

PO-CH/NL/0488
PART A

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PART. A

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PART. A

1989 BUDGET

SPEECH

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Budget ~~488~~.

Speech

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Re

- 1. **MR CULPIN** *9/2*
- 2. **CHANCELLOR**

**FROM: N I MACPHERSON
DATE: 9 February 1989**

cc: Chief Secretary
 Financial Secretary
 Paymaster General
 Economic Secretary
 Sir P Middleton
 Sir T Burns
 Dame Anne Mueller
 Mr Wicks
 Mr Hardcastle
 Mr Byatt
 Mr Scholar
 Mr Riley
 Mr Sedgwick
 Mr Gilhooly
 Mr Matthews
 Miss Simpson
 Mrs Chaplin
 Mr Tyrie
 Mr Call

SECRET

Sir A Battishill)
 Mr Beighton) IR
 Mr Isaac)
 Mr Painter)
 Mr Unwin) C&E
 Mr Jefferson Smith)

B.L.O.

BUDGET: CONSULTATION WITH OTHER MINISTERS

I attach a list of Budget measures on which we think you may need to consult colleagues. Not included are consultations with the Governor of the Bank of England, which are already in hand.

2. Are you content?

N. Macpherson

N I MACPHERSON

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| <u>PROPOSAL</u> | <u>CONSULTATIONS REQUIRED</u> | <u>ACTION</u> |
|-------------------------------|--|---|
| Unleaded petrol | Chancellor to talk to Mr Ridley first about general differential (mid February) and then about details (early March). Mr Parkinson and Mr Channon also to be informed. | Chancellor's office to set up meeting |
| Vehicle Excise Duty | Economic Secretary to write to Mr Bottomley about minor transport starters (mid February). Chancellor to write to Mr Channon about main VED rates by 20 February. | FP to provide drafts |
| Company cars | No need to consult Lord Young, but may want to anyway. | Depends on decisions |
| Pensions | Chancellor to talk to Lord Chancellor about effect of pension limits on judges. | Chancellor's office to set up meeting. S to provide briefing. |
| | Financial Secretary may need to consult Mr Maude on allowing people to run own personal pension schemes. Consultation going on at official level first. | IR |
| | No need to consult Mr Moore on pensions measures, but may want to anyway. | Depends on decisions |
| NICs and subsidised mortgages | Mr Moore to be consulted by late February, if decide to go ahead. Meetings with DSS would then take place at official level (end February onwards). | Depends on decisions |
| Oil taxation | Meeting between Economic Secretary and Mr Morrison (DEn) on incremental investment relief in mid February. | EST office to set up meeting |
| Rent a room | Chancellor may want to consult Mr Ridley, if decide to go ahead. | Depends on decisions |
| Unauthorised disclosure | Chancellor to write to Prime Minister (copies to Home Secretary, Mr Moore and Attorney General) in mid February. | IR/C&E to provide draft |
| Abolition of COBO | No decision on consultation, but Chancellor may want to write to Lord Young. | FIM to provide draft |

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REF NO: MW/90/6 TOP
COPY NO: 13 OF 13



FROM MOIRA WALLACE
DATE 16 FEB 1989

MR MACPHERSON

cc Mr Culpin
Mr Gilhooly
Mr Matthews
Mr Walker
Miss Massie
Mr Wilson
Miss Gaselhine

BUDGET SPEECH

I attach the first chunk of draft speech, based on the notes you and others sent me, and odd jottings from the Chancellor, and Judith Chaplin. I am still assembling the second half which covers the Savings/shares/social security stuff.

I'd be grateful for any corrections and comments by 6.00 pm tonight please. (Sorry!) Comments on this copy in red are best.

Moira Wallace

TAXATION SECTION

I now come to the detailed measures in this year's Budget. I begin with the taxation of business.

2. This Government came to office determined to revive the enterprise culture in Britain. For without a strong economy, all our other aspirations would just have been so much wishful thinking. Higher living standards, better public services, better opportunities can only be realised if you first build a strong economy, rooted in a thriving private sector. And that is precisely what we have seen in Britain in the '80s.

3. The reform of business taxes has played a crucial part in this revival. With lower rates, a broader base, and a less distortive system, profitability is higher than for twenty years, and investment and job creation have boomed.

4. Maintaining this momentum is the best possible preparation for the '90s, and so I have made business one of the priorities of my first Budget.

5. To begin, I have two important measures of deregulation in the field of VAT, which will be of particular benefit to small and medium-sized businesses.

6. At present, traders have to pay VAT on all their sales, whether or not their customers have actually settled the bill. VAT relief for a bad debt can only be claimed once the debtor has been declared formally insolvent. As a result, the trader can be considerably out of pocket for some time. To remedy this, I propose that from [1 August], all debts which are over 18 months old will qualify for relief from VAT.

7. I also propose simpler rules for traders registering for VAT. At present registration is triggered by quarterly and annual turnover thresholds, and businesses also have to peer into the future to see if the limits might be exceeded in the next 12 months. This complication is unnecessary. So as from Budget Day, I propose a single rule for VAT registration, based on turnover in the past 12 months.

8. I also propose to increase the VAT threshold to [X], the maximum permitted under European Community law.

9. Next, I have a number of changes to announce to specific business tax regimes. First, banks. [Scholar contribution].

10. [The Finance Bill will also include a number of measures on Life Assurance, announced by my HF the Financial Secretary last December, which complement the changes in the 1989 Finance Act.]

11. My next announcement also affects the City, though, with the expansion of popular share ownership we have seen in recent years, its effects go far wider than that. In the 1984 Budget, the 2 per cent stamp duty on share transactions was cut to 1 per cent. It was cut again to $\frac{1}{2}$ per cent in 1986. I have now decided to abolish it altogether, with effect from [when?] [to coincide with the introduction of paperless transactions on the Stock Exchange.] This will remove a barrier to ownership, and eliminate an aspect of the tax system which puts the British financial services sector at a disadvantage compared with some of its competitors.

12. I ^{also want to say something about the tax treatment} of the football industry. Implementation of the safety measures recommended in Lord Justice Taylor's Report is obviously going to place a considerable burden on football clubs in the coming years. I recognise this, and have therefore reviewed the tax provisions in this area.

13. Having done so, I am satisfied that the Corporation Tax treatment of football clubs' safety expenditure is fair. In practice, [most?] of the expenditure required to meet the Taylor recommendations should be eligible for capital allowances or indeed for full offset against tax. But the position is complicated, and depends in part on whether the expenditure is necessary to obtain a safety certificate. There may at present be local variations in the precise standards required, but the new Football Licensing Authority should be able to issue guidance on what clubs need to do. For my part, I propose that the Inland Revenue issue a new statement of practice clarifying the tax position, which could be incorporated in any more general guidance the FLA wish to issue.

14. I have also reviewed the rate of Pool Betting Duty, currently 42½ per cent. In the light of the Taylor report, I see some justice in the argument that we now should take less tax from football pool betting, but only on condition that the money goes to improve safety, rather than, say, to provide higher prizes. I am therefore prepared to reduce this duty by 2½ per cent, to 40 per cent, so long as the benefit of the cut is all channelled to the Football Trust, to distribute for essential safety expenditure in football league grounds. I hope that we shall be able to negotiate

such an arrangement with the pools companies and the Football Association.

15. Lastly on business taxation I have some changes to Corporation Tax to propose. I have already referred to the Corporation Tax reforms introduced by my RHF, Blaby, in 1984 which have removed the tax incentive for uneconomic investment, and given the UK one of the lowest CT rates in the world, at 35 per cent.

16. In my Budget today I propose to reduce Corporation Tax still further, first by a significant increase in the limit below which companies pay the reduced rate of Corporation Tax. This limit currently stands at £150,000, and I propose to raise it to £200,000. This amounts to a doubling in two years.

17. Above this limit, the average rate of tax gradually rises until the higher profit limit of £750,000 a year is reached and the full rate is payable. I propose to widen this band by raising the upper limit from £750,000 to £1 million.

18. Finally, I propose to reduce the main rate of Corporation Tax itself, by 1p in the pound, to 34 per cent. Taken together these measures will have a cost of

[£340 million] in 1991-92, and will reduce the tax burden for [how many?] companies.

TAXES ON SPENDING

19. I now turn to taxes on spending. Given the need to keep a very tight fiscal position, my judgement is that the excise duties as a whole must rise [broadly] in line with inflation. Within that overall envelope, however, I have some modest adjustments to make.

20. First, I propose to leave the main rates of Vehicle Excise Duty unchanged once again this year, recouping the cost by increasing petrol duties by rather more than inflation. The duty on leaded petrol will rise by 10 per cent, or almost 11 pence per gallon. For unleaded petrol I propose a similar percentage rise, which means a lower cash increase, at just over 9 pence per gallon. This effect is to widen the differential in favour of unleaded still further, to some 12 pence per gallon at the pump. This should give a further boost to the market share of unleaded petrol, which has increased fivefold, from 6 per cent to 30 per cent, over the last year.

21. As for alcohol, I propose with one exception to raise the duties in line with inflation. This will put 7p on a

bottle of table wine, and tuppence on a pint of beer. The exception is spirits, which have benefited from very favourable treatment for a number of years: here I propose to increase the duty by 10 per cent, putting 54p on a bottle of whisky.

22. I also propose a 10 per cent duty increase for cigarettes, which will put 10p on a packet of 20. [But I do not this year propose any increase in duty on cigars and pipe tobacco.]

INCOME TAX

23. Next, I deal with income tax.

24. This April sees the implementation of a major and long-overdue income tax reform, with the introduction of independent taxation for husband and wife. As a result, 3 million married people will gain, ^{whom} ~~and of that number~~ 2 million have incomes of less than £5,000 a year. It will also be of particular benefit to the elderly. This is, as I say, a welcome and overdue reform, but it does have a high cost - some £500 million in the coming year, and more thereafter. This inevitably limits my freedom to do anything else on the income tax front. So although it would give me great pleasure to announce today further progress towards our

objective of a basic tax rate of 20p in the pound, I am afraid this simply is not the year.

25. However, that is not to say that I am going to raise the income tax burden, by allowing inflation to erode the personal allowances. That is no part of my policy.

26. I therefore propose to raise the main income tax thresholds and allowances by the statutory indexation factor of 7.7 per cent, rounded up. What generosity I can afford, I have thought right to direct to the allowances for the elderly, which will rise by 10 per cent.

27. Thus the single persons allowance will rise by £220 to £3,005. The new married couple's allowance, [do I need to explain here? I come to Independent Taxation later] will be set at £1,720, as will the additional personal allowance, and widow's bereavement allowance. The basic rate limit will rise by £1,600 to £22,300. [Can I mention CGT ^{exemption} uprating here?] L

28. The age allowance for those aged 65 to 74 goes up £340 to £3,740 for a single person and by £200 to £2,185 for a married couple. For those aged 75 and over the higher age allowance goes up by £360 to £3,900 for a single person, and

by £210 to £2,235 for a couple. The income limit for age allowance also rises by 10 per cent to [X].

29. I also have to set the scales for the taxation of private use of company cars. Despite significant increases in these scales in recent Budgets, the tax treatment of this benefit remains extremely generous, in my view unduly so. I therefore propose another substantial increase, of 20 per cent. The yield from this will be X in 1990-91.

[wordcount = 1665]

c.12 minutes.

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BUDGET

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

17 February 1989

Paul Gray Esq
10 Downing Street
LONDON SW1

SECRET

Dear Paul

I attach an aide memoire on the Budget. You will have received a copy of the Budget Security Instructions and I should stress that the aide memoire should not be shown to anyone other than the Prime Minister and yourself.

*Yours
A.C.S.*

**A C S ALLAN
Principal Private Secretary**

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AIDE MEMOIRE ON BUDGET

Income tax and NICs

For the purposes of the figuring in the attached table, it has been assumed that personal allowances and the basic rate limit are indexed; that there is no change in the basic rate; and that there are no changes to NICs. A NICs reform is still under consideration.

Excise duties

2. No change in any of the main excise duties. The duty on unleaded petrol reduced to produce a pump price differential of 2p a litre (approximately 9p a gallon) with 4 star leaded petrol; a surcharge on 2 star leaded petrol to bring it up to the same price as 4 star. Increased VED for coaches and rigid heavy goods vehicles (agreed with DTp).

VAT

3. Implement the changes resulting from the European Court of Justice decision, as already announced; the bulk of the additional yield comes from the public sector (the impact of this on public expenditure was taken into account in the Autumn Statement). No other changes in VAT coverage.

Company cars

4. Car scales (which determine amount of taxable benefit from company cars) to be increased by 20 per cent.

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Corporation tax

5. Thresholds for the small companies' rate increased by 50 per cent; rate itself assumed to remain at 25p.

Stamp duty on shares

6. Abolish stamp duty on share transactions, probably from 1 April 1990. Announcement and legislation needed now to enable the Stock Exchange's new paperless transactions system ('TAURUS') to be planned and implemented on this basis.

Life assurance

7. Maintain the existing structure of taxation. Reduce the tax rates on policyholder's income and gains to 25 per cent (from 35 per cent and 30 per cent respectively). Ring-fence life offices' pension business, so that expenses there cannot be set off against income on life business. Abolish life assurance premium duty. (Life offices will also gain about £100 million a year from the abolition of stamp duty on shares: this is included in the costings of that measure). Allow selling expenses to be deducted from taxable income and gains only over seven years, instead of being offset in full against income and gains in the first year; phase this change over four years.

Unit trusts

8. Reduce the Corporation Tax rate on unfranked income (principally dividends on gilts) from 35 per cent to 25 per cent from January 1990.

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Pensions

9. For final salary schemes, place a limit on tax privileged pensions. Deregulate, so that the Revenue no longer lay down how much pension someone can be paid, but only how much tax-privileged pension. Pensions will be payable from tax privileged funds on earnings of up to £60,000 a year. This translates into limits of £40,000 a year on the total pension and £90,000 on the tax-free lump sum. These limits will apply only to new pension scheme members, and will be indexed to prices. Employers will be free to pay additional amounts without tax privilege.

10. For personal pensions, increase the percentage of earnings which may be contributed with tax relief, subject to a cash limit.

PEPs

11. The limit on the total annual investment to be raised from £3,000 to £4,800; and within that the limits on investments in unit and investment trusts from £750 to £2,400. Rules greatly simplified.

Employee share schemes and ESOPs

12. Various increases in the limits for employee share schemes. And to enable the development of ESOPs, Corporation Tax relief on company contributions.

CGT

13. Abolition of the tax deferral on gifts (but not to charities, or on business assets, or between husband and wives). This was introduced in [1980] to avoid the double charge to CGT and CTT on lifetime gifts, but the CTT charge has since been abolished. The

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exemption limit for CGT to be frozen, pending the effective doubling (for married couples) when independent taxation comes in next year.

Pensioners' Earnings Rule

14. Pensioners' earnings rule to be abolished. Gross public expenditure cost of about £½ billion to be met from the reserve. Retain the option to defer pensions in return for higher pension later.

Deregulation/Simplification

15. A number of measures of deregulation and simplification: additional VAT bad debt relief; simplification of VAT registration rules; changing Schedule E to be charged on a receipts basis; a radical simplification the rules on close investment companies: unincorporated businesses to be allowed to set capital gains against trading losses; the Control of Borrowing Order to be abolished.

Other proposals

16. Other proposals include:

- (i) converting the higher age allowance for the over-80s to one that covers all those over 75; and reducing the marginal withdrawal rate for age allowances to below 40 per cent;
- (ii) increasing the PRP limits to £4000, and other simplifications to the PRP rules;

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- (iii) increasing the Payroll Giving limit from £240 to £480;
- (iv) implementing the tax relief for private health insurance for the elderly.

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TABLE 1.1 THE BUDGET MEASURES¹BUDGET SECRET
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These measures, and the basis of the costings shown, are described in detail in chapter 4.

| | £ million 1988-90 | yield (+)/cost (-) 1990-91 |
|---|---------------------------------------|------------------------------------|
| | Changes from a non-indexed base | Changes from an indexed base |
| | | Changes from an indexed base |
| Income Tax | | |
| personal allowances and basic rate limit indexed | -1465 | - |
| car benefit scales increased | + 90 | + 90 |
| Schedule E put on receipts basis | - 60 | - 60 |
| Excise duties | | |
| petrol, derv etc | - | - 545 |
| duty on unleaded petrol reduced, surcharge added to 2 star petrol | - 30 | - 30 |
| vehicle excise duty | + 40 | - 150 |
| tobacco | - | - 235 |
| alcohol | - | - 255 |
| Value Added Tax | | |
| non-domestic construction etc | + 315 | + 315 |
| bad debt relief, reform of registration rules etc | - 105 | - 105 |
| Stamp duty on shares abolished | - | - |
| Life assurance businesses' tax regime reformed | - 20 | - 20 |
| Reforms to pensions, personal equity plans, share schemes and unit trusts | - 5 | - 5 |
| Corporation Tax | | |
| small companies' rate threshold increased | * | * |
| Petroleum revenue tax | | |
| incremental investment relief introduced | - 10 | - 10 |
| Other tax changes | - 65 | - 30 |
| Total | -1315 | -1040 |
| | | -1885 |

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mpw/90/8

pwp

FROM: MISS M P WALLACE
DATE: 20 February 1990

MR CULPIN (FP)

- cc PS/Chief Secretary
- PS/Financial Secretary
- PS/Paymaster General
- PS/Economic Secretary
- Sir P Middleton
- Sir T Burns
- Sir J Anson
- Mr Wicks
- Mr Scholar
- Mr Hardcastle
- Mr Riley
- Mr Gilhooly
- Mr Matthews
- Mr O'Donnell
- Mr Ritchie
- Mr Macpherson
- Miss Massie
- Mr A Walker
- Mrs Chaplin
- Mr Tyrie
- Mr Lightfoot

- Sir A Battishill - IR
- Mr Isaac - IR
- Mr Painter - IR
- Mr Beighton - IR
- Mr Bush - IR
- Mr McNichol - IR (+1)
- Mr Unwin - C&E
- Mrs Strachan - C&E
- Mr W Parker - C&E
- Mr P Collins - C&E (+1)

pl return to Mr Walker

Thanks. One query. How much does X in § 40 matter?

Mair

Miss Wallace

- a few things.

22ii

M Walker

Consider 33

BUDGET SPEECH

... I attach the Chancellor's first version of the Budget measures section of the speech. There are a number of gaps at present - notably banks, charities, and the details of TESSA, where drafting can wait until decisions are clearer. The Chancellor will also want to draft a more general piece on the rationale behind the savings package, but that may end up in the first half of the speech.

2. The Chancellor plans to work further on the speech during Friday, and so he would be grateful if the first round of comments could reach him by close on Thursday, 22 February. Apologies for this tight deadline. As last year, it would be helpful if copy recipients could mark any comments in manuscript on their copies, and return them to me. I will send them back when I have transcribed them to a master version. Messrs McNichol and Collins

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have kindly agreed to muster collected Revenue and Customs comments.

3. After this, the timetable is for a further version, reflecting the Chancellor's revisions over the weekend, to be circulated next Monday, again with a deadline for comments of the following Thursday.

MOIRA WALLACE

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DRAFT: 20.02.1990

TAXATION SECTION

I now come to the detailed measures in this year's Budget. I begin with the taxation of business.

2. Calvin Coolidge once said "the business of America is business". That must be true here too. For unless we sustain a strong economy, our other aspirations become just wishful thinking. Our ambition to see higher living standards, better public services, and better opportunities, can only be realised if we create wealth. We must therefore continue to build up business and enterprise.

3. There can be no doubt that the structural reform of corporation tax, introduced by my RHF, Blaby, has greatly boosted business and commerce. With lower rates, a broader base, and a less distortive system, profitability has been higher than for twenty years, and as a result, investment and job creation have boomed.

4. But there is still more to be done, and I have some changes to announce that should help.

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5. To begin, I have two important measures of deregulation in the field of VAT, which will be of particular benefit to small and medium-sized businesses.

6. At present, traders have to pay VAT on all their sales, whether or not their customers have actually settled the bill. VAT relief for a bad debt can only be claimed once the debtor has been declared formally insolvent. As a result, the trader can be considerably out of pocket, in some cases for years, and often for large sums. This has been a source of grievance among businesses and I think it is time to deal with it. I propose therefore that from [1 August], all debts which are over 2 years old will qualify automatically for relief from VAT. [Cost?]

7. I also propose simpler rules for traders registering for VAT. At present registration is triggered by quarterly and annual turnover thresholds, and businesses also have to peer into the future to see if the limits might possibly be exceeded in the forthcoming 12 months. This complication is unnecessary. So as from Budget Day, I propose a single simple rule for VAT registration which will be based on turnover in the preceding 12 months. [This should bring certainty, and end the absurdity of taxation by guesswork]. [Cost]

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8. I also propose to increase the VAT threshold to [X], a modest sum, but the maximum permitted under European Community law.

9. I also have a number of changes to announce to specific ^{away dh} business tax ^{ation.} regimes. First, banks. [To follow].

10. [The Finance Bill will also include a number of measures on Life Assurance, announced by my HF the Financial Secretary last December, which complement the changes in the 1989 Finance Act.]

11. My next announcement also affects the City, specifically the equity markets.

12. The UK's pre-eminence as a financial centre, in what has been an increasingly competitive international market, is one of the great success stories of the 1980s. I have no doubt that the reductions in stamp duty introduced by my predecessor in his 1984 and 1986 Budgets have played their part in this. With lower transaction costs, business has boomed, and stamp duty receipts are now [double] what they were in 1984.

13. However, the world has moved on since the present 4 per cent rate of stamp duty was set. With the prospect of 1992

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Moira
Is there a danger that putting this in the business/city section will make the response "give away to city fat cats"??
the alternative would be to put it in the savings section
- will help with share ownership (THERES + SD abolition shed modest transactions costs for small investors)
- will also help City keep competitive position

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and even sharper international competition in financial services, a number of European countries have announced their intention to abolish their taxes on share transactions in the near future.

14. This clearly raises the question ^{how} whether the UK should ^{keep ahead} follow suit. But there is another consideration, which we would have faced anyway, regardless of developments in Europe. Over the next X months, the Stock Exchange will be putting the final touches to their plans for a modern paperless share-dealing system, a project affectionately known as TAURUS. Once implemented, TAURUS faces us with a difficult logical problem: namely, how we apply stamp duty to a transaction where there is no piece of paper to stamp. TAURUS users will soon be beginning to design the new systems on which it will be operated, and they need to know in good time how the Inland Revenue propose to deal with this.

15. I have considered these two ^{issues/challenges} problems together, and I have come to the conclusion that practical and competitive arguments point in the same direction. I therefore propose to abolish stamp duty from [when?]. In doing so, I shall be following my predecessor's excellent example of abolishing taxes [wherever he could], and I shall remove a further barrier to share-ownership. [Cost]

I don't think we should appear just to be reacting and following others.

NB: There are a number of paperless transactions now. SDRT was introduced to cope with them.

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16. I wish to turn now to sport and, in particular, football. The tragedies at Bradford and Hillsborough football grounds shocked everyone. They highlighted the

quite unacceptable conditions of comfort and safety at our

[great] sports stadia. [The subsequent report by

Lord J Taylor ~~...~~ (insert couple of sentences summarising

Taylor Report).] But implementing the Taylor Report is

obviously going to place a considerable burden on football

clubs in the coming years. I recognise this, and have

therefore reviewed the tax provisions in this area. I have

two objectives: to enable necessary improvements in safety

and comfort to be made, and to prevent the closure of many of

our grounds that might occur if we gave no assistance.

17. Much of the expenditure required to meet the Taylor

recommendations should be eligible for capital allowances or

indeed for full offset against tax. But I am aware that

there may be some confusion in this area, and I therefore

propose that the Inland Revenue should offer guidance

clarifying the tax position, which could be incorporated in

any more general guidance the FLA wish to issue.

xx

18. I have also reviewed the rate of Pool Betting Duty,

currently 42¹/₂ per cent. In the light of the Taylor report,

I see some justice in the argument that we now should take

less tax from football pool betting in order that the

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or "to help our national sport."

football ^{Supporter.} fan can benefit. I am therefore prepared to reduce this duty by [X] per cent, to [Y] per cent, for a period of 5 years so long as the benefit of the cut is all channelled to the Football Trust, to distribute for essential safety expenditure in football league grounds. I hope that we shall be able to negotiate such an arrangement with the pools ^{promoters} companies and the Football Association. Such a reduction would yield [Z] over five years, and, ^{with the money football is able to raise from other sources, enable} ~~enable~~ league clubs to bring their grounds up to the high standards we would all like to see.

19. Lastly on business taxation I have some changes to Corporation Tax to propose. I have already referred to the Corporation Tax reforms introduced by my RHF, Blaby, in 1984 which have removed the tax incentive for uneconomic investment, and given the UK one of the lowest CT rates in the world, at 35 per cent.

20. In my Budget today I propose to reduce Corporation Tax still further. I turn first to companies with small profits. They pay a reduced rate of Corporation Tax of 25 per cent on the first £150,000 of profits. I propose to raise it to £200,000. [extending the benefit to a further [X] companies].

This amounts to a doubling in two years.

21. For [medium sized] companies, with profits above this limit, the average rate of tax gradually rises until the higher profit limit of £750,000 a year is reached and the

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full rate is payable. I propose to widen this band by raising the upper limit from £750,000 to £1 million. This means that small and medium sized companies will not pay the full rate of Corporation Tax until their profits reach £1 million a year.

22. For larger companies, I propose to reduce the main rate of Corporation Tax itself, by 1p in the pound, to 34 per cent. [Our rate of corporate tax will then equal the lowest in the industrialised world(?)]

23. Taken together these measures will ~~have a~~ cost ~~of~~ [£340 million] in 1991-92, and will reduce the tax burden for [50,000] companies. In a year with limited room for manoeuvre on the tax front, these changes are a clear indication of the priority I give to maintaining a profitable business sector, one that can invest and innovate.

TAXES ON SPENDING

24. I now turn to taxes on spending. Given the need to keep a very tight fiscal position, my judgement is that the excise duties as a whole must rise broadly in line with inflation. Within that overall constraint, however, I have some modest adjustments to make.

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25. First, I propose to leave Vehicle Excise Duty on cars unchanged once again this year, recouping the cost by increasing petrol duties by rather more than strict revalorisation. The duty on leaded petrol will rise by 10 per cent, or almost 11 pence per gallon. For unleaded petrol the ~~cash~~ increase of a similar percentage rise, is just over 9 pence per gallon. This ~~effect is to~~ ^{will} widen the differential in favour of unleaded still further, to some 12 pence per gallon at the pump. This should give a further [significant] boost to the market share of unleaded petrol, which has increased fivefold, from 6 per cent to 30 per cent, since the changes in the last Budget.

26. As for alcohol, I propose with one exception to raise the duties in line with inflation. This will put 7p on a bottle of table wine, but only tuppence on a pint of beer. The exception is spirits, which have enjoyed a duty standstill for a number of years: here I propose to increase the duty by 10 per cent, putting 54p on a bottle of whisky.

27. I also propose a 10 per cent duty increase for cigarettes, which will put 10p on a packet of 20. But I do not this year propose any increase in duty on cigars and pipe tobacco.

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* More general
passage on the
rationale for savings
package may appear
here, or in first half
of speech.

TAX ON SAVING

28. I now turn to tax on savings.

*

29. I have a number of measures to announce which will encourage financial independence and the savings habit.

30. One important element of the strategy is already in place. Independent taxation, which will come into force this April, brings married women freedom and privacy in tax matters for the first time in 200 years. I believe it will stand as a permanent monument to the tax reforming record of my RHF, Blaby. Few in the past can match that record, and few in the future will do so.

