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PART A

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SECRET

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PART A

PRESENTATION OF BUDGET MEASURES 1984

DDS 25 years N.Agiz 25/08/94

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PART A

BUDGET SECRET

Manpower pss:
CR = 1000 + 1400 savings
of rel on charges
= 2400

To what extent will
this facilitate paying of
interest on CT arcs?

Get Goodison from HoSpch

DNS - limits & target

ECONOMIC SECRETARY TO THE TREASURY

FROM: ECONOMIC SECRETARY
DATE: 24 February 1984

CHANCELLOR

cc Chief Secretary
Financial Secretary
Minister of State
PCC Members
Mr Ridley
Mr Lord
Mr Portillo
Sir L Airey - IR
Mr Fraser - C&E

PRESENTATION OF BUDGET MEASURES

... I attach a paper dealing with the handling of the financial sector as commissioned in John Kerr's minute of 14 February. There is some further work to do on this, but I hope it will at least serve as a basis for discussion at next Tuesday's Overview.

... I also attach a paper by Adam Ridley dealing with the handling of the post-Budget presentation. Because of today's disruptions I was not able to discuss it with him, so I am passing it on as it stands. It seems to be a useful outline.

Adrian Ellis

for IAN STEWART

EST 24/2

PRESENTATION OF BUDGET MEASURES: FINANCIAL SECTOR

This note reports progress in meeting the remit set out in Mr Kerr's minute of 14 February. It identifies some positive themes and potential problem areas and considers how the post Budget presentation might be handled. But the section on the impact of the Budget on different institutions within the financial sector does not yet take full account of Mr Cassell's work (due to be submitted this weekend). And the material on the history of particular measures is still incomplete.

I THE MEASURES

The main proposals in the financial area are:-

(i) the introduction of a composite rate for taxing bank interest;

(ii) the consumer credit duty

(iii) halving of the rate of Stamp Duty on share transfers;

(iv) the withdrawal of life assurance premium relief on new policies;

(v) the corporate bond package

In addition, the financial sector will be affected by other Budget proposals, notably:

(i) the company tax package, which will have a major impact on the banks' leasing activities;

(ii) the abolition of NIS

(iii) the abolition of investment income surcharge;

(iv) the change in PAS, which is likely to increase the demand for bank credit;

(v) the withdrawal of/foreign earnings and foreign emoluments deduction, which is likely to bear on foreign banks; and the change in car scales

- For impact on various groups within financial sector - see Section IV.

II POSITIVE THEMES

1. A flourishing corporate sector

The financial sector's livelihood depends on the health of the wider economy. It can only gain from measures to promote a strong corporate sector, to encourage profitability, and to improve the quality of investment. And it will benefit directly from some of the proposals designed to bring this about, eg./reduction in company taxation abolition of NIS, encouragement of small companies.

2. Helping structural change

UK financial institutions going through period of rapid structural change: Budget measures "go with the grain" eg:

Stamp Duty and Stock Exchange
Composite rate fits with moves towards interest bearing current account, building societies offering bank style services.

3. Reducing discrimination, removing distortions

- as different kinds of financial institutions offer wider range of services and compete more closely, right that the tax system should treat them more even-handedly, eg. composite rate removes long-standing difference between treatment of interest on banks and building societies

IIS with, but not SD

- changes will redress imbalance between individual as against institutional investment, eg. withdrawal of LAPR, abolition of IIS. Halving of Stamp Duty and more generous stock option schemes will encourage individual share ownership

- Stamp Duty changes will remove disadvantages faced by UK investors trading in London. New duty rate will match rate now charged on foreign purchases

- changes will help to even out differences in tax burden between financial and other sectors/ and to widen the tax base, eg. consumer credit duty applies to sector which has not hitherto been subject to indirect tax. Company tax package will even out difference in impact of CT on financial and industrial and commercial companies.

- abolition of expensive and distorting tax reliefs, eg. LAPR (cost has risen very rapdily in recent years - now £700m, and largely unconnected with original purpose envisaged, viz. insuring against death). Foreign earnings and emoluments, car scales.

4. Encouraging companies to return to capital markets

1983 was a record year. Halving of Stamp Duty and Corporate bond package gives further encouragement to companies wanting to strengthen balance sheets by raising long term funds. Less reliance on bank lensing will have monetary benefits, reduce pressure on broad money. (Lower PSBR will also leave more room for private sector issues, despite scale of asset sales).

III DEFENSIVE POINTS

1. Measures reduce the incentives for saving (notably LAPR) ie. constitute move away from ideal of expenditure tax (cf. IFS).

(a) Withdrawal of LAPR unlikely to have significant effect either on overall level of saving or on genuine life assurance business. LAPR has been extended way beyond original intention of relief, ie. to ensure risk of death. Two-thirds of life business is non-qualifying; and have grown very rapidly since over 1981-82 (1983 figures will be affected by MIRAS). Life business continued to grow, albeit at more moderate pace, when relief was withdrawn in Australia in mid-1970's. Life companies will continue to enjoy some privileges, eg, pegged rate.

(b) Abolition of IIS and halving of Stamp Duty will remove some existing disincentives to saving, by increasing returns.

2. Some notorious tax privileges emerge unscathed

(a) No change in MITR; and consumer credit duty will not fall on mortgages under £30,000 (qualifying for relief)

- Private housing is social and political priority.

(b) Exemption of tax-free National Savings instruments from composite tax arrangements is another example of special privileges only for Government debt instruments (cf. criticism of low coupons, following ending of tax loophole for offshore roll-up funds).

- National Savings target is no higher than it would otherwise have been. May be some adjustment in pattern of inflows, with DNS attracting higher share of non-taxpayers. But many non-taxpayers already hold building society accounts despite corporate rate. And only right that non-taxpayers should have option of some gross instruments (as National Consumer Council report argued).

3. Composite rate should be abolished, not extended to banks

- see National Consumer Council recommendation

- it is absolutely right to standardise tax treatment of bank and building society interest. But manpower cost of doing this by abolishing composite rate for building societies would be prohibitive. (Indeed, existing system threatens to become unmanageable, with trend to interest bearing current accounts).

4. Financial sector doesn't need any more change

Some changes will help financial institutions cope with change. Others remove existing distortions. Tax system can't be left to ossify whilst the financial system changes. And this Budget gives companies plenty of time to plan for tax changes, by announcing future rates of CT and capital allowances well in advance.

5. Corporate tax changes will kill leasing and sharply increase tax burden on banks

- Banks have argued that most of the benefits of leasing are passed on to their customers; and they can't complain about paying tax like anyone else.

- Leasing market will undoubtedly change; but it will certainly continue. Longer term leasing will still have significant fair advantages. Shorter term leasing will still be a useful means of providing off balance sheet finance. Changes simply remove artificial tax-induced incentives for leasing.

6. Which tax exemptions are to go next? Mortgage interest relief? Tax exemption of pension funds?

No present plans. Prime Minister has made it clear that mortgage interest tax relief will stay.

7. Is this the last word on taxing the banks?

There are no plans for a special bank tax. This Budget corrects the major anomalies in the tax treatment of banks (eg. composite rate, consumer credit duty, releasing deferred tax liabilities as a result of corporate tax package).

IV EFFECTS ON DIFFERENT GROUPS WITHIN FINANCIAL SECTOR

A. Banks

Representative groups: BBA (composite rate, consumer credit duty, leasing)
Equipment Leasing Association
Finance Houses Association (leasing, consumer credit duty)
TSB's, National GiroBank (composite rate can consumer credit duty)
Association of American Banks in London (foreign emoluments)

- gain from abolition of NIS (1984-85 £10m
1985-86 £20m)
- lose from composite rate (may add £25m to cost of funds:

additional administrative costs) Affects:- All but especially Clearers, TSB's

- consumer credit duty may marginally reduce bank lending. Finance Houses would be most affected by a decision not to exempt existing fixed rate credit. Affects: particularly Clearers, TSB's, FHA.

- CT changes will dramatically change attraction of leasing as a tax shelter. In first two years, leasing may be more active; thereafter much leasing will become much less attractive. Banks exposure to tax (at lower CT rate) will be increased in longer term. [Relief through leasing has been worth about £300m to major clearers alone, but effect on profits is much less, to extent benefits are passed on to customers]. Affects: particularly Clearers, ELA, FHA.

- withdrawal of PAS may increase bank lending (by up to £500m in 1984-85).

- withdrawal of foreign earnings and emoluments deduction may add to costs of foreign banks. About 2000 new bank employees first qualify for this deduction a year: additional tax bill for them may be £1.2m in 1984-85. Affects: foreign banks.

B. Building Societies

Representative group: BSA

- likely to gain business from Budget itself: but decision on 23 February to tax gains on gilts as trading income could cost them up to like £150m a year.

- composite rate will divert some inflows from banks (perhaps £1bn in 1985-86, and maybe up to £½bn anticipatory flows in 1984-85).

- consumer credit duty may lead to some substitution into mortgage lending from other forms of lending (since mortgage lending that qualifies for relief is exempt). Duty on the 3 per cent of mortgage lending likely to be affected could raise about £20m, most of which is likely to be passed on to borrowers.

- LAPR abolition may cause some switch into building society shares but net amount of mortgage loans could be affected (because endowment mortgages will become more expensive). Societies may lose Commission and their ability to change premium interest rates maybe reduced [see Annex].
- halving of Stamp Duty on transfers of property will increase housing transactions and maybe demand for mortgages.

- withdrawal of Building Society SAYE - negligible (only 0.4 per cent of total building society deposits).

C. Life Assurance Companies

Representative group: Life Offices Association

- amount of institutional cash flow at risk from abolition of LAPR on new policies could be around £½ billion in 1984-85 and £2 billion in 1985-86, but in practice only some of this will be lost. Moreover, much of companies new premium income comes from non-qualifying business (in 1982, new premium income was £2.6 billion, of which only one-third qualified for relief).

- some life assurance groups have offshore funds, and will be affected by new tax proposals (published in January). No surprises.

- withdrawal of VAT zero rating on insurance written by overseas branches may cost £3-5m a year.

- companies will benefit from halving of Stamp Duty and reduction in NIS; but employees will be hit by new car scales.

D. Other investing institutions - pension funds, investment and unit trusts, property companies.

Representative bodies: National Association of Pension Funds
Association of Invesmtnet Trust Companies;
Unit Trust Association

- benefit from lower Stamp Duty, but may be anxious about future of tax reliefs not affected by this Budget.

E. Stock Exchange Firms and Other Dealers

Representative bodies: Stock Exchange
National Association of Sharedealers and Investment Managers

- jobbing and broking firms will benefit from increased activity resulting from lower Stamp Duty on share transfers, and corporate bond package, and from increased investment by individuals due to abolition of investment income surcharge. Also gain from abolition of NIS. Re-rating of different sectors after CT changes will greatly increase turnover.

F. Merchant Banks

Representative bodies: Accepting Houses Committee, BBA

Stand to benefit significantly from extra business due to lower Stamp Duty, corporate bond package, and consequences of company tax package. But some have leasing subsidiaries.

G. Consumers of Financial Services

Representative bodies: Consumers' Association, National Consumer Council

- composite rate reduces opportunities for non-taxpayers to receive interest gross. Extension to banks runs counter to NCC recommendation.

- consumer credit duty is likely to be passed on, increasing cost of borrowing by 1 per cent and reducing real disposable income. Could reduce spending as well as borrowing. (Treatment of existing contracts). Duty does not begin to operate until 1 July 1985.

- abolition of LAPR on new policies will increase cost of new premiums by 17½ per cent, reduce attraction of endowment mortgages.

?

- lower Stamp Duty on property and share transfers will help people moving house, and personal investors.

- abolition of investment income surcharge removes double taxation of savings.

See attached table: for summary of effect of changes in NIS, Stamp Duty [and CT changes] on financial sector.

Revenue Effects of major tax changes on financial institutions

Tax paid; £m

	1984-85	1985-86
1. **NIS**		
Banks	- 10	- 20
Building societies	- 2	- 3
Other	- 43	- 67
Total	- 55	-100
(whole economy)	[-460]	[-930]
2. **Stamp Duty**		
Banks	- 5	- 5
Building societies	- 5	- 5
Insurance companies		-685
Superannuation funds		- 75
Investment/unit trusts		- 25
Property companies		- 30
Total	-195	-205
(whole economy)	[-450]	[-515]
3. **Company tax package** (not allowing for changes in leasing, or forestalling)		
Banks		
Total	[- 35]	[-110]
(whole economy)	[-200]	[-340]

Note:

Consumer credit duty, LAPR affect consumers

Figures preliminary and need checking/completing by Revenue Departments

ANNEX

BUDGET - SECRET

LIFE ASSURANCE PREMIUM RELIEF : EFFECT OF WITHDRAWAL ON INDIVIDUALS

The proposal. Abolish LAPR for new policies ~~and~~ wil effect from Budget day.

Positive

(1) Greater freedom of choice for investors caused by removal of fiscal distortion in favour of investment in qualifying life assurance policies.

(ii) Relief now used predominantly for investment, not assurance against death.

(iii) Resources saved by withdrawal of relief will enable reductions in general burden of direct tax.

(iv) No withdrawal of relief for existing policies.

Negative

(i) Increase cost of new qualifying life assurance policies by 18 per cent.

(ii) Existing policy holders will suffer if loss of new business causes life offices or friendly societies to go under.

(iii) Since LAPR is an extremely stable proportion of total income (for all levels of income) up to £30,000, it will form a higher proportion of disposable income at the lower end of the scale. Low earners will therefore be more adverseley affected than high earners.

(iv) Some form of life assurance relief dates from earlie. days of income tax. Introduced by Pitt; re-introduced by Gladstone.

Pitfalls

(i) Relief has been used to sell avoidance schemes. But these are a small minority of Life Assurance business and important not to get out of context. Abolition will take all joy out of some avoidance devices in Life Assurance business, but not all.

Response to Representative Bodies

Wide recognition that Life Assurance relief has long been an anomaly.

LIFE ASSURANCE PREMIUM RELIEF : HISTORICAL BACKGROUND

1799 : relief introduced in Pitt's first Income Tax Bill. Premiums fully deductible.

1842 : dropped when income tax reimposed.

1853 : reintroduced by Gladstone. Allowable premiums not to exceed one-sixth income.

1916 : to counter increasing exploitation of life assurance for investment, relief for new policies restricted ~~up~~ to 3/- in the £. (Standard rate in 1916 5/- in the £). Thereafter, relief was generally up to half standard rate between the wars, and up to two-fifths standard rate after World War II until 1972-73.

1968 : relief restricted to 'qualifying policies (ie. with a term of at least ten years, and annual - or more frequent - premiums spread evenly over the life of the policy. Hitherto, single premium policies had attracted relief).

1973 : following unification of income tax and surtax, relief was given up to half basic rate.

1975 : further restrictions to deal with early surrenders (relief clawed back if surrender within 4 years), loans and other avoidance devices.

1979 : premium relief by deduction (PRBD) came into force. Relief at flat rate 17.5 per cent (15 per cent from 1981) limited to premiums up to one-sixth income or £1500, whichever is greater.

1980 : further legislation to counter misuse of relief through one and two year 'short term bonds'.

& abroad?

FROM: M A HALL

24 February 1984

1. SIR PETER MIDDLETON
2. CHANCELLOR

c c Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir L Airey
Mr Fraser
Sir T Burns
Mr Littler
Mr Bailey
Mr Cassell
Mr Monck
Mr Battishill
Mr Evans
Mr Monger
Mr Odling-Smee
Mr Ridley
Mr Lord
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Mr Green IR
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THE BUDGET : OVERALL PRESENTATION

Tuesday's Overview meeting deals with presentation. Ministers are circulating notes on the measures which fall within their area of responsibility. This personal note is intended to aid discussion of presenting the Budget as a whole. It seeks to avoid duplicating the Ministerial exercise.

General considerations

2. People expect a fiscally neutral Budget. Thoughtful commentators are beginning to say that you are temperamentally unlikely to produce

... boring first Budget (see Matthew Symonds, attached). But no-one has so far come anywhere near guessing the scale of the measures compatibl with fiscal neutrality. We hope that the Budget will come as a dramatic surprise. Initial reactions will be confused and uncertain. Our presentation, both initially and in the follow-up, will be of more than usual importance.

3. Because of the sheer size and novelty of some of the changes, there will be big winners and losers, even where whole sectors (e.g. "business") are sizeable net beneficiaries. Complainants are always more vociferous than satisfied customers. We ought therefore to do our best to ensure that some of the winners speak up, and "conglomerate" representative bodies, especially the CBI, do not allow the stridency of gripes about specific measures to outweigh the benefits for industry of the package as a whole.

4. The popular reaction, and that of the popular papers will be swayed by quite different considerations from the serious economic analysts and the heavier newspapers, not to mention the various interest groups. We need separate arguments for separate targets.

5. There is every advantage in fighting on terms defined by us. The speech obviously must establish the process. But we can consolidate by good press briefing, and by defining what we see as the parts of the Budget bearing on e.g. trade and industry, in separate analytical press notices. It may be possible to extend this principle to other sectors, though problems of overlap complicate matters.

The popular perception

6. The increases in thresholds will be larger than people are expecting, and consequently well-received. The usual indexed price increases - drink, tobacco, petrol, car tax etc will be expected but no more welcome for that. The cut in wine duty will be a bonus not yet fully discounted; despite the price increase, and coupled with strong words on the EEC, the Vermouth duty should go down well. NIS ("tax on jobs") must have penetrate the popular perception. The cut in stamp duty on house purchase is also a plus. But the extension of the VAT base will be extremely unpopular, and hostility will be orchestrated by the newspapers. IIS, the CCLD, and LAPR, will also sour the public's reaction.
CTT

7. I see "rich man's Budget" as likely to be the main criticism at this level.

Business reactions

8. Half the CBI will be furious about PAS, and the organisation itsel will feel slighted at the lack of consultation. There will be outcries from all sides on the Capital Allowances and Stock Relief. But the reductions in CT and the long period of stable planning the Budget offers to industrial tax planners, together with the abolition of NIS, must surely elicit a response which is favourable on balance. There will be specific and heavy criticism of the proposals on foreign earnings, foreign emoluments, and company cars. But share options will be popular.

9. Main criticisms:-

- discourage investment
- no boost to infrastructure
- don't take notice of representations

Economic commentators

10. I expect the Budget to be more saleable to serious economic analysts than to the public and the popular press. It includes bold steps towards reform, and together with the LTPE Green Paper maps out a clear and consistent long term strategy towards price stability. The concerted attack on distortion in the tax system, and the search for simplification, will be widely welcomed. So will the concentrati of personal reliefs on the thresholds, and widening the tax base.

11. I would see the main lines of attack as:-

(i) The strategy remains vulnerable to improved corporate profitability passing through into dividends and wages rather than investment. Removing the allowances gives the wrong signal. (Mr MacMahon's speech hasn't helped).

(ii) There will be criticism of the strategy itself from different angles, depending on political complexion - i.e. not realistic or sensible to go for zero inflation (Guardian) much too little, much too slow (Express, Mail).

(iii) Damaging to economy to reduce borrowing rather than spend on infrastructure if improved prospect gives greater fiscal lee-way than envisaged at time of Autumn Statement (old current/capital argument)

(iv) There might be criticism of apparent lack of consultation and inconsistency on the corporate package (PAS; Green Paper on Corporation Tax).

(v) Inconsistency - and not going far enough on tax expenditures. They will undoubtedly be criticism for not moving on mortgage relief or pensions, and of the further distortion introduced through discriminatory application of the CCTD.

? (vi) Critically based on unrealistic plans for LA and nationalised industry expenditure.

<u>The City</u>

12. The City will obviously not like the CCLD; the banks and building societies will complain. The SD and share option proposals will be widely welcomed. Foreign earnings/emoluments/ company cars all unpopular. At a different level, tight PSBR and MTFS/LTPE should produce a favourable response to the <u>economic</u> impact of the budget. And the economic/City journalists will greatly influence reactions.

<u>Our own presentation</u>

13. My view at this stage of the main overall themes to bring out is as follows:-

(i) <u>A Budget not for this year but for a Parliament and beyond</u>
Continued recovery and progress towards stable prices. Prospect of steady growth. A workable long term strategy.

Yes. but when?

(ii) A start on <u>tax reform</u> - more <u>fairness</u>, more <u>choice</u>, more <u>efficiency</u>.

Fairness

Thresholds - people taken out of tax who ought never to have been in it; corporation tax changes; building societies/banks. (n.b. IIS is a presentational pitfall - but a perfectly good argument for treating investment income in same way as earned income; on the "rich man's Budget" argument, we can cite car perks, foreign earnings/emoluments).

no more than [illegible] - on higher rate bands

hardly

Choice

Continue shift from direct to indirect personal taxation; remove distortions between use of manpower and capital; start to remove distortions between different kinds of investment capital (LAPR, SD).

Efficiency and incentive

CT, share options - better quality of investment, encourage <u>profitable</u> companies; for tax system to evolution of in institutions (stock exchange, building societies, banks).

(iii) Britain can hold its head high

International comparisons - growth, productivity.

MAH

M A HALL

Lawson's chance to boost the free market drive

22

MATTHEW SYMONDS on Budget prospects

IT IS fashionable these days to regard Budgets as being of rather secondary importance in the economics calendar to the Autumn Statement and the publication of the Government's detailed public spending plans in February. This is partly due to the demystification of the Budget process which has been brought about by better informed discussion and officially inspired leaks. But the real reason for the Budget's demotion is the present Government's explicit rejection of fiscal fine-tuning, symbolised by the three-year money supply and borrowing targets laid out in the medium-term financial strategy.

If the Government's spending and borrowing plans for the financial year ahead are known and its assumptions about revenue growth can be second-guessed with reasonable accuracy, thanks to widespread access to the Treasury's computer model of the economy, it does not take a clairvoyant to know by roughly how much the Chancellor needs to raise or lower taxes. The result is that most pre-Budget discussion these days tends to centre on the different ways in which fairly trivial amounts of money can be dispensed. Each pressure group has its own favourite measure, but they are bidding for small favours rather than trying to alter the macro-economic thrust of the Budget.

★

THIS year, even less time than usual need be absorbed in attempting to determine what fiscal stance the Chancellor will adopt. Aggregate demand in the economy is quite buoyant enough without doing anything very much to stimulate it. Whatever constraints exist are broadly speaking supply-determined and therefore somewhat beyond the range of conventional fiscal juggling. At the same time, it would take a real hairshirt Chancellor to contemplate an increase in either income tax or indirect taxation. In short, the Budget will be more or less neutral with any tax concessions limited to a full-year cost of no more than £500 million.

We thus have the makings of a very dull Budget indeed. If he so wishes, Mr Lawson can rise to his feet on March 13, declare himself well satisfied with the way in which the economy has performed in the year past, express the expectation of more of the same during the next 12 months, announce a toughish-sounding reformulation of the MTFS (complete with a couple of sexy new monetary aggregates), and finally, by way of an afterthought, adjust thresholds, allowances and excise duties in line with inflation.

That is what Mr Lawson could do and he might even derive a perverse satisfaction from boring everybody to tears — in that respect he could certainly claim continuity with his worthy predecessor. But Mr Lawson is temperamentally inclined to be anything but boring. It is unlikely that he will want the only message from his first Budget to be a Baldwinesque "steady as she goes."

If Mr Lawson is prepared to seize the opportunity of the hour, the 1984 Budget may prove to be the most innovative since 1980 and the most important since 1981. Its distinctive feature should be the beginning of a four year rolling programme (which would coincide both with full computerisation of the Inland Revenue and the lifetime of the present Parliament) designed to reform Britain's chaotic system of tax and benefits. The declared aim would be to promote supply-side efficiency and attack damaging fiscal distortions.

If it is to command a sufficient level of political support, Mr Lawson's approach must be seen to be both equitable and philosophically coherent. The Chancellor should, therefore, place his proposed reforms in the context of the Government's commitment to the improvement of incentives and the uncluttered working of markets. Two broad themes would underly a package of apparently unconnected measures. First: the need to encourage employment by mitigating the worst effects of the poverty trap; second: the removal of fiscal distortions which misdirect investment and discourage saving.

Nobody disputes the malign effects of the poverty trap. At least five million families are affected by the perverse way in which taxation and benefits interact to produce marginal tax rates of, in some cases, over 100 per cent. on very low earnings. Unfortunately, most of the solutions which have been proposed — the reduction of welfare payments, super-indexation of personal allowances, negative income tax — are either politically unacceptable, barely scratch the surface of the problem or are too ambitious to offer much hope in the short-term.

There is, however, one way in which the Chancellor can achieve a fairly spectacular result which also would correct an anachronism and not cost the Exchequer a penny. The married man's allowance is an absurdity which should be scrapped. It is indiscriminate in its effect and does not reflect the fact that the vast majority of British women are in full or part-time employment. The couples who are most hurt by the poverty trap are those with two or more children. If the whole of the £3·2 billion which would be saved by ending the married man's allowance was used to boost child benefit, Mr Lawson could claim to have done more to reduce the poverty trap than was ever managed by Mr Healey.

The impact of fiscal privilege on the pattern of British savings is almost equally insidious. The tax reliefs (worth over £3 billion a year) enjoyed by pension funds and life assurance companies do not encourage saving as such. Their effect is merely to rig the savings market in favour of large financial institutions and against the personal investor. The result is that people are prevented from investing in the way they wish to, investors are separated from their investments and financial markets are a good deal less healthy than they should be.

It would make sense to phase out tax concessions to the pension funds and use the extra revenue to backdate the indexation of capital gains, abolish the 15 per cent. investment income surcharge and end the 2 per cent. stamp duty on equities which is driving investors out of the City and towards Wall Street.

★

IT would also be encouraging to see the Government perform a U-turn on mortgage interest relief, which does nothing to help would-be home-owners and everything to inflate property prices artificially. That is, however, a vain hope given Mrs Thatcher's views on the subject. What Mr Lawson might consider is the disproportionate relief given to higher rate taxpayers who are, by definition, the better-off.

Finally, the Chancellor might care to take an axe to the 100 per cent. first year depreciation allowance designed to encourage capital spending by companies and reduce it to a more "economic depreciation" (say 50 per cent.). Although investment in labour-saving machinery is generally thought to be a wholly good thing, it is probably a mistake to discriminate in favour of capital and against labour at a time when the Government professes to be deeply worried about unemployment.

The long-term aim of this Government to bring about stable prices should be matched by a commitment to greater fiscal neutrality (best defined as a taxation system which does not provide incentives to companies and individuals to act in a way which they otherwise would not). Tax reform has a role to play in Britain's free market revolution which an ambitious and imaginative Chancellor like Mr Lawson cannot ignore. There is no better time than March 13 to set the ball rolling.

2/2

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1. SIR PETER MIDDLETON
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c c Chief Secretary
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HALL 24/2

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5. There is every advantage in fighting on terms defined by us. The speech obviously must establish the process. But we can consolidate by good press briefing, and by <u>defining</u> what <u>we</u> see as the parts of the Budget bearing on e.g. trade and industry, in separate analytical press notices. It may be possible to extend this principle to other sectors, though problems of overlap complicate matters.

<u>The popular perception</u>

6. The increases in thresholds will be larger than people are expecting, and consequently well-received. The usual indexed price increases - drink, tobacco, petrol, car tax etc will be expected but no more welcome for that. The cut in wine duty will be a bonus not yet fully discounted; despite the price increase, and coupled with strong words on the EEC, the Vermouth duty should go down well. NIS ("tax on jobs") must have penetrate the popular perception. The cut in stamp duty on house purchase is also a plus. But the extension of the VAT base will be extremely unpopular, and hostility will be orchestrated by the newspapers. IIS, the CCLD, and LAPR, will also sour the public's reaction.

7. I see <u>"rich man's Budget"</u> as likely to be the main criticism at this level.

Business reactions

8. Half the CBI will be furious about PAS, and the organisation itself will feel slighted at the lack of consultation. There will be outcries from all sides on the Capital Allowances and Stock Relief. But the reductions in CT and the long period of stable planning the Budget offers to industrial tax planners, together with the abolition of NIS, must surely elicit a response which is favourable on balance. There will be specific and heavy criticism of the proposals on foreign earnings, foreign emoluments, and company cars. But share options will be popular. with some

9. Main criticisms:-

- discourage investment
- no boost to infrastructure
- don't take notice of representations

Economic commentators

10. I expect the Budget to be more saleable to serious economic analysts than to the public and the popular press. It includes bold steps towards reform, and together with the LTPE Green Paper maps out a clear and consistent long term strategy towards price stability. The concerted attack on distortion in the tax system, and the search for simplification, will be widely welcomed. So will the concentration of personal reliefs on the thresholds, and widening the tax base.

11. I would see the main lines of attack as:-

(i) The strategy remains vulnerable to improved corporate profitability passing through into dividends and wages rather than investment. Removing the allowances gives the wrong signal. (Mr MacMahon's speech hasn't helped).

(ii) There will be criticism of the strategy itself from different angles, depending on political complexion - i.e. not realistic or sensible to go for zero inflation (Guardian) much too little, much too slow (Express, Mail).

(iii) Damaging to economy to reduce borrowing rather than spend on infrastructure if improved prospect gives greater fiscal lee-way than envisaged at time of Autumn Statement (old current/capital argument)

(iv) There might be criticism of apparent lack of consultation and inconsistency on the corporate package (PAS; Green Paper on Corporation Tax). ?

