FROM: FINANCIAL SECRETARY
DATE: 1 March 1983

CHANCELLOR

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

CHILD SUPPORT AND THE POVERTY TRAP:
DEPENDENT RELATIVE ALLOWANCE

Following Miss Rutter's minute of 17 February, John Wakeham and I had a talk with Ferdie Mount on February 24. Mr Robson was also present.

It went rather well. Ferdie seems keen to work with us. I hope this makes him less liable to minute the Prime Minister without talking to us first.

I explained to him at some length the way our thinking was developing on NICIT, husband and wife and on tax savings. I emphasised that these had to be seen as a whole and I have given him a copy of the note my private secretary circulated on February 7. I said we were at present fully occupied with the budget but I would be returning to these matters immediately after budget day and I would welcome him joining in the discussions.

John Wakeham set out the way in which ITTA fits into the picture - both in tax and in political terms.

Understandably Ferdie was in no position to react on the substance. He was clearly interested. He said he would like to join in my discussions and would send comments on the note.

He was also interested in the way matters were to be handled. I said that, after a further round with officials, I intended to put proposals to you based on the note of February 7. Ferdie thought that, in the light of your reactions, it might be worth having a session on all this with the Prime Minister. I stressed that we did not want to do this until we were ready. On the manifesto, he accepted that this was not something to be mentioned in specific

terms - at most it might be covered by phrases about 'a simpler and fairer tax system'.

In the light of all this Ferdie seemed to back off both on child tax allowances and on the dependent relative allowance. He certainly did not push the latter. On the former, he said his residual concern was the opposition of certain elements in the Party to child benefit on the grounds that it is labelled a 'benefit'. He felt it was important in more than just presentational terms to find a new label such as 'child allowance' or "child credit". I saw force in this.

He also accepted that our aim at the moment was to map out our strategic objective. He also saw the need in the immediate future to avoid actions or commitments which made those objectives even harder to attain. As an example we mentioned the pressure on mortgage interest relief. Ferdie is clearly on our side on that.

NICHOLAS RIDLEY

BUDGET CONFIDENTIAL

FROM: NICHOLAS RIDLEY
DATE: 1 March 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (R)
Minister of State (C)
Mr Moore
Mr Robson
Mr Griffiths
Mr Ridley
Mr French
Mr Corlett/IR
Mr Battishill/IR
PS/IR

CAR AND FUEL BENEFIT SCALES.
CAPITAL ALLOWANCES FOR BUSINESS CARS (STARTER No.171)

The new car and petrol scales for 1983/84 will hit the company car man for about £50 per year. In addition the petrol and VED duty changes in the Budget will cost the average motorist (private and company) about another £15 per year.

To further tax the company car by reducing capital allowances from 25% to 20% would cause a furious row with SMMT, and would infuriate the company car driver. If we therefore can not do this it would be a mistake to abolish the £8000 limit, with all the benefit going to Rolls Royce drivers.

The only thing we can, and probably should do is to raise the limit from £8000 to £10000, at a small cost in future years.

I would like to discuss the whole question of cars in the near future.

pp NICHOLAS RIDLEY

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 1 March 1983

PS/ECONOMIC SECRETARY

cc PS/Chancellor
Sir D Wass
Mr Moore
Mr Robson
Mr Griffiths
Mr Martin
Mr Caldwell - Parly Counsel
Mr Godfrey - C&E
PS/C&E

REVISION OF CUSTOMS AND EXCISE CONTROL POWERS (STARTER NO 21)

The Financial Secretary has seen Mr Godfrey's submission of 24 February to the Economic Secretary.

In paragraph 8 of his submission Mr Godfrey mentions that the need for computer access by Customs has been endorsed by the Keith Committee. The line Ministers have taken in public on the Keith Committee Report is that the full consultation required on its conclusions will take some time and immediate legislation is therefore not possible. It would therefore be preferable to present this proposed revision of Customs' control powers on its own merits, rather than as a response to Keith. Otherwise there are likely to be demands for legislation on Keith's other recommendations.

MED

M E DONNELLY

FROM: E KWIECINSKI
DATE: 1 March 1983

MR W RANKIN/IR

cc Mr Monck
Mr Pirie
Mr Ilett
Mr Munro/IR
PS/IR

CONSTRUCTION INDUSTRY TAX DEDUCTION SCHEME: 714S BANK GUARANTEE SCHEME.
LETTER FROM STEPHEN ROSS MP: MR E BALL (PS26/85/81)

The Financial Secretary has seen the proposed draft reply in this case. (file attached)

He thinks that we should ask the banks why they have not done more to facilitate the scheme; and also see if there is anything we can do to encourage them.

In the meantime I will send Mr Ross a holding reply.

E KWIECINSKI

FINANCIAL SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Stephen Ross Esq MP

Dear Stephen

You wrote to Jock Bruce-Gardyne on 14 January about the new guarantee arrangements for the 714S certificate. I am sorry I have not been able to send you an earlier reply.

I can confirm that the clearing banks were consulted about the form and wording of the guarantee. But, as I am sure you will appreciate, we can no more interfere in their internal administrative arrangements than we can in any decision about whether or not a guarantee can be given.

The new certificate arrangements did not come into effect until 1 December 1982, and the evidence available from what is only the first few weeks of operation suggests that if a local manager has considered a guarantee possible he has then consulted his head office. Whilst it would save some time if all local managers knew about the scheme, I think we must bear in mind the banks' operational costs. I think it more than likely that the banks wish to gauge the rate at which guarantees are being sought, and can be given, before they incur the cost of drawing up and issuing guidelines to all their thousands of branch managers.

I hope that Mr Ball's application for a guarantee will be successful.

NICHOLAS RIDLEY

FROM: M E DONNELLY
DATE: 1 March 1983

MR G P SMITH

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir D Wass
Mr Burns
Mr Middleton
Mr Byatt
Mr Christie
Mr Kemp
Mr R I G Allen
Ms Holman
Mr Fitzpatrick - IR
PS/IR

RELATIVE BURDEN OF TAXATION ON PERSONAL AND COMPANY SECTORS

The Financial Secretary was most grateful for your note of 28 February showing how relative tax burdens have changed over the last 4 years.

He would be grateful if you would further refine these figures and take into account the effects of the forthcoming Budget. They will then be useful as background material for the Budget debates.

MED

M E DONNELLY

Treasury Chambers, Parliament Street, SW1P 3AG

Miss S P Burns
Office of Parliamentary Counsel
36 Whitehall
LONDON
SW1A 2AY

2 March 1983

Dear Miss Burns

BRITISH FISHING BOATS BILL

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

Yours sincerely

E KWIECINSI
Private Secretary

BRITISH FISHING BOATS BILL

Draft Financial Resolution

BRITISH FISHING BOATS [MONEY]: Queen's Recommendation signified

Mr Nicholas Ridley

That, for the purposes of any Act of the present Session to prohibit the fishing for and trans-shipment of sea fish by or from British fishing boats, in areas specified by order made by the Minister of Agriculture, Fisheries and Food and the Secretaries of State respectively concerned with the sea fishing industry in Scotland, Wales and Northern Ireland, unless those boats satisfy conditions prescribed by an order of those Ministers with respect to the nationality of members of the crew, it is expedient to authorise the payment out of money provided by Parliament of any administrative expenses incurred by those Ministers by virtue of that Act.

