PO-CH/NL/0485
PART A

PO CH/NL/0485
PART A.

PO CH/NL/0485
PART A

1989 BUDGET
INCOME TAX OPTIONS

INCOME 12

TAX 485

OPTIONS

CONFIDENTIAL

Inland Revenue

The Board Room
Somerset House
London WC2R 1LB

Note @ end
N..

FROM: T J PAINTER
30 NOVEMBER 1988

1. MR BATTISHILL 30/11

You may care to be aware of this, since it gives inter alia the first, provisional, indication of the possibilities on the resource front.

2. CHANCELLOR OF THE EXCHEQUER

STARTER 100:
INCOME TAX: ALLOWANCES, BASIC RATE LIMIT AND RATES

The first of the attached papers by Mr Mace is no more than an early attempt at provisional scene-setting for your later

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cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Riley
Miss Hay
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Jenkins (OPC)

Chairman
Mr Isaac
Mr Painter
Mr Beighton
Mr Lewis
Mr Calder
Mr Bush
Mr Mace
Mr Hodgson
Mr R R Martin
Mr Keelty
Mr J C Jones
Mr O'Brien
Mr Boyce
Mr Eason
Mr Glassberg
Mr Oakley
Miss White
Miss Dyall

PS/IR

decisions on rates and thresholds. But it may also provide some relevant reference points for the consideration of specific proposals which would give rise to gainers or losers - for example changes in the car benefit scales.

2. More generally, bare indexation would be one, obvious, reference point if the fiscal outlook were tight. On present figuring it would mean:

- that the married and single allowances were lower as a proportion of earnings than in both 1988/89 and 1978/79;

- average rates of tax would rise marginally compared with 1988/89;

- an increase of some 200,000 in the number of taxpayers compared with 1988/89; and

- an increased staff requirement (of some 30 in a full year).

3. The second paper looks at options if you wanted to act on the age allowance. It would be helpful to know if you would like further work done on any of them.

T J PAINTER

Most grateful to
Mr Mace: these are
v. helpful. Of the various
allowance options (over & above
straight indexation) I am interested
only in (a) an age allowance
withdrawal rate of £1 for £2 (but without
enhancement of the age income limit)
(b) double indexation of the over-80 age
allowance. As for the basic rate, this is
something to be considered later. As to
further work, I should be grateful
for Annexes C & D on the basis of
fractions/multiples of 1978-79
average earnings, price
revaluation for 1988-89
& 1989-90 respectively.
N.

INCOME TAX
STARTER 100

CONFIDENTIAL

Inland Revenue

Personal Tax Division
Somerset House

FROM: B A MACE

DATE: 30 NOVEMBER 1988

1. MR PAINTER 30.11
2. CHANCELLOR OF THE EXCHEQUER

STARTER 100: INCOME TAX ALLOWANCES, BASIC RATE LIMIT AND INCOME TAX RATES

1. With the Autumn Statement completed you may like to have the attached notes which aim to set the scene for decisions early next year on income tax thresholds and rates for 1989-90. The first note reviews where we now stand on the main comparison points for income tax - average rates, marginal rates, take-home pay, the real level of thresholds - and looks briefly at how these might be affected in 1989-90 under certain assumptions. The second note looks at some possible options for specific changes to age allowance.

2. The analysis throughout is consistent with the Autumn Statement and makes use of latest forecasts and assumptions for the growth in earnings and other factors. Costs have been obtained from the personal tax model and are based on

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projections from the 1985-86 Survey of Personal Incomes (SPI). We shall shortly be updating the model to take on board the 1986-87 SPI and analyses using this base will therefore be available for any subsequent work. For the time being estimates of staffing effects are on the basis of the existing (pre-Independent Taxation) system. We are considering how best to handle the interaction with Independent Taxtion in measuring the staffing consequences of Budget changes in 1989. At this early stage, of course, all the figures are provisional.

3. We should be grateful to know whether there is any further work you would like us to undertake at present. In particular

   i. is there any further information or analysis you need on the main income tax rates and thresholds?

   ii. are you attracted by any of the options for changes to age allowance discussed in the second note?

B. A. Mace

B A MACE

CONFIDENTIAL

3 questions –
see paras 5, 14 & 19
N.

FROM: B A MACE
DATE: 30 NOVEMBER 1988

CHANCELLOR

INCOME TAX: MAIN STRUCTURE

1. This note reviews the background to decisions on the main income tax thresholds and rates for 1989-90.

Changes since 1983-84

2. Since 1983-84 you have

- increased the basic personal allowances by some 16 per cent in real terms;

- reduced the basic rate by 5 percentage points from 30 per cent to 25 per cent (the target set by your predecessor in 1979) and set a new target of 20 per cent;

- replaced the previous structure of 5 higher rates between 40 and 60 per cent by a single rate of 40 per cent;

- increased the basic rate limit by just under 5 per cent in real terms;

- abolished the investment income surcharge;

- abolished the minor personal allowances.

Annex A sets out the measures you have introduced in each of your Budgets and their cost on top of indexation in the first year.

Prospects for 1989-90

3. On the basis of the Autumn Statement forecast, income tax allowances and thresholds would rise under indexation in

1989-90 by 6 1/4 per cent. This would cost £1,370 million in 1989-90 and £1,745 million in 1990-91 (but this cost is, of course, included in the baseline for the forecast for 1989-90). For basic rate taxpayers the indexation increases are worth £1.25 per week to a married man and 82p per week to single people. Details of the allowance and threshold levels in 1989-90 under indexation are shown in Annex B. Firm figures for the indexation levels of allowances will not be available until mid-January when the December RPI is published.

4. The following paragraphs look very briefly at some important comparison points for income tax in 1988-89 and examine how they would change in 1989-90 under indexation. For illustration, we have also looked quickly at the effects of a 1p reduction in the basic rate in 1989-90 (on top of indexation) and compared this with the effect of an across the board increase in allowances (but not the basic rate limit) of 6 3/4 per cent on top of indexation. These alternatives would have the same cost in a full year (just over £1 1/2 billion). The costs in 1989-90 and 1990-91 (on top of indexation) are shown in the table below. The analysis throughout excludes any consequential effects on capital gains tax. These are likely to be very small (unless you were to make a large increase in the basic rate limit or a large cut in tax rates).

Cost (at 1989-90 income levels)

£ million

	1989-90	1990-91
1p off basic rate*	1400	1725
6 3/4% on allowances	1250	1590

* Including the consequential effect on receipts of ACT.

5. 1p off the basic rate is worth amounts ranging up to £4 per week to taxpayers, with the largest gain (both in cash terms and as a percentage of gross income) going to those at the top of the basic rate band. A 6 3/4 per cent increase in allowances on top of indexation (slightly more than double indexation in total) is worth £1.35 per week to all married men liable at the basic rate and 87p per week to all single basic rate taxpayers. The largest percentage gain goes to those taxpayers with the smallest incomes. The increase in allowances gives more than the reduction in the basic rate to married men on taxable incomes up to about £11,355 per annum (£220 per week - 80 per cent at average earnings) and to single people on incomes up to £7,275 per annum (£140 per week - 50 per cent of average earnings)). Just over half of all taxpayers would be better off with the allowance increase.

But what proportion of those are on income support?

Average rates

a. Income Tax

6. Annex C gives figures for average rates of income tax at various multiples of average earnings and for various family types. Briefly the picture is that in 1988-89 average rates of income tax are lower than in 1978-79 at all multiples of average earnings (except for those with children below about 1/2 average earnings). With bare indexation in 1989-90 average rates would rise slightly for everyone compared with 1988-89 (but the comparisons with 1978-79 would not be significantly affected). This is because the indexation increase in thresholds (6 1/4 per cent) is smaller than the forecast increase in earnings for 1989-90 (7 1/2 per cent on the basis, as usual, of the assumption given to the Government Actuary's Department for the 1989-90 NIC re-rating). On the present forecast of earnings, increasing thresholds by at least 7 1/2 per cent on 1988-89 levels (1 1/4 per cent more than indexation) would avoid the increase in average rates. Reducing the basic rate by 1 percentage point on top of indexation would also eliminate the increase (except for a few taxpayers in the

short band of income just above the starting point for income tax).

b. Income Tax and NIC

7. Annex D gives similar figures for average rates of income tax and NIC combined. In 1988-89 average rates are lower than in 1978-79 for single people and married couples at or above 3/4 average earnings, and for couples with children at or above average earnings. (Compared with the indexed 1978-79 tax regime average rates of tax and NIC are lower for everyone in 1988-89). As for income tax alone, bare indexation of thresholds in 1989-90 would mean an increase in the average rate of tax and NIC for 1989-90 for everyone compared with 1988-89 (though, again, the comparison with 1978-79 would not alter much). For those below about three quarters of average earnings a $6^{3}/4$ per cent increase in allowances on top of indexation in 1989-90 would improve the comparison with 1978-79 by more than the effect of 1 percentage point off the basic rate. But the strong growth in earnings, in particular over the last two years, means that, even with these reductions, we would still be some way short of reducing average rates of tax and NIC below 1978-79 levels.

Marginal rates

8. Compared with the indexed 1978-79 tax regime, marginal rates of income tax are lower in 1988-89 at all multiples of average earnings (except for a small band of income just above the tax threshold, corresponding to the reduced rate income tax band in 1978-79, where the marginal rate is unchanged at 25 per cent). Similarly marginal rates of tax and NIC combined are lower at all levels in 1988-89 (except for a band of income just above the tax threshold (where the combined marginal rate is now $^{1}/2$ percentage point higher); and in a short band of earnings just below the UEL (where the marginal rate is 1 point higher for a few people not

contracted-out of NICs)). A 1p reduction in the basic rate would eliminate these increased marginal rates altogether; $6^{3}/_{4}$ per cent on allowances on top of indexation would narrow the range of income over which the increase at the lower end applies.

Real take-home pay

9. The strong growth in earnings means that real take home pay in 1988-89 is up substantially at all multiples of average earnings compared with 1978-79. For all family types the increase is at least 21 per cent at half average earnings and more for those with higher earnings. For 1989-90 the increase at half average earnings would be at least 24 per cent under indexation, 25 per cent with a one point cut in the basic rate (on top of indexation), and 26 per cent with a $6^{3}/_{4}$ per cent increase in allowances (on top of indexation).

Thresholds and taxpayer numbers

10. Annex E shows how the basic single and married allowances have changed since 1978-79 compared with prices and earnings. It also shows the total number of taxpayers in each year (counting husband and wife as one).

Allowances

11. Compared with prices the married man's allowance is at its highest level since the War and the single person's allowance at its highest level since 1973-74. As a percentage of male average earnings, however, allowances fell in 1988-89 compared with 1987-88. (In money terms they rose by about $7^{1}/_{2}$ per cent while earnings are assumed to rise by about $8^{3}/_{4}$ per cent.) Compared with earnings, allowances are now below their 1978-79 levels and substantially below the peak which was reached under the present Government in 1985-86. As Annex E shows the position would worsen under indexation in 1989-90. On the present forecast of earnings, an increase of $7^{1}/_{2}$ per cent

in allowances (in total) would be needed to ensure that they do not slip back compared with 1988-89. A $6^{3}/4$ per cent increase in allowances on top of indexation would take allowances back above their 1978-79 levels as a percentage of earnings. An increase of around $16^{1}/2$ per cent (about 10 per cent on top of indexation) would be needed to get back to the best (1985-86) level under the present Government. (But this would cost about £1,800 million in 1989-90 on top of indexation.)

Taxpayer numbers and Revenue staffing

12. Between 1978-79 and 1985-86 the total number of taxpayers fell from around $21^{1}/2$ million to around $20^{1}/4$ million. Since 1985-86, however, the growth in employment, and demographic changes, combined with the fall in allowances as a proportion of earnings have led to an increase in the number of taxpayers and hence in the staff needed in local tax offices. In 1988-89 there are around 700,000 more taxpayers than in 1985-86. Under indexation the total number of taxpayers in 1989-90 would rise by a further 200,000 or so, compared with 1988-89, to over 21 million. After adjusting for the growth in employment, which is handled separately in PES, this would mean that the overall staffing requirement would rise by around 30 in a full year. An increase in thresholds in line with earnings ($7^{1}/2$ per cent on 1988-89 levels) would be needed to keep staff numbers broadly constant.

13. Compared with indexation an additional $6^{3}/4$ per cent increase in allowances would reduce the total number of taxpayers by just under 400,000 and cut the staffing requirement in a full year by about 125 units. If allowances were restored to their 1985-86 levels as a proportion of earnings (a 10 per cent increase on top of indexation) the total number of taxpayers would fall to around $20^{1}/2$ million, about 600,000 fewer than under indexation, and the staffing requirement would fall by around 190 units in a full year compared with indexation.

