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PART B

Part . B.

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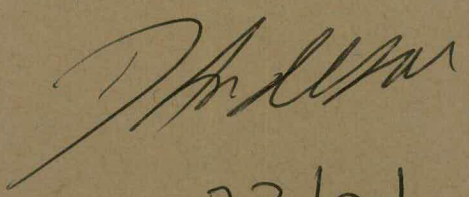
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Chancellor's (Lawson) Papers :
Harmonisation on Taxation Issues
Following the Implementation of the
Single European Market ..

DD's : 25 Year



23/2/96.

PO CH | NL | 0494.
PT.B.



PPA

FROM: S M A JAMES
DATE: 3 October 1988

PS/CHANCELLOR *2*

cc PS/Chief Secretary
PS/Paymaster General
Sir P Middleton
Sir G Littler
Mr Byatt
Mr Lankester
Mr Allen
Mr Culpin
Mr Cropper

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

*Re X, we might
think how
but I see no
advantage in a
of bilaterals.
Re Y, these
taxes are
difficult,
some
will
be
done
in
the
Commission
but
we
are
not
sure
if
it
is
worth
the
effort.*

TAX APPROXIMATION AND FRONTIER CONTROLS

The Economic Secretary has seen Mr Unwin's minute of 28 September and the Chancellor's response (Mr Taylor's minute of 29 September).

X

2. The Economic Secretary wonders whether it would be possible for the UK to initiate a series of bilaterals with other members to discuss alternatives to the Commission's proposals - otherwise the Commission will bring the focus back simply to details of its own plan?

3. The Economic Secretary has commented on Paragraph 7 of Mr Unwin's minute that although the minimum rates idea has some attractions if we want to reach agreement, it has disturbing implications:

- (i) it sets a precedent for all other taxes - there are equally strong arguments for minimum withholding taxes, payroll taxes, corporation taxes;

Y

*Law
tax
Commission
but
we
are
not
sure
if
it
is
worth
the
effort.
this
is
not
a
minimum
withholding
tax
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for
the
Commission
to
bring
back
the
focus
to
details
of
its
own
plan
is
not
clear
if
it
is
worth
the
effort.*



(ii) it establishes the EC as an area which at best resists tax reduction (brought about by market forces or otherwise) and at worst encourages higher than necessary taxes.

A handwritten signature in dark ink, appearing to read 'S M A James'.

S M A JAMES
Private Secretary



FROM: J M G TAYLOR
DATE: 6 October 1988

PS/ECONOMIC SECRETARY

pmf
cc PS/Chief Secretary
PS/Paymaster General
Sir P Middleton
Sir G Littler
Mr Byatt
Mr Lankester
Mr Allen
Mr Culpin
Mr Cropper

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

TAX APPROXIMATION AND FRONTIER CONTROLS

The Chancellor has seen your minute of 3 October.

2. He has commented that, though we might liaise with Luxembourg to discuss alternatives to the Commission's proposals, he sees no advantage in a series of bilaterals.

3. He has also noted the Economic Secretary's comment that the minimum rates idea has disturbing implications, since it sets a precedent for other taxes. The Chancellor has commented that these other taxes are different, since we have to have regard to tax rates in non-community countries, where the minimum would not apply. But for indirect taxes, it is the EC/single market that is relevant.

A handwritten signature, possibly 'JMG', in dark ink.

J M G TAYLOR

Jonathan E

RESTRICTED

011525
MDHIAN 7268

RESTRICTED
FM UKREP BRUSSELS
TO DESKBY 121330Z FCO
TELNO 2950
OF 121153Z OCTOBER 88
INFO PRIORITY EUROPEAN COMMUNITY POSTS

PKK
SPK:
looks like
a JST.

FRAME ECONOMIC

INDIRECT TAX APPROXIMATION: BILATERALS WITH LORD COCKFIELD

SUMMARY

1. MOST MEMBER STATES LIKELY TO FIELD FINANCE MINISTERS FOR BILATERALS, BEGINNING WITH ROUMELIOTIS (GREECE) TOMORROW.

DETAIL

2. OUR INFORMATION IS STILL PATCHY, WITH MOST MEMBER STATES STILL NOT HAVING REPLIED TO LORD COCKFIELD'S LETTER OF 29 SEPTEMBER AND SOME STILL UNDECIDED AS TO WHO PRECISELY SHOULD ATTEND: BUT IT IS CLEAR THAT NEARLY ALL WILL BE COMPLYING WITH COCKFIELD'S REQUEST FOR REPRESENTATION TO BE AT MINISTERIAL LEVEL.

3. GREECE, DENMARK AND SPAIN HAVE ALL ARRANGED THEIR BILATERALS, BEGINNING WITH ROUMELIOTIS (GREEK FINANCE MINISTER) ON THURSDAY 13 OCTOBER, FOLLOWED BY ONE OF THE DANISH MINISTERS SOME TIME BEFORE 7 NOVEMBER: AND SPAIN (BOREL) ON 17 NOVEMBER. THE DANISH MINISTER (SIMONSEN OR HELWET) WILL HAVE A SHORT PRIVATE MEETING A DEUX WITH COCKFIELD BEFORE THE FORMAL BILATERAL.

4. THE DUTCH WILL BE SENDING EITHER RUDING OR KOHLING (STATE SECRETARY). THEY TOYED IN THE HAGUE WITH THE IDEA OF SENDING A SENIOR OFFICIAL BUT DECIDED TO MAKE A 'CLEAR, POSITIVE GESTURE'.

5. GERMANY ARE EXPECTED TO NOMINATE TIETMEYER (STATE SECRETARY) FOR THE BILATERAL, ALTHOUGH WE HAVE HEARD THAT STOLTENBERG WAS CONSIDERING COMING HIMSELF IF THE CHANCELLOR OF THE EXCHEQUER WAS GOING TO ATTEND.

6. THE FRENCH ARE CONSIDERING ASKING COCKFIELD TO PARIS TO MEET BEREGOVY, WHO IS TIED UP WITH DISCUSSION IN PARLIAMENT OF NEXT YEAR'S BUDGET. HE IS APPARENTLY LOATHE TO DELEGATE THE BILATERAL TO HIS JUNIOR FINANCE MINISTER (CHARASSE) WHOSE VIEWS ON TAX APPROXIMATION HE IS SAID NOT TO SHARE.

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7. ITALY ARE UNDECIDED AND NO DECISION IS EXPECTED UNTIL NEXT WEEK. BELGIUM, IRELAND, LUXEMBOURG AND PORTUGAL HAVE NOT YET NAMED THEIR DELEGATES.

8. I SHALL UPDATE THIS INFORMATION BEFORE THE END OF THE WEEK.

HANNAY

YYYY

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NNNN

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PS/EST TSY	MR R ALLEN TREASURY
LANKESTER TSY	MR J E MORTIMER TRSY
ALLEN TSY	MR M. MERCER, TRSY
ISAAC INLAND REV	PERMANENT SEC/MAFF
CORLETT INLAND REV	MR P KENT HM CUSTOMS
SHEPHERD INLAND REV	RESIDENT CLERK
CLEAVE INLAND REV	

NNNN



Ch;

I understand that Ld. C. may not be available until 12.00 noon on 22/11 - after which PTHB needs to go shortly to the B. Council lunch.

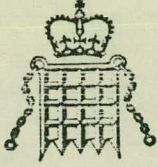
My view is "tough" - if Ld C. insists on Min'l reps., + if we take the trouble to provide them, he can either meet our timetable or bump it. Agree?

Agree

JH

25/10

FROM: P JEFFERSON SMITH
DATE: 17 OCTOBER 1988
Board Room
H M Customs and Excise
New King's Beam House
22 Upper Ground
London SE1 9PJ
Telephone: 01-382 5011



P Jefferson Smith
Deputy Chairman

93

[Handwritten signature]

*cc Mr Morrison
Mrs Symes 19/10*

cc PS/Chief Secretary
PS/Paymaster General
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Byatt
Mr Lankester
Mr RIG Allen
Mr Culpin
Mr Cropper

CHANCELLOR

Mr Allen - PS/Chancellor *RT*

*We spoke about the minor matter of handing
the Chancellor's reply. As I recall, Sir David Hannay
laid stress on the desirability of having an undated letter
hand over. This may be less important now that 5 countries*

Mr Lavelle - Cab. Off
Mr Bostock - UKREP

TAX APPROXIMATION: BILATERAL WITH LORD COCKFIELD

*have signed
Susan Symes
19/10/88*

1. Lord Cockfield's letter of 29 September (text attached - we have only a very poor copy of the original) invited you or "a personal representative at a Ministerial level" to the bilateral discussion mooted at the informal ECOFIN in Crete. This note considers the question of the UK's representation at the meeting, and that of timing (both of the bilateral itself and of your reply to Lord Cockfield).

2. Our input to the bilateral discussion will obviously require careful handling. Given the tenor of Lord Cockfield's remarks it is even more unlikely than we thought already to be a productive exercise from a UK standpoint; and there is a strong likelihood that anything we say will simply be used as ammunition for a valedictory statement to the December ECOFIN. A major aim must therefore be to bring influence to bear on Lord Cockfield's officials, who will remain after his departure. For the bilateral, we suggest that the main aims should be to challenge Lord Cockfield's very limited view of its purpose; to point up the difficult areas of the

Internal distribution: Chairman Mr Allen
Mr Nash Mr Knox
Mr Wilmott Mr Oxenford

2/184



Ch.

I don't know whether you still want to raise this at Prayers, but pls. attached for good measure. (You could take the opportunity to put the PMG in the picture).

AF
18/10

RESTRICTED

FROM: P JEFFERSON SMITH

DATE: 17 OCTOBER 1988

Board Room

H M Customs and Excise

New King's Beam House

22 Upper Ground

London SE1 9PJ

Telephone: 01-382 5011



P Jefferson Smith
Deputy Chairman

Thoughts

*You commented 'looks like a
job for EST' on the reporting tel,
attached. This has now come in.
I think there is something to be said
for fielding PMG in the margins of Blamcil,
simply to meet protocol requirements, +
immediately following up with Mr Urwin.
But you may like to discuss it Prings in
the first instance.*

cc PS/Chief Secretary
PS/Paymaster General
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Byatt
Mr Lankester
Mr RIG Allen
Mr Culpin
Mr Cropper

Mr Lavelle - Cab. Off
Mr Bostock - UKREP

CHANCELLOR

TAX APPROXIMATION: BILATERAL WITH LORD COCKFIELD

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Internal distribution: Chairman Mr Allen
Mr Nash Mr Knox
Mr Wilmott Mr Oxenford

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Commission's proposals (notably the impossibility, which we think is dawning on the Commission, of harmonising rates of excise duties) and stress the need for early progress with these if the aim of abolishing fiscal frontiers is to come about; and to insist that, given the extent of the difficulties, practical and achievable alternatives also warrant consideration.

3. On the question of timing, Cockfield's Cabinet have suggested a range of dates between 17 October and 17 November. Most of the meetings have yet to be arranged, but the bilateral with Roumeliotis has already taken place (13 October) whilst Spain's meeting is scheduled for 17 November. So far as the UK is concerned, we would suggest a date somewhere in the first half of November.

4. As to UK representation at the bilateral, contrary to our earlier information, Lord Cockfield's letter makes it clear that he expects ministerial attendance. The latest information we have suggests that most, if not all, other Member States are likely to field ministers - though not in all cases Finance Ministers themselves - for the bilaterals. Of the five Member States - Denmark, Germany, Greece, the Netherlands and Spain - which have announced their intentions so far, all are sending Ministers (Roumeliotis for Greece, Borel for Spain, Tietmeyer for Germany, Ruding or Kohling for the Netherlands, and Simonsen or Helwet for Denmark). The remainder have yet to make their intentions clear.

5. The question of UK representation has been discussed with the Cabinet Office and with officials of other interested departments. The general view is that the UK could field either a Minister or an official. If you wished to stick to the idea of sending an official as your personal representative, the Chairman, who is well known to Lord Cockfield, would be the appropriate person. If, however, you decided on Ministerial representation, you would presumably wish to ask the Economic Secretary to take this on, with appropriate official support. A further possibility for consideration, if it suited, might be for the Paymaster General, who is in any case due to attend a Budget Council in Brussels in November, to meet Lord Cockfield first, with immediate follow up by the Chairman and/or other

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officials. You will no doubt, however, wish to consider the options further and discuss them with us.

6. I attach a draft reply for you to send to Lord Cockfield. The A section on the UK's representation will need to be added.

Mrs. E. Dibbens

P JEFFERSON SMITH

*(Approved by M. Jefferson Smith
& signed in his absence)*

RESTRICTED

DRAFT REPLY FROM CHANCELLOR TO LORD COCKFIELD

Pre type final to:
The Rt Hon the Lord Cockfield
Vice President
Commission of the European Communities
etc.

Thank you for your letter of 29 September.

The wide-ranging discussion in Crete was welcome, as was the decision to pursue the issues in bilateral discussions with you. I agree that what is required at this stage are broad political guidelines for further discussion.

While I appreciate that you wish the discussions to be on the basis of your proposals, I think we must look at the problem more widely. The UK has offered an alternative approach and my paper remains on the table, as Jacques Delors said when he summed up the discussion in Crete. Given all the difficulties which have been identified - the vast disparities and political difficulties of excise rates are an example - we should be looking for the areas in which we can make progress and alternative means of coping with those issues on which differences are substantial.

[Paragraph stating who will represent UK].

→ AM (A)

N- L-

TEXT OF LORD COCKFIELD'S LETTER OF 29 SEPTEMBER

At the informal meeting of Economics and Finance Ministers in Crete on 17 September, it was agreed that work should now go ahead on the approximation of indirect taxes, on the basis of the Commission's proposals, as an essential part of the programme to abolish controls within the Community by 1993.

In accordance with the conclusions of the meeting in Crete, I am inviting you to continue the political dialogue which was so successfully launched on that occasion. So that we can further explore the avenues for progress and the areas of concern identified at our last meeting, I would like to invite you, or a personal representative at a Ministerial level, to come to Brussels for a bilateral discussion in the course of the coming weeks. I would hope that, in that context, it should be possible for the Commission to identify in more detail the concern of each and every Member State and where opportunities for progress might present themselves. While it will not be an easy task to reconcile all the many interests affected, the Commission was most encouraged to note the willingness to understand one another's concerns which was so widely demonstrated in Crete.

As was made clear by the Presidency and by the Commission at the end of our informal meeting, the idea of a radical revision of the Commission's proposal was overwhelmingly rejected by most of those present. Moreover the Opinions of the European Parliament have yet to be received. There is therefore no question of the Commission intending to put forward revised proposals as a result of the present dialogue. Our objective should, however, be to define broad political guidelines within which further discussion and

examination of our proposals could take place at both a
policial and a technical level.

I look forward to a constructive discussion with you or a
colleague of your choice. If you would like to be accom-
panied by a technical fiscal or economic adviser, my Cabinet
officials would of course stand ready for any immediate
follow-up to our meeting that seemed appropriate.



FROM: J M G TAYLOR

DATE: 19 October 1988

MR JEFFERSON SMITH - C&E

cc PS/Chief Secretary
 PS/Financial Secretary
 PS/Paymaster General
 PS/Economic Secretary
 Sir P Middleton
 Sir G Littler
 Mr Byatt
 Mr Lankester
 Mr R I G Allen
 Mr Culpin
 Mr Cropper

Mr Lavelle - Cab.Off.

Mr Bostock - UKREP

Mr Unwin - C&E

Mr Nash - C&E

Mr Wilmott - C&E

Mr P R H Allen - C&E

TAX APPROXIMATION: BILATERAL WITH LORD COCKFIELD

The Chancellor was grateful for your minute of 17 October, which he has discussed with Ministerial colleagues.

2. The Chancellor's conclusions are that we should arrange to see Lord Cockfield at the time of the November Budget Council. We should be represented by either the Paymaster General or the Economic Secretary - ^{whoever} which ever is attending that Council - together with Mr Unwin. (I understand that at this stage it is not clear on which date the November Budget Council will take place, and hence which Minister will represent the UK). The intention would be for the Minister to make essentially a courtesy call before adjourning to the Council, leaving Mr Unwin to take forward the detailed negotiation.

3. The Chancellor is content with the draft reply to Lord Cockfield. I should be grateful for a paragraph on representation.

J M G TAYLOR



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

FROM: P R H ALLEN

DATE: 24 October 1988

CHANCELLOR

BILATERAL WITH LORD COCKFIELD

As requested in Mr Taylor's note of 19 October, I attach a paragraph on UK representation for inclusion in your reply to Lord Cockfield.

P R H ALLEN

Circulation: PS/Chief Secretary
PS/Paymaster General
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Byatt
Mr Lankester
Mr R I G Allen
Mr Culpin
Mr Cropper

Chairman
Mr Jefferson Smith
Mr Nash
Mr Wilmott
Mr Knox
Mr Oxenford

Mr Lavelle - Cab. Off
Mr Bostock - UKREP

~~PARAGRAPH ON UK REPRESENTATION~~



My personal representative, Peter Brooke, will be in Brussels on 22 November for the Budget Council and it would be helpful if he could meet you then; his office will contact yours to finalise the arrangements. He will be accompanied by Brian Unwin, Chairman of HM Customs and Excise. Mr Unwin would welcome the opportunity for a discussion with your officials.

CH
→ LAL
26/10

cc PS/Ch
PS/Paymaster General
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Byatt
Mr Lankester
Mr R I G Allen
Mr Culpin
Mrs Chaplin



Treasury Chambers, Parliament Street, SW
01-270 3000

26 October 1988

The Rt Hon Lord Cockfield
Vice President of the Commission
of the European Communities
Rue de la Loi 200
1049 Brussels
BELGIUM

Mr Unwin - C&E
Mr Jefferson Smith - C&E
Mr Nash - C&E
Mr Wilmott - C&E
PS/IR
Mr Lavelle - Cab. Office
Mr Bostock (UKREP)

Stan Arthur

Thank you for your letter of 29 September.

The wide-ranging discussion in Crete was welcome, as was the decision to pursue the issues in bilateral discussions with you. I agree that what is required at this stage are broad political guidelines for further discussion.

While I appreciate that you wish the discussion to be on the basis of your proposals, I think we must look at the problem more widely. The UK has offered an alternative approach and my paper remains on the table, as Jacques Delors said when he summed up the discussion in Crete. Given all the difficulties which have been identified - the vast disparities and political difficulties of excise rates are an example - we should be looking for the areas in which we can make progress and alternative means of coping with those issues on which differences are substantial.

My Ministerial colleague, Peter Brooke, the Paymaster General, will be in Brussels on 22 November for the Budget Council and it would be helpful if he could meet you then; his office will contact yours to finalise the arrangements. He will be accompanied by Brian Unwin, Chairman of HM Customs and Excise. Mr Unwin would welcome the opportunity for a discussion with your officials.

Nigel Lawson
NIGEL LAWSON



A large, stylized handwritten signature in the top right corner of the page.

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

26 October 1988

M Norgrove Esq
c/o FCO
(UKREP Brussels)
King Charles Street
London SW1

Dear Mike

TAX APPROXIMATION: MEETING WITH LORD COCKFIELD

... I should be most grateful if you could pass on the enclosed letter from the Chancellor to Lord Cockfield.

Yours sincerely
A handwritten signature in cursive script, appearing to read "J M G Taylor".
J M G TAYLOR
Private Secretary



Office of the United Kingdom Permanent Representative
to the European Community

Rond-Point Robert Schuman 6 1040 Brussels

Telephone 230.62.05

J K Oxenford Esq
HM Customs & Excise
Room 1117
New Kings Beam House
22 Upper Ground
LONDON SE1

Your reference

Our reference

Date 27 October 1988

Dear John,

ppp!
✓ ✓

[Signature]

INDIRECT TAX APPROXIMATION: BILATERALS WITH LORD COCKFIELD

1. We delivered by hand today the Chancellor's reply to Lord Cockfield's letter of 29 September.
2. So far, Cockfield has held bilaterals with only the Greek and Danish Ministers. The Italians had an official meeting yesterday with DG XXI.
3. We understand that the Greeks played down the difficulties they had with the package, stressing only the cash-flow budgetary problems they foresaw with the introduction of the VAT clearing house. The Danes described in some detail the problems they had; Lord Cockfield offered no solutions outside his own package. As soon as the Danish Minister withdrew, so did the Commissioner. Both occasions have been described as "non-events".
4. In the official-level Italian discussion, the Commission were thrown by the revelation that Italy was operating a forfait VAT system for all traders. I think this dates back to a 1985 derogation and therefore antecedes Vilar and Knudsen (who were in the lead for DG XXI) and Birch (Cockfield Cabinet). Cockfield will be seeing Colombo next month (date not yet fixed, but not before 17 November).
5. The French did indeed invite Cockfield to Paris, because of Bérégovoy's preoccupation with the budget; Cockfield declined; and Bérégovoy is now proposing that his deputy chef de cabinet should come and prepare the ground for future discussions.
6. Germany are sending Dr Hans Jörg Häfele, a Parliamentary State Secretary, on 24 November. Jacques Santer is coming for Luxembourg on 29 November; and Meystadt for Belgium on 8 November. The Irish have still not fixed their bilateral but MacSharry is the likely representative. The Dutch are proving elusive and are now pencilled in for 2 December.

(implies a short discussion with PMG!)



7. I shall keep you abreast of developments.

Yours etc,
Mike Norgrove

M W NORGROVE

P Jefferson Smith Esq HM C & E
J M Taylor Esq PS/Chancellor
cc: R Publicover Esq ECD(I) FCO
D Keefe Esq ECD(I) FCO
W L Parker Esq Cabinet Office
G Michie Esq HM Treasury
S J Hawes Esq HM C & E
L Stark Esq HM C & E

4. I am not sure that it matters
greatly if we don't see Ld. C.,
since we won't get much out of
the meeting. But it will give him
more ammo. to be difficult with
us in December.

5. A word in the margins of Prayers?

25

15/11



PPG

James

Ch.

Meeting with Lord Cuckfield.

You discussed this at Monday's Prayers.

2. D Bostock (UKREP) rang me today.

Apparently Lord C. can only manage 4.00 pm on 22/11. That would mean

PMG coming out of the Council. But if PMG doesn't see Lord C., Lord C. will refuse to see Mr Unwin.

3. D Bostock doesn't think it would matter if the PMG missed part of the Council; and Peter Jefferson-Smith rang Alex to say that he thought that if PMG didn't see Lord C., Lord C. would take it as a frightful snub.

over

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FROM: Ms K ELLIMAN
DATE: 31 October 1988

Phf

MR JEFFERSON SMITH - C&E

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir Peter Middleton
Sir Geoffrey Littler
Mr Byatt
Mr Lankester
Mr R I G Allen
Mr Culpin
Mr Cropper
Mr Lavelle - Cabinet Office
Mr Bostock - UKREP
Mr Unwin - C&E
Mr Nash - C&E
Mr Wilmott - C&E
Mr P R H Allen - C&E
Mr Oxenford - C&E

TAX APPROXIMATION: MEETING WITH LORD COCKFIELD

Preliminary arrangements have now been made for the Paymaster General and Mr Unwin to meet Lord Cockfield on the afternoon of 22 November.

2. I would be grateful for briefing, from you and copy recipients, on both substance and handling. It would be useful to receive this by 15 November so we have time to set up a meeting should that prove necessary.

Kim Elliman

KIM ELLIMAN
Private Secretary



From: E McGIVERN
Date: 10 November 1988

- 1. MR ISAAC
- 2. FINANCIAL SECRETARY

Ch: As Mr Isaac's marginalia (part of p3) say, it may be undesirable to waste paper + shift opposing this. But if we do not oppose, it is essential that "withholding tax" is satisfactorily defined (para 8)

EC HARMONISATION: UK LINE ON LONGER-TERM HARMONISATION PROPOSALS

1. This note seeks your views on the line we should take at a meeting of a Commission Working Party on 17/18 November.

2. The meeting will consider three Commission proposals which have been on the table for many years and have been discussed from time to time without, so far, much real progress being achieved. They are

- a. a draft Directive on the tax regime for cross-border mergers;
- b. a draft Directive on the treatment of dividends flowing from a subsidiary in one Member State to a parent in another; and
- c. a proposal (in a draft multilateral convention) for a new arbitration procedure where Member States cannot agree on the appropriate transfer price to be used for tax purposes for cross-border transactions between companies in the same group.

cc Chancellor
Economic Secretary
Sir Geoffrey Littler
Mr Lankester
Mr Scholar
Mr R I G Allen
Mr Culpin
Mr Gilhooly
Mr Mortimer
Mrs Chaplin
Mr Tyrie
Mr Jefferson Smith
(C & E)

Mr Isaac
Mr Painter
Mr Houghton
Mr McGivern
Mr Pitts
Mr Corlett
Mr Shepherd
Mr Cayley
Mr Reed
Mr Alpe
Miss Brand
Ms St Quinton
PS/IR

The Annex to this note describes the proposals, and their implications for the UK, in a little more detail. Together they have become known as the "French package" because they were first grouped together under the French presidency. We know that they have the support of the CBI, the Institute of Taxation and the Accountants as well as UNICE (the European employers' organisation).

Line we have been taking

3. As you will have seen from the Annex, these ideas have been around for some 12 to 20 years and hitherto our general approach in discussions - endorsed by Ministers - has been not to oppose the general idea of the proposals, provided a couple of major points (ie treatment of losses and the retention of our anti-avoidance provisions) are resolved in a way acceptable to the UK. Broadly speaking, having made our objections clear, we have then kept a low profile and left other countries (who have had most of the problems with the proposals) to make the running.

4. The package was last discussed at a meeting of officials in March this year (before the key proposal for a draft directive on harmonisation of the business tax base was promulgated). The Commission's hope was to establish the position of the new Member States, Greece, Spain and Portugal; but little progress was made. We think it is likely that the Commission will now press hard for agreement on the proposals, if only to get at least something agreed on the direct tax harmonisation side in time for 1992. The package is included on the so-called "Rolling Action Programme" of the Presidency for completion of the internal market.

5. In addition, we understand that at ECOFIN on 7 November, Lord Cockfield said that he thought Member States' main problems had been solved since the proposals were last discussed and that agreement with COREPER could therefore be

reached swiftly. Mr Tietmeyer (FRG) confirmed that tax reforms in Germany should have served to facilitate progress and looked to other Member States to help build compromises. On past experience, this analysis looks very optimistic.

X 6. The argument in favour of continuing with the line we have taken since these proposals were first tabled, is that if - but only if - the major points we have raised are met, the draft Directives and Convention would cause no great difficulty for the UK. And allowing the Commission to succeed with what are relatively minor matters could save their face and allow them to point to at least some direct tax measures they had achieved in time for 1992. This might just reduce the pressure on Member States to accept the Commission's major tax harmonisation proposals.

7. An important further consideration is that the mergers and parent/subsidiary Directives ought to encourage cross-border investment within the EC (although there is no evidence that existing tax regimes are major barriers). Apart from any tax considerations, this is possibly one of the reasons why the CBI and others are supporting the proposals.

