appreciate an opportunity to meet you and your colleagues as soon as possible, in order to discuss further the case for removing the unfair VAT treatment of prepared petfoods.

Yours sincerely

Trevor Bell

Trevor Bell
Chairman
The Pet Food Manufacturers Association

(PMP)

bf in force

McGUIGAN → CHEX 18/1

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

1. Mr Jefferson Smith
   not seen by Mr Jefferson Smith.

2. Chancellor

FROM: W F McGUIGAN
DATE: 18 JANUARY 1988

cc Economic Secretary
PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Mr Culpin
Miss Sinclair
Mr Cropper

BUDGET DEPUTATION : TOBACCO ADVISORY COUNCIL (TAC)

I attach briefing, in the standard format, for your meeting, together with the Economic Secretary and Mr Cropper, with the TAC on 20 January at 3.00pm. Mr Jefferson Smith and Mr Boardman will provide official support at the meeting.

W F McGUIGAN

Internal Circulation

CPS MR KNOX MR JEFFERSON SMITH MR ALLEN MR BOARDMAN

TOBACCO ADVISORY COUNCIL : 1988 BUDGET DEPUTATION

ORGANISATION

1. The TAC represents the UK tobacco manufacturers. Their delegation will be led by Mr Peter Wilson (Chairman and Chief Executive of Gallaher Tobacco (UK) Ltd). He will be accompanied by Mr Angus Vine, (Commercial Director of Imperial Tobacco Ltd), Mr John Webb (Director Public Affairs, Rothmans International Services Ltd) and Mr Bill Owen (Chief Executive, TAC).

OBJECT OF MEETING

2. The TAC is on the "core list" of organisations normally seen by Ministers before the Budget.

WRITTEN REPRESENTATIONS

3. The TAC's written representations

(a) welcome the freeze on tobacco duties in the 1987 Budget,

(b) recognise that simple revalorisation of the cigarette duty might be necessary this year, but urge that this should be the ceiling to any increase, and then only if similar increases are to be applied to all excisable goods,

(c) ask for a continuation of the duty freeze on cigars (no duty increase since 1984) and pipe tobacco (no increase since 1982), and

(d) criticise the British Medical Association (BMA) call for swingeing duty increases on cigarettes as "ill conceived in almost every respect".

POINTS LIKELY TO BE RAISED

UK Taxation

4. The UK tobacco industry is deeply concerned about increases in duty, the effect on cigarette consumption, and the fact that health arguments have in the past been deployed to justify repeated real increases in duty levels. Since 1979 the total tax burden on cigarettes has increased in real terms by more than 40 per cent, and the heavy increases in 1981 (adding 17p to the price of a packet of 20), 1984 (adding 10p) and 1986 (adding 11p) were bitterly attacked as excessive (several times the amount required to revalorise) and discriminatory (some other excise duties were increased proportionately less or not at all). The industry greatly welcomed the freeze on tobacco duties in the 1987 Budget, as a "breathing space" in which to reorganise to meet the threat from cheap imports. This year the industry recognises that simple revalorisation of the duty may be necessary, but may be expected to dwell on the adverse impact of any larger "catching-up" increase.

5. The TAC is particularly critical of the BMA proposal for a duty increase in the 1988 Budget to raise the price of cigarettes by 21 per cent (about 33p per packet of 20, depending on the base price assumed) with 6 per cent per year real increases thereafter. The BMA proposal is designed to return cigarette taxation in real terms to its post-war peak (1947) and save some 7000 lives a year in the long term through tax-induced falls in consumption. The TAC criticise the proposal as inflationary, regressive, and based on flawed econometrics, though they have not directly questioned the estimate of lives saved. The Economic Secretary has now agreed to see the BMA in the run-up to the Budget.

Consumption

6. Cigarette consumption fell by about 23 per cent from 1979 to 1986. Dutiable clearances for the 9 months to September 1987 rose by 5.2 per cent, distorted by anticipatory movements ahead of the Autumn industry wide 3p price increase. Industry sources suggest that actual consumption continued to decline by one or two per cent. Long term decline is certainly caused in part by duty increases, but also reflects a long-term trend against smoking. Employment (down about 48 per cent from 1979 to 1986) has fallen at a much faster rate than production, and this reflects streamlining by manufacturers, and investment in more efficient equipment. Competition continues to be intense, and while Gallaher succeeded in edging Imperial out of market leadership in the cigarette market in the early part of 1987, the two companies are currently level pegging, each with just over 38 per cent of the market.

Duty regressive?

7. The tobacco duty is undoubtedly regressive, but the elaborate TAC studies of this point are incomplete. In 1984, only 36 per cent of men and 32 per cent of women smoked cigarettes, and around half of all households did not purchase tobacco products. So while it is true that **on average** the bottom 30 per cent of households ranked by income paid more tobacco tax than income tax, around half of those individual households never paid any tobacco tax at all.

Imports

8. For some years now, Philip Morris have imported all supplies for the UK market of their full priced Marlboro brand from their European factories, and this amounts to around 2 per cent of UK consumption. Other, "cheap" imports come mainly from West Germany, including Berlin where manufacturers receive assistance because of the special position of the city. They are made mainly for sale under supermarket "own labels" and are cheaper than the major UK manufacturers' brands. The industry argue that UK firms cannot compete because of subsidised or marginal costed production in West Germany. They also claim that smokers are less loyal to particular brands, and that increases in taxation now have little impact on overall consumption. Instead, customers trade down to these cheaper imported cigarettes at the expense of sales and employment in the UK tobacco industry. "Cheap" imports grew from negligible levels in 1983 to 10.2 per cent of clearances in 1986 (12.2 per cent for total imports including Marlboro), but fell back in the 9 months to October 1987 to 7.1 per

?!

cent (9.6 per cent for total imports). The industry can certainly point to this as a check to import penetration following the duty freeze of 1987.

9. However, competition with imports has to be seen in the context of the continued unwillingness of UK tobacco majors to compete directly in the "own label" market. As Imperial have argued in previous years, if a company with established branded products enters the "own label" market, it would erode its profits overall. The strengthening of the mark against the pound has meant a rise of around 10 per cent in the unit value of cigarette imports from West Germany in the last year, and the smaller UK manufacturers, who have been capturing "own label" business from importers, can now match the price of the cheapest imports (recommended price currently £1.15 per packet of 20 king size cigarettes compared with £1.55 for the UK major's full priced product). The major manufacturers, especially Gallaher, have also been competing indirectly with "own labels" through the aggressive marketing of brands such as Berkeley, which sell slightly above the price of the cheaper imports. It is an oversimplification, therefore, to ascribe all the decline in imports to the duty standstill.

Pipe tobacco and cigars
10. Despite the standstill in duty since 1982, the market for pipe toabcco remains in gradual decline (down 30 per cent from 1979 to 1986, a bigger fall than for cigarettes). The cigar market has stabilised however, and although consumption fell about 24 per cent from 1979 to 1985, clearances are now running about 5 per cent higher than 1985 levels. These products, which account for around 4 per cent of duty receipts, are manufactured principally in Northern Ireland, Scotland, Wales and Liverpool. The health arguments for increases, particularly as regards pipe tobacco, are less strong than for cigarettes.

EC Harmonisation
11. The excise duty on cigarettes is already harmonised to a limited extent. To conform to an EC directive, the UK duty on cigarettes consists of a specific element, per cigarette, and an ad valorem element, based on the retail selling price. (The current duty rate is £30.61 per thousand cigarettes, plus 21 per cent of the retail price). The Commission proposals for further tobacco harmonisation would cut the tax burden on cigarettes by about 10 per cent, and reduce the price of a packet of 20 by about 12 pence. The effect on minor products would be proportionately larger. The industry is nonetheless alarmed by the structural implications of the proposals, which would reduce the share of the specific element of the combined duty and VAT burden on cigarettes from 54 per cent to 20 per cent and increase the ad valorem element. The UK industry is convinced that this would discriminate against the high quality UK product and encourage cheap imports. The Commission also proposes wholly ad valorem duty structures for the minor products such as cigars, smoking and chewing tobacco: the UK industry prefers the existing, familiar, wholly specific duty structure which suits their high quality products.

12. As you have indicated, the Commission proposals, now being considered by the Economic Policy Committee, pose serious difficulties for the UK and other EC members, in relation to fiscal sovereignty generally, VAT zero-rating and the major rate and structural changes proposed for the excises. The UK enters discussions on these proposals unconvinced that measures of this sort are necessary to completion of the internal market.

POINTS TO RAISE

13. None. The TAC will not expect detailed comment in advance of the Budget judgement.

W F McGUIGAN

TOBACCO
Advisory Council

Glen House, Stag Place, London SW1E 5AG. ~~Telephone: 01 828 2041/2803. Telex:~~ 8953754 TOBCOM. Facsimile: 630 9638.

BR

HM TREASURY — MCU
RECD. - 2 NOV 1987
ACTION Mrs Brenhans FP
CC CHX, CST, FST, PMG, EST, SIR P MIDDLETON, SIR T BURNS, MR CASSELL, MR MONCK, MR SCHOLAR, MISS SINCLAIR, MR RIG ALLEN, MS BOYS, CE
Mr Cropper.
SIGNATURE CHX
REF NO.

OWEN → CHEX 2/11

The Rt. Hon. Nigel Lawson, MP,
Chancellor of the Exchequer,
H.M. Treasury,
Parliament Street,
London.

2nd November 1987

Dear Chancellor,

I have pleasure in enclosing the Tobacco Industry's submission in relation to 1988 Budget considerations.

The nil increase on tobacco goods in the 1987 Budget was greatly welcomed by the Industry for all the reasons which we explained to you a year ago. We stressed that duty increases in the current market conditions had far greater impact on the mix of smoking between British-made cigarettes and low priced, marginally costed imports than on the overall consumption of cigarettes; and we stressed that any further significant increase in duty would lead to the already worrying high level of import penetration continuing its inexorable upward trend.

In the event, the absence of a duty increase brought the growth trend to a complete standstill to the benefit of British-made cigarettes, but without increasing overall consumption and, indeed, our current estimates for 1987 are that consumption will again be down.

We remain, therefore, extremely grateful to you for the decision that you took in March 1987 and our plea now is that you do not reverse the policy which you embarked upon at your last Budget. The situation is still extremely fragile and any significant increase in duty would simply undo the good that was done this year. Having said that, we did recognise that 1986 was a very exceptional year for us in terms of the damage that had been done to the market of British-made cigarettes and the implications on our factories. This year, therefore, in asking for the good work not to be undone, we are recognising that the application of the current annual rate of inflation to the specific tax element in the cigarette structure might be necessary; but our plea remains that this level of increase (approximately 4p per 20) should be the absolute ceiling and, indeed, should only be applied to cigarettes on a non-discriminatory basis, i.e. only if similar increases are being applied to all other excise duty bearing goods.

We are, of course, aware of the arguments put forward by the B.M.A. for substantial duty increases on cigarettes. The above arguments are the best response that we can give to the B.M.A.'s views, but more specific comments are briefly outlined in a separate document attached.

I would greatly value a brief meeting with you along with two or three of my colleagues from the Industry not only to discuss some of the major points in our submission in detail, but more specifically to re-emphasise our very deep concern over the continuing nature of the threat from imports.

Yours sincerely,

Bill Owen.

W.C. Owen
Chief Executive

CHANCELLOR'S BUDGET 1988

TOBACCO INDUSTRY SUBMISSION

TOBACCO ADVISORY COUNCIL
NOVEMBER 1987

TAXATION OF CIGARETTES

1. Chancellor's Budget - March 1987

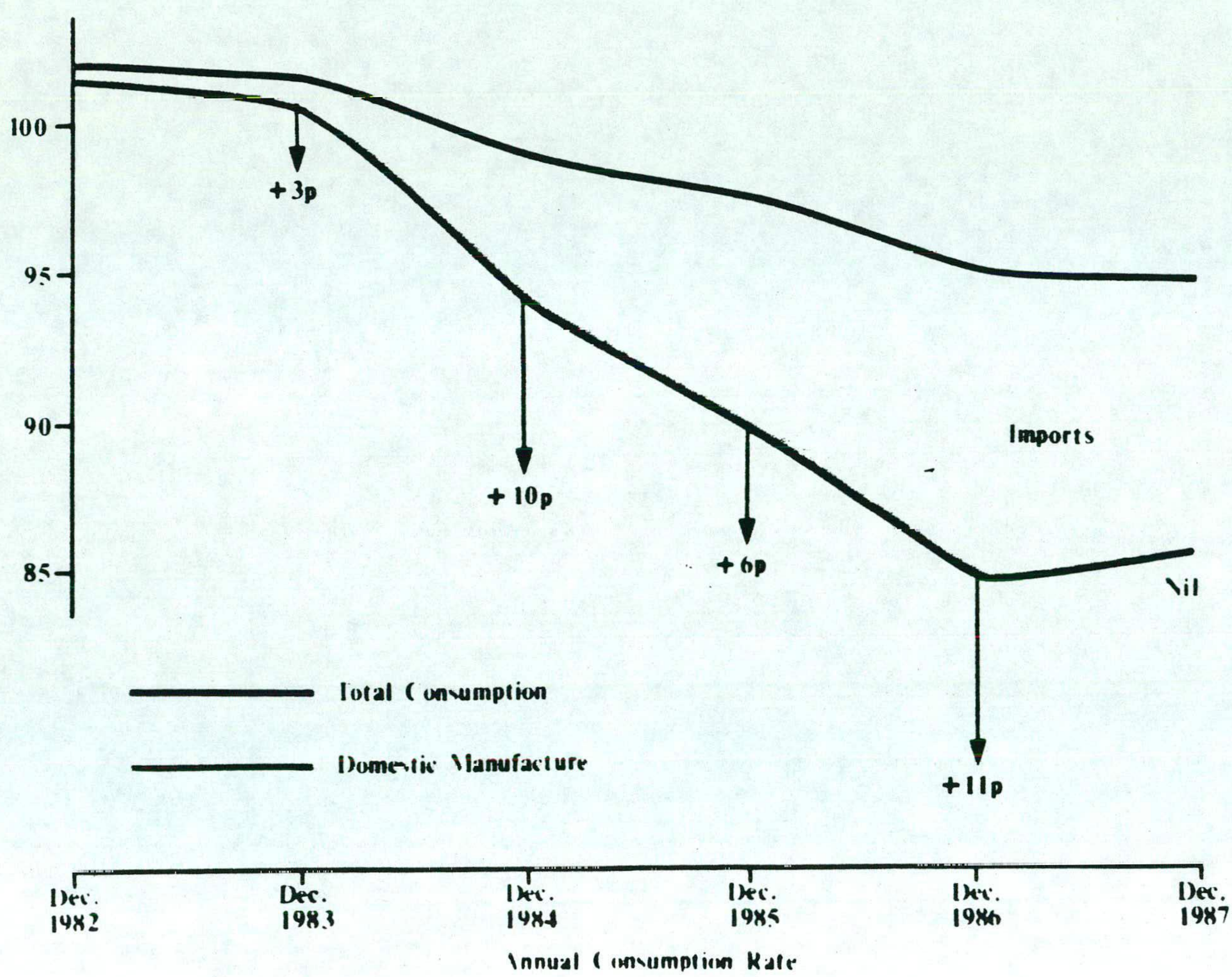
In our submission for the 1987 Budget we highlighted, with regard to market trends,

- the growth of the low price imported sector which had increased from 0.5% to 10% of market in only 3 years;
- how excessive taxation increases provided a stimulus to this growth;
- how, because of this trend towards low price brands, cigarette consumption no longer declined rapidly in the face of excessive duty increases; and
- that such a fiscal policy, therefore, resulted in little more than a move away from domestically produced brands to the lower priced imported sector.

Such was the industry's concern over this import growth that, in spite of rising unit costs, UK manufacturers did not increase retail prices in early 1987 as might have been expected.

Clearly it was of considerable relief to the industry that the Chancellor, in recognising these acute problems, saw fit not to increase cigarette duty at the 1987 Budget; and this action complemented the industry's already ongoing initiatives, the result of which was that the average 'over-the-counter' price of non-low priced cigarettes was lower in the post-Budget period than it was at the end of 1986. The effect of this combined effort has become quickly apparent as the following chart shows -

U.K. CIGARETTE SALES (Bns.)



It can be seen from the foregoing chart that -

- although after the 1986 Budget increase (+11p/20), the market share held by low priced imported cigarettes increased substantially;

- in the post-Budget period 1987, this sector share actually declined, albeit marginally, but for the first time since 1983;

- and with the total UK cigarette market continuing to contract, this reversal of a previously strong upward trend in the imported share is obviously particularly welcome.

It cannot be stressed too strongly, however, that the situation is still very fragile and that the structure of the cigarette market will continue, at least for some while, to be particularly sensitive to price changes. Certainly, excessive increases such as that experienced in 1986, when cigarette duty was increased by almost two and a half times the level justified by inflation, can only serve to undo the benefit now accruing from the 1987 Budget standstill.

2. Principal Government Policies

In their election manifesto the Conservative Party outlined the main policy objectives for their now present term of office. These included -

(i) the continued fall and ultimate eradication of inflation;

(ii) further reductions in unemployment; and

(iii) lower personal taxation and a continuation of the transfer from direct to indirect taxation.

Clearly, the Chancellor's fiscal policy for tobacco products in general, but cigarettes in particular, will impact upon each of these objectives as follows -

(i) Inflation

- In spite of the standstill in cigarette duty at the 1987 Budget, taxes have been increased substantially since the election of the Conservative Government in 1979 and the cigarette element of the RPI remains considerably above the All Items index viz -

	June 1987 cf. May 1979
All Items Index	186.2
Cigarette Index	262.7

- independent research, the results of which have been confirmed by Government officials, illustrates that raising additional revenue from cigarettes has a greater upward effect on the RPI than the effect would be of raising revenue from VAT or almost any other major source of excise taxation;

- any increase greater than that required by inflation is inflationary; and any increase which simply matches inflation cannot have the effect of achieving a lower level of inflation.