Poverty and Unemployment Trap

14. A basic rate reduction and an increase in allowance both reduce the numbers in the poverty and unemployment traps by floating some people off income-related benefits altogether. In neither case is the effect very large, but an allowance increase has the greater impact (because it gives bigger cash gains to those at the lower end of the income distribution).

What are the actual figs (for 1p & equiv on allowances)?

Higher Rate Taxpayers

15. Annex F gives figures for the starting point for higher rate tax for a married man compared with both prices and earnings for each year since 1973-74. (Corresponding figures for the single person would be similar.) The Annex also sets out figures for the total number of higher rate taxpayers (counting husband and wife as one).

16. Compared with prices the starting point for higher rate tax is now some 15 per cent higher than in 1978-79. But compared with earnings it is about 10 per cent lower. This means that for a married man with no reliefs other than the basic personal allowance, higher rate liability is reached at around $1^3/4$ times average earnings ($1^2/3$ times average earnings for a single person). The latest estimates show that in 1988-89 the total number of higher rate taxpayers (at just over 1.3 million) is about 100,000 short of the peak reached in 1976-77. Under indexation in 1989-90 the total number of higher rate taxpayers would rise to around 1.4 million, just below the 1976-77 peak.

17. The tax affairs of higher rate taxpayers are generally more complicated than those of other taxpayers and hence often require more time (and sometimes a higher grade of staff) in local tax offices to deal with them. A $6^3/4$ per cent increase in the basic rate limit on top of indexation in 1989-90 would reduce the number of higher rate taxpayers by 160 thousand in 1989-90 and the staff requirement by

about 75 in a full year (at a cost of about £160 million in 1989-90 and about £245 million in 1990-91).

18. The number of higher rate taxpayers will, of course fall substantially when Independent Taxation is introduced in 1990-91. With indexation in 1989-90 and 1990-91 we estimate that the total number of higher rate taxpayers in 1990-91 would be around 1 million (counting husband and wife separately of course). The staff saving from this reduction is however, already taken into account in our estimates of the net staff cost of Independent Taxation for 1990-91 and subsequent years.

Implications for Independent Taxation

19. There are no particular changes you need to make in 1989-90 in anticipation of the introduction of Independent Taxation from 1990-91. In general allowance increases in 1989-90 would slightly increase the cost of Independent Taxation while a basic rate reduction would slightly reduce it.

I take it the 1990-91 costs given 2 options take this effect into a/c?

Further Work

20. Is there any further information or analysis you need at present on the main income tax rates and thresholds?

BAM

B A MACE

ANNEX A

INCOME TAX ALLOWANCES, THRESHOLDS AND RATES
BUDGET CHANGES 1984-85 TO 1988-89.

Year	Changes	Cost in first year over indexation £ billion
1984-85	Basic allowances increased by $12^1/2$% (compared with 5.3% indexation). Age allowance indexed. Investment income surcharge abolished.	0.9
1985-86	Basic allowances double indexed (2x4.6 per cent). Same cash increase in age allowances. Basic rate limit and higher rate thresholds indexed.	0.7
1986-87	Main allowances indexed (5.7%) Basic rate cut from 30p to 29p, Higher rate thresholds not fully indexed.	0.8
1987-88	Main allowances indexed (3.7%). Basic rate cut from 29p to 27p. Blind allowance doubled. Higher rate thresholds not fully indexed. Higher age allowances for 80 and over.	1.9
1988-89	Main allowances and basic rate limit double indexed (2x3.7%). Basic rate cut from 27p to 25p. Higher rates cut to 40p. Minor personal allowances abolished.	3.9
	(Independent Taxation to start in 1990-91).	(0.5)

ANNEX B

INCOME TAX: ALLOWANCES, THRESHOLDS AND RATES

	1988-89	1989-90* (Indexation)	
Allowances	£	£	
Single person	2,605	2,775	(170)
Married Man	4,095	4,355	(260)
Additional Personal/ Widow's Bereavement	1,490	1,580	(90)
Age - Single person (Age 65-79)	3,180	3,380	(200)
Age - Married (Age 65-79)	5,035	5,355	(320)
Age - Single person (Age 80 and over)	3,310	3,520	(210)
Age - Married (Age 80 and over)	5,205	5,535	(330)
Age - Income Limit	10,600	11,300	(700)
Tax rate bands			
25%	0 - 19,300	0 - 20,600	(1,300)
40%	Over 19,300	Over 20,600	

* Assuming indexation of $6^{1}/4$ per cent in line with the forecast in the Autumn Statement. Figures in brackets show increase over 1988-89.

ANNEX C

PERCENTAGE OF EARNINGS PAID IN INCOME TAX

Multiples of average male earnings (1)	1/2	3/4	1	1 1/2	2	3	4	5
Single								
1978-79	17.0	22.4	25.0	27.7	29.5	37.0	44.4	50.5
1988-89 (Actual)	15.1	18.4	20.1	21.7	25.1	30.1	32.6	34.0
1988-89 (1978-79 indexed)	20.3	24.6	26.7	28.9	33.1	42.9	50.6	56.9
1989-90 (3)								
A	15.2	18.5	20.1	21.7	25.2	30.1	32.6	34.1
B	14.6	17.7	19.3	20.9	24.5	29.7	32.2	33.8
C	14.6	18.1	19.8	21.5	25.0	30.0	32.5	34.0
Married with one earner and no children								
1978-79	9.5	17.3	21.3	25.2	27.2	34.7	42.4	48.8
1988-89 (Actual)	9.5	14.7	17.3	19.8	22.8	28.6	31.4	33.1
1988-89 (1978-79 indexed)	14.4	20.6	23.7	26.8	30.8	40.8	48.9	55.4
1989-90 (3)								
A	9.7	14.8	17.3	19.9	23.0	28.7	31.5	33.2
B	9.3	14.2	16.6	19.1	22.3	28.2	31.1	32.9
C	8.7	14.1	16.8	19.6	22.6	28.4	31.3	33.0
Married with one earner and 2 children (2)								
1978-79	-4.1	8.1	14.4	20.6	23.7	32.0	40.3	47.1
1988-89 (Actual)	-1.9	7.1	11.5	16.0	20.0	26.7	30.0	32.0
1988-89 (1978-79 indexed)	3.0	13.0	18.0	23.0	27.9	38.9	47.5	54.2
1989-90 (3)								
A	-0.9	7.7	12.0	16.4	20.3	26.9	30.2	32.1
B	-1.3	7.1	11.3	15.6	19.6	26.4	29.8	31.8
C	-1.9	7.0	11.5	16.0	19.9	26.6	30.0	32.0

(1) Full time adult males (all occupations)

(2) Under 11 and netting off child benefit from tax payments (to enable comparisons to be made with 1978-79 when child tax allowances still being phased out).

(3) A Indexation

B 1p off Basic Rate

C $6^{3}/_{4}$% on allowances

ANNEX D

PERCENTAGE OF EARNINGS PAID IN INCOME TAX AND NIC

Multiples of average male earnings(1)	1/2	3/4	1	1 1/2	2	3	4	5
Single								
1979-79	23.5	28.9	31.5	33.3	33.7	39.8	46.5	52.2
1988-89 (Actual)	24.1	27.4	29.1	28.9	30.5	33.7	35.3	36.2
1988-89 (1978-79 indexed)	26.8	31.1	33.2	33.3	36.4	45.1	52.3	58.2
1989-90 (3)								
A	24.2	27.5	29.1	28.9	30.6	33.7	35.3	36.2
B	23.6	26.7	28.3	28.0	29.8	33.2	34.9	35.9
C	23.6	27.1	28.8	28.7	30.3	33.5	35.2	36.1
Married with one earner and no children								
1978-79	16.0	23.8	27.8	30.8	31.4	37.5	44.5	50.5
1988-89 (Actual)	18.5	23.7	26.3	27.0	28.2	32.2	34.1	35.3
1988-89 (1978-79 indexed)	20.9	27.1	30.2	31.2	34.1	43.0	50.6	56.7
1989-90 (3)								
A	18.7	23.8	26.3	27.0	28.3	32.2	34.2	35.3
B	18.3	23.1	25.6	26.2	27.6	31.7	33.8	35.0
C	17.7	23.1	25.8	26.7	27.9	32.0	34.0	35.2
Married with one earner and 2 children (2)								
1978-79	2.5	14.6	20.9	26.2	27.9	34.8	42.4	48.8
1988-89 (Actual)	7.1	16.1	20.5	23.2	25.4	30.3	32.7	34.2
1988-89 (1978-79 indexed)	9.5	19.5	24.5	27.4	31.2	41.1	49.2	55.6
1989-90 (3)								
A	8.1	16.7	21.0	23.5	25.7	30.5	32.8	34.3
B	7.7	16.1	20.3	22.7	25.0	30.0	32.5	34.0
C	7.1	16.0	20.5	23.2	25.3	30.2	32.6	34.1

(1) Full time adult males (all occupations)

(2) Under 11 and netting off child benefit from tax payments (to enable comparisons to be made with 1978-79 when child tax allowances still being phased out).

(3) A Indexation

B 1p off Basic Rate

C 6 3/4% on allowances

ANNEX E

TAX THRESHOLDS (£ p.a.)

	Single Person			Married Man			No of Taxpayers(2)
Year	Current Prices	Constant 1988-89 prices	As % of male average earnings(1)	Current Prices	Constant 1988-89 Prices	As % of male average earnings(1)	(Million)
1978-79	985	2093	20.4	1535	3262	31.8	21.5
1979-80	1165	2137	20.5	1815	3330	31.9	21.6
1980-81	1375	2167	20.1	2145	3381	31.4	21.0
1981-82	1375	1944	18.1	2145	3033	28.3	20.8
1982-83	1565	2068	19.1	2445	3230	29.9	20.8
1983-84	1785	2254	20.1	2795	3530	31.4	20.5
1984-85	2005	2409	20.8	3155	3790	32.8	20.2
1985-86	2205	2502	21.4	3455	3921	33.5	20.2
1986-87	2335	2567	21.0	3655	4018	32.9	20.5
1987-88	2425	2564	20.3	3795	4013	31.8	21.0
1988-89	2605	2605	19.7	4095	4095	31.0	20.9
1989-90 (indexation)	2775	2623	19.5	4355	4116	30.7	21.1
1989-90 (indexation + 6 3/4%)	2955	2793	20.8	4635	4381	32.6	20.7

(1) Full time adult males (all occupations)

(2) Counting husband and wife as one.

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ANNEX F

HIGHER RATES: STARTING POINT FOR MARRIED MAN & TOTAL NUMBER OF HIGHER RATE TAXPAYERS

Year	Starting point for higher rates for married man (1)			No of higher rate taxpayers (3) 000s
	Current Prices	Constant 1988-89 Prices	As % of male average earnings (2)	
1973-74	5775	25651	256	392
1974-75	5365	20216	195	752
1975-76	5455	16497	160	1240
1976-77	6085	15962	158	1430
1977-78	7455	17156	178	1060
1978-79	9535	20264	198	763
1979-80	11815	21674	208	674
1980-81	13395	21113	196	796
1981-82	13395	18941	177	1090
1982-83	15245	20141	186	983
1983-84	17395	21966	196	860
1984-85	18555	22291	193	880
1985-86	19655	22304	190	950
1986-87	20855	22924	188	1010
1987-88	21695	22941	179	1140
1988-89	23395	23395	177	1300
1989-90 (indexation)	24955	23586	176	1400

(1) Married Man's Allowance + Basic Rate Limit

(2) Full time adult males (all occupations).

(3) Counting husband and wife as one.

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FROM: B A MACE
DATE: 30 NOVEMBER 1988

CHANCELLOR

AGE ALLOWANCE

1. Whether or not there is scope for a general reduction in income tax in 1989-90 you may like to consider whether there are any specific changes which you would like to make next year in the age allowance.

2. The 1988 Budget changes focused a good deal of attention on age allowance and in particular on the so-called "age trap" in the band of income above the aged income limit where age allowance is withdrawn. This paper looks at possible options for changes to the aged income limit and the withdrawal mechanism; and for increases in the age allowance itself.

Withdrawal of age allowance

3. There are currently two levels of age allowance, the lower level for those aged 65 to 79 and the higher level for those aged 80 and over which you introduced in the 1987 Budget. In both cases the extra allowance above the basic single person's or married man's allowance is withdrawn gradually where the taxpayer's income exceeds the aged income limit (£10,600 for 1988-89). The rate of withdrawal is £2 of allowance for every £3 of income above the limit. This means that the age allowances are fully withdrawn at an income level of around £11,500 for single people and just over £12,000 for married men. But the effect of the withdrawal mechanism is that the marginal rate over the short band of income between the aged income limit and the run-out point is $41^{2}/3$ per cent. (For each additional £3 of income the individual pays tax on that £3 plus tax on £2 of allowances withdrawn. So the marginal rate on the additional income is $\frac{5 \times 25\%}{3} = 41^{2}/3$ percent.)

About 130,000 taxpayers (counting husband wife as one) have incomes in the withdrawal band.

