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1989 BUDGET STATEMENT
AND UNLEADED PETROL

28-2-89

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REGISTERED ON THE
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MR CULPIN

cc Mr Gilhooly
Miss Hay
Mr Michie
Mr Macpherson
Mr Flanagan
Mr Ford

BUDGET STATEMENT

Bits of the tax section attached. Grateful if someone could have a look at them, befor I put them to the Chancellor tonight, since much of it I have just invented off the top of my head.

The stuff I have attached is meant to be pretty much continuous speech up to and including life assurance (except that the pensions section is still in notespeak). After that point, I have only attached passages I have composed myself - and otherwise I shall simply be scissors and pasting what I've been given, and adding in the missing links.

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BUDGET SPEECH : PEPs, ESOPs, AND EMPLOYEE SHARE SCHEMES

Introduction

Wider share ownership has always had a central place in our economic strategy. [detail of share ownership survey - available end February]. But there is still further to go. Accordingly, I am announcing today further measures to widen share ownership further.

[PEPs]

Exactly three years ago I announced my proposals for Personal Equity Plan as a radical new scheme to encourage investment in British equities. In the first two years that the scheme has been in operation more than 350,000 plans have been taken out. This despite the stock market crash. But (in operation) now that we have more experience of the scheme, I have a number of improvements to propose which will make PEPs cheaper, more flexible and more attractive for first time investors.

First, I propose to raise the overall PEP limit from £3,000 to £4,800, [why?] and the limit on holdings of unit and investment trusts from £750 to £2,400. ~~I am more~~

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~~than trebling the trust limit in recognition that~~ Unit and investment trusts are a good way for smaller investors to enter the equity market for the first time. They provide diversification of risk at low cost. ~~[But those with more to invest, or more experience, can combine trusts with equities, or invest their entire PEP in equities.]~~ ~~Unit t~~ The substantial increase in the unit trust limit recognises this.

Second, I intend to make it possible for PEP holders ~~to~~ who apply for new share issues, ~~and~~ to place their resulting allocation in their PEP, provided this does not breach the overall limit. This change will mean that many of the new breed of investors, whose ~~only~~ main experience of share ownership is from subscribing for privatisation issues, will be encouraged to take out a PEP.

There is a close link between the substantial increase in the trust limits and this change on new issues. The investor who chooses to take out a unit or investment trust only PEP may also subscribe for new issues, ~~Once these changes have been made, this investor's plan manager will be able to hold any new issue shares as part of the~~ and add them to his or her PEP. This will have a double benefit; unit trust holders will be encouraged actively to ~~buy~~ equities ~~directly~~, and to retain any shares they are allocated in new issues.

However, since it was always intended that PEPs should encourage investment in British companies, I propose that where unit or investment trust holdings are bought through a PEP the trust itself must invest mainly in UK equities.

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Third, I am radically simplifying the PEP rules. I propose to abolish the one year holding period; if investors choose to cash in their PEPs within a year of purchase, they will, in future be able to do so without tax penalty. Any tax lost through early withdrawal will be negligible, while the cost to both the Inland Revenue and plan managers of collecting such small amounts of tax is inordinate. [The only remaining requirement will be that only £4,800 can be invested in any PEP year.]

I am also abolishing the cash rules, which have been criticised as making it difficult for plan managers to switch investments. Instead, interest on cash held in PEPs will, in future, be subject to composite rate tax.

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

Taken together, these changes will make PEPs more attractive to first time investors. I am confident that

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

Employee Share Ownership

Our measures to encourage employee share schemes have also had a major impact in widening share ownership. The number of approved all - employee share schemes has risen from 30 in 1979 to almost 1600 today, ~~providing shares and options for~~ covering around 1¼ million employees, and involving shares ~~with a market value~~ worth over £4 billion.

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

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The limits on the 1978 profit sharing scheme have not changed since 1983, and those on the 1980 SAYE option scheme since 1984. I therefore propose to raise the limit on the annual value of shares which can be given tax-free to employees under the 1978 scheme, from £1,250 or 10% of salary, subject to an overall limit of £5,000, to £2,000 or 10% salary, subject to a limit of £6,000. This concentrates the increase at the lower end of the scale.

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

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

Employee share ownership plans - known as ESOPs - are a new form of employee share ownership, which have had much recent publicity. [Explain what's new about them] A number have already been put in place in the UK. They are particularly appropriate for employee buyouts, and for some private companies who are not in a position to offer the existing Inland Revenue approved schemes.

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But there has been some uncertainty whether contributions to an ESOP from a company qualify for tax relief. I now propose to clarify this ~~the tax position~~ by establishing a new tax relief for contributions to employer share trusts which meet certain requirements, designed to ensure that their shares are placed in the hands of employees within a reasonable time. I hope that, as a result, more firms will be encouraged to consider establishing ESOPs.

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I ~~also~~ propose to modify the so-called material interest tests where companies have established trusts to acquire their shares for the benefit of their employees. These tests are designed to exclude from tax relief employers who already have a significant interest in the company. But where there is a trust holding the shares for the benefit of employees the present rules can exclude employees too. The changes I propose will ensure that only those employees who have a significant material interest in the company will be excluded in future.

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And I have one further ~~This~~ change to propose which will benefit conventional employee share schemes, and profit-related pay schemes as well as ESOPS.

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Unit trusts

As I mentioned a moment ago, unit trusts have a valuable role to play in providing, for many people, their first introduction to direct investment and share ownership. I therefore consider it desirable to remove an anomaly which means that ~~However, there is one respect in which~~ the tax system bears unduly harshly on unit trust investors, compared with other forms of direct investment. The general principle ~~here~~ is that a unit trust investor pays the same tax on dividends and capital gains as someone who had invested in the same shares or securities independently. But there is ~~one anomaly~~ an important exception to this: if the trust invests in gilts or other securities, and is not an all-gilt trust, it has to pay corporation tax on the income, so the saver ends up bearing tax at 35 per cent, rather than 25 per cent. I have therefore decided that as from 1 January 1990, the Corporation Tax rate on unit trusts should be cut from 35 per cent to 25 per cent. Unit holders' CGT position will be unaffected, as will the additional income tax paid by higher rate taxpayers. And Rules will be introduced to prevent corporate investors using this change as a tax shelter. This reduction in the tax rate on unit trusts will also have the beneficial effect of removing ~~remove~~ the competitive disadvantage which UK mixed unit trusts would otherwise have faced in the near future, when

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firms from other EC countries acquire the right to sell ~~EC~~ collective investment vehicles ~~acquire the right to~~ sell in the UK.

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Stamp duty

Finally, I have one further measure to propose which will remove a barrier to ownership, and eliminate an aspect of the tax system which puts the British financial services sector at a disadvantage compared with its [some of its] competitors. In my 1984 Budget, I was able to reduce the 2 per cent stamp duty on share transactions to 1 per cent. I halved it again to ½ per cent in 1986. I have decided that now is the time to abolish it altogether, with effect from [ ]. This will cost £[X] million in [year]. This is a sizeable sum, but a cost I think well worth paying when set against the benefits that flow from wider share ownership, and from a financial services industry that will no longer be burdened by an inefficient and discriminatory tax.

This is feeble, I know. Improvements, please!

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reforming the tax system in step

~~bringing about the associated tax reforms~~. Today, I have more progress to announce.

I turn first to pensions.

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Tax reform

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

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

This is not an area in which one can make great changes overnight. Nonetheless ~~, during our time in office,~~ we have made considerable progress in enhancing choice, and

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PENSIONS ~~OUTLINE~~

~~Introduction~~

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

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~~Deregulation~~

But there is still scope for further widening of choice, deregulation of the tax system. Therefore propose to:

- make it easier for people in personal pension schemes to manage their own investments. Pension savings often over-institutionalised. This measure will encourage greater individual involvement in pension plans [as IRAs have in US];

still needs to be put into prose.