(ii) Unemployment

- Although direct employment in the UK tobacco industry stands at only some 20,000 jobs, total employment, i.e. including associated industries, is of the order of 185,000;

- this is some 70/80,000 lower than the 1980 level - a reduction of almost 30%;

- furthermore, cigarette manufacture is concentrated in areas of already high unemployment (North, North West, N. Ireland) where the consequences of further factory closures would be particularly far reaching;

- in this context it should be noted that rationalisation is carried out retrospectively and the standstill at the 1987 Budget, although very welcome, was too late to stop factory closures which had become inevitable (e.g Swindon);

- the historical linkage between market decline and lower employment levels is now being exacerbated by import penetration; and

- anything other than the most sensitive fiscal handling at the 1988 Budget will result in significant job losses within the cigarette and associated industries.

(iii) Lower Personal Taxation

- A policy to lower direct taxation need not and should not result in higher levels of indirect taxation;

- but any transfer from direct to indirect taxation which occurs should, at the very least, be spread proportionately over the various indirect taxes;

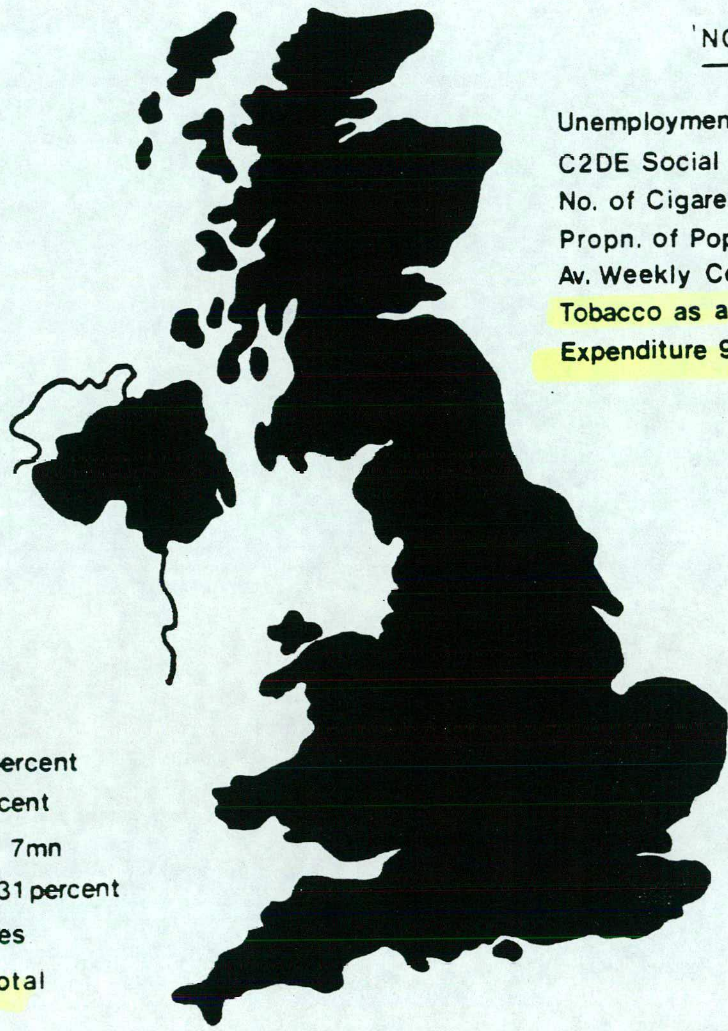
- indeed, because of the already punitive duty incidence on tobacco products, there is a strong argument that any increased emphasis on indirect taxation should fall with less severity on tobacco product groups;

- additionally, the vast disparity which currently exists between UK cigarette duty and the lower levels prevailing in almost all of the other EEC member states must suggest that UK smokers should not be further penalised. (Only 2.5% of total EEC cigarette sales are at tax levels higher than that prevailing in the U.K.)

From the above it is clear that the effect of excessive increases in cigarette duty would run totally counter to the Government's objectives regarding inflation and unemployment. It is also clear that such fiscal measures, as part of a policy to reduce the level of direct taxation, cannot be justified either in the domestic or European context.

3. <u>Public Perception - "The North-South Divide"</u>

A further area of Governmental concern is the representative imbalance in voting patterns which became readily apparent after the last General Election. There are obviously many factors which contribute to this imbalance although two stand out as being of particular significance - the higher level of unemployment in the 'North' and the consequently lower standard of living - and in these respects the following chart is important -



'NORTH'

Unemployment Level 13 percent
C2DE Social Class 68 percent
No. of Cigarette Smokers 7·5 mn
Propn. of Pop. Smoking 35 percent
Av. Weekly Cons. 125 Cttes.
Tobacco as a Propn. of Total Expenditure 9·5 percent

'SOUTH'

Unemployment Level 7·5 percent
C2DE Social Class 56 percent
No of Cigarette Smokers 7mn
Propn of Pop Smoking 31 percent
Av Weekly Cons 120 Cttes
Tobacco as a Propn. of Total Expenditure 8 percent

■ LOCATION OF DOMESTIC MANUFACTURE

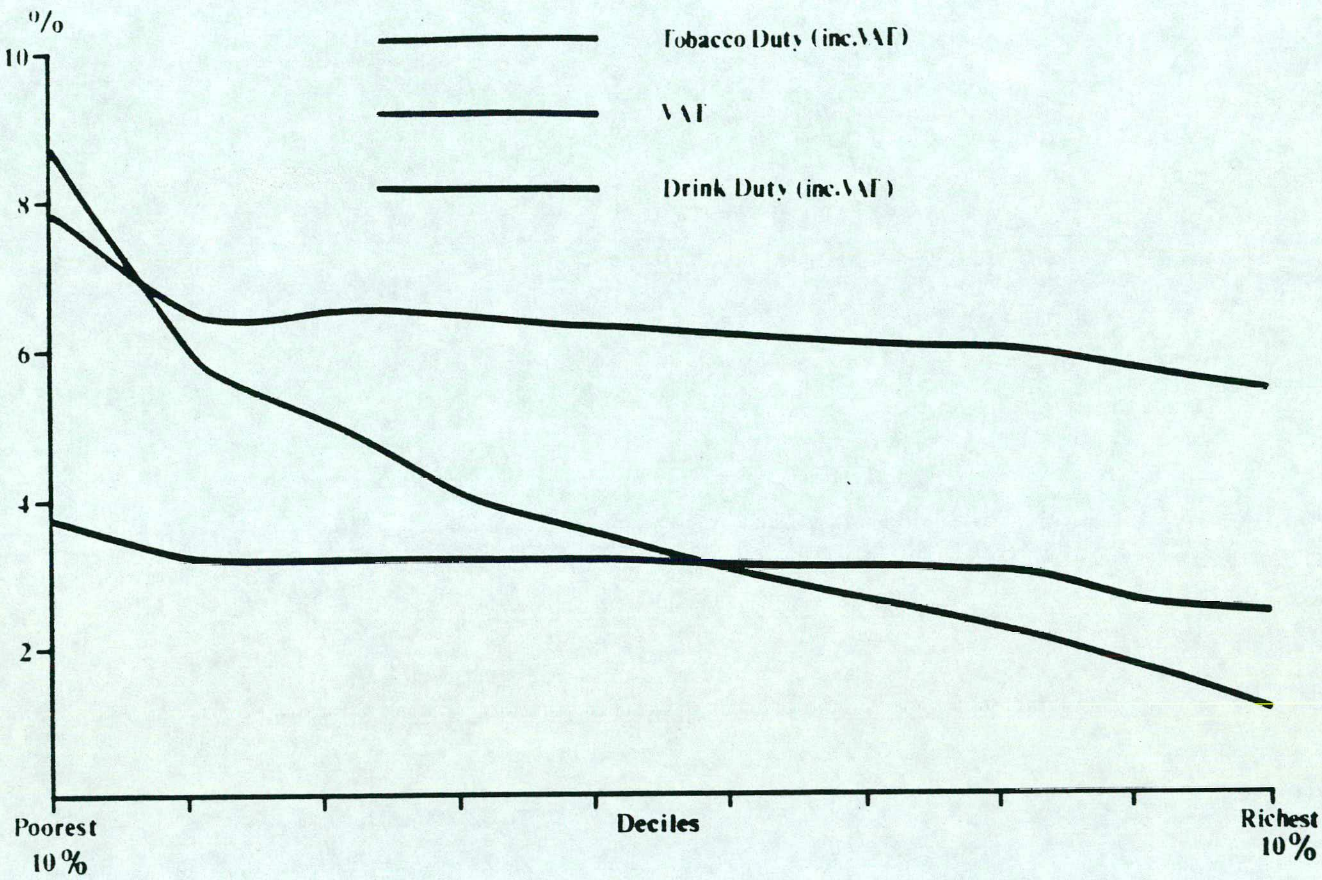
In view of the higher proportion and number of smokers in the 'North', the Government's policy towards cigarette taxation is of far greater significance to this sector of the population because -

- tobacco taxation is the most regressive of all central Government taxes;
- the degree of regressivity has worsened considerably over the period of this Government;

- the poorest 35%/40% of householders pay more in tobacco taxes than in income tax;

- indeed, for the poorest households, expenditure on tobacco taxes is much the same as total expenditure on VAT. This and the degree to which tobacco taxation is particularly regressive, can be demonstrated as follows -

TAX EXPENDITURE AS A PROPORTION OF INCOME



An additional but very significant consideration is the geographical location of cigarette manufacture which is such that over 60% of all UK cigarette production occurs in the 'North' and is concentrated in relatively few manufacturing centres. Consequently the sociological implications of factory closures are indeed serious and will occur in precisely those areas for which the Government is, at present, displaying most concern.

It is clear that, if this Government intends to redress this present imbalance between 'North' and 'South', fiscal policies must not impact with disproportionate severity on the 'Northern' population. Such will be the effect, however, of excessive increases in cigarette duty and overtly so.

4. Long Term Industry Objectives

Clearly the emergence of cheap imported cigarettes is the single biggest commercial threat to the UK industry whose most important objective must, therefore, be to ensure that it competes effectively in order to reduce, or at least contain, the market share held by this sector.

However, almost regardless of any competitive activity which UK manufacturers might undertake, further growth in this sector will be inevitable if smokers are faced with fiscally-induced price increases of such magnitude that trading down to these often marginally-costed products becomes an overwhelmingly attractive proposition.

For this reason it is imperative that any benefits accruing from industry strategies are not negated by fiscal policies which force smokers away from domestically manufactured products. The industry firmly believes that the upward sales trend experienced by imported cigarettes over the past 3/4 years is not irreversible; but an essential pre-requisite of effecting such a reversal is a considerable period of relative price stability, the beneficial consequences of which are potentially very great, viz -

- a less volatile market for domestic cigarettes thus facilitating better planning for UK manufacturers;
- a more stable sales level clearly will offer greater protection for employment levels;
- it will contribute towards export objectives which have suffered significantly over recent years as rapidly falling home sales have too quickly increased unit costs, thus affecting our competitiveness in already very difficult overseas markets; and
- also offers greater protection and predictability for the Revenue.

5. Conclusion

The nil increase at the 1987 Budget was greatly welcomed and the beneficial effects of this policy are already becoming evident in the market-place. But the arguments in support of a continuation of such a fiscal policy are compelling, viz -

- current market trends, although more stable, are still very fragile and in need of consolidation if this is to be anything other than short term;
- a moderate fiscal policy will complement the strategies presently pursued by UK manufacturers;
- the avoidance of excessive duty increases will not increase the already considerable problems associated with excise rate approximation as defined by the EEC;
- a moderate fiscal policy towards cigarettes can assist towards the Government's central economic policy objectives of reducing both inflation and unemployment; and

- such a fiscal policy will be seen as a contributory step towards some alleviation of the 'North-South Divide'.

- it would seem strange and indeed contradictory to reverse the course adopted at the 1987 Budget by compensating, in 1988, for the nil increase in 1987.

It must be clear, therefore, that a continuation of the fiscal policy adopted at the 1987 Budget of no increase for any tobacco products is in the best interests of both the UK industry and the Government. But at the very worst, cigarettes and handrolling tobaccos should not be subjected to any increase greater than that justified by inflation. Above all we must not be faced with a large increase at the 1988 Budget which, in addition to being overtly politically inconsistent, will cause an immediate reduction in the industry's level of competitiveness thus, once more, increasing the vulnerability to import penetration with inevitable consequences for employment etc.

November 1987

TAXATION OF PIPE TOBACCOS AND CIGARS

Pipe Tobaccos

Although pipe tobacco duty has been held at each of the last five Budgets, consumption continues to decline and currently stands at only 75% of the 1982 level. However, this market contraction has occurred at a much slower rate than would have been the case had the duty level been increased and it is imperative therefore that this fiscal policy is continued, the arguments in support of this being -

- almost 50% of pipe tobacco consumption is accounted for by smokers aged 60+;
- over half of smokers are in the C2DE social groups;
- pipe tobacco manufacture is concentrated in areas of already high unemployment - Belfast 18%, Liverpool 20%;
- relative to cigarettes, UK pipe tobacco prices are still amongst the highest in the EEC.

Cigars

Over the period 1979-1984 the fiscal policy towards cigars was such that the duty incidence on this product group increased from 43% to 52% of retail price. Not surprisingly this action reversed the upward sales trend we had experienced since 1974 to such an extent that, by 1984, the cigar market stood at only 85% of its 1979 level.

Since 1984 the Chancellor has not increased cigar duty and, as a result, the market has recovered slightly, although total sales still represent only 90% of their 1979 level. Furthermore, it is our belief that this recovery remains fragile and can only be protected by a continuation of current fiscal policy which can be justified by the following reasons -

- over 50% of cigar smokers are in the C2DE social groups;
- about three-quarters of UK cigar production is located in areas of above average unemployment - Glasgow 17.5%, Glamorgan 14.5%;
- the duty incidence on cigars is still higher than in all bar two other EEC countries;

TAXATION OF CIGARETTES
British Medical Association Demands

1. In August 1987 the British Medical Association called for the Chancellor to increase cigarette prices by 30p per 20 at the 1988 Budget (+21%) and by 6% in real terms at each subsequent budget of this present Government. The rationale for this fiscal policy, in terms of the objectives which might be achieved, is based on statistical research papers written by Townsend, an economist at the Medical Research Council.

2. The U.K. tobacco industry questions the qualifications of the BMA to advise the Chancellor on fiscal matters of any kind. But it positively challenges certain important statements and assumptions contained in the Townsend papers as being either misleading through selective use of data, or ill-founded in the light of more soundly based independent research.

3. Townsend claims that, since the 1947-50 period, cigarette taxes and prices have generally fallen in real terms. The tobacco industry would argue that using this base period is to take, as one's standard of reference, conditions of post-war economic austerity that were quite abnormal and included a duty increase of over 55% in 1947 - proportionately the largest there has ever been. More meaningfully, based on the period 1952-86, cigarette prices currently are higher in real terms regardless of which base year is chosen.

4. It is hardly a revelation that increases in tobacco duty usually produce additional revenue. But the formula used by Townsend in this connection is an over-simplification and certainly takes no account of the way in which the UK cigarette market has changed over the past 3 or 4 years with the development of the low priced imported sector. At the 1986 Budget, cigarette prices rose by over 8% but, because the opportunity existed for smokers to downtrade into low priced imported cigarettes, consumption fell by little more than 2%. But within the total market, the swing to imported brands was substantial and would inevitably be repeated if another excessive duty increase was imposed.

5. Tobacco taxation is the most regressive source of central Government taxation in the United Kingdom; and any increase in tobacco tax rates is likely to make it even more so. Townsend suggests that, at least for male smokers, demand for cigarettes becomes much more price-elastic as one moves down the social scale; and, indeed, Townsend reaches the paradoxical conclusion that, if cigarette prices rose, male smokers in social class 1 - professional - would actually smoke more! In this respect, it would not be surprising if price elasticity for tobacco products among poorer smokers was somewhat higher than for the more affluent social classes. But it does not follow that these differences are sufficient to neutralise the regressive effects of tobacco tax increases and, in fact, the recent study carried out by London Economics - "Who Pays Tobacco Tax?" - shows quite clearly that the tax increases that have taken place since 1978 have markedly increased the regressiveness of tobacco taxation.

6. The basis for the BMA's proposed fiscal policy appears therefore to be questionable, viz -

(i) using any year between 1952-1986 as a base shows the current price of cigarettes to have increased in real terms;

(ii) excessive duty increases no longer significantly reduce total consumption but merely accelerate the swing from domestic to cheap imported cigarettes;

(iii) tobacco duty is regressive with the degree of regressivity increasing significantly since 1978; and there can be little doubt that the BMA's proposed policy would impact with most severity on those in the lower income groups.

7. The BMA proposal therefore is ill-conceived in almost every respect. Obviously an increase of 30p per 20 at the 1988 Budget would achieve some reduction in total cigarette consumption, but nowhere near the magnitude suggested by the BMA. And the downside of such an increase would be immense in that -

- UK domestic production would decline dramatically at the hands of cheap imports;

?

- employment levels would, consequently, come under great pressure;

- some smokers in the lowest income groups eg. pensioners, unemployed etc. would be denied the choice of whether or not to smoke while others who continued would suffer inordinately.

- because of the disproportionate upward effect which tobacco tax increases have on the RPI, the inflationary effects would run totally counter to the Government's objectives.

November 1987

53/2/LPD/3748/037

pmp

FROM: P J WALES
DATE: 19 January 1988

MR BOARDMAN - C&E

cc PS/Chancellor
PS/chief Secretary
PS/Financial Secretary
PS/Paymaster General
Sir P Middleton
Miss Sinclair
Mr Saunders
Mrs Burnhams

PS/C&E

BRITISH MEDICAL ASSOCIATION (BMA) : BUDGET REPRESENTATIONS

Further to my minute of 18 January to Mrs Burnhams, I understand that you have now agreed to coordinate the briefing for the BMA's meeting with the Economic Secretary on Thursday 4 February.

2. I would be grateful if you could arrange for the briefing to reach this office by close of play 2 February.

Peter Wales

P J WALES
Diary Secretary

451/018/AC

FROM: MISS S WALLIS

DATE: 19 January 1988

1. MRS BURNHAMS — I agree [initials] 20/1

2. MISS SINCLAIR — [initials] 20/1

3. MCU

4. FINANCIAL SECRETARY

cc PS/Chancellor 12/2
PS/CST
PS/EST
PS/Paymaster General
Sir A Wilson
PS/IR
Mr A Walker (IR)

BUDGET DEPUTATION: THE ASSOCIATION OF BRITISH CHAMBERS OF COMMERCE (ABCC)

The Association of British Chambers of Commerce have sent in their representations for the Budget, and are asking for an opportunity to discuss them with Ministers.

