

PO/CH/NL/742  
PTA

PO/CH/NL/742  
PTA

Budget 1988  
Unleaded Petrol Duty  
Differential

Starts 8/10/87  
Ends 21/01/88



MINISTRY OF AGRICULTURE, FISHERIES AND FOOD  
WHITEHALL PLACE, LONDON SW1A 2HH

From the Minister

The Rt Hon Nigel Lawson MP  
Chancellor of the Exchequer  
Parliament Street  
London  
SW1P 3AG

CH/EXCHEQUER	
REC.	08 OCT 1987 6 10
ACTION	PS   IR
COPIES TO	CST FST
	SIR P. MIDDLETON
	MR CASSELL
	MR SCHRAAG
	MR BONNEY

8 October 1987

*Dear Chancellor*

I shall shortly be letting you have my suggestions on changes which I would like you to consider for next year's Finance Bill. But there is one issue which I think is worth sending to you early on so that it can be explored at an early stage as I am now convinced that the case for it is overwhelming.

This concerns the case for roll-over relief against CGT to be granted when the proceeds from the realisation of milk quota are re-invested in another business. The present position is anomalous and exposes us to the justifiable criticisms that the absence of roll-over relief stands in the way of enterprise and good commercial practice, restricts the ability of the industry to diversify, and runs counter to what we are trying to achieve in the dairy industry.

As you know, milk quotas are being steadily reduced and production is falling. Many dairy farmers are finding that their quotas are too small to allow their enterprise to be viable and are seeking to move to larger farms. Some are abandoning milk with the aim of diversifying on another, larger holding. When they move, and given that the value of the quota can amount to as much as half the value of their dairy farms, the CGT charge can be considerable. Of course, if a farmer sells his quota and retires then a capital gains charge will arise as it would for any other business, and that is fair. But the absence of roll-over relief for milk quotas means that a farmer must pay such a charge when he moves from one farm to another in order to develop his business. This inevitably inhibits sensible decision-taking and mobility, in a way that does not apply to the sale and re-use of any other business assets. I have a number of specific practical examples of the unjustified deleterious effects this is now having.

Another way of looking at the matter is this. Milk quota is in effect a right to produce milk and seems tantamount to a measure of the goodwill attaching to the value of a dairy farm. The value of goodwill in any business now benefits from roll-over relief but milk quotas are not presently regarded as coming under this heading. Yet had milk quotas not been imposed, a farmer would have been able to move from his dairy farm to another holding and "rolled-over" gains arising on the sale of the dairy business. Treating quotas as goodwill, or by some other means you judge appropriate, so allowing them to attract roll-over relief, would be a return to the status quo ante.

In the correspondence on this matter between officials, the question of precedents has arisen, such as for potato, hops and fish quotas. I do not see that there should be any real difficulties of this kind. Hop quotas were abolished several years ago, fish quotas are not for re-sale and whilst potato quotas are traded, the individual area quotas sold are usually very small indeed.

Peter Walker, Malcolm Rifkind and Tom King have also received many representations on this and are convinced that the present position inhibits just the kind of diversification of farming that we are now exhorting upon farmers. They fully support the line I am taking. I am copying this letter to them.

*John Macgregor*

JOHN MacGREGOR  
(Approved by the Minister  
and signed in his absence)



CH/EXCHEQUER	
REC.	25 NOV 1987
ACTION	MRS T. Burnhams
CLASS	CST, FST, PMG EST

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Belfast BT4 3ST

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CST, FST, PMG EST

SIR P. Middleton SIR T Burns

MR Scholar MR Monck

MR Culpin Miss Sinclair MR A. M White

MR RIG Allen

PS/IR . PS/CE

25 November 1987

Dear Nigel

I am writing to you concerning the 1988 Budget and the issue of duty on tobacco products.

Obviously there are widely differing views on this matter between the people responsible for the health of the community and those responsible for the tobacco industry and the jobs associated with it. These are particularly stark in Northern Ireland where we have on the one hand very high rates of smoking related illnesses such as coronary heart disease and cancer and on the other a major employer in the tobacco industry.

Let me say at the outset that your decision last year not to increase the duty on tobacco products was very much appreciated by the industry here as it gave them a stable market in which to progress their rationalisation plans. Indeed the industry believes that the duty standstill enabled them to recapture some of the ground lost to cheap imported brands of cigarettes.

I am anxious that the gains made against the imports should not be lost and that there should be continued stability in the market. This will be particularly important during the period when Gallahers are moving all operations to their Ballymena plant if employment is to be maintained.



In view of all the arguments I would therefore ask you to consider restricting any increase in tobacco duty to the level of inflation. I would be happy to discuss this further if you feel it would be helpful.

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The Rt Hon Nigel Lawson MP  
Chancellor of the Exchequer  
HM Treasury  
Parliament Street  
SW1P 3AG

CH/EXCHEQUER	
REC.	16 DEC 1987
ACTION	MCU
COPIES TO	

2 MARSHAM STREET  
LONDON SW1P 3EB  
01-212 3434

My ref:  
Your ref:

*MP*

15 December 1987

*Dear Nigel*

BUDGET 1988: UNLEADED PETROL DUTY DIFFERENTIAL

I have one specific request for your next Budget. Your introduction of a differential duty for leaded petrol last year was well-received. This year is the time to widen that differential so that unleaded petrol can begin to take a worthwhile share of the market.

The present differential for unleaded petrol at the pump is about 0.5p per gallon below 4-star. We think we need about 5p per gallon, or 1p a litre. Since we start from a market share of only about 0.1% to 0.2%, that would still yield only about 2% of the market for unleaded petrol over the next financial year. No doubt you will be setting an overall level of petrol duty to meet your revenue objective. I do not ask you to change or reduce that objective. It should be possible to accommodate an increased differential within it.

If we do not have a wider differential, unleaded petrol is likely to remain under 1% of the market for the rest of the decade. That would turn the policy story from a bull point to a bear point.

Officials from Customs and Excise have been in touch about the details with my Department and others interested.

Copies of this letter go to Paul Channon, Cecil Parkinson and David Young.

RIDLEY  
TO  
CX  
15 DEC

*Yours  
Nicola*

NICHOLAS RIDLEY

*BR*

HM TREASURY - MCU	
REC.	16 DEC 1987
ACTION	MRS BURNHAM FP
	<i>a APS/CHX, CE.</i>
	<i>CHX</i>
	<i>29903/87</i>





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The Rt Hon Nigel Lawson MP  
Chancellor of the Exchequer  
Treasury Chambers  
Parliament Street  
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SW1P 3AG

22 December 1987

*Dear Nigel,*

**BUDGET 1988: UNLEADED PETROL DUTY DIFFERENTIAL**

I have seen Nicholas Ridley's letter of 15 December to you on the above. I support Nicholas' view that there should be an increase in the duty differential between leaded 4-star premium petrol and unleaded petrol in the next budget.

I agree that a 5p/gallon increase in the differential is appropriate to achieve a substantial uptake of unleaded petrol in the market by the Spring of 1989 and that such an uptake is required if Government policy on unleaded petrol is to be credible.

Without the proposed increase in the differential, the market share for unleaded petrol is likely to continue at less than 1% for at least another year.

I am copying this letter to Nicholas Ridley, Paul Channon and David Young.

234 BK

HM TREASURY - MCJ	
REC'D	23 DEC 1987
ACTION	Mrs. Bannister P.P.
	cc Aps/CHX
	CHX
	30174/87

*Cecil Parkinson*  
*A. Law*

CECIL PARKINSON

PARKINSON  
TO  
CX  
22 DEC

CONFIDENTIAL



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Rt Hon Nigel Lawson MP  
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*Nigel*

*Advise per ASAP.  
2. What not for the  
cont of X, we have  
would work??  
Cousin??*

*BT to AS on 4/1*

CH/EXCHEQUER	
REC.	23 DEC 1987
ACTION	MRS T C BURNHAMS
COPIES TO	EST FST PMG EST SIR P. MIDDLETON SIR T BURNS MR J ANSON MR N MONCK MR M SCHOLAR MR T BURGNER MR R CULPIN

*23/12*

*NIG GINCLAIR  
MR P GRAY  
MR M WALLER  
MR CROPPER  
MR TYRIE  
MR CALL  
PS/IR PS/C&E*

December 1987

**BUDGET 1988**

I am putting forward in this letter some proposals that I hope you will be able to consider in preparing your Budget statement. They are principally aimed at improving the environment for small firms and encouraging enterprise.

The measures taken by the present Government have already made a great contribution to the flourishing of the small firms sector and the revival of enterprise. Nevertheless, I think there are still areas where a legitimate case can be made out for further changes. There is considerable evidence that the greatest administrative burden on small businesses is V.A.T. This is partly because of the complexities introduced into the simple concept we started with, and cannot be easily dealt with. I understand that studies have been proceeding on this problem and I would emphasise the importance we attach to it. A perennial concern among small businesses is the difficulty of raising finance for new projects or expansion. Argument will continue over the existence and nature of a "finance gap", but the consensus of those with first-hand experience of the subject is that genuine difficulties remain. In part these are due to the managerial and other weaknesses of small firms themselves - which we try to remedy through advice and training - but for some time to come there will still be a case for some measures to help small firms overcome their

FOWLER  
TO  
CX  
22 DEC

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inherent disadvantages in raising finance. Such a case is recognised in the Business Expansion Scheme, which offers investors a very substantial tax incentive to offset the higher risk involved in investing in unquoted shares.

As I suggested in my letter of 11 September there is some doubt whether the BES is fully meeting its original aims. One of these aims was to encourage direct investment by individuals in small companies in which they would take a close personal interest. We know from the BES statistics and from anecdotal evidence that such investment takes place, but it is a small percentage of the total and I believe there is potential for more. The stumbling block is the rule withholding eligibility for BES relief from investors who take paid employment with the company concerned. In practice an investor cannot put both money and management expertise into a company and still get BES relief. I hope that you will give serious consideration to a partial relaxation of the present rule. Item 1 in the Annex to this letter explores this point more fully, and considers other possible changes to BES. I am still of the view that there should be some limit on total BES investment in any one company and you have said you will consider this again.