4. For 1988-89, therefore, the marginal rate of tax in the age allowance withdrawal band exceeds the top rate of income tax (40 per cent). This feature attracted a disproportionate amount of publicity in the press in the post-Budget period and, mainly as a result of an article in the Daily Telegraph, Ministers received a very large amount of correspondence about it*. A number of Government backbenchers expressed concern. The matter was also raised on an amendment during the Standing Committee debates on the Finance Bill. Two Government backbenchers - Mr Jack** and Mr Boswell - asked if Ministers would look sympathetically at the issue (and more generally at the allowances for elderly people). (See attached Hansard extract.) In response to the Standing Committee debate the Chief Secretary pointed out, inter alia, that

- the age allowance withdrawal was a long-standing feature of the tax system and had nothing to do with the 1988 Budget changes;

- the aged income limit was at its highest ever level in real terms and the marginal rate in the withdrawal band at its lowest ever level. (It was 55 per cent in 1978-79);

- the withdrawal feature affected fewer than 2 per cent of all elderly households;

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* In the post-Budget period Ministers received about 450 letters on the age trap, a feature which affects only 130,000 taxpayers. By contrast Ministers had some 350 letters on the doubling of the car benefit scales which affected some 1.3 million taxpayers.

** Mr Jack has also recently tabled a number of Parliamentary Questions about the elderly.

- those in the age allowance withdrawal band had gained very substantially from the double indexation of the aged income limit for 1988-89 (which gave them up to £2.50 per week on top of their gains from double indexation of allowances and the 2p cut in the basic rate.)

- as the basic rate was reduced further towards the new target of 20 per cent the marginal rate in the withdrawal band would automatically fall below 40 per cent.

Similar points were made by Treasury Ministers in reply to correspondence.

5. The Chief Secretary gave no commitment in Standing Committee that the Government would look again at the age allowance withdrawal feature. If the basic rate were to be reduced to 24 per cent in 1989-90 this would automatically reduce the marginal rate in the withdrawal band to 40 per cent. (A 2 point cut in the basic rate to 23 per cent would reduce the marginal rate to $38^{1}/3$ per cent). Nevertheless in view of the attention which this issue continues to attract* you may like to consider making some changes in the age allowance withdrawal mechanism in 1989-90, to reduce the marginal rate in the withdrawal band below 40 per cent, (irrespective of whether there is a reduction in the basic rate in 1989-90). This would forestall further criticism and possible Finance Bill amendments and could be done very cheaply. We have now incorporated facilities within COP and our other computer systems which will enable us to alter the rate at which age allowance is withdrawn for 1989-90. (You will recall that there were operational constraints which prevented us from making a change this year.)

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*We are starting to receive Budget representations seeking a reduction in the marginal rate (for example, from the British Bankers Association). And there was an article in the Observer on 20 November.

6. The following paragraphs consider possible options for reducing the marginal rate in the age allowance withdrawal band.

Abolishing the income limit

7. One option would be to abolish the income limit and the withdrawal mechanism altogether so that age allowance was available to everyone aged 65 or over irrespective of income. This option has a number of attractions since it would

- meet the representations made during this year's Finance Bill debates and elsewhere. In principle, horizontal equity points to giving age allowance irrespective of income since its purpose is to recognise the additional costs and burdens of old age (which in principle arise at all income levels);

- remove altogether the present "hump-backed" marginal rate schedule which elderly taxpayers face;

- be a valuable simplification of the age allowance. It would remove a complex and troublesome feature of the personal tax structure which many elderly taxpayers do not understand and which local tax offices have difficulty in applying satisfactorily (because it usually requires a forecast of the taxpayer's total income). The age allowance withdrawal mechanism will become somewhat more complicated under Independent Taxation when the present married age allowance is split into the personal allowance and the married couple's allowance and withdrawal applies to each allowance separately.

- save around 85 staff in a full year (though there would be some transitional costs in implementing the change).

8. But despite the attractions of simplification and staff saving we would not recommend abolition of the aged income limit in 1989-90 for a number of reasons. In particular

- the case in principle for age allowance (at least at age 65) is weak. Nowadays many people of 65 are healthy and active and many find their living costs fall on retirement (no mortgage to pay, reduced price fares, no travel to work costs and so on). The main justification for age allowance is the very good practical one that it keeps many elderly people on small incomes out of the tax net altogether. This points to targeting the allowance on those with relatively modest incomes (as successive Governments have done since age-related personal allowances were introduced in 1957-58) and hence to retaining the income limit.

- abolition of the limit would be expensive. It would cost around £180 million in a full year (with a small consequential effect on the cost of Independent Taxation). For the same amount it would be possible to raise age allowance by just over 9 per cent (on top of indexation). Compared with indexation this would take 120,000 elderly taxpayers out of tax altogether; give gains of around £2.20 per week to elderly married men with incomes up to the aged income limit (about £1.25 per week to elderly single people); and reduce the staffing requirement by around 30 units in a full year compared with indexation.

- the benefits of abolition of the income limit would go exclusively to the top 10 per cent of elderly households (including about 150,000 elderly higher rate taxpayers who would gain up to about £9.00 per week).

- abolition could increase the number of elderly husbands who would be subject to transitional provisions under Independent Taxation.

9. If, nevertheless, you were attracted by the option of abolishing the aged income limit, we would need to examine the operational consequences for local tax offices, particularly in relation to the timing of the change. It looks as if it would be more straightforward for the measure to be announced next year to take effect from 1990-91. Implementing the change could then be combined with setting - up work for Independent Taxation and the increase in the number of elderly husbands affected by the transitional provisions under Independent Taxation could be avoided.

Changing the withdrawal rate for age allowance

10. The simplest and least costly means of reducing the marginal rate above the aged income limit would be to reduce the rate at which the allowance is withdrawn. Cutting the withdrawal rate means, however, that more taxpayers come within the withdrawal band and so face the increased marginal rate (and the complications of withdrawal). There is thus a balance to be struck between reducing the marginal rate for those already in the band and limiting the number of extra taxpayers who are brought into the band. For example, halving the rate of withdrawal to £1 of allowances for every £3 of income would almost double the number of taxpayers in the withdrawal band. That looks very unattractive.

11. A better compromise would be to reduce the rate of withdrawal to £1 of allowances for every additional £2 of income above the aged income limit. This would

- cost just under £5 million in 1989-90.

- reduce the marginal rate in the withdrawal band to 37.5 per cent (if the basic rate remains at 25 per cent). If the basic rate were reduced to 24 per cent the marginal rate in the withdrawal band would fall to 36 per cent.

- increase the number of taxpayers with income in the withdrawal band by 40,000 to 170,000.

- give average gains of about 50p per week to those within the new withdrawal band.

The draw-back is that the increase in the number of taxpayers within the withdrawal band would raise the staffing requirement by some 15 units in a full year. This could be offset to some extent by increasing the aged income limit above the indexation level for 1989-90. For example, an increase of £500 in the income limit on top of indexation would cost about £10 million in 1989-90 and (combined with a £1 for £2 withdrawal rate) would limit the number of taxpayers in the withdrawal band to 145,000 (at an additional staff cost of 5 units in a full year). Taxpayers above the indexed income limit (£11,300 in 1989-90) would gain up to £1.20 per week from this further change.

12. A reduction in the withdrawal rate to £1 of allowance for £2 of income, possibly combined with a small real increase in the income limit, looks quite an attractive option at relatively modest cost. But other variants are, of course, possible. For example if you wished simply to ensure that the marginal rate in the withdrawal band was no higher than the top rate of income tax this could be done by changing the withdrawal rate to £3 of allowances for every £5 of additional income above the income limit. This would cost a very modest £1.5 million. It would increase the number of taxpayers in the withdrawal band by only about 10,000 (at a staff cost of 5 units). On the other hand the three-fifths fraction looks a little untidy. Making only

the absolute minimum change necessary might also seem rather grudging, and lead to pressure to go further at Committee Stage. (Operationally it is much simpler to change the withdrawal rate as part of the Budget recoding rather than later in the year.) A reduction in the rate of withdrawal to £1 for £2 from the outset looks more secure and should satisfy most people.

Increases in age allowance

13. Whether or not there is scope for general reductions in income tax in 1989-90 you may like to consider some increase in the age allowance next year on top of indexation. Elderly married taxpayers will, of course, generally do well from the change to Independent Taxation in 1990-91. But over half of all elderly taxpayers are single people. There has been a slight rise in the number of elderly taxpayers since 1978-79 caused partly by the overall growth in the number of elderly people and partly by the increase in the number with sources of income in addition to their basic National Insurance retirement pension.

14. Increases in age allowance are not expensive but because there are many elderly taxpayers with small incomes just above the tax threshold they are a relatively efficient means of reducing the total number of taxpayers. Thus, in broad terms, for a given percentage increase in allowances across the board, the part of the cost relating to the increase in age allowance represents about $13^{1}/2$ per cent of the total cost of the allowance increase; but the number of elderly taxpayers (counting husband and wife as one) taken out of tax by the change is about one-quarter of the total reduction in the taxpayer numbers. In addition, because of the aged income limit, all the benefit of the increase is concentrated on elderly people with relatively modest incomes.

15. For example, the cost of a $6^{3}/4$ per cent increase in age allowance would be about £170 million in 1989-90 (compared

with £1250 million for the cost of a 6 3/4 per cent increase across the board) and would take just under 100,000 elderly taxpayers out of tax (out of the total of just under 400,000 taxpayers taken out of tax by an across the board increase of 6 3/4 per cent). It would save some 25 staff in a full year compared with indexation. For taxpayers aged between 65 and 79 with incomes below £11,300 in 1989-90 (the indexed level of the aged income limit) the increase in allowances would be worth £1.63 per week for a married man and £1.06 per week for single people. There would be a small increase in the cost of Independent Taxation in 1990-91.

16. Increasing age allowance in real terms relative to the basic allowances would be something of a change in direction compared with 1984 and 1985. In 1984 the age allowances were increased by only 5.3 per cent, in line with indexation, whereas the basic allowances went up by about 12 1/2 per cent; in 1985 the age allowances and the basic allowances were increased by the same cash amounts. As a result the age allowances have increased by only 16 per cent in real terms since 1978-79 compared with an increase of well over 25 per cent in the basic allowances. The 1986 Green Paper on the Reform of Personal Taxation put forward the case for subsuming age allowance within the basic allowances, as part of the change to transferable allowances.

17. You may feel, however, that the background is rather different now. A differential increase in age allowance would undoubtedly be widely welcomed (and is something for which Age Concern have been pressing very strongly in recent years). It might be presented as a measure to reinforce - and extend to single people - the benefits which elderly married taxpayers will obtain as a result of the introduction of Independent Taxation.

18. An alternative, if you prefer not to increase the level of age allowance for those in the 65-79 age group, would be to raise the allowances only for those aged 80 and over,

building on the new allowance you introduced in 1987. This would cost about 10 per cent of the cost of an increase in age allowance across the board but would have a correspondingly modest effect in reducing taxpayer numbers (and hence on the staffing requirement).

Further work

18. We can, of course, let you have further information on options for changes to age allowance if you wish.

BAM

B A MACE

[Mr. Brown.]

(b) more than a 25 per cent effective tax rate".

The Financial Secretary answered:

"The full year cost of reducing to 40 per cent the effective rate on the band of income over which age allowance is withdrawn would be about £1.5 million at 1988–89 levels of income. An effective rate of 25 per cent could be achieved only if age allowance was not withdrawn at all, which would cost about £190 million. Both costs are calculated by comparison with the income tax regime for 1988–89 proposed in the 1988 Budget."—[*Official Report*, 19 April 1988; Vol. 131, c. 423]

May I make a very modest appeal to the Government and ask them to consider the substantial sums that have been given to the wealthiest in our society and the injust way in which pensioners are being treated in this part of the Bill? I accept that the Government will not feel able to make a move to the 25 per cent rate, but I ask them to consider the £1.5 million—just £1.5 million—that they say it would cost to reduce the penalties that the age allowance taper currently brings in to the same level at which the top rate of income tax has been set.

I should have thought that that modest proposition would appeal to the generosity of all members of the Committee, rather than a narrow, partisan approach. I hope that, in the spirit of what I have said, and eliciting decency from all members of the Committee, the Chief Secretary will say, "Please don't press your amendments to a vote, Mr. Brown, because the Government will come back on Report to give at least £1.5 million, if not more, to pensioners. We will not tax them more than we tax the very wealthy in our society".

Mr. Boswell: The hon. Member for Newcastle upon Tyne, East (Mr. Brown) will be disappointed because he will not lure me into his larder or his Lobby. However, I wish to put down a marker to the Chief Secretary about those matters. The figure of £190 million quoted by the hon. Gentleman for overall costs is substantially accurate. It was confirmed to me in correspondence recently. The effect is that the amendment is either too little, or too much to accommodate comfortably within the Budget judgment at the moment.