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What does this mean?

- simplify and improve rules for occupational pension schemes, particularly those relating to early retirement;

- simplify rules for monitoring additional voluntary contributions. Any surplus contributions will be returned to employees subject to special tax charge; [What happens at the moment?]

- end anomaly whereby limits for tax relief have come to determine limits on pensions paid. [Under the present system - -] If employers pay pensions in excess of the two thirds limit, currently a danger that their pension fund loses all tax privileges. Employers will now be able to set up "top-up" schemes for their employees, with no limits on benefits but without ~~special~~ [additional/further?] tax relief.

With as generous a tax relief, there is clearly a ~~case for~~ need to setting some upper limit to its value. But that is no reason for tax law ~~to~~ effectively to constrain the size of people's pension provision. I therefore propose that

Rationale for limits

With employers able to pay whatever pensions they like, appropriate to put a cap on amount of relief, along same lines as cap on mortgage tax relief.

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[I'd put this lower down. Big earners will be shaking in their shoes - better to let them know the worst now!]

0014

Clear that unfettered relief for pensions savings distorts savings choice:

- people pay less tax if save through pension funds than if invest directly in equities or put money in building society [Allowed tax relief on contributions. Returns untaxed in hands of pension funds, though tax paid on pensions when received].

- savings financing pension lump sums escape tax altogether. Not taxed on way in or out. Anomalous by any standard.

With 1988 reductions in top rate of tax, less need for tax breaks for higher paid. Can afford to save out of taxed income, by investing directly in equities etc.

(A)

<u>Proposals</u>

Therefore propose for final salary schemes:

- a cash limit on pensions paid from tax approved schemes, based on earnings of £60,000

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a year. Consistent with a privileged pension of £40,000 a year or a tax free lump sum of £90,000 a year.

- earnings limit to be indexed to prices.

- changes to apply to members joining new or existing schemes on or after Budget day.

[Take on material from (A) above]

Do we want to say this so openly at outset?

[Also need to redress balance between money purchase and final salary schemes.] Self-employed often unable to contribute to personal pension schemes until late in life, since have to plough back profits into firms. Then fall foul of contributions limits. Propose

[Success of personal pensions... partic. important for self employed But...]

- increase contribution limits for personal pension scheme members over 50.

- but subject them to overall cash limit on contributions. Deliberately pitched at level to improve position of PPs relative to final salary schemes. Indeed will pay some employees to leave FS scheme and take out personal pensions. No bad thing

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- like the final salary scheme limit, the personal pension cash limit will be tied to prices.

Conclusion

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These proposals represent radical reform of pensions system. Because of high level of limits only expect a few thousand high paid employees to be affected, rising to 50,000 by end of century. How it should be. Don't want to undermine pension saving through huge upheaval.

Long term effect though likely to be considerable. Will result in major shift in balance of savings during course of 21st century.

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Last few years have seen a large number of pension reforms. Time they were allowed to settle down. Do not propose any further changes in this Parliament.

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LIFE ASSURANCE

Improvements to the taxation of life assurance.

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

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

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

It is a peculiarity of this system that relief <u>is</u> given up front for the expenses (commission and so forth). This has two distortive effects: first it means that policyholders receive a tax break - "up front" relief on initial costs which would not be available if he invested directly in shares. And it distorts the

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

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

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

But first I have one other proposal which will also restrict the amount of relief available. At present nothing requires life offices to keep their pensions and life assurance

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businesses separate. So Life Offices carrying on pension business, can set the unrelieved expenses on the pensions side against the income and realised gains of Life Funds. This facility means that their pensions profits enjoy unduly favourable tax treatment. The Finance Bill will include provisions to end this anomaly.

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

These measures would cover the main part of the proposals discussed in last year's consultative document. The Finance Bill will provide for them to be introduced from 1 January 1990. But there are other, more technical items which require further consultation with the industry which the Revenue will put in hand **[timing?]**. Any legislative changes which might follow such consultation will be included in the 1990 Finance Bill.

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

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P Putting the tax base on a broader and more rational footing ~~gives me the opportunity to reduce the rates~~ allows tax rates to be reduced. This I propose to do.

At present, Life Funds pay tax at 35 per cent on unfranked investment income and 30 per cent on realised capital gains of their policyholders. As from 1 April 1990, these rates will be reduced to 25 per cent. These reductions, together with the abolition of Life Assurance Premium Duty I announced a few minutes ago, will be worth £[ ]m to Life Assurance in a full year.

[Did I?]

On top of this the industry, like all those who deal in shares will benefit from the abolition of Stamp duty to the tune of x a year.

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

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Schedule E

I have another important simplification to propose, this time in the field of income tax. At present, under Schedule E, tax assessments are done on the basis not of earnings received in a year, but instead on earnings for the year - accruals rather than receipts. I propose to change this, so that in future it is assessed on a receipts basis. For the vast majority of ordinary taxpayers this will make no difference at all. But it will greatly simplify the tax affairs of about half a million people who receive a significant part of their income for a year several months after that year has ended. This change will also ~~simplify the system for taxpayers, and~~ make the tax system ~~considerably~~ simpler and cheaper to administer. There will be no lasting loss of revenue, but there is a transitional cost of £[X] in the first two years, offset thereafter.

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Profit Related Pay

Two years ago, I introduced in my Budget a tax relief for Profit Related Pay Schemes, designed both to give workers a more direct sense of identification with the firms that employ them, and to promote a greater degree of pay flexibility. The current success of British firms is built on improvements in both these respects. The Profit Related Pay Scheme has played its role in this process. It has had a good start, but it is also clear that many firms are interested in launching ~~the~~ schemes, but are not able to comply with all the present rules. I have therefore considered how far the scheme can be modified to meet their needs. ~~Today~~, I ~~am able~~ now propose to ~~announce~~ make three modifications to the scheme in this year's FB, which I trust will be welcomed by business and industry. First, ~~some~~ to help those firms ~~have been~~ keen to make a small start with profit related pay, (I have already announced that I intend to abolish) ~~but have not been able to meet~~ the requirement that PRP ~~it~~ must equal at least 5 per cent of pay. ~~I therefore propose to abolish that rule.~~ ~~Other~~ Some firms, on the other hand, have been deterred from launching a scheme by the present upper limit on the amount of PRP which can attract relief. Accordingly I propose to raise the limit this year from £3,000 to £4,000. Finally, I propose to relax the rules banning headquarters and other central units from using the profits of the whole company or

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group for their own profit calculations, as I am persuaded that this too is unnecessarily restrictive. I am confident that these modifications will ensure continued growth in the number of firms offering some element of profit related pay.

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Corporation Tax

I now turn to the taxation of businesses generally.

It is now five years since I announced the major reform of business taxation which [has given us one of the lowest corporation tax rates in the world?]. A neutral system of business taxation, combined with low rates, has set the scene for a dramatic improvement in the performance of British firms. ~~measured by any standard. With the bias against job creation removed, we have seen [ ]. And~~ The reform of capital allowances has encouraged more efficient investment, based on real returns rather than tax advantages. The removal of the bias against job creation has played a key role in the UK's impressive employment growth. And in this healthier climate, company profitability has recovered dramatically ~~to [ ].~~

The system we have is clearly right, and is working well. Accordingly, I have no change to propose to the main Corporation Tax rate for 1988-89. ~~I do, however, have one change to propose.~~ At the moment, only a small minority of companies pay ~~the~~ this main rate of 35 per cent. The remainder have no liability at all, or pay at reduced rates, determined by the small companies' profits limits. These limits have remained unchanged since 1983. I believe it is now time to increase them,

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and accordingly I propose that the lower limit, below which companies pay at 25 per cent, should be increased from £100,000 to £150,000. Above that level, companies pay at a gradually increasing rate, until they reach the main rate threshold of £500,000. I propose to increase this, too, by 50 per cent, to £750,000.