2. The ABCC are on the "Core List" of organisations that Ministers normally meet as a matter of course. However, they are due to meet the Deputy Chairmen of the Inland Revenue on 21 January.

3. Given this, we and the Revenue see no advantage in you agreeing a separate meeting this time around. We therefore suggest you turn down their request.

4. I attach a reply.

S Wallis

MISS S WALLIS

451/019/AC

Treasury Chambers, Parliament Street, SW1P 3AG

R S Burman Esq
Chairman
The Association of British
 Chambers of Commerce
Sovereign House
212a Shaftesbury Avenue
LONDON WC2H 8EW

January 1988

Thank you for your letter of 6 January to Nigel Lawson setting out your representations for the Budget and asking for an opportunity to discuss them with Ministers.

As you can imagine, Treasury Ministers receive numerous requests for meetings from representative bodies before each Budget. Ministers try and see as many organisations as possible, but as I am sure you will appreciate, they cannot see every organisation which requests a meeting. I am afraid, therefore, that it will not be possible for Treasury Ministers to see you in the run-up to the 1988 Budget. I understand, however, that you met the Deputy Chairmen of the Inland Revenue on 21 January to discuss your Budget representations.

I can assure you, however, that your representations will be carefully considered in the run-up to the Budget.

NORMAN LAMONT

The Association of
British Chambers of Commerce
Sovereign House, 212a Shaftesbury Avenue
London WC2H 8EW
Telephone: 01-240 5831/6 Telex: 265871 MONREF G CHA001 Fax: 01-379 6331

DIRECTOR-GENERAL: R.G. TAYLOR

6 January 1988

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1

Dear Chancellor,

The British Chambers of Commerce look forward to the opportunity which the forthcoming Budget presents for improving further the climate for wealth creation in this country. We have welcomed the steps which you have taken to reform the structure of taxation and anticipate that the first Budget of this new Parliament is the right time for further major steps in this direction, particularly in respect of the marginal rates of personal taxation.

The attached submission is, I trust, self-explanatory and is very much directed towards the issues I mention above. The main proposals are radical and, I hope, will commend themselves to you in view of your own well-established desire for tax reform. I should draw attention in particular, to the benefits which these proposals would bring through enhancing the ability of the lower-paid to meet their Community Charge obligations, whilst carrying through the Government's Manifesto commitment to basic rate tax reductions, in the context of a major reform of personal taxation.

Naturally, I should be very glad to bring a small delegation from the Chambers of Commerce to see you, to discuss these ideas in advance of the finalisation of your Budget proposals.

BR

Yours sincerely

Roger Burman

R S Burman
Chairman, Economic and Industrial Committee

HM TREASURY – MCU	
REC'D	- 7 JAN 1988
ACTION	Mrs Grantham EP
	cc IR
SIGNATURE	FST
REF No.	10287/88

BUDGET 1988

Submission to the Chancellor of the Exchequer from the
Association of British Chambers of Commerce.

Introduction

1. The British Chambers of Commerce have shared the objectives underlying the Government's previous Budgets. These have consistently been: the conquest of inflation, the creation of an enterprise culture, and fostering conditions in which growth in the economy can be maintained and lasting jobs created.

2. The validity of these objectives has in no sense been reduced. They should remain at the corner-stone of the Chancellor's budget strategy and Chambers of Commerce are confident that they will be so.

3. Nor would we expect the essence of the Government's policies to be changed: sound money and free markets. To these, however, we feel we must add another which, while implicit in this Government's philosophy, has slipped from view: **putting wealth-creation first.** Within a given level of public expenditure, and in the priorities chosen for action by Government, including tax changes, it is becoming easier to place to the fore social objectives, particularly the reform and improvement of health and education services, and the reduction of the personal tax burden. That is hardly surprising. They are vital and necessary reforms. The last General Election rightly showed how the future of our health and education services, *and* the level of taxes on individuals weighted very heavily with voters. None of these objectives could be sustained, however, without the continuing improvement of the wealth-creating sectors of our economy.

4. As Chambers of Commerce, all over the country, we see at a local level, as well as national, how **business provides the basis for the well-being and improving welfare of the community.**

5. We therefore **call for a budget** whch takes further steps forward in **helping commerce to create wealth: a Budget that builds for the future.**

ECONOMIC BACKGROUND

6. The background to this Budget is likely to be set by two contrasting features. The performance of British industry and commerce continues to improve. However, the climate in which UK industry trades is increasingly beset by storms, largely external to the economy of the UK.

7. Company performance in the UK has moved ahead strongly since 1981. The real rates of return on capital in manufacturing, and for industrial and commercial companies generally, excluding North Sea, has improved year-on-year from 1981 to 1986, although it still has some way to go. In conditions of continued growth and low inflation, we would look for this improvement to be maintained and further increased levels of real rates of return on capital as a basis for corporate growth and re-investment.

8. Key ingredients to improving profitability are productivity and competitiveness. Productivity of both labour and capital have improved strongly. Allied to this has been relatively slow growth in non-wage labour costs. Between 1986 and 1987, unit labour costs in manufacturing have hardly increased. This is very favourable relative to our major competitors, who are continuing to show year-on-year increases in unit labour costs. Recent indications suggest a less satisfactory trend between 1987 and 1988 so there is no cause for complacency. Given the record of Japanese and German companies in recent years, the objective must be to achieve zero growth in unit labour costs. This is as much a counsel to our own members as it is to the public sector.

9. We foresee a further easing of the non-wage input costs to industry. If specific duties were to be fully revalorised and if interest rates were to remain at their present levels, we see no reason markedly to change the Autumn Statement forecast for change in the RPI in 1988.

(continued . . .)

£1.50

ABCC

The Association of
British Chambers of Commerce
Sovereign House, 212a Shaftesbury Avenue
London WC2H 8EW. Telephone: 01-240 5831/6

10 This sense of equilibrium does not, however, extend to measures of growth and our trade balance. The stock market falls in the United States are evidence of a sharp reversal of confidence in financial markets in the face of the U.S. trade and budget deficits. There may be painful adjustments affecting interest rates, exchange rates and the level of our exports to the USA. In particular, a damagingly substantial rise in real U.S. interest rates is in prospect, **unless** a countervailing reduction in interest rates here and elsewhere can be achieved and sustained. Without an increased interest rate differential the downward pressure on the Dollar may be expected to continue. An effort to maintain exchange rate levels when unsupported by economic fundamentals would pose far too great a danger to UK domestic monetary conditions.

11. The British Chambers therefore foresee difficult trading conditions in international markets. U.S. firms, faced with poor domestic demand and a depreciating dollar, wil be seeking to regain overseas markets. UK companies will find it progressively more difficult to maintain exports to the U.S. Whatever expansion can be generated in German and Japanese markets will be on very tight margins and difficult to capture.

12. In domestic markets, our high import propensity may serve us badly. There is, however, a role for Government here. Central Government, local authorities and public bodies who, between them, import goods worth over £5bn per annum, must take a strong new initiative by adoption, training and practice of 'positive purchasing' – i.e. the long term development of, and commitment to, UK sourcing without any public cost penalty.

13. Without such positive action, the short-run prospect, therefore, is of a reduced rate of increase in demand, not compensated by increased Government consumption or fixed investment. The resulting effect may be a slowdown in growth prospects to a lower increase in GDP in 1988 over 1987 compared with the previous year. Manufacturing output may continue to grow somewhat faster than GDP in total.

14. This level of growth will, nonetheless, put the UK among the faster-growing of the major industrialised countries. The probable increase in imports which this may draw in, allied to a further fall in the value of our oil surplus, makes us foresee a further relatively sharp deterioration in the UK's visible trade deficit.

15. In the light of the views we take regarding inflation and growth, we would expect a target for change in nominal GDP in 1988, compared to 1987, of about 7 per cent. This compares with an overshoot by 1 per cent on the target of 7½ per cent for the change in money GDP, between 1986/7 and 1987/8, since the last Budget. This has been largely evidenced in higher than expected growth, and is therefore no cause for complaint. The decline in sustainable growth expectations, however, suggests that the Government can achieve a return to a downward path in the rate of growth of nominal GDP without excessively tight monetary conditions. In particular, we believe that a target of 7 - 7½ per cent change in money GDP in 1988-89 compared to this year is consistent with both further reductions in interest rates and a public sector borrowing requirement (PSBR) higher than the outturn in fiscal 1987-88. The expansion in borrowing domestically to which this would give rise is, we believe, consistent with the capital inflows resulting from increased deficits on the UK's current trade balance, the improved attractions of Sterling in preference to the Dollar, and a higher personal savings ratio. The combined effect of these policies should give rise to a modest and welcome easing of the sterling exchange rate.

16. In considering the further reduction in interest rates, we have regard to the acknowledged strength of the UK economy, which must be incompatible with a real interest rate of 4 per cent compared with West Germany's 1¾ per cent. We also note that the lower our interest rates the more flexible they are as an instrument of monetary control.

17. Finally, Chambers look forward to continued growth in employment. We remain concerned at the level of long-term unemployment and its social implications. We therefore put strong emphasis on measures to improve the supply of skilled labour, and assistance for those who are unemployed to retrain for useful work. We look forward to the constructive role which Chambers can play in the new training schemes for the adult unemployed.

FISCAL POLICY

18. It is too early now to make an accurate assessment of the fiscal outturn PSBR for 1987-88 or the prospects for general government receipts in 1988-89. However, some provisional assessment may be made as a basis for the proposed tax measures to follow.

19. The latest figures suggest that there will be a very substantial undershoot on this year's PSBR, even a surplus. Between 1986/7 and 1987/8, for illustration, the rate of growth in the public expenditure planning total (at 5.8%) looks set to be very substantially exceeded by the growth in tax revenues (more than 8.7%). The latter is in practice broadly equivalent to the rate of change in money GDP. It is clear that the rate of growth in public expenditure between 1987/88 and 1988/89, at 6.2 per cent, will probably again be outstripped by the growth in tax revenues. If, therefore, tax revenues next year were to increase at not less than 7% in line with money GDP changes, one can estimate that the scope for tax reductions consistent with a £1bn PSBR is £3½bn, but with a substantial margin of error. We believe these estimates, however, to be conservative, given the trend in average earnings and, in particular, the growth in yield from Corporation Tax.

20. In the light of the prospective levels of demand and activity described earlier, however, the ABCC proposes a fiscal stance less restrictive than this; one which avoids any risk of an overall deflationary impact, which indeed provides a modest fiscal stimulus overall, but which need not imperil the target for money GDP nor lead to increases in interest

rates. What such a level is must be a matter of judgement, not least in the light of indicators (and market expectations) shortly prior to the Budget. However, for these purposes, the ABCC would take an initial view that a PSBR of £2½bn may be broadly consistent with this approach. This would suggest a fiscal adjustment of some £5bn.

1988/89 Budget Arithmetic

£ Billion

	1986/87 outturn	1987/8 Autumn Statement forecast	1988/89 ABCC Estimate
General Government Expenditure	165.1	172.8	180.3
General Government Receipts	160.3	171.1	182.0
General Government Borrowing requirement	4.9	1.7	–1.7
Public Corporations Market + Overseas Borrowing	–1.5	–0.7	–1.0
PSBR	3.4	1.0	–2.7
Memo: Autumn Statement planned PSBR in 88-89			1.0
Hence: scope for fiscal adjustment			3.7
ABCC proposed PSBR			2.5
Hence: ABCC proposed scope for tax reductions			5.2

TAX REFORM

21. **The start of a new Parliamentary term, with the present Government's achievement of relative control over public spending and buoyant tax revenues, gives a clear opportunity for substantial tax reform.** There are many candidates for action. Our tax system is far too complex and riddled with anomalies. Principal amongst these is the eccentric pattern of marginal personal tax rates engendered by the interaction of income tax and NICs. Hardly less important is the disincentive effect of the high marginal tax rates both at the top and bottom of the income scale. The tax treatment of husbands and wives is also ripe for reform. In corporate tax, the major reforms of 1984 removed distortions, but have left corporations vulnerable to an increase in inflation and the tax system retains a bias towards debt rather than equity finance. Many detailed points would benefit from early publication of a Technical Tax Bill, and more relaxed consultation. We strongly advocate this.

22. **It is tempting to look only for radical and all-embracing solutions to these problems. It may not, however, be possible to achieve those which best meet the need within the resources that are available in one Budget. We seek, therefore, a firm statement of intention, combined with a series of steps in that direction, as the right way forward.**

23. We believe this Government's objectives in tax reform thus far have been healthy, and are bearing fruit. The pursuit of tax neutrality, of limited reliefs and lower basic rates, of restoration of incentives, of simplicity and enforceability, have all found favour with our members. There are now some further major steps to be taken.

PERSONAL TAXATION

24. The major priorities for Chambers in relation to personal tax are two-fold: to reduce the overall burden; and to increase incentives by removing the anomalous and damaging effects of the high marginal rates. **We therefore propose a series of four very major changes. We must emphasise most strongly that these changes are a package. They stand or fall together in the effects they are intended to achieve.**

25. **The four changes are:–**

- **to remove employees NIC liability in respect of all earnings *below* the Lower Earnings Limit – (i.e. £41 per week from April 1988);**
- **to make employees NIC payable in respect of all earnings, i.e. to remove the Upper Earnings Limit on NIC;**
- **to reduce the higher rates of income tax to 30 per cent from the top of the basic rate band up to £34,800 of taxable income, and to 40 per cent thereafter;**
- **to reduce the basic rate of income tax by two pence to 25 per cent.**

26. We believe these proposals would have a major impact on incentives. For those reaching the lower earnings limit for NIC they would not face penal marginal rates and a "poverty trap" effect by the levying of NIC on all their earned income. The dramatic jump in the marginal rates of tax from 27 per cent to 40 per cent would be removed, as would the top rate of 60 per cent, which is an unjustifiably high impost and which, in the face of much lower marginal rates in some other countries, now needs urgently to be reduced.

27. These changes would lead to a very different and much more coherent pattern of marginal rates. This is illustrated in the graph at Annex A. It will be observed that the marginal tax rate, taking both income tax and NIC into account, will be lower or unchanged across the income range, with the exception of those with earnings above the UEL on NIC but below the threshold for the higher rates of income tax. The proposal is, however, intended to be on a "no losers" basis. Within the four changes proposed "losers" on one count will broadly gain on others. The estimated effects of all four changes on a range of taxpayer incomes is shown, for illustration, in the table at Annex B.

28. We recognise the very substantial net cost of these proposals. They would absorb a very large proportion of the scope available for tax reductions in this Budget. Although we propose other measures later in this submission, we accept that the reform of personal taxation must be the centrepiece of this Budget.

29. We should note that the effect on the National Insurance Fund of these changes may be somewhat to reduce the contributions overall. Given the buoyancy of payments into the Fund, and reducing unemployment, this may not be of concern. If it were, it would be preferable to increase the Treasury Supplement rather than lose the opportunity to rationalise the tax system.

30. In regard to the taxation of husband and wife, the response to the Green Paper "The Reform of Personal Taxation" indicated no consensus of support for fully transferable allowances. The objections to those proposals would, however, be substantially met by a scheme of partially-transferable allowances. While such a scheme should be introduced on a "no loser" basis, it will also be important that the scheme yields, at least in part, the benefit to single-earner couples with children which were predicted with a fully transferable allowance scheme. The introduction of a scheme solely to achieve independent taxation would not be sufficient. This will doubtless be very costly and a scheme may well need to be phased in, utilising very largely the indexation of allowances. The Chambers hope that the Chancellor will come forward with proposals in this Budget for such a scheme to be introduced later in this Parliament.

BUSINESS TAXATION

31. As we have emphasised at the opening of this submission, the Chambers believe this Budget should be a means by which the ability of commerce to create wealth is further enhanced. The key to this is the rate of return, and the consequent levels of profitability, as source of funds for investment, R & D and return to capital. The impact of the Corporation Tax regime is therefore of key importance to the bulk of business.

32. Following the 1984 reforms, which we have welcomed, we note that the total Corporation Tax take has risen considerably. Insofar as this reflects improved profitability, it is natural and unsurprising. But we also note that the present regime, compared to the pre-1984 CT system, while more neutral in its impact on different types of investment, has significantly increased on average the pre-tax rate of return required for a given post-tax return.

33. **Chambers therefore believe that a reduction in both the full rate and the small firms' rate, of Corporation Tax is needed in this Budget. We would urge that this should be not less than a two per cent reduction, in line with the prospective reductions in the basic rate of personal taxation. This will give a highly desirable boost to investment, to income from equity investments and to industry's capacity to undertake R & D.**

34. There are two further measures which, we believe, in their present form act as a continuing disincentive to investment in industry. In both areas, we would welcome the exercise of the Chancellor's commendable instinct that taxes should be removed completely where possible.

35. The first is Capital Gains Tax. We continue to regard this as, in the words of the previous Chancellor in 1979, "unjust and absurd". Its incidence is increasingly eccentric and its administration a considerable burden. We recognise, however, the difficulty of fixing upon a means of preventing the conversion of income into short-term capital gains solely for tax purposes. We therefore propose that CGT should be abolished for long-term capital gains, i.e. in respect of assets held for over two years, except in the case of the prior death of the holder. The short-term gains should be taxed at 40%, equivalent to the top rate of personal tax which we have recommended. Such a system would do much to curb the activities of purely speculative investors whose 'short-termism' has been widely and rightly criticised.

36. The second measure we propose, but to which we attach a lesser priority, is the abolition of stamp duty on share transactions. Previous arguments in favour of this buoyant source of revenue amounted to a desire to retain the "creaming-off" of some of the considerable gains in share prices. This hardly now applies to the same extent, and its true character, as a tax on the beneficial movement of capital and an administrative burden on the City and business, warrants its removal.