I wish to draw the Chief Secretary's attention to two factors, which must inevitably lead to the abolition of the present structure. It goes back a long way, and, as he said in a masterly intervention, has been ameliorated considerably by the present Government. As a mathematician the hon. Member for Wrexham (Dr. Marek) will know that a benefit up to a certain level of income cannot be given and then withdrawn without a super-marginal rate being imposed over the period of withdrawal. The rate functions at $41\frac{2}{3}$ per cent. Under one of the Opposition's proposals we should still have a rate—

Mr. Rhodri Morgan (Cardiff, West): Will the hon. Gentleman give way?

Mr. Boswell: I shall not, because I want to make a brief speech and allow others to speak.

Clearly, there will be a top hat effect, where the rate goes up and then comes down. That is not a happy long-term proposition. Exactly the same applies to the small companies' corporation tax rate in clause 26. The same technical factor arises there.

In 1990 the Government intend to introduce individual allowances for old people, but they have not defined the income limit. I do not expect the Government to respond in terms tonight, but to consider the matter. If individual allowances are introduced with separate income limits, the budgetary advantages of the present structure will be substantially reduced. The only way to get rid of the anomaly is to have a smooth progression, a basic rate and an allowance for old people that is somewhat above the going rate for people under 65. That must be the long-term solution.

Mr. Tony Worthington (Clydebank and Milngavie): I speak on this issue because I am worried about how the Government treat the elderly. This anomaly is one small instance of that. We in the Opposition have been chided about the 98 per cent rate of taxation. I do not accept that chiding, because I was only a child at the time.

The Government say that a 98 per cent rate of taxation is wrong. If it is wrong for the rich to pay that rate of taxation, is it not doubly wrong for the elderly to pay it? I am sure that in surgeries up and down the country hon. Members of both parties have been visited by numerous people who are affronted by being treated as ne'er-do-wells by the Government, and by hearing the Government's language, which is about incentives and the need to penalise those who have contributed nothing. Often people who have contributed everything find that they are paying the highest rates of taxation in the country. This example is but a tiny instance. Moreover, pensioners have to pay more of their income in indirect taxation through VAT. That will be compounded by the poll tax and added to through the housing benefit changes and transitional arrangements.

What do the transitional arrangements mean? They mean that for the foreseeable future—

The Chairman: Order. The hon. Gentleman is going wide of the amendment. We cannot have a broad-ranging debate on the problems of the elderly. We must relate it to the specific amendment before the Committee.

Mr. Worthington: I am grateful for that advice, Mr. Hunt. Had you seen the speech that I intended to make, you would realise how much wider I should have gone. I am gradually getting closer to the subject.

Like my hon. Friend the Member for Newcastle upon Tyne, East (Mr. Brown), I am using the example to illustrate just part of the package of changes that will seriously affect the elderly. The 41 per cent marginal rate of taxation cannot be seen alone. It is part of a package of issues, such as the poll tax, VAT changes, housing benefit changes and the transitional arrangements, which mean that many pensioner households will face increases of taxation or losses of benefit of about 100 per cent. If the Committee views the proposal of my hon. Friend the Member for Newcastle-upon-Tyne, East in that context—the strength of his argument is irrefutable—the Chief Secretary must accept the logic of the amendment.

Mr. Michael Jack (Fylde): I hope that my contribution will be brief.

By way of introduction, I should say that I have a particular and general concern about the way in which tax affects elderly people, but I shall concentrate on the amendment. I should like to point out to the hon. Member for Newcastle upon Tyne, East (Mr. Brown) that I received a letter from the Financial Secretary to the Treasury in reply to points made by one of my constituents in much the same way that the hon. Gentleman used in moving his amendment. I was heartened by the Financial Secretary's letter. He said:

"No elderly person pays more tax than a younger taxpayer with a similar income. And in most cases they will pay substantially less."

My right honourable Friend went on to make other points that reassure me that in general the matter must be seen in perspective. First, only 130,000 people are affected by the age allowance.

The Financial Secretary went on to point out that the group affected by age allowance can make substantial tax savings under the present proposals. They gain not only from the reduction in the standard rate of tax but from indexation of present allowances. We must see the matter in context. It is not all bad news, as the Opposition suggest.

In conclusion, I make a plea to my right honourable Friend the Chief Secretary. There is a slight anomaly in that an elderly person in a nursing home on income support effectively receives an income of £10,117 from the state, but to achieve a similar result if such a person were paying for himself, he would need a gross taxable income in excess of £13,000. That is a difficult target to achieve. It is made more difficult by the operation of the age allowance as proposed in the Budget. I ask my right honourable Friend to consider giving that group of people some help so that if they try to look after themselves from their own resources, the hill that they have to climb is made less steep.

9.15 pm

Mr. Griffiths: There is all-party anxiety about the number of elderly people caught in what is called an age trap but is in fact a tax trap which means that they will pay higher rates of tax than those who are infinitely better off. It is wrong that people with incomes approaching £1 million should face less of a marginal rate of taxation than people whose incomes just pass the trigger of between £10,000 and £11,000.

The problem could be rectified if the Government took on board the point made not just by my hon. Friend the Member for Newcastle upon Tyne, East (Mr. Brown) and by Conservative Members, but by the *Financial Times* and *The Daily Telegraph*. The cost to the Exchequer of rectifying the problem is not great. The Government could alleviate the problems of elderly people who have spent much of their life saving and putting money away into private pensions but now find that they face a higher rate of taxation than those in the rich and super-rich brackets. Members of all parties should accept that people who retire on about £11,000 have modest incomes. The cost of rectifying the anomaly, which I am sure was not deliberate but unforeseen by the Chancellor and his Ministers, would not be great. I hope that the Chief Secretary will take the comments on board and assure us that even at this late stage something can be done to help those elderly people who have saved for their pensions but now have to pay a higher rate of taxation than people whose incomes come easily from stocks, shares and other sources.

Mr. Major: This has been a short but constructive and good-natured debate introduced by the hon. Member for Newcastle upon Tyne, East (Mr. Brown) in his usual agreeable way. I hope that in saying that I shall not do him too much harm in the Labour party because that was not my intention. Some important points have been raised and there are some misunderstandings, not least in the perception held of a marginal band of income upon which the 41 per cent of apparent taxable impact lies. I shall deal with that specific point in a moment.

The hon. Member for Newcastle upon Tyne, East invited a bi-partisan debate. It will be bi-partisan—I have no partisan points to make. At the end of the debate, he will no doubt invite the Opposition to vote for the amendment. In a classical bi-partisan way I shall probably invite my hon. Friends to resist it for reasons that I shall endeavour to explain.

As the hon. Member for Newcastle upon Tyne, East said when he introduced the debate, the purpose of the amendment is to reduce the rate at which the age allowance is withdrawn where the taxpayer's income exceeds the aged income limit. It is a very small band of taxable income that is relevant. The amendment's aim is to reduce the effective marginal rate over the band of income where the withdrawal applies. I suspect that the engine of concern that the hon. Member for Newcastle upon Tyne, East had, as did my hon. Friends the Members for Daventry (Mr. Boswell) and for Fylde (Mr. Jack), is the fact that throughout the marginal rate of income there is a higher effective rate upon that tiny margin of income than the 40 per cent top rate band. I understand that there is anxiety about that, but it may be helpful to the Committee if I examine the background to the present circumstances.

Age allowance is specifically targeted to help elderly people on relatively modest incomes. The income limit is currently set at £10,600 for the financial year 1988–89, above which the allowance is currently withdrawn by £2 for every £3 worth of income above the limit until the allowance is reduced to the level of the ordinary personal allowance. That is the mechanism for the removal of the extra allowance. The purpose of the transition from the age allowance to the ordinary allowance is to avoid a sudden increase in tax when a person's income exceeds the income limit. That is why the slope has traditionally been benevolent and, for a variety of reasons, it remains so.

It is not a novel proposition that age allowance should be subject to withdrawal in this way; it has been chex.ps/jmt/59 CONFIDENTIAL

FROM: J M G TAYLOR
DATE: 5 December 1988

PZP

MR PAINTER - IR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Riley
Miss Hay
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Battishill - IR
Mr Beighton - IR
Mr Lewis - IR
Mr Calder - IR
Mr Bush - IR
Mr Isaac - IR
Mr Mace - IR
PS/IR

STARTER 100: INCOME TAX: ALLOWANCES BASIC RATE LIMIT AND RATES

The Chancellor was most grateful for Mr Mace's papers of 30 November, which he found very helpful.

2. He has commented that, of the various allowance options (over and above statutory indexation) he is interested only in:

(a) an age allowance withdrawal rate of £1 for £2 (but without enhancement of the aged income limit); and

(b) double indexation of the over-80 age allowance.

3. He has commented that the basic rate is something to be considered later.

4. He would be most grateful if Annexes C and D could be reworked on the basis of fractions/multiples of 1978-79 average earnings, <u>price</u> revalorised for 1988-89 and 1989-90 respectively.

J M G TAYLOR

CONFIDENTIAL

Inland Revenue

Personal Tax Division
Somerset House

FROM: B A MACE

DATE: 9 December 1988

Many thanks. We must use this concept & these figures wherever possible in letters & speeches. 2. Re X, I do not understand these figs: at a quick glance looks more like 12-16. 3. Re para 3, what proportion of the over-80s wd not be liable to income tax at all? N

CHANCELLOR OF THE EXCHEQUER

STARTER 100: INCOME TAX: ALLOWANCES, BASIC RATE LIMIT AND INCOME TAX RATES

1. As requested in Mr Taylor's note of 5 December I attach Annexes C and D of my submission of 30 November reworked on the assumption of no real growth in earnings since 1978-79. Comparing these with the previous versions shows, for example, that, if earnings had increased only in line with prices since 1978-79

- average rates of tax and NIC combined in 1988-89 would be lower [than in 1978-79] at all multiples of average earnings by amounts ranging from 5 percentage points or more at ½ average earnings to around 1-2 percentage points at 5 times average earnings.

X

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cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Riley
Miss Hay
Mrs Chaplin
Mr Tyrie
Mr Call
Mr Jenkins (OPC)

Chairman
Mr Isaac
Mr Painter
Mr Beighton
Mr Lewis
Mr Calder
Mr Bush
Mr Mace
Mr Hodgson
Mr R R Martin
Mr Keelty
Mr J C Jones
Mr O'Brien
Mr Boyce
Mr Eason
Mr Glassberg
Mr Oakley
Miss White
Miss Dyall
PS/IR

- with indexation in 1989-90 average rates of both income tax alone and income tax and NIC combined, on this basis, would be the same as in 1988-89 at all multiples, <u>except</u> for families with children. (The unchanged cash level of child benefit in 1989-90 compared with 1988-89 means average rates rise very slightly for them.)

2. In 1989-90 average earnings (male, all occupations) are expected to be over 30 per cent higher in real terms than in 1978-79 (see table below).

Male Average Earnings (All Occupations)
£ per week

	1978-79	1988-89	1989-90
Actual	92.8	254.1	273.1
No real growth	92.8	197.2	208.7

<u>Age Allowance</u>

3. In the light of your comment at 2(b) of Mr Taylor's note you may like to know that, compared with indexation, double indexation of the age allowances for those aged 80 and over would cost £20 million in 1989-90 and 1990-91 and would reduce the number of elderly taxpayers (counting husband and wife as one) by about 15,000.

B A. Mace

B A MACE

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ANNEX C(1)

PERCENTAGE OF EARNINGS PAID IN INCOME TAX ASSUMING NO REAL GROWTH IN EARNINGS SINCE 1978-79

Multiples of average male earnings (1)	1/2	3/4	1	1 1/2	2	3	4	5
Single								
1978-79	17.0	22.4	25.0	27.7	29.5	37.0	44.4	50.5
1988-89	12.3	16.5	18.6	20.8	21.8	27.2	30.4	32.3
1989-90 (3)								
A	12.2	16.5	18.6	20.7	21.8	27.1	30.3	32.3
B	11.7	15.8	17.9	19.9	20.9	26.5	29.9	31.9
C	11.4	15.9	18.2	20.5	21.6	26.9	30.2	32.1
Married with one earner and no children								
1978-89	9.5	17.3	21.3	25.2	27.2	34.7	42.4	48.8
1988-89	5.0	11.7	15.0	18.3	20.0	25.3	28.9	31.2
1989-90 (3)								
A	4.9	11.6	15.0	18.3	20.0	25.2	28.9	31.1
B	4.7	11.2	14.4	17.6	19.2	24.5	28.4	30.7
C	3.6	10.8	14.3	17.9	19.7	24.8	28.6	30.9
Married with one earner and 2 children (2)								
1978-79	- 4.1	8.1	14.4	20.6	23.7	32.0	40.3	47.1
1988-89	- 9.7	1.9	7.7	13.4	16.3	22.8	27.1	29.7
1989-90 (3)								
A	- 9.0	2.4	8.0	13.7	16.5	22.8	27.1	29.7
B	- 9.2	1.9	7.4	12.9	15.7	22.2	26.7	29.3
C	-10.3	1.5	7.4	13.2	16.2	22.5	26.9	29.5

(1) Full time adult males (all occupations)

(2) Under 11 and netting off child benefit from tax payments (to enable comparisons to be made with 1978-79 when child tax allowances still being phased out).