Much attention has recently been focussed on the concept of "corporate venturing". Investment by large firms in smaller ones potentially offers an enormous source of finance (and inputs of expertise). Studies like the NEDO guide published last year show that corporate venturing can have commercial advantages for both sides. As yet, however, there is little evidence that corporate venturing activity is taking off in practice. A limited tax incentive, on a temporary and experimental basis, would encourage larger firms to take the plunge and gain some practical experience in this area. Item 2 in the Annex considers this further.

You will recall that last year David Young proposed a new initiative to provide for "Local Enterprise Companies". A tax incentive for corporate investment would be an element in this proposal. I understand that David Young has revised his proposals and I hope you will seriously consider this imaginative approach.



X For businesses requiring investment of under £100,000 the clearing banks will remain the dominant source of external finance. In those cases where promising businesses cannot be financed on purely commercial terms for lack of security, the Loan Guarantee Scheme provides some assistance. The maximum lending permissible under the Scheme to any one business has been fixed at £75,000 since the Scheme's inception in May 1981. A recent analysis (see Item 3 in the Annex) shows an increasing usage of the Scheme at the upper limit, which suggests that the time has come to reconsider the position. I believe that an increase to £100,000 would be justified.

I should also like to modify slightly the conditions of the Scheme relating to personal assets. Between 1981 and 1984, the LGS was widely used by borrowers who possessed substantial personal assets but were unwilling to make them available as security for conventional lending. This was clearly unacceptable, and following the review of the Scheme in 1984 a rule was introduced that where the borrower could offer personal assets which would be acceptable to the lender as a basis for lending outside the Scheme a guaranteed loan would not be available. This rule has been strictly applied, so that, for instance, where directors of a company seeking an LGS loan (other than those who are primarily consultants or professional advisers) have any equity in their family home, this should be fully committed to non-LGS lending before an LGS loan can be considered. The rule for example, stops a married woman getting an LGS loan for her business unless her husband will pledge their jointly owned home. Moreover, lenders themselves are often reluctant to demand the full commitment of the family home. I would like to give lenders greater flexibility to consider how far personal assets should be taken into account in assessing the personal commitment of borrowers. My proposal is explained more fully in Item 3 in the Annex.

However much loan capital is available, for many small firms gearing problems and the difficulty (and cost) of raising external finance makes it important that they should make the best use of funds generated within the business. The substantial reductions in Corporation Tax (including the "small companies" rate) and Income Tax (affecting the



unincorporated trader) since we took office have increased the ability of businesses to retain and use more of their own earnings but the withdrawal of initial capital allowances has reduced it. The majority of small firms' representative bodies are concerned, as they were last year, that the withdrawal of the allowances bites hardest on expanding small businesses for whom external financing presents the greatest problems. A variety of solutions are offered, most of which involve some tax relief on an initial "tranche" of retained earnings. It is difficult to evaluate these arguments and proposals, and I am aware that with some approaches the loss of revenue could be very heavy. In view of the persistent concern expressed by small firms representatives I believe there is a need for further examination of the problem but I have not put up a specific suggestion this year.

Representative organisations have put forward a number of other suggestions for simplification of taxes or the removal of anomalies. You have received or will receive submissions directly from the organisations concerned, and I am sure you will consider the suggestions on their merits. Some proposals which I think should be viewed sympathetically are discussed at Items 4 onwards in the Annex to this letter.

Moving away from strictly small firms issues, Item 11 in the Annex outlines some proposals on employee share schemes and related matters.

Finally I would like to make the general point that an assessment should be made of the effects on employment and incentives to work of any measures you are proposing to include in the next Budget. For example, despite some restructuring, national insurance contributions still cause particular incentives problems because of the "cliff edge" start to payments and the uneven marginal tax steps resulting from lack of integration between tax and national insurance. While full resolution of these problems would repudiate the contribution principle to which I know you are committed, I believe our aim should be as far as possible to reduce the national insurance burden on the low paid and to bring the tax and national insurance system more into line. If you are prepared to contemplate such changes, I will ask my officials to discuss this approach with yours.



Since we took office in 1979 the needs of small businesses and enterprise have rightly been given a high priority in Budget decisions. Much has been done to improve the climate. A transformation of the small business sector and the prospects for enterprise is well under way. To sustain the momentum I hope you will give sympathetic consideration to the proposals I have outlined.

*Norman Fowler*

**NORMAN FOWLER**

ANNEX

**ITEM 1: BUSINESS EXPANSION SCHEME****A. ENCOURAGING MANAGEMENT INVOLVEMENT**

When the predecessor to the BES, the Business Start-up Scheme, was introduced, the Chancellor commented: "One of the biggest problems faced by people thinking of starting their own business is the difficulty of attracting sufficient risk capital to finance it during its critical early years. The amounts of additional money needed can be modest - at least compared with the sums in which the big financial institutions commonly deal...

The individual private investor has for many years had little encouragement to help fill that gap in the capital market. I propose to change that. The private investor can often contribute not only risk capital, but direct personal business experience. The opportunities are certainly there. What is needed is to make it more attractive and more rewarding for private investors to take advantage of them" (Hansard, 10 March 1981).

2. The BSS and the BES have been only partially successful in meeting the need identified in these comments. The "gap in the capital market" is usually identified as the need for investment in amounts of less than £100,000 or, increasingly, up to £250,000. BES has been of some benefit in this area. Inland Revenue statistics for 1984 - 5 show that 511 companies received BES investment of less than £100,000 - 65% of the total number of companies. Up to £250,000 the number was 666 - 85% of the total. But this is a very small proportion of the total small company sector. The amounts invested were also a small proportion of total BES investment : 10% up to £100,000, 27% up to £250,000.

3. Although no statistics are available on this point, it is doubtful if the scheme has helped investors who wish to contribute "direct personal business experience" as well as money. Discussion with enterprise agencies and others confirms that there are many experienced businessmen - including retired, semi-retired or redundant executives - who are interested in helping small companies. They normally wish, however, to take a close personal interest in the company and to work for it on a full or part-time basis. They reasonably expect to receive remuneration for this employment with the company. However, under section 54 of the Finance Act 1981 a person who takes paid management employment with the company within 5 years of making an investment is not eligible for BES relief. The effectiveness of the BES in these circumstances is therefore limited.

4. To provide a greater incentive for people wishing to contribute both money and expertise it is suggested that the section 54 exclusion of paid employees should apply only to people who have been paid employees before making their investment. People coming in from outside, having no prior connection with the company (of the kinds defined in section 54) would then be eligible for BES relief.

5. There are several possible objections to this proposal:

- a) people closely connected with a company through paid employment would be willing to invest in it anyway, so the additionality of investment would be low. But this surely applies only to people previously connected with the company, not people coming in from outside. BES relief would be a significant incentive to people to take the major step of joining a small business for the first time;

- b) remuneration of BES investors for employment in the company could be used as a device to extract their investment within the 5 year period. This is undeniably a risk, but it should be noted that the remuneration would itself be taxable. Investors would gain from this ploy only if the remuneration were taxable at a lower rate than the BES relief. In some circumstances this would be a danger, but abuse could be controlled by the ability of the Revenue to check that remuneration was reasonable and necessary. Section 54 already allows an investor to receive 'reasonable and necessary' remuneration for professional services (such as accountancy advice). The 'reasonable and necessary' test could be extended to remuneration for other employment.
- c) The company could use these provisions to avoid Corporation Tax, by paying out true profits in remuneration to employees and receiving them back into the company through tax-free BES investment. This is a real danger where existing employees are concerned, but seems far less likely to arise where the employee is previously an outsider.

It is not suggested that the scope for abuse can be eliminated, but the risk of abuse should be balanced against the benefits of encouraging outsiders to invest in small companies and contribute their business expertise.

6. The cost of the proposed change is difficult to estimate, but there is no reason to expect the 'floodgates to open'. A reasonable assumption is that up to 1,000 people a year would take advantage of the new provision, investing an average of, say, £20,000. Assuming an average BES relief of 55% (cf the Peat Marwick report on BES) the maximum loss of revenue would be £11m - a

small proportion of BES as whole. This figure would also be partly offset by taxation of remuneration from the employment of the individuals concerned which might not otherwise have taken place (eg if past retirement age).

#### B. BES - CO-OPERATIVES

1. The Scottish Co-operative Development Committee have argued strongly that the BES rules militate against workers' co-operatives attracting finance under the BES. The SCDC suggests that changes should be made to the rules to allow tax-relief on non-voting preference shares specifically where the authorised ordinary share capital does not exceed £500.

2. The types of co-operative which could take advantage of such a change are those which are:

- a) limited by guarantee under the Companies Act; and
- b) have a co-operative share model constitution.

3. The SCDC have emphasised that preference shares in co-operatives may bear a high risk, comparable to that of ordinary shares in other companies, because the ordinary share capital of co-operatives is usually very limited. Such co-operatives will typically have between 30-50 members with a total issued ordinary share capital at £1 per person not exceeding £50. The preference shareholders would, therefore, only have a preference prior to £30-£50 of ordinary shares issued. In the event of liquidation any deficiency in the assets would quickly eat into the funds available to repay preference shareholders. In addition under the preference share scheme BES investors would be taking more risk and would be clearly disadvantaged compared to ordinary BES investors since they would possess no voting rights.



4. The SCDC have a fair point in saying that preference shares in co-operatives may carry a relatively high risk, although the proposals do not guarantee it. The authorised or issued share capital of a company often bears little relation to the "shareholders' funds" available in a liquidation. If a substantial reserve had been built up, or if the ordinary shares had been issued at a premium, the preference shareholders might be in a relatively safe position.

5. Nevertheless we feel that if this loophole could be dealt with there seem to be good grounds for seeking a change to the BES rules to make it easier for co-operatives to attract BES finance.