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LEADED PETROL

I turn now to the excise duties, and specifically to the duty on petrol. Last year I increased the tax differential in favour of unleaded petrol to nearly 11p a gallon. As a result, the price of unleaded at the pump is generally about 6p a gallon lower than that of 4 star [and what compared with 2 star?]. This has undoubtedly helped to increase the take up of unleaded petrol. But the Government is committed to phasing out leaded petrol, as are the oil companies and car manufacturers, and progress is still too slow. Unleaded petrol still accounts for only 4 per cent of total sales, when X per cent of cars can use it without any adjustment, and $^2/_3$ of the remainder could be adjusted to use it at very little cost - [does CLEAR have an average figure that we could quote].

One of the problems is clearly ignorance of the facts (about unleaded petrol). Many ~~who could use unleaded petrol, do not realise it.~~ do not realise that they can already use it. And ~~many~~ others who could cheaply have their cars converted hold back because they ~~do not realise~~ fear – wrongly – that ~~even~~ after conversion their cars could ~~still~~ no longer use leaded, if unleaded was for some reason not available. Fortunately, the efforts of ~~the~~ Government, the industry, and environmental groups ~~like the campaign for~~

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have increasingly begun to dispel the myths about leaded petrol, and to make the case for changing to it.

But I propose to do my part too, and to make sure that the market signal is clear enough. I therefore propose to further the tax on unleaded petrol by something over 3p a gallon. If this reduction is passed on to consumers - and I look to the oil companies to make sure that this happens - the price of unleaded petrol will generally be about 9p a gallon below that of 4 star. This in itself should provide a strong encouragement for car owners who currently use 4 star to have their cars converted to take the cheaper and healthier alternative. However, I propose to go further than this. To encourage motorists who can already use unleaded to do so, I propose to introduce a surcharge of 5p a gallon on 2 and 3 star petrol. This will bring the price of these grades broadly into line with that of 4 star. Virtually all cars which use 2 and 3 star can run on unleaded petrol without any conversion. These motorists will now have a strong incentive to change their habits. This in turn, will provide the necessary signal for more garages to stock unleaded - if necessary by freeing up a pump that formerly sold 2 star. It is, in any case, time they did so, since from October 1990 all new cars will

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be able to use unleaded. (P) Taken together, these two duty changes will give us the largest differential between leaded and unleaded petrol of any EC country, with the exception of Denmark. I hope that we shall soon ~~lead the field~~ match this performance in terms of take up of unleaded. Both these duty changes will take effect from 6.00pm tonight.

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MP

FROM: MISS M P WALLACE
DATE: 28 February 1989

MR ILETT

cc Mr Odling-Smee
Mr Neilson

BUDGET STATEMENT: TAX SECTION

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

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

MPW.

MOIRA WALLACE

TAXES ON SAVING

24. I now turn to the taxation of saving.

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

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

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

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

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

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

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

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

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

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

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

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

35. Personal equity plans got off to a good start, with over a quarter of a million investors, many who had never owned shares before, subscribing almost £$^1/_2$ billion between them.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

A. INTRODUCTION

Mr Deputy Speaker, the Government's economic policy has two main objectives.

The first is to bring inflation down again. Until that happens, we cannot reduce interest rates and keep them down.

The second is to enable this country to take the opportunities of the 1990s. In Western Europe, the single market is nearly on us. And the whole of Eastern Europe, where there is great goodwill for Britain, has opened up in a most dramatic way. We need to make sure that British business can take advantage of these changes.

These two objectives are closely related. Unless we succeed in the first, we are unlikely to do so in the second.

So this Budget will take no risks with inflation. It will maintain a strong fiscal surplus.

It will, above all, be a budget for savers. It will provide a range of incentives to save <u>and</u> a novel incentive to give. It will bring the introduction of independent taxation for married women. It will introduce important new measures for business and keep up the pace of supply side reform. It will remove an old grievance from the tax system and make the social security system fairer. And it will abolish two taxes.

In framing the Budget I have had the great advantage of the fiscal reforms of my Right Honourable Friend, the Member for Blaby. He has left the public finances stronger than at any time in living memory and was also the architect of as comprehensive a tax reform as any other Chancellor this century. That will be an enduring record.

I will come to the detailed measures later. First, I wish to review the performance of the economy in 1989 and look at the prospects for 1990; I will then deal with monetary policy and public sector finances.

As usual, the Red Book, together with a number of Press Releases filling out the details of the Budget measures, will be available from the Vote Office as soon as I have sat down.

B. ECONOMIC PERFORMANCE AND PROSPECTS

First, the economic background.

1989 saw continued buoyant growth in world trade despite some slowdown in the main economies, particularly in the United States. However increased inflation and fears of overheating in continental Europe led to higher short-term interest rates in most major economies during the year. More recently we have seen a rise in long-term interest rates - particularly in Germany where uncertainty about the effects of unification has been an additional factor.

This general tightening of monetary policy is likely to mean lower growth in 1990 than last

year and, in due course, a fall in inflation. We are likely, therefore, also to see slower growth in world trade in the current year, although the astonishing developments in Eastern Europe improve the longer-term prospects.

High interest rates also reflect very strong investment growth over the last two years in all the major industrialised economies. This rise in investment is to be welcomed - and indeed may be intensified by the emerging investment opportunities in Eastern Europe. But it also emphasises the need for a healthy level of savings to finance it. The need for higher saving is greatest in the US and the UK where the shortfall is reflected in current account

deficits, whereas in Japan and Germany domestic savings have remained more than sufficient to finance their own investment. In the medium term the UK's savings and investment need to come closer into line and we must ensure this occurs through a rise in savings rather than a fall in investment.

During the last year, business confidence in Britain has remained a good deal stronger than many expected. New businesses have outnumbered closures, by around 1,500 every week; a larger figure than we expected and a record never before approached. Employment has continued to rise, and unemployment to fall. Almost 27 million men and women are in work today - a larger number than ever before and 1 1/2 million

more than at the beginning of the '80s. Business investment has risen by a further 9 per cent in the last year, making a total rise of 40 per cent over 3 years and taking it to its highest level ever. And a great part of this investment has been financed from rising company profits. In the last few years profitability has recovered to the levels of twenty years ago.

And as companies have become profitable they have been investing in more than just plant and machinery. Their spending on research and development has also risen in real terms by almost 50 per cent in the five years to 1988. They now spend over £5,000 million a year on R&D nearly all of which is allowable against tax. Similarly in the 5 years up to 1989 the numbers

of employees receiving training has increased by over 70 per cent.

These are all favourable developments which reflect well on businesses' preparation for the future. But recently they have been accompanied by the return of inflationary pressures. That, beyond any doubt, is the most urgent problem before us today.

To a degree it is a problem common to all nations. Since its low point in 1986 and 1987 inflation has risen significantly throughout the Group of Seven - the leading economies of the Western world. But our affliction has been sharper. There are a number of reasons for this - some welcome and some not. The record

rise in business investment is obviously welcome; but it has been accompanied by a rapid growth in borrowing and in consumer spending. Thus investment has been rising but the savings to finance it have not.