(3)
A Indexation
B 1p off Basic Rate
C 6 3/4% on allowances

1JA7.ANX

CONFIDENTIAL

ANNEX D(1)

PERCENTAGE OF EARNINGS PAID IN INCOME TAX AND NIC
ASSUMING NO REAL GROWTH IN EARNINGS SINCE 1978-79

Multiples of average male earnings (1)	1/2	3/4	1	1 1/2	2	3	4	5
Single								
1978-79	23.5	28.9	31.5	33.3	33.7	39.8	46.5	52.2
1988-89	19.3	25.5	27.6	29.8	28.8	31.8	33.9	35.1
1989-90 (3)								
A	19.2	25.5	27.6	29.7	28.8	31.8	33.8	35.1
B	18.7	24.8	26.9	28.9	27.9	31.1	33.4	34.7
C	18.4	24.9	27.2	29.5	28.6	31.6	33.7	34.9
Married with one earner and no children								
1978-89	16.0	23.8	27.8	30.8	31.4	37.5	44.5	50.5
1988-89	12.0	20.7	24.0	27.3	27.0	29.9	32.4	33.9
1989-90 (3)								
A	11.9	20.6	24.0	27.3	27.0	29.8	32.4	33.9
B	11.7	20.2	23.4	26.6	26.2	29.2	31.9	33.5
C	10.6	19.8	23.3	26.9	26.7	29.5	32.1	33.7
Married with one earner and 2 children (2)								
1978-79	2.5	14.6	20.9	26.2	27.9	34.8	42.4	48.8
1988-89	- 2.7	10.9	16.7	22.4	23.3	27.5	30.6	32.5
1989-90 (3)								
A	- 2.0	11.4	17.0	22.7	23.5	27.5	30.6	32.5
B	- 2.2	10.9	16.4	21.9	22.7	26.9	30.2	32.1
C	- 3.3	10.5	16.4	22.2	23.2	27.2	30.4	32.3

(1) Full time adult males (all occupations)

(2) Under 11 and netting off child benefit from tax payments (to enable comparisons to be made with 1978-79 when child tax allowances still being phased out).

(3)
A Indexation
B 1p off Basic Rate
C 6 3/4% on allowances

1JA7.ANX

FROM: A C S ALLAN

DATE: 12 December 1988

pup

MR MACE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Riley
Miss Haye
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Isaac IR
PS/IR
Mr Jenkins (OPC)

STARTER 100: INCOME TAX: ALLOWANCES, BASIC RATE LIMIT AND INCOME TAX RATES

The Chancellor was most grateful for your minute of 9 December. He feels that we must use the concept of the percentage of earnings paid in income tax if there had no real growth in earnings, and the figures in your note, whenever possible in written answers and speeches.

2. The Chancellor was somewhat confused about the comparisons in the first indent of your paragraph 1. We spoke, and you said you would let him have a further note.

3. On your paragraph 3, on age allowance, the Chancellor would be grateful to know what proportion of the over eighties would not be liable to income tax at all under this proposal.

ACSA

A C S ALLAN

CONFIDENTIAL

Inland Revenue

Personal Tax Division
Somerset House

FROM: B A MACE

DATE: 12 DECEMBER 1988

Thanks.

CHANCELLOR OF THE EXCHEQUER

BF 20/12

STARTER 100: INCOME TAX: ALLOWANCES, BASIC RATE LIMIT AND INCOME TAX RATES

1. I am sorry that the message in the first indent of paragraph 1 of my note of 9 December did not come out quite as I intended. There are essentially two points:

- Comparing Annex D(1) (note of 9 December) with Annex D (note of 30 November) shows that if earnings had increased only in line with prices since 1978-79, average rates of tax and NIC combined in 1988-89 would be lower than they actually are by amounts ranging from 5 percentage points or more at 1/2 average earnings to 1-2 percentage points at 5 times average earnings.

- looking solely at Annex D(1) shows that if earnings had increased only in line with prices since 1978-79, average rates of tax and NIC combined in 1988-89 would be lower than in 1978-79 (by amounts ranging from 4-5 percentage points at 1/2 average earnings to around 16-17 percentage points at 5 times average earnings).

B A Mace

B A MACE

---

cc			
	Chief Secretary	Chairman	Mr Eason
	Financial Secretary	Mr Isaac	Mr Glassberg
	Paymaster General	Mr Painter	Mr Oakley
	Economic Secretary	Mr Beighton	Miss White
	Sir P Middleton	Mr Lewis	Miss Dyall
	Sir T Burns	Mr Calder	PS/IR
	Mr Scholar	Mr Bush	
	Mr Culpin	Mr Mace	
	Mr Gilhooly	Mr Hodgson	
	Mr Riley	Mr Hodgson	
	Miss Hay	Mr R R Martin	
	Mrs Chaplin	Mr Keelty	
	Mr Tyrie	Mr J C Jones	
	Mr Call	Mr O'Brien	
	Mr Jenkins (OPC)	Mr Boyce	

CONFIDENTIAL

Inland Revenue

Personal Tax Division
Somerset House

FROM: B A MACE
DATE: 16 DECEMBER 1988

Ch - see also Mr Mace's note of 12/12 behind.

Thanks.

CHANCELLOR OF THE EXCHEQUER

STARTER 100: INCOME TAX: ALLOWANCES, BASIC RATE LIMIT AND INCOME TAX RATES

You asked (Mr Allan's note of 12 December) about the proportion of single people and married couples aged 80 and over who would not be liable to income tax with double indexation of their age allowances in 1989-90. The answer is about four-fifths (450,000 are liable out of a total of 2.2 million). This compares with the familiar figure of two-thirds for the proportion of all elderly taxpayers (those aged 65 and over) who are not liable to income tax.

B A Mace.

B A MACE

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Riley
Miss Hay
Mrs Chaplin
Mr Tyrie
Mr Call
Mr Jenkins (OPC)
Chairman
Mr Isaac
Mr Painter
Mr Beighton
Mr Lewis
Mr Calder
Mr Bush
Mr Mace
Mr Hodgson
Mr R R Martin
Mr Keelty
Mr J C Jones
Mr O'Brien
Mr Boyce
Mr Eason
Mr Glassberg
Mr Oakley
Miss White
Miss Dyall
PS/IR

chex.ps/jmt/90 CONFIDENTIAL

FROM: J M G TAYLOR
DATE: 19 December 1988

PMP

MR B A MACE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Riley
Miss Hay
Mrs Chaplin
Mr Tyrie
Mr Call
Mr Jenkins (OPC)

Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Beighton - IR
PS/IR

STARTER 100: INCOME TAX: ALLOWANCES, BASIC RATE LIMIT AND INCOME TAX RATES

The Chancellor was grateful for your notes of 12 and 16 December.

J M G TAYLOR

Ch

One thought: if we do cut basic rate why don't we <u>freeze</u> composite rate until basic rate below it & then link the two? What is point of composite rate?

"Point" is that HMG shd, we gain: thus the tax improperly drawn for non-taxpayer depositors is handed back AAt to taxpayer depositors as bonus. But it's a pretty rum

justifiable, or I wd like urgent advice ASAP.

A variant wd be to fix a floor of 20% on the basic rate, whichever is the lower.

Copy no 2

Inland Revenue

CONFIDENTIAL
COVERING
BUDGET SECRET

Personal Tax Division
Somerset House

FROM: PETER WARDLE
DATE: 10 FEBRUARY 1989

BAM 10/2

1. MR MACE
2. FINANCIAL SECRETARY

[Await FST's views; see how MIRAS ~~goes~~ my views]

CHANGING THE BASIC RATE OF INCOME TAX

1. If there were to be a change in the basic rate of income tax in 1989-90, a number of provisions would need to be reconsidered. This is our annual submission (bringing together notes from several Divisions here) which seeks decisions on these provisions. It also draws attention to some of the implications of a change in the basic rate for covenants and charities, MIRAS and the deduction of tax generally.

---

cc
Chancellor of the Exchequer
Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Sedgwick
Mr Culpin
Mr Gilhooly
Mrs Chaplin
Mr Tyrie
Mr Call
Mr J C Jenkins (Parl. Counsel)
Chairman*
Mr Isaac
Mr Painter
Mr Beighton*
Mr Lewis
Mr Corlett
Mr Roberts
Mr McGivern
Mr Pitts
Mr Johns
Mr Bush*
Mr Calder*
Mr Cherry
Mr Mace*
Mr Eason
Mr Kuczys
Mr C Stewart
Mr Sullivan
Mr Cayley
Mr Nield*
Mr Haigh*
Mr McManus
Mr Reed
Mr O'Connor
Mr Hodgson
Mr Keelty
Mr Wardle*
Mr I Stewart
Mr Boyce
Mr McNicol
PS/IR*

2. The main points are:

Rate of Life Assurance Premium Relief (LAPR)

3. Ministers decided last year that the rate of LAPR should be reduced to 12.5% (half the basic rate of 25%). The necessary legislation was contained in the 1988 Finance Act, and the new rate takes effect from 6 April 1989. This was a catching-up reduction to take account of successive basic rate changes in Budgets up to 1988. Our Insurance and Specialist Division is advising Ministers separately on the arguments for moving to an automatic link to half basic rate, following the Chancellor's meeting on life assurance on Monday 6 February.

Construction Industry Tax Deduction Rate

4. This is discussed in Annex A. The questions for decision are:

i. Should the construction industry tax deduction rate be reduced in line with any reduction in the basic rate?

ii. If so, should the necessary legislation be included in the 1989 Finance Bill to take effect from 30 October 1989, or from 18 September 1989?

Composite Rate

5. The composite rate for any year of assessment has to be determined by Treasury Order before the preceding 31 December. The composite rate for 1989-90 is based on tax rates and the tax status of depositors in the preceding year, 1988-89.

6. Following your agreement on 29 November 1988, the composite rate for 1989-90 has been fixed at 21.75% (23.25% in 1988-89). A Treasury Order determining this rate was laid before Parliament on 12 December 1988 and the Statutory Instrument was published on 19 December.

Rate of ACT

7. The 1986 Finance Act created a direct link between the basic rate and the ACT rate; so any change in the basic rate will automatically produce a corresponding change in the ACT rate.

Capital Gains Tax

8. With capital gains tax rates now assimilated with income tax rates, any change in the basic rate will automatically flow through to CGT.

Unit Trusts and Life Assurance Policy Holders

9. See annex B (starred Inland Revenue recipients only).

Additional rate on Discretionary Trusts

10. The "additional rate" is charged on the income of discretionary and accumulation trusts. When the income is paid to beneficiaries, the beneficiary gets credit for the basic plus additional rate tax paid by the trustees, and can reclaim it to the extent that his own liability is less. The additional rate charge broadly represents higher rate liability on undistributed income, so as to prevent higher rate taxpayers from using trusts to reduce personal tax.

11. The additional rate was fixed in the 1988 Finance Act at 10%. We assume that, unless there is a substantial change in either the basic or the higher rate, you do not wish to make any further change to the additional rate at this stage.

Small companies rate of Corporation Tax

12. We assume that you would wish to reduce the small companies rate in line with any reduction in the basic rate. If the rate were to be changed, you might wish to reconsider your decision to increase the profits limits for the small companies rate and the marginal relief.

FURTHER IMPLICATIONS OF A REDUCTION IN THE BASIC RATE

Covenants and Charities

13. If a covenant is effective for tax purposes, the covenantor deducts basic rate tax from his payments. Following the 1988 Budget reforms, covenants made by individuals are now effective for tax purposes only if

a. they are covenants to charity, or

b. they were made before Budget Day 1988.

14. A reduction in basic rate would reduce the tax deducted at source from the covenant payments. The effect would depend on whether the covenant was expressed in "gross" or "net" terms -

a. if it is in "gross" terms - eg to pay £100 less tax - the covenantor will have to increase his net payments slightly;

b. if it is in "net" terms - eg to pay such sum as will leave £100 after deducting tax - the covenantor's net payment will remain unchanged but the recipient will have less tax to reclaim.

15. Thus if a "net" covenant is for £75 a year, the £75 currently represents £100 less £25 basic rate tax, and the recipient can reclaim £25 (if a non-taxpayer). If the basic rate was reduced to (say) 24 per cent, the £75 payment would represent £98.68 less £23.68 tax, and the recipient could reclaim up to £23.68.

16. When basic rate is reduced, there are usually a few grumbles from charities that they will lose out because the tax repayments on their covenants will fall. We estimate that a basic rate reduction would mean a loss to charities of about £7m per one-point

reduction. But this is an inevitable consequence of a basic rate reduction, and Ministers have consistently turned down requests for any form of transitional compensation in previous years. We assume that you would wish to take the same view this year if there is any reduction in the basic rate.

