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1989 BUDGET STATEMENT  
AND UNLEADED PETROL.

13-3-89

THIS FOLDER HAS BEEN  
REGISTERED ON THE  
REGISTRY SYSTEM



FROM: MISS M P WALLACE

DATE: 28 February 1989

*mp*

**MR ILETT**

*a the Odling-Smee  
the Neilsen*

cc Mr Odling-Smee  
Mr Neilson

*Pl- see my comments, +  
add yours - M. 27/ii*

**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.

Moira

*We are only discussing stamp duty with Mr Monck - our comments on the rest of the lot are final, and I return them - We will give you agreed stamp duty amendments later today.*

*mpw.*

MOIRA WALLACE

*Miss Wallace*

*HN*

*2/3*

*With apologies for the scribbles, herewith my and the Neilsen's comments. I gather that the Odling-Smee has already commented on paras 24-30; so the only comment of mine on those paras I suggest you note is that on the last sentence of para 29.*

*M. 7/iii*

## TAXES ON SAVING

general (savings ratio etc)

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

Comment.

Not v. happy with  
tone of general  
passage.

There has been  
a sharp decline  
in personal  
savings ratio but  
this is not in  
itself alarming  
- high corporate savings  
- high gov. saving

Objective of neutrality?

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. *by individuals*

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.

*Make it clear that is announced. Each of past 3 yrs*  
31. ~~The latest Treasury/Stock Exchange survey,~~

~~conducted earlier this year, reveals that there are now almost <sup>9</sup> 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.~~

I can now announce that this year's ~~the~~

~~the~~ shows how successful we have been

~~There are now The main of~~ 9  
Clear that there are not just few months' interest

which are those?  
Point is primarily to emphasize that decisions are being taken on their merits in a medium / longer term context + not as a response to conjunctural needs

Inaccurate  
delete

Refs back to  
British Steel?

*add para. Onit.*  
Indeed, there are now more individual shareholders than there are trade unionists. // (Check).

32. The privatisation of the water and electricity industries ~~is likely~~ <sup>will</sup> 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.

*Peps*  
34. ✓ Personal equity plans were first announced <sup>I</sup> 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, <sup>on the plan</sup> 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 £<sup>1</sup>/<sub>2</sub> billion between them.

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

redraft on these lines  
reasonable progress over the last 2 yrs. Clearly  
however that there is need to improve the system. Propose  
to do this.

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

redraft  
as above

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 and

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.

In order to ensure  
that the limit will be success of British industry is maintained,  
I am introducing a new requirement that

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, within the

overall limits for  
investment in any  
one year.

This change will  
meet the concerns of  
the unit trust industry  
that the existing PEP  
machinery does not  
adequately reflect the  
contribution that  
unit trusts can make  
in introducing  
new investors to the  
benefits of investment  
in equities. It will  
also reduce the cost of administering PEPs  
a benefit which I shall expect to see passed  
to investors

Note - Don't say RLAs, because  
there will be no RLAs in water  
falls

details in  
press notice  
issued by UK  
Today

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

ES0.

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

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



Canx??

to almost 1,600 today, involving [number] companies and benefiting some 1<sup>3</sup>/<sub>4</sub> 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.

bring up 46?

*more up?*

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.

*Matched interest test?*



FROM: MISS M P WALLACE  
DATE: 28 February 1989

*MP*

*Miss Wallace* ✓ *a. Mr. Dlett*

MR ILETT

*Mr Neilson*

cc Mr Odling-Smee  
Mr Neilson

*A few suggestions.*

*MP*  
*28/2*

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MOIRA WALLACE

*102/89*

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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~~ <sup>major</sup> inflows of capital from overseas.

[try to plug down  
need for capital  
inflow]

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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. <sup>(rather than a fall in personal assets.)</sup> And the

[net savings ratio  
usually means  
net of depreciation]

It is to simplify the tax system and -  
remove unnecessary anomalies. The Government  
is also committed to

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

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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.

(Do we not care about level playing fields, tax reform etc. any longer?)

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.

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(Note quite same point, so separate out.)

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

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

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

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

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

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

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

86. Stamp duty on share transactions have been a useful revenue raiser over the years. But it sits uncomfortably with the Government's commitment to encourage wider share ownership, and puts London at a competitive disadvantage to those overseas financial centres where there is no tax on share transactions. Moreover I have to tell the House that I have found some difficulty in solving the problem of how to apply stamp duty when there is <sup>no paper document</sup> ~~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 ~~ed~~ 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.



250  
-75

175

Ch

You might like attached  
pages to hand in case PM  
expresses concern about  
car scales.

Main points (Tax + NICs + car scales)

- only 220,000 losers
- average loss only £1 p.w.
- 60% of losers earn over £20,000

Compared with previous package  
(nothing on NICs, 20% car scales↑).

- 150,000 fewer losers
- losers earning less than £20,000  
reduced from 180,000 to 85,000

AA



Inland Revenue

Personal Tax Division  
Somerset House

*Handwritten notes in red ink:*  
That: Round figures 750  
Ok to include Schawm  
effects but use of course as  
separate. I am in sight about 10  
I propose to discuss  
the para 6, but  
costs (not  
Schawm  
Other district  
What is the  
to go ahead with it 28/2

FROM: P LEWIS  
EXT: 6371  
DATE: 28 FEBRUARY 1989

CHANCELLOR

CARS: MISCELLANEOUS POINTS

(a) Car Scales

1. We have looked again at the car scales, following your decision yesterday to increase them by one third, both to see exactly what the figures should be, and to provide a firm figure for the yield (which yesterday we arrived at by interpolation in the Table in paragraph 5 of my note of 27 February).

2. On the scales themselves the question is how much rounding you want, given that this year's main scale figures are in fairly round numbers, and figures which seem too precise may give an air of spurious accuracy.

- |    |                     |                        |
|----|---------------------|------------------------|
| cc | Chief Secretary     | Sir Anthony Battishill |
|    | Financial Secretary | Mr Isaac               |
|    | Paymaster General   | Mr Painter             |
|    | Economic Secretary  | Mr Bush                |
|    | Sir Peter Middleton | Mr Lewis               |
|    | Sir Terence Burns   | Mr Mace                |
|    | Mr Anson            | Mr Massingale          |
|    | Mr Monck            | Mr Hodgson             |
|    | Mr Scholar          | Mr I Stewart           |
|    | Mr Culpin           | Mr Evershed            |
|    | Mr Riley            | PS/IR                  |
|    | Mr Gilhooly         |                        |
|    | Mr Matthews         |                        |
|    | Mr Macpherson       |                        |
|    | Mrs Chaplin         |                        |
|    | Mr Tyrie            |                        |
|    | Mr Call             |                        |

Main Scales

	<u>1988/89</u>	<u>One third increase</u>	
		<u>1989/90</u> (rounded to nearest £10)	<u>1989/90</u> (rounded to nearest £50)
Up to 1400cc	1050	1400	1400
1401 to 2000cc	1400	1870	1850
Over 2000cc	2200	2930	2950
Over £19,250	2900	3870	3850
Over £29,000	4600	6130	6150

It would be possible to round further - to the nearest £100 - but the charge would then start moving away from an increase of one-third. For example, in the crucial 1401-2000cc band (which contains some 60% of company cars), that would give £1,900, an increase of 35.7%. But looking at the whole structure the first band would be exactly right and two would move up and two down. (There would be a similar picture with the - much less important - over 4 year old car scales.)

3. I attach distributional tables for the increase of one-third, on the same lines as in my note of 27 February, on both the £10 and £50 rounding.

4. The yield from the £10 scale would be very slightly higher than from the £50 scale; but in rounded terms they would both be the same:

	<u>1989/90</u> (£m)	<u>1990/91</u> (£m)
Before behavioural changes	155	185
Behavioural changes	<u>10</u>	<u>15</u>
	<u>160</u> (rounded)	<u>200</u>

(The ex-ante figure for 1989/90 is £5m more than the one we discussed yesterday).

5. For the behavioural changes we have roughly halved the relative effect anticipated last year, in the light of experience. (Mr Riley's note of 23 February 1988 discussed the behavioural effect which arises, at the margin, from people cashing out their cars for extra salary). But the behavioural effect is still very uncertain. Last year behavioural effects were not shown in the FSB; we assume that they should be this year.

6. One factor which could be relevant will be the (administrative) change we are proposing to the tax treatment of mileage allowances. In looking at the question of whether, following increased car scales, an employee would do better to drop his company car and instead have his own car with mileage allowances for business use, commentators assume that the going rate of mileage allowance will be tax free however many miles are driven. The cutting attached from today's FT is typical. If, from 6 April onwards, the full rate of tax free mileage allowance only runs for 4,000 business miles, the arithmetic will be altered quite significantly in favour of company cars since the assumption is usually that a substantial number of business miles are being driven (eg 15,000 in the cutting). As this should be seen by the car industry as a useful change from their point of view, it seems a further reason for making an announcement as soon as possible after the Budget.

(b) Private mileage of high business mileage drivers

7. Mr Taylor's minute of 23 February asked for the evidence that private mileage does not drop off even with very high business mileages.

8. The best evidence we know is in a report published by the Department of Transport's Transport and Road Research Laboratory in 1986 (based on data collected in the 1978/79 National Travel Survey). This set out the position as follows:

*Not attached  
for the sake  
of brevity*



<u>Annual Business Mileage</u>	<u>Average Private Mileage</u>
0-1999	7,500
2000-17999	9,500
18000 and over	7,300

The main reason for the differences in the average private mileage between these three groups is that the first and the last have significantly smaller home-to-work travel (1,300 and 1,600 fewer miles respectively than the main group). This probably reflects the fact that the low business mileage cars are sometimes not used for work at all; and, for the high business mileage cars, the more frequent making of business journeys direct from home without a call at the normal place of business.

9. The report also includes the useful conclusion "There does not appear to be any justification, at least in terms of the amount of private mileage, in the differential tax rates that are charged to drivers with high and low business use."

10. As I have said, this report was published in 1986, based on the latest information then available, which was the data collected in the 1978/79 National Travel Survey. There was another National Travel Survey in 1985/86, but it did not repeat the questions which made this analysis possible. But there is no reason to believe that the position has significantly changed. For example, the average private use of all company car drivers increased between the 1978/79 and 1985/86 surveys from 8700 miles to 9300 miles.

11. The SMMT have in the past carried out surveys which have produced higher business mileage and lower private mileage figures. There appear to be a number of reasons for this. For example, they have asked drivers retrospectively to apportion their mileage rather than keep mileometer readings; and questions have been phrased in such a way that some "home to work" travel may have been included in business mileage.

12. There are some general considerations which point to the likelihood that the private mileage of business drivers -

including high business mileage drivers - would be similar to that of the average private motorist. The main car industry argument is based on availability - that a company car cannot be used for private purposes while it is being used for its high business mileage. But it is equally true that many privately owned cars are not in practice available for private use, for a variety of reasons, during working days (for example, there are many more privately owned cars in company car parks than company cars) or when their owners are away on business. And the fact that as many as 60% of company car drivers get free fuel for private mileage must be an encouragement to private use, particularly for longer private journeys where fuel costs may otherwise be a significant factor.

(c) Percentage of cars of the road which are company cars

*Again, not  
attempted for  
sake of  
brevity.*

13. This question arose from the letter of 20 February from Lady Oppenheim-Barnes which said that approximately two-thirds of all cars in Britain are purchased by company fleets, and that 83% of them are British cars. It is difficult to reconcile this with the latest information the Department of Transport have given us.

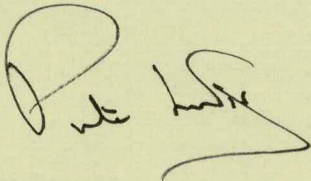
14. In 1988 2.21 million new cars were registered of which 51% were registered at a business address (that will include car hire cars and cars owned by the self-employed as well as company cars). It is not possible to put a figure on cars which, although belonging to businesses, are not registered under the business name.

15. Of the cars registered at a business address, 52% were manufactured in the UK (as compared with 39% of the rest).

16. The stock of business cars (2.17 million) represents only about 12% of the total stock of all cars. It is not possible to say what proportion of the total stock of cars was originally purchased for business purposes, but it is likely to be much higher than 12% given that the business share of new registrations has been substantial for many years.

Question for decision

17. Do you wish to adopt the car scale with roundings to £10 or £50? Or would you like us to look - very quickly - at other roundings, for example, to £100?

A handwritten signature in black ink, appearing to read 'P. Lewis', with a stylized flourish at the end.

P LEWIS

CONQUEROR



Table 1

One third increase in car scales: scales rounded to nearest £10

Tax and NIC: analysis of losers by amount of loss

<u>Annual loss</u>	<u>(thousands)</u>			
	<u>Main Scale</u>	<u>Perk cars</u>	<u>High business</u>	<u>Total</u>
over £200	2	4	-	6
£100-£199	4	9	-	13
£75-99	15	2	-	17
£50-74	38	3	-	41
£40-49	29	1	-	30
£30-39	23	1	2	26
£20-29	23	14	-	37
£10-19	12	2	3	17
£1-9	12	4	16	32
<hr/>				
Total	158	40	21	219
<hr/>				
Average annual loss	£47	£83	£9	£50

Tax and NIC: analysis of losers by total income

	<u>Number</u> <u>(thousands)</u>	<u>Average loss</u>
Under £15,000	39	£ 28
£15-20,000	45	£ 49
£20-25,000	84	£ 37
£25-30,000	16	£ 55
£30,000+	35	£101
<hr/>		
Total	219	£ 50
<hr/>		

Table 2

One third increase in car scales: scales rounded to nearest £50

Tax and NIC: analysis of losers by amount of loss

<u>Annual loss</u>	<u>(thousands)</u>			
	<u>Main Scale</u>	<u>Perk cars</u>	<u>High business</u>	<u>Total</u>
over £200	2	4	-	6
£100-£199	4	7	-	11
£75-99	13	3	-	16
£50-74	44	3	-	47
£40-49	16	3	-	19
£30-39	28	1	2	31
£20-29	11	14	-	25
£10-19	31	1	3	35
£1-9	10	3	16	29
<b>Total</b>	<b>159</b>	<b>39</b>	<b>21</b>	<b>219</b>
<b>Average annual loss</b>	<b>£46</b>	<b>£82</b>	<b>£7</b>	<b>£49</b>

Tax and NIC: analysis of losers by total income

	<u>Number</u> <u>(thousands)</u>	<u>Average loss</u>
Under £15,000	39	26
£15-30,000	46	50
£20-25,000	83	35
£25-30,000	16	54
£30,000+	35	102
<b>Total</b>	<b>219</b>	<b>£49</b>

I agree. See above my  
note below on para 114. A. 1/3

1. MR ANSON
2. PS/CHANCELLOR (Miss Wallace) cc

FROM: J P MCINTYRE  
DATE: 1 March 1989

PS/Chief Secretary  
PS/Paymaster General  
PS/Economic Secretary  
PS/Financial Secretary  
Sir P Middleton  
Sir T Burns  
Mr Anson  
Dame A Mueller  
Mr Wicks  
Mr Hardcastle  
Mr Byatt  
Mr Monck  
Mr Scholar  
Mr Sedgwick  
Mr Riley  
Mr A C S Allan  
Mr Gieve  
Mr Gilhooly  
Mr Matthews  
Mr Pickford  
Mr Macpherson  
Miss Hay  
Miss Simpson  
Mrs Chaplin  
Mr Tyrie  
Mr Call

Sir A Battishill IR  
PS/IR

Mr Unwin C&E  
PS/C&E

**BUDGET STATEMENT: TAX SECTION**

You asked for comments on the draft attached to your minute to PS/FST of 28 February. I attach a marked-up version of the draft. Two of the suggested changes are explained below.

**Para 108**

2. To acknowledge the pensioners' earnings rule as "notorious" would risk provoking people to press for abolition of other earnings rules or relaxation of the rules for means-tested benefits. These benefits (Income Support etc) are withdrawn as income rises in much the same way as the pension is reduced under the earnings rule.