37. **In view of the potential for interaction between personal and business tax rates, we attach importance to the steps outlined above to bring business and personal tax rates into a more narrow spread of rates. With the basic rate at 25 per cent, the higher rates no more than 40 per cent (or 49 per cent, including NIC) and with CT at 33 per cent and CGT at 40 per cent, the incentive to structure one's affairs solely for tax purposes will be reduced as compared with the present structure. This is a valuable benefit, on which we hope the Chancellor will be able to build in future years.**

AN ENTERPRISE PACKAGE

38. In the same way as, in former years, a package of expenditure and tax measures has been presented in the Budget as a specific remedy for unemployment, we believe the time is right in this Budget for a similar package **aimed at promoting enterprise.** We envisage a mix of expenditure and tax measures, directed towards targeted problems, such as:

- ways of increasing the training activity of companies. The Chambers will be responding to the MSC's consultation document "The Funding of Vocational Education and Training" with proposals in this respect.

- ways of increasing companies R & D activity. In particular, Chambers will be looking at the incentives available to smaller and medium-sized firms to contribute to collaborative research through, for example, Research Associations. We would emphasise, however, that in spite of much media comment, research remains relatively strong in this country, but development of that research is much weaker and ways of stimulating it require urgent study.

- scope remains for specific infrastructure projects which would benefit industry, particularly in the Regions, but which are not provided for in Public Expenditure plans. The ABCC is ready to identify priorities amongst these for inclusion in such a package.

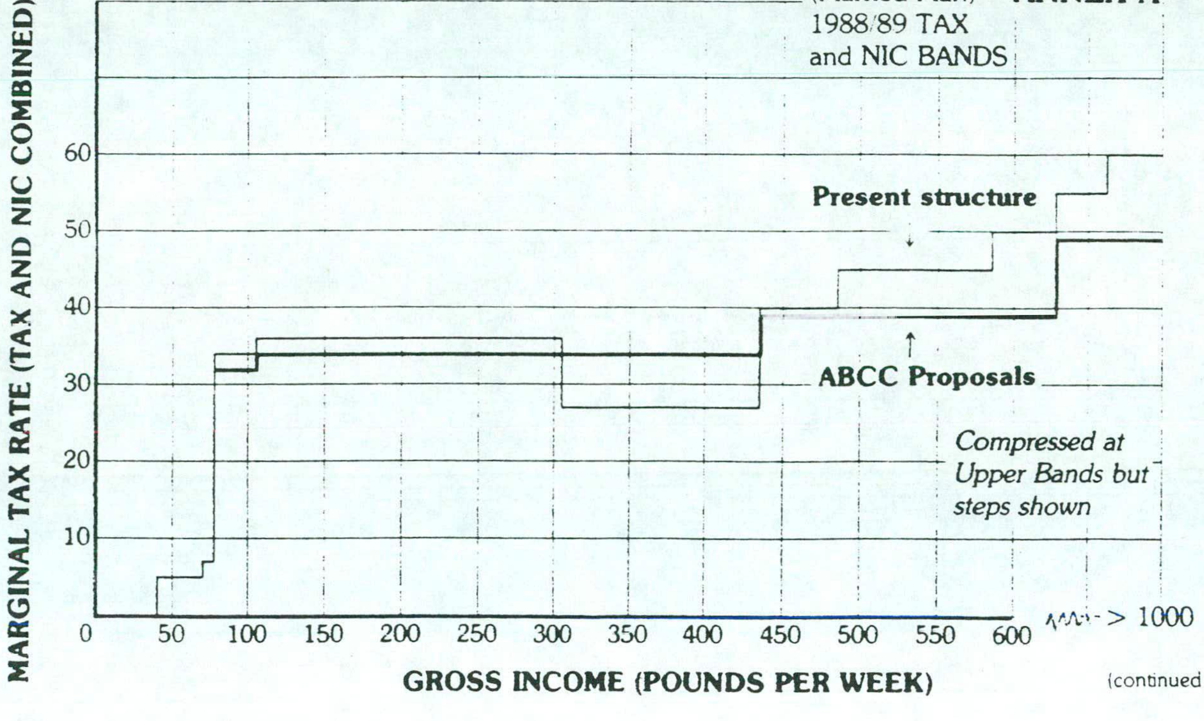
- contributions by local industry to specific non-profit making bodies, charged with undertaking activities beneficial to that local community, but where the body is not charitable, should be tax-allowable as a spur to self-help, particularly in the inner cities. The Chambers of Commerce have produced separate details of this.

- and a range of other matters on which the ABCC's Small Firms' Panel have made representations to the Small Firms Minister, and which we hope will be reflected in the representations which he makes on behalf of small firms' interests generally. In particular, we believe that there is a strong case for the first tranche of taxable profit to be at the basic rate of income tax up to a profit of £100,000 and, similarly, the first tranche of investment expenditure up to £25,000 per year should be allowable for 100% depreciation. Chambers are also keen to see radical changes in the P11D system which is complex and the administrative burden grossly disproportionate. The £8,500 threshold is absurd. It should at least be raised to equivalence with the higher rates of income tax. More generally, an urgent review of the whole system is needed, to which the ABCC would be glad to contribute.

CONCLUSION

39. Chambers of Commerce commend these proposals to the Chancellor of the Exchequer. We recognise the need for further discussion and clarification of some of these ideas. We will be doing so, in consultation with our member Chambers and other business organisations. The Chambers may wish to add to these representations in the light of events in the weeks leading up to the Budget Statement. The ABCC would welcome the opportunity to make personal representations to the Chancellor of the Exchequer in advance of the finalisation of the Treasury's Budget proposals.

ANNEX A



(continued . . .)

ANNEX B

£

Taxpayer Income (Weekly) (ALL EARNED)	£ Present TAX	NIC	TOTAL	£ Proposed TAX	NIC	TOTAL
50	NIL	2.50	2.50	NIL	0.45	0.45
100	6.47	7.00	13.47	5.99	4.13	10.12
200	33.47	18.00	51.47	30.99	14.31	45.30
300	60.47	27.00	87.47	55.99	23.31	79.30
400	87.47	27.45	114.92	80.99	32.31	113.30
600	169.27	27.45	196.72	139.20	50.31	189.51
800	272.19	27.45	299.64	199.20	68.31	267.51
1000	432.80	27.45	460.25	284.66	86.31	370.97

Notes:

1. All Examples shown are for a married man with wife's earnings disregarded or nil for these purposes.
2. The 'present' examples are for allowances after April '88 indexation and NIC after April '88 changes.
3. All NICs are on a "contracted-in" basis.

January, 1988

PAM2

CONFIDENTIAL

FROM: J M G TAYLOR

DATE: 19 JANUARY 1988

NOTE FOR THE RECORD

Meeting with Lord Vinson and Mr Phillip Chappell

Lord Vinson and Mr Chappell saw the Chancellor on 8 December to make their Budget representations. The Financial Secretary and Mr Cropper were also present.

2. Lord Vinson and Mr Chappell's main points were:

i. All savings should be made tax neutral. The tax privileges of pension funds and pensioners should be removed. This would stop the less well paid paying for benefits received by the higher paid, and would also encourage people to save;

ii. CGT should be scrapped or, failing this, indexation should be backdated to deal with the problem of the most inflationary years;

iii. Top rates of income tax should not be reduced unless steps were also taken to remove the "poverty trap";

iv. The distinctions between the employed and the self-employed should be removed;

iv. The Chancellor should reconsider introducing a tax on each personal credit transaction, in order to discourage the accumulation of this credit. This would be analogous to the "bank stamp" which once applied to cheques;

v. The PEPs limit should be raised to £5,000 a year; and the basic rate relief removed.

J M G TAYLOR

ps7/30L

UNCLASSIFIED

2|2

FROM: MRS JULIE THORPE
DATE: 20 January 1988

PS/ECONOMIC SECRETARY

cc PS/Paymaster General
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Monck
Mr Culpin
Miss Sinclair
Mr R I G Allen
Mrs Burnhams
PS/C&E

THE BREWERS' SOCIETY: BUDGET REPS

Following my minute of 14 January, the Chancellor's meeting with a deputation from the Brewers' Society has been postponed from Tuesday, 26 January at 9.30am to Tuesday, 2 February at 11.00am, in the Treasury. I would therefore be grateful if briefing could reach this office by close of play on Friday, 29 January.

2. Please could Customs & Excise let me know who will be attending the meeting.

Julie Thorpe.

MRS JULIE THORPE
Diary Secretary

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

FROM: W D WHITMORE

DATE: 22 January 1988

Chancellor

cc Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Monck
Mr Culpin
Miss Sinclair
Mr R I G Allan
Mrs Burnhams

THE BREWERS' SOCIETY: BUDGET REPRESENTATIONS

1. I attach a brief for your meeting with the Brewers' Society on Tuesday 26 January at 9.30 am.

2. Mr Cain and I will attend the meeting.

W D WHITMORE

Internal circulation:
CPS Mr Knox Mr Jefferson Smith Mr Allen Mr Cain Mr Hawes

mjd 2/86Jn

UNCLASSIFIED

b.f. 5/2

FROM: J M G TAYLOR
DATE: 25 January 1988

pmp

MRS BURNHAMS

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Monck
Mr Scholar
Mr Culpin
Miss Sinclair
Miss Evans

PS/IR
Mr Marshall - IR
PS/C&E
Mr R Allen - IR

1988 BUDGET REPRESENTATIONS

The Chancellor was most grateful for your minute and enclosure of 14 January.

2. He would be grateful if the next summary could come forward in early February.

J M G TAYLOR

BMA

BMA House
Tavistock Square
London WC1H 9JP

BRITISH MEDICAL ASSOCIATION

Telephone 01-387 4499

PSIAD/pl

25 January 1988

ECONOMIC SECRETARY
REC'D 26 JAN 1988
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SIR P MIDDLETON
MISS SINCLAIR
MR SAUNDERS
MRS BURNHAMS
PS/C+E.

Mr P J Wales
Diary Secretary to the
Economic Secretary to the Treasury
Treasury Chambers
Parliament Street
London
SW1P 3AG

Dear Mr Wales

1988 BUDGET REPRESENTATIONS

Thank you for your letter of 18th January confirming the appointment with the Economic Secretary on Thursday, 4th February at 10.30 a.m.

The names of the BMA delegation are as follows:

Dr J Havard, Secretary
Dr J Marks, Chairman of Council
Dr J Dawson, Head of Professional and Scientific Division
Mrs P Taylor, Head of Public Affairs
Mr J Ford, Head of Economic Research Unit
Mrs J Townsend, Economist, Medical Research Council

Yours sincerely

Patricia Langley

Patricia Langley (Miss)
Secretary to Dr John Dawson

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Registered office: BMA House Tavistock Square London WC1H 9JP
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Secretary J D J Havard MA MD LLM

PRE-BUDGET MEETING WITH THE BREWERS' SOCIETY: 26 JANUARY 1988

Organisation.

1. The Brewers' Society represents some 70 large and medium sized UK brewing companies which together account for over 95% of UK beer production. The smaller brewers have their own separate Association.

2. As last year, the Society will be represented by its current Chairman, Mr A G F Fuller and Major General W D Mangham CB. Mr Fuller is Chairman and Managing Director of Fuller, Smith and Turner, a medium-sized Chiswick based brewery company paying some £5 million duty a year, with about 140 managed or tied pubs. Major General Mangham has been a Director of the Society since 1980.

Object of the meeting.

3. The Society is one of the organisations whose representatives normally meet the Chancellor to make pre-Budget representations.

Written Representations.

4. These deal with the general level of beer duty, and specific items with alcoholic misuse aspects.

Level of beer duty.

5. **The beer market.** The Society notes a very small improvement in the demand for beer and says that without the duty standstill of the last two years the present level of the market would not have been sustained.

6. **The price of beer.** The Society says that the average wholesale price of beer rose by 3.8% from September 1986 to September 1987 compared with an RPI increase of 4.2%. Net of duty the average increase was 5.2%. The Society also says that the brewers set retail prices for only 20% of the total market and 24% of the market for beer consumed on the premises; that the retail price reflects improvements brought about by substantial investments made to improve amenities in pubs; and that UK beer prices are favourable in terms of international comparability for equivalent amenities.

Alcohol misuse.

7. **Duty on stronger beers.** The Society argues against loading duty on stronger beers on the grounds that it would restrict efficient production; be unfair to moderate drinkers who are the majority; and would not be effective in its objective of curbing abuse amongst the young because the 18-25 age group have the highest discretionary income amongst all drinkers.

8. **The 1030° duty base for beer.** The Society suggests that if it is wished to stimulate the production of low-strength beers as an aid to inhibit the misuse of alcohol, there should be a new duty category with a flat rate for beer with an original gravity below 1030° an alcohol strength not exceeding 2.2%; but the minimum duty base should be retained. Brewers argue that the general retention of the 1030° base is necessary to protect the public's perception of the quality of British beer.

9. **Mixed alcoholic beverages.** The Society supports the introduction of a new duty band for "coolers" and similar drinks, with the caveat that the rate of duty on such products should not favour them compared with beer.

Points which the Society might make.

10. As on previous occasions, it is to be expected that the Society will develop the points in their paper.

Level of beer duty.

11. **The beer market.** There is a general consensus amongst forecasters that the size of the market is likely to remain virtually static during the next few years, with lager continuing to increase its share of total sales.

12. **The price of beer.** The Society will presumably argue that brewers do not control the majority of retail prices and that their own prices have risen broadly in line with the RPI (also, they have previously argued that their particular costs tend to rise higher than general inflation). However, there is little doubt that brewers exert a considerable influence on retail prices through their managed and tennanted pubs. Also, brewers have "loan tied" some free houses by loans for improvements on favourable financial terms. As far as the off trade is concerned some brewers are in conglomerates which control major off-licence chains.

13. It is difficult to get reliable information about the components of beer prices. But in a largely static market brewers' profits have been healthy and:-

(a) **Wholesale prices.** The Society says that in the year ending September 1987 the duty exclusive wholesale prices rose by 1 percentage point more than the RPI (5.2% compared with 4.2%). Another way of putting this is that the duty exclusive wholesale price of beer increased by nearly 25% more than the RPI.

(b) **Retail prices.** Between March 1985 and December 1987 the retail price rise per pint averaged between 12p and 14p. To put into perspective the Society's repeated assertions that duty increases would have significant adverse consequences for the trade, the 1985 beer duty (and associated VAT) increase was some 1.5p a pint on average strength beer. Revalorisation in the next Budget would mean an increase in duty (and associated VAT) of under 1p.

Alcohol misuse.

14. **Duty on stronger beers.** You will recall that when the inter-Departmental Working Party examined this question officials were split on the issue. Briefly, the arguments for action are that alcohol misuse is a serious problem with large financial and social costs; beer, which accounts for about half consumer expenditure on alcoholic drinks, has been identified as a problem - particularly heavy beer drinking by young men which has been linked with crime and other social problems; and beer duty is regressive and should be altered to encourage a switch to weaker beer. The arguments against are that such an increase would unfairly penalise moderate beer drinkers who are the majority; that it would adversely affect the efficiency of the industry and the collection of beer duty (see Annexe); and that it would be ineffective because any feasible duty increase would be relatively small and aimed primarily at a section of the community with high disposal income. (An additional argument is that there could not be a corresponding increase in wine duty, because the wine/beer ratio is tied to average strength beer.)

15. Revenue considerations are not paramount and the issue needs to be considered on wider economic and social grounds.

16. **The 1030° duty base and a new duty band for mixed alcoholic beverages ("coolers").** Both these are under consideration as a contribution to the campaign against alcohol misuse. The Economic Secretary has written to other members of the Ministerial Group chaired by Mr Wakeham for their views, and these subjects and duty on stronger beers are likely to be discussed at your meeting with Mr Hurd, Mr Moore and Mr Wakeham on 9 February.

Points you may wish to make.

17. You may wish to:-

Acknowledge the largely static beer market, but point out the benefits of the buoyant economy and low inflation.

Put in perspective what has happened to beer prices (12p to 14p a pint up) with the last duty rise (some 1.1/2p a pint) and the effect revalorisation would have this year (less than a 1p a pint).

On alcohol misuse, refer to the success of "low alcohol" lagers which were heavily promoted in the pre-Christmas period. Also, note the Society's response on strong beer and the minimum duty limit and say that these are not primarily taxation issues and you are consulting Ministerial colleagues.

ANNEXE

ANX

BEER DUTY ADMINISTRATION

Present duty.

1. Beer duty is charged at an early stage of manufacture based on the original gravity (OG) of the liquid from which the beer is produced (the worts) before fermentation takes place. On completion of a collection of worts, the brewer must declare the volume and OG of the worts in a brewing record. Worts will be collected at different gravities during the month, so to make calculation of duty easier each collection is converted to a standard gravity of 1055°.

2. Once a month the brewer totals all the collections, deducts a standard 6% to account for process losses after the declaration, and makes a single calculation of the duty payable for the month.

3. Because the present duty per hectolitre per degree of OG is constant, the addition of water or the blending of different strength beers after the duty point does not affect the amount of duty payable (unless beer is diluted below the present 1030° base line for duty which in practice rarely happens).

Progressive duty scale.

4. If a progressive duty scale were introduced the two choices identified by the Brewers' Society, that of either paying more duty than a brewer not using the technique or installing new capacity, are not the only ones. An alternative would be to introduce a rebate scheme whereby a brewer could claim a refund of the difference between the duty paid on the high gravity brewed beer and duty which would have been payable if he had not used this technique and brewed at the "sale" gravity. However, there is no doubt that the administration of such a regime would be more complex and costly both to the brewers and the Department than the present duty.

5. Assuming that duty will continue to be based solely on OG, the following procedures would be adversely affected:

- Dilution of high gravity beer. The volume and OG would have to be declared after the addition of water;

- Blending of beers of differing OGs. The volume and OG would similarly have to be re-declared;

- Dilution and blending of beer away from the brewery of origin would require more premises to be brought under revenue control;

- Priming (sugar) solutions are often collected at OGs exceeding 1100° and would carry a higher rate of duty which might have to be reassessed after adding to beer;

- Beer concentrate. One large brewer concentrates beer after duty declaration to over 1100° OG and then reduces to sale gravity elsewhere. This would require at least two further declarations.

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

Ch

It's CST's wife's
birthday on Friday
He would very much like
to go down to Huntingdon
on Thursday night &
miss Prayers on Friday,
plus ABCC Budget
reps (if that isn't moved).