This has led to excessive growth in domestic demand, a revival of inflationary pressures, and a current account deficit, a good deal of which itself represents suppressed inflation.

Policy was therefore tightened, and interest rates have now been in double figures for 20 months. This tight monetary policy has been backed by large Budget surpluses throughout the last three years. So monetary and fiscal policy have acted together.

Squeezing out inflation is always difficult but there is now clear evidence that demand is slowing down. High Street sales are now only 2 per cent up on a year ago. The housing market has cooled off noticeably. New car and vehicle registrations are down. And import growth has been sharply reduced.

And as demand has fallen back so has output growth, to just over 2 per cent in 1989.

No one likes to see the economy slow but it is inevitable if we are to push inflation downwards. I now expect the economy to grow by only 1 per cent this year, compared with the above trend growth of $4\frac{1}{2}$ per cent in 1987 and

1988. The size of this slowdown shows the extent of the downward pressure on inflation. But growth should return in 1991 towards its sustainable rate of around $2 \frac{3}{4}$ per cent.

I am confident that the period of low growth will be short-lived - not least because of the permanent improvements in the underlying economy in the 1980s. For example, investment has grown more than twice as fast as consumption over the last eight years. As this additional capacity comes fully into use inflationary pressures will lessen and more normal growth will resume. No one need have any doubt about that.

Last year also saw a record level of foreign direct investment into Britain. Overseas

investors see the potential for investment in this country in 1990s. These investments are particularly welcome as they are in industrial sectors like cars and electronic goods where a high proportion of the output is traded. For example, Britain already runs a trade surplus in colour TVs, and by the mid-1990s there will be a dramatic improvement in the trade balance on cars.

Increased investment will enable British industry both to meet domestic demand and to respond to export opportunities. Indeed, that is already beginning to happen. The current account deficit for 1989 as a whole was a little over the £20 billion I forecast at the time of the Autumn Statement. But the deficit in the

last 3 months was substantially lower than in the previous quarter and, in particular, the manufacturing deficit is now improving. Exports have been growing faster than imports since the early Autumn.

The reason for this improvement is twofold. In recent years, rapidly expanding domestic demand sucked in imports to meet a market that fast growing manufacturing output could not satisfy. Moreover, that same demand absorbed British goods that would otherwise have been exported. This pattern is now reversing.

Exports are now growing rapidly, regaining the share of world markets they lost in 1988. Last year, the volume of exports of manufactures grew

by 11 1/2 per cent - the highest recorded rate for nearly 20 years.

So British industry is responding extremely well to export opportunities. The fact that it is doing so clearly illustrates that the present trade deficit is not caused by poor industrial competitiveness. It is caused by excess demand, and as that is reduced the current account deficit will fall - initially to £15 billion in 1990 and further thereafter.

But we cannot afford to relax policy notwithstanding the prospect of lower growth. The buoyancy of past demand means that inflation has been far more stubborn than anyone expected. A significant fall is still some months away and

a number of factors will mean that the position will worsen noticeably before it improves. This will be reflected in the Retail Price Index during the next few months.

The largest single factor is the increase of some £5,000 million in local authority revenue spending next year. This is mainly responsible for the expected growth of over 30 per cent in average community charges compared with domestic rates. This will add over 1 per cent to the RPI next month.

Similarly the further rise in mortgage rates last month will also increase the Retail Price Index. As a result, I now expect that RPI inflation may still be a little over 7 per cent

by the fourth quarter of this year, compared to the $5\frac{3}{4}$ per cent I had previously forecast.

Beyond that - as the effects of these one-off increases drop out and the lagged effect of monetary tightening builds up, I expect inflation to fall below 5 per cent during 1991.

To summarise, the economy - both consumption and investment - has been very resilient in recent years. Adjustment so far has been gradual. But this is not necessarily a good guide to the future. The gradual adjustment may continue but equally the downturn may become quite sharp.

It is against this uncertain background that I must set monetary and fiscal policy, to which I now turn.

C. MONETARY POLICY

I want to deal with monetary policy and interest rates first for two reasons: because they are of great concern in the House and in the country, and because as always they provide the key to progress on inflation.

And, I repeat, my first priority is to prevent inflation entrenching itself. For inflation is immensely damaging socially as well as economically. It damages business by undermining planning and investment and it foments industrial strife. And socially, it penalises the weakest most.

I know that high interest rates are unpopular. They are generally most unpopular as they become most effective. They discourage spending and borrowing. They act directly on the things we have to control if we are to get inflation down.

But interest rates are also the most flexible way of responding to what can be a rapidly changing situation. They can be raised quickly when necessary. And they can be reduced just as quickly when it is safe to do so.

In recent months I have looked carefully to see if there is an effective alternative to interest rates. I have done so because I am very conscious of the burden they place on business and on individuals purchasing their own houses.

I know many people favour direct controls on lending, hire purchase and consumer credit. I do understand that. In particular, I understand the distaste many people feel for the widespread marketing of credit that is so evident today and that is characterised by indiscriminate mailshots encouraging people to borrow. I believe the financial institutions would be wise to reconsider their policy and I hope that this subject will be covered in the Code of Practice the banks and building societies are currently preparing following the Jack Report.

But having looked at the matter I have concluded that it is extremely unlikely that credit controls would work in the modern world in

anything other than the very short-term. They were becoming less and less effective even before exchange controls were abolished over ten years ago. Their main impact now would be to replace domestic borrowing with overseas borrowing. These days it would, for example, be a simple matter for any High Street bank to arrange its lending through an overseas branch.

This, of course, applies to other countries too, and it is for this reason that governments of all persuasions throughout the Western world are abolishing credit controls and are relying on interest rates to control money - and thus inflation. The same is true of those countries in Eastern Europe who are seeking to adapt to the market system.

In recent years financial markets have become more open to competition and their behaviour has changed enormously. As a result monetary conditions have become more difficult to judge. This is one of the problems of financial deregulation, but one that must be set against the great benefits it has brought.

So, although monetary policy remains the key to controlling inflation, it is not realistic to suppose that we can take decisions solely by reference to the way any one particular measure of money is growing. In a more sophisticated world, we must apply judgement and take into account the other evidence about monetary conditions that may be available.

In recent weeks I have looked afresh at the role of monetary targets. Having done so, I am clear that it is sensible to maintain a target for narrow money, and that this is best measured by the familiar aggregate MO. Since this is essentially notes and coin, it clearly is not a comprehensive measure of money in all its uses. But it does have value as an indicator of transactions and has been a reliable guide for many years. For next year I have set the target range at 1 to 5 per cent. Although the growth of MO has fallen from its earlier peaks, it is likely to start the year above the range and it may be some months before it falls within it.

In this re-examination of policy, I have also looked closely at the case for reintroducing a target for broad money. I can understand why some favour this. At times broad money has given a useful indication of the build up of inflationary pressure. The difficulty is that its message has always varied in quality: its growth can represent money that is about to be spent, or money that is very definitely being saved: savings which I wish to encourage, as will become apparent later this afternoon. So, although we will monitor M4 carefully, and give it weight in our decisions, I do not intend to set a target for the year ahead.

I have also reviewed whether there should be any changes in the Government's funding policy. The

objectives must be to manage public debt in a way that supports monetary policy in bearing down on inflation, without distorting financial markets. I have concluded that, in general, policy should continue to be guided by the funding rule followed in recent years, with the public sector avoiding sustained under or overfunding.

But I am also clear that in practice the rule cannot and should not be operated rigidly. In particular, in recent years there has been an increase in the size of the Treasury bill issue, largely as a result of a change in the financial position of local authorities. I therefore announced to the House on 15 February a range of measures intended to limit local authority

borrowing from the Public Works Loan Board. This change should in due course allow a reduction in the Treasury bill issue. But in the meantime, the Government will adjust its funding operations if necessary, increasing gilt sales or reducing gilt purchases, to take account of the overall situation in the money market.