**para 111**

3. Mr Bolton's minutes of 24 and 28 February explained that it was not possible to quantify (in revenue terms) the behavioural effects of abolishing the earnings rule. In any case, the supply side effects will cut both ways. Some additional elderly people may choose to work but they may to some extent displace younger people in the workforce. Some elderly people who already choose to work beyond state retirement age may be encouraged to work longer hours, but others may feel that they can afford to work less now that they can also receive their pension in full.


Jm

**J P MCINTYRE**

At the risk of being a kill-joy, I would advise against para. 114:

- (a) I am not sure that enough of the audience are familiar with the collected sayings of Mr. Darman!
- (b) The abolition only extends to the pensioners' earnings rule, so that even if one accepted it as a tax on the "duck" test, it would not be the abolition of a whole tax.
- (c) It is unwise to stir up the perception of this kind of rule as a "tax". That will only further encourage people to regard as a "tax" (and press the Chancellor to relieve) all the other earnings rules and - more important - the cut off of means-tested benefits, parental contributions, legal aid, etc., etc. But these are methods of targetting benefits, i.e. expenditure measures and not taxes. In other contexts, the Chancellor has disputed the argument that the poverty trap is a high marginal "tax" which he could or should reduce just like the higher rates of personal income tax.

I have attempted a redraft on the copy below, but these points together really go to the heart of the paragraph and I would advise omitting it.

  
**J. ANSON**

# BUDGET - SECRET

## TAXATION OF INCOME

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

104. I propose to raise all the main thresholds and allowances by the statutory indexation factor of 6.8 per cent, rounded up. Thus the single person's allowance will rise by £180 to £2,785, and the married man's allowance will rise by £280 to £4,375. The basic rate limit will rise by £1,400 to £20,700. The single age allowance will rise by £220 to £3,400, and the married age allowance by £350 to £5,385. The higher rate of age allowance will rise by £230 to £3,540 for a single person, and for a married couple by £360 to £5,565.

105. I have a number of measures to help the elderly. I propose that the higher age allowances, which are currently for those over 80, should be extended to cover all those aged 75 and over. This will take an additional [15,000] elderly pensioners out of tax altogether.

106. The income limit for the age allowance will rise by £800 to £11,400, again in line with indexation. However, I propose to reduce the rate at which the age



# BUDGET - SECRET

allowance is withdrawn above this income limit. But I propose that in future it should be withdrawn at the rate of £1 for each £2 of income, instead of the present withdrawal rate of £2 in every £3. This will mean that the marginal tax rate for those in this income band will be reduced to well below 40 per cent.

107. The Finance Bill will also include the provisions to establish the new tax relief for the pensioners' health insurance premiums, which I announced to the House in January, and which will take effect from April next year.

108. Under the ~~notorious~~ <sup>pensioners'</sup> earnings rule, any pensioner who decides to continue to work after reaching the ~~statutory retirement~~ <sup>state pension</sup> age has his or her pension docked at a rate of 50 per cent on every £1 earned between £75 and £79 a week, rising to 100 per cent for every £1 earned over £79 a week.

109. The Manifesto on which we were first elected in 1979 acknowledged that it was wrong to ~~penalise~~ <sup>discourage</sup> ~~people~~ <sup>people</sup> pensioners who wished to work beyond retirement age in this way, and pledged that we would ~~abolish the~~ <sup>phase out this</sup> earnings rule.

# BUDGET - SECRET

110. Of all the pledges in our 1979 Manifesto, that is the only one to remain unfulfilled. It will do so no longer. My Rt.Hon Friend the Secretary of State for Social Services and I have agreed that the pensioners' earnings rule should be abolished as from <sup>[2]</sup> 1 October. The necessary legislation will be included in the Social Security Bill currently before the House.

111. The cost to public expenditure will be <sup>125</sup> £~~125~~ million in 1989-90, which will be entirely met from the Reserves. But the true cost of this measure will be considerably less than this, <sup>to the extent</sup> ~~given the additional income tax and employers' National Insurance Contributions that will flow from the increase in the numbers of elderly at work, once this harsh disincentive has been removed.~~ <sup>it leads to an</sup> ~~increase in the numbers of elderly at work,~~ <sup>and thus to</sup> ~~additional tax revenue.~~

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

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

*Although this is an important improvement in the benefit*  
114. ~~If one were to adopt the so-called "duck test" now regime, many people regard the pensioners' earnings rule as in vogue across the Atlantic, the pensioners' earnings rule would qualify as a tax, and I would now be able to~~  
*To those who feel that way, I might even*

oUDGET - SECRET

claim to have abolished a seventh tax. But my innate modesty and natural reticence inhibits me from doing so.



*MP*

FROM: S M A JAMES  
DATE: 1 MARCH 1989

MR GAW, C & E

cc: PS/Chancellor  
PS/Chief Secretary  
PS/Financial Secretary  
PS/Paymaster General  
PS/Sir P Middleton  
Mr Scholar  
Mr Culpin  
Mr Gilhooly  
Mr Michie  
Miss Simpson  
Miss Wallace  
Mr Call  
PS/C&E  
Mr Jefferson-Smith, C&E  
Mr Wilmott, C&E  
Mr P R M Allen, C&E

**UNLEADED PETROL**

The Economic Secretary was grateful for your minute of 28 February.

2. He notes that at the Overview meeting on 27 February he asked officials to consult the trade about efficiency differentials. The Economic Secretary has commented that it is clear from the attached article that unleaded is noticeably better than 2-star but imperceptibly worse than 4-star leaded. We shall have to use the phrase "there will be no perceptible difference in performance if you switch from 4-star".

3. On your paragraph 10, the Economic Secretary has asked whether the 350,000 cars include vans?

*SMAJ*

S M A JAMES  
Private Secretary



# Octane Update

This could well prove the watershed year for unleaded petrol if only enough motorists can be encouraged to switch over to it. However, the exposure of the health hazards, especially to children, and the environmental factors against leaded fuel do not seem to be convincing people to modify their car engines.

Refuelling points are now never too far away and unleaded petrol carries around 6p less tax than conventional 4-star, making unleaded that much cheaper. Even if you are worried about where to find the pumps, the engine conversion does not preclude the use of ordinary fuel.

More likely it is confusion coupled with a lack of knowledge rather than lack of motivation that has prevented so many of us from making such a positive contribution to our environment. Too many questions seem to remain unanswered.

When going to a dealer or your local garage, are you given clear advice or discouraging noises, disguising lack of knowledge and poor workmanship? Are you under the impression that an engine adjustment to take unleaded fuel is irreversible? Did you know that many cars can already run on both fuels without adjustment? Do you hesitate because you think your car's performance will be affected?

We thought it would be helpful to set out the answers to a few such questions for our readers and correct one or two misconceptions. This does not, however, avoid the need to approach your dealer or mechanic for advice, but, through dispelling some of the myths, we hope to encourage you in making the decision to opt for unleaded fuel.

## 1. Why was petrol leaded? How can we now do without it?

Lead was originally added to petrol to improve the octane rating. This meant that car engines could have higher compression ratios with improved fuel economy and performance. As a lubricant it also helps to improve the durability of exhaust valves and seats. Developments in refinery technology, however, mean that high octane fuel can now be produced without adding lead. Petrol engines can now be made durable without needing lead to lubricate them.

## 2. Why should we change to unleaded fuel?

Lead is a poison; the more we reduce lead in daily use, the better it will be for the environment and the health of our children. A reduction in the amount of lead in petrol at the end of 1985 has already produced a 50% drop in airborne levels and decreases in blood levels of both adults and children. However, lead in petrol still accounts for 80% of lead in air. Unleaded petrol is also generally cheaper than leaded. You can save 6p a gallon over 4-star.

## 3. Can I use unleaded petrol?

It is probably easier than you realise. 10% of cars and 80% of motorcycles on the road at present have engines already designed to run on either leaded or unleaded fuel. A further 55% of cars could run on either with what is usually a minor, inexpensive adjustment to the ignition timing. This could be done at your next service, if not sooner. 80% of new cars sold can run on unleaded, 28% without any adjustment.

By 1 October 1990 all new cars must be able to run on unleaded fuel.

## 4. Can I still use leaded petrol after adjustment?

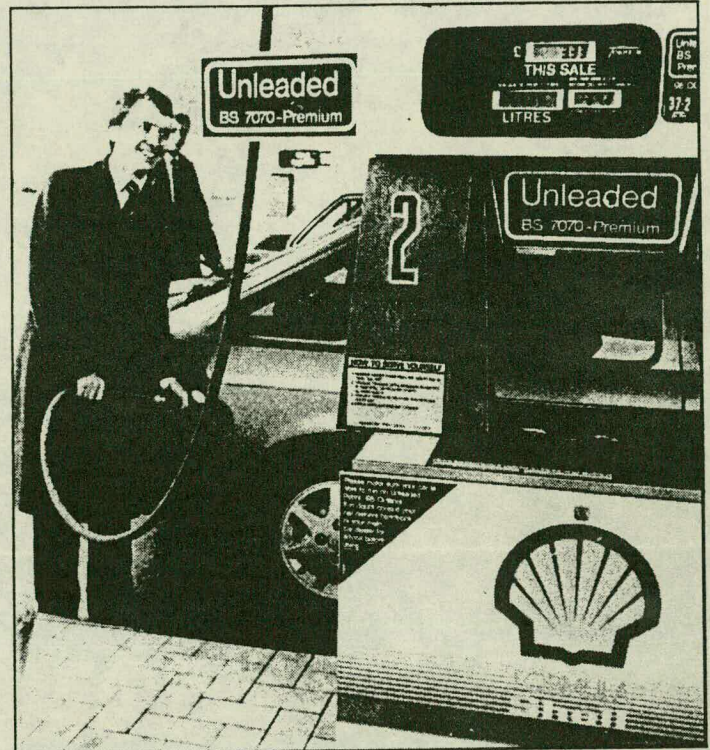
Yes. If you cannot buy unleaded when you need to fill up, you can use 4-star leaded petrol instead, without any further adjustment to the engine and with no risk of damaging your car.

## 5. Will unleaded petrol affect the performance of my car?

No. If your car is suitable and has been adjusted, no significant reduction in performance should be noticed. In fact, if you currently use 2- or 3-star leaded petrol you may well notice some improvement.

## 6. Can I use unleaded petrol in a car that has not been adjusted for the purpose?

It is clearly better to run your car on the type of fuel to which the engine is designed or tuned. A single accidental fill of unleaded petrol in an unadjusted car will not be serious so long as you return to using leaded fuel until a proper engine adjustment can be made.



## 7. I have heard that I must alternate between leaded and unleaded fuel for some cars. What does this mean?

In the case of some engines which have been adjusted to take unleaded fuel, you may be advised to fill up with one tank of leaded to every three of unleaded fuel. This is because the type of metal used in the engine valves can still benefit from the periodic use of lead to provide the cushioning effect referred to under question 1.

## 8. I normally use 2-star petrol. What can I do?

You can probably use unleaded petrol straightaway – but check with your dealer/mechanic – and possibly you will notice some improvement in performance.

## 9. What about my motorbike, lawnmower etc?

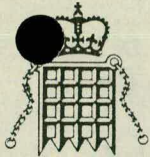
Most motorbikes and some petrol driven machines, like lawnmowers, out-board motors and chain saws, may be able to run on unleaded, but it would be advisable to consult the manufacturer or dealer for accurate advice on the individual product.

## 10. Do I need a more expensive catalytic converter?

No, not for the removal of lead alone. Catalytic converters are designed to reduce other exhaust pollutants. The catalysts in these devices are ruined by lead, and so cars fitted with them have to run on unleaded only. There are only a few car models with catalytic converters on the market in the UK at the moment. These are clearly marked as needing to run on unleaded petrol only and are distinguishable by a narrow orifice in the petrol tank, allowing it to be filled only from the narrower nozzle on the unleaded pump.

Further information can be obtained from the Department of The Environment in the form of a chart, listing the cars that can use either fuel without adjustment and a leaflet entitled *Unleaded Petrol: the Fuel of the Future*; and from the Department of Transport's booklet on *New Car Fuel Consumption*. Write to Room P1/003, 2 Marsham Street, London SW1P 3EB or telephone 01-274 0990. The organisation CLEAR operates an advice hotline on 01-387 4970 and can also provide a list of garages that stock unleaded fuel. Write to CLEAR, 3 Endsleigh Street, London WC1H 0DD.

The best approach, of course, is to consult your dealer or local garage. The quality of information being made available is improving all the time but if you feel your local mechanics are being less than helpful, press them to do their homework on the subject and give you better advice next time.



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

01-620 1313

ECONOMIC SECRETARY

*I asked him at overview to consult Trade.  
It is clear from the attached article that  
unleaded is noticeably better than 2X  
but imperceptibly worse than 4X  
please ~~you~~ will not be able to*

COPY NO 1 of 15

*unleaded will be no perceptible difference  
in performance of  
you scrubbed from 4\**  
FROM: D A GAW  
DATE: 28 February 1989

*re para 7 - can I see the whole report please.  
" 10 - do the 350,000 cars include vans?*

*RSC  
28/2*

UNLEADED PETROL

Points arising at the Overview meeting on 27 February have been actioned as follows:

DUTY CHANGES

2. We have instructed Parliamentary Counsel to:

- (a) increase the rebate of duty on unleaded petrol to £0.0272 a litre; and
- (b) insert a new charging provision for a higher rate of duty on two and three star petrol of £0.2122 a litre.

Distribution:

Chancellor	CPS
Sir P Middleton	Mr Jefferson Smith
Mr Culpin	Mr Wilmott
Mr Gilhooly	Mr Allen
Mr Michie	Mr Vernon
Miss Simpson	Mr Spackman
Mr Call	

BUDGET SECRET

3. The increase in rebate under 2(a) above is equivalent to 0.7 pence per litre duty (3.18 pence per gallon) plus 0.1 pence per litre VAT (0.46 pence per gallon). Total VAT inclusive increase in differential = 0.8 pence per litre (3.64 pence per gallon).

4. The higher rate of duty for two and three star under 2(b) above is equivalent to 0.78 pence per litre duty (3.55 pence per gallon) plus 0.12 pence per litre VAT (0.54 pence per gallon). Total VAT inclusive increase on two and three star = 0.9 pence per litre (4.09 pence per gallon).

5. The total VAT inclusive differential between

four star petrol and unleaded is 3.128 pence per litre (14.22 pence per gallon); and

two and three star petrol and unleaded is 4.028 pence per litre (18.31 pence per gallon).

UK PUMP PRICES

6. The scene is one of rapid change with the price of two star noticeably closing on four star petrol. On 16 February the average national difference was given as 0.9 pence per litre. Information received today indicates a further eroding of the pump price differential: the Department of Employment quotes 0.5p per litre and the Automobile Association 0.6p per litre. A separate source shows that in five areas (16 per cent) four star was cheaper than two star.

ST  
should these  
figures be  
taken as  
a sign that  
these surveys  
are pretty  
unreliable.  
5

## EFFICIENCY DIFFERENTIAL

Are you content with the 'proof' in para 7? I have not seen the original minutes yet but I thought A Tynie would have suggested we talk to the trade. In addition,

7. Department of Energy confirm that as far as the ordinary motorist is concerned there is no detectable difference (after vehicle adjustment) in efficiency between leaded petrol, of any grade, and unleaded. This is supported by "Which" magazine tests. Several motoring magazines have made the same point (eg Motoring and Leisure) and have gone as far as suggesting that two and three star users changing to unleaded might well notice some improvement.

## MARKET SHARE

~~I don't understand~~ are they saying there is a difference (but the "ordinary" motorist won't notice)? S 2 1/2

8. Over recent few weeks the market share of two and three star has declined more sharply than predicted as the trade prepares for an anticipated further widening of the duty differential between leaded and unleaded. Deliveries of two star for the month of January was only 6.1 per cent and still in decline.

9. The market share of unleaded based on deliveries from bonded warehouse increased dramatically in the period ended 14 February 1989 to about 5.5 per cent. We now estimate the share of unleaded to reach 17 per cent by 31 March 1990 (average 11 per cent) and 23 per cent by 31 March (average 20 per cent).

## TWO AND THREE STAR

10. Our best estimate is that fewer than 350,000 cars (less than two per cent) recommended to use two or three star petrol cannot be adjusted to use unleaded.