## ITEM 2: CORPORATE VENTURING

1. A 1986 NEDC report, "Corporate Venturing: A Strategy for Innovation and Growth" described corporate venturing and presented the results of a survey. It found that about a third of large UK firms claimed to have some experience of corporate venturing. It also identified many potential commercial advantages to both sides. Despite this, corporate venturing seems to be developing slowly if at all. For large companies with spare money to invest, straightforward acquisition may seem a better, and certainly simpler, way of using their money. For small companies seeking investment there is the fear that they will lose control or that the large firm will steal their ideas.

2. A recent Bow Paper by Nicholas Panes puts forward a case for a tax incentive, for a limited period, to encourage large firms to experiment with corporate venturing. It proposes an incentive by way of Corporation Tax deferral on profits invested in qualifying companies (rules for eligible investments being based on BES). Assuming a take-up rate of 10% Panes estimates the revenue cost at £150 million in the first year.

3. The Bow Paper proposal is an interesting approach but in some respects probably too generous. The paper suggests that up to 50% of Corporation Tax might be deferred. We think a lower figure, perhaps 10%, with a maximum of, say, £10 million would be more appropriate to prevent abuse. A maximum could also be set to investment in any one company in any one year; we suggest £250,000 in line with our proposals on BES. With these restrictions it might be acceptable to offer the incentive in the form of a relief rather than a deferral (which would simplify administration). As the Bow Paper stresses, large companies would still take a cautious approach to corporate venturing. It is unlikely that total qualifying investment would exceed £100 million in the first year (a figure of the same order as BES) at a maximum revenue cost of £35 million.

### ITEM 3: LOAN GUARANTEE SCHEME

#### a) The £75,000 ceiling

1. Since the inception of the Loan Guarantee Scheme in 1981 each borrower has been limited to a maximum of £75,000 under the Scheme. This applies to the cumulative total of borrowing: a borrower may obtain, for instance, a loan of £50,000 but if he seeks a further loan will be limited to £25,000. At present the cumulative limit applies even where existing loans have been paid off. We have recently agreed with the Treasury that this rule can be modified to enable businesses which have paid off a loan in full to have access to a further loan.

2. During the first 5 years of the Scheme the average size of loan varied little and the proportion of total loans represented by loans at the maximum £75,000 level has varied only between 10 and 12%. There has been little pressure from either banks or borrowers for a higher ceiling. Since the

Scheme was relaunched in May 1986, however, the proportion of loans at the maximum level has increased significantly to about 17%. It is not known how many borrowers have reached the maximum by obtaining second or third rounds of lending.

3. The increase in usage at the upper limit could be explained in several ways. It may be that alternative sources of finance are becoming less accessible, or that bank managers are more willing to consider using the Scheme for relatively large projects (or less willing to use it for small ones). Whatever the reason, after a lapse of over 6 years there is a case for reviewing the ceiling. During this period the RPI has increased by 37.2%. An increase of 1/3 from £75,000 to £100,000 would be justified to keep approximately in line with inflation.

4. Against an increase it could be argued that we should be encouraging the supply of equity capital for projects of this size. Certainly this would be preferable, but at present the supply of small amounts of equity is still limited and may be getting worse, as most venture capital organisations are raising their 'floors'.

5. The effect of raising the ceiling to £100,000 would not be dramatic but there would be some increase both in the number of loans and in the average size of loan. Some loans presently confined to £75,000 would probably be granted for larger amounts. Combining these factors an increase in the total volume of LGS lending of around £13 million a year would be plausible. (This assumes that there would be around 100 additional loans at an average of £85K and that around 350 loans which otherwise would be granted at £75K would be granted on average £10K more). Assuming prudently a failure rate of 10% in each of the 3 years from 1989-90 to 1991-92, and an average guarantee payment of £50K, the additional gross cost would be around £2.25m in 1989-90, £4.5m in 1990-91, and £6.75m in 1991-92.

b) Personal assets

6. The present rule is that borrowers must be willing to make any personal assets available as security for non-LGS lending before being considered for an LGS loan. In theory this means that the family home of the entrepreneur may be placed at risk, even if its value is relatively modest. In practice, the rule is not as harsh as it may seem. The banks have to consider what is 'available' and whether it is 'adequate' as security for non-LGS lending. Their valuation of property tends to be cautious, and if there is any existing charge on the property the remaining value is often too small to be of much use. On the other hand, where there is very substantial equity in the house it seems reasonable that the entrepreneur should put part of it behind the business.

7. We do not propose any dramatic change in the present rules, but it would help remove some of the objections often made to the present position if the banks were explicitly given more discretion to decide how much personal security the borrower should be expected to put behind the business. The key to this is the requirement of personal commitment. Borrowers are already expected to demonstrate personal commitment, but this is loosely defined. Our proposal is that personal commitment and the use of personal assets should be more closely linked. Instead of laying down a specific rule on personal assets where the family home is concerned, the banks should be required to satisfy themselves of the borrower's personal commitment, and in doing so to consider whether the borrower should be required to offer part or all of the equity in the house as security for non-LGS lending. The intention is that in practice this would mean only a marginal difference in treatment in most

cases, and the effect on additionality of lending should be slight. As the banks carry 30% of the risk on LGS lending, we would not expect <sup>them</sup> to be over-generous to borrowers in applying their discretion. If this approach is acceptable, we should need to discuss with the banks how it would be applied before implementing the change.

#### ITEM 4: INHERITANCE TAX

Inheritance tax distorts decisions by unquoted companies. It is payable if the donor dies within seven years of making the gift. This is a barrier to sensible commercial decision-making on the choice of successor in an unquoted company, because it encourages premature transfer of the business. Unquoted companies have to bear heavy insurance charges, from which quoted companies are effectively exempt, against death within seven years, or take irresponsible risks if they fail to insure. The tax is also a disincentive to employee share ownership schemes since it discourages any increase in the net worth of the business.

This obstacle should be removed by 100% Business Property Relief. The cost has been estimated as a direct loss of revenue of about £20 million with additional costs arising out of behavioural changes.

#### ITEM 5: SUB-CONTRACTOR'S TAX CERTIFICATE ("714")

The current eligibility conditions for a sub-contractor's tax certificate have a disincentive effect on self-employment and are of an anti-competitive nature in that those without a certificate suffer cash-flow disadvantages and restrictions on the availability of work opportunities. This could be

remedied by relaxing the eligibility conditions, only requiring a satisfactory explanation of what an applicant for a certificate has been doing in the three years prior to applying rather than three years' continuous employment or self-employment in the last six years. Possible satisfactory explanations would include long-term unemployment (which many Enterprise Allowance Scheme applicants have suffered) or attendance at full-time education or training (such as YTS graduates). [The cost of this change would be neutral in the longer term. There would be a first year cost because those with a certificate pay tax at the end of the financial year rather than week by week.]

#### ITEM 6: BUSINESS EXPENSES AND INCIDENTAL COSTS OF RAISING CAPITAL

The Government are keen to encourage equity investment but, in certain areas, the current tax regime does not support such encouragement. Section 38, FA 1980, allows tax relief on the incidental costs of obtaining finance by means of loans or the issue of loan stock but we consider that extension should be granted to cover the incidental costs of raising all types of finance, particularly equity and short term note issue programmes in the UK or elsewhere. The relief restriction to longer-term loan capital is too narrow and does not take into account the necessity of the smaller businesses seeking to raise equity capital to prevent continuing undercapitalisation with its inherent failure risks. This deterrent to raising more capital can be removed by lifting the current tax bias in legislation.

Other legitimate and bona fide business expenditure can often not be relieved either as a trading expense, as a cost for capital gains purposes, nor be available for capital allowances. It is anomalous that what is clearly business expenditure should not be relieved as a revenue or as a capital

outgoing. We therefore advocate that the cost of abortive capital projects or feasibility studies should be deductible in computing business profits so promoting continuing enterprise and business development.

#### **ITEM 7: CLASS 2 AND CLASS 4 NATIONAL INSURANCE**

The self employed clearly welcomed the 50% allowance for Class 4 National Insurance payments. The Government are consistently encouraging enterprise through self employment and we consider that a similar allowance should be given to Class 2 National Insurance payments. The cost would be about £50 million in 1988-9.

#### **ITEM 8: PIID**

I have received very consistent representation on the administrative burden that the current PIID system places on employers. I understand that the Inland Revenue are currently monitoring the take up of 'dispensations' and that the results should be available early next year. It would be very helpful if any changes to be introduced as a result of this exercise could be announced in the Budget speech.

#### **ITEM 9: VAT REGISTRATION**

The extension of the VAT registration period from 10 days to 30 days has been welcomed but it still falls short of the time many new small businesses need to comply with the regulations. It would be helpful if the registration period could be extended to 60 days.

**ITEM 10: CASH ACCOUNTING**

The introduction of cash accounting has generally been well received. However, the stipulation that businesses opting to join the scheme must be up to date in their VAT payments can disadvantage those small firms facing cash flow problems through late payment by customers. It would therefore be helpful if the rules were relaxed to allow such firms onto the scheme for at least a trial period, perhaps a year, in which they could get their payments up to date.

**ITEM 11: APPROVED EMPLOYEE SHARE SCHEMES AND PROFIT-RELATED PAY**

(i) Proposal to tie executive scheme relief to the introduction of all employee schemes

1. There has been a phenomenal growth in the number of approved 1984 discretionary schemes. By the end of 1987 it seems likely that the number of these schemes will be almost double the total of the other two types of approved share schemes.

2. The main rationale for making discretionary scheme relief conditional upon the company having an all-employee scheme (either a share scheme or PRP) is that it will oblige managements who wish to benefit from the generous 1984 tax concessions to enable all their employees to participate financially. This would give a significant boost to PRP and employee share ownership. The element of coercion in such a measure would be tempered by the fact that managements who, for whatever reason, did not wish to introduce an all-employee scheme would be free to grant non-approved share options to selected employees (without the tax concessions).



3. It was never the intention that discretionary and all-employee schemes should be in competition. However there are signs that this is indeed becoming the case and that discretionary schemes are winning. There is therefore now a stronger case for making executive scheme relief conditional upon the presence of an all-employee scheme, with the aim of encouraging wider employee share ownership. It would also be desirable to raise the maximum limits currently operating on the all-employee schemes.

(ii) Proposals for tax relief for share purchase

4. We still consider that there appears to be merit in a suggestion put forward by the Industrial Participation Association (IPA) that tax relief should be provided on amounts invested by employees to buy ordinary shares in their company through a savings contract. This proposal differs from the existing SAYE scheme in that the employee would immediately become a shareholder and would gradually build up his shareholding before having to decide whether to keep or sell his shares. There would of course be an element of risk for the individual in that the value of his shares could fall as well as rise. However this is not in any way inconsistent with the principle of giving the individual a degree of financial commitment to the success of the company in which he works - a principle which is given expression with Profit Related Pay.

(iii) Proposals relating to employee share trusts

5. The American concept of Employee Stock Ownership Plans (ESOPs) is in many respects similar to the 1978 Approved Profit Sharing Scheme. It would

clearly be undesirable and unnecessary to adopt the American concept without considerable modification taking into account the current scheme in existence in the UK and ensuring avoidance of the abuses which have been noted in the operation of some ESOPs in the US.

6. Nevertheless we do recognise that employee share trusts based on the American concept can be attractive in certain circumstances, in particular we think that employee share trusts could be particularly valuable in assisting private companies to give their employees a substantial stake in the business.

7. Two proposals for encouraging the setting up of employee share trusts and thereby increasing employee share ownership could be examined. The first is to establish incentives for taking out loans to buy substantial shareholdings for such trusts. This could involve an extension of corporation tax relief on a firm's payment to a trust so that not only would relief be available on payments to build up the trust's holding (as at present under the 1978 scheme), but also on payments to pay off the interest and capital on a loan taken out by the trust to buy shares in the company. The second is to give incentives for the owners of family firms or the major shareholders in private companies to donate or bequeath equity to an employee share trust. Gifts of shares to trusts which hold less than 50% of a firm's equity are at present subject to Capital Transfer Tax. This restriction could be removed. In addition some relief from Inheritance Tax could be given for bequests of equity to employee share trusts.

(iv) Proposals relating to Profit Related Pay (PRP) and the public trading sector

8. We fully appreciate that it was considered important to focus the

benefit of PRP on the private sector and also the practical difficulties of applying the scheme to the public sector. Nonetheless the public trading sector in principle stands to gain from the benefits of PRP in terms of closer identification of employees, and in some cases at least, pay flexibility, just as much as the private sector. Also, if PRP becomes widespread in the private sector, its absence in the nationalised industries might lead to higher wage claims there.

9. The main difficulty arises from the extent to which nationalised industries are "price-makers" who can use their market power to achieve Government-set profit targets. If there were a scheme in operation such that the workforce shared in any additional profits made over and above financial target threshold, the industry would be able to set its price so as virtually to fix the size of the PRP payment in advance. A possible solution might be to build in a formula to nationalised industries' PRP schemes so that increases in prices above an agreed threshold would automatically raise the profit threshold which triggers profit related payments to the workforce.

10 Even if this does not prove to be possible, there seems to be a strong case for allowing separate smaller-scale profit-dependent organisations within the public sector to apply for PRP tax relief, subject of course to Inland Revenue approval of each individual application upon its merits.



DEPARTMENT OF TRANSPORT  
 2 MARSHAM STREET LONDON SW1P 3EB  
 01-212 3434

MINISTER  
 FOR ROADS AND TRAFFIC

My ref  
 Your ref *BR*

The Rt Hon Nigel Lawson MP  
 Chancellor of the Exchequer  
 HM Treasury  
 Parliament Street  
 LONDON SW1P 3AG

*173*

HM TREASURY - MCO	
REC'D	30 DEC 1987
ACTION	<i>Mrs Barnham FP</i>
	CC <i>APS/CHX</i>
SEARCHED	CHX
	<i>30301/87</i>

*29 DEC 1987*

BOTTOMLEY  
 TO  
 CX  
 24 DEC

*Dear Nigel*

In Paul Channon's absence I am writing to comment on Nicholas Ridley's letter to you of 15 December about the unleaded petrol duty differential.

One reason why unleaded petrol sales have not yet taken off is that cars designed specifically for the new fuel are only just starting to appear on the market. The numbers will grow rapidly over the next two years as manufacturers change their production in anticipation of the regulatory requirement that we will be imposing in 1990. By April 1989 we estimate that 10% of car mileage will be with cars designed for the new fuel. The existing 0.5p per gallon price advantage will give drivers of these cars a modest incentive to use the new fuel in preference to 4 star.

We think it better for the oil industry to address the rapidly growing market provided by new cars designed to use unleaded petrol, rather than over-encouraging its use by cars not so designed.

Widening the price difference to 5p per gallon might attract users of cars not designed to use the new fuel, with the consequent risk of damage to engines which require lead for lubrication purposes. A 2 star user who switched to unleaded petrol would use a fuel that is about 8p per gallon more expensive to produce. If all did so (which could happen if the oil companies withdrew 2 star from the market) the economic cost would be £40 million per year.

Copies of this letter go to Nicholas Ridley, Cecil Parkinson and David Young.

*Your own  
 Peter*

PETER BOTTOMLEY

FIND PPS

*mp*

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD  
WHITEHALL PLACE, LONDON SW1A 2HH



From the Minister

STRICTLY CONFIDENTIAL

The Rt Hon Nigel Lawson MP  
Chancellor of the Exchequer  
HM Treasury  
Parliament Street  
London  
SW1P 3AG

CH/EXCHEQUER	
REC.	31 DEC 1987
ACTION	PS/IR
COPIES TO	CST FST SIR P. MIDDLETON MR SCHOLAR MR CULPIN MR BONNEY

MACGREGOR  
TO  
CX  
31 DEC

31 December 1987

*[Some points have  
already been  
pushed up  
re: Lawson]*

*Dear Nigel,*

When I wrote to you on 8 October suggesting that CGT roll-over relief be applied to milk quotas I indicated that I would be writing further on other tax matters, most of which would call for provisions to be made in the 1988 Finance Bill. I am most grateful for the positive and early response from Norman Lamont and yourself to the roll-over relief point.

I have endeavoured to keep the detailed suggestions to the minimum, and these are listed later in this letter. My main point for this year relates to Capital Gains Tax, and I would first like to emphasise the major policy context which causes me to give this priority.

As you know, the agriculture and horticulture sectors now face considerable changes. Incomes have been falling in real terms (by about a third in the last 10 years), and with the CAP reforms on which we are insisting this trend is likely to continue. Significantly more agricultural land will have to come out of production, both because of the surpluses and the continued effect of increasing yields resulting from technological developments. Farmers will have to diversify more and more away from production of surplus products, and alternative land uses will feature more prominently. We are endeavouring through a number of policy initiatives to encourage and assist these developments. It is equally important to free farm businesses from constraints that may hinder this process. In areas of tax law the critical one is the present Capital Gains Tax arrangements.

There are two main problems, which cause the present tax to have a particularly heavy impact on farmers and landowners. First, as holders of long-term assets such as land, they are particularly

affected by the tax on the inflationary gains of the 1970s, which the reform to introduce indexation since 1982 does not ameliorate. Second, they are particularly heavily affected also by the fact that their assets cannot easily be divided and so take full advantage of the annual exemption for Capital Gains. I realise that there are other groups affected by the "lumpy assets" problem, but undoubtedly one of the main ones is agriculture. As I am sure you appreciate, in this way farmers and landowners are disadvantaged compared with those owning readily realisable assets which are capable of being split such as stock exchange securities. These two factors combine to deter many from selling land either to finance some alternative venture or to assist in making sensible structural adjustments to respond to the changing agricultural and rural scene.

I could of course make specific proposals, such as alterations to the specific indexation years and allowing those with "lumpy assets" to carry forward unused annual Capital Gains exemption for a number of years. You will also have seen the proposals put to you by the President of the Country Landowners' Association. But if you are contemplating any changes to Capital Gains Tax legislation, I am not sure that that is the most fruitful way for me to proceed. I think the important point is to stress that any changes to Capital Gains Tax legislation should take clearly into account these two points of such critical importance to agriculture in current circumstances. Nor do I wish to plead particularly for agriculture alone; I recognise that others are affected by the "lumpy assets" problem, and I do think that wherever possible it is better not to have specific tax proposals for agriculture. But for the reasons I have given I very much hope that it will be possible for you to deal with the particular Capital Gains Tax problems in the 1988 Finance Bill.

I turn now to other proposals, all of which also in one way or another would be of particular help to farmers as they face the need to diversify their businesses.

First, on Inheritance Tax, some farms with relatively few hectares of land, which in reality constitute small businesses, may attract the higher band of tax, simply because agricultural land remains a high value asset in many areas. Despite the index linking of the nil rate threshold and of the rate bands, both do seem to be out of line now with present day values. I would recommend that the threshold be raised and the rate bands widened to reduce the liability faced by these smallholders. Such a measure would, I appreciate, benefit other individuals also.

On a lesser point in relation to Capital Gains Tax, many farmers are having great difficulty servicing their debts in view of current pressures on farm incomes. The changes introduced in the 1986 Finance Act to allow deferral of CGT in respect of small part disposal of land were clearly helpful, but the benefits were restricted since the monetary limit of £20,000 remained. I do feel that this needs to be raised now to about £50,000 to assist even moderately sized farm businesses to reduce their indebtedness by selling parcels of land.

The 1984 Finance Act provided a very valuable concession on holiday lettings by allowing profits to be treated as trading gains and not rents - and many farmers will, I am sure, be taking advantage of it. It is apparent, however, that in the case of farms in less popular tourist areas and in remote areas such as the north of Scotland, the minimum qualifying letting period is unduly stringent. The holiday season in these areas is necessarily short and I suggest that the stipulated period of availability for commercial letting should be reduced from 140 to 100 days and the minimum number of days for such lettings reduced from 70 to 50 days. Alternatively, the qualifying period of availability could remain at 140 days so long as the minimum period was reduced to 50 days.

Finally, on the question of Capital Allowances the introduction last year of optional balancing charges or allowances when buildings are disposed of through sale or demolition was welcomed by the industry. I have been under pressure on many occasions to support the proposal for the reintroduction of a modest 100% Capital Allowance in the first year up to, say, £10,000 to assist investment in the agricultural industry which is currently down. I have resisted this on the same grounds as I regularly used to do when I was Chief Secretary! There is one small point however which I would like to put forward for your consideration. Many specialised farm buildings are no longer used for the original purpose for which they were intended, well before the end of the 25 year life assumed for tax purposes. It will hardly be practicable to sell such buildings, nor wise to demolish them. Their true value, however, will fall considerably although the farmer may find some other use for them such as storage. For such buildings, I suggest that the farmer should be allowed the option of obtaining the agreement of his District Valuer that the building has become of negligible value. This would be a useful measure which could perhaps be effected without recourse to legislation.

Yours ever,  
JH

JOHN MACGREGOR

ANNEX  
B

4480/35

CONFIDENTIAL

FROM: MRS T C BURNHAMS  
DATE: 8 January 1988

- 1. MISS SINCLAIR
- 2. CHANCELLOR

- cc PS/Chief Secretary
- PS/Financial Secretary
- PS/Paymaster General
- PS/Economic Secretary
- Sir P Middleton
- Sir T Burns
- Sir G Littler
- Mr Anson
- Mr Monck
- Mr Scholar
- Mr Burgner
- Mr Culpin
- Mr MacAuslan
- Mr Waller
- Mr Cropper
- Mr Tyrie
- Mr Call

*Ch*  
*1. 'X' below - you have a*  
*bilateral with Ld Y. on 20/1, and*  
*I thought you might find it helpful to*  
*have a brief on his exp. for that*  
*meeting. - yes psr*  
*2. Confirms to write to Mr Fowler*  
*as proposed? - OK -*  
*df*  
*8/1*  
*A. J. [Signature]*

PS/IR  
PS/C&E

**BUDGET REPRESENTATION FROM SECRETARY OF STATE FOR EMPLOYMENT**

You asked for early advice on the Secretary of State for Employment's letter of 22 December and I attach our assessment of the specific proposals he makes in the annex to his letter. This has been agreed with IAE, Inland Revenue and Customs.

2. Mr Fowler's major proposals are aimed at small businesses and the problems of raising finance for new projects or expansion. He also puts forward a number of suggestions by representative organisations to simplify taxation or remove anomalies. An assessment of each of the proposals is attached. A number of the proposals have been considered before and rejected but the suggestion to increase the ceiling of the Loan Guarantee Scheme does appear reasonable and we have no reason to question the estimated cost of £2.25 million in 1989-90 quoted in the letter.

3. Apart from the specific proposals set out in the annex to his letter Mr Fowler endorses Lord Young's proposal for "Local Enterprise Companies". Separate briefing on Lord Young's Budget representation will be provided next week in time for the Chancellor's meeting on 20 January.



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4. Mr Fowler also comments on the effect the withdrawal of initial capital allowances has had on small firms and asks for further examination of the problem.

5. Finally he expresses concern that any Budget measures are assessed for their effect on employment and incentives to work. He mentions particularly national insurance contributions and highlights the "cliff edge" start to payments and the uneven marginal tax steps resulting from the lack of integration between tax and national insurance although acknowledging the problem of the contributory principle in an integrated system. He suggests the aim of any changes should be to reduce the burden on the low paid and "to bring the tax and national insurance system more into line". He proposes that officials from both Departments should discuss any changes under consideration but I assume you would not wish to take up such an offer.

6. Unless you wish to discuss any of the proposals with Mr Fowler I recommend a standard reply should be sent and this is attached.

What the  
pps on this thing.



MRS T C BURNHAMS

**Item 1 Business Expansion Scheme**

- A. Mr Fowler's proposal would allow relief to a paid employee previously unconnected with the company.

At present, BES relief is not available to an employee of the company. Mr Fowler proposes that this should apply only to people who were employees before making their investment. His idea is to attract experienced businessmen (who may have retired or been made redundant from another job) to invest and take an active part in the running of the company.

A similar scheme, for part-time directors, was considered in the run-up to the 1986 Budget. Although the Chancellor was sympathetic to the proposal, because it would encourage a "hands-on" approach by investors, he decided against it because of the difficulty of holding the line against allowing in other "insiders". Apart from this consideration, there would be a deadweight cost, particularly where someone was investing in a new business (and so by definition could not have been employed in it before). And there would be some danger of "round-tripping": the company pays out a high level of remuneration (or dividends) to reimburse the investor for at least part of the cost of his investment; the BES relief cancels any extra income tax liability, but the company gets a corporation tax deduction for the payments. While it would be possible to devise rules to restrict the deadweight cost and the danger of round-tripping there is still the question of whether the line could be held at new employees.

- B. He also proposes relief on preference shares in co-operatives.

BES relief is available only in respect of ordinary shares, not preference shares. The reason for this is that preference shares can be more secure investments. Mr Fowler says that

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co-operatives often have a very small amount of ordinary share capital and use preference shares to raise the bulk of their capital. In this case the preference shares could be very little more secure than the ordinary shares. So he suggested that where the authorised ordinary share capital of a co-operative does not exceed £500 BES relief should be available on non-voting preference shares.

It is not clear why non-voting ordinary shares, which would be eligible for BES relief, could not be issued instead of preference shares. It is also not clear why co-operatives should be treated more favourably than other companies. In principle, it would be possible to allow BES relief for preference shares generally, subject to restrictions to prevent the investment being too secure, but this would be an added complication which does not seem necessary.

## Item 2 Corporate Venturing

The Secretary of State proposes a modified form of an idea put forward in a Bow Paper to provide an incentive for firms to undertake corporate venturing. This amounts to BES style relief for investment by companies. He suggests a 10 per cent relief from Corporation Tax on profits invested in qualifying companies with a maximum of £10 million and a limit of £250,000 for investment in any one company. It is estimated that the revenue cost would be £35 million.

BES relief is only available to individuals. This is because the relief was aimed at individual outsiders, who would otherwise be unlikely to make equity investments in unquoted trading companies, rather than organisations (like banks and venture capital funds) which make such investments anyway. His aim is to encourage corporate venturing.

The main objection to this proposal is the deadweight cost where the company would anyway have invested. But it would also be necessary to elaborate on the BES anti-avoidance rules to prevent them being got round by the interposition

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of a company (which might be controlled by an individual who was a director or employee of the target company).

## Item 3 Loan Guarantee Scheme

- A. The proposal to raise the ceiling from £75,000 to £100,000 does not seem unreasonable, as it has not been raised since the scheme was introduced in 1981. DE themselves estimate the gross cost of this measure at £2.25 million in 1989-90, £4.5 million in 1990-91 and £6.75 million in 1991-92. This compares with gross costs of £21.7 million in 1989-90 and £22.3 million in 1990-91 on current plans. The assumptions on which these figures are based seem reasonable, and if anything may overstate the cost. Take-up of LGS is currently running at only around 100 a month, and the failure rate is below 10 per cent. However, although we would not rule out this measure, DE officials have told us in the past that there seems to be little demand to raise the ceiling.
- B. He also proposes that banks should be allowed discretion to decide whether they require personal assets to be put forward as security.

This proposal is more far-reaching. Actual evidence suggests that having to put up one's own home, for example, as security is a major disincentive to taking out a loan. Much hinges on the attitudes of individual bank managers, and DE believe that they would not "be over-generous to borrowers in applying their discretion", so there would only be a slight effect on lending. But the banks only bear 30 per cent of the risk of LGS loans, and so may be tempted to be less stringent. At the very least, costs are highly dubious. Nor would it seem desirable to encourage banks to be more lax on the terms of which they make LGS loans.

It should be noted that the present LGS scheme is due to expire at the end of March 1989. Making any changes to the scheme in the 1988 Budget would be odd unless it was expected that the scheme would continue. If you agreed to raise the

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ceiling you should be prepared to announce a continuation of the scheme, or concede it, if asked. IAE therefore think it might be sensible if you agree to raising the ceiling to also put down a marker than DE and HMT should in due course review the small firms' provision across the board. This has grown up in a piecemeal fashion, and we need to know whether it really fits together, particularly given the initiative taken by DTI to be announced in their White Paper next week.

## Item 4 Inheritance Tax - 100 per cent Business Property Relief

Mr Fowler claims the present rules bear heavily on unquoted companies and is a disincentive to employee share ownership. The cost of the proposal is estimated to be a revenue loss of about £20 million.

The case for settling the choice of successors to key positions in businesses as well as taking steps to mitigate the adverse effect of an untimely death applies equally to all businesses and is not therefore a peculiar consequence of the IHT regime.

100 per cent business property relief has been resisted in the past because even in those cases where a tax charge arises due to the premature death of the transferor within 7 years, the existing business property relief and interest free instalment facility are generous.

## Item 5 Sub-Contractor's Tax Certificate

Mr Fowler supports a familiar suggestion from Department of Employment - that the conditions for getting a certificate exempting a subcontractor in the construction industry from deduction at source should be relaxed.

The exemption scheme and its associated paperwork are costly for both the Revenue and the industry to run. So there are resource arguments for reducing the number of certificates in issue. There is a balance to be struck between the limited

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validity of the 'licence to work' arguments (and some much stronger cash flow arguments largely unidentified by the Department of Employment) on the one hand, and security of the scheme against evasion on the other. The scheme will be the subject of an Efficiency Scrutiny, with terms of reference allowing recommendations needing legislative changes.