MIRAS

17. Under MIRAS arrangements qualifying borrowers deduct tax at the basic rate from the interest element of mortgage repayments. This means that the net interest payable to the lender will increase if the basic rate is reduced. If the basic rate were reduced by, say, one point borrowers would have to pay £76 for every £75 net interest paid at present. On a mortgage of £20,000 at a gross interest rate of 13.5% the monthly net interest payable would increase by about £2.25.

18. Mortgagors who are taxpayers would, of course, still benefit from a basic rate reduction even after taking account of increased mortgage repayments - the problem with them is essentially one of presentation. But there would be a real loss for non-taxpayers. Although they do not pay tax the MIRAS arrangement allows them to deduct the 25% basic rate from the interest element of mortgage repayments. If the basic rate were reduced, the deduction would be restricted to the level of the new basic rate. They would be obliged to increase their repayments but have no increase in net income to compensate because they will derive no benefit from the tax reduction.

19. If there were a basic rate cut, we would propose, as in 1987, to issue a Budget Day press release explaining the implications of the reduction for borrowers under MIRAS. Last year this was included in the release about deduction of tax (see paragraph 22 below). The two releases about mortgage interest were reserved to concentrate on the introduction of the residence basis and the abolition of relief for improvement loans.

20. As some relief goes to people below the tax threshold part of the cost of the MIRAS scheme is classified as public expenditure. A one point reduction in the basic rate would reduce the public expenditure cost of MIRAS by about £10 million in 1989-90 on total public expenditure of around £310 million.

21. Because of its effect on MIRAS payments a one point reduction in the basic rate would lead to an increase in the RPI of about 0.06 percentage points. The full effect would appear in the April 1989 RPI (which will be published on 19 May).

Deduction of Tax

22. If there were a reduction in the basic rate we would propose, as last year, to issue a Budget Day press release explaining in broad terms the implications of the reduction for those making payments (other than MIRAS payments) under deduction of tax. Once the necessary Provisional Collection of Taxes Act Resolution giving statutory effect to the new basic rate had been passed by the House of Commons, a more detailed circular would be issued explaining the procedures (and other aspects such as transitional arrangements) more fully.

Summary

23. If there were a (p) change in the basic rate of income tax, should there be consequential changes in:

Yes: 24? i. the construction industry tax deduction rate - and, if so, when should that take effect (paragraph 4)?

Yes: 24? ii. the small companies rate of ACT (paragraph 13)?

24. We have assumed that you would not wish to see any consequential changes in the following areas, ~~and~~ even if there were a change to the basic rate:

i. additional rate on discretionary trusts (paragraphs 11-12);

ii. covenants and charities (paragraphs 14-17).

See also X (para 3)

R

PETER WARDLE

ANNEX A

CONSTRUCTION INDUSTRY TAX DEDUCTION SCHEME

1. Under the provisions of the Special Tax Deduction scheme for the Construction Industry, payments to subcontractors who do not hold exemption certificates are made under deduction of a sum on account of tax, currently 25%. There is no automatic connection between the basic rate of income tax and the construction industry rate. But the two rates have stayed in line through successive basic rate changes.

2. The Efficiency Scrutineer recommended that this linkage be broken. The deduction rate should be taken significantly below basic rate, to allow for expenses and reliefs, and not necessarily changed with every basic rate change. He suggested a figure of 20%. The Scrutiny Action Plan envisages such a change being made in the 1990 Bill. It is for consideration whether such a decrease should be brought forward if the basic rate is cut this year. Our view is that it should not. A big cut in the deduction rate is an obvious sweetener for the tightening of the eligibility rules for exemption certificates, also envisaged for the 1990 Bill. The first-year costs of a big cut could also be significant: perhaps up to £100M in gross cost. We therefore recommend following the past practice of reducing the deduction rate in line with the basic rate; and reconsidering the scrutineer's recommended 20% rate in the light of all the circumstances next year.

3. The Construction Industry rate is contained in primary legislation. A 5-line clause in the 1989 Finance Bill would therefore be needed.

4. The rate change is not covered by the Provisional Collection of Taxes Act. So it cannot have effect

until after Royal Assent. This means that uncertificated subcontractors will be overpaying in the interim, and will have to wait, perhaps until after the tax year, for a refund. There have been suggestions from representative bodies that the timing of the subcontractor rate change should be brought forward to that for the PAYE change. However, with the prospect of loosening the link with basic rate changes next year, we do not suggest amending the Provisional Collection of Taxes Act for any change this year.

5. To allow for printing and distribution of guidance to all contractors in the industry, and for contractors to assimilate this material, the last 6 rates changes were made effective in the autumn. Following this pattern would mean the change would be effective from Monday 30 October. However, we think we can advance the change somewhat, to Monday 18 September, without unacceptable administrative cost or reducing the industry's assimilation period. That would increase the first-year cost by a couple of £million relative to a 30 October start, for a 1-point cut in the deduction rate. The Budget Score Card cost of a cut in the basic rate includes a gross cost of £20 million for a full year, with just over half coming through in the first year with a 30 October start.

6. There would be negligible manpower implications if the subcontractor rate were reduced from either of these dates.

<u>Questions for decision</u>

i. Should the construction industry tax deduction rate be reduced in line with any reduction in the basic rate?

ii. If so, should legislation be included in the 1989 Finance Bill to take effect from 30 October 1989; or from 18 September 1989?

ANNEX B

UNIT TRUSTS AND LIFE ASSURANCE POLICY HOLDERS

1. The proposed legislation on authorised unit trusts will create a direct link between their rate of Mainstream CT and the basic rate of income tax. Any change in the basic rate will automatically produce a corresponding change in their rate.

2. Income and capital gains due to life assurance policy holders are to be taxed, from January 1990, at a corporation tax rate linked directly to the basic rate. If the basic rates were changed, the new life assurance provisions would simply switch on at the new rate rather than at 25 per cent. However, a one-point cut in the basic rate would reduce the overall yield from the life assurance package by about £35 million in 1990/91, and about £50 million in a full year.

rc 1989/1.4.2.02

BUDGET CONFIDENTIAL

ptg

FROM: ROBERT CULPIN
DATE: 14 February 1989

MR A C S ALLAN

INCOME TAX OPTIONS

Your note today has crossed with one from me on contingency planning. Briefly:

(i) **Car scales:** consider an increase of up to 50 per cent; ask the Revenue for a note on distributional effects.

(ii) **Small companies' CT:** 1 per cent is -neg, -30, rising to -45; and it adds -neg, -5 to the cost of raising the small companies' CT thresholds.

(iii) **CGT:** 1 per cent off the basic rate is -neg, -neg, building up to -5.

Unit trusts: 1 per cent is -neg, -neg.

Life assurance: 1 per cent is said to be nil, -35, building up to -50 (Wardle of 10 February). These numbers look high, and I am investigating.

Other technical points are in Wardle of 10 February.

2. The important thing is to think what to do to car scales with a penny off - which I have already raised separately. The rest looks pretty small beer.

RC

ROBERT CULPIN

FROM: A C S ALLAN
DATE: 14 February 1989

MR CULPIN

INCOME TAX OPTIONS

I have commissioned separately from Mr Mace some work on the distributional effects of a rate cut versus a threshold increase. Could you also consider how the package as a whole might look with a rate cut:

(i) What would we then want to do on car scales?

(ii) We would substitute a cut in the small companies' CT rate in place of the increases in thresholds in the current package; what would be the cost and effects of this?

(iii) What would be the implications for life assurance, unit trusts etc? And are there any other consequentials?

ACSA

A C S ALLAN

FROM: A C S ALLAN
DATE: 14 February 1989

MR MACE - Inland Revenue

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Painter - IR
Mr Lewis - IR
PS/IR

INCOME TAX OPTIONS

The Chancellor would be grateful for a quick note comparing the distributional effects of two options: 1p off the basic rate with thresholds indexed; and the basic rate unchanged but thresholds increased by an amount which would produce the same direct revenue cost as the first option. He would like in particular to know what the income cross-over point is, for both single people and married couples, at which the benefits from the two packages are equal; and how many of those who benefit under each package are on income support, and so would have some of their benefits withdrawn?

ACSA

A C S ALLAN

SECRET

Inland Revenue

Personal Tax Division
Somerset House

Mr Allan:

FROM: B A MACE

DATE: 15 FEBRUARY 1989

CHANCELLOR OF THE EXCHEQUER

Income Tax Options

1. You asked (Mr Allan's minute of 14 February) for a note comparing the effects of two options:

Option A: 1p off the basic rate on top of indexation;
Option B: a real increase in thresholds on top of indexation, costing the same as Option A.

2. As I mentioned to Mr Allan there was some information on this comparison in my submission of 30 November 1988. But we have now reworked the analysis using the latest forecasts and on the basis of the firm indexation figures for the allowances.

Equal cost options

3. The latest estimate of the full year cost of a reduction of 1p in the basic rate on top of indexation is £1.56 billion at 1989-90 income levels. For the same full

cc		
	Chief secretary	Chairman
	Financial Secretary	Mr Isaac
	Paymaster General	Mr Painter
	Economic Secretary	Mr Beighton
	Sir P Middleton	Mr Bush
	Sir T Burns	Mr Lewis
	Mr Scholar	Mr Calder
	Mr Culpin	Mr Mace
	Mrs Chaplin	Mr Eason
	Mr Tyrie	Mr Hodgson
	Mr Call	Mr Wardle
		PS/IR

year cost it would be possible to raise the main income tax allowances and the basic rate limit by 12.8 per cent on 1988-89 levels, that is by about 6 per cent in real terms. The table below shows the costs (on top of indexation) in 1989-90 and 1990-91, taking account, of course, of Independent Taxation in the second year.

		£ million
	1989-90	1990-91
1p off basic rate*	1,400	1,725
12.8% on 1988-89 threshold levels	1,225	1,625

*Including the consequential effect on receipts of ACT.

4. If the small companies rate of corporation tax were reduced in line with the basic rate under Option A there would be an additional full year cost of £45 million (negligible cost in 1989-90, £30 million in 1990-91).

5. The full year cost of increasing thresholds by 12.8 per cent across the board includes some £225 million for the cost of increasing the basic rate limit on top of indexation. If the basic rate limit were held at its indexed level it would be possible to double-index the main personal allowances (an increase of about 13.6 per cent on 1988-89 levels) for the same cost as 1p off the basic rate. This would slightly increase the benefit of this option for basic rate taxpayers (for example the married man's allowance would go up by an additional £30) while reducing the benefit to higher rate taxpayers. The difference at the lower income levels is not large, however. For the rest of this note we take Option B to be a 12.8 per cent increase in both allowances and the basic rate limit. Annex A sets out the threshold levels under this option.

6. The following paragraphs look very briefly at the comparison between Options A and B.

Distributional effects and break-even points

7. Option A (1p off the basic rate) is worth amounts ranging up to almost £4 per week to taxpayers, compared with indexation, with the largest gain (both in cash terms and as a percentage of gross income) going to those at the top of the basic rate band. Option B is worth £1.20 per week to all married men liable at the basic rate and 77p per week to all single basic rate taxpayers on top of indexation. Annex B (Table 2 from the Budget Press Notice specimen income tables) compares the overall effect of the two options (including the gain from indexation) at various income levels. The tables show that Option A reduces tax liabilities by broadly the same percentage for married men at all income levels up to around £25,000 whereas under Option B the largest percentage reductions go to those at the lower end of the income distribution and the percentage gain declines as income rises towards the basic rate limit.

9. For taxpayers claiming only the appropriate basic personal allowance the increase in allowances gives more than the reduction in the basic rate to married men with incomes up to £10,625 and to single people with incomes up to £6,785. Higher rate taxpayers also do better from Option B because of the real increase in the basic rate limit (though that could, of course, be avoided by only indexing the limit).

10. The tables in Annex C show the actual distribution of the gains from each option by range of gross income (ie before deductions and allowances). These show that in broad terms single people with gross incomes up to about £8,000 and married couples with incomes up to around £15,000 do better under Option B (allowance increase). These figures are higher than the specimen figures given in the previous paragraph because they take account of reliefs and

deductions actually claimed by taxpayers. Overall just under half of basic rate taxpayers would be better off with the increase in allowances than with the basic rate cut.

Interaction with income-related benefits

11. Under indexation in 1989-90 some 800,000 taxpayers (counting husband and wife as one) are entitled to income-related benefits. All of those would gain under both Options A and B but part of their gains (up to 90 per cent or so) would be offset by a reduction in income-related benefits. In very broad terms we estimate that compared with indexation some 20,000 taxpayers would be floated off entitlement to income-related benefits by Option A (basic rate cut) and some 40,000 would be floated off entitlement by Option B (allowance increase). Of those taxpayers who remain on income-related benefits those who do better under Option B would still do better under that option after the reduction in their income-related benefits has been taken into account. There would be a negligible reduction in public expenditure on benefits under Option A and a reduction of about £25 million under Option B. (The average tax reduction for taxpayers on income-related benefits is baout 28p per week under Option A and about 97p per week under Option B.)