OK?

OK

Sff on -

(BF 4/2)

CHANCELLOR OF THE EXCHEQUER

[illegible] CST + FST -

C/ I understand you have agreed to see the ABCC to discuss their Budget Reps.

Andrew Lansley rang me today & tentatively suggested 10.30am on Friday 26 Feb - when several of his members will already be in London.

Content? OK

Attending from the ABCC will be:

Tom MacPherson - Chairman

Roger Burman - Vice Chairman

Ron Taylor - Director General.

Andrew Lansley - Director Home Affairs.

Miles Middleton - Vice Chairman Economic Industrial Committee

+ one other.

(over)

~~A~~s CST saw them last year would you like him to be present + who else?

Yes: CST + FST + appropriate officials

Julie
1/2.

What subjects discuss.

Ch
FST
Cropper
Sinclair]
Burgner]

240 5831.

Rayner

AH

FROM: P J CROPPER
DATE: 26 January 1988

PS/CHANCELLOR

cc PS/Mr Tebbit

Andrew Lansley has recently taken up the post of Director of Home Affairs at the Association of British Chambers of Commerce. He is anxious for the ABCC to be better regarded at the Treasury - recognising that it had a damp reputation in the early eighties - and asks me if I can help.

2. Two matters are in play

1. A request to see the Chancellor about the ABCC budget submissions. In recent years this has been passed to the Chief Secretary. Any chance of the Chancellor himself seeing them this year?

OK

2. An invitation to the Chancellor to speak at the ABCC annual conference at Manchester in May. Hopefully he will be able to do this.

discuss @ Spch Cttee LSH.

P J CROPPER

Mrs Thorpe

Pl. deal with 2(1).

I will deal with 2(2).

AH

FROM: H. D. MILLER, M.P.

HOUSE OF COMMONS
LONDON SW1A 0AA

29 JAN 1988

BOARD
Nigel Forman Esq MP
House of Commons
London
SW1A 0AA

26th January 1988

Dear Nigel

Re: PROFIT RELATED PAY

I have pleasure in enclosing a copy of my letter on this subject for your information.
*

Yours sincerely

H Hal.

H D Miller

Enc

The Rt Hon Nigel Lawson MP
The Chancellor of the Exchequer
HM Treasury
Parliament Street
London
SW1P 3AG

26th January 1988

Dear Nigel

A neighbour in Worcestershire has buttonholed me on the subject of profit-related pay, for which he is a great enthusiast, and has indeed had experience of the success that can be achieved in his own firm. He maintains that the requirements for our scheme are most inhibiting. There has been recent discussion of the subject in the Financial Times and the Evening Standard, in addition to which I enclose a letter he sent last December to the Treasury on the subject, on which I should be grateful for your comments.

Yours sincerely

H D Miller

Enc

Spare

BUS & COACH COUNCIL

Sardinia House, 52 Lincoln's Inn Fields, London WC2A 3LZ
Telephone: 01-831 7546. Telex 297054. Fax: 01-242 0053

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
H.M. Treasury
Parliament Street
LONDON SW1P 3AG

28 January 1988

Dear Mr Lawson

BUDGET 1988

Following an exchange of correspondence with yourself and other Ministers in your Department on the subject of VAT, BCC believes it is necessary to make specific submissions to you and asks that you will take these into account in preparing your Budget. While we hope that there is no thought of adding any positive rate of VAT to bus fares or other forms of public transport, the matter is of such significance to my members that it is felt necessary to make representations, in the strongest terms, drawing attention to the far-reaching effects of any such action.

Accordingly, I enclose six copies of a memorandum and, in making these submissions, there are certain other points which are of concern to the industry and which we wish to bring to your attention.

Should you, your Ministers or Officials, wish to meet to discuss or seek elaboration of any of the submissions, we shall, of course, be at your disposal.

Yours sincerely

Denis Quinn

Director General

BUDGET 1988

1. INTRODUCTION

1.1 Bus and Coach Council (BCC) makes the following representations to the Chancellor of the Exchequer relating to the preparation of his Annual Budget. The Council is the national association representing the bus and coach industry in the United Kingdom. It has 1,700 members who operate more than 80% of public service vehicles including 95% of the buses and two-thirds of the coaches. BCC's associate members include all the major manufacturers of buses and coaches and other suppliers to the industry, as well as local authorities who are responsible for the provision of subsidised local bus services.

1.2 Thus, it can be seen that BCC has a broad spectrum of responsibility demanding a balanced approach to the problems of the bus industry and, of course, to the public which it exists to serve.

1.3 There are four matters which are of concern at the present time. These are:-

1.3.1 - Current uncertainties over the VAT regime prompted by activities of the European Community, having regard to the far-reaching consequences should a positive rate of VAT be introduced for passenger transport. There would be adverse effects on fares, passengers, rural deprivation, urban congestion, road safety, the industry in all its aspects, inflation and public expenditure.

1.3.2 - The age profile of the bus fleet in the present competitive market and its effect on the British manufacturing industry, raising the possibility of the provision of capital grants or capital allowances for tax purposes.

1.3.3 - The extension of reimbursement of hydrocarbon oil duty to coaches, to put them on the same footing as the railways and to encourage travel by safe public transport rather than by private car.

1.3.4 - Retention of rural transitional grant which has a valuable role to play in sustaining many marginal rural bus routes.

2. VALUE ADDED TAX

2.1.1 When VAT was introduced in the UK, it was recognised that passenger transport was among those essential services which, having been exempt from purchase tax, should be zero rated under the new system. When Britain entered the Common Market in 1973, the industry was aware that this ruling was under threat by virtue of the Second Directive on Turnover Taxes.

2.1.2 This Directive provided for the harmonisation of such taxes and, at that stage, the elimination of zero rate - because the Community had a theory that the ultimate tax passed to the consumer must normally permit the deduction of the whole of the supplier's input tax. We have never understood the logic of this provision and BCC has taken every opportunity during the past 15 years to lobby in Europe for the reversal of this dubious doctrine.

2.1.4 In view of Government assurances on the retention of zero rate in the UK, BCC is more concerned regarding the possible effects of the case brought against the UK by the European Commission currently before the European Court. The goods and services which are challenged in respect of zero rate do not include passenger transport. However, if the Court finds against the UK it must be presumed that VAT will, in future, be charged on the goods and services in question. It may also be assumed that the tax will not be at the full rate of 15% but that a reduced rate will be introduced. BCC is apprehensive that other goods and services may be included in the taxation package and it is profoundly concerned lest a positive rate of tax should be applied to passenger transport, including bus and coach travel. The following paragraphs examine the diverse effects which such an action would have.

2.2 <u>The Effect on Fares</u>

2.2.1 Imposing a positive rate of VAT on the bus and coach industry would result in an increase in fares in excess of the VAT rate. There are several factors leading to this conclusion:

- The industry is now zero rated and there would be no offsetting benefit from reclaimed VAT on its inputs. The whole of the increase would have to be reflected in fares.

- Most bus use is by final consumers and is not an input to other taxable activity, therefore very little of the VAT on fares would be reclaimed and the fares increase would reduce demand like any other fares increase.

- The reduced demand would mean that the percentage increase in revenue would be less than the percentage increase in fares. Thus, to increase revenue by x % fares would have to rise by a multiple of x% .

2.2.2 If VAT were imposed at a rate of 5% the increase in fares, using the industry's extensive experience of price elasticity, would have to be about 7.5%. At a 9% VAT rate, fares would have to rise by 13.5%. These figures are industry averages and operators serving markets which are particularly price-sensitive (like the elderly) would need to increase fares by more than this. Such increases would come on top of those needed to meet rising costs and the substantial increases which have recently been needed in some areas to achieve financial viability.

2.2.3 The impact of VAT on fares is much lower elsewhere in the EEC where subsidies, not fares, cover a high proportion of costs. In Brussels and Luxembourg subsidy covers over 70% of operating costs, in Athens almost 80% and in Paris over 50%. Such figures make the Commission's arguments on harmonisation far less convincing.

2.3 The Effect on Passengers

2.3.1 The passenger will be immediately affected by the fares increase, although, as demonstrated below, further effects will emerge over time. The people most affected in absolute terms are, obviously, those making most use of bus and coach services; also, because it is impossible that there should be discrimination between different modes of passenger transport, of rail and "metro" services. According to the Family Expenditure Survey for 1986 these are as follows:-

Household Type	Annual Expenditure 1986 Survey (£)		Additional Expenditure with VAT			
			Bus and Coach		All Passenger Transport	
	Bus and Coach	All Passenger Transport	5%	9%	5%	9%
4 people, adults and children	175.24	587.08	13.00	22.78	43.55	76.32
3 people, adults and children	137.80	421.72	10.22	17.91	31.28	54.82
All households with children	70.72	266.24	5.25	9.19	19.75	34.61
All households	56.16	224.12	4.17	7.30	16.63	29.14

Thus, as might be expected, large households, especially those with children, would be worst hit in absolute terms.

2.3.2 Equally, if not more important, are those who spend a high proportion of their expenditure on public transport. Again, the Family Expenditure Survey identifies the groups concerned:

Household Type	Proportion of Expenditure on Bus & Coach (%)	All Passenger Transport (%)
Single adult, one child	1.21	2.71
Single adult households:		
- Income less than £60 per week	2.02	4.40
- Income £60-£125 per week	1.11	2.84
All households:		
- Income less than £45 per week	1.06	3.00
- Income £45-£60 per week	1.21	2.10

In this case, it is the low income households who are, in relative terms, most vulnerable to the increased bus fares which would result from imposing a positive rate of VAT.

2.3.3 As 80% of the population use the bus or coach at least once a month, and the usage of all public transport must be higher, a large proportion of the population will be affected. In many urban areas one-fifth of bus journeys are made by the elderly, who would be adversely affected unless provided with a free pass - in which case the whole burden would fall on the Local Authority. Other sections of the community to be penalised would be students, commuter coach users and those in lower income brackets who depend on coaches for their long distance travel needs.

2.3.4 Where buses or coaches are used in the course of business there would also be a problem. The company would be entitled to recover the VAT element of fares but, although the aggregate claim might be considerable, the large number of small amounts involved and the diversity of bus tickets would make the process totally uneconomical. This may be a small matter but it would breach the principle of VAT as a tax.

2.3.5 The other effects on passengers are longer-term but cannot be ignored. As bus and coach travel becomes more expensive, those who keep on travelling at higher fares have a greater incentive to seek alternative modes. The private car, which has been and continues to be the greatest competitor to every bus operator, would become more attractive. This secondary reduction in patronage would eventually have to be met with fewer commercial services and, unless more public funds were forthcoming to finance them under the tendering process, the eventual result would be fewer services overall.

2.3.6 The effects of a positive tax rate would however, go further than the passenger. In rural areas the change would exacerbate transport problems for those dependent on the buses and would contribute to the current decline in the quality of life in the countryside which is already a matter of grave concern in many quarters.

2.3.7 In urban areas there would also be wider problems. Any deterioration in bus services in respect of fares, frequency or reliability of services would lead to an increase in the use of private cars, which has currently been stemmed by initiatives in the bus industry. More cars would result in greater congestion which is already strangling many of our cities. It is really only by encouraging the bus and other forms of public transport that this trend can be reversed. Even vast expenditure on new and improved roads would not help. Experience clearly shows that as road capacity is increased, it is even more rapidly taken up, so that new roads create new bottlenecks. Good public transport is the only real answer to the vast economic cost of traffic congestion.

2.4 <u>The Effect on the Industry</u>

2.4.1 The industry has just undergone, in October 1986, the biggest change in its history; namely deregulation of local bus services coupled with commercialisation of operating companies. Whilst it has responded to the challenge of the free market it is still in the early stages of adaptation. Change has affected the market, the structure of the industry, the regulatory processes and the finance of socially necessary services. Operators are still adjusting to that change and are not well placed to face another major upheaval. In particular it

contd.....it must be realised

must be realised that in certain areas bus fares have had to be greatly increased to satisfy the requirements of the 1985 Transport Act. In some cases there have been rises of over 275% and further increases would stretch the elasticity of demand beyond its limit for many users in those areas, for them making the figures quoted in paragraph 2.2.2 unrealisticly low.

2.4.2 Imposing VAT would place administrative costs on the industry. Although bus operators are registered for VAT, they would have to account for tax on some 5,000 million transactions! They would be obliged to issue VAT invoices, even if of little practical value. As most operators use ticket machines which print on to plain paper, there would be a cost of printing VAT details on the ticket rolls or modifying the printing equipment in ticket machines. Most of the industry is modernising or has just modernised its ticket machinery and would be faced with substantial additional costs. An overnight change would be difficult to achieve.

2.4.3 Bus operators often have several million 'prices' in their fares tables. The task of changing them when VAT rates alter is considerable. Many contracts for subsidised services require the operator to seek permission from the Local Authority before changing prices, thus adding to the administrative burden. When VAT increases, the higher tax is payable immediately regardless of any adjustment to fares and operators could be liable for substantial losses as a result of VAT increases.

2.4.4 In particular, the administrative burden would fall most heavily on the small operator whom the Government is encouraging to enter the industry. A small company in which the owner often drives would find the extra burden of calculating VAT fractions and accounting for VAT a further administrative burden and an inhibition to launching into local bus operation.

2.4.5 The financial viability of many operators - of all sizes - is still under strain following deregulation. An overnight imposition of VAT could have a significant adverse effect on their finances which are already stretched by the costs of deregulation and of the initial competition for markets.

2.4.6 A further effect of deregulation is that it has removed what scope there might have been for absorbing VAT internally by greater efficiency. All operators have seized the efficiency gains which were available in order to compete effectively and there really is little or nothing left to meet new pressures.

2.4.7 One economy effected by bus operators, in many cases, has been to prolong the life of their vehicles. The application of positive VAT to fares would create a greater pressure to adopt such a policy. That in turn would further aggravate the crisis in the bus manufacturing industry and, in the ultimate, could lead to its closing down. In those circumstances, Britain would become dependent on overseas suppliers when replacement vehicles became essential. Not only would this be a rebuff for British industry and a negative influence on the balance of payments, but it would require the use of buses designed for different markets. This could create problems in compliance with our Construction & Use Regulations, because small scale adaptation for a market which has developed on substantially different lines would not lend itself to sound engineering solutions.

2.5 Modal Split

As indicated it is presumed that, if VAT were imposed on public passenger transport, it would relate to all modes. To discriminate between road, rail and air would create unfair competition and would be a distortion of the market. Moreover, the advantage given to private transport by any imposition of VAT on public transport would, for the reasons already stated, be counterproductive, having a totally disportionate adverse effect on the economy relative to the tax which might be collected.

2.6 Inflation

Like any price increase, VAT on bus and coach fares would affect inflation. Increase in fares of 7.5% and 13.5% increase inflation by 0.05% and 0.09% respectively. Those figures relate solely to bus and coach travel. Applied to all modes of public transport, the comparable inflationary effect would be in the order of 0.17% and 0.3%.

2.7 The Public Purse

2.7.1 Whilst the industry is not subsidised in any open-ended form, it does receive public money for

- Losses on socially necessary non-commercial services provided under contract to PTEs, County, Region and Island Councils.

- Provision for Local Education Authorities of school transport.

- The net costs of carrying children and the elderly at non-commercial, reduced fares.

In all three cases it appears that VAT would have to be added to these costs. Whilst in the first two cases VAT can, under the present system, be reclaimed by the contracting authority, at the very least there is an unnecessary extra link in the chain.

2.7.2 In the case of concessionary faces the situation is more complex. The operator needs to be reimbursed the difference between his commercial fare - which will include VAT - and the fare (if any) paid by the concessionaire (less allowance for generated travel). If commercial fares rise for any reason the reimbursement must reflect this and it may be that, under Article 11(1) of the Sixth Directive, VAT would have to be added to the reimbursement. It is far from clear whether the element of the increase which is the result of VAT could be reclaimed as input tax by the PTE or County Council. According to Transport Statistics expenditure on concessionary fares support was over £300m in 1986/87. An increase of 7.5% on this figure gives £22.5m and is thus quite a significant increase in public expenditure.

2.7.3 As the longer-term impact of imposing VAT on fares results in fewer commercial services there will, as indicated above, be increasing calls on resources to provide additional supported services. This would lead to a further increase in the cost to the public purse or to the withdrawal of services, with the consequences demonstrated.

2.7.4 Another aspect is the cost of road accidents which could be expected to occur. The bus and coach are by far the safest means of travel: according to Ministers they are, taking one year with another, as safe

contd......as the railways with

as the railways with their dedicated tracks. It may be expected, as low income groups would be most severely affected, that increased fares or loss of services would result in transfers to bicycle and motorcycle as well as to the car. The former are a notoriously dangerous means of travel. Apart from the tragic loss of life and injury there is the cost. According to the latest Government statistics Road Accidents Great Britain 1986, the average cost per casualty is:-

Fatal	£264,881
Serious injury	14,182
Slight injury	296
Average	7,696

3. CAPITAL EXPENDITURE

3.1 The 1980s have seen a steady decline in capital expenditure by the industry on new vehicles. The number of new buses and coaches registered has declined significantly.

Buses and Coaches

Year	New Registrations	*Production*
1980	5,792	*9,579*
1981	4,441	*6,215*
1982	3,766	*4,308*
1983	3,712	*4,720*
1984	3,379	*4,726*
1985	2,511	*3,885*
1986	2,141	*2,514*
1987	1,989	*n/a*

Source: SMMT - Buses and coaches are defined as vehicles seating 19 and over.

Within these figures, registration of double-deck buses fell from 1,576 in 1982 to 175 in 1987.

3.2 the early part of this period, the decline was the result of phasing out new bus grant which for several years had boosted capital investment in the industry and accelerated the modernisation of its vehicle fleets. Latterly, uncertainties about deregulation and the restructuring of the industry which accompanied it had similar effects on investment.

3.3 As a result the average age of vehicles has been increasing. However, in the present highly volatile state of the market, operators are unwilling to make major commitments to new vehicles which can cost up to £100,000 each. It will be readily appreciated that today's new vehicles are also tomorrow's secondhand buses and coaches. Much of the industry - especially new operators building up their business - depends on secondhand vehicles. Such operators are vital to the competitive market in which the whole industry operates.