## Item 6 Relief for Business Expenses and incidental costs of raising capital

The rules allow for tax deductibility only if revenue expenses are incurred wholly and exclusively for the purposes of trade. Some business expenses cannot meet this test as they are capital in nature but no capital allowances are available.

The present distinction between the tax treatment of the incidental costs of raising equity finance and those incurred in raising for the purpose of a trade, and interest - the cost of servicing equity - are treated as a distribution of profits after tax and are not an allowable expense. The possibility of legislating to make the costs of raising equity finance deductible was considered in 1985 and 1987 but was ruled out mainly on cost grounds.

If relief were allowed for costs incurred on all abortive capital projects it would be given in circumstances where the project, if completed, would not have attracted capital allowances (eg the construction of a commercial building).

## Item 7 National Insurance Contributions

Mr Fowler supports the same allowance for Class 2 payments that was introduced for Class 4 payments.

A major argument for granting tax relief on Class 4 National Insurance Contributions was that they earned no benefit entitlement. This is not the case for Class 2 Contributions which are tied to benefits.

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In contrast to Class 4, Class 2 Contributions are a fixed weekly payment and if there were arguments for reducing payments either on the grounds of the contributory principle or for other policy reasons it would be more logical to alter the rates rather than introduce a relatively complicated tax relief that would not benefit all payers.

Giving tax relief for Class 2 payments would be administratively difficult as unlike Class 4 Contributions the Revenue has no record of who pays Class 2. This would require a much wider exchange of information between the Revenue and the DHSS and would breach present rules on confidentiality.

## Item 8 P11D

Mr Fowler urges that any changes introduced as a result of the Revenue review of "dispensations" should be announced in the Budget.

As part of the Government's initiative to reduce compliance costs on employers, Ministers agreed that greater publicity should be given to encouraging employers to apply for "dispensations" relieving them from the requirement to record expenses payments on P11D forms.

Following a press announcement in February last year, a leaflet (IR69) explaining the circumstances in which "dispensations" may be granted was issued to employers along with P11D forms.

Results so far are encouraging showing a large take up by employers, the vast majority of which Inspectors have allowed. We are continuing to monitor the position and will be minuting Ministers in more detail later. The results of the review to date do not suggest that any major changes will be necessary. If the proposal in starter 104 goes ahead, the form P11D will disappear. It may be however that some form of dispensation system should be retained to deal with eg expenses payments for business purposes.

**Item 9 VAT Registration**

Mr Fowler supports the extension of the registration period to 60 days.

An extension from 10 to 30 days was introduced in the 1987 Finance Act. Many small businesses register on the basis of past taxable supplies made in a quarter and with a 30 day registration period they effectively have 4 months in which to establish their need to register. A further extension would involve a significant loss of revenue.

**Item 10 Cash Accounting**

Mr Fowler supports a relaxation of the rules to allow firms into the scheme for a trial period (a year) during which time they could get their payments up to date. This concession would be aimed at small firms saving cash flow problems through late payment by customers.

Cash accounting, whereby the tax is accounted for on the basis of cash paid and received, assists the cash flow of businesses in this important sector where they are required to offer extended periods of credit to customers and, or, have a high incidence of bad debts. These advantages have, though, to be balanced against revenue collection considerations. The scheme does increase the scope for manipulation and fraud and consequently a number of conditions are necessary before Customs will authorise businesses to adopt the scheme. One of these conditions is that traders have a good compliance record and are up to date with their payments, however Customs are being flexible in this area; applications are being allowed where only small amounts are outstanding and, where amounts outstanding relate solely to the last tax period, the application is not refused until an extended period has elapsed.

The scheme, together with its legal framework and public notice, which has the force of law, was the subject of



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extensive consultation with trade and professional bodies. Customs will embark on further consultations when they undertake a thorough review of cash accounting in the Autumn of 1988, following a full year's practical operation.

## Item 11 Approved Share Option Schemes

i. a. Mr Fowler supports a proposal to tie executive scheme relief to the introduction of all employee schemes.

This has been considered, and rejected, on a number of occasions since the FA 1984 approved share option scheme legislation was first enacted. The purpose of the schemes is different. The all-employee schemes under FA 1978 and 1980 aim at improving the employee's perception of the interest they share with their employer in their enterprise's prosperity as well as contributing to the general widening of share ownership. The discretionary FA 1984 scheme also aims at attracting key personnel by prospects of high rewards in future rather than large salaries now.

Adoption of the proposal could discourage companies from introducing discretionary schemes and thereby reduce the effectiveness of the FA 1984 legislation. The requirement would have to be not only that an all-employee scheme should be in existence but also that it should be operated - to some stipulated extent, and with some required frequency. A requirement of this kind would run counter to the voluntary nature of the share scheme legislation.

b. He also advocates raising maximum limits for all employee schemes.

There is little evidence that the present limits are a constraint.

Both schemes continue to be popular. In no year have average annual appropriations under the FA 1978 scheme exceeded £350 (the present limit is £1,250 per annum or, if greater,

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10 per cent of salary, subject to an overall maximum of £5,000).

## ii Tax Relief for Share Purchase

Mr Fowler suggests that tax relief should be provided on amounts employees invest to buy ordinary shares in their company through a savings contract.

This, in effect, would amount to a form of share incentive scheme, with the employee obtaining his shares at the outset and being allowed tax relief on the money used to purchase them. Individuals who obtain shares under approved schemes already receive favourable tax treatment in that there is no charge to income tax on the benefit that accrues when they buy their shares at less than the prevailing market price. It is not clear that a further relief of the kind proposed is necessary.

## iii Employee Share Trusts

- a. Mr Fowler supports the proposal that there should be incentives for taking out loans to buy substantial shareholdings for employee share trusts (by means of tax relief for companies' payments to trusts reimbursing latter's loan financing costs).

Some of the objects of this proposal can already be achieved under existing law, for instance, using a secondary 'warehousing' trust. Even under the proposal put forward here, some two-thirds of the net cost of the shareholding being acquired would be met by the company itself.

While there is no overriding objection in principle to this particular proposal, in isolation it would be unlikely to have any substantial effect.

- b. He also suggests removing the restriction making gifts of shares to trusts which hold less than 50 per cent of a firm's equity liable to IHT, and give IHT relief for requests to

employee share trusts.

The difficulty with the former would be to devise a workable solution that would eliminate the need for a share valuation and contain adequate safeguards against avoidance while remaining attractive.

On the second point there are a number of exemptions and reliefs already available. There is little evidence that the existing rules are deterring owners of businesses who genuinely wish to pass the ownership of them to their employees.

**iv Profit Related Pay (PRP)**

He proposes allowing separate small scale profit dependent organisations within the public sector to apply for PRP relief.

Ministers gave very careful thought to the inclusion of public sector businesses before the PRP legislation was drawn up. It was decided to exclude the public sector for the following reasons:

- the greater part of public employers are not engaged in trading with the aim to make a profit.
- areas that do trade still have major differences in culture and many trade for only part of their workload.
- public sector businesses are inevitably subject to certain conditions and constraints.
- the benefit of PRP is strongest for businesses operating fully in the disciplines of the market economy.

The problem - as the Secretary of State for Employment recognises - is that the public sector is a price setter. His prescription contemplates wide Revenue discretion which would raise its own difficulties.

**TREATMENT OF PRE-TRADING ACCOUNTS**

Mr Rifkind suggests that there is some inconsistency between the treatment of pre-trading income and pre-trading expenditure on the basis that whereas pre-trading expenditure can only be relieved once a trade starts, pre-trading income is taxed when it arises. He is particularly concerned that this might reduce the value of Regional Selective Assistance grants received prior to the commencement of a trade.

It looks as if there may be some misunderstanding here. There are two points:

- (i) If a company incurs expenditure within three years of the time at which it starts to trade, that expenditure can, under a special relief introduced in 1980, be carried forward and set against the income of the first year's trading.
- (ii) If during a similar pre-trading period a company gets Regional Selective Assistance grants, those grants are not - as Mr Rifkind suggests - taxed at the time the company gets them. But they may reduce the expenditure which it can carry forward to the first year of trading - (i) above. That is in accordance with the general principle that a company only gets tax relief on what it has actually spent out of its own pocket.

R/2  
RIDLEY  
TO  
CX  
11 JAN



2 MARSHAM STREET  
LONDON SW1P 3EB  
01-212 3434

My ref:

Your ref:

BR

The Rt Hon Nigel Lawson MP  
Chancellor of the Exchequer  
HM Treasury  
Parliament Street  
SW1P 3AG

EXCHEQUER	
	12 JAN 1988

114

HM TREASURY - MCU	
RECD	13 JAN 1988
ACTION	MS Evans
	January 1988
	CC/PS/CXX
	PS/EST.
SIGNATURE	CXX
	10681/88

Dear Nigel

I welcome Cecil Parkinson's support in his letter of 22 December for my view that we need an increase of 5p per gallon in the duty differential in favour of unleaded petrol in the next Budget. However Peter Bottomley's letter to you of 24 December implies that he takes a very different view about what pace of change constitutes a politically credible policy.

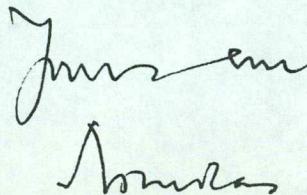
We have stated the Government's commitment to the changeover to unleaded petrol very clearly - you will recall saying in your 1986 Budget speech that you were anxious to do what you reasonably could to assist the introduction of the new fuel. We gained a good deal of political credit for our stance on this issue and for the lead we took in persuading our European Community partners to set targets for the availability of unleaded petrol to the consumer. Now, 18 months on from the opening of the first unleaded pump, one station in about 35 stocks the new fuel, while sales account for about 0.1% of the petrol market, so unleaded pumps are a liability to their proprietors. We now lag behind several European countries in introducing unleaded petrol, and there is a real danger of the initiative turning sour.