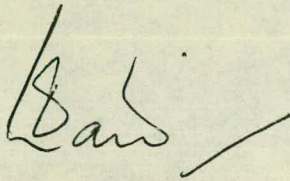


PUBLICITY

11. Customs and Department of Environment officials are meeting on 1  
March to arrange Budget-linked publicity concentrating on:

*EST  
I shall check  
on progress  
tomorrow. S  
28/1-*

- (a) action on two star;
- (b) costs of engine adjustment; and
- (c) the ability of cars adjusted to use unleaded and leaded four star when necessary.



D A GAW

BUDGET SECRET



COPY NO: 8 OF 15

FROM: FINANCIAL SECRETARY  
DATE: 1 March 1989

CHANCELLOR

cc Chief Secretary  
Paymaster General  
Economic Secretary  
Mr Scholar  
Mr Culpin  
Mr Gilhooly  
~~Miss Wallace~~  
Mrs Chaplin  
Mr Tyrie  
Mr Call

Mr Isaac )  
Mr Painter ) IR  
Mr Beighton)

**BUDGET STATEMENT: TAX SECTION**

You asked for comments on the latest draft. I also attach my suggestions for passages on unit trusts and Keith.

**Business Taxation**

para 7: I would replace the last sentence with "Between the two limits, the effective rate of tax will vary between 25 and 35 per cent".

para 9: amend the last sentence to read "These changes will reduce the corporation tax burden for X companies currently above the small profits limit".

para 10: for a definition of close companies, "generally those that are unquoted and controlled by a small number of people.

para 11: I am unhappy with the implied idea that the close company apportionment rules are a "burden" on businesses in the same way as (say) rates are. They only bite if the company is both profitable and does not distribute. I

would prefer the flavour to be more along the lines of "a simplification of the tax system".

para 16: You could make a passing reference at the end to the consultative document on swaps, which is a specific issue within the foreign exchange field.

#### Taxes on Savings

para 27: insert after "but" in the second line "the totality of savings within the economy. In other words, we must include....." and then as before.

para 28: clarify the point by amending the piece after "has" in the third line to "not occurred because gross saving has fallen. Rather, it is the result of the sharp increase in personal borrowing. And the...." and then as before.

para 31: I think we need the point that this has happened despite the stock market crash in 1987.

para 35: say when this happened (calendar year 1987?)

para 39: replace "preponderately invested" with "invest wholly or mainly".

para 41: I think we need the flavour of two separate points here. First, with PEPs as they are, the longer you stay in, the more tax relief you get. But with front-end relief, you have an incentive to take your tax relief and run. Secondly, to mitigate that incentive you would need a mass of complex legislation to protect the exit charge and to try to prevent round tripping and loanbacks.

para 44: these are SAYE share option schemes.

para 45: redraft as follows:-

"Third, a number of my Hon. Friends have been concerned that current tax law may be inhibiting the development of employee share ownership plans, otherwise known as ESOPs. These are trusts set up for the benefit of a company's employees, which invest in the company's shares and then distribute them to the workforce. It is already possible to establish an ESOP; indeed, a number exist in the UK. But I propose to make it clear that for companies that make payments to enable an ESOP to purchase shares in the company, those payments will qualify for corporation tax relief, provided that the ESOP meets certain requirements designed to ensure that the shares become directly owned by the employees within a reasonable time. This relief will override the existing reliance on case law which is proving restrictive. I hope that it will encourage more British companies, particularly in the unquoted sector, to consider setting up ESOPs."

para 49: I think you should mention the material interest changes.

para 52: replace "sui generis" with "unique".

para 54: it is life profits which get unduly favourable tax treatment, not pensions profits! You could also mention the other pensions measures.

para 55: on the yield of the package, I would stick to "broadly neutral".

para 58: I would put the rate cut and the abolition of LAPD before the restriction of acquisition expenses (ie before para 56).

para 62: is this statement true? What about double tax relief through BES Link Schemes?

para 63-67 I would mention decoupling after you have announced the details of the cap.

para 83: this is very vague. I would either be more specific, or drop it.

R.C.M.S.

PP NORMAN LAMONT

UNIT TRUSTS

On unit trusts, there are two ways of presenting this measure:-

- a) as a response to European competition:

"Later this year, UK unit trusts will be able to compete freely in Europe and will face competition from EC investment schemes here. At present, trusts investing in gilts or bonds face a tax disadvantage. They pay corporation tax at 35% on their income but can pass on a credit of only 25% to their investor. So I have decided that from 1 January 1990, as for life assurance companies, the corporation tax rate on unit trusts that come within the EC rules will be cut to 25%. Their investors will then get full credit for all the tax the trusts pay. I am also removing an unfair advantage which offshore umbrella funds enjoy over unit trusts: from today, switches between the individual parts of these umbrella funds will be liable to tax."

- b) as a measure designed to remove unit trusts' disadvantages relative to direct investment in non-equity securities, in which case it might be better to draft it as;

"At present UK unit trusts investing in gilts or bonds, and investors in such trusts, face a tax disadvantage. These trusts pay corporation tax at 35% on their income but can pass on a credit of only 25% to their investors. I have decided that from 1 January 1990, as for life assurance companies, the corporation tax rate on authorised unit trusts recognised under the UCITS Directive will be cut to 25%. Their investors will then get full credit for all the tax the trusts pay. I am also removing an unfair advantage which offshore umbrella funds

enjoy over unit trusts: from today, switches between the individual parts of these umbrella funds will be liable to tax. Together these measures will put UK unit trusts on a fairer footing to compete with their foreign counterparts."

I definitely prefer the first option. It accurately reflects the reason for the changes. And you must make it clear that the rate cut applies only to UCITS trusts, otherwise people might think it applies to all collective investment vehicles. Moreover, if you present it as a general measure, all those not affected (such as futures and options funds) will press for the same treatment.

We will of course be considering the tax position of non-UCITS collective investment vehicles over the coming year.

## ANNEX 2

KEITH

Finally, on Keith, I would insert a short paragraph after the section on taxpayer confidentiality. Again this could be drafted in 2 ways, depending on how detailed you want to be.

**EITHER:**

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

**OR:**

"I shall also be bringing forward in the Finance Bill measures to implement the remainder of the recommendations of the first two volumes of the Keith Report on compliance. These will simplify the system of interest and other penalties for tax offences, and cover the information powers of the Revenue. This will very largely complete the task I began in 1985. I should like to take this opportunity not only to repeat my thanks to Lord Keith and his team for their comprehensive and rigorous reports, but also to thank the very large number of individuals and organisations who have taken part in the wide



measure of consultation which we have subsequently undertaken."

I prefer the second option. It is more specific, but it sounds less sinister.



FROM: J M G TAYLOR  
DATE: 1 March 1989

*Handwritten signature*

MR LEWIS - INLAND REVENUE

cc Chief Secretary  
Financial Secretary  
Paymaster General  
Economic Secretary  
Sir P Middleton  
Sir T Burns  
Mr Anson  
Mr Monck  
Mr Scholar  
Mr Culpin  
Mr Riley  
Mr Gilhooly  
Mr Matthews  
Mr Macpherson  
Mrs Chaplin  
Mr Tyrie  
Mr Call

Sir A Battishill - IR  
Mr Isaac - IR  
Mr Painter - IR  
PS/IR

**CARS: MISCELLANEOUS POINTS**

The Chancellor was grateful for your not of 28 February.

2. He is content to round to the nearest £50. He is also content to include behavioural effects, but not of course as a separate item.

3. He notes the suggestion that the proposed administrative change to the tax treatment of mileage allowances might have some impact. He is not, however, clear why if the full rate of tax free mileage allowance only runs for 4000 business miles, the arithmetic will be altered quite significantly in favour of company cars. This seems distinctly perverse. He wonders whether we really want to go ahead with this proposal.

*Handwritten signature*

J M G TAYLOR



COPY NO <sup>16</sup> 37 OF COPIES

FROM: MISS M P WALLACE  
DATE: 2 March 1989

*pay*

PS/CHIEF SECRETARY

cc PS/Financial Secretary  
PS/Paymaster General  
PS/Economic Secretary  
Sir P Middleton  
Sir T Burns  
Mr Anson  
Dame A Mueller  
Mr Wicks  
Mr Hardcastle  
Mr Byatt  
Mr Scholar  
Mr Culpin  
Mr Sedgwick  
Mr Riley  
Mr A C S Allan ←  
Mr Gieve  
Mr Gilhooly  
Mr Matthews  
Mr McIntyre  
Mr Pickford  
Mr Macpherson  
Miss Simpson  
Mrs Chaplin  
Mr Tyrie  
Mr Call

Sir A Battishill - IR  
Mr Beighton - IR  
Mr Isaac - IR  
Mr Painter - IR  
Mr G Bush - IR  
Mr B Mace - IR  
Mr C MacNichol (plus 1)

Mr Unwin - C&E  
Ms A French - C&E

**BUDGET STATEMENT: TAX SECTION**

... I attach the Chancellor's draft of the NIC section of the speech. As he will be working further on this over the weekend, he would be grateful for quick comments as soon as possible tomorrow, Friday 3 March.

*M.P.W.*

MOIRA WALLACE

## NATIONAL INSURANCE CONTRIBUTIONS

I have one further measure to propose.

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

The two reduced rates, which I introduced for both employers and employees in my 1985 Budget, cut the cost of employing the young and unskilled, among whom unemployment was then high and rising, and cut the burden of national insurance contributions on the very low paid. But at the same time they produce a rather jagged pattern of contribution rates; and this has the unfortunate effect that, at a few points on the income scale, people can be worse off if they earn more. Their extra earnings take them from a lower rate band to a

higher one, and they therefore lose more in National Insurance contributions than they gain in extra pay. These few points have come to be known, somewhat inelegantly, as the National Insurance steps.

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

This will abolish altogether the steps which at present exist at earnings, for 1989-90, of £75 and £115 a week. I believe it right to keep the step which has always existed at the lower earnings limit, where people first come into the National Insurance system, because that is the entry ticket to the full array of contributory benefits. As such, it is an essential feature of the contributory principle. But my proposals will reduce this step very considerably, to only 86 pence in 1989-90.

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

These measures will take effect from 1 October, the earliest practicable date. The cost will be around £1 billion in 1989-90 and £2,900 million in 1990-91. The necessary legislation will be included in the Social Security Bill currently before the House.

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

mp

COPY NO. 1 OF 6 COPIES

FROM: C J RILEY  
DATE: 2 March 1989

MISS WALLACE

cc Mr Culpin  
Mr Gilhooly  
Mr McIntyre

BUDGET STATEMENT : TAX SECTION

May I offer a few comments.

2. Is it really sensible to include the car scales in the section on business taxation? I can see that the Chancellor may wish to get the bad news out of the way early on, but this surely ought to go in the section on personal tax.

3. Paragraph 29, on our policy for the taxation of saving, seems to me exceptionally feeble. Can we not do better than to say that our policy in this area is simply to encourage wider share ownership? Does this mean we would be happy to give tax subsidies for the purpose? Surely our policy is actually:

- to bring down tax rates and so limit the distortions of the savings market;
- encourage share ownership by means of favoured tax treatment falling short of outright subsidy;
- place strict limits on the scale of tax subsidies available for strongly favoured media (pensions and housing), with the expectation that the limits will fall in real terms over time.

4. I realise that making bold statements in this area runs the risk of causing belly laughs all round, but surely some hint that our policy recognises the need to limit the distortions of a savings market would be in order. Mr Culpin would no doubt be able to suggest a lucid form of words!

5. In paragraph 41, do we need to list some of the simplifications which are being made to the PEP rules?

6. I think that paragraph 111 - both in its original form and as redrafted by Paul McIntyre - is misleading. Tax flowbacks will arise even if there is no increase in the number of elderly at work. Although I realise that this can hardly be regarded as a bull point, perhaps we could redraft the second sentence as follows:

"But the true costs will be considerably less than this, given the additional [income tax and employers' National Insurance Contributions] [revenue] that will flow from the extra pensions paid and any increase in the numbers of elderly at work once this harsh disincentive has been removed."



C J RILEY



*Spare - pnp with  
COBO pps -*

FROM M C SCHOLAR  
DATE 3 MARCH 1989

*1 put mine  
in to Ch*

CHANCELLOR OF THE EXCHEQUER

- cc Chief Secretary
- Financial Secretary
- Paymaster General
- Economic Secretary
- Sir Peter Middleton
- Sir Terence Burns
- Mr Wicks
- Mr Hardcastle
- Mr Culpin
- Mr Odling-Smee
- Mr Peretz
- Mr Riley
- Mr Ilett
- Miss O'Mara
- Mr Gieve
- Miss Wallace
- Mrs Chaplin
- Mr Tyrie
- Mr Call

*Mps*

PS/IR

**BUDGET STATEMENT: COBO AND STERLING CAPITAL MARKET DEREGULATION**

I attach a draft section for the speech, as you requested.

2. I suggest that it comes at the beginning of the monetary policy section, following the order of the FSBR.

3. I do not think you need to mention local authorities; nor do I think that the reference to repeal of the 1946 Borrowing (Control and Guarantees) Act should cause problems with QL colleagues.

*MCS*

M C SCHOLAR

Monetary policy

1. Monetary policy, to which I now turn, plays, and must always play, the central role in the battle against inflation. As the House knows, this has been the consistent basis of policy throughout the last ten years. Short-term interest rates have been, as they must be, the principal instrument of monetary control. We reject direct, quantitative controls, which have been tried here and abroad, and found wanting. They create distortions and inefficiencies; and they simply would not work in today's financial markets.

2. I am today adding one more entry to the long list of direct controls which we have swept away during our term of office. The last surviving relic of the post-war apparatus for the direction of capital by the State is the Control of Borrowing Order which since 1946 has involved first the Treasury then the Bank of England in giving consents for equity and bond issues in the capital markets. The Treasury has today made a General Consent under the Control of Borrowing Order 1958, so that it will no longer be necessary for those who wish to make capital markets issues to obtain the Bank of England's consent to the timing of such issues; and we will, as soon as possible, revoke

the Order itself and repeal the legislation on which it depends, the 1946 Borrowing (Control and Guarantees) Act.

3. The sterling capital market has in recent times been going through a period of considerable adjustment, as the government has changed from being a large issuer to a large purchaser of its own debt. I will have more to say about that in a moment. The abolition of the Control of Borrowing Order will remove an unnecessary and bureaucratic restriction on issuers of capital as they move into the space formerly occupied by the government when it was a borrower.

4. This new freedom will be enhanced by a further, important, set of deregulatory measures for the sterling capital market which are being promulgated today in notices issued by the Bank of England. These measures will open up the market for sterling paper of less than 5 years' maturity by extending the range of institutions which can make such issues; and they will create a unified regime for all these issues. In parallel the Inland Revenue are today issuing press notices which set out my proposals for a reformed regime, needed in any event to prevent a loss of tax, of the taxation of deep discount and other bonds.

5. Taken together the changes I have described constitute a major liberalisation of the arrangements for London's capital markets. They will give issuers greater flexibility and investors wider choice.

6. The ultimate objective of monetary policy is a stable price level ...[as in existing draft].

14 14



COPY NO OF COPIES

FROM: J M G TAYLOR

DATE: 3 March 1989

67. 7/3

PS/ECONOMIC SECRETARY

cc Sir P Middleton  
Mr Culpin  
Mr Gilhooly  
Mr Michie  
Miss Simpson  
Mr Call

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

UNLEADED PETROL

The Chancellor would be grateful to know, on the basis of the latest evidence, what will be the average pump price differential between four star and unleaded after the Budget. Perhaps Mr Wilmott could kindly provide advice.

*JMG*

J M G TAYLOR

COPY NO. 3 OF 5.



FROM: MISS M P WALLACE

DATE: 6 March 1989

MP

cc (without attachment)  
Mr Anson .

MR MCINTYRE

BUDGET STATEMENT: TAX SECTION

... Thank you for your comments on last week's version of the Speech.  
The Chancellor considered these over the weekend, and I attach  
extracts from the version he has sent back (paragraphs 103-121).