NR

cc Mr Littler
Mr Unwin
Mr Judd
Mr Edwards
Mrs Healey-Mil
Miss Court
Mr Peek
Mr Salveson
Mr Lannon
Mr Bonney
Mr Hayden

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Douglas Hurd
Minister of State
FCO
Downing Street
LONDON
SW1

2 March 1983

Dear Minister

REPORT OF THE COURT OF AUDITORS OF THE EUROPEAN COMMUNITIES FOR 1981

The House of Commons Scrutiny Committee has recommended debate on the "Annual Report from the Court of Auditors concerning the financial year 1981, together with replies from the Institutions"; this was published in the Official Journal on 31 December 1982. A Treasury Explanatory Memorandum dated 10 February, has been supplied to Parliament on this report.

The Court's Report is currently being considered in the Council's Budget Committee which will produce a draft recommendation from the Council to the European Parliament. Under the German Presidency, Budget Committee have been going through the report more quickly than in the past. It is now intended that this should be taken up in COREPER and then Council as an A point, probably next week. The European Parliament will then debate the report prior to giving a discharge to the Commission on its implementation of the 1981 Budget. Unless a debate is held therefore by the middle of next week, it will not be possible to have Parliament's views before the Council's recommendation is agreed. The Court's report is concerned with detailed operational points, not with general policy. It is unlikely that the debate in the House would affect to any degree our views on the detailed points made by the Court. I do not therefore think it essential to have a debate before next week. I will, however, write to the Chairman of the Scrutiny Committee pointing out the timetable difficulties.

I would suggest that if possible the debate should be arranged in the week commencing 21 March on the basis of a "take note" motion which could read as follows:

> "That this House takes note of the annual report from the Court of Auditors concerning the financial year 1981, together with replies from the Institutions (Official Journal of the European Communities C344 dated 31 December 1982) and supports the Government in seeking to ensure the sound management of Community finance."

This is the wording of last year's Motion. I think that 1½ hours would suffice for the debate; it is unlikely that many members would wish to take part in such a technical debate apart perhaps from the members of the Scrutiny Committee, given also that there was a general debate on the Community Budget as recently as 21 February.

Part 2 of the Court of Auditors' report is about the management of the European Development Funds. Policy on these is of course the responsibility of yourself and of the Minister of State for Overseas Development but I would be prepared, with appropriate briefing, to handle this in the debate without troubling either of you to take part.

I would be grateful for your agreement to these arrangements.

I am copying this letter to the Lord President of the Council, Members and Secretaries of L and OD(E) Committees and the Secretary of the Cabinet.

yours sincerely

Martin Donnelly

pp NICHOLAS RIDLEY

(Affixed by the Financial Secretary and signed in his absence.)

FROM: P W FAWCETT

INLAND REVENUE
POLICY DIVISION
SOMERSET HOUSE

2 March 1983

FINANCIAL SECRETARY

CHARITIES

1. We discussed with you in December the Charity Commission and charities generally from a tax point of view and you asked for a paper examining the best way to supervise charities. We are sorry that because of Finance Bill work (including on charities) this review has not progressed as quickly as we would have wished. We hope that we will now be able to make speedier progress but are meanwhile sending this interim note.

Definition of charities

2. It might first be worthwhile to restate the objects which are charitable in law. Lord Macnaghten in 1891 attempted to classify such objects as follows:

> 'Charity in its legal sense comprises four principal divisions - trusts for the relief of poverty, trusts for the advancement of education, trusts for the advancement of religion and trusts for other purposes beneficial to the community, not falling under any of the preceding heads'.

All four of the heads of charity outlined by Lord Macnaghten have been the subject of numerous decisions in the courts. In every case a benefit to the community is necessary. In the first three

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cc Mr O'Leary
Mr Muir
Mr Harwood
Mr Egerton
Mr Hetherington-Sims
Mr Gray

cases which deal with the relief of poverty, education and advancement of religion, benefit may be assumed providing that the section of the community to be benefited is sufficient in size. In the fourth category, other purposes beneficial to the community, the court has to decide in every case whether there is a benefit to the community within the spirit and intendment of the Statute of Charitable Uses 1601 (which has long since itself been repealed).

The Charity Commission and the Inland Revenue

3. The Charity Commission registers charities, and is a matter for the Home Office. (It registers charities in England and Wales; there is no Charity Commission for Scotland or Northern Ireland). The Inland Revenue's responsibility lies in administering the various tax exemptions and reliefs for charities and for charitable giving, particularly in ensuring that the exemptions provided by Section 360 of the Taxes Act 1970 for charities' income are restricted to ... income applied to charitable purposes only. (I attach a copy of Section 360 for easy reference). We have long-established liaison arrangements with the Charity Commission in relation to the initial applications to the Commission by bodies seeking registration as charities. We can submit a formal Memorandum of Objection to registration and appeal to the High Court against acceptance. However, once a charity is registered there is no provision for any subsequent ongoing consultation between the Commission and the Revenue about charities' activities. The rules of confidentiality for example prevent the Revenue passing the Commission any information such as whether a charity's tax exemption has been withdrawn for a particular year, or even if a certain charity's tax avoidance activities seem to be ultra vires or to involve a breach of charitable status.

Tax repayments

4. The Inland Revenue have about 200,000 charities on their books (compared with about 140,000 registered charities) and currently

pay out some £200 million in tax repayments to them (£70 million in respect of deeds of covenant and £130 million in respect of taxed income). We have some 150 staff engaged on this work, mostly in paying the money out but a small number in looking at particular charities in depth. We understand that the Charity Commission has some 300 staff, mainly concerned with the legal aspects of charities.

The projected study

5. You asked for a paper examining the best way to supervise charities from four points of view and we give our preliminary comments on these as follows:

a. Tax fraud. The small number of staff mentioned above (four people with back up on full-time accounts examinations) who look at particular charities in depth last year prevented repayment of some £0.6 million. Repayment of possibly a few million pounds altogether was prevented by Inland Revenue offices generally following information given by the staff referred to. This is not really 'tax fraud' work but we take it that you include in this term tax avoidance: we do of course in addition have cases where tax avoidance relating to charities spills over into evasion. In any event these figures do not tell the whole story because the work done by these staff acts as a deterrent to tax avoidance and evasion. The staff involved on this work also monitor ways in which people take advantage of charity reliefs. For example, a charitable member of a group of companies can lend money to other members of the group or act as guarantor for other companies in the group. (The Charity Commission drew attention to this in their 1980 Annual Report). Charities can park tax-free income in an associated charity (as in the Helen Slater case, on which we reported to you). The Exchequer in these cases is losing the immediate use of money to which it would otherwise be entitled.

b. Political activities. It is well established (in the High Court) that bodies involved in political activities do not qualify as registered charities. The borderline is not however

always easy to draw. The Charity Commission refused to register Amnesty International and their refusal was upheld in the High Court. The Charity Commission have also criticised War on Want in their 1981 Annual Report, and that body accepted the need to conform to their advice. More recently we have seen examples of bodies ostensibly set up to help young unemployed people but with possibly political aims. Supervision of charities in respect of political activities is done by the Charity Commission. If however we discover political activities, we deny tax relief. This is something which certainly needs to be watched but it is not in our opinion a matter of alarm at the moment.