3.4 The decline in investment in new vehicles is having an adverse effect on the manufacturing industry. A number of companies have withdrawn from bus and coach chassis production altogether. Body builders have also closed and those who have survived, in order to spread the risk, have diversified to serve new industries or new markets. Some produce minibuses but already there are signs of a decline in demand as the operating market has reached maturity. Certainly these businesses are not currently in a position to increase bus production at short notice. A healthy level of competition amongst its suppliers is essential if the operating industry is to compete effectively. Having vehicle production in the hands of one or two manufacturers could prove a serious obstacle to competition; demand could even fall to such a level that domestic production became uneconomic. That could happen unless investment increases.

3.5 Imports are already a major source of concern. They have taken a rising share of the UK market over the last 20 years, currently 37%. The UK market is uniquely open to imports and, with a much steadier domestic demand, foreign manufacturers have found it relatively easy to adapt their vehicles for the UK. Demand in the UK has fluctuated and during the down-turns production capacity has been cut. The result in the next up-turn is lack of capacity and a market for imports! As indicated in paragraph 2.4.7 this results in the influx of vehicles modified on an ad-hoc basis, rather than designed for the actual needs of our domestic operations.

3.6 Looking at the other side of this problem, the British manufacturing industry's export potential requires a sound domestic base. This has not been attainable since 1980, as the figues for overall production appended to the table in paragraph 3.1 clearly demonstrate. The increased penetration of foreign-built vehicles, during a period of significantly reducing demand, has meant that export sales have declined even more rapidly than home sales. This is a sorry contrast to the days when there was substantial home demand and British manufacturers expected to export 70% of production!

3.7 BCC would therefore propose either:

- the provision of capital grants for all new vehicles, possibly the reintroduction of new bus grant; or

- the introduction of capital allowances so that the whole of the capital expenditure on new buses and coaches can be offset against the operator's taxable profits.

Either measure would have significant benefits:

- investment would increase and fleets could be modernised

- the supply of secondhand vehicles would increase, thus encouraging new entry into the industry

- British manufacturers would have a sound home market which would stimulate their own investments in modern production capacity

- manufacturers would have a base on which to expand their achievement in overseas markets

4. FUEL DUTY

4.1 The local bus industry has, for many years, had the benefit of a rebate (actually reimbursement) of the duty it pays on hydrocarbon oil. Despite past representations by BCC this does not apply to coaches. BCC believes there is no longer any logic in this and again urges the extension of the rebate to the whole industry.

4.2 The distinction between a local bus service (on which rebate can be obtained) and a long-distance service is inevitably arbitrary. At present a local bus is one on which the stopping points are less than 15 miles apart, measured in a straight line (1985 Transport Act Section 2). Thus, many commuter coaches into London are not eligible for rebate. However, the train services with which they compete do benefit because British Rail pays minimal tax on its fuel.

4.3 Coaches compete with the railways in many other markets and have done so successfully since 1980. They do, however, suffer the same handicap as the commuter coach. On a long-distance service where there is direct rail competition - for example, Newcastle to Plymouth - fuel forms a significant part of operating cost and lack of rebate damages the competitive position of the coach.

4.4 The benefits of bus services in terms of reduced congestion and improved road safety are widely recognised. They apply equally to coaches, however. Many major sporting events are served by coaches which considerably reduce congestion in the vicinity of these events and on approach roads. If fuel duty rebate is justified for the bus - which it clearly is - it is equally justified for the coach.

4.5 Extending the rebate would also make a contribution to road safety, as it would let the coach compete more effectively with the private car. This could reduce traffic levels on many major roads and motorways. Reference has already been made to the benefits of accident reduction.

4.6 Finally, coaches play a major role in the tourist industry, carrying overseas visitors and adding to foreign currency earnings. Extending fuel duty rebate would allow them to be more competitive, with wider benefits to tourism and to the economy.

5. TRANSITIONAL RURAL GRANT

5.1 Transitional rural bus grant is currently available, at a reducing rate, for four years from April 1986. Many services in rural areas receive 5p per mile, the grant being paid through the fuel duty rebate mechanism by the Department of Transport.

5.2 The grant, designed to compensate for the loss of cross-subsidy on de-regulation of local bus services, helps temporarily to sustain marginal rural services which might otherwise not be provided commercially or on a subsidised basis. Total cost to the Exchequer is very small but the grant plays a significant part in retaining services in highly rural counties. In the absence of the grant, some counties might face an increase of nearly 20% in their revenue support expenditure, to sustain the same level of service. Its loss would therefore be sufficiently damaging to justify retention on a long term basis.

27.1.88

CHANCELLOR OF THE EXCHEQUER

3

C/ The Chairman & Major General Mangham of the Brewers Society would specifically like to see you in January. As the Diary is crowded I offered 9.30am on Tues 26 Jan & they have accepted.

I imagine that you would like to have the EST with you. He has a press engagement in his constituency at this time which he would be reluctant to break

Options are:

1. Hold the meeting without EST.
2. Try & move the meeting to a time when EST can come
3. Ask EST to change his

constituency engagement

Which would you prefer?

Julie

13/1.

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

~~papers~~ PNP ~~psc~~

M

Please Dial my Extension Direct.
Use Code (01)-382 followed by
Extension Number 5...072...

FROM: W D WHITMORE
DATE: 29 January 1988

APS/Chancellor

cc PS/Economic Secretary

THE BREWERS' SOCIETY: BUDGET REPRESENTATIONS

DONE TL 1/2

I shall be grateful if you will substitute the attached page for the third page in the brief I sent over under cover of my note of 22 January.

W D WHITMORE

13. It is difficult to get reliable information about the components of beer prices. But in a largely static market brewers' profits have been healthy and:-

(a) **Wholesale prices.** The Society says that in the year ending September 1987 the duty exclusive wholesale prices rose by 1 percentage point more than the RPI (5.2% compared with 4.2%). Another way of putting this is that the duty exclusive wholesale price of beer increased by nearly 25% more than the RPI.

(b) **Retail prices.** Between March 1985 and December 1987 the retail price index of beer went up by 11.5%, nearly 50% more than the RPI increase. The rise per pint averaged between 12p and 14p. To put into perspective the Society's repeated assertions that duty increases would have significant adverse consequences for the trade, the 1985 beer duty (and associated VAT) increase was some 1.5p a pint on average strength beer. Revalorisation in the next Budget would mean an increase in duty (and associated VAT) of under 1p.

Alcohol misuse.

14. **Duty on stronger beers.** You will recall that when the inter-Departmental Working Party examined this question officials were split on the issue. Briefly, the arguments for action are that alcohol misuse is a serious problem with large financial and social costs; beer, which accounts for about half consumer expenditure on alcoholic drinks, has been identified as a problem - particularly heavy beer drinking by young men which has been linked with crime and other social problems; and beer duty is regressive and should be altered to encourage a switch to weaker beer. The arguments against are that such an increase would unfairly penalise moderate beer drinkers who are the majority; that it would adversely affect the efficiency of the industry and the collection of beer duty (see Annexe); and that it would be ineffective because any feasible duty increase would be relatively small and aimed primarily at a section of the community with high disposal income. (An additional argument is that there could not be a corresponding increase in wine duty, because the wine/beer ratio is tied to average strength beer.)

15. Revenue considerations are not paramount and the issue needs to be considered on wider economic and social grounds.

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

c/ Mr Middleton is now unable to attend

Julie
11/2.

H.M. CUSTOMS AND EXCISE
KING'S BEAM HOUSE, MARK LANE
LONDON EC3R 7HE
Please Dial my Extension Direct:
Use Code (01)-382 followed by
Extension Number 5.023..

PMP

FROM: P R H ALLEN
DATE: 29 January 1988

MR P J WALES

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Sir P Middleton
Mr Wilson
Miss Sinclair
Mr Michie
Mrs Burnhams
PS/IR
Mr Crabb)
Mr Arnold) IR

SOCIETY OF MOTOR MANUFACTURERS AND TRADERS (SMMT) : 1988 BUDGET REPRESENTATIONS

1. I attach briefing for the Economic Secretary's meeting with Sir Godfrey Messervy of the SMMT on 2 February 1988. It covers both the Customs and Excise and Inland Revenue issues raised by the SMMT in both their "Budget Recommendations" and in their technical Budget representations.

2. Alison French will provide official support from here, together with George Michie from the Treasury and David Arnold from the Inland Revenue.

RA.

P R H ALLEN

Internal Circulation: CPS, Mr Knox, Mr Jefferson Smith, Mr Cockerell, Mr Taylor, Mr Trevett, Mr McGuigan, Ms French

CUSTOMS AND EXCISE BRIEF FOR THE ECONOMIC SECRETARY'S MEETING WITH THE SOCIETY OF MOTOR MANUFACTURERS AND TRADERS (SMMT):

Organisation

1. The SMMT's membership includes all the major car manufacturers in the UK as well as importers, dealers, retailers and vehicle component manufacturers. Despite the presence of importers in the SMMT, experience has shown that it is the interests of the UK manufacturers which tend to predominate. The new SMMT President is SIR GODFREY MESSERVY (Former Chairman of Lucas Industries - to which position he rose from production trainee with Lucas in 1949). The SMMT Presidency is an honorary position held by election for one/two years. The post holder is not involved in the day-to-day running of SMMT affairs, although in an interview for "Motor" magazine in August last year Sir Godfrey revealed strong views on many aspects of the motor industry. A copy of the magazine article is included at Annex II.

Object of meeting

2. The SMMT have produced two representations:

   i 1988 Budget recommendations, sent to the Chancellor on 26 November 1987;

   ii 1988 Technical Budget Representations, sent to the Official Treasury on 30 November 1987.

3. Each year the SMMT make proposals for changes they would like to see made in the Budget. The purpose of the meeting is to allow the SMMT to put their case to you personally. The proposals this year closely resemble those put forward last year, with most of the new material occuring in the "technical" paper.

Line to take

4. The SMMT will not expect you to comment substantively on the points they make. In general you need do no more than acknowledge that their views have been noted and say that you will see they

are passed on to the Chancellor. However, some minor comments based on the brief might be prudent as witness of the fact that their representations over recent years have been given due consideration.

5. The structure of last year's meeting was an improvement on previous years. We, therefore, suggest that the SMMT are invited to list the topics they particularly wish to discuss, and then to enlarge on them one at a time so that you can repsond individually to them.

Written Representation

6. The two representations cover the following Customs and Excise topics:

(A) The Motor Industry

(B) Car Tax

(C) VAT on company cars: a. initial purchase
b. scale charges for fuel used on private journeys.

(D) Relief from excise duty on fuels used for research and testing.

(E) Burdens on business : recovery of VAT on imports.

(F) VAT reclamations on vehicles purchased for research and development purposes.

(G) VAT penalty provisions

Annex I contains a short brief on each topic. Inland Revenue briefing is attached as Annex II.

You can pick up the front wheel in first, second or third. I couldn't do a maximum 0-60; I don't have the skill – it would be over backwards! At my age I only ride it quickly in a straight line!"

The words are not in keeping with the perceived image of a captain of industry, though they come from 62-year-old Sir Godfrey Messervy – new President of the Society of Motor Manufacturers and Traders (SMMT), and until very recently chairman and chief executive of Lucas Industries. He is talking of his weekend hobby; riding his Honda 1000R – among the most powerful production motorcycles on the road. And there are other Messervy motorcycles (including a classic Vincent V-twin Black Shadow) tucked away on his 70-acre Midlands farm waiting for their weekly exercise.

At my age I only ride it quickly in a straight line

When it comes to matters automotive, Messervy is very much a hands-on boss, and he even counts himself a motor manufacturer – for, in the 1950s, he designed, built and raced a rear-engined Formula 3 car with mechanical fuel injection. "I claim to be a vehicle manufacturer on the basis of my prototype of one. It still exists and is now in Germany."

Messervy's racing driver technique was a shade unusual for, as the Triumph-engined single-seater snarled its way around the tracks, he could be seen reaching with his right hand through a hole in the engine cover. "I could adjust the fuel level by turning a small knob . . ."

More recently he learned to fly both fixed-wing aircraft and helicopters, and when he isn't being chauffeured to meetings he gets behind the wheel of his Lotus Esprit.

He always has been the sort of person to be up front and leading. At 19, in 1943, he enlisted in the Royal Engineers but trained as a parachutist, saw service in Norway and Palestine, and then left the Army to go to Cambridge. But it was plain that he was going to be a total wheels man. His grandfather has been in the garage trade in Derby for over 50 years, and his father spent a working life with Rolls-Royce, retiring as Service Director of the car division.

So, 38 years ago, Messervy joined Lucas as a production trainee, starting in the tool design office and working his way up to foreman. By the time he was building his Formula 3 car he had become factory superintendent and by 1963 had made the board of Lucas CAV. After that it was onward and upward to become chairman and chief executive of the Lucas group in April 1980.

Now that part of his career is over and Messervy – assertive, a stickler for detail, energetic and determined – takes over the SMMT Presidency from the ebullient and equally assertive former Ford Motor Company chairman Sam Toy.

"There is a great continuity in all the work done by the SMMT," says Messervy. "It has an excellent permanent staff and if I become a radical president I'm sure they would damp out some of my wilder suggestions and ensure that the Society continues to be the voice of authority of its varied membership."

The public's perception of the SMMT – if it has one at all – is probably of an organisation that has been telling us each month for years how many foreign cars we are buying and how the British motor industry was dwindling. That – and the organisation of the Motor Show. But, to put it mildly, there is rather more to the SMMT. It, and its 1400 members and varied committees, are involved in an enormous range of activities, from political lobbying on a whole range of issues to forming a gentlemanly barrier against a flood of Japanese imports and to making motor vehicles safer, more efficient, better value and increasingly environmentally acceptable.

If we don't satisfy the car purchasing public, we get our just desserts

"Sam Toy put in an enormous amount of work for the SMMT," said Messervy, "and we need to go on developing a long-term strategy for the UK automotive industry. We must ensure that Britain remains a vehicle engineering centre – and that vehicles are conceived and engineered here. We don't want the British motor industry to become a satellite industry; and it was certainly in danger of that some time ago."

In the view of some people, the shadows are still lengthening for the British motor industry, but Messervy takes a positive line. "We are reversing the trend to some degree. The greatest change has been the improvement of the quality of product made in this country. Now, if we don't satisfy the car purchasing public, we get our just desserts."

But why was quality allowed to become so disgracefully bad? "I think it was a lack of marketing awareness. It is easy to have 20:20 hindsight and I must stress that I have never sold a vehicle retail, but I believe we were not as clear-headed as we should have been about real quality. This may sound as if I'm having a go at the vehicle manufacturers and am talking in defence of the components and system manufacturers, but the biggest mistake made was when the components and systems manufacturers did not take a proper part in the engineering of the vehicle.

"We were not drawn in on Day One and told by the manufacturer what was to be built. Rather, we gave them our catalogue of bits. They then decided on the size of starter, generator, battery and where these things would be positioned.

You either equal the best in the world or you are not in business

"So cars were sold to operate in the winter of Detroit with the same size of battery and starter as one being driven in the South of France. Some manufacturers might put a battery over the exhaust; that might not matter much in this country but it would in California or other hot climates.

"But we, the component manufacturers in the 1950s, '60s and possibly '70s, worshipped so much the aim of getting the last penny out of a £5 starter. And for a period we were worshipping a false god.

"We had to go down a long dark tunnel before we realised

MR. PRESIDENT

Stuart Birch talks to Sir Godfrey Messervy, new President of the SMMT and a lifelong motor industry man, who has a vision of progress for Britain's manufacturers.

just how bad our quality was; to be close to the Valley of Death and to see markets collapsing before the message got through."

"The message *has* got through, he insists, and the quality god is now pre-emiment among vehicle and components and systems manufacturers.

At Lucas and at other component manufacturers, quality is now higher than it has ever been, claims Messervy – "And still it is not good enough. But now we refuse to have some things fitted to cars; we say to manufacturers that we will not sell specific things to them because it will not do the job – and, of course, as it carries the Lucas name it *must* be right."

Messervy will not name names but said Lucas has done a "terrific turn-around job for a very well-known British company which had a quality problem". The company, of course, is Jaguar.

"Component manufacturers mean to get still better, but in some areas we are already as good as the Japanese."

About 1.5 million people in the UK are employed directly or indirectly in the motor industry and the membership of the SMMT reflects that. Not only does it have the motor and components manufacturers, there are companies which import vehicles; dealers in British and foreign makes; the retail general garage trade and specialist "goodies" producers.

All of these companies could benefit if the Government axed its Special Car Tax of 10 per cent. This is added to the ex-works price of every car and the VAT is added to that; so the VAT becomes a tax on a tax – a situation about which successive SMMT presidents have berated succesive Chancellors of the Exchequer to absolutely no tangible effect while the motorist just keeps shelling out.

No other industry has anything like it but, as Car Tax generated about £1 billion a year for Treasury coffers, it is hardly likely to be abandoned. The SMMT, though, has plans to go on fighting it and Messervy points out that if it was removed sales would soar and he believes the Chancellor would get at least half of his money back anyway, via VAT. But then there is still the matter of the other half . . .

Of course, even reducing it would at least be a step in the right direction. Sales would still rise, the Treasury would not lose too much, and the knock-on effect – through all the peripheral companies associated with motor manufacture – would be felt.

So that is one of Messervy's

We had to go down a long dark tunnel before we realised just how bad our quality was

inherited headaches. Another is one about which he and the SMMT in general feel strongly; the desperate need to deal with the skills shortage.

There is concern in the motor industry generally that universities are not turning out the right people and the SMMT will be trying to get over the message that there is a market to be served and that people with the wrong qualifications are of little use. One way is for companies to help fund training by pumping in money to enable universities to be able to afford the right staff and facilities to ensure that the motor industry gets the graduates it needs. The SMMT is now encouraging its members to do this at universities and colleges around the country.

Messervy is also hoping that the curricula used in schools will be modified to better suit the needs of industry. To help with that the SMMT has produced a project award scheme with a motor industry study pack for schools – including a video, slides and computer program – aimed at showing young people that the industry is stimulating and challenging.