Progress on reducing inflation is also a vital pre-condition of our commitment to take sterling into the exchange rate mechanism of the European Monetary System. Our commitment to do so was set out at Madrid. It remains firm, and the conditions for entry remain unchanged.

When we join the exchange rate mechanism it will provide a new framework for interest rate decisions. But even then, no one should suppose it will bring a dispensation from the need for strong domestic monetary control. Indeed, quite the reverse. Commitment to the one will reinforce the commitment to the other.

To sum up, interest rate decisions will continue to be made on the basis of the growth of monetary aggregates, and a range of other evidence, most notably the exchange rate. This matters because it provides important information about domestic monetary conditions - quite apart from having an effect on prices. Therefore I favour a strong exchange rate. But there is, as I have made clear, no single

lodestar to guide us in monetary policy. Life would be simpler if there were but it just does not exist. So judgement is unavoidable.

And my judgement is that interest rates will stay high for some time to come. The moment I judge I can safely lower them, I will. But to reduce them prematurely only to increase them again would be extremely damaging. When I bring them down it will be because I believe they are likely to stay down.

In Chapter 2 of this year's Red Book I have provided a much longer and more comprehensive account than usual of how monetary policy, including funding policy, is to be operated over the years ahead. I hope this will be helpful to

the House, and in particular to members of the Treasury and Civil Service Select Committee when they come to examine the Budget documents in detail.

D. FISCAL POLICY

Although monetary policy must play the main role in tackling inflation, a tight fiscal policy is also essential. It cannot do the work of monetary policy, but it can and must support it.

The dramatic improvement in the state of the public finances over the last 10 years under the stewardship of my Right Honourable Friends is an achievement of which they can be rightly proud. For decades successive Governments had spent more than they were prepared to raise honestly from taxation and made up the shortfall by borrowing. They left the bill to be picked up by future generations.

Over decades that bill mounted to very considerable levels. Today, just paying the gross interest on the accumulated debt accounts for 10p on income tax.

Over the past 10 years we have reversed that trend; and in the last three we have repaid around £25 billion, reducing the burden of government debt to levels we have not seen since before the first world war.

The rewards of this repayment will be felt by future generations but they bring also an immediate benefit. As a result of the debt repayments we are saving over £2,500 million a year in debt interest. That is sufficient to

meet the annual cost of around 150 district general hospitals.

The very large Budget surplus in 1988-89 owed much to cyclical factors. In the current year, as I indicated to the House some months ago, we expect the surplus to fall back. The position will remain uncertain until the year is complete, but our best estimate is that the debt repayment this year will be around £7 billion.

This fall in the surplus owes less to the slowdown in growth than to a number of special factors. We have seen a fall in privatisation proceeds from the very high level achieved in 1988-89. There has also been a sharp and unwelcome increase in local authority spending.

This has been particularly marked in their capital spending, as they have sought to forestall the new controls which will take effect in April. As a result, we now expect the public expenditure planning total this year to be overshot by £$2\frac{1}{4}$ billion. Central government expenditure remains well under control.

Another, but much more welcome, factor reducing the surplus has been the higher national insurance rebates that have resulted from the huge success of personal pensions. This extension of choice is a considerable tribute to my Right Honourable Friend, the Member for Sutton Coldfield. Over $3\frac{1}{2}$ million people have now taken out personal pensions. As well as

benefiting the individuals concerned, in the long-term this will reduce public spending. But it also reduces national insurance receipts, by £2 $^{1}/_{2}$ billion this year.

Next year, some of these factors will be partially reversed but we will see the effect of slower growth on the debt repayment. In particular corporation tax receipts are likely to fall a little after six years of rapid growth, not least because of the higher investment of recent years which can be offset against tax. These allowances will be worth over £10 billion to companies next year as opposed to £9 billion this year.

It is against the medium-term fiscal prospect that I have framed the Budget judgement; for fiscal policy is not a flexible instrument which should be altered to meet short-term contingencies. Fine tuning fiscal policy is not only disruptive to the public sector, business, and to taxpayers, but its effects on the economy are both uncertain and often destablising.

Accordingly, I am budgeting next year for a further Public Sector Debt repayment of £7 billion - the same as this year. Looking further ahead, I expect our fiscal position to move towards the medium-term objective of a balanced budget, an objective I reaffirm today.

The overall effect of the Budget measures I announce today will be to maintain a tight fiscal policy by modestly increasing the yield from taxation by approaching £$\frac{1}{2}$ billion next year and just under £1 billion in 1991.

E. BUSINESS TAXATION

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

Everyone in this country benefits from the success of British enterprise. Tax reform cannot create success but it can help and encourage it.

Within the tight fiscal position I judge necessary, I am able to make some changes that should help small and medium sized companies.

Cash flow is particularly important to new and growing companies of this size. To improve it, therefore, I have two measures that should help.

At present, traders pay Value Added Tax on all their sales, even if their customers do not actually pay the bill. They can only claim VAT relief for a bad debt when the debtor has been declared formally insolvent. As a result, the trader - who has dealt in good faith - can be out of pocket, in some cases for years, and often for large sums.

This has long been resented by businesses and the time has come to deal with it. I therefore propose that from April next year all debts which are over 2 years old and written off in the trader's accounts will qualify automatically for relief from VAT. This will be worth some £150 million to business next year.

I also propose to help smaller companies by simplifying the rules for traders registering for VAT. At present whether or not you have to register depends on quarterly and annual turnover thresholds. You only have to say this to realise how difficult it is. Businesses also have to peer into the future to see if these limits might possibly be exceeded within the next year.

This complication is unnecessary. So as from today, I propose a simple rule for VAT registration. This will be based on actual turnover in the preceding 12 months and not unknown turnover in the distant future. It will bring certainty and simplicity in place of uncertainty and complexity. And it has a second

benefit for businesses: because they will, in general, register later than they otherwise would have, it will save them £35 million in 1990-91 and £75 million the year after.

I have two further VAT changes. First, I propose to increase the VAT threshold to £25,400, a modest sum, but the maximum permitted under European Community law.

The second change will affect companies which provide accommodation for their own Directors. As things stand, the company can reclaim the VAT they pay on this, for something that is more a fringe benefit than a legitimate business cost. Frankly I do not believe this generous treatment is justified. I therefore propose that VAT paid

on Directors' accommodation should no longer be deductible. This will take effect from Royal Assent.

I also have some changes to Corporation Tax. While the main rate of corporation tax will remain at 35 per cent, I propose to reduce the burden of tax for smaller companies.

At present companies with profits below £150,000 pay a reduced rate of Corporation Tax of 25 per cent. I propose to raise this ceiling by one third, to £200,000. This amounts to a doubling in two years of the profits level for the reduced rate. This will be of special benefit to smaller growing companies.

For companies with profits above this limit, the average rate of tax gradually rises until their profits reach the upper profits limit of £$\frac{3}{4}$ million a year. I propose to raise this limit, again by a third, to £1 million. This means that no single company will be liable for the full rate of Corporation Tax until its profits reach £1 million a year. These changes mean we will have the most favourable structure of corporation tax rates for small companies anywhere in the EC.

I also have one specific tax change to help training.

One of the most welcome features of the last few years has been the massive sums of money being

invested in training throughout the economy by employers in both public and private sectors, large firms and small. Our estimate is that in total this amounts to some £20 billion a year.

In addition the Government is spending £2 1/2 billion a year on training programmes; and the value of tax relief on companies' spending must be at least as much again.

In future, over £2 billion of our public expenditure on training will be spent through Training and Enterprise Councils or TECs, most of which will be coming into operation over the next year. I have no doubt that TECs will do much to improve training in skills and that we shall see the benefits of this in future. They

give employers a genuine opportunity to determine their own needs and will provide generous cash help to meet them.

The Government has already promised to match local business donations to TECs pound for pound within certain limits. I now propose to encourage business to maximise the money they put into training by providing tax relief on business donations to TECs for five years until April 1995. I propose to extend the same concession to local enterprise agencies until the same date.

My next announcement has implications for one in four of the adult population. For that is the number of people - nearly 11 million people -

who now own shares in the UK. That remarkable figure - a new record - is published today in the annual Stock Exchange Survey of share ownership.

Over the next few months, the Stock Exchange will be taking crucial decisions on their plans for a new share-dealing system, affectionately known as TAURUS. This will cut costs, eliminate paper forms, and provide a modern computerised system for transferring shares. Decisions on the design of the new systems for TAURUS will have to be taken shortly. We need, therefore, to decide what stamp duty regime to apply to paperless transactions.

As we approach 1992 we can expect even sharper international competition in financial services, much of it from other European centres. Competitive and practical arguments point in the same direction. I have therefore decided to abolish stamp duty on securities late in 1991-92 to coincide as closely as I can manage with the introduction of paperless dealing. Stamp Duty Reserve Tax will also be abolished at the same time.

Both the abolition of the tax and the introduction of a more modern dealing system will help to secure the UK's position as a leading financial centre in an increasingly competitive world market. They will also reduce transaction costs and permit higher returns for

11 million holders of occupational pension schemes, over $3\frac{1}{2}$ million personal pension holders, and the many millions of people who hold life assurance policies or unit trusts. It will also be of considerable benefit to small shareholders.

The assumption in the Red Book is that abolition will be at the end of 1991, at a revenue cost of £120 million in 1991-92. This date will be subject to confirmation later when I have fuller information about the progress of TAURUS. However, although there is some flexibility about the timing, there is no doubt whatsoever about the decision to abolish stamp duty on shares. I have made the announcement now for two reasons: to remove uncertainty and make

clear that there is no need to plan for stamp duty within TAURUS. I should add, for the avoidance of doubt, that stamp duty on land and property will be unaffected by this measure.

The Finance Bill will also include a number of measures on Life Assurance, announced by my Honourable Friend the Financial Secretary last December. These measures, which flow from the changes in the 1989 Finance Act, followed extensive consultation with the industry. They put the taxation of life-assurance companies' unit trust holdings on a sounder footing and make a number of technical improvements. They will yield £50 million in 1990-91. A further measure will be introduced to "ring-fence" long-term business assets. Without this

measure, there could be a significant loss of tax.

I also have a measure to announce which will clarify the tax regime for banks.

Tax relief is rightly available to banks as it is to other lenders for bad and doubtful debts. But this has given rise to two problems. First, in recent years the banks have increased very substantially the amounts written off for their lending to Third World countries. That has been widely welcomed, but sudden increases do have an adverse impact on the public finances. Over time, the tax cost of the 1989 increases could amount to going on for £1 billion.

Second, although the principle is clear, it is less clear how to implement it in practice. That is because the relief available depends on the extent to which the debts are estimated to be irrecoverable - and that is often far from clear-cut. This difficulty is magnified when the debts in question are those of sovereign nations rather than individuals or firms.

This is an extremely unsatisfactory position for the banks, for the Inland Revenue, and for the taxpayer. I have therefore decided to resolve it, and remove the uncertainties in the present law. Banks will continue to be able to offset their losses on sovereign loans fully against tax, but under a clearer mechanism than previously, which will be broadly based on the

Bank of England's present guidelines. There will be a limit on future increases in the cost of this tax relief between years.

For the 12 months starting today, banks' tax relief on such provisions will be limited to the same high proportion of debts as this mechanism indicates for 1989. Thereafter, the ceiling will be increased in steps of 5 per cent a year, so that the banks will, in time, get all the tax relief to which they are entitled. If the banks sell their debt to a third party and crystallise their losses, their tax relief on them will be similarly phased. But where the debt is sold back to the foreign state, to reduce its debt once and for all, then tax relief on that loss will be available in full and immediately.

This measure produces a yield of around £200 million in 1991-92, compared with what might be expected if I took no action.

F. TAXES ON SPENDING

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

First, Vehicle Excise Duty. I propose a number of changes in VED to remove anomalies in the taxation of different types of lorries. These changes will also dramatically reduce the present vast number of different VED rates. Last year's Budget removed 80 different VED rates, and I propose to eliminate a further

188 today. This will greatly simplify the system.

Vehicle Excise Duty on cars - the tax disc - will be unchanged once again this year at £100. Nor will there be any change in VED for public or private sector buses, coaches, taxis and many lorries.

I will recoup the cost of this by increasing petrol and DERV duties by rather more than strict revalorisation would justify. These will rise by 10 per cent. This will add 9p to a gallon of DERV and almost 11 pence to a gallon of leaded petrol.

For unleaded petrol the cash increase will be smaller at around 9 pence per gallon. This will widen the tax differential even further in favour of unleaded petrol. This will now amount to almost 16 pence a gallon. The market share of unleaded petrol has increased fivefold, to 30 per cent, since the changes in the last Budget. I hope and expect to see it increase even further.

For alcohol, with one exception, I propose to raise the duties in line with inflation. This will put 7p on a bottle of table wine, but only tuppence on a pint of beer. Spirits, however, have enjoyed a duty standstill since 1985. I propose therefore an increase of 10 per cent,

which will increase the price of a bottle of spirits by 54p.

Cigarettes also were not increased last year. This year I propose a 10 per cent increase in duty, which will put 10p on a packet of 20. The duty on cigars will rise similarly and will add 5p to the cost of a packet of five small cigars. But I do not this year propose any increase in duty on pipe tobacco. This at least will be one measure which I hope will command the total support of the Leader of the Opposition.

G. FOOTBALL

I now turn to football.

The tragedies at Bradford and Hillsborough Football grounds shocked us all. The Report by Lord Justice Taylor made recommendations to improve comfort and safety in our football league grounds over the next ten years.

Implementing the programme of work envisaged in the Taylor Report will place a significant burden on football clubs, which many of them will find extremely hard to bear. For many are in a very weak financial position, and only a handful are profitable. I recognise this problem, but I believe there is an acceptable

way to overcome it. The first priority is to ensure that vital improvements in safety and comfort can be made. And the second is to avert what would otherwise be the closure of many of our grounds. If we help football now, I am confident football will contribute itself to the improvements in facilities that are necessary.

Let me say first that much of the expenditure required to meet the Taylor recommendations is eligible for capital allowances or for full offset against tax. I know there has been some confusion about this, and I have asked the Inland Revenue to provide urgent guidance to clarify the tax position.

But tax allowances cannot help where there is no profit to set costs against. This is the case with many clubs. I have therefore reviewed the rate of Pool Betting Duty - the tax which is paid by the pools companies on the stakes they receive. This currently stands at $42\frac{1}{2}$ per cent. I propose to reduce it to 40 per cent on the clear understanding that the full amount saved is passed by the pools promoters to the Football Trust, and is used by them to improve the safety and comfort of fans at English and Scottish football league grounds.

I am confident that such an arrangement can be negotiated with the pools promoters and the football authorities. Provided that we do so, the duty will be reduced, in the first instance

for 5 years. At the end of that period, we shall review the position again.