(v) Inconsistency - and not going far enough on tax expenditures. They will undoubtedly be criticism for not moving on mortgage relief or pensions, and of the further distortion introduced through discriminatory application of the CCTD.

not a real problem

(vi) Critically based on unrealistic plans for LA and nationalised industry expenditure.

this does need to be tackled soon: (given long [illegible] in 1985)

The City

12. The City will obviously not like the CCLD; the banks and building societies will complain. The SD and share option proposals will be widely welcomed. Foreign earnings/emoluments/ company cars all unpopular. At a different level, tight PSBR and MTFS/LTPE should produce a favourable response to the economic impact of the budget. And the economic/City journalists will greatly influence reactions.

Our own presentation

13. My view at this stage of the main overall themes to bring out is as follows:-

(i) A Budget not for this year but for a Parliament and beyond

Continued recovery and progress towards stable prices. Prospect of steady growth. A workable long term strategy.

(ii) A start on tax reform - more fairness, more choice, more efficiency.

more than a start!

Fairness

Thresholds - people taken out of tax who ought never to have been in it; corporation tax changes; building societies/banks. (n.b. IIS is a presentational pitfall - but a perfectly good argument for treating investment income in same way as earned income; on the "rich man's Budget" argument, we can cite car perks, foreign earnings/emoluments).

Choice

Continue shift from direct to indirect personal taxation; remove distortions between use of manpower and capital; start to remove distortions between different kinds of investment capital (LAPR, SD).

Efficiency and incentive

CT, share options - better quality of investment, encourage profitable companies; for tax system to match evolution of ~~in~~ institutions (stock exchange, building societies, banks).

(iii) Britain can hold its head high

International comparisons - growth, productivity.

M A HALL

Lawson's chance to boost the free market drive

2

IT IS fashionable these days to regard Budgets as being of rather secondary importance in the economics calendar to the Autumn Statement and the publication of the Government's detailed public spending plans in February. This is partly due to the demystification of the Budget process which has been brought about by better informed discussion and officially inspired leaks. But the real reason for the Budget's demotion is the present Government's explicit rejection of fiscal fine-tuning, symbolised by the three-year money supply and borrowing targets laid out in the medium-term financial strategy.

If the Government's spending and borrowing plans for the financial year ahead are known and its assumptions about revenue growth can be second-guessed with reasonable accuracy, thanks to widespread access to the Treasury's computer model of the economy, it does not take a clairvoyant to know by roughly how much the Chancellor needs to raise or lower taxes. The result is that most pre-Budget discussion these days tends to centre on the different ways in which fairly trivial amounts of money can be dispensed. Each pressure group has its own favourite measure, but they are bidding for small favours rather than trying to alter the macro-economic thrust of the Budget.

★

THIS year, even less time than usual need be absorbed in attempting to determine what fiscal stance the Chancellor will adopt. Aggregate demand in the economy is quite buoyant enough without doing anything very much to stimulate it. Whatever constraints exist are broadly speaking supply-determined and therefore somewhat beyond the range of conventional fiscal juggling. At the same time, it would take a real hairshirt Chancellor to contemplate an increase in either income tax or indirect taxation. In short, the Budget will be more or less neutral with any tax concessions limited to a full-year cost of no more than £500 million.

We thus have the makings of a very dull Budget indeed. If he so wishes, Mr Lawson can rise to his feet on March 13, declare himself well satisfied with the way in which the economy has performed in the year past, express the expectation of more of the same during the next 12 months, announce a toughish-sounding reformulation of the MTFS (complete with a couple of sexy new monetary aggregates), and finally, by way of an afterthought, adjust thresholds, allowances and excise duties in line with inflation.

That is what Mr Lawson could do and he might even derive a perverse satisfaction from boring everybody to tears — in that respect he could certainly claim continuity with his worthy predecessor. But Mr Lawson is temperamentally inclined to be anything but boring. It is unlikely that he will want the only message from his first Budget to be a Baldwinesque "steady as she goes."

If Mr Lawson is prepared to seize the opportunity of the hour, the 1984 Budget may prove to be the most innovative since 1980 and the most important since 1981. Its distinctive feature should be the beginning of a four year rolling programme (which would coincide both with full computerisation of the Inland Revenue and the lifetime of the present Parliament) designed to reform Britain's chaotic system of tax and benefits. The declared aim would be to promote supply-side efficiency and attack damaging fiscal distortions.

MATTHEW SYMONDS on Budget prospects

If it is to command a sufficient level of political support, Mr Lawson's approach must be seen to be both equitable and philosophically coherent. The Chancellor should, therefore, place his proposed reforms in the context of the Government's commitment to the improvement of incentives and the uncluttered working of markets. Two broad themes would underly a package of apparently unconnected measures. First: the need to encourage employment by mitigating the worst effects of the poverty trap; second: the removal of fiscal distortions which misdirect investment and discourage saving.

Nobody disputes the malign effects of the poverty trap. At least five million families are affected by the perverse way in which taxation and benefits interact to produce marginal tax rates of, in some cases, over 100 per cent. on very low earnings. Unfortunately, most of the solutions which have been proposed — the reduction of welfare payments, super-indexation of personal allowances, negative income tax — are either politically unacceptable, barely scratch the surface of the problem or are too ambitious to offer much hope in the short-term.

There is, however, one way in which the Chancellor can achieve a fairly spectacular result which also would correct an anachronism and not cost the Exchequer a penny. The married man's allowance is an absurdity which should be scrapped. It is indiscriminate in its effect and does not reflect the fact that the vast majority of British women are in full or part-time employment. The couples who are most hurt by the poverty trap are those with two or more children. If the whole of the £3·2 billion which would be saved by ending the married man's allowance was used to boost child benefit, Mr Lawson could claim to have done more to reduce the poverty trap than was ever managed by Mr Healey.

The impact of fiscal privilege on the pattern of British savings is almost equally insidious. The tax reliefs (worth over £3 billion a year) enjoyed by pension funds and life assurance companies do not encourage saving as such. Their effect is merely to rig the savings market in favour of large financial institutions and against the personal investor. The result is that people are prevented from investing in the way they wish to, investors are separated from their investments and financial markets are a good deal less healthy than they should be.

It would make sense to phase out tax concessions to the pension funds and use the extra revenue to backdate the indexation of capital gains, abolish the 15 per cent. investment income surcharge and end the 2 per cent. stamp duty on equities which is driving investors out of the City and towards Wall Street.

★

IT would also be encouraging to see the Government perform a U-turn on mortgage interest relief, which does nothing to help would-be home-owners and everything to inflate property prices artificially. That is, however, a vain hope given Mrs Thatcher's views on the subject. What Mr Lawson might consider is the disproportionate relief given to higher rate taxpayers who are, by definition, the better-off.

Finally, the Chancellor might care to take an axe to the 100 per cent. first year depreciation allowance designed to encourage capital spending by companies and reduce it to a more "economic depreciation" (say 50 per cent.). Although investment in labour-saving machinery is generally thought to be a wholly good thing, it is probably a mistake to discriminate in favour of capital and against labour at a time when the Government professes to be deeply worried about unemployment.

The long-term aim of this Government to bring about stable prices should be matched by a commitment to greater fiscal neutrality (best defined as a taxation system which does not provide incentives to companies and individuals to act in a way which they otherwise would not). Tax reform has a role to play in Britain's free market revolution which an ambitious and imaginative Chancellor like Mr Lawson cannot ignore. There is no better time than March 13 to set the ball rolling.

2/2

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C.
See new MST minute.
27/11

FROM: Minister of State
DATE: 24 February 1984

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Bailey
Mr Littler
Mr Cassell
Mr Byatt
Mr Anson
Mr Unwin
Mr Kemp
Mr Monck
Mr Battishill
Mr Monger
Mr R I G Allen
Mr Folger
Mr Hall
Mr G P Smith
Mr Norgrove
Mr Makeham
Mr Portillo
Mr Ridley
Mr Lord
Mr Evans
Mr Odling-Smee
Mr Lankester
Sir Lawrence Airey, Mr Isaac, Mr Blythe (Inland Revenue)
Mr Fraser, Mr Wilmott (Customs & Excise)

MST 24/2

PRESENTATION OF BUDGET MEASURES

You asked me to let you have by today a note of a provisional presentation strategy for discussion at next Tuesday's Overview meeting. You asked me to consider the effect of the Budget on persons, including distributional effects and RPI effects. Relevant measures are excise duties, the VAT base, income tax thresholds and car benefit scales. There is also common ground between my group of measures and the Chief Secretary's and we will need to look at this.

Further work needs to be done particularly on the indirect tax side and on integrating the effects of direct and indirect tax measures, NIC and benefit changes. You have agreed we should assume a 5½ per cent uprating for child benefit and that officials may consult the

CSO to obtain detailed information required for estimating the precise distributional effect of proposed indirect tax changes.

I attach as annexes notes prepared by officials on relevant measures together with a note on indirect taxes and combined direct-indirect presentation. This material includes key themes, together with positive and defensive points and advice on particular presentational pitfalls. It will provide a basis for further work and for the briefing which will be needed at the time of the Budget.

Presentation

We cannot get away from the fact that, viewed as a whole, there is little in the way of good news with this group of measures. The major task of this exercise, therefore, is to identify the individuals and groups most disadvantaged as well as those who will do better. I have asked for further work to be done on the combined effects of both indirect and direct tax changes on typical households - also taking account of benefit changes. And we must also look at the overall impact on particular groups - the self-employed, pensioners, single parent families etc. These gainers and losers need to be identified so that the appropriate bull points and defensive material can be put together bearing in mind that defensive material may well be needed for some groups of "gainers".

Disagree

In this context, it is worth recalling that last year the TCSC asked us for material on the distribution impact of the Budget measures, direct and indirect tax, taken as a whole. We are likely to be asked again for this material this year; and outside commentators may also be prompted to focus more attention on these distributional questions, given the computer analyses which have been developed by, for example, the Institute for Fiscal Studies and Professor Atkinson at the LSE. When we have further figures we might, therefore, consider volunteering a similar analysis to last year's before we are asked (and, after Budget Day, officials are proposing to analyse the whole Budget package as it affects individuals on the IFS model).

Apart from the losers the analysis of the distributional effect of the Budget will identify, there will be groups hit particularly by the VAT and excise duty changes. We will not be able to avoid accepting that there will be losers. Some of the arguments in the annexes on particular aspects of the indirect tax packages will help to deflect criticism. But we should start from the argument for an extension of the VAT base this year.

The argument that the EC is dictating to us on a number of changes will, I imagine, be a strong theme used by critics. I think we can be robust in refuting much of the criticism, particularly insofar as changes in the VAT base are concerned. As far as the beer/wine and made-wine changes are concerned, there is strong argument that we cannot hope to remove discrimination in other Member States if we do not ourselves observe the rule of the law.

It may be you will want or feel the need to give an assurance that the VAT base will not be further extended. On the assumption you do not want to tie your hands on this, I think there would be advantage in your saying something in the Budget Speech which would not preclude further changes but which could be referred back to when the inevitable questions are asked.

?

Main theme

Although the presentation will need to take account of losers and gainers and will inevitably be fairly defensive, I think the main theme of this aspect of the Budget can be put across fairly positively. The main "personal" theme of your Budget is the significant further step you plan towards taxing spending rather than income. This must be projected in the context of long-term objectives of increasing incentives and reducing the poverty trap, with priority being given to taking more of the lower paid out of the income tax net altogether. And raising the tax thresholds will also give the married man tax reductions of [£2.00] per week.

We need to put this Budget into the perspective of a Parliament. This year's measures will make possible, or more emphatically are the essential foundation, for improvements in the future. With the company package this is more obvious but I think we should argue similarly in the personal sector.

Further work

Apart from what I have already mentioned, further work is being done on RPI effects, international comparisons of zero/standard rates, on the mandate for extending the VAT base and on commitments given in the past.

I think it would also be worthwhile preparing and agreeing before the Budget "standard letters" on the main measures so that replies can be given swiftly to correspondents writing in about the Budget.

JEC

for BARNEY HAYHOE

ANNEX

PRESENTATION OF BUDGET MEASURES

EFFECT ON PERSONS: BACKGROUND MATERIAL

CONTENTS

MAIN INCOME TAX PACKAGE

Key Themes

(i) Substantial increase in main thresholds - [12½%] this year.

(ii) Part of long-term programme to raise tax thresholds progressively to a sensible level in relation to average earnings where low-paid adults are taken out of tax.

(iii) Only then can we hope to achieve an effective solution to the poverty trap.

Positive

(i) Increase in main thresholds means tax reduction of [£2] per week for the married man, [£1.27] for single person.

Do also on [illegible] basis

(ii) [850,000] fewer taxpayers than if allowances had remained at 1983/84 levels.

(iii) Tax thresholds at highest level in real terms and as a percentage of average manual earnings since 1972/73. [refine]

(iii) "MARRIED MAN'S ALLOWANCE AT HIGHEST LEVEL IN REAL TERMS SINCE THE WAR (SUBJECT TO RPI FORECAST). SINGLE ALLOWANCE AT HIGHEST LEVEL SINCE 1973/74."

Defensive

(i) Poverty Trap

Increases in thresholds have little effect on poverty trap - takes out of tax merely part-timers and juveniles?

True that this year's increases in allowances will have only small effect on numbers in poverty trap. But progress on poverty trap in longer term depends on beginning to raise thresholds now. In any case right in principle to keep low-paid out of tax, whoever they may be.

(ii) Housing Benefit

Threshold increases do not compensate for losses from housing benefit changes?

& then lower tax greater reductions.

Allowance increases will compensate perhaps half of single earners and three-quarters of married earners for their losses from housing benefit changes as such. Position for elderly slightly less good but even so perhaps up to half of the elderly will be compensated for their losses.

(iii) Elderly

Elderly lose out because age allowance only indexed?

But positive: Fully overall reductions / points to help those on the lower income group (basic threshold)

Aim of age allowance is to keep bulk of ordinary pensioners out of tax. Right therefore to narrow gap between age allowance and ordinary allowance as main thresholds are increased in real terms. Age allowance still substantially above basic pension levels. Elderly did better than most other taxpayers in two previous years (because they did not suffer NIC increases). Some elderly will gain from IIS abolition. Over half of IIS payers are elderly.

(iv) Higher rates

Higher rate thresholds should have been increased by same percentage as main thresholds?

ditto

Need to raise main allowance by maximum amount possible in order to begin long-term process of putting thresholds back to sensible levels. Same arguments do not apply to increases in the higher rate thresholds. Higher rate thresholds raised in line with the statutory indexation provisions.

BUDGET SECRET

DISTRIBUTIONAL IMPACT OF THE MAIN INCOME TAX MEASURES

I attach some graphs and tables illustrating on the familiar "static" basis the impact of the main income tax changes on incomes at different levels, both including and excluding NIC.

The basic pattern can be seen clearly in all four graphs. The biggest percentage gains are at the bottom of the basic rate band, diminishing thereafter until people see only small percentage gains or (after NIC) a very small loss at the top of the basic rate band. Thereafter, there are greater percentage gains for higher rate taxpayers. But the biggest percentage gains for higher rate taxpayers are less than bigger percentage gains for people at the bottom of the basic rate band. At around average earnings married taxpayers get much the same percentage benefit as higher rate taxpayers, single people get rather less. The pattern is the same both under Option 3XA and is slightly more favourable under the £2 a week option. (Referred to in the drafts as Option 3XAY.) The underlying figures can be seen in the righthand column of Tables 1 and 2.

The graphs also show the effect of the "£2 a week option" is further to reduce - but not quite eliminate - the "static" loss for single people at the top of the basic rate band, when one takes account of the increase in the UEL for NI contributions. Table 6B quantifies that at 8p a week.

There is a tiresome quirk in the figures after tax and NIC. Last Autumn's increase in the LEL for NI has the effect of increasing slightly the NIC liability for those contracted out. Thus, the "£2 a week option" gives a reduction of £2.02 a week in tax alone for all married couples and also reduces by £2.02 a week the combined burden of tax and NIC for all the contracted-in; but the combined burden of tax and NIC for the contracted-out falls by only £1.99 a week.

!!

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BUDGET - SECRET

TABLE 1
SINGLE PERSONS - INCOME ALL EARNED - ANNUAL FIGURES

Income	Charge for 1983-84		Proposed charge for 1984-85		Reduction in tax after proposed charge	
	Income tax	Percentage of total income taken in tax	Income tax	Percentage of total income taken in tax	Income tax	As percentage of total income
£	£	per cent	£	per cent	£	per cent
2,000	64	3.2	0	0.0	64	3.2
2,500	214	8.6	148	5.9	66	2.6
3,000	364	12.1	298	10.0	66	2.2
4,000	664	16.6	598	15.0	66	1.7
5,000	964	19.3	898	18.0	66	1.3
6,000	1,264	21.1	1,198	20.0	66	1.1
7,000	1,564	22.3	1,498	21.4	66	0.9
8,000	1,864	23.3	1,798	22.5	66	0.8
9,000	2,164	24.0	2,098	23.3	66	0.7
10,000	2,464	24.6	2,398	24.0	66	0.7
12,000	3,064	25.5	2,998	25.0	66	0.6
14,000	3,664	26.2	3,598	25.7	66	0.5
16,000	4,264	26.7	4,198	26.2	66	0.4
18,000	5,026	27.9	4,858	27.0	168	0.9
20,000	5,877	29.4	5,658	28.3	219	1.1
25,000	8,198	32.8	7,898	31.6	300	1.2
30,000	10,697	35.7	10,392	34.6	305	1.0
40,000	16,274	40.7	15,762	39.4	512	1.3
50,000	22,274	44.5	21,757	43.5	517	1.0

TABLE 2
MARRIED COUPLES - INCOME ALL EARNED - ANNUAL FIGURES

Income	Charge for 1983-84		Proposed charge for 1984-85		Reduction in tax after proposed change	
	Income tax	Percentage of total income taken in tax	Income tax	Percentage of total income taken in tax	Income tax	As percentage of total income
£	£	per cent	£	per cent	£	per cent
3,000	61	2.0	0	0.0	61	2.1
3,500	211	6.0	106	3.0	105	3.0
4,000	361	9.0	256	6.4	105	2.6
5,000	661	13.2	556	11.1	105	2.1
6,000	961	16.0	856	14.3	105	1.8
7,000	1,261	18.0	1,156	16.5	105	1.5
8,000	1,561	19.5	1,456	18.2	105	1.3
9,000	1,861	20.7	1,756	19.5	105	1.2
10,000	2,161	21.6	2,056	20.6	105	1.1
12,000	2,761	23.0	2,656	22.1	105	0.9
14,000	3,361	24.0	3,256	23.3	105	0.8
16,000	3,961	24.8	3,856	24.1	105	0.7
18,000	4,621	25.7	4,456	24.8	165	0.9
20,000	5,422	27.1	5,202	26.0	220	1.1
25,000	7,693	30.8	7,385	29.5	308	1.2
30,000	10,192	34.0	9,822	32.7	370	1.2
40,000	15,668	39.2	15,135	37.8	533	1.3
50,000	21,668	43.3	21,073	42.1	595	1.2

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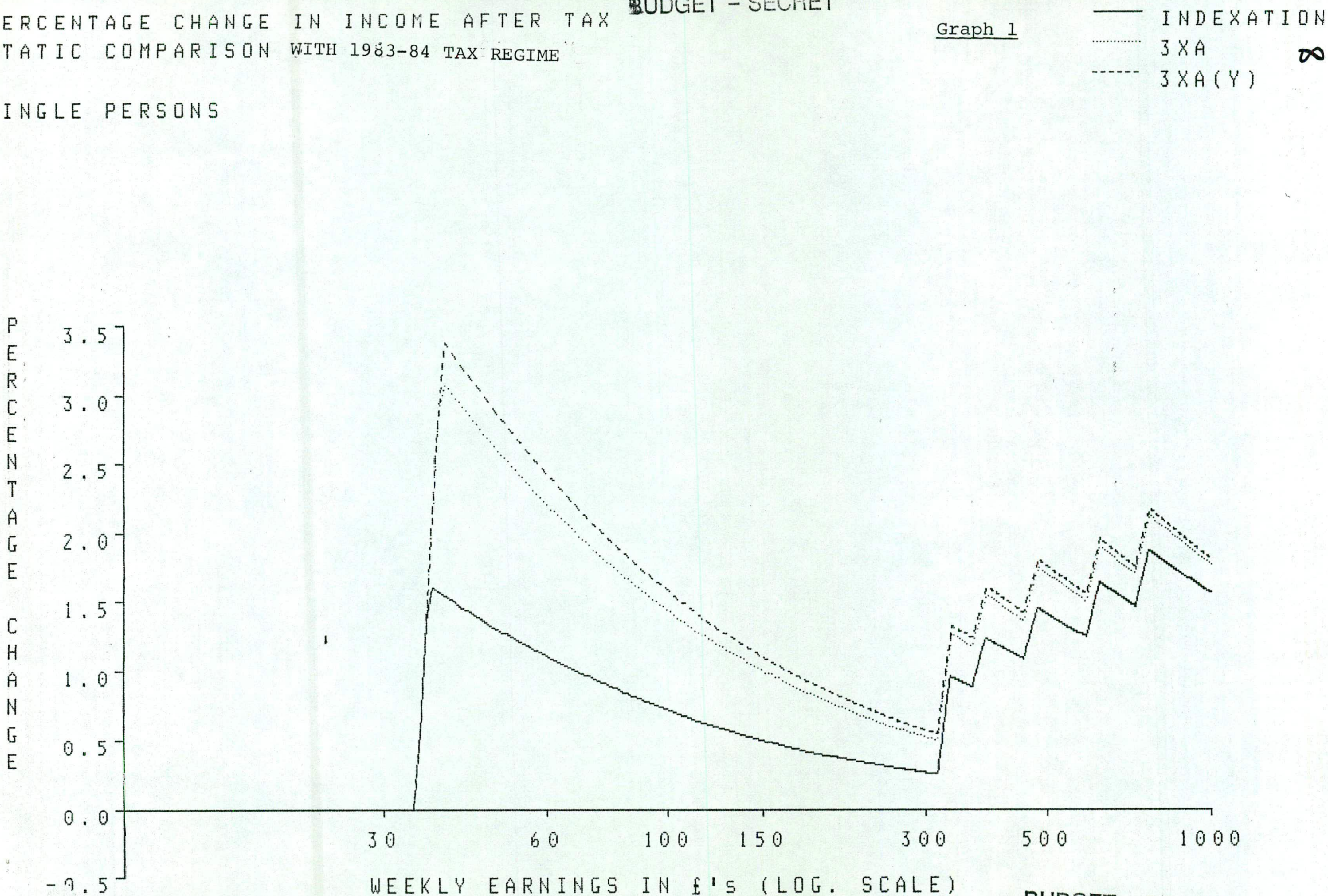
TABLE 6A
SINGLE AND MARRIED COUPLES - INCOME ALL EARNED - WEEKLY FIGURES
INCOME TAX AND NATIONAL INSURANCE CONTRIBUTIONS
NIC - CONTRACTED IN

Income	Charge for 1983-84			Proposed charge for 1984-85			Change in income after tax and NIC
	Income tax	NIC	Net income after tax and NIC	Income tax	NIC	Net income after tax and NIC	
£	£	£	£	£	£	£	£
SINGLE PERSONS							
35.00	0.20	3.15	31.65	0.00	3.15	31.85	0.20
40.00	1.70	3.60	34.70	0.43	3.60	35.97	1.27
50.00	4.70	4.50	40.80	3.43	4.50	42.07	1.27
60.00	7.70	5.40	46.90	6.43	5.40	48.17	1.27
80.00	13.70	7.20	59.10	12.43	7.20	60.37	1.27
100.00	19.70	9.00	71.30	18.43	9.00	72.57	1.27
120.00	25.70	10.80	83.50	24.43	10.80	84.77	1.27
140.00	31.70	12.60	95.70	30.43	12.60	96.97	1.27
160.00	37.70	14.40	107.90	36.43	14.40	109.17	1.27
180.00	43.70	16.20	120.10	42.43	16.20	121.37	1.27
200.00	49.70	18.00	132.30	48.43	18.00	133.57	1.27
220.00	55.70	19.80	144.50	54.43	19.80	145.77	1.27
240.00	61.70	21.15	157.15	60.43	21.60	157.97	0.82
300.00	79.70	21.15	199.15	78.43	22.50	199.07	-0.08
350.00	98.19	21.15	230.66	94.96	22.50	232.54	1.88
400.00	119.94	21.15	258.91	115.53	22.50	261.97	3.06
MARRIED COUPLES							
60.00	1.87	5.40	52.73	0.00	5.40	54.60	1.87
80.00	7.87	7.20	64.93	5.85	7.20	66.95	2.02
100.00	13.87	9.00	77.13	11.85	9.00	79.15	2.02
120.00	19.87	10.80	89.33	17.85	10.80	91.35	2.02
140.00	25.87	12.60	101.53	23.85	12.60	103.55	2.02
160.00	31.87	14.40	113.73	29.85	14.40	115.75	2.02
180.00	37.87	16.20	125.93	35.85	16.20	127.95	2.02
200.00	43.87	18.00	138.13	41.85	18.00	140.15	2.02
220.00	49.87	19.80	150.33	47.85	19.80	152.35	2.02
240.00	55.87	21.15	162.98	53.85	21.60	164.55	1.57
300.00	73.87	21.15	204.98	71.85	22.50	205.65	0.67
350.00	90.42	21.15	238.43	86.85	22.50	240.65	2.22
400.00	111.20	21.15	267.65	106.19	22.50	271.31	3.66

PERCENTAGE CHANGE IN INCOME AFTER TAX
STATIC COMPARISON WITH 1983-84 TAX REGIME

Graph 1

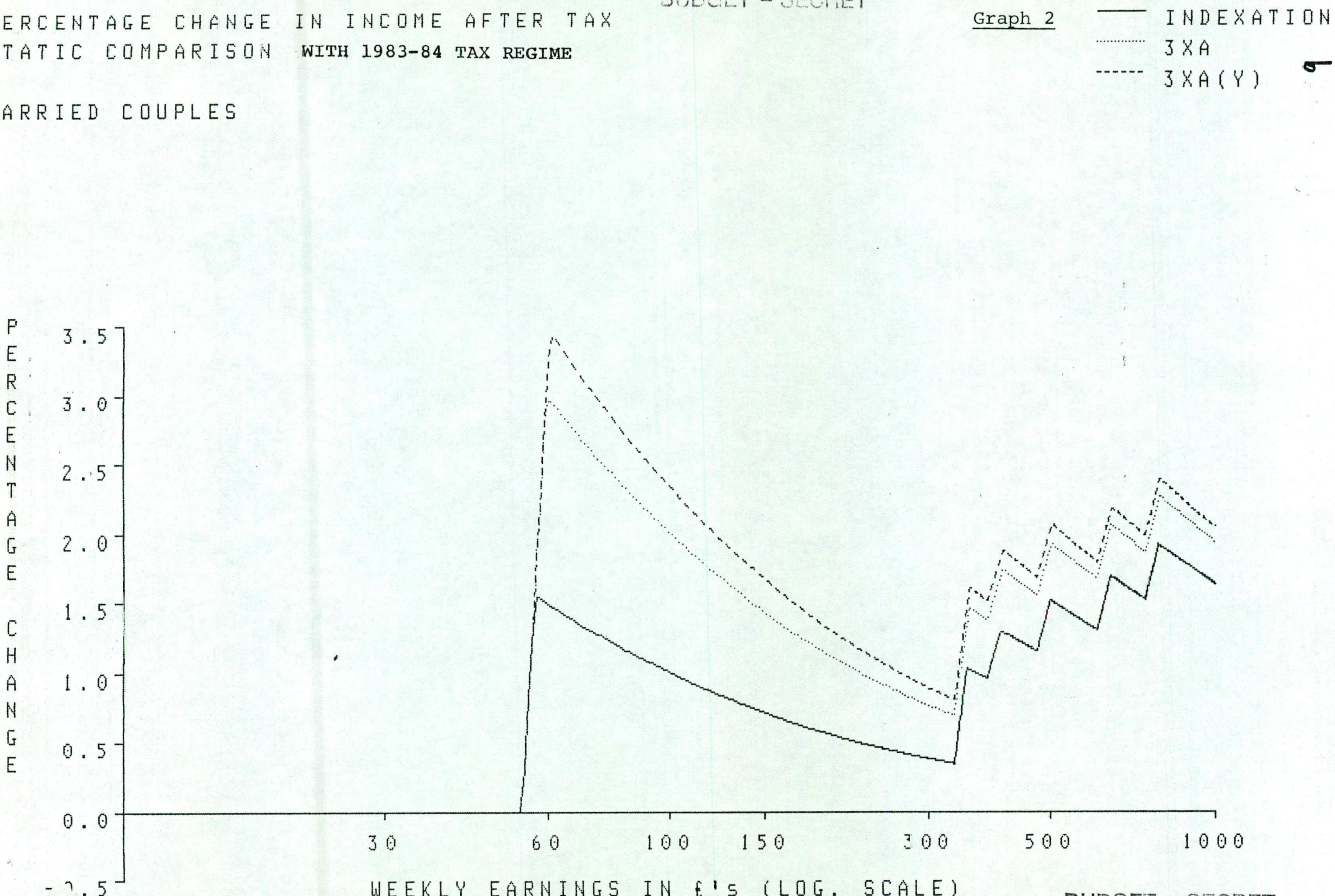
SINGLE PERSONS



PERCENTAGE CHANGE IN INCOME AFTER TAX
STATIC COMPARISON WITH 1983-84 TAX REGIME

Graph 2

MARRIED COUPLES



PERCENTAGE CHANGE IN INCOME AFTER TAX AND NIC
STATIC COMPARISON WITH 1983-84 TAX REGIME

SINGLE PERSONS

BUDGET - SECRET

Graph 3

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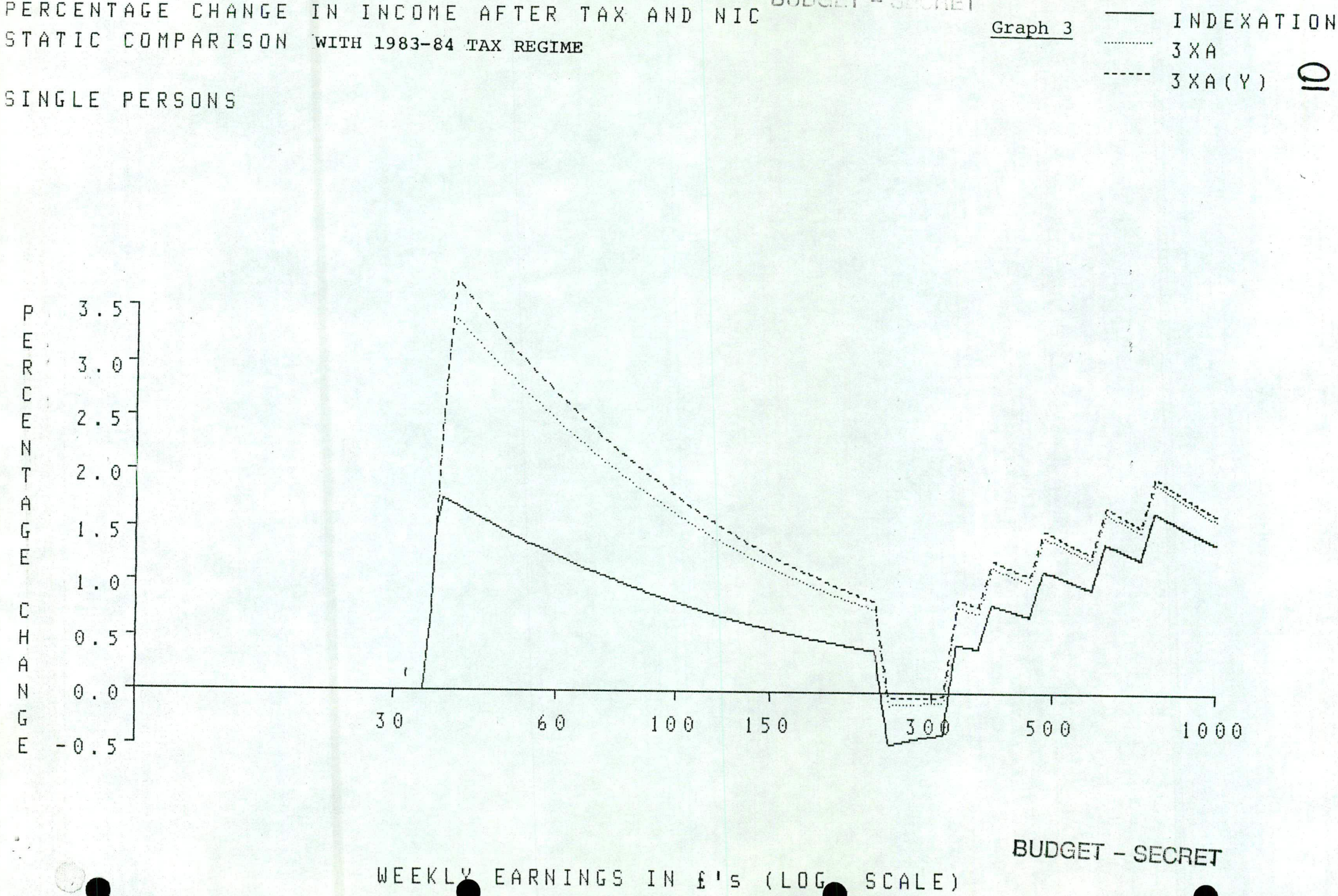
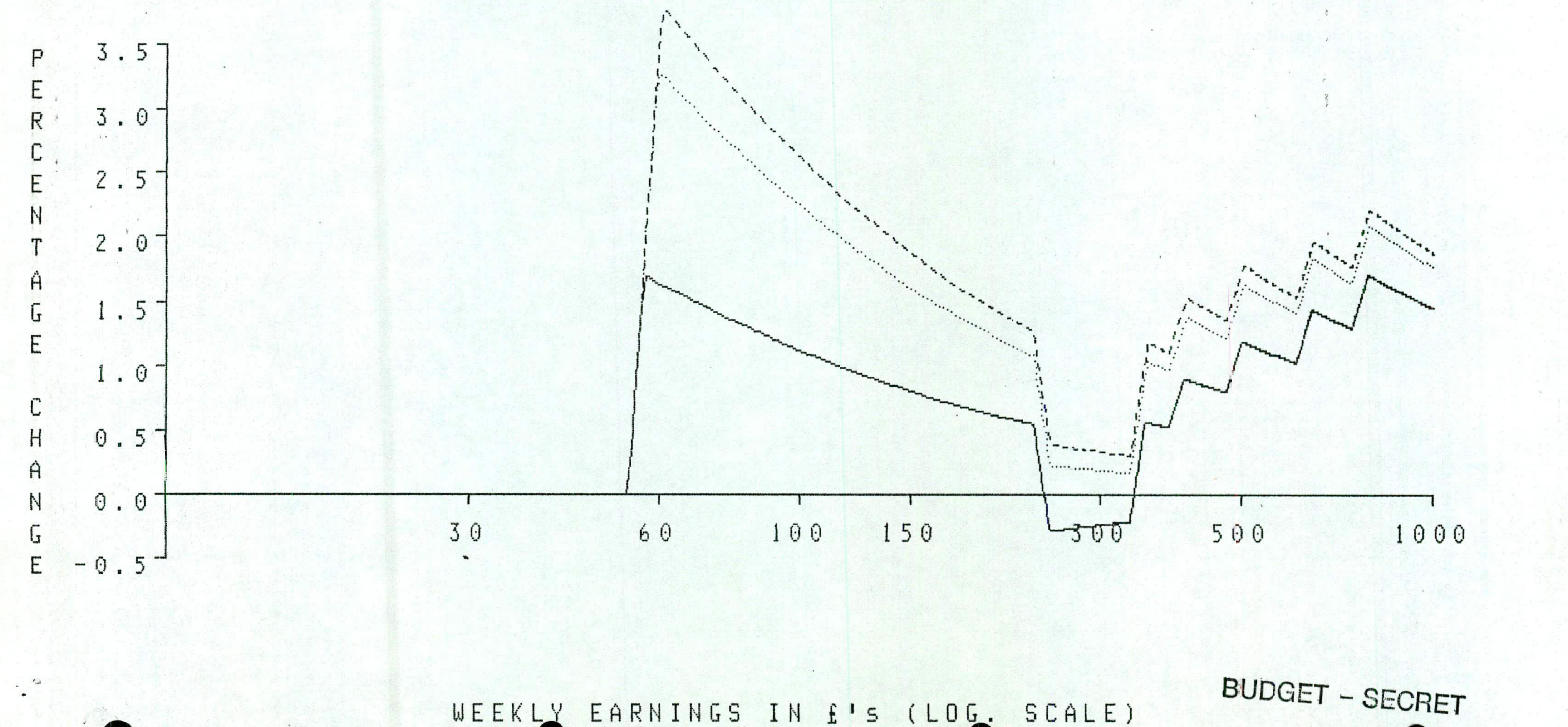


BUDGET - SECRET

PERCENTAGE CHANGE IN INCOME AFTER TAX AND NIC
STATIC COMPARISON WITH 1983-84 TAX REGIME

Graph 4

MARRIED COUPLES



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BUDGET - SECRET

TABLE 6B
SINGLE AND MARRIED COUPLES - INCOME ALL EARNED - WEEKLY FIGURES
INCOME TAX AND NATIONAL INSURANCE CONTRIBUTION
NIC - CONTRACTED OUT

Income	Charge for 1983-84			Proposed charge for 1984-85			Change in income after tax and NIC
	Income tax	NIC	Net income after tax and NIC	Income tax	NIC	Net income after tax and NIC	
£	£	£	£	£	£	£	£
SINGLE PERSONS							
35.00	0.20	3.10	31.70	0.00	3.13	31.87	0.17
40.00	1.70	3.44	34.86	0.43	3.47	36.10	1.24
50.00	4.70	4.12	41.18	3.43	4.16	42.41	1.23
60.00	7.70	4.81	47.49	6.43	4.84	48.73	1.24
80.00	13.70	6.18	60.12	12.43	6.21	61.36	1.24
100.00	19.70	7.55	72.75	18.43	7.58	73.99	1.24
120.00	25.70	8.92	85.38	24.43	8.95	86.62	1.24
140.00	31.70	10.29	98.01	30.43	10.32	99.25	1.24
160.00	37.70	11.66	110.64	36.43	11.69	111.88	1.24
180.00	43.70	13.03	123.27	42.43	13.06	124.51	1.24
200.00	49.70	14.40	135.90	48.43	14.43	137.14	1.24
220.00	55.70	15.77	148.53	54.43	15.80	149.77	1.24
240.00	61.70	16.80	161.50	60.43	17.17	162.40	0.90
300.00	79.70	16.80	203.50	78.43	17.86	203.71	0.21
350.00	98.19	16.80	235.01	94.96	17.86	237.18	2.17
400.00	119.94	16.80	263.26	115.53	17.86	266.61	3.35
MARRIED COUPLES							
60.00	1.87	4.81	53.32	0.00	4.84	55.16	1.84
80.00	7.87	6.18	65.95	5.85	6.21	67.94	1.99
100.00	13.87	7.55	78.58	11.85	7.58	80.57	1.99
120.00	19.87	8.92	91.21	17.85	8.95	93.20	1.99
140.00	25.87	10.29	103.84	23.85	10.32	105.83	1.99
160.00	31.87	11.66	116.47	29.85	11.69	118.46	1.99
180.00	37.87	13.03	129.10	35.85	13.06	131.09	1.99
200.00	43.87	14.40	141.73	41.85	14.43	143.72	1.99
220.00	49.87	15.77	154.36	47.85	15.80	156.35	1.99
240.00	55.87	16.80	167.33	53.85	17.17	168.98	1.65
300.00	73.87	16.80	209.33	71.85	17.86	210.29	0.96
350.00	90.42	16.80	242.78	86.85	17.86	245.29	2.51
400.00	111.20	16.80	272.00	106.19	17.86	275.95	3.95

BUDGET - SECRET

I DIRECT TAXATION
Car Benefit Scales

CAR BENEFITS

Factual

i. Scale charges for car and car fuel benefits go up by about 15 per cent from 6 April 1984 - announced last year.

ii. They will go up a further 10 per cent from 6 April 1985 - to be announced in Budget Statement - an extra 52p a week in tax for average company car driver getting free petrol.

Positive

i. The increases for both the coming year and the year after are lower than in the recent past. This reflects the Government's success in reducing inflation and Ministers' concern not to move too far too fast.

ii. It remains the Government's view that rewarding effort by salary and wages is preferable to provision of fringe benefits.

Defensive

i. The new scale charges still fall short of any realistic measure of the benefit enjoyed. No real evidence yet of a shift in habits.

ii. Too tough? Cars with heavy business use (over 18,000 miles a year) are charged at half the normal level.

iii. Too lenient? Purely perk cars (under 2,500 miles a year business use) are charged double.

Pitfalls

i. Avoid any claim that the scales are more than a rough and ready measure of the benefit.

ii. Avoid giving any undertaking about level of future increase.

Representations	Most representative bodies urged increase in line with inflation. [Department of Trade and Industry would regard 10% as moderate].

BUDGET SECRET

ANTI-EC LOBBY

Suggestions that wine and beer duty levels dictated by EC to detriment of beer

(i) The European Court found that the relative levels of duty on beer and wine protected beer production against imports of wine. But there is no question of actual duties being decided by Brussels. There were a number of options open to the Government and we have chosen one designed to meet the Court's requirements and avoid damaging the home brewing industry. Other alternatives for complying with the Court judgment could have involved as much as 7p on a pint of beer.

(ii) It would be wrong to disregard the EC judgment. It is in the UK interests to see that the rule of law is observed in the alcoholic drinks field: there is much to be gained by the removal of discrimination against our spirits exports to Europe. Apart from Greece whose Community membership is in its transitional phase, the Commission has successfully taken legal proceedings against a number of countries and, of these, only Italy still openly maintains discriminatory taxation against Scotch whisky. This is why the Chancellor has decided to introduce a temporary surcharge on Vermouth most of which comes from Italy. As soon as Italy comes into line with the decisions of the European Court decisions against it, the surcharge will be removed.

TRADE EFFECTS

(i) Damaging to beer industry
Beer still has a lower weight of tax in its price (38%) than other major drinks and is effectively the only drinks candidate for producing significant additional revenue. Although the real level of taxation has been raised in recent years it remains well below the historically high level of the 1950s. Moreover, the 2p increase is below the level of price increases made by a number of brewers over the past year. Beer consumption has held its level during 1983 and should benefit from the increase in consumer spending.

(ii) Spirits increase too low?

The Government was conscious of the need to take into account the relatively high price elasticity of demand of spirits and the high weight of tax in price (about 75%). While it was not appropriate to allow the duty to fall too much in real terms, it was right to recognise the current under-utilisation of capacity and job losses in the Scotch Whisky industry.

(iii) Damaging to employment in tobacco industry

Employment has been falling steadily over time due to the secular trend against smoking and to increased automation: about 3,000 job losses over the next 12 months were announced prior to the Budget. However, the 4p cigarette increase does little more than round up the strict revalorisation increase of 3½p, and employment may be helped by no change in pipe tobacco much of which is produced in areas of high unemployment (Northern Ireland and Liverpool).

DISTRIBUTIONAL EFFECTS

(i) Working man's pint clobbered at the expense of Scotch and Claret

There is no escaping the need to adjust the relative duty levels of beer and wine and the Government has struck a balance which will not hit the price of beer as much as some alternative solutions - up to 7p on a pint was possible. That said, it is important to recognise that the demand for drinks such as sherry, port, and spirits has declined much more in recent years than beer consumption.

(ii) Pubs and clubs threatened by beer increase

While the Government recognises the importance of beer to pubs and clubs, a 2p increase is not large enough to be a decisive influence. Given the Government's strategy of giving people more choice in how they spend their money, their future will be more affected by their ability to provide customers with what they want.

(iii) Rural motorist loses out again

The Government recognises the concern in rural areas at increases in petrol duty. Since, however, the oil companies have withdrawn their selective price support for urban garages the differences between towns and remote areas are not so marked. The 4½p increase keeps the petrol duty at last year's level in real terms and in practice will do little more than replace the oil companies' recent 4p price reduction.

PRESENTATIONAL PITFALLS

(i) Kerosene

Although the abolition of the duty on kerosene will benefit old age pensioners who may depend on premium kerosene (domestic paraffin), the greater benefit will accrue to (possibly) more affluent owners of certain central heating systems, who use standard kerosene.

(ii) Made-wine

The duty differential between wines of fresh grapes and made-wines is being abolished. On the face of it, this would indicate a large potential price increase of 18p on a bottle of British sherry, which accounts for over 80% of the made-wine market. In practice, the impact will be much smaller because of blending. Since, however, the Commission have started infraction proceedings alleging discrimination against wine in favour of made-wine, attention should not be drawn to the practice of blending or dilution after the duty point is passed. If the matter is pursued, an offer to write to the MP might be the best course.

Need for an extension of the VAT base this year

Within the overall context of his Budget strategy the Chancellor needed to look to the indirect taxes for a bigger than normal contribution this year. The proposed extension of the VAT standard rate to previously zero-rated items is an important element in meeting this requirement and will raise about £610m in 1984/85 and £965m in a full year (equivalent to an increase in the standard rate of rather more than 1%). Extension of the VAT base in this way is consistent with the Government's general policy of shifting the balance from direct to indirect taxation, and with the underlying concept of VAT as a broad-based tax consumer expenditure

Extension of VAT base not a response to EC pressure

The decision to extend the VAT standard rate does not reflect a response to pressure from the European Commission for removal of United Kingdom. The European Community's Sixth Directive on VAT, which came into effect on 1 January 1978, lays down the structural framework within which Member States are to operate their VAT system. In the United Kingdom's view the Directive allows zero-ratings in existence on 1 January 1978 to be maintained, and the scope of these can only be reduced by a unanimous decision of the Council of Ministers. It is true that the Commission have been threatening to initiate infraction proceedings against the United Kingdom in respect of a number of United Kingdom zero-ratings, on the ground that these are not for the benefit of the final consumer or for clearly defined social purposes. The items selected for zero-rating in the Budget package do not however correspond with those on which we have been challenged by the Commission. (In particular, the main impact of standard rating building alterations will be to tax supplies to consumers whereas the Commission were pressing for taxation of commercial property development).

Decision not to increase standard rate

The Chancellor preferred to extend the tax base rather than increasing the standard rate (a rise of about 1⅓ per cent would have been needed to raise the same revenue). An increase in the standard rate would have ~~risked~~ increased ~~causing~~ distortions of competition between standard and zero-rated items, and also between VAT registered traders who have to charge the tax and traders below the registration threshold who do not.

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Future of remaining zero-ratings

The Government [has no plans at present for further extensions of the VAT base. It] cannot [however] give any undertaking in respect of future Budgetary action, which will continue to be determined in the light of the Government's general enonomic policy.

Implications of extension of zero-rating for the less well-off

VAT was introduced as a broad-based tax on consumer expenditure, but extensive reliefs, amounting in total to about one half of total consumer expenditure, were allowed for those items of greatest importance in the Budgets of ordinary families. /̲VAT is therefore a slightly progressive tax̲7. /̲It is difficult to evaluate precisely the impact of the proposed changes, but it seems likely that the overall effect will be broadly neutral̲7. (/̲ Taxation of building alterations, which are carried out proportionately more by the better off, should be progressive, taxation of newspapers etc regressive, and of hot take away food about neutral̲7).

Don't believe

Arguments for taxing hot take-away food

Taxation of hot take-away food will make a revenue contribution of about £200m in a full year (£130m in 1984-85) to the Government's fiscal requirement from VAT. Some "convenience" foods are already subject to VAT (including ice cream, confectionery, chocolate biscuits, crisps, salted or roasted nuts), as are restaurant meals and other forms of catering. The take-away food industry has developed rapidly since VAT was introduced in 1973, and there is a good argument on the ground of fiscal equity for applying the same rate of tax as to convenience foods and to catering. Take-away food supplied cold (eg sandwiches) not taxed, as this is difficult to distinguish from other forms of processed food supplied by shops. Taxation will of course have to apply to all suppliers of take away food operating over the VAT registration threshold eg traditional fish and chip shops and 'Chinese take aways' as well as high turnover 'hamburger take aways'. [Overall impact of taxation should be socially neutral, although inevitably there will be hard cases eg people living in rented accommodation without cooking facilities eho are dependent on take away food.]

Anomalies inherent in taxing take-away food

There will be some borderline difficulties eg for kiosk traders supplying both hot take-away food and sandwiches or sea-food. [These should not however be greater than the difficulties inherent in the existing borderline].

Reasons for taxing building alterations

Do not use!

Taxation of building alterations will raise about £450m in a full year, and £250m in 1984-85. [Building alterations are used proportionately more by the better off and the effect of inclusion of this item in the package is to make it more progressive from an income distribution point of view]. Taxation will put the VAT treatment of alterations on the same footing as repairs and maintenance and remove a long-standing source of administrative difficulty for HM Customs and Excise, and of confusion for the building industry.

Effect on construction industry

There will necessarily be some impact on the level of demand for alteration services, which are mainly supplied by the smaller building firms. However the prospects for the future level of building activity are closely linked to the overall rate of recovery in the economy. This is now gathering momentum, partly as a result of the economic policies which the Government has pursued.

Black economy

The increased tax burden on the building industry will inevitably mean increased incentives to tax evasion in the construction industry and this is the main reason for the increase in level of Customs and Excise staff (90 in all) which the Government have agreed to following the Budget. Removal of the difficult administrative borderline between repairs and maintenance and alterations will help Customs and Excise to work more effectively in combatting VAT fraud in this area.

BUDGET SECRET

VAT BASE

Newspapers etc

Arguments for taxing newspapers etc

Taxation of newspapers and magazines will raise about £315m in a full year and about £230m in 1984-85. It will put them on a footing with the VAT treatment of other, competing, sources of information, which have continued to develop since the tax was introduced eg. radio and television.

Economic effect on newspapers

The Government accepts that some newspapers are in a difficult financial position, but this is not in itself a good reason why they should not be subject to a tax like VAT which is chargeable on most forms of discretionary expenditure, including radios and television sets.

Effect on retail newsagents

The imposition of VAT on newspapers may adversely effect the financial position of some retail newsagents, who have tended in any case to lose sales volume in recent years because of the decline in the level of cigarette sales. The main reasons for these difficulties are however inherent in the changing structure of retailing, and the imposition of a tax like VAT, which is chargeable on most discretionary consumer expenditure, should not of itself prove a serious source of difficulty.

Arguments against taxing books

It is preferable to continue to zero-rate books, since knowledge of permanent value is usually stored in this form. There will be some obvious anomalies eg. pornographic books zero-rated, learned periodicals standard-rated. But anomalies of this kind are inevitable in any ~~multi-rate~~ VAT system, with extensive reliefs.

BUDGET SECRET

Effect of removal of PAS on United Kingdom industry

Removal of PAS will impose an ongoing cash flow financing burden on commerce and industry equivalent to about £120 million a year at current interest rates. The change has however been introduced following representations from sectors of British manufacturers about the discriminatory effect of the PAS in favour of imports. The cash flow burden will fall on firms importing raw materials and semi-manufactured goods for further processing, as well as finished manufactures, but a system which differentiated between the two types of product would be difficult to operate adminstratively in practice, and would almost certainly infringe the European Community's rules on firm competition.

Registration threshold not increased in line with inflation this year?

The VAT registration threshold has been increased every year since the previous Conservative Government took office in 1979. These regular increases have helped to keep the number of small traders registered for VAT down, and to reduce the administrative costs of running the tax. However under the European Community's Sixth Directive on VAT Member States are allowed to increase their registration limits in line with inflation. Under the United Kingdom's interpretation of the Directive, this would allow revalorisation of the original 1973 threshold of £5,000 to £18,700, and the proposed limit of £18,500 represents a sensible rounding down of this figure.

SOCIAL SECURITY BENEFITS

General Uprating

1. The budget speech will not include the usual announcement of the uprating of social security benefits. That will be announced by Mr Fowler in June, when the May RPI is known. This follows last year's switch to the "historic" basis of uprating. The November 1984 uprating will be based on the actual increase in prices in the 12 months to May 1984, instead of the forecast increase to November. The public expenditure White Paper included provision for an uprating of pensions and benefits - including child benefit-of 5½ per cent (in line with the Autumn Forecast). But that is/a working assumption only, and the actual uprating may be different. That will have to be borne in mind if statements are made about families' or pensioners' post-Budget income levels in 1984-85.

2. The advantage of the 'historic' method is that it removes the uncertainty inherent in the forecasting method. It avoids arguments about clawing back over-forecasts or compensating for under-forecasts. It was used until the Labour govemment switched to the forecasting method in 1976.

1. Housing benefit was introduced on a partial basis in November 1982 and on a full basis in April 1983, to replace the housing element in supplementary benefit, local authority rent rebates and allowances and rate rebates. The Autumn Statement included proposals to secure £230million of savings by reducing benefit to better off families, and in particular to households with working non-dependants. These proposals were modified in a statement by Mr Fowler on 6 February. The main effect of these modifications was to postpone some of the changes from April to November (see below).

2. The main 'losers' in April are now families with working teenagers. Families with incomes below needs allowance lose no benefit in April. More than half of all claimants lose less than 50p. 81% of all claimants and 89% of pensioners will lose less than £1. Average losses in April will be about 69p, or 56p for pensioners.

3. The main advantage of postponing some of the changes until November is that pensioners and families with children who stand to lose housing benefit from those changes will have the impact softened by the uprating of pensions, child benefits and the housing needs allowance used in the calculation of the benefit . Some families may lose in real terms, but not, overall, in money terms, leaving aside any advantage they might get from changes in tax thresholds.

4. In answering PQs on the modified proposals, DHSS have concentrated on the changes taking effect in April which affect far fewer people than the original proposals and fewer than could be affected in November. DHSS have taken the line that it is not feasible to produce estimates of the number of people affected by the November changes or the scale of losses for particular family types. They have said that "this would require a number of assumptions about increases in earnings, rent and rates and about possible limits on losses which we are only now discussing with the local authority associations". This line will not hold indefintely but should hold until after the Budget.

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5. DHSS have been doing some work to see how far changes in tax threshold could be said to offset the effect of the housing benefit changes for particular families and whether any presentationa

mileage could be got from such a line. We expect to know their conclusions shortly. If there is no mileage to be made from that and it is not to be pursued there is no reason to expect any ~~new~~ new interest in housing benefit. The changes have already been well discussed, and a full review under independent chairmanship has been announced, to report later this year.

6. The main line of defence remains that housing benefit currently goes to 1 family in 3 and higher up the income ladder than any other means tested benefit. It is far better to look for economies here than in the safety net benefits and it is right to expect working teenagers and adults to contribute to housing costs.

7. SUMMARY OF MAIN CHANGES

Changes taking effect in April

(1) an increase in the rent taper (the rate at which assistance towards rent is lost on income rises) from 21% to 26%;

(2) an increase in the rate taper (the rate at which assistance towards rates is lost on income rises) from 7% to 9%;

(3) an increasein the contributions expected from working 18 to 20 year olds from £5.55 to £8.20 a week, and contributions from over 20s in work to rise from £6.55 to £8.20.

Further changes to take effect in November

(1) a further increase in the rent taper from 26% to 29%;

(2) minimum payments, except to those below the needs allowance, to rise from 10p for rent assistance and 20p for rate assistance to 50p each;

(3) working 16-17 year olds expected to start contributing at a rate of £3.10 a week;

(4) the number of authorities who can give extra help to claimants in high rent areas to be restricted by raising the qualifying threshold to 130% of national average rent.

(5) Childrens needs allowance to rise by 50p in real terms. (It was planned to increase this by £1 in April but this has had to be postponed to help pay for the concessions. In addition to the 50p real rise in November, there will be a further increase of £1 in April 1985).

<u>BENEFITS AND CONTRIBUTIONS</u>
Child Benefit

CHILD BENEFIT

1. On present plans, the Budget speech will not include any announcement of the Government's intentions for child benefit. Expenditure plans provide for child benefit, along with other benefits, to be uprated in line with prices in November 1984. The new level will be announced by Mr Fowler in June along with the general uprating of benefits, which will be based on the increase in prices in the year ending May 1984.

2. If nothing is said about child benefit, there will certainly be queries about the Government's intentions. Mr Fowler has already given the very strong implication that it will be price-protected. There are no present proposals to do less (or more) than this. In this situation, there is everything to be gained by confirming in the Budget speech that child benefit will be price-protected. To avoid this statement would risk a row (which would certainly involve Government backbenchers, many of whom are supporters of child benefit). The only disadvantage would be loss of the opportunity between now and the uprating to do less than price-protect. In view of Mr Fowler's very strong opposition, this cannot be rated a feasible option.

3. Even if price protection is confirmed, the Child Poverty Action Group etc will be disappointed that there is no announcement of a real increase. They argue that it is the most effective way of improving the poverty and unemployment trap. The increase announced in last year's Budget brought child benefit to its highest level ~~every~~ ever in real terms, a point which was made much of at the time. But it would take quite a large real increase to make a significant impact on the traps, and this would include a substantial increase in public expenditure.

RUBBISH! [illegible]

4. There will be arguments that Child Benefit should be raised in line with any increase in tax thresholds. Because of its origin in family allowances and the child tax allowance there is a perceived, but not formally acknowledged link between increases in

tax thresholds and child benefit. But in practice, there has been no regular or clear link (see attached table).

5. The Government's record on child benefit, and the additional supplement for the first child of a single parent is as follows (£ per week):

	Child Benefit		One Parent Benefit	
	cash	Nov '83 prices	cash	Nov '83 prices
from April 1979	4.00	6.83	2.50	3.94
Nov 1980	4.75	5.92	3.00	3.73
Nov 1981	5.25	5.82	3.30	3.66
Nov 1982	5.85	6.13	3.65	3.82
Nov 1983	6.50	6.50	4.05	4.05

Date	Child Benefit Rate £ pw	Percentage Increase in child benefit	Percentage Increase in basic Pension	Percentage Increase in tax Thresholds
November 1978	3.00	30.4	11.4	-
April 1979	4.00	33.3	-	18.3
November 1979	-	-	19.5	-
April 1980	-	-	-	18.0
November 1980	4.75	18.75	16.5	-
April 1981	-	-	-	-
November 1981	5.25	10.5	9.0	-
April 1982	-	-	-	13.8
November 1982	5.85	11.4	11.0	-
April 1983	-	-	-	14.0
November 1983	6.50	11.1	3.7	-

NATIONAL INSURANCE CONTRIBUTIONS

1. Although changes in national insurance contributions are not pa[r]of the Budget, changes which were announced in the Autumn Statement come into effect in April and will affect some post-tax incomes.

2. There is no change in the Class 1 employer and employee contribution rates. But the lower earnings limit (LEL) will increase from £32.50 to £34.00 and the upper earnings limit (UEL) will increase from £235 a week to £250. Most employees (those earning less than £235 and contracted in) will pay no more. Those earning about £235 will pay a maximum increase of £1.35 a week).

3. This is the first time since 1979-80 that there has been no increase in Class 1 contribution rates. The increase in the UEL is in line with the assumed increase in average earnings. The UEL is relevant to the calculation of earnings related pensions and has to increase if the value of these pensions is to be maintained.

IV INDIRECT TAXES AND COMBINED DIRECT-INDIRECT PRESENTATION

Covering BUDGET SECRET

FROM: G P SMITH
DATE: 23 FEBRUARY 1984

PS/MINISTER OF STATE

cc: Mr Monger
Mr Allen
Mr Griffiths
Mr Folger
Mr Isaac) I.R.
Mr Calder)
Mr Wilmott) C&E
Mr de Berker)
Ms Holman
Mr Aaronson
Mr R J Smith

PRESENTATION OF BUDGET MEASURES

I attach a note on indirect taxes and combined direct-indirect presentation. Some of the figures are still a bit provisional and of course exclude the VAT changes.

G.P.S.

G P SMITH

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PRESENTATION OF BUDGET MEASURES - DISTRIBUTIONAL EFFECTS

We shall as usual keep in touch with I.R. about income tax and NIC. This note is about the indirect taxes and the presentation of direct and indirect taxes combined.

Indirect Taxes

2. Unlike the last two years, indirect taxes will need fairly full treatment. In particular the VAT and income tax measures imply a switch of /something like £1 billion/ from direct to indirect. Not a switch on the scale of 1979 but /fairly/ substantial compared with recent years.

3. VAT - Because of the particular changes in the tax base we cannot analyse the effects without further detailed analysis of the Family Expenditure Survey data for which we rely on the CSO. With their help he should be able to make reasonable estimates for newspapers etc; takeaway food and alterations may be more difficult because of the data.

Other Indirect taxes

4. We have produced a 1984-85 column for the tax payments of specimen families of the kind we give to TCSC and for PQs, Table A (attached). We have also produced tables for specimen households of the extra cost of a given consumption bundle, both in straight cash and relative to indexation. Increases tend to be in the range /30 - 80 p/wk/ on a straight cash basis, but there are small gains and losses (up to 12p/wk) relative to indexation. Examples are attached. Table B. We do not normally publish such tables but they are a possible option this year. (The figures will of course look a lot worse when VAT is included). Progressivity is not significantly affected by the non-VAT changes. For a given consumption bundle a single person's indirect tax-bill (excluding VAT) increases 3.9% at ¾ average earnings and 3.5% at 1½ times average earnings.

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Combined presentation

5. A. The "PQ/TCSC" type figuring annexed is an established way of showing changes in tax burdens. It reflects many factors - changes in gross incomes, changes in disposable incomes (taking account of income tax and NIC); changes in indirect tax payments due to changes in expenditure as well as changes in tax rates. This year the indirect tax increase will be 'exaggerated' by the over-indexation of personal allowances. There is also a danger that people will add the changes in indirect tax to those in direct tax. This would give misleading results. For example, suppose income tax allowances were raised to such an extent that someone's income tax payments stayed constant in cash terms from one year to the next, and that rates of specific duties were left unchanged. The tables would then show an increase in indirect tax payments, arising from higher disposable income. The net effect would be increased tax payments, even though the tax regime had been made more generous.

5. B. The most direct way of showing indirect tax effects - via the extra cost of a given consumption bundle - cannot readily be combined with direct tax changes. It would for instance make no sense to subtract these extra costs from the 'static' gains from income tax allowances. This is because the income tax calculation assumes unchanged money income and the indirect tax calculation unchanged real consumption. With prices rising the two are incompatible.

6. C. A further possibility would be to take the income tax gains over and above indexation and subtract the indirect tax increases (again over and above indexation). This would give a measure of the net abstraction from the taxpayer in some real sense. We have given figuring on this basis to TCSC - a 1984-85 version is attached (but excluding VAT). This is a logical way of presenting the changes but is rather esoteric for many purposes.

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7. On balance we think that the most direct comparison (the extra cost of a fixed consumption basket) is the best for immediate presentational purposes. But it is not easy to integrate with the direct tax changes.

Special groups

8. Preliminary 'dry run' analysis on the DHSS model suggests that low income pensioners - some ¾ of pensioner households - will be worse off in 1984-85 than this year in spite of a 5½ per cent uprating in November. The effects of the Housing Benefit changes and the age allowance proposals may draw attention to pensioners (though comparatively few of them are in fact affected by the age allowance changes).

9. We will be extending our analysis of indirect tax changes to pensioner families this year but we cannot at this stage say whether there are any problems on this front.

Further analyses

10. (i) Our usual indirect tax analyses cover a limited income range - from ¾ to 1½ times average (all occupations) earnings. This range in fact includes about 45% of earning families - but there is always pressure to consider more extreme cases. We have been developing a new method of estimating which should enable us to extend the range with reasonable confidence to cover about 90% of earning families. We will need to do this for internal purposes, but it is not clear whether there is any presentational advantage in extending the range.

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(ii) The Budget package will as usual be simulated on the DHSS model - the main results will be available by Monday 12th. (But the model in its present state will not be able to cope with the indirect tax changes.)

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TCSC - style comparison TABLE A

1984-85 Tax Payments under Budget proposals £ per week

MULTIPLES OF AVERAGE EARNINGS	½	¾	1	1½
SINGLE				
Gross	91·20	136·80	182·40	273·60
Income tax	15·79	29·47	43·15	70·51
NIC	8·21	12·31	16·42	22·50
Net income	67·20	95·02	122·83	180·59
Indirect taxes (1)		20.24	26.19	38.56
MARRIED				
Gross	91·20	136·80	182·40	273·60
Income tax	9·21	22·89	36·57	63·93
NIC	8·21	12·31	16·42	22·50
Net income	73·78	101·60	129·41	187·17
Indirect taxes (1)		21.18	26.20	36.64
MARRIED + 2 CHILDREN				
Gross	91·20	136·80	182·40	273·60
Income tax	9·21	22·89	36·57	63·93
NIC	8·21	12·31	16·42	22·50
CB	13·26	13·26	13·26	13·26
Net income	87·04	114·86	142·67	200·43
Indirect taxes (1)		20.63	25.02	34.14

BUDGET SECRET

37

(1) Includes VAT and LA rates, but excludes effects of extending VAT base.

TABLE B : CHANGES IN TAX ON A GIVEN CONSUMPTION BUNDLE excluding VAT.

38

(+ indicates higher tax payments, – lower).

Multiples of average earnings	SINGLE 3/4	SINGLE 1	SINGLE 1½	MARRIED 3/4	MARRIED 1	MARRIED 1½	MARRIED + 2 CHILDREN 3/4	MARRIED + 2 CHILDREN 1	MARRIED + 2 CHILDREN 1½
'Cash' comparison (1984-85 rates compared to 1983-84)	+0.44	+0.54	+0.75	+0.47	+0.52	+0.62	+0.53	+0.56	+0.60
'Dynamic' comparison (1984-85 Budget rates compared to indexed 1983/84 rates)	-0.01	-0.04	-0.11	+0.02	-0.01	-0.08	+0.09	+0.05	-0.03

BUDGET SECRET

TABLE C: CHANGE IN TAX PAYMENTS[1] RELATIVE TO INDEXATION

1984 - 85

£ per week

	SINGLE				MARRIED			
Multiples of average earnings	3/4	1	2	5	3/4	1	2	5
Income tax	-0.58	-0.58	-0.77	-1.15	-0.87	-0.87	-1.15	-1.73
NIC	0	0	+0.45	+0.45	0	0	+0.45	+0.45
Indirect taxes[2]	-0.01	-0.04	-	-	+0.02	-0.02	-	-

Note

(1) A plus sign indicates that tax payments are higher than they would have been if the previous years system had simply been indexed.

(2) These figures do not include the VAT package.

BUDGET SECRET

BUDGET: SECRET

E 3

FROM: ADAM RIDLEY
24 February 1984

000285

24 FEB 1984

ECONOMIC SECRETARY

cc Mr Cassell
Mr Allen
Mrs Lomax
Mr Pirie
Mr Mowl

Mr Lewis, I/R

PRESENTATION OF BUDGET: FINANCIAL SECTOR

... I attach a first draft of the last part of your paper for the Chancellor, which is supposed to fit at the end of the material submitted by Rachael Lomax earlier today.

2. I must apologise for its length and imprecision - the product of various diversions earlier in the day.

AR

A N RIDLEY

RIDLEY
24/2

Handling Post-Budget Presentation

The first issue to resolve is the degree of likely concern in key groups, how they are likely to respond, and what assurances they may seek, some of which could well be difficult to handle. The groups who matter most are:

(a) Trade associations and perhaps individual firms;
(b) Members of Parliament;
(c) The Press, who will set so much of the tone.

A first sighting shot at who might be involved under (a) can be derived from the analysis set out in iv above, and suggests the following minimum catalogue of the "concerned":

Measure	Activity Affected	Organisations
1. Credit Licence Duty.	HP & Leasing	Finance Houses Clearing Banks Equipment Leasing Association and key clients such as - producers of goods thus bought (white goods, cars) or retailers who depend on such financing (Curry's, Rumbelows, big stores, etc.)
2. Corporate rate and CT changes affecting allowances.	Bank lending and all leasing	Clearing Banks Equipment Leasing Assoc and sectors particularly dependent on leasing, e.g. Civil Engineering, Motor vehicles, farm equipment, construction, machine tool users. Tax exhausted cos. (i.e. CBI)
3. Life Insurance Relief.	Life insurance proper, house purchase via mortgage, sundry tax-sheltering devices	Life Offices Building Societies Other financial institutions dependent on life policies in some respect and key client groups such as House Buyers, tax planners and accountants (i.e. IOD) and the wealthy. Pension Funds and others who may fear

4. Foreign Emoluments	Overseas firms, particularly Banks, on their pay to UK-based expatriates.	US, Japanese and other Banks ? selected multi-nationals other sensitive foreigner-related activities such as shipping, oil, etc.

2. As far as MPs go, we do not yet have details. But clearly the Whips and the register of members' interests could help if we had permission and resources to consult them.

3. The members of the Press who are most likely either to share the concern of a particular group or to publish uncritically what they are told by lobbyists are potentially numerous. We need to seek advice from IDT about those of them who matter most. But if it is judged that there could be a major reaction by those concerned, it could well be simpler and more effective to tackle city editors or financial commentators fairly comprehensively and all together, as well as picking off some key individuals.

4. Once one is confident that the groups have been adequately identified, it will be possible to suggest reasonably specifically how to cope with them. But even at this stage clear conclusions are possible in some areas as are important questions about others.

Trade Associations

5. Some, at least, will make early moves to make representations to ministers, such as the Clearing Banks, the Leasers and the Life Offices.

(a) - Should Ministers pre-empt that in at least some cases by an invitation? If so how quickly should they be invited in; and how soon should one aim to meet them?

(b) - Should Ministers rather wait to be approached? And when approached, how hard to get should they play?

(c) - Is there any risk that the TCSC or other Select Committees might be induced to give them embarrassing platforms? And if so, should anything be done to stop or encourage that?

Members of Parliament [illegible] quote from Ken [illegible] figs

6. (a) The first and most obvious thing to do is for the Economic Secretary - and perhaps one or two others - to invite any key backbenchers to discuss their anxieties very shortly after the Budget. One way of starting this would be to leave on the members' letter-board an invitation to such a meeting and perhaps a special brief, to be picked up immediately after the Chancellor has finished his speech.

advisers [illegible]

(b) It could be worth approaching Chairmen of one or two non-Treasury Backbench Committees to indicate willingness to appear before them. And it would even be possible in principle to induce the Finance Committee to have a second meeting on the Budget in addition to the traditional one on Tuesday evening, which is inevitably rather breathless and offers little or no scope for any issue to be dealt with in detail.

(c) If past experience is anything to go by, Ministers will get a good many letters from backbenchers. It pays handsomely if these are handled with unusual speed and care.

The Press

7. Prima Facie there is a case for

(a) A Press Conference for financial editors and specialists generally, and/or briefing for a significant number of key individuals on Wednesday or Thursday. If humanly possible such invitations should be dispatched and received on Tuesday afternoon so as to induce potential critics to hold their fire for a while, or at least to qualify their criticism.

(b) A major Ministerial speech could help greatly, not least if it were on the record very shortly after Budget Day. What is said in the House would most emphatically not be enough. However organising that would be difficult; and the second best might be such an occasion in April, when the text could deal with the views of critics as well as the Government's purpose and case, and in a considered way.

A difficult question

8. The Budget measures will clearly not be seen as the last word in the Chancellor's strategy. People will ask who or what is to come next. The most important are likely to be the Pension Fund Managers, who would be mad not to press Ministers to declare unequivocally whether they are at risk in the same way as the Life Offices; the Building Society movement and a part of the political world, who will be concerned about Mortgage Interest Relief and possible extension of the Credit Licence duty to mortgages; and the Banks, who will want to know what else they may be at risk to.

Satisfied Customers

9. Finally, one should note that there should be some happy groups, too. Should anything be done to encourage them?

Identify them first

BUDGET SECRET

See revised FST minute

COPY NO. 1 of 22

FROM: FINANCIAL SECRETARY
DATE: 24 February 1984

3½% NIS = 3p Basic Rate of income tax

Defensive stuff. Lead with case on taxing inflation...

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Minister of State
Economic Secretary
Sir Lawrence Airey - IR
Mr Fraser - C&E
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Monck
Mr Battishill
Mr Odling-Smee
Mr Monger
Mr Ridley
Mr Allen
Mr Folger
Mr Hall
Mr Norgrove
Mr Portillo
Mr Lord

FST 24/2

PRESENTATION OF BUDGET MEASURES: BUSINESS TAXES [The toughest & most important bit]

1. This minute gives my proposed strategy for presenting the business tax changes (as allocated to me in John Kerr's 14 February minute). I attach an Annex dealing with share options, in brief compass. Detailed background information is in the annexes attached to Mr Monck's 22 February minute to me.

2. In addition, I attach a first shot at a Budget Day press release covering the structural changes and some of the individual measures, which puts across the main ideas very clearly.

Main Themes

2. The main themes should be these:

a. The new freedom for businesses. The aim of the reforms is to encourage and reward efficiency and enterprise, reducing the tax bite on profits; and to make the tax system more even-handed between different types of investment and finance, and between capital and labour. It will be better to be in business when managers are free to make decisions without distortions from discriminatory tax breaks. These reflect the prejudices of politicans or civil servants. The present system too often favours losers and less successful projects.

b. Financial benefit to business overall. The announced changes in business taxes, taken together, will increase retained profits by up to £800 million in 1984/85 and £1400 million in 1985/86. There will be a longer term shift in favour of business because the low CT rate will stay low beyond the transition. These sums will enable business to increase expenditure on research and market development activities of all kinds without incurring extra debt or diluting. They might also stimulate investment.

c. Reduction of distortions. Lower capital allowances will reduce the tax subsidies which at present distort business decisions. Lower CT rates, made possible by a wider tax base, will increase the post-tax profitability of other activities which do not benefit from the present tax breaks. Some lower yielding projects will be knocked out at the margin. But the net result will be better quality investment, yielding a higher return than the present discriminatory and interventionist (though not discretionary) system has produced. Compared with other major advanced countries we have the largest tax bias in favour of plant and machinery and industrial buildings but the lowest rate of return, and often a lower level of investment. We can now begin to reform this in effective system to get a higher rcturn on invcstmcnt.

d. More Jobs. We can also now complete the abolition of NIS, the "pernicious tax on jobs" which makes even less sense with 3 million unemployed. Both the stimulus to enterprising activities from higher retained profits and the reduction in the bias of the tax system against labour and in favour of capital will produce more jobs. This must be right in the present economic situation but the improvement in the quality of investment as a result of these reforms is equally vital.

3. The themes we agree on will, of course, emerge the Budget speech. I suggest we have a Treasury Press Notice on the reform of business tax in addition to the normal notices on individual measures from the revenue departments. A first shot is attached.

<u>History</u>

4. The history of each measure will of course be covered in the detailed briefing on each measure (and is covered in the attachments to Mr Monck's minute to me of 22 February). ~~which~~

<u>Pitfalls</u>

5. These are familiar:

a. possible warnings about investment projects at risk from the losers. Some of these will be unforeseen;

b. claims that the CT reform is anti-manufacturing or anti-investment (including inward investment);

c. failure to consult about CT reform;

d. the reliability of a lasting low CT rate;

e. presentation of sectoral effects.

6. The vulnerable projects at a. are part of the low quality investment the present system produces, but we have invested political capital in some of them. We can do a little, eg by announcing that cable ducts do qualify for capital allowances, and by asking DTI to look out for companies which advance projects as a result of lower future CT rates. But the main defence must be that it is better for "loser" projects not to proceed and rather to let the market help our industry to invest in more winners.

7. On b. we should argue that better quality investment is right for manufacturing and good for competitiveness as it is for any other sector. The argument about preparing for adjustment "when the oil runs out" far from pointing to retaining the present distortions, is an argument for getting rid of them and fostering investment which does not need subsidy (or needs less subsidy). The same goes for inward investment which depends on subsidy: the low CT rate will be the attraction for potential investors in the UK.

8. I do not think we should use the probable acceleration of investment to catch the remaining capital allowances as a main argument. Some of the projects accelerated will be low yielding ones and this is not part of the objective of the reform. Accelerated investment can, however, be used as a reply to those who are interested only in the quantity of investment, and will seek to suggest our measures will put in doubt the 1984 pick-up in investment.

9. On c. there is a slight awkwardness in the consultations on the CT Green Paper and Sir Geoffrey Howe's acknowledgement last year of the "overwhelming desire on the part of industry for stability in the CT regime". He concluded that there should be "no change in the broad structure of the present arrangements". Our defence is that we have stuck to the imputation system, that the time for reform is now because the economic situation favours it. We should also point to the care with which the Government are phasing the reform and enabling business to plan with confidence not only by pre-announcing but by legislating for the future changes.

10. On d. we can argue that the reform will itself promote faster growth which will leave room for lower business taxes given sensible control of public expenditure, as the LTPE will show.

11. On e. we should be cautious about using detailed numbers about particular sectors. We shall clearly need to give overall figures for business as a whole, probably with the main component measures. But for sectors we should confine our statements to saying that they gain overall with some broad indication of the measures which benefit or hit them and their relative importance.

12. So far as the CT reform is concerned I suggest the FSBR should give first year and full year costs of changes in the normal way but speak of "broad revenue neutrality" for the remaining years of the CT transition.

VAT on imports

13. It will be important to present VAT on imports with emphasis on the following points:

a. It represents merely a once and for all bringing forward of tax payments that are in any case to be made, so that the only realistic measurement of the impact on business is the interest cost. To the extent that people insist on focusing on the cash flow effect, we must emphasise the two-year picture for Business.

b. Some of the cost will in any case be borne by foreigners.

c. Businesses using imported inputs will bear a cost, but they will be in no more a priority than importers in, say, France already are.

d. UK producers of goods then compete with imports will now be in a better competitive position that they were in the home market - a position which equivalent producers in France, already enjoy.

North Sea tax changes

14. It will emerge that North Sea existing fields do well from the CT reform. But once the ACT change is taken into account, the benefit overall is much reduced, although it will still be substantial for particular companies. We can meet some of any criticism by repeating that the CT reform makes excellent sense and that it is acknowledged that there will be winners and losers. It is perhaps not surprising, since the North Sea pays so much tax, that it benefits from changes to improve the system.

15. We need to consider further to what extent to treat the North Sea as separate from other economic activity. We need of course to make the point that we intend to change the treatment of incremental investments which are damaged by the CT changes. That will involve us in arguing that the North Sea regime is "separate" and that we got the balance for new investment right in the last budget and simply wish to restore that position. We may also wish to give the oil industry an indication of how we see its position for some years ahead. I understand that that is usual Revenue procedure given the industry's particularly long lead times. That again would indicate treating North Sea taxation as a distinct area.

16. But there are obvious dangers in separating the North Sea too much in our presentation, particularly since on the whole it does well out of the changes.

Key Groups

17. Special approaches should be made to the CBI, the Institute of Directors and the Institute of Fiscal Studies, and the Institute of Chartered Accountants. In the case of the CBI we should seek to persuade them that it cannot sensibly reject what is pre-eminently a pro-business budget, despite some losers in manufacturing, if it is to become a broadly based business organisation. I propose a special note for the CBI and it may be possible to brief members of the Council or heads of individual firms like GEC to speak up easy for the package. The Revenue are proposing to write to the Eueopean Commission explaining the CT tax changes.

Special Briefing

18. The Treasury should offer help especially to economic Ministers like Norman Tebbit in particular, Patrick Jenkin, and Tom King.

19. Political advisers will be preparing briefing for the backbenchers as usual.

20. We should aim at a good reaction to the business tax package in the heavy Press of the weekend after the Budget.

for JOHN MOORE

ANNEX

PRESENTATION OF SHARE OPTION SCHEMES

Themes

1. We shall want to bring out three themes:

a. Share option schemes are very important in enabling companies to secure the services of key executives, and motivate them. This is of particular value to small companies who cannot afford to pay large salaries or offer large benefits.

b. The motivation effect is particularly direct: the benefit from the scheme will depend on the success of the company, to which the executive is therefore committed.

c. Share option schemes are an aspect of the Government's support and encouragement for employee share schemes generally, an aspect of the committment to wider share ownership.

History

2. i. History to 1974 Pre 1972 - uncertain tax law; 1972-3 - express tax reliefs for approved employee share schemes, charging provisions to cover others; 1974-abolition of reliefs.

ii. Recent developments 1978 relief for approved all-employee profit sharing schemes; 1980 relief for approved all-employee savings related share option schemes; 1982 payment by instalments permitted for income tax on unapproved option gains.

Pitfalls

3. a. We shall be asked for quantifiable evidence of the benefit of the proposed reliefs. This cannot be done directly. A defence could be to point to their success elsewhere.

b. We shall be asked why the new generous reliefs are needed when schemes are underway now. This is not, of course, a reason for not seeking more schemes, and helping companies to set them up.

c. We shall be asked whether we should not allow reliefs to exectives only if the company runs an all employee scheme. Apart from the practical difficulties, we would not want to constrain companies in this way.

d. We may be asked why the scheme is not targeted on small companies. The answer could be that large companies have the same desire to motive key executives, and that there are safe-guards against their simply using share options as an alternative to salary.

Key groups to address, and briefing lines required

4 ~~3~~. The same areas broadly will need to be covered as for the company tax changes.

DRAFT PRESS NOTICE:
THE BUDGET, BUSINESS AND TAX REFORM

Overall Effect

1. Over the two years the combined effect of all the budget measures directly affecting business will be to raise after tax profits by up to £2¼ million.

Long a good thing: profitability of Bus. ind.

Tax Reform

2. Within the overall business tax package, the Chancellor of the Exchequer announced a major reform of company taxation. But the essential structure of corporation tax will be unchanged and will continue to be based on the imputation system.

3. The reform package has the following components:

- a progressive reduction in the rate of corporation tax: an immediate reduction to 50 per cent for 1984-85, falling to 45 per cent for 1985-86, 40 per cent for 1986-87 and 35 per cent for 1987-88 and thereafter. The corporation tax for small companies will be immediately reduced to 30 per cent. The exceptional rate of 40 per cent for building societies will remain until 1986-87. Thereafter it will have absorbed into the standard rate. The rates for this year and the years up to 1987-88 will be set in this year's Finance Bill.

- the reduction of initial capital for allowances to 75 per cent for 1984-85 machinery from 100 per cent to 50 per cent for 1985-86, and their replacement by 25 per cent annual writing down allowances in 1987-88. The reduction of the initial industrial buildings allowance from 75 per cent to 50 per cent for 1984-85, and to 25 per cent for 1985-86, and its replacement by 4 per cent annual writing down allowance in 1986-87. There will be comparable changes in the allowances for other capital assets. The allowances for other capital assets. The allowances for this year and the years ahead will be set in this year's Finance Bill.

- the immediate abolition of stock relief;

- the National Insurance Surcharge (NIS) will be abolished from August this year.

4. The package reflects the Government's policy of tax reform: to produce simpler taxes and lower tax rates so as to leave all taxpayers, whether companies or individual with more freedom to choose how to spend and invest their money. The company tax reforms will offer greater opportunity and reward for business energy and initiative. This will make for a more efficient economy able to provide new jobs and rising living standards.

5. The changes in CT will:

(a) Reduce the tax bite on profits. For a given yield the current allowances require a high rate.

(b) Reduce the tax subsidy given to certain types of investments, and the major distortion which can lead to wasteful investment and which has favoured capital against labour. In future more investment will be undertaken because it is truly profitable and productive not merely because tax subsidy makes it appear so. The quality of investment will improve.

(c) Remove the bias against risk taking which results from the current discrimination in favour of borrowing rather than funding by equity.

6. The removal of the tax subsidy on certain types of investment will be accompanied by the removal of the tax on employment (the NIS). The choice for businessmen between committing to more capital investment or taking on more labour will be much less distorted by tax considerations. In some new projects it will be economic to substitute labour for capital equipment. That is one reason why the package should lead to some increases in employment.

7. Greater freedom for enterprise and higher quality investment should produce more productive and efficient economy able to sustain a real increase in wealth from one year to the next and able to provide more worthwhile jobs.

THE EFFECTS OF THE PACKAGE

Companies will be left with more money to make their own decisions.

8. Companies will have more resources available to them because the CT and NIS changes will increase post-tax company profitability.

9. In 1984-85 the combination of 2 per cent reduction in CT rate and the abolition of NIS should increase company profits by about £740m. The abolition of PAS will mean that companies have to pay VAT on imports earlier than before. That will mean a small offsetting cost to them of interest amounting to about £30m. All main company sectors are expected to benefit from the package as a whole. For example, the NIS and CT measures are estimated to benefit manufacturing by £260m, so that it will be a clear beneficiary overall, even though

manufacturing will bear most of the interest costs of the PAS abolition. In 1985-86 the reduction in corporation tax and the NIS abolition together should lead to a substantial increase in company profits, after taking account of the reduction in capital allowances and the abolition of stock relief. Overall the company sector is expected to gain by substantially more than £1 billion, of which nearly a quarter will benefit manufacturing industry. Estimates beyond this year are difficult to make, but the Government has designed the changes so as to benefit business as a whole during the transition period.

10. With more resources available to them, companies will be able to engage in more R&D, more intensive product development, more active search for process innovation, and will be able to make greater marketing efforts and offer improved services.

More Productive Investment

11. The quality of investment is crucial to economic success. The economy loses if money is channelled into investment which produces a return lower than might have been achieved elsewhere. The current system has tended to distort the appraisal of returns, and may have contributed to the exceptionally low return on investments in this country. Removing the tax distortions will encourage investment which does not need a subsidy and that will strengthen the economy.

12. For some investments the pre-tax real return can be lower than the post-tax return, or even negative. The current system also favour debt finance at the expense of equity. The effect of the package is to reduce these differences.

13. Some unproductive investment may be curtailed. But in the transitional period, other investment is likely to be brought forward in order to benefit from the remaining first year allowances. But after this initial period of adjustment, the Government is confident that there will be a movement from lower to higher quality investment. The return on this investment will be enhanced by immediate and future cuts in the CT rate.

Stock Relief Abolition

14. Stock relief was introduced to counter the impact of high inflation. Its value and the need for it have been declining with the reduction in inflation. The impact on companies is more than made up by other components of the package.

Summary

15. The Government recognises that not all companies will gain from this package. There will be losers as well as gainers. This is inevitable in any measure of tax reform. The Government believes that the many distortions in the company tax system are partly to blame for the persistent and past failures in the United Kingdom's economic performance. The Chancellor has made clear the Government's intentions for the tax system over a number of years ahead, so that companies can plan and invest with confidence.

BUDGET SECRET

FROM: ECONOMIC SECRETARY
DATE: 24 February 1984

CHANCELLOR

cc Chief Secretary
Financial Secretary
Minister of State
~~PCC~~ Members
Mr Ridley
Mr Lord
Mr Portillo
Sir L Airey - IR
Mr Fraser - C&E

PRESENTATION OF BUDGET MEASURES

... I attach a paper dealing with the handling of the financial sector as commissioned in John Kerr's minute of 14 February. There is some further work to do on this, but I hope it will at least serve as a basis for discussion at next Tuesday's Overview.

... I also attach a paper by Adam Ridley dealing with the handling of the post-Budget presentation. Because of today's disruptions I was not able to discuss it with him, so I am passing it on as it stands. It seems to be a useful outline.

Adam Allan

fr IAN STEWART

PRESENTATION OF BUDGET MEASURES: FINANCIAL SECTOR

This note reports progress in meeting the remit set out in Mr Kerr's minute of 14 February. It identifies some positive themes and potential problem areas and considers how the post Budget presentation might be handled. But the section on the impact of the Budget on different institutions within the financial sector does not yet take full account of Mr Cassell's work (due to be submitted this weekend). And the material on the history of particular measures is still incomplete.

I THE MEASURES

The main proposals in the financial area are:-

(i) the introduction of a composite rate for taxing bank interest;

(ii) the consumer credit duty

(iii) halving of the rate of Stamp Duty on share transfers;

(iv) the withdrawal of life assurance premium relief on new policies;

(v) the corporate bond package

In addition, the financial sector will be affected by other Budget proposals, notably:

(i) the company tax package, which will have a major impact on the banks' leasing activities;

(ii) the abolition of NIS

(iii) the abolition of investment income surcharge;

(iv) the change in PAS, which is likely to increase the demand for bank credit;

(v) the withdrawal of/foreign earnings and foreign emoluments deduction, which is likely to bear on foreign banks; and the change in car scales

- For impact on various groups within financial sector - see Section IV.

II POSITIVE THEMES

1. A flourishing corporate sector

The financial sector's livelihood depends on the health of the wider economy. It can only gain from measures to promote a strong corporate sector, to encourage profitability, and to improve the quality of investment. And it will benefit directly from some of the proposals designed to bring this about, eg./reduction in company taxation abolition of NIS, encouragement of small companies.

2. Helping structural change

UK financial institutions going through period of rapid structural change: Budget measures "go with the grain" eg:

Stamp Duty and Stock Exchange
Composite rate fits with moves towards interest bearing current account, building societies offering bank style services.

3. Reducing discrimination, removing distortions

- as different kinds of financial institutions offer wider range of of services and compete more closely, right that the tax system should treat them more even-handedly, eg. composite rate removes long-standing difference between treatment of interest on banks and building societies

- changes will redress imbalance between individual as against institutional investment, eg. withdrawal of LAPR, abolition of IIS. Halving of Stamp Duty and more generous stock option schemes will encourage individual share ownership.

- Stamp Duty changes will remove disadvantages faced by UK investors trading in London. New duty rate will match rate now charged on foreign purchases

- changes will help to even out differences in tax burden between financial and other sectors/ and to widen the tax base, eg. consumer credit duty applies to sector which has not hitherto been subject to indirect tax. Company tax package will even out difference in impact of CT on financial and industrial and commercial companies.

- abolition of expensive and distorting tax reliefs, eg. LAPR (cost has risen very rapdily in recent years - now £700m, and largely unconnected with original purpose envisaged, viz. insuring against death). Foreign earnings and emoluments, car scales.

4. Encouraging companies to return to capital markets

1983 was a record year. Halving of Stamp Duty and Corporate bond package gives further encouragement to companies wanting to strengthen balance sheets by raising long term funds. Less reliance on bank lensing will have monetary benefits, reduce pressure on broad money. (Lower PSBR will also leave more room for private sector issues, despite scale of asset sales).

III DEFENSIVE POINTS

1. Measures reduce the incentives for saving (notably LAPR) ie. constitute move away from ideal of expenditure tax (cf. IFS).

(a) Withdrawal of LAPR unlikely to have significant effect either on overall level of saving or on genuine life assurance business. LAPR has been extended way beyond original intention of relief, ie. to ensure risk of death. Two-thirds of life business is non-qualifying; and have grown very rapidly since over 1981-82 (1983 figures will be affected by MIRAS). Life business continued to grow, albeit at more moderate pace, when relief was withdrawn in Australia in mid-1970's. Life companies will continue to enjoy some privileges, eg. pegged rate.

(b) Abolition of IIS and halving of Stamp Duty will remove some existing disincentives to saving, by increasing returns.

2. Some notorious tax privileges emerge unscathed

(a) No change in MITR; and consumer credit duty will not fall on mortgages under £30,000 (qualifying for relief)

- Private housing is social and political priority.

(b) Exemption of tax-free National Savings instruments from composite tax arrangements is another example of special privileges only for Government debt instruments (cf. criticism of low coupons, following ending of tax loophole for offshore roll-up funds).

- National Savings target is no higher than it would otherwise have been. May be some adjustment in pattern of inflows, with DNS attracting higher share of non-taxpayers. But many non-taxpayers already hold building society accounts despite corporate rate. And only right that non-taxpayers should have option of some gross instruments (as National Consumer Council report argued).

3. Composite rate should be abolished, not extended to banks

- see National Consumer Council recommendation

- it is absolutely right to standardise tax treatment of bank and building society interest. But manpower cost of doing this by abolishing composite rate for building societies would be prohibitive. (Indeed, existing system threatens to become unmanageable, with trend to interest bearing current accounts).

4. Financial sector doesn't need any more change

Some changes will help financial institutions cope with change. Others remove existing distortions. Tax system can't be left to ossify whilst the financial system changes. And this Budget gives companies plenty of time to plan for tax changes, by announcing future rates of CT and capital allowances well in advance.

5. Corporate tax changes will kill leasing and sharply increase tax burden on banks

- Banks have argued that most of the benefits of leasing are passed on to their customers; and they can't complain about paying tax like anyone else.

- Leasing market will undoubtedly change; but it will certainly continue. Longer term leasing will still have significant fair advantages. Shorter term leasing will still be a useful means of providing off balance sheet finance. Changes simply remove artificial tax-induced incentives for leasing.

6. Which tax exemptions are to go next? Mortgage interest relief? Tax exemption of pension funds?

No present plans. Prime Minister has made it clear that mortgage interest tax relief will stay.

7. Is this the last word on taxing the banks?

There are no plans for a special bank tax. This Budget corrects the major anomalies in the tax treatment of banks (eg. composite rate, consumer credit duty, releasing deferred tax liabilities as a result of corporate tax package).

IV EFFECTS ON DIFFERENT GROUPS WITHIN FINANCIAL SECTOR

A. Banks

Representative groups: BBA (composite rate, consumer credit duty, leasing)
Equipment Leasing Association
Finance Houses Association (leasing, consumer credit duty)
TSB's, National GiroBank (composite rate can consumer credit duty)
Association of American Banks in London (foreign emoluments)

- gain from abolition of NIS (1984-85 £10m
  1985-86 £20m)

- lose from composite rate (may add £25m to cost of funds:

additional administrative costs) Affects:- All but especially Clearers, TSB's

- consumer credit duty may marginally reduce bank lending. Finance Houses would be most affected by a decision not to exempt existing fixed rate credit. Affects: particularly Clearers, TSB's, FHA.

- CT changes will dramatically change attraction of leasing as a tax shelter. In first two years, leasing may be more active; thereafter much leasing will become much less attractive. Banks exposure to tax (at lower CT rate) will be increased in longer term. [Relief through leasing has been worth about £300m to major clearers alone, but effect on profits is much less, to extent benefits are passed on to customers]. Affects: particularly Clearers, ELA, FHA.

- withdrawal of PAS may increase bank lending (by up to £500m in 1984-85).

- withdrawal of foreign earnings and emoluments deduction may add to costs of foreign banks. About 2000 new bank employees first qualify for this deduction a year: additional tax bill for them may be £1.2m in 1984-85. Affects: foreign banks.

B. Building Societies

Representative group: BSA

- likely to gain business from Budget itself: but decision on 23 February to tax gains on gilts as trading income could cost them up to like £150m a year.

- composite rate will divert some inflows from banks (perhaps £1bn in 1985-86, and maybe up to £½bn anticipatory flows in 1984-85).

- consumer credit duty may lead to some substitution into mortgage lending from other forms of lending (since mortgage lending that qualifies for relief is exempt). Duty on the 3 per cent of mortgage lending likely to be affected could raise about £20m, most of which is likely to be passed on to borrowers.

- LAPR abolition may cause some switch into building society shares but net amount of mortgage loans could be affected (because endowment mortgages will become more expensive). Societies may lose Commission and their ability to change premium interest rates maybe reduced [see Annex].
- halving of Stamp Duty on transfers of property will increase housing transactions and maybe demand for mortgages.

- withdrawal of Building Society SAYE - negligible (only 0.4 per cent of total building society deposits).

C. Life Assurance Companies

Representative group: Life Offices Association

- amount of institutional cash flow at risk from abolition of LAPR on new policies could be around £½ billion in 1984-85 and £2 billion in 1985-86, but in practice only some of this will be lost. Moreover, much of companies new premium income comes from non-qualifying business (in 1982, new premium income was £2.6 billion, of which only one-third qualified for relief).

- some life assurance groups have offshore funds, and will be affected by new tax proposals (published in January). No surprises.

- withdrawal of VAT zero rating on insurance written by overseas branches may cost £3-5m a year.

- companies will benefit from halving of Stamp Duty and reduction in NIS; but employees will be hit by new car scales.

D. Other investing institutions - pension funds, investment and unit trusts, property companies.

Representative bodies: National Association of Pension Funds
Association of Invesmtnet Trust Companies;
Unit Trust Association

- benefit from lower Stamp Duty, but may be anxious about future of tax reliefs not affected by this Budget.

E. Stock Exchange Firms and Other Dealers

Representative bodies: Stock Exchange
National Association of Sharedealers and Investment Managers

- jobbing and broking firms will benefit from increased activity resulting from lower Stamp Duty on share transfers, and corporate bond package, and from increased investment by individuals due to abolition of investment income surcharge. Also gain from abolition of NIS. Re-rating of different sectors after CT changes will greatly increase turnover.

F. Merchant Banks

Representative bodies: Accepting Houses Committee, BBA

Stand to benefit significantly from extra business due to lower Stamp Duty, corporate bond package, and consequences of company tax package. But some have leasing subsidiaries.

G. Consumers of Financial Services

Representative bodies: Consumers' Association, National Consumer Council

- composite rate reduces opportunities for non-taxpayers to receive interest gross. Extension to banks runs counter to NCC recommendation.

- consumer credit duty is likely to be passed on, increasing cost of borrowing by 1 per cent and reducing real disposable income. Could reduce spending as well as borrowing. (Treatment of existing contracts). Duty does not begin to operate until 1 July 1985.

- abolition of LAPR on new policies will increase cost of new premiums by $17\frac{1}{2}$ per cent, reduce attraction of endowment mortgages.

- lower Stamp Duty on property and share transfers will help people moving house, and personal investors.

- abolition of investment income surcharge removes double taxation of savings.

See attached table: for summary of effect of changes in NIS, Stamp Duty [and CT changes] on financial sector.

Revenue Effects of major tax changes on financial institutions

Tax paid; £m

	1984-85	1985-86
1. NIS		
Banks	- 10	- 20
Building societies	- 2	- 3
Other	- 43	- 67
Total	- 55	-100
(whole economy)	[-460]	[-930]
2. Stamp Duty		
Banks	- 5	- 5
Building societies	- 5	- 5
Insurance companies		-685
Superannuation funds		- 75
Investment/unit trusts		- 25
Property companies		- 30
Total	-195	-805
(whole economy)	[-450]	[-515]
3. Company tax package (not allowing for changes in leasing, or forestalling)		
Banks		
Total	[- 35]	[-110]
(whole economy)	[-200]	[-340]

Note:

Consumer credit duty, LAPR affect consumers

Figures preliminary and need checking/completing by Revenue Departments

ANNEX

BUDGET - SECRET

LIFE ASSURANCE PREMIUM RELIEF : EFFECT OF WITHDRAWAL ON INDIVIDUALS

The proposal. Abolish LAPR for new policies ~~and~~ with effect from Budget day.

Positive

(1) Greater freedom of choice for investors caused by removal of fiscal distortion in favour of investment in qualifying life assurance policies.

(ii) Relief now used predominantly for investment, not assurance against death.

(iii) Resources saved by withdrawal of relief will enable reductions in general burden of direct tax.

(iv) No withdrawal of relief for existing policies.

Negative

(i) Increase cost of new qualifying life assurance policies by 18 per cent.

(ii) Existing policy holders will suffer if loss of new business causes life offices or friendly societies to go under.

(iii) Since LAPR is an extremely stable proportion of total income (for all levels of income) up to £30,000, it will form a higher proportion of disposable income at the lower end of the scale. Low earners will therefore be more adverseley affected than high earners.

(iv) Some form of life assurance relief dates from earlie days of income tax. Introduced by Pitt; re-introduced by Gladstone.

Pitfalls

(i) Relief has been used to sell avoidance schemes. But these are a small minority of Life Assurance business and important not to get out of context. Abolition will take all joy out of some avoidance devices in Life Assurance business, but not all.

Response to Representative Bodies

Wide recognition that Life Assurance relief has long been an anomaly.

LIFE ASSURANCE PREMIUM RELIEF : HISTORICAL BACKGROUND

1799 : relief introduced in Pitt's first Income Tax Bill. Premiums fully deductible.

1842 : dropped when income tax reimposed.

1853 : reintroduced by Gladstone. Allowable premiums not to exceed one-sixth income.

1916 : to counter increasing exploitation of life assurance for investment, relief for new policies restricted ~~up~~ to 3/- in the £. (Standard rate in 1916 5/- in the £). Thereafter, relief was generally up to half standard rate between the wars, and up to two-fifths standard rate after World War II until 1972-73.

1968 : relief restricted to 'qualifying policies (ie. with a term of at least ten years, and annual - or more frequent - premiums spread evenly over the life of the policy. Hitherto, single premium policies had attracted relief).

1973 : following unification of income tax and surtax, relief was given up to half basic rate.

1975 : further restrictions to deal with early surrenders (relief clawed back if surrender within 4 years), loans and other avoidance devices.

1979 : premium relief by deduction (PRBD) came into force. Relief at flat rate 17.5 per cent (15 per cent from 1981) limited to premiums up to one-sixth income or £1500, whichever is greater.

1980 : further legislation to counter misuse of relief through one and two year 'short term bonds'.

BUDGET: SECRET

E 3

FROM: ADAM RIDLEY 000285
24 February 1984

24 FEB 1984

ECONOMIC SECRETARY

cc Mr Cassell
Mr Allen
Mrs Lomax
Mr Pirie
Mr Mowl
Mr Lewis, I/R

PRESENTATION OF BUDGET: FINANCIAL SECTOR

... I attach a first draft of the last part of your paper for the Chancellor, which is supposed to fit at the end of the material submitted by Rachael Lomax earlier today.

2. I must apologise for its length and imprecision - the product of various diversions earlier in the day.

AR

A N RIDLEY

Handling Post-Budget Presentation

The first issue to resolve is the degree of likely concern in key groups, how they are likely to respond, and what assurances they may seek, some of which could well be difficult to handle. The groups who matter most are:

(a) Trade associations and perhaps individual firms;

(b) Members of Parliament;

(c) The Press, who will set so much of the tone.

A first sighting shot at who might be involved under (a) can be derived from the analysis set out in iv above, and suggests the following minimum catalogue of the "concerned":

Measure	Activity Affected	Organisations
1. Credit Licence Duty.	HP & Leasing	Finance Houses Clearing Banks Equipment Leasing Association and key clients such as - producers of goods thus bought (white goods, cars) or retailers who depend on such financing (Curry's, Rumbelows, big stores, etc.)
2. Corporate rate and CT changes affecting allowances.	Bank lending and all leasing	Clearing Banks Equipment Leasing Assoc and sectors particularly dependent on leasing, e.g. Civil Engineering, Motor vehicles, farm equipment, construction, machine tool users. Tax exhausted cos. (i.e. CBI)
3. Life Insurance Relief.	Life insurance proper, house purchase via mortgage, sundry tax-sheltering devices.	Life Offices Building Societies Other financial institutions dependent on life policies in some respect and key client groups such as House Buyers, tax planners and accountants (i.e. IOD) and the wealthy. Pension Funds and others who may fear

4. Foreign Emoluments	Overseas firms, particularly Banks, on their pay to UK-based expatriates.	US, Japanese and other Banks ? selected multi-nationals other sensitive foreigner-related activities such as shipping, oil, etc.

2. As far as MPs go, we do not yet have details. But clearly the Whips and the register of members' interests could help if we had permission and resources to consult them.

3. The members of the Press who are most likely either to share the concern of a particular group or to publish uncritically what they are told by lobbyists are potentially numerous. We need to seek advice from IDT about those of them who matter most. But if it is judged that there could be a major reaction by those concerned, it could well be simpler and more effective to tackle city editors or financial commentators fairly comprehensively and all together, as well as picking off some key individuals.

4. Once one is confident that the groups have been adequately identified, it will be possible to suggest reasonably specifically how to cope with them. But even at this stage clear conclusions are possible in some areas as are important questions about others.

Trade Associations

5. Some, at least, will make early moves to make representations to ministers, such as the Clearing Banks, the Leasers and the Life Offices.

(a) - Should Ministers pre-empt that in at least some cases by an invitation? If so how quickly should they be invited in; and how soon should one aim to meet them?

(b) - Should Ministers rather wait to be approached? And when approached, how hard to get should they play?

(c) - Is there any risk that the TCSC or other Select Committees might be induced to give them embarrassing platforms? And if so, should anything be done to stop or encourage that?

Members of Parliament

6. (a) The first and most obvious thing to do is for the Economic Secretary - and perhaps one or two others - to invite any key backbenchers to discuss their anxieties very shortly after the Budget. One way of starting this would be to leave on the members' letter-board an invitation to such a meeting and perhaps a special brief, to be picked up immediately after the Chancellor has finished his speech.

(b) It could be worth approaching Chairmen of one or two non-Treasury Backbench Committees to indicate willingness to appear before them. And it would even be possible in principle to induce the Finance Committee to have a second meeting on the Budget in addition to the traditional one on Tuesday evening, which is inevitably rather breathless and offers little or no scope for any issue to be dealt with in detail.

(c) If past experience is anything to go by, Ministers will get a good many letters from backbenchers. It pays handsomely if these are handled with unusual speed and care.

The Press

7. Prima Facie there is a case for

(a) A Press Conference for financial editors and specialists generally, and/or briefing for a significant number of key individuals on Wednesday or Thursday. If humanly possible such invitations should be dispatched and received on Tuesday afternoon so as to induce potential critics to hold their fire for a while, or at least to qualify their criticism.

(b) A major Ministerial speech could help greatly, not least if it were on the record very shortly after Budget Day. What is said in the House would most emphatically not be enough. However organising that would be difficult; and the second best might be such an occasion in April, when the text could d[illegible] with the views of critics as well as the Governm[illegible] purpose and case, and in a considered way.

A difficult question

8. The Budget measures will clearly not be seen as the last word in the Chancellor's strategy. People will ask who or what is to come next. The most important are likely to be the Pension Fund Managers, who would be mad not to press Ministers to declare unequivocally whether they are at risk in the same way as the Life Offices; the Building Society movement and a part of the political world, who will be concerned about Mortgage Interest Relief and possible extension of the Credit Licence duty to mortgages; and the Banks, who will want to know what else they may be at risk to.

Satisfied Customers

9. Finally, one should note that there should be some happy groups, too. Should anything be done to encourage them?

FROM: FINANCIAL SECRETARY
DATE: 27 February 1984

CHANCELLOR

cc Chief Secretary
Minister of State
Economic Secretary
Sir Lawrence Airey - IR
Mr Fraser - C&E
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Monck
Mr Battishill
Mr Odling-Smee
Mr Monger
Mr Ridley
Mr Allen
Mr Folger
Mr Hall
Mr Norgrove
Mr Portillo
Mr Lord
Mr Bailey
Mr Littler
Mr Anson
Mr Kemp
Mr Byatt
Mr Unwin
Mr Makeham

PRESENTATION OF BUDGET MEASURES: BUSINESS TAXES

This minute gives a suggested strategy for presenting the business tax changes (as allocated to me in John Kerr's 14 February minute). I attach an Annex dealing with share options; and a note on the structure of personal taxation. Detailed background information is in the annexes attached to Mr Monck's 22 February minute.

2. In addition, I attach a first shot at a Budget Day press release covering the structural changes and some of the individual measures (circulated with my 24 February minute).

Main Themes

3. The main themes should be these:

a. The new freedom for businesses. The aim of the reforms is to encourage and reward efficiency and enterprise, reducing the tax bite on profits; to make the tax system more even-handed between different types of investment and finance, and between capital and labour. It will be better to be in business when managers are free to make decisions without distortions from discrimatory tax breaks. These reflect the prejudices of politicians. The present system favours projects unlikely to be successful without tax payer support.

b. Financial benefit to business overall. The announced changes in business taxes, taken together, will increase retained profits by up to £800 million in 1984-85 and £1400 million in 1985-86. There will be a longer term shift in favour of business because the low CT rate will stay low beyond the transition. These sums will enable business to increase expenditure on R and D, product development, process innovation, and enable it to make greater marketing efforts, offer improved services without incurring extra debt or dilution. ?

c. Reduction of distortions. Lower capital allowances will reduce the tax subsidies which at present distort business decisions. Lower CT rates, make possible by a wider tax base, will increase the post-tax profitability of other activities which do not benefit from the presenttax breaks. Some lower yielding projects will be knocked out at the margin. But the net result will be better quality investment, yielding a higher return than the present discriminatory and interventionist (though not discretionary) system has produced. Compared with other major advanced countries we have the largest tax bias in favour of plant and machinery and industrial buildings but the lowest rate of return, and often a lower level of investment. We can now begin to reform this ineffective system to get a higher return on investment.

d. More Jobs. We can also now complete the abolition of NIS, the "pernicious tax on jobs" which makes even less sense with 3 million unemployed. Both the stimulus to enterprising activities from higher retained profits and the reduction in the bias of the tax system against labour and in favour of capital will produce more jobs. This must be right in the present economic situation but the improvement in the quality of investment as a result of these reforms is equally vital.

4. These themes will of course emerge in the Budget speech. But I suggest we have a Treasury Press Notice on the reform of business tax in addition to the normal notices on individual measures from the revenue departments. A first shot is attached.

History

5. The history of each measure covered in the detailed briefing on each measure.

Pitfalls

6.

a. announcements about investment now at risk from the losers.

b. claims that the CT reform is anti-manufacturing or anti-investment (including inward investment);

c. failure to consult about CT reform; (Green Paper)

d. how will we sustain a low CT rate;

e. presentation of sectoral effects.

Pitfalls Answers:

6a. Vulnerable projects are part of the low quality investment the present system produces, but we have invested political capital in some of them. We can do a little, eg by announcing that cable ducts do qualify for capital allowances, and by asking DTI to look out for companies which advance projects as a result of lower future CT rates. But the main defence must be that it is better for "loser" projects not to proceed and rather to let the market help our industry to invest in more winners.

6b. We should argue that <u>better quality investment</u> is as right for manufacturing, and as good for competitiveness there, as it is for any other sector. The argument about preparing for adjustment "when the oil runs out" far from pointing to retaining the present distortions, is an argument for getting rid of them and fostering investment which does not need subsidy (or needs less subsidy). The same goes for inward investment which depends on subsidy: the low CT rate will be the attraction for potential investors in the UK.

I do not think we should use the probable acceleration of investment to catch the remaining capital allowances as a main frame argument. Some of the projects accelerated will be low yielding ones and this is not part of the objective of the reform. Accelerated investment can, however, be used as a response to those who are interested only in the quantity of investment, and will also say reform will put in doubt the 1984 pick-up in investment.

6c. There is a slight awkwardness in the consultations on the CT Green Paper and Sir Geoffrey Howe's acknowledgement last year of the "overwhelming desire on the part of industry for stability in the CT regime". He concluded that there should be "no change in the broad structure of the present arrangements". Our defence is that we <u>have</u> stuck to the imputation system, and that the time for reform of the rates and reliefs is now because the economic situation allows it. We should also point to the care with which the Government are phasing in the reform so enabling business to plan with confidence not only by pre-announcing but by legislating for the future changes.

yes

6d. We can argue thatthe reform will itself promote faster growth which will leave room for <u>lower</u> business taxes from a larger broader base provided we have sensible control of public expenditure, as indicated in the LTPE.

6e. We should be cautious about using detailed numbers about particular sectors. We shall need to give overall figures for business, probably with the main component measures. But for sectors we should confine our statements to saying that they gain overall with some broad indication of the measures which benefit or hit them and their relative importance.

So far as the CT reform is concerned I suggest the FSBR should give first year and full year costs of changes in the normal way but speak of "broad revenue neutrality" for the remaining years of the CT transition.

Discuss

<u>VAT on imports</u>

7. It will be important to present VAT on imports with emphasis on the following points:

a. It represents merely a once and for all bringing forward of tax payments that are in any case to be made, so that the only realistic measurement of the impact on business is the interest cost. To the extent that people insist on focusing on the cash flow effect, we must emphasisethe two-year picture for Business.

b. Some of the cost will in any case be borne by foreigners.

c. Businesses using imported inputs will bear a cost, but they will be in no worse a position than importers in, say, France already are.

? Government

d. UK producers of goods that compete with imports will now be in a better competitive position than they were in the home market - a position which equivalent producers in France, already enjoy.

North Sea tax changes

8. It will emerge that North Sea existing fields do well from the CT reform. But once the ACT change is taken into account, the benefit overall is much reduced, although it will still be substantial for particular companies. We can meet some of any criticism by repeating that the CT reform makes excellent sense and that it is acknowledged that there will be winners and losers. It is perhaps not surprising, since the North Sea pays so much tax, that it benefits from changes to improve the system.

9. We need to consider further to what extent to treat the North Sea as separate from other economic activity. We need of course to make the point that we intend to change the treatment of incremental investments which are damaged by the CT changes. That will involve us in arguing that the North Sea regime is "separate" and that we got the balance for new investment right in the last budget and simply wish to maintain that position. We may also need to give the oil industry an indication of how we see its position for some years ahead. I understand that that is usual Revenue procedure given the industry's particularly long lead times. That again would indicate treating North Sea taxation as a distinct area.

10. But there are obvious dangers in separating the North Sea too much in our presentation, particularly since on the whole it does well out of the changes.

Key Groups

11. Special approaches should be made to the CBI, the Institute of Directors and the Institute of Fiscal Studies, and the Institute of Chartered Accountants. In the case of the CBI we should seek to persuade them that it cannot sensibly reject what is pre-eminently a pro-business budget, despite some losers in manufacturing, if it is to become a breadly based business organisation. I propose a special note for the CBI and it may be possible to brief members of the Council or heads of individual firms where we know they may support this kind of radical package - to establish a mood - to pre-empt like GEC to speak up easy for the package. The Revenue are proposing to write to the European Commission explaining the CT tax changes.

Special Briefing

12. The Treasury should offer help especially to economic Ministers like Norman Tebbit in particular, Patrick Jenkin, and Tom King.

13. Political advisers will be preparing briefing for the backbenchers as usual.

14. We should aim at a good reaction to the business tax package in the heavy Press of the weekend after the Budget.

JM.

JOHN MOORE

ANNEX

PRESENTATION OF SHARE OPTION SCHEMES

Themes

1. We shall want to bring out three themes:

a. Share option schemes are very important in enabling companies to secure the services of key executives, and motivate them. This is of particular value to small companies who cannot afford to pay large salaries or offer large benefits.

b. The motivation effect is particularly direct: the benefit from the scheme will depend on the success of the company, to which the executive is therefore committed.

c. Share option schemes are an aspect of the Government's support and encouragement for employee share schemes generally, an aspect of the committment to wider share ownership.

History

2. i. History to 1974 Pre 1972 - uncertain tax law; 1972-3 - express tax reliefs for approved employee share schemes, charging provisions to cover others; 1974-abolition of reliefs.

ii. Recent developments - 1978 relief for approved all-employee profit sharing schemes; 1980 relief for approved all-employee savings related share option schemes; 1982 payment by instalments permitted for income tax on unapproved option gains.

Pitfalls

3. a. We shall be asked for quantifiable evidence of the benefit of the proposed reliefs. This cannot be done directly. A defence could be to point to their success elsewhere.

b. We shall be asked why the new generous reliefs are needed when schemes are underway now. This is not, of course, a reason for not seeking more schemes, and helping companies to set them up.

c. We shall be asked whether we should not allow reliefs to exectives only if the company runs an all employee scheme. Apart from the practical difficulties, we would not want to constrain companies in this way.

d. We may be asked why the scheme is not targeted on small companies. The answer could be that large companies have the same desire to motive key executives, and that there are safeguards against their simply using share options as an alternative to salary.

Key groups to address, and briefing lines required

4. The same areas broadly will need to be covered as for the company tax changes.

A radical Budget

PRESENTATION OF THE BUDGET

You asked me to maintain general oversight of our presentation of how the Budget improved the structure of taxation on individuals.

2. Much of the relevant ground is of course covered by the work the Chief Secretary and Minister of State have undertaken. This note indicates how, I suggest, we should tackle the general, structural, theme.

3. Generally, I suggest, we need to keep the presentation as simple and robust as possible and, it goes without saying, closely in line with the speech itself (which will be usefully buttressed by what is now emerging from the drafting of the relevant paragraphs of the Green Paper on Public Expenditure in the Longer Term).

4. This means that the <u>key themes</u> are:

<u>Personal tax thresholds</u>

i. Overriding requirement to raise the basic tax thresholds [by 12½%] this year:

- to maintain the reversal of the long term [post-war] trend in which the starting point for tax has been allowed to fall as a proportion of average earnings to finance public expenditure which was rising inexorably in real terms, and in particular;

- to ease the burden on the lower paid; and

- to contribute to the long-term solution of the poverty trap problem. & employment

<u>Indirect tax base</u>

ii. Some broadening of the indirect tax base:

- improves balance of taxation on income and spending (without increasing already high rate of VAT);

- reduces anomalous exemptions and indefensible borderlines;

- helps to finance real increase in personal tax thresholds in context of a broadly neutral Budget.

High rates of tax

iii. Further attack on the problem of absurdly high rates of tax - CTT and IIS;

- pre-1979 regime of very high rates which had to be offset to some extent by large, discriminatory reliefs, was the wrong perscription. Right course is to get down the top rates themselves;

- IIS was an outdated distinction contributing to problem of highest rates of income tax (75% at the top) but also giving a 45% rate for the high proportion of IIS payers liable at the basic rate.

Outdated reliefs

iv. Rigorous scrutiny of special income tax reliefs:

a. running down of foreign earnings and foreign emolument reliefs:

- strengthens personal tax base;

- reduces gap between real and perceived rates of personal tax;

- reduces complications in the personal tax system.

Tax expenditures

v. Abolition of LAPR on new policies reflects critical approach to tax expenditures which:
- have outlived relevance; and

- distort personal savings decisions.

POSITIVE POINTS

5. These are very much a reflection of the themes of the Budget. Reforming the personal tax structure:

- to redress the balance of personal tax where it hits hardest - at the bottom of the scale - and where it still does excessive damage - IIS and the top rates of CTT;

- to buttress freedom of personal choice;
- to bring appearances more in line with reality;
- to get rid of outdated and complicating burdens and reliefs.

PITFALLS

6. The main ones are already familiar from our discussions:

- some very big gainers among the better-off (IIS and CTT);
- some big losers (especially from the foreign earnings changes);
- extension of indirect tax base will effect families and less well-off to some extent;
- among the better-off, those (the minority) with investment income gain more (from IIS abolition) than those with mainly earned income (bare indexation of higher rate bands and increase in UEL);
- unincorporated business sector a net loser from the CT package after the second year, with possibly, some large individual losers;
- vested interests in longstanding relief like LAPR.

As I have said, we shall need to take a robust line in countering attacks on these themes: there are some nettles to be grasped, and some of them are bound to sting. It will I suggest be important not to be drawn too far into attempting detailed justifications of particular gains and losses. The general theme is that there are bound to be substantial gainers and losers when much needed, and too long delayed, reform of this kind is tackled. The objective is not to produce the individual gainers and losers but to achieve a sounder, more broadly based, less complicated personal tax structure overall which contributes to the objective of reducing the burden of the tax and buttresses our policy of freedom of individual choice.

BUDGET SECRET

FROM: R A L LORD

DATE: 27 February 1984

cc. Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir Lawrence Airey - IR
Mr Fraser - C&E
Sir T Burns
Mr Cassell
Mr Monck
Mr Battishill
Mr Odling-Smee
Mr Monger
Mr Ridley
Mr Allen
Mr Folger
Mr Hall
Mr Norgrove
Mr Portillo

CHANCELLOR

PRESENTATION OF BUDGET: KEY TARGETS AND THEMES

I attach some thoughts on how to present the Budget to key target groups which may be relevant to your meeting tomorrow. IDT will of course play an important role which I have not itemised under each heading. The message for different target groups will overlap a great deal and I have listed only a skeleton of points to make under each heading. These can be fleshed out as the Budget briefing develops.

R A L LORD

NEW. LORD.

PRESENTATION OF BUDGET: KEY TARGETS AND THEMES

Backbench MPs

Method

- Chancellor to address Finance Committee.
- Comprehensive briefing for backbenchers (Advisers).
- Ministers to talk to MPs with special interests (e.g. oil, agriculture, insurance, small business, construction, banks).
- TCSC: Chancellor to see Terence Higgins ?

Message

1. Budget to be seen in context of Parliament as a whole. This is the time to take difficult but necessary decisions. Many measures increase scope for manoeuvre in later years.

2. Begins to fulfill pledge on tax cuts: Finance Bill will legilsate for substantial cuts in burden on industry in later years.

3. Takes radical steps towards tax simplification, abolishing two major taxes on the way.

4. A Budget for jobs: NIS (the "tax on jobs"); CT (allowances discriminate in favour of capital intensive); unemployment trap eased.

5. MTFS charts path toward lower inflation.

6. Not a Budget for the rich: IT threshold increase gives maximum help to low paid; VAT extension neutral (neither progressive nor regressive).

7. Detailed briefing.

POLITICAL CORRESPONDENTS

Method

Chancellor to speak to Lobby.
Ministers and advisers to use appropriate contacts.

Message

1. Budget to set a programme for the Parliament.

2. Government has not lost its radical convictions or run out of ideas.

3. Government is thinking strategically: MTFS plans take full account of likely decline in North Sea production towards end of decade; LTPE paper maps out longer term demands of public sector within economy.

4. See also briefing for backbenchers.

ECONOMIC CORRESPONDENTS

Method

Chancellorial and official briefing day after.

Message

1. A supply-side Budget. Makes tax system more neutral as between different types of investment, different ways of financing, different methods of saving .

2. Expenditure tax too great an upheaval and requires higher rates, not lower. (IFS will argue that to move from, say, 80 p.c. of savings tax exempt, or partially tax exempt, to 70 p.c. does not make tax system more neutral.)

3. Threshold increase eases poverty and unemployment traps. Lower SD on house sales encourages labour mobility.

4. Firmly re-states MTFS. Extended to 5 years to help mould expectations. Steady reduction in PSBR/GDP and inflation.

5. Big step down in PSBR in 1984-85 /takes account of [PAS,] asset sales [and fiscal and monetary overrun of current year] 7 Bigger reserve and better control procedures in PE planning.

very small – & no lasting effect (cf 1979)

6. RPI effect of Budget [much smaller than 1979 and inflation expectations lower.]

7. MO useful new monetary gauge with closer relationship to short term interest rates.

8. Distributional effects: all industrial sectors gain from year 2 ~~but manufacturing less than others~~. VAT extension roughly neutral. Thresholds benefit low earners.

9. LTPE paper shows tax cuts can only be afforded with strict public expenditure control.

FINANCIAL CORRESPONDENTS

Method

Briefing from officials day after.

Message

1. SD cut helps to improve competitiveness of London market. With IIS, will ease transition to negotiated commissions.

2. LAPR and SD help to swing balance back from institutions to individuals. Only new life policies affected. ~~Many~~ People will still ~~save~~ take out ~~with life offices~~ options ~~out of convenience.~~ ~~[Satisfied it will not endanger any company's solvency.]~~

3. [CCD. VAT substitute - but well below rate of VAT. Does not start until July 1985.]

4. CT package effect on leasing: bonanza year or two followed by substantial reduction, but not extinction. Financial sector net gainer from lower CT rates and NIS.

5. Composite rate. Welcome new competitiveness of building societies but they must have equal treatment with banks. Non-taxpayer can still get interest paid gross from DNS.

6. Corporate bond package reduces recourse to banks and strengthens balance sheets.

7. Share options: will help the small company attract entrepreneurial executives. Both postpones and reduces tax for option holder. All-employee schemes also improved with increase in limit on SAYE-linked options. not just small

8. ~~Net cut in company taxation shouldhelp equity prices.~~

9. See also Economic Correspondents' briefing.

[illegible] MATT

POPULAR PRESS

Method

Lobby

Message

1. A budget for incentives and for jobs.

2. Legislates for future tax cuts.

3. Simplifies tax system.

4. ~~Not a Budget for the rich.~~

[illegible] changes will encourage [illegible] investment.

5. ~~Ending first year allowances will not discourage productive investment, only unproductive.~~ (Abs, [illegible])

VAT on [illegible]

6. ~~PAS abolition~~ reduces unfair advantage to importers.

7. (Consumer Credit Duty equivalent to only /¼%/ on rates at which consumers can borrow; does not affect mortgages eligible for IT relief. A VAT substitute - not right to tax e.g. clothes and leave financial services untaxed.)

8. LAPR removal will not detract greatly from genuine life assurance element: general insurance flourishes. Puts savings element on all fours with saving by individuals.

9. Foreign earnings relief: goes as much to energetic importers as exporters; has become a blatant tax planning device; introduced when rates were much higher.

10. See also briefing for backbenchers.

TV AND RADIO

Chancellor's Budget Broadcast
Special Correspondents as above.
EST on 'Money Box'?

ENERGY CORRESPONDENTS

Briefing from officials with DEn ?

INDUSTRIAL ORGANISATIONS

Budget day briefing on CT package to CBI, IoD., ABCC, BIM. Also accountancy bodies ?

BREWERS

Courtesy letter from Chancellor informing them of his decisions vis-à-vis European Court judgement ?

FROM: M E Corcoran
DATE: 27 February 1984

PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Bailey
Mr Littler
Mr Cassell
Mr Byatt
Mr Anson
Mr Unwin
Mr Kemp
Mr Monck
Mr Battishill
Mr Monger
Mr Evans
Mr Odling-Smee
Mr Lankester
Mr R I G Allen
Mr Folger
Mr Hall
Mr G P Smith
Mr Norgrove
Mr Makeham
Mr Portillo
Mr Ridley
Mr Lord

Sir Lawrence Airey } Inland Revenue
Mr Isaac
Mr Blythe

Mr Fraser } Customs & Excise
Mr Wilmott

PRESENTATION OF BUDGET MEASURES

On re-reading his minute of 24 February - and in particular the first sentence of paragraph 4 - the Minister of State finds it gives too gloomy a view. He has commented that the latest proposals for a substantial real increase in tax thresholds more than matches the "real" increases in indirect taxes as is shown by the latest score card - an overall gain of some £450 million by individuals in 1984/85 and £150 million in 1985/86 (table 5). He has further commented that this gives an excellent "bull point" which must be exploited to the full.

I agree

NEW MST

I am taking this opportunity to circulate to those who have not seen it, a copy of Mr Wilmott's note of 24 February on international comparisons of VAT.

MEC

M E CORCORAN
Private Secretary

BUDGET SECRET

H.M. CUSTOMS AND EXCISE
KING'S BEAM HOUSE, MARK LANE
LONDON, EC3R 7HE
01-626 1515

MB 24 FEB 1984 -29.

From: P G WILMOTT
Date: 24 February 1984

MINISTER OF STATE

cc Sir P Middleton
Sir T Burns
Mr Monger
Mr Battishill
Mr Folger
Mr Hall
Mr Portillo
PS/IR

PRESENTATION OF BUDGET MEASURES : VAT AND EXCISE DUTIES (INTERNATIONAL COMPARISONS)

I attach the tables on international comparisons on VAT referred to in my note of 23 February.

On building services the position is satisfactory. Only Ireland taxes alterations at a reduced rate (5 per cent, not zero); the other Member States with a VAT tax them at their standard rate. The same is true of repairs and maintenance. We shall therefore clearly be coming into line with the majority of our partners.

On printed matter the situation is a little more complicated. Denmark and Italy zero rate papers. Presentationally this is particularly awkward in the case of Denmark, as their standard rate of 22% applies otherwise to virtually all taxable expenditure. We do not know what the reasons for these zero rates are, but suspect that straightforward subsidy, plus cultural, regional and linguistic considerations all have a part to play. Indeed, no Member States taxes papers at the standard rate, although the Irish rate of 23 per cent (technically a 'reduced' rate) is higher than our standard rate. The picture on magazines and books is similar, with a zero rate in Italy for some periodicals and in Ireland for books. Only Denmark applies the standard rate. The situation on advertisements and news services is more straightforward, with standard-rating the rule rather than the exception.

On take-away food the situation is again complicated. The concept of 'take-away' is generally not as well developed on the Continent as here, and most of the foreign legal texts available to us do not distinguish it as such. For obvious reasons we have not approached the embassies or administrations of the countries concerned for confirmation of our understanding of their law, and the table gives our best current interpretation of the situation. Where two rates are shown, it is because we think taxation varies with the nature of the food supplied (eg higher rates for 'luxury' foods). Regrettably the picture differs slightly in some aspects

Internal distribution: CPS, Mr Knox, Mr Freedman, Mr Jefferson Smith, Mr Battle from that given in your recent written answer to Mr Speller MP; this is because our further research has led us to take a different view about liability in some countries. Overall, though, it is clear that take-away food is taxed at a positive rate in all Member States (including Ireland, which zero-rates food), and in two cases (Denmark, Italy) invariably at the standard rate.

The main presentational problems are likely to arise therefore on newspapers, magazines and take-away food. Most countries give some relief through applying reduced rates. This course is not open to us without the introduction of a multi-rate VAT structure. Whether this point is used in argument will depend among other things on the view taken about the possible future development of VAT in this country.

P.G.W

P G WILMOTT

COMPARISON OF VAT RATES IN OTHER MEMBER STATES(1)

	NEWSPAPERS	MAGAZINES	BOOKS	ADVERTISEMENTS	NEWS SERVICES
BELGIUM	6	6	6	19	19
DENMARK	0(2)	22	22	22	22
FRANCE	2.1, 7(3)	7(4)	7(4)	18.6	7,18.6(5)
GERMANY	7	7(5)	7(6)	14	14
IRELAND	23	23	0	35	23
ITALY	0(7)	0,2,18(8)	2	18	EXEMPT
LUXEMBOURG	6	6	6	6	12
NETHERLANDS	5	5(9)	5	5(9)	EXEMPT

(1) Excluding Greece, which has not yet introduced VAT.

(2) For VAT purposes newspapers are defined as papers published at least once a month with an editorial content of 15% or more. Other publications are taxed at 22%.

(3) 2.1% effective rate applies only to dailies and national weeklies of a political nature.

(4) Pornographic publications and those inciting violence are subject to the increased rate of 33⅓%.

(5) 7% for press agencies, otherwise 18.6%.

(6) Publications which are deemed unsuitable for minors (i.e. pornographic and publications featuring excessive violence) are taxable at the standard rate of 14%.

(7) Applies only to daily newspapers.

(8) Zero for the supply of "periodicals and publications registered as such" costing not more than 8,000 lire and sold by persons other than the editor; 2% for "periodicals with a primarily trade-union, cultural, religious or sporting nature; others 18%.

(9) 5% rate applies to publications appearing at least three times a year and to advertisements in such publications. Otherwise the standard rate applies (19%)

VAT ON CONSTRUCTION, ALTERATION, REPAIRS AND MAINTENANCE[1]

	CONSTRUCTION OF NEW BUILDINGS BY PROFESSIONAL	ALTERATIONS	REPAIRS AND MAINTENANCE
BELGIUM	17	17	17
DENMARK	22	22	22
FRANCE	18.6	18.6	18.6
GERMANY	EXEMPT[2]	14	14
IRELAND	5	5	5
ITALY	2, 10, 18[3]	18	18
LUXEMBOURG	12	12	12
NETHERLANDS	19	19	19

(1) Excluding Greece, which has not yet introduced VAT.

(2) Germany has a derogation from the EC Sixth Directive. The supply of new buildings is exempt, but subject instead to the Immovable Property Acquisition Tax ("Grunderwerbsteuer"). However, an entrepreneurwho is selling to another entrepreneur may waive the exemption, in which case the tax rate would be 14%.

(3) 2% for public residential buildings; 10% for "low-priced" dwellings; 18% for others

VAT ON TAKE-AWAY FOOD - EC COMPARISON(1)

	VAT RATE
BELGUIM	6, 25
DENMARK	22
FRANCE	5.5
GERMANY	7, 14
IRELAND	23
ITALY	18
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NETHERLANDS	5, 19

(1) Excluding Greece, which has not yet introduced VAT

COPY NO. 1 OF 32

FINANCIAL SECRETARY TO THE TREASURY

FROM: A P HUDSON
DATE: 27 February 1984

PRINCIPAL PRIVATE SECRETARY

cc Chief Secretary
Minister of State
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Bailey
Mr Littler
Mr Cassell
Mr Byatt
Mr Anson
Mr Unwin
Mr Kemp
Mr Monck
Mr Battishill
Mr Monger
Mr Evans
Mr Odling-Smee
Mr Lankester
Mr Folger
Mr Hall
Mr Norgrove
Mr Makeham
Mr Portillo
Mr Ridley
Mr Lord

Sir L Airey } IR
Mr Painter

Mr Fraser } C&E
Mr Wilmott

NEW FST

PRESENTATION OF BUDGET MEASURES

1. The Financial Secretary has done some more work on his allocation over the weekend.

New material

2. I attach a substitute version of the Financial Secretary's 24 February minute. A piece on the strucutre of personal taxes is now attached, and I am sorry this was not attached to the earlier minute. It is the only completely new material.

Where?

Next steps

3. Subject to discussion tomorrow morning, the Financial Secretary proposes to augment and refine the material in these areas, at least:

a. VAT registration threshold;

b. small companies;

c. unincorporated businesses;

d. international comparisons on corporation tax & capital allowances.

4. He will also work up, with officials, summary sheets of the arguments on each measure, and in particular precisely which groups need to be contacted, how, and at what time.

Correction

5. I am afraid there is one correction to be made in the background material to the Financial Secretary's minute, the annexes originally circulated by Mr Monck on 22 February. In the Annex on capital allowances, page 4, paragraph 15, the sentence on Films should read "Expenditure on British Films to be entitled to first-year capital allowances beyond 1987."

APH

A P HUDSON

FROM: M E Corcoran
DATE: 27 February 1984

PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir Peter Middleton
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Private Secretary

BUDGET SECRET

H.M. CUSTOMS AND EXCISE
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LONDON, EC3R 7HE
01-626 1515

MB 24 FEB 1984 -29.

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Date: 24 February 1984

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cc Sir P Middleton
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Mr Hall
Mr Portillo
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P G WILMOTT

BUDGET SECRET

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BUDGET SECRET

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NETHERLANDS	5, 19

(1) Excluding Greece, which has not yet introduced VAT

2.52

BUDGET SECRET

CH/EX REF. NO. B(84) 336

FROM: MISS J C SIMPSON

DATE: 28 February 1984

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Mr Ridley
Mr Lord

MR PORTILLO

PRESENTATION OF BUDGET MEASURES: BACKBENCH OPINION

The Chancellor has seen and was grateful for your minute of 24 February. He has amended the PSBR section, to suggest that David Crouch should be recorded as in favour of the PSBR proposals, and Stephen Dorrell and Fred Silvester as thinking the PSBR should be higher. He has also queried whether Charles Morrison should really be recorded as in favour of the CTT proposal.

2. More generally, he has also commented that the Budget will need to be presented as helping business and industry, and attention directed to the 1985-86 score-card. The listings you have produced here rather imply the reverse.

JS

MISS J C SIMPSON

BUDGET SECRET

FROM: A P HUDSON
DATE: 28 February 1984

MR PORTILLO

cc Chancellor
Chief Secretary
Minister of State
Economic Secretary
Mr Ridley
Mr Lord

PRESENTATION OF BUDGET MEASURES: BACKBENCH OPINION

1. The Financial Secretary has seen your 24 February minute.

2. There are two areas where he would like to add to the list.

a. Holiday lettings

I attach a list of some backbenchers who will be coming to see the Financial Secretary this afternoon, and other who are sympathetic.

b. Petrol duty

Most Scottish Tory MPs have talked privately.

APH

A P HUDSON

The Rt. Hon. Sir Peter Blaker, KCMG MP

HOUSE OF COMMONS
LONDON SWIA OAA

TAXATION OF FURNISHED HOLIDAY LETTINGS

Members of deputation to John Moore on Monday, 27th February

Sir Peter Blaker ✓
Roger Gale ✓
David Gilroy Bevan ×
Lord Cranborne ✓
Robert Adley ×
Robert Hicks ×
Patrick Nicholls ✓
David Harris ✓
Sir Michael Shaw ✓
Norman Miscampbell ✓
Barry Henderson ✓
Sir Anthony Meyer ✓
Sir Walter Clegg ✓
Robin Maxwell-Hyslop ✓

Supporters (not necessarily complete)

Alex Pollock
Albert McQuarrie
David Mudd
Gerry Neale
Barry Porter
John Townend
Sir Ian Percival
Kenneth Warren
Robert Banks
Hon.Mark Lennox-Boyd
Sir Frederic Bennett
Bill Walker
John Ward
Hector Monro
Peter Emery
David Atkinson
Keith Best
Michael Brown
John Hannam
John Butterfill
Michael Jopling

BUDGET - SECRET

FROM : M D X PORTILLO
DATE : 28 FEBRUARY 1984

MISS SIMPSON

c/ See also FST's minute below. B

cc PS/CST
PS/FST
PS/MST
PS/EST
Mr Ridley
Mr Lord

PRESENTATION OF BUDGET MEASURES : BACKBENCH OPINION

Thank you for your minute of today. The Chancellor is undoubtedly correct in re-classifying Mr Fred Silvester as one who believes that the PSBR should be higher. However, Mr David Crouch is recorded (by Rodney Lord in his minute of 9 February 1984) as wanting a higher PSBR. As I understand it, Mr Stephen Dorrell's position is that during recession the PSBR should rise. As a corollary to that, he believes that in the present recovery the PSBR is about right. What he is afraid of is that the MTFS will limit the Chancellor's flexibility in moving to a higher PSBR if and when the recovery falters.

2. Mr Charles Morrison is recorded (in Mr Ridley's minute of 13 February) as "wishing to see some changes in the CTT and its impact on horse owners". It was on that basis that I thought he might welcome the revision of the CTT threshold.

MP

M D X PORTILLO

BUDGET - SECRET

CH/EX REF. NO. B(84) 358

FROM: MISS J C SIMPSON

DATE: 29 February 1984

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Mr Ridley
Mr Lord

PMP

MR PORTILLO

PRESENTATION OF BUDGET MEASURES: BACKBENCH OPINION

The Chancellor has seen and noted your further minute to me of 28 February. He has also seen Mr Hudson's minute to you of the same date.

JS

MISS J C SIMPSON

(pup)

CHIEF SECRETARY TO THE TREASURY

FROM: JOHN GIEVE
DATE: 2 March 1984

MR ISAAC

cc PPS
Financial Secretary
Mr Monger
Mr Allen
Mr Portillo
Mr Ridley
Mr Battishill
Mr Folger
Mr Lovell
Mr Hall
PS/Inland Revenue

PRESENTATION OF THE BUDGET

I understand that at yesterday's meeting, Ministers were generally content with the proposals in the Chief Secretary's minute of 24 February but that concern was expressed about the need for a full defensive brief and relevant figures for the effects of the Budget on agriculture.

2. Please would you set in hand urgently the preparation for such a brief in consultation with IA Division here and Mr Ridley. More generally, the Chief Secretary is looking forward to the further material requested in my minute of 24 February to you.

JG

JOHN GIEVE

pup

BUDGET: SECRET

COPY NO 1 OF 24 COPIES

FROM: ADAM RIDLEY
5 March 1984

E 3

MISS SIMPSON

cc CST
FST
MST
EST
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Monck
Mr Battishill
Mr Lankester
Mr Monger
Mr R I G Allen
Mr Folger
Mr Hall
Mr Portillo
Mr G P Smith
Mr Martin
Mr Norgrove
Sir L Airey }
Mr Green } I/R
Mr Isaac }
Mr Fraser }
Mr Knox } C&E

BUDGET PRESENTATION: BUSINESS SECTOR ISSUES

The last item in the conclusions of the Chancellor's meeting of March 1 which you circulated on March 2 records that I am to consider what press release(s) would be needed beyond the standard ones on particular tax measures. I have discussed this at some length with Messrs Folger and Allen, and it may be helpful to others if I note what seems to us to be the best way to proceed:

(1) The basic need now is to prepare a fairly all-embracing release which sets out the philosophy and reasoning behind the measures proposed for business and enterprise, and then goes on to explain how the main measures fit in with that approach.

(2) This will have to be started de novo, though obviously it will draw on the many valuable bits of work to hand, such as the draft press release at the back of the Financial Secretary's minute of February 24 to the Chancellor on

presentation, and the material in the front part of the Economic Secretary's piece of the same date, and the (shortly-to-be-circulated) first draft of EB's overall Budget Brief.

(3) In addition nearly every other piece of work commissioned at last Thursday's meeting will be relevant to this exercise. [Can copy recipients please keep Messrs Folger, Allen and myself in touch with their work as it progresses? Even rough first drafts will be very helpful.]

(4) It will not be possible for me at this stage to devote much time to considering whether further press releases might be called for beyond this special general one. I shall assume that EB, CU and appropriate ministerial private offices are keeping a close eye on this issue. However it would be most helpful if I could be sent drafts of business-related press releases as they emerge during the week.

2. Mr Allen and I would hope to be able to submit a very rough first draft to the Chancellor and others tomorrow night so that we can establish clearly agreement on how to proceed later in the week, when the Chancellor himself will be pre-occupied with the speech.

AN

A N RIDLEY

BUDGET SECRET

COPY NO 27 OF 27 COPIES

CH/EX REF NO B(84)414

FROM: MISS J C SIMPSON

DATE: 2 March 1984

(PW)

SIR T BURNS
SIR L AIREY
MR FRASER
MR MONCK
MR GREEN (IR)
MR ISAAC (IR)
MR KNOX (C&E)
MR MONGER
MR RIDLEY
MR HALL
MR PORTILLO

cc Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir P Middleton
Mr Cassell
Mr Battishill
Mr Lankester
Mr Folger
Mr R I G Allen
Mr G P Smith
Mr Martin
Mr Norgrove

ACTION ARISING FROM A MEETING HELD IN HM TREASURY ON THURSDAY 1 MARCH TO DISCUSS THE PRESENTATION OF THE BUDGET

A Corporate Sector

1. More work was needed to develop the argument that "investment profitability" was as important and valid as the traditional concept of "labour profitability".
[Sir T Burns]

2. Arguments and, if possible, examples should be prepared to refute claims that the revised pattern of capital allowances would lead to the abandoning of worthwhile projects.
[Mr Monck, consulting DTI as necessary]

3. Figures should be worked up to prove that the manufacturing sector would be a net gainer from the measures and that its interests were not being subordinated to those of the service sector.
[Mr Monck]

4. The presentation of the timing balance between the revised capital allowances and the reduced CT rate needed further thought.
[Mr Monger]

5. Examples of the effects of the corporation tax measures should be provided, but not on the basis of the "tax wedges" approach used by the IFS and in some earlier discussions.
[Mr Green (IR)]

6. More work was needed to develop the theme that high profitability was the key to a buoyant economy cf the present position in the US.
[Sir T Burns]

7. Figures should be prepared to show the corporate sector had benefitted from the abolition of NIS, compared to the reduction in income tax which would have been possible otherwise.
[Mr Monger]

8. Figures were required on international comparisons on
(a) rates of tax on company profits overseas;
(b) rates of return on investment.
[Mr Monger]

9. The effects of the package on farmers needed to be explored urgently, and defensive briefing prepared.
[Mr Isaac]

B Personal Sector

10. More thought needed to be given to the defence of the extension of the VAT base. General impressions would be more valuable here than precise figures.
[Mr Fraser]

11. Specific figures were required for the number of widows taken out of tax by the increase in thresholds.
[Mr Isaac]

12. More work was required generally on the identification of the gainers and losers.
[Mr Monger]

13. A reassuring form of words needed to be devised for defensive response to questions like "what is the next candidate in extension of the VAT base". But this should not close any doors to future action.
[Mr Knox]

14. Precise information about foreign practice on LAPR was needed urgently.
[Mr Isaac]

C Financial Sector

15. Figures should be provided for the IR manpower savings from the introduction of the composite rate, including those that would otherwise be added by payment of interest on current accounts and the (hypothetical) cost of removing the composite rate from the building societies.
[Sir L Airey]

16. Proposed measures on foreign earnings would affect individuals particularly; they would be bound to arouse opposition and therefore detailed defensive briefing should be prepared.
[Mr Isaac]

17. A firm line on tax treatment of pensions (next candidate for reform?) was needed.
[Mr Monger]

D General

18. A list of individuals and organisations who would be prepared to come out in support of the Budget should be compiled, and steps taken to mobilise them to

speak out at a suitable time.
[Mr Portillo]

19. A checklist should be prepared of things to be done after the Budget: a possible schedule for Ministerial meetings with key groups (including industry)
[Mr Battishill]

20. A checklist of key themes to establish in the first couple of days post-Budget.
[Mr Hall]

21. Consideration to be given to the press releases that would be necessary (beyond the standard tax etc ones).
[Mr Ridley]

JS

MISS J C SIMPSON

COPY NO 2 OF 17 COPIES

From P Pegler
Date 5 March 1984

BUDGET CONFIDENTIAL

cc PS/Chancellor
PS/Minister of State
PS/Financial Secretary
PS/Economic Secretary
Mr Monger
Mr Allen
Mr Portillo
Mr Lord
Mr Isaac
Mr Painter
Mr Blythe
Mr Mace
Mr Driscoll
PS/IR

MR BLYTHE (IR)

PRESENTATION OF THE BUDGET

The Chief Secretary was most grateful for the historical notes on the Investment Income Surcharge and the foreign emoluments deductions and the foreign earnings reliefs attached to your minute of 2 March.

P PEGLER

BUDGET CONFIDENTIAL

B(84)425

BUDGET SECRET

FROM: A M ELLIS
DATE: 5 March 1984

MR CASSELL

MR RIDLEY

MR HALL

MR MARTIN

cc PS/Chancellor)
Mrs Lomax)
Mr Allen) without attachments
Mr Folger

FINANCIAL SECTOR: PRESENTATION OF BUDGET MEASURES AND BUDGET SPEECH

You are meeting the Economic Secretary at 3 o'clock this afternoon to discuss the presentation of Budget measures and the content of the Economic Secretary's winding speech during the Budget debate. The relevant paper is Mrs Lomax's, covered by her minute of 29 February, which she will be revising in the light of last Thursday's overview meeting and the Economic Secretary's comments this afternoon.

Additionally, the Economic Secretary asked for details on each of the specific measures affecting the financial sector. Mrs Lomax
... and I have put together the attached notes, some of which were specifically commissioned, but all of which you will have previously
... seen. I attach them simply for ease of reference in case the Economic Secretary refers to them in this afternoon's discussions. The relevant material will be incorporated into Mrs Lomax's revised paper.

AE

A M ELLIS

Morck → Chilcx

2/3

– smu / naslall

[o Tax bulset

mm → sm

5/3.

BUDGET SECRET

FROM: A M ELLIS
DATE: 6 March 1984

MR ISAAC - IR
MR LANKESTER
MR BRYCE - IR
MRS LOMAX
MR WATTS
MR WILLETTS
MR RIDLEY
MR PORTILLO

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
Sir P Middleton
Mr Cassell
Mr Battishill
Mr Folger
Mr R I G Allen
Mr Hall
Mr G P Smith
Mr Martin
Mr Norgrove

BUDGET PRESENTATION AND WINDING SPEECH: FINANCIAL SECTOR

The Economic Secretary held a meeting to discuss the presentation of Budget measures affecting the financial sector in the light of last week's Overview meeting.

2. It was agreed that Mrs Lomax's minute of 29 February should be re-drafted to corporate the comments made at the meeting. [Mrs Lomax].

3. It was agreed that Section V (handling post-Budget presentation) should be detatched from the paper and that Mr Portillo, in the context of his consideration of "bodies and persons to be contacted" (Mr Portillo's minute of 2 March) should also consider how best to contact them, drawing on the suggestions in Section V. [Mr Portillo]

4. In addition to the factual material already gathered on impact of Budget measures on the financial sector, the Economic Secretary asked for details on the following five items:

i. LAPR: the precise criteria for qualification for premium relief under current legislation; the precise criteria for qualification after the Budget; an account (quantified where appropriate) of factors that have led to a growth of non-qualifying life assurance business; a list of specific interest groups (eg independent schools) whose interests will be directly affected by the proposals; any information on the claim by the LOA reported in Saturday's Times that the IR had given a commitment that "there would be a year's notice of any change in the rate". [Mr Isaac]

ii. Capital Markets:a list of the measures the Government has already taken to improve capital markets in recent years together with a brief (and where appropriate quantified) note of recent developments in capital markets; [Mr Willetts]

iii. LIFFE:a note, containing defensive briefing and background, on all the Budget measures affecting LIFFE, as soon as decisions are taken on Mr Bryce's minute of 1 March; [Mr Bryce]

iv. Leasing:a quantative analysis of the leasing market by customer and dealer; [Mrs Lomax]

v. Interest Rates:a list of current interest rates in the personal savings sector (building societies media; national savings instruments and bank deposit accounts and interest bearing **current** accounts); [Mr Watts].

Budget Debate

5. Although it is not certain whether the Financial Secretary of the Economic Secretary will wind on the second day of the Budget Debate, it was agreed that the material in the revised version of Mrs Lomax's

paper should be worked up into "building blocks" suitable for incorporation into a winding speech. [Mr Lankester, Mrs Lomax].

6. The Economic Secretary would be grateful for this material (with the exception of that in paragraph 4iii and paragraph 6) by close of play Thursday.

AE

A M ELLIS

10-33

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pwp

FROM: P MAKEHAM
DATE: 9 MARCH 1984

cc Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir Peter Middleton
Sir Lawrence Airey
Mr Fraser
Sir Terence Burns
Mr Littler
Mr Bailey
Mr Byatt
Mr Cassell
Mr Monck
Mr Evans
Mr Lovell
Mr Monger
Mr Odling-Smee
Mr Ridley
Mr Hall
Mr Lord
Mr Crawley
Mr Portillo

Note below.

1. MR BATTISHILL

2. CHANCELLOR OF THE EXCHEQUER

'Draft' letters for Annex 2

Check with R Dawson? N.

BUDGET PRESENTATION

I attach a possible schedule for meetings and other contacts with key groups and individuals to provide a basis for a concerted programme of action after the Budget. I have drawn on the list of contacts drawn up by Mr Portillo.

2. There appear to be two objectives. First, to influence the immediate response which will be reported by the media. Second, to influence the more considered views of key groups.

3. There are some people who should be contacted immediately after the Budget speech. A suggested list of those to be approached is given in Annex 1 and includes:

- personal (telephone) contact with individuals who may favour reforms and who could be quoted in the Press

[illegible]

- contact with key industrialists, who are representative of the most influential groups, to invite them to post Budget meetings. Arrangements are already in hand to provide a brief for the CBI which Mr Monck is submitting this evening, and for the Financial Secretary to write to North Sea Oil groups. A brief for the IOD could also be prepared. More

below

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extensive briefing for the North Sea Oil groups should be considered to forestall criticism of the effect of CT changes.

4. Meetings and contacts with other important representative groups could be initiated in Budget week. The groups which should be seen together with possible Ministerial coverage are indicated in Annex 2. We are also trying to identify high corporation taxpayers who would be likely to welcome the package.* Ministerial meetings with selected MPs with Ministers could perhaps be supplemented by the PPSs and Advisers contacting other members. There may be some advantage in officials contacting the IFS (who have a link with the Economist) to brief them immediately after the Budget on the effects of the company tax measures.

*Now attached, Annex 5.

5. Speaking engagements will provide an opportunity to present Budget themes and respond to criticisms. The current speech programme is set out in Annex 3 and details of non-Treasury Minister speaking engagements in Annex 4:

- you are addressing the Conservative Central Council (24 March) and Manchester Industrialists/Lennox-Boyd constituency (30 March);
- we suggested previously that IFS might be approached to provide a suitable platform for a speech [on the long term public expenditure Green Paper;] ?
- the FST has three speaking engagements just after the Budget and the CST and MST have engagements in the week starting 26 March;
- you may wish to consider approaching some non Treasury Ministers about the possibility of including Budget themes in speeches on which officials could provide briefing. Mr Monck is already supplying briefing to Mr Jenkin for a speech on 15 March. Other possible suitable occasions include Mr Jenkin's visit to Liverpool on 16 March, Mr Tebbit's speech to the Finance Houses Association on 27 March, and perhaps one of Mr King's March engagements.

6. IDT will be putting up a submission on media arrangements.

Peter Makeham

P MAKEHAM

Potentially this is a pretty extensive programme of contacts, and you will want to discuss with other Treasury Ministers how to divide up the targets between you. But I hope the suggested programme, on which we have had considerable help from Mr Portillo, provides the basis for a discussion on Monday.

AMWB

A M W BATTISHILL

ANNEX 1

CONTACTS IMMEDIATELY AFTER THE BUDGET

	Name	Form of contact	By whom
1.	**People who may favour reforms**		
	Lord Weinstock	Telephone	Chancellor
	Sir Clive Sinclair	Telephone	FST
	Eddie Ray (Spicer and Pegler)	Telephone	Mr Issac - IR
Who knows him?	George Copeman (Wider Share Ownership Council)	Telephone	FST/EST
	Sir Hector Laing	Telephone	FST(EST) [illegible].
	Peter Gifford (Country Landowners Association)	Telephone	CST
2.	**Most influential groups**		
	CBI		
		Meeting to be offered by Chancellor's office at end of Budget speech	Chancellor's office
	Sir Campbell Fraser Sir Terry Beckett Sir James Cleminson Ken Durham (Chairman Economic Committee)	In addition consider personal contact with selected CBI members	?Chancellor
	Institute of Directors		
		Meeting to be offered by Chancellor's office at end of Budget speech)	Chancellor's office
	Walter Goldsmith Bruce Sutherland Barry Bracewell-Milnes	In addition consider personal contact with selected IOD members	Chancellor FST/EST
	Graham Mather	Telephone	Mr Portillo

4. City and other contacts

Sam Brittan	Chancellor
Lord Harris?	Chancellor
Gordon Pepper	Officials ?Sir P Middleton
Paul Neild	Officials ?Sir T Burns
Tim Congdon	Officials ?Sir T Burns

ANNEX 2

CONTACTS AFTER BUDGET DAY

[Ren will ch.!

Group	Minister
1. Meetings with other representative groups	
Life Offices Association	Chancellor
Industrial Life Offices Association	Chancellor
[British Insurance Association]	
Association of British Chambers of Commerce	CST
EEF	Chancellor
NFBTE	CST
London Clearing Banks	FST/EST
Consultative Committee of Accountancy Bodies	FST/EST
Union of Independent Companies	FST
Association of Independent Businesses	MST
National Federation of Self Employed	MST
Building Societies Association	EST
Friendly Societies Liaison Committee	EST
[SMMT - asked for post Budget meeting: wait to see if they follow up]	

2. Telephone contacts with individuals

Stock Exchange - Sir Nicholas Goodison	Chancellor
Dr Herman Hauser - Acorn Computers	FST
Lord Hanson	FST or EST
Sir John Sparow	EST or FST
Sir Kenneth Bond	FST

3. MPs

To be contacted personally

Edward du Cann	Chancellor
Terence Higgins	Chancellor
Sir William Clark	Chancellor
David Howell	Chancellor
Peter Hordern	Chancellor
Cecil Parkinson	Chancellor
Nick Budgen	CST or MST
Anthony Beaumont Dark	CST or MST
John Browne	CST or MST
Roger Freeman	CST or MST
Ralph Howell	CST or MST
John Townend	CST or MST
Michael Grylls	FST or MST
Tim Eggar	FST or EST
Peter Lilley	FST or EST
Nigel Forman	FST or EST
John Hannam	FST or EST
William Powell (Corby)	Special Adviser telephone contact
Lord Bruce Gardyne	Chancellor
John Selwyn Gummer?	Chancellor

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North Sea Oil interests

UKOOA	Letter arranged	FST
	Background brief by telephone?	IR or Mr Portillo
	Meeting?	FST
BRINDEX UKIOTC	Copy of letter to UKOOA	FST
	Background brief by telephone?	IR

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ANNEX 3

MINISTERIAL SPEAKING ENGAGEMENTS AS AT 8 MARCH 1984

DATE 1984	MINISTER CHX	OTHERS	OFFICIAL SPEECHES AND MEDIA APPEARANCES*	PARTY SPEECHES
MARCH				
Week 12-18				
Tues 13	CHX		**Budget**	
Thurs 15	CHX		*Jimmy Young	
Sat 17		FST		Esher C A
Sun 18	CHX		*Weekend World	
Week 19-25				
Wed 21		FST	Westminster Ind Brief	
Thurs 22		FST	Croydon Soc Ch Acc	
Sat 24	CHX			Cons Central Council
Week 26-01 Apr				
Wed 28		CST		Carshalton CA
Fri 30		MST	Devon Soc of Accountants	
Fri 30	CHX		Manchester Industrialists	
Fri 30	CHX			M Lennox-Boyd MP
APRIL				
Week 2-8				
Tues 3	CHX		1900 Club	
Wed 4		CST		Cons Small Business
Fri 6	CHX		British Shoe Corp	
Fri 6	CHX			Claybrooke Rectory
Week 9-15				
Mon 09	CHX		**Internat. Assoc. Energy Economists**	
Tues 10		FST	Assoc Ec Reps London	
Tues 10		MST	Drinks Marketing Club	
Wed 11		CST	Royal Coll Defence	
Thurs 12		CST		Cons Ind Fund
Thurs 12		FST		Pimlico C C
Week 16-22				
Mon 16	CHX			CPC (City)
Tues 17		FST	IOD	
Wed 18	CHX		EEF	
Week 23-29				
Week 30 - 6 May				
Mon 30		CST		Westminster YC

ANNEX 4

FROM: MISS M O'MARA
DATE: 8 March 1984

MR MAKEHAM

cc Mr Battishill

NON-TREASURY POST-BUDGET MINISTERIAL SPEECHES

You asked if I could discover whether those of the Chancellor's colleagues most directly affected by the Budget were making any major speeches in the immediate post-Budget period. The position is as follows:

Secretary of State for Trade and Industry

27 March-speech to Finance Houses Association

Secretary of State for the Environment

15 March-speech at Placemakers Luncheon (Mr Monck is already supplying briefing)

16 March-Liverpool tour. Speech to a group of Liverpool businessmen.

20 March-speech to Central and Local Government Show

Secretary of State for Employment

14 March-speech to Conservative Women's National Committee
22 March-speech to Women's National Commission Conference
29 March-speech to Westminster Chamber of Commerce

Secretary of State for Energy

14 March-speech to Industrial Council for Wales

20 March-speech to Midland Industrialists' Advisory Council

21 March–speech to All Party Group for Energy Studies

2. We are also trying to establish whether the Home Secretary has any speaking engagements in the near future for which he is likely to pick an economic theme. I will let you know when we hear from his office.

MOM

MISS M O'MARA

ANNEX 5

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C J Farrow
Assistant Director

01-601 4657

BANK OF ENGLAND
Threadneedle Street
London
EC2R 8AH

9 March 1984

N J Monck Esq
H M Treasury
Parliament Street
London SW1P 3AG

Dear Nick,

As agreed I enclose two schedules which we have compiled from Datastream:-

1 Large companies which pay large amounts of Corporation Tax, tabulated to include an effective tax rate;

2 Large companies with irrecoverable ACT, which may be assumed not to benefit from a reduction in CT. In some cases the companies have substantial other tax liabilities. Where the ACT liability appears to result from double-taxation relief on overseas earnings this has been noted.

Yours

Kit

COMPANIES WHO PAY CORPORATION TAX OF OVER £10m LAST YEAR (after double tax relief)

COMPANY NAME	LATEST PRICE	MARKET VALUE	TOTAL SALES	PRE-TAX PROFITS INC. ASSOCS	*CORPORATION TAX	DOUBLE TAX RELIE	NET CT / PRE-TAX PROFITS %
BRIT. PETROLEUM	425.0	7749.5	34583.0	2305.0	338.0	241.0	4.2%
GENERAL ELEC.	186.0	5102.9	4626.0	670.4	223.6	7.4	32.2%
MARKS & SPENCER	241.0	3171.9	2505.5	237.4	78.6		33.1%
CONSD. GOLDFIELDS	597.0	1117.2	760.4	89.7	73.3	48.1	28.1%
UNILEVER	925.0	1693.4	13215.7	761.5	73.0	45.5	3.6%
PLESSEY	226.0	1633.1	1074.8	146.6	68.5	7.7	41.4%
IMPERIAL GROUP	144.0	1040.8	4381.5	188.8	68.0	0.9	35.5%
DISTILLERS	257.0	933.3	1127.2	209.1	67.1	3.8	30.3%
BASS	326.0	1053.0	1988.4	161.4	60.6		37.5%
GRAND METROPLTN.	348.0	2109.6	4468.8	295.3	49.9	4.2	15.5%
GLAXO HLDGS.	807.0	2970.9	1027.5	192.7	47.9	3.7	22.9%
RACAL ELECTRONIC	210.0	1122.7	762.2	114.3	44.7		39.1%
ALLIED-LYONS	154.0	997.5	2176.0	144.6	44.2	7.7	25.2%
SEARS HOLDINGS	83.0	1116.9	1596.7	110.1	43.4	1.1	38.4%
BOOTS	163.0	1185.4	1670.0	125.6	41.7	3.9	30.1%
RIO TINTO-ZINC	657.0	2027.7	3680.4	341.0	40.4	17.6	6.7%
GT. UNIV. STORES	598.0	1476.9	2037.6	201.4	37.2	8.3	14.3%
PILKINGTON BROS	300.0	508.3	1021.6	76.0	36.1	22.1	18.4%
ASSD. DAIRIES GRP	150.0	981.6	1519.1	78.4	35.1		28.8%
THORN EMI	657.0	1147.7	2715.9	122.0	31.6		25.9%
CABLE & WIRELESS	343.0	1543.5	403.3	146.2	28.3	13.7	10.0%
TARMAC	482.0	654.1	988.4	68.7	27.8		40.5%
REED INT.	412.0	487.2	1809.0	74.1	25.0	1.2	32.1%
SAINSBURY, J	478.0	1650.6	2305.9	100.2	24.8		24.7%
HAWKER SIDDELEY	398.0	784.3	1407.0	123.0	24.8	2.2	18.4%
STD. TEL. & CABLES	328.0	1066.0	628.5	61.3	24.0	0.0	39.2%
WHITBREAD 'A'	148.0	566.1	1001.9	80.0	23.0		28.7%
RECKITT & COLMAN	443.0	546.9	901.3	76.3	20.6	9.9	14.0%
GRANADA GROUP 'A'	210.0	329.6	521.1	43.5	19.5		44.8%
BRIT. HOME STORES	214.0	442.5	502.7	48.9	19.0		38.8%
GUINNESS, ARTHUR	155.0	273.5	872.4	69.2	18.3	7.3	15.9%
B. P. B. INDUSTRIES	266.0	505.7	465.8	65.4	18.1	2.4	24.0%
REDLAND	277.0	580.1	799.1	60.0	18.0	4.0	23.3%
ASSD. BRIT. FOODS	174.0	692.8	3366.0	146.5	17.8	3.7	9.6%
BARRATT DEV.	162.0	288.3	512.9	52.2	17.6		33.7%
TESCO	178.0	600.3	2404.0	53.5	16.3		30.5%
RMC GROUP	426.0	373.5	924.9	42.3	16.0	4.0	28.4%
ROWNTREE MACK.	246.0	389.6	770.5	50.5	15.7		31.1%
BURTON GROUP	235.0	406.2	299.2	38.8	15.5		39.9%
SCOT. & NEWCASTLE	113.5	320.1	641.8	41.1	15.0		36.5%
ENG. CHINA CLAYS	224.0	363.2	490.2	46.4	14.5	0.5	30.1%
KWIK SAVE DISCT.	172.0	258.8	556.2	27.5	13.3		48.4%
UNIGATE	125.0	275.3	1662.0	46.1	12.5	0.3	26.5%
COALITE GROUP	192.0	165.1	415.9	25.5	11.5	0.3	43.9%
HOUSE OF FRASER	270.0	415.2	876.7	30.9	10.9		35.3%
HABITAT M'CARE	314.0	332.1	317.2	25.1	10.8		} 43.0%
SMITH, W. H. 'A'	136.0	237.1	871.3	25.2	10.8		
HEPWORTH CERAMIC	148.0	232.9	298.8	24.6	10.6	0.0	43.1%
BELL, ARTHUR&SONS	158.0	176.2	246.7	31.3	10.5		33.5%
					£2012.3m	472.5	

* Probably including CT paid abroad.

Mostly from Accounts for 1982 calendar year or 1982/83 Financial Year.

£2012.3m
472.5
Net CT £1539.8m

Companies with Irrecoverable ACT and Turnover over £200m.
(i.e. effectively had tax losses)

COMPANY NAME	LATEST PRICE	MARKET VALUE	TOTAL SALES	PRE-TAX PROFITS INC. ASSOCS	CORPOR-ATION TAX	DTR	IRRECOVER ABLE A. C. T.
B. A. T. INDS	188.0	2743.5	11507.0	856.0	156.0	138.0	28.0
IMP. CHEM. INDS	576.0	3522.5	5368.0	579.0	32.0	23.0	54.0
PEN. &ORIENT. DFD	296.0	421.5	4205.6	32.7	1.3	0.8	5.5
DALGETY	444.0	344.8	2842.0	48.9	10.4	2.6	1.9
BERISFORD, S. &W.	194.0	371.4	2729.2	54.7	0.0	–	7.1
LONRHO	142.0	372.7	2336.1	72.8	2.3	2.2	9.5
BRIT. AEROSPACE	224.0	448.0	2053.0	-15.3	0.0	–	7.3
COURTAULDS	130.0	473.6	1906.0	63.3	8.5	7.3	3.6
GUEST, KEEN	217.0	479.3	1892.0	53.2	11.5	4.7	6.4
TATE & LYLE	390.0	266.3	1783.7	58.2	8.8	4.9	1.3
BEECHAM GROUP	315.0	2269.4	1702.4	237.1	50.0	29.8	11.4
BOC GROUP	277.0	1072.7	1701.6	114.8	24.8	14.9	10.2
INCHCAPE	333.0	282.3	1697.4	50.3	12.1	7.7	2.7
BICC	275.0	521.7	1654.9	101.7	12.1	9.1	6.2
RANKS, HOVIS	89.0	248.6	1636.9	40.7	5.4	1.8	2.4
CADBURY SCHWEPPS	132.0	586.7	1577.8	89.7	11.3	5.8	4.5
BOWATER CORP.	250.0	401.7	1566.0	72.5	8.1	4.2	4.0
DUNLOP	43.0	61.8	1525.0	-5.0		–	4.0
ULTRAMAR	692.0	934.2	1513.3	181.3	21.4	21.4	3.0
METAL BOX	344.0	259.8	1394.3	52.5	6.0	6.2	3.2
LUCAS INDUSTRIES	202.0	183.1	1217.0	20.1	13.7	3.9	3.3
UNITED BISCUITS	147.0	465.6	1205.2	68.4	9.9	–	1.9
HANSON TRUST	186.0	1255.9	1148.3	60.4	-0.3	–	5.0
TI GROUP	276.0	163.7	1095.6	-1.5	1.7	1.3	1.7
JOHNSON, MATTHEY	273.0	363.7	1044.8	38.0	2.1	2.1	5.5
GILL & DUFFUS	190.0	125.1	1006.0	12.9	0.3	0.3	1.9
TRUSTHOUSE FORTE	209.0	814.6	963.1	69.3	12.0	1.9	3.2
BROOKE BOND	82.0	255.4	913.7	47.9	11.4	7.4	3.1
DEE CORPORATION	510.0	302.2	910.1	16.0	0.7	–	3.4
NTHN ENG. INDS	86.0	186.9	867.0	39.6	4.7	1.4	3.0
COATS PATONS	104.5	289.1	856.2	77.3	15.6	14.1	3.6
ICL	73.0	328.6	846.5	46.3	0.0	–	3.2
FITCH LOVELL	170.0	116.6	804.1	12.6	2.2	–	1.3
BLUE CIRCLE INDS	440.0	510.8	785.2	106.5	8.7	4.7	4.5
PEARSON, S. &SON	426.0	399.0	718.5	59.9	8.2	4.0	2.2
OCEAN TRANSPORT	123.0	138.7	714.8	12.8	0.2	0.2	3.1
DAVY CORP.	70.0	66.1	708.0	6.4	3.4	1.0	1.4
DEBENHAMS	155.0	211.3	676.4	17.7	0.0	–	1.5
VICKERS	160.0	146.5	656.1	22.7	1.6		3.4
IMI	75.0	201.6	633.0	28.8	3.9	–	4.0
DRG	133.0	111.3	579.6	12.5	1.6	1.2	2.1
DELTA GROUP	79.0	113.0	508.0	19.2	8.6	2.9	1.3
GLYNWED	149.0	124.8	444.3	13.7	4.4	2.3	3.6
TOOTAL GROUP	45.5	80.6	401.2	14.9	1.9	1.6	1.8
FOSECO MINSEP	169.0	137.7	333.1	14.1	0.3	0.3	2.5
KENNING MOTOR	122.0	51.4	326.4	11.8	3.0	0.9	1.4
CRODA INT.	114.0	129.2	307.1	14.3	2.1	–	2.3
CRODA INT. DFD	80.0	129.2	307.1	14.3	2.1	–	2.3
COOKSON GROUP	301.0	143.3	289.3	11.5	1.3	0.8	1.3
L. C. P. HDGS.	96.0	61.7	277.5	4.1	-0.3	–	1.2
FISONS	753.0	337.3	235.1	21.0	2.2	2.2	2.0
DE LA RUE	625.0	237.9	225.9	31.6	5.7	4.8	3.7

FOR AN EXPLANATION OF OPTIONAL FACILITIES TO STORE THIS LIST SEE NEXT PAGE

CONFIDENTIAL

From: T Burns

Date: 9 March 1984

Thanks.
PSU extract & circulate
useful figs to prop[?] potential[?]
points @ X & XX.
N.

Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir P Middleton
Mr Cassell
Mr Battishill
Mr Evans
Mr Odling Smee
Mr Folger
Mr Allen
Mr Smee
Mr Smith
Mr Norgrove

Mr Ridley
Mr Lord
Mr Portillo

CHANCELLOR

PRESENTATION OF THE BUDGET: CORPORATE SECTOR

I attach two notes on the corporate sector relating to points raised at last week's overview meeting on presentation. The first deals with the argument that investment productivity is as important and valid as the traditional concept of labour productivity. The second presents some fairly recent figures for profitability to compare recent trends in the UK and US.

TB

T Burns

COMPANY TAXATION: THE IMPORTANCE OF INVESTMENT PRODUCTIVITY

Traditionally, the most common productivity measure has been that of labour productivity. This note argues that investment (capital) productivity is just as important and valid a measure as labour productivity and suggests why, as a measure, it has been less frequently employed.

2. Output depends on the use of both capital and labour, and, for a given factor supply, the level of output depends on the efficiency with which both these factors are employed. Moreover simple measures of labour productivity - output divided by numbers employed or man-hours - will be influenced by the amount and quality of capital employed, just as a simple measure of capital prductivity will be influenced by the amount and quality of labour. The two measures are interdependent. There is no à priori reason to stress labour rather than capital productivity: a profit maximising firm will seek to use both as efficiently as possible.

3. Capital productivity has not been totally neglected. Total factor productivity measures, which look at the productivity of both labour and capital have a long history: and capital productivity is often approached obliquely eg via the rate of return on investment or the level of profits. Nevertheless labour productivity has been the more commonly used measure in comparative productivity studies. One reason for this is that it is easier to measure in physical terms. For comparative purposes, it is often difficult, at a firm level, to evaluate the relative quantities of capital employed; and at an aggregate level there are considerable doubts as to the reliability of capital stock figures. Another reason for the stress on labour productivity is the belief that there is more scope for increasing growth through changes in labour productivity than in capital productivity. This reflects two factors: one, the post-war belief that labour was the scarce factor and the major constraint on growth; the other that, as the best technology and the capital embodying it is relatively freely traded on world markets, in the absence of other distortions international differences in the productivity of capital might be considerably less than differences in the productivity of labour.

/4...

4. Many of the factors that contribute to low labour productivity also apply to capital productivity. There are, however, some factors which affect capital uniquely; for instance investment incentives distort the capital-labour mix and the asset-distribution of investment, and this may be reflected in low capital productivity. There is evidence that the UK has a high capital stock per worker, especially in manufacturing, and that its stock is more plant and machinery intensive than that in other countries. Moreover, the rate of return on investment, the incremental output associated with new investment and the output per unit of capital are very low compared to those in other western countries. (Mr Monk's submission, "Company Tax and Investment" of March 2 summarized the evidence on the low productivity of UK investment).

X

XX

5. Given that there seeems to be considerable scope for improvement in capital productivity in the UK, and given that we may be in a period when capital not labour is the scarce factor, it is important to adopt policies which raise the productivity of capital by improving the "quality" of investment.

FROM: H P EVANS

DATE: 8 March 1984

cc Mr Byatt
Mr Odling-Smee
Mr Horton
Mr Owen

SIR TERENCE BURNS

PRESENTATION OF THE BUDGET : CORPORATE SECTOR

You asked for some briefing on the theme that

> "More work was needed to develop the theme that high profitability was the key to a buoyant economy cf the present position in the US".

2. Mr Owen and Mr Horton have dug out some fairly recent figures for profitability. I attach at A an extract from the September EPR, and at B a minute and table prepared by Mr Owen. The figures for 1982 (even) are not published and there could well be changes. A group under Mr Byatt is looking into the measurement problems in the UK in this area.

3. While the precise figures are very uncertain, the general trends in the last couple of years in the UK and the US are familiar. Profitability is recovering in both countries, earlier but more steady in the UK and from a lower base.

4. Points to make:

i. Profitability has declined, in most countries, since the fifties and sixties.

ii. The decline in the UK has been greater, and to a lower level, particularly in manufacturing.

1023

iii. The cyclical decline in the period 1980-81 is now being reversed, but there is some way to go - above all in manufacturing in the UK - before we reach the average of the seventies (even).

iv. The extent of the decline in UK output in the period 1979-81, especially in the manufacturing sector, owed much to the fall in profitability.

v. Rising profitability, accompanied by rising employment, is a feature of the recovery in both the UK and the US. A rise in profitability is a vital part of the recovery process, bringing with it increased spending and employment.

HPE

H P EVANS

A

Table 1

INTERNATIONAL COMPARISONS OF PROFITABILITY 1955—1981

*Pre-tax rate of return to fixed capital** — *per cent*

	Non-financial corporations UK	US	Japan	France	Manufacturing industry UK	US	Canada	West Germany
Averages for years†								
1955-58	13	17	na	na	17	27	23	39
1959-62	12	17	na	11	16	26	19	31
1963-67	11	22	na	12	14	34	18	22
1968-71	9	17	na	14	11	24	15	23
1972-75	6	14	18	13	8	20	17	17
1976-80	6	14	15	9	6	18	14	16
Years								
1980	5	12	15	8	4	12	15	14
1981	5	13	14	7	2	12	14	na

*Net of stock appreciation and capital consumption.
†Apart from the first, which is governed by availability of data, the groupings of the years are related to the cycles in UK rates of return. Figures for other countries for the same years may cover more or less than a complete cycle and in this sense can only provide a broad comparison with the UK.
Note: For further details, see *British Business*, 19 August 1983, pp 22-23.

index remained flat until September last year the twelve-monthly inflation rate is likely to rise further.

The underlying twelve-monthly increase in whole economy **average earnings** was 7 per cent in June. Although well ahead of price inflation, earnings are now rising at a consistently lower rate than at any time since 1967. **Manufacturers' unit wage and salary costs** have risen much less — about 2½ per cent in the year to the second quarter of 1983 — reflecting above average productivity growth of 5½ per cent (see chart 2). This is the lowest increase for over 16 years and would be even smaller if changes in labour taxes (including the recent cuts in the national insurance surcharge) were incorporated in these statistics.[3]

Company profitability

Recently published international comparisons show that pre-tax real **rates of return** on fixed capital (net of stock appreciation and capital consumption) have generally been on a long-term downward trend in the major industrialised countries (see table 1). In recent years it would appear that Japan and the United States have had the highest rates of return for non-financial corporations, followed by France, with the UK lowest. In manufacturing, rates of return in the UK appear to be substantially below those in Canada, the United States and West Germany.[4]

Table 2

CAPITAL EXPENDITURE IN MANUFACTURING, CONSTRUCTION, DISTRIBUTION AND FINANCIAL SECTORS

£ billion, 1980 prices, seasonally adjusted

	Manufacturing* (including leased assets)	Construction, distribution and financial sectors (excluding assets leased to manufacturers)	Total
1979	8.2	8.7	16.8
1980	7.3	8.5	15.8
1981	5.8	8.5	14.2
1982	5.5	9.4	14.8
1982 H1	2.8	4.6	7.3
H2	2.7	4.8	7.5
1983 H1	2.5	4.9	7.4

*Revised definition.

No manufacturing net rate of return is available for Japan but their gross rates are considerably higher than those of other countries despite being much lower since 1975 than before. However, comparisons of levels between countries must be treated with considerable caution given the problems in measuring and comparing capital stock. Moreover, these figures are based on average rates of return on existing capital and may be a misleading guide to prospective rates on new investment.

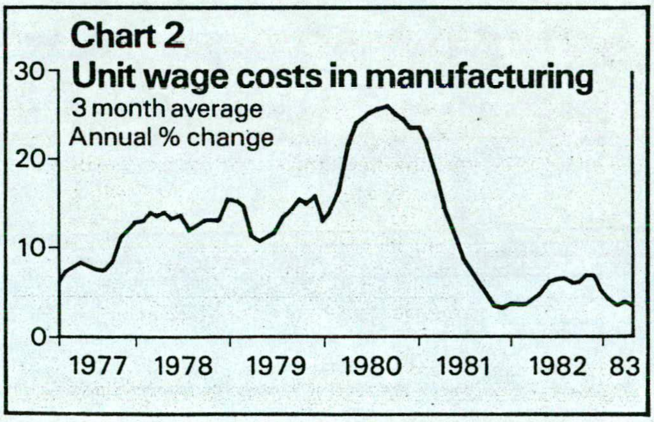
Demand

Real **domestic demand** in the first quarter of 1983 was nearly 4 per cent higher than a year earlier, with the turnround in stock-building contributing to the particularly fast growth in that quarter. Export demand has been much weaker so that **total demand** rose by less — 3 per cent — over the same period. **Consumer spending** has been notably strong and is estimated to have risen 4½ per cent in the year to the second quarter. Retail sales in July were similar to their second quarter average and in the May-July period were some 6 per cent higher than a year earlier. New car registrations have been particularly buoyant and in August may have been 15-20 per cent* higher than last year's record level.

Information about other components of domestic demand in the second quarter is limited. **Fixed investment** for manufacturing, construction, distribution and financial sectors — accounting for about 40 per cent of economy-wide investment — was virtually unchanged between the first and second quarters and was at much the same levels as a year ago (see table 2). Manufacturing investment rose in the second quarter and investment intentions surveys suggest it may continue to increase slowly this year. Overall **stocks** held by manufacturers and distributors changed little in the first half of 1983, after being run down in the previous six months (see table 3).

Trade and balance of payments

The **current account** surplus in 1982 has been revised upwards from £4 billion to £5½ billion, some £2½ billion arising in the last quarter. In the first half of this year the current account was around £½ billion in surplus. **Non-oil imports** rose significantly at the beginning of 1983 but now appear to have flattened out at



[3] In November 1982 the Government announced that for 1983-84 the NIS rate would be cut to 1½ per cent. Special arrangements were made to enable half of the cut to be brought forward into 1982-83. In this year's Budget it was announced that the rate would be reduced again — to 1 per cent from August 1983.

[4] Although based on different definitions, more recent information for the UK suggests that manufacturing rates of return have improved in 1982 (to 3¼ per cent from 2¼ per cent in 1981 — see *Bank of England Quarterly Bulletin*, June 1983, pp 232-239).

(B)

FROM: DAVID OWEN

DATE: 7 MARCH 1984

MR EVANS

cc Mr Shields
Mr Horton

BUDGET PRESENTATION : CORPORATE SECTOR

You asked me to update the profitability figures from the September 1983 EPR (Table attached). These figures were taken from British Business 19 August 1983 and are based on OECD calculations together with Department of Commerce information for the US. The calcualtions are based,as far as possible,on a standard definition, using national accounts information submitted in a standardised form to OECD and the UN. Unfortunately the OECD calculations for 1982 will not be available until June. Moira O'Connor (DTI) felt that, in the absence of these figures, it would not be practicable to update the table using the non-standard information available from individual country sources - at least not in time for the Budget.

2. However I have, with Mr Horton's help,attempted to use these sources to get estimates for the US and UK - these are attached. There seem to be insufficient data available from other countries even to attempt estimates. The methods I have used are very crude, and I would not have thought the figures should be quoted though they probably reflect the trends accurately. For the US I have taken figures for corporate profits (net of stock appreciation and capital consumption) as a proportion of gross domestic project of non-financial corporate business - these are available up to 1983(3) - and assumed that profitability has changed by the same proportion since 1981. This involves the assumption that the capital output ratio has remained constant over this period. For the UK I have taken published estimates of net pre tax rate of return for 1982. These are not on the same basis as the EPR figures so once again I have taken the 1981 EPR figure as a base and rescaled the 1982 figures appropriately. The 1983 figure for non-financial companies is based on our forecast for all ICCS.

David Owen

DAVID OWEN
EA1

International Comparisons of Profitability

(update of Table from September 1983 EPR)

Pre tax net rate of return to fixed capital

Years		Non Financial Corporations UK	Non Financial Corporations US	Manufacturing UK	
1976-80	published data	6	14	6	
1980		5	12	4	
1981		5	13	2	(4)+
1982	Estimates not published	6	11	4	
1983		7*	15**		

* Based on Treasury forecast for All ICCs.

** Estimate based on first 3 quarters.

+ Revised figure based on revisions to published official series since September 1982. No estimates for 1983 available

209/3

CONFIDENTIAL

E3

FROM: MISS J C SIMPSON

DATE: 12 March 1984

SIR T BURNS

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mr Battishill
Mr Evans
Mr Odling-Smee
Mr Folger
Mr Allen
Mr Smee
Mr Smith
Mr Norgrove
Mr Ridley
Mr Lord
Mr Portillo

PRESENTATION OF THE BUDGET: CORPORATE SECTOR

The Chancellor has seen and was grateful for the two notes attached to your minute of 9 March. He has asked that useful figures should be extracted and circulated to substantiate the points in paragraph 4 of the note on the importance of investment productivity: ie that the UK has a high capital stock per worker, and that the incremental output associated with new investment and the output per unit of capital are very low compared to those in other western countries.

MISS J C SIMPSON

Miss Simpson cc Sir T. Burns.

I disseminated these figures fairly widely; & believe that S. Hogg will be using them as a theme for a piece in the Times on Monday.

14/3

CONFIDENTIAL

FROM: JOHN GIEVE
DATE: 12 March 1984

CHIEF SECRETARY TO THE TREASURY

PS/CHANCELLOR

cc PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Mr Battishill
Mr Makeham
Mr Ridley
Mr Lord
Mr Portillo

BUDGET PRESENTATION: CONTACTS AFTER BUDGET

The Chief Secretary is to buy the Officer's of the Backbench Finance Committee a drink following their meeting with the Chancellor.* Later in the evening, he intends to ring Peter Gifford of the CLA.

2. After Budget Day, we will arrange meetings with the Association of British Chambers of Commerce and the National Federation of Self-Employed. He will telephone Lord Hanson and Sir Kenneth Bond. And he will contact the following MPs: Julian Amery, Sir Paul Brown, Nick Budgen, and John Townend (if appropriate following *)

3. Finally, in addition to the speeches noted in the attachment to Mr Makeham's minute, he is to speak to some Kent businessmen on Friday 16 March and that will provide the opportunity for a Press Release.

JG

JOHN GIEVE

CONFIDENTIAL

FRom: C H SMEE
Dare: 12 March 1984

MISS SIMPSON

C

These figs will have to be very discounted! Ask to show no action, pse. N–

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Battishill
Mr Evans
Mr Odling-Smee
Mr Folger
Mr Allen
Mr Smith
Mr Norgrove
Mr Ridley
Mr Lord
Mr Portillo
Mr Byatt
Mr Monck

PRESENTATION OF THE BUDGET: CORPORATE SECTOR

The Chancellor asked that useful figures should be extracted and circulated to substantiate the points in para 4 of the note on the importance of investment productivity, which was attached to Sir T Burns' minute of 9 March.

2. The relevant tables are attached:-

Table 1 shows that in 1980 in manufacturing the net capital stock per worker was higher in UK than in Germany, France or USA - looking at the economy as a whole capital stock per worker is larger in UK than in France and USA, but not Germany (the source for the figures used for this table and the other tables is OECD).

Table 2 shows ICORs and ICORs adjusted for changes in employment. The figures (which have been revised and differ from those circulated under cover of Mr Monck's minute of 2 March) show that over the period 1973-79 UK performed worse than Germany and France on all measures. If the labour adjustment is made UK does somewhat better than USA (but not if the straight ICOR is used). Canada seems to perform better than UK in manufacturing but not for the economy as a whole. (A high ICOR shows that a lot of capital is associated with the change in output; conversely a low ICOR means that extra output can be achieved with relatively little increase in capital; a negative ICOR means that output has fallen even though capital has increased.)

Eh?

CONFIDENTIAL

Table 3 shows that output per unit of capital stock is, for manufacturing, low in UK as compared to Germany, France or USA. If figures for the whole economy are taken UK seems to be on a par with Germany, but to be inferior to both USA and France.

C H Smee

TABLE 1

NET CAPITAL STOCK PER WORKER* 1980

	Whole economy	Manufacturing
UK	100	100
Germany	120	60
France	50	80
USA	80	80

*Converted to $ at OECD PPP rates

TABLE 2

ICORs, 1973-79

	Whole economy		Manufacturing	
	ICOR	ICOR(L)	ICOR	ICOR(L)
UK	5.6	6.1	negative	16.6
Germany	3.1	2.8	0.2	0.1
France	1.5	1.6	1.0	0.9
USA	1.7	negative	1.5	negative
Canada	1.9	negative	1.9	2.6

TABLE 3

OUTPUT PER UNIT OF CAPITAL* 1980

	Whole economy	Manufacturing
UK	100	100
USA	170	270
Germany	110	250
France	260	230

*converted to $ at OECD PPP rates

(pup)

CNOFIDENTIAL

From: N J HARTLEY
Date: 13 March 1984

MISS SIMPSON

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Byatt
Mr Monck
Mr Battishill
Mr Monger
Mr Evans
Mr Odling- Smee
Mr Hall
Mr Folger
Mr Smee
Mr Allen
Mr Smith
Mr Norgrove
Mr Ridley
Mr Lord
Mr Portillo

PRESENTATION OF THE BUDGET: CORPORATE SECTOR

I am afraid there was a mistake in the table of ICORs circulated under cover of Mr Smee's minute of 12 March. The ICOR(L)s for USA and Canada should not have been shown as negative. The UK is now shown to perform worse than the other countries on all measures. The correct table is:-

ICORSs, 1973-79

	Whole economy		Manufacturing	
	ICOR	ICOR(L)	ICOR	ICOR(L)
UK	5.6	6.1	negative	16.6
Germany	3.1	2.8	0.2	0.1
France	1.5	1.6	1.0	0.9
USA	1.7	4.2	1.5	2.1
Canada	1.9	8.4	1.9	2.6

N J Hartley

N J Hartley

CONFIDENTIAL

FROM: MISS M O'MARA
DATE: 13 March 1984

MR SMEE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Monck
Mr Cassell
Mr Battishill
Mr Evans
Mr Odling-Smee
Mr Folger
Mr Allen
Mr Smith
Mr Norgrove
Mr Ridley
Mr Lord
Mr Portillo

PRESENTATION OF THE BUDGET: CORPORATE SECTOR

The Chancellor was grateful for your minute of 12 March and has commented that these figures will need to be disseminated widely. He would be grateful if Mr Ridley could ensure that this is done.

MOM

MISS M O'MARA

CONFIDENTIAL

AWT

FROM: APS/Minister of State

DATE: 13 March 1984

PS/CHANCELLOR OF THE EXCHEQUER

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir Peter Middleton
Mr Battishill
Mr Makeham
Mr Ridley
Mr Lord
Mr Portillo

BUDGET PRESENTATION: CONTACTS AFTER THE BUDGET

The Minister of State will telephone Sir Hector Laing immediately after the Budget.

He has arranged to meet the Building Employers Confederation, formerly the National Federation of Building Trades Employers, on Thursday, 15 March at 10.30am. In addition we shall be arranging for him to meet the Tobacco Advisory Council and the Brewers' Society in the near future. The Minister is also having lunch on Thursday, 29 March with the Society of Motor Manufacturers and Traders (SMMT). Whilst this is some time ahead, they have confirmed that the Budget is one of the subjects which they wish to raise with him.

The Minister will contact the following MPs personally: Anthony Beaumont Dark, John Browne, Roger Freeman and Ralph Howell.

Debbie McCambridge

MISS D C McCAMBRIDGE

CONFIDENTIAL

FROM: M A HALL
13 March 1984

CHANCELLOR
CHIEF SECRETARY
FINANCIAL SECRETARY
MINISTER OF STATE
ECONOMIC SECRETARY

c c For Information
Sir Peter Middleton
Sir Terence Burns
Mr Bailey
Mr Cassell
Mr Battishill
Mr Folger
Mr Ridley
Mr Lord
Mr Portillo
Mr Monaghan
Mr Page
Mr Towers
Mrs McKinney
Mr Evans
Mr Segal
Mr Bosley
Mr Macrae
Miss Edwards

Mr Ingham - No 10

THE BUDGET : INITIAL PRESENTATION

There is only one amendment to be made as a result of the final re-drafting of the speech.

2. The second sentence of the first quotation on the last page of the annex should be amended to read as follows:-

"Certainly, with over 3 million unemployed, it cannot make sense to subsidise capital so heavily at the expense of labour."

MH.

M A HALL

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

C

No, it wasn't agreed, since Ministers decided to impose as little upheaval on the building societies in relation to the composite rate this year as possible.

This point, along with various others, will be put to Ministers in a few weeks so that decisions can be taken on legislation for 1985.

Mary
21/3

Thanks.
N.

PWT

CONFIDENTIAL

Did we not agree to X? M..

FROM: T M STUBBINGTON
DATE: 19 March 1984

NOTE OF A MEETING HELD IN THE ECONOMIC SECRETARY'S ROOM ON FRIDAY 16 MARCH 1984

Those Present: Economic Secretary
Mr Walden)
Mr Weir) BSA
Mr Boleat)
Mr Lankester
Mr Pirie

BUDGET PRESENTATION: CONTACTS AFTER THE BUDGET

The Economic Secretary thanked Mr Walden and his colleagues for coming and said that he very much welcomed the news that had been announced at lunchtime on interest rates. He told them in confidence that we will respond on National Savings broadly in line. He hoped this would be done soon and said it would be done without warning. Mr Walden responded by saying that this new structure was on the basis that the Budget had been more in their favour than they had expected and felt that societies should take a lead, also they wanted to help the Government wherever possible. It was noted that Budget measures which helped building societies were LAPR, composite rate for banks, stamp duty and National Savings targets.

Mr Walden said that mortgage demand was still very good and would possibly be around £2,000 million in March. He also noted that the housing market in general was starting to become more active again. The BSA made it clear that premium share rates would also come down by one percentage point in general, with a corresponding effect on the general cost of building societies' liabilities. A few marginal exceptions on premium rates would not upset the general validity of this point. Mr Weir pointed out that although they had reduced the rates on lending and borrowing it was still very much the intention of societies to meet mortgage demand rather than allowing queues to develop.

The Economic Secretary asked for the BSA's views of the effect on endowment mortgages following the announcement on LAPR. The general feeling was that insurance companies would be seeking new ways of making it attractive, and although initially popularity may diminish, they saw no reason for it not to continue in the future. Mr Walden raised the gilts issue and said that the BSA still had strong views on the way that this had been handled, but that having now seen it in the wider context of Budget measures he was more relaxed about it. The Economic Secretary said that he would like to have told him more at the time but obviously was unable to do so.

Mr Weir mentioned composite rate. He said that without going into detail, as Mr Isaac was meeting representatives of the BSA to discuss this more thoroughly, he was a little concerned about the concession given to banks for foreign residents. He said that building societies had been lobbying for a concession of this kind for some time but it was not clear if they were to be given the same treatment. Whilst acknowledging the fact that they were not identical to banks he thought that societies should be on an equal footing.

X

Mr Walden expressed his gratitude for the quick response from the Chancellor in reply to his letter, and he also thanked the Economic Secretary for inviting him so soon after the Budget.

T M Stubbington

T M STUBBINGTON

Circulation

Chancellor	Mr Ilett
Chief Secretary	Mr Willetts
Financial Secretary	Mr Ridley
Minister of State	Mr Lord
Mr Cassell	Mr Portillo
Mrs Lomax	

FROM: L J H BEIGHTON
INLAND REVENUE
POLICY DIVISION
SOMERSET HOUSE
22 March 1984

PS/FINANCIAL SECRETARY

FT

BUDGET PRESENTATION : CONTACTS AFTER THE BUDGET

1. In his minute to you of 21 March Mr Stubbington suggests that we should have briefing in hand on the effect of the Budget measures on the shipping and ship building industries.

2. The shippers are currently going around trying to attract support for their case - they have recently seen, or will shortly be seeing, both the Bank and the Department of Transport in this connection. Doubtless thereafter they will seek a meeting with Ministers.

3. At that time we shall of course prepare a brief specifically directed at the points which are then being made. Meanwhile, should there be any occasion for a quick reference to the background on the matter, the Chancellor's letter to Mr Ridley of 20 March may serve as a suitable brief.

LJHB

L J H BEIGHTON

---

cc PS/Chancellor of the Exchequer
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Sir Peter Middleton
Mr Battishill
Mr Lankester
Mr R I G Allen
Mr Pirie
Mr Ilett
Mr Ridley
Mr Green
Mr Beighton
Mr Corlett
Mr Elmer
Mr Willis
PS/IR

FROM: T M STUBBINGTON
DATE: 21 March 1984

PS/FINANCIAL SECRETARY

2

cc PS/Chancellor
PS/Chief Secretary
PS/Minister of State
Sir P Middleton
Mr Battishill
Mr Lankester
Mr Allen
Mr Pirie
Mr Ilett
Mr Ridley
PS/IR
Mr Corlett/IR

BUDGET PRESENTATION: CONTACTS AFTER THE BUDGET

Miss O'Mara's minute of 20 March gave the Chancellor's comments to my 19 March minute on a meeting with the Equipment Leasing Association.

As you will see, the Chancellor agrees that the Government is likely to get criticism from the shipping and shipbuilding industries on the Budget measures affecting the leasing industry. Depending on the context in which this is raised in the future, it could fall to you to deal with. I have spoken to Mr Corlett who, whilst there is very little he feels we can usefully say, has in hand the necessary briefing.

T M Stubbington

T M STUBBINGTON

FROM: F MARTIN

DATE: 2 April 1984

CHIEF SECRETARY

cc PS/Chancellor
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Mr Monger
Mr Battishill
Mr Lovell
Mr Lord
Mr Portillo

PS/Inland Revenue
Mr S Jones IR
PS/Customs & Excise
Mr P Smith C&E

POST-BUDGET CONTACTS: NATIONAL FEDERATION OF SELF-EMPLOYED AND SMALL BUSINESSES.

As part of the programme of post-Budget meetings with the main representative bodies, you are meeting a delegation from the National Federation of Self-Employed and Small Businesses at 11am on Wednesday 4 April. The Federation team will be Mr Tony Miller, chairman of the VAT/Taxation committee, committee members Mr Cliff Holland and Mr Neil Hamper, and Mr Ralph Jackson, press and parliamentary officer. Mr Stephen Jones of Inland Revenue, Mr Peter Smith of Customs and Excise and I will be in support.

Federation's Budget response

2. Attached at Flag A is a copy of the Federation's press release on the day after the Budget. Their line is that the Budget revealed a "big business bias" and did nothing to help unincorporated businesses, with specific criticism of the extension of the VAT base. There is no acknowledgement of such changes as the abolition of NIS and the investment income surcharge, despite the fact that the Federation called for these in its pre-Budget representations. This suggests that you will need to adopt a fairly robust approach to the meeting, attempting to hold the initiative by detailing the

range of Budget measures which assist the business sector, including unincorporated business. The following paragraphs are in the form of speaking notes for this purpose.

The Budget as a whole

3. Wish to look at Budget measures as a whole. Radical programme of tax reform - including outright abolition of two major taxes, NIS and IIS, as Federation recommended in pre-Budget representation - both for business taxation and taxation of savings and investment, coupled with substantial real increases in income tax allowances as a start in restoring thresholds to realistic levels. Budget measures will significantly reduce the tax burden over the next two years, while monetary and public expenditure policies designed to provide scope for further tax reductions in future Budgets. Measures will sustain current recovery, which must be good for all businesses, whatever size, whatever form. Inevitably carping criticism from political opponents; important therefore that all who share these basic aims - lower tax, more efficient economic performance - should give Budget measures in the round fair consideration.

"Big business bias"

4. Not the case that Budget measures show "big business bias". Difficult to reconcile that suggestion with, for example, immediate reduction in small companies rate of corporation tax to 30 per cent - now 12 percentage points lower than in 1979. Similarly, NIS abolition helps all firms with employees, whatever size. Business tax reforms designed to reduce distortions in present system, to encourage and reward efficiency, enterprise and a stronger economic performance. Inevitable that there will be a mix of gainers and losers from such changes, but this not a reason for putting off reforms which will be of substantial benefit to the economy. And overall, unincorporated business gain in 1984-85 and 1985-86 from the business tax changes announced in the Budget. Effects of NIS abolition outweigh those from reducing first year allowances and refurbishing stock relief [until 1986-87 at the earliest].

Small businesses/unincorporated businesses

5. Hence, not the case that Budget provides no help to small businesses, self-employed, unincorporated businesses. Large numbers of measures which provide direct help:

- substantial real increase in main personal allowances helps all unincorporated businesses and should be of particular help to smaller firms;

- abolition of NIS, benefitting small firms and unincorporated businesses with employees;

- abolition of IIS, especially welcome to self-employed and small businessmen, particularly those saving for retirement by re-investing in their own businesses. Also helps small businesses not treated as a trade, for example, furnished lettings;

- doubling of CGT retirement relief to £100,000 similarly helps self-employed;

- reduction in top rates of CTT must also be welcome to small businesses, increasing rewards for reinvestment in business;

- would also assume that halving of stamp duty likely to be of some benefit;

- and there is a further increase in the VAT registration threshold, despite difficulties UK faces with EC Commission.

6. Moreover, these measures not isolated events: come on top of whole series of measures in Budgets since 1979 to help small businesses, including self-employed and unincorporated businesses (for example, improved interest reliefs, improved retirement annuity relief).

VAT extensions

7. Recognise that all Budget measures may not be welcome to Federation, including widening of VAT base. But this essential to Government's objective - which assume Federation share - of easing the burden of tax on income. Extension of VAT to take-away food and building alterations provides direct contribution towards raising main income tax allowances by some 7 percentage points above last years inflation.

8. Moreover, extension removes anomalies and major sources of confusion for traders - for example, current difficult borderlines between catering and take-away food, and between repairs and alterations. Most of traders affected likely already to be in VAT net on account of their other activities - for example, supply of repairs and maintenance - and should not find it difficult to accommodate change.

9. Extension should not increase black economy in construction industry. Work now made taxable is on the whole done by bigger firms - harder to suppress in accounts. May be greater incentive to fraud, but removal of unclear borderlines will make it easier for Customs to tackle. And best antidote to black economy is lower tax on income - Government's objective.

Summary

10. Suggest, therefore, that balance of Budget as a whole not disadvantageous to small firms, self-employed and unincorporated businesses. Some measures help directly and overall benefits to economy in improved performance, increased output etc will help all firms.

The Federation's Budget representations

11. With its letter to your Private Secretary concerning the meeting the Federation forwarded a further copy of its pre-Budget representations. In addition to the abolition of NIS and IIS

these called for:-

(a) "unused" personal allowances to be set against income or profits from other years;

(b) capital allowances to be set against tax payable rather than adjusted profit and allowances to be given for all businesses premises;

(c) scope of stock relief to be extended;

(d) retirement relief for CTT to be introduced;

(e) Business Expansion Scheme to be extended to sole traders and partnerships and relief to be given for loan capital;

(f) VAT to be abolished between registered traders.

In addition, at the pre-Budget meeting with the Financial Secretary the Federation voiced its complaint regarding the Revenue "campaign" to reclassify the self-employed. Mr Selwyn Gummer has also written to the Chancellor (16 March) on this question following a meeting with the Federation.

12. You will not wish to discuss these matters at the 4 April meeting. But in case it proves impossible to avoid them (the Federation is nothing if not persistent in voicing complaints), short briefing is attached at Flag B. This excludes points (b) and (c) of the representations, which are overtaken by the Budget proposals.

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National
Federation of
**Self Employed
and
Small Businesses
Limited**

PRESS RELEASE

IMMEDIATE
Wednesday, 14th March, 1984

LAWSON'S BIG BUSINESS BIAS

"The self employed and small businessman are bound to suffer as a result of Nigel Lawson's first Budget" commented Tony Miller, Chairman of the VAT/Taxation Committee of the NFSE.

Mr. Miller continued:

"Capital and corporate tax changes reveal the Chancellor's definite big business bias. Changes in first year allowances will mean the small businessman will pay more tax out of his profits.

"The widening of VAT to include take-away foods and building alterations will have a dramatic effect on small businesses involved. Increased prices, losses in trade, more 'cowboy' operators and a bigger black economy are some of the consequences of this move.

"The self employed will of course receive those benefits from increased personal allowances. However, no other direct measures of assistance in this Budget were directed towards the sole trader and those in small unincorporated businesses, who together represent literally hundreds of thousands of firms.

"The Chancellor has not distinguished between these small businesses and other limited companies with his 'tax neutral' measures. The latter have benefited, the former have not. The Government must be made to realise this distinction if it really wishes to help the burgeoning small business sector; in this Budget it plainly has not".

- ENDS -

For further information please contact:

Tony Miller - VAT/Taxation Committee Chairman - 03955-78316
Ralph Jackson - Press & Parliamentary Officer - 01-928-9272

ANNEX B

POINTS FROM THE NFSE'S PRE-BUDGET REPRESENTATIONS

(a) Carry over of personal allowances

Line to take Fundamental misconception to think that personal allowances are a "minimum ration" which can be regarded as lost if not fully absorbed by taxable income. Object is simply to ensure that those with no, or low, income in any particular year pay no tax that year. That is achieved. (The Financial Secretary wrote to Mr Miller on 12 March setting out the arguments in detail).

(d) Retirement relief for CTT

Line to take Existing business reliefs (50 per cent and 30 per cent) already generous, having been increased in 1983 Budget. And of course, 1984 Budget reduces top rates - this the preferable route to reduce effective burden.

(e) Business Expansion Scheme

Line to take

i. Extending relief to loan stock would not help companies which need equity because proprietors have already invested their own funds.

ii. Business Expansion Scheme cannot be applied to unincorporated businesses. With no share capital there is no way of identifying money which is genuinely at risk.

(f) Abolition of VAT between registered traders

Line to take Studied previously by working party including trade representatives: working party recommended against such change - no evidence that anything changed since then. Would mean increased burden for retail sector and increased opportunity for evasion; considerable efforts made to reduce compliance burden on traders, through simplified VAT return forms and special schemes for retailers.

Revenue reclassification "campaign"

Line to take   No Revenue drive against self-employed. Criteria which distinguish employment from self-employment have been independently laid down by the Courts. Anyone who disagrees with an Inspector's decision can appeal to the Commissioners, an independent tribunal. Since 1979 the number of self-employed has increased by some 400,000.