Messervy is confident that the message is getting over. "We have had group discussions with 30 or 40 of us from the SMMT going to see the Education Secretary and the Prime Minister – and I am encouraged.

"Multi-disciplinary engineers are particularly needed by the motor industry – engineers who could not only turn a piece of round steel to oblong but to be true manufacturing/process engineers able to deal with the manufacturing process from the moment an order is received to despatch of the final product to

In 10 years time I don't think a 120mph one-litre car will be remarkable

the customer. If we can get them from university with some of these systems skills attached to their basic engineering ability they will be much more usefull people from Day One."

And Messervy is convinced that there will be a motor industry in Britain for which they will be able to work. "I don't think that some of the remarkable changes in quality and productivity have yet worked their way through the system. We need to build a variety of cars – and to survive we need to compete with the Japanese, I believe we can, because the gap is closing.

"You either equal the best in the world or you are not in business. It should not be that difficult. We are a fairly low-wage economy in this country compared to Japan, Germany, France and the USA. We could close the productivity gap – and when we do we could possibly pay more in wages."

Vitally important in getting better cars built more efficiently in Britain is good communication between management and workforce in all companies.

"Instead of telling people what to do, we *explain*. And we have to show that unless we take certain action we will not survive as a business. At Lucas almost everyone's job had changed, including mine. There is constant training and re-training. The unions are generally on our side now. It is jolly difficult for them because they are changing shape and size, too."

But Messervy is adamant that there should not be a union representation on the boards of British companies.

"Personally I don't believe you can put someone on the board representing a special interest group; I believe that anyone on the board must be fully accountable and responsible to all persons dependent on that company – owners, suppliers, customers, employees."

Messervy's tenure as SMMT President – it can be for one or two years – will see him heavily involved in preparation for the 1988 Motor Show at the NEC in Birmingham. And he is absolutely convinced of the need for the show, as a shop window on the world, as a place for designers and engineers and businessmen to meet, and for the message to be put over to the general public that Motor Car A is better than Motor Car B.

And the trend of cars at those shows is going to be towards ever greater technology believes Messervy. "Clever braking systems will be far more common; engine efficiency will continue to improve, and in 10 years time I don't think a 120 mph one-litre car will be remarkable.

"After a working lifetime in the motor industry, Messervy is convinced that he would do it again given the chance: "The only problem is that as my colleagues remind me, with much higher acceptance levels these days I probably wouldn't get in again!" M

A. THE MOTOR INDUSTRY

SMMT Case

The SMMT argues that the UK motor industry faces increasing international competition, without the level of economic and fiscal support enjoyed by its main competitors. As the industry is a major employer and the biggest UK manufacturing exporter its continued health is vital to the nation's well being.

Comment

Following the achievements noted in 1986 the SMMT again point to significant progress in 1987. Car sales have risen from 1.88 to 1.96 million units, while the proportion of British-produced cars registered for road use is expected to rise from 44 to 49 per cent of the total. The SMMT seek to maintain this progress and ask the Government to ensure that it is not put at risk by unfavourable policies.

Line to take

Appreciative of the detail of the SMMT case. Note and welcome the progress made. Recognise the important contribution which the motor industry makes to the economy - but the Government must try to achieve an overall balance between the competing demands from all sectors of industry.

B. CAR TAX

Background

Car tax was introduced in 1973 mainly to compensate for the revenue which would otherwise have been lost from cars when the purchase tax rate of 25% was replaced by the standard rate of VAT which was then 10%, **now 15%**. The rate of **car tax** has remained unchanged at **10%** of the wholesale value. The current combined VAT and car tax give an effective rate of 24.6% of the tax exclusive retail price. The tax is paid, in the main, by UK manufacturers and the major importers, quarterly in arrears. It is payable on small passenger vehicles, including motor caravans and, since 1981, motorcycles, mopeds and scooters.

SMMT Case

The SMMT argue for the abolition of car tax. As alternatives they suggest reducing the rate of tax or abolition in stages. They maintain that it is discriminatory in that an additional tax is not payable on other consumer durables, and that it has an adverse effect on the UK motor manufacturing industry and the related components industry. They claim that abolition would reduce inflation (a once and for all effect), increase demand for cars, generate employment, and through the related components industry provide increased opportunities for small businesses. The SMMT recently received support for their case from the Trade and Industry Select Committee. (House of Commons Third Report from the Trade and Industry Committee. The UK Motor Components Industry, 13 May 1987 (HC 407)).

Line to take

a. **Revenue** (the strongest argument against abolition)

Car tax is important revenue raiser - expected to yield over £1,000 million in 1987/88. Obviously difficult for Chancellor to forego revenue of this magnitude. Revenue lost would have to be recouped elsewhere. Phased abolition or reduction would not solve problem but merely spread effect over number of years. Car tax is cheap to collect and relatively simple to administer.

b. **Government Policy**

Government action on inflation and Trade Union reform has helped create climate for recovery. While Government is anxious to see healthy motor industry, Chancellor must pay regard to overall tax structure and the case for abolishing car tax must be balanced against other possible tax changes particularly those which would be helpful to industry generally, and thus to employment.

c. **Select Committee Report**

Government noted recommendation that car tax be abolished, but response (see attachment) is that the Government does not share Committee's view on this point.

DEFENSIVE ONLY

d. **Import penetration**

Level of import penetration has fallen from 56% to about 51% over the last year. Despite fall, it is inevitable that significant proportion of any increased demand following abolition of car tax would be met by imports. Multinational nature of many manufacturers' operations could mean that any benefit to UK plants would depend on their competitive position in comparison with others operated elsewhere by same manufacturer. (Cf recent trend for overseas manufacturers either to collaborate with UK manufacturers on vehicle production or to establish manufacturing plants in the UK.)

e. **Effect of taxation on demand**

Level of taxation is only one of the factors which affects demand. Much depends on <u>price</u> which is governed by commercial factors such as unit production costs and manufacturers' (often discriminatory) pricing policies. Fair to say that, excluding taxation, many cars identical to those sold in UK cost less in other EC Member States. Other factors are size and wealth of population, cost of petrol, other taxes on motoring, and quality of public transport. Even if car tax were abolished, doubtful whether prices would be reduced by full amount of tax; likely that some part of reduction would be used to increase manufacturers' and dealers' profit margins.

f. **Employment**

Additional employment from abolition would depend on size of any additional demand. Views differ on effect prices have on sales of cars: total abolition might result in only small increase in demand - possibly only one fifth of most favourable estimates. Excess production capacity currently exists in Europe and elsewhere and despite drop in import penetration, significant proportion of increased demand would be met by imports. UK manufacturers' share could be small compared with market as whole - so could entail very significant loss of revenue for limited number of additional jobs.

g. **Exports**

Car tax has no direct effect on competitiveness of new vehicles of UK manufacture when sold abroad since full export relief is available.

S●2/43

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Telephone Direct Line 01-270 4656
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P Neale Esq
Department of Trade and Industry
Ashdown House
123 Victoria Street
LONDON
SW1E 6RB

Your reference

Our reference

Date

18 September 1987

Dear Mr Neale,

SELECT COMMITTEE ON TRADE AND INDUSTRY: UK MOTOR COMPONENT INDUSTRY: THE GOVERNMENT'S RESPONSE TO THE COMMITTEE'S REPORT

In response to your letter of 1 September enclosing a copy of the Select Committee on Trade and Industry's Report on the UK Motor Components Industry and the Government's draft response to the Report, I offer the following comments on the draft response to Recommendations 1, 2, 3, 4, 5, 6 and 10 which have been agreed within the Treasury.

Recommendation 1

A revised form of words for the Government response is suggested below. This omits the use of the work 'special' in relation to car tax since this is used by oppoents of the tax as one reason for its abolition and using the term in the response would be unhelpful.

X

"The Government do not share the Committee's view. The imposition of car tax has regard to a range of factors besides the particular circumstances and prospects of the UK based car manufacturing industry. The tax yielded some £980 million revenue for the year ended 31 March 1987, and any reduction in the rate of car tax would be expensive in terms of lost revenue which would have to be recouped from other sources: it is also to be noted that the combined effect of VAT and car tax in the UK, at 24.6 per cent, is broadly in line with the level of taxation on new cars in most EC Member States. Although the Government welcome the recent increase in the proportion of the UK car markets supplied from UK based factories, the Government do not at present consider that expansion of the UK industry is in any significant way held up by an insufficiency of domestic demand which has been at record levels successively in each of the past four years."

Recommendation 2

This draft response seems to give insufficient emphasis to the Government's main policy stance that it is for industry itself to address the shortcomings identified in the Report. This suggests that some re-ordering of the present draft would be helpful is given below. There seems to be 1 or more lines missing at the bottom of page 3 of the present draft.

"The Government have noted the evidence submitted to the Committee about areas of component supply where the UK capability is said to be either uncompetitive or non-existence. However it is for industry to consider

(Signed) MS H.M. ROBERTS

C VAT ON COMPANY CARS

The SMMT argue that since the majority of company cars are primarily business tools VAT incurred should be deductible in part if not in full.

(a) **Initial purchase**

Background

VAT paid on cars purchased by businesses is not allowed as deductible input tax, both for revenue reasons and because of the potential for tax avoidance (many business cars are also used for private purposes, and input tax can be deducted only if it incurred for a business purpose).

Comment

This disallowance of the input tax is an important revenue raiser, yielding some £700 million annually. If the Chancellor forewent revenue of this magnitude, the loss would have to be recouped elsewhere. Most countries with a VAT system restrict input tax deduction on certain purchases, particularly those likely to be used for both business and private purposes. If deduction were allowed, it would be very difficult to exercise effective control on private use. The VAT system would be made more complicated at a time when every effort is being made to keep costs for traders and the Department to a minimum.

EC position

It is our understanding that by virtue of Article 17.6 of the 6th VAT Directive we cannot amend our present legislation on input tax deduction. A draft 12th VAT Directive, designed to harmonise the forms of expenditure on which input tax deduction should be blocked, has been proposed.

12th VAT Directive

The latest draft proposes blocking a wider range of expenditure than that at present blocked by the UK - including 50% of the tax incurred on the purchase of business cars and on their running costs. The draft has met with a universally hostile reception from trade and industry and there is no sign that it would be welcomed by other member states. To date the Government has indicated that it is prepared to accept blocking only on terms similar to those already applied in the UK.

(b) **Scale charges for fuel used on private journeys**

A system of scale charges to assess the VAT due on road fuel used by businesses for private motoring came into effect on 6 April 1987. When it came into force the SMMT and others argued that it was unfair because the blocking of input tax on the purchase of the car itself took care of any subsequent private use.

Background

Under the previous system, where a car was used for both business and private journeys, the tax on purchases of road fuel had to be apportioned so that only tax relating to business use was counted as input tax. This system was unsatisfactory because we had never insisted on the maintenance of private mileage records, which meant that the apportionment could not be properly checked, and the procedure was abused. VAT Tribunals had also ruled that where a car was used for business and private journeys the tax on repair, maintenance and leasing charges should also be apportioned to reflect the private use.

Two consultation papers were issued in 1985 and the scale charge procedure stems directly from these. Ministers decided that although Inland Revenue only applied the scale charge system to directors and employees, it would be sensible for VAT purposes to apply it to all VAT businesses which fund private mileage. Moving to scale charges would reduce record keeping and be administratively simple for both sides. It would also reduce the need to proceed with apportionment of repair, maintenance and leasing charges. The VAT scale is the same as the Inland Revenue fuel benefit scale.

The volume of complaints about the VAT scale has been considerable. They are mainly from sole proprietors and partners who look only at the fuel scale and take no account of the repair, maintenance and leasing concession. The Paymaster General reviewed the level of the scales in July 1987 and concluded that for the time being the status quo on petrol charges should be maintained.

The scale charge applies only where a business funds private motoring. But if, in order to escape the scale charge, the business maintains that the input tax claimed relates wholly to its business mileage proper records must be maintained to enable this to be properly verified.

Line to take

The Inland Revenue fuel benefit scale is reviewed annually and the VAT scale is now included in this review.

Annex I

Topic (D)

D. RELIEF FROM EXCISE DUTY ON FUELS USED FOR RESEARCH AND TESTING

Background:

This question has been raised during the passage of the last three Finance Bills; and has been examined in detail by officials who consulted fully with the SMMT. After taking account of all the arguments, Ministers decided against allowing any relief at the time of the 1986 Budget. This decision was reiterated in a letter from the Minister of State to Mr Sam Toy, President of the SMMT(18 November 1986 - copy attached). The SMMT's 1987 and 1988 Budget Submissions renewed the claim but contain nothing new. In practice, the Society still seeks relief across a wide range of manufacturing activities going well beyond R&D, with unacceptable revenue implications.

Comments

It is encouraging to find that since 1.1.87 West Germany, with whom the UK has been unflatteringly compared by the SMMT, has substantially curtailed its exemption arrangements. Broadly the use of leaded petrol is now excluded and the relieved use of unleaded petrol is due to end in mid 1988. The French look kindly only on diesel engines and we are already reasonably generous in this regard because we allow the use of rebated gas oil. Our comparative position is thus considerably strengthened and the SMMT's indifferently argued case correspondingly weakened.

LINE TO TAKE

Ministers prepared to consider again, but little prospect of any change in previously advised decision not to allow any relief.

cc PS/Chancellor
PS/CST
PS/FST
PS/EST
Mr Monger
Mr Scholar
Miss Sinclair
Mr Crowther
Mr Tyrie
Mr Ross Goobey
PS/IR
Mr McGuigan - C&E
Mr Geddes - C&E

MINISTER OF STATE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Sam Toy Esq
President
The Society of Motor Manufacturers
& Traders Ltd
Forbes House
Halkin Street
LONDON SW1X 7DS

18 November 1986

Dear Mr Toy.

Thank you for your letter of 3 October commenting on the decision not to allow any relief for fuel used in motor industry research and testing. I am sorry for the delay in replying.

As I explained in my letter of 21 August to Mr Fraser, all the implications of the proposals, including the points in your letter, were taken into account before a decision not to grant relief was taken. That decision was arrived at only after a great deal of thought but it was meant to be final and I can hold out no hope of it being changed.

I did much enjoy the opportunity to visit the Motor Show. Thank you for such agreeable hospitality and interest

Yours sincerely

Peter Brooke

PETER BROOKE

Annex I

Topic (E)

E BURDENS ON BUSINESS : RECOVERY OF VAT ON IMPORTS

Background

The postponed accounting system for VAT due at importation, which operated until 31 October 1984, was available only to VAT registered traders importing goods in the course of their business. Registered importers undertook on the import entry to account for tax in the "tax due" section of the VAT return for the period in which the importation occurred. On the same return traders were normally entitled to reclaim the import VAT as input tax, subject to the usual rules. This balancing action effectively meant that traders were able to import goods without any cash outlay for import VAT. Thus the postponed accounting system had an inbuilt bias in favour of imports when compared with domestic supplies.

Under the present system VAT is either payable at the time of importation or may be deferred, under a guarantee, until the 15th day of the month following importation. Subject to the normal rules, the import VAT is deductible as input tax on a subsequent VAT return.

Under the terms of the EC Directive on Deferment of Duties and the provisions of the Customs and Excise Management Act 1979 security is required for customs duties. It would be administratively cumbersome to operate a separate, unsecured, system for VAT deferment in tandem with the cumbersome to operate a separate, unsecured, system for VAT deferment in tandem with the customs duty deferment arrangements and there would be increased risk of delays in clearance and to the revenue. Where banks provide cover they tend to reduce overdraft facilities by corresponding amounts but cover may be provided by approved insurance companies. Rates charged for guarantee cover vary widely (eg from around 1/4% to around 3%).

SMMT Representation

The SMMT are complaining of increased administration resulting from the present arrangement for recovering input tax and of excessively laborious accounting requirements.

Line to take

Accounting requirements for claiming deduction of import VAT are now no more than those for claiming input tax on purchases from UK suppliers. Traders must hold prescribed evidence of tax due when they reclaim it. In case of imports, evidence consists of officially certified documentation issued when VAT is paid or deferred. Documentation is normally issued to importers' freight agents for forwarding to importers. Customs are currently investigating procedures for issuing certificates of VAT paid directly to importers.

DEFENSIVE (if guarantee requirement also raised)

Cost of guarantees is recognised as additional burden on importers but deferment provides significant cash-flow benefit when compared with immediate payment. Traders are free to "shop around" amongst banks and other financial institutions for guarantee cover at competitive rates.

Annex I
Topic (F)

F VAT RECLAMATIONS ON VEHICLES PURCHASED FOR RESEARCH AND DEVELOPMENT

SMMT Case

The SMMT consider that companies other than the manufacturer should be able to reclaim VAT on vehicles bought purely for research and development.

Background

Under the VAT (Cars) Order 1980, tax charged on the supply or importation of a car cannot be claimed as input tax subject to certain specific exceptions - eg cars produced and used by a UK manufacturer solely for research and development purposes.

Line to take

Customs are prepared to consider whether there are grounds for widening this particular relief, and will be writing to SMMT to obtain more details of its view.

[NOT FOR DISCUSSION WITH THE SMMT

A complaint has been lodged with the European Commission that UK law in respect of cars used for research and development discriminates against imported cars from other member states. We have had an exploratory meeting with the Commission to explain the provisions in UK law and the reasoning behind them. The Commission's view is that all cars used solely for R & D purposes should in principle be eligible for input tax deduction wherever they are produced. Their reasoning is that since R & D is by definition a business purpose, there is a prima facie entitlement to deduction of input tax in all cases. It will be very difficult for the UK not to bring UK law into line iwth Article 95 of the Treaty of Rome, which states

"No Member State shall impose, directly or indirectly, on the products of other Member States any internal taxation of any kind in excess of that imposed directly or indirectly on similar domestic products."

Annex I
Topic (G)

G VAT PENALTY PROVISIONS

(a) Mitigation of penalties

SMMT case

The SMMT believe that some form of mitigation should be made available with the introduction of the new VAT penalty rules.

Background

The Keith Committee recommended that the scope for administrative discretion should be reduced to a minimum so that it is only available where required for strictly practical reasons. It further recommended that as a general rule particular consequences should follow particular acts. Moreover, if everyone is treated alike the grounds for complaint are minimised. It was with these reasons in mind that automatic civil penalties were introduced.