8. If you were content with this approach we would still need to look for some further safeguards on the parents and subsidiaries Directive. The Commission have agreed in the past that ACT is not a withholding tax, but the Directive does not define "withholding tax". There is no guarantee that at a later point, after the Directive is in force, the Commission would not seek to change the interpretation of "withholding tax". If they were to do so, and were successful (so that ACT was treated as a withholding tax), the Directive would have a major impact on our corporation tax system and would probably also profoundly affect some other Member States). There is no indication that they are likely to do so - and I doubt if they could sustain such a view - but to avoid the risk we should try to ensure that the final text of the parents and subsidiaries

X or, at least, that we should not use up negotiating ³ credit by opposing proposals which would not cause us any problems in practice (etc).

Directive includes a satisfactory definition of a withholding tax. This apart, we would not propose to raise any other points unless any new problems arose.

9. The alternative approach would be to harden our line on the package. The arguments in favour are:

- a. it would be in keeping with Ministers' approach to major tax harmonisation by Directive, ie that it is unnecessary and undesirable and that market forces will bring about any necessary alignment in tax systems; and
- b. if the Commission should succeed with the French package, it might whet their appetites, and encourage them in their efforts to achieve harmonisation of the base, structure and rates of tax for business profits.

If you felt that this was the better course, our line might be not to pursue our particular objections, but argue for the market based approach and say that the Commission must demonstrate the need for the proposed measures before the UK could agree to their adoption.

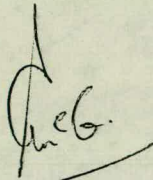
The draft mergers Directive

10. There has been concern expressed in some quarters, including the CBI, about hostile takeovers of UK companies by foreign predators. The debate is quite unconnected with this draft Directive which, provided we get the amendments we are pressing for, will give no tax advantages that are not already available under UK law.

Decision sought

11. Are you content that we should continue as we have done in the past, ie make certain that the proposals in their final form fully protect UK interests by incorporating the changes we are seeking? Then, and only then, would we agree to the package at official level. Alternatively, do you wish us to stiffen our line on the basis that Directives of this kind (and the proposed arbitration convention) are unnecessary and that the market based approach is the way to achieve a successful Single Market?

12. We would be grateful if you could let us know your views in advance of the meeting on 17/18 November.

A handwritten signature in dark ink, appearing to read 'E. McGivern', written over a horizontal line.

E MCGIVERN

3. COMMON SYSTEM OF TAXATION APPLICABLE TO MERGERS,
DIVISIONS AND CONTRIBUTIONS OF ASSETS OCCURRING BETWEEN
COMPANIES OR FIRMS OF DIFFERENT MEMBER STATES (THE
DRAFT MERGERS DIRECTIVE)

Proposal

To remove tax obstacles (especially capital gains tax) on mergers etc of companies across borders within the Community.

History

The proposal was submitted to the Council in January 1969, was amended in August 1973, and lay inactive until 1976. Since then it has been discussed on many occasions in the Council's Working Party on Financial Questions and in COREPER. No significant progress has been made because of political objections by the Dutch and the Germans.

Implications for UK

UK's main objection is that the proposals are not compatible with the UK schedular system of taxation which imposes a distinction between capital and revenue and, in the latter case, distinguishes individual sources of income. The directive would allow more generous use of losses than we do at present and ideally the relevant provision (Article 6) would be deleted. However there would be no strong objection to it provided that the Directive permitted us to keep losses from different sources separate and allowed us adequate protection at Article 14a through domestic anti-avoidance legislation.

Exchequer effects

Not possible to estimate, but small if we are allowed to retain adequate protection in our tax system.

DRAFT DIRECTIVE ON A COMMON SYSTEM OF TAXATION FOR PARENT AND SUBSIDIARY COMPANIES

Proposal

To harmonise the tax rules under which dividends are paid from a subsidiary company in one Member State to a parent company in another mainly by removing withholding taxes.

History

A draft Directive was drawn up by the Commission and presented to the Council in 1969. It was considered by the European Parliament and by the Council Working Party on Financial Affairs before the UK joined the Community in 1973. It has since been considered on a number of occasions and some changes made.

The main difficulty is that Germany operates a two-tier system of corporation tax charging retained and distributed profits at different rates. Without the protection of a withholding tax, German companies with foreign parents would be able to reduce the overall burden of tax in Germany by distributing all their profits. A compromise solution to this difficulty was formally put forward in July 1985 (now included as part of Article 5), but has still not been accepted despite recent further discussions. The compromise solution provides for more favourable treatment for Germany. At the G6 Heads of Tax Administrations meeting in June this year the Dutch and the French were still looking for Germany to move further.

Implications for UK

The basic requirements would not affect the UK as withholding taxes are not levied on dividends. Similarly the suggested amendments to Article 5 to permit Member States to maintain (in part) a withholding tax in respect of dividends paid to a German parent company would not affect the UK.

Exchequer effects

Nil.

Elimination of double taxation in connection with the adjustment of transfers of profits between associated undertakings (the arbitration procedure)

The proposal

The proposal is designed to ensure that transfer pricing adjustments affecting the profits of associated undertakings will not result in double taxation of those profits. It does so by appointing a panel of arbitrators to decide on the arm's length price appropriate for transactions between the undertakings in question.

History

A draft directive was prepared and submitted by the Commission to the Council in November 1976. Following representations from Member States the Commission accepted that a directive was inappropriate and prepared a draft multilateral convention. This has been considered intermittently at working party meetings over the years but it has so far proved impossible to arrive at an agreed text for the convention. Greece, Spain and Portugal have reservations on the entire text.

UK implications

This Convention has no harmonisation aspects. The UK has double taxation treaties with all of the EC Member States and the procedure for consultation and mutual agreement provided therein, coupled with domestic law, means that we see no particular need for such a convention. Nevertheless, our line at ECOFIN and working party meetings has been that we are prepared to go along with it with the objective of ensuring that a workable instrument is produced. Representations in support of the procedure have been received from the CBI, the International Chamber of Commerce and the Institute of Chartered Accountants and a number of discussions have taken place between representative bodies and the Inland Revenue on the subject. In the course of these meetings the Inland Revenue has invited details of cases where the absence of an arbitration procedure has presented problems. No such details have yet been forthcoming.

Exchequer effects

Negligible.



FROM: J M G TAYLOR
DATE: 11 November 1988

PS/FINANCIAL SECRETARY

cc PS/Economic Secretary

Sir G Littler

Mr Lankester

Mr Scholar

Mr R I G Allen

Mr Culpin

Mr Gilhooly

Mr Mortimer

Mrs Chaplin

Mr Tyrie

Mr Jefferson Smith - C+E

Mr Isaac - IR

Mr Painter - IR

Mr Houghton - IR

Mr McGivern - IR

Mr Pitts - IR


Mr Corlett - IR

PS/IR

EC HARMONISATION: UK LINE ON LONGER-TERM HARMONISATION PROPOSALS

The Chancellor has seen Mr McGivern's note of 10 November.

2. He has commented that, as Mr Isaac says in his marginalia (foot of page 3) it may be undesirable to use up negotiating credit by opposing proposals which would not cause us any problems in practice. But if we do not oppose these proposals, it is essential that we secure a satisfactory definition of "withholding tax" in the parents and subsidiaries Directive.


J M G TAYLOR

Rse type final

FROM: R I G ALLEN
DATE: 8 DECEMBER 1988

CHANCELLOR

cc Economic Secretary
Sir G Littler
Mr Byatt
Mr Lankester
Mr Culpin
Mr Gieve
Mr Meyrick
Ms Symes
Mr Tyrie

*Ch. content?
2/8/12*

*OK on
✓*

PS/Customs
Mr P R H Allen C&E

ECOFIN: TAX APPROXIMATION

I attach a draft Speaking Note for you to use at ECOFIN on Monday.
This has been agreed with Customs.

2. The draft follows the general lines agreed at your meeting on Tuesday. The text may need some tailoring to take account of Lord Cockfield's presentation, and points raised by the other Member States.

3. If you approve the general thrust of the attached text, we can also work up a slightly shorter Speaking Note for use with the Press. This again would need to be tailored to fit in with the ECOFIN discussion.

4. It would be most helpful to have your comments by first thing tomorrow morning.

RIG

R I G ALLEN

DRAFT

ECOFIN, 12 DECEMBER 1988

TAX APPROXIMATION: SPEAKING NOTE

(i) Commission's oral statement noted. Member States will require time to reflect. Clear that, while many Member States seem ready to support tax approximation in principle, there are considerable practicable difficulties to face before a firm, workable agreement can be reached. Much further work is required before we can resolve this issue. Appropriate that ECOFIN should return to the discussion in the New Year.

(ii) The most severe practical difficulties arise in relation to the Commission's proposals on excise duties. Not at all clear what can be done to resolve these problems. ~~What is clear is that harmonisation of these duties could give rise to some absurd and wholly unacceptable price changes for the products concerned.~~ To quote just two examples, ^{of the wide divergence that cannot be} In Denmark, the duty on a bottle of spirits is nearly 10 ecu, in Greece only one-tenth of an ecu.

And, in the case of table wine, duty in Ireland is almost 2 ecu a bottle while in five Member States there is no duty at all. ~~Conclude therefore that~~ ^{Can we do anything about this? How are these gaps to be bridged?} the Commission's proposals on excise

duties ^{clearly} require a radical rethink, ^{and no part in discussing VAT until this problem has been addressed.}

(iii) Have been looking again at the Cecchini Report. Interesting document. In context of tax harmonisation proposals, two conclusions stand out. First, the problem of differing tax rates ~~though significant~~ needs to be put in perspective. The Report estimates that the cost of all border controls amount to

~~only~~ about 0.25 per cent of Community GDP. UK experience is that only about one quarter to one half of these costs - that is, ~~about~~ ^{about} 0.1 per cent of GDP - is associated with fiscal controls. Second, the Report estimates that the cost of different countries having different technical standards and regulations is about seven times ~~greater than~~ ^{as great as} the cost of border controls - of which fiscal checks at frontiers are ~~only a part~~ ^{themselves}. ~~Industries in which technical barriers were found to be particularly costly include automobiles, telecommunications, foodstuffs, pharmaceuticals and building equipment. In a survey of 11,000 firms undertaken by the Commission, differences in tax rates featured well down the list of perceived barriers to trade. Firms rated as more important than tax differences, not only differing technical standards and regulations, but also factors such as excessive Customs formalities, physical frontier delays and costs, capital market and exchange restrictions, freight transport regulations raising transport costs, and restrictions in open procurement of Government contracts. All countries were identified as "sinners", to varying degrees. Many of the barriers identified in the Cecchini Report are, of course, being dealt with, as part of the programme to complete the internal market. But many others still remain to be tackled.~~ ^{UK will not get an extra 5%}

(iv) I say this, simply to put tax approximation in its proper perspective. There are many other, and perhaps more important, problems to be addressed under the general rubric "completion of the internal market".

(v) ^{let me update} As we consider the way forward over the next few months, I would reemphasise that the UK's alternative approach, which I put

forward in September, is still very much on the table. I must make clear that the aim of our approach is ^{the goal} elimination, not just reduction, of fiscal frontier formalities. Offers prospect of real, achievable progress by 1993. But would stress that the UK paper was a sketch, not a blueprint. Ample scope for accommodating other Member States' concerns. UK developing the proposals I outlined in September with the clear aim of abolishing fiscal frontier controls. Hope that in the New Year other Member States will join us in developing workable proposals which will achieve the objective of the Single Market and so avoid the massive ~~practical~~ difficulties (for example, on excise duty rates) of the Commission's proposals.

^{I must do repeat that}
(vi) ~~On one point, however, I must be absolutely firm.~~ There can be no question of the UK reneging on its pledges to maintain ~~the existing range of VAT zero rates.~~ ^{was planned to} I note in this context the recent report by the Economic Committee of the European Parliament recommending a lower rate ^{of} 0 to 6 per cent. Other Member States' anxieties about trade distortion arising from the continuation of UK zero rates is misplaced. Difficult to envisage coachloads of visitors arriving in Dover to stock up with zero-rated UK milk, Yorkshire puddings or tap water! Plain fact is that these zero rates are ^{highly} unlikely to cause significant distortion in patterns of trade. 175

^{In the New Year,}
(vii) I hope that ~~under the next Presidency,~~ and with a new Commission in place, there will be a fresh look at, and fresh attitudes to, this difficult subject. Repeat UK keen to make real, achievable progress.



FROM: J M G TAYLOR

DATE: 8 December 1988

A handwritten signature in ink, appearing to be 'JMG'.

MR R I G ALLEN

cc PS/Economic Secretary
Sir G Littler
Mr Byatt
Mr Lankester
Mr Culpin
Mr Gieve
Mr Meyrick
Ms Symes
Mr Tyrie

PS/Customs
Mr P R H Allen C&E

ECOFIN: TAX APPROXIMATION

The Chancellor was grateful for your note of 8 December.

... 2. He has amended the draft Speaking Note, and I attach a fair copy.

A handwritten signature in ink, appearing to be 'JMG'.

J M G TAYLOR

DRAFT

ECOFIN, 12 DECEMBER 1988

TAX APPROXIMATION: SPEAKING NOTE

(i) Commission's oral statement noted. Member States will require time to reflect. Clear that, while many Member States seem ready to support tax approximation in principle, there are considerable practical difficulties to face before a firm, workable agreement can be reached. Much further work is required before we can resolve this issue. Appropriate that ECOFIN should return to the discussion in the New Year.

(ii) The most severe practical difficulties arise in relation to the Commission's proposals on excise duties. Not at all clear what can be done to resolve these problems. To quote just two examples of the wide divergences that currently exist: in Denmark the duty on a bottle of spirits is nearly 10 ecu, in Greece only one-tenth of an ecu. And, in the case of table wine, duty in Ireland is almost 2 ecu a bottle and in the Netherlands [] while in five Member States there is no duty at all. How are these gaps to be bridged? The Commission's proposals on excise duties clearly require a radical rethink, and no point in discussing VAT until this problem has been addressed.

(iii) Have been looking again at the Cecchini Report. Interesting document. In context of tax harmonisation proposals, two conclusions stand out. First, the problem of differing tax rates needs to be put in perspective. The Report estimates that the cost of all border controls amount to about 0.25 per cent of Community GDP. UK experience is that only about one quarter to one half of these costs - that is, about 0.1 per cent of GDP - is associated with fiscal controls. Second, the Report estimates

that the cost of different countries having different technical standards and regulations is about seven times as great as the cost of border controls - of which fiscal checks at frontiers are themselves only a part. We really must get our priorities right.

(iv) As we consider the way forward over the next few months, let me repeat that the UK's alternative approach, which I put forward in September, is still very much on the table. I must make clear that the aim of our approach is the total elimination, not just reduction, of fiscal frontier formalities. Offers prospect of real, achievable progress by 1993. But would stress that the UK paper was a sketch, not a blueprint. Ample scope for accommodating other Member States' concerns. UK developing the proposals I outlined in September with the clear aim of abolishing fiscal frontier controls. Hope that in the New Year other Member States will join us in developing workable proposals which will achieve the objective of the Single Market and so avoid the massive difficulties (for example, on excise duty rates) of the Commission's proposals.

(v) I must also repeat that there can be no question of the UK reneging on its pledges to maintain its VAT zero rates. I was pleased to note in this context the recent report by the Economic Committee of the European Parliament recommending a lower rate band of 0 to 6 per cent. Other Member States' anxieties about trade distortion arising from the continuation of UK zero rates is misplaced. Difficult to envisage coachloads of visitors arriving in Dover to stock up with zero-rated UK milk, Yorkshire puddings or tap water! Plain fact is that these zero rates are highly unlikely to cause significant distortion in patterns of trade.

(vi) I hope that in the New Year, with a new Commission in place, there will be a fresh look at, and fresh attitudes to, this difficult subject. Repeat UK keen to make real, achievable progress.

cc Mr RIG Aden } P.2
Ms Sgmes } 754

Caps of Lord Cockfield's
speech handed to
his cabinet 12. vii. 88
18.00 hrs.

CPS
Mr Jefferson Smith
Mr Nank
Mr Wilmett
Mr Verox
Mr Oxenford

I have marked the
key passages.
Perhaps no more
important than X,
where L.C
conclude that with
differences in interest
rate rates do not
in themselves,
present an obstacle
to the internal
market. Mr.

ECOFIN 12 DECEMBER 1988

FISCAL APPROXIMATION

SPEAKING NOTE

AT ITS MEETING IN RHODES AT THE BEGINNING OF THIS MONTH, THE EUROPEAN COUNCIL DISCUSSED THE PROGRESS OF THE PROGRAMME TO CREATE THE INTERNAL MARKET. THE EUROPEAN COUNCIL POINTED OUT THAT THE CREATION OF THE SINGLE MARKET FORMS A WHOLE AND THAT MAINTENANCE OF AN OVERALL APPROACH WAS ONE OF THE CONDITIONS FOR SUCCESS. IT WAS THEREFORE NECESSARY, THE COUNCIL SAID, TO MAKE PROGRESS IN A BALANCED AND COORDINATED FASHION IN ALL AREAS AND TO ENSURE THAT THE APPROPRIATE HARMONISATION OR APPROXIMATION IS CARRIED OUT WHERE NECESSARY. THE EUROPEAN COUNCIL URGED THE COUNCIL OF MINISTERS TO STEP UP ITS EFFORTS IN ALL

- 2 -

AREAS WHERE PROGRESS HAS NOT BEEN RAPID AND THIS OF COURSE IS ONE OF THE MAIN AREAS CONCERNED.

THE COUNCIL EXPRESSED THE HOPE THAT THE CONTACTS BETWEEN THE COMMISSION AND THE MEMBER GOVERNMENTS WOULD LEAD TO A CONVERGENCE OF VIEWS AND IT CALLED UPON THE COUNCIL - THAT IS THIS COUNCIL - TO SPEED UP ITS WORK TO ENABLE THE TAX MEASURES NEEDED TO BE ADOPTED ON TIME.

GIVEN THE NECESSARY POLITICAL WILL, WE ARE NOW IN A POSITION TO FULFIL THE EUROPEAN COUNCIL'S WISHES. SINCE OUR INFORMAL MEETING IN CRETE, I HAVE HAD CONTACTS WITH ALL THE MEMBER STATES ON A BILATERAL BASIS, AS WE AGREED. AS WAS ALREADY APPARENT IN CRETE, THERE IS INDEED A CONVERGENCE OF VIEWS, AS THE EUROPEAN COUNCIL HAS HOPED.

- 3 -

THE FIRST AND MOST IMPORTANT THING IS THAT I FOUND GENERAL AGREEMENT THAT THE PRESENT SPREAD OF INDIRECT TAXES - BOTH VAT AND EXCISE DUTIES - IS TOO WIDE TO ENABLE A SINGLE MARKET WITHOUT INTERNAL FRONTIERS TO OPERATE WITHOUT UNACCEPTABLE DISTORSIONS, AND THAT THOSE TAX RATES MUST THEREFORE COME CLOSER TOGETHER. THERE WAS ALSO AN OVERWHELMING MAJORITY VIEW THAT THIS SHOULD BE DONE IN AN ORDERLY AND PLANNED MANNER, AT A COMMUNITY LEVEL. THE IDEA THAT IT COULD SIMPLY BE LEFT TO MARKET FORCES TO REDUCE THE PRESENT WIDE DISPARITIES WAS ONLY PUT FORWARD BY ONE MEMBER STATE AND RECEIVED VIRTUALLY NO SUPPORT.

WE MUST WORK, THEREFORE, ON THE BASIS THAT IT IS THE WISH OF THE OVERWHELMING MAJORITY THAT THERE SHOULD BE A HARMONISED VAT SYSTEM, AND A COORDINATED APPROXIMATION OF VAT RATES.

THERE WAS ALSO WIDESPREAD AGREEMENT, THAT THE SYSTEM SHOULD BE BASED ON TWO RATES, A STANDARD RATE FOR MOST SUPPLIES, AND A LOWER RATE FOR BASIC NECESSITIES.

RATE AND BANDS

THERE WAS A CONSIDERABLE MEASURE OF SUPPORT FOR THE COMMISSION'S PROPOSAL THAT MEMBER STATES SHOULD ALLOW THEMSELVES FLEXIBILITY ON VAT RATES BY MEANS OF THE CONCEPT OF RATE BANDS. BUT THERE WAS EQUALLY A STRONG VIEW THAT THE STANDARD RATE BAND IN PARTICULAR SHOULD BE NARROWER THAN WE ORIGINALLY PROPOSED. ONLY ONE MEMBER STATE WANTED WIDER BANDS.

THERE WERE VARYING VIEWS AS TO THE DEGREE OF NARROWING REQUIRED - WHETHER IT SHOULD BE BY ONE POINT AT EACH END OR TWO - SO AS TO PRODUCE BANDS OF, SAY, 15% TO 19%, OR 15% TO 18%, OR EVEN 16% TO 18%. SOME MEMBER STATES WERE PARTICULARLY CONCERNED TO RAISE

- 5 -

THE LOWER LIMIT OF THE BAND TO WELL ABOVE THE 14% WHICH WE HAD PROPOSED. A VARIANT OF THAT APPROACH WAS THE IDEA OF A HIGH MINIMUM RATE, WITH NO UPPER LIMIT. IF IT WERE PLACED AT A SUITABLE POINT IN THE PRESENT DISTRIBUTION OF RATES - SAY, AT 17% AS SUGGESTED BY ONE MEMBER STATE - IT COULD, IT IS TRUE, SHARE THE BURDEN OF ADJUSTMENT REASONABLY EQUALLY AMONG THE MEMBER STATES, THOSE BELOW IT WOULD HAVE TO BRING THEIR RATES UP TO AT LEAST THAT LEVEL; AND THOSE WITH HIGHER RATES WOULD TEND TO BE DRAWN DOWNWARDS. ON THE OTHER HAND THE IDEA OF A LOW-MINIMUM RATE, PUT FORWARD BY ONE MEMBER STATE IN PARTICULAR IN CRETE, WOULD OF COURSE PUT THE WHOLE BURDEN OF ADJUSTMENT ON THE MORE HIGHLY-TAXED MEMBER STATES; THAT CANNOT BE DESCRIBED AS A COMMUNITY SOLUTION.

ON THE VAT RATES AND RATE BANDS, THEREFORE, THE POSITION IS CLEAR: THERE IS A GENERAL VIEW THAT THE APPROACH AND STRUCTURE

- 6 -

PROPOSED BY THE COMMISSION IS THE RIGHT ONE. IT REMAINS FOR THE COUNCIL TO AGREE ON THE FIGURES - THE FIGURES FOR THE LEVELS AND THE FIGURES FOR THE DEGREE OF FLEXIBILITY TO BE ALLOWED. THAT CAN ONLY BE RESOLVED BY NEGOTIATION AMONG THE MEMBERS OF THE COUNCIL THEMSELVES.

THE TIME HAS COME, THEREFORE, IN THE COMMISSION'S VIEW FOR THE COUNCIL TO INSTRUCT COREPER TO RECOMMEND TO IT WHAT THE RATES AND RATE BANDS ARE THAT MIGHT COMMAND THE SUPPORT OF ALL THE MEMBER STATES. THIS COULD BE DONE ON THE BASIS OF PREPARATORY WORK BY A COUNCIL WORKING GROUP SETTING OUT THE IMPLICATIONS OF SUCH RATES AND BANDS IN TERMS OF BUDGETARY REVENUES AND TRADE FLOWS. IT COULD ALSO EXAMINE THE POSSIBILITY OF MINIMUM RATES.

- 7 -

THE COMMISSION WILL, OF COURSE, PARTICIPATE IN THIS PROCESS; BUT IT CANNOT ITSELF TELL THE MEMBER STATES WHAT THEY THEMSELVES WILL, AT THE END OF THE DAY, BE ABLE TO AGREE UPON. ONLY YOU CAN DECIDE THAT.

THE LOWER RATE

CONCERN IN RELATION TO THE LOWER RATE WAS IN THE MAIN DIRECTED NOT TO ITS LEVELS (I WILL RETURN TO THE QUESTION OF ZERO RATES SHORTLY) BUT WITH ITS CONTENT. THERE WAS NO DISAGREEMENT WHATEVER WITH THE IDEA THAT IT SHOULD COVER WHAT ARE BROADLY THOUGHT OF AS BASIC NECESSITIES. BUT, OF COURSE, THERE ARE VARYING VIEWS, AND NATIONAL TRADITIONS, AS TO WHAT THOSE ARE. ONE MEMBER STATE FOR INSTANCE, SUGGESTED THAT WINE WAS A NECESSITY AND SHOULD BE AT THE LOWER RATE.

THE UNRESOLVED QUESTIONS BROADLY FALL INTO TWO TYPES. THE FIRST IS TO WHAT EXTENT GREATER DEFINITION IS NEEDED OF THE

- 8 -

CATEGORIES OF GOODS AND SERVICES WHICH THE COMMISSION PUT FORWARD IN ITS PROPOSALS. WE WERE CAREFUL TO CHOOSE CLEAR AND PLAIN LANGUAGE, BUT QUESTIONS HAVE ARISEN IN THE COURSE OF THE BILATERALS AS TO, FOR INSTANCE, THE AMBIT OF THE TERM "FOODSTUFFS ". I DO NOT BELIEVE THERE IS ANY NEED FOR THE COUNCIL TO GET BOGGED DOWN IN THE MINUTIAE OF DEFINITION OF THIS KIND, BUT CLEARLY SOME WORK IS NEEDED TO CLARIFY HOW MEMBER STATES WOULD IMPLEMENT THE CATEGORIES INCLUDED.

THE SECOND GROUP OF QUESTIONS IN RELATION TO THE LOWER RATE CONCERNED POSSIBLE ADDITIONAL ITEMS FOR INCLUSION AND, IN ONE CASE, A POSSIBLE EXCLUSION, THE ADDITIONAL SUPPLIES WHICH IN EACH CASE AT LEAST A SIGNIFICANT MINORITY OF MEMBER STATES WISHED TO SEE INCLUDED IN THE LOWER RATE WERE, FIRST, HOUSING - ESPECIALLY SOCIAL HOUSING; SECOND, CULTURAL SUPPLIES (BOOKS, NEWSPAPERS AND PERIODICALS ARE ALREADY

INCLUDED IN THE LOWER RATE BAND IN OUR PROPOSALS; AND THIRD, POPULAR RESTAURANTS AND NON-LUXURY HOTELS. WHETHER ALL OF THESE CAN BE DESCRIBED AS "BASIC NECESSITIES" IS PERHAPS DEBATABLE. THERE WAS ALSO A SIGNIFICANT BODY OF OPINION WHICH CONSIDERED THAT, FOR ENERGY CONSERVATION POLICY REASONS, FUEL FOR HEATING AND LIGHTING SHOULD BE TAXED AT THE STANDARD RATE.