This reduction will yield around £100 million for football over five years. This is in addition to the £75 million that the Football Trust have already said will be available over the next ten years. These sums represent very large contributions towards making sure that football league clubs can implement the Taylor recommendations and bring their grounds up to the safety standards both we - and they - want to see.

Millions of people watch football every year. With better and safer grounds I hope many more will join them.

H. INCOME TAX

Next, I deal with income tax, before turning to other matters.

I have no change to announce to either the basic or the higher rate of tax. They will remain at 25p and 40p respectively. But I do re-affirm our objective of moving towards a basic rate of 20p when it is possible to do so.

I turn now to personal tax allowances. This year I propose to uprate the main income tax allowances by the statutory indexation factor of 7.7 per cent, rounded up.

The personal allowance will rise by £220 to £3,005. The new married couple's allowance will be set at £1,720, as will the additional personal allowance for single parents, and the widow's bereavement allowance. But the basic rate limit, the level at which higher rate liability begins, will be unchanged, at £20,700 of taxable income. This still means a married man with a £30,000 mortgage will not begin to pay higher rate tax until his income is over £30,000.

The allowances for the elderly will similarly be fully uprated in line with inflation. For those aged 65 to 74, the personal allowance goes up by £270 to £3,670 and the married couples' allowance by £160 to £2,145. For those aged 75

and over, the personal allowance goes up by £280 to £3,820 and the married couples' allowance will rise to £2,185. The income limit for these allowances will also be fully indexed to £12,300.

I also propose to raise the Inheritance Tax threshold by £10,000 to £128,000 in line with inflation.

The Capital Gains Tax exemption - that is, the amount of real Capital Gains free of tax in any one year - currently stands at £5,000. However, from April, the introduction of independent taxation means married couples will be entitled to not one but two exempt amounts rather than having to share one between them as at present.

I have therefore decided to leave the exempt amount at £5,000 per person which effectively gives a married couple an exemption of £10,000 in total.

I also have to set the scales for the taxation of the private use of company cars. The tax treatment of this benefit remains generous, though less so than previously, as a result of the significant increases in these scales in recent Budgets. I therefore propose an increase - but a smaller one than in previous years, at 20 per cent. The yield from this will be £160 million in 1990-91. There will be no change in the fuel scales.

In the tax system there is one allowance - the tax allowance for the blind - that although anomalous has long been accepted as a proper recognition of the special difficulties faced by blind people. The allowance is modest, but welcome, at £540 a year. I propose to make it less modest and more welcome, and double it. From 6 April it will stand at £1,080.

Before I leave income tax, I have a supply side measure to announce, which will help the labour market to work better.

We have always made it clear that it is not for the Government to encourage or discourage women with children to go out to work. That is rightly a decision for them to take, and one in

which the Government would be wise not to interfere.

But it is undeniable that an increasing number of mothers do want to return to work. And many employers - in private industry, and in public services such as health and education - are keen to encourage them to do so.

If an employer provides a nursery for his staff in order to recruit and retain skilled people, he can set the cost against corporation tax. But any employee who benefits and who earns more than £8,500 a year is required to pay tax on the value of the benefit in kind. Many employers have argued that this is an obstacle to the growth of nursery provision and has created

recruitment difficulties for them. And many women see this as a positive disincentive to return to work.

For these reasons, therefore, I have decided to exempt the value of workplace nurseries and playgroups from taxation as a benefit in kind. This will take effect from 6 April this year.

J. CHARITIES

I indicated at the beginning of this speech that this Budget would include incentives both to save and to give. I will come to saving in a moment, but I want to deal with giving first. I have a number of proposals to help.

We are by instinct a generous nation to causes that appeal to us. The tax system already offers a great deal of help to charities. It offers reliefs on their income and on their expenditure. And it provides incentives to encourage charitable giving. There is a relief for charitable covenants that has now been in operation for many years, and is worth nearly £200 million to charities every year. We have

been considering how covenants can be made easier for charities and donors to use and the Inland Revenue will therefore be issuing new guidance today to simplify them.

Since 1987 relief for covenants has been complemented by the payroll giving scheme, a very user-friendly way to relieve regular giving from tax. This scheme has been doing well since its launch and I now propose to increase the annual limit from £480 to £600.

These reliefs are focused mainly on regular giving, which is of great importance to charities. But they are ill-suited to encourage the one-off gift which, for a variety of reasons, many people find more convenient. Over

the years, this has been a persistent source of concern to charities. This year, I propose to go some way to meet that concern.

I propose a Gift Aid scheme which for the first time will give tax relief for large money donations. It is simply not practical to operate a relief for all small one-off gifts. And in any event, I do not want to undermine regular giving through the payroll scheme and covenants, which are very important to some Charities. So this scheme applies to larger donations.

The lower qualifying limit for Gift Aid will therefore be £600 per donation - the new ceiling for payroll giving. The relief will be

available on one-off gifts up to an annual ceiling of £5 million per individual donor. The tax relief will be reclaimable by the Charity, and payable to them at basic rate. As with covenants, the donor will get any higher rate tax relief which is due direct from the tax office.

This relief, which will apply to gifts by both individuals and companies, will come into operation from 1st October this year. I am confident that it will maintain and strengthen the growth of charitable giving, and I very much hope that charities will promote it actively. It will, of course, be open to the whole range of charities from social causes to those whose activities are devoted to the arts.

I have one further measure to help charities. This is a package of VAT reliefs giving help especially to organisations engaged in sea rescue, medical care and research. These will come into effect on 1 May and give an additional benefit of about £5 million a year to charitable work. Full details are set out in a Customs and Excise press release issued today.

K. SAVINGS

I now turn to the taxation of savings, where I have a number of measures to announce. As I do so I am conscious that the majority of personal savings are the fruits of earnings which have already been taxed.

I start with saving in shares.

The development of the personal equity plan, which stands to the immense credit of my Right Honourable Friend, the Member for Blaby, has been an important boost for share-ownership. I am pleased to report to the House that last year was a record one for PEPs, with 300,000 plans taken out, to the value of some £750 million.

To build on this success I propose to raise the overall annual limit on investment in PEPs by a quarter, from £4,800 to £6,000. Within that, the annual limit on investment in unit and investment trusts will be increased by the same percentage, to £3,000.

I am also sympathetic to the problems investment and unit trusts face in qualifying for PEP treatment. This arises from the requirement that 75 per cent of their portfolio should be invested in ordinary UK equities. I propose therefore to relax this rule, to 50 per cent. I also propose to raise the PEP limit for those trusts that do not satisfy this rule, from the present £750 to £900.

Last year, my Right Honourable Friend put employee share-ownership plans, or ESOPs, as they are known, on the statute book. ESOPs are a vehicle for giving employees a direct stake in the business for which they work. I believe they are an attractive option and deserve further encouragement. One impediment to their growth has been that the transfer of shares to the workforce can mean that the company owner faces an immediate tax charge. To prevent this happening I propose to introduce a rollover relief from capital gains tax for sales of shares to ESOPs. I believe this will remove an obstacle to their development and give this form of employee share ownership the fillip it deserves.

In a moment, I will turn to some new and significant tax changes for savers. But first, I wish to discuss a reform which was announced in the 1988 Budget and comes into effect next month - independent taxation for women. There is too little understanding yet of what this change will mean. It will fundamentally change the financial affairs of women.

At present the taxation of married women's income is wholly inconsistent with their role in society. In tax law their income is still considered to belong to their husbands. The effect of this is twofold. It denies married women any privacy or independence in tax matters. And too often it results in heavier

taxation than is fair. Frankly it is time for this system to go, and go it will from April.