31. One very welcome result of independent taxation is the encouragement it will give to saving and the acquisition of capital. Indeed, this is where the reform is likely to have its greatest impact. ^{married women} Working wives have for many years been able to set their ^{tax allowance only} ~~earned income~~ against an earned income allowance. It is their savings which have been penalised, with each pound of income taxed at their husband's marginal rate. But from April, wives who do not work outside the home, or whose earnings are less than their tax allowance, can have the income from savings, tax-free up ^{to the value of} to their allowance.

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32. A number of women will have their money invested in shares, or in national savings, or in other accounts which pay interest gross of tax. They will benefit automatically. However, many women, particularly those with only small savings, prefer to save with banks or building societies, where income tax - or rather a proxy for it, the so-called composite rate - is deducted before it ever gets to the saver, and indeed, whether the saver is liable to pay tax or not.

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33. Composite rate was introduced for administrative convenience - and it is a great convenience - to reduce the costs of collecting small amounts of tax from large numbers of people. But the fact remains that with CRT, we overtax the poorest savers. [In the past, this was broadly defensible because married women did not have their own tax allowance. Now, rightly, they do.] If matters remain unchanged, they and others will pay tax that they should not pay.

is the argument that married women are the poorest savers? (suspect not.)

Can you illustrate something like "From April, many married women who get their own tax allowance for the first time will also be overtaxed in this way. This is indefensible."?

34. The scale of the injustice is compelling. Once Independent Taxation is implemented there will be 14 million people - over [one-fifth?] of the population - who have savings income that does not merit taxation, but which will be taxed under present legislation.

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35. They include [5 million] married women with little or no income of their own, [3 million] pensioners, [2 million] others, and [2 million] children with small savings accounts often funded with small gifts of money from parents and grandparents, or savings from pocket money.

36. There is no easy way out of this ~~intractable~~ ^{not intractable if there is a way out.} problem. But there is a way - and I propose to take it. I intend to abolish CRT for non-taxpayers, with effect from [?] the earliest practicable day. This measure will lift the burden of income tax from [14 million] savers who should not bear it, and in future, will not. [cat/yield]

37. I also want, in this Budget, to give some further encouragement to share-ownership. I am convinced that share-ownership is a trend we want to encourage. Not just because it provides industry with another source of funds, or indeed individuals with another investment product, although both of these are welcome. But just as important is the role that wider share-ownership can play in building bridges between what used to be called the two sides of industry.

38. [The last year has seen a further welcome increase in the number of individual share owners, which the latest Stock Exchange survey puts at 11 million, a new record.] The development of the personal equity plan, which again stands

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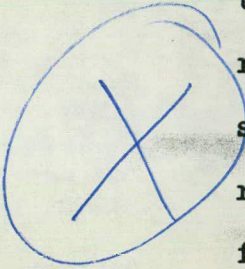
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Is this perhaps just one too many references to RHF/Blaby?

to the credit of my predecessor, has been an important factor in spreading popular capitalism. Last year was a particularly good one for PEPs, with a record 300,000 plans taken out, to the value of some £750 million.

39. This year, I propose to give PEPs a further boost, by raising the overall annual limit on investment by 25 per cent, from £4,800 to £6,000. Within that, the annual limit on investment in unit and investment trusts will be increased by the same percentage, to £3,000.

40. I am also sympathetic to the problems that investment trusts have experienced in qualifying for PEP treatment, as a result of the requirement that 75 per cent of their portfolio should be invested in UK ^{ordinary shares} equities. I propose to relax this rule, to 50 per cent. I also propose to raise the PEP limit for those investment trusts that do not satisfy this rule, from the present £750 to £900.



41. Last year, my RHF put employee share-ownership plans, or ESOPs, on the statute book, making it clear that companies' contributions to them qualify for corporation tax relief. I have received representations suggesting that ESOPs should be given further encouragement. I therefore propose to introduce a rollover relief from capital gains tax for sales of shares to ESOPs. This will enable company owners,

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particularly in the unquoted sector, to sell their shares to their workforce without incurring an immediate tax charge. I hope this will give ESOPs the fillip they deserve.

Voiron - there are several others not mentioned here: Stamp duty; extending ST42 to banks; increase in the friendly society tax-exempt limits. The last one might be with a

42. One more measure completes this package of savings incentives. Those I have already announced take our objective of widening share-ownership a little further, and remove ^{one long-standing} disincentive to capital accumulation. But I also want to do something to encourage and reward the habit of thrift, which will be targeted at the ordinary investor, the person who saves a little with the building society or bank every month, or the person who has a one-off capital sum that they are prepared to lock away for some time. [Details of TESSA.]

X

(- to be drafted later)

INCOME TAX

43. Next, I deal with income tax.

"I am also proposing to raise the limit for tax-exempt friendly society policies from £100 to £150."

44. I have already referred to the implementation this April, of a major and long overdue income tax reform, with the introduction of independent taxation for husband and wife. ~~This will mean gains for~~ ^{will be better off} nearly 3 million married women, of whom 2 million have incomes of less than £5,000 a year. It will also be of particular benefit to the elderly.

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45. It is, as I say, a welcome and overdue reform, but it does have a high cost - some £500 million in the coming year, and more thereafter. Inevitably, this limits my freedom to do anything else on the income tax front. So although I would wish to announce today further progress towards our objective of a basic tax rate of 20p in the pound, I am afraid this simply is not the year. So I have no change to announce to either the basic or the higher rate of tax. They will remain at 25p and 40p respectively.

46. However, I do propose to uprate the main income tax thresholds and allowances by the statutory indexation factor of 7.7 per cent, rounded up. Otherwise, inflation erodes their value and tax rises, by stealth. What additional generosity I can afford, I have thought right to direct to the allowances for the elderly, which will rise by 10 per cent.

47. As a result, the personal allowance will rise by £220 to £3,005. The new married couple's allowance will be set at £1,720, as will the additional personal allowance for single parents, and widow's bereavement allowance. The basic rate limit will rise by £1,600 to £22,300. I will also index the CGT exemption which goes up by £400 to £5,400; and despite the fall in many house prices I propose to raise the IHT threshold by £10,000 to £128,000.

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48. As I said before, I propose to over-index the tax allowances for the elderly. The age allowance for those aged 65 to 74 goes up by £340 to £3,740 for a single person and by £200 to £2,185 for a married couple. For those aged 75 and over the higher age allowance goes up by £360 to £3,900 for a single person, and by £210 to £2,235 for a couple. The income limit for age allowance also rises by 10 per cent to [X]. These increased allowances, taken together with the effects of independent taxation, will cut the tax bills of a significant proportion of pensioners. I know the whole House will welcome this.

49. I also have to set the scales for the taxation of private use of company cars. Despite significant increases in these scales in recent Budgets, the tax treatment of this benefit remains generous, though less so than previously. I propose therefore a smaller increase than in previous years of 20 per cent. The yield from this will be [X] in 1990-91.

[Charities - to be drafted later]

50. I have one final measure to propose, which builds on the measures which I have already announced to remove penalties on thrift. It relates not to the tax system but to the benefit system. At present, the income-related benefits -

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housing benefit, community charge benefit, income support and family credit - are subject to a capital rule. This means that if someone claiming means-tested benefits has significant amounts of capital, benefit is reduced. And above a certain level of capital - £6,000 in the case of income support and family credit, and £8,000 in the case of housing benefit and community charge benefit, a claimant becomes completely ineligible for benefit.

51. There is clearly a justification for some limit, so that the benefits can be targeted on those who need them most, but I am persuaded that the present limits should be higher.

52. With the agreement my RHE, SoS for Social Security, I therefore propose to raise the capital cut-off for those on income support or family credit to £9,000, and that for housing benefit and community charge benefit to £12,000. This measure will benefit (who? how many? how much?).

53. Subject to consultation with the local authorities, which administer housing benefit and community charge benefit, these measures will be introduced as soon as possible, and backdated to the beginning of the new financial year. The cost will be some [£70 million] in 1990-91, which

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will be met from the Reserve and not add to the overall
planning total.

[wordcount = 3289]

Conclusion and peroration to follow later.

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From: C D FORD
Date: 20 February 1989

MISS WALLACE

cc: Mr Culpin
Mr Gilhooly
Mr Matthews
Miss Hay
Mr Macpherson
Miss Simpson

BUDGET SPEECH - NOTES ON EUROPE

At Mr Culpin's meeting on Tuesday I agreed to produce some notes on the relationship between the Budget measures and European issues. I am sorry this has been delayed.

Commitment to single market

2. UK Government is firmly and whole-heartedly committed to the goal of completing the single European Market.
3. Believe that releasing market forces generates the economic growth which makes it possible to fulfil social and other objectives.
4. Recent history of the UK economy demonstrates the benefits which flow from deregulation, from freeing up markets and from dismantling barriers and controls, all within a proper framework of financial discipline.
5. Believe 1992 campaign should have similar revitalising results, community wide, to UK experience.

Opposition to central harmonisation

6. Important that approach should be based on deregulation rather than harmonisation - objective is to remove bureaucratic and other barriers, not to create more.
7. However do recognise the need to adjust tax system where it puts UK businesses at a competitive disadvantage
8. Should allow market forces to influence government policies as well as the actions of private citizens.

BUDGET CONFIDENTIAL

Measures in past budgets

9. Reduced rates of income tax - excessive rates drive talent to more hospitable shores overseas.

10. 1984 corporation tax reforms produced system with fewer distortions and one of lowest rates of CT in industrialised world.

1989 Budget - Savings measures

11. EC now undertaking the long awaited liberalisation of financial services. UK government regards this as a high priority. We reject view that harmonisation of savings taxes or regulatory regimes is a precondition for liberalisation.

12. Nevertheless it is appropriate to examine the tax system to ensure that UK financial companies are not unnecessarily disadvantaged or encouraged to emigrate.

Unit Trusts

13. It has become clear that investors in unit trusts which invest in gilts or other securities (but are not all gilt trusts) are paying tax at the corporate rather than the basic rate. This is unduly harsh and would put UK mixed trusts at a competitive disadvantage relative to European competitors. The rate is therefore being reduced to the basic rate.

Stamp Duty

14. Stamp duty is an inefficient tax which discourages transactions and encourages avoidance devices. The abolition of stamp duty will preserve London's position as an international financial centre and will eliminate the complexities which arise with regard to internationally traded securities.

Life Assurance

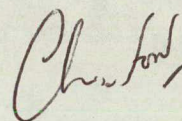
15. Several responses to the Inland Revenue's consultative document have drawn attention to the need to safeguard the position of the UK industry prior to the liberalisation of the European market. Conscious of need to avoid placing unreasonable burden on the industry; hence the phased introduction of the changes.

16. It would not be right to allow existing ramshackle regime to continue awaiting European developments. Present package of reforms provides a sound system - low rates and a broad base - which will leave the industry able to plan for the future. Do not believe harmonisation of tax systems required for a single market in savings; however it is important for Britain to have a rational, fair system which can be defended in any international discussions.

BUDGET CONFIDENTIAL

1989 Budget - Other measures

17. The other measures which have a significant European dimension are the extension of the VAT base ("required to follow ECJ judgement") and the excise duty package. Perhaps the latter should be presented as a gesture to Lord Cockfield ?



CHRIS FORD

REF : M 87 3
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PRIME MINISTER

This minute sets out my proposals for the Budget this year.

2. My aim, as in previous years, has been to devise a Budget which will give us a solid financial framework, with a safety margin built into it, for the year ahead; which will reduce taxation within the limits of prudence; and which will improve incentives and encourage enterprise.

3. I will minute you separately about my proposals for monetary targets and the PSBR when the final pieces of the jigsaw are available, early next week. But it is already plain that we shall be able this year both to plan on a PSBR substantially below the level envisaged in last year's MTF5 and at the same time to afford a tax reduction of £2½ billion in 1987-88 rising to just under £3 billion in 1988-89.

Income tax

4. I propose to increase the main personal allowances by the statutory indexation factor of 3.7 per cent. As last year, I am sure our priority must be to cut the basic rate - the starting rate for everyone, and the marginal tax rate for 95 per cent of all taxpayers. I am therefore proposing a 2p cut, to 27 pence in the pound. This will do more than any other measure available to us to add momentum to the growth of the enterprise culture. It is desirable in itself and is the best means of improving the longer term potential of the economy. It also highlights the difference between our approach and that of the Opposition.

5. Our presentation of these proposals should, I suggest, follow closely the line which we got across so successfully last year:

that it is aimed at the vast majority of taxpayers and will help all the sensitive groups in the middle - the nurse, the teacher married to a bank clerk and so on. To strengthen our presentation I propose, as last year, to set the higher rate bands so as to ensure that higher rate taxpayers will not benefit disproportionately from the income tax changes as a whole. Thus the first (40 per cent) higher rate threshold would be fully revalorised, the second (45 per cent) threshold partially revalorised, and the subsequent higher rate thresholds left unchanged.

6. For two groups I propose increases in the allowances beyond simple indexation: for those over 80 the age allowance will be increased by twice the indexation factor, ie by 7.4 per cent; and the blind allowance will go up from £360 to £540.

Excise duties

7. Apart from three minor changes in Vehicle Excise Duty and an increase in gaming machine duty, I am proposing no increases in the excise duties this year. This means that the overall impact of the Budget on the RPI as conventionally measured will be about 0.15 per cent (entirely reflecting the effect of the basic rate cut on mortgage payments), well below last year's 0.5 per cent. Although I expect some criticism from the health lobby I am sure that public opinion will well understand why I am not proposing tax increases on fuel, drinks and tobacco this year. I shall be reducing the duty on unleaded petrol by 5p a gallon, this honouring my promise last year; and I shall be abolishing the duty on on-course betting, recouping the revenue by the increase in the gaming machine duty.

Business and enterprise

8. My other Budget proposals are designed to carry further the themes of my previous Budgets. I am again taking action to tilt the balance towards small businesses, both by cutting their tax rates and by lightening the administrative load they bear. The small

companies' rate of Corporation Tax comes down to 27 per cent, in line with the basic rate cut. The self-employed will benefit from the reductions in income tax.

9. I am also legislating to ease the burden of VAT on small businesses. My proposals here follow the lines of the consultation exercise we launched last autumn. The main change here is the introduction of "cash accounting" which will mean that companies with an annual turnover of up to £¼ million (and not £100,000, as in the consultation document) will not have to pay VAT until they themselves have been paid by their customers. This will help their cash flow, as well as giving them automatic bad debt relief, something for which they have long asked. I would personally have liked to set a still higher limit, probably £½ million; but I have reluctantly concluded, on the basis of legal and other expert advice, that that would jeopardise our prospects of getting the necessary derogation from the EC Commission. I shall also be introducing optional annual accounting, which will enable small companies to make VAT payments on account and send only one return a year to Customs and Excise; and a number of other changes, including a further increase to the VAT threshold to keep it to the maximum currently possible under European Community law.

10. I am making a number of changes to streamline the taxation of the corporate sector. These changes have been made possible by, and build upon, the 1984 corporation tax reform, which has proved an outstanding success. It is improving both the environment for business and the quality of business decisions, and at the same time increasing the yield of the tax.

11. At present companies pay corporation tax at different times depending on whether they were established before or after 1965. This difference of treatment no longer has any justification. It is also open to abuse: you may remember the Habitat case last year. I therefore propose that all companies (and building societies)

should be treated in the same way, so that all will be liable to pay corporation tax nine months after the end of the accounting period on which the tax is due. The change will be phased in. For the longer term I am taking steps now to introduce a more streamlined method of collecting corporation tax, called Pay and File.

12. I am also making changes to the taxation of companies' capital gains. In future these will be taxed at the same rate as company income - either 35 per cent or, for small companies, 27 per cent - not, as now, at 30 per cent. Companies will be allowed to offset payment of Advance Corporation Tax against their tax liability on gains, something which will be generally welcomed.

13. Peter Walker and I have been looking closely at the effect of the last year's oil price on North Sea producers and their suppliers. We have already legislated to bring forward to 1986-87 the repayment of over £300 million of Advance Petroleum Revenue Tax. As agreed last November, I propose to introduce two further reliefs designed to encourage research and development in the North Sea oil sector. These have been carefully aimed where they should do most good. They are to allow part of the expenditure on new fields to be set against PRT liabilities on other fields; and to allow special relief for R&D even though it is not related to any individual field.

14. As in all previous years, I propose that the scale charge for assessing the taxable benefit of company cars should be increased by 10 per cent. There will be no change in the car fuel benefit scales.

15. The Budget will also contain a number of measures designed to block up loopholes where substantial losses of tax are at stake. On one of these, VAT partial exemption, we have already exchanged minutes (my minute to you of 16 December and David Norgrove's reply of 18 December) and it is now clear that the scale of avoidance is larger than we at first supposed (£300 million in 1987-88 and £400 million in 1988-89). The business community accepts that we must act to stop this practice. As you know, I am also proposing action, in line with what the US are doing, on dual resident

companies, to stop them getting tax relief twice on the same interest payment. And I am bringing to an end the present over-generous treatment of tax credit relief for foreign withholding tax paid on interest on bank loans.

16. I have one further measure in this category. Lloyd's have now discovered a loophole in the law which prevents the Revenue from challenging for tax purposes syndicates' "Reinsurance to Close" - ie their provision for outstanding liabilities. I am proposing to put this right and to bring the arrangements for Lloyd's into line with the tax treatment of provisions for outstanding liabilities made by ordinary insurance companies. The Revenue will consult Lloyd's on the details immediately after the Budget.

17. I am convinced that, where we can, we must give a push to moves towards more flexibility on pay throughout the economy. I accordingly propose now to introduce a scheme of tax relief broadly on the lines floated in the Green Paper on Profit Related Pay which David Young, Paul Channon and I published last July. But it will be a little more generous: half, rather than a quarter, of profit-related pay will be relieved from income tax, subject to limits; even so, the very small cost of this relief will, I fear, lead to accusations that this is derisory. All the same, for someone on average earnings receiving 5 per cent of their pay in profit-related form, the tax relief will be equivalent to a penny off the basic rate of income tax. The administration will be kept simple.

Savings

18. I have agreed with Norman Fowler a major package of proposals on pensions which will complement the reforms in 1985 and 1986 Social Security Acts. Our aim is wider pension ownership, and to encourage people to provide for themselves in old age.

19. There are several strands to the proposals. First, I am introducing a system of tax relief for personal pensions on broadly the same lines as that now applying to retirement annuities. This will make it easier for employees to opt out of their employers' schemes and make their own arrangements; and it will also benefit

those whose employers do not offer an occupational pension scheme. Second, I propose changes which will make it simpler for employers to set up occupational schemes with the minimum of red tape and with less of an open-ended commitment on the size of final pensions. This should encourage wider pension coverage and be of particular benefit to the 10 million or so employees who are not covered by occupational schemes.

20. Third, I am introducing arrangements to allow members of occupational schemes to make additional voluntary contributions, with full tax relief, to a plan outside their employer's scheme. They will be able to top their pension right up to the present tax approval limits. This goes well beyond what we have already announced. It will be good for choice and individual responsibility.

21. The generous tax treatment of pensions can be justified only if it is not abused. I propose, therefore, to introduce some limited changes to the present rules to restrict the excessive relief which can be obtained in some circumstances by a few people, including an upper limit of £150,000 on the tax-free lump sum and more rigorous rules for calculating final salary.

22. Last year's Budget abolished the tax on lifetime gifts between individuals. This year I propose to extend the same exemption from tax to gifts involving settled property where there is an interest in possession. This will be welcomed by many of our own supporters.

23. I am also making a substantial increase in the threshold for inheritance tax, from £71,000 to £90,000 and reducing the number of tax rates from seven to four. This change will mean worthwhile reductions in tax liability at all levels, particularly for smaller estates, and take a third of the estates currently liable to inheritance tax out of the tax net altogether.

24. Last year's Budget contained a substantive package of measures to help charities. The encouragement we give to charitable giving is now very generous; and the Payroll Giving Scheme which starts next month will give it a further boost. I therefore have no major new proposals in this field, though I propose to extend slightly the VAT reliefs for charities which I introduced last year. These extensions will meet points which have been put to me by the charities lobby.

... 25. I attach a table which summarises the revenue effects of these changes. I would be grateful to know if you are content with my proposals.

N.L.

N.L.

5 March 1987

REVENUE EFFECTS OF BUDGET CHANGES

| | £m (rounded to £5m) | |
|--|------------------------|--------------|
| | 1987-88 | 1988-89 |
| | (cost (-)/yield (+)) | |
| Income tax (including higher rates) | -2160 | -2740 |
| Excise duties | - 535 | - 575 |
| VAT - small business package | - 115 | - 60 |
| - change in partial exemption rules | + 300 | + 400 |
| Corporation tax - small companies rate | * | - 45 |
| - capital gains | * | + 60 |
| - payment dates | * | + 100 |
| - dual residents | * | + 125 |
| - tax credit relief for banks | * | + 20 |
| Car and car fuel benefits | nil | + 30 |
| North Sea oil | - 5 | - 15 |
| Profit related pay | * | - 35 |
| Pensions | * | - 65 |
| Inheritance Tax | - 70 | - 150 |
| Other | - 30 | + 40 |
| Total | -2595 | -2900 |

Note: (All figures are net of the cost or yield of indexation or revalorisation, which is included in the base forecast)

(* means negligible)

BLO
Budget Secret

Ret No: MPW/89/4
Copy No 10 of 10

FROM: MOIRA WALLACE
DATE: 24 FEBRUARY 1989

MP

MR CULPIN

cc: Mr Scholar
Mr Gilhooly
Miss Hay
Mr Macpherson
Mr Michie
Mrs Chaplin
Mr Tyrie

BUDGET SPEECH: TAX SECTION

I attach my redraft of the tax section, reordered as the Chancellor has suggested. All comments, improvements and corrections, of course, gratefully received.

Overall, I think this order will work better. But this version is still pretty patchy, and there are some gaps to fill. You are doing something on NICs and the earnings rule. And I still need bright ideas for the peroration. Otherwise, my main caveats and questions are :

I still don't like cars and - particularly - Schedule E receipts in the business section. Will they look too awful in the income tax section?

I also don't like the CGT odds and sods in their present slot, after independent taxation. It's contrived, breaks up the flow of the savings logic, and is very difficult to get into, and out of again. Where else can these go?

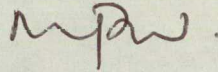
Also on CGT, you will see I have made up the paragraph on CGT gifts relief. It does mention chattels - since I have the impression the Chancellor wants to - and it doesn't mention abuse. Does this seem right?

On PEPS, I've messed around with the Walker draft. But the pensions bit is almost unadulterated Kuczys: the only changes I made to his text are marked on my copy at annex A, and I'll fax him a copy for checking.

I've taken on quite a lot of comments from the Revenue as I went along. The bulk of them were in Charles MacNicol's letter to me, attached at Annex B (sorry the copy's so faint). I shall offer the Chancellor the contributions on relocation, Keith, and exchange rate gains and losses. I'm not sure that he'll want any of them in the speech. But do you or copy recipients have strong views?

Finally, I'm conscious costs and yields still need to be mentioned in a number of places. Where? Is there a hard and fast rule?

As you'd expect, comments and suggestions required ASAP please.

A handwritten signature in dark ink, appearing to read 'Mpw.', is centered on the page.

MOIRA WALLACE

Version
11.00 am
24/2

TAX SECTION

Before I turn to my specific tax proposals, I should tell the House of a general measure which will be of considerable importance to all taxpayers, and indeed to the integrity of the tax system as a whole.

2. The new Official Secrets Bill [?Act] removes the sanctions contained in the previous legislation against leaks by staff of the Revenue departments about the private affairs of individual taxpayers. That is because the Bill is quite properly concerned only with official secrets. In the tax system it is the individual's right to privacy that needs to be protected.

3. When taxpayers give information to the Inland Revenue or the Customs and Exercise about their private affairs, they have a right to expect that the information will be kept entirely confidential. That assurance is essential, and there can be no compromising on it.

4. I therefore propose to restore the provision that it should be a criminal offence for officials or former officials of the Revenue Departments to reveal information about an individual taxpayer's affairs.

Appropriate provision will be included in the Finance Bill.

TAXES ON BUSINESS

X 5. I now turn to ^{my} specific tax measures, and first to the taxation of businesses.

6. I have to set the main corporation tax rate for 1989-90. I propose to leave it unchanged at 35 per cent, one of the lowest corporation tax rates in the world.

7. At the moment only a small minority of companies pay at the full rate. The remainder have no liability at all, or pay at reduced rates, determined by the small companies profits limits. These limits have not changed since 1983. I now propose to increase them by 50 per cent. [Do we need to spell out the limits or the reduced rates etc?] This will reduce the tax liability of some [18,000] companies.

8. I have a further change to corporation tax to propose, to recognise industry's growing willingness to undertake capital investment with very long lead times. To help new companies planning this kind of investment,

I propose to extend pre-trading expenditure relief to cover a full five years before trading begins, rather than three years as at present.

9. I have one change to capital gains tax which will be of substantial benefit to unincorporated businesses. At present, although incorporated businesses can offset trading losses against realised capital gains, unincorporated ones cannot. I propose to remedy this [so that in future an unincorporated trader who sustains a trading loss and realises a capital gain in the same year can set off the loss against the gain] [I propose further to extend the offset not only to capital gains of the business but to all the trader's capital gains.]

10. ~~[The Finance Bill will also set out the new arrangements for the levy on independent television contractors.]~~ [Following consultation with the Independent Broadcasting Authority] [as RHF Home Secretary has already announced] the levy for the period January 1990 to December 1992 will be three quarters based on net advertising revenue, with the remainder based on profits. It is intended that this levy should yield broadly the same amount of revenue as would have arisen under the pre-1986 regime. Compared with the present system, this will raise an extra £60 million a

year. [Another reason for not having this in the speech - apart from the fact that it is boring - is that as far as I can remember the PAC criticised us for letting the broadcasters off since 1986, and I don't see why the Chancellor should admit that!]

11. I have to set the 1989-90 car benefit scales. I propose to increase them by 20 per cent. [I propose no change to the fuel scales.]

[Could we put Schedule E in here, if it must go in business taxation at all?]

12. I have one measure to propose which will simplify an area of the tax system which is ripe for reform. The apportionment of close companies' retained earnings is governed by a notoriously complex set of rules, taking up some 20 pages of legislation. ~~This is~~ ^{These are} a relic of the days when we had six or more rates of income tax and a penal top rate.

~~There is no need for~~ I therefore propose to abolish them.

13. In future, close companies will be taxed under the normal corporation tax rules, subject only to two simple provisions. First, as a safeguard against abuse, the profits of close investment companies will be taxed

X at 40 per cent, the ^{higher} ~~top~~ rate of income tax. This means that there will be no tax advantage in channelling investment income through a close company.

X 14. Second, to prevent this from being unduly restrictive, ~~the 40 per cent~~ ^{this higher} rate will not apply where close investment companies distribute 85 per cent or more of their profits.

15. These simple rules will cut through a mass of unnecessary calculations and red tape.

XX 16. I have an important simplification to propose in the income tax field. At present, under schedule E, employees' income tax is assessed on the basis not of earnings received in a year, but instead on earnings for the year. I propose to change this, so that in future it is assessed on a receipts basis. For the vast majority of ordinary employees this makes no difference. But it will considerably simplify the tax affairs of about half a million people - mostly directors whose fees may not be formally voted until well after the year to which they relate. There are transitional costs of £60 million in 1989-90 and £80 million in 1990-91, but in the long term there will be a revenue yield [of about £50 million per year].