WHAT IS NOW NEEDED ON BOTH THESE SETS OF QUESTIONS IS FOR THE PRESIDENCY TO CONVENE A COUNCIL WORKING GROUP TO TRY TO ACHIEVE CONSENSUS ON WHAT CATEGORIES MEMBER STATES WISH TO SEE INCLUDED AND TO WHAT EXTENT THOSE CATEGORIES MAY NEED A DEGREE OF CLOSER DEFINITION AT COMMUNITY LEVEL.

- 10 -

CLEARING SYSTEM

IT WAS GENERALLY ACCEPTED BY MOST MINISTERS THAT A CLEARING SYSTEM WAS A NECESSARY PART OF THE SYSTEM PROPOSED, IF THE EXISTING RELATIONSHIP BETWEEN PATTERNS OF CONSUMPTION AND OF REVENUE WAS TO REMAIN UNAFFECTED. BUT THERE WAS A GREAT DEAL OF CONCERN AND CRITICISM DIRECTED AT THE SYSTEM ITSELF. IT IS MY FIRM BELIEF, HAVING LISTENED CAREFULLY TO ALL THE POINTS MADE TO ME, THAT MUCH OF THAT CONCERN IS MISPLACED AND THE CRITICISM BASED ON MISUNDERSTANDING. THE SYSTEM WHICH WE PROPOSED LAST YEAR WAS AN IMMENSE IMPROVEMENT ON THE IDEA ORIGINALLY PUT FORWARD IN THE WHITE PAPER, AND IS IN FACT EXTREMELY SIMPLE. IT IS BASED ON MEMBER STATES'S EXISTING VAT ADMINISTRATION MECHANISMS, WITH THE VERY MINIMUM OF CHANGE OR EXTRA WORK. WE ARE CONFIDENT THAT WE HAVE DEVISED MECHANISMS WHICH, PERHAPS WITH

- 11 -

SOME FURTHER REFINEMENT, CAN BE AT LEAST AS PROOF AGAINST FRAUD OR EVASION AS MEMBER STATES' EXISTING VAT ADMINISTRATION.

BUT BECAUSE A CONSIDERABLE DEGREE OF SCEPTICISM STILL EXISTS WE SHALL PUTTING FORWARD IN THE NEW YEAR A MUCH MORE DETAILED ACCOUNT AND EXPLANATION OF THE SYSTEM WE HAVE IN MIND, WITH A VIEW TO DISPELLING THE MYTHS WHICH ARE BEGINNING TO ATTACH TO THE SYSTEM. WE SHALL THEN CONVENE...
A... COMMISSION... WORKING... PARTY... IN... WHICH
NATIONAL... EXPERTS... WILL... BE... INVITED... TO
PARTICIPATE, ... WHICH WILL EXAMINE THE SYSTEM
IN DETAIL.

DEROGATIONS

THE QUESTION OF DEROGATIONS IS NOT ONE WHICH CAN BE SETTLED AT THIS STAGE. BUT IT AROSE IN MOST OF THE BILATERAL MEETINGS I HAD, AND I THEREFORE MENTION IT HERE. THERE WAS A CLEAR PATTERN OF OPINION THAT

- 12 -

DEROGATIONS MAY WELL HAVE TO BE CONSIDERED FOR PARTICULAR CASES OF DIFFICULTY, BUT THERE WAS AN EQUALLY CLEAR VIEW EXPRESSED BY THE GREAT MAJORITY THAT SUCH DEROGATIONS SHOULD BE OF A LIMITED DURATION, DESIGNED TO EASE THE TRANSITION TO THE COMMUNITY SYSTEM. TWO CASES IN PARTICULAR STOOD OUT AS CANDIDATES FOR SUCH TEMPORARY DEROGATIONS. ONE IS THE ZERO-RATE OPERATED BY A VERY SMALL NUMBER OF MEMBER STATES, THERE WAS WIDESPREAD SYMPATHY FOR THE POLITICAL DIFFICULTIES FACED BY THOSE MEMBER STATES, BUT IN NO CASE WAS ANY OF THE OTHER MEMBER STATES PREPARED TO SEE THE ZERO RATE MAINTAINED EITHER AS A GENERAL FEATURE OF THE COMMUNITY VAT SYSTEM OR EVEN AS A PERMANENT FEATURE OF THE SYSTEM OF PARTICULAR MEMBER STATES.

THE OTHER AREA IN WHICH TRANSITIONAL ARRANGEMENTS MAY NEED TO BE MADE FOR CERTAIN MEMBER STATES IS THE ADJUSTMENT FROM A LARGE NUMBER OF RATES TO ONLY TWO.

SEVERAL MEMBER STATES RAISED THE POSSIBILITY OF MAINTAINING TWO RATES WITHIN EACH OF THE TWO BANDS OR AT LEAST WITHIN THE LOWER BAND SINCE THAT WOULD EFFECTIVELY BE A THREE OR FOUR-RATE REGIME, IT CLEARLY RUNS CONTRARY TO THE AIMS OF HARMONISATION, BUT AS A TEMPORARY DEROGATION, IT MAY BE FOUND USEFUL AND NOT UNDULY DISRUPTIVE.

EXCISE DUTIES

THE EXCISE DUTIES PRESENT A MUCH GREATER PROBLEM THAN THE VAT, GIVEN THE MUCH LESS ADVANCED STAGE OF HARMONISATION THAT HAS BEEN REACHED SO FAR WITHIN THE COMMUNITY.

NEVERTHELESS, THE PROBLEM CAN BE CONTAINED. THE OVERWHELMING MAJORITY OF CROSS-FRONTIER MOVEMENTS OF EXCISEABLE GOODS ARE, AND ALWAYS WILL BE, CARRIED OUT BY REGISTERED TRADERS, THAT IS ALL THOSE WHO ARE IN THE BUSINESS OF TRADING IN MINERAL OILS, IN ALCOHOLIC DRINKS AND IN TOBACCO PRODUCTS

ARE REGISTERED FOR VAT PURPOSES, MOREOVER, FOR REASONS OF CONVENIENCE AND CASH FLOW, ALL SUCH COMMERCIAL MOVEMENTS TAKE PLACE IN BOND, WITH ALL TAXATION SUSPENDED UNTIL THEY ARE RELEASED FROM BOND IN THE COUNTRY OF CONSUMPTION. X [THIS FOR ALMOST ALL MOVEMENTS OF SUCH GOODS WITHIN THE COMMUNITY, THE PRESENT DISPARITY BETWEEN EXCISE DUTIES DOES NOT PRESENT AN OBSTACLE TO THE INTERNAL MARKET.

NEVERTHELESS, THERE IS A SIGNIFICANT DEGREE OF CONCERN ABOUT PRIVATE INDIVIDUALS AND TRADERS - WHETHER LEGITIMATE OR NOT - WHO DO NOT FORM PART OF THAT FISCAL AND COMMERCIAL NETWORK. IT WAS GENERALLY AGREED BY ALL TO WHOM I SPOKE THAT THE PROBLEM HERE IS THE PRESENT WIDE DISPARITY OF EXCISE DUTY RATES, AND THEREFORE OF PRICES, [WHICH PROVIDES A SIGNIFICANT ECONOMIC INCENTIVE FOR CROSS-BORDER SHOPPING AND DEFLECTIONS OF TRADE.

- 15 -

THERE IS, EQUALLY, GENERAL AGREEMENT THAT THE FUNDAMENTAL SOLUTION TO THE PROBLEM MUST LIE IN A NARROWING OF THOSE DISPARITIES AND THUS A REDUCTION OF THE ECONOMIC INCENTIVE TO A POINT WHERE IT CEASES TO BE SIGNIFICANT. WE ARE, I THINK, ALL AGREED THAT WHAT NEEDS TO BE ACHIEVED IS A SUFFICIENT DEGREE OF APPROXIMATION TO ENABLE THESE GOODS TO MOVE FREELY FROM COUNTRY TO COUNTRY AFTER THE INTERNAL FRONTIERS ARE REMOVED AT THE END OF 1992.

THE SIMPLE TRUTH, CONFIRMED IN THE COURSE OF MY BILATERAL CONVERSATIONS, IS THAT THE IMMEDIATE DIFFICULTY, IF THERE IS INSUFFICIENT APPROXIMATION WHEN THE BARRIERS COME DOWN, WILL BE FELT BY THE MEMBER STATES WITH THE HIGHEST RATES OF DUTY. BUT IT WOULD BE NO MORE FAIR AND EQUITABLE HERE THAN IN THE CASE OF THE VAT TO CONCLUDE THAT THE BURDEN OF ADJUSTMENT SHOULD FALL ENTIRELY ON THEM. AND I BELIEVE WE SHOULD TAKE HEART FROM THE FACT THAT, IN

- 16 -

THE COURSE OF MY MEETINGS, I ENCOUNTERED A REAL UNDERSTANDING AMONG THE MORE LIGHTLY-TAXING MEMBER STATES THAT THEY, TOO, WILL NEED TO MAKE AN EFFORT TO MOVE TOWARDS A COMMUNITY SOLUTION.

IT WILL NOT SURPRISE THE COUNCIL TO LEARN THAT IT WAS THE GENERAL VIEW OF ALL TO WHOM I SPOKE THAT IT WILL BE AT BEST VERY DIFFICULT TO ACHIEVE THE COMPLETE HARMONISATION WHICH THE COMMISSION PROPOSED BY 1992. THERE WAS ALSO A STRONG BODY OF OPINION THAT TOTAL HARMONISATION WAS NOT, IN ANY CASE, ABSOLUTELY NECESSARY AND THAT A DEGREE OF FLEXIBILITY IN EXCISE DUTY RATES WAS LIKELY TO BE MANAGEABLE WITHOUT MARKET OR BUDGETARY DISRUPTION. THE COMMISSION HAS AN OPEN MIND ON THIS SCORE. OUR PROPOSALS WERE BASED ON WHAT WE BELIEVED MEMBER STATES COULD TOLERATE IN THE WAY OF VARIATIONS BETWEEN THEM OF THE VAT AND EXCISE DUTIES COMBINED. IF THE

- 17 -

GENERAL VIEW PROVES TO BE THAT WE UNDERESTIMATED MEMBER STATES' TOLERANCE, THE COMMISSION WOULD NOT OBJECT.

NEVERTHELESS, THE QUESTION REMAINS UNANSWERED AS TO WHAT MARGIN OF VARIATION OF MEMBER STATES WOULD REGARD AS MANAGEABLE. OR, TO PUT IT THE OTHER WAY ROUND, WHAT DEGREE OF APPROXIMATION IS JUDGED SUFFICIENT TO ENABLE FRONTIER CONTROLS TO BE LIFTED IN 1992? WE MUST BEAR IN MIND HERE THAT THE PURPOSE OF THIS PROPOSED LEGISLATION IS TO BRING MEMBER STATES' TAX REGIMES SUFFICIENTLY CLOSE FOR THE INTERNAL MARKET TO BE ABLE TO OPERATE WITHOUT UNACCEPTABLE DISTORTIONS. IT IS NOT AN ATTEMPT TO ACHIEVE PERFECTION BY LEGISLATIVE MEANS. AS I HAVE SAID ON MANY OCCASIONS BEFORE, MEMBER STATES MAY WELL FIND THAT, AFTER 1992, THEY WILL WISH TO MOVE THEIR TAX RATES EVEN CLOSER TOGETHER, BUT WHAT NEEDS TO BE DECIDED FOR OUR

- 18 -

PRESENT PURPOSES IS ONLY HOW MUCH APPROXIMATION MEMBER STATES BELIEVE THEY NEED TO ACHIEVE BY 1992.

WHEN WE TABLED OUR PROPOSALS LAST YEAR, WE MADE IT CLEAR THAT WE HAD CONFINED OUR OBJECTIVES TO MEETING PURELY FISCAL CONSIDERATIONS. WHILE WE TRIED AS FAR AS POSSIBLE NOT TO CUT ACROSS OTHER COMMUNITY POLICIES, WE DID NOT ADJUST OUR PROPOSALS ACTIVELY TO PROMOTE OTHER POLICY

OBJECTIVES. IT WAS CLEAR, HOWEVER, FROM MY BILATERAL CONTACTS THAT THERE IS A GENERAL CONCERN IN PARTICULAR ABOUT THE HEALTH CONSEQUENCES OF SMOKING AND DRINKING, AND ALSO ABOUT THE IMPLICATIONS FOR INDUSTRIAL AND ENERGY POLICY OF MINERAL OILS TAXATION.

THE TENDENCY IN THE FORMER CASE WAS TO CONCLUDE THAT THERE WAS A CASE FOR AIMING TOWARDS GENERALLY HIGH RATES OF TAXATION ON ALCOHOLIC DRINKS AND TOBACCO PRODUCTS, THOUGH THE SPEED AT WHICH THAT WAS ACHIEVED WOULD HAVE TO TAKE ACCOUNT OF ECONOMIC

*But will
by simplification,
case of the
alcohol & tobacco*

ADJUSTMENT PROBLEMS IN THE SECTORS CONCERNED, IN THE CASE OF MINERAL OILS, THE STRONGLY-HELD VIEW OF MOST WAS THAT COMPLETE HARMONISATION OF EXCISE DUTY RATES WAS NECESSARY BOTH IN THE INTERESTS OF ENERGY POLICY AND TO AVOID DISTORTION OF COMPETITION.

THE COMMISSION DOES NOT, AS WE HAVE REPEATEDLY STATED, WISH TO THRUST AN UNNECESSARY DEGREE OF UNIFORMITY OR RIGIDITY ON THE MEMBER STATES IN THIS FIELD. WE ARE, RATHER, TRYING TO PROVIDE THE MEANS OF FOCUSING MEMBER STATES' MINDS ON WHAT COMBINATION OF HARMONISATION AND FLEXIBILITY WILL BEST ENABLE THEM TO ABOLISH FRONTIER CONTROLS IN 1992 WITHOUT UNACCEPTABLE DISRUPTION. ONLY YOU - THE MEMBER STATES - CAN DECIDE THAT. THAT IS THE ROLE OF THE COUNCIL.

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THE COMMISSION WOULD THEREFORE SUGGEST THAT, HERE AGAIN, THE TIME HAS COME FOR THE COUNCIL TO INSTRUCT COREPER TO PREPARE A DISCUSSION OF WHAT DEGREE OF FLEXIBILITY AROUND WHAT LEVELS OF EXCISE DUTY WOULD BE COMPATIBLE WITH THE ABOLITION OF FRONTIERS AND FRONTIER CONTROLS IN 1992.

SUMMARY

TO SUM UP WE PROPOSE THAT IN THE VAT FIELD:

1. COREPER SHOULD STUDY AND RECOMMEND RATES AND RATE BANDS

2. A COUNCIL WORKING GROUP SHOULD DEAL WITH THE CATEGORIES TO BE INCLUDED IN THE LOWER RATE BAND AND WITH CLOSER DEFINITION OF THE ITEMS INCLUDED.

3. A COMMISSION WORKING PARTY WITH THE PARTICIPATION OF NATIONAL EXPERTS SHOULD EXAMINE THE CLEARING SYSTEM IN DETAIL

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AND

4. IN THE CASE OF THE EXCISES: COREPER SHOULD PREPARE A DISCUSSION OF WHAT DEGREE OF FLEXIBILITY, AROUND WHAT LEVELS, WOULD BE CONSISTENT WITH THE ABOLITION OF FRONTIERS AND FRONTIER CONTROLS BY 1992.

CONCLUSION

I AM CONSCIOUS OF THE FACT THAT THIS IS A FORMIDABLE WORK PROGRAMME BUT IF WE ARE TO RESPOND TO THE WISHES OF THE EUROPEAN COUNCIL, AND IF WE ARE NOT TO BEAR THE RESPONSIBILITY FOR PUTTING THE ACHIEVEMENT OF THE OBJECTIVES OF THE SINGLE EUROPEAN ACT IN JEOPARDY, WE CANNOT PUT OFF THE DAY WHEN THE COUNCIL AND COREPER GET DOWN TO THE HARD AND DETAILED WORK OF NEGOTIATION.



FROM: J M G TAYLOR
DATE: 13 December 1988

Handwritten notes and signatures on the right margin, including '20/12' and several illegible scribbles.

MR ILTT

Large handwritten signature or scribble in the center of the page.

cc Sir G Littler
Mr Lankester
Mr R I G Allen
Mrs Lomax
Mr Mortimer
Ms Symes

LEBEGUE REPORT

... I attach the Conclusions of the recent Lebegue Report which looked at the French tax treatment of savings in the context of the single European market. The Chancellor would be most grateful if you could provide an assessment of this Report.

Handwritten mark resembling the number '25'.

J M G TAYLOR



CONCLUSION

The single European market in capital and financial services is a historical development without precedent. Different national financial systems will find themselves in direct competition with one another. Households will be able to choose from a vast range of investment opportunities on offer from financial intermediaries established throughout the Community.

The taxation applied to these savings in each of the Member countries will be a determining factor in savers' choices and in the strategies adopted by financial intermediaries. Where differences in taxation are sufficiently large, this may even cause destabilising movements of capital, threatening each country's macroeconomic equilibrium and reducing the competitiveness of the financial intermediaries.

- 1 - French taxation of savings is on average less favourable than that of other European nations.

The working group which met at the Conseil national du crédit turned first of all to a detailed analysis of the taxation of savings in Europe (as well as in the United States and Japan), without, however, making a study of the taxation of financial intermediaries. For each type of investment, the members of the working group compared the tax burden on French savers in France with what they would bear if their investments had been made abroad. The single market will enable each individual to enjoy non-resident status in the other countries of the Community.

Admittedly, this approach has its limitations. It does not take into account taxation of income from property, inheritance or transfers, nor the possibilities of developments in the medium-term. What it does show, however, is the particular position of France as regards the taxation of savings.

France's singular position is explained primarily by the fact that France imposes a higher average level of taxation on savings than the majority of its partners. The effectiveness of the fiscal control measures which have gradually been implemented in order to guarantee that these rules are respected, (measures covering the totality of the forms these savings can take, the yields and the profits from them) serve only to strengthen the position.

The results of the comparison hardly seem to favour France:

- French residents would have a fiscal interest in delocalising a large proportion of their investments to another Community country. The only things which would not benefit from more favourable taxation abroad would be savings in tax-exempt savings accounts and French shares held by taxpayers not in the highest bands of income tax.

(Surely French residents should - in theory - pay French tax on investments abroad)

- there are, furthermore, only very few French investments for which taxation could constitute an attraction for non-residents. They could derive some tax advantage from acquiring bonds or securities on the French money markets, from making deposits at banks in France or from trading on the futures or negotiable options markets. But the attraction of investing in shares, CIUTS (collective investment undertakings for transferable securities [Fr. OCPVM]) issues or notes seems, from a fiscal point of view, to be negligible or non-existent.

is there a fiscal penalty? relative to shares & domestic markets or what?

2 - There is a serious, but controllable risk of the delocalisation of French savings.

This observation led the working group to assess the risk of delocalisation of French households' savings. Two theories prevailed in the course of the work.

The first lays emphasis on the inertia of savers and administrators. It states that after an inevitable period of

adjustment, the creation of the internal market would bring about no significant change in the movements of savings in Europe. Local financial circumstances would, moreover, help stabilise the market share of national financial intermediaries in each country.

The second theory, in contrast, stresses the risk of large-scale delocalisation of French savings. It holds that freedom of movement of capital, of establishment and of provision of services would in fact overturn previous practices. With cut-throat competition among financial intermediaries, French households would be directly and intensively approached (home banking, mail order, etc) and would be able, not least for tax reasons, to show increasing interest in investment abroad. The majority of the working group considered this to be a real risk.

The consequences of such a shift of savings would be considerable. Studies carried out on behalf of the group have revealed that delocalisation of even a small proportion of French households' savings would have a serious impact on the finances of the nation. It would necessitate a sharp rise in interest rates and result in a simultaneous reduction in available savings and investment.

The working group highlighted three types of delocalisation:

- fiscal delocalisation, causing "expatriation" of investments (including investment in French products), leading to loss of tax revenue and loss of business for financial intermediaries;
- financial delocalisation, defined as a shift of savings away from investment in France and towards investments abroad;
- delocalisation of banking, corresponding to the establishment abroad of French financial intermediaries.

From this scheme, the working group devised a "scale of risks" on the basis of which the probability of delocalisation can be estimated for each category of household investment (totalling 6,200 thousand million francs). The probability seems particularly high

for savings invested in securities (bonds especially) and for that part of savings which is administered by insurance companies (individual life insurance contracts and group insurance contracts for borrowers). A number of other investments seem to have a significant probability of delocalisation (cf. table on page 30).

3 - The completion of a single European system of finances requires harmonisation of taxation on yields from savings.

The opinion of the working group was that it was impossible to be satisfied with the status quo. Each Member country would both seek to attract investment from non-residents by means of low-rate or zero taxation and run the risk of delocalisation of its own residents' savings. The resulting fall in taxation revenue would counteract the redistributive function assigned to fiscal levies and create distortion between the taxation of earned and unearned income.

Therefore a policy must be promoted which is based on co-operation among all the Member-States: unanimity is, in any case, required for all Community decisions affecting fiscal matters and the agreement of 13 June 1988 on the liberalisation of movements of capital recognised that the harmonisation of tax rules constituted a prerequisite for the success of the combined market. Such a policy must respect the State's budgetary constraints and meet the objectives of simplicity, equity and neutrality.

Against this background, the working group formulated a series of proposals which could contribute simultaneously both to an approximation of the systems of taxing savings in Europe and to the nationalisation of the French system of taxing savings:

- the introduction within the European Community of a withholding tax on interest gained by EEC residents on securities themselves issued by Community residents. This tax would have the effect of discharging the investor's tax obligation in the country of investment, if the investor were not a resident of that country. It would not necessarily have this effect in the investor's country

of residence.⁽¹⁾ Whether or not the withholding tax has this effect, the working group recommends a lowering of the discharge levy rates (which are higher than the European average) and a narrowing of the bands for such taxes in France. Similar rates, or if possible a uniform rate, should be adopted by the Community countries. The application in practice of this officially harmonised taxation ought naturally to be monitored from State to State;

- a system combining a withholding tax on income in the source country (refundable in the recipient's country of residence) and tax credits already operates in a number of European countries. If applied throughout the Community, it would prevent delocalisation of savings invested in shares. It does not therefore seem necessary to modify the existing French arrangements regarding the taxation of dividends. The working group suggests that the existing policy on tax credits should be continued. Its preference here is for a progressive lowering of rates of company tax to favour the competitiveness of French firms rather than for a direct raising of tax credit to 100% of company tax. This supposes that, at the level of company tax, no differences will be introduced between taxation of distributed and undistributed profits.

4 - Adjustment of certain aspects of the French system of taxation of savings would benefit France's entry into the European capital and financial services market.

1 - The first task is to prepare French CIUTSS to confront European competition from October 1989. Adjustment of their fiscal arrangements is primarily a question of abolishing the unmatured coupon⁽²⁾ rule and returning to the matured coupon rule. It further implies, over and above this one fiscal reform, that French CIUTSS will no longer be compelled to hold debt securities to the value of at least 30% of their assets. It also implies, finally, the

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2 - The members of the working group consider that the stock exchange tax constitutes a serious handicap to Paris as a financial market. Therefore they propose its withdrawal. For budgetary reasons this could be applied initially only to transactions over 5 million francs (including certain securities transactions still subject to this tax.)

3 - Because of the high risk of delocalisation of household investments in insurance, the working group recommends the progressive abolition of the tax on insurance agreements.

4 - The existence of tax-exempt savings accounts [Fr.: livrets défiscalisés] may in time prove incompatible with the single European market. The availability of such accounts remains restricted to certain institutions. For this reason, the members of the working group, with the exception of the representatives of the Post Office, the savings banks and, but for certain conditions, Crédit Mutuel, advocate the extension to the banks of the possibility of offering 'blue book' accounts [livret bleu], within, in the initial stages, a maximum limit. The savings banks and the Post Office would meanwhile continue to offer 'A-book' accounts [livret A]. The monies raised would continue to be used primarily to finance public housing.

5 - Greater neutrality must be sought in the tax incentives offered for people to save; at the same time, the mechanisms designed to ensure the loyalty of French savers must be preserved - always provided these mechanisms conform to Community rules. For this reason, the group suggests that personal allowances which favour certain investments should be extended to cover all income from savings.

6 - The promotion of saving for retirement is a priority. Appropriate measures might include, in addition to our

redistributive pensions scheme, devising a new mechanism characterised by contractualisation of commitments, capitalisation of interest, disposal of capital and collective administration of all savings invested in this way. The fiscal advantages of this system would stem from the granting of a reduction in contributions from taxable income with, in return, normal taxation of pensions.

(92)

Ch
Some odd stuff - but maybe full
report explains - Need
assessment from FIM ?
-1-
YH psc

Lebegue Report

CONCLUSION

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Therefore a policy must be promoted which is based on co-operation among all the Member-States: unanimity is, in any case, required for all Community decisions affecting fiscal matters and the agreement of 13 June 1988 on the liberalisation of movements of capital recognised that the harmonisation of tax rules constituted a prerequisite for the success of the combined market. Such a policy must respect the State's budgetary constraints and meet the objectives of simplicity, equity and neutrality.

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From: Sir G. Littler
Date: 14 December 1988

MR J M G TAYLOR

c.c. Mr Lankester
Mr R I G Allen
Mrs Lomax
Mr Ilett
Mr Mortimer
Ms Symes

*Ch. We are getting further
advice on this report
from Mr Ilett.*

dr 13/12

[Red signature]

LEBEGUE REPORT

A point for future debate with Beregovoy.

2. Part of the French argument for harmonising tax on savings is the risk of loss to other countries of French domestic savings. Trichet has on several occasions (in discussions of general trends in economies) spoken with great passion about the devastating decline in personal/household savings in France over the last decade. He also claims on less convincing evidence that it is a widespread problem in Europe and other developed countries. But his real worry is France and I think it is widely shared by his French colleagues.

3. If the French are really worried about savings, they should (as I have told him) be addressing the disincentives to savings in their own tax system and the Lebegue report makes it pretty clear that there could be some mileage in that road.

[Handwritten signature]

(Geoffrey Littler)

*Ch. to UK, too. For Ilett in
Lomax a note on
hands in press house (L)
97 Gumborn*



HOUSE OF COMMONS
LONDON SW1A 0AA

Handwritten initials and numbers:
67. 5/11
9/11

Handwritten note:
Passed on to Robert

Large handwritten note in red ink:
What I would like to see is a
commitment from the Government
to support the proposals for
the new VAT proposals.

Rt Hon Nigel Lawson MP
The Chancellor
11 Downing Street
London

December ^{20TH} 14TH

Dear Chancellor

Last week you appeared to welcome the new proposals that have come from the EEC Commissioner Lord Cockfield on VAT

In the light of the proposals he has now made I would be grateful for clear assurances on two vital points of his proposals

First that you would not support a VAT rate of 16% or 17%

Second that, in addition to opposing VAT on food fuel and childrens clothes and shoes, you would not charge VAT on books and newspapers, on water and on rail tube and bus fares

Yours sincerely

Handwritten signature: Gordon Brown

Gordon Brown
Labour Treasury spokesman

CH/EXCHEQUER	
REC.	22 DEC 1988
ACTION	Mr Culpin
COPIES TO	CS7, PS7, PMG, EST Mr Schob
	Sir P. Middleton, Mr Scholar
	Mr Lambester, Mr R. G. Allen
	Mr Gilhooly, Mrs Chaplin
	Mr Tyrie, Mr Call
	PS/C & E

HM TREASURY - MC	
RECD	22 DEC 1988
ACTION	
	cc Mrs Thorne
SIGNATURE	CHX
OFF. No.	



FROM: J M G TAYLOR
DATE: 4 January 1989

MS SYMES

cc Mr Byatt
Mr R I G Allen
Mr Gilhooly
Mr Mortimer

Mr Unwin - C&E
Mr Jefferson Smith - C&E
Mr Wilmott - C&E

LORD COCKFIELD'S SPEAKING NOTE FOR ECOFIN, 12 DECEMBER,
ON FISCAL APPROXIMATION

The Chancellor was grateful for the copy of Lord Cockfield's speaking note which you enclosed with your note of 14 December.

2. He has read through this, and marked the key passages. A
... marked-up copy is attached.

3. The Chancellor has commented that perhaps the most important of these passages is that on page 14, where Lord Cockfield concedes that wide differences in indirect tax rates do not, in themselves, present an obstacle to the internal market.

A handwritten signature in dark ink, appearing to be "J M G Taylor".

J M G TAYLOR

Caps of Las Corchfeld's

speech made to

his cabinet 12. vii. 88

11.00 hrs.

Ms Jones § 257

CPS

Mr Jeffrey Smith

Mr Nash

Mr Wilmett

Mr Knox

Mr Oxenford

ECOFIN 12 DECEMBER 1988

FISCAL APPROXIMATION

SPEAKING NOTE

AT ITS MEETING IN RHODES AT THE BEGINNING OF THIS MONTH, THE EUROPEAN COUNCIL DISCUSSED THE PROGRESS OF THE PROGRAMME TO ^{complete} CREATE THE INTERNAL MARKET. THE EUROPEAN COUNCIL POINTED OUT THAT THE CREATION OF THE SINGLE MARKET FORMS A WHOLE AND THAT MAINTENANCE OF AN OVERALL APPROACH WAS ONE OF THE CONDITIONS FOR SUCCESS. IT WAS THEREFORE NECESSARY, THE COUNCIL SAID, TO MAKE PROGRESS IN A BALANCED AND COORDINATED FASHION IN ALL AREAS AND TO ENSURE THAT THE APPROPRIATE HARMONISATION OR APPROXIMATION IS CARRIED OUT WHERE NECESSARY. THE EUROPEAN COUNCIL URGED THE COUNCIL OF MINISTERS TO STEP UP ITS EFFORTS IN ALL

- 2 -

AREAS WHERE PROGRESS HAS NOT BEEN RAPID AND THIS OF COURSE IS ONE OF THE MAIN AREAS CONCERNED.

THE COUNCIL EXPRESSED THE HOPE THAT THE CONTACTS BETWEEN THE COMMISSION AND THE MEMBER GOVERNMENTS WOULD LEAD TO A CONVERGENCE OF VIEWS AND IT CALLED UPON THE COUNCIL - THAT IS THIS COUNCIL - TO SPEED UP ITS WORK TO ENABLE THE TAX MEASURES NEEDED TO BE ADOPTED ON TIME.

GIVEN THE NECESSARY POLITICAL WILL, WE ARE NOW IN A POSITION TO FULFIL THE EUROPEAN COUNCIL'S WISHES. SINCE OUR INFORMAL MEETING IN CRETE, I HAVE HAD CONTACTS WITH ALL THE MEMBER STATES ON A BILATERAL BASIS, AS WE AGREED, AS WAS ALREADY APPARENT IN CRETE, THERE IS INDEED A CONVERGENCE OF VIEWS, AS THE EUROPEAN COUNCIL HAS HOPED.

- 3 -

THE FIRST AND MOST IMPORTANT THING IS THAT I FOUND GENERAL AGREEMENT THAT THE PRESENT SPREAD OF INDIRECT TAXES - BOTH VAT AND EXCISE DUTIES - IS TOO WIDE TO ENABLE A SINGLE MARKET WITHOUT INTERNAL FRONTIERS TO OPERATE WITHOUT UNACCEPTABLE DISTORSIONS, AND THAT THOSE TAX RATES MUST THEREFORE COME CLOSER TOGETHER. THERE WAS ALSO AN OVERWHELMING MAJORITY VIEW THAT THIS SHOULD BE DONE IN AN ORDERLY AND PLANNED MANNER, AT A COMMUNITY LEVEL. THE IDEA THAT IT COULD SIMPLY BE LEFT TO MARKET FORCES TO REDUCE THE PRESENT WIDE DISPARITIES WAS ONLY PUT FORWARD BY ONE MEMBER STATE AND RECEIVED VIRTUALLY NO SUPPORT.

WE MUST WORK, THEREFORE, ON THE BASIS THAT IT IS THE WISH OF THE OVERWHELMING MAJORITY THAT THERE SHOULD BE A HARMONISED VAT SYSTEM, AND A COORDINATED APPROXIMATION OF VAT RATES.

THERE WAS ALSO WIDESPREAD AGREEMENT, THAT THE SYSTEM SHOULD BE BASED ON TWO RATES, A STANDARD RATE FOR MOST SUPPLIES, AND A LOWER RATE FOR BASIC NECESSITIES.

RATE AND BANDS

THERE WAS A CONSIDERABLE MEASURE OF SUPPORT FOR THE COMMISSION'S PROPOSAL THAT MEMBER STATES SHOULD ALLOW THEMSELVES FLEXIBILITY ON VAT RATES BY MEANS OF THE CONCEPT OF RATE BANDS. BUT THERE WAS EQUALLY A STRONG VIEW THAT THE STANDARD RATE BAND IN PARTICULAR SHOULD BE NARROWER THAN WE ORIGINALLY PROPOSED. ONLY ONE MEMBER STATE WANTED WIDER BANDS.

THERE WERE VARYING VIEWS AS TO THE DEGREE OF NARROWING REQUIRED - WHETHER IT SHOULD BE BY ONE POINT AT EACH END OR TWO - SO AS TO PRODUCE BANDS OF, SAY, 15% TO 19%, OR 15% TO 18%, OR EVEN 16% TO 18%. SOME MEMBER STATES WERE PARTICULARLY CONCERNED TO RAISE

- 5 -

THE LOWER LIMIT OF THE BAND TO WELL ABOVE THE 14% WHICH WE HAD PROPOSED. A VARIANT OF THAT APPROACH WAS THE IDEA OF A HIGH MINIMUM RATE, WITH NO UPPER LIMIT. IF IT WERE PLACED AT A SUITABLE POINT IN THE PRESENT DISTRIBUTION OF RATES - SAY, AT 17% AS SUGGESTED BY ONE MEMBER STATE - IT COULD, IT IS TRUE, SHARE THE BURDEN OF ADJUSTMENT REASONABLY EQUALLY AMONG THE MEMBER STATES, THOSE BELOW IT WOULD HAVE TO BRING THEIR RATES UP TO AT LEAST THAT LEVEL; AND THOSE WITH HIGHER RATES WOULD TEND TO BE DRAWN DOWNWARDS. ON THE OTHER HAND THE IDEA OF A LOW-MINIMUM RATE, PUT FORWARD BY ONE MEMBER STATE IN PARTICULAR IN CRETE, WOULD OF COURSE PUT THE WHOLE BURDEN OF ADJUSTMENT ON THE MORE HIGHLY-TAXED MEMBER STATES; THAT CANNOT BE DESCRIBED AS A COMMUNITY SOLUTION.

ON THE VAT RATES AND RATE BANDS, THEREFORE, THE POSITION IS CLEAR: THERE IS A GENERAL VIEW THAT THE APPROACH AND STRUCTURE

- 6 -

PROPOSED BY THE COMMISSION IS THE RIGHT ONE. IT REMAINS FOR THE COUNCIL TO AGREE ON THE FIGURES - THE FIGURES FOR THE LEVELS AND THE FIGURES FOR THE DEGREE OF FLEXIBILITY TO BE ALLOWED. THAT CAN ONLY BE RESOLVED BY NEGOTIATION AMONG THE MEMBERS OF THE COUNCIL THEMSELVES.

THE TIME HAS COME, THEREFORE, IN THE COMMISSION'S VIEW FOR THE COUNCIL TO INSTRUCT COREPER TO RECOMMEND TO IT WHAT THE RATES AND RATE BANDS ARE THAT MIGHT COMMAND THE SUPPORT OF ALL THE MEMBER STATES. THIS COULD BE DONE ON THE BASIS OF PREPARATORY WORK BY A COUNCIL WORKING GROUP SETTING OUT THE IMPLICATIONS OF SUCH RATES AND BANDS IN TERMS OF BUDGETARY REVENUES AND TRADE FLOWS. IT COULD ALSO EXAMINE THE POSSIBILITY OF MINIMUM RATES.

- 7 -

THE COMMISSION WILL, OF COURSE, PARTICIPATE IN THIS PROCESS; BUT IT CANNOT ITSELF TELL THE MEMBER STATES WHAT THEY THEMSELVES WILL, AT THE END OF THE DAY, BE ABLE TO AGREE UPON. ONLY YOU CAN DECIDE THAT.

THE LOWER RATE

CONCERN IN RELATION TO THE LOWER RATE WAS IN THE MAIN DIRECTED NOT TO ITS LEVELS (I WILL RETURN TO THE QUESTION OF ZERO RATES SHORTLY) BUT WITH ITS CONTENT. THERE WAS NO DISAGREEMENT WHATEVER WITH THE IDEA THAT IT SHOULD COVER WHAT ARE BROADLY THOUGHT OF AS BASIC NECESSITIES. BUT, OF COURSE, THERE ARE VARYING VIEWS, AND NATIONAL TRADITIONS, AS TO WHAT THOSE ARE. ONE MEMBER STATE FOR INSTANCE, SUGGESTED THAT WINE WAS A NECESSITY AND SHOULD BE AT THE LOWER RATE.

THE UNRESOLVED QUESTIONS BROADLY FALL INTO TWO TYPES. THE FIRST IS TO WHAT EXTENT GREATER DEFINITION IS NEEDED OF THE

- 8 -

CATEGORIES OF GOODS AND SERVICES WHICH THE COMMISSION PUT FORWARD IN ITS PROPOSALS. WE WERE CAREFUL TO CHOOSE CLEAR AND PLAIN LANGUAGE, BUT QUESTIONS HAVE ARISEN IN THE COURSE OF THE BILATERALS AS TO, FOR INSTANCE, THE AMBIT OF THE TERM "FOODSTUFFS ". I DO NOT BELIEVE THERE IS ANY NEED FOR THE COUNCIL TO GET BOGGED DOWN IN THE MINUTIAE OF DEFINITION OF THIS KIND, BUT CLEARLY SOME WORK IS NEEDED TO CLARIFY HOW MEMBER STATES WOULD IMPLEMENT THE CATEGORIES INCLUDED.

THE SECOND GROUP OF QUESTIONS IN RELATION TO THE LOWER RATE CONCERNED POSSIBLE ADDITIONAL ITEMS FOR INCLUSION AND, IN ONE CASE, A POSSIBLE EXCLUSION, THE ADDITIONAL SUPPLIES WHICH IN EACH CASE AT LEAST A SIGNIFICANT MINORITY OF MEMBER STATES WISHED TO SEE INCLUDED IN THE LOWER RATE WERE, FIRST, HOUSING - ESPECIALLY SOCIAL HOUSING; SECOND, CULTURAL SUPPLIES (BOOKS, NEWSPAPERS AND PERIODICALS ARE ALREADY

INCLUDED IN THE LOWER RATE BAND IN OUR PROPOSALS; AND THIRD, POPULAR RESTAURANTS AND NON-LUXURY HOTELS. WHETHER ALL OF THESE CAN BE DESCRIBED AS "BASIC NECESSITIES" IS PERHAPS DEBATABLE. THERE WAS ALSO A SIGNIFICANT BODY OF OPINION WHICH CONSIDERED THAT, FOR ENERGY CONSERVATION POLICY REASONS, FUEL FOR HEATING AND LIGHTING SHOULD BE TAXED AT THE STANDARD RATE.

WHAT IS NOW NEEDED ON BOTH THESE SETS OF QUESTIONS IS FOR THE PRESIDENCY TO CONVENE A COUNCIL WORKING GROUP TO TRY TO ACHIEVE CONSENSUS ON WHAT CATEGORIES MEMBER STATES WISH TO SEE INCLUDED AND TO WHAT EXTENT THOSE CATEGORIES MAY NEED A DEGREE OF CLOSER DEFINITION AT COMMUNITY LEVEL.

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CLEARING SYSTEM

IT WAS GENERALLY ACCEPTED BY MOST MINISTERS THAT A CLEARING SYSTEM WAS A NECESSARY PART OF THE SYSTEM PROPOSED, IF THE EXISTING RELATIONSHIP BETWEEN PATTERNS OF CONSUMPTION AND OF REVENUE WAS TO REMAIN UNAFFECTED. BUT THERE WAS A GREAT DEAL OF CONCERN AND CRITICISM DIRECTED AT THE SYSTEM ITSELF. IT IS MY FIRM BELIEF, HAVING LISTENED CAREFULLY TO ALL THE POINTS MADE TO ME, THAT MUCH OF THAT CONCERN IS MISPLACED AND THE CRITICISM BASED ON MISUNDERSTANDING. THE SYSTEM WHICH WE PROPOSED LAST YEAR WAS AN IMMENSE IMPROVEMENT ON THE IDEA ORIGINALLY PUT FORWARD IN THE WHITE PAPER, AND IS IN FACT EXTREMELY SIMPLE. IT IS BASED ON MEMBER STATES'S EXISTING VAT ADMINISTRATION MECHANISMS, WITH THE VERY MINIMUM OF CHANGE OR EXTRA WORK. WE ARE CONFIDENT THAT WE HAVE DEVISED MECHANISMS WHICH, PERHAPS WITH

SOME FURTHER REFINEMENT, CAN BE AT LEAST AS PROOF AGAINST FRAUD OR EVASION AS MEMBER STATES' EXISTING VAT ADMINISTRATION.

BUT BECAUSE A CONSIDERABLE DEGREE OF SCEPTICISM STILL EXISTS WE SHALL PUTTING FORWARD IN THE NEW YEAR A MUCH MORE DETAILED ACCOUNT AND EXPLANATION OF THE SYSTEM WE HAVE IN MIND, WITH A VIEW TO DISPELLING THE MYTHS WHICH ARE BEGINNING TO ATTACH TO THE SYSTEM. WE SHALL THEN CONVENE...
A... COMMISSION... WORKING... PARTY... IN... WHICH
NATIONAL... EXPERTS... WILL... BE... INVITED... TO
PARTICIPATE, ... WHICH WILL EXAMINE THE SYSTEM
IN DETAIL.

DEROGATIONS

THE QUESTION OF DEROGATIONS IS NOT ONE WHICH CAN BE SETTLED AT THIS STAGE. BUT IT AROSE IN MOST OF THE BILATERAL MEETINGS I HAD, AND I THEREFORE MENTION IT HERE, THERE WAS A CLEAR PATTERN OF OPINION THAT

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DEROGATIONS MAY WELL HAVE TO BE CONSIDERED FOR PARTICULAR CASES OF DIFFICULTY, BUT THERE WAS AN EQUALLY CLEAR VIEW EXPRESSED BY THE GREAT MAJORITY THAT SUCH DEROGATIONS SHOULD BE OF A LIMITED DURATION, DESIGNED TO EASE THE TRANSITION TO THE COMMUNITY SYSTEM. TWO CASES IN PARTICULAR STOOD OUT AS CANDIDATES FOR SUCH TEMPORARY DEROGATIONS. ONE IS THE ZERO-RATE OPERATED BY A VERY SMALL NUMBER OF MEMBER STATES, THERE WAS WIDESPREAD SYMPATHY FOR THE POLITICAL DIFFICULTIES FACED BY THOSE MEMBER STATES, BUT IN NO CASE WAS ANY OF THE OTHER MEMBER STATES PREPARED TO SEE THE ZERO RATE MAINTAINED EITHER AS A GENERAL FEATURE OF THE COMMUNITY VAT SYSTEM OR EVEN AS A PERMANENT FEATURE OF THE SYSTEM OF PARTICULAR MEMBER STATES.

THE OTHER AREA IN WHICH TRANSITIONAL ARRANGEMENTS MAY NEED TO BE MADE FOR CERTAIN MEMBER STATES IS THE ADJUSTMENT FROM A LARGE NUMBER OF RATES TO ONLY TWO.

SEVERAL MEMBER STATES RAISED THE POSSIBILITY OF MAINTAINING TWO RATES WITHIN EACH OF THE TWO BANDS OR AT LEAST WITHIN THE LOWER BAND SINCE THAT WOULD EFFECTIVELY BE A THREE OR FOUR-RATE REGIME, IT CLEARLY RUNS CONTRARY TO THE AIMS OF HARMONISATION, BUT AS A TEMPORARY DEROGATION, IT MAY BE FOUND USEFUL AND NOT UNDULY DISRUPTIVE.

EXCISE DUTIES

THE EXCISE DUTIES PRESENT A MUCH GREATER PROBLEM THAN THE VAT, GIVEN THE MUCH LESS ADVANCED STAGE OF HARMONISATION THAT HAS BEEN REACHED SO FAR WITHIN THE COMMUNITY.

NEVERTHELESS, THE PROBLEM CAN BE CONTAINED. THE OVERWHELMING MAJORITY OF CROSS-FRONTIER MOVEMENTS OF EXCISEABLE GOODS ARE, AND ALWAYS WILL BE, CARRIED OUT BY REGISTERED TRADERS, THAT IS ALL THOSE WHO ARE IN THE BUSINESS OF TRADING IN MINERAL OILS, IN ALCOHOLIC DRINKS AND IN TOBACCO PRODUCTS

ARE REGISTERED FOR VAT PURPOSES, MOREOVER, FOR REASONS OF CONVENIENCE AND CASH FLOW, ALL SUCH COMMERCIAL MOVEMENTS TAKE PLACE IN BOND, WITH ALL TAXATION SUSPENDED UNTIL THEY ARE RELEASED FROM BOND IN THE COUNTRY

X [OF CONSUMPTION. THUS FOR ALMOST ALL MOVEMENTS OF SUCH GOODS WITHIN THE COMMUNITY, THE PRESENT DISPARITY BETWEEN EXCISE DUTIES DOES NOT PRESENT AN OBSTACLE TO THE INTERNAL MARKET.

NEVERTHELESS, THERE IS A SIGNIFICANT DEGREE OF CONCERN ABOUT PRIVATE INDIVIDUALS AND TRADERS - WHETHER LEGITIMATE OR NOT - WHO DO NOT FORM PART OF THAT FISCAL AND COMMERCIAL NETWORK. IT WAS GENERALLY AGREED BY ALL TO WHOM I SPOKE THAT THE PROBLEM HERE IS THE PRESENT WIDE DISPARITY OF EXCISE DUTY RATES, AND THEREFORE OF PRICES,

[WHICH PROVIDES A SIGNIFICANT ECONOMIC INCENTIVE FOR CROSS-BORDER SHOPPING AND DEFLECTIONS OF TRADE.

- 15 -

THERE IS, EQUALLY, GENERAL AGREEMENT THAT THE FUNDAMENTAL SOLUTION TO THE PROBLEM MUST LIE IN A NARROWING OF THOSE DISPARITIES AND THUS A REDUCTION OF THE ECONOMIC INCENTIVE TO A POINT WHERE IT CEASES TO BE SIGNIFICANT. WE ARE, I THINK, ALL AGREED THAT WHAT NEEDS TO BE ACHIEVED IS A SUFFICIENT DEGREE OF APPROXIMATION TO ENABLE THESE GOODS TO MOVE FREELY FROM COUNTRY TO COUNTRY AFTER THE INTERNAL FRONTIERS ARE REMOVED AT THE END OF 1992.

THE SIMPLE TRUTH, CONFIRMED IN THE COURSE OF MY BILATERAL CONVERSATIONS, IS THAT THE IMMEDIATE DIFFICULTY, IF THERE IS INSUFFICIENT APPROXIMATION WHEN THE BARRIERS COME DOWN, WILL BE FELT BY THE MEMBER STATES WITH THE HIGHEST RATES OF DUTY. BUT IT WOULD BE NO MORE FAIR AND EQUITABLE HERE THAN IN THE CASE OF THE VAT TO CONCLUDE THAT THE BURDEN OF ADJUSTMENT SHOULD FALL ENTIRELY ON THEM. AND I BELIEVE WE SHOULD TAKE HEART FROM THE FACT THAT, IN

- 16 -

THE COURSE OF MY MEETINGS, I ENCOUNTERED A REAL UNDERSTANDING AMONG THE MORE LIGHTLY-TAXING MEMBER STATES THAT THEY, TOO, WILL NEED TO MAKE AN EFFORT TO MOVE TOWARDS A COMMUNITY SOLUTION.

IT WILL NOT SURPRISE THE COUNCIL TO LEARN THAT IT WAS THE GENERAL VIEW OF ALL TO WHOM I SPOKE THAT IT WILL BE AT BEST VERY DIFFICULT TO ACHIEVE THE COMPLETE HARMONISATION WHICH THE COMMISSION PROPOSED BY 1992. THERE WAS ALSO A STRONG BODY OF OPINION THAT TOTAL HARMONISATION WAS NOT, IN ANY CASE, ABSOLUTELY NECESSARY AND THAT A DEGREE OF FLEXIBILITY IN EXCISE DUTY RATES WAS LIKELY TO BE MANAGEABLE WITHOUT MARKET OR BUDGETARY DISRUPTION. THE COMMISSION HAS AN OPEN MIND ON THIS SCORE. OUR PROPOSALS WERE BASED ON WHAT WE BELIEVED MEMBER STATES COULD TOLERATE IN THE WAY OF VARIATIONS BETWEEN THEM OF THE VAT AND EXCISE DUTIES COMBINED. IF THE

- 17 -

GENERAL VIEW PROVES TO BE THAT WE UNDERESTIMATED MEMBER STATES' TOLERANCE, THE COMMISSION WOULD NOT OBJECT.

NEVERTHELESS, THE QUESTION REMAINS UNANSWERED AS TO WHAT MARGIN OF VARIATION OF MEMBER STATES WOULD REGARD AS MANAGEABLE, OR, TO PUT IT THE OTHER WAY ROUND, WHAT DEGREE OF APPROXIMATION IS JUDGED SUFFICIENT TO ENABLE FRONTIER CONTROLS TO BE LIFTED IN 1992? WE MUST BEAR IN MIND HERE THAT THE PURPOSE OF THIS PROPOSED LEGISLATION IS TO BRING MEMBER STATES' TAX REGIMES SUFFICIENTLY CLOSE FOR THE INTERNAL MARKET TO BE ABLE TO OPERATE WITHOUT UNACCEPTABLE DISTORTIONS. IT IS NOT AN ATTEMPT TO ACHIEVE PERFECTION BY LEGISLATIVE MEANS. AS I HAVE SAID ON MANY OCCASIONS BEFORE, MEMBER STATES MAY WELL FIND THAT, AFTER 1992, THEY WILL WISH TO MOVE THEIR TAX RATES EVEN CLOSER TOGETHER, BUT WHAT NEEDS TO BE DECIDED FOR OUR

- 18 -

PRESENT PURPOSES IS ONLY HOW MUCH APPROXIMATION MEMBER STATES BELIEVE THEY NEED TO ACHIEVE BY 1992.

WHEN WE TABLED OUR PROPOSALS LAST YEAR, WE MADE IT CLEAR THAT WE HAD CONFINED OUR OBJECTIVES TO MEETING PURELY FISCAL CONSIDERATIONS. WHILE WE TRIED AS FAR AS POSSIBLE NOT TO CUT ACROSS OTHER COMMUNITY POLICIES, WE DID NOT ADJUST OUR PROPOSALS ACTIVELY TO PROMOTE OTHER POLICY

OBJECTIVES. IT WAS CLEAR, HOWEVER, FROM MY BILATERAL CONTACTS THAT THERE IS A GENERAL CONCERN IN PARTICULAR ABOUT THE HEALTH CONSEQUENCES OF SMOKING AND DRINKING, AND ALSO ABOUT THE IMPLICATIONS FOR INDUSTRIAL AND ENERGY POLICY OF MINERAL OILS TAXATION.

THE TENDENCY IN THE FORMER CASE WAS TO CONCLUDE THAT THERE WAS A CASE FOR AIMING TOWARDS GENERALLY HIGH RATES OF TAXATION ON ALCOHOLIC DRINKS AND TOBACCO PRODUCTS, THOUGH THE SPEED AT WHICH THAT WAS ACHIEVED WOULD HAVE TO TAKE ACCOUNT OF ECONOMIC

*But will
by simplification,
one of the
alcohol & tobacco*

ADJUSTMENT PROBLEMS IN THE SECTORS CONCERNED. IN THE CASE OF MINERAL OILS, THE STRONGLY-HELD VIEW OF MOST WAS THAT COMPLETE HARMONISATION OF EXCISE DUTY RATES WAS NECESSARY BOTH IN THE INTERESTS OF ENERGY POLICY AND TO AVOID DISTORTION OF COMPETITION.

THE COMMISSION DOES NOT, AS WE HAVE REPEATEDLY STATED, WISH TO THRUST AN UNNECESSARY DEGREE OF UNIFORMITY OR RIGIDITY ON THE MEMBER STATES IN THIS FIELD. WE ARE, RATHER, TRYING TO PROVIDE THE MEANS OF FOCUSING MEMBER STATES' MINDS ON WHAT COMBINATION OF HARMONISATION AND FLEXIBILITY WILL BEST ENABLE THEM TO ABOLISH FRONTIER CONTROLS IN 1992 WITHOUT UNACCEPTABLE DISRUPTION. ONLY YOU - THE MEMBER STATES - CAN DECIDE THAT. THAT IS THE ROLE OF THE COUNCIL.

- 20 -

THE COMMISSION WOULD THEREFORE SUGGEST THAT, HERE AGAIN, THE TIME HAS COME FOR THE COUNCIL TO INSTRUCT COREPER TO PREPARE A DISCUSSION OF WHAT DEGREE OF FLEXIBILITY AROUND WHAT LEVELS OF EXCISE DUTY WOULD BE COMPATIBLE WITH THE ABOLITION OF FRONTIERS AND FRONTIER CONTROLS IN 1992.

SUMMARY

TO SUM UP WE PROPOSE THAT IN THE VAT FIELD:

1. COREPER SHOULD STUDY AND RECOMMEND RATES AND RATE BANDS

2. A COUNCIL WORKING GROUP SHOULD DEAL WITH THE CATEGORIES TO BE INCLUDED IN THE LOWER RATE BAND AND WITH CLOSER DEFINITION OF THE ITEMS INCLUDED.

3. A COMMISSION WORKING PARTY WITH THE PARTICIPATION OF NATIONAL EXPERTS SHOULD EXAMINE THE CLEARING SYSTEM IN DETAIL

- 21 -

AND

4. IN THE CASE OF THE EXCISES: COREPER SHOULD PREPARE A DISCUSSION OF WHAT DEGREE OF FLEXIBILITY, AROUND WHAT LEVELS, WOULD BE CONSISTENT WITH THE ABOLITION OF FRONTIERS AND FRONTIER CONTROLS BY 1992.

CONCLUSION

I AM CONSCIOUS OF THE FACT THAT THIS IS A FORMIDABLE WORK PROGRAMME BUT IF WE ARE TO RESPOND TO THE WISHES OF THE EUROPEAN COUNCIL, AND IF WE ARE NOT TO BEAR THE RESPONSIBILITY FOR PUTTING THE ACHIEVEMENT OF THE OBJECTIVES OF THE SINGLE EUROPEAN ACT IN JEOPARDY, WE CANNOT PUT OFF THE DAY WHEN THE COUNCIL AND COREPER GET DOWN TO THE HARD AND DETAILED WORK OF NEGOTIATION.

CONTINUED TO GROW AT ITS PRESENT RATE (WHICH IN TURN WAS A FUNCTION OF THE GROWTH OF THE EUROPEAN ECONOMY).

EMS

5. BEREGOVY UNDERLINED THE CARDINAL IMPORTANCE OF EXCHANGE RATE STABILITY, AND IN PARTICULAR TYING THE FRANC TO THE DM. THERE WAS NO QUESTION OF FRANCE SEEKING A DEVALUATION OF THE FRANC OR A REALIGNMENT IN THE EMS. ASKED IF THAT MEANT THAT IF THE DM WERE REVALUED THE FRANC WOULD BE TOO, BEREGOVY SAID YES. HE AND STOLTENBERG HAD MADE IT CLEAR THEY WERE SATISFIED WITH THE CURRENT FRANC/DM PARITY.

EC/US

6. BEREGOVY SAID HE WANTED TO DE-DRAMATISE THE CURRENT EC/US DIFFERENCES. EUROPE HAD TO BE A GREAT MARKET, NOT A FORTRESS. IT WAS VITAL TO COMBAT PROTECTIONISM EVERYWHERE. THE BIG PROBLEM WAS AGRICULTURE, WHERE EVERYONE WAS COMPETING TO PROVIDE SUBSIDIES TO THEIR FARMERS. THE IMPORTANT THING WAS TO PLACE ALL SUBSIDIES ON THE TABLE. IT WOULD NOT BE EASY, BUT A NEGOTIATION IN THE GATT WAS POSSIBLE. NO ONE HAD ANYTHING TO GAIN IN A TRADE WAR.

FRANCE AND 1992

7. ASKED HOW A FRENCH GOVERNMENT OBLIGED BY THE PARLIAMENTARY SITUATION TO TAKE ACCOUNT OF COMMUNIST VIEWS COULD SQUARE UP TO 1992, BEREGOVY SAID THAT FOR FRANCE THE EUROPEAN COMMUNITY WAS A SOCIAL NECESSITY. THE LIBERALISATION OF CAPITAL, TRADE AND LABOUR WAS NEEDED TO STIMULATE ENTERPRISE AND CREATE JOBS. THE SOCIAL DIMENSION COULD NOT BE IGNORED, BUT WHAT IT REALLY AMOUNTED TO WAS A BETTER SHARING OF THE FRUITS OF CREATED WEALTH.

LLEWELLYN SMITH

YYYY

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*Helpful, sp X:
BF
Janatha
10/11*

FRAME ECONOMIC

FRANCE AND THE EC

SUMMARY

1. BEREGOVY CONFIRMS FRANCE WILL NOT BLOCK EC CAPITAL LIBERALISATION IN 1990, AND SUGGESTS NATIONAL MEASURES TO OBTAIN A DISPLACEMENT OF CAPITAL IF NO AGREEMENT ON TAX HARMONISATION IS POSSIBLE. COMMENTS ON OTHER EC SUBJECTS INCLUDING FRANC/DM IN THE EMS.

DETAIL

2. TAKING QUESTIONS ON THE FRENCH ECONOMY IN 1989 BEFORE A CONFERENCE OF BUSINESSMEN ON 5 JANUARY, BEREGOVY (MINISTER OF THE ECONOMY) MADE A NUMBER OF OBSERVATIONS ON EC SUBJECTS.

TAXATION OF FINANCIAL ASSETS

3. BEREGOVY SAID HE WAS AWAITING COMMISSION PROPOSALS ON THE HARMONISATION OF TAXATION OF FINANCIAL ASSETS. HOWEVER, HE EMPHASISED THAT THE DECISION TO ABOLISH CAPITAL CONTROLS IN 1990 WAS ALREADY TAKEN. FRANCE WAS NOT GOING TO CHALLENGE IT. HE HOPED AND BELIEVED THAT, WITH THE HELP OF THE GERMANS, AGREEMENT ON THE FORTHCOMING COMMISSION PROPOSALS WOULD BE POSSIBLE. BUT IF NOT, HE WOULD TAKE THE NECESSARY STEPS TO AVOID A DISPLACEMENT OF FRENCH CAPITAL BY CUTTING THE RELEVANT FRENCH TAXATION RATES BEFORE 1990. THESE WOULD HAVE A BUDGETARY COST OF SOME F15 BILLION. BUT THEY WOULD ALSO HAVE THE ADVANTAGE OF ENCOURAGING FRENCH SAVINGS - A SEPARATE IMPORTANT MACROECONOMIC OBJECTIVE TO HELP CURB EXCESS DEMAND.

VAT APPROXIMATION

4. BEREGOVY SAID VAT HARMONISATION DID NOT MEAN UNIFORMITY. BUT HE DID THINK NARROWING OF EC RATES WAS NECESSARY AND DESIRABLE BY 1992. FRENCH VAT RATES WOULD BE LOWERED, AND ALTHOUGH THERE WOULD BE A BUDGETARY COST OF SOME F20-25 BILLION PER ANNUM FOR THE FOUR BUDGETS OVER THE PERIOD 1990-1993, THIS WOULD BE MANAGEABLE IF THE ECONOMY

TELNO
17
FROM
PARIS

FROM: J F GILHOOLY

DATE: 6 January 1989

CHANCELLOR OF THE EXCHEQUER

- cc Chief Secretary
- Financial Secretary
- Paymaster General
- Economic Secretary
- Sir Peter Middleton
- Mr Lankester
- Mr Scholar
- Mr R I G Allen
- Mr Culpin
- Mr Macpherson
- Mr Michie (O/R)
- Ms Symes
- Mrs Chaplin
- Mr Tyrie
- Mr Call

PS/Customs & Excise
Mr P R H Allen C&E

*Ch. Content to write
as proposed?
25/9*

OK on

EC VAT APPROXIMATION: LETTER OF 20 DECEMBER FROM
GORDON BROWN MP

I attach a draft reply, agreed with Customs. (Copies were
delayed in the Christmas post.)

J F GILHOOLY

DRAFT LETTER FROM:

CHANCELLOR

TO:

GORDON BROWN MP

Thank you for your letter of 20 December about the EC Commission's proposals on VAT approximation.

You have been misled if you believe that I have endorsed Lord Cockfield's proposals. I welcomed his belated acceptance at ECOFIN on 12 December of the need for greater flexibility in dealing with the indirect taxation aspects of the single market. ~~In no way did I support a VAT rate of 16 or 17 per cent.~~ ~~Our~~ view firmly remains that the fiscal harmonisation package proposed by the Commission is unnecessary to achieve the completion of the internal market and takes insufficient account of changing conditions, needs and social and other priorities than in Member States.

Our objective is deregulation and trade facilitation through reduced government intervention, not greater and more detailed regulation from the centre. You will be aware that I have suggested to my European colleagues an alternative market-based approach, which would not require Member States to make what in many cases could be large and unwelcome changes in tax rates with damaging consequences for national economic, social, health and other policies.

In sum, we believe that the framework that has been put forward by the Commission is seriously flawed. The question of whether we support this or that detail of it does not therefore arise.

my C has now taken of a M in member man

HMG's

As to VAT rates, the Government is pledged not to impose VAT on food, domestic fuel supplies and young children's clothing and shoes.

Beyond that, you should know that the convention is that statements on tax rates are matters for Budgets.

[NL]



HOUSE OF COMMONS
LONDON SW1A 0AA

Rt Hon Nigel Lawson MP
The Chancellor
11 Downing Street
London

December ^{20TH} ~~14th~~

Dear Chancellor

Last week you appeared to welcome the new proposals that have come from the EEC Commissioner Lord Cockfield on VAT

In the light of the proposals he has now made I would be grateful for clear assurances on two vital points of his proposals

First that you would not support a VAT rate of 16% or 17%

Second that, in addition to opposing VAT on food fuel and childrens clothes and shoes, you would not charge VAT on books and newspapers, on water and on rail tube and bus fares

Yours sincerely

Gordon Brown

Gordon Brown
Labour Treasury spokesman

CH/EXCHEQUER	
REC.	22 DEC 1988
ACTN	Mr Culpin
COPIES TO	CSZ, FSZ, PMG, EST Mr Scholt
	Sir P. Middleton, Mr Scholt
	Mr Lankester, Mr RIG Allen
	Mr Gilhooley, Mrs Chaplin
	Mr Tyrie, Mr Call
	PS/C & E

HM TREASURY -	
REC'D	22 DEC 1988
ACTN	
	cc Mrs Thorne
	CHX

22/26

FROM: R I G ALLEN
DATE: 9 JANUARY 1989

RGA
→
CH EX
9/1

CHANCELLOR

OK
OK 2. Sir Hannay
HH
Anger's
later
remains

cc PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Wicks
Mr Lankester
Mr Culpin
Mr Odling-Smee
Mr Ilett
Mr Mortimer
Ms Symes
Mr Tyrie

Mr Corlett - IR

TAX ON SAVINGS: MME SCRIVENER

Sir David Hannay rang me this afternoon to say that Mme Scrivener, the new French Commissioner on tax policy, has expressed a strong wish for an early meeting with you to discuss the Commission's forthcoming proposals on the taxation of savings. She has proposed similar meetings with Finance Ministers from the other major countries with a substantive interest in this subject. She would be prepared to fly to London on the morning of 19 January to meet with you either shortly before lunch (post-Cabinet) or in the early afternoon: half an hour would, I think, suffice, and your diary suggests you are free.

2. Sir David Hannay's advice, which I endorse, is that you should agree to a meeting. Sir David's impression was that Mme Scrivener has not yet reached a firm view about which direction she wishes to go in this area, and a meeting would be a useful opportunity to influence her thinking whilst still at a formative stage. I learned today from another source (Martin Donnelly in Sir Leon Brittan's Cabinet) that the Commission are likely to come forward with their proposals by about the end of

January. Donnelly confirmed that there was still some room for manoeuvre though he indicated that the Commission were likely to recommend the exclusion of eurobonds from the scope of a withholding tax and a 15 per cent rate of tax, which they would be prepared to see negotiated down to 10 per cent.

3. Would you be prepared to see Mme Scrivener?

RIA

R I G ALLEN



cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary

Treasury Chambers, Parliament Street
01-270 3000

PM
Sir P Middleton
Mr Lankester
Mr Scholar
Mr R I G Allen
Mr Culpin
Mr Gilhooly

9 January 1989

Gordon Brown Esq MP
House of Commons
LONDON
SW1A 0AA

Mr Macpherson
Mr Michie
Ms Symes
Mrs Chaplin
Mr Tyrie
Mr Call

PS/CE
Mr P R H Allen - C&E

John Gordan

Thank you for your letter of 20 December about the EC Commission's proposals on VAT approximation.

You have been misled if you believe that I have endorsed Lord Cockfield's proposals. I welcomed his belated acceptance at ECOFIN on 12 December of the need for greater flexibility in dealing with the indirect taxation aspects of the single market, not his new idea of a minimum main VAT rate of 17 per cent. HMG's view firmly remains that the fiscal harmonisation package proposed by the Commission is unnecessary to achieve the completion of the internal market and takes insufficient account of changing conditions, needs and social and other priorities than in Member States.

Our objective is deregulation and trade facilitation through reduced government intervention, not greater and more detailed regulation from the centre. You will be aware that I have suggested to my European colleagues an alternative market-based approach, which would not require Member States to make what in many cases could be large and unwelcome changes in tax rates with damaging consequences for national economic, social, health and other policies.

In sum, we believe that the framework that has been put forward by the Commission is seriously flawed. The question of whether we support this or that detail of it does not therefore arise.



As to VAT rates, the Government is pledged not to impose VAT on food, domestic fuel supplies and young children's clothing and shoes.

Beyond that, you should know that the convention is that statements on tax rates are matters for Budgets.

A handwritten signature in black ink, appearing to read 'Nigel Lawson', written in a cursive style.

NIGEL LAWSON



FROM: J M G TAYLOR
DATE: 10 January 1989

MR R I G ALLEN

cc PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Wicks
Mr Lankester
Mr Culpin
Mr Odling-Smee
Mr Ilett
Mr Mortimer
Ms Symes
Mr Tyrie


Mr Corlett - IR

TAX ON SAVINGS: MME SCRIVENER

The Chancellor has seen your note of 9 January.

2. He is content to see Madame Scrivener. Perhaps you could liaise with UKREP/Mrs Thorpe to arrange a suitable time.

3. The Chancellor commends - if you have not already seen it - Paris telno 17, which reports some helpful remarks by Bérégovoy on this subject.


J M G TAYLOR

Chy Mme Scriver

The team so far consists
of Mme Scriver
Emmanuel Constant
Sir David Hannay
PST.
Tini Lancaster
Nigel Dicks.

EST would like to
know if you want him
to attend as well, but
it may make our team
seem rather large?

John
12/11. **Include**
PST -

SB A briefing meeting is
being arranged. ✓

* Hanray now suggests we
dispenze with the interpreter.
Mme Scrivener is happy to speak
French & listen to



English. Are you
content to speak
English & listen in
French? *Julie*

Ch/ I have provisionally
arranged for you to see
Mme Scrivener at 2.30pm
on Thursday 19 Jan.

Content?

Mme Scrivener will be
accompanied by her
Chief de Cabinet -

Emmanuel Constant and an
interpreter* & Sir David Hanray.

FST & Nigel Wicks have

expressed an interest in attending
the meeting. Richard Allen will

be in Luxembourg & has suggested

Tim attend instead? *OK.*

Are you content with this team

+ Jonathan? *OK.*

Julie
"||".

4926



FROM: J M G TAYLOR
DATE: 10 January 1989

MR R I G ALLEN

cc PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Wicks
Mr Lankester
Mr Culpin
Mr Odling-Smee
Mr Ilett
Mr Mortimer
Ms Symes
Mr Tyrie

Mr Corlett - IR

TAX ON SAVINGS: MME SCRIVENER

The Chancellor has seen your note of 9 January.

2. He is content to see Madame Scrivener. Perhaps you could liaise with UKREP/Mrs Thorpe to arrange a suitable time.

3. The Chancellor commends - if you have not already seen it - Paris telno 17, which reports some helpful remarks by Bérégovoy on this subject.

A handwritten signature in dark ink, appearing to be 'JMG'.

J M G TAYLOR

19/1



FROM: MRS JULIE THORPE

DATE: 12 January 1989

MR R I G ALLEN

cc PS/Financial Secretary
PS/Economic Secretary
PS/Paymaster General
Sir P Middleton
Mr Wicks
Mr Lankester
Mr Culpin
Mr Odling-Smee
Mr Ilett
Mr Mortimer
Ms Symes
Mr Tyrie
Mr Corlett IR
PS/C+E
Mr Jefferson-Smith C+E
Mr R H Allen C+E

TAX ON SAVINGS: MADAME SCRIVENER

The Chancellor has agreed to see Madame Scrivener at 2.30pm on Thursday 19 January, at No.11.

2. Madame Scrivener will be accompanied by her Chief de Cabinet - Emmanuel Constant and Sir David Hannay. The Chancellor is content for the FST, EST and Mr Lankester to attend the meeting as well.

3. As you know the Chancellor will be holding a briefing meeting here in the Treasury on Tuesday 17 January at 4.00pm.

A handwritten signature in cursive script that reads 'Julie Thorpe'.

MRS JULIE THORPE

FROM: N J ILETT

DATE: 12 JANUARY 1989

CHANCELLOR OF THE EXCHEQUER

cc: Financial Secretary
 Paymaster General
 Economic Secretary
 Sir P Middleton
 Sir T Burns
 Mr Wicks
 Mr Lankester
 Mr Scholar
 Mr R I G Allen
 Mr Culpin
 Mr Odling-Smee
 Mr Peretz
 Mrs M E Brown (EC)
 Mr Gilhooly
 Miss O'Mara
 Mr Kroll
 Mr Neilson
 Mr Ritchie
 Mr Sharples

Mr Isaac IR
 Mr Corlett IR
 PS/IR

*Man...
 W...
 need to discuss
 X 2 documents*

*Ch.
 I am keeping back the
 (French) volumes of the report itself
 - though you can of course see
 them if you wish!*

*28
 18/1*

TAXATION OF SAVINGS : "THE LEBEGUE REPORT"

Introduction

I attach the assessment of the Lebegue Report for which you asked. EC and FIM Divisions hold copies of the Report itself (in French) and a translation of the conclusions has already been circulated.

2. As you are seeing Mme Scrivener tomorrow, I thought you would like to see this note now. Neither the Bank, Revenue nor FCO have done any detailed analysis of the Report which we could use at this stage. However, it makes sense to get their comments on the note, which I would propose to do if you are content.

3. We can get specialist advice on particular bits of the Report if you think that helpful.

Comment

4. The Lebeque Report considers the implications of the internal market, and in particular of the freedom of capital movements, for the taxation of savings in France. The central worry is that French savers will use the abolition of exchange control to place savings in other Community countries where taxation is lower or (on non-residents) non-existent and mechanisms to enforce payment of tax due back in France may be inadequate. The Report shows convincingly that the French approach to taxing savings is in urgent need of change anyway, even without 1992. But it does not face up to the consequences of the removal of the present closed and overregulated system. There is no answer to the problem that, in the absence of exchange controls, savings can move outside as well as within the Community.

5. Nevertheless, the authors pine for at least some extension of the French approach to taxation into the rest of the Community. The terms in which this argument is put may reflect the views of hard-liners within the tax administration. If so, over time the French will move away from their position; there are signs that this process may be under way already. But politically this will not be easy for the present French Government. Understandably, the authors of the Report have been careful to avoid weakening their Government's stance that a degree of tax harmonisation is virtually an essential consequence of the freedom of capital movements. They have also had to tread carefully because of domestic political sensitivities. Some of the structural reforms suggested would damage vested interests such as the Post Office savings bank.

6. On the whole, I suspect that the Report may exaggerate the extent to which French households will place savings abroad, at least in the early years of the internal market. In part, this is because inertia and habit are powerful forces; in part, because regulation eg of advertising and financial intermediaries will make access to foreign markets less easy; and in part because the

present French system is so inefficient that it should be possible to get a good deal of extra tax by giving people more latitude to invest and taxing at more responsible rates (a possible consequence for tax receipts that the Report does not even address).

7. That said, I think it is fair comment that some of us were a bit slow to appreciate just how much importance the French were going to attach to this subject when they first started to make noises about it. The extent to which all the legal resources of the state - exchange control, financial regulation, banking secrecy law etc and the power of information technology had been linked together to defend the tax regime on savings is, as the Report says, different in nature as well as degree to the systems which exist in most other countries. Those in charge of it are understandably in something of a panic about what happens next. They are having to jump in the dark further than we did when we abolished exchange controls.

8. The arguments about macro-economic and exchange rate effects are pretty feeble and seem very much to be taking second place in the French armoury.

9. The Working Group's terms of reference excluded any study of the taxation of savings vehicles, except where this was incidental to their work on taxes paid by individuals. So the Report says little on this subject. The Luxembourg problem with UCITS is highlighted; and the extent to which funds managed by institutional investors may shift is acknowledged to have implications for the French system of the transparent tax treatment of savings vehicles. Nevertheless the Report's obsession with the non-declaration of tax implies that the French may lay rather less weight on the differences in the taxation of savings vehicles as a source of distortion post 1992 (October 1989 for UCITS).

10. For the reasons we have discussed in other contexts, FIM tends to the view that the taxation of savings vehicles as opposed to individuals' income from savings may raise more significant

policy issues. Because institutions which pay less tax can offer a better tax return to investors and financial services are highly mobile, we suspect that it is here that the danger of a downward competitive spiral taxation, resulting in the undertaxation of the financial sector, is more serious. We think there may be a case for a measure of harmonisation of minimum tax rates in this specific area.

M.

N J ILETT

THE LEBEGUE REPORT**Introduction and general comments**

This note discusses the report on "The Taxation of Savings in the Context of the Internal European Market" which was completed in June 1988 by the French "Conseil National du Credit". This Report is usually known by the name of its Chairman, Daniel Lebegue, Chief Executive of the Banque Nationale de Paris, formerly an official of the French Treasury. The Report runs to 80 pages of analysis with 200 pages of annex. An English translation of the conclusions has already been circulated.

2. The Conseil National du Credit is a corporatist consultative body in the French tradition. Over a hundred individuals from various parts of Government, nationalised and private sector institutions, universities, representative bodies etc are listed as having participated in its preparation, and the Report is clearly a piece of committee drafting. HM Embassy Paris advised last year that key French policy makers were being guided in general terms by the Report, but were not convinced by everything it says.

3. Naturally, much of the analysis depends on detailed comparison with the tax and regulatory treatment of savings in other Community countries. The Report presents these in summary form in over 50 pages of Annex II, apparently largely on the basis of work by Arthur Andersen, who were employed as consultants. The analysis covers France, all other Community countries except Greece and Portugal, and the USA. It is easy to pick holes in abridged descriptions of tax systems; that said, there appear to be a number of errors in what is said about the UK system, the overall effect being to underestimate our effectiveness in collecting tax. If the same is true of the analysis of other tax systems, the French may be less efficient in collecting tax relative to everybody else than they assume.

4. The Report only addresses the taxation of the product of savings. It does not look at differences in the taxation of savings vehicles. Arguably, however, assuming reasonable taxpayer honesty, the latter may well be the more important determinant of the location and pattern of savings when the internal market is complete. The Group's terms of reference (pp73-74 - very long by UK standards) say that it shall not deal directly with the taxation of financial institutions. Nevertheless, some of the authors of the Report are clearly profoundly sceptical about taxpayer honesty, and believe that the desire to place funds outside the reach of the tax system is more important than most other factors in investment decisions. The underlying assumption which runs through the Report is that no French citizen will pay tax unless some third party automatically declares his receipts to the authorities, and preferably deducts tax at source.

Organisation of the Report

5. Chapter 1 compares tax regimes and tax collection and enforcement mechanisms among members states .

6. Chapter 2 attempts to assess the risks of "delocalisation" - the shift of activity consequent on complete freedom of capital movements.

7. Chapter 3 identifies priorities for action. It recommends a number of changes to French systems, partly on merits, partly in response to Community pressures. These are described below. The main interest to the UK is part 3.3 (pp45-53) which contains recommendations for harmonisation of systems and rates throughout the Community.

8. The 24 Annexes in the second volume support all this. They vary in quality and interest. There is a long tabular exposition of the relative tax treatment of savings which - if accurate - may be a useful source of reference.

9. The rest of this note discusses the Report broadly by chapter. This involves some repetition but illustrates how the conclusions were reached.

Chapter 1: Comparison of systems

The French tax system

10. The most convincing passage by far in the Report is the analysis of the French system for regulating and taxing savings. The Report allows the reader to draw the clear inference that the French savings market is distorted by excessive tax rates and the poor choice of savings products for the consumer. This situation is the product of a closed financial system where regulation has been allowed to become an instrument of tax collection.

11. Savings are almost exclusively held in French assets (97% of French households have no non-French assets). Tax-free instruments, notably Post Office savings facilities, provide a pretty generous incentive to the first layer of savings. In total, a French household can accumulate about £30,000 in tax free savings; but there are serious distortions in the narrow choice of instruments which get this treatment - Post Office savings, Loi Monory etc. (Annex 24, by the Ministry of Post and Telecommunications, claims that if banks were allowed to compete for "livret" savings, 6,000 post offices and 30,000 jobs would go.) Thereafter tax rates on savings are higher than in most other Community countries; but differ between products according to marketability, length of term, risk etc (typical rates are 27% on most bonds, 47% on bank interest, 16% on capital gains above a threshold of £28,000). French death duties are harsh where children are few or none, and difficult to avoid.

12. Having established convincingly that there are important reasons for radical reform of the existing system, the Report attempts to set these squarely in the 1992 context (understandable, and a useful cover for making changes which would have been necessary anyway) and to recommend compromises between

aspects of the French system and general practice in other Community countries (much less convincing).

Comparison with other systems

13. The analysis of comparative tax systems is based on the proposition that because savers will not pay tax if they can possibly evade doing so, what matters is whether tax rates actually payable at home are higher than tax rates actually payable abroad. This means that what needs to be compared, for the purposes of French policy-making, is the taxation of French residents in France against the taxation of non-residents in every other Community country (in reality, of course, every other financial centre in the world, but the Report fails to grasp that nettle. It talks of the attractions of New York and Tokyo, but the Channel Islands get only a passing mention. The main target is of course Luxembourg.)

14. Against this test, bank deposits, debt and money market instruments would be more attractive to a French investor in nearly every other country studied than in France. Roughly the same is true of capital gains, where only Spain is said to tax non-residents; and particularly of UCITS, where the French are keenly aware of the Luxembourg problem. (Until the UCITS Directive comes into effect this October, however, they have banned the marketing in France of Luxembourg UCITS.) However, existing devices to encourage investment in French equity greatly reduce the attractiveness of investing abroad in foreign equity (the UK ACT system gets a favourable mention in this context, as it applies to non-residents). Bits of the exposition appear contradictory at this point.

15. That said, the Report suggests that in significant respects non-residents of France would find fiscal advantage in a number of savings instruments in that country. This leads to the conclusion, later, that it is in the general interest of member states to prevent a "vicious circle" of tax cutting and the inefficiencies and complications that would follow if large

numbers of people routinely invested outside their own country for tax reasons.

Tax Law, collection and enforcement

16. Over many years, the French tax authorities have used all the apparatus of Government to ensure that tax is collected. The exchange control and tax collection systems are integrated; banks automatically report interest paid; the dematerialisation of assets is well advanced, which greatly facilitates tax collection given that the fisc has access to the computer files involved; authorised depositaries hold individuals' financial assets, and have to report on them to the authorities. Indeed, the authorities' access to bank accounts and similar sources of information is virtually automatic - the authorities could isolate flows from abroad in individuals' bank accounts, and so have some defence against non-declaration of income from assets placed overseas. Evasion would still be possible if money was never repatriated, or was collected and spent abroad, but this would be difficult for the medium - wealth households where the Report thinks the risks of new savings flight are greatest.

17. The Report shows that, with the partial exception of Denmark, no other Community country has anything like the French enforcement and collection system; "the French system differs not only in degree but in kind from other European systems". The authors admit the analysis is thin where other countries are concerned. As noted above, their analysis of UK tax systems and enforcement seems to underestimate the effectiveness of our defences (though this is a point on which the Revenue are more qualified to judge than FIM). If this is so and the effectiveness of our partners' systems is also underestimated, that would cast doubt on the conclusion that because the French are so strict there must be less tax evasion in France than in other countries. (Anecdotal evidence and casual acquaintance in France make me sceptical of that claim anyway.)

18. Outside France banking secrecy, the absence of deduction at source (Belgian dentists crossing the border to Luxembourg ...)

etc are taken to mean that "our partners do not really discourage evasion and non-declaration ... the most lax are those who have lived for years without exchange controls and who have been led to show tolerance in order to avoid delocalisation". There is said to be a particular problem outside France with debt (eurobond) interest (75% of which is said not to be declared in Germany). (Comment: if true, this will be one reason why the public holds relatively few equities in Germany, equities being more effectively taxed.) If a French resident wished to invest in eurobonds, he would be obliged by law have to lodge them with an authorised depository who would declare income for tax; and if he held them outside France, routine inspection of his bank accounts would reveal any incoming payments derived from the overseas source.

19. The Report recognises that it is unlikely that some other countries would accept the French collection and enforcement system. Nevertheless it recommends (in a passage that appears to have been drafted by the fisc's equivalent of the Gendarme of Saint Tropez) that the French Government should try to persuade other member states of this approach - Denmark, Spain and even the Netherlands are listed as potential allies. Having reached the conclusion that the French system is the unsustainable product of closed markets, however, it is a bit odd to suggest that there is advantage in extending elements of it to the Community as a whole - as, of course, critics of the Lebegue Report and the likely Commission proposal, not least the UK, have been quick to point out.

20. Failing the adoption of French-type enforcement machinery as the Community norm, the Report suggests (in Chapter 3) that France should press for:

- improved double taxation agreements or a multilateral EC equivalent;
- the rigorous use of existing French powers to inspect bank accounts to identify inflows and outflows of funds which could help to identify missing revenue, subject (contradiction) to the need to reduce administrative

burdens on financial institutions which are already too high;

- removal throughout the Community of differences between the tax treatment of residents and EC non-residents (people who live in other Community countries) to discourage tax-biased competition for other countries' savings;
- evolution towards a standard Community rate of withholding tax on interest income, starting with a tax which provides final settlement in the country of investment but not necessarily in the home country of the investor. This is described as the minimum acceptable basis for a Community approach.

Chapter 2: "delocalisation"

21. The Report is rather less convincing in its discussion of the scale of "delocalisation" - the shift of activity following complete liberalisation of capital movements. It distinguishes three types of delocalisation. First, the placing of savings so as to evade or avoid tax. Second, the shift from French assets to non-French assets. Third, the shift from the use of banks in France to banks outside France. (Note: tax evasion is "fraude" in French; avoidance seems to be "evasion" in French.) An initial discussion of the nature of these risks lead into an assessment of the sensitivity of French households to the taxation of their savings. The general approach is that the very rich will evade anyway if that is what they want to do (we would say that is happening already); but middle-rich households with useful sums to invest will become aware of foreign possibilities for the first time.

22. A table on page 30 attempts to describes the risks of delocalisation of each type defined in the preceding paragraph on a scale increasing from 1 to 5. The highest risks are in the life insurance sector, particularly single premium policies and group

schemes; portfolio management; and UCITS. Medium risks include some deposits, and money market instruments. The conclusion is that overall France is at greater risk than her partners while the tax rates and regulatory and tax enforcement regimes remain so different. Tax-led capital flight will lead to a change in the nature of investment away from French instruments; and if no steps are taken Paris will suffer as a financial centre. Luxembourg, Amsterdam and London are thought likely to gain and are rather offensively grouped together as centres of low taxation and liberal regulation (a view we might find useful in coping with lobbyists from parts of the City).

23. The macro-economic argument is that initially the savings rate of households will not change but there may be considerable change in the location of saving, leading to macro-economic imbalances, tension between interest and exchange rate policy, and reduced real activity, particularly investment. For example, domestic interest rates would have to rise 2 or 3 percentage points to compensate for a 27% withholding tax competing with a tax-free investment abroad; French Finance Ministry forecasters think that even so savings would nevertheless fall by over £1.5b, and investment ultimately by £4 billion.

24. As the Report says, there are defects in this approach. It ignores the economic policy response which would be necessary if there were a substantial outflow of savings which was not intermediated back efficiently. It does not take sufficient account of the extent to which deposits outside France would be denominated in French francs and flow back to the French system, or be invested in French instruments, if the precedent of German activity in DM in Luxembourg is followed. There are several pages of not very illuminating debate about the extent to which inertia ("viscosity of savings") might come to the rescue. The majority view is that 1992 will bring changes of behaviour of a degree to which precedent will give little guide - the "pessimistic" prognosis from the point of view of the French industry, but no doubt encouraging to European integrationists. But changes on this scale seem unlikely; while the tendency will be towards more

saving across frontiers, the development is surely bound to be gradual and give time for adjustment.

25. There must have been a pretty strong temptation for the various vested interests who put the Report together to exaggerate the extent to which French households are likely to shift their savings across frontiers. It is significant that the French have chosen to make their stand on the tax analysis, and that not much has been heard of the macroeconomic part of the Report.

26. The argument at the end of this chapter is that notwithstanding the scale of the adverse economic consequences which might follow, policy changes in France alone could do a good deal to redress the balance, and that policy changes within the Community would also make a difference. What this should actually mean in practice is discussed in Chapter 3.

Chapter 3 : Priorities and Recommendations

27. This part of the Report opens with impressive principles - taxation of savings must promote efficiency, encourage a greater and more stable volume of saving directed by market forces, reflect budgetary constraints, but also respect the objectives of simplicity equity and neutrality. The new arrangements must be "coherent" both at the European level (through some harmonisation) and at the social level - ie there should be tax on the income from savings as well as on the income from labour and property. All this is easier said than done.

28. It is at least arguable that more realistic tax rates and less regulatory interference with savings products would lead to an increase in the savings ratio, more effective use of capital and an increase in tax receipts from savings. But the Report does not say this, still less attempt to quantify such effects. Politically, the French Government would have some difficulty in presenting this argument publicly, but it may have helped Mr Beregovoy decide to use his room for manoeuvre over the next 3 years to bring taxes on savings down to competitive levels.

29. Some of the Report proposals are eminently sensible in so far as they relate to the French system itself:

- abolish the differential tax rates on interest income, which are a function of perceived risk and savings term, both of which should be priced by the market;
- at least reduce differences in the treatment of interest income and capital gain on securities;
- tax distributed and non-distributed profits alike;
- abolish the 5.5% duty on insurance policy premiums, which is at the top of the Community league table for such taxes and cannot be sustained in the internal market;
- reduce transaction taxes, to make markets more efficient.

30. More controversial proposals are:

- give tax privileges to genuinely stable saving involving long term contracts - life assurance, the equivalent of personal pensions, housing finance saving plans;
- encourage saving by widening the range of instruments entitled to a tax-free slice, removing the considerable discrimination which now exists, ie move towards a ration of savings. The elimination of privileges for the Post Office and Savings Bank networks would (as noted above) have major structural and political implications.

31. Costing is not the Report's strong point, but it seems from footnotes on page 53 that the alignment of bank interest and fixed interest investment tax rates at the CGT rate (16%) is of the order of £1 billion (10.5bn francs). Beregevoy's recent statements suggest that he expects to "spend" between 15 and 20

billion francs on bringing tax rates on saving broadly into line with other countries.

32. The major interest for the UK is the section on harmonisation. The argument for harmonisation is that on the logic of the analysis described above, without a significant convergence of policies, rates and tax practice member states will find themselves in a Dutch auction of tax rates, cutting rates to compete with other centres. Income from savings would then become effectively tax-free, so that only employees would pay income tax - "a distribution of the fiscal burden which our European partners who appear to tolerate the non-declaration of income from savings could accept but which does not correspond to the French conception of fiscal justice".

33. The specific harmonisation proposals are those described in paragraph 20 above - improved enforcement and cooperation, similar treatment of residents and EC non-residents, and a common level of withholding tax on interest income for all Community residents (individual member states could charge more tax on their own residents if they wanted). Interestingly, the Report rejects a suggestion that a common tax treatment of UCITS should be introduced throughout the Community, because of the distortion this would create with other types of investment in national markets.

34. One final point. The Report looks at the delicate question of the compatibility with Community law of tax privileges which favour domestic savings media. It acknowledges that although Belgium, Italy and the UK also have tax measures which discriminate in favour of investment in domestic equities, the French measures are on a larger scale. For the moment, the Report's authors think the French system should be left as it is to encourage loyalty to French savings vehicles, but they note that the Commission will be discussing this.

FIM(2)
HM TREASURY
18 JANUARY 1989

Handwritten signatures and initials at the top of the page.

FROM: S J FLANAGAN
DATE: 13 January 1989

MR S F D POWELL - DEN

cc PS/Chancellor 12/2
PS/Economic Secretary
Mr Culpin
Mr Gilhooly
Mr Michie

Mr Oxenford - C&E

LETTER FROM TONY BLAIR: "EC PROPOSALS TO IMPOSE VAT ON ELECTRICITY"

We spoke about Tony Blair's letter of 6 January to your Secretary of State. As the letter deals with VAT, I would ordinarily suggest it should be transferred to Treasury Ministers, but given the references to whether DEN knew about the proposals, I agree that it should be your Secretary of State who answers.

2. I understand that you have a copy of the Treasury Weekly Brief, which sets out the background to the EC indirect tax approximation proposals. You might also like to be aware of a recent exchange of correspondence between the Chancellor and Gordon Brown about indirect tax approximation. I attach copies of Mr Brown's letter of 20 December 1988 and the Chancellor's reply of 9 January.

3. I suggest that your draft letter for your Secretary of State includes the following:

"The European Commission's proposals for the approximation of indirect tax rates - including the proposal that fuel and power should be subject to a "reduced" VAT rate of between 4 and 9 per cent - were published in August 1987. Since then, we have repeatedly made it clear that we do not consider centrally-imposed tax approximation to be either necessary or desirable for the completion of the single

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market. Indeed, Nigel Lawson has taken a lead in bring forward alternative proposals for a market-based approach which would allow Member States to retain flexibility in setting indirect tax rates.

"The Government is pledged not to impose VAT on food, domestic fuel supplies and young children's clothing and shoes: we have repeatedly made that clear, too. I understand that Nigel wrote to Gordon Brown on these lines just last week. I should add that changes to EC tax law require unanimity, so there is no danger of the Commission's proposals being forced upon us".

S J FLANAGAN
FP Division
HM Treasury

From: Tony Blair M.P.

Via Special
Hand post



HOUSE OF COMMONS

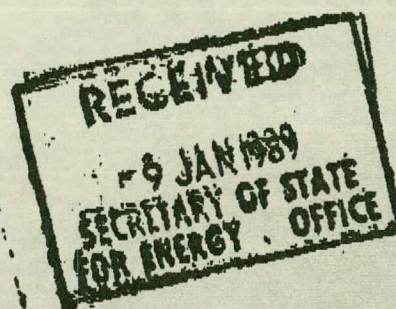
LONDON SW1A 0AA

Tel: 01- 219 4456 / 5059



6th January, 1989

The Rt. Hon. Cecil Parkinson MP,
The Secretary of State,
Department of Energy,
Thames House South,
Millbank,
London,
SW1P 4QJ.



Dear Secretary of State,

The Mail on Sunday Newspaper is claiming that the EEC Commission has not received a response from the Government on its plans to put VAT on electricity. Apparently your Department had no knowledge of any such plans though they are at a developed stage within the Commission.

I would be grateful if you would confirm for me: firstly, that your Department is aware of such plans and secondly, that it will oppose them fully, since the imposition of VAT on electricity would have a very serious effect on electricity prices particularly for pensioners and low income families.

Yours sincerely,

M Thomas

CO. Tony Blair.

SECRETARY OF STATE'S OFFICE	
TOM Thorne	Copies to
FOR ADVICE (AND DRAFT: IF APPROPRIATE)	PS/PUS (possibly)
PLEASE BY: 17/11	PS/POS
VIA PS/PUS	Mr Guinness
	Mr Wilcock
	Mr Macintyre
	Mr Grant
	Mr Merton

Box

The Mail Jan 8, 1989

VAT blow to power prices

By ADRIAN LITHGOW

THE cost of electricity is set to rocket by up to nine per cent — on top of increases already announced.

The shock rise follows moves by the European Commission to slap VAT on fuel. It will mean an extra £2.50 a week for the average household.

Similar increases are proposed by the commission on the price of gas.

Clarify

The move — part of Brussels' scheme to harmonise taxation throughout the EEC — would hit plans to privatise electricity.

And it will give added clout to Opposition complaints over the cost to consumers of privatisation.



PROBING: Tony Blair

Labour's energy spokesman, Tony Blair, wants Energy Secretary Cecil Parkinson to clarify the commission's proposals and set out the response of the Government.

He said: 'The plan to impose VAT would be particularly hard on low-income families and pensioners'

'I do not see a privatised industry doing anything other than passing this cost on to the consumer.'

C O N F I D E N T I A L

FROM: J F GILHOOLY

DATE: 17 January 1989

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
 Financial Secretary
 Paymaster General
 Economic Secretary
 Sir Peter Middleton
 Mr Wicks
 Mr Lankester
 Mr Scholar
 Mr R I G Allen
 Mr Culpin
 Mr Hoare O/R
 Mr Michie
 Ms Symes
 Mrs Chaplin
 Mr Tyrie
 Mr Call

Ch. Since at this stage C+E are proposing only to circulate their note at official level, it would not be embarrassing if Tony Ministers later decided that the scheme was too expensive. But this is a useful matter.

SINGLE EUROPEAN MARKET : INDIRECT TAX AND FRONTIER CONTROLS

There is a public expenditure point which needs watching in the proposals set out in Jefferson Smith's note, circulated by Mr Unwin under his submission of 12 January and relevant to your briefing meeting this afternoon for your meeting with Mme. Scrivener.

2. Paragraph 7(b) of the Jefferson Smith's note is the fullest statement we have yet seen about the resource costs of the new system. The points it makes are:

- that the long run administrative costs for Customs might be similar to the present system and cheaper; but
- there will be a transitional "hump" of uncertain size or duration.

3. There is potentially a public expenditure problem here. Customs would have to find, or failing that, be given, the extra resources mentioned in paragraph 7(b) of Mr Jefferson Smith's note. So far they have said that they cannot make estimates of what would be involved until the new arrangements are worked up in more detail. This is plausible enough, but we may well be faced by a very substantial bid for extra manpower, at least for the transitional phase. (This would be in addition to that needed for the Channel Tunnel where we have heard they think they might need something close to 1,000 extra staff.)

4. We need to pursue two points with them and will do so at official level:

- (i) how thorough the new control system needs to be: plenty of scope for "gold plating"
- (ii) what scope there is for starting now to look for manpower savings.

5. But the point could be flagged this afternoon that the Treasury could not sign up to the new system until it knows its cost.



J F GILHOOLY



Prp

Board Room
H M Customs and Excise
New King's Beam House
22 Upper Ground
London SE1 9PJ
Telephone: 01-620 1313

FROM: P R STEVENSON

DATE: 19 January 1989

PS/CHANCELLOR

SINGLE EUROPEAN MARKET: FRENCH PROPOSALS ON FRONTIER CONTROLS

Mr Allen attached to his note of 16 January a rough translation of M Weber's letter and accompanying paper. The French documents have now been examined more carefully by our translation service, and I enclose a revised English version.

Paul Stevenson

P R STEVENSON

Private Secretary

CC		
PS/Chief Secretary	Ms Symes	Mr Jefferson Smith
PS/Financial Secretary	Mrs Chaplin	Mr Nash
PS/Paymaster General	Mr Tyrie	Mr Wilmott
PS/Economic Secretary	Mr Call	Mr Finlinson
Sir P Middleton		Mr Allen
Mr Wicks		Mr Cockerell
Mr Lankester		Mr Savins
Mr Scholar	Sir D Hannay UKREP	Mr Gaw
Mr R I G Allen		Mr Kent
Mr Gilhooly	Mr Lavelle Cab Off.	Mr Knox

THE DIRECTOR GENERAL OF CUSTOMS AND EXCISE
Paris

06.01.89

To: Mr Unwin
Head of UK Customs

Dear Colleague

We have devised a new procedure in the light of discussions on the existing procedures applied to trade within the Community and external trade statistics.

This procedure would enable border controls to be abolished and noticeably reduce the requirements upon traders, whilst safeguarding the revenue of the States. Furthermore, the quality of statistical information would be maintained. I had the opportunity to outline this procedure to the Cabinet of the President of the Commission a few days ago. I enclose a description of it.

This suggestion has no effect on discussions concerning harmonization of VAT, which are continuing independently.

I would be very pleased to receive your comments on this proposal, or to have a talk with you at some future meeting that we could easily arrange.

[in manuscript] My best wishes. I should be very pleased to talk about this proposal with you. We could arrange a date on which to meet whenever you wish.

Regards

[signed]

Jean Weber

ANNEX TO THE LETTER OF 6 JANUARY

Information Sheet

The Community Movement System for goods

In order to remove systematic controls on goods at the internal borders of the Community the Commission is proposing a set of arrangements for the movement of goods within the single market involving the requirement to pay VAT in the country of consignment of the goods, refund in the country of destination by a system of financial compensation, and the introduction of a new system of trade statistics, essentially of a voluntary nature. The statistical declaration of the movements of goods, which would remain, would no longer be linked to the tax declaration.

Such a highly innovative system has been criticized on various grounds: its complexity, the lack of security with regard to recovery of charges, and the possibility of disputes between Member States.

Preliminary discussions have therefore been held concerning another set of arrangements. For the sake of simplicity it will be referred to here as "The Community Movement System".

These arrangements may be described under two headings: the first concerning procedure and the second concerning the document for declaration purposes.

1. Procedure

1.1 Summary of the current arrangements

Customs procedures are the same, regardless of the origin or destination of the goods: administrations make little distinction, in clearance and transit formalities, between intra-Community and extra-Community movements.

Trade proceeds in accordance with Community rules. These rules provide for the use of customs declarations of a single, standard kind (the "single administrative document" - SAD) and use of a transit procedure common to all Member States (Community transit) allowing transfer of goods "under customs control" from one country to another and ensuring that they are registered by customs in the country of destination.

The different types of procedures currently in use lead to a number of restrictions on traders - at departure, in transit, and on arrival of the goods. These include:

the requirement to lodge a customs declaration giving about fifty items of information for customs, taxation and statistical purposes, either singly, for clearance operations carried out at the customs office, or in summary form on a ten-day or monthly basis for clearance operations carried out at the trader's premises;

the requirement to produce goods at the customs office, or in the case of simplified procedures at the premises, to inform the administration of any movement in progress, on consignment or on receipt. The procedures are based in all cases on the possibility of monitoring the actual movements of goods, and thus, at importation, of being satisfied that the declaration is accurate and that VAT is correctly charged before release to home use;

payment of VAT in cash or guaranteed where deferred payment is permissible

the requirement to transfer goods "under customs control" from one Member State to another under cover of a Community transit form issued against deposit of a guarantee and to lodge a transit advice note at the border office of the country of destination given on the form.

Such formalities as these cause delays of varying length, depending on the procedure, and lead to relatively high costs for the traders involved.

However, it is true to say that these procedures ensure that in France today around 99.9% of VAT payable on importation is recovered. Furthermore, the Community transit procedure is very reliable since, in France, the rate of non-discharge of the 14 million movements recorded in 1987 is close to 1% after a year, or even less than this if it is assumed that most inquiries started at Community level during that period to trace such consignments will succeed in recovering the VAT payable.

1.2 The Community Movement System for goods

A. Goods are no longer produced at the customs office. They are consigned, received and cross borders without restriction, under cover of commercial documents, without prior notification or any special customs formalities.

B. Eliminating the above formalities enables the following to be abolished:

the necessity to notify customs of departure and arrival;

the necessity to lodge individual customs declarations;

Community transit forms and all the restrictions these involve;

transit advice notes and delays at borders;

costs caused by clearance and transit formalities, as well as by delays at borders.

C. Consignors and consignees (taxable or non-taxable institutions, i.e. financial institutions, insurance companies, hospitals, etc.) are assigned to a local office of the competent administration. This office is responsible for monitoring the flow of goods on the basis of accompanying documents, periodic declarations of consignments and receipts and the registration of such movements in which traders are involved. It is also possible for a company to be assigned to more than one office.

D. To be specific, goods freely leave the premises of the consignor company; they are accompanied throughout their journey by a document bearing their description and naming the consignee and the consignor's local office. The goods are taken direct to their destination without stopping at the border.

Within a time limit to be agreed (e.g. every ten days or each month) the company which consigned the goods sends a return to its local office summarizing all its consignments.

For its part the consignee sends its own local office two copies of the accompanying document and a periodic return of all consignments received. One copy of the accompanying document is returned after authentication by the consignee's local office to the consignor's local office. The latter may thus check the periodic return of consignments and satisfy itself that VAT was paid in the Member State of destination.

E. The system works in the same way for non-taxable institutions which are assigned to a local office and required to enter periodic returns with payment of VAT.

F. This system of cross-checking works well because it operates in the mutual interest of the Member State of consignment and the Member State of destination: the one ensures that the goods have actually left its territory, and are therefore entitled to exemption, whilst the other ensures that VAT has been paid on any goods entering its territory.

This exhaustive cross-checking, based on the return of a form by the office of destination to the office of departure, which already occurs under Community transit (see above), could be improved:

by increasing the number of staff carrying out such jobs (by redeploying some customs officers currently involved in physical and documentary controls of intra-Community trade);

by improving automatic transmission of data between different customs administrations, and between customs administrations and traders;

by promoting the use of information technology by traders, enabling despatch and receipt of goods and their legal status to be ascertained at any time, within the company;

by making all arrangements genuinely Community-wide - there should be frequent inspections by officers of the Commission to ascertain the effectiveness of the administrations running the system, officials on detached duty with the customs authorities of Member States other than their own, and the possibility of excluding from the procedure those Member States which seriously and repeatedly fail to fulfil their obligations (and thus to treat them as non-member countries).

G. To prevent goods being consigned within the Community without invoices, the following action could be taken, in addition to cross-checking:

checks on goods during consignment (ensuring that there is an accompanying form and that the load agrees with the particulars on it) together with simultaneous verification with the consignee's records;

spot checks at loading or unloading of goods - this would be easier to carry out than the types of verification currently employed at intra-Community borders, and less inconvenient for traders (the means of transport would not be held up). Such checks could be coordinated between customs administrations.

The form of declaration

The requirement to make a declaration will of course remain in the Community Movement System to ensure payment of VAT, and also to enable statistics on external trade to be compiled.

Such a requirement also occurs in the Commission's proposal, the only new feature of which is to recommend the separation of tax and statistical requirements.

Before setting out the proposals in detail, it would be advisable to describe the present position.

2.1 The present position

The basis of collecting statistics is the customs declaration which comprises about 50 items of information, some of which are used mainly for compiling public statistics (trade balance, balance of payments, national finances, transport statistics, etc) and for providing information to traders.

As a secondary feature, they enable customs controls to be put to best effect by means of a statistical analysis of trade.

Data capture on foreign trade is exhaustive, whatever the mode of transport used or the size of the company involved. Information on intra-Community trade is gathered in exactly the same way as that on trade with non-member countries.

2.2 Proposals

The need to retain information on intra-Community trade operations was strongly reasserted.

The top 20,000 French firms, out of a total of about 130,000 involved in intra-Community trade, account for 97% of all trade.

The proposals put forward in this respect are based on this fact.

Companies' statistical obligations will remain since they are linked to their tax obligations, and these are controlled by the system set up by the local offices to gather data on trade.

However, such obligations would be reduced considerably compared with the present system, in two ways:

- a simplified declaration procedure would be available to traders whose importations and exportations within the Community were less than a fixed amount per operation (eg 100,000 francs) and an annual turnover figure (eg 500,000 francs).

The only information which these traders would have to pass on to the authorities would be the ten or so items of information needed for checking the basis of assessment and the payment of VAT (consignor, consignee, value, rate, etc).

In particular, they would no longer need to supply the 13-digit customs nomenclature number used to describe the goods (eg 64 03 59 91 00 00 P for children's footwear with soles of leather).

As a result, foreign trade statistics would remain correct, particularly with regard to the balance; however, as far as the description of the goods involved was concerned, one line would cover the operations of these traders under the simplified procedure.

The annual ceilings would be set each year in such a way that this line would be restricted to about 3% of the total: thus the interests of foreign trade statistics would not suffer in any way.

- a standard declaration procedure would be available to all other traders. In addition to the ten or so items of information needed for VAT control purposes, these traders would have to supply the nomenclature number for the goods concerned, by transcribing the commercial references shown in their tariff. Thus for those carrying out 97% of trade by value, detailed statistics for products could be given.

However, certain data currently gathered exhaustively (eg transport, financial transactions) could be obtained by test-checks made on the traders.

The (exhaustive) data gathered for the basis of assessment of VAT could constitute the essential test-check basis for applying this system. Different levels of checks would be possible, where the checking rates could be varied according to the significance of the results, using a low rate for firms with an average amount of trade. This would apply even more if the data gathered by test-checks seemed to be very consistent.

In these circumstances, whilst reducing the constraints currently placed on all firms, it would be possible to obtain more valuable economic data by introducing on the same basis queries covering all aspects of intra-Community trade. Traders, national authorities and Community authorities would therefore have at their disposal an additional source of data.

Finally, it should be stressed that firms questioned would be selected before the start of the period in question, so that they would have no difficulty in replying to the questions without having to consult their accounts or their files to describe operations carried out in the previous period.

*

* *

The proposed system is original. It is in the spirit of the Community, and differs from other systems (eg the Benelux system) in that it eliminates the need to stop at frontiers, it makes use of exhaustive cross-checking (and not just test-checks) and it introduces an accompanying document which enables the status of the goods to be checked at any time.

Doubtless further improvements could be made to this scheme once the Community has been able to reflect on these initial ideas.