In future, a husband and wife will be taxed entirely separately. Every married woman will have a tax allowance of her own to set against her income - whether this income is from earnings, pension or savings.

Three and three quarter million people will gain, of whom 2 million have incomes of less than £5,000 a year. One million elderly married couples will pay less tax, with 200,000 pensioner couples taken out of tax altogether.

No one will be sorry to see the old system go. One of its worst features was its treatment of the savings of married women. Whether they had other income or not, the interest on their savings was added to their husband's income and taxed at his rate. This was a clear penalty on thrift. But from April all that will end. This may well be the area where the reform has its greatest effect and will be most welcomed.

However, independent taxation has thrown into sharp relief another aspect of the tax system that affects all savers, and which no longer deserves to survive.

Some women will see the benefit of independent taxation automatically, if they have their money

invested in national savings, or other accounts which pay interest gross of tax. But many women with only small savings prefer to save with High Street banks or building societies. And so, frankly, do many other small savers. For all these savers, income tax - or rather a proxy for it, called the composite rate - is deducted before the interest ever gets to the saver, and whether or not the saver is liable to pay tax.

Composite rate tax was introduced originally in 1894, and put on the statute book in 1951. It currently stands at just under 22 per cent. It is deducted at source. It cannot be reclaimed in any circumstances. This means that basic rate taxpayers gain by about 3 per cent - the difference between the composite rate and the

basic rate of income tax, which is what they should pay. And it means that non-taxpayers are worse off by 22 per cent.

The attraction of composite rate has always been that it allows small amounts of tax to be collected with ease from very large numbers of people. It is <u>very</u> convenient and very cost-effective. But the fact remains that with CRT, we tax people on low incomes who should not be taxed.

It has, of course, always been possible for these people to avoid taxation entirely, by saving in accounts that pay interest gross or tax-free, or where tax can be reclaimed. But the convenience of using banks and building

societies has meant that many of them have not done so.

The scale of the problem is compelling. Once Independent Taxation is implemented there will be 14 million people - nearly one quarter of the population - who have savings income that does not merit taxation, but which will be taxed under present legislation.

They include some 5 million married women with little or no other income of their own, 4 million pensioners, $2\frac{1}{2}$ million other adults, and $2\frac{1}{2}$ million children with small savings accounts - often funded with small gifts of money from grandparents, or savings from pocket money.

There is no way out of this problem other than to abolish composite rate tax entirely. This I propose to do with effect from 6 April 1991, the earliest practicable date. From then on tax will fall on those who should pay it, and will not fall on those who should not pay it.

We shall discuss with the banks and building societies how to effect this change. I envisage a scheme of self-certification that will allow non-taxpayers to be paid their interest without deduction of tax. For other savers, tax will continue to be deducted at source, but at basic rate. However, unlike composite rate tax, any tax deducted will be reclaimable by any

non-taxpayers who, for any reason, may not have been able to self-certify for gross payment.

This change will reduce significantly the amount of tax paid by millions of married women, pensioners, children, and others with small savings. It will relieve them of tax which they should never pay. And by removing the penalty of composite rate tax it will play an important part in encouraging the savings habit.

Meanwhile, the Department of National Savings also has a part to play in encouraging the savings habit. I am therefore announcing today a 1 per cent increase in the interest rates paid on National Savings Investment Account and Income Bonds where interest is already paid

gross. This too will help encourage saving, particularly by non-taxpayers.

However, as well as removing the tax impost for non-taxpayers, I do wish to do more to encourage the saving habit among taxpayers - all of them.

In the 11 years we have been in office, a series of Budgets have removed penal rates of tax, abolished the investment income surcharge and introduced important new schemes to encourage saving and investment. I intend now to build further on those measures. And that means going beyond the incentives to saving that we have built up so far. These schemes have been immensely successful in spreading share ownership, and will continue to be so in the

future. But I now want to extend savings incentives to the mass of ordinary taxpaying savers - and potential savers - who prefer to put their money in the familiar security of High Street banks and building societies.

My next measure is addressed precisely to them. I propose to introduce a wholly new tax incentive which will reward saving and encourage people to build up a stock of capital.

The scheme will work as follows. Every adult will be entitled to one Tax Exempt Special Savings Account, TESSA for short. All commercial banks or building societies will be able to offer such an account. The essence of the scheme is to encourage people to save

regularly over a 5 year period. The incentive for them to do so is that all the interest earned on their capital will be entirely free of tax, provided only that the capital itself is left undisturbed over the 5 years.

The annual limit on the amount that can be invested will be £1,800, or £150 a month. In the first year, anyone who has capital that they are willing to tie up for longer can put this money in their account from the outset, up to a limit of £3,000. But the overall limit of £9,000 for the whole plan applies nonetheless.

To cope with the circumstances of many small savers - particularly pensioners - who use the interest on their savings for their everyday

expenses, it will be possible to withdraw interest as it accrues, but only up to the net-of-tax level. At the end of the 5 years, the depositor then gets a bonus representing the money which would otherwise have gone in tax. The depositor will get this provided none of the capital has been withdrawn before the five years is up. They can, of course, withdraw the capital at any time, but without tax relief.

This scheme is convenient, flexible and simple. It extends a form of PEP treatment to ordinary savings. It caters for those who want to save monthly, annually, or in irregular amounts. It represents a substantial incentive to save, and I am confident that TESSA will play its part in reviving the culture of thrift. I also believe

it is both desirable and fair to reduce tax on small savings.

This new relief will be available from next January. Its cost will depend on take-up but could be around £200 million in the first full year, and rising thereafter.

This Budget has contained a whole range of savings incentives. It has done so because I believe it is economically right to encourage savings. And because I believe also it is socially right - not least because of the independence and security it offers to savers as they build up capital of their own. But there is little point in encouraging savings if you leave in the system an over-severe penalty for

doing so. I turn therefore, to the social security system, and to what has become known as the capital rule.

As the House knows, people with capital over £3,000 start to have their benefits reduced and those with more than a certain level of savings - £6,000 in the case of income support and family credit and £8,000 in the case of housing benefit and community charge benefit, become completely ineligible for all means-tested benefits, however low their income.

There must, of course, be some upper limits above which help is no longer given. But the present limits are widely resented as a penalty on thrift and self-provision. This is

particularly so in the case of elderly people with some capital but only modest incomes. They believe it is unfair that they must use the money carefully saved during their working lives while others, less provident, have immediate access to the benefit system.

I have therefore reviewed the present limits with my Right Honourable Friend, the Secretary of State for Social Security, and we have decided that they should be raised. The limit for income support and family credit will rise from £6,000 to £8,000. But the problem is most acute for those whose savings disqualify them from housing benefit and community charge benefit. I propose therefore to double the capital cut-off for both these benefits from

£8,000 to £16,000. This new limit will be of particular help to couples. But it will also apply to single people and therefore extend help to some widows and widowers who would otherwise continue to be excluded.

This measure will benefit around a quarter of a million people, two-thirds of them pensioners who are at present wholly excluded from benefit. The total cost will be £120 million a year, which will be met from the Reserve and will not increase the public expenditure totals.

To avoid delay, my Right Honourable Friend is laying the necessary regulations today so that the limits will be increased when benefits are

uprated at the beginning of April. He will discuss the operational implications of this change with local authorities immediately.

L. PERORATION

Mr Deputy Speaker, this is a saver's Budget. It takes no risks with inflation. It further strengthens the public finances.

It helps the less well off. It gives women a better deal. It offers help to charities and sport. And it reduces the tax burden on growing companies.

It is the right Budget for this year, and it sets the right course for the '90s.

I commend it to the House, and the country.