X

~~[Deep discounts]~~

17. In my 1984 Budget, I reformed the tax treatment of deep discounted bonds issued by UK corporations. The regime I put in place then has stood the test of time. So far, overseas government borrowers have been unable to issue such bonds in London, because they have been prevented under the Control of Borrowing Order. But I have already announced that this will go. I therefore propose to make the tax regime for corporate deep discounted bonds available for similar bonds issued by other borrowers. This will ensure parity of treatment for all borrowers who wish to make use of these instruments.

18. To counter an avoidance device, I propose to extend similar treatment to index-linked bonds issued for less than 3 years maturity.

19. I ^{now} have one set of deregulation measures to propose in the VAT field, which will be of considerable benefit to the small business sector.

20. At the moment, traders normally have to pay VAT on their sales whether or not their customers pay their

bills. Bad debt relief can be claimed only where the debtor has become formally insolvent. This is far too complicated. I therefore propose that from 1 October, all debts which are over eighteen months old and have been written off in the trader's accounts will qualify for bad debt relief.

21. I also propose simpler rules to determine who has to register for VAT. At present there are quarterly and annual turnover thresholds, and businesses also have to say if they see any chance of their exceeding the [annual] threshold in the next twelve months. This complication, too, is unnecessary. As from Budget Day I propose a single rule ["for most businesses", Customs say - who are the exceptions?] based on turnover in the past twelve months. For 1989-90, I propose to increase the threshold to £23,600 a year, the maximum allowed under European Community law.

22. Finally, I propose to simplify the VAT default surcharge. At present this rises by stages of 5 per cent each time a business defaults, to a maximum of 30 per cent. Experience suggests that by the time a business reaches a surcharge rate of over 20 per cent, the problem is not that it won't pay but rather that it

can't. I propose to recognise this by capping the default surcharge rate at 20 per cent.

23. Together, these measures will cost £X in 1989-90. They represent a major simplification and deregulation of the VAT system, and will be of considerable benefit to a great many small businesses.

TAXATION OF SAVINGS AND INVESTMENT

24. I now turn to the taxation of savings and investment. Reforms in this area of the tax system have been a common theme ^{throughout our ten years in office.} ~~in all my Budgets as Chancellor.~~ Reform has had two strands. First we have taken steps to remove long-standing biases against saving in the tax system. And second, we have shaped the tax system so as to promote greater choice amongst different forms of saving, and to influence that choice in directions that are of wider economic benefit.

x ^{I was able to make a major} 25. ~~Progress in removing~~ ^{disincentives} to saving ~~began~~ as long ago as my first Budget, in 1984, with the abolition of the investment income surcharge. And last year, I was able to announce the removal of ^{perhaps} the major fiscal disincentive to saving. Independent taxation, which will come into operation in April 1990, will end the 200 year old injustice whereby a married women's investment income was taxed as if it belonged to her husband. [More about how wonderful this is, and some link (!) to next para....].

26. With the introduction of independent taxation next year married couples will benefit from a double exempt threshold for capital gains tax. For this year, I have

[therefore] decided to leave the exempt threshold unchanged at £5,000.

27. I have also decided to restrict the circumstances in which capital gains tax on gifts may be deferred. When capital transfer tax still existed, deferral of CGT on gifts had to be allowed so as to avoid a double tax charge. But that need is gone, and I therefore propose to restrict this provision to gifts made to charities, and gifts of business and heritage assets. The vast majority of everyday possessions will, of course, continue to be entirely exempt from CGT as long as their value does not exceed the chattels exemption threshold. This currently stands at £3,000 and I now propose to raise it to £5,000.

x
x
x
28. As^I mentioned a moment ago,ⁱⁿ the second strand of our reforms in the taxation of savings ^{we have} ~~has~~ addressed the balance between different forms of saving. Here we have taken the approach that choice should be distorted as little as possible by the tax system. Where more investment of particular kinds would help the economy to work better, we have removed fiscal disincentives, or offered fiscal encouragements. ^P One form of saving we have always encouraged is share ownership, where specific tax measures to promote investment in equities

have complemented the success of the privatisation programme. Over the last ten years the number of shareholders has risen from [X] to [Y], and with this increase has come a greater sense of participation in British industry. [Survey results.]

29. Personal Equity Plans have now been running for just over two years. In that time, despite the Stock Market crash, [nearly 400,000] plans have been taken out. The scheme has encouraged some people to invest in equities for the first time, and it has helped existing shareholders to deepen their commitment to equity investment.

30. I want more people to take up this opportunity. Accordingly, I am making a number of improvements.

31. First, I propose to raise the annual amount that can be invested in a plan. From 6 April, I am raising the overall limit from £3,000 to £4,000. At the same time, ~~I recognise that investment trusts and unit trusts offer a good introduction to the equity market for smaller investors.~~ *in recognition of the useful role played by* ~~investment trusts and unit trusts~~ *in introducing investors* ~~offer a good introduction to the equity market for smaller investors.~~ I am ~~therefore~~ raising the amount that can be invested in authorised unit trusts and investment trusts substantially, from a maximum of £750

to £2,400. In future there will be nothing to stop holders investing all their PEP in unit trusts.

32. However, Personal Equity Plans have always been intended to encourage investment in British companies. I therefore propose that, from 6 April 1990, where a plan invests in a unit or investment trust, the trust itself should invest mainly in UK equities.

33. I am proposing other improvements to PEPs which will take effect from 6 April 1989. First, I propose to enable PEP holders to apply for new issue shares, including privatisation shares, outside their PEP, and subsequently bring the shares into the plan.

34. Second, [as a number of plan managers have indicated that they find some of the scheme rules are too complicated and restrictive,] I am proposing a number of simplifications which will help plan managers keep their costs - and their charges - to a minimum.

[35. This leaves out a lot of the detail. Any objections?] Overall, the changes I propose will cost £5 million in 1989-90 and £10 million in 1990-91.

[1 wd. omit]

[36. There have been suggestions that I should give a grater measure of tax relief to PEPs; for example, along the lines of the - now defunct - Loi Monory in France. I do not, however, believe that British investors need to be bribed in this way. Nevertheless,] taken together, the changes I am proposing will make PEPs more attractive to new investors in equities. The scheme will continue to play an important part in helping to build up individual ownership of British equities.

37. The various schemes that exist to encourage employee share ownership are another important element of our strategy in this area. This year I have a number of further improvements to the employee share legislation to propose.

38. The limits on the 1978 profit sharing scheme have been unchanged since 1984. I propose to raise them. The annual limit on the value of shares which can be given income tax-free to employees will rise from £1,250 to £2,000. For the alternative limit of 10 per cent of salary, the overall ceiling will be raised from £5,000 to £6,000. [Can anyone make sense of this?]

39. The maximum monthly savings limit for the 1980 all-employee SAYE scheme has been unchanged since 1983. I propose to increase it too, from £100 to £150. And I propose to increase the maximum discount from market value at which options can be granted from 10 per cent to 20 per cent.

40. These changes should give a substantial further boost to existing share schemes.

41. Employee share ownership plans - known as ESOPs - are a new form of employee share ownership, which have had much recent publicity. [Explain what's new about them].

42. A number have already been put in place in the UK. To encourage their development, I propose to introduce a provision to ensure that contributions to ESOPs qualify for corporation tax relief, provided they meet certain requirements, designed to ensure that the shares are placed in the hands of employees within a reasonable time. I hope that, as a result, more firms will be encouraged to consider establishing ESOPs.

43. The growing trend [?] towards employee share ownership is, ^{of course,} doubly desirable. In addition to

increasing share ownership per se it promotes employee participation and commitment to the firms for which they work.

44. The desire to see increasing workforce participation in industry was one of my principal motives in introducing the Profit Related Pay Scheme in my 1987 Budget.

45. The Profit Related Pay Scheme has had an encouraging start. But it is also clear that some firms who are interested in launching schemes are not able to comply with all the present rules. I therefore propose to make the following modifications to the scheme in this year's Finance Bill.

46. First as I have already announced, I intend to abolish the requirement that PRP must equal at least 5 per cent of pay.

47. Second, I propose to raise the limit on the amount of PRP which can attract relief from £3,000 to £4,000. Finally, I propose to relax the rules preventing headquarters units from using the profits of the whole company or group for their profit calculations, as I am

persuaded that this too is unnecessarily restrictive. I am confident that these modifications will ensure further growth in the number of firms offering some element of profit related pay.

x 48. The package of measures I have just announced will make it easier and more attractive for ordinary people to join the ranks of those who already have a direct stake in the fortunes of industry, either because their pay is linked to their employer's profits or because they own shares ^{directly.} ~~in British companies.~~

[!] 49. However, disincentives to direct equity investment remain, not least the [still disproportionate] cost of share transactions for small investors. In this context I am pleased to see that the Stock Exchange is forgingahead with its plans to get rid of paper transactions and move to a cheaper and more efficient system. ¶ To give the Exchange a firm basis on which to plan this ambitious undertaking, I think it right to make clear now the tax regime that will apply. I have fully considered the difficulties of applying stamp duty in a world where there is nothing to stamp. And I am happy to say that I have found the problem insuperable. I therefore propose to take ^{this} ~~the~~ opportunity to abolish stamp duty on shares altogether. This is the sixth

x

major tax I have abolished as Chancellor, and one I take particular pleasure in adding to the list. I have long regarded it as inefficient, and have progressively reduced the rate as I was able to do so. Abolition will take effect from 1 April 1990, the earliest date at which the Stock Exchange is likely to introduce paperless transactions. In 1990-91 it will have a revenue cost of [X].

50. The measures I have just announced will further strengthen the growing trend of wider and deeper share ownership. They will remove a major disincentive to the more direct forms of saving. And they build on the targeted incentives that already exist to promote ownership.

[51. As such, their longer-term effect may be to redress an imbalance that arguably exists in the pattern of savings in the UK, which, in the last 30 years has become increasingly dominated by institutional forms of saving, such as life assurance and pensions. **P** The taxation of these institutional forms of saving is one of the more complex and idiosyncratic areas of the tax system. And it is not an area where one can make great changes overnight. These factors argue for caution, and we have proceeded cautiously. Nonetheless we have made

considerable progress in improving choice, and reforming the tax system in step. Today, I have more progress to announce.

52. I turn first to pensions.

53. Over the past few years, we have seen through an important series of measures in the pensions field.

x Taken together, these are encouraging a shift away from
x dependence on the State, towards individuals taking more responsibility for their own pension arrangements, on the basis of improved rights as pension scheme members, better information about their pensions, and a much wider choice of pensions options. I propose to bring this process to a conclusion [one step further?] today.

[?]

54. First, I intend to rectify a long-standing anomaly. The tax rules for occupational pension schemes set limits on the pensions which can be paid. I do not propose to do away with the notion of rules to limit the tax relief available - indeed, there is a case for tightening them in some respects. But it is quite wrong that tax law has, effectively, come to set a limit on the overall pension someone can receive. Accordingly, I propose to remove the obstacles in the way of employers setting up pension schemes to provide benefits above the

tax limits. I propose that in future such "top-up" schemes will carry no limit on benefits whatsoever, but, equally, will have no special tax privileges. Employers will now be free, therefore, to provide whatever pensions package they believe necessary to recruit and reward their employees.

55. The other anomaly with the tax reliefs for pensions is that there is no limit to them, in cash terms: the higher someone's salary, the greater the pension they can have, and the more tax relief goes with it. Of course, someone who receives a very high salary will expect a pension of a comparable level, so as to maintain his or her standard of living on retirement. But there is no reason why the tax advantages of pension provision should be available with no upper limit, any more than (for example) tax relief for mortgage interest.

56. So long as the limits on tax relief effectively constrained total pension provision, it was not practicable to avoid this result. But dealing with the first anomaly makes it possible to act on the second.

57. I therefore propose to set a limit on the pensions which may be paid from tax-approved occupational

schemes, based on earnings of £60,000 a year. I have deliberately set the ceiling at a level which will leave the vast majority of employees unaffected, and it will be subject to annual indexation. It will still be possible for a tax-approved occupational scheme to pay a pension of as much as £40,000 a year, of which up to £90,000 may be commuted for a tax-free lump sum. [Is this *the best way to put the last point?*]

58. The House will, I am sure, be interested to know that I have no plans to tax lump sums paid from tax-approved pension schemes.

59. The new ceiling will only apply to pension schemes set up, or to new members joining existing schemes, on or after today. And, as I have already said, there will now be complete freedom to provide benefits above the limits without the tax advantages.

60. The introduction of this ceiling on tax relief also enables me to simplify and improve the rules for the majority of pension scheme members, in particular to improve the conditions on which people can take early retirement. Full details will be included in a press release issued by the Inland Revenue.

Additional voluntary contributions

61. I also propose to simplify very substantially the rules affecting additional voluntary contributions. In particular, the present requirements place a heavy [administrative?] burden on employers at the point where an employee wants to start paying AVCs. In future, the necessary checks will be greatly reduced in many cases employers will not need to be involved at all.

62. Still on AVCs, I intend to rectify the present anomaly in the system which can mean that, if AVC investments perform very well, occupational pensions have to be reduced to keep total benefits within the permitted limits. Instead, in future any surplus AVC funds will be returned to employees, subject to a special tax charge. This will remove the penalty on good investment performance.

63. These changes should give a further impetus to saving through AVCs.

Personal Pensions

64. The most important development in the pensions field in recent years has undoubtedly been the

introduction and success of personal pensions. Since July last year, a million people have already taken advantage of the new flexibility and opportunities these offer. I have two proposals today to encourage take-up still further.

65. First, I propose to make it easier for people in personal pension schemes to manage their own investments. In general, pension savings have been highly institutionalised. There has been little opportunity for scheme members to be involved in the investment decisions taken on their behalf. I now intend to remove the obstacles to greater individual involvement in personal pension plans.

66. Second, I propose to increase substantially the annual limits, as a percentage of earnings, on contributions to personal pensions for those aged 35 or more. This will be of particular value to those running their own business, who are often unable to make contributions until later on in working life. It will also improve the position of personal pensions relative to occupational schemes. The new limits will be subject to an overall cash ceiling based on earnings of

£60,000 - corresponding to the new ceiling for occupational pensions, and similarly index.

Conclusion

67. These proposals build on, and complete, the measures I introduced in my 1987 Budget. They represent a deregulation which will make life simpler for employers and employees, and allow more flexibility in a number of circumstances, while setting a limit on the tax relief available to any individual. They should give a boost, in particular, to personal pensions and free-standing AVCs.

68. At the same time, there is no question of undermining pension saving by a huge upheaval, and I am not proposing any fundamental change to the tax treatment of pensions. The last few years have involved important changes for pensions. It is now time they were allowed to settle down. Accordingly, I propose to make no further changes in their tax treatment this Parliament.

LIFE ASSURANCE

69. I now turn to the taxation of life assurance. In July last year, the Revenue issued a consultative document on the taxation of Life Assurance. It pointed to some important defects in the present tax regime and outlined possible changes.

70. There has now been a very full process of consultation and I have considered the representations made very carefully. My conclusions are as follows.

71. The Life Assurance industry is unique, not just in the product it provides but also in the tax regime which applies to it. The policyholder's returns and the shareholder's profits are not, as in a normal business, taxed individually but jointly by taxing the funds held by the Life Offices on their policyholders' and shareholders' behalf.

X 72. In this system ~~that~~ relief is given "up front" for expenses incurred on the policyholder's behalf. This has two distortive effects: first it means that policyholders receive a tax break - "up front" relief on initial costs which would not be available if they invested directly in shares. And it distorts the

incidence of tax as between one Life Fund and another. The system unduly favours the rapidly expanding Life Office where tax can be deferred for many years.

73. I have considered very carefully whether this problem is best resolved by improving the existing system; or by adopting a completely new basis of taxation for the Life Office. I have concluded that the defects can be dealt with within the present regime. In this, I accept the main conclusions and proposals put forward by the industry.

74. I shall be bringing forward in the Finance Bill measures which will mean that in future, relief for the initial expenses associated with new policies will be spread forward so that one-seventh only is available for relief against tax in the year in which expenses are incurred and in each of the subsequent six years. Taken on its own this would increase the tax liability of life offices, indeed quite markedly in the early years. But this effect will be eased by phasing provisions to give the industry time to adjust to the new regime, and by other measures which I have to propose.

75. But first I have one other proposal which will also restrict the amount of relief available. At present

nothing requires life offices to keep their pensions and life assurance businesses separate. So some Life Offices can set the unrelieved expenses on the pensions side of their business against the income and realised gains of Life Funds, giving their pensions profits unduly favourable tax treatment. The Finance Bill will include provisions to end this anomaly.

76. [The Finance Bill will also include a number of lesser measures, giving a better specification of charge, and bringing into charge miscellaneous items of income which currently fall outside the tax net].

77. These measures would cover the main part of the proposals discussed in last year's consultative document. The Finance Bill will provide for them to be introduced from 1 January 1990. But there are other, more technical items which require further consultation. Any legislative changes following that consultation will be included in the 1990 Finance Bill.

78. These measures give a fairer basis for the taxation of the Life Companies. In isolation they would increase the long-run tax burden by £[]m. However, here as

throughout the tax system, widening the tax base allows tax rates to be reduced. This I propose to do.

79. At present, Life Funds pay tax at 35 per cent on income and ~~30 or 35 per cent on capital gains of their policyholders and~~ shareholders ^{on capital gains} respectively. As from January 1990, all these rates will be reduced and aligned with the basic rate of income tax. Life Assurance Premium Duty will be abolished from the same date. Together these will be worth £[]million to Life Assurance in a full year. On top of this, the industry, like all those who deal in shares, will benefit from the abolition of stamp duty to the tune of £X a year.

80. [Net effect of these changes on the industry as a whole.]

81. I have just added tax on life funds to the list of tax rates that are aligned to the basic rate of income tax. I now propose similar treatment to deal with a problem we will shortly face in the taxation of unit trusts.

82. Later this year, collective investment schemes from other EC countries will acquire the right to sell their

products here. It is important that the tax system should not place UK products at a competitive disadvantage, and normally it will not do so. The exception is that if a trust invests in gilts or bonds, and is not a gilt only trust, it pays corporation tax at 35 per cent on the income and can pass on a credit at only 25 per cent to the investor. The simple solution is to align this special corporation tax rate with the basic rate, and this I propose to do with effect from [].

TAXES ON SPENDING

83. I now turn to taxes on spending.

84. First, VAT. I have already announced a package of significant deregulatory measures which will be included in this year's Finance Bill. The FB will also implement the changes necessary to comply with the ECJ's judgement on certain of the UK's zero rates. The Government has had no choice but to implement the Court's judgement by applying VAT to [x,y,z]. However, where possible, steps have been taken to mitigate the effects of the changes, particularly as they bear on charities. These changes

will take effect from [] and will have a revenue yield of [].

85. The only other change I propose to make to the coverage of VAT is to introduce a small number of extra reliefs for charities, of which the most important is the exemption for their fund-raising events [I trust this change will be welcomed by the ...].

86. I also propose to relieve from car tax vehicles leased to the disabled. [Explicitly refer to Motability?]

87. The main thrust of Government encouragement to charities, however, continues to be focused on the act of giving. The Payroll Giving Scheme, which I introduced in my 1987 (?) Budget, has been growing steadily: about 3400 schemes have now been set up and over 100,000 employees are already participating, quite a few of them giving up to the full annual limit. To allow scope for more generous donations, I propose to double the annual limit for the PRG scheme to £480, or £40 a month.

88. I turn now to the duty on petrol. Last year I increased the tax differential in favour of unleaded

petrol, giving it a price advantage of some 6p a gallon over 4 star. This has undoubtedly helped to increase the take up of unleaded petrol.

89. But the Government is committed to phasing out leaded petrol, and progress is still too slow. Unleaded petrol still accounts for only 4 per cent of total sales, even though two out of three cars on the road can use it - either without any adjustment, or with a relatively inexpensive conversion.

90. One of the problems is clearly ignorance of the facts about unleaded petrol. Many people do not realise that they can already use it. And others who could cheaply have their cars converted hold back because they fear - wrongly - that after conversion their cars could no longer use leaded. Fortunately, the myths about unleaded petrol are beginning to be dispelled.

91. But I propose to do my part too, and to make sure that the market signal is clear enough. I therefore propose to reduce the tax on unleaded petrol further by something over 3p a gallon. If this reduction is passed on to consumers - and I look to the oil companies to make sure that this happens - the price of unleaded petrol at the pump will generally be about 9p a gallon

below that of 4 star. This in itself should provide a strong encouragement for motorists to have their cars converted.

92. However, I propose to go further by increasing the rate of duty on 2 and 3 star petrol by 5p. This will bring the price of these grades broadly into line with that of 4 star. Virtually all cars which use 2 and 3 star can run on unleaded petrol without any conversion. These motorists will now have a strong incentive to change their habits. This in turn, will provide the necessary signal for more garages to stock unleaded - if necessary by freeing up a pump that formerly sold 2 star.

93. Both these duty changes will take effect from 6.00pm tonight. Taken together, they will give us the largest differential between leaded and unleaded petrol of any EC country, with the exception of Denmark. I hope that we shall soon match this performance in terms of take-up of unleaded.

~~VED~~

94. The measures I have proposed on petrol duty will have a revenue cost of X in 1989-90. I propose to

recover this cost from vehicle excise duty. At the moment a bus or a coach has to have sixty six seats before it pays as much VED as a family car. I propose to increase the relevant rates to bring this group up to cover their track costs - that is, the wear and tear they cause to the roads. There will also be increases in the rate of VED for the heaviest of the rigid HGVs so as to [put them on a more equal basis?] with articulated HGVs.

Is this right?

95. [The other main rates of VED will remain unchanged?] However, I also propose a major simplification of the structure of VED by reducing the number of tax classes by over 70.

96. I have no other changes in excise duties to propose.

TAXATION OF INCOME

97. Nor do I propose any change this year to the basic rate of income tax.

98. For 1989-90 I propose to raise all the main thresholds and allowances by the statutory indexation factor of 6.8 per cent, rounded up. Thus the single

persons allowance will rise by £180 to 2,785, and the married (man's) allowance will rise by £280 to £4,375. The basic rate limit will rise by £1400 to £20700. ^P The single age allowance will rise by £220 to £3400 for a single person, and the married age allowance will rise by £350 to £5385. For those over 80, the higher rate of age allowance will rise by £230 to £3540 for a single person, and by £360 to £5565. However, I propose that the higher age allowances, which are currently for the over eighties only, should be extended to cover all those aged 75 and over. So all those between 75 and 80 will have their tax allowances rise by more than normal indexation.

99. The income limit for age allowance will rise by £800 to £11400, again in line with normal indexation. However, I propose to change the rate at which age allowance is withdrawn above this income limit. I propose that it will now be withdrawn at the rate of £1 for each £2 of income, rather than the present sharper withdrawal rate of £2 in every £3. [This will mean that the marginal tax rate for those in this income band will be reduced to X per cent.]

100. The Finance Bill will also include the provisions to establish the new tax relief for the premier ^a on

pensioners health insurance, which I announced to the House in January.

101. [Earnings rule etc - to be supplied].

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From: C.S. McNICOL
NOT TO BE COPIED

Date: 22 February 1959

Ext: 7221

Miss M. Wallace

Chancellor's Office

HM TREASURY

ANNEX (A)
to mpw of 24/2 → RAC

BUDGET SPEECH (ANNOTATED)

I attach our comments in the form of annotations to your first draft. The only section so far not covered is the one on Life Assurance. I hope to let you have that in the morning.

So far, the only substantial additions are on Relocation expenses and payroll giving (though

I see you refer to this en passant in paragraph 82.

Q

C.S. McNICOL

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RELOCATION EXPENSES

I have two proposals relating to the tax treatment of payments which employers make to employees when they need to move house because they are required to work elsewhere. First, I have decided to introduce a statutory relief for ~~force~~ incidental ~~un~~ removed costs which will broadly replace a long-standing ~~concess~~ extra-statutory income tax concession. This will put an ~~important~~ ^{second} important relief on a proper footing. But I have also decided that the extra-statutory concession which at present exempts housing subsidies where the move is to a higher cost ~~to~~ area should be withdrawn since it reduces the pressures on employers to relocate to cheaper areas and ~~so~~ exacerbates house price increases in already expensive areas.

Canasty ought to
Peter Lewis. 2011

BUDGET

SHARE OWNERSHIP

Introduction

I place first in my Budget measures to encourage wider share ownership. Over the last 10 years the number of shareholders has risen from X to Y; and with this increase has come a greater sense of identification with British industry. [Survey results]

2. Exactly three years ago I introduced the Personal Equity Plan - a radical new scheme to encourage investment in British equities. In the first two years that the scheme has been in operation more than 375,000 plans have been taken out. This despite the stock market crash. I now have a number of improvements to propose.

WC
AWK

3. First, I propose to raise the limit on the amounts that can be invested in unit and investment trusts. It will rise from £750 to £2,400. Unit and investment trusts are a good introduction to the equity market for smaller investors, and I want to encourage them. This increase will apply only to unit and investment trusts which invest mainly in UK equities.

or year

One of the original intentions of the scheme was to help British industry, so I propose that where a PEP investment is in a unit trust or investment trust, the trust itself should

4. Second, I propose to raise the overall PEP limit from £3000 to £4,800.

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Third

desired

5. I also intend to make it possible for PEP holders who apply for new share issues, ^(including privatisation) to put their resulting allocation straight into their PEP, provided this does not breach the overall limit.

Furthermore

6. ~~Third~~, I propose to ~~abolish~~ a number of ~~restrictions~~ on PEPs, ~~and to simplify them as much as possible.~~

7. I propose to do away with the rule that PEPs must be held for a full year; if investors choose to cash in their PEPs within a year of purchase, they will, in future be able to do so without tax penalty. I also propose to abolish the rules governing the amount of an investment that may be held in cash. Instead, interest on cash held in PEPs will, in future, be subject to composite rate tax.

8. Finally, I intend to move the PEP year from a calendar to a fiscal year basis. It has become clear that this would be more convenient for all concerned. I therefore intend that the next PEP year will start on 6 April. Anyone who has taken out a plan already in 1989 will also be able to take one out in the new PEP year.

9. Taken together, these changes will make PEPs simpler to administer and more attractive to first time

the scheme in a number of ways, making it more flexible, more directed to small & new investors and

CWC
AWK

cheaper to administer.

BUDGET

even more attractive

~~investors~~. I am confident that the ~~package~~ will lead to a considerable increase in PEP take up, and a substantial widening and deepening in share ownership.

10. Our measures to encourage employee share schemes have also had a major impact in widening share ownership. The number of approved all - employee share schemes has risen from 30 in 1979 to almost 1600 today, ~~covering~~ around 1½ million employees, and involving shares worth over £4 billion.

benefitting

11. This year I have a number of further improvements to the employee share legislation to propose.

PR
SDF

all-employee

12. I propose to raise the limits on the 1978 profit sharing scheme and on the 1980 SAYE option scheme ~~since 1984~~. The ^{income} limit on the ^{annual} value of shares which can be given ^{tax-free} to employees under the 1978 scheme, will rise from £1,250 ~~or 10% of salary~~, subject to an overall limit of £5,000, to £2,000 or 10% salary, subject to a limit of £6,000. [This will be of particular benefit to lower paid employees.]

to £2,000; and, for the alternative limit of 10% of salary, the ceiling will be raised from £5,000 to £6,000

13. I also intend to raise the maximum monthly savings limit for the all-employee SAYE scheme from £100 to £150. And I propose to increase the maximum discount from market value at which options can be granted from 10 per cent to 20 per cent.