Tax Losers under Option A

12. As you know Option A (basic rate cut) will give losses amongst non-taxpayers with mortgages because their net interest payments (under MIRAS) will rise. We estimate that perhaps as many as 3/4 million mortgagors will lose an average of 30p per week. Most of these will be compensated to some extent by increased income-related benefits.

Average rates

13. Both Options A and B will reduce average rates of income tax at all income levels compared with 1988-89 (except for a very few cases under Option A with incomes just above the tax threshold.)

Allowance levels

14. Under Option B allowances would go back above their 1978-79 levels as a percentage of earnings.

Taxpayer numbers

15. Option B would reduce the number of taxpayers (single people and married couples) by around 320,000 compared with indexation. There would be around 185,000 fewer higher rate taxpayers compared with indexation. (On the basis of the latest forecast the number of higher rate taxpayers under indexation will be the highest ever.)

NIC losers

16. Option A would eliminate cash loses from the increase in the UEL for 1989-90 (and indeed would give significant gains to those basic rate taxpayers in the kink between the UEL and the basic rate limit). Option B would eliminate all the losers (except single people who are contracted-in) but would leave them with only relatively small gains in cash terms.

Car benefits

17. You also asked us to look at the distributional effects of combining a reduction of 1p in the basic rate with further increases in the car scales. The results for this and other options are set out in Annex D.

Interaction with Independent Taxation

18. We will let you have a separate note shortly in answer to your question about the numbers benefiting from an increase in allowances in 1990-91 as a result of the interaction of Independent Taxation.

B A Mace

B A MACE

ANNEX A

INCOME TAX: ALLOWANCES, THRESHOLDS AND RATES

	1988-89 £	1989-90ø (Indexation) £		1989-90 (12.8%)* £	
Allowances					
Single person	2,605	2,785	(180)	2,945	(340)
Married Man	4,095	4,375	(280)	4,625	(530)
Additional Personal/ Widow's Bereavement	1,490	1,590	(100)	1,680	(190)
Age - Single person (Age 65-79)	3,180	3,400	(220)	3,590	(410)
Age - Married (Age 65-79)	5,035	5,385	(350)	5,685	(650)
Age - Single person (Age 80 and over)	3,310	3,540	(230)	3,740	(430)
Age - Married (Age 80 and over)	5,205	5,565	(360)	5,875	(670)
Age - Income Limit	10,600	11,400	(800)	12,000	(1,400)
Tax rate bands					
25%	0 - 19,300	0 - 20,700	(1,400)	0 - 21,800	(2,500)
40%	Over 19,300	Over 20,700		Over 21,800	

ø On the basis of the RPI for December 1988 which at 110.3 (January 87 = 100) is 6.8 per cent above the level of December 1987 (103.3).

* Increase of 12.8 per cent on 1988-89 levels of allowances and basic rate limit.

Annex B

SECRET

TABLE 2A

MARRIED COUPLES - ANNUAL FIGURES - INCREASING PERSONAL ALLOWANCES AND BASIC RATE LIMIT BY 12.8% FOR 1989-90

	Charge for 1988-89		Proposed charge for 1989-90		Reduction in tax after proposed change	
Income £	Income tax £	Percentage of total income taken in tax per cent	Income tax £	Percentage of total income taken in tax per cent	Income tax £	As percentage of total income per cent
4,000	0	*0.0*	0	*0.0*	0	*0.0*
5,000	226	*4.5*	94	*1.9*	132	*2.6*
6,000	476	*7.9*	344	*5.7*	132	*2.2*
7,000	726	*10.4*	594	*8.5*	132	*1.9*
8,000	976	*12.2*	844	*10.6*	132	*1.6*
9,000	1,226	*13.6*	1,094	*12.2*	132	*1.5*
10,000	1,476	*14.8*	1,344	*13.4*	132	*1.3*
11,000	1,726	*15.7*	1,594	*14.5*	132	*1.2*
12,000	1,976	*16.5*	1,844	*15.4*	132	*1.1*
13,000	2,226	*17.1*	2,094	*16.1*	132	*1.0*
14,000	2,476	*17.7*	2,344	*16.7*	132	*0.9*
15,000	2,726	*18.2*	2,594	*17.3*	132	*0.9*
16,000	2,976	*18.6*	2,844	*17.8*	132	*0.8*
17,000	3,226	*19.0*	3,094	*18.2*	132	*0.8*
18,000	3,476	*19.3*	3,344	*18.6*	132	*0.7*
19,000	3,726	*19.6*	3,594	*18.9*	132	*0.7*
20,000	3,976	*19.9*	3,844	*19.2*	132	*0.7*
22,000	4,476	*20.3*	4,344	*19.7*	132	*0.6*
24,000	5,067	*21.1*	4,844	*20.2*	223	*0.9*
26,000	5,867	*22.6*	5,344	*20.6*	523	*2.0*
28,000	6,667	*23.8*	6,080	*21.7*	587	*2.1*
30,000	7,467	*24.9*	6,880	*22.9*	587	*2.0*
40,000	11,467	*28.7*	10,880	*27.2*	587	*1.5*
50,000	15,467	*30.9*	14,880	*29.8*	587	*1.2*
60,000	19,467	*32.4*	18,880	*31.5*	587	*1.0*
70,000	23,467	*33.5*	22,880	*32.7*	587	*0.8*

Calculations assume that only the husband has earned income.

ANNEX B

SECRET

TABLE 2B

MARRIED COUPLES - ANNUAL FIGURES - INDEXATION PLUS 1 PENNY OFF THE BASIC RATE FOR 1989-90

	Charge for 1988-89		Proposed charge for 1989-90		Reduction in tax after proposed change	
Income £	Income tax £	Percentage of total income taken in tax per cent	Income tax £	Percentage of total income taken in tax per cent	Income tax £	As percentage of total income per cent
4,000	0	*0.0*	0	*0.0*	0	*0.0*
5,000	226	*4.5*	150	*3.0*	76	*1.5*
6,000	476	*7.9*	390	*6.5*	86	*1.4*
7,000	726	*10.4*	630	*9.0*	96	*1.4*
8,000	976	*12.2*	870	*10.9*	106	*1.3*
9,000	1,226	*13.6*	1,110	*12.3*	116	*1.3*
10,000	1,476	*14.8*	1,350	*13.5*	126	*1.3*
11,000	1,726	*15.7*	1,590	*14.5*	136	*1.2*
12,000	1,976	*16.5*	1,830	*15.2*	146	*1.2*
13,000	2,226	*17.1*	2,070	*15.9*	156	*1.2*
14,000	2,476	*17.7*	2,310	*16.5*	166	*1.2*
15,000	2,726	*18.2*	2,550	*17.0*	176	*1.2*
16,000	2,976	*18.6*	2,790	*17.4*	186	*1.2*
17,000	3,226	*19.0*	3,030	*17.8*	196	*1.2*
18,000	3,476	*19.3*	3,270	*18.2*	206	*1.1*
19,000	3,726	*19.6*	3,510	*18.5*	216	*1.1*
20,000	3,976	*19.9*	3,750	*18.8*	226	*1.1*
22,000	4,476	*20.3*	4,230	*19.2*	246	*1.1*
24,000	5,067	*21.1*	4,710	*19.6*	357	*1.5*
26,000	5,867	*22.6*	5,338	*20.5*	529	*2.0*
28,000	6,667	*23.8*	6,138	*21.9*	529	*1.9*
30,000	7,467	*24.9*	6,938	*23.1*	529	*1.8*
40,000	11,467	*28.7*	10,938	*27.3*	529	*1.3*
50,000	15,467	*30.9*	14,938	*29.9*	529	*1.1*
60,000	19,467	*32.4*	18,938	*31.6*	529	*0.9*
70,000	23,467	*33.5*	22,938	*32.8*	529	*0.8*

Calculations assume that only the husband has earned income.

SECRET

Annex C

1989-90 OPTIONS
MARRIED COUPLE

Total Income (lower limit) £p.a.	Number of taxpayers (thousands)	Basic Rate Average Gain £p.a.	at 24p Gain £m	Thresholds up 12.8% [1] Average Gain £p.a.	Gain £m
<5,000	59	3	(2)	44	3
5,000	561	12	7	62	35
7,000	189	21	4	66	12
7,500	214	22	5	67	14
8,000	423	23	10	68	29
9,000	479	32	15	71	34
10,000	463	38	18	70	32
11,000	597	47	28	74	44
12,000	592	54	32	82	49
13,000	584	65	38	76	44
14,000	302	70	21	72	22
14,500	315	72	23	75	24
15,000	2,494	94	234	78	195
20,000	1,602	137	219	85	136
25,000	839	180	151	113	95
30,000	1,023	228	233	230	236
50,000	313	265	83	294	92
Total	11,049	101	1,121	99	1,096

(1) 12.8% increase over 1988-89 levels.

(2) Less than £0.5 million.

1989-90 OPTIONS
SINGLE PERSON

Total Income (lower limit) £p.a.	Number of taxpayers (thousands)	Basic Rate at 24p Average Gain £p.a.	Gain £m	Thresholds up 12.8%[1] Average Gain £p.a.	Gain £m
<5,000	2,018	10	20	40	81
5,000	2,065	29	59	43	88
7,000	499	37	19	42	21
7,500	505	41	21	42	21
8,000	894	47	42	42	38
9,000	627	54	34	42	26
10,000	577	66	38	42	24
11,000	597	75	45	44	26
12,000	427	85	36	49	21
13,000	396	94	37	42	17
14,000	154	97	15	41	6
14,500	163	104	17	40	7
15,000	770	120	92	42	32
20,000	292	164	48	45	13
25,000	102	197	20	133	14
30,000	110	206	23	227	25
50,000	46	207	10	230	11
Total	10,242	56	576	46	471

(1) 12.8% increase over 1988-89 levels.

SECRET

ANNEX C

ANNEX C

NOTE

Although Options A and B have the same exchequer cost in a full year (£1.56 billion at 1989-90 income levels) their overall impacts on about 20 million basic rate income taxpayers are slightly different because of the effects of the imputation system. For example, when the basic rate is cut, payments of tax credits to exempt institutions decline, but there is no corresponding loss of revenue from corporation tax because the reduction in ACT is matched by increased mainstream CT. Similarly, as tax credits are reduced higher rate taxpayers will pay more excess over basic rate tax on dividends. The effect of these interrelationships is that with a basic rate cut, the gain to individual taxpayers is some £130 million higher than the overall cost of £1.56 billion.

ANNEX D

Car Benefits

Option	No of losers*	Average loss £/year	No losing* over £50/year	No brought over PIID threshold
i. 1p off basic rate 50% on car scales	200,000	41	80,000	30,000
ii. 1p off basic rate 40% on car scales	100,000	26	10,000	30,000
iii. Basic rate unchanged 20% on car scales	170,000	27	20,000	10,000
iv. Thresholds up by 12.8% 35% on car scales.	140,000	33	20,000	20,000

* excluding cases brought above P11D threshold by change in scales.

Analysis based on comparison of income tax liability in 1989-90 on:

a. 1988-89 scales, rates and allowances.

b. four options listed above.

chex.rm/aal/20 SECRET

FROM: A C S ALLAN
DATE: 15 February 1989

BF 22/2

MR O'CONNOR - IR

cc PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mrs Chaplin

Mr Corlett - IR
Mr P Lewis - IR
Mr Mace - IR
PS/IR

COMPOSITE RATE

The Chancellor would be grateful for quick advice on the following two options for changing the composite rate:

(i) Freeze it at 21.75 per cent until the basic rate is below that and then link the two;

(ii) Fix a floor to the composite rate of 20 per cent or the basic rate, which ever is the lower.

ACSA

A C S ALLAN

Inland Revenue **BUDGET SECRET**

Savings and
Investment Division
Somerset House

FROM : B O'CONNOR
15 February 1989

Thanks. NPA.

1. Mr ~~Isaac~~ [illegible] CJL 15/2

2. Chancellor

Ch
I suppose the pressure to refund to non-taxpayers is the killer. But it's a pretty rum system – especially post independent taxation. AA

COMPOSITE RATE

1. You asked for advice (Mr Allan's note of 15 February) on two options for changing the composite rate.

Present law

2. The composite rate is the rate at which tax has to be accounted for on interest paid to individual investors by building societies, banks and local authorities. It is a final tax and cannot be repaid to those who are not otherwise liable. It is determined on the basis of data for the preceding rather than the current year, and has to be, as nearly as possible, revenue neutral (ie. it should yield the same amount of tax as would be raised if those investors who were liable at basic rate suffered tax at that rate, and those who were not liable suffered no tax).