Line to take

Acceptance of principle of mitigation would strike at heart of Keith philosophy that penalties should be assessed on objective, not subjective, tests. From revenue standpoint would seriously impair our efforts to improve trade compliance and reduce amount of tax outstanding at any one time. Introduction of mitigation would encourage virtually everyone to try their luck first with Customs and then VAT Tribunal with very little to lose. Would have significant effect on resources both in Customs and in Lord Chancellor's Department.

(b) New penalty rules

SMMT Case

The SMMT believe that the new VAT penalty rules will substantially increase the compliance burden on companies. They particularly feel that the Serious Misdeclaration Penalty is not neutral between various types of company and that it should be based on a percentage of inputs, if the default is on inputs; or on a percentage of outputs, if the default is on outputs. They would also like to see a maximum penalty of £15000.

Line to take

Allegation that new penalty rules will substantially increase compliance burden on companies is misleading. Traders are already required to furnish accurate returns. Serious misdeclaration penalty is intended to improve accuracy and will affect only those businesses who continue to make substantial errors. For vast majority of traders error has to be 30% or greater.

Maximum penalty of £15,000 would benefit large traders only. To incur penalty of this size trader would have to make error of £50,000 in single period. So, unlikely that small and medium sized businesses would benefit from maximum level of penalty.

Concept of penalty directly related to true tax liability for an accounting period was recommended by Keith. Morever, simple ground rules coupled with automatic application through obejctive tests leaves no room for administrative discretion and everyone knosw where they stand. Whether or not any particular trader or section of trade has more input tax to claim than another is irrelevant, to majority of businesses, because if basic return is accurate, no penalty will ensue.

To require a penalty to be calculated as percentage of input or output tax for a particular accounting period would, of itself, seriously complicate procedures both on and off computer. Changes would be premature when we have no practical experience of how the provisions will work; and, it is intended to review the system after 2 years operational experience.

ANNEX II

ECONOMIC SECRETARY'S MEETING WITH THE SOCIETY OF MOTOR MANUFACTURERS AND TRADERS - TUESDAY 2 FEBRUARY 1988

ADMINISTRATIVE BURDEN IMPOSED BY INLAND REVENUE "INSPECTIONS"

POINT AT ISSUE

SMMT complain that Inland Revenue "Inspections" create an unwelcome administrative burden in the degree of detail they require.

(We assume that the SMMT refer to accounts investigations.)

LINE TO TAKE

- More than 90% of accounts of unincorporated businesses (including the self employed) and 80% of the accounts of small companies are accepted without any challenge whatsoever. Indeed, in 1986/87 only 1.1% of the relevant company accounts and 2.2% of non-company accounts were investigated in depth.

- Where points are taken up or investigations made the procedures are designed to ensure that enquiries are kept to a minimum and if a case proves not to be worth pursuit, it is closed down as quickly as possible. The Revenue must, however, be able to obtain sufficient information to be able to reach a judgement on the correctness of accounts, and this will in certain cases mean going into some detail.

BACKGROUND

If SMMT see the Revenue's conduct as constituting harrassment, they are not supported by the findings of two recent independent examinations of complaints:

- First the Ombudsman. There have only been three complaints in recent years (out of a total of 40 or 50 a year) alleging harassment of small businesses or self-employed. In each of these cases the Ombudsman found that there had been mistakes in handling the case both by the Revenue and by the taxpayer but that the Revenue mishandling by no means amounted to harassment;

- Second the Keith Committee on the enforcement powers of the Revenue departments. They too found mistakes on both sides in the cases they looked into but nothing more. They concluded "in our opinion neither the powers nor the manner of their exercise are unduly harsh". They recommended that the Revenue should tell taxpayers much more clearly about their approach to enforcement and this has been done. Within the past year, the Revenue has issued two leaflets (IR 71 & IR 72) explaining what is involved in accounts investigations and PAYE audits.

ECONOMIC SECRETARY'S MEETING WITH THE SOCIETY OF MOTOR MANUFACTURERS AND TRADERS - TUESDAY 2 FEBRUARY 1988

GROUP RELIEF FOR CAPITAL LOSSES (PARAGRAPHS 9 AND 10 OF TECHNICAL REPRESENTATIONS)

POINT AT ISSUE

Introduce group relief for capital losses, so that capital losses made by one member of a company group can be claimed against gains made by another member of a group.

LINE TO TAKE

Recognise case in principle. Groups can and do - at slight inconvenience - get round the absence of group relief for capital losses. Legislation would be long and complex - usual problems of finding Finance Bill space - and anyway seems sensible to wait till we have Court decisions on three loss-buying cases and are clearer on details of proposed EC Directive on mergers and demergers: otherwise legislation might need to be substantially revised in a couple of years' time.

BACKGROUND

Equivalent group relief is available for income losses and there is a case in principle for similar relief for capital losses. But there is no evidence that the absence of such relief is causing significant problems: groups get round it by transferring assets (tax-free) between members of the group so that gains and losses are made by the same company and can be set against each other. There are some costs and inconvenience involved, but they are small.

Legislation for group relief for capital losses would be complex probably 20 pages or more and would be inappropriate at the present time for two reasons:-

(i) the technical details would be affected by the terms of Court decisions on three cases on capital-loss-buying which the House of Lords are due to hear this year, and

(ii) the detail will also be affected by the terms of a proposed European Community Directive on the tax treatment of mergers and demergers. This Directive is part of the Internal Market initiative and could well be agreed in the next 2 or 3 years.

It would not be sensible to prepare complex and long legislation now only to have to revise it all in 2 or 3 years' time in the light of the Lords' decision and European Community development.

ECONOMIC SECRETARY'S MEETING WITH THE SOCIETY OF MOTOR MANUFACTURERS AND TRADERS - TUESDAY, 2ND FEBRUARY 1988

COMPANY CAR AND CAR FUEL BENEFITS

POINTS AT ISSUE

(a) No increase in the car benefits scale charges. Last year's increase was in excess of the expected rise in RPI and this not consistent with the available evidence on private use of company cars.

(b) The fuel benefit scale charges are excessive in comparison with the estimated value of fuel used by the average company car user on private journeys and should not be increased.

LINE TO TAKE

(a) The car scale charges are still well short of the true measure of the benefit. Tax at basic rate on the current scale for a 1600cc car is only £189 (27 per cent of £700) and the scale charge is halved when business use reaches 18,000 miles a year. For 88/89 tax at the same basic rate on the same size car would be £208 (27 per cent of £770). Evidence suggests that the provision of company cars as a benefit is still increasing.

(b) The fuel scale charges are at a more realistic level. SMMT's views are noted and the Government will be keeping the level of the fuel scale charges under review.

BACKGROUND

1. The benefit to a director or "higher paid" employee of a company car available for private use is taxed by reference to standard scale charges depending on the size or value of the car, its age and the amount of business use. There is a separate scale charge for fuel provided for private motoring. The practice has been to adjust these scales annually and to announce any changes a year in advance.

2. It is generally recognized that the car benefit scale charges bear little relation to the true value of the private use element in company cars and the Government's aim has been gradually to increase the charges to more realistic levels. Increases in the last 4 years have averaged 10 per cent a year. There is little evidence to suggest that the level of the scale charges acts as a disincentive to the provision of company cars or that there is yet much pressure to allow claims based on actual private mileage.

3. No increase was made in the fuel scale charge for 1988/89. From 1987/88 the car fuel scale has been used to assess VAT due on fuel provided out of business resources for private motoring by registered traders and their employees. Customs and Excise have received considerable criticism from small traders that the private mileage assumed in the scale charges often exceeds actual private mileage and sometimes total mileage. Although nothing can be said to SMMT you will be aware that the possibility of a decrease in the fuel scale charges is being considered - though retention of the fuel scale charges at the present level remains a strong option.

ESTs MEETING WITH SOCIETY OF MOTOR MANUFACTURERS AND TRADERS 2 FEBRUARY 1988

CAPITAL ALLOWANCES FOR MOTOR CARS COSTING IN EXCESS OF £8,000

What SMMT wants

1. Cars costing over £8000 when new are subject to a restriction limiting the amount of annual writing down allowance that can be given in any one year to a maximum of £2000. This restriction to be abolished.

If 1. not conceded:

2(a). Raise cost limit;

and

2(b). abolish restriction on lease rentals;

Line to take

2. Proposals noted. £8,000 limit among those financial limits kept under annual review.

Background

3. Capital allowances are allowances given in substitution for depreciation charged in business accounts. Their purpose is to take account of capital consumed in a business by way of the depreciation of assets used in the earning of business profits. Allowances for plant and machinery are given at the rate of 25 per cent of the reducing balance. But there are special rules for ordinary cars used for business purposes.

4. For business cars costing over £8,000 (other than used for short term hire) the 25 per cent annual writing down allowances are restricted to a maximum of £2,000. Ceiling was fixed at present figure in 1979. Such cars are excluded from short-life asset treatment (Sch 15 FA 1985) but balancing allowance arising on a disposal is not restricted.

5. So that this restriction cannot be circumvented by leasing of business cars, allowable lease rentals for cars costing over £8,000 are also restricted.

The "lost" rental deductions cannot be recovered whereas the capital allowances are brought into line with actual depreciation by way of a balancing adjustment when the car is disposed of.

There is a concession in this area: if there is a rebate of rentals received by the lessee at the end of the lease, part only (calculated by reference to the same formula that led to a disallowance during the life of the lease) is taxed.

6. Abolition/uplift hardy annual in Budget representations; considered by Ministers as a starter for FB 1985 and 1986; not on 1987 or 1988 lists.

7. Inflation has whittled ceiling away (equivalent at April 1987 if RPI followed £15,000); abolition would reduce record keeping by businesses and save Revenue a handful of staff; a page or so of legislation would disappear; as would present double restriction on leased cars (lessors capital allowances <u>and</u> lessees rents restricted).

8. Cost of abolition estimated as 1988/89 neg; 1989/90 £m50 rising to 1991/92 £m110 before declining. The cost of an increase in the limit to £15,000 would be only marginally lower, possible £m90 by 1991/92. In 1987, out of some 1 million business cars bought estimated that some 6-700,000 were within £8,000 limit ie unaffected by restriction.

9. Present ceiling could be increased by statutory instrument but a substantial increase would produce much of the cost without securing all the advantages.

10. In a case of <u>blatant</u> incongruity between the type of car and the business use to which it is put, (also because of the absence of any limit on a balancing allowance when a car costing over £8,000 is sold) an Inspector of Taxes would in any event be expected to seek to restrict allowances on the grounds of personal choice in accordance with the 1965 decision of the Courts (G H Chambers (Northiam Farms) Ltd v Watmough (36TC711)).

CAPITAL ALLOWANCES: REINTRODUCE FIRST YEAR ALLOWANCES ETC

Points made by SMMT

1. Phasing out of first year allowances over period to 31 March 1986 affects small firms particularly and restricts investment.

2. Average life of commercial vehicles is six or seven years. They are not then fully depreciated for tax purposes. System works against replacement on safety/environmental grounds.

What the SMMT wants

3. Reintroduction of 100 per cent first year allowances.

4. As alternative,25 per cent allowances on straight line basis (4 year write-off) instead of reducing balance.

5. If not possible to introduce above measures generally, apply them to commercial vehicle industry to help competitiveness.

Line to take

6. SMMT proposals run counter to purpose of 1984 reform of business taxation i.e. to move away (with a transitional period) from system of over-generous and out-dated reliefs which distorted investment decisions, in favour of lower rates of tax and depreciation allowances more closely linked to useful asset life.

7. Little evidence that such incentives strengthened economy or improved quality of investment. Indeed, business investment here yielded lower rate of return than principal overseas competitors'.

8. Rates of writing down allowance reckoned to be reasonable averages when compared with strict system of commercial depreciation. At end of 7 years, relief amounts to 87 per cent of cost.

9. 1984 changes included significant reductions in Corporation Tax rates. Main rate from 52% to 35% in 1986, small companies' rate from 38% to 30% immediately (now 27%). National Insurance Surcharge abolished. When changes have fully worked through, companies expected to enjoy substantial reductions in tax they pay.

10. If confined to companies operating commercial vehicles, effect would be highly discriminatory. Not possible to contemplate special rates of writing down allowance for specific assets or industries.

11. Depooling provisions of 1985 Finance Act were aimed at short-life assets generally. On facts stated, general run of heavy commercial vehicles not within that category although operator who expects to sell a vehicle within up to about 5 years for less than tax written down value can elect to depool.

BACKGROUND

1984 Business Tax Reforms

12. Under programme of business tax reform commenced in 1984, first year allowances for plant and machinery and initial allowances for industrial buildings phased out over period to 31 March 1986 in favour of more neutral system based on lower corporation tax rates coupled with annual writing down allowances at rates more closely linked to commercial depreciation.

13. In general, rates of allowances applicable for expenditure incurred on or after 1 April 1986 are:-

Plant and machinery 25 per cent per annum (reducing balance basis)

Industrial buildings 4 per cent per annum (straight line).

14. Writing down allowances at rate of 25 per cent of the reducing balance will still provide for relief on nearly 60 per cent of the cost of an item of machinery and plant over the first 3 years of ownership.

15. At the end of 6 years, relief will amount to 82 per cent of cost and at the end of 7 years, 87 per cent of cost.

16. A further refinement of the system was introduced in 1985 which allows a taxpayer to elect to have these allowances calculated separately from the general pool. The new arrangement, which applies to expenditure incurred on or after 1 April 1986, is designed to meet the needs of short life assets. Separate calculation allows a balancing adjustment to be made on a disposal so as to adjust the depreciation allowed for tax purposes to the depreciation actually suffered. If the machinery or plant has not been sold within a period of up to about 5 years from acquisition it is thereafter dealt with as if it had never been depooled.

Why the SMMT Proposals are unacceptable

17. Reintroducing first year allowances goes against business tax reforms. Four year write-off period with allowances at 25 per cent straight line clearly greatly in excess of commercial depreciation and also incompatible with pooling system. Would also run counter to underlying purpose of 1984 reforms.

18. Any write-off period confined to specific assets or industries - implicit in the SMMT's bottom line proposal of relief for commercial vehicles - would also be incompatible with present capital allowances code.

19. In any event, allowances at 25 per cent reducing balance rate already meet the needs of the situation. If heavy commercial vehicles are sold after 7 years use, only 13 per cent of original cost will remain unrelieved for tax purposes at that stage.

RESEARCH AND DEVELOPMENT INCENTIVES

What SMMT wants

1. SMMT say industry would welcome any measure which might aid investment in R&D. Report of Trade and Industry Select Committee into UK components industry quoted as having recommended more favourable tax treatment of capital spending on research and development.

Line to take

2. Government response to Select Committee on Trade and Industry Report on UK Motor Components Industry not yet available although expected to be published shortly. But important to bear in mind that R&D expenditure already favourably treated for tax purposes. Current expenditure R&D is allowable as it is incurred, while capital expenditure on trade related scientific research also qualifies for the special 100 per cent scientific research allowance (SRA).

3. In carrying through 1984 programme of business tax reform, Government decided to retain 100 per cent SRA even though general thrust of policy has been to phase out special incentive allowances in favour if more neutral system based on lower rates of tax and allowances for depreciation at rates more closely linked to economic reality.

4. Joint Inland Revenue/Treasury international study published in 1987 shows that special tax incentives for R&D are not cost effective.

5. Government's view is that individual companies best placed to decide on commercial merits what they wish to spend on R&D and that they are now well placed to increase R&D spending out of their own resources.

6. New framework of Government support for industry as set out in White Paper 'DTI - The Department for Enterprise'.

BACKGROUND

SELECT COMMITTEE ON TRADE AND INDUSTRY: REPORT ON UK MOTOR COMPONENTS INDUSTRY

7. What the Committee recommended:

Recommendation 11: We urge the Government to consider modifying the 1984 Finance Act so as to allow 100 per cent tax allowances against Research and Development in the first twelve months of research on any project (paragraph 62).

8. The Government Response: (NOT YET PUBLISHED BUT TO GO BEFORE THE SELECT COMMITTEE SHORTLY).

"The Government do not believe that any change is needed to the existing law. The tax treatment of R&D in the UK is already favourable. Current expenditure on R&D can be set off against income for tax purposes and capital expenditure on trade-related research can benefit from the 100 per cent Scientific Research Allowance (whereas 100 per cent first year capital allowances generally have been withdrawn). The Government monitor tax arrangements for R&D in other countries and in July 1987 Inland Revenue and HM Treasury completed and published a study of fiscal incentives for R&D in ten developed countries. As the Government response to the House of Lords Select Committee report on Civil Research and Development pointed out, the balance of evidence is that the cost-effectiveness of fiscal measures to encourage R&D is low. The Government are concerned that industry generally should increase its R&D expenditure, particularly in high technology, high added-value areas and believe that, with the current level of economic activity and improved company profitability, it is now in a strong position to do so."

9. The Inland Revenue/HM Treasury International Survey covered arrangements in 10 major OECD countries and reviewed economic literature on the effectiveness of the incentives offered. The countries studied were selected to represent the UK's main international competitors and to include countries with special fiscal incentives; it does not in general cover grants. When the report was published, the Financial Secretary commented "Now that industry is making record profits and the Government's policies have ensured stable, non-inflationary growth, the prime need is for industry to make its own investment in the future by spending more on R&D. The figures show that this is a distinguishing feature of the most successful economies."

10. A major conclusion of the survey was that the best evidence available - admittedly uncertain - indicated that special tax incentives for R&D are not cost effective. The results of the survey formed the basis of the Government's response to the House of Lord's Select Committee's recommendation that the Government should examine tax incentives in other countries (Cm185, paragraph 27).

11. Substantial tax relief is available for R&D expenditure. There are 100 per cent first year scientific research allowances for plant, buildings and other capital expenditure; allowances for capital spending on development plant and buildings; and most current

spending on R&D will be allowable as a deduction in calculating profits.

12. In addition, the Business Expansion Scheme has been expanded to assist companies engaged in R&D to raise equity finance.

13. DTI White Paper "DTI - the department for Enterprise" published January 1988 proposes new policies on innovation, concentrating on technology transfer, collaborative research and aid to technologically advanced projects in small companies/ of great national benefit.