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14. These changes should give a substantial further boost to existing share schemes.

15. Employee share ownership plans - known as ESOPs - ~~are a new form of employee share ownership, which have had much recent publicity.~~ ~~Explain what's new about them?~~

They provide a new route to employee share ownership.

but uncertainty about their tax position may be hindering their development

16. A number have already been put in place in the UK. ~~To encourage their development,~~ ^{Accordingly} I propose to introduce a ~~provision making it clear that~~ ^{ESOPs} ~~new tax relief for contributions to employer share trusts provided they~~ ^{which} meet certain requirements, designed to ensure that their shares are placed in the hands of employees within a reasonable time. ^(qualify for corporation tax relief) I hope that, as a result, more firms will be encouraged to consider establishing ESOPs.

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10E

[17. I have one further change to propose which will benefit conventional employee share schemes, ESOPs, and profit-related pay schemes alike. I propose to modify the so-called material interest tests where ~~companies~~ ^(trusts) have ~~established trusts~~ ^(been) to acquire ~~their shares~~ ^{in the company} for the benefit of ~~their~~ employees. These tests are designed to exclude from tax relief employers who already have a significant interest in the company. Sometimes, however, the present rules can exclude

BUDGET SECRET

(who have only a remote or minimal interest.) *(save the position.)*
employees ~~too~~. The changes I propose will ~~ensure that~~
~~only these employees who have a significant material~~
~~interest in the company will be excluded in future.]~~

Unit trusts

18. ~~As I mentioned a moment ago, unit trusts have a~~
~~valuable role to play in providing, for many people, the~~
~~first introduction to direct investment and share~~
~~ownership. I therefore consider it desirable to remove~~
~~an anomaly which means that the tax system bears unduly~~
~~harshly on unit trust investors, compared with other~~
~~forms of direct investment.~~

19. Normally a unit trust investor pays the same tax on
dividends and capital gains as someone who had invested
in the same shares or securities independently. But if
the trust invests in gilts or other securities, and is
not an all-gilt trust, it has to pay corporation tax on
the income, so the saver ends up bearing tax at 35 per
cent, rather than 25 per cent.

20. I have therefore decided that as from
1 January 1990, the Corporation Tax rate on unit trusts
should be cut from 35 per cent to 25 per cent. [Unit
holders' CGT position will be unaffected, as will the
additional income tax paid by higher rate taxpayers.]

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Attached.

MAJ
AGN

And ~~rules~~ will be introduced to prevent corporate investors using this change as a tax shelter.]

21. This reduction in the tax rate on unit trusts will incidentally have the beneficial effect of removing the competitive disadvantage which UK mixed unit trusts would otherwise have faced in the near future, when firms from other EC countries acquire the right to sell collective investment vehicles in the UK.

Stamp duty

22. I have one further measure to propose in this context.

23. In my 1984 Budget, I was able to reduce the 2 per cent stamp duty on share transactions to 1 per cent. I halved it again to $\frac{1}{2}$ per cent in 1986. I have now decided to abolish it altogether, ^(along with the associated stamp duty reserve tax) with effect from 1 April 1990, [to coincide with the introduction of paperless transactions on the Stock Exchange.] These measures will remove a barrier to ownership, and eliminate an aspect of the tax system which puts the British financial services sector at a disadvantage compared with some of its competitors.

This measure continues the process of simplifying the tax system. It will aid the changeover to [less costly] paperless transactions and further encourage wider share ownership. [It will also enable the British financial services sector to gear itself up to the challenges of the 1990s.] And stamp duty on shares ~~will be~~ is the 6th major tax I have

abolished since becoming Chancellor.

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Tax reform

24. The measures I have just announced will further strengthen the growing trend of wider and deeper share ownership. They will remove a major disincentive to the more direct forms of saving. And they build on the targeted incentives that already exist to promote ownership.

[25. As such, their longer-term effect may be to redress an imbalance that arguably exists in the pattern of savings in the UK, which, in the last 30 years has become increasingly dominated by institutional forms of saving, such as life assurance and pensions. Throughout our time in government, our approach to the provision and taxation of savings has had two common threads. First, as far as possible, we have been concerned to ensure maximum choice for individuals. Secondly, we have tried to ensure that choices are distorted as little as possible by the tax system.

26. This is not an area where one can make great changes overnight. Nonetheless we have made considerable progress in improving choice, and reforming the tax system in step. Today, I have more progress to announce.

PENSIONS

27. I turn first to pensions.

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NB: This figure includes PP, taken out by self-employed (who formerly would have bought RAs) - (all figs available in a week or two.)

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AWK

28. The Government record is one of widening pensions' choice and encouraging private provision. We have reformed SERPS, improved the rights of pension scheme members and, most important of all, introduced personal pensions. These have been a great success with a million taken out in the first 6 months of operation.

29. ~~But~~ there is still scope for further widening of choice, deregulation of the tax system. I have a number of changes to propose.

37. ~~(Finally)~~
30. ~~First~~, I propose to make it easier for people in personal pension schemes to manage their own investments. Pension savings are highly institutionalised with scheme members having little involvement in investment policy. This measure will encourage greater individual involvement in pension plans [as IRAs have in US].

33. (The introduction of this earnings limit also enables me to)
31. ~~I also~~ propose a number of changes to ~~simplify and improve~~ ^{the} rules for occupational pension schemes, in particular to improve the conditions on which people can take early retirement.

SECRET

38
32. And I intend to simplify ^{Very substantially} the rules for additional voluntary contributions. (At present, if AVCs perform very well, occupational pensions ^{have to} may ^{to keep total benefits within} be reduced. In future ^{limits} any surplus contributions will be returned to employees subject to special tax charge. ↕

This will remove the penalty on good investment performance and will allow for much simpler rules for the payment of AVCs. These changes will add a further impetus to saving through AVCs.

30 33. ^(It is at present a strange) ~~And finally I propose to rectify the~~ anomaly whereby ^{that} limits for tax relief have come to determine limits on pensions paid. With a tax relief as generous as that for pensions, it is clearly essential that there should be some upper limit. But that is no reason for tax law effectively ^{to} constrain ^{ing} the size of the pension an employer may choose to provide. Accordingly, I propose that employers should ~~now~~ be able to set up "top-up" schemes for their employees, with no limits on benefits but without any special tax privileges.

[In future, if employers wish to offer, for example, pensions above 2/3rds final salary, or fast account for late entrants, they will be free to do so.]

Rationale for limits

31 Second,

34. [With employers able to pay whatever pensions they like, it is clearly appropriate to put a cap on ^{the} amount of relief. ^{Most} All other reliefs - BES, PEPS, mortgage interest - are subject to a ceiling.

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[To remove this anomaly, and place pension provision on a more rational and flexible basis, I have two main proposals. First,

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~~32~~

35. I therefore propose to build on my 1987 changes by ^{introducing} ~~making final salary schemes subject to a cash limit on~~ pensions paid from tax approved ^(occupational pension) schemes, ^(This will be) based on earnings of £60,000 a year. This is consistent with a ~~privileged~~ pension of £40,000 a year or a tax free lump sum of £90,000 ~~a year~~. I intend that this earnings limit should be indexed to prices and that these changes should apply to members joining new or existing schemes on or after Budget day.

[36. It ~~is~~ clear that unfettered relief for pensions savings distorts savings choice. People pay less tax if ^{they} save through pension funds than if ^{they} invest directly in equities or put money in building society. They are allowed tax relief on contributions. The returns are untaxed in the hands of pension funds, though tax is paid on the pensions when received. And savings financing pension lump sums escape tax altogether. They are not taxed on the way in or out. This is anomalous by any standard.

37. With the 1988 reductions in top rate of tax, there is less need for tax breaks for higher paid. They can afford to save out of taxed income by investing directly in equities etc.]

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make them more attractive

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38. I also propose changes to the rules for personal pensions, to enable them to equal the benefits of final salary schemes. The self-employed are often unable to contribute to personal pension schemes until late in life, at which point they may fall foul of contributions limits. I therefore propose to increase ^(substantially) the contribution limits for personal pension scheme members over ³⁵50.

6
39. This will improve ^{the} position of PPs relative to ^(occupational) final salary schemes. Indeed it will pay some employees to leave ^(occupational) FS schemes and take out personal pensions. However I also propose ^{At the same time} to subject ^(based on earnings up to 60,000) an overall cash limit on contributions ^(occupational) Like the final salary scheme limit, the personal pension cash limit will be tied to prices.

CWC
AWK

Conclusion

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40. These proposals represent an important long-term reform of ^(the) pensions ^(tax) system. However, the effects will take time to come through. Because of the level at which the limits will be set only a few thousand high paid employees

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BUDGET SECRET

the number will rise, perhaps to as many as the

will be affected at first, ~~rising to 50,000 by~~ ^{the} end of ~~the~~ century. But that is how it should be. There is no question of undermining pension saving by a huge upheaval. *On the other hand, the new limits will not affect the vast majority of ordinary scheme members. (if all these changes, taken together)*

41. The long term effect, ~~though,~~ ^(over time,) is likely to be considerable. It will result in ^{improvements} a major ~~turnaround~~ ^{pension provision} in the balance of ~~savings in the course of 21st century.~~

CWC
AWK

42. The last few years have seen a large number of pension reforms. It is time they were allowed to settle down. Accordingly, I do not plan any further ^(tax) changes in this Parliament.

LIFE ASSURANCE

43. I now turn to the taxation of life assurance. In July last year, the Revenue issued a consultative document on the taxation of Life Assurance. It pointed to some important defects in the present tax regime and outlined possible changes.

KVD
MDRH

44. There has now been a very full process of consultation and I have considered the representations made very carefully. My conclusions are as follows.

45. The Life Assurance industry is unique, not just in the product it provides but also in the tax regime which

BUDGET

applies to it. The policyholder's returns and the shareholder's profits are not, as in a normal business, taxed individually but jointly by taxing the funds held by the Life Offices on their policyholders' and shareholders' behalf.

46. It is a peculiarity of this system that relief is given "up front" for expenses incurred on the policyholder's behalf. This has two distortive effects: first it means that policyholders receive a tax break - "up front" relief on initial costs which would not be available if they invested directly in shares. And it distorts the incidence of tax as between one Life Fund and another. The system unduly favours the rapidly expanding Life Office where tax can be deferred for many years.

[47. I have considered very carefully whether this problem is best resolved by improving the existing system; or by adopting a completely new basis of taxation for the Life Office. I have concluded that the defects can be dealt with within the present regime.]

48. I shall be bringing forward in the Finance Bill measures which will mean that in future, relief for the initial expenses associated with new policies will be spread forward so that one-seventh only is available for relief against tax in each of the first and subsequent

KVD
MDRH

six years. Taken on its own this would increase the tax liability of life offices, indeed quite markedly in the early years. But this effect will be eased by phasing provisions to give the industry time to adjust to the new regime, and by other measures which I have to propose.

49. But first I have one other proposal which will also restrict the amount of relief available. At present nothing requires life offices to keep their pensions and life assurance businesses separate. So some Life Offices can set the unrelieved expenses on the pensions side of their business against the income and realised gains of Life Funds. This means that their pensions profits enjoy unduly favourable tax treatment. The Finance Bill will include provisions to end this anomaly.

50. [The Finance Bill will also include a number of lesser measures, giving a better specification of charge, and bringing into charge miscellaneous items of income which currently fall outside the tax net].

51. These measures would cover the main part of the proposals discussed in last year's consultative document. The Finance Bill will provide for them to be introduced from 1 January 1990. But there are other, more technical items which require further consultation.

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MDRH

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BUDGET SECRET

Any legislative changes following that consultation will be included in the 1990 Finance Bill.

52. These measures give a fairer basis for the taxation of the Life Companies. In isolation they would increase the long-run tax burden by £[]m. However, here as throughout the tax system, widening the tax base allows tax rates to be reduced. This I propose to do.

53. At present, Life Funds pay tax at 35 per cent on unfranked investment income and 30 per cent on realised capital gains of their policyholders. As from 1 April 1990, these rates will be reduced to 25 per cent. Life Assurance Premium Duty will be abolished from the same date. Together these will be worth £[]m to Life Assurance in a full year. On top of this, the industry, like all those who deal in shares, will benefit from the abolition of stamp duty to the tune of X a year.

if passed
save +100m

54. [Net effect of these changes on the industry as a whole.]

[A conclusion still needed for this tax reform section]

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KVD
MDRH

gain a
substantial.

Account given on
PL
of weight CWC
KVD

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55. I now have a number of other, less daunting, reforms to propose. Most of them represent simplifications and deregulation.

56. The first is a piece of tidying up which follows from the major reforms of income and capital gains tax in my last Budget.

57. My reforms of capital gains tax have produced a fairer and more neutral system. However they have exacerbated one existing anomaly, which I now propose to remove. The holdover relief for gifts postpones tax on past gains made by the giver until the recipient disposes of the asset. When we still had capital transfer tax on lifetime transfers, this relief was necessary to avoid a double capital tax charge. But this need no longer remain. Moreover, now that a single rate of capital gains tax has been replaced by 2 rates aligned with income tax, the gifts relief is open to exploitation by higher rate taxpayers wishing to avoid paying CGT at their marginal rate. I therefore propose to abolish the general gifts relief. There are some circumstances where tax deferral continues to be justified for wider ~~economic~~ reasons, notably in the case of gifts of business and heritage assets and gifts to charities. For these cases, the relief will be retained.

BUDGET SECRET

[off a number of reforms representing simplification and deregulation]

DYP
MFC

[58. Still on capital gains tax, I propose to change the tax treatment of certain bonds so as to simplify the tax rules and to prevent a loss of yield by the conversion of income into capital gains.

59. First I propose to exempt from capital gains tax, all sterling non-convertible corporate bonds. This will prevent exploitation of indexation relief to manufacture capital losses.

60. Second, I propose to put the tax rules for deep discount bonds onto a simpler and more effective basis. Where the return on a bond can be mathematically split into capital gains and income then those two elements will be taxed separately. Where the return on a bond cannot be so split then it will be taxed as income.

61. These changes will apply to gilts ^{except that} although existing issues of deep discount gilts will continue to be taxed under the existing rules.]

62. Last year, by rebasing capital gains tax to 1982, I completed the process of taking purely paper gains out of tax. At the same time I reduced the exempt threshold as it no longer needed to compensate for the lack of indexation relief for pre-1982 gains. Its only remaining function is to exclude small gains from the tax. I judge that it still performs that

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B²OC
MFC

DYP
MFC

Paragraph 64

There is now a notoriously complex set of rules providing for the so-called "apportionment" of close companies' income. There is no longer any need for these rules in the case of ordinary trading businesses, and no justification for retaining this apparatus to deal with the ^{special case} ~~special problem~~ of personal investments being put into a closely controlled investment company so as to avoid tax.

I propose therefore to abolish the close company apportionment rules. I am sure that many hundreds of thousands of small businesses will welcome the removal of this burden.

There will be special - and relatively simple - rules for closely controlled investment companies, and a special rate of corporation tax at 40 per cent for such a company which does not distribute its profits.

Julia (am content
✓ 22/2
Her = further accepted revision.
my concern pl?

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*C for
22.2.*

also mentioned

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function perfectly adequately and I therefore propose to maintain it at its current level of £5000. Following independent taxation in 1990, husbands and wives will, of course, benefit from a double exemption.

63. The taxation of close companies is another area ripe for simplification. Again this has been made possible by last year's reform of personal tax.

~~64. Under the current rules undistributed income and gains of close companies are apportioned among its shareholders in order to determine tax payable. The rules governing this are an exceptionally complicated area of the tax system, running to some 20 pages of legislation. I therefore propose to abolish apportionment rules for close companies. In future income and gains of a close company will be subject to normal corporation tax rules, subject only to simple rules to prevent abuse. This reform will represent a major simplification of the tax affairs of a great many small businesses.~~

65. The next set of deregulation measures I have to propose will also benefit the small business sector. These measures relate to the operation of VAT.

66. At present, traders are normally liable to VAT on their sales whether or not their customers pay them.

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MHC
P. J. P. P.

New paragraph

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EMcG
JHR

No. Tax
at 40%
on less profits/gain
substantially
distributed.

? sub-ventures
Keith

BUDGET

Bad debt relief can be claimed only where the debtor has become insolvent. This takes far too long. I therefore propose that from 1 August, all debts which are over eighteen months old will qualify for bad debt relief. This will be of great help, from both an administrative and financial point of view, to a great many businesses.

SECRET

67. I also propose simpler rules to govern registration for VAT. At present there are quarterly and annual turnover thresholds, and businesses are required to look ahead to the next twelve months to see if the limits might be exceeded. This complication is unnecessary. As from Budget Day I propose a single rule for determining registration based on turnover in the past twelve months.

BUDGET SECRET

68. Finally, I propose to simplify the VAT default surcharge. At present this rises by stages each time a business defaults to a maximum of 30 per cent. Experience suggests that by the time a business reaches a surcharge rate of over 20 per cent, it has moved from the "won't pay" to "can't pay" category. I propose to recognise this by capping the default surcharge rate at 20 per cent.

Schedule E

69. I propose ^{an important} ~~one~~ simplification in the income tax field. At present, under Schedule E, tax ^{is assessed} ~~assessments~~ ~~are done~~ on the basis not of earnings received in a year, but instead on earnings for the year - accruals rather than receipts. I propose to change this, so that in future it is assessed on a receipts basis.

70. For the vast majority of ordinary ^{employees} ~~taxpayers~~ this will make ~~no~~ difference at all. But it will ^{considerably} ~~greatly~~ simplify the tax affairs of about half a million people. It will also ~~make~~ the tax system simpler and cheaper to administer. ~~There will be no lasting loss of revenue, but there is a transitional cost of £[X] in the first two years, offset thereafter.~~

Business Taxation
Corporation Tax

There are transitional costs of £60 million in 1989-90 and £50 million in 1990-91, but in the long term there will be a revenue yield of about £50 million per year.

71. I now turn to the taxation of businesses generally.

72. It is now five years since I announced the major reform of business taxation which has given us one of the lowest corporation tax rates ~~in the world~~. ^{This} ~~Our~~ ~~neutral system of business taxation, combined with low rates,~~ has set the scene for a dramatic improvement in the performance of British firms. The reform of capital

BUDGET

PL
IF

because PAYE collects tax on a receipts basis

at present assessed on accruals

EMcG
JHR

allowances has encouraged more efficient investment, based on real returns rather than tax advantages. And the removal of the bias against job creation has played a key role in the UK's impressive employment growth. In this healthier climate, company profitability has recovered dramatically.

73. The system we have is clearly right, and is working well. Accordingly, I have no change to propose to the main Corporation Tax rate for 1988-89. ~~1989-90~~

EMcG
JHR

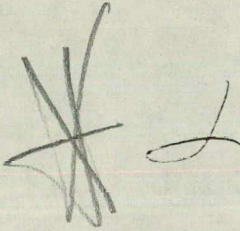
74. However, at the moment, only a small minority of companies pay this main rate of 35 per cent. The remainder have no liability at all, or pay at ~~reduced~~ ^{lower average} rates, determined by the small companies' profits limits. These limits have remained unchanged since 1983. I propose now to increase them, so that the lower limit, below which companies pay at 25 per cent, will increase from £100,000 to £150,000. Above that level, ^{Companies} pay at a gradually increasing rate, until they reach the main rate threshold of £500,000. I propose to increase this, too, by 50 per cent, to £750,000.

Marginal relief is available.

Added
? CGT relief for unincorporated businesses EMcG.
MJGE

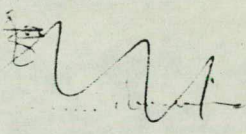
business losses

75. [I have one other minor change to ~~24~~ ^{business taxation}]. I propose to extend relief available for expenditure incurred by individuals or companies prior to their commencing trading from the present 3 years before trading



Foreign Exchange Gains & Losses

[Finally on business taxation] I am responding to calls for change in the tax treatment of foreign exchange gains and losses. This complex issue is becoming increasingly important with the growing globalisation of business but there are major questions to be resolved before changes to the present treatment could be considered. I have therefore authorised the Inland Revenue to issue today a consultative document which explores those questions and examines the scope for legislative reform.

This is an important issue for
UK business particularly with


commences to 5 years. This will benefit new ^{businesses} ~~companies~~ undertaking projects requiring long lead times.]

Cars

76. I have to set the 1989-90 car and fuel benefit scales for ^{the private use of} ~~those with~~ company cars. ~~For~~ ^{always} years, the car scale charges have fallen significantly short of the true value of the benefit ^{to the employee} and in successive Budgets I have made significant progress to redress this. I intend to continue this, and ^{to} increase the car scales by a further 20 per cent for 1989-90. I propose no change to the fuel scales.

Profit Related Pay

77. Two years ago, I introduced in my Budget a tax relief for Profit Related Pay Schemes, designed both to give workers a more direct sense of identification with the firms that employ them, and to promote a greater degree of pay flexibility. The current success of British firms is built on improvements in both these respects.

78. The Profit Related Pay Scheme has played its role in this process, but it is also clear that more firms are interested in launching schemes, but are not able to comply with all the present

BUDGET
EMC
MISGE
Add
exchange
& losses

PL
ERM

[The yield will be
£90 million in
1989/90 and £110
million in 1990/91.]

PL
JDF

Some
rules. I therefore propose to make ~~three~~ modifications to the scheme in this year's Finance Bill. First as ~~I~~ ~~have~~ already announced, I intend to abolish the requirement that PRP must equal at least 5 per cent of pay.

PL
JDF
79. Second, I propose to raise the ^{cash} limit on the amount of PRP which can attract relief from £3,000 to £4,000. Finally, I propose to relax the rules ^{preventing} banning headquarters and other central units from using the profits of the whole company or group for their own profit calculations, as I am persuaded that this too is unnecessarily restrictive. I am confident that these modifications will ensure continued growth in the number of firms offering some element of profit related pay.

TAXES ON SPENDING

80. I now turn to taxes on spending.

81. First, VAT. I have already announced a package of significant deregulatory measures. The FB will also implement the changes necessary to comply with the ECJ's judgement on certain of the UK's zero rates, notably that on non-domestic construction. The only other change I propose to make to the coverage of VAT is to introduce a small number of extra reliefs for charities,

Contribution for Budget Speech: Payroll Giving

Mr Isaac
bwb
22/2

Mr Mitchell
C/S
22.2

The Government remain committed to a thriving and growing Voluntary Sector, and I particularly welcome the fact that interest in the payroll giving scheme has been growing steadily. About [3,400] schemes have now been set up, and [over 100,000] employees are already participating. It is encouraging to find that ~~some~~ ^{some} donors are giving up to the full £240 annual limit. In order to allow scope for more generous donations and to encourage the development of payroll giving generally, I propose to [double the annual limit to £480, or £40 a month].

quite a few

of which the most important is the exemption of their fund-raising events, subject to an upper limit.

82. The main thrust of Government encouragement to charities, however, continues to be focused on the act of giving. Accordingly, I propose to increase the weekly limit for the PRG scheme from X to Y.

VED

83. Next, I have a number of measures to propose which will greatly simplify the structure of vehicle excise duty and make it more equitable.

84. There are at present X rates of VED. I propose to reduce the number of tax classes by over 70 - a major simplification.

85. At the same time I propose to rectify anomalies in the present structure of rates. At the moment a bus or a coach has to have sixty six seats before it pays as much VED as a family car. I propose to increase the relevant rates to bring this group up to track cost.

86. There will also be increases in the rate of VED for the heaviest of the rigid HGVs so as to put them on a more equal basis with articulated HGVs.

87. I turn now to the duty on petrol. Last year I increased the tax differential in favour of unleaded petrol to nearly 11p a gallon. This has undoubtedly helped to increase the take up of unleaded petrol.

88. But the Government is committed to phasing out leaded petrol, and progress is still too slow. Unleaded petrol still accounts for only 4 per cent of total sales, when X per cent of cars can use it without any adjustment, and most of the remainder could be adjusted to use it at very little cost.

89. One of the problems is clearly ignorance of the facts about unleaded petrol. Many people do not realise that they can already use it. And others who could cheaply have their cars converted hold back because they fear - wrongly - that after conversion their cars could no longer use leaded. Fortunately, the myths about unleaded petrol are beginning to be dispelled.

90. But I propose to do my part too, and to make sure that the market signal is clear enough. I therefore propose to reduce the tax on unleaded petrol further by something over 3p a gallon. If this reduction is passed on to consumers - and I look to the oil companies to make sure that this happens - the price of unleaded petrol will generally be about 9p a gallon below that of

4 star. This in itself should provide a strong encouragement for 4 star users to have their cars converted.

91. However, I propose to go further by introducing a surcharge of 5p a gallon on 2 and 3 star petrol. This will bring the price of these grades broadly into line with that of 4 star. Virtually all cars which use 2 and 3 star can run on unleaded petrol without any conversion. These motorists will now have a strong incentive to change their habits. This in turn, will provide the necessary signal for more garages to stock unleaded - if necessary by freeing up a pump that formerly sold 2 star.

92. Taken together, these two duty changes will give us the largest differential between leaded and unleaded petrol of any EC country, with the exception of Denmark. I hope that we shall soon match this performance in terms of take-up of unleaded. Both these duty changes will take effect from 6.00pm tonight.

93. I have no other changes in excise duties to propose.

BUDGET

INCOME TAX [to follow]

allowances

rates

[NICs]

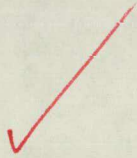
Earnings rule

CONCLUSION AND PERORATION [to follow]

SECRET

B.L.O.

SECRET

**EUROPEAN LEAGUE TABLES****CHART 1a****Output Growth**

| 1960-1970 | 1970-1980 | 1980-1987* |
|--------------|--------------|--------------|
| Italy | France | UK |
| France | Italy | Italy |
| Belgium | Netherlands | France |
| Netherlands | Belgium | West Germany |
| West Germany | West Germany | Netherlands |
| UK | UK | Belgium |

* 1987 - OECD estimate



Inland Revenue

The Board Room
Somerset House
London WC2R 1LB

BUDGET CONFIDENTIAL

FROM: L J H BEIGHTON
28 February 1989

FINANCIAL SECRETARY

pmf

BUDGET SPEECH: KEITH

The Chancellor asked you to draft a short paragraph on Keith for the Budget speech. He has not yet decided whether to include this in the speech or not but would like to consider it again. I attach a draft for your consideration. It is not easy to see where this could best fit into the speech as at present drafted and this may be a consideration in deciding whether or not the passage should be included.

L J H B

L J H BEIGHTON

cc Mr Culpin
Miss Wallace

Mr Beighton
Mr Roberts
Mr Shaw
Mr McNicol
PS/IR

I shall also be bringing up to date the powers of the Inland Revenue to enforce the collection of tax and the safeguards available to taxpayers. This will very largely complete the task I began in 1985 of implementing the recommendations in the first two volumes of Lord Keith's Report on the Enforcement Powers of the Revenue Departments, those relating to Income and Corporation Tax, Capital Gains Tax and VAT. I should like to take this opportunity not only to repeat my thanks to Lord Keith and his team for their comprehensive and rigorous reports but also to thank the very large number of individuals and organisations who have taken part in the wide measure of consultation which we have subsequently undertaken.

MP
FROM: J F GILHOOLY

DATE: 28 February 1989

FINANCIAL SECRETARY

cc Mr Culpin
Miss Hay
Miss Wallace

| | |
|-------------|----|
| Mr Beighton | IR |
| Mr Johns | IR |
| Mr Nield | IR |
| Mr Fawcett | IR |
| Mr McNicol | IR |
| PS/IR | |

BUDGET SPEECH : UNIT TRUSTS

Mr Johns' note of today provides a draft paragraph for the Budget speech

2. There is a choice in presentation, namely whether to ascribe the measure to the UCITS directive giving the change a European flavour; or to present it as a measure justified in its own right, with the European advantages as it were purely coincidental.

3. The European route could be awkward, presentationally, because

- it will be seen as a second example of tax changes being driven by Europe (cf the ECJ judgement, elsewhere in the speech);
- in one sense it fits with the Chancellor's approach to tax approximation, as an example of tax approximation without central direction from Brussels. But it is not a very happy example. Presenting it as a response to UCITS makes it look like a change we were forced to make because of EC action.

4. An alternative approach would be to present this as a straight removal of a disadvantage (compared with direct investment) which unit trusts have in dealing in securities other than equities. Putting the trusts on a better footing vis-a-vis their European competitors would then become a handy by-product of a change which was justified in its own right. The presentational difficulty about Europe would be resolved at the price, possibly, of underlining the "Budget for unit trusts" criticism, but that criticism will come anyway.

5. If you wished to go for this alternative presentation, little change would be needed to the Revenue's draft:

- delete first sentence
- insert "and thus investors in such trusts" after "bonds" in the second sentence
- (possibly) replace "trusts that come within the EC rules" with "authorised unit trusts recognised as UCITS"
- add at end "Together these measures will put UK unit trusts on a fairer footing to compete with their foreign counterparts."

6. I attach a text with these changes made. (Paragraph 4.18 and note 33 to table 4.1 of the FSBR need to be amended to bring them into line with this presentation.)

7. On either presentation, the non-UCITS trusts will press for the new treatment to be applied to them. The alternative presentation above might encourage them to be a bit more hopeful. But it should be possible to demonstrate after the Budget that the "fairer footing to compete" does not apply to them with the same force as it applies to the UCITS trusts,

whether or not the EC is mentioned explicitly in the Budget speech.

8. At present, the passage on unit trusts slots into the speech immediately after Life Assurance. A linking sentence will be needed (whether it stays there or is moved to follow the PEPs section). But the link is best left until after it is decided how the unit trusts change will be presented.



J F GILHOOLY

A N N E X

At present UK unit trusts investing in gilts or bonds, and investors in such trusts face a tax disadvantage. These trusts pay corporation tax at 35% on their income but can pass on a credit of only 25% to their investors. I have decided that from 1 January 1990, as for life assurance companies, the corporation tax rate on authorised unit trusts recognised as UCITS, [Undertakings for Collective Investment in Transferable Securities], will be cut to 25%. Their investors will then get full credit for all the tax the trusts pay. I am also removing an unfair advantage which offshore umbrella funds enjoy over unit trusts: from today switches between the individual parts of umbrella funds will be liable to tax. Together these measures will put the UK unit trusts on a fairer footing to compete with their foreign counterparts.



FROM: MISS M P WALLACE
DATE: 28 February 1989

MR BURR

cc Ms Young (IAE)

BUDGET SPEECH: SECTION ON PRP

... I attach the extract from the Budget speech that covers PRP (paragraphs 46-50). If you have any comments, I should be grateful if they could reach me by close tomorrow, Wednesday 1 March.

A handwritten signature in cursive script, appearing to read 'mpw'.

MOIRA WALLACE

46. Those firms with employee share ownership schemes have no doubt that it helps to improve company performance, by giving the workforce a direct personal interest in its profitability and success.

47. This was one of the reasons why I introduced the profit-related pay scheme in my 1987 Budget. I have some improvements to make to that, too.

48. First, as I have previously announced, I propose to abolish the restriction that profit-related pay must equal at least 5 per cent of total pay. Second, I propose to raise the limit on the annual amount of profit-related pay which can attract relief from £3,000 to £4,000.

49. And, third, I propose to relax the rules preventing headquarters units from using the profits of the whole company or group for their profit calculations.

50. Taken together, the package of measures I have announced to encourage wider share ownership in general, and employee share ownership and profit participation in particular, will help to ensure that the idea of a share-owning democracy becomes ever more entrenched as a part of the British way of life.



FROM: MISS M P WALLACE
DATE: 28 February 1989

MR ILETT

cc Mr Odling-Smee
Mr Neilson

BUDGET STATEMENT: TAX SECTION

... I attach those sections of the latest speech draft covering share ownership measures (paragraphs 24-50) and the section that covers (briefly) the COBO-related tax measures, and stamp duty ... (paragraphs 83-88). I have separately sent the whole speech to Mr Monck.

2. If you or others have any comments, it would be helpful to have them by close tomorrow, Wednesday 1 March.

A handwritten signature in cursive script, appearing to read 'M P Wallace'.

MOIRA WALLACE

TAXES ON SAVING

24. I now turn to the taxation of saving.

25. The sharp decline in the ratio of personal saving to personal income over the past two years in particular has led to even more discussion than usual of the merits of providing greater tax incentives for personal saving.

26. Certainly it is desirable that, over the medium-term, we generate as a nation a level of saving high enough to finance a high level of investment without having to rely too much on inflows of capital from overseas.

27. But what matters here is not personal savings alone, but corporate savings too, which are running at historically high levels, and even public sector savings, which are higher than they have been for some considerable time.

28. Moreover, the fall in the personal savings ratio, which is of course measured in net terms, that is to say gross saving net of borrowing, has occurred as a result of the sharp increase in personal borrowing. And the

appropriate remedy for that is to raise the cost of borrowing, as we have done.

29. But above all, it is essential that tax reform is seen in a medium-term, even a long-term context. It is wholly inappropriate as an answer to what are essentially cyclical or even conjunctural difficulties. In that context, the Government's policy is clear. It is to strengthen and deepen popular capitalism in Britain, by encouraging in particular wider share ownership.

30. If, in doing so, the overall level of personal saving rises, well and good; but that is not the object of the exercise and is something which in any event would only become apparent over the longer term. Over the past ten years we have done a great deal, on a number of fronts, to encourage wider share ownership in general and employee share ownership in particular.

31. The latest Treasury/Stock Exchange survey, conducted earlier this year, reveals that there are now [X] million individual shareholders in this country, equivalent to one adult in every (five), and some three times as many as there were ten years ago.

Indeed, there are now more individual shareholders than there are trade unionists. (Check).

32. The privatisation of the water and electricity industries is likely to provide a further impetus to popular capitalism over the next two years.

33. Meanwhile, I have a number of measures to announce today to the same end.

34. Personal equity plans were first announced in my 1986 Budget, and started up in January 1987. As the House knows, those who invest in these plans pay no tax at all, either on the dividends they receive or on any capital gains they may eventually make - indeed, there will normally be no need for them to get involved with the Inland Revenue at all.

35. Personal equity plans got off to a good start, with over a quarter of a million investors, many who had never owned shares before, subscribing almost £¹/₂ billion between them.

36. Since then, however, the rate of growth has slowed down considerably, not least as a result of the changed

climate in the equity market since the October 1987 Stock Exchange crash.

37. So the time has come to give them a new lease of life.

38. First, I propose to raise the annual limit on the overall amount that can be invested in a PEP from £3,000 to £4,800.

39. Second, within that, I propose to raise substantially the amount that can be invested in unit trusts or investment trusts from £750 to £2,400 a year. Moreover, the requirement that the amount invested in unit or investment trusts should not exceed one-quarter of the total amount invested in a PEP will be dropped, and replaced simply by the requirement that, to qualify for PEP treatment, a unit or investment trust must be preponderately invested in UK equities.

40. Third, at present, only cash may be directly invested in a PEP. I propose that investors should also be permitted to place renounceable letters of allotment, obtained by subscribing to new share issues, including privatisation issues, directly into a PEP.

41. Fourth, I propose to simplify the PEP rules in a number of important respects, so as to make the scheme more flexible, better directed to the needs of small and new investors, and cheaper to administer. The substantial improvements I have announced respond to a number of detailed representations I have received from plan managers. Needless to say, I have not been persuaded to accept every suggestion that has been made. In particular, I have not been persuaded to replace the complete tax relief on exit, which is the essence of the PEP scheme, by tax relief on payments into a plan instead - not least because, while the degree of relief is in principle the same in both cases, those countries which have opted for front-end relief have been forced to festoon it with a complex web of restrictions to prevent abuse. I am confident that the changes that I have announced today will enable personal equity plans to play an important part in stimulating individual ownership of British equity in the years ahead.

42. I also have a number of improvements to announce specifically designed to encourage employee share ownership.

43. It is a striking fact that the number of approved employee share schemes has risen from a mere 30 in 1979

to almost 1,600 today, involving [number] companies and benefiting some $1\frac{3}{4}$ million employees. I propose, first, to increase the annual limit on the value of shares which can be given income tax-free to employees under all-employee profit-sharing schemes from £1,250 to £2,000; and for the alternative limit of 10 per cent of salary, to raise the ceiling from £5,000 to £6,000.

44. Second, I propose to increase the monthly limit for contributions to all-employee save-as-you-earn schemes from £100 to £150, and at the same time to double the maximum discount from market value at which options may be granted from 10 per cent to 20 per cent.

45. Third, a number of my Hon. Friends have been concerned that current tax law may be inhibiting the development of employee share ownership plans, otherwise known as ESOPs. (Insert brief definition/description of what an ESOP is.) I propose to make it clear that companies that place their shares in ESOPs qualify for corporation tax relief, provided they meet certain requirements designed to ensure that the shares become directly owned by their employees within a reasonable time. I hope that this will encourage more British companies, particularly in the unquoted sector, to consider setting up ESOPs.

46. Those firms with employee share ownership schemes have no doubt that it helps to improve company performance, by giving the workforce a direct personal interest in its profitability and success.

47. This was one of the reasons why I introduced the profit-related pay scheme in my 1987 Budget. I have some improvements to make to that, too.

48. First, as I have previously announced, I propose to abolish the restriction that profit-related pay must equal at least 5 per cent of total pay. Second, I propose to raise the limit on the annual amount of profit-related pay which can attract relief from £3,000 to £4,000.

49. And, third, I propose to relax the rules preventing headquarters units from using the profits of the whole company or group for their profit calculations.

50. Taken together, the package of measures I have announced to encourage wider share ownership in general, and employee share ownership and profit participation in particular, will help to ensure that the idea of a share-owning democracy becomes ever more entrenched as a part of the British way of life.

83. My last capital gains tax proposal is to change the tax treatment of certain bonds so as to simplify the tax rules and prevent a loss of yield by the conversion of income into capital gains.

84. My final proposal for the taxation of savings concerns stamp duty on share transactions. I halved this from 2 per cent to 1 per cent in my 1984 Budget, and again from 1 per cent to $\frac{1}{2}$ per cent in my 1986 Budget.

85. I now have to decide how to adapt it in the light of the Stock Exchange's welcome plans to get rid of paper transactions and move to a cheaper and more efficient electronic system - a process happily known as dematerialisation.

86. Stamp duty on share transactions have been a useful revenue raiser over the years. But it sits uncomfortably with the Government's commitment to encourage wider share ownership, and puts London at a competitive disadvantage to those overseas financial centres where there is no tax on share transactions. Moreover I have to tell the House that I have found some difficulty in solving the problem of how to apply stamp duty when there is nothing to stamp.

87. I therefore propose that, as from 1 April next year, the earliest date on which the Stock Exchange is likely to be able to introduced paperless transactions, stamp duty on share transactions be abolished. The legislation will be in this year's Finance Bill, and the cost in 1990-91 will be £900 million.

88. This brings the number of major taxes I have abolished since becoming Chancellor to six: an average of one a Budget.



FROM: MISS M P WALLACE

DATE: 28 February 1989

MR BURR

cc Ms Young (IAE)

BUDGET SPEECH: SECTION ON PRP

... I attach the extract from the Budget speech that covers PRP (paragraphs 46-50). If you have any comments, I should be grateful if they could reach me by close tomorrow, Wednesday 1 March.

A handwritten signature in cursive script, appearing to read 'Moira Wallace'.

MOIRA WALLACE

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mpw

*place Mr Mowde
to whom I promised
this, for interest,
and return.*

[Isaac]

BUDGET SPEECH: SUGGESTED REDRAFT
OF STAMP DUTY PASSAGE

mpw

2/3

*2/1/86
A Radical
[Signature]*

1.3

My final proposal for the taxation of savings concerns stamp duty on share transactions. I halved this from 2 per cent to 1 per cent in my 1984 Budget, and again from 1 per cent to a half per cent in my 1986 Budget.

The time has now come to consider the future of this tax. One important factor is London's position as a financial centre. We need to safeguard that position, by ensuring that our tax on share transactions does not put London at a competitive disadvantage internationally. Another factor is the need to keep down dealing costs, so as not to inhibit wide share ownership.

I believe these considerations point to abolishing stamp duty on shares during the life-time of this Parliament. The need is not yet acute, but will become increasingly so. In my judgment the right time to take action is the next financial year.

I am announcing this a year in advance because of the work that is being done, by the Stock Exchange and others, to move, from the present largely paper-based arrangements for share dealing, to a cheaper and more efficient electronic system. It is only right that those involved in this

initiative - which I very much welcome - should
have early warning^{of my} plans for stamp duty.

I therefore propose that, as from 1 April next
year, all stamp duties on share transactions be
abolished. The legislation to abolish the duties,
and to deal with certain interim arrangements,
will be in this year's Finance Bill, ~~and~~ The cost
in 1990-91 will be £900 million.

This brings the number of major taxes I have
abolished since becoming Chancellor to six: an
average of one a Budget.

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BUDGET

CHANCELLOR

**FROM: ROBERT CULPIN
DATE: 6 March 1989**

cc: Chief Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Scholar
Mr Riley
Mr Gilhooly
Mr Matthews

SECRET

BUDGET: MINUTE TO THE PRIME MINISTER

Now that everything is settled except, I think, the precise figure for the ITV levy, I attach a draft minute for you to send the Prime Minister. I am grateful to Mr Gilhooly for breaking the back of it.

2. For the avoidance of doubt, I should say that the totals in the table are: Friday's Scorecard (3 March) minus relocation expenses plus numberplates.

a
Rather annoying that this doesn't follow the Budget speech presentation more closely. But it's primarily for the record and complete consistency is not really necessary.

Rc

ROBERT CULPIN

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DRAFT MINUTE TO PRIME MINISTER

This minute sets out my proposals for the Budget this year.

2. I have decided to give priority to a major reform of employees' national insurance contributions, and to measures which will further encourage wider share ownership. I ~~have~~ ^{am not therefore proposing} ~~therefore deferred for this year~~ ^{in this year} further reductions in the basic rate of income tax, or increases in allowances over and above the rate of inflation. I do not propose to raise excise duties. I can finance these and the other measures I am about to describe while continuing to repay debt on a very substantial scale. I shall send you a separate note shortly about the MTFs, including my proposals for monetary targets and the precise level of the PSDR.

National insurance contributions

My main reason for

3. ~~[I am]~~ giving priority to the reform of national insurance contributions ~~[for three main reasons. First, it is the best way to lighten the load on the low paid. Second, I want]~~ to deal with the ^(so-called) "steps", ^{those points on the earnings scale} (at which people can find themselves worse off if they earn more, because they lose

- 1 -

is that I want to deal

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more in national insurance contributions than they gain in extra pay. ~~Third, the reform~~ will leave everyone ~~earning~~ around ~~half the average~~ or more with £3 a week more of their own money.

The NIC reform is also the best way to lighten the load on the lower paid and will

4. ~~The present system is as follows (using the rates and income bands for 1989-90).~~ No one who earns less than £43 a week pays ^{no} NICs at all. Anyone earning between £43 and £75 pays 5 per cent on the whole of his or her earnings, including the first £43. Anyone earning between £75 a week and £115 a week pays 7 per cent, again on the whole of ^{their} earnings. Anyone earning between £115 a week and the upper earnings limit of £325 pays 9 per cent on all ^{their} earnings.

5. There are thus three steps, at £43, £75 and £115. At each of these points, an extra pound of earnings can trigger more than an extra pound of NICs.

6. I propose instead that, from ^(1 October is a Sunday,) 1 October, employees who pay NICs will do so at only 2 per cent on ^{their} earnings up to £43. On ^{earnings} above this ~~excluding the first £43~~ they will pay 9 per cent, up to an unchanged upper earnings limit.

7. This will increase by £3 a week the take home pay of those earning £115 a week or more. That is about 40 per cent of male average earnings. With indexation of the personal allowances for income tax, the combined burden of income tax and NICs for someone on half average earnings will fall by over 2 per cent, *of gross pay.*

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8. The reform will greatly reduce marginal rates at the present steps. It will abolish altogether the steps at £75 and £115, and reduce the last remaining step at £43 to only 86 pence. I have thought it right to retain this modern-day equivalent of the old national insurance stamp because it is the entry ticket to contributory benefits and essential to the contributory principle.

9. There will be a consequential reduction in the voluntary NIC rate which ^{those not in employment} people can make, if they so wish, ^{This detail is yet to be finalised.} to maintain their national insurance records. There will be no change for employers or the self-employed. (The steps are ^{not} such a problem for employers as for employees; and to extend the changes to employers would roughly double the cost.) ^{PR} ^{it} The reform will cost about £1 billion in 1989-90 and £2.8 billion in 1990-91. I have ^{discussed these proposals} [of course agreed it in detail] with John Moore, who greatly welcomes ^{them} it. ^{They} It will meet the concerns expressed by colleagues and others that the Budget should reduce the burden on the lower paid.

Income tax

10. I do not propose to change the basic or higher rate of income tax. I shall increase the personal allowances and the basic rate limit by the amount required for statutory

The reform needs primary legislation, which will be introduced at the Report stage of the Social Security Bill. ~~It will be implemented from 2 October 1989.~~

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indexation, which is 6.8 per cent rounded up. The main personal allowances will thus be maintained at a level 26 per cent higher in real terms than when we came to office.

The elderly

11. I want to do ^{something} more for the elderly, [~~especially as they cannot benefit from the NICs reform, for the simple reason that they do not pay NICs in the first place~~].

12. First, I propose to redeem our 1979 election pledge by abolishing the pensioners' earnings rule from 2 October. If people wish to defer taking their pensions, they will ^{continue to} be free to do so, and ~~will continue~~ to earn a higher pension when they retire; but that will be entirely a matter of choice. The public expenditure cost will be about £185 million in 1989-90, ^{and will be} met from the Reserve, and about £370 million in 1990-91. The ^{net} true cost will be considerably less, because we shall get back additional revenue from the increased pensions in payment, and from pensioners' higher earnings. I have agreed this, too, with John Moore.

13. Second, I propose to extend the higher age allowance which currently applies to those aged 80 and over to those ^{take in all} aged 75 and over. This will take an additional 15,000 pensioners out of tax. Single pensioners in the 75-80 age band will have a tax reduction of £1.73 a week, and married couples £2.55.

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14. Third, I propose to reduce the rate at which the age allowance ^{are} is withdrawn. This has given rise to complaints because, after last year's abolition of the top rates of income tax, the withdrawal rate now exceeds the higher rate of tax. It will come down from nearly 42 per cent to 37½ per cent.

15. Finally, the Finance Bill will include the new tax relief for pensioners' health insurance premiums announced in ~~the~~ ^{the} ~~January~~ ^{Health White Paper;} to come into effect in April 1990.

Company car scales

^{I plan a further}
16. ~~It is widely expected that I will announce a further large~~ increase in the scales for taxing the benefit from company cars, which continues to be undertaxed. ~~But there is a slight awkwardness about the timing this year, because the increase in car scales will affect pay packets in May, whereas the reduction in national insurance will not come through until October. Taking everything into account,~~ I have decided ^{they should be} ~~on an~~ increase ^{of} ~~of~~ a third, ~~Averaging over the year,~~ the great majority of company car drivers will be better off from the Budget as a whole; and in the second half of the year, significantly so.

↑
When the effects of the NIC reform come in,

A significant increase set
the plan is generally
expected.

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Schedule E

to remove a major complication which stemmed from the days when there were many different higher rates, and

17. I propose to simplify the taxation of income under Schedule E, which mainly affects ~~company~~ directors. In future, they will be taxed when they receive income, instead of when they are deemed, after complicated adjustments, to

have earned it. This will have a short-term cost, but ~~then~~ in the long-term will save Revenue staff and ~~have a long-term~~ ^{produce a revenue} yield.

Excise duties

18. I propose to make no ~~increase~~ ^{change} in excise duties this year save for two areas.

19. First, I shall reduce the tax on unleaded petrol by ~~something over 3~~ ^{rather on for 4} pence a gallon. That should make unleaded ~~9~~ ^{nearly 10} pence a gallon or ~~2~~ ^{a little over} pence a litre cheaper at the pumps than four star - one of the largest differentials in the EC. At the same time, I propose to increase the tax on two and three star petrol by roughly 4 pence a gallon, so that the pump price of these grades will be at least as high as that for four star. This should accelerate the phasing out of two star, which is already underway, and ~~free~~ ^{straight space} pumps for unleaded petrol. I have told Nicholas Ridley about this proposal, and he welcomes it.

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20. Second I propose a number of changes to the Vehicle Excise Duties, which I have agreed with Paul Channon. At present, a bus or coach has to have 66 seats before it pays as much tax as a family car. I propose to increase the rates for this group of vehicles. I also propose to increase the rates on non-articulated lorries, to put them on a more equal footing with the tax paid by articulated lorries. And I propose to simplify VED, cutting the number of main rates by about a third.

Value added tax

As usual!

21. One of the best indicators of our economic success is the rate at which new businesses are being formed and are growing. However, a consequence is that the numbers becoming liable to register for VAT is also growing rapidly: on average over 1,250 a month in 1988. For many the need to register involves unwelcome compliance costs and I therefore propose to raise the VAT registration threshold from £22,100 to £23,600 - *as much as* [once again] the maximum increase I can make under EC law, *namely from £22,100 to £23,600.*

only *to be coverage of VAT*

22. The ~~major VAT~~ change I have to propose this year has already been announced - the measures to implement the ECJ judgement of last June requiring us to end the zero-rating of non-domestic construction; of supplies of electricity and gas to non-domestic consumers, and of water and sewerage services

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to industry; of protective clothing and headgear supplied to employers; and of news services (but not newspapers, which continue to be zero rated). As you know, I have decided to give generous transitional arrangements for non-domestic construction, and have agreed to defer until July 1990 the standard rating required for fuel, power, water and sewerage to enable these industries to cope more easily with the administrative changes involved. The loss of these zero rates derives from the 6th EC VAT Directive agreed by our predecessors in 1977.

Charities

23. The effects of the ECJ judgement on charities is a sensitive issue and I have done all I can to soften the blow, as the charities ^{themselves} have ~~generously~~ acknowledged. All fuel and power supplies and construction for their non-business activities will remain zero-rated, as will water for all their activities. But some charities may still have to pay ~~a certain amount of increased~~ ^{extra} VAT. I have therefore ~~decided to make the following further tax changes to benefit them.~~ ^{introduce} some additional reliefs.

26. (I) propose to double the annual amount which can be given tax free to charities under the payroll giving scheme from £240 to £480 a year.

I continue to believe that the best way to help charities is to encourage charitable giving. I therefore

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24
25. I propose to extend exemption from VAT to fund-raising events by charities (and certain other fund-raising organisations, including political parties and trade unions); and to extend zero-rating to all advertisements placed by charities, and to sterilising equipment used by medical charities. And I propose to exempt from special car tax vehicles purchased by Motability for leasing to the disabled.

25
26. I also propose a change in the rules on covenanted membership subscriptions so that it is clear beyond doubt that charities such as the National Trust can offer members free or cheap entry to their properties without loss of tax relief. This will remove a long-standing anxiety.

→ payroll giving.

Capital gains tax

27. I shall keep the annual exemption from CGT at £5,000 this year. Married couples will then have a £10,000 exemption when independent taxation comes in next year.

28. I propose to restrict the deferral of CGT on gifts. This was originally introduced by Geoffrey Howe to prevent a double tax charge when Capital Transfer Tax was levied on lifetime gifts. Now that CTT has gone, the continued CGT exemption for gifts has become a popular form of tax avoidance. I therefore propose to restrict the exemption, but I shall keep it for gifts of business, farm and heritage

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assets, gifts to charities, and gifts between husband and wife. Gifts or sales of ordinary personal belongings are already exempt from CGT if they are worth less than £3,000.

I propose to double this to £6,000.

29. ^{finally on CGT,} I propose to block off a device for turning income into capital through deep discounted bonds, ~~which might otherwise become available with the effective abolition, in the Budget, of the Control of Borrowing Order.~~

Company taxation

30. I propose to reduce the burden of corporation tax on many companies, not by changing the main rate of 35 per cent, which is still one of the lowest in the world, but by making the benefit of the 25 per cent small companies rate available to more companies. Ever since the corporation tax reform I introduced in 1984, the small companies' rate has applied to companies with an annual profit of less than £100,000. The benefit is only gradually withdrawn, so that companies only pay the full 35 per cent rate if they have an annual profit of £500,000 or more. I propose to increase both the £100,000 and the £500,000 limits by 50 per cent, reducing the CT burden for more than half the companies which do not already benefit from the small companies rate.

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31. I intend to simplify the tax rules for close companies.

At present, 20 pages of complex legislation - the apportionment rules - are in force to ensure that they are not used for tax avoidance. After last year's reforms, the rules are no longer necessary, and I shall abolish them.

Special provisions will be required to prevent the use of close companies for avoidance purposes, but these will be put straight forward.

Wider share ownership

32. I propose a number of measures to encourage the further widening of share ownership. I shall be able to announce

these against the background of the annual Treasury/Stock Exchange Survey into share ownership, which carries the encouraging news that, despite the aftermath of the October 1987 Stock Market crash, there has been no change in the level of share ownership over the past year, [and 9 million people continue to own shares.] *which remains at 9 million.*

Personal equity plans

33. I propose to raise from £3,000 to £4,800 the limit on the overall amount which can be invested in a Personal Equity Plan each year. Within that, I propose to raise the amount which can be invested in unit trusts or investment trusts from £750 to £2,400 a year. I shall drop the rule that no more than a quarter of a PEP may be invested on unit or

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investment trusts, but require instead that such trusts be invested preponderantly in UK equities.

mainly
fact - the work of the Commission on that, but I see no point in anticipating (v.)
34. So far, investors in privatisations and other new issues have not been able to take advantage of the tax reliefs which PEPs provide, because of the rule that only cash may be invested in a PEP. I propose to change this so that all ~~renounceable~~ *shares obtained from a new equity issue* letters of allotment obtained by ~~subscribing to new share issues can be invested~~ *can be placed directly* in a PEP.

This should not only encourage wider use of PEPs but also contribute to the success of future privatisations, *in particular*

water - in electricity.
35. Finally, I propose to make a number of important simplifications to the rules, to make PEPs more flexible, better directed to the needs of small and new investors and cheaper to administer.

Employee share schemes

36. All-employee share schemes have been a *major* ~~real~~ success, growing in number from 30 in 1979 to some 1500 at present. We need to ensure that the limits governing such schemes do not hamper this growth. I therefore propose to increase the annual limit on the value of shares which can be given to an employee income-tax free; to increase the monthly limit for all-employee save-as-you-go share schemes; and to double the maximum discount from market value at which options may be granted, from 10 per cent to 20 per cent.