3. The rate is announced by Treasury Order, before at the latest, 31 December preceding the relevant tax year starting on the following 6 April. The Order fixing the rate at 21.75 per cent for 1989-90 was laid before Parliament on 12 December and the Statutory Instrument was published on 19 December.

---

cc.	
PS/Financial Secretary	Mr Isaac
PS/Economic Secretary	Mr Corlett
Sir P Middleton	Mr P Lewis
Sir T Burns	Mr Bush
Mr Scholar	Mr Mace
Mr Culpin	Mr O'Connor
Mrs Chaplin	PS/IR

4. Any higher rate liability on a taxpayer, in receipt of interest on which composite rate has been charged, is assessed in the tax districts. But for basic rate and non-taxpayers no Revenue action is required.

Option (i) Freeze at 21.75 per cent until basic rate is lower and then link the two.

5. This option does not affect the 1989-90 composite rate. However legislation would be required to ensure that future rates are frozen. As matters stand a Treasury Order will be laid next December fixing the rate for 1990-91. This will be based on tax rates and the tax status of depositors in 1989-90. A reduction below 21.75 per cent is almost certain to emerge if personal allowances are increased and/or the basic rate is reduced.

Option (ii) Fix a floor at the lower of 20 per cent or the basic rate.

6. Again this option does not affect the 1989-90 composite rate. It is also unlikely under the present rules, that the composite rate for 1990-91 would be less than 20 per cent, provided the basic rate for 1989-90 is not set below 23 per cent. This presupposes that the ratio of non-taxpaying to taxpaying depositors will not change significantly during 1989-90. In 1990-91, which will form the basis of the 1991-92 composite rate, this ratio is likely to increase with the advent of newly independent, non-taxpaying wives. A reduction of two or more points in the basic rate over the next two years could well result in a composite rate of less than 20 per cent in 1991-92.

Conclusion

7. Under either option a point will be reached where the composite rate is higher than a revenue neutral rate. This will make it more difficult to deny repayment to non-taxpayers. Such a course would be impossible to justify at the point where composite rate and basic rate reach parity.

Why?

8. On the best information currently available we think about 5 million non-taxpaying units (ie. counting married couples as one) are in receipt of deposit interest on which composite rate tax has been charged. If any question of refunding the tax arose it would impose an intolerable administrative burden requiring many hundreds of additional staff.

B O'CONNOR

For the reasons that we all know, the composite rate is a rather unusual sort of creature.

However, in all cases where tax is simply withheld at basic rate (for example from interest on bonds etc; or for that matter the different but comparable arrangements for ACT on dividends) tax is refunded to any taxpayer who is not liable at least at the basic rate of tax.

The special feature of composite rate is that it is an average rate. The bank or building society pays over to the Revenue the amount (as near as may be) that the Revenue would receive if tax was deducted in all cases at the basic rate, and tax was repaid to those depositors who are below the tax threshold. That is, for better or worse, the intellectual justification for refusing any refunds of composite rate tax.

As Mr O'Connor says, there would be a huge administrative cost in giving tax-~~free~~ re funds to bank and building society depositors below the tax threshold; and this potential cost will be much greater after Independent Taxation. Indeed, there is a question (raised in other papers which you have seen) over the potential staff cost of giving refunds under the present system, when the building societies create genuine shares and when accordingly (under the present rules) dividends qualify for ACT/tax credit arrangements.

A J G ISAAC

BUDGET CONFIDENTIAL

H.M. CUSTOMS AND EXCISE
VAT CONTROL DIVISION B
ALEXANDER HOUSE, 21 VICTORIA AVENUE
SOUTHEND-ON-SEA, X, SS99 1AH
TELEPHONE: SOUTHEND-ON-SEA (0702) 367105

DWP

FROM: R D GODDARD
VCB

DATE: 16 FEBRUARY 1989

APS/ECONOMIC SECRETARY

DEFAULT SURCHARGE: MAXIMUM RATE

Thank you for your note dated 6 February.

Implementing the reduced maximum surcharge rate for returns required to be furnished on or after 31 March 1989 means in practice that it will have effect in relation to any liability to a surcharge arising on or after 1 April 1989.

The draft clause and resolution have been expressed in these terms.

R D Goddard

R D GODDARD
VCB

Circulation:

PS/Chancellor	CPS	Mr Call	Mr Holloway
PS/Chief Secretary	Mr Jefferson Smith	Mr Culpin	Mr Paynter
PS/Financial Secretary	Mr Finlinson	Mr Gilhooley	Dr. McFarlane
PS/Paymaster General	Solicitor	Mr Michie	Mr Mault

FROM: N D HUGHES
DATE: 6 February 1989

MR R GODDARD - C&E

DEFAULT SURCHARGE : MAXIMUM RATE

The Economic Secretary was grateful for your minute of 31 January.

2. He is content for the new default surcharge rate to be implemented from 31 March 1989.

N D HUGHES
Assistant Private Secretary

CONFIDENTIAL

H.M. CUSTOMS AND EXCISE
VAT CONTROL DIVISION B
ALEXANDER HOUSE, 21 VICTORIA AVENUE
SOUTHEND-ON-SEA, X, SS99 1AH
TELEPHONE: SOUTHEND-ON-SEA (0702) 367105

FROM: R D GODDARD
VCB

DATE: 31 January 1989

Economic Secretary

DEFAULT SURCHARGE: MAXIMUM RATE

One of the recommendations of the Default Surcharge Review is that the maximum specified surcharge percentage should be reduced from 30% to 20%. This has been accepted as a Finance Bill 1989 clause.

If enacted, it is proposed that the reduced maximum surcharge rate should apply to returns required to be furnished on or after 31 March 1989 (the first standard "due date" after the Budget).

R D Goddard

Circulation:

PS/Chancellor	CPS	Mr Call	Mr Holloway
PS/Chief Secretary	Mr Jefferson Smith	Mr Culpin	Mr Paynter
PS/Financial Secretary	Mr Finlinson	Mr Gilhooley	Dr. McFarlane
PS/Paymaster General	Solicitor	Mr Michie	
			Mr Mault

chex.ps/jmt/42 BUDGET SECRET

COPY NO. 15 OF 15 .

FROM: J M G TAYLOR

DATE: 16 February 1989

MR O'CONNOR - Inland Revenue

cc PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mrs Chaplin

Mr Isaac - IR
Mr Corlett - IR
Mr Lewis - IR
PS/IR

COMPOSITE RATE

The Chancellor was grateful for your note of 15 February. No further action need be taken on this.

J M G TAYLOR

BUDGET CONFIDENTIAL

H.M. CUSTOMS AND EXCISE
NEW KING'S BEAM HOUSE, 22 UPPER GROUND
LONDON SE1 9PJ
01-620 1313

PS/ECONOMIC SECRETARY

FROM: D A GAW
REVENUE DUTIES DIVISION A

DATE: 16 FEBRUARY 1989

BINGO DUTY : GREG KNIGHT MP AND JOHN WATTS MP

In your note of 8 February some points were raised about bingo duty and the questionnaire on bingo duty sent to clubs by Customs. Our comments follow:

(i) contrary to the view expressed, the commercial bingo trade association has claimed at a recent meeting with Customs officials that the smallest commercial halls and proprietary clubs are in competition with non-commercial bingo promoted in the same localities;

(ii) the thresholds have admittedly been eroded by inflation. Commercial promoters however argue against what they consider privileged treatment of non-commercial bingo. Some of their number are operating below the thresholds but are still having to pay duty;

Distribution:

PS/Chancellor	CPS
Mr Culpin	Mr Jefferson Smith
Mr Gilhooly	Mr Wilmott
Mr Michie	Mr Allen
Mr Call	Mr Hewett
	Mr Pritchard-Woollett
	Ms French

101-BC

(iii) liability to duty is based on aggregate stakes (or prizes) in "a particular week". Changing to quarterly or annual thresholds would mean determining liability at the end of a quarter or year. Clubs often fail to acknowledge their liability and make no provision to pay duty, giving rise to financial difficulties when duty is demanded. Present problems would be compounded by lengthening the charging period, and other administrative complications could result.

(iv) Although commercial interests might object, the timing is about right for the thresholds to be revalorised. Given the widespread support for the clubs' movement, increasing the thresholds would generally be popular. Abolition of duty for non-profit making clubs would be contrary to the competition considerations which led to the existing arrangements and would almost certainly meet justifiable and strenuous opposition from commercial interests.

(v) **VAT and Gaming Machines.** Takings from all types of gaming machines are excluded from the general exemption applying to most forms of betting and gaming and are liable to tax at the standard rate. They are not the only forms of gambling subject to VAT. A number of other gambling activities are excluded from the general betting and gaming exemptions. The introduction of a relief for gaming machines would give rise to renewed pressure for further reliefs in the leisure sector. Successive Governments have regarded the playing of gaming machines as discretionary expenditure of a kind eminently suitable for taxation.

It has been argued in the past that gaming machines are subject to double taxation, given the interaction of VAT and Gaming Machine Licence Duty. Unlike VAT which applies to takings, gaming machine licence duty is payable on the licence which it is necessary for an operator to hold before a machine can be provided for gaming.The licence duties were reduced in 1975 to compensate in part for the introduction of VAT on gaming machine takings and subsequent licence increases have been from this lower base.

We understand that in the EC most member states consider that gaming machines are taxable and that a large majority takes the view that the taxable amount should consist of the sum of money inserted into the machine; UK practice is to tax only the net amount of the take, ie the amount left after winnings have been paid out, which is more advantageous to the taxpayer. EC VAT law permits member states to apply the relevant provisions "subject to conditions and limitations laid down by each Member State".

(vi) As social law limits for bingo were raised last year, the Gaming Board is unlikely to oppose an increase in the exemption limits to say £500 (daily) and £1250 (weekly).

2. The authority to require information (which includes the use of questionnaires) is in the Betting and Gaming Duties Act, 1981, Schedule 3, paragraph 12(3). A number of clubs have been discovered to be playing bingo above the exemption limits without registering with Customs. In some cases their failure to register was deliberate. The use of questionnaires is more likely to nip such problems in the bud and saves the time of Customs staff and club officials, which would otherwise be taken up in official visits to club premises.

3. Increasing the exemption limits was offered as a Budget 'lollipop' even though a change can be made by Order at any time. We would be happier with a concession at Committee Stage than with a Finance Bill starter. Should the change be conceded there is a possibility that the lobby may turn its attention to getting the present liability period reduced during the passage of the Finance Bill (the change would need amendment in primary legislation). We advise against conceding on both counts and would suggest that it be made clear that an increase in the exemption limits is as far as Ministers are prepared to go.

Gaw

D A GAW

est.ld/james/7 Feb/Gaw

FROM: S M A JAMES
DATE: 8 February 1989

MR GAW - C&E

cc: PS/Chancellor 2
Mr Culpin
Mr Gilhooly
Mr Michie
Mr Call

PS/C&E
Mr Jefferson-Smith - C&E
Mr Wilmott - C&E

BINGO DUTY

The Economic Secretary has been passed the attached papers by Greg Knight MP and John Watts MP (top copy only) who lobbied him about bingo duty. They made the following points:

(i) small commercial clubs do not feel that social clubs constitute a competitive threat compared with newspaper bingo;

(ii) even if they are, the thresholds are far too low;

(iii) they recognise the undesirability of frequent de/re registration. John Watts suggested working on quarterly or annual thresholds which would be easier to administer. (The Economic Secretary would be grateful for comments on this idea please;

(iv) we should at least revise the threshold and better still abolish duty;

(v) VAT and gaming machines. This is the only form of gambling paying VAT. It bears on clubs as only they are able to have machines. The UK is the only country in Europe to impose this 'double taxation'.

(vi) The Chairman of the gaming board would probably support raising the threshold at least.

2. On the papers attached below (top copy only) concerning questionnaires circulated to clubs, Mr Watts asked what is the authority for questionnaires on bingo duty sent to clubs by Customs. This creates extra paperwork.

3. The Economic Secretary thinks we should be prepared to make a concession on bingo duty at Committee Stage.

S M A JAMES
Private Secretary

chex.md/jmt/30 **BUDGET CONFIDENTIAL**

cc: Mr Jaundoo IR
Mr Pitts IR
Mrs Evans IR
PS/IR

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

20 February 1989

J C Jenkins Esq
Office of the Parliamentary
Counsel
36 Whitehall
London SW1A 2AY

Dear Christopher

INHERITANCE TAX

Thank you for your letter of 16 February, which I have shown to the Chancellor.

The Chancellor has noted the possibility of altering the structure of inheritance tax so as to introduce into it the notion of a tax-free slice, rather than a slice charged at nil per cent. He has commented that this is clearly the answer to the problem. He would be most grateful if this could be done, once the drafting of the rest of the Bill is completed.

Yours sincerely

Jonathan Taylor

J M G TAYLOR
Private Secretary