c. Activities not in the public good. We suppose that popularly activities not in the public good would be activities of say the Moonies or certain other 'religious' organisations. Since our meeting the Court of Appeal confirmed the verdict of the High Court which turned down an accusation of libel against the Daily Mail by the Moonies, a registered charity (or, more correctly, two trusts of the Moonies). This matter is currently one for the Home Secretary whose main responsibility it is; we understand that following the Court of Appeal decision there have been further representations to the Charity Commission to de-register the Moonies and/or hold a formal enquiry. The Charity Commission in their 1981 Annual Report said that it was for the Court or Parliament to decide whether the Moonies' activities were contrary to public policy so as to affect charitable status. We certainly see a need for a more up to date view of what is and what is not in the public interest, whether this is achieved by way of court judgments, legislation or administrative action. We understand, incidentally, from the Eire tax authorities that they last year rescinded their earlier decision to give tax exemption to the Moonies.

d. The Revenue's control of the tax aspects of charities. It would clearly be possible to prevent a larger amount of tax repayments

if more Inland Revenue staff were involved (cf a. above) but we have the impression that a large number of registered charities stay within the law and that there is a limit to the usefulness of employing more staff on this work. This is not to say however that we could not profitably put another say 2 or 3 staff on the work. You suggested the possibility of giving publicity to cases that have been refused tax advantages. I am afraid that we see great dangers in this approach on grounds of confidentiality. It was foreshadowed in the meeting in December that you would have a word with the Home Secretary to confirm that he is content for further work to be done in the matter of the interface between the Inland Revenue and the Charity Commission. We would suggest that it might now be appropriate to have a word with the Home Secretary. As we see it, the most fruitful outcome to such a discussion would be a statutory provision for liaison between the Inland Revenue and the Charity Commission. While this should assist us to combat tax fraud, it would not of course go any further than that because the definition of charity is wide and the Charity Commissioners necessarily look at charities from a different angle from ourselves: they see themselves as friend and adviser rather than policeman (Education, Arts and Home Office Sub-Committee, January 1975, paragraph 154-55). On the other hand there would be a benefit to the Charity Commission because we would be able to give them information of activities against the public good.

Conclusion

6. It has been suggested that there is a degree of overlap between the work of the Charity Commission and the Inland Revenue and we would like to explore this further with the Charity Commission with the Home Secretary's permission. Our preliminary view is that the overlap may not be very substantial in terms of staff and that we need to turn our attention to greater liaison rather than

reorganisation. We certainly can - and do - examine the bodies' accounts and make enquiries on them but we are bound in the last resort to a very large extent by the ruling of the Charity Commission on charitable status. This raises the question - although this is not within our current terms of reference and is a matter for the longer term - of a revised definition of charity in statute. Making such a definition would of course be no easy task, either conceptually or politically. A neat encapsulated definition defeated the Goodman Committee on Charity Law and Voluntary Organisations (1976), although that Committee clearly addressed itself to the problem with some earnestness.

P.W. Fawcett.

P W FAWCETT

PART XIII

SPECIAL EXEMPTIONS

Charities.
[1952 ss.447, 448; 1964(M) Sch.II; 1965 s.53(6).]

360.—(1) The following exemptions shall be granted on a claim in that behalf to the Board—

[1952 s.447(1)(*a*); 1969 Sch.XX 1(1)(*a*).]

(*a*) exemption from tax under Schedules A and D in respect of the rents and profits of any lands, tenements, hereditaments or heritages belonging to a hospital, public school or almshouse, or vested in trustees for charitable purposes, so far as the same are applied to charitable purposes only,

[1952 s.448(1)(*b*).]

(*b*) exemption from tax under Schedule B in respect of any lands occupied by a charity,

[1952 s.447(1)(*b*); 1966 Sch.V 3(2).]

(*c*) exemption—

(i) from tax under Schedule C in respect of any interest, annuities, dividends or shares of annuities,

(ii) from tax under Schedule D in respect of any yearly interest or other annual payment, and

(iii) from tax under Schedule F in respect of any distribution,

where the income in question forms part of the income of a charity, or is, according to rules or regulations established by Act of Parliament, charter, decree, deed of trust or will, applicable to charitable purposes only, and so far as it is applied to charitable purposes only,

(a) 1979(C) s.157(2) *and* Sch.7 para.9 *for* 1979-80 *et seq.*

(*d*) exemption from tax under Schedule C in respect of any interest, annuities, dividends or shares of annuities which are in the names of trustees and are applicable solely towards the repairs of any cathedral, college, church or chapel, or of any building used solely for the purpose of divine worship, so far as the same are applied to those purposes, Charities —(*cont.*). [1952 s.447(1)(*c*).]

(*e*) exemption from tax under Schedule D in respect of the profits of any trade carried on by a charity, if the profits are applied solely to the purposes of the charity and either— [1952 s.448(1)(*c*).]

(i) the trade is exercised in the course of the actual carrying out of a primary purpose of the charity, or

(ii) the work in connection with the trade is mainly carried out by beneficiaries of the charity.

(2) A charity shall .....(a) in respect of tax on chargeable gains .....(a) be allowed exemption in accordance with [section 145 of the Capital Gains Tax Act 1979(b)]. [1962 s.15(1).]

(3) In this section "charity" means any body of persons or trust established for charitable purposes only(c). [1952 ss.447(1)(*b*), 448(3); 1962 s.15(1).]

(a) *Words omitted repealed for* 1971-72 *et seq. by* 1971 ss.56 *and* 69(7) *and* Sch.14 Part IV.

(b) 1979(C) s.157(2) *and* Sch.7 para.9 *for* 1979-80 *et seq.*

(c) *See*—

1970 s.194—*relief in respect of premises held by a charity or ecclesiastical corporation for use as official residence of clergyman or minister.*

1970 s.434—*dispositions of income for short periods.*

1970 s.455(*c*)—*application of* 1970 Part XVI ch.III (*income under revocable settlements, etc.*) *where settlement trustees are trustees for charitable purposes.*

1970 ss.457 to 459—*surtax on income under certain settlements.*

1970 s.461A—*cancellation of tax advantages from certain transactions in securities.*

1970 s.473—*interest and dividends on securities purchased and resold.*

1973 s.16(2)(*c*)—*income of charitable trusts exempted from tax at additional rate.*

1973 ss.22 *and* 23—*disallowance of relief, and charge at additional rate, on income from stripping distributions etc.*

1973 s.52—*transitional relief in respect of convenanted payments expressed in figures net of tax.*

1980 s.118—*exemption of* Trustees of National Heritage Memorial Fund.

Charities Act 1960 (8 & 9 Eliz. 2 c.58) s.5 (*construed as in* ss.45 *and* 46)—*effect of registration as a charity in England and Wales and* s.9 (*in* Part II)—*exchange of information with other government departments and local authorities.*

MANAGEMENT IN CONFIDENCE

FROM: NICHOLAS RIDLEY
DATE: 2 March 1983

PPS PS/CST Mr Monroe
PS/ET Mr Coney
PS/MST(R) Mr Monger
PS/MST(C) Mr Stanley
Sir D Wass
Sir A Rawlinson
Mr Wilding
Mrs Brown
Mr Perfect

SIR LAWRENCE AIREY

FINANCIAL MANAGEMENT INITIATIVE

We have now had a chance to consider the Inland Revenue's programme more fully, and to compare it with the others. I should like to say that all concerned here think that the programme is one of best we have received, and to thank you and your staff very warmly for the excellent work that has gone into it. The following points seem to me especially important:-

(a) The effectiveness of the proposed system for the Board to set and monitor targets and objectives for the department will be crucial.