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Employee share ownership plans (ESOPs)

37. I have been impressed by the enthusiasm for Employee Share Ownership Plans in the representations I have received about the Budget, both from some of our ^{mm} backbenchers and from outsiders. These schemes involve putting shares into a trust for later transfer to employees. They are a relatively new development in the UK, but could have a useful potential for increasing employee share ownership, especially in unquoted companies. They are at present being hindered by uncertainties about the deductibility for corporation tax of employers' contributions to ESOPs. I propose to clarify the legislation to put this beyond doubt.

Profit related pay

38. Profit related pay schemes have been spreading, but more slowly than I would like. In the light of experience, I propose to abolish the restriction that PRP must equal at least 5 per cent of total pay; to raise the limit on the amount which can attract relief from £3,000 to £4,000 a year; and to relax the rules which prevent headquarters staff from using the profits of the whole company or group in calculating their PRP.

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Life assurance

39. I propose to make reforms in the tax treatment of life assurance and pensions. You will recall that last June I authorised the Revenue to issue a consultative document on the taxation of life assurance. This drew attention to defects in the tax regime, which mean that the incidence of tax is uneven between companies, and the overall yield lower than it should be by any reasonable yardstick. There has been a full response from the industry and others, and the Financial Secretary and the Revenue have had consultations with the main representative bodies, including in particular the Association of British Insurers.

40. I have concluded that it is right to make a number of changes within the existing tax regime, which is special to life assurance, but not to pursue the more radical alternatives canvassed in the consultative document. More radical reform could ^{arguably} place an unnecessary burden on the industry when it is adjusting to the changes flowing from the Financial Services Act, and when it is preparing for the increased competition it may face in the 1990s in the European Community.

41. I propose, first, to separate for tax purposes the pension business of the life offices from life assurance proper. This will stop the life offices from setting pensions expenses against life business profits. The ABI ^{has}

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acknowledges that it is anomalous to allow this at present.

This single measure is the source of ~~most of~~ the net yield of the life assurance package: the other measures are broadly neutral over a run of years, with a modest reduction in yield to start with.

42. I propose to spread over seven years the deductibility of expenses associated with selling new life assurance policies, which the present regime allows to be deducted all at once; to reduce the tax on life assurance policyholders' funds from 35 per cent on income and 30 per cent on capital gains to a single rate of 25 per cent; and to abolish Life Assurance ~~Premium~~ ^{Policy} Duty, the special stamp duty paid on Life Assurance Policies. The changes will come into effect on 1 January 1990; but, to give the life offices time to adjust, the spreading of expenses will be phased in over four years.

Unit trusts

43. I also propose to reduce the rate of tax on unit trusts to 25 per cent, ~~[putting them on a par with life offices.]~~ The change will apply to authorised trusts recognised in the Community as "Undertakings for Collective Investment in Transferable Securities", for whom the EC UCITS directive comes into effect later this year.

This will remove a tax disadvantage ~~to~~ which UK unit trusts face.

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Pensions

44. For pensions, I propose first to make an important deregulatory change. At present the tax reliefs for contributory to occupational pensions, and for the tax-free lump sum, are ~~only available~~^{fixed} to schemes which comply with the relevant Inland Revenue rules and limits. If an employer wants to pay pensions beyond the Inland Revenue limits, the whole of the tax relief is lost. I propose to end this restriction.

all-or-nothing rule. Employees will be free to pay large pension benefits, but from non-tax privileged funds.

45. At the same time, I propose to put a limit on the tax relief which occupational pensions can receive. This will be related to final salary of £60,000, indexed to prices. Even if it were applied immediately, only some 50,000 employees would be affected; but I propose that the measure should only apply to new entrants to existing schemes, and to new schemes. [The numbers affected will therefore be very small indeed; and it will be well into the next century before the increase in real earnings causes the new limit to affect significant numbers of employees.]

46. I also propose to improve the tax regime for personal pensions, by increasing the proportions of salary which people of 35 and over can invest tax-free in a personal pension. Of all the pensions measures, this will be the one with the largest immediate impact, and will encourage further

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growth in personal pension provision. There will be a cash limit on the total contributions which can be made tax-free.

47. Public service pension schemes will, of course, have to comply with these new rules. I have told colleagues most directly involved about my proposals and, after the Budget, I will want to consider with them how the new rules should be applied in the public services.

Other measures

48. I propose, at Paul Channon's request, to include in the Finance Bill provision for the sale to the public of "cherished" car registration numbers.

49. I propose to exempt from taxation as a benefit-in-kind the security equipment which a few employers now have to provide at the home of key employees at risk from terrorist or other attacks.

50. I propose to include in the Finance bill two sets of measures dealing with tax administration, which have been subject to full consultation, and should not be controversial.

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51. I also propose, ^{as you know,} to include in the Bill provisions to restore criminal sanctions against Revenue or Customs officials who reveal information about the private affairs of individual taxpayers.

52. I intend to issue consultative documents on the tax treatment of gains and losses on foreign currency borrowing, and of interest swaps between companies, and on proposals to simplify the administration of the tax scheme for sub-contractors in the construction industry.

53. Finally, I should let you know the conclusion I have reached on residence. The representations on the consultative document the Revenue published last summer have convinced me that the world wide income approach would be damaging and unworkable. I intend to have it made clear during the Budget debates that we do not intend to continue with this proposal. However, the consultations suggest there may be scope for a sensible reform of the definitions of residence, and possibly for reforms within the existing framework to prevent abuses. I propose to put in hand further consultations.]

This needs urgent discussion.
I am not sure about the whole thing.

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Cost

54. I attach a table which summarises the revenue effects of the main Budget measures. ~~I should be glad to know that you are content.~~

unnecessary *invis?*

NIGEL LAWSON

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From: S D H SARGENT

Date: 7 March 1989

PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary
Sir T Burns
Mr Scholar
Mr Culpin
Mr L Harris
Mr Riley
Mr Gilhooly
Mr Matthews

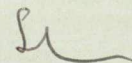
BUDGET: MINUTE TO THE PRIME MINISTER

Sir Peter Middleton has suggested some amendments to Pensions section of Mr Culpin's draft of 6 March.

Paragraph 45: amend beginning of fourth sentence to read: "The numbers immediately affected ...".

Paragraph 47: revise to read as follows:

OK
"Public service pension schemes including the Civil Service pension scheme will have to be amended to comply with these new rules before the implementation date of 1 June. I have told colleagues most directly involved about my proposals. After the Budget, I will want to consider with them the implications of the new rules for public service pensions."



S D H SARGENT
Private Secretary

BUDGET CONFIDENTIAL

MP

PS/CHIEF SECRETARY

FROM: A G TYRIE
DATE: 8 March 1989
cc: PS/Chancellor
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Culpin
Mr Davies
Mr Mowl
Mr Pickford
Miss O'Mara
Mrs Chaplin
Mr Call

**CHIEF SECRETARY'S SPEECH TO THE CONSERVATIVE CENTRAL COUNCIL,
17TH MARCH**

Here is a suggested redraft (quickly done!) of the opening section on the economy.

We are only a few days away from the tenth anniversary of the decisive vote in the House of Commons that brought down the last Labour government. That government needed a budget every six months. They had an economic policy which was nothing more than a rag bag of sops to supporters, concessions to power brokers, and sacrifices to placate the IMF.

2. We have broken decisively with that. In 1979 we set out a clear strategy, a strategy to rebuild Britain, a policy for the future.

3. We dispensed with Labour's apparatus of controls and government interference, turned our back on shabby compromises and concessions to the unions.

4. We decided to tap the resources, the energy, and the imagination of the British people. We decided to take government off peoples' backs and let them get on with rebuilding Britain.

5. We had some tough times, particularly in the early years, but we stuck to it. Now we are reaping the rewards. For the last five years out of six (check) the British economy grew faster than any other in Europe. In fact we've grown faster than any other European economy in the 1980s. In the 1960s and 70s we were the slowest.

6. Production is at an all time high, so are exports. So is manufacturing output. In the 1980s Britain has become more and more efficient as a manufacturing economy. The amount each man or woman produces in manufacturing has grown faster here than in any other major country.

7. Businesses are more profitable than they have been for more than 20 years. Much of those profits are being ploughed back in investment, and Britain is experiencing the biggest investment boom for a generation. By investing the country is preparing itself for the future, in a way undreamed of in those desperate days of the Winter and Spring of 1979.

8. We have stuck to our guns and it has paid off. We told people that businesses and individuals create jobs and prosperity, not governments. And, just as we said it

would, our policies have brought down unemployment, down by over a million in the past x months. We are employing more people in this country than ever before.

9. Not only jobs but prosperity too. Living standards are now higher in this country than they have ever been.

10. I have been telling a story of success. But there are problems too. But it helps, now and again, to keep these problems in perspective and to see just how far we have come.

11. At the beginning of this debate Mr Normington moved a motion calling on the Government to bring down inflation and not to be deflected by short term pressure over interest rates and the balance of trade. Absolutely right. We stuck to it in the early 1980s when the going was really tough. We are not going to loosen our grip now.

12. In the last few months there has been too much demand in the economy. It pushed inflation up. So we took swift action and raised interest rates. At its present level of 7.5% the RPI is getting on for half the average rate under Labour. That keeps the problem in perspective but it's not good enough.

13. We will take no risks with inflation.

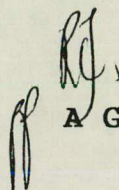
14. Some people regard a cosy level of inflation as bearable, even benign. We didn't in 1979. We don't now. Inflation must be recognised for what it is: an economic evil that destroys savings and the carefully accumulated security of a life time of sacrifice and prudent budgeting.

15. Inflation is the most unfairest and most arbitrary tax of all. It bears down on those with very little and shores up those with a great deal. It damages business confidence. It costs jobs. Promotes disorder in the wage market and it is the raw material of militancy. That is why we cannot tolerate it.

16. So we are going to keep interest rates at the level required to bear down on inflation and we are not going to loosen our grip until we have done what is needed. Some people tell you that inflation can be cured with government intervention, credit controls, exchange controls and the like. Don't believe them. In the long run credit controls have never worked - history tells us that. And while you're imposing them, in the short run, they are unfair. Those who know their way around the financial system, they will go abroad and get their money, they will find a way round the rules. The man who gets clobbered by credit controls is the ordinary man in the street.

17. Add paragraph 9.

18. I started by saying that Britain is incomparably stronger now than when the Conservatives came to power in 1979. Carry on with paragraph 12 and following.


A G TYRIE



TOP
COPY

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

9 March 1989

Paul Gray Esq
10 Downing Street
LONDON
SW1

Dear Paul,

... I enclose, as promised, two copies of the latest draft of the taxation section. The Economic Section will follow tomorrow.

Yours,

Moir

MOIRA WALLACE

TAXPAYER CONFIDENTIALITY

Before I turn to my proposals for changes in taxation, I have one other change of a specific nature to announce.

2. As the House knows, the new official secrets legislation currently passing through Parliament is very much narrower in scope than the present Official Secrets Act. In particular, it does not cover information in the possession of either the Inland Revenue or Customs & Excise concerning the private affairs of specific taxpayers.

Too much mystery

3. I am sure that the whole House will agree that it is essential for taxpayer confidentiality to be properly protected. I therefore propose to introduce provisions in this year's Finance Bill to ensure that it will continue to be a criminal offence for officials or former officials of either of the Revenue Departments to reveal information about the private affairs of a specific taxpayer.

4. I would only add that the need for this protection is in no sense a reflection on the probity and integrity of the members of those two Departments. Indeed, after nearly six years as Chancellor and more than eight years

as a Treasury Minister, I would like to take this opportunity to pay public tribute to the outstanding service I have consistently received from the officials of both Departments.

BUSINESS TAXATION

5. I now turn to taxation. As I have done on a number of previous occasions, I propose to divide this into three broad sections: the taxation of business, the taxation of savings, and the taxation of personal income and spending.

6. First, taxes on business.

7. Ever since the corporation tax reform I introduced in 1984, the rate of corporation tax for small companies, defined for this purpose as those with annual profits of less than £100,000, has been set at the basic rate of income tax, currently 25 per cent. Large companies, defined as those with profits of £¹/₂ million or more, pay the main rate of corporation tax of 35 per cent, one of the lowest rates of tax on company profits in the world. Between £100,000 and £¹/₂ million the average rate of tax gradually rises from 25 to 35 per cent.

8. I propose to keep the small companies rate in line with the basic rate of income tax for 1989-90 and to leave the main corporation tax rate unchanged. But I propose to increase the small companies' rate band substantially, by 50 per cent.

9. Thus the small companies' rate will apply to companies with profits of under £150,000, and the 35 per cent rate will only be reached at profits of £³/₄ million. These changes will reduce the corporation tax burden for more than half of all those companies that do not already enjoy the benefit of the small companies rate.

10. I propose to increase the VAT threshold to £23,600, the maximum permitted under European Community law.

11. I also have to set the scales for the private use of company cars. This remains far and away the most widespread benefit in kind. When I doubled the car scales in last year's Budget, I made it clear that this still left this benefit significantly undertaxed.

12. Accordingly, I propose to increase the car scales by one third for 1989-90. The yield from this will be £160 million in 1989-90 and £200 million in 1990-91. There will be no change in the fuel scales.

13. Over the years I have received a number of representations from business complaining about the long-standing tax treatment of foreign exchange gains and losses. I recognise that as business becomes more global this subject becomes increasingly important. However, I have to say that I find it one of the most intractable I have encountered. Certainly, there can be no question of any change in the present system until a number of crucial and complex issues have been satisfactorily resolved. I have therefore authorised the Inland Revenue to publish today a consultative document which explores those issues and examines the scope for reform.

14. Finally, on business taxation, I have two major simplifications to propose, both of which follow from the income tax reforms I introduced last Budget.

15. One of the many undesirable features of an income tax system with several higher rates was that since a taxpayer's marginal rate could well be very different in

different years, the question of which year income related to made a great deal of difference. This was true of Schedule E where the strict rule is that income is taxed in the year to which it relates, on an accruals basis.

16. For the vast majority of employees, this basis of assessment for Schedule E poses no problem. But for about half a million people, mainly directors, who do not receive all their income in the year to which it relates, it causes complications and often needless assessments and correspondence long after the tax year is over. [It is also open to manipulation.]

17. I therefore propose that income tax under Schedule E should in future be assessed on a receipts basis, with the simple principle that you pay the tax when you receive the income. This will have a transitional cost of £80 million in 1989-90 and £60 million in 1990-91, but in the long term it will yield both extra revenue and a significant saving in both taxpayer's time and Inland Revenue staff.

*Also open
to manipulation*

18. The reduction in the top rate of income tax to 40 per cent in last year's Budget also enables me to make a major simplification of the tax treatment of the

vast bulk of the incorporated sector of small businesses: those known as close companies - generally speaking, unquoted companies that are controlled by five or fewer people.

19. The rules for the so-called apportionment of close companies' income are notoriously complex, taking up some twenty pages of impenetrable legislation. These rules are no longer needed and I propose to abolish them. I believe that family businesses in particular will welcome this substantial simplification.

20. I do, however, have to guard against the avoidance of tax on investment income by channelling it through a closely controlled investment company. Any such company which does not distribute most of its profits and other investment income will therefore be taxed at 40 per cent, equivalent to the higher rate of income tax.

What proportion is "most"?

TAXES ON SAVING

21. I now turn to the taxation of saving.

22. The sharp decline in the ratio of personal saving to personal income, over the past two years in

particular has led to even more discussion than usual of the merits of providing greater tax incentives for personal saving.

23. Certainly it is desirable that, over the medium-term, we generate as a nation a level of saving sufficient to finance a high level of investment. But what matters for that is not personal savings alone, but corporate savings too, which are running at historically high levels, and public sector savings, which have been boosted by the move to budget surplus.

24. Moreover, the personal saving ratio is measured in net terms, that is to say as gross saving net of borrowing, and it has fallen not because of a decline in gross saving but as a result of the sharp increase in personal borrowing. And the appropriate remedy for that is to raise the cost of borrowing, and with it the return on saving, as we have done.

25. Above all, the role of tax reform is to encourage enterprise and improve economic performance in the medium term. It is wholly inappropriate as an answer to short term or cyclical phenomena. So for the taxation of savings, the Government's policy is clear. It is to

strengthen and deepen popular capitalism in Britain, by encouraging in particular wider share ownership.

26. I have a number of specific tax measures to announce today to that end.

27. Personal equity plans, or PEPs, were first announced in my 1986 Budget, and started up in January 1987. As the House knows, those who invest in these plans pay no further tax at all, either on the dividends they receive or on any capital gains they may make - indeed, there is no need for them to get involved with the Inland Revenue at all.

28. Personal equity plans got off to a good start, with over a quarter of a million investors, many who had never owned shares before, subscribing almost £¹/₂ billion between them in 1987.

29. Since then, however, the take-up of new PEPs has slowed down, not least as a result of the changed climate in the equity market which followed the October 1987 Stock Exchange crash.

30. So the time has come to improve and simplify PEPs and give them a new boost.

31. First, I propose to raise the annual limit on the overall amount that can be invested in a PEP from £3,000 to £4,800.

32. Second, within that, I propose to raise substantially the amount that can be invested in unit trusts or investment trusts. For many small savers, these provide an excellent introduction to shareholding. At present PEP investors may only place £540 a year, or a quarter of their PEP, in unit or investment trusts. I propose to more than ^{quadruple} treble this amount, to £2,400 a year; and I propose to allow the whole of a PEP to be invested in unit or investment trusts, up to this limit. To qualify for tax relief, the unit or investment trusts will be required to invest wholly or mainly in UK equities.

33. Third, at present, only cash may be paid into a PEP. I propose that investors should also be permitted to place directly into a PEP shares obtained by subscribing to new equity issues, including privatisation issues.

34. Finally, I propose to make a number of important simplifications to the PEP rules so as to make the

scheme more flexible, better directed to the needs of small and new investors, and cheaper to administer.

35. I am confident that the changes that I have announced today will enable personal equity plans to play an important part in stimulating the spread of ownership of British equities in the years ahead.

36. I also have a number of improvements to announce specifically designed to encourage employee share ownership.

37. It is a striking fact that the number of approved employee share schemes has risen from a mere 30 in 1979 to almost 1,600 today, involving some $1\frac{3}{4}$ million employees. At present the annual limits on the value of shares which can be given under all-employee profit-sharing schemes are £1,250 or 10 per cent of salary up to a ceiling of £5,000. I propose to raise these cash limits to £2,000 and £6,000 respectively.

38. Second, I propose to increase the monthly limit on contributions to all-employee save-as-you-earn share option schemes from £100 to £150, and at the same time to double the maximum discount from market value at

which options may be granted from 10 per cent to 20 per cent.

39. Third, a number of my Hon. Friends have been concerned that current tax law may be inhibiting the development of employee share ownership plans, otherwise known as ESOPs. These are distinguished from ordinary approved employee share schemes by the fact that they use a wider variety of finance, acquire more shares and tend to operate on a longer timescale. I propose to make it clear that companies' contributions to ESOPs qualify for corporation tax relief, provided they meet certain requirements designed to ensure that the employees acquire direct ownership of the shares within a reasonable time. I hope that this will encourage more British companies, particularly in the unquoted sector, to consider setting up ESOPs.

40. Those firms with employee share ownership schemes have no doubt that giving the workforce a direct personal interest in their profitability and success improves the company's performance. The same benefits flow from profit related pay.

41. This was one of the reasons why in my 1987 Budget, I introduced a tax relief to encourage its development. I have some improvements to make to this scheme, too.

42. First, as I have previously announced, I propose to abolish the restriction that, to qualify for the tax relief, prospective profit-related pay must equal at least 5 per cent of total pay. Second, I propose to raise the limit on the annual amount of profit-related pay which can attract relief from £3,000 to £4,000.

43. Third, I propose to enable employers to set up schemes for headquarters and other central units using the profits of the whole company or group for their profit calculations. And fourth, to help share schemes and ESOPs as well as profit related pay, I propose to change the so-called material interest rules which may at present unnecessarily exclude employees from schemes where they can already benefit from a trust set up for employees.

44. Taken together, the package of measures I have announced to encourage wider share ownership in general, and employee share ownership in particular, will help to ensure that the idea of a share-owning democracy becomes

ever more entrenched as a part of the British way of life.

45. Last June, the Inland Revenue issued with my authority a major consultative document on the taxation of life assurance.

word later

46. The tax regime for life assurance is sui generis. The present system dates back to the First World War and has developed over the years in a piecemeal way, leading to a state of affairs in which the incidence of tax is extremely uneven, with some successful life offices paying no tax at all.

47. There is clearly a powerful case for reform, with a view to securing a tax regime which is more equitable both within the industry and as between life assurance and most other forms of savings.

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48. () I have considered very carefully the representations the industry has made, and taken full account both of the changes to the regulation of life assurance proposed by the Securities and Investment Board under the Financial Services Act and the prospects for increased competition within the European Community after 1992. In the light of these factors, I have

decided not to proceed with the more radical reforms canvassed in the consultative document. But I do have a number of important changes to propose, based for the most part on the general tax reform principle of seeking lower rates on a broader base.

49. First, many life offices run a pension business alongside their main life assurance business, and they are not required to keep the two businesses entirely separate for tax purposes. This enables them to set the unrelieved expenses of the pensions business against the income and gains of their life business, thus giving their life profits unduly favourable tax treatment. The life offices themselves have accepted that this treatment is anomalous and I propose to end it.

50. This change, along with some minor related changes, will come into force on 1 January 1990, and will yield some £150 million in 1990-91. The remainder of the changes I have to propose constitute a broadly balanced package which, because of the transitional provisions, will reduce the taxation of life assurance in 1990-91 by some £100 million.

51. I propose that the expenses incurred by life offices in attracting new business should continue to be

fully deductible for tax purposes from the income and gains of life funds, but should in future be spread over a period of seven years. To give the industry time to adjust, this change will be phased in gradually over the next four years, starting on 1 January, 1990.

52. There are certain other, more technical matters raised in the consultative document which will require further discussion with the industry, and any legislative changes on these issues will have to wait for next year's Finance Bill.

53. But I can say here and now that I propose, as from 1 January 1990, to abolish Life Assurance Policy Duty. And I also propose, from the same date, that the rate of tax payable on the policyholder's share of income and gains of life offices, which at present stands at 35 per cent on unfranked investment income and 30 per cent on realised capital gains, should be reduced to the basic rate of income tax.

54. The net effect of all these changes to the taxation of life assurance will be a cost of £20 million in 1989-90 and a yield of £45 million in 1990-91, rising somewhat in subsequent years.

55. But above all it will provide a more efficient and equitable tax regime for this most important industry.

56. Later this year, UK unit trusts will be able to compete freely in Europe and will face competition from analogous Community investment schemes here. At present, trusts investing in gilt-edged securities or other bonds face a tax disadvantage. They pay corporation tax at 35 per cent on their income but can pass on a credit of only the basic rate to their investor. So I propose that from 1 January 1990, as for life assurance companies, the corporation tax rate on unit trusts that come within the new European Community rules will be equal to the basic rate of income tax. Their investors will then get full credit for all the tax the trusts pay.

57. I now turn to pensions.

58. The tax treatment accorded to pension schemes is quite rightly particularly favourable; and the extent of this privilege has to be circumscribed by Inland Revenue rules. So pension schemes only qualify for tax relief if they meet certain conditions, notably that the pension paid may not exceed two-thirds of final salary:

and if they fall foul of any of these rules, they lose all relief.

59. This has the perverse result that tax law effectively constrains the overall pension an employer can pay his employee. This is neither desirable nor necessary. Accordingly, I propose to make it possible for employers to provide whatever pensions package they believe necessary to recruit and reward their employees.

60. However, while it is clearly right that employers should be free to provide whatever pension they see fit, it would not be right to make the present generous tax treatment available with no upper limit at all. I therefore propose to set a limit on the pensions which may be paid from tax-approved occupational schemes, based on final salary of £60,000 a year.

61. I have deliberately set the ceiling at a level which will leave the vast majority of employees unaffected, and it will be subject to annual uprating in line with inflation. It will still be possible for a tax-approved occupational scheme to pay a pension of as much as £40,000 a year, of which up to £90,000 may be commuted for a tax-free lump sum.

62. The new ceiling will apply only to pension schemes set up, on or after today, or to new members joining existing schemes after 1 June. And, as I have already said, there will now be complete freedom to provide benefits above the Inland Revenue limits, though without the tax relief.

63. The introduction of this ceiling on tax relief also enables me to simplify and improve the rules for the majority of pension scheme members, in particular to ease the conditions under which people can take early retirement.

64. I also propose to simplify very substantially the rules concerning additional voluntary contributions to pension schemes, or AVCs. In particular, the present requirements for free standing AVCs place a heavy administrative burden on employers. These requirements will be greatly reduced. Indeed, in many cases employers will not need to be involved at all.

65. Furthermore, if AVC investments perform very well, occupational pensions may at present have to be reduced to keep total benefits within the permitted limits. I propose that in future any surplus AVC funds should be returned to employees, subject to a special tax charge.

This will remove the penalty on good investment performance.

66. The most important development in the pensions field in recent years has undoubtedly been the introduction and success of personal pensions. Since July last year, a million people have already taken advantage of the new flexibility and opportunities these offer. I have two proposals today to make personal pensions still more attractive.

67. First, I propose to make it easier for people in personal pension schemes to manage their own investments.

68. Second, I propose to increase substantially the annual limits, as a percentage of earnings, on contributions to personal pensions for those over the age of 35. This will be of particular value to those running their own business, who are often unable to make contributions until later on in their working life. It will also improve the position of personal pensions in relation to occupational schemes. The new limits will be subject to an overall cash ceiling based on earnings of £60,000, corresponding to the new ceiling for occupational pensions, and similarly indexed.

69. These changes build on, and complete, the pension measures I introduced in my 1987 Budget. They represent a significant deregulation which will allow more flexibility, while setting for the first time a reasonable cash limit on the tax relief available to any individual. They should give a boost, in particular, to saving through personal pensions and through AVCs.

69a. Coupled with the changes I made in 1987, this is as far as I wish to go in amending the ^{tax} treatment of pensions.

70. Finally, on the taxation of saving, it should not be overlooked that a far-reaching reform which I announced in last year's Budget, to come into effect in April 1990, is relevant in this context.

71. I refer to Independent Taxation. For there can be little doubt that one of the greatest disincentives to saving in the present tax system is the treatment of the savings of married women. At present a wife's income from savings has to be disclosed to her husband and taxed at his marginal rate. Independent Taxation will change all that. In particular, those married women who have little or no earnings will in future have their own personal allowance to set against their savings income. Independent Taxation may well do much to encourage the growth of personal saving in this country.

Goes too
far. Need
room to build
up.

TAXES ON SPENDING

72. I now turn to taxes on personal income and spending.

73. As the House knows Her Majesty's Government are obliged to implement the European Court's judgement that certain of our zero rates of VAT on supplies to business, notably on non-residential construction, but also on fuel and power and on water, are not lawful. This derives from the Court's interpretation of the Community's Sixth VAT directive to which the UK agreed in 1977. The necessary changes will be introduced in this year's Finance Bill, and draft clauses have already been published.

74. In implementing the judgement I have sought to do as much as possible to minimise the burden. From 1 April VAT will be payable in respect of all non-residential construction unless carried out under a agreements entered into before the court ruling. And from 1 August landlords will have the option to tax rents, which means that in most cases no extra VAT will be paid at all.

75. These measures will reduce the burden of VAT on construction so far as the private sector is concerned to just £35 million in 1989-90 rising to £110 million in 1992-93. Without them the yield from VAT on construction in the private sector would have risen to £450 million. There will also be a yield of £250 million from construction carried out for the public sector, and the public sector programmes concerned have already been protected by compensatory adjustments where necessary.

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76. VAT will not be payable until July 1990 on water for industry or on fuel and power - then only on business users above a specified threshold. Private households will remain zero rated.

77. I have been particularly concerned about the impact of the European Court's ruling on charities. Unfortunately charities' business activities cannot lawfully be shielded from the effects of the ruling but I have been able to retain zero-rates for construction, water, fuel and power for all charities' non-business activities, for churches and for most residential accommodation such as old people's homes, students' hostels and hospices.

78. I have considered whether there is anything further I can sensibly do to assist charities with their VAT bills in these special circumstances. I propose to relieve charities from VAT on fund raising events, on sterilising equipment for medical use, and on classified advertising.

79. I also propose to relieve from car tax cars leased to the disabled. This is equivalent to an overall saving of about £400 on each vehicle leased to a disabled person.

80. I also propose to allow the present rules on tax relief for membership subscriptions paid by covenant to heritage and conservation charities. If the member is given the right of full entry to view the charity's property, that benefit will be ignored in determining whether relief is due. This will be of particular benefit to organisations such as the National Trust.

81. But in general, I continue to believe that the best way of helping charitable causes through the tax system is by directly encouraging the act of charitable giving. The Payroll Giving Scheme, which I introduced in my 1986 Budget, has been growing steadily. Some 3,400 schemes have now been set up, and over 100,000

employees are already participating, quite a few of them giving the full £240 annual limit for tax relief. I now propose to double that limit to £480, or £40 a month.

82. But for the Payroll Giving Scheme to achieve its full potential, it is clearly necessary for the charities themselves, and others involved, to mount a major information and marketing campaign to promote it. I am particularly glad that my Rt.Hon. Friend, the Viscount Whitelaw, has agreed to become Chairman of the new Payroll Giving Association, which will co-ordinate efforts in this field.

83. I now turn to the excise duties.

84. The damage to the environment in general, and to child health in particular, from lead in the atmosphere, and the contribution of ordinary leaded petrol to this problem, is increasingly widely known. The government is committed to phasing out leaded petrol altogether, and in successive Budgets I have sought to assist this. I first introduced a tax differential in favour of unleaded petrol in 1987, and increased it last year. But although sales are undoubtedly rising, unleaded petrol still accounts for only some 5 per cent of total petrol sales, even though two-thirds of the cars now on

the road could use it, either without any adjustment or else with a conversion costing only some £20 or so.

85. One of the problems is ignorance of the facts. Many motorists do not realise that their cars can already use unleaded petrol. Many others are unaware how modest the conversion cost usually is. Others wrongly imagine that their car's performance would suffer were they to use unleaded fuel. Many are under the false impression that, if they do switch to unleaded petrol, their cars will no longer be able to use leaded petrol.

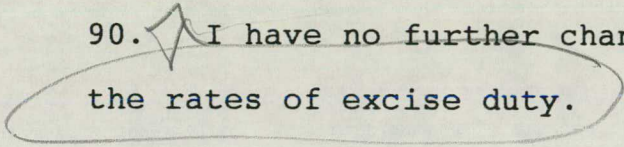
86. It is clearly essential that these myths are rapidly dispelled. Meanwhile, I propose to take the opportunity of this Budget to increase still further the tax differential in favour of unleaded petrol, by nearly fourpence a gallon. If this reduction is fully passed on to the customer - and I look to the oil companies to see that it is - it means that the price of unleaded petrol at the pump will generally be getting on for tenpence a gallon, or just over twopence a litre, cheaper than four star leaded petrol. This will be one of the most substantial differentials between the price of leaded and unleaded petrol within the European Community.

87. But I do not intend to stop there. I also propose to raise the tax on two and three star petrol, so that the pump price of these grades will be at least as high as that of four star. This should encourage garages to phase out two star petrol, which is already down to about 6 per cent of the total market, thus enabling them to switch storage capacity to unleaded petrol - quite apart from the incentive to the remaining two-star users to switch to unleaded fuel.

88. I am confident that the duty changes I have announced, which will take effect from six o'clock this evening, will help to lead to a marked increase in the use of unleaded petrol over the next twelve months.

89. They will of course also lead to a loss of revenue of some £40 million in 1989-90. I propose to recoup this from Vehicle Excise Duty. At the present time a bus or a coach has to have 66 seats before it pays as much in Vehicle Excise Duty as a family car. I propose to rectify this anomaly by increasing the tax rates of this group of vehicles so that they cover their track costs. I also propose to increase the rates of duty for the heaviest non-articulated lorries, to put them on a more equal footing with articulated lorries. These changes

will also simplify the system, greatly reducing the number of separate rates of Vehicle Excise Duty.

X 90.  I have no further changes to propose this year in the rates of excise duty.

TAXATION OF INCOME

91. Nor do I propose any change this year to either the basic or higher rate of income tax.

92. Since I aligned the rates of income and capital gains tax in last year's Budget, it follows that I also propose no change this year in the capital gains tax rates. However, I do have a few changes to capital gains tax to propose.

93. With the advent of independent taxation from April 1990, married women will acquire their own capital gains tax threshold, so that a married couple will enjoy two such exemptions. In the light of this, I propose to maintain the capital gains tax threshold at £5,000 for 1989-90.

94. Second, I propose to abolish the general holdover relief for gifts.

95. This was introduced by my predecessor in 1980, when there was still capital transfer tax on lifetime gifts, in order to avoid a form of double taxation. But the tax on lifetime giving has since been abolished, and the relief is increasingly used as a simple form of tax avoidance.

96. But while the general holdover relief will go, I propose to retain it for gifts of business, farm and heritage assets. I also propose to extend the existing relief for all gifts to charities to gifts of land to housing associations. And of course gifts between husband and wife will continue to be exempt.

97. In the case of gifts of personal belongings, these benefit from chattels relief, under which any items worth less than £3,000 on disposal are entirely exempt from capital gains tax. I propose to double the chattels exemption limit to £6,000.

98. Lastly, on capital gains tax, I propose to change the tax treatment of certain bonds so as to simplify the tax rules and prevent a loss of yield by the use of

indexation to create losses and the conversion of income into capital gains.

99. To return to income tax, I propose to raise all the main income tax thresholds and allowances by the statutory indexation factor of 6.8 per cent, rounded up. Thus the single person's allowance will rise by £180 to £2,785, and the married man's allowance will rise by £280 to £4,375. The basic rate limit will rise by £1,400 to £20,700.

100. The single age allowance will rise by £220 to £3,400, and the married age allowance by £350 to £5,385. The higher level of age allowance will rise by £230 to £3540 for a single person, and by £360 to £5565 for a married couple.

101. I have a number of measures to help the elderly. In 1987 I introduced a new higher age allowance, for those aged 80 and over. I now propose to extend this to all those aged 75 and over. This will take an additional 15,000 elderly single people and married couples out of tax altogether. Three quarters of all those aged 75 and over will not be liable to income tax at all.

102. The income limit for the age allowance will rise by £800 to £11,400, again in line with indexation. However, I propose to reduce the rate at which the age allowance is withdrawn above this income limit. I propose that in future it should be withdrawn at the rate of £1 of allowance for each £2 of income above the limit, instead of the present rate of £2 in every £3. This means that the marginal tax rate for those in the withdrawal band will be reduced to well below 40 per cent, thus meeting a large number of representations I have received over the past year.

103. The Finance Bill will also include the provisions to establish the new tax relief for the over-60s' health insurance premiums, which I announced to the House in January, and which will take effect from April next year, at a cost of £40 million in 1990-91.

104. I have one further change to make to help pensioners. Under the earnings rule, any pensioner who decides to continue to work after reaching the statutory retirement age has his or her pension docked at a rate of 50 per cent on every £1 earned between £75 and £79 a week, rising to 100 per cent for every £1 earned over £79 a week. This rule applies until he or she has reached five years beyond the State pension age.

105. The Manifesto on which we were first elected in 1979 acknowledged that it was wrong to discourage people who wished to work beyond retirement age in this way, and pledged that we would abolish the earnings rule.

? surely
qualification

106. That is precisely what we shall do. My Rt.Hon Friend the Secretary of State for Social Services and I have agreed that the pensioners' earnings rule should be abolished from the beginning of October, the earliest practicable date. The necessary legislation will be included in the Social Security Bill currently before the House.

107. The cost to public expenditure will be £125 million in 1989-90, which will be entirely met from the Reserve. But the net cost of this measure will be significantly reduced by the income tax payable on the increased pensions.

108. Those who wish to defer taking their pension will remain entirely free to do so, and will continue to earn a higher pension in return.

109. I am sure the whole House will welcome this long overdue reform.

110. If I were to adopt the so-called "duck test" now in vogue across the Atlantic, the pensioners' earnings rule would probably qualify as a tax, and I would now be able to claim to have abolished a sixth tax. But sound tax principles coupled with my innate modesty and natural reticence prevent me from doing so.

NATIONAL INSURANCE CONTRIBUTIONS

111. I have one further measure to propose.

112. It has long been a feature of the National Insurance system that, once people earn more than the lower earnings limit, which in 1989-90 will be £43, they have to pay National Insurance contributions at the same rate on the whole of their earnings up to the upper earnings limit. There are currently three different rates - 5 per cent and 7 per cent for those on lower pay and the standard rate of 9 per cent,

113. The two reduced rates, which I introduced for both employers and employees in my 1985 Budget, cut the cost of employing the young and unskilled, among whom unemployment was then high and rising, and cut the

burden of national insurance contributions on the low paid. But the highly desirable reduction in the steep step at the lower earnings limit was at the expense of two small steps further up the earnings scale. This inevitably means that, at certain points on the income scale, people can still be worse off if they earn more. Their extra earnings take them from a lower rate band to a higher one, and they therefore lose more in National Insurance contributions than they gain in extra pay.

114. In agreement with my Rt Hon Friend the Secretary of State for Social Security, I now propose to build on my 1985 reform. For everyone who pays employee National Insurance contributions, I propose to reduce to only 2 per cent the rate of contributions on earnings up to and including the lower earnings limit. On earnings above that limit, there will be a single rate of 9 per cent, up to the upper earnings limit, which has already been set for 1989-90 at £325 a week.

115. This will abolish altogether the steps which at present exist at earnings, for 1989-90, of £75 and £115 a week. The step which has always existed at the lower earnings limit, where people first come into the National Insurance system, is the entry ticket to the full array of contributory benefits. As such, it is an

essential feature of the contributory principle. But my proposals will more than halve this step, to only 86 pence a week in 1989-90.

116. There will be no change in the contributions payable by employers.

117. This reform will significantly reduce the burden of employees' National Insurance contributions across the board. For the lowest paid, that burden is now heavier than the burden of income tax. This is the most effective measure I can take to lighten it. For everyone on just under half average earnings or more, it will leave them £3 a week more of their own money.

118. The new system will take effect from the beginning of October, the earliest practicable date. The cost will be £1 billion in 1989-90 and £2.8 billion in 1990-91. The necessary legislation will be included in the Social Security Bill currently before the House.

119. The total additional cost of all the measures in this Budget, on an indexed basis, is under £2 billion in 1989-90 and £3¹/₂ billion in 1990-91.

[PERORATION]

BUDGET CONFIDENTIAL



FROM: MALCOLM BUCKLER

DATE: 9 March 1989

MISS WALLACE 13/2

cc Mr Phillips

BUDGET SPEECH: PAYROLL GIVING

We spoke about the proposed reference in the Budget Speech (paragraph 85) to Lord Whitelaw as Chairman of the Payroll Giving Association.

Lord Whitelaw's appointment as you know has not yet been formally announced. This is mainly because he has been out of the country over the last few weeks (he is expected back tomorrow) and because certain legal complexities have been encountered in actually setting up the Payroll Giving Association.

The Paymaster General has done some delving and thinks that it would be a mistake to mention Lord Whitelaw, as it was likely to catch him flat-footed. However if the Chancellor particularly wanted to refer to Lord Whitelaw he might do so in the context of the Council for Charitable Support. That organisation being better placed to provide any necessary support that a mention in the Budget Speech might generate.

The Paymaster is quite happy to discuss this with the Chancellor if he so wishes.

MALCOLM BUCKLER
Private Secretary

Ch/
This is a bit of a drag.
One might have expected things to be further advanced by now. I suspect this means the relevant para shd go altogether. Speech extract behind.

mpw
V. unusual.
delete para 82-
v

BUDGET - SECRET

78. I have considered whether there is anything further I can sensibly do to assist charities with their VAT bills in these special circumstances. I propose to relieve charities from VAT on fund raising events, on sterilising equipment for medical use, and on classified advertising.

79. I also propose to relieve from car tax cars leased to the disabled. This is equivalent to an overall saving of about £400 on each vehicle leased to a disabled person.

80. I also propose to allow the present rules on tax relief for membership subscriptions paid by covenant to heritage and conservation charities. If the member is given the right of full entry to view the charity's property, that benefit will be ignored in determining whether relief is due. This will be of particular benefit to organisations such as the National Trust.

81. But in general, I continue to believe that the best way of helping charitable causes through the tax system is by directly encouraging the act of charitable giving. The Payroll Giving Scheme, which I introduced in my 1986 Budget, has been growing steadily. Some 3,400 schemes have now been set up, and over 100,000

BUDGET - SECRET

employees are already participating, quite a few of them giving the full £240 annual limit for tax relief. I now propose to double that limit to £480, or £40 a month.

82. But for the Payroll Giving Scheme to achieve its full potential, it is clearly necessary for the charities themselves, and others involved, to mount a major information and marketing campaign to promote it. I am particularly glad that my Rt.Hon. Friend, the Viscount Whitelaw, has agreed to become Chairman of the new Payroll Giving Association, which will co-ordinate efforts in this field.

83. I now turn to the excise duties.

84. The damage to the environment in general, and to child health in particular, from lead in the atmosphere, and the contribution of ordinary leaded petrol to this problem, is increasingly widely known. The government is committed to phasing out leaded petrol altogether, and in successive Budgets I have sought to assist this. I first introduced a tax differential in favour of unleaded petrol in 1987, and increased it last year. But although sales are undoubtedly rising, unleaded petrol still accounts for only some 5 per cent of total petrol sales, even though two-thirds of the cars now on

FROM: MISS M P WALLACE
DATE: 10 March 1989

MP

MR R K C EVANS - IDT

cc PS/Chief Secretary
Mr Gieve
Mr Pickford
Mr Deane

BUDGET SPEECH

... I attach two copies of the full Budget speech for press officers'
use on Sunday. Copy recipients already have the latest draft of
... the tax section (my minute of 9 March) but I now enclose for them
a copy of the economic section*, and a peroration for the whole
thing.

mpw.

MOIRA WALLACE

**draft of 8.00 pm, 10/3*

BUDGET SPEECH - FIRST SECTION

The background to this year's Budget is the unprecedented strength of the British economy, coupled with the continuing need to combat inflation, at a time when, throughout the world, it is unmistakably edging up again.

2. I shall begin with an account of the performance of the economy in 1988 and the prospects for 1989, set in the context of the past ten years. I shall then deal with monetary policy and the public sector finances. Finally, I shall propose a number of measures to carry forward the process of tax reform.

3. As usual, the Financial Statement and Budget Report, together with a number of Press Releases filling out the details of my proposals, will be available from the Vote Office as soon as I have sat down.

ECONOMIC PERFORMANCE AND PROSPECTS

4. The Government's first ten years in office have seen a transformation both in the way in which economic

policy is conducted, and in the results that have been achieved.

5. For the first time, financial policy has been set firmly and explicitly in a medium-term context. We have been guided by the basic philosophy that the Government should set a sound medium-term financial framework and leave the private sector free to operate with confidence within it.

6. The Government came to office with two central objectives - to defeat inflation, and to breathe new life into a moribund economy - and a clear idea of how to achieve those objectives. Inflation is a disease of money; and monetary policy is its cure. The role of fiscal policy is to bring the public accounts into balance and keep them there, and thus complete the process of re-establishing sound money. And strong sustainable growth is achieved, not through any artificial stimulus, but by allowing markets to work again and restoring the enterprise culture, by removing unnecessary restrictions and controls and rolling back the frontiers of the State, by reforming trade union law and promoting all forms of capital ownership, and by reforming and reducing taxation.

7. Our first and most urgent task was to stamp out the inflationary fires that had raged in the '70s, and wrought so much economic and social havoc. And we succeeded. Between 1974 and 1979 inflation had averaged more than 15 per cent. Over the past six years it has averaged 5 per cent.

8. Once business and industry recognised the fundamental changes that were taking place, they responded to the new economic climate with vigour and confidence. As a result, we have experienced the longest period of strong and steady growth this century. Output in the United Kingdom has grown faster than in all the other main European nations during the '80s - a marked contrast to the previous two decades, when we were bottom of the league. And this growth has been based on a dramatic and sustained improvement in productivity. For the economy as a whole our productivity growth has been second only to that of Japan among all the major nations during the '80s. In manufacturing it has exceeded even Japan's.

9. In Britain today we have more people in work than ever before in our history; they are better motivated than ever before, and their living standards have improved beyond recognition.

10. But it is not just our economic performance that has been transformed: so have our prospects for the future. For over the past seven years, investment has grown more than twice as fast as consumption, creating the increased capacity necessary to meet future demand. Total business investment is now a higher proportion of national income than ever before. And its quality has improved immeasurably, too; as has the quality of British management. We have seen a dramatic and long overdue improvement in company profits. And a remarkable growth in the total number of businesses, now at the rate of more than a thousand a week.

11. Provided we stand firm in our resolve to get on top of inflation, the prospects before us are excellent. And at least on this side of the House, we do.

12. A year ago, in the aftermath of the worldwide stock market crash, it looked as if there would be some slowing down from the rapid growth of 1987. In fact that was not to be.

13. As the House knows, the state of the national income statistics leaves much to be desired. But it now appears that we had in 1988 a second successive year of

growth at $4\frac{1}{2}$ per cent, with unemployment falling by over half a million to well below the European average.

14. Manufacturing output grew particularly rapidly, by more than 7 per cent, to a level well above the previous peak.

15. But total spending also grew by getting on for 7 per cent, mainly because of the boom in industrial investment, in itself a welcome event, but also because of continued strong growth in consumer spending. This last was financed to an unprecedented degree by borrowing, overwhelmingly mortgage borrowing.

16. Inevitably the rapid growth of total spending led to renewed inflationary pressure. To some extent this was diverted into a sharp rise in imports, and hence in the deficit on the current account of the balance of payments. The published figures put this at $\text{£}14\frac{1}{2}$ billion in 1988, although given the $\text{£}15$ billion positive balancing item - another name for errors and omissions - the true figure is almost certainly less than this. But whatever the true figure, it is undoubtedly large, and a sharp increase on the deficit recorded in 1987 after seven successive years of surplus.

17. But given sound policies it can readily be financed. Moreover, unlike previous current account deficits we have known in this country, it reflects not excessive Government borrowing, but rather an upsurge of private investment unmatched by private savings. This is something that will in due course correct itself.

18. As the House knows, however, there has also been some pick up in recorded inflation. Excluding the distorting effect of mortgage interest payments, the RPI rose by $4\frac{1}{2}$ per cent last year, much the same as the average over the previous five years. But this underlying rate increased significantly through the year, and now stands at $5\frac{1}{2}$ per cent.

19. Moreover the pick up in inflation appears to be a worldwide trend. Taking the seven major industrial nations as a whole, inflation is now at its highest level for some three years.

20. In the UK, as in a number of other countries, it became clear that it was necessary to tighten monetary policy sharply. That meant raising short-term interest rates, which I duly did, starting last June.

21. I am of course keenly conscious of the difficulties many borrowers, particularly home owners, and now experiencing. But however unwelcome high interest rates are, they are infinitely preferable to the damage that would be done by high inflation.

22. There are now increasing signs that the determined action I have taken is having the desired effect. The housing boom that played such a large part in the events of last year has subsided. Monetary growth has slowed down appreciably. And retail sales, too, seem to have levelled off over the past four months, presaging a gradual recovery in the personal savings ratio.

23. The outlook for 1989 is for inflation to rise a little further over the next few months, from $7\frac{1}{2}$ per cent including mortgage interest payments to about 8 per cent, before falling back in the second half of the year to $5\frac{1}{2}$ per cent in the fourth quarter and perhaps $4\frac{1}{2}$ per cent in the second quarter of 1990.

24. Some slow down in real growth is inevitable as we get inflation back onto a downward path - indeed, it has almost certainly already begun to happen. Overall growth is forecast to fall from the $4\frac{1}{2}$ per cent recorded last year to $2\frac{1}{2}$ per cent this year, with

growth through the year at 2 per cent. Domestic demand is forecast to slow down even more markedly. But within this, investment, which is holding up well, is once again forecast to grow faster than consumption. The current account deficit is forecast to remain at the same level as last year.

25. But the question of just how "soft" or "hard" the so-called landing will be is not in the hands of Government alone. The Government's task is to reduce inflation by acting, through monetary policy, to bring down the growth of national income in money terms. The extent to which, over the short term, this is reflected in a reduction in inflation, and the extent to which it is reflected in slower output growth, is largely up to business and industry.

26. The better that industry succeeds in controlling its pay and other costs, the less painful the necessary adjustment will be, not least in terms of employment prospects.

27. But over the medium-term, it is clear from our experience over the past ten years that the policy we are pursuing will bring inflation down, and steady growth will resume. The best contribution the

Government can make to this is to carry forward the process of supply side reform, to help make the economy work better. That is the objective of the specific measures to which I shall turn in the second part of my speech.

Monetary policy

28. As I said at the outset, monetary policy plays and must always play, the central role in the battle against inflation. It is at the very heart of the medium-term financial strategy, the tenth edition of which I am publishing today.

29. I have described the monetary tightening that has taken place over the past nine months. This has already led to a sharp deceleration in the rate of growth of the target aggregate, narrow money, or M0.

30. For 1989-90, the target range for M0 will be 1-5 per cent, as envisaged in last year's MTFS. Although it will start the year above the top of that range, its very low growth over the past six months - under 3 per cent at an annualised rate - suggests that it will fairly soon come back within the range. As in the past two years, there is no target for the growth of broad

money, or liquidity, but I will continue to take it into account in assessing monetary conditions.

31. The exchange rate is of particular importance in the conduct of monetary policy. A clear commitment not to accommodate increases in domestic costs by exchange rate depreciation remains a key safeguard against inflation. This has been demonstrated both by the level of interest rates and by our readiness to use the massive reserves we have accumulated. In this context, we will continue to work with our G7 partners to maintain the exchange rate stability that has been a feature of the past two years.

32. Short-term interest rates remain the essential instrument of monetary policy. I repeat what I have stated clearly on a number of previous occasions: interest rates will stay as high as is needed for as long as is needed. For there will be no letting up in our determination to get on top of inflation.

Public Sector finances

33. I now turn to fiscal policy.

34. When we first took office the public sector borrowing requirement was over 5 per cent of GDP - equivalent to £25 billion in today's terms.

35. This we steadily reduced over the years as a deliberate act of policy, until, by 1987-88, the PSBR had been eliminated altogether and we started to repay the public debt.

36. Accordingly, last year I budgeted for a further Public Sector Debt Repayment, or PSDR, of some £3 billion. In the event, it looks like turning out almost five times as large, at £14 billion, or 3 per cent of GDP. Even if there had been no privatisation proceeds at all, the public finances would still be in surplus, to the tune of some £7 billion. Government debt as a proportion of GDP is now lower than at any time since the First World War.

37. Nothing like this has ever been achieved in the past 40 years. And no other major country enjoys a comparable budget surplus. It has not been easy, even though we have been assisted this year by the exceptional buoyancy of the economy, which both boosted tax receipts and reduced public expenditure well below the planned level.

38. Moreover, the substantial net repayment of public debt over the past two years has permanently reduced the burden of debt servicing, both now and for future generations. For the coming year, for example, the debt repayments of the last two years mean that net debt interest costs will be lower by some £1³/₄ billion a year. This saving is being put to good use, allowing extra spending on departmental programmes within our overall public expenditure constraints.

39. The dramatic improvement in the United Kingdom's public finances has also provided a welcome opportunity to devote more attention to the structure of the debt that remains. We will continue to seek both to minimise the cost of servicing the Government's domestic debt and to improve its quality by relying less on the more liquid borrowing instruments.

40. We have also been able to restructure part of the Government's foreign currency debt, launching an innovative and cost-effective programme of Treasury Bills denominated and payable in ecu. The first series of six monthly tenders for these bills has proved very successful, and this is an innovation we plan to continue, at around the current level.

41. Meanwhile, I am today adding one more entry to the long list of financial controls which we have swept away during our term of office. The last surviving relic of the post-War apparatus for the direction of capital by the State is the Control of Borrowing Order, which since 1946 has involved first the Treasury and then the Bank of England in giving consents for equity and bond issues in the capital markets. As from today it will no longer be necessary for companies who wish to make capital market issues to obtain the Bank of England's consent to the timing of such issues; and we will, as soon as possible, revoke the Order itself and repeal the 1946 Act from which it stems.

42. The sterling capital market has in recent times been going through a period of considerable adjustment, as the Government has changed from being a large issuer to a large purchaser of its own debt. The abolition of the Control of Borrowing Order will remove an unnecessary and bureaucratic restriction on issuers of capital as they move into the space formerly occupied by the Government when it was a borrower.

43. This new freedom will be enhanced by a further, important, set of deregulatory measures for the sterling

capital market which are being promulgated today in notices issued by the Bank of England. These measures will open up the market for sterling paper of less than 5 years' maturity by extending the range of institutions which can make such issues; and they will create a unified regime for all these issues.

44. Taken together the changes I have described constitute a major liberalisation of the arrangements for London's capital markets. They will give greater flexibility to issuers and wider choice to investors.

45. In last year's Budget Speech, I set out the principle of a balanced budget as the proper objective of fiscal policy, in these terms:

"A balanced budget is a valuable discipline for the medium term. It represents security for the present and an investment for the future. Having achieved it, I intend to stick to it. In other words, henceforth a zero PSBR will be the norm. This provides a clear and simple rule, with a good historical pedigree."

46. It is a rule that ensures that, as national income continues to rise, the ratio of public debt to national

income continues to fall, and with it the burden of debt interest. It ensures, too, that the State makes no claim either on the savings of the private sector or on flows of finance from overseas. To go further than this, and seek to achieve the maximum possible repayment of public debt, would not be consistent with the Government's policy, as it would mean deferring for a very long time the benefits of a reduction in the burden of taxation.

47. So I reaffirm the principle of the balanced budget. However, given the substantial surplus we now have, the path of prudence and caution must be to return to balance not overnight, but gradually, over a period of years. Thus we can expect to have a number of further years of debt repayment ahead of us.

48. Moreover, given the particular uncertainties there are at the present time, I believe it would be right to budget for 1989-90 for a surplus similar to that secured in the year now ending; in other words, a further public sector debt repayment, or PSDR, of some £14 billion. This means that, in the space of three years, we shall have repaid roughly a sixth of the public debt that has accumulated over two centuries. But it also means that it will not be possible in this year's Budget to reduce

the burden of taxation; that is to say, to reduce
taxation as a share of national income.

TAXPAYER CONFIDENTIALITY

Before I turn to my proposals for changes in taxation, I have one other change of a specific nature to announce.

2. As the House knows, the new official secrets legislation currently passing through Parliament is very much narrower in scope than the present Official Secrets Act. In particular, it does not cover information in the possession of either the Inland Revenue or Customs & Excise concerning the private affairs of specific taxpayers.