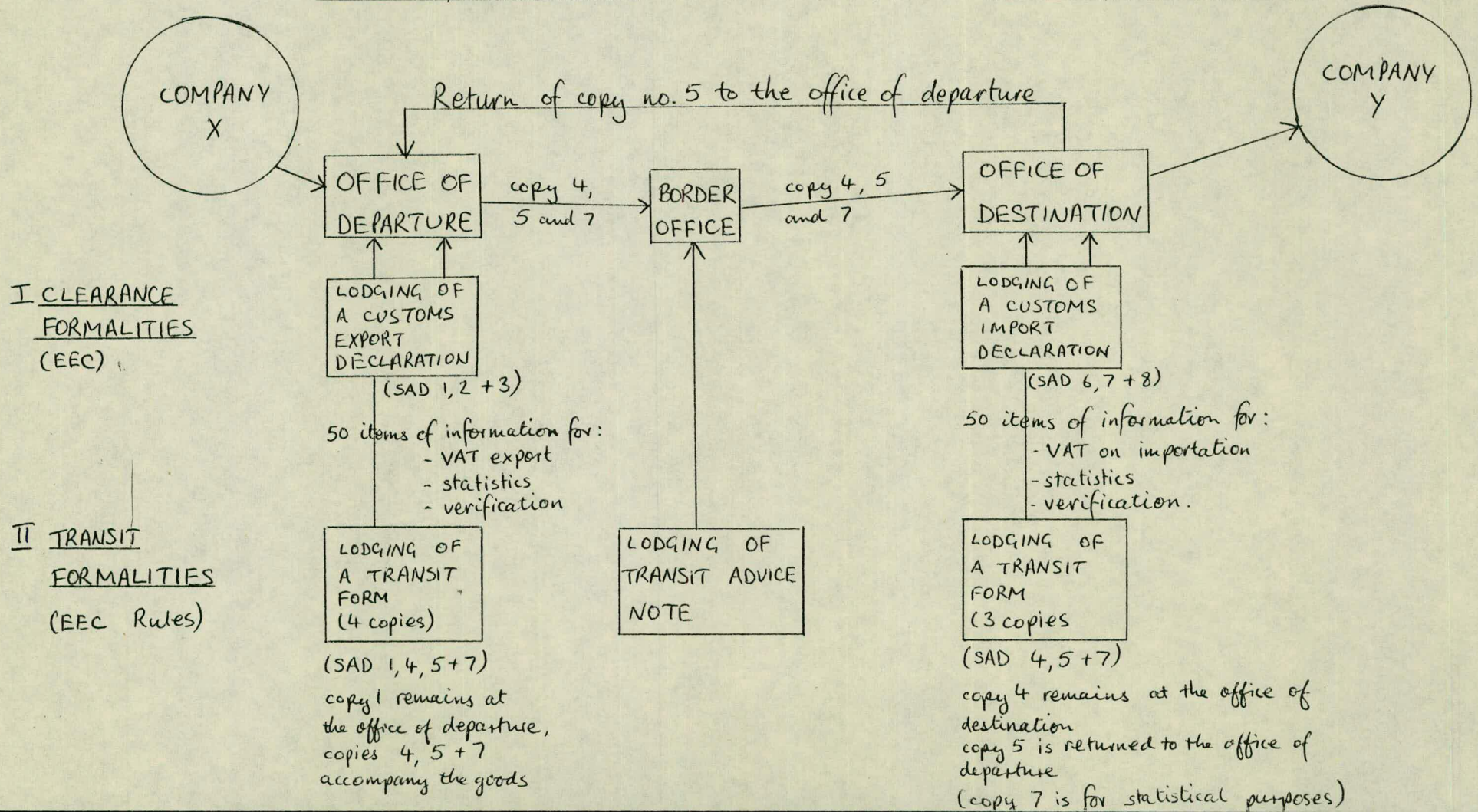
COMMON CLEARANCE AND TRANSIT PROCEDURE

(at the Customs Office)

CURRENT POSITION

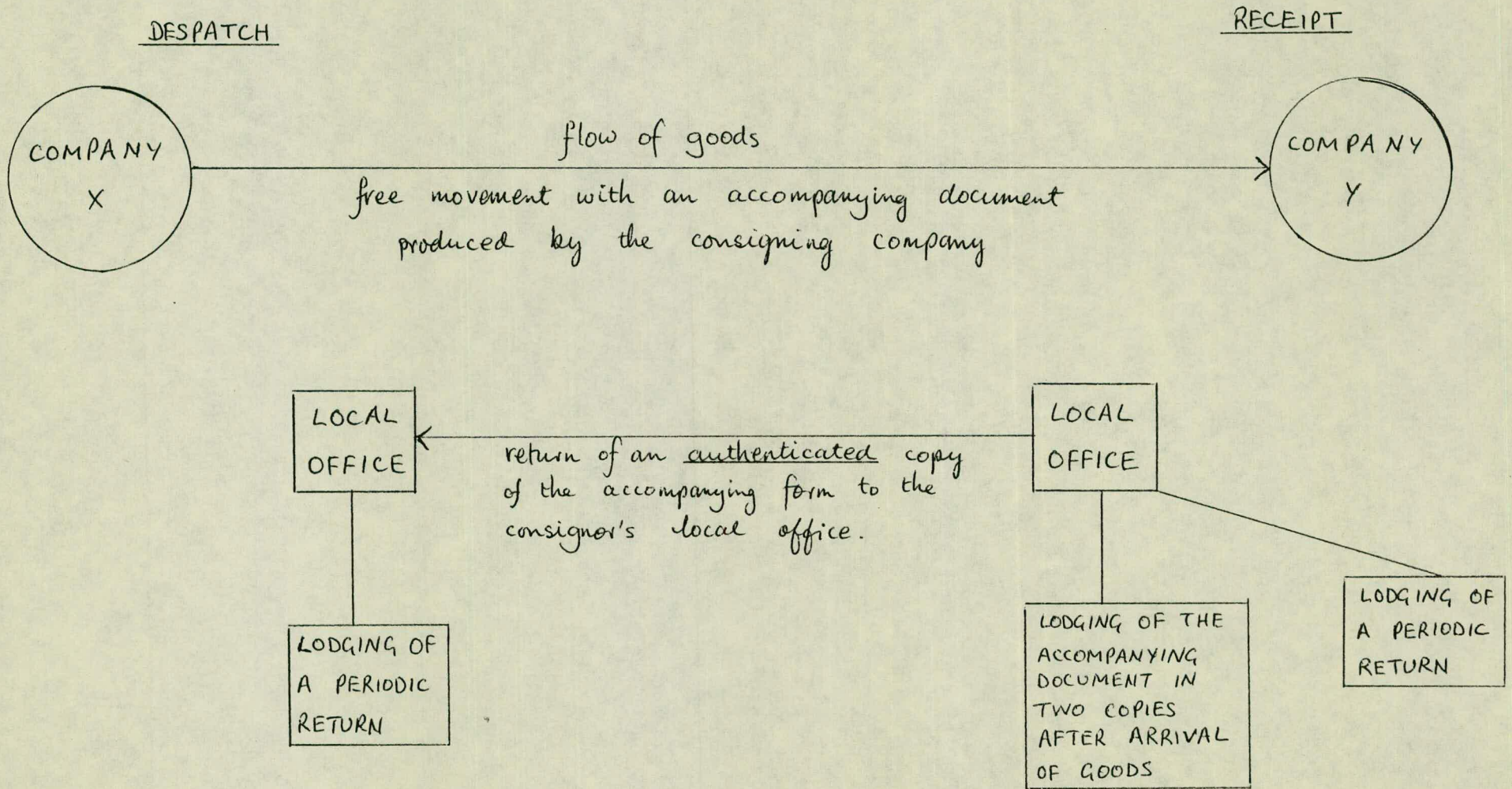
DESPATCH/EXPORTATION

RECEIPT/IMPORTATION



DECLARATION AND VERIFICATION PROCEDURES IN INTRA-COMMUNITY

TRADE





FROM: J M G TAYLOR

DATE: 19 January 1989

A large, stylized handwritten signature in dark ink, possibly reading 'JMG'.

MR ILETT

cc PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Wicks
Mr Lankester
Mr Scholar
Mr R I G Allen
Mr Culpin
Mr Odling-Smee
Mrs M E Brown (EC)
Mr Gilhooly
Miss O'Mara
Mr Kroll
Mr Neilson
Mr Ritchie
Mr Sharples

Mr Isaac IR
Mr Corlett IR
PS/IR

TAXATION OF SAVINGS: "THE LEBEGUE REPORT"

The Chancellor was most grateful for your note of 12 January, and the enclosed assessment of the Lebegue report.

2. He notes (your para 10) FIM's view that there may be a case for a measure of harmonisation of minimum tax rates in the specific area of taxation of savings vehicles (as opposed to individuals' income from savings). He has commented that we will clearly need to discuss this in due course.

A handwritten mark or signature in dark ink, possibly a stylized 'JMG'.

J M G TAYLOR



Office of the United Kingdom Permanent Representative
to the European Community
Rond-Point Robert Schuman 6 1040 Brussels

Telephone 230 62 05

Mr Hebb thinks it would be helpful to give an authoritative UK
view early but no great harm
if Chancellor cannot go. I agree. Must But
PS/Chancellor the April, May
and June meetings
Mr Nicks an far more
Mr Lambester important

Ms S Symes
HM Treasury
LONDON

MUFAX
(11 a.m.)

Your reference

Mr RIG Allen Dixie by me

Our reference

Mrs Mc Brown 23

Date 23.01.89

Mr Hebb 1.

Dear Susan

ECOFIN 13 FEBRUARY: TAXATION OF SAVINGS

1. You asked whether there was likely to be substantive discussion of the Commission's proposal.
2. The Delors Cabinet (Dixon) say that the Commission will not want to do more than present the proposal. I am still trying to get in touch with Mrs Scrivener's Cabinet but would expect that to be their view too.
3. Pini (Council Secretariat) sees no useful purpose in a substantive discussion on 13 February and wonders whether delegations will by then have had the Commission's proposals long enough for well-informed comment to be possible. But he says that the Spanish Presidency from Solchaga down are determined to have a discussion of substance at next month's Council, if only to show that EcoFin Councils under the Spanish Presidency are a serious affair. Since Pini has been in personal contact with Solchaga in recent days, I have no reason to doubt his account.
4. So it seems that, if the Chancellor decides to come to the February EcoFin, there will be an opportunity for him to make known his views on this subject. But it is in the nature of initial reactions to Commission proposals that everyone will keep their powder dry and that there will be no negotiation until the High Level Group has examined the Commission's proposals. So if you were to ask me about the importance of the Chancellor's coming to the February Council relative to the April and June meetings (and of course the May informal) I would say that it is the second half of this Presidency which is likely to see some action on fiscal questions - as well of course as on EMU.

Yours sincerely
David Bostock

D J Bostock

(X)

Ch, Refermt to Item 6.

See Mr Bostock's letter behind,

written after this minute. I

think this boils down to you

not going to this ECOFIN.

PS/CHANCELLOR

FROM: MS S SYMES
DATE: 23 JANUARY 1989

cc: Mr Wicks
Mr Lankester
Mr R I G Allen
Mrs M E Brown
Mr Ilett

ECOFIN 13 FEBRUARY

23/11

We spoke this morning about whether the Chancellor might wish to consider attending this meeting, as the Commission proposals ^{on withdrawing taxes} will be presented then (although the rest of the agenda, perhaps NICV and two own resources implementing regulations, is very thin).

2. UKREP have previously advised that there will be no discussion, but the agenda is otherwise very thin and the Presidency do attach great importance to this subject. So as we agreed, I asked David Bostock to check again with M. Pini. But David Bostock warns that we can never really tell until we get there!

Susie Symes

MS S SYMES

RESTRICTED
 FM UKREP BRUSSELS
 TO IMMEDIATE FCO
 TELNO 213
 OF 261730Z JANUARY 89
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ADVANCE COPY

FRAME ECONOMIC

COREPER (AMBASSADORS) 26 JANUARY: TAX HARMONISATION (PROCEDURE)

SUMMARY

1. PRESIDENCY CONFIRMS INTENTION OF SETTING UP AD HOC GROUP TO DISCUSS TAX ON SAVINGS: ON INDIRECT TAX, AGREEMENT ON PROCEDURAL RECOMMENDATIONS MADE BY COMMISSION IN DECEMBER: COREPER TO CONSIDER VAT RATES AND BANDS AND EXCISES: FQG THE COVERAGE OF A REDUCE RATE: AND A COMMISSION WORKING PARTY THE CLEARING HOUSE. FQG TO CONTINUE WORK ON 3 DIRECT TAX COOPERATION MEASURES AND 18TH VAT DIRECTIVE.

DETAIL

TAX ON SAVINGS

2. WESTENDORP (PRESIDENCY) CONFIRMED THE PRESIDENCY'S INTENTION TO SET UP A SPECIAL GROUP TO LOOK AT THE TAX ON SAVINGS PROPOSALS WHEN THEY EMERGED FROM THE COMMISSION EARLY NEXT MONTH. THE GROUP WOULD BE 'AD HOC' RATHER THAN 'HIGH LEVEL', AND FORMALLY WOULD REPORT TO ECOFIN THROUGH COREPER. THE PATTERN OF WORK MIGHT BE FOR THE GROUP TO ANALYSE THE COMMISSION'S PROPOSALS, WITH THE LATER TASK OF FINDING COMPROMISES LEFT TO COREPER. SOLCHAGA (CHAIRMAN OF ECOFIN COUNCIL) WANTED REPRESENTATIVES TO BE AT DIRECTOR GENERAL/PERMANENT SECRETARY LEVEL AND TO COMBINE MACRO-ECONOMIC AND TAX EXPERTISE.

3. THE AD HOC GROUP WOULD MEET AT LEAST TWICE (PERHAPS ON 20 FEBRUARY AND 9 MARCH): COREPER COULD THEN DISCUSS ON 6 AND 13 APRIL PRIOR TO DEBATE IN ECOFIN ON 18 APRIL AND INFORMAL ECOFIN 19-21 MAY AND, HE HOPED, DECISION AT ECOFIN ON 19 JUNE (IE MEETING THE DEADLINE IN THE 1988 CAPITAL MOVEMENTS DIRECTIVE.)

4. THERE WAS A LITTLE GRUMBLING FROM SOME OF MY COLLEAGUES ABOUT THE PROLIFERATION OF AD HOC GROUPS, ABOUT THE NEW GROUP'S RELATIONSHIP TO COREPER, AND ABOUT FINDING A SUITABLE REPRESENTATIVE (SEND MORE THAN ONE, SAID WESTENDORP). BUT NO ONE OPPOSED THE PRESIDENCY'S PROCEDURE.

OTHER DIRECT TAX MEASURES

In part, TL

*1. Westendorp
 Mr Scholar
 perhaps
 supported by
 Mr Lett.*

5. WESTENDORP SAID THAT, BEGINNING ON 9-10 FEBRUARY, THE FINANCIAL QUESTIONS GROUP WOULD BE PRESSING AHEAD WITH THE THREE DIRECT TAX MEASURES TO ENCOURAGE COOPERATION BETWEEN ENTERPRISES IN DIFFERENT MEMBER STATES (DRAFT PARENTS AND SUBSIDIARIES DIRECTIVE, MERGERS DIRECTIVE AND ARBITRATION CONVENTION).

INDIRECT TAX

6. WESTENDORP RECALLED THAT SOLCHANGA HAD UNDERTAKEN AT THE DECEMBER ECOFIN TO COME FORWARD WITH PROCEDURAL SUGGESTIONS ON THE PACKAGE OF INDIRECT APPROXIMATION PROPOSALS. THE PRESIDENCY'S VIEW WAS THAT THE FOUR RECOMMENDATIONS MADE BY THE COMMISSION AT THE TIME WERE ACCEPTABLE: IE

(I) COREPER TO LOOK AT THE VAT (STANDARD) RATES AND BANDS AND

(II) EXCISES:

(III) FQG TO CONSIDER THE SCOPE AND COVERAGE OF A VAT REDUCED RATE (BAND): AND

(IV) COMMISSION WORKING PARTY TO EXPLORE FURTHER THEIR CLEARING HOUSE PROPOSAL.

7. IN ADDITION HE HOPED FOR RAPID PROGRESS IN FQG ON THE (1984) DRAFT 18TH VAT DIRECTIVE (WHICH SEEKS TO END CERTAIN DEROGATIONS FROM THE SIXTH DIRECTIVE). HE SAW THIS AS THE KEY TO PROGRESS IN OTHER AREAS.

8. I AGREED THESE PROCEDURAL PROPOSALS AND ASKED FOR SOME INDICATION ON TIMING. WESTENDORP HOPED COREPER WOULD MEET 'SOON' TO DISCUSS VAT RATES AND EXCISES: ON REDUCED RATE COVERAGE, COREPER WOULD MEET AS SOON AS IT RECEIVED A REPORT FROM FQG. TROJAN (COMMISSION) AGREED WITH THE PROCEDURE SUGGESTED AND UNDERTOOK TO LET AMBASSADORS KNOW WHEN THE COMMISSION WORKING PARTY WOULD MEET TO DISCUSS THE CLEARING HOUSE.

9. NO-ONE SPOKE AGAINST THE PRESIDENCY'S PROCEDURAL RECOMMENDATIONS. GRUNHAGE (GERMANY) ASKED IF URGENT ATTENTION COULD ALSO BE GIVEN TO THE DRAFT SEVENTH VAT DIRECTIVE (SECOND-HAND GOODS AND WORKS OF ART). WESTENDORP SAID HE UNDERSTOOD THAT A PROPOSAL FROM THE COMMISSION WAS IMMINENT (CONFIRMED BY TROJAN), WHICH THE FQG WOULD MEET TO DISCUSS AS SOON AS IT APPEARED.

HANNAY

YYYY

delay is to give Mme Scrivener time to consult Luxembourg. Cabinets are meeting on 3 February (today week); the Commission hopes to adopt on 8 February. More important, Ministers will want to settle how to handle the initial discussion at ECOFIN on 13 February. Sir D Hannay expects negotiations to last into the French Presidency.

Mutual Assistance

3. This is a proposal to amend the 1977 Directive. That said that Member States cannot be obliged to make enquiries or hand over information to other Member States if

- (i) they do not have powers to get the information for their own purposes; or
- (ii) their administrative practices prevent them from getting the information themselves.

4. The new proposal is that Member States should no longer be able to plead administrative practice, but "should exhaust every legal possibility when the Member State making the request cites specific grounds for supposing one of its taxpayers has transferred abroad significant funds ..."

5. This falls, of course, far short of the French Treasury's thought that they should be able to pursue French taxpayers in this country under French information powers. Depending on exactly what vague statements like "administrative practices", "specific grounds" and "significant funds" actually mean, there is a risk that the Inland Revenue would not be able to plead lack of resources or other priorities if it faced a request from another Member State. So there are potential resource implications. Also, it is not clear whether the home or host authorities would be responsible for handling the legal procedures required in some Member States. For example, would the French or British tax inspector have to convince the UK Commissioners that they should issue a warrant to obtain information about a Frenchman from a UK bank? The Revenue is looking urgently into these questions.

6. In short, this proposal is very much a second string to the withholding tax. The Commission is not prepared to take on a number of member states on banking secrecy - notably Germany as well as ourselves. Mr Fitchew has reportedly done well in suppressing more extreme proposals.

Withholding Tax

7. ^{The} Commission justify the withholding tax on predictable grounds. The explanatory memorandum alleges that the Council recognised that the liberalisation of capital movements should (my underlining) be accompanied by measures "to eliminate or reduce the risks of distortion, tax evasion...". This is arguably implicit in the instruction to the Commission to produce proposals, but the nuance is important.

8. The main features of the proposal are:

- (a) the tax is at 15% and would operate from 1 July 1990, ie the capital movements liberalisation date. Both home and host states could impose income tax above this if they want provided they credit withholding tax paid;
- (b) the tax does not apply to eurobonds, defined essentially as for the recent prospectuses directive (I have asked DTI to study this urgently);
- (c) the tax does apply to gilts and other public sector debt (Article 1) and inter alia to premium bonds;
- (d) the entire return on deep discount bonds is treated as interest and subject to the tax;
- (e) interest payments which banks automatically notify to the tax authorities of the recipient's member state are exempt;

- (f) interest payments to people who reside outside the Community are exempt;
- (g) there is a very wide French-style exemption for interest-bearing current and savings accounts denominated in member states' own currency (the latter test appears at odds with the theology of monetary union);
- (h) that element of income from UCITS (unit trusts etc) attributable to untaxed bond interest is to be deducted by the UCIT (goodbye Luxembourg);
- (i) member states need not tax "interest which constitutes commercial and industrial income for the recipients. They shall lay down the conditions governing any such exemption";
- (j) withholding tax charged to non-taxpayer must be refunded. (This would apply to CRT, as drafted);
- (k) member states shall account to each other for tax levied in one country and refunded in another - a complex clearing house procedure and a sensitive precedent;
- (l) double tax agreements are not overridden (this may be inconsistent with other bits of the proposal).

Assessment

9. There are two major problems;

- (a) Wholesale money markets. The exemption for "commercial and industrial income" is supposed to cover the inter-bank and wholesale money markets. There have been some indications that the Commission and the French may be prepared to accommodate our requirement for a ceiling. May be this is the first attempt at a form of words which would allow us to continue as at present. It is

very far from meeting our needs and others may well find it unacceptable;

- (b) The overall impact of the Directive on the retail sector. We shall need to take a view on whether the rigidities it threatens to impose, for example on the development of national savings products, multi-purpose bank accounts etc are such that we would not be prepared to accept it even if the wholesale market problem is solved, given that the policy justification is so weak.

10. A number of medium-sized problems are evident from the details above; how far do we want the French to get away with the exclusion of their substantial network of national savings-type accounts; can we live with the proposition that automatic declaration by bank to revenue should earn exemption from the tax; why the penal treatment of deep discount bonds; has the Commission got the frontier between equity and bonds exactly right; how can we or anybody else change the tax treatment of Government debt instruments already in issue as the Commission apparently are suggesting?

11. There will also be numerous small points.

Next steps

12. The Revenue, Treasury and Bank will be working on the details early next week. UKREP advise that the last chance for getting technical changes to the draft will be Friday 3 February at the meeting between Cabinets, but we could only hope to influence points of detail. Sir D Hannay is anxious that we should get as many technical improvements as possible into the Commission next week. Thereafter you will wish to decide how ECOFIN is to be handled. This is likely to be the only formal agenda item.

13. For the moment, press briefing can continue to be based on your Chatham House speech; we cannot comment on the details of the draft until it is in the public domain. We shall need a fuller line for 8 February.

14. Sir D Hannay recommends we should concert with friendly capitals before ECOFIN. UKREP is considering which these capitals are; certainly Luxembourg and probably the Hague, maybe Dublin. Bonn/Frankfurt is the important unknown. The others will be on the other side to a greater or lesser degree. Guidance to posts will also need careful preparation.

M.

N J ILETT

19 January 1989

R H T Gozney Esq
PS/Secretary of State for Foreign and
Commonwealth Affairs
Foreign and Commonwealth Office
King Charles Street
LONDON
SW1

CHANCELLOR'S MEETING WITH EC TAX COMMISSIONER

x The Chancellor held a meeting today with ^{Mme.} ~~Madame~~ Christiane Scrivener, the EC Commissioner in charge of tax affairs. ^{Mme.} ~~Madame~~ Scrivener was accompanied by her Chef de cabinet, M. Constant. The Financial Secretary, the Economic Secretary, Mr Lankester and Sir David Hannay were also present.

Tax on Savings

^{Mme.} ~~Madame~~ Scrivener said that she would put a proposal to the Commission on 1 February. She would propose a minimum withholding tax of 15 per cent on all interest earned by EC residents. She was not recommending that financial institutions be forced to declare ^{these} earnings to the fiscal authorities. Under her proposal, the ~~minimum~~ ^{tax} would not apply to (i) non-EC residents (in order to ^{avoid} provide a shift of savings to third countries), (ii) Eurobonds,

(iii) 'Passbook' accounts (because these related to "modest savings"), (iv) intercompany transactions. The proposals were not intended as a harmonisation measure, but as a minimal device to prevent fraud and the outflow of funds from the Community, following capital liberalisation. The 15 per cent rate appeared to her low enough to maintain the attractiveness of EC investment to ^{actual and} potential savers.

The Chancellor said he was grateful to ^{Mme.} ~~Madame~~ Scrivener for letting him know what she had in mind. He would give his preliminary reactions. He recalled Delors' statement that the financial services industry was one of the fastest growing in the modern world, and the Community should aim to be a world leader in it. He would strongly endorse this sentiment. There were three world financial centres - London, New York, and Tokyo - and London did not wish to lose business to the others. More generally, he did not wish to drive business away from the Community. He had to say that ^{Mme.} ~~Madame~~ Scrivener's proposal would have this ^e affect, for two reasons. First, there were large sums of mobile capital which would not tolerate any withholding ~~at~~ tax at all. Second, although non-residents were exempted from the proposals, they would still need to declare themselves. This would be unattractive to many actual and potential non-resident investors, and they would move their capital out of the EC. In general, therefore, he could not accept the proposals.

The Chancellor ^{doubted that the} ~~he wondered whether the~~ proposals were necessary. ^{The UK} We had abolished exchange controls in 1979, after 40 years of very rigorous regulation, and had suffered no damage at all of the kind that eg France was concerned about. He noted that the French were already likely to reduce their tax on savings - this would be consistent with the recommendations in the Lebegue report. France had, also, already abolished the overwhelming part of its exchange controls. So ^{it was} ~~they were~~ unlikely to ^{experience} ~~be~~ harmful effects from ^{the relatively small shift from to full} ~~fall~~ capital liberalisation. Even if ^{Mme.} Madame Scrivener introduced the proposals in the careful way she had outlined, there would be a serious loss of business ^{to} ~~away from~~ the Community.

^{Mme} ~~Madame~~ Scrivener ^{agreed} ~~said~~ that she did not want to see this loss of business. But there were some member states who ^{had} ~~could~~ not manage the 'violent change' to full capital liberalisation without some protection. France was one of these; Spain was another. She needed to take account of their wishes. She was proposing the absolute minimum necessary to bring ^{these member states} ~~them~~ on board. The Chancellor ^{his objections were practical, not} ~~he did not object to a withholding tax on ideological~~ grounds. For example, we had CRT, which he had himself extended to cover bank deposits. But ~~for purely practical considerations,~~ ^{importantly,} he had ~~set~~ a ceiling on CRT so that business would not be lost.

^{Mme.} ~~Madame~~ Scrivener said that she was not persuaded that savings would go to third countries if a withholding tax were introduced.

X She was persuaded that, if there were no such tax, there would be a big capital outflow and that Spain and France would need to impose frontier controls. Speaking personally, she could agree with the Chancellor's objective of full ^{and free} capital liberalisation. But her personal opinion was that it would be better to achieve this by ~~stelf~~ ^{stealth,} through the introduction of a withholding tax which could be reduced over time.