Peter may be correct in estimating that by April 1989 10% of car mileage will be by cars designed to use the new fuel without any adjustment. However, 0.5p per gallon is certainly not a significant price incentive unless a motorist finds himself on a forecourt where unleaded is stocked - and the motorist who is most price sensitive will go to the Independents, who do not at present sell unleaded petrol. Unless we achieve a breakthrough in the number of stations stocking the new fuel, we shall be lucky if one-twentieth of the car mileage to which Peter refers is actually run on unleaded petrol, leaving us with a 0.5% market penetration 15 months hence. To me, this is simply not acceptable. Quite apart from the political aspect, the EC Directive requires us to ensure the availability and balanced distribution of unleaded petrol throughout the UK by 1 October 1989.

Overseas experience suggests both that it is harder than one would expect to persuade motorists to change the habit of using leaded petrol, and that there is no significant misfuelling problem with a reasonable duty differential.

The £40 million figure Peter quotes is not relevant. We have accepted that the switch to unleaded petrol will have some economic cost; in the long term this cost will be minimised by the design of all cars to the European standard 95 octane, which was carefully chosen with this in mind. Peter is concerned with possible additional costs in the transitional period. Two-star will in any event disappear at some point in the next decade, but from all the oil companies have told us it seems out of the question that it would disappear through their choice within a year of an increase in duty differential. The £40m figure (or something like it) would become relevant only if we banned 2-star, as we are now permitted to do. Public pressure to do this would certainly mount if the changeover to unleaded fails to take place at a reasonable rate as a result of not increasing the duty differential.

I am copying this letter to Paul Channon, Cecil Parkinson and David Young.



NICHOLAS RIDLEY



DEPARTMENT OF HEALTH AND SOCIAL SECURITY

Richmond House, 79 Whitehall, London SW1A 2NS

Telephone 01-210 3000

From the Secretary of State for Social Services

bf to m 22/1

CH/EXCHEQUER	
REC.	14 JAN 1988
ACTION	MRS T. BURNHAMS
COPIES TO	CST. FST. PMG EST
	SIR P. MIDDLETON
	MR SCHOLAR
	MR CULPIN
	MISS SINCLAIR
	MR MICHIE
	MR CROPPER
MR TYRIE	

15/1

MR CALL  
PS/C&E  
MR KNOX C&E

The Rt Hon Nigel Lawson MP  
Chancellor of the Exchequer  
Treasury Chambers  
Great George Street  
London SW1

14 January 1988

*Dear Nigel.*

1988 BUDGET: TOBACCO TAXATION

I hope that this year you will feel able, through a substantial increase in tobacco duty specifically linked as in 1986 to health, to give a clear signal of the Government's determination to act over what remains the nation's most serious cause of ill-health and premature death. With over 100,000 deaths - more than 40,000 of them from lung cancer - and the loss of some 50 million working days each year, the cost of smoking-related diseases to the nation is substantial, and the burden on the NHS of preventable illness is obvious.

Despite good progress over the years in reducing smoking, recent evidence shows a flattening out in the overall rate of decrease and, among certain categories of the population, no decrease at all. I am particularly concerned about smoking rates among women, where over the past two years there has been no statistically significant change and a possible increase. We have seen a rise of 27 per cent in lung cancer deaths among women since 1979, compared to a 6 per cent fall among men, and lung cancer is likely shortly to overtake breast cancer as the main cause of cancer death among women, as it has already done in Scotland.

The problem of smoking among women extends right down to teenage girls. Our most recent survey shows the level of smoking among adolescent girls remaining disturbingly high compared with that among teenage boys, which has fallen significantly. Adult smoking habits are formed during adolescence. If we are to avoid future increases in smoking-related disease and premature death, we must deal effectively with the problem of teenage smoking now. Given the relative levels of disposable income amongst children and teenagers, substantial price rises could be expected to be particularly effective in deterring consumption in this age-group.

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CX  
14 JAN

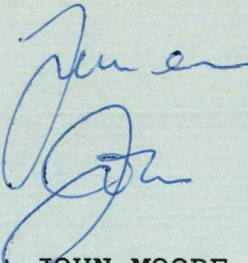
**E.R.**

Another factor causing increasing concern is the damage to health from breathing other people's tobacco smoke, sometimes called "passive smoking". The Independent Scientific Committee on Smoking and Health (ISCSH) produced an interim statement on the subject earlier in the year which received a considerable amount of attention and led to calls for restrictions on smoking in public places and the workplace. A recent survey by NOP indicates that 82 per cent of people believe passive smoking to be harmful. The ISCSH will be presenting its full report to me shortly, and as the existence of the report is known we shall have to publish it as soon as we can - probably in early March and before the Budget. It is likely to generate considerable attention. Health interests certainly will be looking for a response by Government which recognises the increasing public concern about the harm smoking creates for smokers and non-smokers alike. I am hoping to provide Ministerial colleagues with some ideas on this in advance of the publication of the report but action on the fiscal front would, I believe, carry particular weight.

The tobacco industry has traditionally maintained that tobacco taxation is regressive, and that increases in duty should be mitigated on that account. As an argument this seems to me increasingly tendentious. It would mean that fiscal policy was, in effect, perpetuating those greater relative disadvantages on most measures of health the further down the socio-economic scale you look. These indicators of health status, ranging from neonatal death rates and average height to the incidence of diseases like coronary heart disease, are closely related to socio-economic status. As you may be aware smoking, despite the overall decreases of recent years, is highest in the lower socio-economic groups. Arguments for keeping tobacco duty low on the notion of "protecting" the poorer sections of the community are, therefore, fundamentally misconceived.

On the contrary, I suggest that if there is not a significant increase in duties this year, the Government will come under criticism not only from the Opposition but also, on grounds of inconsistency, from more thoughtful and important sources. The Government is committed to increasing the emphasis on prevention of ill health, we know the considerable burden of unnecessary sickness and disability which smoking imposes on the NHS, and no opportunity is lost to point out to us the growing pressures on the NHS. An increase in duty would be consistent with our health policies and in line with the advice the Government is receiving from important and impartial bodies such as the Royal College of Physicians. It could be further justified as a way, in the longer term, of conserving valuable NHS resources.

A copy of this letter goes to Malcolm Rifkind, Peter Walker and Tom King.



JOHN MOORE



bf to m 221,



SCOTTISH OFFICE  
WHITEHALL, LONDON SW1A 2AU

A C S Allan Esq  
Principal Private Secretary to the  
Chancellor of the Exchequer  
IIM Treasury  
Parliament Street  
London  
SW1P 3AG

/8 January 1988

CH/EXCHEQUER	
REC.	19 JAN 1988
ACTION	MRS T BURNHAMS
COPIES TO	CST, FST, PMG, EST
	SIR P. MIDDLETON
	MR M. SCHOLAR
	MR CULPIN
	MISS SINCLAIR
	MR AM WHITE
	PSIR PSICRE

*Dw Alex,*  
**1988 BUDGET**

I am writing, in accordance with previous practice at about this time of year, to draw to the Chancellor's attention a number of matters to which my Secretary of State would be grateful if consideration could be given in the context of the 1988 budget preparations. They reflect a wide range of functions covered by the Scottish Office, and are set out below.

Scotch Whisky Industry

As the Chancellor will know, the Scotch Whisky Association is still concerned about the way in which whisky stocks are treated for Corporation Tax and about duty deferment. Although the Chancellor has not so far been attracted to the Association's proposed statutory maturation allowance for Corporation Tax purposes, or for an extension to the period of excise duty deferment, my Secretary of State continues to believe that these proposals are reasonable and that they could be defended politically if introduced in the next Budget. Mr Rifkind is of course aware, as Health Minister for Scotland, of the pressure for higher duties on all alcoholic drinks; but believes that an increase in excise duty on spirits would cause particular difficulties for the Scotch Whisky industry at a time when it is beginning to show signs of recovering from a very difficult trading period, and considers that nothing should be done to set that recovery back.

Unleaded Petrol

There was concern at the beginning of the 1987 tourist season about the limited availability of unleaded petrol, particularly in the Highlands. Pressure on the oil companies resulted in an increase from 21 to 40 outlets in Scotland, and the companies have plans to increase the number to 60 this year. This will, however, still leave significant gaps, notably in the Borders and Dumfries and Galloway, and progress towards extensive coverage remains slow. Despite efforts by the BTA, the perception in Northern European countries, which are important to the car-touring market in Scotland, is that there are too few such outlets and that travelling by car to Western and Northern areas of Britain should be

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ALLAN  
18 JAN

avoided. Mr Rifkind considers that a tax differential in favour of unleaded petrol would not only encourage new outlets but would be seen as being helpful to the overseas visitor and to our tourism industry. There are also strong health grounds for reducing the level of lead pollution in the atmosphere, particularly in its effects on children, and a tax differential would create the right climate for more extensive use of unleaded fuel.

#### Tobacco Duty

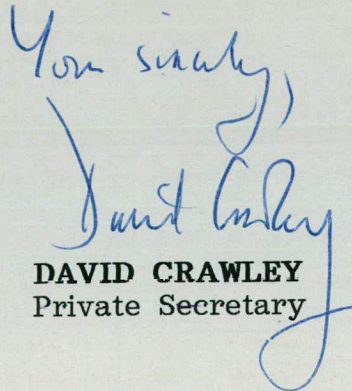
We understand that DHSS are to discuss with Customs and Excise the health case for an increase in tobacco duty. It would seem to my Secretary of State that because of the health risks involved with smoking, increased duties would be justified. For the first time in many years the consumption of cigarettes in the UK has increased from 94.9 billion in 1986 to 95.1 billion in the year ending August 1987. While in Scotland the overall prevalence of adult smoking has decreased from about 39% in 1984 to 35.7% in 1986, the fall is entirely due to a reduction in the number of male smokers. The continuing incidence of smoking among women is a particular concern, as it affects the health of pregnant women and their children.

#### Treatment of pre-trading accounts

Mr Rifkind is also concerned at what appears to be an inconsistency between the Finance Act treatment of pre-trading income and of pre-trading expenditure. Pre-trading expenditure (ie expenditure incurred during the formation of a project) must be carried forward and offset for taxation purposes against profits earned during the first year of trading. Pre-trading income, however, including instalments of Regional Selective Assistance grant paid in respect of project capital expenditure, may not be carried forward and is therefore treated as taxable income for the year in which it is received. This has the effect of reducing the value of selective assistance paid in respect of projects which have a lengthy construction period and are undertaken by new start companies who have no expenditure to offset against the income. There is therefore an inhibiting effect on potential inward investors whereas projects undertaken by companies already trading in the UK can be structured to avoid the designation of "pre-trading" income and expenditure.

#### Agriculture

The Scottish Office Minister with responsibility for agriculture, Lord Sanderson, has already written to Mr Lamont about a number of suggestions made by the Scottish Landowners' Federation. Mr Rifkind is grateful for Mr Lamont's acknowledgement in his letter of 23 December that the Chancellor will give these proposals careful consideration. He will, of course, be happy to discuss this and any of the matters raised in this letter should the Chancellor so wish.

*You sincerely,*  
  
**DAVID CRAWLEY**  
Private Secretary



SECRETARY OF STATE FOR ENERGY  
THAMES HOUSE SOUTH  
MILLBANK LONDON SW1P 4QJ  
01 211 6402

CH/EXCHEQUER	
REC.	22 JAN 1988
ACTION	MRS T. BURNHAMS
COPIES TO	CST, FST, PMG, EST SIR P MIDDLETON MR ANSON MR SCHOLAR MR CULPIN PS/IR PS/C&E

The Rt Hon Nigel Lawson MP  
Chancellor of the Exchequer  
Treasury Chambers  
Parliament Street  
LONDON  
SW1P 3AG

21<sup>st</sup> January 1988

*Dear Nigel,*

**BUDGET 1988: UNLEADED PETROL DUTY DIFFERENTIAL**

I have seen Peter Bottomley's letter of 24 December and Nicholas Ridley's further letter of 11 January to you on the above. I am disappointed that Peter has been unable to support Nicholas' and my view that there should be an increase in the duty differential between leaded 4-star premium petrol and unleaded petrol in the next budget and I believe his conclusions may be based on certain misunderstandings.

First let me clarify the position regarding the current disappointingly low uptake of unleaded petrol.

There are now 550 petrol stations capable of selling unleaded petrol, with reasonable geographical coverage of most of the UK. Although the number is still increasing fairly rapidly we foresee a slowdown or even a reversal in petrol station conversions unless sales of unleaded petrol increase substantially in the near future.

Although Peter states that cars specifically designed for the new fuel are only just starting to appear on the market, about 10 per cent of current petrol-engined vehicles can already use unleaded petrol without any adjustment. They are mostly using leaded 2-star petrol because it is cheaper. Substantially more cars in the current UK car population could use unleaded petrol following low-cost, minor retuning.

Peter's concern about misfuelling seems exaggerated if one looks at experience in Europe. Austria, Denmark, Germany, Norway and Switzerland have created substantial petrol duty incentives to encourage the uptake of unleaded petrol. In those countries the sales of unleaded are now between 20 and 40 per cent and we have no evidence of misfuelling arising from the price incentive to use unleaded petrol.

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TO  
CX  
21 JAN



I agree that unleaded petrol costs about 8 pence/gallon more than leaded 2-star petrol to produce. We were aware of the increased capital operating costs which have been and will be incurred by the UK oil industry in manufacturing and distributing unleaded petrol when the decision was made to stimulate its sale in the UK. That additional cost, therefore, cannot now be prayed in aid to argue against the promotion of unleaded petrol sales.

I hope these comments are helpful and I continue to support Nicholas Ridley's view that there should be a further increase in the duty differential of 5p/gallon between leaded 4-star premium and unleaded petrol in the next budget.

I am copying this letter to Nicholas Ridley, Paul Channon and David Young.

*James Eves,*  
*Lead*

**CECIL PARKINSON**

FROM: MRS T C BURNHAMS

DATE: 21 JANUARY 1988

- As 21/1
1. MISS SINCLAIR
  2. CHANCELLOR OF THE EXCHEQUER

cc Principal Private Secretary  
 Chief Secretary (2)  
 Financial Secretary (2)  
 Paymaster General (2)  
 Economic Secretary (2)  
 Sir Peter Middleton  
 Sir Terence Burns  
 Sir Geoffrey Littler  
 Mr Anson  
 Sir Anthony Wilson  
 Mr Scholar  
 Mr Culpin  
 Mr Sedgwick  
 Mr Odling-Smee  
 Mr Riley  
 Miss Evans  
 Mr Hudson  
 Mr Cropper  
 Mr Tyrie  
 Mr Call

CL  
 Lord Young's 6 (on VAT  
 registration threshold) seems  
 worth an urgent look?  
 AA

Mr Battishill - IR  
 Mr Isaac - IR  
 Mr Painter - IR  
 Mr Unwin - C&E  
 Mr Knox - C&E

#### MINISTERIAL REPRESENTATIONS

Monday's overview meeting is to run through the main representations you have received from Ministers in other Departments. We suggest you might take them in the following order:-

#### Secretary of State for Trade and Industry

Lord Young wrote to you on 7 December. Briefing on his proposals is attached at Annex A. You are having a <sup>a</sup> bilateral meeting with Lord Young on 29 January.

#### Secretary of State for Employment

Mr Fowler wrote to you on 22 December and briefing was provided under cover of my minute of 8 January. A copy is attached at Annex B.

(letters arranged in order referred to in the note)

**Secretary of State for Northern Ireland**

Mr King wrote to you on 25 November about tobacco duty and asked you to consider restricting any increase to the level of inflation.

**Secretary of State for Social Services**

Mr Moore wrote to you on 14 January supporting a substantial increase in tobacco duty. His view is shared by Mr Rifkind.

**Secretary of State for Transport**

Mr Channon wrote to you on 9 December about motoring taxation. He favours a freeze on VED in favour of increased fuel duty. You agreed at the Overview meeting on 18 January that VED should be left unchanged and that duty should be increased on leaded petrol and derv.

In addition Mr Bottomley wrote to the Economic Secretary about a number of minor VED Starters and these are still under consideration. *(at end of Rider)*

**Secretary of State for the Environment****Secretary of State for Energy**  
**Minister for Roads and Traffic**

Mr Ridley wrote to you on 15 December and again on 11 January supporting an increase in the duty differential between leaded and unleaded petrol. This view was endorsed by Mr Parkinson in his letter of 22 December and also by Mr Rifkind, but opposed by Mr Bottomley in his letter of 24 December. You are considering increasing the differential from 5p to 10p.

*and now further letter of 21 Jan.*

**Secretary of State for Scotland**

Mr Rifkind's Private Secretary wrote on 18 January with his Secretary of State's proposals for the Budget. Apart from duty on unleaded petrol and tobacco which are mentioned above he suggested the following:-

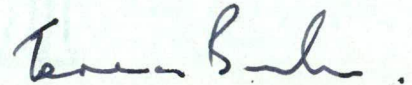
- no increase in duty on Scotch Whisky
- CGT to be replaced by a tax on short-term gains
- greater flexibility over carry forward of losses for income tax
- changes in the treatment of pre-trading accounts

A note on the present treatment of pre-trading accounts is attached at Annex C.

Minister of Agriculture, Fisheries and Food

Mr MacGregor wrote to you on 31 December suggesting certain easements connected with CGT, IHT and Capital Allowances which would be of benefit to farmers and landowners. He drew attention to the particular problem of indexation from only 1982 and "lumpy assets" but made no specific proposals on CGT apart from an increase on the limit for deferral of CGT on part disposal of land. On Inheritance Tax he suggested increasing the threshold and widening the bands. He proposed an easing of the concession given in the 1984 Finance Act on holiday letting, which would reduce the number of days of letting necessary to qualify. He also suggested a minor change on Capital Allowances which would allow farm buildings no longer used for their original purpose to be deemed to have a negligible value.

2. Finally, you are to have a meeting with the Home Secretary, the Secretary of State for Social Services and the Lord President of the Council on 9 February to discuss the duty on alcohol.



MRS T C BURNHAMS



MINISTER  
FOR ROADS AND TRAFFIC

DEPARTMENT OF TRANSPORT  
2 MARSHAM STREET LONDON SW1P 3EB  
01-212 3434

My ref:

Your ref:

The Rt Hon Nigel Lawson MP  
Chancellor of the Exchequer  
Treasury Chambers  
Parliament Street  
LONDON  
SW1P 3AG

CHANCELLOR	EXCHEQUER
29 JAN 1988	
28 JAN 1988	

Dear Nigel

**UNLEADED PETROL DUTY DIFFERENTIAL**

I wrote to you on 24 December about the unleaded petrol duty differential, following Nicholas Ridley's suggestion that it should be doubled from 5p to 10p per gallon. I have also now seen Cecil Parkinson's letter of 21 January to you.

We have drawn attention to the possibility of misfuelling and of oil companies accelerating the withdrawal of 2 star leaded petrol. The AA and RAC have made these points at greater length direct to Customs and Excise. We also mention a potential economic cost.

We recognise the political and environmental need to boost the use of unleaded petrol. We will not object further to a minor increase in the price differential. The greater the price difference, the greater the potential disbenefits.

I am copying this letter to Nicholas Ridley, Cecil Parkinson and David Young.

*Trans ca  
Rt Hon*

PETER BOTTOMLEY

BR

HM TREASURY - MCV	
RECD	29 JAN 1988
ACTION	Mrs Brownhams PP relates to 30301/87 cc APS/CHX, UK.
SIGNATURE	CHX
REF No.	12506/88

BOTTOMLEY  
TO  
CHX  
28 JAN