(b) The proposed management and financial information systems should be brought together at the earliest practicable and sensible date. This will produce important measures of efficiency and open the way for better delegated management.

(c) The Treasury should be involved in the annual report and forward decisions on management and audit services.

(d) The department has a big job ahead. To co-ordinate the many activities and keep to the timetable, I hope you will think it right to appoint somebody to be responsible for management of the project overall.

Turning to procedure, as you know, a report is to be published by July. The aim is to do this in time for the Treasury and Civil Service Committee to consider it before the Summer Recess. This follows an undertaking the Prime Minister has given to Edward du Cann.

MANAGEMENT IN CONFIDENCE

Janet Young and I are concerned that the introduction of new systems should be accompanied by vigorous action to influence attitudes at all levels. Policies concerning people, especially those on training and staff management need to be linked to the work on financial management. Full weight will need to be given to this in Departmental reports in the forthcoming White Paper.

The Report must include an account of each department's programme. These will need to be completed in the course of April wherever possible. Officials will be in touch shortly about the mechanics. The Chief Secretary intends, in consultation with the Lord Privy Seal, to make a report to the Prime Minister in April about the outcome of the initiative.

It is obviously important that accounts published with the White Paper should be convincing. They must set out in specific terms, intelligible to the lay reader, what improvements each department intends to bring about and how it proposes to make them. Generalised discussion will arouse suspicion and criticism. Projects, dates and the resources to be used will need to be specified as clearly as possible. The Government will be putting its intentions for each department on public record and must expect to be questioned thereafter on its success in carrying them through. So I am sure you will make sure that the good progress made by the Inland Revenue so far is convincingly reflected in the account of it that is published.

NICHOLAS RIDLEY

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 3 March 1983

MR PRESCOTT - IR

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Mr Kemp
Mr Moore
Mr Ridley
Mr French
Mr Battishill - IR
PS/IR

RICHARD PAGE MP: SUMMARY OF BSS PROBLEMS

The Financial Secretary was grateful for your submission of 1 March.

The Financial Secretary would be grateful if you could provide a draft letter to Mr Page dealing with his points 3, 4 and 5 along the lines of your note; and saying that on the other matters we have taken note of what he says.

MED

M E DONNELLY

NOTE OF A MEETING IN THE FINANCIAL SECRETARY'S ROOM AT 4.30PM ON THURSDAY 3 MARCH TO DISCUSS THE ASSOCIATION OF BRITISH CHAMBERS OF COMMERCE BUDGET REPRESENTATION

Those present: Financial Secretary
Mr Newsome)
Mr Nicholson) ABCC
Mr Veiler)
Mr Hobbs)
Mr S Wayre)
Mr R Allen
Mr F Martin

The Financial Secretary welcomed the ABCC delegation and invited them to develop the points made in their Budget representation.

The ABCC said that since they had last written on 25 January they appreciated that the further fall in the value of sterling and the weakness in the oil price had affected the macro-economic outlook. But they did not think it lessened the force of their argument that the Budget priority should be to reduce the cost to industry rather than personal tax relief. The Financial Secretary stressed that there had been an increase in uncertainty in recent months. The fall in sterling would benefit some parts of industry although it was not without its costs. Equally the fall in oil prices should overall have beneficial effects on world activity; but could also affect Government revenue and hence any possible fiscal adjustment. The overall cost of the ABCC measures would be in the region of £4.5 billion. A large figures. Did the ABCC have specific priorities within this?

The ABCC said that their central demand was abolition of NIS. Measures to increase capital expenditure and improvements in tax allowances and bands were also important. Business rates should be reduced by Government action if necessary. There were also a number of technical taxation amendments set out in the annex of the ABCC's 4 November letter to the Chancellor.

The Financial Secretary said that the problem of business rates was not Budget material, nor primarily for central Government. It was important that the ABCC made clear to local authorities the effect of high commercial rates on employment. The ABCC agreed. There was now more awareness of the effects of large rate increase on local businesses. On the technical tax points, the Financial Secretary pointed out that the Government had made progress in indexation. But this was a complex area and changes could not be made hastily. The ABCC might like to look at the Treasury evidence to the TCSC Meacher Sub-Committee, which set out the difficulties with schemes of the kind outlined by the ABCC. The Financial Secretary said he would draw the Economic Secretary's attention to the ABCC's comments on the Sterling v Customs (EDN/81/37) decision on the disallowance of otherwise deductible input tax.

The Financial Secretary asked how the ABCC saw the economic outlook. The ABCC said that their end December surveys had shown an increase in orders in Merseyside and the West Midlands. Prospects seemed to be looking up; but already a shortage of skilled labour was reported in some areas. But they did not wish to appear too optimistic.

The Financial Secretary thanked the ABCC representatives for putting their case. He said that their points would be noted in the context of the Budget.

The meeting ended at 5.15pm.

MED

M E DONNELLY

Circulation:
Those present (NOT ABCC)
PS/Chancellor
PS/CST
PS/EST
PS/MST(R)
PS/MST(C)
Mr Kemp
Mr Moore
Mr Robson
Mr Griffiths
Mr Ridley

FROM: FINANCIAL SECRETARY
DATE: 3 March 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Sir A Rawlinson
Mr Wilding
Miss Kelley
PS/IR
PS/C&E

CHARITIES

I enclose this minute from Mr Fawcett.

It shows the nature and extent of the problems. They are:

1) We probably need a new legal definition of Charity. But this is hard to work up. I don't expect you feel we can take this one on now?

2) The administration of the Income Tax relief by the Revenue needs 150 staff. The Charity Commission employs 300. The "interface" between the two is clearly inadequate, but needs "Keith-shaped" legislation to put right.

   I would like to explore the possibility of a combined Charities task force - CC, IR and C&E, combined - to see how the present work could be streamlined, and whether VAT relief could be "grafted" onto the system or not.

3) There is no Charity Commission for Scotland or Northern Ireland. I would like to investigate how things are done in those territories.

After I have explored the points at 2 and 3 above, I will report back to you - and at that stage I suggest we approach Willie Whitelaw to discuss how we could operate a better system.

I would be grateful for your views.

NICHOLAS RIDLEY

CONFIDENTIAL

NOTE OF A MEETING HELD IN FINANCIAL SECRETARY'S OFFICE, HM TREASURY, AT 10.00 AM, 3 March 1983

Present at Meeting: Financial Secretary
John Stanley MP - Minister for Housing
Mr Pickup)
Mr Dudding) Dept of Environment
Mr Balls)
Mr F Mount, No 10
Mr Godber
Mr Robson
Mr Battishill) IR
Mr Corlett)

ASSURED TENANCIES SCHEME: EXTENSION TO SHARED OWNERSHIP PROPERTIES: APPROVAL OF PARTNERSHIPS AS APPROVED BODIES BY DOE MINISTERS

Extension of the Assured Tenancies Allowance to Shared Ownership Properties

1. The Financial Secretary opened the discussion by commenting that he could not agree to an extension of the assured tenancies allowance to shared ownership properties.

2. The main problem was cost. Even a scheme limited to capital allowances would be very expensive. Assuming an average building cost of £20,000, capital allowances on a rented element of 50 per cent which was bought out by the tenant after 6 years, and an annual rate of construction which rose to 50,000 units by 1985-86, the annual cost after 5 years would be about £m225.