3. I am sure that the whole House will agree that it is essential for taxpayer confidentiality to be properly protected. I therefore propose to introduce provisions in this year's Finance Bill to ensure that it will continue to be a criminal offence for officials or former officials of either of the Revenue Departments to reveal information about the private affairs of a specific taxpayer.

4. I would only add that the need for this protection is in no sense a reflection on the probity and integrity of the members of those two Departments. Indeed, after nearly six years as Chancellor and more than eight years

as a Treasury Minister, I would like to take this opportunity to pay public tribute to the outstanding service I have consistently received from the officials of both Departments.

BUSINESS TAXATION

5. I now turn to taxation. As I have done on a number of previous occasions, I propose to divide this into three broad sections: the taxation of business, the taxation of savings, and the taxation of personal income and spending.

6. First, taxes on business.

7. Ever since the corporation tax reform I introduced in 1984, the rate of corporation tax for small companies, defined for this purpose as those with annual profits of less than £100,000, has been set at the basic rate of income tax, currently 25 per cent. Large companies, defined as those with profits of £¹/₂ million or more, pay the main rate of corporation tax of 35 per cent, one of the lowest rates of tax on company profits in the world. Between £100,000 and £¹/₂ million the average rate of tax gradually rises from 25 to 35 per cent.

8. I propose to keep the small companies rate in line with the basic rate of income tax for 1989-90 and to leave the main corporation tax rate unchanged. But I propose to increase the small companies' rate band substantially, by 50 per cent.

9. Thus the small companies' rate will apply to companies with profits of under £150,000, and the 35 per cent rate will only be reached at profits of £³/₄ million. These changes will reduce the corporation tax burden for more than half of all those companies that do not already enjoy the benefit of the small companies rate.

10. I propose to increase the VAT threshold to £23,600, the maximum permitted under European Community law.

11. I also have to set the scales for the private use of company cars. This remains far and away the most widespread benefit in kind. When I doubled the car scales in last year's Budget, I made it clear that this still left this benefit significantly undertaxed.

12. Accordingly, I propose to increase the car scales by one third for 1989-90. The yield from this will be £160 million in 1989-90 and £200 million in 1990-91. There will be no change in the fuel scales.

13. Over the years I have received a number of representations from business complaining about the long-standing tax treatment of foreign exchange gains and losses. I recognise that as business becomes more global this subject becomes increasingly important. However, I have to say that I find it one of the most intractable I have encountered. Certainly, there can be no question of any change in the present system until a number of crucial and complex issues have been satisfactorily resolved. I have therefore authorised the Inland Revenue to publish today a consultative document which explores those issues and examines the scope for reform.

14. Finally, on business taxation, I have two major simplifications to propose, both of which follow from the income tax reforms I introduced last Budget.

15. One of the many undesirable features of an income tax system with several higher rates was that since a taxpayer's marginal rate could well be very different in

different years, the question of which year income related to made a great deal of difference. This was true of Schedule E where the strict rule is that income is taxed in the year to which it relates, on an accruals basis.

16. For the vast majority of employees, this basis of assessment for Schedule E poses no problem. But for about half a million people, mainly directors, who do not receive all their income in the year to which it relates, it causes complications and often needless assessments and correspondence long after the tax year is over. It is also open to manipulation.

17. I therefore propose that income tax under Schedule E should in future be assessed on a receipts basis, with the simple principle that you pay the tax when you receive the income. This will have a transitional cost of £80 million in 1989-90 and £60 million in 1990-91, but in the long term it will yield both extra revenue and a significant saving in both taxpayer's time and Inland Revenue staff.

18. The reduction in the top rate of income tax to 40 per cent in last year's Budget also enables me to make a major simplification of the tax treatment of the

vast bulk of the incorporated sector of small businesses: those known as close companies - generally speaking, unquoted companies that are controlled by five or fewer people.

19. The rules for the so-called apportionment of close companies' income are notoriously complex, taking up some twenty pages of impenetrable legislation. These rules are no longer needed and I propose to abolish them. I believe that family businesses in particular will welcome this substantial simplification.

20. I do, however, have to guard against the avoidance of tax on investment income by channelling it through a closely controlled investment company. Any such company which does not distribute most of its profits and other investment income will therefore be taxed at 40 per cent, equivalent to the higher rate of income tax.

TAXES ON SAVING

21. I now turn to the taxation of saving.

22. The sharp decline in the ratio of personal saving to personal income, over the past two years in

particular has led to even more discussion than usual of the merits of providing greater tax incentives for personal saving.

23. Certainly it is desirable that, over the medium-term, we generate as a nation a level of saving sufficient to finance a high level of investment. But what matters for that is not personal savings alone, but corporate savings too, which are running at historically high levels, and public sector savings, which have been boosted by the move to budget surplus.

24. Moreover, the personal saving ratio is measured in net terms, that is to say as gross saving net of borrowing, and it has fallen not because of a decline in gross saving but as a result of the sharp increase in personal borrowing. And the appropriate remedy for that is to raise the cost of borrowing, and with it the return on saving, as we have done.

25. Above all, the role of tax reform is to encourage enterprise and improve economic performance in the medium term. It is wholly inappropriate as an answer to short term or cyclical phenomena. So for the taxation of savings, the Government's policy is clear. It is to

strengthen and deepen popular capitalism in Britain, by encouraging in particular wider share ownership.

26. I have a number of specific tax measures to announce today to that end.

27. Personal equity plans, or PEPs, were first announced in my 1986 Budget, and started up in January 1987. As the House knows, those who invest in these plans pay no further tax at all, either on the dividends they receive or on any capital gains they may make - indeed, there is no need for them to get involved with the Inland Revenue at all.

28. Personal equity plans got off to a good start, with over a quarter of a million investors, many who had never owned shares before, subscribing almost £¹/₂ billion between them in 1987.

29. Since then, however, the take-up of new PEPs has slowed down, not least as a result of the changed climate in the equity market which followed the October 1987 Stock Exchange crash.

30. So the time has come to improve and simplify PEPs and give them a new boost.

31. First, I propose to raise the annual limit on the overall amount that can be invested in a PEP from £3,000 to £4,800.

32. Second, within that, I propose to raise substantially the amount that can be invested in unit trusts or investment trusts. For many small savers, these provide an excellent introduction to shareholding. At present PEP investors may only place £540 a year, or a quarter of their PEP, in unit or investment trusts. I propose to more than treble this amount, to £2,400 a year; and I propose to allow the whole of a PEP to be invested in unit or investment trusts, up to this limit. To qualify for tax relief, the unit or investment trusts will be required to invest wholly or mainly in UK equities.

33. Third, at present, only cash may be paid into a PEP. I propose that investors should also be permitted to place directly into a PEP shares obtained by subscribing to new equity issues, including privatisation issues.

34. Finally, I propose to make a number of important simplifications to the PEP rules so as to make the

scheme more flexible, better directed to the needs of small and new investors, and cheaper to administer.

35. I am confident that the changes that I have announced today will enable personal equity plans to play an important part in stimulating the spread of ownership of British equities in the years ahead.

36. I also have a number of improvements to announce specifically designed to encourage employee share ownership.

37. It is a striking fact that the number of approved employee share schemes has risen from a mere 30 in 1979 to almost 1,600 today, involving some $1\frac{3}{4}$ million employees. At present the annual limits on the value of shares which can be given under all-employee profit-sharing schemes are £1,250 or 10 per cent of salary up to a ceiling of £5,000. I propose to raise these cash limits to £2,000 and £6,000 respectively.

38. Second, I propose to increase the monthly limit on contributions to all-employee save-as-you-earn share option schemes from £100 to £150, and at the same time to double the maximum discount from market value at

which options may be granted from 10 per cent to 20 per cent.

39. Third, a number of my Hon. Friends have been concerned that current tax law may be inhibiting the development of employee share ownership plans, otherwise known as ESOPs. These are distinguished from ordinary approved employee share schemes by the fact that they use a wider variety of finance, acquire more shares and tend to operate on a longer timescale. I propose to make it clear that companies' contributions to ESOPs qualify for corporation tax relief, provided they meet certain requirements designed to ensure that the employees acquire direct ownership of the shares within a reasonable time. I hope that this will encourage more British companies, particularly in the unquoted sector, to consider setting up ESOPs.

40. Those firms with employee share ownership schemes have no doubt that giving the workforce a direct personal interest in their profitability and success improves the company's performance. The same benefits flow from profit related pay.

41. This was one of the reasons why in my 1987 Budget, I introduced a tax relief to encourage its development. I have some improvements to make to this scheme, too.

42. First, as I have previously announced, I propose to abolish the restriction that, to qualify for the tax relief, prospective profit-related pay must equal at least 5 per cent of total pay. Second, I propose to raise the limit on the annual amount of profit-related pay which can attract relief from £3,000 to £4,000.

43. Third, I propose to enable employers to set up schemes for headquarters and other central units using the profits of the whole company or group for their profit calculations. And fourth, to help share schemes and ESOPs as well as profit related pay, I propose to change the so-called material interest rules which may at present unnecessarily exclude employees from schemes where they can already benefit from a trust set up for employees.

44. Taken together, the package of measures I have announced to encourage wider share ownership in general, and employee share ownership in particular, will help to ensure that the idea of a share-owning democracy becomes

ever more entrenched as a part of the British way of life.

45. Last June, the Inland Revenue issued with my authority a major consultative document on the taxation of life assurance.

46. The tax regime for life assurance is sui generis. The present system dates back to the First World War and has developed over the years in a piecemeal way, leading to a state of affairs in which the incidence of tax is extremely uneven, with some successful life offices paying no tax at all.

47. There is clearly a powerful case for reform, with a view to securing a tax regime which is more equitable both within the industry and as between life assurance and most other forms of savings.

48. , I have considered very carefully the representations the industry has made, and taken full account both of the changes to the regulation of life assurance proposed by the Securities and Investment Board under the Financial Services Act and the prospects for increased competition within the European Community after 1992. In the light of these factors, I have

decided not to proceed with the more radical reforms canvassed in the consultative document. But I do have a number of important changes to propose, based for the most part on the general tax reform principle of seeking lower rates on a broader base.

49. First, many life offices run a pension business alongside their main life assurance business, and they are not required to keep the two businesses entirely separate for tax purposes. This enables them to set the unrelieved expenses of the pensions business against the income and gains of their life business, thus giving their life profits unduly favourable tax treatment. The life offices themselves have accepted that this treatment is anomalous and I propose to end it.

50. This change, along with some minor related changes, will come into force on 1 January 1990, and will yield some £150 million in 1990-91. The remainder of the changes I have to propose constitute a broadly balanced package which, because of the transitional provisions, will reduce the taxation of life assurance in 1990-91 by some £100 million.

51. I propose that the expenses incurred by life offices in attracting new business should continue to be

fully deductible for tax purposes from the income and gains of life funds, but should in future be spread over a period of seven years. To give the industry time to adjust, this change will be phased in gradually over the next four years, starting on 1 January, 1990.

52. There are certain other, more technical matters raised in the consultative document which will require further discussion with the industry, and any legislative changes on these issues will have to wait for next year's Finance Bill.

53. But I can say here and now that I propose, as from 1 January 1990, to abolish Life Assurance Policy Duty. And I also propose, from the same date, that the rate of tax payable on the policyholder's share of income and gains of life offices, which at present stands at 35 per cent on unfranked investment income and 30 per cent on realised capital gains, should be reduced to the basic rate of income tax.

54. The net effect of all these changes to the taxation of life assurance will be a cost of £20 million in 1989-90 and a yield of £45 million in 1990-91, rising somewhat in subsequent years.

55. But above all it will provide a more efficient and equitable tax regime for this most important industry.

56. Later this year, UK unit trusts will be able to compete freely in Europe and will face competition from analogous Community investment schemes here. At present, trusts investing in gilt-edged securities or other bonds face a tax disadvantage. They pay corporation tax at 35 per cent on their income but can pass on a credit of only the basic rate to their investor. So I propose that from 1 January 1990, as for life assurance companies, the corporation tax rate on unit trusts that come within the new European Community rules will be equal to the basic rate of income tax. Their investors will then get full credit for all the tax the trusts pay.

57. I now turn to pensions.

58. The tax treatment accorded to pension schemes is quite rightly particularly favourable; and the extent of this privilege has to be circumscribed by Inland Revenue rules. So pension schemes only qualify for tax relief if they meet certain conditions, notably that the pension paid may not exceed two-thirds of final salary:

and if they fall foul of any of these rules, they lose all relief.

59. This has the perverse result that tax law effectively constrains the overall pension an employer can pay his employee. This is neither desirable nor necessary. Accordingly, I propose to make it possible for employers to provide whatever pensions package they believe necessary to recruit and reward their employees.

60. However, while it is clearly right that employers should be free to provide whatever pension they see fit, it would not be right to make the present generous tax treatment available with no upper limit at all. I therefore propose to set a limit on the pensions which may be paid from tax-approved occupational schemes, based on final salary of £60,000 a year.

61. I have deliberately set the ceiling at a level which will leave the vast majority of employees unaffected, and it will be subject to annual uprating in line with inflation. It will still be possible for a tax-approved occupational scheme to pay a pension of as much as £40,000 a year, of which up to £90,000 may be commuted for a tax-free lump sum.

62. The new ceiling will apply only to pension schemes set up, on or after today, or to new members joining existing schemes after 1 June. And, as I have already said, there will now be complete freedom to provide benefits above the Inland Revenue limits, though without the tax relief.

63. The introduction of this ceiling on tax relief also enables me to simplify and improve the rules for the majority of pension scheme members, in particular to ease the conditions under which people can take early retirement.

64. I also propose to simplify very substantially the rules concerning additional voluntary contributions to pension schemes, or AVCs. In particular, the present requirements for free standing AVCs place a heavy administrative burden on employers. These requirements will be greatly reduced. Indeed, in many cases employers will not need to be involved at all.

65. Furthermore, if AVC investments perform very well, occupational pensions may at present have to be reduced to keep total benefits within the permitted limits. I propose that in future any surplus AVC funds should be returned to employees, subject to a special tax charge.

This will remove the penalty on good investment performance.

66. The most important development in the pensions field in recent years has undoubtedly been the introduction and success of personal pensions. Since July last year, a million people have already taken advantage of the new flexibility and opportunities these offer. I have two proposals today to make personal pensions still more attractive.

67. First, I propose to make it easier for people in personal pension schemes to manage their own investments.

68. Second, I propose to increase substantially the annual limits, as a percentage of earnings, on contributions to personal pensions for those over the age of 35. This will be of particular value to those running their own business, who are often unable to make contributions until later on in their working life. It will also improve the position of personal pensions in relation to occupational schemes. The new limits will be subject to an overall cash ceiling based on earnings of £60,000, corresponding to the new ceiling for occupational pensions, and similarly indexed.

69. These changes build on, and complete, the pension measures I introduced in my 1987 Budget. They represent a significant deregulation which will allow more flexibility, while setting for the first time a reasonable cash limit on the tax relief available to any individual. They should give a boost, in particular, to saving through personal pensions and through AVCs.

69a. Coupled with the changes I made in 1987, this is as far as I wish to go in amending the tax treatment of pensions.

70. Finally, on the taxation of saving, it should not be overlooked that a far-reaching reform which I announced in last year's Budget, to come into effect in April 1990, is relevant in this context.

71. I refer to Independent Taxation. For there can be little doubt that one of the greatest disincentives to saving in the present tax system is the treatment of the savings of married women. At present a wife's income from savings has to be disclosed to her husband and taxed at his marginal rate. Independent Taxation will change all that. In particular, those married women who have little or no earnings will in future have their own personal allowance to set against their savings income. Independent Taxation may well do much to encourage the growth of personal saving in this country.

TAXES ON SPENDING

72. I now turn to taxes on personal income and spending.

73. As the House knows Her Majesty's Government are obliged to implement the European Court's judgement that certain of our zero rates of VAT on supplies to business, notably on non-residential construction, but also on fuel and power and on water, are not lawful. This derives from the Court's interpretation of the Community's Sixth VAT directive to which the UK agreed in 1977. The necessary changes will be introduced in this year's Finance Bill, and draft clauses have already been published.

74. In implementing the judgement I have sought to do as much as possible to minimise the burden. From 1 April VAT will be payable in respect of all non-residential construction unless carried out under a agreements entered into before the court ruling. And from 1 August landlords will have the option to tax rents, which means that in most cases no extra VAT will be paid at all.

75. These measures will reduce the burden of VAT on construction so far as the private sector is concerned to just £35 million in 1989-90 rising to £110 million in 1992-93. Without them the yield from VAT on construction in the private sector would have risen to £450 million. There will also be a yield of £250 million from construction carried out for the public sector, and the public sector programmes concerned have already been protected by compensatory adjustments where necessary.

76. VAT will not be payable until July 1990 on water for industry or on fuel and power - then only on business users above a specified threshold. Private households will remain zero rated.

77. I have been particularly concerned about the impact of the European Court's ruling on charities. Unfortunately charities' business activities cannot lawfully be shielded from the effects of the ruling but I have been able to retain zero-rates for construction, water, fuel and power for all charities' non-business activities, for churches and for most residential accommodation such as old people's homes, students' hostels and hospices.

78. I have considered whether there is anything further I can sensibly do to assist charities with their VAT bills in these special circumstances. I propose to relieve charities from VAT on fund raising events, on sterilising equipment for medical use, and on classified advertising.

79. I also propose to relieve from car tax cars leased to the disabled. This is equivalent to an overall saving of about £400 on each vehicle leased to a disabled person.

80. I also propose to allow the present rules on tax relief for membership subscriptions paid by covenant to heritage and conservation charities. If the member is given the right of full entry to view the charity's property, that benefit will be ignored in determining whether relief is due. This will be of particular benefit to organisations such as the National Trust.

81. But in general, I continue to believe that the best way of helping charitable causes through the tax system is by directly encouraging the act of charitable giving. The Payroll Giving Scheme, which I introduced in my 1986 Budget, has been growing steadily. Some 3,400 schemes have now been set up, and over 100,000

employees are already participating, quite a few of them giving the full £240 annual limit for tax relief. I now propose to double that limit to £480, or £40 a month.

82. But for the Payroll Giving Scheme to achieve its full potential, it is clearly necessary for the charities themselves, and others involved, to mount a major information and marketing campaign to promote it. I am particularly glad that my Rt.Hon. Friend, the Viscount Whitelaw, has agreed to become Chairman of the new Payroll Giving Association, which will co-ordinate efforts in this field.

83. I now turn to the excise duties.

84. The damage to the environment in general, and to child health in particular, from lead in the atmosphere, and the contribution of ordinary leaded petrol to this problem, is increasingly widely known. The government is committed to phasing out leaded petrol altogether, and in successive Budgets I have sought to assist this. I first introduced a tax differential in favour of unleaded petrol in 1987, and increased it last year. But although sales are undoubtedly rising, unleaded petrol still accounts for only some 5 per cent of total petrol sales, even though two-thirds of the cars now on

the road could use it, either without any adjustment or else with a conversion costing only some £20 or so.

85. One of the problems is ignorance of the facts. Many motorists do not realise that their cars can already use unleaded petrol. Many others are unaware how modest the conversion cost usually is. Others wrongly imagine that their car's performance would suffer were they to use unleaded fuel. Many are under the false impression that, if they do switch to unleaded petrol, their cars will no longer be able to use leaded petrol.

86. It is clearly essential that these myths are rapidly dispelled. Meanwhile, I propose to take the opportunity of this Budget to increase still further the tax differential in favour of unleaded petrol, by nearly fourpence a gallon. If this reduction is fully passed on to the customer - and I look to the oil companies to see that it is - it means that the price of unleaded petrol at the pump will generally be getting on for tenpence a gallon, or just over twopence a litre, cheaper than four star leaded petrol. This will be one of the most substantial differentials between the price of leaded and unleaded petrol within the European Community.

87. But I do not intend to stop there. I also propose to raise the tax on two and three star petrol, so that the pump price of these grades will be at least as high as that of four star. This should encourage garages to phase out two star petrol, which is already down to about 6 per cent of the total market, thus enabling them to switch storage capacity to unleaded petrol - quite apart from the incentive to the remaining two-star users to switch to unleaded fuel.

88. I am confident that the duty changes I have announced, which will take effect from six o'clock this evening, will help to lead to a marked increase in the use of unleaded petrol over the next twelve months.

89. They will of course also lead to a loss of revenue of some £40 million in 1989-90. I propose to recoup this from Vehicle Excise Duty. At the present time a bus or a coach has to have 66 seats before it pays as much in Vehicle Excise Duty as a family car. I propose to rectify this anomaly by increasing the tax rates of this group of vehicles so that they cover their track costs. I also propose to increase the rates of duty for the heaviest non-articulated lorries, to put them on a more equal footing with articulated lorries. These changes

will also simplify the system, greatly reducing the number of separate rates of Vehicle Excise Duty.

90. I have no further changes to propose this year in the rates of excise duty.

TAXATION OF INCOME

91. Nor do I propose any change this year to either the basic or higher rate of income tax.

92. Since I aligned the rates of income and capital gains tax in last year's Budget, it follows that I also propose no change this year in the capital gains tax rates. However, I do have a few changes to capital gains tax to propose.

93. With the advent of independent taxation from April 1990, married women will acquire their own capital gains tax threshold, so that a married couple will enjoy two such exemptions. In the light of this, I propose to maintain the capital gains tax threshold at £5,000 for 1989-90.

94. Second, I propose to abolish the general holdover relief for gifts.

95. This was introduced by my predecessor in 1980, when there was still capital transfer tax on lifetime gifts, in order to avoid a form of double taxation. But the tax on lifetime giving has since been abolished, and the relief is increasingly used as a simple form of tax avoidance.

96. But while the general holdover relief will go, I propose to retain it for gifts of business, farm and heritage assets. I also propose to extend the existing relief for all gifts to charities to gifts of land to housing associations. And of course gifts between husband and wife will continue to be exempt.

97. In the case of gifts of personal belongings, these benefit from chattels relief, under which any items worth less than £3,000 on disposal are entirely exempt from capital gains tax. I propose to double the chattels exemption limit to £6,000.

98. Lastly, on capital gains tax, I propose to change the tax treatment of certain bonds so as to simplify the tax rules and prevent a loss of yield by the use of

indexation to create losses and the conversion of income into capital gains.

99. To return to income tax, I propose to raise all the main income tax thresholds and allowances by the statutory indexation factor of 6.8 per cent, rounded up. Thus the single person's allowance will rise by £180 to £2,785, and the married man's allowance will rise by £280 to £4,375. The basic rate limit will rise by £1,400 to £20,700.

100. The single age allowance will rise by £220 to £3,400, and the married age allowance by £350 to £5,385. The higher level of age allowance will rise by £230 to £3540 for a single person, and by £360 to £5565 for a married couple.

101. I have a number of measures to help the elderly. In 1987 I introduced a new higher age allowance, for those aged 80 and over. I now propose to extend this to all those aged 75 and over. This will take an additional 15,000 elderly single people and married couples out of tax altogether. Three quarters of all those aged 75 and over will not be liable to income tax at all.

102. The income limit for the age allowance will rise by £800 to £11,400, again in line with indexation. However, I propose to reduce the rate at which the age allowance is withdrawn above this income limit. I propose that in future it should be withdrawn at the rate of £1 of allowance for each £2 of income above the limit, instead of the present rate of £2 in every £3. This means that the marginal tax rate for those in the withdrawal band will be reduced to well below 40 per cent, thus meeting a large number of representations I have received over the past year.

103. The Finance Bill will also include the provisions to establish the new tax relief for the over-60s' health insurance premiums, which I announced to the House in January, and which will take effect from April next year, at a cost of £40 million in 1990-91.

104. I have one further change to make to help pensioners. Under the earnings rule, any pensioner who decides to continue to work after reaching the statutory retirement age has his or her pension docked at a rate of 50 per cent on every £1 earned between £75 and £79 a week, rising to 100 per cent for every £1 earned over £79 a week. This rule applies until he or she has reached five years beyond the State pension age.

105. The Manifesto on which we were first elected in 1979 acknowledged that it was wrong to discourage people who wished to work beyond retirement age in this way, and pledged that we would abolish the earnings rule.

106. That is precisely what we shall do. My Rt.Hon Friend the Secretary of State for Social Services and I have agreed that the pensioners' earnings rule should be abolished from the beginning of October, the earliest practicable date. The necessary legislation will be included in the Social Security Bill currently before the House.

107. The cost to public expenditure will be £125 million in 1989-90, which will be entirely met from the Reserve. But the net cost of this measure will be significantly reduced by the income tax payable on the increased pensions.

108. Those who wish to defer taking their pension will remain entirely free to do so, and will continue to earn a higher pension in return.

109. I am sure the whole House will welcome this long overdue reform.

110. If I were to adopt the so-called "duck test" now in vogue across the Atlantic, the pensioners' earnings rule would probably qualify as a tax, and I would now be able to claim to have abolished a sixth tax. But sound tax principles coupled with my innate modesty and natural reticence prevent me from doing so.

NATIONAL INSURANCE CONTRIBUTIONS

111. I have one further measure to propose.

112. It has long been a feature of the National Insurance system that, once people earn more than the lower earnings limit, which in 1989-90 will be £43, they have to pay National Insurance contributions at the same rate on the whole of their earnings up to the upper earnings limit. There are currently three different rates - 5 per cent and 7 per cent for those on lower pay and the standard rate of 9 per cent,

113. The two reduced rates, which I introduced for both employers and employees in my 1985 Budget, cut the cost of employing the young and unskilled, among whom unemployment was then high and rising, and cut the

burden of national insurance contributions on the low paid. But the highly desirable reduction in the steep step at the lower earnings limit was at the expense of two small steps further up the earnings scale. This inevitably means that, at certain points on the income scale, people can still be worse off if they earn more. Their extra earnings take them from a lower rate band to a higher one, and they therefore lose more in National Insurance contributions than they gain in extra pay.

114. In agreement with my Rt Hon Friend the Secretary of State for Social Security, I now propose to build on my 1985 reform. For everyone who pays employee National Insurance contributions, I propose to reduce to only 2 per cent the rate of contributions on earnings up to and including the lower earnings limit. On earnings above that limit, there will be a single rate of 9 per cent, up to the upper earnings limit, which has already been set for 1989-90 at £325 a week.

115. This will abolish altogether the steps which at present exist at earnings, for 1989-90, of £75 and £115 a week. The step which has always existed at the lower earnings limit, where people first come into the National Insurance system, is the entry ticket to the full array of contributory benefits. As such, it is an

essential feature of the contributory principle. But my proposals will more than halve this step, to only 86 pence a week in 1989-90.

116. There will be no change in the contributions payable by employers.

117. This reform will significantly reduce the burden of employees' National Insurance contributions across the board. For the lowest paid, that burden is now heavier than the burden of income tax. This is the most effective measure I can take to lighten it. For everyone on just under half average earnings or more, it will leave them £3 a week more of their own money.

118. The new system will take effect from the beginning of October, the earliest practicable date. The cost will be £1 billion in 1989-90 and £2.8 billion in 1990-91. The necessary legislation will be included in the Social Security Bill currently before the House.

119. The total additional cost of all the measures in this Budget, on an indexed basis, is under £2 billion in 1989-90 and £3¹/₂ billion in 1990-91.

CONCLUSION

Mr Deputy Speaker, in this Budget I have reaffirmed the Government's commitment to the defeat of inflation through the maintenance of prudent monetary and fiscal policies. I have budgeted for a debt repayment of £14 billion - the largest ever. I have announced a major reform and reduction in employees national insurance contributions; and I have fulfilled our pledge to abolish the earnings rule for pensioners.

I commend this Budget to the House.