The Chancellor ^{repeated that} said he did not think he could possibly accept the proposal which ~~Madame~~ ^{Mme.} Scrivener intended to make. The fears of a capital outflow were quite unfounded. ~~Madame~~ ^{Mme.} Scrivener said that she had explained the situation as she saw it. The Commission would present its proposals to ECOFIN on 13 February. Capital liberalisation was, she thought, very important for Europe as a whole. The Chancellor agreed; it would not be possible to have the single market without it. ^{He noted that the Council had accepted capital liberalisation without any pre-conditions.}

Indirect taxation

^{Mme.} ~~Madame~~ Scrivener said that much work had already been done on VAT. But the Commission must recognise that the member states ^{had} ~~have~~ not been able to reach agreement. More work would be necessary. First, the clearing house proposals would need to be considered again. The current proposals did not seem acceptable. Second, more thought would need to be given to the possibility of defining VAT rates by product. She recognised the importance of the zero

rate in the UK and Ireland. She could not at this stage propose a solution to that problem; but it was clear that much more thought would need to be given to it. It was essential to look at the problems in a practical way. Work needed to be set in hand quickly.

The Chancellor welcomed ^{Mme.} ~~Madame~~ Scrivener's intention to take a more practical approach. He also agreed that the clearing house idea was a non-starter. Since his paper for the Informal ECOFIN in Crete, we ^{had} ~~have~~ undertaken more work. We believed it was possible to abolish substantially fiscal frontiers while retaining the existing system, the destination principle, and different rates of VAT and excise duties. As far as tax approximation was concerned, ^{he saw} there were two main ^{areas of difficulty} ~~problems~~ for the UK. We had always had zero rates on certain goods even before the introduction of VAT, and the Government was ^{these rates} ~~politically committed to retaining~~ ^{must be retained,} these rates on a permanent basis. He did not think that zero rates on food had a significant distorting effect in practice. Second, there were serious difficulties over excise duties.

^{Mme.} ~~Madame~~ Scrivener said it was necessary to approach the problem of excise duties more flexibly. She had some ideas, but could not go into details about them today. The Chancellor noted that in his Crete paper he had suggested a high minimum rate of duty on alcohol and tobacco goods, for health reasons. But he could see

X that a number of countries would not be prepared to sign up to this. Madame Scrivener agreed that excise duties were an enormous problem. The Commission would have to start a fresh.

X The Chancellor ^{said} ~~noted~~ that the Ceccini report had shown that the cost of ~~indifferences in~~ ^{different rates of} indirect tax was a tiny fraction of the cost of different technical standards in different member states. The Economic Secretary noted that the ^{principal} ~~principle~~ objective was to remove frontier controls. Tax approximation was only an intermediate objective. If it were possible, therefore, to achieve the main objective without going through the intermediate stage, that would be so much the better.

X The Chancellor said that a step-by-step approach ^{to harmonizing excise duties might} should be taken, eg through a gradual increase in travellers' allowances. ^{Mme.} Madame Scrivener said she was attracted to this approach. But the steps taken should not be too small: ^(pressure should be kept up.) The Chancellor said he ~~agreed with this general principle.~~ He noted, however, that in ^{sometimes (e.g. in financial markets)} financial markets even a small step had a big effect. Care should be taken.

Sir David Hannay said that the excise sector was a major test case. Discussions so far had shown that approximation was not a viable route. Even if a step-by-step approach were taken, we would not achieve the abolition of frontiers for decades (^{Mme.} Madame Scrivener agreed). We should, therefore, look to see

whether other ways could be found of abolishing frontiers. We would ourselves have some ideas to put forward. The Chancellor said we were looking positively at the problem. The approach we were considering could be applied both to VAT and to excise. But the Community should, as far as possible, rely on market forces. Madame Scrivener agreed with this. M.Constant said the Commission would be studying the problem of excise again during February. It might then come forward with new proposals.

Double taxation

Madame Scrivener referred to the three directives. The Chancellor confirmed that we had no difficulties with these. If it were proposed to table them again at ECOFIN, we would support the Commission. He noted that he would not be able to attend the March ECOFIN, because of the imminence of the Budget.

I am copying this letter to Trevor Woolley (Cabinet Office).

AP At the end of the meeting, Mme. Scrivener handed over the 'non-paper' (attached) which she had used as a speaking note.

J M G TAYLOR

Private Secretary



FROM: J M G TAYLOR
 DATE: 30 January 1989

BF 6
Alex
1/2

MR N J ILETT

Alex
MB X
R

cc PS/Financial Secretary
 PS/Paymaster General
 PS/Economic Secretary
 Sir P Middleton
 Sir T Burns
 Mr Wicks
 Mr Lankester
 Mr Scholar
 Mr R I G Allen
 Mr Culpin
 Mr Odling-Smee
 Mr Peretz
 Mr Gieve
 Mr Gilhooly
 Mr Sharples
 Ms Symes
 Mrs Chaplin
 Mr Tyrie

Mr Isaac - IR
 Mr O'Connor - IR
 Mr Sullivan - IR
 PS/IR

COMMISSION PROPOSALS ON THE TAXATION OF SAVINGS

The Chancellor was most grateful for your note of 27 January.

X | 2. He agrees with Sir David Hannay's recommendation (your paragraph 14) that we should concert with friendly capitals before ECOFIN; he would like to know as soon as possible where other countries stand. Meanwhile, he will raise this with Stoltenberg in the margins of G7 later this week.

3. He has commented that, incidentally, the allegation in the explanatory memorandum that the Council recognise that the liberalisation of capital movements should be accompanied by measures "to eliminate or reduce the risks of distortion, tax evasion" is wholly unwarranted, and we should insist on its being altered forthwith.

JMG

J M G TAYLOR

FROM: N J ILETT

DATE: 31 JANUARY 1989

CHANCELLOR

cc: Financial Secretary
 Paymaster General
 Economic Secretary
 Sir P Middleton
 Mr Wicks
 Mr Lankester
 Mr Scholar
 Mr R I G Allan
 Mr Culpin
 Mr Odling-Smee
 Mr Peretz
 Mrs Brown
 Mr Michie
 Mr Sharples

Mr Corlett IR
 Mr O'Connor IR
 Mr C D Sullivan IR
 PS/IR

Ch. Content that UKREP
 Should pass on these technical
 comments?

2/31/1

John

PS - V. important
 will be kept
 close to
 the bank
 No touch
 LR

WITHHOLDING TAX

My submission of 27 January reported the likely content and timing of the Commission's proposals. We are now seeking your authority to pass a list of technical comments to the British Cabinets, via UKREP, without prejudice to our negotiating position. This has to be done immediately if there is any chance of influencing the contents of the Directive before it is published. A decision by tomorrow morning would therefore be very helpful.

2. You have already said that we must press strongly for the allegation that the Council has decided that tax measures are desirable to be removed from the introductory memorandum.

3. There is a tactical point to be decided first. Given the strength of our objections to the principle of a withholding tax, and the deficiencies and uncertainties, not to say contradictions, of the draft directive, is it wiser not to offer any comment at this stage? The argument would be that we might make the text look less silly while it remains no less objectionable.

4. Against that, if we fail to respond at all, key people in the Commission will think we are being deliberately unhelpful and will say later that silence implied indifference or consent. Sir D Hannay's strong advice is that we should give quick technical comments privately. EC, FP and FIM Divisions and the Revenue agree. So we have drawn up a list of comments, which I attach.

5. However, we were conscious in drafting the note that we should avoid giving the Commission any comfort on the key points - the definition of eurobonds (ie whether the proposed exemption works) and the exemption for inter-company transactions (where the Commission is clearly on the wrong track in talking of commercial and industrial income, but is we judge as yet unwilling to stomach a cut-off like our £50,000 limit on CRT). So the draft is low-key in tone and avoids endorsing even on technical grounds any element of the Commission's text.

6. We do not expect this exercise will achieve much in the way of amendments to the text; but it should leave the Commission in no doubt about the scale of the technical task which it will have to undertake when detailed negotiations begin. One telling point is that it will be very difficult to get tax changes of this magnitude in place by 1 July 1990, as systems as well as legislation are involved.

Other countries' positions

7. You asked for advice as soon as possible on where other countries are likely to stand. I attach Mr Bostock's provisional assessment, based on UKREP contacts. This is rather as we expected. The FCO is telegraphing posts for their assessment, and Mrs Brown has telephoned the Embassy in Bonn to underline the need for a reply before you meet Herr Stoltenberg later this week.

M.

N J ILETT

PROPOSAL
FOR DIRECTIVE

- 1 -

PROPOSAL FOR A COUNCIL DIRECTIVE

ON A SYSTEM OF WITHHOLDING TAX ON INTEREST INCOME

Explanatory memorandum1. General considerations

1. In adopting Council Directive 88/361/EEC⁽¹⁾ on 24 July 1988, the Council of Ministers recognized that the liberalization of capital movements should be accompanied by measures to "eliminate or reduce the risks of distortion, tax evasion and tax avoidance, linked to the diversity of national systems for the taxation of savings and for the control of the application of these systems".
2. As explained in the Communication to the Council, to which the present proposal is attached, the Commission believes that the most effective measure for combatting international tax fraud is a Community-wide withholding tax at source on payments of interest income made by Community debtors and issuers to all Community residents. The present Directive accordingly provides for the introduction of such a tax; The most important loophole in Member States' national tax systems is that in most cases they make no provision for the taxation of interest to non-residents. The main purpose of the present proposal is accordingly to block this loophole.
3. While this measure does not guarantee the full application of progressive taxation to the income in question, it will ensure that a minimum level of taxation is applied to all investment income arising within the Community and will thus discourage Community investors from *dividends* transferring funds to other Member States solely in order to evade paying tax.
4. The Commission considers that the minimum rate of withholding tax should be 15%. In proposing this rate the Commission has had regard to :

(1) O.J. L 178, 8.7.1988, p.5

- the range of withholding tax rates at present applied in Member States (0%-35%);
 - the need to set the rate at a level which will discourage capital movements solely for tax purposes;
 - the risk that the imposition of the tax will lead to upward pressures on interest rates;
 - the risk that too high a rate of tax could lead to a diversion of savings outside the Community.
5. The Commission considers that the tax should be designed to fit as easily as possible into the existing domestic tax systems of Member States. It is accordingly proposed that the tax should have the following characteristics :
- (i) it should be a minimum rate of withholding tax. Member States would remain free to apply a higher rate of tax either to their own domestic taxpayers or to all Community residents;
 - (ii) Member States having an effective system of automatic declaration of interest payments by their banks to their own tax authorities would be permitted to apply the withholding tax to Community residents from other Member States only;
 - (iii) Member States would have the option to disapply the tax in the case of all interest payments constituting industrial or commercial revenues and all interest payments to residents of third countries.
6. In addition it is proposed that Member States would be free to exempt certain international loans ("Eurobonds") meeting defined criteria. This exemption already applies in a number of Member States. Moreover, in the Commission's view the application of the withholding tax to Eurobond issues would either disadvantage major European companies in comparison with their international competitors through

the increase in the cost of their borrowing or drive them to escape the tax through establishing off-shore subsidiaries as vehicles for borrowing.

7. As indicated in the Commission's Communication of 4 November 1987, no system to prevent tax fraud is likely to be water-tight. The Commission therefore considers that in the long-run the Community should consider the possibility of negotiations with its major trading partners, for example in the OECD, in order to reduce the risk of capital outflows to third countries.

II. Comments on certain articles

Article 2

1. For the purpose of the tax arrangements established by the Directive, the term "interest" covers all income from claims of any kind, even if those claims carry a profits participation clause. The expression "claims of any kind" of course includes cash deposits and cash guarantees, public debt securities and bond loans. Moreover, claims, and in particular bonds which entitle the holder to participate in the debtor's profits, are still regarded as loans if at least the contract is, overall, clearly one for an interest-bearing loan.

The second sentence of the first paragraph excludes penalties for late payment from the definition of interest. Such penalties, which are the result of a contract, a practice or a judgement, consist of payments calculated on a pro rata temporis basis or of a fixed sum.

2. In the case of non-interest-bearing securities (zero bonds) or securities producing income made up partly of a relatively low rate of interest and partly of capital gain (deep discount bonds), the difference between the issue price and the redemption value is regarded as interest subject to withholding tax.

not
equivalent

withholding tax. Member States also retain complete freedom to decide whether or not to levy personal income tax on the income in question and whether or not withholding tax should be allowed as a credit.

Article 3

1. The debtor of the interest or its paying agent (financial institution) is required to apply withholding tax at the rate fixed by the Member State in which it is resident. The withholding tax is applied to securities issued inside or outside the Community, before or after the Directive comes into force, irrespective of whether the interest is paid inside or outside the Community and of the currency in which the loan was issued.
2. Where the interest is paid not in the Member State in which the debtor is resident but by an establishment located in another Member State which deducts the interest from its taxable profits, the withholding tax must be applied by the permanent establishment and paid over to the tax authorities in the Member State in which it is situated.

Article 4

Paragraph 2

Member States are free to apply different withholding tax rates to residents and non-residents. They are of course prohibited by the Treaty from applying a higher withholding tax rate to residents of other Member States than to their own residents.

Paragraph 3

- (a) This paragraph permits Member States not to levy withholding tax where the identity of the recipients of the interest is known to them and there is therefore no risk of evasion.

- (b) Member States are free not to levy withholding tax where the recipient is one of their residents and is not liable for income or profits tax (e.g. undertakings for collective investment in transferable securities, charitable institutions, low-income taxpayers).
- Article 4(b)
- (d) In order to ensure that a private individual is not required to comply with the formalities laid down by this Directive, particularly as regards the application of a withholding tax and payment of such sums to the tax authorities, Member States are free not to apply withholding tax in such cases (e.g. in the case of a private loan).
- (e) Member States are free not to levy withholding tax where the interest is not subject to income or profits tax (e.g. public loans).
- (f) Member States are free not to levy withholding tax on international loans (eurobonds), as defined in this sub-paragraph.

Paragraph 4

The Directive does not preclude application of agreements concluded between Member States where a taxpayer wishes to benefit from a lower rate of withholding tax provided for under such an agreement, since he may benefit from such agreements only by declaring the income in question to his national tax authorities. It goes without saying that in such cases the recipient may set against his personal tax (see Article 8) only that amount of withholding tax still borne by him.

Article 5

Member States are free not to levy withholding tax on interest paid on sight current accounts which, if they bear interest at all, do so only at a very low rate, or on savings accounts in view of their social nature, where these are denominated in their own currency.

Article 6

In the case of undertakings for collective investment in transferable securities (UCITS) there are two possibilities :

- either the withholding tax is transferred as an allowable credit to the unitholder, in which case the redistribution of interest by the UCITS is exempt from withholding tax;
- or the withholding tax is not applied or is refunded, in which case the redistribution of interest is subject to withholding tax.

In both cases, unitholders are entitled to set the withholding tax against their personal tax and to a refund of any amount in excess.

equities.

Article 7

Member States are free not to levy withholding tax on interest which constitutes commercial and industrial income for the recipients, as there is no risk of evasion because those recipients are subject to full tax control.

Article 8

As withholding tax is simply a payment on account towards the definitive tax payable by the recipient of the interest, it must clearly be allowable as a credit or be refunded if the recipient is not taxable.

Article 9

1. In order to ensure that the budgetary cost of crediting or refunding the withholding tax under the items of Article 8 is borne by the Member State in which the income arose, this paragraph provides for financial compensation between the two Member States concerned.
2. The two Member States concerned may arrange, on the basis of a bilateral agreement, to divide the amount of withholding tax between each other, provided that the rights of the recipients of the interest as regards the crediting and possible refund of the tax in their own Member State are not affected.

Proposal for a Council Directive
on a system of withholding tax on interest income

THE COUNCIL OF THE EUROPEAN COMMUNITIES

having regard to the provisions of the treaty establishing the European Economic Community and particularly Article 100,

having regard to the opinion of the Economic and Social Committee,

having regard to the opinion of the European Parliament,

whereas the Council directive 88/361/EEC ⁽¹⁾ provides that Member States shall abolish not later than 1 July 1990 restrictions on movements of capital taking place between persons resident in Member States;

whereas the complete liberalization of capital movements in the Community entails risks of distortion, tax evasion and tax avoidance linked at the diversity of national systems for the taxation of savings and for controlling the application of these systems;

whereas the application of a general withholding tax guarantees a minimum taxation of interest paid by a debtor which is resident in the Community,

whereas it is necessary to allow Member States not to levy a withholding tax in cases where the risk of fraud is remote;

whereas the intervention of an undertaking for collective investment in transferable securities should put the recipient of interest exactly in the same situation as if the interest had been paid directly to him;

whereas the withholding tax should be simply a payment on account of the final tax liability of the recipient of interest; whereas in order to avoid complicated formalities, any possible excess of tax ought to be repaid by the State in which the recipient is resident; whereas Member States must nevertheless be allowed to conclude bilateral agreements on the sharing of budgetary costs resulting from these provisions;

whereas a withholding tax should be introduced not later than 1 July 1990, at which moment the complete liberalization of capital movements will be achieved,

HAS ADOPTED THE PRESENT DIRECTIVE :

Article 1

Member States shall apply, in accordance with the provisions of this Directive, a common system of withholding tax to interest where the debtor is a Member State or a political subdivision, local authority or a resident of a Member State.

Article 2

*premiums
bonds!*
For the purposes of this Directive, "interest" means income from claims of any kind, including premiums and prizes linked to public debt securities and bond loans. Penalties for late payment shall not be regarded as interest for the purposes of this Directive.

In the case of securities producing income made up exclusively or partly of a gain, "interest" means the difference between the issue price and the redemption price.

Article 3

1. The debtor of the interest or its paying agent shall deduct from the amount of interest due, a withholding tax the rate of which shall be fixed by the Member State in which the debtor is resident. It shall pay over the sums withheld to the tax authorities of that Member State in accordance with the conditions laid down by that State.
2. Where payment of the interest is effected by a permanent establishment of the debtor located in a Member State other than that of the debtor, the withholding tax shall be deducted by the permanent establishment,

in as much as this interest is a deductible charge for it, and shall be paid over to the tax authorities of the Member State in which it is situated.

Article 4

1. The rate of the withholding tax may not be less than 15%.
2. Member States may vary withholding tax rates according to whether interest is paid to their own residents or to non-residents.
3. Member States shall be free not to levy withholding tax on interest where:
 - (a) the name and address of the recipient and the amount of interest paid are automatically notified to the tax authorities of the Member State in which the recipient is resident;
 - (b) the recipient is one of their own residents and is exempt from income or profits tax;
 - (c) the recipient is a resident of a non-member country;
 - (d) the debtor of the interest is a private individual;
 - (e) the interest is not subject to income or profits tax;
 - (f) the interest is payable on an international loan ("Eurobond"), which is defined for the purposes of this Directive as a transferable security in the form of a bond, which :
 - is to be underwritten and distributed by a syndicate at least two of the members of which have their registered offices in different States,
 - is offered on a significant scale in one or more States other than that of the issuer's registered office and

*doubtful
that this
will
do*

- may be subscribed for or initially acquired only through a credit institution, as defined in Article 2 of Directive 77/780/EEC, or other financial institution.

4. The provisions of paragraph 1 shall not preclude application of the provisions of agreements which have been concluded between Member States or between Member States and non-member countries and which provide for lower rates of withholding tax.

Article 5

Member States shall be free not to levy withholding tax on interest paid on sight current accounts or savings accounts, where these are denominated in their own currency.

They shall lay down the conditions governing any such exemptions.

Article 6

Where interest redistributed by an undertaking for collective investment in transferable securities (UCITS) has not been charged withholding tax in the hands of that UCITS or where withholding tax has been refunded to it, that interest shall be subject to withholding tax if such tax would have been chargeable if the interest had been paid directly by the debtor.

In the contrary case, such interest shall be exempt from withholding tax.

However, withholding tax charged on interest in the hands of a UCITS shall be allowable against the amount of income or profits tax payable by the unitholder. It shall be refunded to him in the cases referred to in the second paragraph of Article 8.

Article 7

Member States shall be free not to levy withholding tax on interest which constitutes commercial and industrial income for the recipients. They shall lay down the conditions governing any such exemption.

Article 8

Withholding tax on interest shall be allowed as a credit against the amount of income or profits tax payable by the recipient in respect of such interest.

It shall be refunded to the recipient by the Member State which levies the tax referred to in the preceding paragraph if it exceeds the amount of that tax or if the recipient is not taxable.

Article 9

1. Where the withholding tax levied by a Member State is allowed as a credit or refunded in another Member State, the Member State which levied the withholding tax shall refund it to that other Member State.
2. By way of derogation from the provisions of paragraph 1, Member States may divide the amount of the withholding tax between each other on the basis of a bilateral agreement, provided that that agreement in no way affects the rights of the recipients of the interest as established by this Directive.

Article 10

1. Member States shall bring into force, not later than 1 July 1990, the laws, regulations and administrative provisions necessary to comply with this Directive. They shall forthwith inform the Commission thereof.
2. Member States shall communicate to the Commission the main provisions of national law which they adopt in the field governed by this Directive.

Article 11

This Directive is addressed to the Member States.

Done at

For the Council

The President

COMMENTS ON DRAFT DIRECTIVES**WITHHOLDING TAX DIRECTIVE**

1. The following comments, covering both general and technical points, are without prejudice to the UK's position.

Memorandum

2. The first sentence of the explanatory memorandum is seriously misleading. The Council instructed the Commission to prepare proposals; it did not "recognise that the liberalisation of capital movements should be accompanied by measures". It is important that this misrepresentation is put right before the document is finalised.

Article 1

3. The Article applies to interest paid by a debtor who is a member State or a political subdivision, local authority or a resident of a member State. It therefore appears to exclude a non-EC resident's permanent establishment located in a member State. Does this mean that, for example, the London branch of a US bank need not impose the withholding tax on interest paid to a resident of a member State?

Article 2**- Prizes**

4. The reference to "prizes" would cover UK premium bonds, which cannot seriously be argued to offer tax-free incentives to residents of other member States. Apart from the product's basic characteristics, individuals are not allowed to hold more than £10,000. Is the proposal that the withholding tax be applied to the prize money? Or, rather, should this come under Article 5 and be exempt?

- Discounts

5. The suggested treatment of discount appears to overlook the fact that many discounted bonds are negotiable instruments. So, for example, a discounted bond issued in 1990 at say 50 and redeemable in 1995 at say 100 could pass through many hands, both EC and non-EC residents, during its life. How are persons buying and selling bonds in the market expected to know the tax status of each other?

6. If the Commission envisage that the tax should be charged at the time of issue, how will it be calculated if the bond does not have a fixed redemption date or if it carries a floating rate coupon as well as discount?

7. It is also not clear whether the withholding tax is to apply to index linked bonds where the uplift is likely to be of a capital nature. The treatment would be harsh if applied to capital as well as income uplift.

8. Although the commentary refers to deep discounts, the article does not seem to preclude shallow discounts as well as indexed uplift. Is this intended?

Article 3

9. Read with the explanatory memorandum, this Article implies that the tax will apply to securities issued by member States before 1 July 1990 and indeed before the Commission's proposals are published. Member States may not, however, be able lawfully to change retrospectively the conditions on which they issued securities; and the prospectus terms of other issuers may entitle the issuer to repay bonds earlier or investors to demand early repayment or the borrower to bear any withholding tax imposed. The absence of protection for existing securities could therefore cause market disruption and impose additional costs on borrowers.

10. Paragraph 2 extends the withholding tax to EC permanent establishments of EC residents but it does not cover EC permanent establishments of non-EC residents (see Article 1). It is also not clear whether it is intended to exclude non-EC permanent establishments of EC residents.

Article 4

11. 4.3(a) creates a distortion in favour of banks which are prepared to take on the heavy administrative task explicit in this provision. There is a case for de minimis exclusions - it is disproportionately expensive for borrowers to declare small sums to tax authorities and for tax authorities to make use of that information. There will have to be extremely complicated arrangements if names and addresses are to be correctly declared and checked.

12. Does 4.3(e) mean that where the member State of the debtor normally exempts a particular category of debt instrument, no withholding tax need be imposed - irrespective of the tax status of the recipient?

13. The definition of eurobonds in 4.3(f) may be acceptable but will require detailed consideration and discussion with banks etc.

Article 5

14. What is the definition of "sight current accounts or savings accounts"? If there is no limit, a serious distortion of competition could be encouraged; for example, member States could allow their own public sector savings institutions to offer tax-free savings accounts which would have a competitive advantage over private sector institutions from other member States wishing to compete in the retail market.

Article 7

15. As drafted, this Article places a duty on banks to identify the nature of large deposits or money-market instruments placed with them. It may prove very difficult to apply this approach without hampering wholesale money markets.

Article 10

16. The timing for the introduction of new tax mechanisms is tight.

Double tax agreements

17. Little reference is made to double tax agreements. What is to be their status, especially where they provide for no withholding tax on interest between member States.

MUTUAL ASSISTANCE DIRECTIVE

18. Paragraph 1 of the Explanatory Memorandum is misleading, for the reason in paragraph 2 above.

19. The Directive as a whole raises important questions about the most effective use of limited resources available to tax administrations. Careful consideration will need to be given to the likely scale of the extra demand for mutual assistance.



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OTHER
COUNTRIES
VIEWS

R I G Allen Esq
HM Treasury
LONDON

Your reference

Our reference

Date 26.01.89

Dear Richard

WITHHOLDING TAXES

1. You asked me to find out how other Member States were likely to react to the forthcoming Commission proposal for a withholding tax. A quick poll of my opposite numbers yielded the following reactions, most of them saying that any reactions could only be preliminary and provisional until the Commission's proposal appeared, the enthusiasts in principle saying that there would no doubt be difficulties of detail.

- France - strongly in favour
- Spain - strongly in favour
- Italy - in favour, 'not fanatically'
- Portugal - in favour
- Belgium - in favour
- Greece - 'unlikely to be negative'
- Germany - flexible (but 10% not 15%)
- Denmark - somewhere between indifferent and mildly favourable
- Ireland - don't know
- Luxembourg - strongly opposed
- Netherlands - strongly opposed (Ruding appears to have said publicly, and to have been reported by the press as saying, that a withholding tax would be incompatible with existing Dutch tax arrangements).

Yours sincerely

David Bostock

D J Bostock

cc: N J Ilett Esq, HMT
B O'Connor Esq, IR
M A Arthur Esq, FCO
W L Parker Esq, CO



FROM: J M G TAYLOR

DATE: 31 January 1989

MR N J ILETT

Handwritten initials

cc PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Wicks
Mr Lankester
Mr Scholar
Mr R I G Allen
Mr Culpin
Mr Odling-Smee
Mr Peretz
Mrs M Brown
Mr Michie
Mr Sharples

Mr Corlett - IR
Mr O'Connor - IR
Mr C D Sullivan - IR
PS/IR

WITHHOLDING TAX

The Chancellor was grateful for your note of 31 January.

2. He is content for UKREP to pass on these technical comments to the British Cabinets. He has commented that it is very important that we keep in close touch with the Dutch.

A handwritten signature, likely of J M G Taylor, consisting of stylized initials.

J M G TAYLOR