2. May I ask for any further comments by close tomorrow, Tuesday  
7 March.

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

MOIRA WALLACE

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

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

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

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

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



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

109. That is precisely what we shall do. My Rt.Hon Friend the Secretary of State for Social Services and I have agreed that the pensioners' earnings rule should be abolished as from 2 October, the earliest practicable date. The necessary legislation will be included in the Social Security Bill currently before the House.

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

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

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

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

#### NATIONAL INSURANCE CONTRIBUTIONS

114. I have one further measure to propose.

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

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

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

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

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

full array of contributory benefits. As such, it is an essential feature of the contributory principle. But my proposals will further reduce this step very considerably, to only 86 pence a week in 1989-90.

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

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

121. The changes will take effect from 1 October, the earliest practicable date. The cost will be some £1 billion in 1989-90 and £2,800 million in 1990-91. The necessary legislation will be included in the Social Security Bill currently before the House.

MP  
COPY NO. 11 OF 20



FROM: ECONOMIC SECRETARY

DATE: 6 March 1989

CHANCELLOR

cc: Chief Secretary  
Financial Secretary  
Paymaster General  
Sir P Middleton  
Mr Scholar  
Mr Culpin  
Mr Gilhooly  
Mr Michie  
Miss Simpson  
Miss Wallace  
Mrs Chaplin  
Mr Tyrie  
Mr Call

PS/C&E  
Mr Jefferson-Smith C&E  
Mr Wilmott C&E  
Mr P R H Allen C&E  
Mr Gaw C&E

**UNLEADED PETROL**

I have had a last look at the unleaded petrol package, in the light of the latest market information and Customs' most recent figures on two-star users who cannot convert to unleaded.

2. When originally proposed the two-star share was around 8%. It was on a steeply descending curve and in January had fallen to 6.1%. (This is the latest figure available. The February figure, which is likely to be below 6% will not be available until the end of March).

3. The initial proposal was also based on the assumption that "virtually all" vehicles using two-star could convert to unleaded. It now emerges that some 350,000 two-star users cannot do so. There are around 2 million or so vehicles which are recommended to use two-star. But the two-star consumption figures

suggest that only between about 1.2 million and 1.5 million do so. The rest use either four-star or unleaded.

4. So the proportion of vehicles recommended to use two-star which cannot convert to unleaded is about 17%. But the proportion of two-star users who cannot convert could be anything up to 30%. This compares with the proportion of four-star users who cannot convert to unleaded of around 24%.

5. There are three options:-

The first, which I favour, is to retain the proposed package but ensure the rhetoric does not rest on the supposed much greater ease of conversion of two-star users to unleaded. The increased differential between two-star and unleaded which we propose is still justified by (i) the need to give the 800,000 to 1.2 million two-star users the same incentive to convert as four-star users (ii) the desirability of releasing two-star pumps, storage and advertising space to switch to unleaded (roughly half of all stations sell two-star but less than a quarter currently sell unleaded).

The second option is to drop the two-star "surcharge" but retain the planned increase in the unleaded differential. This may well open us up to criticism for stinginess as the  $3\frac{1}{2}$ p per gallon increase in the differential is less than the 5p most people are demanding. Moreover, it will not, of itself, quite increase the average price differential at the pump to double figures - 10p or more.

The third option would be to drop the two-star "surcharge" but increase the unleaded differential by 5p per gallon instead of the planned  $3\frac{1}{2}$ p. However, this is quite costly. Customs estimate a net extra cost of £40 million in the first year and £65 million in the second year.

6. I should be glad of your agreement to the first option. Customs need a decision by first thing tomorrow.

*fruity*

PETER LILLEY

(agreed by the Economic Secretary  
and signed in his absence)



COPY NO. 1 OF 20

FROM: ECONOMIC SECRETARY

DATE: 6 March 1989

CHANCELLOR

cc: Chief Secretary  
 Financial Secretary  
 Paymaster General  
 Sir P Middleton  
 Mr Scholar  
 Mr Culpin  
 Mr Gilhooly  
 Mr Michie  
 Miss Simpson  
 Miss Wallace  
 Mrs Chaplin  
 Mr Tyrie  
 Mr Call

PS/C&E  
 Mr Jefferson-Smith C&E  
 Mr Wilmott C&E  
 Mr P R H Allen C&E  
 Mr Gaw C&E

*Ch*  
 EST getting old feet,  
 but I think we ought to  
 stand by original decision  
 I agree with the stick  
 with 15% option.  
 I was not aware  
 that we  
 were doing  
 this  
 on no  
 "suppose"  
 think gtr  
 have a  
 conversion  
 of 2\*  
 users to  
 unleaded.

UNLEADED PETROL

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3. The initial proposal was also based on the assumption that "virtually all" vehicles using two-star could convert to unleaded. It now emerges that some 350,000 two-star users cannot do so. There are around 2 million or so vehicles which are recommended to use two-star. But the two-star consumption figures

*PS. How many  
 users who cannot  
 convert will have  
 to pay more (and  
 for 2 star or 4 star).  
 how many users  
 have converted?  
 how many users  
 have converted?  
 how many users  
 have converted?  
 how many users  
 have converted?*

suggest that only between about 1.2 million and 1.5 million do so. The rest use either four-star or unleaded.

4. So the proportion of vehicles recommended to use two-star which cannot convert to unleaded is about 17%. But the proportion of two-star users who cannot convert could be anything up to 30%. This compares with the proportion of four-star users who cannot convert to unleaded of around 24%.

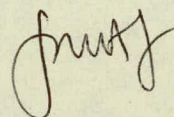
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The second option is to drop the two-star "surcharge" but retain the planned increase in the unleaded differential. This may well open us up to criticism for stinginess as the  $3\frac{1}{2}$ p per gallon increase in the differential is less than the 5p most people are demanding. Moreover, it will not, of itself, quite increase the average price differential at the pump to double figures - 10p or more.

*Not on*  
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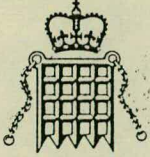
6. I should be glad of your agreement to the first option. Customs need a decision by first thing tomorrow.



PETER LILLEY

(agreed by the Economic Secretary  
and signed in his absence)





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

*In the light of X,  
possible sus so  
a difference of about  
10p a gallon  
(or 2p a litre)*

FROM: D A GAW  
REVENUE DUTIES DIVISION  
DATE: 6 March 1989

PS/ECONOMIC SECRETARY

*2p a litre  
(of this sum)  
or used in  
Budget speech, wh.  
psr  
account*

UNLEADED PETROL

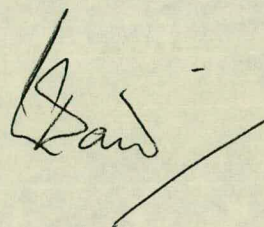
1. The Chancellor asked what will be the average pump price differential between four star and unleaded after the Budget.

2. Our latest available information suggests that if the full increase in the rebate of duty (including VAT) were passed on by the oil companies the average pump price differential on the forecourt between four star and unleaded petrol would be 2.1 pence a litre (9.55 pence a gallon). We cannot, however, exclude the possibility of heavily discounted four star being much closer (and sometimes cheaper) in price to unleaded in the same area.

Distribution: PS/Chancellor  
Sir P Middleton  
Mr Culpin  
Mr Gilhooly  
Mr Michie  
Miss Simpson  
Mr Call

CPS  
Mr Jefferson Smith  
Mr Wilmott  
Mr Allen  
Mr Vernon  
Mr Spackman

3. The scenario at filling stations changes almost daily. For example, over the week-end Fina at some locations joined Conoco and Texaco in withdrawing two star in favour of unleaded. The differential between Fina four star and unleaded now is 7.3 pence a gallon (1.6 pence a litre) but their example so far has not been followed by the majors who continue to show a differential of 5.9 pence (1.3 pence a litre).

A handwritten signature in dark ink, appearing to read 'D A GAW', with a long horizontal stroke extending to the right.

D A GAW



difficult to communicate those improvement that have taken place because of the absence of a series of output measures. Those that we have developed for PES rightly focus on cost effectiveness, and tend to cover those factors most easily quantified. I wonder whether we need to develop/improve measures of customer service level, which cover quality as well as quantity. I know it can be argued that that would just be creating a rod to beat ourselves, but on the other hand public services are there to serve the public. We shouldn't be guilty of the producer focus that we condemn in the private sector.

*MC*

**MARK CALL**



FROM: MISS M P WALLACE

DATE: 6 March 1989

MR BURR

cc Ms E. Young

**BUDGET STATEMENT: TAX SECTION**

... I attach the passage on PRP from the latest draft of the Chancellor's speech (paragraphs 41-44). You will see that material interest has been reinstated.

2. I should be grateful if any further comments you may have could reach me by close tomorrow, Tuesday 7 March

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

MOIRA WALLACE

41. 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. The same benefits can flow from profit related pay.

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

43. First, as I have previously announced, I propose to abolish the restriction that, to qualify for the tax relief, 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.

44. Third, I propose to enable employers to set up schemes for headquarters and other central units using the profits of the whole company or group for their profit calculations. <sup>P</sup> And fourth, to help share schemes and ESOPs as well as profit related pay, I propose <sup>to change</sup> ~~changing~~ the material interest rules which <sup>may</sup> ~~be~~ at present unnecessarily exclude employees from their schemes where they already benefit from a trust set up for employees.



FROM: MISS M P WALLACE

DATE: 6 March 1989

mp

MR L J HARRIS

cc PS/Sir P Middleton\*

(\* without attachment)

**BUDGET STATEMENT: PENSIONS**

... I attach a copy of the pensions passage from the latest draft of the Budget Speech (paragraphs 58-72). I understand that it was agreed at the Chancellor's meeting on 24 February, that there should be some reference to the position in the public sector. I should be grateful if you could advise on what ought to be said. Could I ask for this, and any other comments you may have, by close tomorrow, Tuesday 7 March, please.

*M P Wallace*

MOIRA WALLACE



58. I now turn to pensions.

59. Of all forms of savings, the most favourable tax treatment is that accorded to pension schemes. This is necessarily circumscribed by Inland Revenue rules.

60. But as a result, tax law has effectively come to set a limit on the overall pension someone can receive. This is neither desirable nor necessary. Accordingly, I propose to remove the obstacles in the way of employers setting up pension schemes to provide benefits above the tax limits. Such "top-up" schemes will carry no limit on benefits whatsoever, but, equally, will have no tax privileges. Thus, employers will henceforth be free to provide whatever pensions package they believe necessary to recruit and reward their employees.

61. This change enables me to deal with another anomaly in the existing tax reliefs for pensions; namely that there is no limit to them at all, in cash terms: the higher an individual's salary, the greater the pension they can have, and the more tax relief that goes with it. Of course, someone who receives a very

high salary will expect a good pension. But given that one man's tax relief is another man's tax increase, and in the light of the income tax reforms I introduced last year, it is hard to justify a state of affairs in which the tax advantages of pension provision are effectively available with no upper limit whatever.

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

63. I therefore propose to set a limit on the pensions which may be paid from tax-approved occupational schemes, based on earnings of £60,000 a year. I have deliberately set the ceiling at a level which will leave the vast majority of employees unaffected, and it will be subject to annual uprating in line with inflation. It will still be possible for a tax-approved occupational scheme to pay a pension of as much as £40,000 a year, of which up to £90,000 may be commuted for a tax-free lump sum.

64. The new ceiling will apply only to pension schemes set up, or to new members joining existing schemes, on or after today. And, as I have already said, there will

now be complete freedom to provide benefits above the Inland Revenue limits, though without the tax advantages.

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

66. I also propose to simplify very substantially the rules concerning additional voluntary contributions or AVCs. In particular, the present requirements for free standing AVCs place a heavy administrative burden on employers at the point where an employee wants to start paying AVCs. In future, the necessary checks will be greatly reduced. In many cases employers will not need to be involved at all.

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

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

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

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

71. Second, I propose to increase substantially the annual limits, as a percentage of earnings, on contributions to personal pensions for those aged 35 and over. This will be of particular value to those running their own business, who are often unable to make

contributions until later on in their working life. It will also improve the position of personal pensions in relation to occupational schemes. The new limits will be subject to an overall cash ceiling based on earnings of £60,000, corresponding to the new ceiling for occupational pensions, and similarly indexed.

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



FROM: MISS M P WALLACE

DATE: 6 March 1989

MP

cc Ms E. Young

MR BURR

**BUDGET STATEMENT: TAX SECTION**

... I attach the passage on PRP from the latest draft of the Chancellor's speech (paragraphs 41-44). You will see that material interest has been reinstated.

2. I should be grateful if any further comments you may have could reach me by close tomorrow, Tuesday 7 March

*M.P.W.*

MOIRA WALLACE

41. 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. The same benefits can flow from profit related pay.

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

43. First, as I have previously announced, I propose to abolish the restriction that, to qualify for the tax relief, 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.

44. Third, I propose to enable employers to set up schemes for headquarters and other central units using the profits of the whole company or group for their profit calculations. <sup>P</sup> And fourth, to help share schemes and ESOPs as well as profit related pay, I propose <sup>to change</sup> ~~changing~~ the material interest rules which <sup>may</sup> ~~be~~ at present unnecessarily exclude employees from their schemes where they already benefit from a trust set up for employees.



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FROM: MISS M P WALLACE  
DATE: 6 March 1989

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- PS/Paymaster General
- PS/Economic Secretary
- Sir P Middleton
- Sir T Burns
- Mr Anson
- Dame A Mueller
- Mr Wicks
- Mr Hardcastle
- Mr Byatt
- Mr Scholar
- Mr Culpin
- Mr Sedgwick
- Mr Riley
- Mr A C S Allan
- Mr Gieve
- Mr Gilhooly
- Mr Matthews
- Mr Pickford
- Mr Macpherson
- Mr Michie
- Miss Hay
- Miss Simpson
- Mrs Chaplin
- Mr Tyrie
- Mr Call

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- Sir A Battishill - IR
- Mr Beighton - IR
- Mr Isaac - IR
- Mr Painter - IR
- Mr G Bush - IR
- Mr C McNicol IR [+1]

- Mr Unwin - C&E
- Mr Jefferson Smith - C&E
- Mr P R H Allen - C&E
- Ms A French - C&E [+1]

**BUDGET STATEMENT: TAX SECTION**

The Chancellor was most grateful to all those who commented on last week's version of the tax section (my minute of 27 February).  
... I attach his latest version, with the amendments side-lined.

2. There are one or two specific points which you might like to note.

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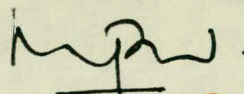
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- (i) The Chancellor has decided, on balance, not to include Keith, so the Financial Secretary may want to mention it in his speech.
  - (ii) The Chancellor has also decided not to mention the consultative document on swaps in the Budget speech.
  - (iii) He has deleted the bulk of what was formerly paragraph 41 - the explanation of why other PEP modifications had been ruled out - but he feels this might usefully be developed for defensive briefing.
  - (iv) For the moment, he has retained a paragraph on deep discounted bonds, with the other CGT changes. But, depending on how he revises the first section of the speech, it is possible that these could be replaced by an allusion in a more general section on COBO.

3. He would be grateful if any further comments on this revise could reach me by close tomorrow, Tuesday 7 March.



MOIRA WALLACE

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**TAXPAYER CONFIDENTIALITY**

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

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

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

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

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

**BUSINESS TAXATION**

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

6. First, taxes on business.

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



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

X

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

X

10. I propose to increase the VAT threshold to £23,000, the maximum permitted under European Community law.

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

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

[13. There is one further tightening in the general area of employee benefits which I believe it right to make. There is an extra statutory concession which exempts from income tax additional housing costs paid by an employer when an existing employee moves to a higher cost area. This relief blunts the market forces which should be leading employers to relocate in lower cost areas, and I therefore propose that it should be withdrawn. Anyone who has moved, or entered into a commitment to move, before today will, however, continue to receive the relief. At the same time I propose to put on a proper statutory footing the more important and fully justified extra statutory concession exempting from tax payments made by an employer to cover an employee's inevitable moving costs when he is required to move house because of his job.]

14. Over the years I have received a steady stream of representations from business complaining about the long-standing tax treatment of foreign exchange gains and losses. I recognise that as business becomes more

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global this subject becomes increasingly important. However, I have to say that I find it one of the most intractable I have encountered. Certainly, there can be no question of any change in the present system until a number of crucial and complex issues have been satisfactorily resolved. I have therefore authorised the Inland Revenue to publish today a consultative document which explores those issues and examines the scope for reform.

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

16. One of the many undesirable features of an income tax system with several higher rates was that since a taxpayer's marginal rate could well be very different in different years, the question of which year income was attributed to made a great deal of difference. To remove the scope for manipulation, the rule was that income was taxed in the year to which it related, on an accruals basis.

17. This is still the basis of Schedule F and poses no problem at all for the vast majority of employees, who are on PAYE. But for about half a million people,

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mainly directors, who do not receive their income in the year to which it formally relates, it causes untold complication, with needless form-filling long after the tax year is over. With only one higher rate of income tax, the potential for this abuse is gone. I therefore propose that income tax under Schedule E should in future be assessed on a receipts basis, with the simple principle that you pay the tax when you receive the income. Initially, this will have a transitional cost of £80 million, but in the long term it will yield both extra revenue and significant Inland Revenue staff savings.

18. The reduction in the top rate of income tax to 40 per cent in last year's Budget also enables me to make a major simplification of the tax treatment of that section of the small business sector known as close companies - generally, unquoted companies that are controlled by five or fewer people.

19. The rules for the so-called apportionment of close companies' income are notoriously complex, taking up some twenty pages of impenetrable legislation. These rules are no longer needed and I propose to abolish them. I believe that many [hundreds of thousands] of

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small businesses, and particularly family businesses, will welcome this substantial simplification.

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

#### **TAXES ON SAVING**

21. I now turn to the taxation of saving.

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

23. Certainly it is desirable that, over the medium-term, we generate as a nation a level of saving high enough to finance a high level of investment. But what matters in this context is not personal savings alone, but corporate savings too, which are running at historically high levels, and public sector savings,

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which have of course been boosted by the move to budget surplus.

24. 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 not occurred because gross saving has fallen; rather it is the result of the sharp increase in personal borrowing. And the appropriate remedy for that is to raise the cost of borrowing, and with it the return on saving, as we have done.

25. Above all, it is essential that tax reform is always seen in a medium-term, even a long-term time-scale. It is wholly inappropriate as an answer to what are essentially cyclical phenomena. 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.

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

27. Meanwhile, I have a number of specific tax measures to announce today to the same end.

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28. 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 further tax at all, either on the dividends they receive or on any capital gains they may eventually make - indeed, there is no need for them to get involved with the Inland Revenue at all.

29. 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 £<sup>1</sup>/<sub>2</sub> billion between them in 1987.

30. Since then, however, the rate of growth has slowed down, not least as a result of the changed climate in the equity market since the October 1987 Stock Exchange crash.

31. So the time has come to improve and simplify PEPs and give them a new lease of life.

32. 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.

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33. 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 investment through a PEP a unit or investment trust must invest wholly or mainly in UK equities.

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

35. Finally, I propose to make a number of important simplifications to the PEP rules so as to make the scheme more flexible, better directed to the needs of small and new investors, and cheaper to administer.

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



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

X 38. It is a striking fact that the number of approved employee share schemes has risen from a mere 30 in 1979 to almost 1,600 today, involving 10,000 companies and benefiting some 1<sup>3</sup>/<sub>4</sub> million employees. At present the annual limits on the value of shares which can be given income tax-free to employees under all-employee profit-sharing schemes are £1,250 or 10 per cent of salary up to a ceiling of £5,000. I propose to raise these limits to £2,000 and £6,000 respectively.

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

40. Third, a number of my Hon. Friends have been concerned that current tax law may be inhibiting the development of employee share ownership plans, otherwise known as ESOPs. These are distinguished from ordinary approved employee share schemes by the fact that they

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use a wider variety of finance, acquire more shares and tend to operate on a longer timescale. I propose to make it clear that companies' contributions to ESOPs qualify for corporation tax relief, provided they meet certain requirements designed to ensure that the employees acquire direct ownership of the shares within a reasonable time. I hope that this will encourage more British companies, particularly in the unquoted sector, to consider setting up ESOPs.

41. 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. The same benefits can flow from profit related pay.

X

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

43. First, as I have previously announced, I propose to abolish the restriction that, to qualify for the tax relief, 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.

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44. Third, I propose to enable employers to set up schemes for headquarters and other central units using the profits of the whole company or group for their profit calculations. <sup>PP</sup> And fourth, to help share schemes and ESOPs as well as profit related pay, I propose <sup>to change</sup> ~~changing~~ the material interest rules which <sup>may</sup> ~~be~~ at present unnecessarily exclude employees from their schemes where they already benefit from a trust set up for employees.

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

46. I now turn to life assurance.

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

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48. There is clearly a powerful case for reform, with a view to securing a tax regime which is more equitable both within the industry and as between life assurance and most other forms of savings. Accordingly, last July the Inland Revenue issued with my authority a major consultative document on the taxation of life assurance.

49. Since then, I have considered very carefully the representations the industry has made, and taken full account both of the changes to the regulation of life assurance proposed by the Securities and Investment Board under the Financial Services Act and the prospects for increased competition within the European Community after 1992. In the light of these factors, I have decided not to proceed with the more radical reforms canvassed in the consultative document. But I do have a number of important changes to propose, based for the most part on the general tax reform principle of seeking lower rates on a broader base.

50. First, many life offices run a pension business alongside their life assurance business, and they are not required to keep the two businesses separate for tax purposes. This enables them to set the unrelieved expenses of the pensions business against the income and gains of their life business, thus giving their life



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profits unduly favourable tax treatment. I propose to end this anomaly.

51. This change, which will come into force on 1 January 1990, will yield £155 million in 1990-91. The remainder of the changes I have to propose constitute a broadly balanced package which, because of the transitional provisions, will reduce the taxation of life assurance in 1990-91 by some £110 million.

52. I propose that the expenses incurred by life offices in attracting new business should continue to be fully deductible for tax purposes from the income and gains of life funds, but spread over a period of seven years rather than being deductible immediately, as now. To give the industry time to adjust, this change will be phased in gradually over the next four years, starting on 1 January, 1990.

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

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

55. The net revenue effect of this reform of the taxation of life assurance will be a cost of £20 million in 1989-90 and a yield of £45 million in 1990-91, rising somewhat in subsequent years.

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

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

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rate of income tax. Their investors will then get full credit for all the tax the trusts pay.

58. I now turn to pensions.

59. Of all forms of savings, the most favourable tax treatment is that accorded to pension schemes. This is necessarily circumscribed by Inland Revenue rules.

60. But as a result, tax law has effectively come to set a limit on the overall pension someone can receive. This is neither desirable nor necessary. Accordingly, I propose to remove the obstacles in the way of employers setting up pension schemes to provide benefits above the tax limits. Such "top-up" schemes will carry no limit on benefits whatsoever, but, equally, will have no tax privileges. Thus, employers will henceforth be free to provide whatever pensions package they believe necessary to recruit and reward their employees.

61. This change enables me to deal with another anomaly in the existing tax reliefs for pensions; namely that there is no limit to them at all, in cash terms: the higher an individual's salary, the greater the pension they can have, and the more tax relief that goes with it. Of course, someone who receives a very

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high salary will expect a good pension. But given that one man's tax relief is another man's tax increase, and in the light of the income tax reforms I introduced last year, it is hard to justify a state of affairs in which the tax advantages of pension provision are effectively available with no upper limit whatever.

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

63. I therefore propose to set a limit on the pensions which may be paid from tax-approved occupational schemes, based on earnings of £60,000 a year. I have deliberately set the ceiling at a level which will leave the vast majority of employees unaffected, and it will be subject to annual uprating in line with inflation. It will still be possible for a tax-approved occupational scheme to pay a pension of as much as £40,000 a year, of which up to £90,000 may be commuted for a tax-free lump sum.

64. The new ceiling will apply only to pension schemes set up, or to new members joining existing schemes, on or after today. And, as I have already said, there will



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now be complete freedom to provide benefits above the Inland Revenue limits, though without the tax advantages.

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

66. I also propose to simplify very substantially the rules concerning additional voluntary contributions or AVCs. In particular, the present requirements for free standing AVCs place a heavy administrative burden on employers at the point where an employee wants to start paying AVCs. In future, the necessary checks will be greatly reduced. In many cases employers will not need to be involved at all.

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

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

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

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

71. Second, I propose to increase substantially the annual limits, as a percentage of earnings, on contributions to personal pensions for those aged 35 and over. This will be of particular value to those running their own business, who are often unable to make

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contributions until later on in their working life. It will also improve the position of personal pensions in relation to occupational schemes. The new limits will be subject to an overall cash ceiling based on earnings of £60,000, corresponding to the new ceiling for occupational pensions, and similarly indexed.

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

73. The proposals I have announced for personal equity plans, for life assurance and for pensions amount to a significant further measure of tax reform, this time in the field of the taxation of saving.

74. But it should not be overlooked that a more far-reaching reform which I announced in last year's Budget, to come into effect in April 1990, may well have an even more marked effect in encouraging the growth of personal saving.

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75. I refer, of course, to Independent Taxation. For there can be little doubt that one of the greatest disincentives to saving in the present tax system is the treatment of the savings of married women. At present a wife's income from savings has to be disclosed to her husband and taxed at his marginal rate. Independent Taxation will change all that. In particular, those married women who have little or no earnings will in future be able to set their personal allowance against their savings income. Independent Taxation is a major reform. Preparations are well in hand for its introduction in April next year, and three new leaflets have just become available from Inland Revenue offices to explain all the main features of the new system.

**TAXES ON SPENDING**

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

77. As the House knows Her Majesty's Government are obliged to implement the European Court's judgement that certain of our zero rates of VAT on supplies to business, notably on non-residential construction, are not lawful. This derives from the Court's



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interpretation of the Community's Sixth VAT directive to which the UK agreed in 1977. The necessary changes will be introduced in this year's Finance Bill, and draft clause have already been published.

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

79. These measures of mitigation will reduce the burden on the private sector from £450 million to just £35 million in the first year rising to £110 million in a full year. There will also be a yield of £xyz million from the public sector, which has been fully taken into account in the Public Expenditure plans already announced.

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

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

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

83. I also propose to relieve from car tax cars leased to the disabled. [Add, if possible, statistics on benefit to individual.]

84. But in general, I continue to believe that the best way of helping charitable causes through the tax system is by directly encouraging the act of charitable giving. The Payroll Giving Scheme, which I introduced in my 1986 Budget, has been growing steadily. Some

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3,400 schemes have now been set up, and over 100,000 employees are already participating, quite a few of them giving the full £240 annual limit. I now propose to double that limit to £480, or £40 a month.

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

86. I now turn to the excise duties.

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

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petrol sales, even though two-thirds of the cars now on the road could use it, either without any adjustment or else with a conversion costing only some £20 or so.

X 88. One of the problems is ignorance of the facts. Many motorists do not realise that their cars can already use unleaded petrol. Many others are unaware how modest the conversion cost is. Many are under the false impression that, if they do switch to unleaded petrol, their cars will no longer be able to use leaded petrol. Others wrongly imagine that their car's performance would suffer were they to use unleaded fuel.

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



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price of leaded and unleaded petrol within the European Community.

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

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

92. They will of course also lead to a loss of revenue of some £40 million in 1989-90. I propose to recoup this from Vehicle Excise Duty. At the present time a bus or a coach has to have 66 seats before it pays as much in Vehicle Excise Duty as a family car. I propose to rectify this anomaly by increasing the tax rates of this group of vehicles so that they cover their track costs.

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I also propose to increase the rates of duty for the heaviest non-articulated lorries, to put them on a more equal footing with articulated lorries. These changes will also simplify the system, reducing the number of separate rates of Vehicle Excise Duty from 220 to 70.

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

**TAXATION OF INCOME**

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

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

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

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

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

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

100. In the case of gifts of personal belongings, these benefit from chattels relief, under which any items worth less than £3000 on disposal are entirely exempt from capital gains tax. I propose to double the chattels exemption limit for capital gains tax to £6000.

101. The last of these three capital gains tax proposals is to change the tax treatment of certain bonds so as to simplify the tax rules and prevent a loss

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

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

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

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



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

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

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

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

109. That is precisely what we shall do. My Rt. Hon Friend the Secretary of State for Social Services and I have agreed that the pensioners' earnings rule should be abolished as from 2 October, the earliest practicable date. The necessary legislation will be included in the Social Security Bill currently before the House.

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

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

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

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

**NATIONAL INSURANCE CONTRIBUTIONS**

114. I have one further measure to propose.

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

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

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

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

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



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full array of contributory benefits. As such, it is an essential feature of the contributory principle. But my proposals will further reduce this step very considerably, to only 86 pence a week in 1989-90.

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

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

121. The changes will take effect from 1 October, the earliest practicable date. The cost will be some £1 billion in 1989-90 and £2,800 million in 1990-91. The necessary legislation will be included in the Social Security Bill currently before the House.

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122. The total additional cost of all the measures in this Budget, on an indexed basis, is under £2 billion in 1989-90 and £3<sup>1</sup>/<sub>2</sub> billion in 1990-91.

[Peroration to follow]

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PS/ECONOMIC SECRETARY

FROM: J M G TAYLOR

DATE: 7 March 1989

cc PS/Chief Secretary  
PS/Financial Secretary  
PS/Paymaster General  
Sir P Middleton  
Mr Scholar  
Mr Culpin  
Mr Gilhooly  
Mr Michie  
Miss Simpson  
Miss Wallace  
Mrs Chaplin  
Mr Tyrie  
Mr Call

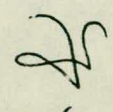
Mr Jeffersor. Smith - C&E  
Mr Wilmott - C&E  
Mr P R H Allen - C&E  
Mr Gaw - C&E  
PS/C&E

## UNLEADED PETROL

The Chancellor has seen the Economic Secretary's note of 6 March.

2. He agrees that we should stick with the first option, ie to retain the proposed package but ensure the rhetoric does not rest on the supposed much greater ease of conversion of two star users to unleaded (he has commented, however, that he was not aware that we did ever use this justification).

3. He has commented, incidentally, that two star users who cannot convert will have to pay more (either for two star or, more likely, four star). How much more would this be than if petrol tax had been revalorised? Perhaps Customs could kindly provide advice.



J M G TAYLOR



FROM: J M G TAYLOR

DATE: 7 March 1989

*M*

PS/ECONOMIC SECRETARY

cc Sir P Middleton

Mr Culpin

Mr Gilhooly

Mr Michie

Miss Simpson

Miss Wallace

Mr Call

Mr Unwin - C&E

Mr Jefferson Smith - C&E

Mr Wilmott - C&E

Mr Allen - C&E

Mr Gaw - C&E

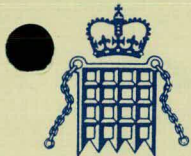
UNLEADED PETROL

The Chancellor has seen Mr Gaw's note of 6 March.

2. He has commented that, in the light of the information in Mr Gaw's paragraph 2, the changes should be presented as a difference of almost 10p a gallon (or just over 2p a litre). This should also be used in the Budget Speech.

*JMG*

J M G TAYLOR

**BUDGET-SECRET**

H.M. CUSTOMS AND EXCISE  
 DEPARTMENTAL PLANNING UNIT  
 NEW KING'S BEAM HOUSE, 22 UPPER GROUND  
 LONDON SG1 9PJ  
 01-620 1313

*Phf*  
 (FAX 4/11)  
 seen

Copy 1 of 24

FROM: P. R H ALLEN  
 DEPARTMENTAL PLANNING UNIT

DATE: 7 March 1989

PS/CHANCELLOR

**UNLEADED PETROL**

1. Your note to the PS/Economic Secretary today asked for advice on how much more two star users who cannot convert to unleaded would pay under the proposed package than if petrol had been revalorised.

2. Revalorisation would have added 1.6 pence a litre (7.3 pence a gallon) in duty and VAT to all grades of leaded petrol compared with the proposed increase on two and three star alone of 0.9 pence a litre (4.1 pence a gallon). Two star users will therefore pay 3.2 pence a gallon less for two star than they would have done had all leaded petrol duty simply been revalorised.

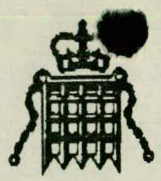
*RA.*

P R H ALLEN

Circulation:	
PS/Chief Secretary	CPS
PS/Financial Secretary	Mr Jefferson Smith
PS/Paymaster General	Mr Wilmott
PS/Economic Secretary	
Sir P Middleton	Mr Gaw
Mr Scholar	Mr Vernon
Mr Culpin	Ms French
Mr Gilhooly	Mr Warr
Mr Michie	
Miss Simpson	
Miss Wallace	
Mrs Chaplin	
Mr Tyrie	
Mr Call	

2A 191/89

# BUDGET-SECRET



H M CUSTOMS AND EXCISE  
DEPARTMENTAL PLANNING UNIT  
NEW KING'S BEAM HOUSE, 22 UPPER GROUND  
LONDON SG1 9PJ  
01-620 1313

*Handwritten notes in red ink:*  
Chamber  
Assess  
Budget  
Note below  
7/3

Copy 1 of 21

FROM: P R H ALLEN  
DEPARTMENTAL PLANNING UNIT

DATE: 7 March 1989

PS/CHANCELLOR

## UNLEADED PETROL

1. Your note to the PE/Economic Secretary today asked for advice on how much more two star users who cannot convert to unleaded would pay under the proposed package than if petrol had been revalorised.

2. Revalorisation would have added 1.5 pence a litre (7.3 pence a gallon) in duty and VAT to all grades of leaded petrol compared with the proposed increase on two and three star alone of 0.9 pence a litre (4.1 pence a gallon). Two star users will therefore pay 3.2 pence a gallon less for two star than they would have done had all leaded petrol duty simply been revalorised.\*

*\* And they can buy 4 star for*  
*- the same pump price as two star*  
*- less than they would have had to pay for 4 star*  
*- 3.2 pence less than 4 star would have been.*

*RA.*

P R H ALLEN

- Circulation:
- |                        |                    |
|------------------------|--------------------|
| PS/Chief Secretary     | CPS                |
| PS/Financial Secretary | Mr Jefferson Smith |
| PS/Paymaster General   | Mr Wilmott         |
| PS/Economic Secretary  |                    |
| Sir P Middleton        | Mr Gaw             |
| Mr Scholar             | Mr Vernon          |
| Mr Culpin              | Ms French          |
| Mr Gilhooly            | Mr Warr            |
| Mr Michie              |                    |
| Miss Simpson           |                    |
| Miss Wallace           |                    |
| Mrs Chaplin            |                    |
| Mr Tyrie               |                    |
| Mr Call                |                    |

*21*  
*1/3*



COPY NO 33 OF 34

FROM: MISS M P WALLACE

DATE: 7 March 1989

SIR T BURNS

- cc PS/Chief Secretary
- PS/Financial Secretary
- PS/Paymaster General
- PS/Economic Secretary
- Sir P Middleton
- Mr Anson
- Dame A Mueller
- Mr Wickes
- Mr Hardcastle
- Mr Byatt
- Mr Scholar
- Mr Culpin
- Mrs Lomax
- Mr H P Evans
- Mr Peretz
- Mr Riley
- Mr Sedgwick
- Mr A C S Allan
- Mr Gieve
- Mr Hibberd
- Mr O'Donnell
- Mr Pickford
- Miss Simpson
- Mrs Chaplin
- Mr Tyrie
- Mr Call

Sir A Battishill IR  
PS/IR

Mr Unwin C&E  
PS/C&E

**BUDGET STATEMENT: ECONOMIC SECTION**

I attach the Chancellor's redraft of the Economic section of the speech. He would be grateful for quick comments, if possible to reach me by lunchtime tomorrow, Wednesday 8 March.

*MPW.*

**BUDGET SPEECH - FIRST SECTION**

The background to this year's Budget is the overriding need to bear down on inflation, at a time when, throughout the world, it is edging up for the first time this decade.

2. It is only by doing this, whatever the short-term difficulties, that we will preserve the great gains we have made in this country over the past ten years, gains which offer so much hope for the future.

3. I shall begin, as usual, with the economic background to the Budget, I shall then deal with monetary policy and the public sector finances. Finally, I shall propose a number of measures to carry forward the process of tax reform.

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

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

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

6. For the first time, economic policy has been set firmly and explicitly in a medium-term context. That means that we do not bend to every puff of wind that comes along: we resist the blandishments of those who urge reflation or deflation in automatic response to every new number that fashion dictates should assume special significance. We stand ready to act and act promptly whenever inflationary pressures threaten to re-emerge. But that is within a general philosophy that the Government should set a sound medium-term financial framework and leave it to the private sector to operate with confidence within it.

7. The Government came to office with two central objectives: to defeat inflation, and to breathe new life into a moribund economy. Inflation is a disease of money; and monetary policy is its only cure. Fiscal policy is used to bring the public accounts into balance and keep them there, and thus complete the process of re-establishing sound money. And within the context of sound money, markets had to be allowed to work again, and the enterprise culture restored, by the removal of unnecessary restrictions and controls, by the reform of

trade union law and promotion of all forms of capital ownership, and by the reform and reduction of taxation.

8. In the early years, the urgent task was to stamp out the inflationary forces that had raged in the '70s, and wrought so much economic and social havoc. Between 1974 and 1979 inflation averaged over 15 per cent. By 1983 we brought it down to 5 per cent, and that is what it has averaged since.

9. It was not surprising that in those early years less progress was made in improving the supply performance of the economy. But once business and industry recognised the dramatic changes that were occurring in the economic climate, they responded with vigour and confidence. As a result, we have experienced the longest period of sustained strong growth since records began. Indeed, output in the United Kingdom has grown faster than in all the major European nations during the '80s - a marked contrast to the previous two decades, when we were bottom of the league. And this growth has been based on a dramatic and sustained improvement in productivity, which in the economy as a whole has been second only to that of Japan among all the major nations during the '80s - and in manufacturing has exceeded that of Japan.

10. We have more people in work than ever before, and their living standards have improved beyond recognition.

11. But it is not just our economic performance over the past ten years that has been transformed: so have our prospects for the future. For over the past seven years, investment has grown very nearly twice as fast as consumption, and total business investment is now a higher proportion of GDP than ever before. And its quality has improved immeasurably, too: witness the dramatic improvement in profitability.

12. So the outlook is good, provided we remain firm in our resolve to get on top of inflation.

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

14. It now looks as if we had in 1988 a second successive year of growth at  $4\frac{1}{2}$  per cent - the first time this has happened [since the War/for 30 years] - with unemployment falling by half a million to well below the European average. [This means, incidentally,

that we have had six successive years of growth at 3 per cent or better, the first time this has ever occurred.]

15. Manufacturing output grew particularly rapidly, by more than 7 per cent, to a level well above the previous peak reached as far back as the first half of 1974.

16. But total domestic demand also grew by some 7 per cent, faster than the economy's capacity to supply, mainly because of the boom in industrial investment, in itself a welcome event, but also because of continued strong growth in consumer spending. This last was financed to an unprecedented degree by borrowing, overwhelmingly mortgage borrowing. Of all borrowing by households, almost 85 per cent is accounted for by mortgages compared with under 5 per cent by credit cards.

17. Inevitably this led to renewed inflationary pressure. To some extent this was relieved by a sharp rise in imports, and hence in the current account of the balance of payments. This is officially recorded as having reached  $\text{£}14\frac{3}{4}$  billion in 1988, although given the  $\text{£}15\frac{1}{4}$  billion positive balancing item (another name for errors and omissions) the true figure is almost certainly less than this. More important - for whatever

the true figure, it is undoubtedly large, and a sharp increase on the deficit recorded in 1987 after seven successive years of surplus - it is one that, given sound policies can readily be financed.

18. Unlike previous current account deficits we have known in this country, it does not reflect a budget deficit, but rather the excess of private sector investment over total private savings. And this is something that will in due course correct itself.

19. But there has also been some pick up in recorded inflation. Excluding the distorting effect of mortgage interest payments, the RPI, which rose by  $5\frac{1}{4}$  per cent in 1983, increased by  $4\frac{1}{2}$  per cent last year. But the rate picked up markedly through the year, and the most recent figure is  $5\frac{1}{2}$  per cent.

20. Moreover this pick up in inflation appears to be a worldwide trend. Indeed, over the past six months, the rate of inflation excluding mortgage payments has probably risen by slightly less than inflation in the rest of the G7.

21. In any event, it soon became clear that it was necessary to tighten monetary policy sharply, by the only effective means of raising short-term interest

rates, and this was duly done, starting last June. I repeat what I have stated clearly on a number of previous occasions: interest rates will stay as high as is needed for as long as is needed to get on top of inflation. Nor am I prepared to allow the struggle against inflation to be undermined by exchange rate depreciation.

22. I am of course keenly conscious of the effects of the rise in interest rates on borrowers, particularly home owners. But however unwelcome high interest rates are, they are infinitely preferable to the damage that would be done by high inflation.

23. There are now increasing signs that the determined action already taken is having the desired effect. The housing boom that played such a large part in the events of last year has largely subsided. Monetary growth, particularly as measured by the target aggregate, M0, has slowed down appreciably. And retail sales, too, seem to have levelled off over the past three months, presaging a gradual recovery in the personal savings ratio.

24. The outlook for 1989 is for inflation to rise a little further to something approaching 8 per cent as



recorded by the RPI (although excluding mortgage interest payments the rate is forecast to remain well below 6 per cent) before falling back in the second half of the year to  $5\frac{1}{2}$  per cent in the fourth quarter and perhaps  $4\frac{1}{2}$  per cent in the second quarter of 1990.

25. A slow down in real growth is probably inevitable as we get inflation back onto a downward path - indeed, it has almost certainly already begun to happen. Overall growth is forecast to fall from the  $4\frac{1}{2}$  per cent recorded last year to 2 per cent this year, with domestic demand growth also at 2 per cent. Within this, investment is once again forecast to grow faster than consumption. The current account deficit is forecast to remain at roughly the same level as this year's.

26. But the question of how "soft" or "hard" the landing is as we get the economy back on track is not a matter for Government, nor is it a sensible objective of economic policy. The Government's policy is to reduce inflation by acting, through monetary policy, to bring down the growth of GDP in money terms. The extent to which, over the short term, this is reflected in a reduction in inflation, and the extent to which it is reflected in a growth in real output, is up to business and industry.

27. In a free economy, it is up to them to ensure that the temporary rise in inflation during the first half of this year does not lead to an unwarranted rise in pay and other costs. Any failure by industry to control its costs will only make the necessary reduction in the growth of nominal GDP more painful, not least in terms of employment prospects.

28. But over the medium-term, it is clear from experience over the past ten years that it is inflation that will come down, while steady growth will resume. Indeed, it is clear that over anything but the very short term, the use of fiscal and monetary policy to promote growth merely leads to inflation; whereas the use of macroeconomic policy to curb inflation, when coupled with the right supply side policies, produces real growth.

—  
Monetary policy

29. Monetary policy, to which I now turn, plays and must always play, the central role in the battle against inflation. It is at the very heart of the medium-term financial strategy, the 10th Edition of which I am publishing today.

30. I have already described the monetary tightening that has taken place over the past nine months. This has led to a sharp deceleration in the rate of growth of the target aggregate, M0, although for 1988-89 as a whole it is likely to have grown at some [2] percentage points above its target range.

31. For 1989-90, the target range will be 1-5 per cent, as envisaged in last year's MTFS. Although starting the year above the top of that range, its very low growth over the past six months - some  $2\frac{1}{2}$  per cent at an annualised rate - suggests that it will soon come back within it. The exchange rate is also of particular importance in the conduct of monetary policy. The Government's clear commitment not to accommodate increases in domestic costs by exchange rate depreciation remains a key safeguard against inflation. It has recently been demonstrated in the markets by our readiness to make use of the massive reserves we have accumulated. In this context, we will continue to work with our G7 partners to maintain the exchange rate stability that has been a feature of the past two years.

32. As for the past [three] years, there is no target for the growth of broad money, or liquidity, but it will continue to be taken into account.

33. Short-term interest rates remain the essential instrument of monetary policy. As I have already indicated, the battle against inflation is paramount, and there can therefore be no question of any premature reduction in interest rates.

34. Meanwhile, I am today adding one more entry to the long list of financial controls which we have swept away during our term of office. The last surviving relic of the post-War apparatus for the direction of capital by the State is the Control of Borrowing Order which since 1946 has involved first the Treasury then the Bank of England in giving consents for equity and bond issues in the capital markets. The Treasury has today made a General Consent under the Control of Borrowing Order 1958, so that it will no longer be necessary for those who wish to make capital market issues to obtain the Bank of England's consent to the timing of such issues; and we will, as soon as possible, revoke the Order itself and repeal the legislation on which it depends, the 1946 Borrowing (Control and Guarantees) Act.

35. The sterling capital market has in recent times been going through a period of considerable adjustment,

as the Government has changed from being a large issuer to a large purchaser of its own debt. I will have more to say about that in a moment. The abolition of the Control of Borrowing Order will remove an unnecessary and bureaucratic restriction on issuers of capital as they move into the space formerly occupied by the Government when it was a borrower.

#### Public Sector finances

36. When we first took office the public sector borrowing requirement was almost 6 per cent of GDP - equivalent to some £[30] billion in today's terms.

37. This was steadily reduced over the years as a deliberate act of policy, until, by 1987-88, the PSBR had been eliminated altogether and we started to repay the national debt.

38. Accordingly, last year I budgeted for a further Public Sector Debt Repayment, or PSDR, of some £3 billion. In the event, it looks like turning out five times as large, at £15 billion, or 3 per cent of GDP. Even if there had been no privatisation proceeds at all, the public finances would still be in surplus, to the tune of some £8 billion.

39. Nothing like this has ever been achieved since the War. And no other major country enjoys a comparable budget surplus. It has not been easy, even though we were assisted in the year now ending by a combination of an extra £2 billion of privatisation proceeds, and by the exceptional buoyancy of the economy, which both boosted tax receipts and reduced public expenditure well below the planned level. As a result, total public debt as a proportion of GDP is now lower than at any time since before the First World War.

40. Moreover, the substantial repayment of public debt over the past two years has permanently reduced the burden of debt servicing, both now and for future generations. For the coming year, for example, the debt repayments of the last two years mean that debt interest costs are lower by £[X] billion a year. Indeed, debt reduction on this scale means that in this year's Finance Bill I shall have to take a new power, not needed before, to enable gilts to be acquired by the NLF, for cancellation.

41. The dramatic improvement in the United Kingdom's public finances has also provided a welcome opportunity to devote more attention to the structure of the debt

that remains. Now that the Government has become a net purchaser of debt, it has become possible to tailor repayment policy so as to reduce future interest costs, and to improve the quality of outstanding Government debt by relying less on the more liquid borrowing instruments.

42. Similarly it has proved possible to restructure part of the Government's foreign currency debt, launching an innovative and cost-effective programme of Treasury Bills denominated in ecu. The first experimental six-monthly tenders for these bills have proved extremely successful, and I can today inform the House that the programme will be continuing, at a level of around ecu  $2\frac{1}{2}$  billion. [What period?]

43. In last year's Budget Speech , I set out the principle of a balanced budget as a proper objective of fiscal policy.

A balanced budget is a valuable discipline for the medium term. It represents security for the present and an investment for the future. Having achieved it, I intend to stick to it. In other

words, henceforth a zero PSBR will be the norm. This provides a clear and simple rule, with a good historical pedigree."

44. It is a rule that ensures that, as GDP continues to rise, the ratio of public debt to GDP continues to fall, and with it the burden of debt interest. It ensures, too, that the State makes no claim either on the savings of the private sector or on flows of finance from overseas. But to go further than this, and seek to achieve the maximum possible repayment of public debt, would be neither economically sensible, nor consistent with the Government's policy, as it would mean deferring for a very long time the prospect now before us of a sustainable and progressive reduction in the burden of taxation.

45. So I reaffirm the principle of the balanced budget. However, given the substantial surplus we now have, the path of prudence and caution is clearly to return to balance not overnight, but gradually, over a period of years. Thus we can expect to have a number of further years of debt repayment ahead of us. Moreover, given the particular uncertainties there are at the present time, I believe it would be right to budget for 1989-90 for a surplus similar to that secured in the



year now ending, after adjusting for the change in privatisation proceeds: that is to say, a further public sector debt repayment, or PSDR, of some £13 billion. What this means is that it will not be possible in this Budget to reduce the burden of taxation that is to say, to reduce taxation as a share of GDP.

BUDGET SECRET

*mp*

COPY NO *1* OF 3

FROM: S W MATTHEWS  
DATE: 7 March 1989

MISS WALLACE

BUDGET STATEMENT : TAX SECTION

A few minor drafting changes to the version which you circulated on 6 March.

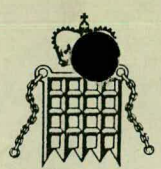
Para 7 Last sentence : "average" instead of "effective".

Para 24 Fall in saving ratio is not solely due to rise in personal borrowing.

Para 105 Last sentence: delete "well" - 37½ per cent is not much below 40 per cent.

*SM*

S W MATTHEWS



H.M. CUSTOMS AND EXCISE  
DEPARTMENTAL PLANNING UNIT  
NEW KING'S BEAM HOUSE, 22 UPPER GROUND  
LONDON SG1 9PJ  
01-620 1313

*VP*

Copy 12 of 24

FROM: P. R H ALLEN  
DEPARTMENTAL PLANNING UNIT

DATE: 7 March 1989

PS/CHANCELLOR

UNLEADED PETROL

1. Your note to the PS/Economic Secretary today asked for advice on how much more two star users who cannot convert to unleaded would pay under the proposed package than if petrol had been revalorised.

2. Revalorisation would have added 1.6 pence a litre (7.3 pence a gallon) in duty and VAT to all grades of leaded petrol compared with the proposed increase on two and three star alone of 0.9 pence a litre (4.1 pence a gallon ). Two star users will therefore pay 3.2 pence a gallon less for two star than they would have done had all leaded petrol duty simply been revalorised.

*RA.*

P R H ALLEN

- 
- Circulation:
- |                        |                    |
|------------------------|--------------------|
| PS/Chief Secretary     | CPS                |
| PS/Financial Secretary | Mr Jefferson Smith |
| PS/Paymaster General   | Mr Wilmott         |
| PS/Economic Secretary  |                    |
| Sir P Middleton        | Mr Gaw             |
| Mr Scholar             | Mr Vernon          |
| Mr Culpin              | Ms French          |
| Mr Gilhooly            | Mr Warr            |
| Mr Michie              |                    |
| Miss Simpson           |                    |
| Miss Wallace           |                    |
| Mrs Chaplin            |                    |
| Mr Tyrie               |                    |
| Mr Call                |                    |

MP

FROM: L J HARRIS

DATE: 7 MARCH 1989

MISS M WALLACE

cc Sir P Middleton  
Mr Gieve  
Mr Dixon  
Mr Rayson

## BUDGET STATEMENT: PENSIONS

Paragraph 64 of the extract from the draft Budget Speech which you sent me with your minute of 6 March does not accurately reflect the Chancellor's decision that the pension changes should apply only to new members joining existing schemes on or after 1 June. The opening sentence of the paragraph should read:

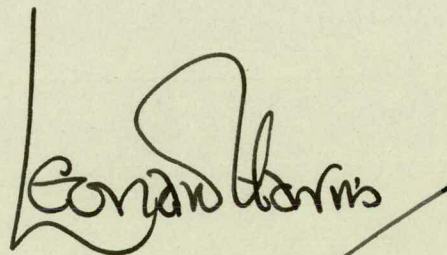
"The new ceiling will apply only to pension schemes set up on or after today, and to new members joining existing schemes on or after 1 June."

2. I assume that the Chancellor will not want to touch on the detail of how the changes will be applied in the public services, and will want to avoid any commitment to particular kinds of possible public service top-up schemes. That being so, the reference to the public service implications should be as brief as possible. I suggest:

(i) in paragraph 63, line 2, add, after "tax-approved", "and relevant statutory";

(ii) at the end of paragraph 64, add a new sentence as follows:

"The Government will be considering further the implications for the statutory public service pension schemes, taking account of developments in the private sector and of any future recommendations by the Top Salaries Review Body."



L J HARRIS



BUDGET CONFIDENTIAL

2 MARSHAM STREET  
LONDON SW1P 3EB  
01-276 3000

0483

My ref:  
Your ref:

*mp*

The Rt Hon John Major MP  
Chief Secretary  
HM Treasury  
Parliament Street  
LONDON  
SW1P 3AG

CHIEF SECRETARY	
REC.	- 9 MAR 1989
ACTION	<i>Mr Sewell</i>
COPIES TO	<i>ex Sir P Middleton</i>
	<i>Mr Hanson, Mr Mankie</i>
	<i>Mr Phillips, Mrs Comax</i>
	<i>Mr Edwards, Mr Potter</i>

9 March 1989

*Dear Tom*

*McCall*

DOE PESC PROGRAMMES 1989-90

I wrote to you on this subject on 28 February. Our officials are presently discussing the details of the expenditure changes I have proposed for 1989-90.

The Chancellor will be using the Budget to introduce a further duty differential in favour of unleaded petrol. This will give an important further push to our policy, and he and I both want to be sure that we get the maximum credit for it. Virginia Bottomley will be putting the message across with unpaid publicity on the day after the Budget. I believe we must punch home this message with a short sharp advertising campaign starting in the following week. I have in mind expenditure of £1m, £800,000 on television and £200,000 on newspaper advertising which will incorporate a clip out coupon offering a booklet which we already have in hand.

If we are to strike while the iron is hot, I must begin work on the publicity campaign as soon as the Chancellor has made the announcement. I should be very grateful, therefore, for your urgent agreement to an additional £1m of publicity expenditure, in 1989-90. For the reasons set out in my letter of 28 February, I would be looking for this expenditure to be a call on the Reserve. By analogy with our other special publicity programmes on housing and the community charge, we would not expect this publicity to score as running costs. If any or all of it were to be classified as running costs we would need to seek a corresponding increase in our running cost limit.

In view of the urgency, I should be grateful for your agreement to this increase in advance (if necessary) of a more general response to my earlier letter.

*John Major*  
*Nicholas Ridley*

NICHOLAS RIDLEY

COPY NO 1 OF 8 COPIES *py*FROM M C SCHOLAR  
DATE 8 MARCH 1989CHANCELLOR OF THE EXCHEQUER *h-*cc Chief Secretary  
Sir Peter Middleton  
Sir Terence Burns  
Mr Peretz  
Miss Wallace**BUDGET STATEMENT: ECONOMIC SECTION**

You asked for comments.

2. I like the sober note right at the beginning as in your paragraph 1. But there is each year an overriding need to bear down on inflation, and 'bear down' seems very flat for the opening sentence. I suggest instead:-

"This year's Budget comes at a time of concern, worldwide and at home, that the forces of inflation are beginning to gain ground again for the first time this decade. Against this background we must be more than ever vigilant, and more than ever resolute in our efforts to combat inflation, whenever and wherever it occurs.

2. It is only by doing this ..."

3. Paragraph 7 line 6 delete "complete" and substitute "to provide vital support for".

4. Paragraph 4 line 2 delete "less progress was made in improving" and substitute "we saw no immediate results in our efforts to improve".

5. Delete last sentence of paragraph 16, which interrupts the flow?

6. I suggest a re-ordering and rewording (too many "pick-ups" at present) of paragraphs 19 and 20 in order to provide cover for the deduction of mortgage interest payments from the RPI, as follows:-

"19. But there has also been some increase in inflation, at home and worldwide. Indeed, the rate of inflation in the rest of the Group of 7 major industrialised countries has, over the past six months, risen slightly more rapidly than in Britain, if we exclude, as all the other countries except Canada do, mortgage interest payments from the comparison. On this basis the RPI, which rose by 5½ per cent in 1983, increased by 4½ per cent last year; but the rate picked up markedly throughout the year, and the most recent figure is 5½ per cent."

7. Insert comma after 'means' in line 2 of paragraph 21.

8. No need for the last two sentences of paragraph 21 in view of paragraph 33. But if, instead, you keep paragraph 21 as it is and shorten paragraph 33, delete "the struggle" in the antepenultimate line and substitute "our achievements in the battle".

9. Paragraph 23 4 lines from the bottom "sharply" instead of "appreciably".

10. The bracketed words in the first line of paragraph 24 p8 might better be omitted. If they are retained you need "including mortgage interest payments" after "5½ per cent" in the penultimate line.

11. I think it will seem paradoxical to many to say that the Government has no objective as regards a hard or soft landing for the economy. Your point would not be diminished if this sentence were omitted.

12. Delete one of the "it is clear"s from paragraph 28.

13. Wouldn't paragraph 33 be better inserted after the second sentence of paragraph 31, to bring both the monetary aggregates together? You could then start a new paragraph on the exchange rate "The exchange rate is also of particular ...".

14. I can see why you have omitted the tax reference in the sterling capital markets section. But, as it stands, this section leaves out the most important part of the liberalisation (opening up the market for sterling issues). I suggest you add:

"This new freedom will be enhanced by a further, important, set of deregulatory measures for the sterling capital market which are being promulgated today in notices issued by the Bank of England. These measures will open up the market for sterling paper of less than 5 years' maturity by extending the range of institutions which can make such issues; and they will create a unified regime for all these issues.

Taken together the changes I have described constitute a major liberalisation of the arrangements for London's capital markets. They will give issuers greater flexibility and investors wider choice."

Or if you want something shorter you could model it on the section we put in the note for the Queen (attached).

15. Paragraph 39 last sentence. Delete "As a result".

16. Paragraph 42. Delete the hyphen in "six-monthly". The Bank would prefer the last sentence to read:

"The initial series of six monthly tenders for these bills has proved extremely successful, and I can today inform the House that this is an innovation that we plan to continue."



BUDGET SECRET

The point of this change is not to give an amount (to give ourselves flexibility to increase it if necessary). I think you could retain your own wording if you prefer; but it would be best to leave out the amount, or at least not to fix it to a period of time for it.

*D. Crane*

PP M C SCHOLAR

Capital Markets liberalisation

I shall be announcing on Budget day a substantial liberalisation of the London sterling capital market. I am abolishing the queue for bond and equity issues which has been operated by the Bank of England since 1946, opening up the market for sterling paper and at the same time simplifying its regulatory regime. I am also making some consequential changes in the taxation of deep discount and other bonds. Taken together all these changes <sup>will</sup> ~~should~~ give greater flexibility to those who issue capital in London; and wider choice to those who invest here.

COPY NO. 2 OF 12 *any*From : D L C Peretz  
Date : 8 March 1989

MISS WALLACE

cc PS/EST  
Sir P Middleton  
Sir T Burns  
Mr Wicks  
Mr Scholar  
Mr Riley  
Mr Sedgwick  
Mr A C S Allan  
Mrs Chaplin  
Mr Tyrie

## BUDGET STATEMENT : ECONOMIC SECTION

A number of points on the draft circulated yesterday. I give these in the order they appear in the draft, not in order of importance.

2. Paragraph 7, second and third sentences. Others will no doubt have comments on these two sentences. One minor difficulty with playing up monetary policy as the only cure for inflation is that it somewhat undermines the argument we have been advancing on EMU (including in the Chancellor's Chatham House speech) that a European monetary policy would have to be supported by a European fiscal policy. A possible reformulation would be :-

"Inflation is a disease of money; and monetary policy the correct medicine. Fiscal policy is used to bring the public accounts into balance and keep them there, and thus support the process of re-establishing sound money."

3. Paragraph 8. Only a small point. Do you "stamp out" "forces", and do forces "rage"? How about inflationary "fires"?

4. Paragraph 21. The last two sentences are repeated later on in paragraphs 31 and 33. They could be deleted.

5. Paragraph 23, penultimate sentence. To say that MO has slowed down "appreciably" is a bit of an understatement. Why not "sharply"?

6. Paragraph 30, second sentence. The target for MO is for its 12 month growth rate, month by month. To avoid confusion I suggest the second half of the sentence might read :-

" ... although on average during 1988-89 it has been some 2 percentage points above its target range."

7. Paragraph 31, penultimate sentence. This sentence is a bit high profile - and a break with the tradition of not commenting on intervention. The point could be made in another way as follows :-

"We have accumulated massive reserves and are ready to use them as and when necessary. We will continue to work ..."

8. Paragraph 32. This looks a bit isolated where it is. If the sentence is to be retained I would suggest adding the words "in assessing monetary conditions" at the end, and then placing it after the second sentence of the present paragraph 31, starting a new paragraph with the next sentence beginning "The exchange rate is also ...".

9. Paragraph 37. There is I understand a problem with saying that "we started to repay the national debt". The national debt, as defined in the statistics, is a gross concept. The increase in the reserves in 1987-88 means that it actually increased quite sharply. Nor, I believe, can we even say that in 1987-88 we reduced the public sector's net debt. This is because valuation changes (eg to the sterling value of the foreign exchange reserves and foreign currency borrowing) outweighed repayments. I suggest either "and we had a debt repayment" or "and we moved into financial surplus".

10. Paragraph 40. For a similar reason I suggest inserting the word "net" before "repayment" in the first sentence and before "debt interest costs" in the second sentence. Partly for accuracy, can we amend the last sentence to read :-

"Indeed, continuing debt reduction on this scale means that in this year's Finance Bill I shall be taking a new power, not needed before, to enable gilts to be acquired with money from the National Loans Fund, for cancellation."

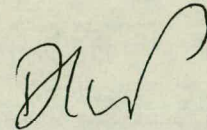
11. Paragraph 41. I suggest the following shorter version of the second sentence :-

"We will continue to seek to minimise the cost of servicing the Government's domestic debt and to improve its quality by relying less on the more liquid borrowing instruments."

12. Paragraph 42. In the first sentence insert the words "and payable" after "denominated". This is one of the features that marks our ecu bills out from other countries'. The second sentence should begin :-

"The initial series of six monthly tenders for these bills has proved ..."

We do not need to specify the period for which the programme will continue (see separate submission today from Miss O'Mara).



D L C PERETZ



FROM: J M G TAYLOR

DATE: 8 March 1989

*Prof*

MR P R H ALLEN - Customs &amp; Excise

cc PS/Chief Secretary  
PS/Financial Secretary  
PS/Paymaster General  
PS/Economic Secretary  
Sir P Middleton  
Mr Scholar  
Mr Culpin  
Mr Gilhooly  
Mr Michie  
Miss Simpson  
Miss Wallace  
Mrs Chaplin  
Mr Tyrie  
Mr Call

Mr Unwin - C&E  
Mr Jeffersor Smith - C&E  
Mr Wilmott - C&E  
Mr Warr - C&E

## UNLEADED PETROL

The Chancellor was grateful for your note of 7 March. He has commented that this is a useful argument to adduce.

*JMGT*

J M G TAYLOR

*pmf*



FROM: R C M SATCHWELL  
DATE: 9 MARCH 1989

PS/CHANCELLOR *2*

cc PS/Chief Secretary  
PS/Paymaster General  
PS/Economic Secretary  
Sir P Middleton  
Sir T Burns  
Mr Wicks  
Mr Scholar  
Mr Odling-Smee  
Mr Gieve  
Mr Ilett  
Mr Pickford  
Mrs Chaplin  
Mr Tyrie  
Mr Call

*[seen by Uh]*

**SHARE OWNERSHIP SURVEY**

The Financial Secretary would like to include a passage on the latest Share Ownership Survey in his Budget Speech. He also thinks that the material should be Press Released; though for logistical reasons, this may have to be done slightly in advance of his mentioning it in his speech.

*R.C.M.S.*

**R C M SATCHWELL**  
Private Secretary



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

9 March 1989

Roger Bright Esq  
PS/Secretary of State for the  
Environment  
Department of the Environment  
2 Marsham Street  
LONDON  
SW1P 3EB

Dear Roger,

**UNLEADED PETROL**

I mentioned to you today that the Chancellor was anxious for the unleaded petrol passage from the Budget speech to be checked by one of your experts. I enclose the relevant extract. When you have nominated an expert, he or she might like to have a word with Michael Scholar (270-4389) here.

Yours

Moirz

MOIRA WALLACE



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

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

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

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

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

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

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B.L.O.

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MPW/89/7.  
41 OF 43 COPIES

REF  
COPY NO 41 OF 43 COPIES  
FROM: MISS M P WALLACE  
DATE: 9 March 1989

PS/FINANCIAL SECRETARY

- cc PS/Chief Secretary
- PS/Paymaster General
- PS/Economic Secretary
- Sir P Middleton
- Sir T Burns
- Mr Monck
- Mr Anson
- Dame A Mueller
- Mr Wicks
- Mr Hardcastle
- Mr Byatt
- Mr Scholar
- Mr Culpin
- Mr Sedgwick
- Mr Riley
- Mr A C S Allan
- Mr Gieve
- Mr Gilhooly
- Mr Matthews
- Mr Pickford
- Mr Macpherson
- Mr Michie
- Miss Hay
- Miss Simpson
- Mrs Chaplin
- Mr Tyrie
- Mr Call

- Sir A Battishill - IR
- Mr Beighton - IR
- Mr Isaac - IR
- Mr Painter - IR
- Mr G Bush - IR
- Mr C McNicol IR [+1]

- Mr Unwin - C&E
- Mr Jefferson Smith - C&E
- Mr P R H Allen - C&E
- Ms A French - C&E [+1]

**BUDGET STATEMENT: TAX SECTION**

... The Chancellor was most grateful for all the further comments on the speech version I circulated on 6 March. I now attach his virtually final version\*. It has been sent to No.10 in this form.

\* amendments sidelined.

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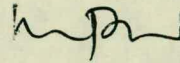
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2. If you or copy recipients have any further comments - essential changes or factual corrections - could they reach me by lunchtime tomorrow, Friday 10 March, please.



MOIRA WALLACE

**SECRET**

**B.L.O.**

**SECRET**

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Version of  
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9/3, noon.

### TAXPAYER CONFIDENTIALITY

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

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

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

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

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

**BUSINESS TAXATION**

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

6. First, taxes on business.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**TAXES ON SAVING**

21. I now turn to the taxation of saving.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

57. I now turn to pensions.

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

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

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

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

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

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

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

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

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

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This will remove the penalty on good investment performance.

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

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

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

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

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

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

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

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TAXES ON SPENDING

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

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

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

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

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

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

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

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

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

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

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

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

83. I now turn to the excise duties.

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

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

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

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

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

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

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

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

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

**TAXATION OF INCOME**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**NATIONAL INSURANCE CONTRIBUTIONS**

111. I have one further measure to propose.

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

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

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

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

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

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

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

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

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

119. The total additional cost of all the measures in this Budget, on an indexed basis, is under £2 billion in 1989-90 and £3<sup>1</sup>/<sub>2</sub> billion in 1990-91.

[BRIEF PERORATION TO COME]

*mw/89/8*



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

9 March 1989

Paul Gray Esq  
10 Downing Street  
LONDON  
SW1

*Dear Paul,*

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

*Yours,*

*Moir*

MOIRA WALLACE

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#### TAXPAYER CONFIDENTIALITY

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

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

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

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

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

**BUSINESS TAXATION**

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

6. First, taxes on business.

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



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

#### **TAXES ON SAVING**

21. I now turn to the taxation of saving.

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



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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



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

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

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

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

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

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

57. I now turn to pensions.

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

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

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

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

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

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

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

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

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



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This will remove the penalty on good investment performance.

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

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

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

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

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

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

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

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TAXES ON SPENDING

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

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

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

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

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

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



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

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

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

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

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

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

83. I now turn to the excise duties.

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

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

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

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

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

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

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



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

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

**TAXATION OF INCOME**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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



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

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

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

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

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

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

**NATIONAL INSURANCE CONTRIBUTIONS**

111. I have one further measure to propose.

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

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

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

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

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

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

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

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

BUDGET

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

SECRET

119. The total additional cost of all the measures in this Budget, on an indexed basis, is under £2 billion in 1989-90 and £3<sup>1</sup>/<sub>2</sub> billion in 1990-91.

[ PERORATION ]



FROM: MRS R LOMAX  
DATE: 10 MARCH 1989

PS/CHANCELLOR

cc: PS/Chief Secretary  
Sir P Middleton  
Mr Anson  
Sir T Burns  
Mr Scholar  
Mr Culpin  
Mr Riley  
Mr A C S Allan  
Mr Gieve  
Mr Tyrie

## BUDGET STATEMENT: ECONOMIC SECTION

I have two suggestions on the draft attached to your minute of 9 March:-

Para 7. The fourth sentence lists some of the developments that have helped to breathe new life into a moribund economy. Could we add a reference to the reduced role of the State (or privatisation: I suspect firm control of public expenditure is pushing it a bit).

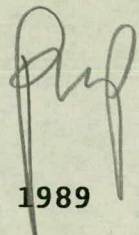
Paras 47 and 48. Could we inject the thought that "the benefits of a reduction in the burden of taxation", referred to at the end of para 47, have already been earned, in that the GGE ratio has fallen dramatically, while the tax burden has, if anything, risen. While it may not be prudent to reduce the surplus now, for the reasons given in paragraph 48, when the time comes, reducing the tax burden will have a prior claim. This thought now appears in the MTFS, and, without making a great meal of it, I think it is worth picking up in the speech. One way of doing this would be to add the following to the end of para 47:

... "which have already been earned by our great success in controlling public expenditure".

RL

RACHEL LOMAX

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*MW*

*Don't want to look at this alongside the speech material on*

1. MR NELSON WSO that Labour Revenue are subsidiary tonight
  2. FINANCIAL SECRETARY
- NM 10/3*

FROM: N BARKER  
DATE: 10 March 1989

- cc PS/Chancellor  
PS/Chief Secretary  
PS/Paymaster General  
PS/Economic Secretary  
Sir P Middleton  
Sir G Littler  
Mr Wicks  
Mr Scholar  
Mr Culpin  
Mr Moore  
Mr Odling-Smee  
Mr Bent  
Mr Gieve  
Mr Ilett  
Mr Pickford  
Mr S Matthews  
Mr Dyer  
Dr Kosmin  
Mrs Chaplin  
Mr Call  
Mr Tyrie

*Mr Kueys - 102  
PS/102.*

*Ch. see also B/BT note behind.  
26/3/89*

**1989 SHARE OWNERSHIP SURVEY**

We have just received the full results of this year's survey, and we shall let you have a detailed analysis shortly.

2. The Chancellor has decided that this year he will not refer to the survey results in the Budget speech, but that you should announce them in your speech in the Budget debate on the following day. We recommend that, as was done last year, arranged written PQs are tabled that day for both Houses. This would allow the headline figures to be placed on record, and for a 3.30 pm press release to reach the next day's papers.

3. In both the last two years the Survey results have been written up fairly fully in the EPR. We and IDT think it would be unduly repetitive to go for as comprehensive a coverage this year. However, we will be considering a shorter presentation, drawing out the main themes, which we will submit on the normal EPR timetable.

4 I attach a draft PQ, written answer and press release.

*Nicholas Barker*

FOR ANSWER : 15 MARCH 1989

Draft Written PQ

[ ]: To ask the Chancellor of the Exchequer if he will make a statement on the level of share ownership in Great Britain.

MR NORMAN LAMONT:

A joint Treasury/Stock Exchange Survey carried out in January and February of this year shows that:

- 9 million people, or 20% of the adult population, now own shares, the same as one year ago, and compared to 7% in 1979;
- 13% hold shares in privatised companies, and 5% own only privatised shares;
- 3% hold shares in the company for which they work;
- Share ownership is widely spread; two-thirds of British shareholders come from outside the ranks of managers and the professionals; similarly, almost two-thirds come from outside the South East;

I am placing copies of the survey report in the Libraries of both Houses.

DRAFT

PRESS RELEASE

15 MARCH 1989

**SHARE OWNERSHIP: SURVEY RESULTS**

In a Parliamentary Written Answer today, the Rt Hon Norman Lamont, Financial Secretary to the Treasury, announced the results of the latest major survey of individual share ownership in the UK. These show that:

- 9 million people, or 20% of the adult population, now own shares, the same as one year ago, and compared to 7% in 1979;
- 13% hold shares in privatised companies, and 5% own only privatised shares;
- 3% hold shares in the company for which they work;
- Share ownership is widely spread; two-thirds of British shareholders come from outside the ranks of managers and the professionals; similarly, almost two-thirds come from outside the South East.

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Commenting on the results the Financial Secretary said:

"We believe that individual share ownership is now firmly established in this country. This is confirmed by the results of the survey. There are as many small investors now as there were before the 1987 crash. And the number of individual shareholders has remained steady over the last year, at about 9 million."

"The survey shows that 6 million people own privatisation shares. This means that most investors have held on to their privatisation shares. The wider share ownership measures announced in the Budget will also benefit share ownership. And there will be further opportunities in the next two years with the privatisation of water and electricity."

Press Office  
H M Treasury  
Parliament Street  
LONDON SW1P 3AG

01-270 5187

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Notes for Editors

This joint Treasury/International Stock Exchange survey was commissioned by the Office of Population Censuses and Surveys and carried out by NOP Market Research Ltd between 18 January and 13 February 1989. It follows a similar survey published in March 1988. A total of 6,825 interviews were conducted with adults aged 16 and above who were selected according to a systematic probability sample designed to be representative of all adults in Great Britain.

The figure of 9 million covers shares quoted on the Stock Exchange, and other shares in public and private companies, but excludes unit trusts and building society share accounts.

The most closely comparable information for 1979 is the British Market Research Bureaux Target Group Index which estimated that about 7% of the adult population were then shareholders.

Copies of the Survey are available from HM Treasury Publications (Tel.270 4558), and from the Stock Exchange (Tel.588 2355), price £20.

BUDGET CONFIDENTIAL

*AWP*

FROM: S N WOOD  
DATE: 10 March 1989

CHIEF SECRETARY

cc **Chancellor**  
Economic Secretary  
Sir P Middleton  
Mr Anson  
Mr Monck  
Mr Phillips  
Mr Culpin  
Mr Edwards  
Mr Hansford  
Mr Betenson  
Mr Michie  
Mr Call

Mr Gaw (Customs)

*Answered.*

*Ch.  
NB "X"*

*2/10/89*

**PUBLICITY FOR UNLEADED PETROL**

Mr Ridley wrote to you on 9 March, to bid for £1 million for expenditure on publicity in 1989-90 to promote unleaded petrol following the Budget.

**Recommendation**

2. On strict value for money grounds, I would be inclined to recommend you approve only the newspaper campaign at £200,000. We could take account of this marginal extra amount when we advise you (shortly) on the much larger bid outstanding from Mr Ridley's letter of 28 February, which we have been discussing with his officials. However, I am not fully familiar with the discussions that have taken place with your Ministerial colleagues on this in the Budget context, where I understand the Economic Secretary has indicated that he believes that DOE should spend the full £1 million. You might like to discuss with your colleagues at Prayers on Monday.

X

Background

3. As you know, the Chancellor intends in the Budget to announce a further widening of the duty differential in favour of unleaded petrol. DOE will issue a press release and Mrs Bottomley will hold a press conference immediately after the Budget. Mr Ridley now asks for £1 million (£0.8 million for television, £0.2 million for newspapers) for a short media campaign to drive home the message.

4. I understand that the initiative for a Budget-related campaign (not necessarily on television) on lead-free petrol came from Treasury Ministers: DOE, at official level at any rate, were sceptical that the expenditure would be value for money, given the favourable price differential which would follow the budget and related campaigns. For example, a number of Departments, including DTp, DEn, DTI and DH as well as DOE, have been engaged for some time in promoting lead-free petrol through press briefing and explanatory booklets; the oil industry will also be keen to promote lead-free petrol, in which they are investing; and some car manufacturers (eg Vauxhall) are offering to convert cars already on the road to lead-free petrol.

5. In view of this, I do not think we could reasonably expect DOE to drop other expenditure they regarded as higher priority. The case for a television campaign does not seem to me to be conclusive. However, a newspaper campaign would, at much less cost than television, be presentationally attractive and reinforce the message of Government leadership in improving the environment.

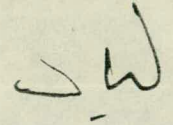
6. I have consulted Mr Spencer in OMCS, and we agree that this paid publicity would present no problem of propriety since Parliament's approval to the policy being promoted would have been obtained through the Budget Resolutions.

7. Mr Ridley asks whether the additional expenditure would score as running costs. RC are prepared to accept that it be defined as programme expenditure.



Conclusion

8. On value for money grounds, I would be inclined to suggest you approve only the newspaper element. However, I understand that the Economic Secretary believes the more red-blooded approach recommended by Mr Ridley would be justified. You may wish to discuss with your colleagues at Prayers: in the meantime I attach a draft letter in alternative forms.



S N WOOD

BUDGET CONFIDENTIAL

DRAFT LETTER FROM THE CHIEF SECRETARY TO:

The Rt Hon Nicholas Ridley AMICE MP  
Secretary of State for the Environment  
2 Marsham Street  
LONDON SW1P 3EB

PUBLICITY FOR UNLEADED PETROL

Thank you for your letter of 9 March.

I am sure it would be right to promote the Government's message on unleaded petrol following the Budget. [EITHER: However, I believe that the newspaper campaign you propose would be adequate at much less cost than television. I should be content for you to spend £200,000, which I regard as programme expenditure rather than running costs, on this.] [OR: I am content with the campaign you propose. I regard it as programme expenditure rather than running costs.] I shall take account of it in my response to your letter of 28 February.

JOHN MAJOR

*Pop*

*12/13/89*

FINANCIAL SECRETARY

FROM: ROBERT CULPIN  
DATE: 13 March 1989

cc: **Chancellor**  
Chief Secretary  
Paymaster General  
Economic Secretary  
Sir Peter Middelton  
Mr Scholar  
Mr Odling-Smee  
Mr Gieve  
Mr Gilhooly  
Mr Ilett  
Mr Matthews  
Mr Pickford  
Mr Neilson  
Mr Barker  
Mrs Chaplin  
Mr Tyrie  
Mr Call

*govt for*

Mr Kuczys )IR

**1989 SHARE OWNERSHIP SURVEY**

When you announce the results of this year's survey - Mr Barker's note of 10 March - you clearly have to lead with the finding that, as last year, 9 million people own shares; but would it be worth adding this time that about 10 million people have either shares or savings in unit trusts? I would not make a meal of it; but there will be some interest this year in equity unit trusts, because the Chancellor is making it much easier for PEPs to be invested in them with tax relief.

*Rc*

ROBERT CULPIN

## BUDGET CONFIDENTIAL

FROM: A C PIRIE  
DATE: 13 March 1989

1. MR SCHOLAR
2. ECONOMIC SECRETARY

cc

*Phf*

~~PS/Chancellor~~  
PS/Financial Secretary  
Mr Odling-Smee  
Mr Ilett  
Mr Gilhooly  
Mr Dickson  
Mr Kroll  
Mr Neilson  
Mr MacPherson  
Ms Hay  
Mr Johnson

Mr Bridgeman - BSC  
Mrs Diggle - BSC

Mr Johns - IR  
Mr Cayley - IR  
Mr Neild - IR

There is a great deal to be said for replying tomorrow to the BSD's summary letter. Given the complexities of the left hand's issue it will clearly be impossible to give anything but the essentially holding reply we are recommending. The Commission and the Revenue differ somewhat on how tentative that holding reply should be. Our recommendation is in para 22 of Mr Pirie's note.

MCs 13/3

**NEW FORMS OF CAPITAL FOR BUILDING SOCIETIES: TAX TREATMENT**

The Halifax Building Society and the Building Societies Association have written to you (on 12 January and 1 February respectively) requesting tax changes to facilitate the issue of equity-type building society shares. Morgan Grenfell also wrote to the Financial Secretary on 19 December requesting a similar change on behalf of an unnamed society and Nationwide Anglia have just written to the Chancellor (27 February) on the same theme. This submission gives FIM's and the Building Societies Commission's views of the desirability of the changes and the Inland Revenue's assessment of the tax changes that would be required and their feasibility this year. It also gives an agreed recommendation on the way forward, if you are content with the issue in principle.