3. There was also the question of what sort of scheme the Minister for Housing had in mind. To give capital allowances in respect of trading stock was one thing. But to treat the construction of these dwellings as an investment activity for tax purposes, so that, in addition to the costs of construction qualifying for capital allowances, the profits from sale of successive slices of equity

would be taxed as a capital gain, would be justifiable only if certain conditions were met. He had three main ones in mind: first, the builder should hold the shared ownership property in an investment company separate from his normal trading stock; second, there would have to be a minimum period of renting; and, third, the proportion of property rented would have to remain above a certain percentage. The minimum requirements would probably have to involve the builder retaining at least 50 per cent of the equity for 5 years or more, and at least 25 per cent of the equity for 10 years or more.

4. Mr Stanley commented that he was glad to hear that there were no insuperable technical difficulties in extending the allowances to shared ownership. He did, however, question the costings; and suggested that officials should discuss these and the legislation that would be required. The cost might be reduced if building could be restricted by the DOE [though this would be an undesirable arrangement]. He would favour making any legislation as simple as possible, even if that involved an element of rough justice. He considered that the tax concessions for shared ownership should be considered on housing policy and social grounds. Extending the capital allowances to shared ownership would provide a means of attracting institutional funds into the housing market, and, in this context, 2 letters, one from Kleinworts and the other from the Volume Housebuilders Study Group (copies attached) were handed round. Furthermore, the capital allowances cost should not be viewed in isolation, since there was a trade-off against potential savings in public expenditure on housing.

5. Turning to the need for conditions in any scheme under which landlords of shared ownership properties would be deemed to be investing rather than trading, Mr Stanley said that they should not be as restrictive as suggested by the Financial Secretary. Otherwise, the regime would be unattractive to potential investors. He suggested that it would be sufficient if there were balancing charges to recover the allowances on sale, in the same way as they were in the case of investment in industrial buildings.

6. Mr Corlett said that there was an important distinction here. Landlords of industrial buildings normally held those properties as an investment, receiving rents in respect of the whole of the property. If an investor in industrial buildings were, however, to on-sell his properties in the way suggested for the shared ownership scheme, then this would normally be regarded as trading, and capital allowances would not be due.

7. There was a short discussion about the role of the tax system in housing policy. The Financial Secretary commented that he had a fundamental philosophic difficulty in accepting that the tax system should be used to subsidise uneconomic rents. If the desire were to restore the private rented sector, the best way would be by removing rent control, and not by using the blunt instrument of tax reliefs.

8. Mr Stanley agreed with this, as far as the rented sector was concerned. Reform of the Rent Act had been proposed by the DOE at the start of this Parliament, but had been turned down by Cabinet. The extension of the assured tenancies scheme into shared ownership was, however, aimed at a different market: that of low cost home ownership. As for the present assured tenancies scheme, this had improved the let sector. He was confident that in a further year there would be several hundred units under the scheme, and several thousand by the next Parliament.

9. In summing up this part ~~of this part~~ of the discussion, the Financial Secretary commented that the cost alone ruled this measure out for this year.

Partnerships as approved bodies

10. The Financial Secretary recalled that the assured tenancies allowance had been intended for companies only. It had been agreed between Ministers last year that neither the assured tenancies scheme, nor the capital allowance, should be extended to individuals. If, however, partnerships were

now being approved, and able to claim the capital allowances, entitlement would effectively extend to any individuals forming partnerships. He asked Mr Stanley if he would agree that no more partnerships would be approved.

11. Mr Stanley commented that under housing legislation partnerships could be regarded as bodies, so he doubted whether he could or should stop approving them. Partnerships' eligibility for capital allowances was not really his concern. He was simply required to ensure that they were reputable bodies.

12. Mr Dudding commented that correspondence between the DOE and the Country Landowners' Association, which the Treasury had seen, indicated that partnerships would be included. Giving approval to the scheme was a housing policy matter, and the DOE did not give tax advice to the bodies they approved. Approval did not, therefore, imply any guarantee of capital allowances.

13. Mr Battishill commented that the 1982 legislation had been expressly drafted with corporate bodies in mind. The problem with partnerships was that individuals who were not part of the partnership when it was approved, and who had no interest in the land and buildings, could join later and have a claim to a share of the tax reliefs.

14. In summing up this part of the discussion, the Financial Secretary commented that if the DOE continued to approve partnerships as approved bodies, he would have to introduce legislation in this year's Finance Bill to ensure that they could not get capital allowances. The question of whether individuals (in partnership or otherwise) should be eligible to claim capital allowances on assured tenancies was a new policy issue, which should be dealt with in the normal way. He had not been consulted on this, and was not prepared to let indivuduals into the scheme through the back door. Mr Stanley said he could not give an assurance that no more partnerships would be approved. S 59 the 1982 Finance Act was to be amended on partnerships, this should be done so as to make clear that they were eligible for capital allowances rather than to exclude

Housing policy

15. There was a general discussion on housing policy matters. Mr Godber commented that the Chancellor had introduced capital allowances for assured tenancies to assist the rented sector. Extending them to shared ownership schemes would simply be another form of subsidy for home ownership. This type of measure should be considered in the round with other, possibly more effective, measures for low cost home ownership, such as low-cost mortgages.

16. Mr Mount agreed. He thought that a collective decision would need to be taken by Ministers to decide which way to go at helping to facilitate low cost home ownership. The decision would need to be taken on whether or not shared ownership should be a large contributor to the housing market; this was a long-term policy issue.

17. The Financial Secretary said that the call for more help - particularly from the tax shelter market - for home ownership had to be considered alongside other claims on the Exchequer, including, for example, the need to attract funds into the business start-up scheme and other industrial and commercial activities.

18. In conclusion, Mr Stanley registered his determination to press for the assured tenancies allowance to be extended to shared ownership ~~next~~ this year.

19. The meeting closed about 11.00 am.

E KWIECINSKI

Circulation:
Those Present
PS/Chancellor
PS/CST
PS/EST
PS/MST(R)
Sir D Wass
Sir A Rawlinson
Mr Middleton
Mr Moore
PS/IR

Covering ~~BUDGET SECRET~~ OFFICIAL – SENSITIVE

(D. B. Hay) 27/3/2014

FROM: M E DONNELLY
DATE: 4 March 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Mr Burns
Mr Kemp
Mr Moore
Mr Allen
Mr G P Smith
Ms Holman
Mr Ridley
Mr French

RELATIVE BURDEN OF TAXATION ON PERSONAL AND COMPANY SECTORS

The Financial Secretary wishes to draw to the attention of the Chancellor and other Ministers of the trends in Mr Smith's note of 3 March (attached).

The Financial Secretary thinks that the figures might be valuable as defensive material in the Budget debate. They make the points that we have relieved industry's tax burdens but given the difficult economic background this has meant persons having to carry a relatively greater burden.

MED
M E DONNELLY

~~BUDGET SECRET~~ OFFICIAL - SENSITIVE 3 MAR 1983

(D. B. Lloyd 27/3/2014)

FROM: G P SMITH
DATE: 3 MARCH 1983

MR DONNELLY

cc: Mr Moore
Mr Kemp
Mr Allen
Ms Holman

RELATIVE BURDEN OF TAXATION ON PERSONAL AND COMPANY SECTORS

I attach figures bringing the story up to 1983-4 taking account of Budget changes. They are still provisional and I am not circulating widely at this stage.

2. On the personal side we have ignored a number of administrative etc complications. These include MIRAS; the excess MIR (about £150m) in 1982-83 and the clawback in 1983-4 (since our previous 1982-3 figures were on an accruals basis) and the new arrangements for helping SB recipients with their local rates. None of this makes any difference to sensible comparisons about tax burdens, but can easily give rise to confusions when other comparisons are made (and no doubt will).

3. On this basis personal tax payments rise in real terms in 1983-4 and the deviation from the indexed 1978-79 base narrows a little (though this is lost in the rounding).

4. On the business side, real taxes fall somewhat and 'under-indexation' increases slightly (lower NIS being partly offset by higher NIC and local rates). Compared with 1978-79, the under-indexation remains at about £1 billion in round figures.

5. These figures are our own tentative estimates: they are unlikely to be too far out, but the Revenue and Customs experts would have to be brought in if they were to be refined.

G.P.S.

G P SMITH

1. Actual taxation (£bn)

	1978-79	(%)	1982-83	(%)	1983-84	(%
Persons	41.7	78	76.1	81	82.6	8
Business (excl. North Sea)	12.0	22	18.3	19	18.7	1
	53.7		94.4		101.3	

2. Taxation in real terms (£bn, 1982-83 prices, deflated by GDP (mp) deflator)

	1978-79	1982-83	1983-84
Persons	68.4	76.1	78.6
Business (excl. North Sea)	19.7	18.3	17.8
	88.1	94.4	96.4

3. Taxation in 1982-3 and 1983-4 compared with indexed 1978-9 system (at 82-83 prices)

	difference from indexed 78-79 system	
	1982-83	1983-84
Persons	+ 9½	+ 9½
Business (excl. North Sea)	- 1	- 1
	+ 8½	+ 8½

COVERING ~~BUDGET SECRET~~ OFFICIAL - SENSITIVE

FROM: FINANCIAL SECRETARY
DATE: 7 March 1983

MR RIDLEY

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Mr R I G Allen
Mr French
Mr Harris

SDP/LIBERAL ALLIANCE BUDGET

It might be worth costing our own (real) budget in terms of jobs created on the basis of the SDP measure of jobs created tables at the end of their budget. I have started to do this on the attached table - but it is hard to do without the relevant information. If we could price our budget as taking as many unemployed off the Register as theirs does it would be a useful counter.

Otherwise their budget is more or less words - of a very self congratulatory sort. It is hard to attack our budget before they have even seen it.

NR

NICHOLAS RIDLEY

~~BUDGET SECRET~~ OFFICIAL - SENSITIVE

NEW JOBS

N.I.S	1700	($\frac{1}{3}$ of 5000)
Small business measures	15000	(same as SDP)
Income tax	10000	($\frac{14}{5\frac{1}{2}}$ X 3000 (SDP))
Social programme	50000	(Same as SDP)
YTS	100,000	
Community works?	?	
Small business CT rates	?	
Total:		

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 4 March 1983

NOTE OF A MEETING HELD IN FINANCIAL SECRETARY'S ROOM, HM TREASURY, 5.15PM 3 MARCH 1983

Present at Meeting: Financial Secretary
Minister of State (C)
Minister of State (R)
Mr Williams
Mr Porteus
Mr Driscoll - IR

TAXATION OF CIVIL SERVICE ALLOWANCES

The meeting had before it Miss Rutter's minute of 2 March and Mr Williams' note of 1 March.

Detached duty allowances

It was noted that the Chancellor abhorred the grossing up mechanism because of its administrative absurdity.

The Financial Secretary commented that when considering the tax treatment of civil service allowances it was important to bear in mind the affect any change would have on the private sector. The simplest solution to the problem would be to deem all expenses paid by employers as necessary for the performance of the duties of the employment: they would then be non-taxable. This would be all right in the civil service where the Government could ensure that all expenses paid were necessary for the "performance...etc" but in the private sector it would be impossible to control and would present a massive tax loop-hole for employers and employees to exploit. At the heart of the problem was the 12 month rule which was applied by the Revenue to determine whether a detached duty should be regarded as temporary - with tax free allowances, or permanent - with taxable allowances.

Mr Driscoll commented that the 12 month rule had been regarded by the Courts as a reasonable indicator of whether a detached duty was temporary or not.

The Minister of State (C) commented that it was important to present the problem in its proper perspective. Out of a total estimated expenditure on these allowances in the civil service of £250 million, only £10 million worth were deemed to be taxable by the Revenue and would thus require grossing-up.

The Financial Secretary commented that as he saw it there were only two alternatives: 1) for civil service management to certify all expenses they paid as necessary for the performance of the duties of the employment, and therefore non-taxable, or 2) continue with the grossing-up process as originally planned.

Ministers agreed that 1) was impossible for two reasons
a) if restricted to the civil service only it would be seen as preferential treatment and would cause even more of a public storm than the grossing-up proposals had done; and
b) if allowed throughout the public and private sector it would be impossible to control and would be widely abused as a tax avoidance measure.

Ministers agreed that in the short term the only way forward was to continue with the plans for grossing-up.

In the longer term a statutory solution might be possible.

Mr Driscoll commented that he was at present generally reviewing the tax treatment of expenses eg in the construction industry where the working rule agreements applied. It might be possible to devise a new statutory basis on which to exempt expenses from taxation which could be given a wide application.

He would prefer to go down the route of creating a new class of tax free allowances paid by employers rather than allowing actual expenses incurred by employees to be tax deductible.

The Financial Secretary agreed with this approach, although the Minister of State (R) envisaged some problems.

In the meantime the proposed course of action would need to be presented to the Chancellor.

Ministers asked officials to prepare a draft minute for the Financial Secretary to send to the Chancellor which would 1) explain the problems, 2) give reasons for the short term decision to gross-up the allowances, and 3) refer to a possible longer term solution based on a change in the law applicable to all sectors.

E KWIECINSKI

Circulation:

Those Present
PS/Chief Secretary
PS/Economic Secretary
PS/Chancellor
Mr Robson
PS/IR

BUDGET CONFIDENTIAL

FROM: M E DONNELLY
DATE: 4 March 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (R)
Mr Kemp
Mr Moore
Mr Robson
Mr French
Mr Graham - Parly Counsel
Mr Green)
Mr Battishill) IR
Mr Prescott)
PS/IR

BES: OUTSTANDING POINTS: CLAIMS FOR RELIEF

Point h. in paragraph 4 of Mr Battishill's note of 3 March says that it would be possible to handle 1983-84 claims for relief from 1 January 1984 rather than from 1 March 1984. He estimates this could cost up to £25 million (with a corresponding fall in the cost of the Scheme in 1984-85). The Financial Secretary considers that this estimate is very much on the high side. Subject to the Chancellor's views, the Financial Secretary would recommend going ahead with this advance in the payment of claims. Although it involves a bringing forward of some expenditure, it would be a most desirable addition to the attraction of the Scheme.

MED

M E DONNELLY

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 4 March 1983

MR CORLETT - IR

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Mr Robson
Mr Godber
Mr Graham - Parly Counsel
Mr Battishill - IR
PS/IR

ASSURED TENANCIES SCHEME: 1. PARTNERSHIPS AS APPROVED BODIES.
2. EXTENSION TO SHARED OWNERSHIP PROPERTIES

Following his meeting with the Minister of Housing yesterday, the Financial Secretary discussed with you and Mr Battishill a proposed course of action on these two matters.

1. Partnerships as Approved Bodies

The Financial Secretary gave his provisional decision to exclude partnerships from the Assured Tenancies capital allowances provisions. He asked you to proceed with the drafting of legislation for this year's Bill. A final decision would be taken later when the Department of Environment had clarified their position.

2. Extension to Shared Ownership

The Financial Secretary told the Minister for Housing of the Chancellor's decision not to extend the assured tenancies allowances to shared ownership properties this year. He did though give Revenue officials authority to discuss with DOE officials the costs of extending the Scheme in this way, and also the legislation that would be needed to facilitate such an extension.

EK
E KWIECINSKI

BUDGET CONFIDENTIAL

FROM: M E DONNELLY
DATE: 4 March 1983

MR KEMP

cc PPS
Mr Norgrove

FINANCIAL SECRETARY'S REDRAFT OF BLOCK P: FAIRNESS IN TAXATION

... I attach the Financial Secretary's redraft of this Block.

The Financial Secretary is aware that the Abraham Lincoln quote in paragraph one may not be in the ideal place in the speech; but he thinks it would be worth using somewhere.

MED
M E DONNELLY

BLOCK T: FAIRNESS IN TAXATION

1. I have always tried to keep a fair balance in taxation between industry and persons, lenders and borrowers, rich and poor. I find myself in complete agreement with these words from Abraham Lincoln.

> "You cannot bring about prosperity by discouraging thrift. You cannot strengthen the weak by weakening the strong. You cannot help the wage earner by pulling down the wage payer. You cannot further the brotherhood of man by encouraging class hatred. You cannot help the poor by destroying the rich. You cannot keep out of trouble by spending more than you earn. You cannot establish sound security on borrowed money. You cannot build character and courage by taking away man's initiative and independence. You cannot help men permanently by doing for them what they could and should do for themselves."

Hon Gentlemen opposite should ponder those wise words.

2. But if we have a tax regime which tries to keep those balances, I do believe that there is an onus on the citizen to accept them too. That is why I believe it to be right to stop some practices which offend against them.

3. For individuals, it is not equitable that some parents should benefit by having their children's education paid for by their companies, when others cannot. Nor is it equitable for companies to provide luxurious homes for their directors, at minimal cost. I propose to bring both benefits within the charge to tax. Details are contained in an Inland Revenue press release. As already announced, I proposed to end exploitation of the Revenue through secondhand bonds.

4. For companies, the considerations have less of a moral flavour about them, but equity is none the less essential.

5. I propose to introduce legislation to tackle avoidance through the exploitation of group relief. I propose to improve the arrangements for collecting DLT on disposals by non-residents.

6. On the taxation of international business, I have considered carefully the responses to the latest round of consultation. I have decided not to proceed this year with any measures in two of the three areas concerned. These are company residence and upstream loans. Both need further consideration. On tax havens, clauses will be laid which take account of the recent consultations.

7. The measures on tax havens and changes on ACT and double tax relief taken together do not represent an increase in the burden of tax on international business, but a switch in the burden away from those who remit profits to the UK, towards those who accumulate surplus cash balances in tax havens overseas.

8. I said last year that I would give further thought to the problem of how best to ensure a sufficient contribution to tax revenues by the banking sector. I have examined the position with great care. I am not convinced that it is satisfactory. But the conclusions this might normally have led to have had to be tempered by the international and domestic pressures on the banking system. I believe UK banks are in a stronger position to deal with these pressures than banks in some other countries. But it

CC CST
Mr Robson
Mr French
Mr Caldwell - Parl Counsel
Mr Robertson - IR
PS/IR

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon the Lord Hailsham of
St Marylebone CH FRS DCL
House of Lords
LONDON
SW1A 0PW

4 March 1983

Dear Quintin

INCIDENCE OF CAPITAL TRANSFER TAX

We last corresponded on this subject in October. A clause has now been drafted, which I believe is suitable for both ... Scotland and the rest of the United Kingdom. I enclose a copy.

When you wrote to me on 28 October you raised the question of statutory protection for executors against claims from beneficiaries. I can assure you this has been closely considered here and discussed with your department at official level. Our view here is that the existing statutory protection is adequte and in the circumstances your officials have indicated that they do not wish to press the matter further.

The Revenue will therefore now show the draft clause to the representative bodies consulted and explain to those who have raised the point (notably the Law Society) why we believe special protection for executors is not needed.

I am sending a copy of this letter to George Younger.

Yours ever

Norman

10/8/4/117

REPEAL

Chapter	Short title	Extent of repeal
1925 c.23	The Administration of Estates Act 1925	In the first Schedule, paragraph 8(b).

Burden of tax.

.-(1) In section 28 of the Finance Act 1975 (burden of tax) the following subsections shall be substituted for subsection (1) -

"(1) Where personal representatives are liable for tax on the value transferred by a chargeable transfer made on death, the tax shall -

(a) so far as it is attributable to the value of property in the United Kingdom which -

(i) vests in the deceased's personal representatives; and

(ii) was not, immediately before the death, comprised in a settlement; and

(b) subject to any contrary intention shown by the deceased in his will;

be treated as part of the general testamentary and administration expenses of the estate.

(1A) Where any amount of tax paid by personal representatives on the value transferred by a chargeable transfer made on death does not fall to be borne as part of the general testamentary and administration expenses of the estate, that amount shall, where occasion requires, be repaid to them by the person in whom the property to the value of which the tax is attributable is vested."

(2) This section has effect in relation to any death occurring after the passing of this Act.

BUDGET CONFIDENTIAL

FROM: M E DONNELLY
DATE: 4 March 1983

MR BATTISHILL - IR

cc Chancellor
Chief Secretary
Economic Secretary
Minister of State (R)
Mr Moore
Mr Robson
Mr French
Mr Graham - Parly Counsel
Sir L Airey)
Mr Green)
Mr Battishill) IR
Mr Painter)
Mr Lawrence)
Mr Northend)
Mr Prescott)
Mr Battersby)
PS/IR

BES: OUTSTANDING POINTS

Your note of 3 March, covering Mr Prescott's submission of the same date.

The Financial Secretary's comments on the conclusions of the submission summarised in your paragraph 4 are as follows:

a. he would prefer the scheme to run to March 1987;

b. agree;

c. agree;

d. agree;

e. he wishes to consider the question of treatment of partly-paid shares further;

f. agree;

g. agree;

h. see my separate minute to the Chancellor;

i. agree.

MED

M E DONNELLY

~~BUDGET SECRET~~ OFFICIAL - SENSITIVE

(DBL) 27/3/2019

FROM: M E DONNELLY
DATE: 7 March 1983

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Mr Robson
Mr Hall
Mr Crawley - IR
Mr Stewart - IR
PS/IR

MIRAS AND THE BUDGET

The Financial Secretary has revised the question and answer briefing on the new MIRAS arrangements, which also covers the 1982 fall in mortgage interest rates and its effects. This is attached. It should be added to Mr Crawley's submission of 7 March covering the revised draft letter to MPs on MIRAS.

Recipients will note that the answer to the first question on page 2 refers to the new ceiling for mortgage interest relief. Until the Budget therefore, this annex must be treated as "Budget Secret".

MED

M E DONNELLY

(1) B.Uy 27/3/2014

A. MORTGAGE INTEREST AND TAX RELIEF: THE NEW ARRANGEMENTS

From April 1983 most borrowers will be getting their tax relief on their mortgages in a new and simpler way. Instead of getting that relief in their PAYE codings or tax assessments, as they do at present, most borrowers will get tax relief at the basic rate by making lower mortgage payments to their lender. The borrower's payments will go down because tax relief at the basic rate of 30 per cent will be taken off the interest part of the mortgage payment. But because the borrower will no longer be given an allowance for the interest in PAYE codings or assessments, the amount of tax he/she pays will go up. The change is administrative. It does not affect the tax relief rules or the amount of the relief, only the way in which it is given. Borrowers entitled to relief will still get all the relief which is due on their interest payments.

Why is the change being made?

The main reasons are to make the system simpler and more efficient. Frequent changes in interest rates have made it difficult to give the correct relief through PAYE, and taxpayers often overpay or underpay tax. With the new system, the right amount of relief can be given at once, even if interest or tax rates change, without involving the tax~~payer~~ office. This is better for the borrower and has the added benefit of enabling administrative savings in the Inland Revenue - about 1,000 staff by April 1984 - from which taxpayers generally should also benefit.

I everyone affected by the change?

Although most borrowers will be affected, some will be outside the scheme. For example, some borrowers whose loans are above the [new] tax relief limit [of £30,000] will find that their relief will still be given by their tax office. This is because their lender has exercised its option to keep loans above the tax relief limit outside the scheme. And although the major lenders are within the scheme, some lenders - mainly those bodies for whom mortgages form a small part of their business, and private lenders - will remain outside. Borrowers with those lenders will, of course, continue to get their tax relief through their PAYE codings or assessments as they do now.

Will borrowers still get the higher rate tax relief to which they are entitled?

Yes. Because only basic rate relief can be given under the new system, those entitled to relief at the higher rates will continue to get that relief through their PAYE codings or tax assessments. The mortgage interest paid will, of course, still be taken into account in determining whether a taxpayer is in fact liable to tax at the higher rate.

Does the scheme only affect mortgages?

No. Some improvement loans which qualify for tax relief ~~can~~ will also come within the scheme. The scheme can also apply to certain loans used to purchase an annuity by a borrower who is over the age of 65.

Will borrowers be obliged to pay more?

No. At present, except for endowment mortgages, the net cost of a mortgage gradually increases, because as the capital debt is paid off, the interest element in the monthly payments goes down and so the tax relief also goes down. ~~When~~ Under the new scheme ~~is introduced,~~ some lenders, notably the building societies and local authorities, ~~are likely to~~ may propose a change in the way borrowers pay back their loans, so that future net payments remain constant, except when interest or tax rates change. Compared with the present pattern, the borrower's payments would be slightly higher in the early years and slightly lower in later years. The legislation permits the lender to propose this change, but it also gives existing borrowers the right, if they wish, to keep their payments [to the present] at a lower level (the amount they would have had to pay at the beginning of 1983-84 if the lender had not proposed the change).

Lenders who wish to propose this change have to notify individual borrowers, and the borrower will then be able to see what his options are and decide.

Are option mortgages affected by the change?

Yes. The option mortgage scheme comes to an end on 31 March 1983. For those with an option mortgage, the subsidy will normally be replaced by the benefit of tax relief, whether or not they pay tax. After March, an option borrower will become like, and have the same rights as, any other borrower. In general, option borrowers are likely to find that their payments will be little, if any, different under the new scheme. The individual borrower will hear from his lender how he is affected and what choices he may have.

How will people know whether they are affected?

Borrowers should hear from their lenders, who will tell them whether and exactly how their payments are affected.

B. THE 1982 FALLS IN MORTGAGE INTEREST RATES

Why are PAYE codes for 1983-84 being reduced to recover morgage interest relief for 1982-83?

Allowances for mortgage interest relief in PAYE codes for 1982-83 were originally calculated on the basis of building society interest rates in force at the time. But during the course of 1982 mortgage interest rates were reduced. This means that the original estimates of relief in PAYE codes were too high, and insufficient tax was deducted during 1982-83. The purpose of the adjustments to 1983-84 codes is to recover the excess relief. An important benefit of the new system of giving relief is that for most borrowers this kind of adjustment will not be necessary in future years because the relief will be given in the calculation of the mortgage payments and not through PAYE.

Why were PAYE codes for 1982-83 not adjusted when interest rates changed?

When PAYE codes are adjusted, they operate to correct the tax position from 6 April to the date of their operation. Where, as in the case of the fall in interest rates, allowances are reduced, the results can be heavy deductions of tax on the first pay day the new code is applied. To avoid heavy deductions, reduced codes are usually applied only from the date they are received; arrears are

t collected during the year but in a later tax year. If codes had been adjusted in August/September they would have been applied only from the date of receipt. There would still have been arrears to recover in 1983-84.

But it was clear in August 1982 that there would be a second reduction in interest rates (this was announced on 12 November 1982). Any recoding in August/September would have been incorrect by December. All the calculations of arrears would have had to be revised and would have been confusing to the taxpayer.

Because only part of the arrears could have been recovered in 1982-83 and this at the cost of confusion for the taxpayer, it was decided to make one comprehensive adjustment in 1983-84.

Borrowers should remember that the reductions in their mortgage interest [~~which they paid~~] in August and November 1982 were of course larger than the resulting reductions in tax relief.

BUDGET CONFIDENTIAL

FROM: M E DONNELLY
DATE: 7 March 1983

MR BATTISHILL - IR

cc Chancellor
CST
EST
MST(R)
Mr Moore
Mr Robson
Mr French
Mr Graham - Parly Counsel
Sir L Airey)
Mr Green)
Mr Painter) IR
Mr Lawrence)
Mr Northend)
Mr Prescott)
PS/IR

BUSINESS EXPANSION SCHEME: REPLACEMENT CAPITAL

The Financial Secretary was grateful for your note of 4 March and Mr Prescott's note of 3 March.

He has commented that one cannot deny the existence of a risk that the new Scheme may be manipulated. He considers that the solutions outlined in paragraph 13 and 22 of Mr Prescott's note provide a reasonable response and he is content for you to proceed on the basis outlined there.

On the points concerning replacement capital for new PLC's (outlined in paragraph 25-29 of Mr Prescott's minute) the Financial Secretary sees no reason not to derestrict the Scheme ab initio if we can.

MED
M E DONNELLY

CONFIDENTIAL

FROM: FINANCIAL SECRETARY
DATE: 7 March 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Sir D Wass
Mr Burns Mr Littler
Mr Middleton
Mr Lavelle
Mr Odling-Smee
Mr Bottrill

WILLIAMSBURG SUMMIT

I have seen your suggested themes for discussion at this Summit, and Mr Littler's response.

Taking up your first theme-abjuring protectionism - and fourth theme - the restructing of LDC debt - I wonder if we might press for some explicit linkage here. We are all aware of the inconsistency between making efforts to reschedule LDC debt while global protectionism makes it more difficult for these countries to export and so gain the funds to service that debt. Attempts by LDCs to subsidise exports while closing their markets to imports only make the position worse by creating a climate for retaliation by developed countries.

The current round of rescheduling offers us a good chance to break into this worrying cycle. Surely the price for debt rescheduling should be acceptance by LDC's - particularly the middle income countries such a Brazil, Nigeria, