COVERING CONFIDENTIAL

FROM: M E DONNELLY
DATE: 5 January 1983

CHANCELLOR

cc Mr Littler
Mrs Hedley-Miller
Miss Court
Mr Edwards

EC BUDGET - NEXT STEPS

I attach a draft paper written by the Financial Secretary over the holiday setting out the type of public line on our Budget refunds which is likely to have the most positive effect on the European Parliament. It is at present in the form of a draft speech; but you may wish to discuss how best the material might be used over thenext few weeks.

The Financial Secretary feels you might like to see in its current draft form before tomorrow morning's meeting.

MED
M E DONNELLY

DRAFT SPEECH TO EUROPEAN PARLIAMENT

In constructing Europe, there are bound to be major problems, which will often appear to take too long to solve. There are bound to be differences of view, often immensely difficult to resolve. There will even be crises when the whole future of the Community seems to be at stake. All three of these elements were present at the end of last year when the European Parliament voted against the 1982 Supplementary and Amending Budget. The Parliaments action focused attention on a major problem: the imbalance of contributions towards the Community's financing. There is certainly a difference of opinion among the Member States as to how this problem is to be solved. And the Parliament's action created a crisis: not just a crisis of cash flow for the United Kingdom, but a crisis in inter institutional relationships. The Council had reached an agreement after long and difficult negotiations, which was then rejected by the Parliament.

Let me say at the outset that I understand the reasons for the Parliament's action. I can even sympathise with them on 2 or 3 counts!

First of all the Parliament was saying that it did not like ad hoc arrangements for dealing with the imbalance of Community financing, and that it wanted the 1982 agreement to be the last of its sort. It wanted a permanent financial mechanism to be in place for next year. So do I:

I can sympathise and agree with that. I put forward just such a scheme myself in my speech at the Hague in 1981. Time has moved on since then, and what I have to propose now is slightly different, as you will hear. But the basic objective is a shared one. Indeed the Commission is bringing forward new financing proposals at this very time, and bringing forward more radical proposals more urgently, I believe, as a result of the action of Parliament. Thus the point is taken-although there was no need to make the point to me!

Secondly, Parliament wants the solution to be of a communautaire nature. This brings into the debate the whole spectrum of community policies - what can be done by the Community and what must still be done by nation states. Again , I have much sympathy with the Parliaments view, but on this point my sympathy is overpowered by some wider, perhaps even more European thoughts. I can certainly go along with the concept that the best way to redress the budgetary imbalance of the UK is to have European policies from which all states in the round derive benefits commensurate to their contributions. But this has not happened. We have pressed, and pressed in vain for increases in the ERDF and ESF from which we might stand to benefit more than we contribute.

But progress in this direction on a sufficient scale has been miniscule. Again I hope the point is taken, but again there was no need to make the point to me!

My doubts arise because I do not believe we could ever redress the imbalances simply by increasing the money spent on the ERDF and ESF. For the UK to receive as much money as it puts into the Community, these two funds would have to be increased from their present [X] mecu to [Y] mecu - others expenditures remaining as they are. To increase the funds by this amount is clearly a ludicrous suggestion, putting the budgetary make-up completely out of balance.

Moreover, it is a basic principle of all of our domestic taxation and social security systems that the better off pay more, for the benefit of the less well-off. I am sure all of us agree that it should be the same in Europe. To ask the taxpayers of Liverpool to subscribe to the welfare of Copenhagen's citizens who are [X] times as well off is standing logic, fairness, even morals are their heads: it should be the other way round. And we must in our future arrangements make sure we achieve this. It cannot be left to chance, who pays and who benefits. No adult political society would doing that.

The factor which causes all these difficulties is of course the enormous preponderance of expenditure on disposing of agricultural surplusess - Feoga guarantee expenditure. This does not mean that the UK is against the CAP - but it is necessary to point out that we cannot as a community

go on having to pay so much for the disposal of these surpluses. It does no good to third world food markets and production. It causes us to subsidize food stuffs for Russia. It distorts our economies. It swallows up the lion's share of our European budget. And it is the root cause of the problem which the UK keeps bringing to your attention - because the UK is the only member state that does not produce farm surpluses.

So if you really have the interests of Europe at heart, and not just the interests of the Farming lobbies of continental Europe, Parliament should address itself to the problem of agricultural surpluses. It is illogical, and in no way communautaire, to fail to deal with this, the real problem, and instead to take dramatic action against the British who are the only country which has not contributed to the problem.

There is much talk of the problem of "trop percu" the suggestion that the United Kingdom was paid too much money back, in 1980 and 1981 in recompense for its excessive contributions. But in reality what happene was that world agricultural prices were high, and the cost of financing European agricultural surpluses was commensurately low. Thus we received more back under the agreement of 30 May 80 than had been expected. But so did every other member state. The Germans received [X] mecu back - the French received [Y] mecu more than

they had expected etc/etc. I do not understand why it is only the UK who is accused of "trop percu. We are content to include all this in the negociations on the 1983 imbalance, although in truth that is a concession which no other member state seems willing to offer. But it was an integral part of the agreement of 25 Oct 1982 that no account would be taken of the "trop percu" problem in the 1982 settlement.

Not only do I beg you to concentrate your attention on this, the real problemof agricultural overproduction but also to be much more specific about what should be the priorities in Community expenditure: which programmes can rightly and properly be undertaken by the Community, and what funds should be put into them. We cannot run before we can walk - and many programmes must for the time being remain the responsibility of the member states. But the Council would be much more impressed by Parliament making constructive suggestions not just for greater expenditure - but for a planned and logical transfer of functions to Europe that makes sense in the present state of the development of the community and of our own economies.

Of course I realise Parliaments frustrations, both with the slowness of progress towards integration, and with its own lack of powers. This is another reason underlying

your rejection of the 1982 S.A. Budget with which I can sympathise. To us in Britain where Parliament can legislate, but cannot increase expenditure, it seems strange that your powers should be exactly the opposite. I say in the same sentence both that it seems to me that the time has come to reexamine the powers and functions of Parliament, and also that the case for so doing was weakened by the vote of the Parliament on 16 December. In other words, we all want to make better progress towards building Europe: but the fault is not all with the Council, and certainly not with Britain. Perhaps our joint cause would prosper more if Parliament listened to what the British are saying, because we are just as good Europeans as any of you, and Parliament puts at risk the building of Europe if it makes the UK the whipping boy for its frustrations.

This brings me to the question of classification of expenditure as obligatory or non-obligatory. The further reason for Parliament's rejection of the Budget was that it wanted the British and German refunds to be classified as non obligatory. Here I cannot agree with Parliament. I know they were prepared to abandon any claim that refunds would add to the "assiette" if they were classified as non-obligatory. Perhaps you would have even been prepared to undertake not to increase or reduce them if they had been so classified. But then two of the characteristics of obligatory expenditure are that it does not add to Parliaments margin, and that it is within the Council's power to determine the quantity of it. To concede non-obligatory classification would have been

no more than cosmetic, as well as wrong in principle.

If we could solve our problem by a permanent Community financing mechanism, combined with policies that helped to reduce our financial imbalance with the Community, then Parliament could have a much more important role to play. But that is the way forward, not taking action to upset agreements which are in fact vital to the progress of the Community, and vital to the interest of member states: and which have in the long run to be properly redressed if the Community is to prosper, as we hope it will.

Finally, therefore, I come to the question of the permanent financing mechanism. With enlargement comming soon, the mechanism has got to be worked out, and put in place. The European Parliament has demanded that the Council do this, and do it quickly.

I have no quarrel with that view. But we have to work out the details.

Herr Lange suggested in 1979 a mechanism not dissimilar to that which contributes resources between the German Lande. The more prosperous contribute to the less prosperous. While I doubt if that formula will do in its entirity because the less prosperous Lande in Germany do not have to shoulder excessive burdens simply because they are

not agricultural surplus producers; nevertheless his thinking seems to me to have been on the right lines.

[There could follow some suggestions for financial mechanisms].

In conclusion, may I say that you cannot build Europe without the United Kingdom. Nor can you ride roughshod over the vital interests of the United Kingdom. The fact that the United Kingdom has not enough farm land to over produce agricultural products, is not an indication that it is not Communautaire. It is just a simple fact of geography. In struggling to bring Europe together, beware that you do not cause it to fall apart by ignoring that simple fact.

FROM: M E DONNELLY
DATE: 7 January 1983

MR BATTISHILL - IR

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (R)
PS/Minister of State (C)
Mr Bailey
Mr Middleton
Mr Moore
Mr Pirie
Mr Robson
Mr Turnbull
Mr Gordon
Mr French
PS/IR

STRUCTURE AND FINANCE OF SMALL ENTERPRISES

During a recent visit to the new Gloucester Enterprise Agency representations were made to the Financial Secretary about a a bias in the tax system affecting small enterprises.

Most people starting up a business apparently begin as sole traders, and then tend to expand by becoming partnerships, rather than limited liability companies. Although a limited liability company would seem to offer the best prospects for growth small traders are apparently advised not to incorporate because the taxation they would face would be heavier. They would need to pay both corporation tax and income tax on their salaries.

On the face of it this discouragement of small firms to incorporate would seem a regrettable side effect of the current tax system. The Financial Secretary would be grateful for your comments on this question; and on possible steps which might be taken to alleviate it.

MED
M E DONNELLY

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 7 January 1983

MR BATTISHILL - IR

cc Chief Secretary
Economic Secretary
Minister of State (R)
Sir D Wass
Mr Middleton
Mr Moore
Mr Robson
Mr Chivers
Mr French
Mr Corlett - IR
PS/IR
Mr Graham - Parly Counsel

CAPITAL ALLOWANCES FOR RENTED TELEVISION SETS

The Financial Secretary was grateful for your note of 23 December covering Mr Corlett's note of 22 December.

The Financial Secretary's view is that:

i) we should extend the 100 per cent FYA for teletext for one year. To bring the arrangements into line with Viewdata is less untidy; and if that is what they want we should say yes, provided

ii) it is absolutely clear that this is the final concession - all TVs go to 25 per cent after 1986;

iii) we try and get DOI to take the cost on to their vote, as Mr Corlett suggests.

MED

M E DONNELLY

FROM: M E DONNELLY
DATE: 7 January 1983

MR CORLETT

cc Minister of State (R)
Mr Moore
Mr Robson
Mr French
Mr Battishill - IR
PS/IR

AGRICULTURAL CO-OPERATIVES: TAX RELIEF ON REVOLVING FUNDS

The Financial Secretary was grateful for your note of 31 December.

He has commented that surely such a special tax relief concession is available to incorporated businesses, through the abolition of surcharge discretion. Small companies may now retain as much profit as they like, which is surely similar to what is proposed here?

The Financial Secretary further considers that for a cost of £1 million it is a very small concession - though he well appreciates the arguments of principle against it. He is inclined to leave it on table at this stage until it becomes clearer what the consequences of the Budget are likely to be for farmers. This concession may be a useful "plum" if one is needed!

MED
M E DONNELLY

FROM: FINANCIAL SECRETARY
DATE: 7 January 1983

MR DRISCOLL - IR

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir D Wass
Mr Middleton
Mr Moore
Mr Robson
PS/IR

BUSINESS EXPENSES ETC

On all sides I hear complaints that many in profitable business get exaggerated "expenses" which are not taxed in their hands, nor disallowed for company taxation. These benefits range through boxes at racecourses, shoots, villas abroad, expensive meals and parties, to providing directors' houses, paying their bills, motor cars - all the usual. I think we should have a look at this area, which is becoming notorious.

Perhaps we should do this in conjunction with your 'Benefits in Kind' paper; or should we do it on a separate exercise?

pp NICHOLAS RIDLEY
7 January 1983

FROM: M E DONNELLY
DATE: 6 January 1983

MR STEWART - IR

cc Chancellor
Chief Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Mr Middleton
Mr Monck
Mr Peretz
Mr Robson
Mr Turnbull
Mr Crawley - IR
PS/IR
Mr Graham - Parly Counsel

DEEP DISCOUNTED STOCK: CONSULTATIVE DOCUMENT

The Financial Secretary has seen your further note of 4 January on this subject.

As I told you on the telephone he is content with the latest redraft of paragraph 13, in order that the document can be issued as quickly as possible.

More generally however the Financial Secretary finds the position odd in that a bond would appear to be a capital asset in the hands of the lender but not one in the hands of the borrower; whereas assets such as houses are treated as simple capital assets whether being bought or sold. He rather feels that a clever tax consultant could find a way of making a capital bond of this sort into an allowable CGT loss - Ramsay permitting. But he feels it now best to float the document and consider the matter further in the light of outside reactions to it.

MED
M E DONNELLY

FROM: M E DONNELLY
DATE: 7 January 1983

MISS HART - IR

cc Mr Driscoll - IR
PS/IR
Mr Boyd (Solicitor)

NOTES ON INCOME TAX FOR MEMBERS OF PARLIAMENT

The Financial Secretary has read your note of 20 December.

... He has amended paragraphs 4, 5c, and 6iii. I attach re-drafts.

In addition he has pointed out that the third sentence from the end of paragraph 2 should read:P

"...to the amount <u>of</u> the emoluments..."

Notes: 1. Line 3, to read

"...are allowable as deductions, <u>and</u> the Fees Office..."

The Financial Secretary had no comments on the revised notes on income tax for members of the European Parliament.

MED
M E DONNELLY

Procedure for claiming expenses

4. Cash allowances are paid by the Fees Office to reimburse Members in respect of additional living costs, and secretarial etc expenses. These are paid in full. Travel expenses are dealt with in Paragraph 10. A PAYE coding allowance is consequently only due for any estimated expenses in excess of the amounts payable by the Fees Office.

On election, a Member is invited to make a provisional claim for a coding allowance if he considers it appropriate. In any case, a final claim is necessary at the end of the year, for the purpose of an income tax assessment for that year.

A coding allowance is estimated for subsequent years, the estimate being based upon the most recent information available at the time the coding is made. In the event of a dispute, an appeal against the code number, or an assessment, may be made to Income Tax Commissioners, an independent tribunal and in the case of an assessment, a further appeal on a point of law may be made to the High Court.

5.c For the purpose of this sub-paragraph "London" is taken to be an area within about a twenty mile radius of the Palace of Westminster; and "constituency" to include an area within about twenty miles of the boundary line. Although individual cases will depend upon circumstances.

6. iii. Ministers

a. A Minister by reason of his Ministerial office is normally regarded as having to live in or near London. On the basis that he must spend the bulk of his time London. Ordinarily, therefore, no part of the cost of living in London is admissible as a deduction, although a Minister with a constituency outside London may claim against his remuneration as a Member the additional cost of living which he has to incur wholly, exclusively and necessarily in carrying out his Parliament duties in the constituency.

As a matter of practice the Inland Revenue are prepared normally to accept a claim for 2/7 of the overhead expenses of a Minister's constituency base. This applies even if that base is also his family home and notwithstanding that the extra cost incurred through the need to conduct constituency business may in fact be less than that. (This practice acknowledges the fact that Ministers do incur additional expense through having to maintain two bases and can be expected to be in their constituency at weekends at least. If you made a claim on this basis the likelihood is that it would be accepted. This practice does not, however, prevent any Minister from demonstrating as a matter of fact that the additional costs of maintaining a base in his constituency are greater than this. It might be, for example, that his London home was his family home, where he normally lived with his wife and children and the constituency base merely a pied-a-terre kept and used exclusively for constituency business. In that case the whole of the expenses of maintaining it might be allowable. The additional cost of living allowance is given according to the facts of the Minister's circumstances. Normally the constituency base is also the family home and therefore only a proportion of the expenses arising from constituency business can be allowed but if exceptionally, the circumstances justify it then a Minister may be able to claim a higher allowance.

c. 'London' is taken to mean a point within a twenty mile radius of the Palace of Westminster and a place is taken to be within daily commuting distance if the normal practice of the Minister is to stay in London only when his Parliamentary duties so require and otherwise to travel daily to perform his Ministerial duties.

FROM: M E DONNELLY
DATE: 7 January 1983

MR PAYNE - IR

LETTER FROM SIR PAUL HAWKINS MP

The Financial Secretary has seen your note of 22 December. He considers that a short acknowledgement of Mr Hawkins' letter would be courteous, saying that we have taken his points on board.

Perhaps you would provide this Office with a draft.

MED
M E DONNELLY

From: J PAYNE
INLAND REVENUE
POLICY DIVISION
SOMERSET HOUSE

22nd. December 1982

PS 20/1047/82

PRIVATE SECRETARY TO THE FINANCIAL SECRETARY

LETTER FROM SIR PAUL HAWKINS MP

We spoke on the phone about this case on 21 December 1982. In view of the MP's note at the top of this letter do you agree that a draft reply is not required please? A copy of the earlier correspondence is attached.

We shall of course take note of the MP's comments about the Tax Return and Guidance Notes.

FST
Are you content not to reply to Mr. Paul?
LH 23/12/82

J PAYNE

FROM: FINANCIAL SECRETARY
DATE: 11 January 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (R)
Minister of State (C)
Mr Ridley
Mr French
Mr Harris

BRUCE SUTHERLAND'S LETTER OF 13 DECEMBER

I have the following thoughts on Bruce Sutherland's letter.

1. As between abolishing LAPR and Superannuation relief, and instituting a relief for subscription to equity shares (Loi Monory à la Sutherland) I vote strongly for abolishing the existing reliefs. It may be we should introduce his Loi Monory - and then say "look - everybody is getting a relief; let's abolish them all and use the proceeds to lower income tax". That would take too long, and be too devious in my opinion. I would prefer to press on with our plans to abolish the reliefs, and hope to implement them in the first post election budget. It is simple, avoids complications (think of the schedules to his Loi Monory clause!) and widens the tax base. But we must lower income tax (or increase the thresholds) when we do it.

2. To some extent, paradoxically and superficially, we are moving in his direction. The expanded BSS scheme is becoming an unlimited relief for investment in equity - but only for unquoted companies and unconnected persons.

Secondly, I hope you will favour my scheme to allow every employee to be given up to 15% of his gross salary in the form of shares in his company - whether private or public.

This replaced the stock options in the 1972 Act, and is just about as good for the top employees - but much better for the lowlier ones. It is not only because I believe a Labour Government would end

stock options (which they would, although there may well not be another Labour Government), but it is also because I believe it is wrong to have privileges which are available for some but not others. 15% of everyone's salary is defensible and fair. Options for the bosses but nothing for the others is not.

Overall these two - business expansion and share ownership - go a long way in Bruce Sutherland's direction. If we later abolished LAPR and superannuation relief they might appear too generous - but I am in favour of discriminating in favour of investors in shares.

The other question is, do we discriminate too much in favour of unquoted, as approved to quoted, shares? The answer in probably yes, but the best cure is to abolish IIS.

I would welcome a meeting, or a talk at Chevening, to discuss all this.

ME Donnelly
pp NICHOLAS RIDLEY

FROM: M E DONNELLY
DATE: 11 January 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (R)
Mr Middleton
Mr Moore
Mr Monger
Mr French
Mr Graham - (Parly Counsel)
PS/IR
Mr Isaac - IR

WIDOW'S BEREAVEMENT ALLOWANCE

The Financial Secretary has seen Mr Isaac's note of 23 December covering Mr Spence's submission of 22 December. He has also seen the comments from the Economic Secretary and the Minister of State(R).

On balance the Financial Secretary is in favour of extending Widow's Bereavement Allowance for an extra year. He considers that it would be a useful "caring" measure for the Budget, and would also be something specifically for widows, which we need.

The difficulty with this course is not so much the possibility of ITTA in 1989, but the additional staff cost of about 40 extra personnel. However the Revenue cost (£25-£30 million) is small compared to the welcome this concession would receive from an important group in society.

MED
M E DONNELLY

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 11 January 1983

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir D Wass
Mr Middleton
Mr Kemp
Mr Moore
Mr Monger
Mr Robson

THE MORAL HAZARDS OF SOCIAL BENEFITS

The Financial Secretary has seen your note of 30 December to Mr Kemp.

The Financial Secretary considers that the key to the problems set out by Hermione Parker lies in NICIT. To implement NICIT would lead to massive problems, but give us a framework for a new departure in this area; the real problem being with NICs rather than the straighforward income tax system. If on the other hand we do not implement NICIT we have to live with the criticisms made by Ms. Parker.

Either way the resources problem means that we have to transfer some of the burden from the worst-off to the better-off.

The Financial Secretary would therefore like to take the decision on NICIT before any consideration of a new Beveridge: the need for such an exercise is likely to be greater if we decide against NICIT.

MED
M E DONNELLY

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 11 January 1983

PS/CHANCELLOR
(Ms Rutter)

cc PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (R)
Sir D Wass
Mr Littler
Mr Middleton
Mr Monck
Mr Moore
Mr Robson
Mr French
Mr Battishill - IR
PS/IR
Mr Quinn - B of E

INTERNATIONAL BANKING SCENE: TAX TREATMENT OF BAD DEBTS

You asked for the Financial Secretary's comments on Mr Battishill's submission of 5 January, and on the draft letter to the British Bankers' Association.

The Financial Secretary has commented that if banks re-schedule dubious sovereign risk debt, in theory it is not a bad debt. Since the banks are so keen to avoid defaults, one of the consequences should be that they should not be able to write-off sovereign - risk debts against their taxable profits. Moreover, he thinks that as we are not going to tax the banks this year, we should not make it easy for them to pay even less tax.

In his view the banks were pretty reckless in the way they lent money in the past to poor risk Sovereign States. He thinks they should get their fingers burned a little on this occasion - it may make them more careful next time. This is another reason for being a little sticky in letting them have tax relief for their losses. The Financial Secretary would therefore be fairly hard-nosed about the problem. It is however for the Revenue to administer the law as it stands.

He is happy for the letter to go to the BBA, subject to point (c) being toughened up a bit by a phrase like: "although re-scheduling will normally indicate that the debt is not bad.".

EK.

E KWIECINSKI
11 January 1983

CONFIDENTIAL

FROM: FINANCIAL SECRETARY
DATE: 11 January 1983

CHIEF SECRETARY

cc PS/Chancellor
PS/Economic Secretary
Mr Middleton
Mr Monck
Mr Moore
Mr Pirie
Mr Robson
Mr Godber
Mr Ridley
Mr French
Mr Harris
PS/IR

LETTER FROM IAN GOW TO CHANCELLOR: CHRISTOPHER HAWKINS' PAPER - LOW START MORTGAGES

I am commenting only on the Corporate Finance part which the Chancellor asked me to look at (Miss Rutter's note of 29 December). I hope the Inland Revenue will comment on this too, but some preliminary views might help, upon which I would also like their comments.

There is nothing, but their own refusal to do so, to stop companies issuing indexed bonds. The tax treatment of the bonds as Hawkins would have it, is as follows: the "real" interest would be deductible in the companies' hands, and taxable in the lenders. The lender pays CGT (after indexation allowance) upon redemption: ie. no tax. The borrower cannot treat his repayment as a capital "loss". It is all there, and available.

When pressing companies to issue indexed bonds I always receive the same reply. "We want certainty as to what our obligation to repay will be. With indexed bonds we cannot calcuate our eventual liability". How wrong they are. Indexed bonds are the only bonds they can calculate. In real terms, the value is the same as they borrowed.

I think Hawkins is right that Companies are repaying capital early by borrowing conventionally. But there are no obstacles to them adopting Hawkins scheme, and if there are we will sweep them away in the deep discount legislation in FB 1983.

He also argues that the taxation on the lender is excessive. That is not true if the lender is an exempt fund or a foreigner. There is no tax payable on an indexed bond which they buy. When it comes to individuals, yes, the rates of tax on "unearned" income are very high: but they are much lower on an indexed bond already, than on a conventional one. They only pay tax on any real interest they receive; the capital gain is shielded by the indexation allowance.

It seems that Hawkins has seen what is good for other people, who refuse to see it for themselves.

Incidentally I also suspect there is nothing to stop Building Societies issuing indexed mortgages as Hawkins wants now, too. But no doubt others will comment on this.

pp Sir Kenneth

NICHOLAS RIDLEY

FROM: M E DONNELLY
DATE: 11 January 1983

PS/CHIEF SECRETARY

cc Mr Mountfield
Mr Moore
Mr Robson
Mr Reed

CIVIL SERVICE NUMBERS AFTER 1984

... The Financial Secretary is content with the attached redraft by Mr Mountfield of the letter attached to Mr Reed's submission of 5 January for you to send to the Chairman of the Board of Inland Revenue.

MED
M E DONNELLY

DRAFT MINUTE TO PS/INLAND REVENUE

CIVIL SERVICE MANPOWER AFTER 1984

At Cabinet on 16 December Ministers discussed their policy on civil service numbers after April 1984 and concluded that, to provide a basis for setting for each department a manpower programme for each year up to 1988-89, the Chief Secretary should now co-ordinat a review of the prospects for further reductions.

2. The policy of the Governments first term in office has been successful in reducing the total size of the civil service, and in stimulating both efficiency and review of functions which the civil service performs.

3. Indictions are that there will be scope for further savings, taking numbers below 630,000, for example by further simplifying procedures, by speeding computerisation and by contracting out more work to the private sector. At Cabinet Ministers agreed to give special attention to this last.

4. The Chief Secretary has asked me to tell you of the intended form of the review and to put some suggestions. The aim should be always to improve efficiency, and to match staff numbers to departmental functions.

5. Ministers agreed to examine civil service manpower programmes with three main headings: first, the scope for reducing numbers on the basis of the continuation of existing policies; second, the manpower and financial implications of new policies envisaged, but not yet incorporated into expenditure plans; third, additional options for producing a further substantial reduction in manpower.

6. In carrying out the review in your department, the Chief Secretary asks you please to consider, and provide answers to, a number of questions. Most of these, which apply to all departments, are set out in the Annex to this letter. In addition I would like to stress the need for general improvements in efficiency and adequate means for monitoring these: as you know, most of your savings over the last few years have come from cuts in functions. It is also important to deliver the possible savings identified by the various reviews and scrutinies. It would be helpful to have a breakdown of the deployment of your present staff and of how their time is spent (by activity and/or function). It would also be helpful to have an assessment of the effect of COP including an up to date forecast of the savings it will produce.

7. Ministers are particularly anxious that the scope for contracting-out should be carefully examined. This is already being considered for the Valuation Office in the

Valuation Office review but it would be helpful to have your views on this and on other possibilities in your response to this letter. .One possibility would be some parts of tax collection e.g. the Accounts Office and bankruptcy proceedings. Ministers appreciate that it may be desirable to retain some of the staff savings and redeploy them onto other activities, e.g. action against the Black Economy. They also appreciate that new policy initiatives, such as changes in the taxation of husband and wife, may increase the work-load on departments and this will be taken into account. On the other hand, there may be scope for policy changes to cut staff requirements. For example, imposing interest and penalties on overdue PAYE might produce a net saving.

8. It will be helpful if your reply records any major policy options already being considered because of the public expenditure consequences, but which also have manpower effects.

9. Please indicate so far as possible, separately for each year from 1984-85 to 1988-89, both the manpower and related financial implications of your proposals. The baseline is the Estimates provision for 31 March 1984, and the programme figures for 1985 and 1986 set in the 1982 Survey.

10. I ask for your reply, please, by 31 March. When Treasury officials have had a chance to study these, a bilateral talk may be helpful in some cases before the Chief Secretary puts his proposals to Cabinet. If this seems useful, I shall get in touch with you again in due course.

11. The Chief Secretary is writing similarly to all Ministers in charge of departments.

LEON BRITTAN

DATE: 5 January 1983

1. FINANCIAL SECRETARY

2. CHIEF SECRETARY

cc Mr Mountfield — 9413
Mr Moore
Mr Robson

CIVIL SERVICE NUMBERS AFTER 1984

... I attach a draft letter for the Chief Secretary's Private Secretary to send to the Chairman of the Board of Inland Revenue.

2. Paragraphs 4 and 5 are specific to the Inland Revenue - the other paragraphs are in substance the general ones going to all Departments. There are two radical ideas in paragraph 5. First, the contracting-out of part of the collection service (the Accounts Office are computerised offices which print and issue assessments and routine reminders for payment of tax and handle the accounting work). Second, imposing interest and penalties on overdue PAYE. Neither is uncontroversial and it may be that examination would show that neither is worth doing. But you may feel that it is worth raising these issues now to ensure that they are properly considered.

J H REED

DRAFT LETTER FROM THE PS/CHIEF SECRETARY TO THE CHAIRMAN OF THE BOARD OF INLAND REVENUE

CIVIL SERVICE MANPOWER AFTER 1984

At Cabinet on 16 December, Ministers agreed that the time has come to consider the policy on Civil Service numbers after April 1984. The policy adopted for the Government's first term in office has been successful in that it has stimulated efficiency and productivity, and led to a questioning of the functions which the Civil Service performs. To date we have achieved savings of 77,000 out of the planned reduction of 102,000 by April 1984.

2. All the indications are that there is scope for a further rundown below 630,000 as procedures are simplified, computerisation spreads, and more work is contracted out to the private sector. At the same Cabinet meeting, it was agreed that special attention should be paid to the scope for the latter. It was concluded that the Chief Secretary should conduct a review of the prospects for further reductions after April 1984, and that this would be used as the basis for decisions on Civil Service manpower numbers between 1984 and 1988. The underlying aim of the exercise is to improve efficiency and motivation and to match staff numbers more closely to departmental functions.

3. The Chief Secretary has asked me to write to you now to let you know the form the review will take and to make some specific suggestions for savings in you department. Ministers agreed to examine manpower proposals under three main headings. First, the scope for reducing numbers on the basis of the continuation of existing policies; second, the manpower and financial implications of new policies envisaged, but not yet incorporate into expenditure plans; and third, additional options for producing a further substantial reduction in manpower.

4. In carrying out the review in your department the Chief Secretary would like you to consider, and provide answers to, a number of questions. Most of these, which apply to all departments, are set out in the annex to this letter. In addition I would like to stress the need for general improvements in efficiency and adequate means for monitoring these : as you know, most of your savings over the last few years have come from cuts in functions. It is also important to deliver the possible savings identified by the various reviews and scrutinies. It would be helpful to have a breakdown of the deployment of your present staff and of how their time is spent (by activity and/or function). It would also be helpful to have an assessment of the effect of COP including an up to date forecast of the savings it will produce.

A.

5. Ministers are particularly anxious that the scope for contracting-out should be carefully examined. This is already being considered for the Valuation Office in the Valuation Office review but it would be helpful to have your views on this and on other possibilities in your response to this letter. One possibility would be some parts of tax collection e.g. the Accounts Office and bankruptcy proceedings. Ministers appreciate that it may be desirable to retain some of the staff savings and redeploy them onto other activities, e.g. action against the Black Economy. They also appreciate that new policy initiatives, such as changes in the taxation of husband and wife, may increase the work-load on departments and this will be taken into account. On the other hand, there may be scope for policy changes to cut staff requirements. For example, imposing interest and penalties on overdue PAYE might produce a net saving.

B

6. In letting me have your answers, would you please indicate both the manpower and related financial implications of your proposals? It would be helpful if you could provide these figures for each of the years 1984-88. I recognise, however, that this may not be possible in each case. The baseline for the review is the Estimates provision for 31 March 1984, and the figures for 1985 and 1986 agreed in the 1982 PES.

7. I should be grateful if you would let me have your replies by 31 March.

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 11 January 1983

MR GRIMSTONE

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (R)
Sir D Wass
Sir A Rawlinson
Mr Bailey
Mr Middleton
Mr Burgner
Mr Morgan
Mr Wilson
Mr Wicks
Mr Neilson
Mr Ridley
Mr Harris

RESIDUAL GOVERNMENT SHAREHOLDINGS

The Financial Secretary was grateful for Mr Neilson's note of 7 January listing residual Government shareholdings in privatised and other companies.

The Financial Secretary considers that there is scope for reducing our minority shareholdings in BP and BAe by sales of shares during the course of the summer. He would be grateful if you would provide advice on how best to take this forward.

Further sales of shares in Britoil and Cable and Wireless must await the next Parliament. But there would be no reason for us not to aim for more sales of these shares then.

The Financial Secretary has also queried why we retain shares in many of the Companies Act Companies listed in the 14 December 1981 ... PQ. I attach a list (top copy only). He would be grateful for an updated list of these companies; and the reasons why these shares have not yet been sold off.

MED

M E DONNELLY

FROM: E KWIECINSKI
DATE: 11 January 1983

MR E McGIVERN - IR

cc PS/Minister of State (C)
PS/IR

REVIEW OF PERSONNEL WORK

The Financial Secretary has seen your note of 5 January, and has read the summary of recommendations in chapter 1 of the Report. It is a major report and he looks forward to hearing the views of the Minister of State (C) and those of the Board.

He has commented that the main issues it raises will be for discussion with MPO because they impinge on Service-wide rules and practices.

The main issues seem to him to be the two you have highlighted: 1) Recruitment at local level and 2) Inefficient staff, and also 3) Efficiency savings (paragraph 5.25).

His own view is that the Civil Service should be less monolithic, so that if these three major (and the many other minor) recommendation suit the Inland Revenue, then the fact that they may not suit the other Departments should not be a reason for not proceeding with them.

He is content for you to proceed as requested, including in due course, discussing the Report with the Unions.

He wonders whether we should make the Report publicly available by placing it in the House of Commons' library at the right moment. He thinks it is far better for us to publish it first, rather than let the Unions leak it.

E KWIECINSKI
11 January 1983

Extract from Hansard 14 December 1981

WA 8-9

Public Sector Companies

Mr. David Atkinson asked the Prime Minister if she will list those industries and companies which are State-owned, or in which the Government own shares, giving the percentage stake where appropriate.

The Prime Minister: The information requested is set out as follows. Details of the subsidiaries, associated companies or minority interests of each of these industries, companies and other bodies are given in their published annual reports and accounts. The list excludes companies in receivership, liquidation or no longer trading in which the Government own only non-voting shares.

Nationalised Industries

National Coal Board
Electricity Supply Industry (England and Wales)
North of Scotland Hydro-Electric Board
South of Scotland Electricity Board
British Gas Corporation
British National Oil Corporation
British Steel Corporation
Post Office Corporation
British Telecommunications Corporation
National Girobank
British Airways Board
British Airports Authority
British Railways Board
British Transport Docks Board
British Waterways Board
National Bus Company
Scottish Transport Group
British Shipbuilders

Companies Act Companies	*Percentage of shares held by the Government*
Amersham International	100·00
American Monitor International	84·00
Ards Holdings	28·00
Ben Shennan (1975)	100·00
British Aerospace	48·43
British Leyland	99·60
British Nuclear Fuels	100·00
The British Petroleum Company Ltd.‡	21·89
Cable and Wireless	50·40
Channel Tunnel Company	100·00
Cince Textiles	46·30
Cor Van Houghton	28·60
C. P. Trim	49·00
C. Walker and Son (Ireland)	49·90
Duratool	23·40
Franzen UK	25·00
Harland & Wolff	100·00
International Military Services	100·00
Irlandus Circuits	40·00
Issac Hamilton	25·00
John Hastie (Greenock)	41·00
Kearney and Trecker Martin	26·50
Lintrend Development (Northern Ireland)	99·90
Mersey Docks and Harbour Company*	20·00
National Freight Company†	100·00
National Nuclear Corporation	35·00
National Seed Development Organisation	100·00
Northern Ireland Planners	100·00
Norton Villiers Triumph	21·60
Oaks Development Laboratories (Ireland)	25·00
Power Automation Products	49·00
Rolls Royce	100·00
Short Brothers	100·00
Sperrin Textiles	31·00
Standard Mills (Rochdale)	57·00
Tufted Carpet Tile	28·60
Ulster Catamics	47·70
Viking Manufacturing	100·00
Villiers	1·20

*Further special rights are also guaranteed to the Government.
†The Government intend to sell their shares in the NFC before the end of this financial year.
‡ Shares held by Bank of England have now been transferred to Treasury – the Government shareholding is now 34·3%

There is a number of other companies in which the Government have a nominal interest, or which have no share capital. In addition, a number of the public corporations listed in table 5.1 of the Public Expenditure White Paper, Cmnd. 8175, e.g. the National Enterprise Board and the Civil Aviation Authority, could also be regarded as falling into the same category.

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 11 January 1983

MR MONGER

cc PS/MST(R)
Mr Moore
Mr Robson Ms. Seammen.
Mr French Mr. Kidley
Mr Isaac/IR Mr. Harris

FINANCIAL SECRETARY'S HOLIDAY THOUGHTS ON PENSIONS

... I attach the Financial Secretary's paper: "Holiday Thoughts on Pensions'.

... Also attached is the Institute of Directors' paper 'A New Approach to Pensions'.

The Financial Secretary's initial comment on the latter is that it seems to make things a bit too complicated:-

1) NIC's - would be compulsory but not tax deductible

2) Superannuation contributions - would be compulsory but tax deductible.

3) The "RPF" contributions - bringing the employee up to say 15% of his income, would be tax deductible but compulsory.

He suggests that the IoD paper should be considered alongside his own. He would welcome your and copy recipients early comments.

E KWIECINSKI

CONFIDENTIAL

HOLIDAY THOUGHTS ON PENSIONS

One of the difficulties we come up against in our discussions on pensions is the undesirability of allowing more than the minimum number of people arriving at pensionable age with pension entitlements less than the level of supplementary benefit. First, we hope they will all have a NI pension, and we make contributing to that compulsory. Second we hope as many as possible will have an occupational pension too: we give them tax relief, if contracted out, and make it (more or less) compulsory for them to contribute.

2. We do this because it costs a lot in SB if they have to have their pensions "topped up". [I believe the figure is £700m - confirm please!]

3. Surely the time is coming when we should make the NI pension at least equal to basic SB levels? I would be grateful to know what this would cost, but there are two ways by which we could pay for it.

a) we could increase NI contributions to cover the cost of it;

b) we could end tax relief for contributions to private occupational pension schemes (£900m) and use this money to top up the National Insurance Fund; or

c) we could do a combination of both.

Furthermore, there would be a gross cost of such an increase in pension, and a net cost - because there would be more tax paid on the increased pensions. It is the net cost that matters.

4. To do this would of course be politically popular; but equally it is undesirable, in that it would be a further transfer of income from earners to pensioners. But read on!

5. It must be right to treat all contributions to pension entitlement the same way for tax purposes. For NI contributions, and graduated contributions, to come out of taxed income, and occupational pension contributions to come out of untaxed income, is an anomaly indeed, [made worse by the quasi-compulsory nature of the latter].

6. If superannuation contributions were voluntary, the combination of that and of no tax relief, would doubtless reduce the scale of occupational pension provisions. This would mean a reduced transfer of income from earners to pensioners, offsetting the increase identified in para 4.

7. In two changes - increasing the NI pension to SB levels, and removing tax relief for occupational pension contributions would thus be more or less self-balancing - both in revenue terms, and in terms of the shift of resources from earners to pensioners. In other words, what they would result in would be an increase in the mandatory minimum level of pension, at the expense of the help given

to those who want to increase their pension above the minimum.

8. But it unlocks some doors to do this. It enables us to be indifferent to whether people save over and above the NIC or not. It enables us to dismantle the pension funds over time, and return the savers' capital to the saver, and to introduce much more freedom to people to deal with their own money as they will. It begins to take away the bias in favour of Institutions.

9. It could also open the way to the "private money box", discussed at our meetings on this subject. It would work something like this:-

a) employees could contract <u>in</u> to the graduated pension scheme, or out of it. The contracted in would continue much as at present, but contracting in would be voluntary for the individual;

b) contracted out employees would get no tax relief on their contributions to their occupational pension scheme, but would still get their employers' contributions, tax deductible for the employers, and treated as a tax free addition to wages for the employers;

c) contributions, employees' and employers', to pension funds would be on a <u>contractual</u>, but <u>individual</u> basis. Each employee would have his own fund, in trust, as it were. His fund's income would remain

tax exempt, but the ultimate ownership would be his. Whether we should require him to keep it in trust for a specified number of years, or until he reaches a certain age, or until retirement, is a question for discussion. But according to whichever route we decided to adopt the capital would ultimately become his own nest egg. He would be free to blow it; invest it and live off the proceeds, or to buy an annuity. He would be taxed on the income (unearned) from the capital however invested; but not taxed on the realisation of any capital sum.

Director General
Walker Goldsmith

116 Pall Mall
London
SW1Y 5ED
Telephone
01-839 1233
Telegrams
Boardrooms
London SW1
Telex 21614

A NEW APPROACH TO PENSIONS

A discussion paper prepared by
Derek C. Bandey
Hon. Pensions Adviser, Institute of Directors

December 1982

A NEW APPROACH TO PENSIONS

1.1 It is perceived that occupational pension schemes suffer from some defects, brought about by the monetary inflation rates of the past few years.

1.2 These defects can be summarised by stating that generally - except in the Public Sector - such schemes provide benefits in 'money-terms' rather than 'real-terms'. Also, they have been generally constructed in an era of more stable employment than recently experienced with, therefore, an ordering of priorities different from what now might be considered preferable.

1.3 This results in apparent penalties falling upon the 'early-leaver' and the 'pensioner' both of whom see a realistic value at the time of vesting becoming later an unrealistic benefit.

1.4 Legislation has been mooted as the answer to these problems. The Chancellor of the Exchequer, in a major speech to the National Association of Pension Funds, questioned the viability of the transference of assets from the active to the retired population. Legislation as generally understood, and as recommended by the OPB and the Scott Committee requires a greater transference, which is incompatible with the fears expressed by the Chancellor and the current ability of industry to finance.

1.5 The only way in which legislation can help is to direct the redeployment of existing resources earmarked for pensions, with the unpopularity stemming therefrom. Legislation directing the deployment of additional resources would inevitably fail in the current economic climate.

2.1 It is not so well known that the current operation of the Superannuation Funds Office of the Inland Revenue Authorities (SFO) in monitoring occupational pension schemes under the terms of the Statute, is a positive deterrent to people helping to solve the problems for themselves. Accordingly, there is a source of additional resource which is not fully utilised.

2.2 The relaxation of those controls could release the energies of the market-place to resolve the problems and enable the populace to more effectively provide for their old age themselves.

3.1 Some of the controls exercised by the SFO are more social in nature than fiscal. It is, for instance, a social decision that a retired employee

shall have a lower income than a non-retired employee and the existing imposition of a two-thirds limit, with the concomitant plethora of variations and regulations attaching thereto, seems to be an unscientific hang-over from the early part of the 19th Century.

3.2 The fiscal undertone is of little consequence. That undertone stresses the fiscal inequity of a person transferring present highly-taxed income to more lowly-taxed retirement income. This argument had some force, but not very much, when penal marginal rates of personal taxation applied. With the continued reduction in the levels of personal taxation, the argument becomes increasingly insignificant.

3.3 It must be accepted that there should properly be fiscal controls. The authorities should ensure that the input to pension provision is reasonable; namely, where tax relief is provided there should be fiscal control over the amounts of the employer's contributions and those of the contributing person. The only other area of fiscal control necessary is to regulate the amount of tax-free benefit emerging from the pension arrangement.

3.4 None of the other myriad of controls exercised by the SFO are primarily fiscal in nature - such as a limit on the amount of taxable pensions that can be provided; limits on amounts transferred to a widow or other dependant; benefits on leaving service and/or death.

4.1 An apparently simple solution is to 'set the people free' and allow market forces to operate in an uncontrolled manner. Unfortunately, this does not seem practical and some control in order to guide the enormous resource utilisation will continue to be necessary. For instance:-

> if existing occupational schemes were to become de-institutionalised, through outlawing compulsory entry, vast numbers of employees would opt out of pension provision placing an even greater burden on social security provision;
>
> a movement away from the present institutionalised method to personal provision must inevitably involve a move from a benefit-orientated provision to one that is contribution-orientated, thus ultimately creating even greater problems;
>
> there would be inexorable pressure for benefit levels even higher than the present two-thirds which (particularly in the Public Sector) already leads to retirement incomes equal to, or in excess of, pre-retirement earnings.

4.2 It has to be recognised that solutions lie only in the area of either additional resource allocation or the re-allocation of existing resource. To alter the method, i.e. to move from final-pay benefits to contribution-based money purchase achieves no increase in the totality of the provision; if one happens to achieve more than the other then a greater resource allocation is involved. What such a move does is to re-allocate the resource by arriving at a different order of priorities.

4.3 If such a different order of priorities is required, then that can be achieved under existing arrangements. The only thing stopping such re-allocation is a lack of desire to do so. To pretend that by using the same resource better results can be achieved through a different method of construction, is a 'con trick' that will be exposed through the passage of time.

5.1 It can be argued that the current resource deployed for pensions is too great. Future cost trends are worrying. Yet pressures abound covertly if not overtly for yet further deployment in such areas as:-

- indexation of pensions in payment (Scott Committee)
- indexation of deferred pensions (Occupational Pensions Board)
- flexible and equal retirement ages (House of Commons, Select Committee)
- sex equality (EEC and EOC)

5.2 To meet such ever-growing needs of society it seems that, so long as re-allocation is impracticable and additional resource is not generally available, those needs must to a greater extent be placed upon the individual. By creating an environment enabling the individual to voluntarily transfer some of his current earning capacity to provide additional retirement income at his expense, the burden of resource utilisation is more evenly spread where it is required.

6.1 Thus, solutions lie not in one or other extreme but in finding a way to more effectively marry the advantages of the two extreme systems of institutionalised benefit - orientated schemes and personal contribution-based schemes.

7.1 Freedom from some existing controls could pave the way to solutions. For instance, an employed person may now apply 15% of his Schedule E earnings for pension provision - in addition to the contribution made for him by his employer. In a contributory pension scheme such employee may be paying 5 or 6% - leaving 9 - 10% that he can, if he so chose, apply to solve the problems of a money pension versus a real pension. Why employees do not do so is because:-

(i) There is, even now, a general unawareness on his part because an active market is constrained by the SFO requirements.

(ii) Some employers are not prepared to offer a facility and even many of those who do fail to actively promote it.

(iii) Even the aware employee will often be reluctant to contribute up to the maximum currently allowable for tax, in the fear that the application of the SFO benefit limits may deprive him of any benefit therefrom - which, of course, they can do. As an illustration, a pension scheme may quite properly be established with a retirement age of, say, 60 providing a full two-thirds pension. But if the scheme is established with a retirement age of, say, 65 and the employee is retired (early) at 60 his pension must be proportionately reduced. Yet it is just in this area, with unemployment at current levels, that there could be benefit in encouraging employees to contribute to build-up an adequate early retirement pension to meet such redundancies.

7.2 It is suggested that a free market, but not an irresponsible one, should be allowed to develop to enable people to more freely make additional provision for their old age. This would have the twin objectives of

(a) enabling a move towards the solution of the problems confronting occupational pension schemes in their present form and

(b) diminishing the ultimate demands upon the State which will otherwise arise from inadequate personal provision.

As an encouragement to this end, it would not be unreasonable to require, as a condition of exempt approval, every occupational pension scheme to provide for the facility of additional voluntary contributions. That facility could further embrace a range of choices, such as investment in the fund itself, a Building Society, Unit Trust, etc.

7.3 In essence, it is suggested:-

(i) that occupational pension schemes should continue in broadly their present form;

(ii) that all the institutional investors, Banks, Insurance Companies, Building Societies, Unit Trusts, etc. should be allowed to accept, in a specially segregated fund contributions from individuals specifically ear-marked for 'retirement provision', e.g. a Retirement Provision Fund (RPF). Contributions to such RPFs would be rolled up gross - as for occupational pension schemes and retirement annuities at present, with the contributions fully allowable for tax.

(iii) that (as at present) every employed person may contribute as level annual payments or single payments from time to time, a proportion of his earnings - over and above what an employed person is required to pay to his Company's scheme - up to a fiscal percentage (whether or not the present 15% is the right level is a detail for later consideration). The benefit from such RPF can arise only as a retirement benefit upon proof of retirement.

Where part of the benefit is paid as untaxed cash, a monitoring system would be established to ensure that the totality of such cash did not exceed the prescribed limits. Otherwise, the benefit would be paid as taxable income to the employee and/or his dependants, without limits applied thereto. If it is considered essential to retain the 'two-thirds limit' - and owing to the extravagant provision in the Public Sector that may be the only practical way to prevent even further extravagant provision - it would be necessary to have a further monitoring provision to ensure that the totality of the benefit did not exceed that limit.

(iv) Furthermore, it is recommended that the Social Security Statutes should then be reviewed to enable/encourage a part of redundancy payments (or other lump sums) to be directed into an RPF. It is scandalous that the present statutes positively encourage redundant employees to fritter away such payments and to then become a burden on the State.

8.1 The creation of such a wider free market could have a significant effect in translating the burden of retirement provision away from the State and Corporate bodies and create the educational environment that is necessary. The problems of such a radical development may be briefly summarised as:-

(i) Primary legislation would be involved as what is proposed falls outside the principles of Finance Act 1970. And, certainly any amendment to the Social Security Statutes would be a significant development.

(ii) The total taxable income would exceed the arbitrarily imposed two-thirds limit and its concomitant controls unless monitoring controls are introduced. In any event Section 32 of the Finance Act 1981 has itself undermined this particular control.

(iii) Inevitably, comparisons will be drawn between employed and self-employed persons. The former could enjoy the benefits of an occupational scheme as well as making their own provision in respect of excess allowable contributions. This hardly seems an insuperable barrier and, perhaps, simply means that the retirement provisions for the self-employed are inadequate.

(iv) The creation of such a free market may undermine the existence of occupational pension schemes - through, for instance, employees seeking to opt out and totally provide for themselves, although by doing so they would forego substantial benefits. Such a development would be unfortunate and should be resisted, as the criteria in seeking to solve problems would be thwarted. Any such development should therefore be geared to preserving the effectiveness of such schemes and not in their replacement.

9.1 This paper outlines an idea which to some may be seen as a radical one. However, tinkering around with what exists at present is unlikely to solve the problems and more far-reaching solutions have to be found. It is accepted that considerable detail would need to be considered in furthering this idea.

9.2 If it is not practical to seek the additional resource from employees, then a determined educational campaign needs to be embarked upon, leading perhaps even to legislation, to achieve a re-ordering of the priorities allocated within the present resource capability. To allow other methods to start to impinge as apparent panaceas will inevitably lead to a situation of 'the best of both worlds' which must involve additional resources.

D.C. BANDEY

9th December 1982

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 11 January 1983

MR C STEWART/IR

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir D Wass
Mr Middleton
Mr Robson
Mr Crawley/IR
Mr Green/IR
PS/IR
Mr Graham (Parly Counsel)

"JOB-RELATED" MORTGAGE INTEREST RELIEF FOR THE SELF-EMPLOYED - BUDGET STARTER No.191

The Financial Secretary has seen your submission of 7 January.

His feeling is that we should legislate the narrow and restricted solution - (A): where there is a contractual requirement. He has commented that Frost v Feltham may have opened the door, but it is too complex and it is not clear who will qualify and who will not. He thinks it is better to clear the situation up properly, and to put the employed and self employed on the same footing as regards job related accommodation. As far as he is aware only public house and farm tenants have been pressing, and it will stop this running saga, if we meet their case.

He therefore suggests that we proceed with (A), with the concomitant CGT relief limited to the (A) category.

E KWIECINSKI

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 12 January 1983

MR BATTISHILL - IR

cc PS/Chancellor (with attachments)
PS/Chief Secretary (")
PS/Economic Secretary (")
PS/Minister of State (C) (")
PS/Minister of State (R) (")
Sir D Wass (")
Mr Middleton (")
Mr Moore (")
Mr Lovell (")
Mr Robson (")
Mr Chivers (")
Mr French (")
Mr Graham - Parly Counsel (")
Mr Corlett - IR (")
PS/IR (")

CAPITAL ALLOWANCES AND FILMS

... I attach a note of the Financial Secretary's recent meeting with representatives of the Independent Television Companies Association Ltd.

I can confirm Ministers' decision to extend the present transitional relief for British films from two to five years.

As discussed after the meeting with ITCA, the Financial Secretary would be grateful if you could prepare a draft PQ and Answer to be used to announce the decision next week.

EK

E KWIECINSKI
12 January 1982

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 12 January 1983

NOTE OF A MEETING HELD IN FINANCIAL SECRETARY'S ROOM, HM TREASURY AT 5.00PM, 11 JANUARY 1983.

Present at Meeting: Financial Secretary
Mr McCall)
Mr McNally) ITCA
Mr Connell)
Mr Battishill) IR
Mr Corlett)

CAPITAL ALLOWANCES FOR TV AND FILMS: MEETING WITH REPRESENTATIVES OF THE INDEPENDENT TELEVISION COMPANIES ASSOCIATION LTD

The Financial Secretary opened the discussion by briefly summarising the reasons which lay behind the decision to change the provision of capital allowances for films in the last Budget. There was a real need to stop foreign film makers from routing the finance of their films through the UK solely to obtain UK capital allowances. Many millions of pounds of revenue were being lost, yet the benefit from the films in terms of profits and export value was going to the foreign companies in their foreign domicile. While this was primarily a problem in the cinematographic film making industry, foreign TV companies could also take advantage of the loop-hole which existed. Something had to be done to stop this. The Government recognised the problems facing the domestic film industry, but to have given the UK industry permanent reliefs would have caused us severe problems with our trading partners under the GATT agreements. Hence the introduction of transitional relief for the domestic industry, which so far, had not been challenged under GATT, although strictly it was not legal. He stressed that the UK industry's continual public campaign could alert our trading partners to the preferential treatment currently given to domestic companies. It would be better for all concerned if the television companies would keep quiet.

Mr McCall commented that the ITCA appreciated the problem and he would try to ensure that the campaign was less public in the future. He did though feel that the TV companies had been caught in a net which was meant for the cinema film industry. In particular they

were aggrieved that domestic TV should have to qualify for the transitional relief by satisfying the "Eady" definition. He wondered if a different special definition could be used for TV programmes, which would not be quite so restrictive on the use of non-EEC labour. More generally the companies would face severe cash flow problems when the transitional relief ended.

Mr Battishill explained that the "Eady" definition had been chosen because it was judged that its use would not cause us any problems with our EEC partners; so far this had proved to be the case. He wondered though if this really was such a problem for the TV companies. He felt sure that in practice very few programmes made by UK TV companies would fail the "Eady" test.

Mr McCall agreed that it was not a major problem but he envisaged difficulties with certain programmes made on location overseas.

Mr McNally felt that the main problems with "Eady" could prove to be administrative ones in that eg every programme in a series had to be tested for content individually, rather than the series being tested as a whole. This could give the companies problems with their auditors. But he agreed that this was more something to be taken up with the Department of Trade.

In summing up the discussion the Financial Secretary commented that he and his colleagues would continue to consider sympathetically the needs of the UK TV and film making industry. However, the Government's room for manoeuvre in giving relief solely to UK companies was severely limited by our international trading obligations under GATT and within the EEC. These should not be underestimated.

The ITCA members thanked the Financial Secretary for a most helpful meeting.

EK

E KWIECINSKI

12 January 1983

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 12 January 1983

MR L J H BEIGHTON - IR

cc PS/Chief Secretary
PS/Minister of State (R)
Mr Moore
Mr Robson
Mr French
Mr Graham - Parly Counsel
Mr Bryce - IR
PS/IR

CAPITAL GAINS TAX: RETIREMENT RELIEF

The Financial Secretary was grateful for your minute of 7 January covering Mr Bryce's submission of 6 January.

He thinks it is impossible to contemplate a major recasting of the CGT retirement relief in the 1983 Finance Bill. Apart from outside consultation, we would need time for internal discussion and debate.

However he sees the advantage of increasing the relief from £50,000 to £100,000 (at a cost of £1½m).

He thinks it could form part of an "enterprise" package in the Budget.

E KWIECINSKI
12 January 1983

FROM: E KWIECINSKI
DATE: 12 January 1983

PS/CHIEF SECRETARY

cc PPS
Minister of State (R)
Mr Moore
Mr Robson
Mr French
Mr Kemp
PS/IR
Mr. Beighton/IR.

THE UNQUOTED COMPANIES GROUP: BUDGET REPRESENTATIONS

The Financial Secretary has seen your minute of 7 January and Mr Bryce's note of 11 January.

He has made the following comments:-

1) he is wholly against the proposal to exempt from CGT any asset disposed of after being held for seven years or more; especially as the indexation provisions were enacted only last year;

2) the indexation of CTT rates and bands is the subject of a separate note that he will be sending to the Chancellor in the near future;

3) he would be grateful for the Chief Secretary's views on the Unquoted Companies' proposal for "holdover relief" for CTT now that he has seen Mr Beighton's submission of 22 December. He would appreciate a quick word with the Chief Secretary about this.

SK.

E KWIECINSKI
12 January 1983

FROM: E KWIECINSKI
DATE: 12 January 1983

PS/CHIEF SECRETARY

cc PS/Minister of State (R)
Mr Moore
Mr Robson
Mr French
Mr Graham - Parly Counsel
Mr Beighton - IR
PS/IR

CAPITAL GAINS TAX: RETIREMENT RELIEF

You will have seen my minute of today's date containing the Financial Secretary's comments in response to Mr Beighton's submission of 7 January.

The Financial Secretary suggests that the CGT retirement relief exemption limit should be raised from the present £50,000 to £100,000.

He thinks this could form part of an "enterprise" package in the Budget.

E KWIECINSKI
12 January 1983

FROM: M E DONNELLY
DATE: 11 January 1983

MR TURNBULL

cc PS/Chancellor
PS/Economic Secretary
Mr Burns
Mr Middleton
Mr Monck
Mr Oddling-Smee
Mr Sedgwick
Mr Willetts

PAPER BY MR STANLEY PASSMORE

The Financial Secretary was grateful for your interesting analysis of Mr Passmore's ideas.

The Financial Secretary remains uncertain about the effects of Mr Passmore's zero PSBR on velocity. He would be grateful for your further comments on this point; and also on whether Mr Passmore is suggesting that lower interest rates but higher taxes would have caused less unemployment over recent years during the transition to lower inflation.

The Financial Secretary feels that we need to refer to this aspect of Mr Passmore's argument in the draft reply. He has therefore re-drafted the final paragraph of the letter as follows:

> "Finally, I share Mr Passmore's view that controlling Government borrowing is vital, though I would see it as an essential component in our financial strategy which needs to be made consistent with monetary targets, rather than as an alternative to such targets. As I said at our lunch, to have had a zero PSBR over the last two or three years would in my opinion have created even tighter monetary conditions, while he argues that they have already been on the tight side. Nor do I believe the political consequences of even higher taxes, lower spending, or a mixture of both would have been acceptable."

MED
M E DONNELLY

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 13 January 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Mrs Hedley-Miller
Mr Lavelle
Mr Edwards
Mr Gordon
Mr Mercer
Mr Ridley

REVIEW OF THE EUROPEAN SOCIAL FUND

The Financial Secretary has seen Mr Tebbit's letter of 5 January to Mr Pym and Mr Mercer's submission of 11 January.

2. The Financial Secretary is concerned about the terse line on additionality suggested in paragraph 6 of Mr Mercer's note. He has commented that while not disagreeing with the substance of this line we must find a way of being less blatant in our presentation of it, to cater for European sensitivities. We should call some of our expenditure programmes "European" (or even 'Strasbourg"!) in order to stress the Community element to the spending.

3. The Financial Secretary would be happy to discuss this question further, in the light of any comments the Chancellor may have.

MED
M E DONNELLY

CONFIDENTIAL

FROM: THE FINANCIAL SECRETARY
DATE 13 January 1982

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (R)
Sir D Wass
Mr Burns
Mr Bailey
Mr Moore
Mr Lovell
Mr Robson
Mr Odling-Smee
Mr Turnbull
Mr Sedgwick
Mr Willetts
Mr Crawley) IR
Mr Stewart)
PS/IR

TAX TREATMENT OF GILTS: A RE-EXAMINATION

On a first reading of the papers attached to Mr Monck's submission of 11 January my instinct is not to reimpose CGT on gilts held for over a year, nor on the uplift on low coupon gilts. To do so would be complex, cosmetic, and could interfere with funding (although perhaps it might help restrict over-funding!). Instead, I prefer the concept of extending similar privileges to corporate bonds. This would not be difficult with indexed bonds - which would pay the "real" rate of interest, which would be taxable; and they effectively separate interest from capital uplift by following the RPI.

2. Indeed this is what we should seek to do throughout - to tax "real" interest, but not to tax apparent capital gain which is neither a real gain nor loss. The trouble is that we do now tax nominal interest on eg conventional bonds and gilts. We simply cannot afford to stop doing this; but we should try and move towards the principle outlined above if and when we can afford to do so!

3. Similarly when considering deeps and zeros the same principle should apply: tax any interest paid, or not paid, that represents "real" interest but give CGT status to that part of the capital uplift which merely matches inflation.

4. But this is probably impossibly complicated to do. It would mean allocating the discount between deemed "real" interest, and the index capital uplift. On this point we must await replies to the Revenue consultative document.

5. The best solution of all - in theory - is to tax all "real" interest on gilts and bonds only - and treat the rest as capital. That would be even harder to do - the complications increase!

NICHOLAS RIDLEY

FROM: M E DONNELLY
DATE: 13 January 1983

MR LITTLER

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir D Wass
Mr Middleton
Mr Kemp
Mr Lovell
Mr Carey
Mr Traynor
Mr Beastall
Mr Andren
Mr Ridley
Mr French
Mr Harris

FOOTWEAR AND LEATHER INDUSTRIES: BRAZIL

The Financial Secretary has been considering Sir K Couzens' note of 22 December, and Miss O'Mara's note of 23 December.

2. He wonders whether Sir K Couzens' note was not rather too dismissive of the possibilities of using such IMF rescue operations as a lever for obtaining better trade behaviour. Although we are only a junior partner in this Brazilian rescue operation, surely the more senior partners also want, and have an interest in, better trade behaviour. The view of most people - with which the Financial Secretary would agree - would be that stopping unfairly cheap imports is a more important UK interest than mounting a financial rescue operation for Brazil. These circumstances provide a unique opportunity to link the two, which in the longer term even the Brazilians would not thank us for passing over. He therefore considers that this matter should be raised urgently with Larosiere.

MED
M E DONNELLY

FROM: E KWIECINSKI
DATE: 14 January 1983

NOTE OF A MEETING HELD AT HM TREASURY, 4.15PM, 13 JANUARY 1983

Present at Meeting: Financial Secretary
Sir Emmanuel Kaye)
Mr M Worley) The Unquoted Companies'
Mr M Brent) Group
Mr R Fawcett)
Mr. A. Tracey - IR

THE UNQUOTED COMPANIES' GROUP: BUDGET REPRESENTATION

The Financial Secretary welcomed the UQCG delegation. He commented that he was very familiar with the Group's case, and Ministers were considering their representation along with the many others they receive at this time of year.

Mr Worley commented that the Group's main request for action this year was on CTT, as follows:-

a) the introduction of "hold-over" relief from CTT for business assets;

b) improving the 20% and 50% reliefs from CTT for business assets;

c) indexation of CTT rates schedule to reflect price movements from the introduction of the rates in 1974; and

d) abolition of grossing-up of lifetime gifts for CTT.

Of the four points, a) and b) were their priority for action.

The Group argued at length about the major disincentive the CTT had on the growth of unquoted companies.

Their main arguments were that:

i) Unquoted Companies performed better economically than public companies and should be encouraged to expand; and

ii) that the measures they proposed were relatively cheap.

Hold-over relief

The Group argued that this relief would remove the inhibitions that family businesses had about expanding beyond certain levels.

The Financial Secretary commented that he was worried about the possible "locking-in" effect such a relief would have on asset-holders. Also such a relief could not be restricted to unquoted companies but would have to be extended to the business assets of farmers; something he was less keen to do.

It would also be fairly expensive, and he felt that now was perhaps not the time to introduce such a radical and complex measure. Given that the cost of introducing this relief was akin to that of complete exemption he did not see what particular advantage it had over the latter course.

Business reliefs

Mr Worley commented that it should not be politically difficult to improve these reliefs. It would be inexpensive and beneficial to the economy.

The Financial Secretary accepted these arguments but commented that in making changes to taxation of any kind the Government had to bear in mind the wishes and needs of the broad mass of taxpayers as well as those of special interest groups such as the UQCG.

Indexing the rate schedules and cutting the rates

The Group commented that the UK had about the most burdensome CTT regime in Europe. Mr Brent felt sure that this was one of the reasons why the UK had fewer family businesses than the rest of Europe.

The Financial Secretary commented that the various reliefs available to business mitigated the more onerous burden at the top end of the scale. Also as the system was a "slice" one it was not quite as oppressive as it appeared on paper. He agreed to write to the UQCG with details of the cost of fully indexing the schedules from 1974 (Mr Beighton please supply draft.)

The meeting closed at 4.50pm.

E KWIECINSKI
14 January 1983

Circulation:

PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Mr Robson
Mr French
Mr Tracey) IR
Mr Beighton)
PS/IR

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 17 January 1983

MR J P B BRYCE - IR

cc PS/Chief Secretary
PS/Minister of State (R)
Mr Moore
Mr Robson
Mr French
Mr Graham - Parly Counsel
Mr Beighton - IR
PS/IR

CGT: ANNUAL EXEMPT AMOUNT (BUDGET STARTER NO 107)
CGT: OTHER MONETARY LIMITS (BUDGET STARTER NO 141)

The Financial Secretary has seen your submission of 13 January.

He has made the following comments on para 23 of your submission:-

a) he agrees that the annual exempt amount should be revalorised;

b) he agrees that the £250,000 limit on the payment by instalment facilities should be abolished (and that the period should be increased from 8 to 10 years);

c) he agrees that the small gifts exemption should be abolished;

d) he agrees that the limit on the relief for small part disposals of land should be increased from £10,000 to £20,000;

e) he agrees that the limit on residential letting reliefs should be increased from £10,000 to £20,000;

f) he is content for the chattels exemption to remain unchanged at its present level of £3,000.

He commends this useful budgetary package to his Ministerial colleagues.

I Kwiecinski.

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 18 January 1983

MR L J H BEIGHTON - IR

cc PS/IR

CAPITAL TRANSFER TAX

The Financial Secretary has seen your note of 17 January.

His CTT recommendations will be submitted to the Chancellor etc shortly.

He has made the following comments on the three minor points you raised:-

1) He agrees that the lifetime rate scale set out at the top of page 3 of your note would be acceptable, if his proposed death rate scale is agreed.

2) He agrees that assets now qualifying for business relief at 30% should be given the same level of relief as that decided upon for minority shareholdings.

and 3) He thinks the facility to pay CGT by interest-free instalments should be dropped.

E KWIECINSKI
18 January 1983

CONFIDENTIAL

FROM: NICHOLAS RIDLEY
DATE: 18 January 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Mr Middleton
Mr Moore Mr. Lovell.
Mr Robson
Mr Fitchew
Mr Kemp
Mr Ridley
Mr French
Mr Harris
Mr Beighton - IR
PS/IR

CAPITAL TRANSFER TAX

We need to decide the main changes to capital transfer tax to be made in the Budget. In considering my recommendations I have had three main factors in mind:-

i) we have done less to reduce the overall burden of CTT than we have done for most other direct taxes;

ii) despite the reliefs already available for businesses, the psychological impact of the tax still appears to be a disincentive to growth; and

iii) while the main cause of the continuing decline in let agricultural land is our failure to reform the tenure laws, a further shift in the balance in favour of let land would be an appropriate gesture.

These factors point to an increase in the threshold and rate bands and an improvement in the reliefs for businesses and agriculture. Compared with the cost of changing other direct taxes, the cost of even major improvements would not be substantial. I consider each in turn.

The rate Scale

Last year we indexed the CTT rate scale in broadly the same way as for the income tax personal allowances. Hence if we do no more, the threshold and rate bands will rise by some 6%. The full year cost to be shown in the FSBR will be £40m (£15m in 1983-84), but this figure is already in the forecasts so it does not affect the size of the fiscal adjustment. Nor of course does it affect the real burden of the tax. We should regard it as the base from which our decisions should be taken.

Last year we increased the threshold and bands all the way up the scale. But this was the first such adjustment. The only other change we have made to CTT was in 1980 when we increased the threshold to £50,000 without altering any other rate band. Our predecessors also made only one change which was largely weighted towards the bottom of the scale. The result is that, although the threshold is substantially higher in real terms than when the tax was introduced in 1975, the starting rates are so steep that above £80,000 the tax is heavier in real terms than on its introduction - indeed at some points the average rate of tax is some 10 percentage points higher now than then. Although international comparisons are particularly difficult for this tax, the burden is also high by comparison with other countries.

A particular area for consideration is the three top rates of 65%, 70% and 75%. Very few people pay at these rates, so that their significance is almost entirely political and not economic or social. I do not think we can remove them altogether; but I suggest that we should cut down the number of steps in the rate scale by charging only at multiples of 10% and, if we apply that principle to the top of the scale, the only rate above 60% would be at 70%, reducing the maximum rate by 5%.

Ideally I should like substantially to increase the threshold and to reduce the burden of the tax so that at no point does its real weight exceed that in 1975. But the full year cost of so doing would be well in excess of £100m so I fear that it must be rejected this year. I recommend instead a smaller increase in the threshold and a reduction in the burden all the way up the scale to bring it closer, though not down, to its 1975 real equivalent. This would

cost £70m in a full year (£25m in 1983-84). If you considered that that was too much then on this occasion I think we ought to do no more with the treshold than round it up to the nearest convenient number. While I should like to see a real increase in it to keep the number of taxpayers and Inland Revenue staff to a minimum, given the concentration on the threshold in the past, I think that, if we cannot afford to do both, we should concentrate this year on those parts of the scale which have hitherto been left largely untouched. The cost of this alternative would be £45m in a full year (£15m in 1983-84).

... Table 1 attached shows the various scales I have considered. My preferred scale is scale H; my fall back scale is scale G. Table 2 shows the distributional effect of scales H and G and the graph (which is on a log scale) shows their effective rate compared with the 1975 and current scales indexed to date. This more detailed information is available for all the scales I have considered if you want it.

All these figures show only the rates on death. Any changes we make can be carried forward to the lifetime rate scale: the cost of changes to the latter will be within the margin of error of the estimates of changes to the scale on death. If the maximum rate on death is reduced from 75% to 70%, the maximum rate in life should drop correspondingly from 50% to 45%.

Business and Agriculture

One advantage of concentrating reductions in the rates further up the scale and not simply on the threshold is that it will be particularly helpful to those with significant interests in medium-sized businesses and to farmers who have tended not to benefit from all our measures for smaller businesses. But more than that is required. The Inland Revenue are keen to point out the extent to which businesses and farms are already favoured under the tax: for example on an estate containing only quoted securities worth £½m the tax would be £237,500, while if the estate comprised a business to the same value the tax would be only 37% thereof, £87,500, and even that would be payable by interest-free instalments which

(depending on the discount rate chosen) is equivalent to a further reduction of 20-30%. I believe however that it is right that owners of productive assets should be subject to a far less onerous regime which recognises the very different nature and value to the economy of businesses and farms.

I have therefore looked closely at the proposals put forward by the Unquoted Companies' Group and a number of other representative bodies and have discussed it with them formally (as well, needless to say, as over lunch). In essence their scheme provides that, on the death of an owner of a business, or of shares in an unquoted company, no tax would be payable unless his heir sold the business or shares. When the heir himself died, the tax due on the first death would be forgiven altogether and the tax then becoming due would similarly be held over. This process would be carried on down the generations so that no tax would ever be paid so long as the business was run by the same family.

By the time it had been fully worked out, including its implications for agriculture, this scheme would be quite complex which is itself a reason for looking askance at it. But its major defect is that it would lock a family into its business, regardless of whether the younger generations were suitable to run it or not, and discourage the bringing in of outside equity or share ownership, or, if it prospered, the seeking of a Stock Exchange listing. So it would run counter to a lot of our other policies. One means of removing the locking-in effect would be to exempt businesses altogether - this would cost very little more than the holdover scheme. But even with a long qualifying period of ownership, there would be some people who would buy unquoted shares or agricultural land solely as a tax shelter, so I cannot recommend this either.

However I think we ought to do rather more to counter the belief that there is little point in expanding a business beyond a certain size because the CTT burden placed on the heirs would then be unmanageable. The Inland Revenue have shown in figures that this view is misplaced and our challenge to be given examples of cases where CTT has actually been damaging remains to be taken up. The feeling that it is a disincentive remains however among those to whom I have spoken so that the tax continues to be psychologically

damaging, however unreasonable that attitude may be.

As a separate matter I think that we should make a gesture towards the difficulties faced by agricultural landowners. It is now, I believe, becoming more fully recognised that the major reason for the decline in let agricultural land and hence the drying up of openings for would-be tenant farmers is our system of land tenure, but (apart from some minor changes in Scotland to be introduced next month) there is nothing which can be done in this Parliament. Tax changes by themselves will have little effect on the problem, but they would act at least as a sign of good intent. Although in the longer term we should in my view be moving towards some recognition in the tax system that good estate management is closely analogous to the running of a business, a simple immediate step would be to increase the CTT relief we introduced in 1981.

You may recall that the main CTT business reliefs are:-

50% for owners of businesses, partners, and controlling shareholders; and

20% for minority shareholders in unquoted companies.

Similarly the CTT agricultural reliefs are:-

50% for agricultural land with vacant possession; and

20% for let agricultural land.

In each ase the lower level of relief recognises the lower value of minority shareholdings and of land subject to a lease.

My minimum recommendation in this area is that we should slant these reliefs by increasing both the 20% reliefs to 30%. The cost would be only £5m in a full year (£2m for businesses, £3m for agriculture) and £1m in 1983-84. But my preference would be to improve the reliefs as well as adding this slant by increasing the 50% reliefs to 60% and the 20% reliefs to 40%. The cost would then by £15m in a full year (£6m for businesses and £9m for agriculture) and £1½m in 1983-84. Table 3 shows the impact of relief at different levels on

There is one other point. Tax on businesses and on agriculture is payable by interest-free instalments over 8 years. I believe that we should ease the cash flow problems caused by taxing productive assets by increasing this period to 10 years. This would fit in with ten-year cumulation and, in the case of discretionary trusts, with the new ten-year charge to be introduced this April. In effect it would mean paying a little CTT every year and this could almost always be met out of income if the owners or trustees so wished. This would mean a lag in receipts of about £2½m a year, rising to £20m in the eighth year. By the tenth year the yield would be restored but lagged by a year. There would be no full year cost.

There is a corresponding facility to pay CGT and DLT by interest-free instalments. John Wakeham thinks we should make similar changes for DLT; we should also do so for CGT although the Inland Revenue are considering whether, following the changes made in the last two years in the treatment of gifts, there are any circumstances left in which the instalment provisions will apply. If not, they can be removed.

Capital Gains Tax

Following last year's major changes to CGT, I think we should leave the tax alone this year. The exempt amounts £5,000 for an individual, £2,500 for a trust) are now indexed and we should allow that to run through. I am also looking at those fixed money amounts which are not indexed to see if any should be updated this year. But none of this has any significance which needs to be examined in a Budgetary context, rather than in the detail of the Finance Bill.

Summary

Accordingly my recommendations are as follows:-

i) we should introduce a new CTT rate scale H as shown in Table 1 attached or, if that is too expensive, scale G;

ii) we should not introduce a hold-over relief for productive assets;

iii) we should increase the 50% business and agriculture reliefs to 60% and the 20% reliefs to 40%: failing that the 50% reliefs should be left untouched but the 20% reliefs should be increased to 30%;

iv) we should increase the period over which tax can be paid by instalments from 8 years to 10; this should apply to CTT, DLT and - unless the provision is now all but otiose - CGT; and

v) we should allow statutory indexation to apply to the CGT exempt amounts but make no changes to the tax of Budgetary significance.

None of these changes would be at all complex; nor would they require lengthy legislation.

pp Eric Heseltine
NICHOLAS RIDLEY
18 January 1983

TABLE 1

BOTTOM POINT OF BAND £'000

RATE %	NOW	INDEXED	SCALE F	SCALE G	SCALE H	SCALE B	SCALE C	SCALE D	SCALE E
30	55	59	65	60	65	60	60	75	100
35	75	80							
40	100	106	100	120	110	150		150	150
45	130	138					200		
50	165	175	150	180	175	250		225	200
55	200	212							
60	250	265	250	300	300	400	350	400	300
65	650	689	700					1,500	1,350
70	1,250	1,325	1,325	1,325	1,325			2,000	2,000
75	2,500	2,650	2,650					3,000	3,000
Cost full year		[£m40]	£m45	£m45	£m70	£m80	£m90	£m155	£m230
First year		[£m15]	£m15	£m15	£m25	£m30	£m35	£m 60	£m 90

CONFIDENTIAL

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

TABLE 2

TAX PAID ON AN ESTATE AT THE LOWER LIMIT OF THE RANGE

Lower limit of range of taxable estate	Number of estates in range	Indexed 1982/83	Scale H	Reduction £	%	Scale G	Reduction £	%
65	5,900	1,800	0	1,800	100.0	1,500	300	16.7
80	4,900	6,300	4,500	1,800	28.6	6,000	300	4.8
100	4,900	13,300	10,500	2,800	21.1	12,000	1,300	9.8
150	1,600	33,600	29,500	4,100	12.2	30,000	3,600	10.7
200	1,200	57,350	52,000	5,350	9.3	52,000	5,350	9.3
300	390	113,500	102,000	11,500	10.1	102,000	11,500	10.1
400	150	173,500	162,000	11,500	6.6	162,000	11,500	6.6
500	150	233,500	222,000	11,500	4.9	222,000	11,500	4.9
750	50	386,550	372,000	14,550	3.8	372,000	14,550	3.8
1,000	40	549,050	522,000	27,050	4.9	522,000	27,050	4.9
2,000	10	1,232,800	1,189,500	43,300	3.5	1,189,500	43,300	3.5
TOTAL	19,300							

TABLE 3

CTT LIABILITY ON SPECIMEN ESTATES ASSUMING VARIOUS LEVELS OF RELIEF
(1982/83 scale indexed by 6%)

Value of taxable estate qualifying for relief	No Relief	20% relief	30% relief	40% relief	50% relief	60% relief
£'000	£	£	£	£	£	£
65	1,800	0	0	0	0	0
80	6,300	1,500	0	0	0	0
100	13,300	6,300	3,300	300	0	0
150	33,600	20,300	15,050	9,800	4,800	300
200	57,350	38,100	29,100	21,000	13,300	6,300
300	113,500	78,750	62,350	47,350	33,600	21,000
400	173,500	125,500	101,500	78,750	57,350	38,100
500	233,500	173,500	143,500	113,500	84,250	57,350
750	386,550	293,500	248,500	203,500	158,500	113,500
1,000	549,050	419,050	354,050	293,500	233,500	173,500
2,000	1,232,800	952,800	812,800	679,050	549,050	419,050

In all cases where relief is available the tax due is payable by interest-free instalments.

CONFIDENTIAL

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 18 January 1983

PS/CHANCELLOR
(Ms Rutter)

cc PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Mr Moore
Mr Robson
Mr French
Mr Driscoll - IR
PS/IR

HOUSE OF LORDS DECISION - WICKS AND FIRTH, JOHNSON AND FIRTH

The Financial Secretary has seen Mr Driscoll's note of 13 January, and yours of 14 January.

The Financial Secretary remains of the view that we should make an early announcement that the Court decision will be reversed in the 1983 Finance Bill with effect from 4 April 1983, or if the Chancellor would prefer the effective date could be deferred to 1 September 1983. The Financial Secretary feels that it will be the announcement of the decision which disappoints rather than the actual date when the tax first has to be paid; deferring the date will simply lose us more revenue.

He is equally not in favour of an extra transitional year for existing beneficiaries.

E KWIECINSKI
18 January 1983

RESTRICTED

FROM: M E DONNELLY
DATE: 18 January 1983

MRS HEDLEY-MILLER

cc PS/Chancellor
Mr Littler

Miss Court
Mr Edwards
Mr Peet
PS/Mr Hurd
Mr Hancock - Cab Office

EC BUDGET: NEXT STEPS

This note is to record the action to be taken following the meeting between the Financial Secretary, Robert Jackson MEP, Neil Balfour MEP, yourself and Mr Peet on 17 January.

1983 Supplementary Budget

It was agreed that the Financial Secretary would host a lunch in Strasbourg on Tuesday 8 February during the Plenary session of the Parliament. It would be for substantially the same group of influential MEPs that he lunched with during November, though extended if possible to include Socialists. Mr Peet agreed to liaise with UKREP over the details.

Mr Balfour and Mr Jackson suggested that it might be helpful for the Financial Secretary to address some of the Party Groups during their co-ordinating sessions in Brussels on 1 or 2 February. Mr Balfour agreed to check on the logistics of this and come back with firmer proposals. The Financial Secretary has already received a provisional invitation to address the EDG Group Meeting in London at the beginning of February.

It was agreed that continued attention should be paid to all MEPs before the critical votes in February and March. The Financial Secretary will liaise with Mr Hurd over possible initiatives here.

Officials agreed to consider the possibility of writing to MEPs setting out the UK case. This might be based on the wider briefing being put together for use in the longer term Budget negotiations. The timing of this remained a question for discussion; Mr Balfour and Mr Jackson felt that it would be helpful to produce some material aimed specifically at MEPs by 1 February, in order to influence internal Group discussions before the February Plenary session.

Longer Term Budget Negotiations

Officials agreed to produce a further draft of the possible speech aimed at the European Parliament, by the weekend if possible. This might be used as a basis for a handout at a press conference given by the Chancellor on 7 February in Brussels. Alternatively it could form the basis for a letter to MEPs; or as a speech to be given in Europe by another senior Minister.

MED
M E DONNELLY

Treasury Chambers, Parliament Street, SW1P 3AG

E G Bowman Esq
Office of Parliamentary Counsel
36 Whitehall
LONDON
SW1A 2AY

19 January 1983

Dear Bowman

DISEASES OF FISH BILL

Thank you for your letter of 14 January.

... I enclose a money resolution for this Bill duly initialled by the Financial Secretary.

Yours sincerely

E KWIECINSKI
Private Secretary

DISEASES OF FISH [MONEY]: Queen's Recommendation signified

Mr Nicholas Ridley

That, for the purposes of any Act of this Session to make further provision for preventing the spread of disease among fish, it is expedient to authorise the payment out of money provided by Parliament of -

(1) any expenses of any Minister of the Crown incurred in consequence of the Act, and

(2) any increase attributable to the Act in the sums so payable under any other Act.

X

N.R.

23.10.80

CONFIDENTIAL

FROM: NICHOLAS RIDLEY
DATE: 19 January 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (R)
Sir D Wass
Mr Middleton
Mr Moore
Mr Pestell
Mr Robson
Mr Hopkinson
Mr Godber
Mr French
Mr Battishill/IR
PS/IR

REVIVING THE PRIVATE RENTED HOUSING SECTOR

... I have discussed briefly with officials the attached notes (top copy only) of 22 December from the Revenue about the various Department of Environment proposals for dealing with the problems of the private rented sector.

I do not like any of the proposals. They are inconsistent with our general philosophy of freeing markets wherever possible. Financial relationships between private landlords and their tenant are hopelessly distorted because of legal encumbrances - largely the Rent Acts. The right way to correct those distortions is by removing the encumbrances, not by attempting to compensate for them by introducing costly new tax reliefs of one sort or another. Our aim should remain the ending of rent control, and we should make it our objective to start on this as soon as possible after the election. It will of course mean taking the issue back to Cabinet in due course.

The proposals canvassed here are simply palliatives for de-regulation - but palliatives that would be difficult to get rid of once we had tackled rent control. In any case, a minimum pre-requisite for most of them - including your own wish to see ex-council houses released into the control-free, private sector - would be a major extension of the DOE's own assured tenancies scheme. This would require new housing legislation, which, I understand, would in any event have to wait until after the election. So this package of proposals does not really offer us a quick interim solution.

Whether in practice general de-regulation can be achieved directly, or only through a series of extensions to the assured tenancies scheme, is something which we shall have to wait and see. But if in the event the latter is unavoidable, I hope that any further tax reliefs can be kept to a minimum, and so do the least damage. All experience suggests that, once given, further tax concessions would be extremely difficult to unwind, even in a free market for rented accommodation.

Only one of the proposals - the extension of the new assured tenancy capital allowance to shared ownership properties - is a possible short term measure - because shared ownership is already permissible under the assured tenancy scheme. It is included in the DOE's Budget representations (Michael Heseltine's letter of 6 January). As I have said, I am strongly against any further tinkering with tax reliefs.

But there are other reasons for resisting this proposal. First, even this limited extension could involve lengthy and complex legislatic straddling the boundaries between trading profits and capital gains. Second, it is in many respects directed not at private renting but at a form of phased owner-occupation. And, third, you may recall that when I discussed the assured tenancy allowance with John Stanley in the summer, I offered him the choice between the scheme we had worked up at short notice for the 1982 Finance Bill (expressly without allowances for shared ownership which we had considered and rejected) and a major review to see whether a more wide-ranging tax relief could be developed for introduction in a following year. I said that if we did the former, that was it; we could not agree to the scheme being reopened and widened next year. The decision was to go for the scheme as it stood; but the DOE are now reneging on the understanding, and we are being pressed for an immediate extension.

My strong recommendation is that at this point we say: not an inch further so far as tax relief is concerned.

NICHOLAS RIDLEY

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 19 January 1983

MR COLLINSON

cc PS/Chancellor
PS/Chief Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir D Wass
Mr Bailey
Mr Burgner
Mr Monck
Mr Morgan
Mr Traynor
Mr St Clair

CONTRACTING OUT EXERCISE: PAYMASTER GENERAL'S OFFICE

Mr Burnham, Mr Cooke and Ms Hale of Cooper and Lybrand Management Consultants met the Financial Secretary this morning for a brief discussion of the aims of their Study.

Coopers gave the Financial Secretary the attached list of ques s. On the objectives of the Study the Financial Secretary said the overall aim should be to identify what if any scope exis for cost savings without detriment to the service provided by PGO. If th Study showed that PGO was most efficient in its current form then this too would be useful information. More generally by reviewing the possibilities for contracting-out of some or all of the pension payments arrangements it would be a useful basis for any future reviews of other pension-paying bodies in the public sector.

Coopers said that they had been generally impressed so far in their Study by the PGO's efficiency. They were aiming to find suitable measure: of performance for these activities; and to think about the overall division of responsibilities for pension negotiation and payment so that there was a more clearly accountable unit overall. There would be political difficulties in separating the payment of pensions entirely from the Government. The Financial Secretary agreed with this point; and suggested Coopers might also wish to comment on whether the lines of Ministerial responsibility for the operation and efficieny PGO were sufficiently clearly drawn.

MED

QUESTIONS FOR MEETING WITH NICHOLAS RIDLEY

~~9.30~~ 8.45 AM WEDNESDAY 19 JANUARY 1983.

1. What was the Financial Secretary's objective in suggesting that it might be feasible to privatise the PGO's pension-paying function.

2. Does the Financial Secretary prefer any particular form of privatisation - eg. transfer of complete pension function to a private company.

3. What importance does the Financial Secretary attached to cost saving as a result of privatisation of the pension function.

4. Did the Financial Secretary have any particular reason for suggesting that the pension-paying function might be attractive to a high technology company like IBM.

5. Did the Financial Secretary consider transferring **all** clerical activities associated with pensions back to the Awarding Departments - with or without any increase in Departmental establishments - thereby leaving the computer operations with PGO.

PERSONAL AND CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 19 January 1983

MR ISAAC/IR

WORK PRIORITIES

Further to your discussion with the Financial Secretary yesterday morning, I attach a draft minute to go from him to the Chancellor. He would be grateful for your early comments.

E KWIECINSKI

DRAFT MINUTE

FROM: FINANCIAL SECRETARY
TO: CHANCELLOR

INLAND REVENUE: WORK PRIORITIES

I have been considering the current state of work regarding our priorities on taxation issues for the future. I am concerned that the Revenue's resources should be utilised as best as possible in the forthcoming months. I think it may be best to try and categorise our priorities in the following three ways:

a) work which must be finished for inclusion in this year's Budget.

b) Issues to be worked on for inclusion in the first Budget after the next Election.

c) Other long term work

and d) Items which could be dropped altogether.

A) Pre-Budget Work

i) Major work on Income tax changes - well in hand

ii) Capital Transfer Tax -: Reform rate bands and thresholds: my recommendations to you on 18 January 1983 - work well in hand.

iii) Group Avoidance: BL. etc: legislation required: IR submission imminent.

iv) Life Assurance: Minor points (Second hand bonds etc): action in Budget already announced - work well advanced.

v) Stamp duty: Minister of State (R) has not ruled out the possibility of some legislation in this year's Finance Bill.

vi) Share options: decisions taken in principle at your meeting on 12 January: drafting to proceed.

vii) Minor personal allowances: Mr Fowler's proposals to abolish the dependent relative allowance in the context of a new invalid relative allowance: decisions not yet taken.

viii) Widows Bereavement Allowance: awaiting your late decision for possible inclusion as part of a "caring package".

ix) Rates and revaluation

x) tax treatment of deep discounted bonds etc - Revenue consultative document issued.

xi) Business Expansion scheme and Gryllsery - work well in hand.

C) Post election-Long term work

i) Taxation of Husband and Wife - Green paper to be issued : target date early summer (timing may be effected by Prime Minister's decision on election date) implementation of change (if ITTA) dependent on COP.

ii) Current year Assessing for Schedule D - decisions required.

iii) Black Economy- Keith Report imminent - decisions to flow from its recommendations: for next Parliament.

iv) Cork Report: Inland Revenue issues arising, Crown preference etc. Little pressure for early action, further discussions needed with DOT and Bank of England, before decisions are taken. Again something for the next Parliament.

v) Stamp Duty Review - decisions arising from the consultative process.

D) Candidates to be dropped

i) Allowances for rented accommodation
ii) Enterprise bonds

I would be glad of your views, and those of colleagues on this; and I suggest we have an early meeting to discuss our priorities further.

FROM: E KWIECINSKI
DATE: 19 January 1983

MR R G LUSK/IR

cc Chancellor
Chief Secretary
Economic Secretary
Minister of State (R)
Minister of State (C)
Sir D Wass
Mr Middleton
Mr Moore
Mr Robson
Mr French
Mr Graham - Parly Counsel
Mr Battishill - IR
PS/IR

PUBLIC LENDING RIGHT (PLR) - STARTER NO 122

The Financial Secretary was grateful for your note of 17 January.

1) He confirms his views (as expressed in my minute of 10 January) as to the tax treatment of the Registrar.

2) On paras 7a) and 7b) he confirms his views and adds:

"The purpose of the PLR is to assist penniless authors whose income is reduced because the libraries buy their books and pay no borrowing fee. I cannot see why they need to spread the income (or the proceeds of selling the rights): they present themselves as starving authors, deprived of a living by the Libraries. Surely there is no need to spread an income which is deprived".

3) On 7c) - he agrees that payments of PLR to authors living overseas should be made subject to deduction of standard rate tax.

4) He agrees that S16 of the TMA 1970 should be amended to put a statutory duty on the Registrar to make returns of PLR payments to the Revenue.

E KWIECINSKI

CONFIDENTIAL

NOTE OF A MEETING HELD IN FINANCIAL SECRETARY'S ROOM, H M TREASURY
4.00pm 17 JANAURY 1983

Present at Meeting: Financial Secretary
Minister of State (R)
Mr Moore
Mr French
Mr Isaac
Mr Battishill)
Mr Blythe)
Mr R Martin) IR
Mr R Lusk)

EMPLOYERS, EMPLOYEES AND SELF-EMPLOYED

The meeting had before it the Financial Secretary's minute of 14 December, Mr Hudson's of 17 December, Miss Rutter's of 20 December and Mr Driscoll's paper of 21 December (Schedule D/Schedule E).

The Financial Secretary commented that the discussion should be divided up into three parts:-

1) Simplification of PAYE procedures for small employers
2) Equalising the treatment of the employed and self-employed
and 3) The problem of defining employed and self-employed.

Simplification of PAYE for small employers

The Financial Secretary envisaged a system whereby employers paid a flat percentage rate of their payroll (say 25%) over to the Revenue at say quarterly intervals. The employers/employees correct liabilities would be quantified at the end of the year and the balancing payment paid over to the Revenue at that time. The employer and employee would strike a bargain at the beginning of the year to determine the level of net of tax wages to be paid weekly (monthly). He thought this would have several benefits: a) it would reduce the accounting burden on employers, b) it would give employer's a cash flow benefit and c) the net of tax pay system would have an incentives effect on employees.

Mr Isaac commented that in seeking to simplify the system we might in fact make it more burdensome: mainly by allowing/encouraging employe to store up liabilities they would later be unable to meet. He saw the only benefit as lying in quarterly as opposed to monthly accounting. Indeed a flat rate percentage deduction if it were less than/ultimate liability would disadvantage the employer, if the full balance of the gross wages was paid to the employee.

The Financial Secretary commented that the level of the % deduction could only be deduced after analysis, although he thought it should be at a/beneficial to the employer; the employees actual net wages would have to be set at a level which did not waste the cash flow advantage given to the employer.

Mr Isaac commented that if the ultimate liability for the PAYE was to l with the employer then he would be increasing his responsibilities, expecially where employees left without warning: in this situation he would be wholly at risk. He did not think that many employers would be attracted to this proposition.

The Minister of State (R) commented that he saw a real need for net of tax pay. It would make it easier for employers to set the market rate for jobs. Also it would have an incentives effect on employees who regarded their take-home pay as the real level of their wages, rather than their gross-pay. He wondered if net of tax pay tax tables could be produced by the Revenue for use in a "grossing-up" system by employers, as an alternative/the present system.

Mr R Martin commented that a firm in Liverpool did use a net of tax system, and they had produced their own tables with the help of the local tax office. If such a system were encouraged on a wider scale it could have staffing implications for the Revenue.

Mr Isaac disliked the "grossing-up" system because he thought it would saddle the employer with PAYE liabilities he had not anticipated.

The Financial Secretary disagreed and commented that there was a developing market in taxless wages: the Government should introduce a system to acknowledge what was already happening.

In summing up this part of the discussion the Financial Secretary identified two areas for further work:-

a) Net of tax pay tables - the Revenue would comment on the viability of producing such tables, how they would be used in practice and the implications such a system would have for administrative costs.

b) Quarterly payments - the Revenue and Treasury would comment further on the merits of such a scheme for employers, and on the cost to the Exchequer of any system allowing more infrequent payments of PAYE.

Employed/Self employed

The Financial Secretary commented that he was unhappy with the imprecise nature of the (eight) case law tests used to establish an individual's status as self employed or employed (see Miss Hart's note of 26 November para 6 et seq). It was too complex and was not easily understood by the man in the street.. We were in danger of creating the impression that we were trying to deny people the advantages of Schedule D treatment by defining them as employed when they were not.

The Minister of State (R) commented that he saw grave difficluties in trying to enact a definition, but he thought that the case-law approach was out of line with what alot of people thought. He thought that the conditions of employment such as: a) paid holidays, b)pensions, c)sick-pay entitlement d) period of notice e) regularity of work etc. should be regarded as more important when defining "an employment".

Mr Isaac commented that the Schedule D man currently enjoyed considerabl tax advantages over his Schedule E counterpart. This was increasing pressure at the margins for Schedule D treatment to be granted to those who do not satisfy the current definition. Perhaps the disparity of treatment between D and E was now too great. As to the actual definition, this was clear: a person was either employed by somebody or he was in business on his own account. The case law tests had refined the definition of "being in business on ones onw account."/reality of actual situations. In 99% of cases there were by referring to the no problems: a person's status could be easily defined, but at the margin things were not so clear cut.

The Financial Secretary commented that if we were to some degree to equalise Schedule D and E treatment then to some extent the problem would evaporate. But he was still keen to have a more clearly defined border-line, so that taxpayers could more easily tell for themselves on which side of the line they belonged.

Mr Isaac commented that part of the answer to the problem of differing treatment could lie in the issuing of a discussion document on Current Year (CY) assessing for Schedule D (as a follow up to the recent reviews on Self Assessment carried out by the Revenue and outside consultants). A move to a CY basis with an appropriate payments regime would move Schedule D treatment closer to that of Schedule E.

Mr Battishill commented that we should never make the Schedule D and E treatment so close that the opting by a taxpayer for one or the other would have no effect on his actual tax treatment. A certain advantage would have to be retained for the man in business on his own account.

The Minister of State (R) agreed but felt that the balance between the two should be better.

The Financial Secretary pointed out that the CY basis for Schedule D was a long term solution which relied on COP. The political pressure was for more immediate action. Also it did not deal with the definitional problem.

Mr Isaac suggested that the Revenue should issue a statement of practice in layman's terms which explained how self-employed status was defined.

Mr Moore wondered whether the Revenue advised people of their status at local office level when they commenced trading.

Mr Blythe said this was not the practice although it could be done by the local Inspector.

In discussion it was agreed that a mechanism which allowed taxpayers to establish their status at local level, with a right of appeal to the General Commissioners, would be desirable.

The Revenue agreed to look at 1) the feasibility of setting up such a mechanism and 2) the possibility of producing a statement of practice to help with the definitional problem. In concluding the discussion the Financial Secretary commented that the further work to go ahead would

be helpful. He was however still unhappy about the problem of defining Self-employment at the margin and he wanted those present to have further thoughts on this. There was also the question of a substantive response to No.10's queries about the self-employed. The Financial Secretary thought it was best to leave this until there was something positive to say, possibly in the light of the further work commissioned at this meeting.

E KWIECINSKI

Circulation:

Those Present
PS/Chancellor
PS/CST
PS/EST
Mr Robson
PS/IR

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 20 January 1983

MR BROADBENT

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir D Wass
Mr Bailey
Mr Burgner
Mr Morgan
Mr S Thomas

ASSOCIATED BRITISH PORTS HOLDING (ABPH)

This note records the conclusions of the meeting between yourself, Mr Burgner and the Financial Secretary to discuss the developments outlined in your note of 20 January.

It was agreed:

(i) it was necessary for Schroders to check the revised profit figures endorsed by the Board, with the Board's accountants Price Waterhouse. If Schroders could agree amended figures with Price Waterhouse these could be presented to the Board, even though

(ii) this would inevitably involve a delay of 1 week in the sale date (from 26 January to 2 February);

(iii) an urgent meeting should be held between the Board, Mr Howell and the Financial Secretary to discuss the Board's new decisions.

You agreed to keep this Office closely in touch with developments.

MED
M E DONNELLY

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 20 January 1983

MR BROADBENT

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir D Wass
Mr Bailey
Mr Burgner
Mr Morgan
Mr S Thomas

ASSOCIATED BRITISH PORTS HOLDING (ABPH)

This note records the conclusions of the meeting between yourself, Mr Burgner and the Financial Secretary to discuss the developments outlined in your note of 20 January.

It was agreed:

(i) it was necessary for Schroders to check the revised profit figures endorsed by the Board, with the Board's accountants Price Waterhouse. If Schroders could agree amended figures with Price Waterhouse these could be presented to the Board, even though

(ii) this would inevitably involve a delay of 1 week in the sale date (from 26 January to 2 February);

(iii) an urgent meeting should be held between the Board, Mr Howell and the Financial Secretary to discuss the Board's new decisions.

You agreed to keep this Office closely in touch with developments.

MED
M E DONNELLY

FROM: M E DONNELLY
DATE: 20 January 1983

MR EDWARDS

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
Sir D Wass
Mr Littler
Mrs Hedley-Miller
Miss Court
Mr Peet
Mr S Mathews
Mr Ridley

LLOYDS BANK ECONOMIC BULLETIN: GAINS OF EEC MEMBERSHIP

The Financial Secretary has seen Christopher Johnson's article in the January 1983 Lloyds Bank Economic Bulletin (attached).

The article concludes that "the cumulative effect of EEC membership on the UK's GNP is estimated at/£19 billion gain on industrial exports, and a £7 billion loss on agriculture of Budget transfers, leaving a net gain of £12 billion". The Financial Secretary would be grateful if you could check whether these figures are sufficiently meaningful for public use. If they are not it would be helpful to see whether calculations on broadly similar lines could be carried out by the Treasury to produce alternative figures.

MED
M E DONNELLY

LLOYDS BANK ECONOMIC BULLETIN

A MONTHLY ANALYSIS FROM LLOYDS BANK NUMBER 49 JANUARY 1983

Gains of EEC membership

The tenth anniversary of Britain's entry into the EEC on 1 January 1973 is being celebrated with little enthusiasm. The Labour Party is committed to withdrawal. Even supporters of the EEC in other parties regard the case for staying in as being mainly political, and are disappointed that the promised economic benefits have apparently failed to materialize. Economists have generally been quicker to measure the losses than to discern any gains from membership. The strong support for EEC membership in industry is based more on practical intuition than on rigorous proof. In this tenth anniversary issue, we attempt to show that the economic gains have been greater than the losses, but not by as large a margin as indicated in this Bulletin No. 6, June 1979.

In one sense, it is impossible to make any economic assessment of membership, because we cannot know what the state of affairs would have been had the UK remained outside the EEC. It is easy, but not helpful, to make assumptions about what would have happened to the UK economy, or about what might happen to it in future, outside the EEC, in such a way as to support the case for withdrawal or for membership. It is more objective, though still somewhat conjectural, to extrapolate pre-membership trends as an indication of what might have been the case had we remained outside.

The comparison is made difficult by the marked slowdown in world economic growth which took place just after the UK joined the EEC, which affected both the UK and the other members. There has also been a series of major changes during the last ten years in British economic policy, which may have had as much effect on the economic growth rate as EEC membership. North Sea oil has also been developed during this period, but it can be assumed that it has had little net effect on the growth rate, since the five per cent which it contributes to GDP is exactly the same as the loss of GDP share by manufacturing industry resulting from the rise in the exchange rate. The benefits of North Sea oil on living standards have come about by a rise in the terms of trade, not in GDP.

As Table 1 shows, when the UK was in EFTA and outside the EEC, her growth rate was 64 per cent of the EEC's. From 1973 on, the EEC's growth rate fell to the former UK rate, but the UK's rose to 70 per cent of the EEC's. Thus the UK did slightly better in relative terms. Had the UK continued to grow at 64 per cent of the EEC rate, her growth rate would have been 0.15 per cent a year less than it had been. This is at least a plausible estimate of the gains of membership.

The cumulative gain over the last decade looks considerably more, since an extra 0.15 per cent has been added to the GDP each year. GDP is thus 1.5 per cent, or £3.5bn higher in 1982, and 8.25 per cent, or £19bn at 1982 prices, has been added to GDP over the last ten years. Over a quarter of this benefit may have gone to agriculture, and the other two thirds to industrial production.

Most of the gains of membership may have occurred in the first year, 1973. GDP then grew by an astonishing 7.5 per cent in real terms, with exports and imports each nearly 12 per cent up in volume. Although much of the increase was due to the expansionary fiscal, monetary and exchange rate policies of 1972, there was also the impact of joining the EEC on the 'animal spirits' of businessmen. By the same argument, withdrawal from the EEC might well have a sharp immediate downwards impact on GDP.

Table 1
UK MEMBERSHIP OF EEC
GDP growth per head

	1 EEC 9	2 UK	3 2 as % of 1
1963-72	3.76%	2.42%	64.36%
1973-80 (actual)	2.39%	1.69%	70.81%
1973-80 (out of EEC)	2.39%	1.54%	64.36%

Source: OECD National Accounts 1951-1980.

Trade effects

The gain to GDP has occurred through an increase in trade with the EEC, which accelerated after 1972. Britain has nearly always had a trade deficit with the EEC, but trade in both directions has increased rapidly, without any long-run tendency for the deficit to increase in real terms. As Table 2 shows, private sector credits on current account have risen faster than debits, even after allowing for a surge in imports this year. The deficit has averaged 1 per cent of GDP, which is the likely figure for 1982 after two years of surplus during the 1980-81 recession.

The increase in the deficit on visible trade alone, which began in 1971, continued for the first three years of membership but then improved steadily until 1980 to a position of surplus, with some deterioration in the next two years. If the coverage of EEC visible imports by exports in 1981 had been the same as it was in 1972 – 83 per cent – the UK

Lloyds Bank Economic Bulletin *is published as a monthly service and is normally written by Christopher Johnson, the Group Economic Adviser. Each issue covers a topic of current interest, setting out some of the economic principles involved in a manner understandable to the non-economist. Copies may be obtained from the Group Economics Department, Lloyds Bank, 71 Lombard Street, London EC3P 3BS.*

Table 2
UK CURRENT ACCOUNT WITH EEC – 1973-82

	Private sector merchandise and invisibles trade†				General government balance				Current account balance	
	Credits 1	Debits 2	Balance 3 (1 –2)		EEC Institutions 4	EEC Countries 5	EEC Total 6 (4 + 5)		7 (3 + 6)	
	% of GNP	% of GNP	% of GNP	£m	% of GNP	% of GNP	% of GNP	£m	% of GNP	£m
1973	8.9	10.2	–1.3	– 854	–0.2	–0.5	–0.7	– 438	–2.0	–1292
1974	10.5	12.6	–2.1	–1558	neg	–0.6	–0.6	– 468	–2.7	–2026
1975	9.1	11.4	–2.3	–2170	neg	–0.5	–0.5	– 461	–2.8	–2631
1976	10.9	12.2	–1.4	–1554	–0.1	–0.7	–0.8	– 860	–2.2	–2414
1977	12.1	13.0	–1.0	–1248	–0.3	–0.7	–1.0	–1253	–2.0	–2501
1978	11.9	13.0	–1.1	–1602	–0.5	–0.7	–1.2	–1820	–2.3	–3422
1979	13 5	14.3	–0.8	–1343	–0.6	–0.6	–1.2	–2009	–2.0	–3352
1980	13.3	12.7	+0.6	+1243	–0.4	–0.5	–0.9	–1776	–0.3	– 533
1981	12.8	12.4	+0.4	+ 845	–0.2	–0.5	–0.7	–1515	–0.3	– 670
1982††	13.3	14.4	–1.1	–2722	–0.4	–0.5	–0.9	–2000	–2.0	–4722
1973-1982 annual growth %	4.6	3.9	–1.0*		–0.3*	–0.6*	–0.9*		–1.9*	

†Including public corporations. ††Estimate. *Average. Source: Derived from *UK Balance of Payments,* 1982 edition, tables 12.1 and 12.2

would have exported £3.6bn less to the EEC. By 1981 the coverage had improved to 100 per cent. In terms of value added, after deduction of imported inputs, this comes close to our estimate of about £2.5bn extra industrial GDP resulting from membership.

The gains from trade have been due to the dismantling of tariffs between Britain and the EEC over the 4½ years to mid-1977. On each side of the Channel, producer prices rose, consumer prices fell, with new price levels somewhere between the former tariff-inclusive and tariff-exclusive prices, and demand and output increased. Unfortunately there are still numerous non-tariff barriers to trade in the EEC. The UK has been running a surplus of about 0.5 per cent of GDP a year with the EEC on private sector invisibles. But the surplus has not been rising, since the UK has been so far prevented from reaping the benefits of freer trade in services, such as insurance and civil aviation. Since the integration process is no more than half-completed, the UK can hope for continuing gains to trade and GDP from membership if agreement can be reached on further liberalization.

Table 3 gives more evidence of the improvement in the UK's visible trade performance in the EEC. Exports to the EEC rose from 30 to 43 per cent of total UK exports in the first eight years of membership, and the UK's share of the EEC import market from 5 to 7 per cent. The UK's exports to the EEC, as to the rest of the world, have shifted in their composition towards oil and away from manufactures, so that oil accounts for 20 per cent of her exports to the EEC. The UK had nevertheless slightly increased its share of EEC imports of manufactures up to 1980, although this may not have been maintained in the last two years, owing to the over-valuation of the pound.

The EEC's share of UK imports is now nearly 45 per cent, and thus higher than its share in UK exports, but the import share has risen less rapidly since 1972 than the export share. The UK has become more important to the EEC as an export market, taking 6.4 per cent of all EEC exports, compared with 5.3 per cent before entry. The loss of EFTA preference between the UK, Ireland and Denmark has resulted in a loss of trade shares between the three countries, but this has been greatly outweighed by their increase in trade shares with the original six EEC members.

Some losses too

The main losses to the UK from entry have been from the Common Agricultural Policy (CAP) and the EEC Budget, which are connected, since two-thirds of the Budget is spent on agriculture. Here again, estimates of the losses depend on the assumptions made about alternative arrangements. A reasonable hypothesis would be a return to the pre-entry position, when UK consumers benefited from world prices, which are generally, but by no means always lower than EEC prices, and farmers were subsidized by deficiency payments. It turns out that most of the 'cost' of the CAP consists of what are effectively internal transfers to UK agriculture from the rest of the UK economy, rather than payments across the exchanges to the rest of the EEC.

To put together rough estimates from various sources for 1981, it seems that UK agriculture has benefited by nearly £2bn at present prices in that year, with an income rise of about 60 per cent, divided between increases of about 20 per cent in output and 33 per cent in prices. The degree of self-sufficiency in indigenous farm products has risen from 61 per cent before entry to 75 per cent in 1980. Although farm incomes have fallen in the UK and the rest of the EEC (see this Bulletin No. 41, May 1982), they are expected to recover sharply this year and would have been even lower outside the EEC, as the severe farm depression in the US shows.

British consumers are, however, paying over £3bn more for their food than if world prices had prevailed. About £700m of this is being paid across the exchanges to the EEC either as higher prices to Continental farmers or as import levies to the EEC Budget. About £600m of the £3bn could have been avoided, had the UK revalued the 'green pound' in line with the high exchange rate of sterling, but this was not done, as it would have meant lower prices for UK farmers. (Some saving was made in the earlier years of membership by not fully devaluing the 'green pound'). So only £2.4bn in extra consumer costs should be attributed to the CAP as such in 1981, and another £600m to the way in which the UK has chosen to apply it.

The extra prices paid to Continental farmers and the diversion of UK agricultural imports from outside the EEC to inside must be seen in the wider trade context. Between 1972 and 1980 UK food, drink and tobacco exports to the EEC trebled, while imports from the EEC doubled, so that the trade deficit in this sector was cut by 60 per cent in real terms to £1.4bn at 1980 prices. The income loss to the UK from an adverse shift in the terms of trade on food has in any case probably been made up for by a

favourable shift in the terms of trade on industrial goods exchanged between the UK and the EEC.

It can be assumed that any British Government would continue to subsidize its farmers by a reversion to deficiency payments in the event of withdrawal from the EEC, as the Labour Party itself has admitted. The cost of doing so might be roughly the £2bn income benefit which farmers now get from the CAP, although it could well be £500m more or less according to how it was done. Hard decisions would be needed on whether on the one hand to allow agriculture to go into decline or on the other to maintain the higher present level of production by generous subsidies.

British consumers might thus continue to pay £2bn to UK agriculture, but as taxpayers rather than through the CAP price mechanism. The additional £700m which they pay for imports would probably not be regained if Britain left the EEC, because of other adverse effects on the terms of trade. The main saving from withdrawal would be the payment of about £1bn a year in Budget contributions to EEC agriculture financed by UK taxes. Net of EEC rebates to the UK, however, the Budget costs to the UK have been much lower. The Budget income transfer has averaged 0.3 per cent of GDP a year since 1972, and the cumulative loss over the decade has been 3 per cent of GNP, or £7bn at 1982 prices. This is considerably less than the 8.25 per cent gain to GDP from membership, and is a loss to GNP and not GDP, since it is an income transfer, not a loss of output. It is only half the annual average 0.6 per cent of GNP which British governments have transferred to EEC countries for other purposes, such as maintaining troops in Germany.

Because of the rise in both domestic and imported farm prices, the CAP has had a small adverse effect on the UK inflation rate. The decade of membership can be divided into two periods; up to 1976, when UK, EEC and world farm prices rose faster than other prices, and world prices were at first higher than those in the EEC; and since 1976, when UK, EEC and world farm prices fell in real inflation-adjusted terms. Real UK farm prices were 17 per cent lower in 1981 than in 1972, and real food prices only 3 per cent higher. Farm prices are only about a third of total food prices, and other costs and profits in the food chain have risen more.

Real farm prices would be even lower had they fallen to the present depressed world levels. If the extra £3bn paid by British consumers because of the CAP in 1981 is added to their expenditure of food, it comes to 12.5 per cent extra, and this may be taken as an estimate of how much higher food prices were. (The rise in farm prices is nearly three times as much, because farm imports are only about a third of total food prices). An extra 12.5 per cent on food comes to 2.7 per cent on the Retail Price Index, just over 1 per cent of the 244 per cent rise from 1972 to 1981, or an increase of 0.3 per cent a year. This is almost certainly counterbalanced by the fall in the price of industrial imports from the EEC due to tariff cuts.

It is difficult to believe that the UK economy has benefited from EEC membership, because its performance has been so poor over the last decade. The evidence is, however, that the UK economy would have done and would do even worse outside than inside the EEC.

References

'Britain in the Community 1973-1983, the Impact of Membership'. Commission of the European Communities, December 1982.

Forster, Norvela, MEP, 'UK Trade with the EEC States', Industrial Aids Ltd., February 1981.

Grant, R.M., 'British Industry and the EEC'. Paper to British Association for the Advancement of Science, 8 September 1982.

Harvey, David, 'Economic Effects of the CAP'. Paper to Federal Trust Conference, 10 May 1982.

Mayes, David, 'The Effects of the EEC on Trade'. Paper to Federal Trust Conference, 10 May 1982.

Morris, C.N., 'The Common Agricultural Policy', *Fiscal Studies,* Vol. 1, No. 2, March 1980.

Conclusions

1. The UK's rate of economic growth may have increased by 0.15 per cent a year as a result of joining the EEC, and GDP may this year be 1.5 per cent, or £3.5bn higher than if we had not joined.
2. The UK's exports to the EEC have risen faster than imports from the EEC, and the private sector current account deficit has been held to an average of 1 per cent of GDP.
3. The main avoidable cost to Britain of the EEC Common Agricultural Policy is the Budget transfers, which have averaged 0.3 per cent of GNP, or £700m a year.
4. The CAP has increased UK inflation by 0.3 per cent a year, or 3 per cent, and thus accounts for just over 1 per cent of the rise in prices since 1972. This has probably been offset by price cuts due to the abolition of tariffs on industrial goods within the EEC.
5. The cumulative effect of EEC membership on the UK's GNP is estimated at a £19bn gain on industrial exports, and a £7bn loss on agricultural Budget transfers, leaving a net gain of £12bn, or 5 per cent of this year's GNP. This is well below expectations, but well worth having.

CHRISTOPHER JOHNSON
Group Economic Adviser, Lloyds Bank

Table 3
UK-EEC TRADE – MARKET PENETRATION
(Percentage share of visible trade)

	UK exports to EEC		UK imports from EEC		UK exports as % of imports*
	% of total UK exports	% of total exports to EEC††	% of total UK imports	% of EEC exports to world	
1970	29.7	5.2 (6.6)	28.4	4.4	104
1971	28.1	5.3 (6.6)	30.7	4.8	93
1972	30.2	5.0 (6.3)	33.8	5.3	83
1973	32.2	4.8 (6.0)	35.7	5.6	74
1974	33.8	4.5 (6.0)	35.3	5.9	72
1975	32.2	5.0 (6.3)	38.5	5.9	71
1976	35.5	4.9 (6.6)	38.4	5.6	80
1977	36.8	5.7 (7.0)	40.0	6.0	86
1978	38.1	5.9 (7.0)	43.3	6.3	84
1979	42.6	6.3 (7.1)	45.2	6.8	87
1980	43.1	7.0 (7.0)	42.7	6.4	104
1981	40.9	6.6	43.3	6.4	100
1982†	41.8		44.7		95
1972-81 annual growth of share	3.4	3.1 (1.2)	2.8	2.1	

†First six months. ††Figures for manufactures in brackets. *Balance of payments basis.
Sources: Col. 1, 2, 3 and 5 *Monthly Review of External Trade statistics.*
Col. 2 and 4 *IMF Direction of Trade Statistics Year Book.*

FROM: M E DONNELLY
DATE: 20 January 1983

MR GRIMSTONE

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir D Wass
Mr Bailey
Mr Burgner
Mr Morgan
Mr Wilson
Mr Wicks
Mr Ridley
Mr Harris

RELATIVE VALUE OF PUBLIC SECTOR ASSETS

The Financial Secretary would be grateful for a note setting out the price received for nationalised industries that have been privatised compared with the cost of their original acquisition by the Government.

These figures and the change between them should be expressed in real rather than nominal terms, to give some idea of how the value of the enterprises may have changed.

It may be more straightforward to estimate these figures for some industries rather than for others. It would be helpful to have an initial reply as soon as possible setting out whatever information is easily available; and assessing any problems there might be in extending this exercise to all industries which have been privatised.

MED
M E DONNELLY

FROM: E KWIECINSKI
DATE: 20 January 1983

NOTE OF A MEETING HELD AT H M TREASURY 11am ON 19 JANUARY 1983

Present at meeting: Financial Secretary
Mr Tracey/IR
Mr Haldane) Scottish
Mr Lynch) Landowners
Mr Barry) Federation

SCOTTISH LANDOWNERS' FEDERATION: BUDGET REPRESENTATION

The Financial Secretary invited the SLF to open the discussion.

Mr Haldane commented that the SLF's proposals had two thrusts:-

a) to obtain recognition that the letting of land was a business activity. Agricultural landlords were involved in the full time management of their estates.

and b) deferral of CTT liability on agricultural land generally.

The Financial Secretary wondered what the SLF's motives were in seeking these changes.

Mr Haldane commented that they wanted to increase investment in agricultural industry. They were particularly worried that the landlords were no longer letting their land.

The Financial Secretary commented that the Government's aim was to have a fiscally neutral regime for owner-occupied and let land. The problem was that in the law as it applied today, all income derived from letting land was treated as unearned, whereas the landowner who farmed his land in hand had all his income from this activity treated as trading profits (ie earned). At the heart of the matter was the question, "what constitutes a trade?" The truth of the matter was that to some extent, and in varying degrees, both activities had an element of "trading." Also there was a problem of where to draw the line: if "earned income" treatment were given to agricultural landlords, other landords both at the margins of agricultural activity and in the urban areas, would expect the same treatment.

Mr Lynch commented that there was a clear distinction between a farm landlord who had day to day involvement with his tenants, and the urban landlord whose relationship with his tenants was more at "arms-length".

The Financial Secretary accepted the practical differences but pointed out that the financial involvement of the two was the same, and therefo: so was their fiscal treatment.

CTT

Mr Haldane was grateful for the measures taken in the 1981 Finance Act, but did not see why let land should only get 20% relief, while land with vacant possession received 50% relief. He accepted that there was a premium on the value of land in vacant possession but didn't see the logic of penalising the landlord with let land by denying him CTT relief. In a sense he was doubly penalised: a) his land was worth less on the market because it was tied to the tenant and b) yet the Revenue taxed it as if it were worth the same as vacant land.

The Financial Secretary was sympathetic to the arguments, but pointed out the danger of abuse, by eg death-bed letting, if let land was given the full 50% relief. Overall he felt that the answer to the problem lay in tenure law reform, especially in England.

CTT - Partnership under Scottish Law

Mr Lynch said there was a problem with Scottish partnerships and CTT liability on the death of one or other of the partners. The FA 1982 CTT reliefs were being strictly interpreted by the Scottish CTO as applicable only to individual tenants and not to partners under tenancies.

The Financial Secretary commented that it was not the Government's intention for there to be any difference in Scotland.

Mr Tracey commented that to his knowledge the Scottish CTO were going to allow the some reliefs to Scottish partners; he would check on this.

CTT: deferrment

Mr Lynch made an impassioned plea on behalf of the agricultural landowners who he said were making a long term committment to the nation by leaving their money in productive farmland. Yet the foreigner who owned land in this country was at an advantage. The value of the UK landowners' asset was being whittled away by CTT through the generations.

The Financial Secretary said he was worried about the "locking-in" effect deferrment would have. He pointed out that owners of farmland already benefited from very generous reliefs compared with owners of other sorts of assets. He concluded that the Government had to take measures which they judged to be broadly fair to all taxpayers.

The meeting closed at 12.00pm.

E KWIECINSKI

Circulation:

PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (R)
Mr Robson
Mr Martin
Mr French
Mr Tracey) IR
Mr Beighton)
PS/IR

FROM: E KWIECINSKI
DATE: 20 January 1983

NOTE OF A MEETING HELD AT H M TREASURY AT 11.00am ON 18 JANUARY 1983

Present at meeting: Financial Secretary
Mr French
Mr Battishill - IR
Mr A Miller)
Mr C Holland) National Federation of
Mr W Davis) Self-Employed

NATIONAL FEDERATION OF SELF-EMPLOYED: BUDGET REPRESENTATION

The Financial Secretary invited the NFSE to open the discussion.

Mr Miller commented that the NFSE were concerned about the Government's perception of "Small businesses". Successive budgets had been heralded as being "good for small business". But in the NFSE's view the measures taken were aimed at rather larger businesses. 80% of all UK businesses had a turn-over of £100,000 p/a, on average employing five people or less, so measures like eg increasing the Corporation tax thresholds, were not relevant to small businesses.

The Financial Secretary asked the NFSE how they thought assistance could best be given.

Mr Miller commented that most of the NFSE's suggestion were measures aimed at allowing businesses to retain more of their profits as working capital.

Pension Provision

Mr Miller commented that this provision had a dual function. It would enable small businesses to retain more in their capital account which could be used if necessary as working capital, and it would also provide a pension for the businessman. If the business failed, and all of the capital was used up, then the pension provision would also fail, and the Revenue could "claw-back" the tax relief that had been would be granted. The idea was that contributions to the "pension-fund" tax deductible from the businesses' profits.

The Financial Secretary was not attracted to this idea. Its major draw-back as a pensions provision was the disappearance of the fund if the business failed.

Carry-over of personal allowances

Mr Holland commented that alot of small businessmen did not use up their personal allowances. This provision would allow them to, in effect, average out their profits over two years, like farmers. In the event of their income in any given year falling below the level of the personal allowance, the balance of the allowance could be carried forward and set against the next year's income. It was aimed at the low income self employed man, who could not qualify for any form of state benefit.

The Financial Secretary was wholly opposed to this idea. It was against the nature of the tax, which was a tax on income in any given year; also such a provision would be widely abused.

Mr Battishill commented that the tax system did not operate negatively. The NFSE's proposal differed from the regime applicable to farmers, which averaged income over two years rather than allowed the carry forward of allowances.

The Financial Secretary commented that the Government's aim was to use tax reliefs to encourage businesses to expand, which was why so many of its measures were aimed at the corporate sector, where the target could be more easily identified. If the NFSE wanted to assist those self-employed people on very low income, perhaps the answer lay with the DHSS.

Training Allowances

The NFSE's provision would allow expenditure on training to be used as an offset against a business's tax liability. Mr Miller argued that this would be a better use of the Government's resources than pouring in million of pounds to the MSC's training schemes, which often missed their target.

The Financial Secretary said he would think about this proposal.

E KWIECINSKI

Circulation:

PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (R)
Mr French
Ms Seammen
Mr Battishill - IR
PS/IR

FROM: E KWIECINSKI

DATE: 21 January 1983

MR S THOMAS/AP3 DIVISION

cc Mr R Allen
Mr D Norgrove
Mr B Potter

THE ACCOUNTANT AND STOCK EXCHANGE ANNUAL AWARDS: 14 FEBRUARY 1983

Martin Donnelly has spoken to you about this, and you kindly agreed to prepare five minutes' worth of speech material for the Financial Secretary on accountancy related matters.

... I attach a copy of the ASEAA's letter. Please could we have your contribution by the 31 January.

E KWIECINSKI

The Accountant & Stock Exchange Annual Awards

Alhambra House,
Trafalgar Square,
27-33 Charing Cross Road,
London WC2H 0AU
01 930 3956

18th January 1983

The Rt. Hon. Nicholas Ridley, MP,
Financial Secretary to
The Treasury,
Treasury Chambers,
Parliament Street,
LONDON SW1P 3AG

Dear Mr. Ridley,

The Mansion House, Monday 14th February, 11.00 for 11.30 am

Firstly, may I say how pleased we are that you have kindly agreed to be our Guest Speaker on the occasion of The Accountant & Stock Exchange Annual Awards 1983.

The final arrangements have not, as yet, been agreed with the Mansion House but I enclose my first draft of the timetable for the Awards ceremony which should give you an idea of the proceedings.

I would also like to take this opportunity to invite you to a lunch at The Stock Exchange (23rd Floor) on the day of the Awards. The timing of the lunch is 1.00 for 1.15 pm so all those invited will therefore be leaving the Mansion House shortly before 1.00 pm. I enclose a draft list of our lunch guests and we very much hope that it will be possible for you to attend.

We shall, of course, be covering the presentation ceremony in our weekly magazine, The Accountant, and the Editor has asked me to enquire whether you could kindly make a copy of your final speech available to us shortly before the Awards presentation day.

I shall, of course, send you further details on the arrangements as soon as these become available.

Yours sincerely,

J. Langridge

Judith Langridge
Secretary, Annual Awards

THE ACCOUNTANT & STOCK EXCHANGE ANNUAL AWARDS 1983

Presentation Ceremony at The Mansion House

Monday 14th February 1983

11.00 Messrs Cliff Waller (Editor, The Accountant) and Patrick Mitford-Slade (Deputy Chairman, The Stock Exchange) at reception point in Salon.

11.20 Messrs Waller and Mitford-Slade leave reception point and enter Drawing Room where the platform party and their wives have assembled.

11.25 The Lord Mayor with Alderman and Sheriff Alan Traill enter the Drawing Room, accompanied by Lieut. Colonel St. J. C. Brooke Johnson. Mr. Waller greets the Lord Mayor and presents the various guests in the Drawing Room.

11.28 The Toastmaster invites the ladies and platform party other than those in the procession to take their places in the Egyptian Hall (Mrs Langridge to direct them).

11.30 The procession party leaves the Drawing Room.

11.32 Mr. Waller's address of welcome.

11.37 Mr. Mitford-Slade speaks.

11.42 The Rt. Hon. Nicholas Ridley, MP speaks.

11.47 Mr. Waller invites the Lord Mayor to speak and present the award for large companies to Mr. ....., Chairman of ... and the award for smaller companies to Mr. ....., Chairman of ...
The Lord Mayor speaks and makes the presentations.

11.55 Mr. ... (large company) returns thanks and speaks.

12.00 Mr. ... (small company) returns thanks and speaks

12.05 Mr. Waller invites Mr. Richard Sykes to speak on the 1983 Awards.

12.15 Mr. Waller thanks the speakers and invites guests to take refreshments.

The Accountant & Stock Exchange Annual Awards

Alhambra House,
Trafalgar Square,
27-33 Charing Cross Road,
London WC2H 0AU
01 930 3956

LUNCH AT THE STOCK EXCHANGE (23rd Floor)

14th February 1983 - 1.00 for 1.15 pm

The Rt. Hon. N. Ridley, MP	Financial Secretary to The Treasury
Mr. J. R. Knight	Chief Executive of The Stock Exchange
Mr. P. B. Mitford-Slade	Deputy Chairman of The Stock Exchange
Mr. C. Waller	Editor of 'The Accountant'
The Hon. Mr. Justice Nolan	Former Chairman of the Judging Panel
Mr. R. Sykes, QC	Chairman of the Judging Panel
Mr. P. Gee-Heaton	Former Chairman of the Annual Awards
Mr. M.L.J. Fisher	Member of The Stock Exchange Council
Mr. G. M. Nissen	Member of The Stock Exchange Council
Mr. G. H. Fryer	Head of Quotations Department of The Stock Exchange
Mr. P. R. Davis	Head of Public Relations Department of The Stock Exchange
Mrs. J. A. Langridge	Secretary of the Annual Awards

Award Winners

Representatives from 'large' company (2)

Representatives from 'small' company (2)

FROM: M E DONNELLY
DATE: 24 January 1983

PRINCIPAL PRIVATE SECRETARY

cc Mr Littler
Mrs Hedley-Miller
Miss Court
Mr Edwards

EC BUDGER REFUNDS: POSSIBLE VISIT OF HERR LANGE

The Financial Secretary has commented on Mrs Hedley-Miller's attached submission as follows:-

> "I am sure it would be a good thing if Herr Lange came to London, and good too if the Chancellor could spend ten minutes with him."

The Financial Secretary will be joining Mr Hurd in giving Herr Lange lunch.

MED
M E DONNELLY

From : Mrs M Hedley-Miller
Date : 24 January 1983

1. FINANCIAL SECRETARY - you may care to comment

2. PRINCIPAL PRIVATE SECRETARY

cc Mr Littler
Miss Court
Mr Edwards

EC BUDGET REFUNDS AND THE EUROPEAN PARLIAMENT. POSSIBLE VISIT TO LONDON OF HERR LANGE

It was agreed earlier this month that it was neither desirable nor practicable for the Chancellor to invite Herr Lange to London to try to influence him about our Budget refunds. The possibility arose because Herr Lange, who is German, has for the last 5 years been the Chairman of the Parliament's Budgets Committee (having been in the European Parliament for more like 9 years), and is influential. He is thought to be generally quite well disposed to the UK, but he does not like ad hoc refunds arrangements.

2. Mr Hurd is now proposing to invite Herr Lange to London, though 2 February is apparently the possible/only date for him, and I do not know yet whether it will suit Herr Lange. If the visit does come off, I think it would be helpful for the Chancellor, if his engagements permit, to receive Herr Lange for a courtesy call - about a quarter of an hour ought to do.

3. Unless the Financial Secretary disagrees therefore, I hope that it may be possible, if Mr Hurd's office do approach you, to find a time when the Chancellor could shake Herr Lange's hand.

Y. Engledow.

pp MRS M HEDLEY-MILLER

CONFIDENTIAL

FROM: FINANCIAL SECRETARY
DATE: 24 January 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (R)
Minister of State (C)
Sir D Wass
Mr Bailey
Mr Middleton
Mr Monck
Mr Moore
Mr Gordon
Mr Robson
Mr French
Mr Battishill - IR
PS/IR
Mr Hewitt - B/E

SMALL FIRMS AND ENTERPRISE PACKAGE: DEBT-EQUITY CONVERSION AND EQUITY LINKED SUBSIDISED LOANS

John Wakeham and I have had further discussions with officials on these two possible elements in the enterprise package in the budget. This minute seeks your agreement that they should both now be dropped, at least as far as this year's budget is concerned.

A. Debt-equity conversion

The scheme we have been considering involved giving the banks tax incentives to turn their present lending into equity. This was aimed at relieving the pressure on company cash flow of servicing debt and so encouraging increased activity by companies. These cash flow constraints have been identified by, among others, the Grylls Group.

We have been awaiting a Bank paper on the scheme. This was circulated under the cover of Mr Moore's minute of January 11.

The Bank oppose the scheme, primarily on the grounds of the prudential problems involved in a substantial increase in banks' holdings of company shares. I see force in this argument, although I have asked the Bank for a further note setting out how far the process might go before the prudential problems become significant.

More generally, I dislike the idea of banks becoming holders of equity. We want individuals, not institutions, to hold equity. This would not be so strong an objection if we could see a way of getting the banks to dispose quickly of the equity while retaining a workable scheme but, at the moment, we cannot. On top of this I do doubt if we want to introduce a new tax shelter for the banks. Our concern until recently has been that they do not pay enough tax. What is more it is not clear whether the banks themselves would find the scheme attractive.

The scheme would, of course, require legislation and the legislation would not be simple. We would have to guard against exploitation of the tax advantages.

With declining interest rates and increasing company profitability, the liquidity problems of industry seem to be easing a little, making such a scheme less necessary than when we first considered it.

Overall, John Wakeham and I agree that we should not decide against taking this any further in the context of this year's budget. This does not mean we dismiss the idea entirely. After the budget it would certainly be worth examining it further to see if something more attractive could be devised. This would probably mean discussions with the banks.

B. Equity linked subsidised loans

The scheme was set out in Mr Gordon's minute of 9 December. It provided long term subsidised loans for unquoted companies which were raising new equity. The loans were to be financed in a non-monetary manner.

Again it would help companies facing a tight cash position and would also encourage them to take outside equity.

Against this the scheme is formidably complex. It has already been commented on adversely by the Prime Minister who sees it leading to demands for subsidies in other areas. We all have political reservations about subsidised credit.

On balance John Wakeham and I agree that we should concentrate in this budget on the business expansion scheme and that we should leave this idea over for the present. Again we do not dismiss it forever and we might look at it again if the expansion scheme seemed to need buttressing in the future.

C. Conclusion

I seek your agreement that these two schemes should be dropped as starters for this budget.

NICHOLAS RIDLEY
24 January 1983

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 24 January 1983

CHANCELLOR

cc Chief Secretary
Mr Bailey
Mr Ridley

PARLIAMENTARY REFORM: LETTER FROM MR ST JOHN STEVAS TO MR LAWSON

The Financial Secretary has seen Mr Ridley's note to you of 21 January.

The Financial Secretary does not see why we should not say things on this subject that our own back-benchers do not like. He feels there is a danger of becoming too jittery about back-benchers' reactions.

MED
M E DONNELLY

CONFIDENTIAL

FROM: NICHOLAS RIDLEY
DATE: 24 January 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Mr Ridley
Mr French
Mr Harris

I am uneasy about Ferdie Mount's latest ideas on child tax allowances. They would complicate the system enormously. To have child benefit and child tax allowances seems fairly odd to start with. They will use up a lot of money that should go to raising the allowances. Finally having children is (mostly) a voluntary activity. To make it too lucrative can increase the supply of children. If it is not lucrative enough one can forego the joys of having them, or even have one less.

NICHOLAS RIDLEY
24 January 1983

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 24 January 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (R)
Sir D Wass
Mr Middleton
Mr Moore
Mr Monck
Mr Robson
Mr French
Mr Graham - Parly Counsel
Mr R Martin - IR
PS/IR

EMPLOYEE SHAREHOLDING

The Financial Secretary has seen Mr Martin's submission of 21 January.

He agrees with Mr Martin that this year's legislation should be limited to that provisionally contemplated at your meeting on 12 January; and he has made the following comments on the recommendations for legislation detailed in paragraph 27 of Mr Martin's note:-

a) He agrees that the current £1250 limit for the 1978 profit sharing schemes should be changed to include an alternative limit of 10% of salary and that this should be subject to an overall maximum of £5000 (cost up to £25m).

b) He thinks that the £50 monthly limit for the 1980 savings - related share option scheme should be raised to £70 (no cost for 5 years, and then cost probably notional).

and c) he thinks that the three year instalments period for options outside approved schemes should be extended to four years (cost £5m - £10).

The Financial Secretary would be grateful for your agreement that these three changes should form the Government's Budget package on employee shareholding.

E KWIECINSKI

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 24 January 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (R)
Minister of State (C)
Sir D Wass
Mr Middleton
Mr Kemp
Mr Monger
Mr Moore
Ms Seammen
Mr Corcoran
Mr Ridley
Mr French
Mr Harris
Mr Spence - IR
Mr Blythe - IR
PS/IR

DEPENDENT RELATIVE ALLOWANCE AND MINOR PERSONAL ALLOWANCES

The Financial Secretary has seen Mr Spence's notes of 18 January and the Secretary of State for Social Services' paper "Care of Elderly People" (FPG/83(1)).

He suggests that the following three allowances could be abolished:-

1) Dependent Relative Allowance - £100p.a [£145 for a single woman]
which is worth £30 [48] per annum or 58p per week

2) Housekeeper's allowance - £100 p.a, worth £30 per annum or 58p per we

and 3) Sons or daughters' Service - £55 per annum, worth £16-50 per annum or 32p per week

Provided that:-

a) there is a sizeable increase in personal allowances over Rooker - Wise (which is planned anyway)

and b) the Invalid Care Allowance is extended, as Mr Fowler recommends (at a cost of £11m).

The Financial Secretary thinks that this makes sense on any grounds, and the losers are very small in number - (and they would not be losers overall if the personal allowances are increased in real terms).

E KWIECINSKI

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 24 January 1983

PS/CHANCELLOR

cc PS/CST
PS/EST
PS/MST(R)
PS/MST(C)
Sir D Wass
Mr Middleton
Mr Moore
Mr Griffiths
Mr M Hall
Mr French
PS/IR
Mr. Blythe/IR
Mr Fraser/C&E
PS/C&E.

FINANCE BILL STARTERS: CLASSIFICATION B2 ITEM 5 VAT ANNUAL ACCOUNTING WITH ANNUAL PAYMENT FOR SMALL BUSINESSES

The Financial Secretary has seen Mr Fraser's minute to the Economic Secretary of 20 January.

He is strongly in favour of doing this, and he thinks the first year PSBR cost should be included in this year's budget, when we will have room for the "fiscal adjustment".

He thinks that this together with (perhaps) annual PAYE accounting and optional net of tax pay (on which work in in hand) would make a very attractive package for small businesses.

E KWIECINSKI

FROM: M E DONNELLY
DATE: 24 January 1983

MR DAY

cc PS/Chief Secretary
Sir A Rawlinson
Mr Bailey
Mr Mountfield
Mr Burgner
Mr Kelly
Miss King
Mr Wicks
Mr Webb
Mr Harris
French

DEPARTMENT OF ENERGY ESTIMATES - PROPOSED COAL VOTE

The Financial Secretary has seen your submission of 11 January and Mr Gieve's note of 13 January. He agrees with the Chief Secretary that it would be useful to have a "coal" Vote; and wonders whether this Vote might be extended to include the further subsidy received by the NCB due to the Electricity Supply Industry being forced to buy expensive coal, even though this element of subsidy is paid by consumers in the form of higher electricity prices rather than as tax.

MED
M E DONNELLY

FROM: E KWIECINSKI
DATE: 24 January 1983

cc Chancellor
CST
EST
MST(R)
MST(C)
Mr Moore
Mr Robson
Mr Ridley
Mr Harris
Mr Bryce - IR
PS/IR

MR FRENCH

CGT - LOOKING AHEAD

The Financial Secretary has seen your note of 20 January.

He finds it difficult to accept Mr Morpeth's argument and figures, but he agrees that the criticism does not seem to go away. Indeed it may well come back at us next year. He suggests that you discuss the problem with him in the near future; I will be in touch to arrange a convenient time.

E KWIECINSKI

FROM: E KWIECINSKI
DATE: 24 January 1983

MR FRENCH

cc Chancellor
CST
EST
MST(C)
MST(R)
Mr Ridley
Mr Harris

LETTER FROM ONE PARENT FAMILIES

The Financial Secretary has seen your minute of 19 January enclosing the letter from One Parent Families.

He is totally against their suggestion. It would "socialise" a new slice of income, and a far less meritorious one than Child benefit. It would also be a further inducement towards divorce. Finally he has commented that it should not be assumed that the better off can be made to pay for everything.

E KWIECINSKI

From: M E DONNELLY
Date: 24 January 1983

MRS HEDLEY-MILLER

cc PS/Chancellor
Mr Littler
Miss Court
Mr Edwards

THE EUROPEAN BUDGET ISSUE: NOTE BY ROBERT JACKSON

The Financial Secretary thought you might be interested to see the attached note given to him by Robert Jackson MEP on the European Budget Issue over the coming year. The Financial Secretary finds Mr Jackson's assessment rather depressing but probably realistic. He considers the vital point to be that at X on page 3: the question of the European Court's judgement of any withholding by the UK.

MED
M E DONNELLY

The 1982 Refund (payable out of the 1983 Budget)

The European Parliament will probably give a first reading approval to the 1982 refunds at its mid-FEBRUARY session. It will impose conditions. These will have to be negotiated with the Council. The final vote will probably take place at the Parliament's MARCH session: but the timetable may slip to APRIL.

The 1983 Refund

Between FEBRUARY and JULY the Council will doubtless pursue negotiations about a long-term solution to the problem, covering the refunds for 1983: arising from this, or included in it, will be a negotiation about a fourth year of ad hoc payments, in respect of 1983 (possibly also for 1984 and another year or so ahead).

There will therefore be no provision for the 1983 Refund in the Commission's Preliminary Draft Budget for 1984 - presented in APRIL or MAY. Council could include provision when it adopts the Draft Budget in JULY. But the probability must be that this will not be done, and the Commission will have to propose amendments to the 1984 Draft in the autumn.

Such amendments to the 1984 Draft could be introduced at any stage up till early NOVEMBER. Following the precedent of the 1982 Refund it would even be possible to finance an ad hoc payment for 1983 from a supplementary budget for 198 passed before the end of MARCH 1984 (to fall within the British 1983 financial year).

Implications for the British election

If the general election were to be in OCTOBER 1983 it would probably be possible to fudge this issue, provided that (a) the European Parliament had approved the 1982 Refund in MARCH/APRIL 1983, and (b) that the Commission brings forward proposals in the early autumn to cover 1983 in the form of amendments to the 1984 Draft Budget.

If the election were to be in the Spring of 1984 it would probably be very difficult to defuse this issue, even if there had been agreement on 1982, unless there had also been agreement before MARCH 1984 on the 1983 Refund.

An Assessment of the chances for the 1982 and 1983 Budget

I am pessimistic about the chances of the Council agreeing to the minimum concessions acceptable to Parliament in respect of the 1982 Refund. Probably all that Parliament will insist on is the classification of the Refunds as non-obligatory, with Parliament accepting that it will not then draw advantages from such classsification. Even if the British Government were to agree to this is it doubtful if others would.

I am very pessimistic about the chances of Refunds for 1983 and further years. (a)Unlike the 1982 Refund there is no political agreemnt in Council on this. (b) Parliament may not continue to press its "no-more-ad-hoc payments" line in relation to 1982: but it will almost certainly do so in respect of 1983. (c) The Commission is so worried about being censured by Parliament that it may not be prepared to bring forward proposals for a 1983 Refund without strong cover from Council.

The Choice

If the probability, thus, is a major bust-up on this issue, the choice for the British Government is

- should it ensure that there is no agreement in Council for minimum concessions to Parliament in respect of the 1982 Refund, thus provoking the rejection of that Refund in MARCH/APRIL 1983 - with the crisis following immediately, but the blame falling largely on Parliament;

- or should it work hard for agreement with Parliament on the 1982 Refund, in the hope of playing the 1983 issue beyond the general election.

Two Points to note: (a) whatever the British Government may try to do in Council, there may be no agreement in respect of 1982 - leading to rejection and presumably, a crisis: (b) the longer 1983 wears on without any agreement for Refund to cover the year, the more difficult it will be to get the money back by with-holding.

Observations on "With-holding"

A British decision to with-hold part or all of the payments from Britain to the European Budget would almost certainly be found illegal by the Court. Our legal ground is strongest in respect of the 1982 Refund, where there is at least a political agreement within Council to rest on.

The impact on our partners would not be immediate: it would be cumulative; and, depending on the state of the agricultural markets, it would eventually be quite serious. There is little prospect of any agreement ending the illegal situation before the election, whenever it is held.

With-holding payments does in a sense solve the problem: Britain is paying what she considers to be a reasonable amount; the others are obliged to find ways of carrying the burden. On the other hand, we could not - nor could the Community - carry on indefinitely in such an irregular situation. With-holding should therefore be seen as in the context of the need to find a legal solution.

Such a solution would be more diffficult to obtain if the British were to play the with-holding card in a triumphalist manner. The tone should be "more in sorrow than in anger".

This surely fits with the electoral logic of the situation, in which our line would presumably be that the best way to serve Britian's interest is to stay in Europe (cp Labour), and to fight hard to win for Britain (cp Alliance).

FROM: E KWIECINSKI
DATE: 24 January 1983

MR ISSAC/IR

cc PS/Chancellor
PS/CST
PS/MST(C)
PS/MST(R)
Sir D Wass
Mr Middleton
Mr Moore
Mr Gilmore
Mr Hall
Mr French
Mr Cassels
Lord Privy Seal
PS/IR

LARSEN SWEENEY

The Financial Secretary has seen the attached letter from the American Chamber of Commerce (UK) and the current issue of Atlantic.

He would be inclined, subject to your views, to let the matter rest now.

E KWIECINSKI

AMERICAN CHAMBER OF COMMERCE (UNITED KINGDOM)
75 Brook St, London, W1Y 2EB. Telephone: 01-493 0381. Telex: 8954665 (for ACC) GITS G
INCORPORATED WITH LIMITED LIABILITY IN THE DISTRICT OF COLUMBIA U.S.A.

The Hon Nicholas Ridley MICE MP
Financial Secretary to the Treasury
Treasury Chambers
Parliament Street
London SW1P 3AG

Office of the Director-General

20 January 1983

Dear Mr Ridley,

With reference to your letter of January 17 to Roger Lloyd our President re Larsen Sweeney.

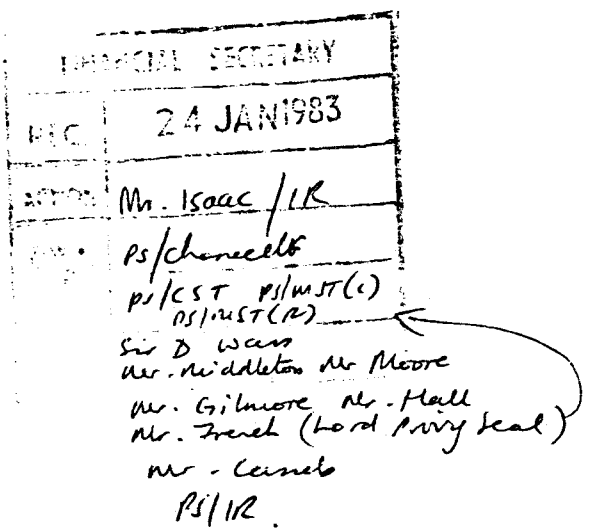
Please find attached three copies of the current issue of Atlantic which carries our editorial on the subject.

With kindest regards,

Yours sincerely,

Harry G. Cressman
DIRECTOR GENERAL

HGC/SEA
Encl



CONFIDENTIAL

NOTE OF A MEETING HELD AT 10.30am, 20 JANUARY IN THE FINANCIAL SECRETARY'S ROOM ON INVESTMENT IN SMALL BUSINESSES: TAX STATUS OF INVESTMENT COMPANIES

Those Present: MST(R)
Mr Bailey
Mr Moore
Mr Robson
Mr French
Mr Prescott - IR

The meeting had before it Mr Prescott's minute of 4 January, Mr Moore's minute of 11 January, Mr Milner's note of 13 January, and Mr Robson's minute of 19 January.

The Financial Secretary said that there were two main questions to be looked at:

i) how to find a satisfactory vehicle for institutional investment in unquoted companies;

ii) how best to find bodies to fulfil the brokerage role of making a market in unquoted shares.

Brokerage function

In discussion it was agreed that the market in unquoted shares needed to be improved. But it had to be recognised that the reason thes shares were less marketable than quoted shares was because the companies involved did not have to submit to so onerous a regime of disclosure.

But as Mr Robson's note made clear there was at present considerable scope for setting up a market in private company shares. Any third party licensed as a dealer in securities by the Department of Trade could perform this brokerage function, including Enterprise Agencies, or Approved Investment Funds. There were infact no legal inhibitions on private company shares being traded on the unlisted security markets; but Stock Exchange rules closed this market to non public companies.

Summing up the Financial Secretary said that what was required was not further legislation but more effective publicity for the available options. The scope for marketing private company shares should be stressed in the context of the Budget debates. The precise wording to be used on this topic could be first agreed internally and then shown to the Secretary of State for Trade for his approval.

Vehicle for Institutional Investment

The Financial Secretary said that this problem was summarised in the Secretary of State for Scotland's letter of 2 December to the Chancellor. At present there seem to be tax disadvantages preventing institutional investors from making significant investments in small firms. In discussion it was suggested that the current provision for Approved Investment Trusts, if amended as in paragraph 4 of Mr Moore's note to make it more flexible, offered a way forward. For example the rule that AITs had to be quoted companies seemed an unecessary blockage in the system. Companies should at least be given the choice of being quoted or unquoted. But the Revenue pointed out that at present there was insufficient information about the extent of institutional investment in small firms; and about the main obstacles to such investment which the institutions found. On the other hand even publishing the current arrangements would be a major step forward. If institutions said that more was required extra measures could be considered. The Financial Secretary pointed out that it was also necessary to look at these issues from the point of view of the small firm whose equity we were trying to boost.

Summing up, the Financial Secretary said that the Treasury and Revenue should talk to the financial institutions to find out if the changes suggested by Mr Moore to the AIT scheme would be likely to have much effect: and come back with any other points they might raise. In the meantime he would send a short non-committal reply to Mr Younger's letter.

MED
M E DONNELLY

Circulation:

Those Present
PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/MST(C)
Sir D Wass
Mr Middleton
Mr Kemp
Mr Monck

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 24 January 1983

NOTE OF A MEETING HELD AT 4.00PM ON 20 JANUARY 1983 IN THE FINANCIAL SECRETARY'S ROOM ON MEASURES TO ASSIST SMALL FIRMS: EQUITY LINK SUBSIDISED LOANS AND DEBT EQUITY CONVERSIONS.

Those Present: Minister of State (R)
Mr Bailey
Mr Monck
Mr Moore
Mr Robson
Mr Battishill - IR
Mr Hewitt - B/E

The meeting had before it Mr Gordon's note of 9 December, and subsequent correspondence; and Mr Moore's note of 11 January covering the Bank of England paper.

Debt Equity Conversion

The Financial Secretary said that the aim of any scheme here should be both to encourage banks to convert more of their debt into equity holdings and then to sell the resulting equity. In discussion the following points were made:-

i) debt equity conversion/by banks could leave the banks in an overwhelmingly dominant position of control in many small companies;

ii) the Bank of England expressed reservations over banks becoming more exposed, leading to possible prudential difficulties;

iii) some incentive was needed to persuade banks to move from relatively safe loans to exposed high risk equity; without some fiscal advantages little change to the present position was likely.

One suggested way forward would be to allow banks tax reliefs on the equity value of any loan written off into equity rather than simply allowing tax relief on the written off debt as at present. Tax would still be payable when the equity was sold; but this scheme would provide some additional relief over time. Such a concession might have to be extended to all corporate/individual lenders and not restricted to banks only. However this scheme did not encourage banks to dispose of equity so acquired; from the banks' viewpoint it had similar tax advantages to leasing. The Minister of State (R) pointed out the inconsistencies in going further and providing greater relief for banks that could sell the shares they had acquired through debt-equity concession rather than for those whose converted equity holding proved valueless. Moreover this scheme would encourage banks to hold on to their shares in the hope of capital appreciation which might increase the tax concession available.

Summing up the Financial Secretary said that overall it was not clear that any of the debt-equity schemes examined offered clear advantages, while all were open to prudential objections on banking supervisory grounds, and offered the prospect of increased tax evasion. Again there was a problem of lack of information on the extent of the problem. It would be necessary to consult with the banks as to what obstacles stood in their way in converting debt into equity. This could not reasonably be done before the Budget. He invited the Bank and the Treasury to discuss this further with the clearing banks after the Budget. They should continue to concentrate on the dual problem of encouraging banks to convert debt into equity in an acceptable way and then to dispose of the shares so acquired. He also asked the Bank to produce a further paper showing more precisely the level at which banks' equity holding would pose a significant prudential problem.

Equity Link Subsidised Loans

The arguments for and against a scheme for equity-linked subsidised loans were briefly reviewed. The arguments in favour were:

i) it would encourage greater equity participation;

ii) it could improve company gearing;

iii) it would be politically advantageous in appearing to move some way towards the ideas advocated by Grylls;

iv) it might offer a means of phasing out the Loan Guarantee Scheme.

Arguments against were:

i) the scheme would be extremely complicated;

ii) it would probably also be costly;

iii) there would be problems of avoidance and arbitrage which could be hard to overcome;

iv) there were arguments of principle against putting forward any scheme to subsidise loans.

In discussion it was agreed that the proposed Business Expansion Scheme would in any case provide a significant initial boost to equity holdings and small firms gearing. It would therefore be better to concentrate on this scheme. Moreover the monetary implications of the Gordon scheme, even though the best of its type, were not necessarily favourable. The Minister of State (R) suggested one possible alternative whereby a firm applying for equity and taking out loan capital at the same time might allow the lender to lump both of these together for CGT purposes, giving some tax advantage. But this would be of use only in limited cases; and difficult to pursue before the Budget.

Summing up the Financial Secretary said that there was not great enthusiasm for pursuing any subsidised loan scheme at present. He therefore proposed that it be shelved and work concentrated on the BES. It might then be looked at again after the Budget in the light of public reactions to the BES. He would minute the Chancellor accordingly.

MED
M E DONNELLY
24 January 1983

Circulation:

Those present
PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
Sir D Wass
Sir A Rawlinson
Mr Middleton
PS/IR

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 24 January 1983

MR RIDLEY

cc Chancellor
Chief Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Mr French
Mr Harris

OPINION SURVEYS: THE TREATMENT OF MORTGAGE INTEREST

Your note of 20 January.

... I attach your page of draft questions, with manuscript amendments suggested by the Financial Secretary.

MED
M E DONNELLY

CONFIDENTIAL

MORTGAGES: DRAFT OPINION SURVEY QUESTIONS

1. Do you live in a rented home or flat, or ~~is it~~ Do you privately owned? if.

2. ~~Was~~ Has it been, or is it being, bought on a mortgage, e.g. from a Building Society, Bank or Insurance Company?

3. Are you yourself responsible for the mortgage, or do you at least know something about the details of it?

4. Did you know that the interest payments on money borrowed under a mortgage can be "set off" against the borrower's income tax?

5. Are you aware of any limit on the the size of mortgage which is eligible for this kind of tax relief?

6. In fact the Government decided [in 1974] that interest payments would only qualify for tax relief on mortgages of £25,000 or less.

   - Do you think that is a reasonable upper limit?

7. Some people say that the limit for this tax relief should be set at the typical mortgage needed for the average (family) (man) (person) buying his first house.

   - Do you think that's reasonable?

8. Some people argue that this £25,000 limit should be increased because house prices have risen a lot since it was fixed.

   - Do you agree?

9. Raising the limit would cost the Government a lot of money ~~in lower~~ income tax ~~which~~ would only ~~go to~~ help the wealthier house-buyer who can afford a mortgage of over £25,000.

   - Do you think the Government should ~~cut income tax~~ raise the limit in that way, or would you rather the money was used to cut income tax a little for everyone?

10. Because wealthier people pay income tax at a higher rate, the tax they save when they have interest payments on their mortgages to set against taxable income is greater than for the ordinary tax payer. So some people say the relief should only be at the 30% basic rate of income tax.

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 24 January 1983

MR D B ROGERS/IR

cc EST
MST(R)
Mr Moore
Mr Robson
Mr French
PS/IR

BLACK ECONOMY: RETURN OF SECONDARY EARNINGS

The Financial Secretary was grateful for your note of 21 January.

He is quite keen on the alternative scheme outlined in paras 3-7 of your note, and would be quite happy to legislate.

He agrees that this should be considered again when we have sight of the Keith Report.

E KWIECINSKI

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 25 January 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (R)
Minister of State (C)
Sir D Wass
Sir A Rawlinson
Mr Bailey
Mr Wilding
Mr Lovell
Mr Mountfield
Mr Chivers
Mr C Kelly
Mr Halligan
Mr S Thomas
Mr Ridley
M. Harris

BL 1983 CORPORATE PLAN

The Financial Secretary has seen Mr Lovell's note of 20 January covering Mr Halligan's submission of 17 January.

The Financial Secretary considers that just as we should have sold Land Rover when it was profitable and appeared to have relatively better prospects than it does at present so we should try to sell the Jaguar group now. A successful sale would provide a substantial contribution towards the extra £250 million required by BL. And if we do not sell Jaguar now there is a risk that, like Land Rover, its prospects will not improve.

MED
M E DONNELLY

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 25 January 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Sir A Rawlinson
Mr Wilding
Miss Kelley
Mr Kemp
Mr Mountfield
Mr Pestell
Mr Faulkner
Mr Ridley
Mr Robson
Mr Harris
Mr Sargent.

WIDER PARENTAL CHOICE AND EDUCATION VOUCHERS

The Financial Secretary has seen Sir Keith Joseph's paper; and Mr Faulkner's note of 19 January.

The Financial Secretary finds the suggested approach too timid. He sees little point in waiting for the results of pilot schemes which will only be the subject of hard fought rearguard actions by teachers' unions, and education pressure groups. It would be better to press on with a full scheme.

The paper also misses out one extremely important point. This is that if all primary and secondary education was financed by vouchers - provided by central Government - at a stroke some 60 per cent of local authority spending would have been transferred to central Government. This will tend to make the financing of the rump of LA expenditure much more manageable. The remainder of LA expenditure might be 100 per cent funded locally out of "reformed" rates, perhaps a poll tax, and other changes. Education vouchers could therefore be a major step forward in increasing the responsibility of LAs for their own expenditure in other areas.

MED
M E DONNELLY

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 25 January 1983

CHANCELLOR

cc Chief Secretary
Mr Ridley

C&AG: SUPPORT FOR BACKBENCHERS AT COMMITTEE STAGE

The Financial Secretary has seen Mr Ridley's note of 25 January giving details of his conversation with Tim Eggar.

The Financial Secretary thinks that we should certainly provide him with briefing on all aspects of the Bill. But he is less sure whether it would be wise to go so far as to give him drafting amendments.

MED

M E DONNELLY

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 25 January 1983

PS/CHIEF SECRETARY

cc Economic Secretary
Mr Monck
Mr Pirie
Mr Pestell
Mr Robson
Mr Godber
Mr Hood

Mr Crawley) IR
Mr Stewart)
Mr Hosker)
Mr Harrington) T. Sol
Mr Wilson)
Mr Devlin) RFS
Mrs Hay)

LEGALITY OF INDEX-LINKED MORTGAGES

The Financial Secretary has seen Mr Bridgeman's note to the Chief Secretary of 24 January.

He thinks that, despite the arguments for not legislating put forward by Mr Bridgeman, we should ask the Department of the Environment to legislate in the Housing Bill so that any doubts are cleared up.

E KWIECINSKI
25 January 1983

FROM: M E DONNELLY
DATE: 25 January 1983

MR CRAWLEY - IR

cc Mr Middleton
Mr Monck
Mr Peretz
Mr Robson
Mr Turnbull
PS/IR

DEEP DISCOUNT STOCK - LETTER FROM MAN. HAN

The Financial Secretary has seen Mr Robinson's letter of 20 January commenting on the Revenue consultative document. He fears that this response is likely to be typical, as all those who reply try to maximise their own advantages out of any new regime. When we have sufficient responses it would be helpful to have a general note summarising the areas which need further thought.

MED
M E DONNELLY

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 25 January 1983

MR J H GRACEY/IR

cc Mr Moore
PS/IR

1982 RAYNER SCRUTINY PROGRAMME: VISITS TO THE PUBLIC: MANAGEMENT RESPONSE

The Financial Secretary has seen your submission of 20 January. He had made the following comments:-

COLLECTION VISITS

Items detailed in paras 11 a) to d) and f) of your covering note - he agrees with the management response to these recommendations.

Para 11(e) - he is content with the proposals, but would be interested to see the old form C.55

Para 12) Discontinue use of bailiff on distraint calls - he agrees that we should await the Keith Report.

Para 12 contd. - Small sums of outstanding tax to be rolled over: He thinks that this is a good idea and could help to make the work more cost - effective. He has just one question on the background comment to the main note which says "We have considered raising our limit before but found that the loss of Revenue .... etc"; his question is - "surely if the tax is rolled-over it is not a loss to the Revenue?

Para 13 - he agrees that these two recommendations should not be accepted. On the latter one - that visits to private households during normal office hours should be made only on appointment - he has commented that this type of call should be kept to a minimum and hopefully a better information index will reduce the number of abortive calls.

METHOD OF TRANSPORT

He thinks that the recommendations (which have all been accepted) are reasonable and sensible, and should give a greater degree of flexibility to local managers. In particular he thinks it is essential that hired cars with drivers are used only in exceptional circumstances.

TRADE UNION SIDE REACTION

He has noted their comments and the management response to them.

VALUATION OFFICE VISITS

He would like a meeting with officials to discuss this whole section. I will be in touch shortly to arrange the meeting.

E KWIECINSKI

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 25 January 1982

NOTE FOR THE RECORD

cc Chancellor
Chief Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Mr Bailey
Mr Burgner
Mr Morgan

ASSOCIATED BRITISH PORTS

Mr Burgner and Mr Broadbent reported to the Financial Secretary at 6pm on 24 January on the latest position in the discussion about the sale of ABP.

Mr Broadbent said that following the revised, more pessimistic, profits forecasts adopted by the Board last week (as reported in his note of 20 January) Schroders had spent the weekend clarifying the figures with ABP's accountants. Some agreement had been reached on exceptional items. But a major problem had arisen because the Board's latest estimates now showed 1983 operating profits lower by £2.1 million at £11.5 million, implying a downturn in profits in 1983. The Board were prepared on the basis of these figures to say only that had they been a public company in 1982 they would have paid a dividend of £2.8 million and in the absence of unforeseen circumstances they would pay £2.8 million in 1983. Schroders had real doubts whether a sale was possible on this basis. In their opinion, the new profits forecast was cautious in the extreme. It would support a sale only if the Board were prepared to go further in forecasting a dividend and committing themselves to "not less than £2.8 million" in 1983. Even on this basis, equity valuation would be well down at around £43 million.

The Board were open to criticism in that they had waited until the last moment to make the strength of their views on the profit forecasts known. In retrospect the ABP Chairman had made commitments which did not reflect the views of the majority of the Board and

it appeared he had now failed to carry his Board. But though they were perhaps being excessively cautious it was not possible with certainty to impute any other motive to them.

In discussion it was agreed that there were now three options:

i) assuming the Board did in the event provide a dividend forecast of not less than £2.8 million, to sell ABP on Wednesday 2 February for about £43 million;

ii) the Board could be restructured. This would mean a delay of one year in the sale since the markets would want to have a full year's operating figures behind a new management team;

iii) the sale could be deferred, leaving the present Board substantially unchanged. The sale might then take place in September when higher proceeds could well be secured on the basis of half year 1983 figures - assuming that there was then no further election uncertainty.

Option (i) provided for immediate privatisation; but might be open to the criticism that the Government was giving overriding priority to selling public sector assets quickly and possibly therefore below their true value. Option (ii) could have a wider and useful demonstration effect on management involved in later, and more important, privatisations. But how far it would in fact produce this effect was debatable. Option (iii) would probably lead to increased proceeds, although one could not be certain. But it would be heavily dependent on the timing of an election.

Summing up the Financial Secretary said that it would be necessary to review the situation again when the Board's decision on whether or not to provide a dividend forecast was known.

MED
M E DONNELLY

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 26 January 1983

MR BATTISHILL/IR

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir D Wass
Mr Bailey
Mr Middleton
Mr Moore
Mr Robson
Mr Gordon
Mr French
PS/IR

BUSINESS EXPANSION SCHEME: STARTER No.150

The Financial Secretary was most grateful for your note of 17 January covering the first paper on extending the BSS. He has made some initial comments on the paper, which I set out below. He has emphasised that these are merely initial reactions and looks forward to discussing the range of issues with officials tomorrow.

The Financial Secretary's specific comments are as follows:

A 4 c. & d.: further discussion needed.

f. consider an increase.

g. is three years enough?

B. Para 8 - discuss

Para 10: no tightening up; retain existing definition.

Para 12. agree that all companies in a group must be eligible unquoted trading companies in their own right.

Para 13: probably right - but discuss.

Para 14. content.

Para 17. & 18. - agree

Para 25. need the shares be new?

Para 26. (a) agree.

Para 27. Clarification needed of the position of an investor buying existing ordinary shares.

Pars 28. Necessary to discuss the ratios between limits on individual shareholding and overall limits on share capital qualifying for relief.

Para 30. Agree.

Para 36. Agree.

Para 42. Further discussion of this line of argument is needed.

Para 45. (h) the principle is right;but the 5 year figure needs discussion.

Para 49. This argument is reasonable.

Para 50. (a) not necessarily.

(b) they can surely ask the investors

(c) accept the confidentiality point.

Para 52. This needs discussion.

Para 58. Abandon 50% rule.

pp M E DONNELLY

FROM: E KWIECINSKI
DATE: 26 January 1983

MR D G DRAPER/IR

cc Chancellor
Chief Secretary
Minister of State (R)
Economic Secretary
Mr Robson
Mr French
Mr Graham - Parly Counsel
Mr O'Leary
PS/IR

COLLECTION: LIMITS FOR PROCEEDINGS IN THE MAGISTRATES AND COUNTY COURTS: STARTER 138

The Financial Secretary has seen your submission of 25 January.

He is content with all the changes and gives his authority for you to instruct Counsel to draft legislation.

He does wonder though whether it would be more practical to index the limit of £250 for Summary proceedings. He would be grateful for your comments.

E KWIECINSKI

FROM: E KWIECINSKI
DATE: 26 January 1983

MR P FAWCETT/IR

NATIONAL HERITAGE BILL - COMMISSION FOR ANCIENT MONUMENTS

The Financial Secretary has seen your minute of 25 January, attaching a draft of Lord Avon's speaking note.

Of the two options on the last page, he would choose option 2, with the slight addition at the start of the sentence: "I expect that .....". In the penultimate paragraph of the speaking note he would leave out: ".... and from Government Departments".

Otherwise he is content.

E KWIECINSKI

FROM: M E DONNELLY
DATE: 27 January 1983

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Mr Burns
Mr Littler
Mr Middleton
Mr Kemp
Mr Hall
Mr Ridley

PUBTLIC HANDLING OF QUESTIONS ABOUT THE BENEFITS OF AN EXCHANGE RATE DEPRECIATION

The Financial Secretary has seen Mr Ridley's note of 25 January and the Economic Secretary's comments in Mr Harrison's note of 26 January. The Financial Secretary broadly agrees with the Economic Secretary's comments. But he feels it also important to distinguish between the short/long term effects of an exchange rate depreciation. In the short term the main effect must be increase profitability of exports. One of the longer term effects is that companies in industries with very long lead times - such as the construction industry - can win contracts through the price advantage given by the lower exchange rate for orders which will be delivered in perhaps 3 or 4 years time. How profitable these orders will turn out to be will depend - among other factors - on how the exchange rate moves over the following period - but there is still an initial boost to the order book.

M E

M E DONNELLY

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 27 January 1983

MR GRIMSTONE

cc Chancellor
Chief Secretary
Economic Secretary
Minister of State (R)
Sir D Wass
Sir A Rawlinson
Mr Bailey
Mr Burgner
Mr Lovell
Mr Mountfield
Mr Chivers
Mr Morgan
Mr Rickard
Mr Wilson
Mr Wicks
Mr Halligan
Mr Spearing
Mr Ridley
Mr Harris

RESIDUAL GOVERNMENT SHAREHOLDINGS

The Financial Secretary was grateful for your note of 26 January. He is writing to Mr Jenkin about further sales of British Aerospace Shares, on the lines of your draft.

The Financial Secretary was also grateful for Mr Spearing's list of companies in which the Government retains shares.

The Financial Secretary has asked to be kept in touch with developments in the disposal of shares in the following firms:

Kearney and Trecker Martin;
Norton Villiers Triumph;
Mersey Docks and Harbour Company.

On the explanation provided for the continued Government shareholding in Villiers the Financial Secretary has commented that we should have a plan for ending this involvement.

The Financial Secretary was unclear about the justification for the Government's 100 per cent holding in the National Seed Development Organisation. He does not see why the State should be involved in plant breeding in this way at all; and therefore thinks that the NSDO should be sold. He would be grateful for a further note from IA3 on how best to follow this up.

MED

M E DONNELLY

FROM: E KWIECINSKI
DATE: 27 January 1983

MR HARRIS

cc PS/Chancellor
Mr Kemp
Mr Allen
Mr Potter

CITY FINANCIAL SERVICES CONFERENCE: WHOSE INDUSTRY IS IT?: 2 MARCH 1983

The Financial Secretary has agreed to give the opening address at this conferences. I attach all the relevant papers.

He would be grateful if you would prepare a short (10 minute) speech, suitable for the occasion.

E KWIECINSKI
27 January 1983

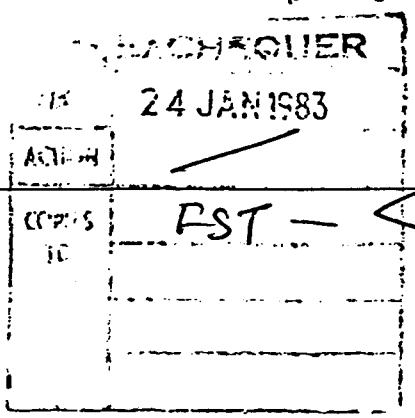
Oxford Centre for Management Studies

Kennington
Oxford OX1 5NY

Telephone
Oxford (0865) 735422
Telex 83147 attn. OCMS

26 JAN 1983

Sir Douglas Hague, CBE.



DCH/JH

21st January, 1983.

The Rt. Hon Sir Geoffrey Howe,
Chancellor of the Exchequer,
Treasury Chambers,
Parliament Street,
London, SW1P 3AG.

Dear Geoffrey

Just a brief note to thank you very much for your kind letter of 17th January. I am delighted to hear that Nicholas Ridley will be pleased to open the Conference planned by City Financial Services for 2nd March.

Thank you so much for your consideration and help.

Yours ever

Douglas

→PS/CST

19 JAN 1983

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

17 January 1983

Sir Douglas Hague CBE
Oxford Centre for Management Studies
Kennington
OXFORD OX1 5NY

Dear Douglas

I am so sorry to have been slow to reply to your letter of 13 December inviting me to address the Conference planned by City Financial Services Ltd for 2 March.

Sadly at that time of the year I tend to be in pre-Budget "purdah" and I fear I must decline the invitation. I understand however that Nicholas Ridley would be pleased to open the Conference and his secretary will contact yours about arrangements.

GEOFFREY HOWE

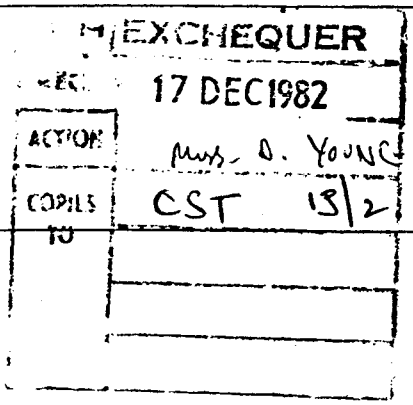
15 minutes.

Oxford Centre for Management Studies

Kennington
Oxford OX1 5NY

Telephone
Oxford (0865) 735422
Telex 83147 attn. OCMS

Sir Douglas Hague, CBE.



DCH/JH

13th December, 1982.

48525

The Rt. Hon. Sir Geoffrey Howe,
Chancellor of the Exchequer,
11 Downing Street,
London, S.W.1.

Dear Geoffrey,

I enclose the brochure for a conference being planned in March by City Financial Conference Services Limited. Ian McDonald Wood, who runs these conferences, has asked if I would approach you. I spoke at last year's conference and was extremely impressed both by the organisation and by the calibre of a large, international audience. I agree with Ian that it would help enormously if a senior member of the Government could give a short opening address at 9.30 a.m. on Wednesday, 2nd March at the Royal Lancaster Hotel.

I think that the leaflet speaks for itself, but am sure that Ian McDonald Wood would be happy to give more details to your office if you wanted them.

All I am doing is to write and suggest that it would be valuable if you, or one of your senior colleagues, were able to open this conference. I very much hope that might be possible.

Yours ever, Douglas

Chancellor

Too close to Budget?

Regrets?

→ Yes - but

Dates
The dates to mark in your diary are Wednesday and Thursday, 2 and 3 March 1983.

Fee
The fee is £325/US $600. This is exclusive of value added tax at the rate of 15% (£48.75 or $90) which we are required to charge all delegates.

Early Booking
Reservations received and paid before 1 December are entitled to the preferential rate of £295/US $545 plus VAT (£44.25/$81.75).

Reservation
This should be done by completing the attached reservation form, and then mailing it to City Financial. Late reservations may be made by telex or telephone, subject to availability of places.

Venue
The conference is moving this year to a larger venue, the Royal Lancaster, a prestigious 4 star hotel which is located at Lancaster Gate on the north side of Hyde Park. The Royal Lancaster Hotel is conveniently situated for easy access to both the City and to Heathrow Airport.

Eve of Conference Reception
A reception for delegates and speakers will be held on the eve of the conference, Tuesday 1 March, at the Inn on the Park.

Hotels
Delegates requiring hotel accommodation should request a hotel reservation form when making their conference reservation. We will return the form with confirmation of booking. City Financial has obtained concessionary rates for delegates at the following hotels: The Royal Lancaster, a 4-star hotel and the venue of the conference; The Inn on the Park, a 5-star hotel and the location of the eve of conference reception;The Holiday Inn, a 4-star hotel in George Street near Marble Arch, which is five minutes from the conference venue.

Conference Language
The conference language is English.

Cancellation
A refund will be made in the event of cancellation, provided such is communicated to CFCS before 11 February. Substitutions may be made at any time.

About City Financial

City Financial was established in 1979 by a group of people interested in assisting the exchange of information at a senior level throughout the international insurance and reinsurance industry; the organisation is based in London.

City Financial Conference Services Ltd has already developed a high reputation for its international conferences and 1983 will see the third event in the Changing World Insurance Markets series.

More recently the publishing division, City Financial Insurance Publications Ltd, has made a major contribution to the United Kingdom and international markets with two new annual publications, the 'Insurance Register' and the 'International Handbook and Legal Guide'.

The Managing Director of City Financial is Ian McDonald Wood, a professional accountant and business graduate who has spent sixteen years working with the industry in the UK, US and throughout the world.

The organisation is planning further interesting developments for 1983 and 1984.

CITY FINANCIAL CONFERENCE SERVICES LTD
20/24 Ropemaker Street, London EC2Y 9AS
Telephone 01-588 4274 Telex 8811725

...nging World Insurance Markets

3rd Strategic Conference
London 2 and 3 March 1983

Whose industry is it?

Wednesday and Thursday, 2 and 3 March 1983
at
The Royal Lancaster Hotel, London

Please make conference reservation(s) for the listed delegate(s).
Please send a hotel reservation form with confirmation of booking YES/NO*

The fee per delegate is £325/US$600 plus VAT at 15% (48.75/$90.00). Reservations received and paid before 1st December are entitled to the preferential rate of £295/US$545 plus VAT (£44.25/$81.75)

Method of payment:

- ☐ We enclose our cheque, payable to City Financial Conference Services Ltd.
- ☐ We have instructed our bank to make a transfer to a/c 21059017 Midland Bank Ltd, Winchester House, Old Broad Street, London EC2N 1BA
- ☐ Please invoice us.

To: CITY FINANCIAL CONFERENCE SERVICES LTD
20/24 Ropemaker Street, London EC2Y 9AS
Telephone 01-588 4274 Telex 8811725

Registered in England No. 1411919. Registered office: 25-35 City Road, London EC1Y 2ED. VAT Registration No 350 4126 93

Reservation Form

A1	SURNAME		MR/MRS/MISS/MS
	INITIALS	POSITION	
2	SURNAME		MR/MRS/MISS/MS
	INITIALS	POSITION	

B	COMPANY NAME	
	ADDRESS	
		TOWN/CITY
	COUNTY/STATE	POSTCODE/ZIP
	TELEPHONE	TELEX

PLEASE READ NOTES OVERLEAF

*Delete as applicable.

Whose industry is it?

CONFERENCE RESERVATION FORM

Notes

1. To register more than two delegates append details on a separate sheet of paper, or request additional forms.
2. HM Customs & Excise require that we charge value added tax at 15% to all delegates.
3. VAT invoices will be returned with confirmation of booking.
4. Sterling cheques should be drawn on a UK bank. Where this is not possible a bank draft should be used.
5. Admission cards and other details will be mailed to you well in advance of 1 March.
6. Cancellations communicated to CFCS before 11 February will attract a full refund.

Please complete details overleaf

CONFIDENTIAL

FROM: NICHOLAS RIDLEY
DATE: 28 January 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (R)
Mr Middleton
Mr Moore
Mr Monger
Mr Robson
Mr French
Mr Isaac/IR
PS/IR

INLAND REVENUE: WORK PRIORITIES

I have been considering the current state of work regarding our priorities on taxation issues for the future. I am concerned that the Revenue's resources should not be overstretched and should be utilised as best as possible in the forthcoming months. I think it would be helpful to categorise our priorities in the following four ways:

(a) work which must be finished for inclusion in this year's Budget.

(b) work which must be finished after the Budget but before the Summer Recess.

(c) issues to be worked on for inclusion in the first Budget after the next Election.

(d) other long tem work.

and (e) items which could be dropped altogether.

A. Pre-Budget Work

(i) Major work on income tax changes - well in hand; figures being reworked in light to December r.p.i and later forecasts.

(ii) Share options and profit sharing: decisions taken in principle at your meeting on 12 January - detailed submission 21 January.

(iii) Minor personal allowances: Norman Fowler has proposed abolition of dependant relative allowance in conjunction with extension of invalid care allowance - I have recommended abolition of all minor personal allowances in my minute of 24 January. You feel that this is not for this year, but no final decision has been taken.

(iv) Child benefit, child tax allowance etc: draft response to No.10 submitted to you by Mr Isaac on 24 January.

(v) Widows bereavement allowance: awaiting your ultimate decision for possible inclusion as part of "caring" package.

(vi) Employees, employers and self-employed: further work commissioned at my meeting on 17 January on net pay schemes for PAYE and the problems of the Schedule E/Schedule D dividing line. We owe No 10 a letter on the latter point.

(vii) capital transfer tax: reform rate bands and thresholds: my recommendations to you on 18 January 1983 - work well in hand.

(viii) Other CTT points - incidence
- deemed domicile
- miscellaneous settled property starters

(ix) CGT: capital loss buying
parallel pooling
miscellaneous other starters

(x) DLT: miscelleaneous Finance Bill starters

(xi) Life assurance: minor points (second-hand bonds etc): action in Budget already announced - work well advanced.

(xii) Stamp duty: Minister of State (R) has not ruled out the possibility of some legislation in this year's

Finance Bill. But we need decisions soon.

(xiii) Reform of Special Commissioners: work well advanced but further consultation with Lord Chancellor's department and Council on Tribunals needed.

(xiv) Further review os subcontractors' scheme: possibility of further changes in this year's Finance Bill for unemployed and overseas workers. Revenue have barely started on this.

(xv) Tax treatment of Eurobond interest paid by companies to non-residents: Revenue consultative document issued on 26 January.

(xvi) Business expansion scheme and Gryllsery: work well in hand but a great deal remains to be done. Drafting of the legislation has not yet started.

(xvii) CT: rate changes and response to the Green Paper. (ACT, DTR, "nothings" etc).

(xviii) Oil package - general easements; and the PRT expenditure reliefs and charge on non-oil receipts.

(xix) Tax havens: the legislation is drafted, but there is a further process of consultation to be gone through.

(xx) Work on other Budget packages.

(xxi) Deep discount bonds - Revenue Consultative document issued 11 January 1983.

B. <u>Major items - post-Budget but before Summer Recess</u>

(i) Husband and Wife-Green Paper.

(ii) Local Government and rates: Green Paper.

(iii) Simplification and reform of Schedule D assessing and collection: Consultative document in Summer 1983.

(iv) CT self assessing: practicle tests and internal review in progress.

C. Major issues for possible inclusion in first Budget after Election

(i) Pensions, LAPR, IIS etc

(ii) NICIT

(iii) Benefits in kind: possible approaches to be discussed in Revenue note to be submitted shortly.

(iv) Foreign earnings relief: consider abolition.

(v) General expense deduction: Revenue note shortly on options to replace small "employment expenses" claims, in particular the flat rate tools and clothing allowances.

(vi) Minor personal allowances: as above.

(vii) CGT: group relief.

(viii) Further response to the CT Green Paper including, eg treatment of groups.

(ix) Taxation of international business: upstream loans and profit and loss importation.

(x) Relative treatment of employed and self-employed.

D. Post-Election long-term work

(i) Taxation of husband and wife: implementation of change (if ITTA) dependent on COP.

(ii) Taxation of remaining short term benefits

(iii) Possible changes to statutory rules on home to work travelling expenses.

(iv) CGT: long term future following indexation.

(v) Retirement relief.

(vi) Disincorporation.

(vii) Treatment of leases and annuities

(viii) Rates: Non-domestic revaluation, including privatisation.

(ix) Future of domestic rating and revaluation.

(x) Miscellaneous rating reforms.

(xi) Black Economy: Keith Report imminent - decisions to flow from its recommendations: for next Parliament.

(xii) Cork Report: Inland Revenue issues arising, Crown preference etc. Little pressure for early action, further discussions needed with DOT and Bank of England, before decisions are taken. Again something for the next Parliament.

(xiii) Stamp Duty Review: decisions arising from the consultative process. [possibly category C].

(xiv) Alternative health financing: a possibility for the next Parliament.

(xv) Charities: examination of the best way to supervise

charities from the points of view of tax fraud, political activities and the public good, also consideration of the Inland Revenue's duties in this field.

(xvi) Cross-frontier collection of tax: a fairly long-term aim being pursued in connection with proposed Council of Europe Convention on mutual assistance.

(xvii) Capital allowances for oil and other extractive industries.

(xviii) Assessment of the balance of fiscal regime in relation to borrowing from abroad.

(xix) Earned income treatment of landlords.

D. Candidates to be dropped

(i) Allowances for rented accommodation.

(ii) Enterprise bonds.

I would be glad of your views, and those of colleagues on this; and I suggest we have an early meeting to discuss our priorities further.

pp Sue Kwiecinski
NICHOLAS RIDLEY

COVERING CONFIDENTIAL

FROM: M E DONNELLY
DATE: 28 January 1983

PS/CHANCELLOR

cc Mr Burgner
Mr Morgan
Mr Broadbent
(without attachment)

RELATIVE VALUE OF PUBLIC SECTOR ASSETS: ABPH

... The Financial Secretary wishes to pass on to the Chancellor the attached note by Mr Broadbent giving details of past Government loans to ABPH compared to its likely market value.

The Financial Secretary wishes to point out that the figures for commencing capital debt and NLF loans are given in nominal terms; the effect of inflation should therefore be taken into account.

MED
M E DONNELLY

FROM: R J BROADBENT
DATE: 25 January 1983

PS/FINANCIAL SECRETARY

cc Mr Burgner
Mr Morgan

RELATIVE VALUE OF PUBLIC SECTOR ASSETS: ABPH

I agreed to let you have separately some estimates of how the price we are likely to receive for ABPH compares with the finance provided by Government in the past. PE Division will be letting you have a co-ordinated reply on other privatised, nationalised industries.

2. In simple terms of past Government loans compared to likely market value, the figures look like this:

	£m
Outstanding commencing capital debt	34.7
Outstanding NLF loans	46.6
Total Government debt (written-off)	81.3
Proceeds from refinancing ABPH debt	25.0
Proceeds from sale of 49% of equity - say	22.0
Total Proceeds	47.0
Value of residual shareholding	22.0
	69.0

3. These figures assume we sell on the basis of a dividend forecast from theBoard of not less than £2.8 million in 1982. On the basis of the Board's earlier forecasts of profits and dividend we estimated proceeds would almost exactly equal the value of Government loans previously outstanding. It was on this basis that the Inland Revenue decided that no liability arose under S48 of the 1981 Finance Act (which provides for the

write-down of past or future tax losses in line with any write-off of Government debt except where the debt has been replaced with other securities of similar value). One of the points we are checking, following the revisions made to the figures by the Board, is whether the position under S48 has changed.

R J BROADBENT

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 27 January 1983

MR R MARTIN/IR

cc PS/Chancellor
PS/MST(R)
Mr Moore
Mr Robson
Mr French
Mr Isaac/IR
Mr Blythe/IR
PS/IR

NET OF TAX PAY

After his recent meeting with Emile Woolf, the Financial Secretary discussed with you several questions which he wishes the Revenue to consider in the context of the work commissioned at his meeting on 17 January; these are:-

a) Net of tax pay tables;

b) what would be the potential problems for the Revenue if there was a major switch by employers to a net of tax system?

c) would it be possible to work out a simple deduction system for employers to use when caculating the level of their monthly PAYE/NIC payment to the Revenue?

d) what would be a suitable vehicle for publicising any new provisions?

The Financial Secretary decided that the idea of allowing employers to make quarterly payments of PAYE/NIC should be dropped on the grounds that it would be too expensive.

E KWIECINSKI

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 28 January 1983

MR I R SPENCE- IR

cc Chancellor
Chief Secretary
Minister of State (R)
Mr Middleton
Mr Moore
Mr Kemp
Mr Robson
Mr Martin
Mr Isaac - IR
PS/IR

MEACHER COMMITTEE

The Financial Secretary has seen your submission of 26 January.

He is amazed by the work done to answer the sub-committee's questions - and most impressed.

He thinks the figures show how little mileage there is in trying to raise taxes and child benefit for everybody.

He thinks the Revenue should be protected from having to do endless work to meet any whim the sub-committee may have. In future he would like to know before any further work is undertaken.

He is content for you to send the paper to the sub-committee.

E KWIECINSKI
28 January 1983

FROM: E KWIECINSKI
DATE: 28 January 1983

MR C STEWART - IR

cc Chancellor
Chief Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Mr Moore
Mr Graham - Parly Counsel
Mr Crawley - IR
PS/IR

MIRAS - AMENDMENTS TO LEGISLATION (BUDGET STARTER 168)

The Financial Secretary has seen your note of 26 January.

He is content with all three of the recommendations in paragraph 13 of your note. However he wonders whether or not the power under 5(c) could be exercised much sooner than April 1984.

Would it be possible for the change to take effect from, say, August 1983?

E KWIECINSKI
28 January 1983

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 31 January 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Mr Middleton
Mr Moore
Mr Robson
Mr Ridley
Mr French
Mr Driscoll - IR
PS/IR

HOUSE OF LORDS DECISION - WICKS V FIRTH, JOHNSON V FIRTH

The Financial Secretary has seen Mr Driscoll's submission of 28 January.

He suggests the following amendments to the letter (Annex B) to Sir Keith Joseph:-

1) Page 1, line 5: delete "have decided", and insert "would like".

2) Page 2, add at the end of the second indented paragraph: "..., which is available in different forms both in the public and the private sector."

3) Page 2, line 21: delete "rewards" and insert "adds to the remuneration of...".

In addition the Financial Secretary thinks that the letter should include a more political paragraph setting this question in the context of help for education generally. He suggests something along the following lines:-

"I realise the difficulties of this course of action, with an election not far away; and some of our supporters will be disappointed by what I propose. Indeed they set particular store on being able to

achieve private education for their children. But to leave this unintended tax advantage in place would be to allow some to achieve help with their school fees by the "back door". Many people who are not offered similar facilities by their private sector employees, and all in the public sector, would not be able to benefit from this. If we want to provide tax relief for private education, we should decide to do it for all as a matter of deliberate policy. We have never even discussed doing so in Cabinet, and I am sure it would be wrong to do so simply by turning a blind eye to the consequences of a decision in the House of Lords."

E KWIECINSKI
31 January 1983

FROM: M E DONNELLY
DATE: 31 January 1983

PS/CHANCELLOR

cc Chief Secretary
Mr Littler
Mr Unwin
Mrs Hedley-Miller
Miss Court
Mr Edwards
Mr Fitchew
Mr Hall
Mr Ingham
Mr Peet
Mr Towers
Mr Ridley

BRUSSELS PRESS CONFERENCE: 7 FEBRUARY PRELIMINARY DRAFT OF PREPARED PRESS RELEASE

The Financial Secretary has seen the draft press release attached to Mr Edwards' minute of 28 January.

He thinks it is very much on the right lines; and has made many, largely presentational, amendments to the text. A suggested redraft of paragraphs 1 to 13 and paragraph 20 is attached.

The Financial Secretary would welcome the opportunity to comment further on the final draft.

MED
M E DONNELLY

PRESS CONFERENCE

1. Oral Statement

Thank you, everyone for coming.

2. The Community's most significant achievement in recent weeks has been the agreement on a Common Fisheries Policy. But there have been two other developments which many prove of even greater importance in the longrun - new attitudes resulting from the Parliament's rejection of the 1982 supplementary budget and the publication of the Commission's Green Paper on the Community's financing system. I should like to share a few thoughts about each of these.

1982 supplementary budget and UK refunds for 1982

3. To begin with the 1982 supplementary budget, I obviously regretted the Parliament's December decision. That an agreement reached after so many months of painful negotiation in the Council should be rejected at the final stage seemed, in those dark December days, a hard cross to bear. With the wisdom of hindsight, it is easier to see the matter in perspective. The Council was perhaps unreasonably optimistic in assuming that the Parliament would be willing simply to endorse the Council's compromise, and perhaps we should be grateful for the emphasis now put upon the lack of progress towards a long term solution.

4. The important task now for the Community's institutions must surely be to learn from past mistakes, to turn what has happened to good account, and to reach an early agreement on the

1983 supplementary budget which goes before the Parliament this week. We need to lay the foundations for a more harmonious and constructive relationship between the Community's institutions in the future.

5. I hope and believe that this is in fact beginning to happen. Since December's vote, the Commission and the Council have begun a dialogue with the Parliament which has already been highly constructive. Representatives of the Community's institutions have been sitting down together and discussing the Community's problems, as befits partners in a common enterprise. This seems to me a valuable way of doing business - one which we should develop and extend.

6. The Council has moved a long way towards the Parliament's position. I mention four points in particular:

- the Council has endorsed the Parliament's demand to get away from ad hoc solutions and achieve a long-term solution to the budget problem as soon as possible;

- the Council has accepted the principle of staging the payment of supplementary measures to Germany and the United Kingdom so that final payments are left over until levels of expenditure on support programmes have been certified;

- the Council has accepted new proposals by the Commission which will strengthen the link between supplementary measures

for the United Kingdom and Germany and Community policies, including a new programme of support for energy projects; and

- The Council has [acceded to the Parliament's view that] the new grants for energy measures should be classified as non-obligatory, by analogy with other Community expenditure on energy.

7. It seems to me that the Council has travelled a remarkable distance in a short time. I hope very much that the Parliament will respond in a similar spirit of flexibility and cooperation, so that the new draft budget which the Council have proposed can be adopted, with a minimum of delay. I hope that the Parliament will not press for further concessions and undertakings which the Council could not possibily give - for example, on the timetable for implementing lasting solutions. I sense an increasing awareness on all sides that lasting solutions are likely to require Treaty amendment and ratification by member states, so that implementation is bound to take a considerable time.

8. It would in my view be particularly unfortunate if the confrontation of last December were to be repeated. The main practical effect would be to penalise the United Kingdom [again]. This would do untold damage to the image of the Community in the eyes of the British people. It would also be a cruel irony. For Britain's views on the matters at issue are probably closer to the Parliament's than those of any other member state.

We in Britain have called repeatedly for a lasting Community solution to the budget problem which will free the Community from the damaging and protracted quarrels of recent years. These quarrels are a by-product of the continuing ad hoc solutions which both the Parliament and Britain would like to replace at the earliest opportunity with a lasting solution.

Commission's Green Paper and longer-term solution

9. I turn now to the Commission's Green Paper and the vitally important question of long term solutions. The Commission's paper contains, in my view, a great deal of useful analysis, and I agree very much with its thesis that a solution to the Community's problems will need changes both in the financing system and expenditure policies. Which in turn will solve the problems of budgetary imbalances. But I have two comments on the paper.

10. First, the Green paper says 'in accepting the principle of enlargement the Community has also accepted the principle of additional financial resources' - 'additional financial resources' presumably means an increase in the own resources ceiling. The newly acceding countries Spain and Portugal will swell the Community's revenues as well as its expenditure, and it is only their net receipts which will increase the need for a higher own resources ceiling. I offer no prediction as to how much these net receipts might be. But they will not be large in comparison with the potentional for savings on agricultural expenditure. Rather than looking first for more resources the Community should concentrate on how to reduce the agricultural surpluses and their costly financing, which is the cause of so much distress to our trading partners.

I welcome the Commission's endorsement of the policy that agricultural expenditure should grow more slowly than own resources, I know the Parliament agrees with that too. Even a difference of one percentage point between the two growth rates would release an additional 150 mecu each year for expenditure elsewhere. I am sure the Parliament will develop its thinking on ways to guide the CAP in this direction.

11. My second comment is that, although the Commission recognise that any reform of the Community's financing system must contribute to a lasting solution to the problem of budgetary imbalances they do not put forward any ideas which would actually solve the problem. Some of their ideas could reduce its scale; but none would provide a permanent and total solution of the kind needed to take the subject off the Community's regular agenda.

12. I want to suggest that genuine solutions are possible which would be lasting, communautaire, simple, constructive and unembarrassing. In a speech at the Hague in June 1981, I set out a broad philosophy. I want today to be severely practical. I believe that the solutions should comprise two elements:

- first, development of Community policies so as to give extra net receipts to member states now bearing unfair burdens, and

- second, changes in the Community's financing system which will reduce the gross contributions which these members

states make to the budget. Herr Lange has already suggested some ways in which this might be done.

13. The need for the development of Community policies is widely and rightly accepted. The President of the Commission will today be presenting some ideas in this area to the Parliament. We look forward to studying these. As the Commission's Green Paper points out, however, such developments cannot solve the problems of unfair budget burdens on their own. There are two reasons for this.

- First, the scale of the UK's problem in particular is such that there is no realistic prospect of solving it totally through this route. To take a simple example, the Regional Development Fund would need on present quota shares to be increased by 50 billion ecus (twice the size of the present Community budget) to give the UK net receipts equivalent to the refund negotiated for 1982 of 850 mecus, which still leaves us bearing a net contribution of [X] mecus.

- Second, new policies which are good for the Community as a whole and hence attractive in themselves may not in fact produce net receipts for member states now suffering excessive burdens.

[PARAS 14 - 19 UNCHANGED]

20. To sum up, then, the Community must find a lasting solution, and find it urgently. I have contributed two ideas. I hope that the Commission, Council and Parliament will examine these, as well as putting forward their own ideas in the period which lies ahead.

FROM: E KWIECINSKI
DATE: 31 January 1983

PS/CHANCELLOR

cc PS/CST
PS/EST
Sir D Wass
Mr R Wilding
Mr D Moore
PS/IR

FINANCIAL MANAGEMENT INITIATIVE IN THE INLAND REVENUE

The Financial Secretary has seen Sir Lawrence Airey's submission to the Chancellor of 25 January. He has commented that the principles of the study must be right and he certainly supports the general approach.

On the whole he does not think that the costs and savings are as promising as one might have hoped. At para 1.35 the report says: "On the whole, we would expect - although it is almost impossible to prove - that over time the benefits will outweigh the costs". The Financial Secretary wonders why the Revenue have doubts about the initiative's efficacy. Or is there doubt about some of the non-financial benefits such as, better compliance, and better internal and external relations?

He would be interested in the Revenue's comments on this.

E KWIECINSKI

CONFIDENTIAL

FROM: NICHOLAS RIDLEY
DATE: 31 January 1983

CHIEF SECRETARY

cc Chancellor
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Sir A Rawlinson
Mr Le Chèminant
Mr Mountfield
Mr Monger
Mr St Clair
Ms Seammen
Mr White
Mr Ridley
Mr Harris

CABINET
MINISTERIAL GROUP ON SOCIAL SECURITY ISSUES
MISC 88(83)1: POSSIBLE APPROACHES TO LEGISLATION

There is a fifth option over and above the four set out in Ms Seammen's note of 28 January.

It is to have no legislation on the subject but to rely instead on our record - which is satisfactory; and our pledges - which we can tailor to suit the circumstances. This way, we can put the pension at the level which we can afford, and which we think is right politically. Formulae for uprating, whether on forecast or historic methods have not proved free of controversy.

pp NICHOLAS RIDLEY
31 January 1983

FROM: M E DONNELLY
DATE: 31 January 1983

CHIEF SECRETARY

cc Chancellor
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Sir A Rawlinson
Mr Wilding
Mr Le Cheminant
Miss Kelley
Mr Judd
Mr Farrington

HEAVY GOODS AND PUBLIC SERVICE VEHICLE TESTING

The Financial Secretary has been reflecting on the minutes by Sir A Rawlinson, Miss Kelley, and Mr Farrington over the weekend. He is not happy with the project as it stands. Even taking the most favourable view of the figures provided by Mr Farrington's earlier minute of 2 December and discounting those items which are clearly inevitable, there would still seem to be a £2½ million subsidy to Lloyds to take on the testing stations; and an increase in fees of about 10 per cent to the customers.

Such a deal would be ammunition to those critics who claim that we put our doctrinare views of privatisation at any cost before the goal of improving overall efficiency. It is hard to argue that Lloyds are adopting a very entrepreneurial approach; they are going to operate a monopoly to Government standards and do it in what would seem to be a bureaucratic way.

The Financial Secretary's advice is therefore that this is not a good enough deal. But he is very willing to discuss either the figures involved or the issues if time permits before a final decision must be taken.

MED
M E DONNELLY

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 31 January 1983

NOTE OF A MEETING HELD IN THE FINANCIAL SECRETARY'S ROOM AT 2.45PM ON 28 JANUARY ON THE EC BUDGET

Those present: Financial Secretary
Minister of State FCO
Mr Hannay)
Mr Spreckley) FCO
Mr Lampard)
Mr Hancock - Cabinet Office
Mrs Hedley-Miller)
Miss Court) Treasury
Mr Edwards)

1983 Supplementary Budget

The Financial Secretary invited officials to report developments on the draft 1983 Supplementary Budget. Officials said that the UKREP telegrams 394 and 411 set out the current position. The Presidency's meeting with the Parliament's Budget Committee had gone fairly well. If the draft Budget could be adopted over the next few days, either through a further meeting of the Budget Council on Monday, or possibly as an A point at another Council, the Parliament might adopt it on 9 February. Mr Hurd said that this view had been confirmed by his talk with Herr Lautenschlager earlier in the day. The French Foreign Office was apparently prepared to move on the key question of classification; but they had yet to persuade the Trésor. The French could be outvoted on the adoption of the Budget. The Regulations, which would be before the March Foreign Affairs Council, required unanimity; but once the French had agreed to the refunds deal in principle there would be no purpose in their vetoing the Regulations.

The Financial Secretary said that the major remaining concern over the Supplementary Budget was whether Dankert could in fact deliver the Parliament. The outcome would be affected by Thorn's keynote addressed to the Parliament on 7 February, and whether the Parliament

felt that this sufficiently met their preoccupations There was one remaining risk, probably slight, that the Parliament might be tempted to reclassify UK Supplementary Measures as non-obligatory; and there might still be problems with the declaration.

Commons Debate

The Financial Secretary said that the general atmosphere in the UK Parliament and in the press remained relatively relaxed about the UK refunds, despite the European Parliament's rejection of the 1982 Supplementary Budget. This was due largely to the reassuring nature of the Chancellor's statement in the House before Christmas. We needed to be able to continue this line. The best timing of the Parliamentary debate on recent European documents was therefore difficult to determine. It had to be held soon. If it were held before the EP's February plenary session it could be seen by the EP as unacceptable pressure for a settlement favourable to the UK. But after the Plenary there was a fair chance of good news to report. Mr Hurd agreed that the week beginning 14 February would on balance be the best one to go for. The Commission's Green Paper on future Own Resources would have been published by that date but might not have been deposited, and so would not appear on the Scrutiny Committee's list of papers to be debated. If MPs wished to discuss it in the course of the debate they would be free to do so. It would arise later in the context of the debate on the Foreign Office White Paper on developments within the Community to be published in May.

Contacts with MEPs

The Financial Secretary said that it would be important to keep up lobbying of MEPs over the next six weeks with the immediate object of influencing them over the 1983 Supplementary Budget. He was giving a lunch in Strasbourg for prominent MEPs on 8 February. Mr Hancock thought that it would be worth considering which party Groups one could most easily influence. Mr Hurd suggested that the German Social Democrats and the European Liberals were in some ways easier to influence than the German Christian Democrats, who took a

particularly independent line. Such contacts should be developed and extended even after the present problem of the 1982 refunds had been settled. Mr Dankert would be paying an official visit to the UK as President of the European Parliament in May. And Mr Hurd had already invited Herr Lange, Chairman of the EP Budget Committee, to come to London in mid-February.

Longer Term Solutions

Looking ahead, the Financial Secretary said that it would be important to get a line for 1983 refunds put into the Commission's 1984 draft Budget. It would then be less vulnerable. Mr Hurd agreed. General discussions of future Community financing needed to focus both on the longer term and on providing the UK with some form of refunds for at least 1983 and 1984. Insisting that the longer term discussions should be linked with arrangements for the transitional period was almost the only lever which the UK had. The immediate goal should be a statement on both these issues from the March European Council.

Mr Hancock said that there would be a meeting of the senior Ministers involved on 15 February in order to discuss strategy. The Cabinet Office was preparing a paper for this. On balance it was not in any other country's interest to prevent an outcome acceptable to the UK. But the background had changed and in taking their decisions Ministers would now need to take into account the fact that the two issues had become linked: realistically there was no prospect of the UK receiving further financial refunds unless these could be closely tied in with progress on longer term Community financing. The Financial Secretary agreed. The UK's relations with the Parliament could also be a useful further source of pressure on the Council. But a satisfactory refund deal for 1983, even if agreed in the Council, would almost certainly be vetoed again by the Parliament unless they were satisfied about progress towards a longer term solution. The 15 February Ministeral meeting would be very important in clarifying the UK's approach to the forthcoming discussions about 1983 and beyond.

The meeting ended at 3.45pm.

MED
M E DONNELLY
31 January 1983

Circulation:

Those present
PS/Chancellor
Mr Littler
Mr Unwin
Sir M Butler) UKREP
Mr Butt)

CONFIDENTIAL

NOTE OF MEETING HELD AT 9.30am ON THURSDAY 27 JANUARY IN THE FINANCIAL SECRETARY'S ROOM ON THE BUSINESS EXPANSION SCHEME

Those present: Financial Secretary
Minister of State (R)
Mr Bailey
Mr Moore
Mr Robson
Mr Battishill - IR
Mr Prescott - IR

The meeting had before it Mr Battishill's submission of 17 January, covering the Revenue paper; Mr Harrison's note of 25 January; and Mr Donnelly's note of 26 January.

The meeting considered the points arising for decision in the order set out in the Revenue paper. Decisions are recorded below.

Paragraph 4

(a): No limit on the size of company able to attract eligible investment. Agreed.

(b). Uniform relief for all qualifying investments, at the investor's full income tax rates including IIS. Agreed .

(c): Agreed that there should be a single annual limit of eligible investment per individual, with no provision to carry this forward or back from year to year; and that the limit itself should probably be set at £40,000.

(d): Relief to be available only for new equity investment by individual outsiders. Agreed.

(e): Investor would normally have to hold his shares for 5 years to retain full relief. Agreed.

(f): Remove present restriction limiting relief in total to 50% of company's issued ordinary share capital. Agreed.

(g): Revenue to consider whether the new scheme should run for 4 or 5 years, rather than 3 years as suggested. Revenue also considering arrangements for transition from BSS to BES.

Paragraph 5

Agreed that BES should apply to all unquoted trading companies, as defined in paragraph 5.

Paragraph 6

Agreed that unquoted companies whose shares were dealt in on the Unlisted Securities Market should not be eligible for BES. To allow otherwise would weaken the thrust of the scheme towards companies whose shares were not easily marketable; and would lead to pressure for the scheme to be extended to quoted companies.

Paragraph 9 and 10: UK companies

Agreed that to be eligible, companies to be incorporated and resident in the UK. The further requirement that the company should carry on its trade "wholly or mainly" in the UK was not entirely satisfactory. It left an element of discretion to the Revenue and implied some uncertainty for companies and investors, though the Revenue were able to give informal guidance to companies. The Minister of State (R) suggested, and it was agreed, that this rule should also be retained for the present; if problems arose as the scheme developed the matter could be considered further.

Paragraph 11-13: Group relationships

Agreed that each group member would have to qualify under the Scheme, and that only 100% subsidiaries would be permitted. The Revenue to consider the position with regard to a group member which is a holding company for assets used wholly in the group.

Paragraphs 15-17: Qualifying period for companies

Agreed that the present retrospective element in the qualifying period should be dropped, as recommended by the Revenue.

Paragraph 18: Qualifying trades

Agreed that the qualifying trades should remain more or less as at present. Financial and leasing trades were excluded because these were trades in which the risk element was usually minimal. In discussion, it was suggested that the Revenue might consider further the position with regard to eg certain kinds of ship chartering where there might be a real degree of risk.

Paragraph 20: Permissible share structure

Agreed that the present restrictions on the kinds of share capital which a company may have in order to qualify should be removed.

Paragraph 25: Shares eligible for relief

Agreed that relief available only for investment in new ordinary shares carrying full equity risk, and that present "additionality" rules (paragraph 31-34) should be maintained. It was also for consideration whether ordinary shares which had a right to redemption (which was now possible , as a result of the Companies Act 1980) but which were not redeemable for some considerable period, should be eligible for BES relief. It was agreed that this could be considered further in Committee Stage if the point arose.

Paragraph 28: Part paid shares

Agreed that relief would not be available on partly paid shares. The Revenue to consider further whether the company itself might be permitted to have partly paid shares. This might be possible, but a rule would be needed to specify

whether the nominal or part paid value of such shares would be used for purposes of determining the size of shareholder's interest in the company.

Paragraphs 37-42: Conversion of loan capital to equity

The Financial Secretary and the Minister of State (R) pointed out that the opportunity for individual loan creditors, excluding proprietors, to convert their debt into equity with full BES tax relief would be a major attraction. But there were counter arguments, as noted in the Revenue paper. In further discussion, it was noted that relaxing the present rule could be expensive, though this depended on the extent of outstanding loan capital in unquoted companies from individual creditors, other than proprietors, and information on this was hard to come by. It was agreed that this issue should be set aside for the moment, and put forward for consideration by the Chancellor.

Paragraphs 43-52: Withdrawal of relief

It was agreed that the present rules should be maintained whereby an investor is open to forfeit some or all of his relief if he ceases to be an outsider, or if he realises his investment or otherwise receives his money back from the company in some form within 5 years.

On the proposal that there might, however, be some softening of the clawback provisions in circumstances where the target company itself ceased to satisfy the qualifying conditions, the difficulties set out in the Revenue paper were noted. This could only be done by claiming back relief from the company itself. The Financial Secretary suggested that this was something on which there could be consultation with representatives of small firms, after the new Scheme was announced.

The Economic Secretary's concerns about disqualifying a company if it became quoted within 5 years of the issue of new equity capital were discussed. It was agreed that the qualifying period should be reduced to 3 years.

Summing up, the Financial Secretary said that decisions had now been taking on most of the first order issues arising from the new Scheme. The question of loan-equity conversion was one which could be considered separately with the Chancellor. It would now be helpful for the Revenue to produce further advice on the more detailed points, where this had been asked for. An attempt should also be made at a preliminary costing of the Scheme, although all the uncertainties involved in this were fully recognised. He would minute the Chancellor reporting the conclusions of the meeting.

MED

M E DONNELLY

Circulation:

Those present
Chancellor
Chief Secretary
Economic Secretary
Minister of State (C)
Sir D Wass
Sir A Rawlinson
Mr Middleton
Mr French
PS/IR

FROM: E KWIECINSKI
DATE: 31 January 1983

MR N MUNRO/IR

cc PS/Chancellor
Mr Robson
Mr French
PS/IR

CHANCELLOR'S MEETING WITH THE NATIONAL ASSOCIATION OF PENSION FUNDS

The Financial Secretary has seen Ms Rutter's minute of 27 January, attaching your submission to her of 25 January.

He has made the following comment:-

"I do not see why the "transfer club" is not all right, if there is also a transfer of money to represent the accrued value of the pension rights of the employee transferring. After all this is the transferability of pensions which we seek. To transfer without money being paid across may be hard on the pension fund receiving the employee, but is not hard on the Revenue. If an employee has paid contributions all his life, with tax relief, but changes jobs in the middle and still gets a full pension: he loses nothing, the Revenue loses nothing, the firm he left gains and the firm he joins loses."

He would be grateful for your comments before he redrafts the letter.

E KWIECINSKI

cc Chancellor
CST
EST
MST(R)
Mr Moore
Mr Robson
Mr French
Mr Prescott
Mr Battishill
PS/IR

Treasury Chambers, Parliament Street, SW1P 3AG

Deputy President
Institute of Taxation
37-39 Melville Street
EDINBURGH
EH3 7JL

25 January 1983

Dear Mr Nosse

PURCHASE OF OWN SHARES

You kindly wrote to Geoffrey Howe on 17 December, enclosing a Note with your Institute's comments on the Business Start-up Scheme, and last year's purchase of own shares (POS) legislation. You will not expect me to comment on the aspects of your representation which might be the subject of changes in the Budget, and I can assure you that all of the Institution's representations will be considered carefully in the run-up to the Budget. I would, however, like to respond now to the more substantive criticisms about the POS legislation, as set out on pages 4-6 of your Note.

I cannot agree that the benefit to the trade test is "largely irrelevant". On the contrary, it was precisely in order to help the trading activities of small unquoted companies in cases where some clear economic benefit was likely to ensue from companies repurchasing their shares that we thought it right to introduce the new legislation, giving relief from the normal tax charge on a distribution, and replacing this with Capital Gain Tax treatment, which is a major relaxation.

The Consultative Document issued in September 1981, explained that there are numerous instances where it will be to the benefit of a company's trade to purchase its own shares (even though this will involve an adverse cash flow) eg where there is a dissident shareholder whose actions are inhibiting the management of the company's trade; where the company wants to pass control into the hands of a younger management team who already hold some shares; or where a shareholder dies and where the alternative to a purchase of own shares might be the sale of the deceased's shares/or to an outsider causing virtual loss of control, or to a competitor company. Similarly, the availability of the new tax treatment should help trading companies to manage their affairs more flexibly and efficiently eg by encouraging equity investment in them without

fears of the new investor being locked in, and by encouraging proprietors themselves to seek equity investment from others without necessarily surrendering a permanent equity stake.

As to the "trade benefit" test itself, I agree that this is in fairly general terms. The alternative would have been to try and specify in the legislation itself each and every situation in which a POS would qualify for the new relief. This would have been much more complicated (and we are getting sensitive to the charge of making things too complicated). In framing the legislation we were guided by the responses to the Consultative Document in many of which there was a clear preference for a general test (together with a clearance procedure) rather than for detailed and complex rules in the legislation which tried to cover every conceivable variation of circumstance. Moreover, a general test of this kind allows considerable room for flexibility. Fears that the test might prove unduly restrictive have not, been borne out by experience. By end December 1982, the Inland Revenue had received 380 formal applications for clearance. Of these, clearante was given for 279, and a further 43 are still under consideration. Of those refused only 6 were refused clearance because the benefit to the trade test appeared not to have been satisfied.

Nor, I believe, is there any inconsistency between the legislation itself, and the way the Revenue interpret the benefit of trade test in particular cases. As you say, the legislation requires, inter alia, that a shareholder must reduce his proportionate interest in the company as a result of the transaction by at least 25 per cent. But that is not sufficient. The purchase of own shares must also be to the benefit of the company's trade. The Statement of Practice (SP 2/82) issued by the Inland Revenue was designed, simply, to give guidance on circumstances in which the "trade benefit" test would be likely to be satisfied. The main example given (paragraph 4) is that of a dissident shareholder whose actions were inhibiting the management of the company's trade. All that the Statement says is that in such a case, there is a strong presumption that the purchase of the shareholder's total interest in the company will be for reasons which satisfy the test - and not simply to extract profits that would otherwise have emerged in the form of dividends. But the Statement also listed circumstances in which partial buy-backs would nevertheless pass this test. Moreover, that test was not intended to be exhaustive, and the Revenue has accepted schemes for partial buy-backs which fall outside the examples given.

The Institute also suggest that it would be sufficient to rely on the general anti-avoidance provisions in Section 460 etc of Taxes Acts. I cannot agree. All that is necessary under Section 460 is to show that the transaction is for "bona fide commercial reasons". Thus, a shareholder who wished to withdraw his money in order to invest elsewhere might be able to satisfy the Section 460 test, even though such a withdrawal may not be to the benefit of the purchasing company's trade. Again, this seems to run counter to the primary purpose of this legislation which is to benefit the company, rather than the shareholder.

Finally, the Institute proposes that the minimum (5 year) period of ownership should be dropped altogether. Again, I beg to question the wisdom of this suggestion.

The purpose of the legislation is not to enable shareholders to extract dividends without paying tax. Some of your suggestions seem to be designed to securing this objective. If so, I can only repeat that that is not our objective. It was generally agreed by respondents to the Consultative Document that, precisely in order to prevent shares being bought simply with a view to taking profit out of the company, there needed to be a minimum period for which the shares should be held in order to qualify for the new relief. Moreover, the purpose of the new relief is in part to encourage new equity investment in unquoted trading companies, with the aim that the investment should be held in the company for a reasonably long term, and not left in for a short time and then withdrawn. The period for which the shares should be held is, essentially, a matter of judgement but the Government decided that a minimum period of 5 years was reasonable and consistent with the aims of the relief.

You were kind enough also to give us your comments on a number of more detailed technical points on the legislation and its application to particular situations. Let me say that I am extremely grateful for the time you have obviously spent on this and for the very thorough way in which the Institute have studied the new provisions. I have asked the Revenue to consider these other points carefully and they will certainly let me know if any problems of this nature arise in operating this important new legislation. We shall naturally want to keep the new rules under close scrutiny and ensure that they are having the intended effect as companies and their advisers make increasing use of them.

Yours sincerely

Nicholas Ridley

NICHOLAS RIDLEY

CC Chancellor
EST
MST(R)
Mr Littler
Mrs Healey-Miller
Mr Edwards
Mr Donovan
Mr Lennon
Mr Peat
Mr Shore
Mrs Algar
Miss Court

Treasury Chambers, Parliament Street, SW1P 3AG

Julius Silverman Esq
House of Commons
LONDON
SW1A OAA

24 January 1983

Dear Julius

PRELIMINARY DRAFT SUPPLEMENTARY AND AMENDING BUDGET NO.1 FOR 1983

Following the rejection of the supplementary and amending budget number 1 for 1982 by the European Parliament, the Commission have revised their proposals. On 19 January they presented the preliminary draft supplementary and amending budget number 1 for 1983. As soon as we receive an English text we shall deposit it together with an explanatory memorandum.

As the Chancellor of the Exchequer reported to the House on 21 December 1982, the Finance Council was unanimous on 17 December in confirming that the commitments contained in the 26 October agreement must be fully honoured. The Commission have proposed in their preliminary draft that the UK's gross refund of 1092 million ecus (about £630 million) together with the compensation for Germany should be met from 1981 and 1982 surpluses, as stated in their earlier proposals. But there are some changes, mainly to take account of the European Parliament's reasons for rejecting the supplementary budget last year. I mention below the main changes.

The Commission have split the UK's gross refund of 1092 million ecus across two items of expenditure: supplementary measures and special measures of Community interest under the energy strategy. The German compensation will also come from this latter item. The Commission have also proposed that the supplementary measures appropriations should be classified as obligatory expenditure (on which the Council has the final say), and that the energy strategy measures be classified as non-obligatory expenditure (on which the European Parliament has the final say). This is a compromise between the European Parliament's position that both supplementary measures for 1982 refunds and German compensation should be classified as non-obligatory expenditure and the Council's position that they should be classified as obligatory.

We want the Council to submit a draft budget to the European Parliament in time for their plenary session which starts on 7 February, to secure adoption of the budget and payment to the UK before 31 March. The timetable is, however, now very tight and the draft budget may be adopted at a Budget Council on 26 January. I hope that once again you will appreciate the reasons for not waiting for the advice of your Committee.

I also wrote to you on 17 December 1982 about pressing ahead with the procedures for adopting the Regulations (Documents 10969 and 10970/82) providing the legal base for UK and German refunds in 1982. In the event these were never adopted and have been replaced by new Commission drafts which we shall deposit in the next day or so. I had, however, noted the Scrutiny Committee's recommendation for debate of the earlier drafts.

I hope that your Committee would agree to all these documents being debated together. We are working out what would be the best time for such a debate.

Yours ever

Nicholas

NICHOLAS RIDLEY

cc Chancellor
CST
CST
MST(C)
MST(R)
Mr Moore
Mr Kemp
Mr Fitchew
Mr Robson
Mr Baigent-Mercer
PS/IR
PS/Customs

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon The Earl Ferrers
Minister of State (Lords)
Ministry of Agriculture,
Fisheries and Food
Whitehall Place
London SW1A 2HH

24 January 1983

Dear Robin

AGRICULTURAL TAXATION

Thank you for your letter of 21 January about possible tax changes in this year's Finance Bill.

It is certainly important that we should try to stop the decline in the supply of private agricultural land for letting and we can point to the very significant steps which we have already taken to remove the tax bias in favour of owner-occupiers.

I have seen most of the leading representative bodies in the last few weeks and I shall certainly consider the further points which you and they have made. However it is now becoming generally accepted that fiscal factors are playing a very small part in the supply of land to let. The major incentive to taking land in hand is the security given to tenants under our tenure laws. We have of course discussed this before now and I recognise that there have been difficulties to overcome. But the way ahead seems clearer now and we are much more likely to make progress by tackling the problem at its root than by tinkering with the fringes.

I am copying this letter to William Mansfield and Nicholas Edwards.

Yes - I & Peter discussed this whole matter briefly

Yours ever
Nicholas

NICHOLAS RIDLEY

FINANCIAL SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Nick Budgen Esq MP
House of Commons
LONDON
SW1A OAA

20 January 1983

Dear Nick

Thank you for getting in touch about the St John Stevas Bill. I am enclosing some Background Notes on the Bill which you may find useful.

Let us talk about this when we meet

Yours ever

Nicholas

NICHOLAS RIDLEY

PARLIAMENTARY CONTROL OF EXPENDITURE (REFORM) BILL

This Bill is concerned with the functions and status of the Comptroller and Auditor General (C&AG).

The Public Accounts Committee, in its 1981 Report on the Role of the C&AG based its recommendations with regard to the range of functions of the C&AG on the principle that he should have right of access to the books and records of every body in receipt of money voted by Parliament. This would mean that the C&AG and his staff had right of entry and investigation into thousands of privately owned industrial, commercial and farming businesses, and large numbers of other bodies (such as denominational schools) which receive grants and loans (however small) from the Government.

In view of the many objections to giving the C&AG such widespread access the Bill may reject the PAC's principle and take a narrower and pragmatic view of the range of his duties. This would be welcome. But the Bill may provide for the C&AG to have access to the books and records of the nationalised industries, other public corporations, and companies mainly dependent on Government grants and loans. He would use that access to publicly question and criticise the decisions of management. This would not be in the interests of the undertakings or the tax payer.

Nationalised Industries

The Government has set a firm framework of control for the nationalised industries - three year financial targets, performance

aims, and external financing limits - and within this framework the industries have been encouraged to operate commercially. Competition is being increased wherever possible. The Monopolies and Mergers Commission and management consultants are helping to ensure that there is an external check on the industries' efficiency

There is a long way to go to improve the efficiency of the industrie But to give the C&AG access to them would be a backward step, making the industries less commercial and more like Government departments.

For example British Telecom are finding it a painful process to develop from their origins as a Government department to a corporation trading in a commercial environment. Until it separated from the Post Office in 1980 it was not possible to measure the profitability of the various parts of BT. Decision making and accountability were highly centralised with combersome procedures and too much paper work

The Government fully support BT's move away from these arrangements towards a more devolved and business-orientated organisation. The type of control appropriate to Government departments is not appropri for the commercial operations of nationalised industries. But that is the direction in which the industries would be pushed if they were subject to constant scrutiny by the C&AG, leading to questioning by the PAC.

In those circumstances the industries would face detailed enquiries about their commercial decisions, eg on tariff levels and quality of service. This would tend to make them cautious and defensive. A commercial approach calls for speed of analysis and decision, and the willingness to take risks. It would be incompatible with that for the C&AG to watch constantly over managements' decisions.

It would be even more difficult to attract top quality people from the private sector into the industries. Good management would not accept that its decisions should be subject to constant outside supervision and retrospective criticism.

Relations between Parliament, Ministers and the industries would be confused. At present there is a clear line of responsibility from

the industries through Ministers to Parliament. However Parliament has always accepted that Ministers should not be held responsible for the day to day running of the industries.

If the C&AG, reporting directly to Parliament, was monitoring and reporting on the day to day activities of the industries this would cut across the existing line of responsibility. The danger would be that the Government would be drawn into accepting responsibility to Parliament for the detailed management of the industries. In that case departments would need more staff, and the industries would have yet another layer of supervision imposed upon them.

Access for the C&AG, together with increased Parliamentary scrutiny, of their commercial operations, would create a situation in which it was much more difficult to privatise the industries.

The C&AG and his staff do not have the expertise to carry out a proper scrutiny into the efficiency of the industries. The Monopolies and Mergers Commission, which already carries out this function under a Competition Act 1980, is better suited to the task because of its commercial outlook.

Companies

If the Bill gives the C&AG access to the books and records of those companies in which the Government has a major stake the commercial performance of these companies and the value of the country's investment in them might well suffer. Rolls Royce and BL (and Shorts and Harland and Wolff) operate in a fiercely competitive market. Constant investigation and criticism by the C&AG would be bound to affect their management style, and it would be more difficult to attract top class executives. Cooperation with other companies would be more difficult. Overall, the commercial performance of the companies would suffer.

Also, inward investment could be discouraged if the C&AG is given access to the books and records of British subsidiaries of foreign corporations which are predemoninately funded by the government. Foreign companies investing in the UK would be concerned about the public disclosure and questioning of their commercial policy and

day to day operations.

The Independence of the C&AG

With regard to the status of the C&AG, the Government believe that the Bill must maintain his complete independence from both the Executive and Parliament. The Government are willing to see the Exchequer and Audit Departments Acts amended so that it is clear that the C&AG is completely independent from the Executive, and the staff of the Exchequer and Audit Department would no longer be civil servants but employees of the C&AG.

It is equally important that the C&AG should be independent from Parliament. Of course he works closely with the PAC, and would normally accede to their requests for reports on particular subjects But it would be very different if he was forced to carry out investigations on the instructions of the PAC or any other Select Committee.

There would then be a risk that he would be pushed into examining question of policy - an area he has always avoided - and the non political nature of his activities might be put at risk. In that case the whole nature of the C&AG's activities would be changed, and his current free access to departmental files would have to be reconsidered. The previous PAC (Session 1978-79) warned against the dangers of the C&AG being subject to direction.

The independent status of auditors is widely recognised. The C&AG should be independent to pursue proper audit objectives, and he should be the judge of where his staff can be used most efficiently.

cc Chancellor
CST
EST
MST(C)
MST(R)
Mr Bailey
Mr R H Wilson
Mr Burgner
Mr Bell-Barry
Mr Castree
Mr Harris

Treasury Chambers, Parliament Street, SW1P 3AG

Iain Sproat Esq MP
Parliamentary Under Secretary
of State
Department of Trade
1 Victoria Street
LONDON
SW1H OET

17 January 1983

Dear Iain

PRIVATISATION OF AIRPORTS

You wrote to John Sparrow on 10 December, copied to Leon Brittan, enclosing a paper by your officials setting out proposals for a form of privatisation of airports. I see that John Sparrow gave you his initial reactions on 22 December and I thought you might also like to have mine.

Like John, I consider that the paper represents a very useful start to the discussion of privatisation of airports. As at present drafted, however, it does seem to be rather narrowly geared to its own conclusions and as John Sparrow has said it needs to tackle wider and more fundamental questions.

The main objectives of privatisation as I see them are:-

a) to maximise competition and market choice and to ensure that decisions are therefore based as far as possible on proper commercial considerations; and

b) to maximise the proceeds of privatisation.

In support of these objectives I should like to see a rather fuller examination of the possibilities of what I might call genuine privatisation, ie involving the sale of assets to the private sector. Clearly, those of the BAA are in the most saleable state, but there are obvious disadvantages in selling them en bloc via a single company and thus replacing a state monopoly with a private sector monopoly. Indeed the best way to ensure genuine competition would be to aim to sell each airport as a separate unit. There are already three profitable airports serving London and the south east and I do not see why under separate ownership there could not be a useful measure of competition - particularly between Heathrow and Gatwick as the latter continues to grow.

Local authority airports present special problems, both political and also financial/economic. I agree with John Sparrow that we should identify our longer term policies and objectives for airports generally, but in view of the problems mentioned I see some advantage in taking the privatisation of airports in stages. I am sure Tom King will be concerned to ensure that Local Authority Airports are not subsidised out of the rates.

Finally, I should like to see the policy of privatisation of airports linked with and acting as a spur to deregulation in the aviation business-rather than existing regulations, treaties and agreements being cited as reasons for moderating our approach on privatisation. The aviation industry is now sufficiently mature to stand on its own commercial profit-oriented feet; and encouraging competition between airports will be one moreincentive for it to do so.

But in any event I should be happy for my officials to co-operate with yours and the CPRS to consider the privatisation of airports in more detail.

I am sending copies of this letter to Tom King, John Sparrow and to Sir Robert Armstrong.

Yours ever

Nicholas

NICHOLAS RIDLEY

cc Chancellor
CST
EST
MST(C)
MST(R)
Sir D Wass
Sir A Rawlinson

Treasury Chambers, Parliament Street, SW1P 3AG

Mr Bailey
Mr Lovell
Mr Monnyfield
Mr Burgner
Mr Fitchew
Mr Binns
Mr Ridley
Mr Harris

The Minister of Agriculture,
Fisheries and Food
MAFF
Whitehall Place
LONDON
SW1

18 January 1983

Dear Peter

LAND SETTLEMENT ASSOCIATION: FUTURE

Thank you for your letter of 13 January seeking agreement to the continuation of marketing services if required until 31 December 1983.

The original timetable was undoubtedly ambitious. In the light of the representations you have received I am prepared to agree to the principle of a continuation of the centralised marketing services after early April 1983. I would have thought there was a case for fixing the revised "closing date" at the end of the growing season in the autumn, ie. end September/mid-October. But if you and the Chairman of the LSA remain convinced that it would be better to offer the services up to 31 December 1983 I will not object. There is, however, a risk that the extension could be misinterpreted to mean that the LSA might have a longer term future beyond that date. I therefore regard it as essential that the announcement of the extension should make it clear that this is not the case.

My agreement is also on the understanding that the provision of the marketing service will be fully self-financing. It would be helpful if, before setting the charges, my officials could scrutinize the relevant data on which the proposals are based. If, unexpectedly, a shortfall appears on the receipts side, I would expect you to live within the overall cash limit on Class III, Vote 3 for 1983-84 as it then was. Perhaps my officials could also see the monthly monitoring dated for the extension period.

I am glad to note that there should be no effect on the arrangement of sale of holdings to tenants arising out of the extension of the availability of the marketing services.

I do have some changes to suggest to the draft answer attached to your letter. For ease of reference a complete revise is attached.

Yours ever

Nicholas

NICHOLAS RIDLEY

It remains the Government's policy that the tenants of the estates should take over the responsibility for the marketing of their own produce. However, in the light of the representations which I have received, and on the advice of the Chairman of the Land Settlement Association, I am prepared to arrange for the continuation of the Association's centralised marketing services up to 31 December 1983. These services will be provided to those growers who wish to use them, provided the uptake at each estate is sufficient to support the services on a full recoupment basis. The aim of this final extension is to provide more time for the estates concerned to develop the alternative marketing arrangements foreshadowed in my announcement of 1 December 1982. I hope that those estates which have made substantial progress towards establishing co-operatives will in the event be able to take over responsibility for their own marketing well before 31 December 1983, when the LSA arrangements described above will be terminated.

All other aspects covered by my announcement of 1 December 1982, including the arrangements for the sale of holdings to tenants, will remain unaffected.

FINANCIAL SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Richard Luce Esq MP
House of Commons
LONDON
SW1A OAA

17 January 1983

Dear Richard

I know you have spoken with the Chancellor about the St John Stevas Bill. I am enclosing some background briefing on this Bill which you may find helpful.

For your eyes only

Yours ever

Nicholas

NICHOLAS RIDLEY

FINANCIAL SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Tim Eggar Esq MP
House of Commons
LONDON
SW1A OAA

17 January 1983

Dear Tim

... We have had a word about the St John Stevas Bill. I am now enclosing some notes on the Bill which you may find useful.

For your eyes only!

Yours ever
Nicholas

NICHOLAS RIDLEY

FINANCIAL SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Michael Grylls Esq MP
House of Commons
LONDON
SW1A OAA

17 January 1983

Dear Michael

... I am enclosing some background notes on the St John Stevas Bill, which I hope you will find of some use.

For your eyes only!

Yours ever

Nicholas

NICHOLAS RIDLEY

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon John Payton MP
House of Commons
LONDON
SW1A 0AA

17 January 1983

Dear John

I know you had a word with the Chancellor about the St John Stevas Bill. I am enclosing some Background Notes on the Bill which you may find useful.

For your eyes only!

Yours ever

Nicholas

NICHOLAS RIDLEY

PARLIAMENTARY CONTROL OF EXPENDITURE (REFORM) BILL

This Bill is concerned with the functions and status of the Comptroller and Auditor General (C&AG).

The Public Accounts Committee, in its 1981 Report on the Role of the C&AG based its recommendations with regard to the range of functions of the C&AG on the principle that he should have right of access to the books and records of every body in receipt of money voted by Parliament. This would mean that the C&AG and his staff had right of entry and investigation into thousands of privately owned industrial, commercial and farming businesses, and large numbers of other bodies (such as denominational schools) which receive grants and loans (however small) from the Government.

In view of the many objections to giving the C&AG such widespread access the Bill may reject the PAC's principle and take a narrower and pragmatic view of the range of his duties. This would be welcome. But the Bill may provide for the C&AG to have access to the books and records of the nationalised industries, other public corporations, and companies mainly dependent on Government grants and loans. He would use that access to publicly question and criticise the decisions of management. This would not be in the interests of the undertakings or the tax payer.

Nationalised Industries

The Government has set a firm framework of control for the nationalised industries - three year financial targets, performance

aims, and external financing limits - and within this framework the industries have been encouraged to operate commercially. Competition is being increased wherever possible. The Monopolies and Mergers Commission and management consultants are helping to ensure that there is an external check on the industries' efficiency.

There is a long way to go to improve the efficiency of the industries. But to give the C&AG access to them would be a backward step, making the industries less commercial and more like Government departments.

For example British Telecom are finding it a painful process to develop from their origins as a Government department to a corporation trading in a commercial environment. Until it separated from the Post Office in 1980 it was not possible to measure the profitability of the various parts of BT. Decision making and accountability were highly centralised with combersome procedures and too much paper work.

The Government fully support BT's move away from these arrangements towards a more devolved and business-orientated organisation. The type of control appropriate to Government departments is not appropriate for the commercial operations of nationalised industries. But that is the direction in which the industries would be pushed if they were subject to constant scrutiny by the C&AG, leading to questioning by the PAC.

In those circumstances the industries would face detailed enquiries about their commercial decisions, eg on tariff levels and quality of service. This would tend to make them cautious and defensive. A commercial approach calls for speed of analysis and decision, and the willingness to take risks. It would be incompatible with that for the C&AG to watch constantly over managements' decisions.

It would be even more difficult to attract top quality people from the private sector into the industries. Good management would not accept that its decisions should be subject to constant outside supervision and retrospective criticism.

Relations between Parliament, Ministers and the industries would be confused. At present there is a clear line of responsibility from

the industries through Ministers to Parliament. However Parliament has always accepted that Ministers should not be held responsible for the day to day running of the industries.

If the C&AG, reporting directly to Parliament, was monitoring and reporting on the day to day activities of the industries this would cut across the existing line of responsibility. The danger would be that the Government would be drawn into accepting responsibility to Parliament for the detailed management of the industries. In that case departments would need more staff, and the industries would have yet another layer of supervision imposed upon them.

Access for the C&AG, together with increased Parliamentary scrutiny, of their commercial operations, would create a situation in which it was much more difficult to privatise the industries.

The C&AG and his staff do not have the expertise to carry out a proper scrutiny into the efficiency of the industries. The Monopolies and Mergers Commission, which already carries out this function under a Competition Act 1980, is better suited to the task because of its commercial outlook.

Companies

If the Bill gives the C&AG access to the books and records of those companies in which the Government has a major stake the commercial performance of those companies and the value of the country's investment in them might well suffer. Rolls Royce and BL (and Shorts and Harland and Wolff) operate in a fiercely competitive market. Constant investigation and criticism by the C&AG would be bound to affect their management style, and it would be more difficult to attract top class executives. Cooperation with other companies would be more difficult. Overall, the commercial performance of the companies would suffer.

Also, inward investment could be discouraged if the C&AG is given access to the books and records of British subsidiaries of foreign corporations which are predemoninately funded by the government. Foreign companies investing in the UK would be concerned about the public disclosure and questioning of their commercial policy and

day to day operations.

The Independence of the C&AG

With regard to the status of the C&AG, the Government believe that the Bill must maintain his complete independence from both the Executive and Parliament. The Government are willing to see the Exchequer and Audit Departments Acts amended so that it is clear that the C&AG is completely independent from the Executive, and the staff of the Exchequer and Audit Department would no longer be civil servants but employees of the C&AG.

It is equally important that the C&AG should be independent from Parliament. Of course he works closely with the PAC, and would normally accede to their requests for reports on particular subjects. But it would be very different if he was forced to carry out investigations on the instructions of the PAC or any other Select Committee.

There would then be a risk that he would be pushed into examining question of policy - an area he has always avoided - and the non political nature of his activities might be put at risk. In that case the whole nature of the C&AG's activities would be changed, and his current free access to departmental files would have to be reconsidered. The previous PAC (Session 1978-79) warned against the dangers of the C&AG being subject to direction.

The independent status of auditors is widely recognised. The C&AG should be independent to pursue proper audit objectives, and he should be the judge of where his staff can be used most efficiently.

cc Miss J Court
Mrs Hedley-Miller
Mr Edwards
Mr Peet
Mr Lennon
Mr Sanderson

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Francis Pym MP MC
FCO
Downing Street
LONDON
SW1

12 January 1983

Dear Secretary of State.

EC BUDGET: HOUSE OF COMMONS DEBATE

I wrote to you on 6 December about a number of outstanding Scrutiny Committee recommendations for debate. Since then the number has increased and events on the Community front have become more difficult.

I am writing now to propose that 'L' tomorrow should discuss the possibility of a general debate as early as possible to sweep up all the outstanding recommendations.

Background

Many of these documents impinge on the continuing problem of securing title to our refunds from the European Community. We hoped to receive these by 31 December by means of a 1982 Amending Budget. In the event the European Parliament rejected it. At ECOFIN on 17 December it was agreed that the UK would not suffer financially and the Commission have deposited funds in a special account held by the Paymaster General as agreed. The Chancellor had foreshadowed this in his statement to the House on 21 December. But the House has not been informed since that the funds arrived on time. The Commission's action in doing this has been questioned by the European Parliament and it is important to put the position on record with our own Parliament. The debate would provide an opportunity to do this.

It is now proposed that title to our and Germany's refunds will be secured through a supplementary and amending budget for 1983. The Commission are drawing up this now so that the European Parliament can have its first reading during its February plenary session (7 to 11 February). The Commission are also producing a Green Paper on new resources which will be published during January.

All these events are linked. They are moving fast and the later we leave a debate the more difficult it might be for the Government. It would also help the various stages I have mentioned for the Commission and the European Parliament to know the strength of feeling there is in the UK about failure to obtain our refunds and to secure a lasting solution.

If you are content that a motion should cover all the documents mentioned above the debate would be handled jointly by FCO and Treasury Ministers. The motion might be a 'take note' one, but we can consider the drafting urgently as soon as we know that the Lord President and Chief Whip are able to allocate time for a debate this month .

I am copying this to Member of OD(E) and L Committees and to Sir Robert Armstrong.

yours sincerely,

Mark Donnelly

ppNICHOLAS RIDLEY

(Approved by the Financial Secretary and signed in his absence).

cc Chancellor
CST
EST
MST(C)
MST(R)
Sir D Wass

Treasury Chambers, Parliament Street, SW1P 3AG

Mr Middleton
Mr Bailey
Mr Burgner
Mr Robson
Mr Wood
Mr Wicks

Mr Moore
Parliamentary Under Secretary
Department of Energy
Thames House South
Millbank
LONDON
SW1P 4QJ

12 January 1983

Mr A R Williams
Mr Ridley
Mr Harris
Mr Martin-IR

Dear John

DISPOSAL OF BGC'S OFFSHORE OIL ASSETS

Thank you for your letter of 22 December.

I am sure that you are right that the ability to recruit good calibre management will be crucial to a successful flotation. As you know from my earlier letter, you have my full support for the creation of a suitable share incentive scheme if such a scheme is established formally after the company is privatised. This would help to reduce the real political difficulty for the Government in setting up and presenting what might be regarded as a highly generous arrangement. It is therefore a pity that it now appears that the details of the scheme will have to be settled before privatisation and disclosed in the prospectus. Although it will be harder for the Government to distance itself from the arrangements, I do not object to the share option scheme if you judge it to be critical for a successful and early privatisation. In devising our proposals, it will be important to do everything possible to make the scheme as politically acceptable as possible, perhaps by structuring it so that its cost clearly falls on the new company after privatisation rather than on the Exchequer. We also need to avoid any arrangement which would provide the management with yet a further incentive to work against us for a low initial share price so that subsequent capital gains operate to their financial advantage. This might be done by stipulating that the price at which the option is granted is the share price say 6 months after flotation.

I also see the case for service agreements for key management personnel. The terms of any agreement would need careful consideration; for example, it should not effectively bind the Government to sell the company within an unreasonably short time by giving the management a right to a contractual claim against the company if the sale did not proceed in that period.

I agree that the next step is to agree detailed proposals which can be put to colleagues in E(DL) if the flotation route is endorsed. Please could your officials keep Treasury and Inland Revenue officials in close touch with developments.

I also note from your letter that there may be serious legal difficulties created by the matching rights provisions in the operating agreements, if the individual subsidiaries were sold directly. This is disturbing. I had understood from Nigel Lawson's letter of 16 June that the statutory direction route would permit the option of piecemeal disposal to oil companies. But if the matching rights provisions cause legal difficulties, it seems that the options available are either a public flotation, with all the difficulties of recruiting management, or a sale to oil companies and the risk that BGC's partners would invoke their matching rights. This is something that will have to be decided by colleagues collectively when you have the legal advice. The Treasury will clearly be interested in an approach which maximises proceeds.

Finally, may I reinforce a point which my officials have already made to yours. When the Government takes over from BGC responsibility for the shares in the new company, any net cash requirement of the compar eg for field development, will no longer be met by BGC from within their EFL. The Company would then have to raise the money on its own account to finance development. There will then need to be a compensating reduction in BGC's EFL if public expenditure overall is not to increase.

Yours ever

Nicholas

NICHOLAS RIDLEY

CONFIDENTIAL

cc PS/Chancellor
PS/CST
PS/EST
PS/MST(R)
Mr Middleton
Mr Monck
Mr Lovell
Mr Gordon
Mr Bailey
Mr Turner
Mr Pirie
Mr Traynor
PS/IR
PS/CandE

Treasury Chambers, Parliament Street, SW1P 3AG

Secretary of State for Trade
Department of Trade
1 Victoria Street
LONDON
SW1

21 January 1983

Dear Arthur

CORK COMMITTEE PROPOSALS - THE ADMINISTRATOR

At my request Treasury officials have been doing some preliminary work about aspects of the Cork Committee's recommendations on reform of UK insolvency practice - in particular, the package of proposals for an "administrator" regime and for changes in the ranking and rights of creditors in the recovery of assets.

... The attached paper, which has been prepared in consultation with the ... Bank of England and Revenue Department, is the outcome. I also attach a second paper prepared by the Bank of England on the CLU procedures in the US; the Bank intends to publish this in due course.

I recognise, of course, that the whole subject is primarily for your department, and no doubt a good deal of work has been going on. I hope you will regard these contributions as helpful to that consideratio and propose that your officials should arrange for inter-departmental discussion of the main policy issues, leading to a paper or papers which Ministers might then consider collectively. I recognise that there may well be no room for legislation in this Parliament, but we ought to consider whether there is a case for some form of document setting out the Government's views including a more definite set of legislative proposals.

I am sending a copy of this letter to Patrick Jenkin, who I know is also interested in this subject.

Yours ever

Nicholas

NICHOLAS RIDLEY

CORK COMMITTEE REPORT: THE ADMINISTRATOR PROPOSAL

The purpose of this paper is to discuss the case for and agains introducing the administrator proposal recommended by the "Cork" Report on Insolvency Law and Practice, Cmnd 8558.

Background

2. Under UK law, insolvent companies cease trading and are wound up either through direct liquidation or through the intermediate step of receivership.

3. A company can be liquidated at its own instigation if it simply wishes to cease trading. Others are compulsorily liquidated; this is ordered by the Courts at the petition of creditors, shareholders or in certain circumstances the Secretary of State for Trade or the Official Receiver. The purpose of a liquidation is to wind up the company, realising all assets and distributing them amongst all creditors.

4. Different creditors have different ranking in their claims upon these assets. Preferential creditors (mainly the Crown) rank ahead of all other creditors. Secured creditors who have lent money on the security of a fixed charge on a specific asset - or, more typically in the case of loans from banks, a floating charge over wider assets - then have preference over unsecured creditors such as suppliers and over equity shareholders. In the distribution of assets following liquidation preferential creditors rank ahead of secured creditors who in turn rank ahead of the unsecured.

5. Many insolvent companies begin the winding-up process by being placed into receivership. The issue of a floating charge normally gives the bank the right to appoint a receiver and manager to a company if and when they consider the loan to be at risk of default. The function of the receiver in such circumstances is to realise those assets subject to a floating charge and pay the proceeds towards the discharge of the loan. This need not involve immediate liquidation; it can mean managing the company for a period of time in order to find buyers for all or part of the company as a going concern. But usually the company is close to being or actually is

insolvent when the receiver is brought in. Hence the act of recovering the security under receivership often leads to or necessitates full liquidation of the company.

Criticisms of Present Practice

6. There are many arguments directed against these present arrangements. But it is useful to concentrate on four general criticisms.

7. First, it is argued that present insolvency law is too "black and white": companies are either solvent and trading or insolvent and in the hands of a liquidator or receiver. There is no effective mechanism* whereby a company that is close to insolvency can obtain a temporary respite from its creditors while it tries to restructure financially. Any hint of trouble typically leads to rapid loss of confidence, falling share price and the risk of the bank appointing a receiver. The economic significance of this "black and white" approach is that viable companies with good products and healthy markets may nonetheless become over-extended financially and then be unnecessarily liquidated with a loss of output and employment. It is argued that the absence of a mechanism to restructure the economically healthy but financially unsound company may lead to misallocation of resources. A recent example was the Stone-Platt receivership. Some argue that, had there been an arrangement available whereby the company could have been restructured financially earlier without going into receivership, more of its activities, and employment, could have been sustained.

8. Secondly, even the avenue of receivership, which offers the prospect of the company or some part of it continuing as a going concern, is not available where there is no floating charge. Only the holder of a floating charge can appoint a receiver. It appears that very many small and some medium-sized companies do give a floating charge over assets as security for bank loans. Banks also tend to take a floating charge over larger companies when and if they consider the loans are at serious risk. Nonetheless many companies are not 'protected' by floating charges (including

*Other arrangements are available under Section 206 of the Companies' Act 1948 but remain largely unused. (See Cork 404-418.)

those in trouble which lenders fail to spot in time). This exacerbates the "black and white" problem for companies facing insolvency with no floating charge and can lead to misallocation of resources through unnecessary liquidations.

9. Thirdly, reinforcing these resource allocation points, it is said that because banks are primarily concerned with the money lent on the security of a floating charge, their decisions to appoint receivers are bound to be mainly influenced by the desire to protect bank resources. It is argued that a wider view of the balance of interests in a company is called for, taking account of the suppliers shareholders, employees and even the "national" interest in sustainin that company. It follows that the Courts, and not the banks, are the appropriate arbiter of the company's interests.

10. Fourthly, it is argued that in giving banks the right to appoint a receiver in certain circumstances the floating charge gives banks excessive power. This is an argument about the balance of interest in a company between equity shareholders and bankers. It is said that receivership gives banks rather greater hold over a company and its management than its shareholders; it is argued that shareholders are unwilling or unable, because of the dominance of passive institutions, to probe management actions and to exercise their power of dismissal. Although perhaps overstated, in essence this argument is that calling in the receiver is more likely to change management than shareholders' ballots. Receivership also gives banks considerabl indirect power over other creditors, such as suppliers, because their own claims rank above all others (except of course preferential claims - see separate paper by Inland Revenue).

Cork proposals

11. The Report on Insolvency Law and Practice covers a wide range of both company and personal insolvency matters. But the major proposal addressed to the problems outlined above is the creation of an administrator regime.

12. Simply stated, its purpose is to establish a new mechanism to enable companies in trouble to reorganise. It provides for a short interval in which creditors are held off while the company continues to trade and tries to restructure financially. The

administrator would be appointed by the Courts on the application of any creditor (whether or not there is a floating charge) or the company's directors for any of the following reasons:

(a) to consider the reorganisation of the company and its management with a view to restoring profitability or maintaining employment;

(b) to ascertain whether a company of doubtful solvency could be restored to profitability;

(c) to make proposals for the most profitable realisation of assets for the benefit of creditors and shareholders.

However the report also makes it clear that the holder of a floating charge may choose instead to appoint a receiver even if other creditors wish to opt for the administrator (paragraph 504).

13. It is envisaged that once the Court appointed an administrator, he would consult widely and openly with all interested parties - creditors, shareholders, the employees and where appropriate, Government departments. On his appointment, all executions and actions against the company would be stayed and the company would continue trading, with the debts temporarily suspended. Following consultations, the administrator might recommend continuation of the company, perhaps with new management, or decide that receivership or full liquidation of the company would be more appropriate. His executive powers would be those of a receiver and he could enforce a receivership or liquidation. But paragraph 512 indicates that he can only let the company go on where agreement about past debts is reached. And in practice the banks would also have to agree to back the company.

14. Other details of the arrangements - length of period, responsibility for cost sharing etc. - are described in Chapter 9 of the report and not considered here. Cork has suggested that two other proposals should be included to form a complete package, centred on the administrator. These are:

(a) A new definition of 'wrongful trading' which would provide a stiffer test of solvency than at present. Directors would be held personally responsible for the company's debts, when a company incurred liabilities without a reasonable prospect of meeting them in full.

(b) Changes in the ranking and rights of creditors in the recovery of assets. Certain debts to the Revenue departments would assume lower priority (see separate paper). And 10 per cent of the net realisations subject to a floating charge would be set aside for unsecured creditors.

15. The Cork Committee intend that the administrator regime, along with these other reforms, should have the following impact:

(i) Directors of companies will have to admit they are getting into trouble earlier than at present; they will therefore have to monitor their financial position more carefully;

(ii) but, while being obliged to identify problems earlier, directors will have a new mechanism available that avoids liquidation and offers an opportunity to reconstruct financially while continuing to trade. That will be open to companies whether or not there is a floating charge;

(iii) the unique power of banks to appoint a receiver will in effect be diluted (because other creditors can do so indirectly, via the appointment of an administrator). The power conveyed by the floating charge however remains unchanged - since it can override the option of the administrator. Finally, changes in the ranking of preference between secured and unsecured creditors would reduce the banks' ability to protect their security.

Assessment

16. Any assessment of the economic consequences of the Cork proposals has to consider several dimensions. The effects are likely to be different for small, medium-sized and large companies; they may also be different in the short term, as people first react to new institutional arrangements, from the long term when economic agents change their behaviour in response. Any analysis is seriously handicapped by a lack of evidence. The Cork Committee report provides very little objective material in support of its arguments. Any estimates of the size of effects from institutional changes are necessarily highly speculative, particularly when our information on bank lending practices is qualitative and patchy. A dominant consideration for the Government will be whether the proposals are likely to contribute to improved economic performance (eg through better allocation of resources, and less distortion in capital markets). There may also be other policy dimensions, such as making company rescue operations easier to mount.

17. No framework is ideal for taking account of all these considerations. The approach adopted here is to identify and consider four (out of a complex range of) policy options to address some or all of the problems at which Cork's recommended administrator package is aimed. Options 1 and 2 stop short of the full Cork package; Option 3 is in effect the Cork proposals; and Option 4 goes beyond it, to try and enforce the use of the administrator. In summary the options are:

(1) Extending the right to appoint a receiver where there is no floating charge.

(2) Introducing the administrator regime, with the change to 'wrongful trading' provisions (para 14(a) above) but without the alteration to the ranking of creditors.

(3) As in (2) but with the two changes in the ranking of creditors in para 14(b).

(4) As in (3) but compelling the banks to co-operate with the administrator regime, by withholding (at least temporarily) their right to override it by appointing a receiver where they have a floating charge on assets.

OPTION 1

18. This can be relatively quickly reviewed. It would be a small step - the removal of one particular difficulty with present insolvency practice viz that a receiver cannot be appointed where there is no floating charge. It has been mentioned as the minimal solution. It means giving unsecured creditors - suppliers or banks with no floating change - the right to appoint a receiver. But a receiver could then only act as a liquidator unless agreement could be reached with all the creditors on keeping all or part of the company going. But it is this ability to act as liquidator or manager of the company which constitutes the case for the administrator concept. In this sense, option 1 might in practice achieve much the same results as option 2 (apart from 'wrongful trading').

OPTION 2

19. This option is the core administrator proposal plus the reform of wrongful trading, but without the changes in the ranking of creditors which Cork wishes to associate with the administrator. The case for the reform is described here by identifying the economic consequences for each of the main parties affected - companies, shareholders, Government and banks. The case against is then noted but no attempt is made at this point to judge the desirability of the administrator reform.

20. Because of the new provisions on "wrongful trading", companies will in principle be obliged to monitor their financial affairs more closely. For some smaller companies, this may enforce better financial discipline (although the greater involvement of the Courts rather than banks may cause delay and more initial uncertainty). But for the bulk of companies this will represent no great change. From a wider viewpoint, there might be marginal economic gains from better financial management of small firms.

Companies, or more accurately present managements, will gain from the availability of the administrator mechanism. This is clearly particularly true for those without loans carrying a floating charge, since solvency previously meant direct liquidation. But the option of an administration is also open to companies with a floating charge if their banks do not opt for receivership.

21. However, there will be problems for those companies who are creditors of a company placed under an administrator. They will not immediately be able to pursue the debt, so that there will be implications for their own financial position, for example their borrowing from banks (although, to the extent that the alternative for the ailing company was receivership or even default on the debt, the creditor company may be better off). But it seems reasonable to conclude that the company sector as a whole will regard the reform as a gain.

22. Shareholders seem likely to welcome the change as giving them greater power to pursue changes in the management of companies through the administrator. But there would be no major improvement in their financial position unless their preference in liquidations were enhanced (option 3).

23. The financial position of the Government will again not be affected unless there are changes in the preference given to Crown debts. But one other aspect needs to be noted. Past experience has suggested that the Government finds legal difficulties in offering financial support to ailing companies, where it wishes to do so, without becoming liable for the company's debts. The administrator regime could provide a convenient mechanism for mounting rescues in such cases; the Government could, as a creditor, seek an administrator.

24. The clearing banks and other similar lenders should neither gain nor lose very much from these proposals. They may be a little more confident in their lending to companies (because of the new provisions on wrongful trading). But that must be a very minor gain.

The main reason banks will not lose is that their security is not impaired under the basic administrator option. Under the Cork proposals, banks are allowed unilateral access to receivership and can choose to appoint a receiver where unsecured creditors might otherwise appoint an administrator. Banks can therefore override the administrator option and protect their security whenever they choose to do so.

25. But, while banks may not lose or gain much, it is useful to consider what use banks will make of the administrator regime and how it might affect banking practices. In order to protect their security, banks might be expected to appoint a receiver, rather than an administrator, on most occasions. Indeed one might expect banks to go further, in order to ensure they have that option, and seek floating charges over more of their clients. They may also increase their monitoring activities and intensive care facilities so as not to be 'caught out' in an administrator regime where they do not have a floating charge.

26. This seems likely to be the broad direction of banks' policy. Yet it seems improbable they will override the appointment of an administrator in all cases; and some administrators will be appointed for companies where there is no floating charge. Banks may also wish to adopt a co-operative attitude in other instances where, for example, they see real hope of sustaining the company as it stands. So there would be some trial of the regime to test its merits. If over a period of time it became clear that administrators were - as critics suspect - delayed receivers or liquidators, banks' attitudes would seem likely to harden, back in favour of present practices. If, on the other hand, there were "saved" companies which showed that the appointment of an administrator had been worthwhile, banks might tend to make more use of it. However on balance, the strong advantages of present arrangements to the banks suggest that, even in the longer term, they are not likely to adopt the new regime willingly to any large extent.

27. In broad terms, the case against put forward by the opponents of the administrator regime is that there is no need for the creation of a new arrangement. They argue that receivership provid an efficient mechanism for new management of all or part of a viable company to be brought in, or for the quick disposal of the assets of the non-viable company. Many of these critics do not defend the status quo but accept that the ability of banks to appoi a receiver conveys special privileges. They would like to see the right to appoint a receiver extended to unsecured creditors (option But they believe the receivership mechanism itself is perfectly adequate and superior to the administrator regime.

28. Specifically they argue receivership is a superior resource allocation mechanism to the administrator idea in three respects:

(i) They question whether the Courts are the appropriate institution to oversee decisions about the viability and financial reconstruction of companies (though it would be the administrator who took the actual decisions Some argue that banks will always be better placed to make judgements about these matters, not least because they must take the necessary supportive action if a company is to continue. They deny the charge that banks do not take account of wider national interest in dealing with receiverships. Moreover, so far as providing a breathing-space for financial restructuring is concerned, some see the intensive care facility as a better way of nursing sick companies to recovery.

(ii) It is argued that the administrator regime is unlikely to be effective in preserving capacity. The chances of new owners or management emerging for small companies during an administration period are limited by the small scale of the enterprise (paragraph 508 of the report acknowledges this). For most, outright liquidation avoids delay in disposals of the assets. For larger firms, there may tend to be too much emphasis on preserving the existing company rather than breaking it up under receivership. Bank credit, which could be recycled to new users, will be held up in the administration exercise - particularly if banks are

expected to extend extra credit to suppliers.

(iii) It is suggested that the administrator regime will be less efficient than receivership. Because of uncertainty about the eventual outcome - continuation, receivership, liquidation - there may be unwillingness to trade with a company under an administrator. The intangible assets (customer and supplier loyalty) of a company which continues trading under a receiver wither quckly; and the assets basis is usually being dissipated by losses. These problems may be worse for the company under an administrator, not only becaus of this greater uncertainty about the outcome, but because some key advantages of the receiver - his ability to deal quickly and secretly - will be lost under the open consultative approach of the administrato

29. The nub of these arguments is that the administrator is likely to be a delayed liquidator. In practical terms, refloating the existing company will be precluded because of lingering uncertainty about prospects and loss of assets and markets etc. during the administrator period.

30. Finally, the significance of the administrator regime should not be over-rated. It needs to be borne in mind that Cork's proposals for an administrator seem to be addressed mainly to the problem of the company without a loan secured by a floating charge (as indicated in paragraph 503). And as has already been noted, the lender with a floating charge is allowed in effect to override a decision to appoint an administrator. Far from reducing the role of the receiver or of floating charges (as some commentators have supposed), therefore, the Cork proposals seem to strengthen them in certain respects.

OPTION 3

31. Under option 2, the administrator approach would have to stand or fall on its merits as a reconstruction mechanism. However the analysis suggested that the banks might make relatively little use of the new facility. Underlying that view, is perhaps a judgement that banks will prefer to protect their security rather

rather than risk the uncertain outcome of an administration exercise. It can be argued that some incentive is necessary to persuade creditors to take the longer-term view of a company's interests (thus the administrator) rather than the short-term (protecting security). This thinking underpins the Cork proposals for changes in the ranking of creditors.

32. This involves:

(a) ending the preferential treatment of most debts to the Revenue Departments and, as far as these debts are concerned, making the Departments unsecured creditors ranking pari passu with other unsecured creditors;

(b) 10 per cent of the net realisations of a floating charge would be set aside for the unsecured creditors.

33. The Revenue Departments are strongly opposed to the ending of their preferential status. The Financial Secretary's reaction at his meeting in September was to share this view.

34. Unlike other creditors, the Revenue Departments have no choice with whom they trade and of the terms they trade on. Other traders can decide not to trade with a company they consider to be a bad risk or can decide to do so only on special terms eg cash on the nail. In addition, the Departments cannot refuse an existing debtor the opportunity to become more indebted. Ending preference for Revenue Departments would mean higher taxes to cover the loss of yield, with the result that good taxpayers were paying more to provide funds for commercial creditors who have the means of looking after themselves.

35. Ending preference is also likely to mean the Revenue Departments taking earlier and more robust action against debtors. This could well undermine the idea of a "breathing space" which the administrator proposals are intended to provide. It would also have political disadvantages.

36. Setting aside 10 per cent of the proceeds of a floating charge would obviously impinge on the banks. As with the change in Crown preference, it could lead to the creditor, in this case the bank, taking earlier and more robust action against companies to protect the loan - so undermining the administrator.

37. Looking beyond the case of an individual loan, it could be argued that the 10 per cent set aside ought to have relatively little impact on banks. It has been suggested that Crown debts represent on average about 10 per cent of net realisations. On thi logic the 10 per cent fund for unsecured creditors would mainly be at the expense of the Exchequer, not the banks.

38. Even accepting this logic, there is no obvious case in principle for a switch of this sort in the balance between the Crown and the unsecured creditor. It may be there is an implicit judgement that the long-term interests of the company are deemed to be those of the nation and that the public sector should therefore provide the financial incentive to take the long-term view and avoid liquidations. But other creditors may gain too from continuation of the company, and that might be held to require a rather different balance between public and private sector financial support for the longer view.

39. Whatever the case in principle, the logic of an aggregate view of liquidations as set out in paragraph 37 is likely to cut little ice in practice when a bank is deciding what action to take on a particular loan that is looking suspect. Its main aim will be to protect its money. It is unlikely to take a relaxed view of the loss of 10 per cent of the proceeds of its floating charge on the grounds that the company may be able to get a corresponding amount of unsecured credit from the Crown - particularly as the Crown is likely to press its claims more strenuously under the new regime.

40. This has two consequences. First reduced security may initially make banks more cautious, and this will be reflected in a hardening of margins and reluctance to lend further to shaky

companies. It may also encourage banks to take more fixed charges (which rank as preferential debts) rather than floating charges. Any consequent downward impact on activity in the short-term might be at least partially offset by companies trading on under an administrator rather than being liquidated. But over the long term, looked at across the whole range of company lending, one would not expect the final impact to be large. No institutional change of this nature can affect the economic risks associated wit lending to companies or the expected rate of return on projects. And only a small proportion of bank loans are at risk at any time. Some lasting impact on particular sectors could however arise. Reduced access to security must make banks less willing to lend on riskier projects, making it more difficult for small companies generally, and larger ones engaged in high-risk ventures, to get credit. To the extent that Government policy is to encourage lending in this area, that might be regarded as unwelcome. One does need to note however that because the risk element on equity may be marginally reduced, there could be greater availability of equity finance.

41. Second, there is no necessary link between the proposal to set aside 10 per cent of the realisations of a floating charge and the proposal to end Crown preference. They can be examined separately on their individual merits. The ending of Crown preference is unattractive to the Exchequer. The proposal with regard to floating charges is less objectionable to the Government. It could be pursued on its own.

OPTION 4

42. Some of the above conclusions would need to be modified where banks were compelled to co-operate with the administrator regime, by removing (at least for a specified time) their right to override it and appoint a receiver where there is a floating charge; clearly there are questions of detail about how far this compulsion would go and what form it would take. Bank lending practices should not be directly affected, but there could be indirect effects. Greater use of the administrator is likely

to involve less use (at least in the first stage) of the receiver. To the extent that under administrators banks found more security was lost than under receivers, some tightening of lending might then be expected.

43. Important though the attitude of the banks is under this option, and indeed option 3, it should not be the crucial test for the new proposals. Rather, the desirability of putting pressure on the banks to co-operate with the administrator scheme, setting aside political or libertarian considerations, would seem to hinge on the relative efficiency of the administrator and receivership mechanisms in resource allocation terms. As already noted, opponents of the scheme believe the relative inefficiency of the administrator regime is a serious drawback.

CONCLUSION

44. At this stage, it would be unwise to draw firm conclusions about the desirability of the administrator regime or the four broad options explored here. This paper has however tried to identify and examine some rather complex and inter-related considerations. The following key issues emerge:

(i) Some kind of reconstruction facility for companies in trouble is generally thought desirable. The defence that banks' intensive care facilities provide this is unconvincing; apart from the fact that such facilities are not available to every firm, and particularly not small ones, there remain questions about the width and length of the banks' vision and the position of companies without a floating charge.

(ii) Whether that reconstruction facility should take the form of the administrator regime (option 2) is less clear. Some believe a less far-reaching reform of receivership practice would suffice, widening the right of access to receivership from the banks to include unsecured creditors (option 1).

(iv) Receivership is considered by many to be an efficient method of allocating and recycling the resources of insolvent companies. There are fears that the administrator regime as drafted by Cork,with its involvement of the Courts, emphasis on wide consultation and open-dealing, might prove at best no more efficient, and at worst less effective in maintaining viable assets.

(v) The changes in the ranking and rights of creditors proposed in the main Cork package (option 3) seem likely to have some effect on banks' access to security, and a substantial effect unless Crown preference is changed to offset the proposed 10 per cent of the proceeds of a floating charge for insecured creditors. That could mean a more cautious attitude to lending. Changes in lending practice seem likely to be fairly muted however; some minor adverse impact on lending at the riskier end of the spectrum seems possible.

(vi) If banks are given a free hand, they are likely to extend the use of the floating charge if the Cork proposals are enacted, so as to protect their right to appoint a receiver where other creditors or the company itself wish to bring in an administrator. In the longer term, the use made of the new facility is likely to depend on whether banks find the administrator regime useful.

(vii) If banks are compelled to make use of the administrator (option 4), some further tightening in lending practices might be expected - assuming loss of security is greater than under receivership.

IC DIVISION

COMPANY REORGANISATION

Introduction

1 The increase in the United Kingdom in the number of companies facing financial difficulties, and in receiverships, has stimulated interest in the procedures available in the United States for dealing with company problems, and in particular in the reorganisation provisions of Chapter 11 of the US Bankruptcy Code. The Report of the Review Committee on Insolvency Law*, under the chairmanship of Sir Kenneth Cork, discussed possible modifications of UK company law with respect to insolvency, but its proposals do not draw to any material extent on US practice. In view of the interest in this country in US reorganisation procedures, and the apparently incomplete understanding of them outside a small circle of specialists, the following account describes the significant features of American law and practice in this area and offers some comparison with the UK position. It reflects discussion with a number of leading American bankers, lawyers and accountants with experience of Chapter 11 cases, as well as with practitioners on this side of the Atlantic with experience of American procedures. The aim of the paper is to inform, though it will have relevance for discussion and in due course decisions about possible future legislation in the light of the proposals in the Cork Report.

2 It is generally accepted in this country to be desirable to deal so far as possible constructively with the business and assets of an insolvent company; that is, to keep its constituent business or businesses going where they are prospectively viable. There is obvious merit in preserving the maximum amount of goodwill, trade and employment in the business; and by doing so, the insolvency practitioner will almost certainly increase the level of recoveries for creditors and even for investors. Within the framework of present UK company law, the instrument that makes possible the most constructive approach to insolvency is the floating charge, a form of security which, because of its comparative simiplicity, and the speed and lack of expense with which it can be taken, plays a large part in commercial lending. The floating charge gives the secured lender, in this context often referred to as the debenture holder, a

*June 1982: Cmnd 8558

comprehensive security over the entire undertaking of the debtor company, and all of its assets. Until the occurrence of an event specified in the deed, the floating charge does not attach to specific assets in the way that a fixed charge does (the lender may have fixed charges over certain assets as well), but "floats" over all of the assets for the time being of the debtor, who is free to deal in them in the normal course of his business. In an event of default, the debenture holder can appoint a receiver and manager, and the charge then "crystallises" and attaches to all of the assets then in the company.

3 The Cork Committee, which heard, and to an extent shared, expressions of general disquiet about the extent of recoveries by secured lenders, and the generally small if not negligible return to the unsecured, concluded that the nature of the floating charge should not be interfered with because of "the one aspect... which we believe to have been of outstanding benefit to the general public and to society as a whole; we refer to the power to appoint a receiver and manager of the whole property and undertaking of the company... In some cases [receivers and managers] have been able to restore an ailing enterprise to profitability, and to return it to its former owners. In others, they have been able to dispose of the whole or part of the business as a going concern... None of these steps is possible in the absence of a floating charge". (Technically a liquidator may continue to trade, but in practice this is rarely possible.)

4 Receivership has frequently made it possible to take the firm grip of a business that is needed to restore it to viability, but the suggestion has been increasingly made recently that provision for a somewhat more flexible approach would bring advantage. While the receiver is often able to ensure the continuance of businesses, his overriding responsibility is to discharge the debt secured by the floating charge. This almost invariably involves sale of the underlying businesses, often over a short period. Some have argued that there should be available some means of permitting companies to reorganise themselves in circumstances in which they would otherwise be put into receivership and their businesses disposed of; in effect, that a middle course should be available that does not involve so traumatic a discontinuity as receivership. In recognition of this case, the Cork Report proposed that provision should be made for recourse to the courts which would be able, in certain specified cases, to appoint an administrator; this might, inter alia, make

voluntary arrangements more readily achievable. The report does not, however, envisage that an administrator would be appointed without the consent of the debenture holder where a floating charge existed. Since there will frequently be a floating charge in the case of a company in serious difficulty - excepting in the case of larger companies which are usually able to borrow unsecured, the restriction of the Administration proposal to cases where there is either no debenture or where the debenture holder is ready to waive, for the time being, his right to appoint a receiver, implies that despite its obvious attraction, it would not represent a generally available alternative to receivership. It should be added here that whereas Section 206 of the Companies Act 1948 offers the possibility on certain terms and conditions of company reorganisation, the timing problems involved in agreeing the necessary scheme of arrangement with all classes of creditors have rendered these provisions almost completely unusable for this purpose; implicit in the Cork Committee's Administrator proposal is the possibility that greater use might be made of Section 206, but again the extent in which this is possible will depend on the attitude of the debenture-holder.

5 In this situation, the possibilities open to US companies under Chapter 11 may be seen as having some attractions to managements of companies in difficulty. These procedures, described below in detail, provide for a stay of creditor pressure during which time a reorganisation of the company can be agreed, with the various claims on the old company being transformed into different types of claim on the new one. Management may often remain in place, subject to a degree of supervision by creditors and the court, and the process often enables unsecured creditors and shareholders to exercise considerable influence and, despite their junior positions, to emerge with at least some interest in the reorganised company. But while such features may seem attractive, Chapter 11 procedures are in practice found to be complex, not least because of the need for relatively detailed involvement on the part of the courts; and given that Chapter 11 provisions in their present form have been in place for only four years, it is still too early to assess their impact on creditor attitudes and lending practices, a critical element in assessment of proposals in this area. But while it is hard to imagine wholesale adoption of Chapter 11 procedures into the UK

system, there may well be specific features of emerging US practice that might be seen as ways of improving the capacity of the UK mechanisms for dealing with a company in difficulty and for ensuring more effective involvement of unsecured creditors and shareholders. This question is addressed further in the final section of this paper: the following sections provide, for convenience, a brief summary of main elements in the familiar UK system and then a fuller account of the Chapter 11 mechanism.

RECEIVERSHIP

6 A receiver and manager is usually appointed by the holder of the floating charge under the terms of his deed; a floating charge is commonly granted as security for bank lending, and typically the appointment of a receiver will be by the bank. Such an appointment does not require application to the court; all the bank need do, when it is clear that the company cannot meet its indebtedness, is to give the receiver a document of appointment. The receiver will usually be empowered by the document creating the floating charge to take custody of the property of the company: if, as usually happens, he is appointed manager as well, he may continue the business, borrowing money on the security of the assets, dealing in or disposing of the assets, and generally taking such actions as he determines to be in the interest of those appointing him. The main specific task of the receiver, however, is to satisfy the claims of the creditor by whom he was appointed, and in practice this means that, having first settled preferential debts (crown claims, wages etc), his primary duty is to pay out the claim of the debenture holder. Once this claim is satisfied, any remaining assets will be paid over to the company - or more probably to the liquidator if winding up proceedings have been commended. Winding-up is a separate exercise from the receivership, but is held in abeyance while the receivership proceeds. In recent years it has become more common for the receiver to have used substantially all of the assets in fulfilling his obligations to the debenture holder, liquidation tends to be a fairly routine exercise.

7 It is not surprising, therefore, that one of the common criticisms of the receivership mechanism relates to the low level of distributions available to the unsecured creditors. Such concerns may be seen as arising more from the nature of the floating charge, or from the extent of preferential debt generally, than from the typical conduct of a receivership; though it is clear that the receiver's main and overriding duty is to the holder of the floating charge and, while he occupies a position as agent of the company, he looks to the debenture for his authority. The Cork Committee recommended some improvement in the position of unsecured creditors, in particular by suggesting restrictive abandonment of Crown preference and the entitlement, as of right, of unsecured creditors to 10% of all the proceeds of the floating charge. But while the Committee suggested* that the fiduciar nature of the receiver's position should be clarified, they concluded that any attempt to widen his formal accountability to extend to unsecured creditors would make the conduct of a receivership more complex yet without significantly affecting the outcome.

8 Apart from the undoubted effectiveness of receivership in ensuring the continuance of basically viable businesses, the availability of floating charges giving the power to appoint a receiver means that the banks, as principal holders of floating charges, are more willing to continue support for companies in financial difficulty than if the form of security charges were not available. It follows that the perceived benefit of any trammelling of the position of the debenture holder with the object of easing the position of the company, unsecured creditors or shareholders, needs to be assessed side-by-side with the potential cost or disadvantage of a diminution of lender support at an earlier stage, which could in some cases mean that moves toward start earlier.

THE CHAPTER 11 PROCESS

9 It is a long-standing premise of American bankruptcy law that it will, as a general rule, be desirable to encourage company reorganisation as an alternative to liquidation, on the basis that such reorganisation will be likely to preserve business assets and employment, and should also benefit creditors and stockholders.

* Ibid paras 453-4

Background

10 The present Chapter 11*, enacted in 1978, represents a consolidation of three former business rehabilitation Chapters, which date back to 1898. They were:

(a) Chapter X, which was designed to permit a thorough investigation and reorganisation of a larger corporation. Administration in these cases was time-consuming and complicated, and management was invariably replaced by an independent trustee, who operated the business pending the outcome of the case. The plan for reorganisation, which was formulated by the trustee, had to be evaluated by the court and the SEC.

(b) Chapter XI, which was available to individuals and partnerships as well as to corporations. It was less formal than Chapter X, and allowed management to operate the business as "debtor-in-possession". Chapter XI effected an extension or reduction of unsecured debt only: secured creditors could be affected only by negotiation. Chapter XI did not provide for the discharge of all unsecured indebtedness.

(c) Chapter XII, which provided for real property arrangements; it had much of the flexibility of Chapter XI and some of the formality of Chapter X. There were some difficulties with this section in that a lender could have his interest reduced to the value of the security without becoming also an unsecured creditor for the remainder, thus making the section a windfall for the debtor at a time of property price rises.

11 There were major divergences between the financial standards applied in Chapter XI and Chapter X cases. Chapter X was governed by an absolute priority rule, whereby senior creditors had to be satisfied before junior creditors realised anything. The rule required a going-concern valuation of the business to determine the worth of new securities issued under the plan: the court made the assessment, often with some understandable difficulty. On the other hand, in Chapter XI the standard was "best interests of creditors" - which meant only that if a class of creditor received at least as much they could expect in a liquidation, more junior classes could participate in the reorganised company.

*Arabic numerals distinguish the present Chapter 11 from its predecessors.

12 There were a number of procedural problems with Chapter XI cases:

(a) Creditors were unable to compel a Chapter XI case, which could be opened by voluntary petition only.

(b) The debtor had an exclusive right to prepare a plan, and to threaten, if creditors refused to accept it, to go directly into liquidation.

(c) There were no formal investigative processes.

As a result of these inadequacies in Chapter XI, there was invariably litigation over the appropriate route to follow - management of the company would try to go for Chapter XI, while the SEC and some creditors tended to seek Chapter X. Delays were inevitable, and damaging to the company and to the creditors. The present Chapter 11 incorporates features of all the previous reorganisation Chapters and has eliminated some of the more obvious deficiencies.

Framework of a Chapter 11 case

13 Whereas the legal framework in Chapter 11 cases can readily be described, to a very large extent reorganisation plans emerge as a result of negotiation and litigation. For example, secured creditors can in theory argue for their claims to be fully dealt with before any payment is made to a lower-ranking creditor (the "absolute priority" rule): in practice, however, the unsecured creditors and even the stockholders have the capacity to threaten to delay the approval of any reorganisation plan unless they are allowed a share in the interests in the reorganised company. Moreover, the allowed extent of any secured claim will depend upon the value assigned to the collateral, a matter which, when not determined by the courts, is for negotiation between the parties.

14 In broad outline, a Chapter 11 case goes through the following stages:

(a) Filing: a business under intense creditor pressure may file for protection under Chapter 11 as an alternative to filing for straight bankruptcy and liquidation under Chapter 7. Alternatively, creditors may petition on the debtor's behalf in the form of an "involuntary petition".

(b) Protection: immediately upon filing under Chapter 11, the debtor has protection from collection efforts by both secured and unsecured creditors.

(c) Debtor continues to manage: the business will, unless the court orders otherwise, remain under the control of the existing management, who will be empowered to run the business and to raise credit on priority terms. At the petition of the creditors or other interested parties, the court may, however, appoint a trustee to run the business instead: usually this happens where there is evidence of fraud or mismanagement. Where there is any doubt, the court may appoint an examiner to investigate the debtor's conduct of the business.

(d) Creditors' committee: soon after commencement of a Chapter 11 case, an unsecured creditors' committee is appointed by the court; other committees, such as an equity holders' committee, may also be appointed. The committees play an important part in negotiating with the debtor (or the trustee), and in the preparation of the reorganisation plan.

(e) Preparation of a reorganisation plan: usually within 120 days of a Chapter 11 petition, the debtor (or trustee) must present to all creditors a plan for the reorganisation of the business. This will provide for the continuation of the business and for the conversion of old claims into claims on the new business having regard to priority.

(f) Confirmation of a reorganisation plan: the court will confirm a plan if it is prepared in accordance with the principles laid down in the Act - adequate disclosure, good faith, consideration of "best financial interests" of creditors of each class, etc - and if it is accepted by all classes of creditor. If certain classes of creditor object, the court may still confirm the plan provided that its treatment of the dissenting creditors is "fair and equitable", or if the class is "unimpaired".

(g) Implementation of the plan: the debtor company, discharged from his former debts, is then obliged to implement the plan, and to discharge the new and converted debts in the manner set out in the plan. If conditions deteriorate and he is unable to do this, he will have to return to the court and seek a modification of the plan which will have to be approved by all the committees of creditors. If all goes well, the new corporation will emerge from the jurisdiction of the court in its reorganised form.

15 The main elements of a Chapter 11 case are:

(a) Survival: if the company is viable, and no fraud is involved, the debtor will usually be able to deal with the assets of the company, to put forward a reorganisation plan which will in effect compress the liabilities into a form which is appropriate to the new going-concern valuation of the assets.

(b) Speed: the new law makes possible very rapid reorganisation. Congress was acutely aware of cases where the corporate patient died on the operating table while lawyers - notably those of the SEC - wrangled over the terms of disclosure. In the latest Chapter 11, the role of the SEC is only advisory.

(c) Disclosure: the debtor is under an obligation to keep the court informed. The plan when put to creditors has to be accompanied by a disclosure document and approved by the court. Where there is an issue of new securities under the plan, disclosure has to be virtually to prospectus standard.

(d) Fairness: whenever possible, Chapter 11 preserves a secured lender's interest, though it limits it to the value of his security, as agreed by the court, and treats the balance of his loan as unsecured. This, and the capacity of the unsecured lender to introduce delay and threaten litigation, makes it likely that a final plan will have regard to the interests of all parties, and not just the secured lenders.

Events before a petition

16 Although Chapter 11 has substantial attractions to a financially-embarrassed company, it is by no means the route which will be automatically chosen to deal with creditor pressure. Companies will prefer to avoid resort to the bankruptcy courts, which necessarily confer a certain stigma; when financial pressures mount, the natural preference will be to negotiate voluntary arrangements with creditors. Creditors and lenders may also see merit in pursuing voluntary arrangements. Some companies, especially those selling goods where a continuing flow of spare parts is necessary (eg cars, agricultural machinery etc), are bound to suffer to some extent in the market-place from the initiation of formal bankruptcy proceedings. Very often a voluntary arrangement will have been attempted before Chapter 11 proceedings are commenced: and there can be significant advantages to all parties entering a Chapter 11 filing if a voluntary arrangement has previously been pursued. For example, if a plan put to creditors in the out-of-court period conforms to Chapter 11 standards of discrimination and disclosure, acceptance of it by a class of creditors may bind that class to accept a similar arrangement proposed under Chapter 11. Similarly, a committee of creditors convened informally in the pre-petition stage, may become the official committee of creditors if the court regards it as "fairly chosen". Lawyers emphasise the need to observe in voluntary arrangements as much as possible of the form of a Chapter 11 case.

17 But in many cases there will be significant advantages to be gained from entering into a Chapter 11 proceeding. From the point of view of the debtor company, onerous contracts can be avoided, preferences and prior set-off by banks of cash against borrowing are recaptured, and a plan is worked out that affects all lenders, not just those with whom the company has traditionally worked closely. Debt collection efforts are stayed, and a breathing space gained. The banks may welcome a Chapter 11 filing because of the opportunity it offers to involve all classes of creditor in the reorganisation: a voluntary deal, because of its closed nature, usually puts most of the burden onto the banks, with the other creditors being dealt with bilaterally or not at all. Chapter 11 proceedings also enable all claims on the company to be identified; they remove the danger, always present in a voluntary arrangement, of claims arising unexpectedly, for example from litigation.

Filing for Chapter 11

18 There is no obvious point at which a company must file under the bankruptcy code. US law does not appear to contain provisions directly analogous to Section 332 of the Companies Act 1948, which seeks to prevent continued trading by a company which has no prospect of paying its debts; neither is there anything similar to the more objective "wrongful trading" provision of the kind proposed by the Cork Report. To the extent that management of a company does feel itself under pressure to file for Chapter 11, this is likely to arise, first, from an inability to meet the demands of its creditors and, second, from a fear of stockholder suits alleging that the management acted imprudently in allowing continued wastage of the assets*.

19 In the final analysis, the decision to file for Chapter 11 protection will be taken when the company and its advisers conclude that a better prospect of continuation lies within a formal reorganisation than in a voluntary arrangement. In part the decision will be influenced by the need to raise working capital: bank set-off and other preferences can be reversed on filing, cash collateral

---

*There may, however, well be stockholder suits if management are thought to have filed for Chapter 11 too early.

obilised and new loans taken on a priority basis. For the remainder, the general attitude of the banks and the extent of creditor pressure is likely to be the major spur. But while most petitions for Chapter 11 are lodged by debtors, it is also possible for creditors to file an "involuntary petition" on behalf of the debtor. In the latter case, at least three creditors with unsecured claims of $5,000 or more must join in the action: they need to be capable of showing that the debtor is "generally not paying debts as they become due".

20 The opening of a Chapter 11 case gives a debtor automatic stay on collection efforts by creditors, suspends interest payments and enables him to continue to trade using cash collateral and new borrowings, which are accorded priority. Given that this may involve a continued erosion in the value of the business, an early consideration for the creditors, faced with a Chapter 11 petition, is to decide whether to apply to the courts for a conversion to straight liquidation under Chapter 7. If the liquidation value is greater than the going concern value (allowing for the value of tax losses carried forward), they will probably do so. But the key to deciding this issue will be the potential viability of the company, which is in essence a matter for the court to decide, based on the information provided by the debtor (listing of claims, statement of affairs etc) on filing. If potential viability can be established - in the sense that the trading assets of the company are capable of earning a pre-interest return sufficient to service the level of debt likely to prevail after conclusion of the case - the court is unlikely to accede to a request for conversion into Chapter 7.

21 It should be noted that Chapter 7 does not provide, as receivership in the UK does, for continued trading: this part of the bankruptcy code requires, in general, a rapid disposal of the company's assets at break-up value.

Continued management control

22 It is the rule rather than the exception that in a Chapter 11 case the existing management will continue to operate the business. The debtor effectively acquires a new legal identity as "debtor-in-

possession" and is responsible (initially at least) for the preparation of a rehabilitation plan. Bankruptcy law makes provision for the debtor to be replaced in certain circumstances, and on application of a "party in interest" - a creditor, an equity holder or anyone else with an interest in the case - the court may appoint a trustee:

(a) "For cause" - including fraud, dishonesty, incompetence or gross mismanagement of the affairs of the debtor by current management; or

(b) If the appointment would in the view of the court be in the interest of the creditors, equity security holders or the estate.

The standards employed in determining the appropriateness of a trustee appointment are deliberately flexible, and the court has wide discretion. Congress has made it clear, however, both that it expects the court to allow continued trading by the debtor-in-possession wherever possible, and that the size of the business should not be a factor in the decision whether or not to appoint a trustee.

23 In fact there appears to be a general acceptance among the major US banks that it will often be more desirable to continue to back present management than to risk court appointment of a trustee, who may prove (and has quite often done so) to be little better than the outgoing management at running a complex business; and even when a trustee is fully competent, his capacity to master all of the detail of the business in a very short time is likely to be limited. In the United States, the banks and other creditors tend to feel that the weaknesses of existing management are at least a known quantity, and that the dangers of changing horses in mid-stream can be great. Moreover, it is not unusual for management to have been changed shortly before a Chapter 11 filing at the instance of the banks or other creditors. Often the lenders will have persuaded the company to bring in a turn-round specialist, of whom there are a number; the banks maintain short-lists of such individuals, who tend to be offered high salaries and incentive arrangements.

24 If a trustee is appointed, he will take over the management of the company and conduct the business during the reorganisation process. He will be accountable for all property received by the

estate, and will be required to examine claims and object to improper ones: it is his duty to furnish information to creditors, and to file reports with the courts and the taxing agencies. He is also responsible for filing the reorganisation plan or, if the circumstances do not appear to him to justify continuance, he may recommend conversion to Chapter 7.

Appointment of an examiner

25 As noted above, the present law seeks where possible to avoid the appointment of a trustee and to leave the debtor in possession of the estate. Where there is some doubt as to the appropriateness of the latter course, the courts may appoint an examiner. This will be particularly useful where the court is persuaded that the continuation of present management is essential to the survival of the business, but where some specific doubt exists as to their conduct. In these circumstances an examiner may be a helpful alternative to a trustee. The examiner will usually be an accountant, and in theory his role is purely investigative. He will examine the affairs of the company, and look into allegations such as fraud, irregularity or incompetence. He will file his findings with the court and with the other creditors. The examiner may also play a role in advising the bankruptcy judge on the merits of the reorganisation plan proposed by the debtor, and the judge may involve the examiner in functions that go beyond his narrow investigative role. In practice, however, the appointment of an examiner is infrequent. This is perhaps surprising, though it appears that the professional advisers employed by the creditors' committees (their fees are part of the expense of the administration of the case) may play much the same role.

Continuation of the business

26 Chapter 11 makes provision for the business of a company to be continued by the debtor-in-possession (or the trustee, if appointed), pending the negotiation of a reorganisation plan. No special court permission is needed for this to happen, and there are a number of ways in which continued operation is made easier:

(a) Automatic stay: the company will benefit from an automatic stay on the collection of debts or the enforcement of claims. This is an important benefit: a debtor effectively freezes all collection efforts by his creditors, and is able to administer the assets of the company free of such financial pressures.

(b) Rejection of burdensome contracts: the debtor can reject contracts previously entered into, and may avoid leases (whether as lessor or as lessee); any consequent liabilities will rank as unsecured creditors. This enables a company to put a cap on its obligations.

(c) Occupation of premises: the debtor may be in arrears on rent payments, but he may continue to occupy his premises if he cures the default or gives adequate assurance that he will do so.

(d) Use or sale of property: obviously the continuation of the business will require the debtor-in-possession or trustee to have continued use of the assets; it may also require him to deal in, or dispose of, some of the assets. For so long as his transactions in assets are in the ordinary course of business, the debtor can act without reference to the court. As a general rule, he may buy or sell assets, collect and pay cash, and freely enter into contracts. With the approval of the court he may also enter into contracts not in the ordinary course of business.

(e) Use of collateral: subject to providing adequate protection for the secured lenders, the debtor may make use of collateralised assets including (most importantly) cash collateral.

(f) Reclaim of preferences: the debtor may seek the return of payments made within 90 days of the filing; there will be a presumption that during that period he was insolvent unless it can be shown that he was not. Set-off by a bank of cash against debt can also be reversed if the net improvement in the position of the bank was greater than could have been achieved on the ninetieth day prior to filing. The preference recovery period can be extended to one year if the debtor can show that the recipient of the preference enjoyed actual or de facto control of the debtor. It is not normally difficult for a bank to be deemed to be in this position; even if there is no common directorship, the bank may have sought to persuade the company to change management, which may be regarded as tantamount to the exercise of control.

(g) Additional borrowing: within limits agreed with the court, the debtor may borrow additional unsecured funds. Such borrowings rank alongside the administrative expenses of the case, having a priority on the unencumbered assets.

27 In permitting a company to deal in collateralised assets, the bankruptcy code offers a degree of protection to secured creditors.* First, to the extent that the value of physical assets deteriorates as the result of the debtor's continued use or consumption of them, the secured lender may be granted super-priority - ie, a claim on the unencumbered assets ranking ahead of all other claims. (If the secured lender can show that the debtor does not need the collateral in the running of his business, or if adequate protection against depreciation or consumption cannot be provided, the court may grant relief from the automatic stay.) The court will allow the debtor to use cash collateral - almost always essential to continued trading - only if the bank obtains the "indubitable equivalent" by way of substitute security. It is relevant, however, that the banks tend to complain that it is seldom possible to provide the indubitable equivalent of cash.

Committee of creditors

28 Soon after the case is commenced, an official meeting of creditors will be held in court. The debtor is obliged to attend and to submit to examination. He will already have filed with the court a statement of his affairs, and this gathering provides him with the opportunity to discuss the likely shape of the reorganisation plan, and the immediate implications of continued trading. The court is obliged to appoint a committee of unsecured creditors "as soon as practicable" after an order for Chapter 11 relief. Usually, the creditors with the seven largest claims will be appointed, where willing to serve. There will often be banks represented, and this is welcomed by the debtor and other creditors as the banks will be seen as a source of further finance for the

---

*In the United States bank lending tends to be subject to fewer security requirements than is the case in the United Kingdom. The great majority of lending to companies is unsecured, and companies tend to resist giving liens and other forms of security. It is clear, though, that many companies in serious difficulties have often given security nearly as comprehensive as that obtained by a UK bank. For example, under the uniform commercial code a general lien may be given which, in effect, gives security over present and future assets of the company in a way not dissimilar to a floating charge. Liens or mortgages may be taken over fixed and current assets; and a lien over receivables would extent to cash realised thereafter. Thus when a company enters Chapter 11 it may well, in one way or another, have pledged a very large proportion of its assets as security. In general, however, it seems fair to say that the extent of security will be generally less than in the UK and that companies' resistance to granting it will be greater.

company to enable it to continue to trade. Committee members are, however, required to sit in a representative capacity, and have fiduciary obligations to other creditors: they cannot represent only their own interests.

29 The committees serve important functions; with the assistance of accountants and lawyers (whose remuneration is met by the debtor, but whose appointment must be sanctioned by the court) they gather information about the company, and assist and supervise the debtor in the conduct of his business. The committees will negotiate with the debtor, with each other and with the secured lenders (who are not usually members of a committee) about the content of the reorganisation plan, and if the debtor's plan is unacceptable, the committee has the right to file one of its own.

The reorganisation plan

30 The main purpose of the Chapter 11 procedure is that the debtor should file a plan of reorganisation which, on acceptance by the parties judged to have an interest in the case - the creditors and, if there are sufficient assets, the shareholders - will result in the re-emergence of the company as a viable entity. The plan will include both the management's strategy for restoring the company to viability, and the financial arrangements for dealing with the various classes of creditor: at its simplest, this involves taking those assets which can form the basis for a viable business and re-writing the liabilities side of the balance sheet to match, compressing the claims or converting them into new or different types of interest.

31 The process by which a plan emerges is far from straightforward. In theory a debtor has, for the first 120 days, the exclusive right to file a plan; if this plan has not been confirmed by the court within the first 180 days,* the creditors have the right to put forward a plan of their own. In practice, the plan will be negotiated with the creditors from the start, and will reflect the outcome of approaches to court by creditors to determine the value of their security interests.

---

*In practice the courts are usually prepared to extend this period to at least a year.

32 In theory, the plan may contain anything that does not conflict with the bankruptcy code. It may alter the rights of any class of creditor; it may reduce the amount of each claim, or extend maturities; the collateral of secured creditors may be replaced; and contracts or unexpired leases may be disclaimed (if this has not already been done). The court requires that the plan should be feasible, and that it should provide adequate means for its own execution. The court also imposes disclosure requirements (described below), and will have to be satisfied with the quality of the management of the reorganised company. The plan must also be in the "best financial interests" of the creditors of each class - specifically, the present value of what they obtain from the plan must be better than their likely proceeds from an immediate liquidation.

33 Normally the plan needs to be accepted by a positive vote of each class of creditor: a vote of two-thirds in value and one-half by number of claims is sufficient to bind a class to accept. But the court may deem a class of creditor to have accepted notwithstanding a negative vote. If a class of creditor is judged to be "unimpaired" under the plan, or if, despite impairment, the plan is "fair and equitable", the court may confirm the plan over the objections of one or more classes of creditors. This process is described as "cramdown".

34 The expressions "unimpaired" and "fair and equitable" are of course terms of art. A lender may be judged unimpaired by the plan if he receives cash or securities in the new company up to the value of his allowed claim; he does not have to be fully repaid, but only fully compensated in the terms of the plan. The creditor may argue that the value of the securities given to him in exchange for his old claim is uncertain; but if the court has accepted the valuation in the plan, there is nothing that he can do. Similarly, a secured creditor will be regarded as unimpaired for so long as he receives security (or maintains his old security) equal to the value of his former collateral; for the rest of his claim, he need receive only cash and securities in the new company in the same way as an unsecured creditor. It is important to note that secured lenders are not regarded as secured to the full extent of their claim, but rather for the value of their collateral as determined by the

court. Thus a loan of $1,000 secured on a rail-car, originally worth $1,000 but now worth only $800, translates into a secured loan for $800 and an unsecured claim for $200. Valuation of collateral is thus a very important part of the Chapter 11 case; and the same assets may need to be valued at different times for different purposes.

35 A lender may be judged impaired by the plan, but the plan may nonetheless be deemed "fair and equitable" and thus confirmed over his objection. In this sense, to be "fair and equitable" a plan must pay regard to a rule of absolute priority: ie, no junior creditor should receive any payment until the claims of more senior creditors have been fully satisfied.

36 In practice, the process of creditor dynamics often makes the absolute priority rule redundant. The law provides a framework and a discipline, but the relative strengths of the creditors require negotiation, and the outcome will be based on a concept of relative priority. In theory, a secured or senior creditor could insist on receiving a full payout before a junior creditor received anything under the plan; but he will probably see a speedy settlement as the more important consideration. The unsecured creditors, public security holders and equity holders can introduce significant delays to the Chapter 11 process if they choose to do so. Litigation can be protracted, and the secured bank lender will be acutely conscious of the cost of delay - the "time value of money". To prevent delay the banks will often agree to allow the unsecured creditor a greater share in the reorganised company than that for which the law strictly provides, and may equally permit a participation by the old equity holders, even where in theory their interest is eliminated.

37 Thus the reorganisation plan will give the secured lender a secured interest in the new company (or cash) up to the present value, as determined by the court, of his old security. The unsecured creditor, and the secured lender in respect of the element of his loan not covered by collateral as valued by the court, will receive a combination of cash, securities and equity in the reorganised company. The former equity holders may be allowed a small equity interest also. The net effect of all this is to spread the interests in the reorganised company far more widely than would be

the case in a regime that adhered to the rule of absolute priority, while paying some attention to the value of the claims of secured lenders.

Disclosure

38 An important concern of the Bankruptcy Act is to ensure that the Chapter 11 procedure is suitably transparent and that all parties with an interest should have adequate information about the debtor and about the plan.

39 The law requires that the plan must be accompanied by a disclosure statement which must contain "adequate information". The definition of "adequate information" is fairly flexible: "of a kind that would enable a hypothetical reasonable investor typical of holders of claims of interest of the relevant class to make an informed judgment about the plan". The court will tend to recognise that financially-troubled debtors often have inadequate information, and certified audited financial statements or reconstructed books and records may not be required if the cost and inconvenience outweighs the need. The amount of disclosure required may be different for each class of creditor, and will depend on the sophistication of the creditors concerned and their ability to obtain information from other sources. Each disclosure statement, however, has to be approved by the court.

Public security holders

40 The Bankruptcy Act provides for a large number of "parties in interest" to be heard by the court, even where they have no direct interest. The SEC is one such. Under previous law, the SEC had an even bigger role, in that under Chapter X they had to approve the plan. Now participation by the commission is not mandatory, and the SEC has no more than the right to be heard. The disclosure statement described above does not need to meet the Securities Acts requirements, though in cases involving the restructuring of large public corporations, it is likely that the SEC will play an active role in the disclosure statement hearing. However, the SEC cannot appeal from any order approving the disclosure statement.

41 The role of the SEC is to protect the interests of holders of securities, especially bonds. Although the public debt almost always ranks below the secured debt, the courts are likely to take a sympathetic attitude to the holder in a reorganisation, and this, combined with the capacity of security-holders to delay proceedings, often results in a more generous settlement. There is a thriving market in "busted bonds", and some speculators have been able to buy a sufficiently large proportion of an issue to secure appointment to a committee of creditors where they have an even better chance of obtaining a participation in the reorganised company.

THE IMPACT OF CHAPTER 11

42 It would be misleading to suggest that the Chapter 11 procedures outlined above can of themselves be expected to preserve more viable business assets than a receivership under the UK system. Although the former approach is directed towards rehabilitation, and the latter nominally based on a "selling-up" philosophy, in many respects the practical differences from the point of view of the business are not great. Both systems, after all, can be expected to preserve, no more than those parts of a business which are judged viable.

43 But Chapter 11 procedures differ from receivership in a number of ways which US practitioners, at least, regard as generally helpful. The main ones are:

(a) Chapter 11 is seen as offering a "second chance" to management. An underlying principle of US legislation, and one reinforced by the Bankruptcy Reform Act of 1978, is that existing management should wherever possible have the opportunity to remain in control of their business, and to formulate a reorganisation plan. The debtor has exclusive rights to prepare and negotiate such a plan for the first six months after petition, and the courts may extend this period. This does not mean that weak, incompetent or fraudulent management remain in control; the court has discretion to appoint a trustee in such cases, or an examiner when there is doubt, and more often than not top management is replaced either shortly before or shortly after a Chapter 11 filing. The banks seem quite comfortable with the concept of a debtor-in-possession; they accept the need for a degree of continuity, especially in high-technology industries or in industry subject to fashion trends.

(b) Chapter 11 may make possible a more equitable participation in the conduct of a bankruptcy case than is possible where a receiver is appointed under a floating charge. In the American system, unsecured creditors will be represented by a committee which has substantial investigatory (and delaying) powers; and the court may also appoint a committee of shareholders.

(c) The secured lender has less influence on the course of a Chapter 11 proceeding than on a receivership in the UK. The court will regard his secured interest as amounting to no more than the value of his security, and will treat the remainder of his claim as unsecured. Thus, in a reorganisation plan he will be regarded as "unimpaired" if he receives a secured interest with a present value equal to the value of his security, and an unsecured interest for the balance.

(d) Conversely, the unsecured creditor and the shareholder not only participate in the Chapter 11 process but may come out of the reorganisation in a rather better position than under a receivership. To an extent this reflects their power to intervene in the court process; the secured lenders are forced, in the interest of a speedy settlement, to deal realistically with the unsecured. Furthermore, there is less pressure to realise the whole of the business in a short time. On occasion, sales by a UK receiver may be depressed to some degree by a forced sale factor.

44 It is however fair to say that not all of these features are generally regarded as desirable. The capacity of the unsecured creditor - and in particular of the public bond holder - to influence the outcome of a Chapter 11 case is arguably excessive. Many banks regard Chapter 11 as inequitable in that their security interests can too easily be compromised, and feel that this, together with the power of the unsecured creditor to initiate or at least threaten protracted litigation, has substantially reduced the backing for some of their lending to troubled comanies. This, they feel, could in time influence their willingness to provide finance in many difficult cases, and perhaps precipitate more insolvencies.

45 These concerns are of course in part a reflection of the US legal system. The capacity and willingness of individuals in the United States to turn to litigation is much greater than in this country, and lawyers play a much larger part in business life - and

in insolvency cases - than is the case here. In contrast, accountants, who play so large a role in the UK insolvency system, play a comparatively subordinate role in the United States. The courts themselves are often seen by the banks, at least, as overly sympathetic to the debtor and to the unsecured creditor, and liable to impose unfair burdens on secured bank lenders. While such criticisms are perhaps inevitable, it seems clear that in Chapter 11 cases the courts are frequently asked to pass judgment on extremely difficult and complex questions with which they are not invariably well-equipped to cope.

46 An inevitable result of the process described above is to make company reorganisation substantially more expensive than is the case in the UK. In the place of the receiver, with his capacity quickly and effectively to sell assets and to close unviable operations, is substituted a range of committees, lawyers and court officials, whose fees can in some cases, eventually account for a significant proportion of the earning capacity of the company being reorganised.

RELEVANCE FOR THE UK: A PRELIMINARY ASSESSMENT

47 In the case of an insolvent company of which at least some parts are potentially viable, the principal difference between the US and UK systems is that the former is geared to a restructuring within the existing corporate framework; whereas in a UK receivership, individual assets or businesses will be sold off, where possible on a going concern basis, out of the shell of the insolvent company. There will almost inevitably be differences of view - especially after the event - as to the optimal means of handling an individual case but, from the standpoint of efficient resource allocation, there is no particular presumption in favour of keeping potentially viable but immediately insolvent businesses going within one particular corporate structure or ownership rather than any other. In other words, the resource allocation criterion is probably neutral as between the Chapter 11 procedure and receivership as practised in the UK, and further assessment of the potential relevance of the former in the UK environment turns on the two related considerations of relative effectiveness and equity.

48 An appraisal of degrees of effectiveness must take account of the likely impact on creditor and shareholder behaviour on the availability of a court process which could override for a period the rights of the holder of the floating charge to appoint a receiver and manager, as well as freezing the position of unsecured creditors. This would necessarily imply a diminution in the powers of the debenture holder and affect the degree and continuity of creditor support for problem companies (to the extent that such support depends on an unquestioned ability to enforce security) with the result that bankers might adopt a more restrictive stance at an earlier stage than at present. In some cases this might be damaging but, in others, the earlier application of effective pressure on the management of a problem company whose business is sliding could offer substantial benefit: there is may be some tendency for the existence of comprehensive security to weaken the attention given by a bank to regular monitoring of the position of a customer. With respect to shareholder attitudes, it seems possible that the ability of a secured bank creditor to appoint a receiver makes for less shareholder readiness to support a capital reconstruction for a problem company than would be the case if greater emphasis were placed on maintaining the existing corporate and shareholder structure. On the other hand, risk capital may be available more readily to support individual businesses that are carved by the receiver out of an insolvent corporate shell than for restructuring of an existing insolvent company.

49 There are thus considerations both ways with respect to likely creditor and shareholder responses to a move toward a Chapter 11 procedure in the UK, but there is no strong balance of argument on this score that would point to any material change in UK law and practice unless it were justified on other grounds. A further factor bearing on the relative effectiveness of the Chapter 11 procedure is that it commonly, though not invariably, leaves existing management in place. Although it would seem odd to many familiar with the British system to leave in post the management that presided over the decline of a company into insolvency, it should be borne in mind that in most Chapter 11 cases the management will have been changed substantially

Chapter 11 cases the management will have been changed substantially as a result of creditor pressure when the financial difficulties first became acute; indeed a Chapter 11 filing may be the means by which a reorganisation plan devised and negotiated by a new management is implemented. Where the preferred course encompasses the break up of the company or its sale as a going concern there is no question of the effectiveness of the receiver, who is in practice often acts in consultation with former management but the principal responsibility of the receiver is to realise assets, albeit where possible on a going concern basis, primarily with a view to satisfying the claims of secured creditors. There may be cases in which this obligation, coupled with the inevitable complexity of some companies, involves a shortening of perspective and some arbitrariness in the decision-taking process which may lead to an outcome inferior to what might have been achieved by the existing management had they been allowed to continue under a regime that combined an appropriate degree of protection and direction from the court. There are thus here also arguments both ways, but, in particular against the recent record of receiverships in keeping businesses going - the so-called constructive receiverships - the case for avoiding undue discontinuity in the corporate structure would not itself appear to justify a significant move in the direction of Chapter 11 procedure.

50 Concerns about the fairness of receivership tend to focus on the position of the unsecured creditor, who has no part in the decision to appoint a receiver and whose claims will be met only after those of preferential and secured creditors have been satisfied. It was with these concerns in mind that the Cork Report suggested a statutory provision for appropriating a proportion of the realisations under a floating charge for the benefit of the unsecured creditors* but, whether or not this and related recommendations of the report are in due course adopted, the case for improving the position of the unsecured creditor would not of itself justify the significant reduction in the role and influence of the floating charge that would follow from incorporation into the British system of major elements of Chapter 11 procedure. It is also relevant there that the Chapter 11 procedures themselves involve a significant degree of contribution by the unsecured to any reorganisation plan, in the sense that they are likely to have to accept impairment of their claims on the company; this is

*Ibid, paragraphs 1538 et seq.

eldom the case when voluntary arrangements are negotiated in the UK, where the legal framework necessary to deal with large numbers of claimants - Section 206 - is largely unusable because of the absence of moratorium provisions.

51 The general conclusion to be drawn from this study is that there seems no general case for displacing the main lines of existing UK practice with Chapter 11 type procedures. But there are clearly lessons to be drawn from the latter. For the insolvent company, present UK arrangements offer no satisfactory facility for reorganisation short of receivership, and in particular no facility for dealing with the creditors as a body where a reorganisation within the existing corporate structure is contemplated. The administration proposal in the Cork Report might be seen as offering such a facility but, since an administrator could be appointed only where no floating charge had been given (or where, if there was such security, the debenture-holder had agreed), the cases for which it might be relevant are likely to be few; and it is not clear how the company is to be financed during the administration. But to go further than the present administrator proposal raises difficult questions: most critically, whether provision to override the powers of the debenture-holder would be either desirable or practicable.

52 If it were judged acceptable to override, even for only a limited period, the rights conferred by the floating charge, a range of reorganisation possibilities could be envisaged. A court-imposed moratorium on the collection of debts and enforcement of security could give time for an administrator, in conjunction with a company's management, to develop reorganisation proposals along with a financial reconstruction plan that could look for contributions from both unsecured and secured creditors, as well as from shareholders. The solution that emerged from this process, even if not very different from receivership in its treatment of the business assets, might be seen as more equitable in balancing the interests of the various creditors of the company, and generally as a less disruptive approach to the insolvent but potentially viable concern. But the continuation of trading during the moratorium period would require funding and involve, if the company were loss-making, a wastage of the assets.

In this sense, the severely practical question that remains is whether some limited moratorium affecting the right to petition for winding up, and to enforce security, could be devised which would leave creditors adequately protected in circumstances in which the value of the assets of a company is both uncertain and quite possibly diminishing.

Chief Secretary
Economic Secretary
MST(C)
MST(R)
Sir D. Wass
C&AG List
Mr Hall
Mr Ridley
Mr French
Mr Harris

Treasury Chambers, Parliament Street, SW1P 3AG

Chief Whip
Chief Whip's Office
12 Downing Street
LONDON
SW1

11 January 1983

Dear Michael

PARLIAMENTARY CONTROL OF EXPENDITURE (REFORM) BILL

We discussed on the telephone last week the handling of the briefing note for back-benchers, and I enclose a copy of the note.

Cabinet agreed on 16 December that colleagues should draw attention to the defects in the Bill, and the Chancellor intends to circulate the note to his Cabinet colleagues as an aide memoire.

In doing so he will want to advise them on how they should use the note. When we spoke you felt that it should not be issued to back-benchers before 17 January. This leaves very little time for our back-benchers to influence the sponsors of the Bill, or to generate opposition to the Bill at Second Reading. In the meanwhile it would be particularly valuable if a few of our own MPs, who are known to us to be willing to take a pro-Government position, could be briefed as soon as possible.

I shall be most grateful for your urgent advice on the handling of the note, including the advice which the Chancellor should give to colleagues on the use of the note, when he circulates it.

Yours ever
Nicholas

NICHOLAS RIDLEY

PARLIAMENTARY CONTROL OF EXPENDITURE (REFORM) BILL

This Bill is concerned with the functions and status of the Comptroller and Auditor General (C&AG).

The Public Accounts Committee, in its 1981 Report on the Role of the C&AG based its recommendations with regard to the range of functions of the C&AG on the principle that he should have right of access to the books and records of every body in receipt of money voted by Parliament. This would mean that the C&AG and his staff had right of entry and investigation into thousands of privately owned industrial, commercial and farming businesses, and large numbers of other bodies (such as denominational schools) which receive grants and loans (however small) from the Government.

In view of the many objections to giving the C&AG such widespread access the Bill may reject the PAC's principle and take a narrower and pragmatic view of the range of his duties. This would be welcome. But the Bill may provide for the C&AG to have access to the books and records of the nationalised industries, other public corporations, and companies mainly dependent on Government grants and loans. He would use that access to publicly question and criticise the decisions of management. This would not be in the interests of the undertakings or the tax payer.

Nationalised Industries

The Government has set a firm framework of control for the nationalised industries - three year financial targets, performance

aims, and external financing limits - and within this framework the industries have been encouraged to operate commercially. Competition is being increased wherever possible. The Monopolies and Mergers Commission and management consultants are helping to ensure that there is an external check on the industries' efficiency.

There is a long way to go to improve the efficiency of the industries. But to give the C&AG access to them would be a backward step, making the industries less commercial and more like Government departments.

For example British Telecom are finding it a painful process to develop from their origins as a Government department to a corporation trading in a commercial environment. Until it separated from the Post Office in 1980 it was not possible to measure the profitability of the various parts of BT. Decision making and accountability were highly centralised with combersome procedures and too much paper work.

The Government fully support BT's move away from these arrangements towards a more devolved and business-orientated organisation. The type of control appropriate to Government departments is not appropriat for the commercial operations of nationalised industries. But that is the direction in which the industries would be pushed if they were subject to constant scrutiny by the C&AG, leading to questioning by the PAC.

In those circumstances the industries would face detailed enquiries about their commercial decisions, eg on tariff levels and quality of service. This would tend to make them cautious and defensive. A commercial approach calls for speed of analysis and decision, and the willingness to take risks. It would be incompatible with that for the C&AG to watch constantly over managements' decisions.

It would be even more difficult to attract top quality people from the private sector into the industries. Good management would not accept that its decisions should be subject to constant outside supervision and retrospective criticism.

Relations between Parliament, Ministers and the industries would be confused. At present there is a clear line of responsibility from

the industries through Ministers to Parliament. However Parliament has always accepted that Ministers should not be held responsible for the day to day running of the industries.

If the C&AG, reporting directly to Parliament, was monitoring and reporting on the day to day activities of the industries this would cut across the existing line of responsibility. The danger would be that the Government would be drawn into accepting responsibility to Parliament for the detailed management of the industries. In that case departments would need more staff, and the industries would have yet another layer of supervision imposed upon them.

Access for the C&AG, together with increased Parliamentary scrutiny, of their commercial operations, would create a situation in which it was much more difficult to privatise the industries.

The C&AG and his staff do not have the expertise to carry out a proper scrutiny into the efficiency of the industries. The Monopolies and Mergers Commission, which already carries out this function under a Competition Act 1980, is better suited to the task because of its commercial outlook.

Companies

If the Bill gives the C&AG access to the books and records of those companies in which the Government has a major stake the commercial performance of those companies and the value of the country's investment in them might well suffer. Rolls Royce and BL (and Shorts and Harland and Wolff) operate in a fiercely competitive market. Constant investigation and criticism by the C&AG would be bound to affect their management style, and it would be more difficult to attract top class executives. Cooperation with other companies would be more difficult. Overall, the commercial performance of the companies would suffer.

Also, inward investment could be discouraged if the C&AG is given access to the books and records of British subsidiaries of foreign corporations which are predemoninately funded by the government. Foreign companies investing in the UK would be concerned about the public disclosure and questioning of their commercial policy and

day to day operations.

The Independence of the C&AG

With regard to the status of the C&AG, the Government believe that the Bill must maintain his complete independence from both the Executive and Parliament. The Government are willing to see the Exchequer and Audit Departments Acts amended so that it is clear that the C&AG is completely independent from the Executive, and the staff of the Exchequer and Audit Department would no longer be civil servants but employees of the C&AG.

It is equally important that the C&AG should be independent from Parliament. Of course he works closely with the PAC, and would normally accede to their requests for reports on particular subjects. But it would be very different if he was forced to carry out investigations on the instructions of the PAC or any other Select Committee.

There would then be a risk that he would be pushed into examining question of policy - an area he has always avoided - and the non political nature of his activities might be put at risk. In that case the whole nature of the C&AG's activities would be changed, and his current free access to departmental files would have to be reconsidered. The previous PAC (Session 1978-79) warned against the dangers of the C&AG being subject to direction.

The independent status of auditors is widely recognised. The C&AG should be independent to pursue proper audit objectives, and he should be the judge of where his staff can be used most efficiently.

NOTE OF A MEETING HELD AT H M TREASURY, 10.AM 28 JANUARY 1983

Present at meeting: Financial Secretary
The Hon Peter Brooke MP
Mr J Church (Moore, Stephens & Co)
Mr Moore (" ")
Mr Bryce/IR

CGT: NON DOMICILED RESIDENTS AND FOREIGN CURRENCY ACCOUNTS

The Financial Secretary invited Mr Church to open the discussion. Mr Church presented the Financial Secretary with Moore, Stephens and Co's memorandum on the subject, (copy attached).

Mr Church commented that a similar anomaly which resulted in CTT liability under S478 of ICTA 1970 was removed by S.45(5) FA 1981. The liability to CGT was now left as the only (yet obvious) anomaly. Also he found it very difficult to believe that the Revenue had actually made any computations of capital gains on foreign bank accounts belonging to non domiciled residents of the UK. Most of his clients were unaware of the potential liability.

Mr Bryce acknowledged the practial difficulties in making the computations, and the Revenue had a pragmatic approach to assessing the liability. However, in his opinion foreign residents were well aware of the provisions.

The Financial Secretary commented that he did have sympathy with the foreign resident over this. But it did really all hinge on where the bank account was deemed to be situated. Under our law the CGT code says that a foreign bank account is located in the country where the creditor is resident (whether domiciled or non domiciled). So a foreign deposit account belonging to a UK resident is deemed to be situated in the UK.

Mr Church contended that this definition of location was illogical for the non-domiciled resident who was caught by a peculiarity in the

UK law. Also it was unnecessary for the UK domiciled resident who would be taxed anyway.

The Financial Secretary feared that such a relaxation would give the non-domiciled UK resident dealing in currency speculation an advantage over his UK domiciled counterpart.

Mr Church discounted this fear: the professional speculator would anyway find ways round the present law, so the only person who suffered was the ordinary individual.

In summing up the discussion the Financial Secretary commented that the arguments for and against a change in this area were very finely balanced; but the Government would look at the situation again to see if anything should be done.

The meeting closed at 10.40am.

In discussion with the Financial Secretary after the meeting Mr Bryce agreed to send a further note with the Revenue's recommendations for future action with specific comments on:-

1) How far our CGT rules are out of step with the other provisions in the Taxes Acts

and 2) If the rules were changed for non UK domiciled residents whether there would be repercussions for the non resident trading in the UK (eg with a dollar deposit account in the UK).

E KWIECINSKI

Circulation:

PS/Chancellor
PS/MST(R)
Mr Robson
Mr French
Mr Bryce/IR

MATTERS TO BE RAISED WITH THE FINANCIAL SECRETARY TO THE TREASURY ON FRIDAY JANUARY 28 1983

1. GENERAL

The Revenue have consistently over the past months made the point that the rules regarding capital gains or losses on the holding of foreign currency bank accounts by non-domiciled residents of the United Kingdom are well understood and have been so understood since 1965, but this is not the case as is evidenced by correspondence between the Law Society and the Inland Revenue in 1981. Moreover, at a recent high level European Study Seminar on November 25 1982 attended by a number of taxation specialists this particular question was put to the Panel, and none of the Panel had known of this regulation neither had those attending the Seminar.

There is a concern that a large number of people within the category of non-domiciled residents owning overseas currency accounts are unaware of their liability to return details of their profits and losses on exchange, bearing in mind that the rules apply for all withdrawals from a foreign currency account and not merely conversion of currency. For example, it would include the case where Dollars are withdrawn from a Dollar account for Dollar investment purposes. It would be interesting to know how many such computations have actually been made by non-domiciled and resident tax-payers.

Attached hereto is a hypothetical computation, and this indicates the complexity of the calculation.

The Revenue has said that the same difficulty arises whether a tax-payer is domiciled or non-domiciled, but as a practical matter even with the freeing of exchange control non-domiciled persons are much more likely to hold a number of foreign currency accounts than are domiciled people by the very nature of their intent to return to a place of residence outside the United Kingdom and the probability that they will be in receipt of income and capital in foreign currencies.

2. BASIS OF THE LAW

The liability to Capital Gains Tax apparently arises by reason of Section 18(4)(c) of C.G.T.A. 1979. Under this Sub-Section it appears that a debt has a different classification if it is a straight loan or represented by a foreign currency account in a bank than if it is a Debenture or a Bond, which are clearly excluded under Sub-Sections (d) and (e) of Section 18(4). It is clear that most debts, therefore, could be rearranged to fall within the exceptions provided by the Section, but non-domiciled residents should not be required to carry out such a cosmetic arrangement.

There must be some concern by what the Revenue regards under Section 18(3) as "in the United Kingdom for some temporary purpose only and not with any view or intent to establishing his residence in the United Kingdom", since there are a large number of non-domiciled persons who are resident in the United Kingdom in any year in which they set foot in the United Kingdom by reason of their possession of a place of abode available for their use. The fact that they have established a place of abode available for their use appears to have excluded them from the protection under this Section, and

it is clear that a non-domiciled person who is resident in the United Kingdom for one day only (at the extreme end of the spectrum) could hardly be expected to produce a computation on capital gains or losses on his foreign currency accounts abroad which may well represent his entire assets.

It is also surprising that provisions for Capital Gains Tax purposes should take a different view on the residence of certain assets compared with provisions for Capital Transfer Tax purposes, in that a foreign banking account of a non-domiciled person for Capital Transfer Tax is excluded property whereas for the purposes of Capital Gains Tax it is situated in the United Kingdom.

3. GENERAL PRINCIPLES OF UNITED KINGDOM TAXATION LAW

United Kingdom taxation law has always recognised, probably because of the special position of the United Kingdom as an international trading centre, that non-domiciled persons have a special position in regard to taxation. Basically they are not taxed on income or capital gains arising abroad, such taxation being limited to taxation on the remittance of such income or gains.

It seems to be an absolute anomaly for a special rule to exist in regard to the residence of a debt in foreign currency, which rule would affect only a non-domiciled person because domiciled and resident persons would be taxable on transactions on such an account in any event. Since this special rule appears to be outside the general principles of the taxation of non-domiciled persons, and in addition there is bound to be substantial difficulty in the computation and collection of taxation which might arise, there does seem to be a very strong reason for altering the rules to comply with generally accepted practices.

It is interesting that following the Vestey case the application of Section 478 of Income & Corporation Taxes Act 1970 was altered by Section 45(5) of Finance Act 1981 to remove a similar anomaly, and in fact it appears that the problem described above could be "avoided" by holding the foreign currency within a "Section 478" company!

Enclosure

27 January 1983
18/18/350.DOM

APPENDIX

ILLUSTRATIVE EXAMPLE OF THE CAPITAL GAINS TAXATION IMPLICATION ON A SIMPLE TRANSACTION ON A FOREIGN CURRENCY ACCOUNT

1. £2,000 converted to Dollars and placed on bank deposit in 1980 - acquired $4,400.

   Disposal of Sterling exempt: Acquisition of Dollar asset with base cost of £2,000.

2. Deposit of $4,400 held for 12 months, interest $440 kept in separate account - no tax consequences. Rate of Exchange at date of credit - $1.80 to £1. Sterling equivalent £232. Under Section 65(7) Capital Gains Tax Act 1979 the two holdings of Dollars are pooled - total pool $4,840, C.G. base value £2232.

3. 1981 - $2,200 used to purchase shares in IBM when exchange rate is $2 to £1.

   Disposal of Dollar asset - notional proceeds £1,100, base value £1,015 - chargeable gain £85 on foreign currency, taxable on "arising" basis. IBM shares have C.G. base value of £1,100.

4. 1981 - IBM shares sold for $2,200 when Dollar is $1.80 to £1. Dollars brought to deposit account outside the United Kingdom. No apparent profit, but share proceeds of $2,200 must be notionally converted to Sterling ($2,200 at $1.80 = £1,222). Notional profit is therefore £122, taxable only if remitted.

5. During 1982 interest on the balance of Dollars is paid to the Dollar interest account $220 making the balance there $660. Rate of Exchange at date of credit $1.6 - Sterling equivalent £138.

6. At the end of 1982 there are the following balances outside the United Kingdom:

Dollar capital	$4,400
Dollar interest	$660

The two accounts contain the following:-

Balance of Original Dollars	$2,200)	base cost	£1,217
1981 Interest	440)		
Proceeds of IBM	$2,200	base cost	1,222
1982 Interest	220	base cost	138
	$5,060		£2,577

The taxable gains are	£ 85	- (3) above
and	122	- (4) above
	£207	

The gain of £85 is taxable whether or not remitted and is therefore "pure" capital. The gain of £122 is taxable on the remittance basis, as is the interest of $660, Income Tax on which will be calculated by reference to the average rate of exchange for the year in which remittance is made.

The above illustrates the complexities which arise over a simple hypothetical series of small transactions. The non-domiciled residents who are likely to be affected would clearly have positions far more complicated than the above illustration, and there is an impracticability of applying the legislation where persons assets are mainly outside the United Kingdom.

CONFIDENTIAL

FROM: FINANCIAL SECRETARY
DATE: 31 January 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (R)
Minister of State (C)
Sir D Wass
Sir A Rawlinson
Mr Bailey
Mr Middleton
Mr Moore
Mr Robson
Mr French
Mr Green
Mr Battishill 3 IR
PS/IR

BUSINESS EXPANSION SCHEME

1. John Wakeham and I have discussed with officials the proposals for a major extension of the Business Start-up Scheme (Mr Battishill's note to me dated 17 January). This minute sets out our provisional conclusions and recommendations on the main features of the new scheme. There is still a lot to be done in working up the details, and not much time in which to do it. So it would be helpful to know whether you are broadly content with the way the new scheme is now shaping up.

2. Broadly, like the BSS, the extended scheme (BES) will be intended to give relief for new (ie additional) genuine equity investment, in qualifying companies, by individuals who are not directly connected with the company. It will still be a scheme for "outsiders".

3. But we propose major extensions in the range of qualifying companies, and the limits on relief. And there are a number of other relaxations and simplifications which can be made.

Width of the Scheme

4. The schemes will be extended to cover new genuine equity investment in all qualifying unquoted trading companies - established companies as well as start-ups.

5. We see no need to impose any limit on the size of company able to attract eligible investment, even though that will let in a few quite large unquoted companies. But because the purpose is to help companies raise new equity which do not have ready access to venture capital, we agree with Jock Bruce-Gardyne that the scheme need not extend to unquoted companies whose shares are dealt in on the Unlisted Securities Market. They are not so different in this respect from companies quoted on the Stock Exchange.

6. The scheme will apply, as now, only to companies which are incorporated in the UK, resident in the UK, and carrying on a qualifying trade wholly or mainly in the UK. This latter rule does not preclude a reasonable degree of overseas activity; and relief is not affected if the company is a high exporter. But we do not want to give relief for investment in companies operating largely overseas.

7. In the case of groups of companies broadly the same rules would apply. With one possible exception, which John Wakeham has asked the Revenue to consider, each group member would have to qualify under the scheme - to stop relief being syphoned out for a purpose we did not intend.

8. Under the present scheme, companies must show they have satisfied certain qualifying conditions for up to 2 years <u>preceding</u> the issue of shares on which relief is claimed. This simply flows from the need to define a start-up - ie a "new" company carrying on a "new" qualifying trade. For <u>existing</u> companies we can drop this retrospective feature from the new scheme, though we shall probably have to keep something of the same kind for new companies. Otherwise people will simply move business to new companies to pick up the relief with no real expansion in the small firms sector.

9. Despite the occasional complaint the range of qualifying trades is already pretty wide. You will remember that Arthur Cockfield found a way to bring in genuine retailing and wholesaling. The only real exclusions now are financial, dealing and some service trades where it is only too easy to get your investment back intact.

We think this is right, though one or two minor relaxations may just be possible at the edges.

The relief

10. Consistent with the purpose of encouraging outside investment, the 30% limit on an individual shareholding qualifying for relief should remain. The scheme is not for institutional or corporate investors, not for proprietors, paid directors or employees of a company. But directors can still protect their investment so long as they receive no payment.

11. At an earlier stage we considered the possibility of a two-tier relief, with a more generous scheme for start-ups, because of their added risk. But it would add yet further complication, and we want the scheme to succeed. So we propose a uniform relief for all qualifying investments, whether in start-ups or established unquoted companies. This would be given at the investors' full income tax rates (including IIS) - up to 75% - as at present for the BSS.

12. We propose a single annual limit for investment in start-ups or existing companies. We considered whether to allow carry-forward relief from year to year, but came down against this in the interests of a simple scheme. Instead we prefer to increase the present £20,000 limit. We suggest that doubling the limit - to £40,000 - would be about right.

13. We also propose that the present limitation of tax relief to only 50% of the company's issued ordinary share capital should be dropped completely. This is a major change which we recognise removes some of the protection in the present scheme against deliberate contrivance and abuse. But it has been criticised in some quarters, and the fact of the matter is that it would be virtually impossible for the Revenue to operate it properly for companies with hundreds, if not thousands, of shareholders.

Kinds of share capital

14. Relief should continue to be given only for investment in new ordinary shares that have no preferential rights to dividends, capital or redemption - ie full risk equity capital. That is where the need to encourage investment arises, and is the purpose of the scheme. But we consider most (and possibly all) the present restrictions on the kinds of other capital a company may have can safely go.

Duration of the new scheme

15. We recommend that the new extended scheme should come into effect from 6 April 1983, though obviously not much extra investment may happen until the Finance Bill becomes law in the summer. As a practical matter it would probably not be possible to start processing claims for tax relief until January 1984 - or even perhaps, the end of the year (the same as now).

16. We need to consider for how long the scheme should be announced to run. At present BSS ends in April 1984. For technical reasons, to do with the rules relating to investment which has already gone into start-ups under the BSS, it might be simplest to go for 3 years - ie up to April 1986. Politically, however, there may be a case for a longer period than this and I have asked the Revenue to look at the implications of this for the legislation.

17. Whether the old rules disappear completely, or are adapted for the extended scheme is something which is also being considered.

Remaining issues

18. There are, as I have said, still a lot of details to sort out, including the transition from BSS to BES. But the Revenue are working on these and John Wakeham and I will look at them as they come forward.

19. But there is one more substantial point which you should know about. This is what to do when an investor simply replaces an outstanding loan to a company with share capital. Should he get tax relief then or not?

20. Under the present scheme he does not. This follows directly from the object of the scheme as encouraging new capital to go into start-ups and in equity form. There had to be checks to stop people simply recycling existing capital for no other reason than to pick up tax relief. With a scheme for all unquoted trading companies no 50% rule and a £40,000 annual limit, the opportunities for recycling will be even greater.

21. Against this background, there are conflicting arguments. We want small companies to improve their gearing; and one main effect of the scheme will in any case be to encourage such companies to raise new equity in order to pay off their loans. Any private individual who has lent to a company and has had his loan paid off can then of course hope to qualify for tax relief for investing in equity under the scheme. It may well seem unfair discrimination if he can get relief for investing in equity in any <u>other</u> company, and so can any other individual investing in the company to which he has lent, but he will himself be disqualified from relief if he takes up equity in the company which he has supported and knows best. On the other hand, companies will already be able to use the scheme to do that in other ways. There will be nothing to stop them as now, raising new equity and using it to reduce their bank borrowing, or pay off institutional lending, or other creditors (other than the shareholder himself). As Jock Bruce-Gardyne has pointed out, allowing shareholders to convert their own loans into equity would weaken the incentives for companies to reduce their bank borrowing.

22. There are two other considerations. Any relaxation here will add to the dead weight cost of the scheme. It is difficult to say how many people who have lent money to unquoted companies

(with varying degrees of security) will want to convert their loans to shares; but the opportunity to take shares in exchange up to three-quarters of the outstanding value of a loan (which is what this would effectively amount to) would obviously be very tempting. Second, the scheme is basically for new money. Those who convert debts into equity are not putting up new money. They may be taking on a significantly increased risk (eg by converting a fixed interest debenture with a prior charge on assets); or they may be taking on very little extra risk (eg if they are converting an unsecured loan which merely stands ahead of the proprietors own interest). But it will not be new money.

23. We have not come to any firm conclusion on this. The Revenue are trying to get information about the extent of lending in the unquoted sector, but figures are hard to come by. This may be something you would like to discuss.

24. I should welcome your reactions to our proposals. They will not do everything people have asked for but this is a simpler scheme than the Start up scheme, and it would meet many of the suggestions that have been pressed on us. I think it will be very much welcomed by the small and medium sized businesses, and we must not forget that this is the "European Year of smalll and medium sized enterprises"!

NICHOLAS RIDLEY

OFFICIAL - SENSITIVE

~~SECRET~~

(D B. Lloyd 27/3/2014)

FROM: M E DONNELLY
DATE: 18 January 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Mr Littler
Mr Burns
Mr Middleton
Mr Monck
Mr Kemp
Mr Lavelle
Mr Ridley

INTEREST RATE DEVELOPMENTS

The Financial Secretary has seen the Economic Secretary's note of 13 January.

He would be inclined to interpret recent developments as suggesting that the markets expect roughly 8 per cent of inflation over 1983 as a whole; which with real interest rates at about 3 per cent would give a base rate of 11 per cent. He is therefore concerned that the markets appear to be expecting rather more inflation than the Government expects.

MED
M E DONNELLY

OFFICIAL - SENSITIVE

(D.B. Lloyd 27/3/2014)

FROM: M E DONNELLY
DATE: 11 January 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Sir A Rawlinson
Mr Wilding
Mr Monger
Mr Mountfield
Mr Evans
Mr St Clair
Ms Seccombe
Mr White

BENEFIT UPRATING

The Financial Secretary has seen Mr Monger's note of 23 December, the comments by the Chief Secretary and the Minister of State (C), and your comments in Miss O'Mara's note of 4 January.

The Financial Secretary wished to add just one comment on the presentation of this subject. The extremely bad reaction to proposals for "clawback" for 1983 which we received after the Autumn Statement has already virtually disappeared. To a large extent it was a failure of our own communication - and now that people understand that cash is not to be "clawed back" from pensioners they are content. The Labour party exploited this ignorance very successfully but their success lies in the Financial Secretary's opinion been short lived. He therefore concludes that perhaps we need improvements in publicity rather than a new system.

M E DONNELLY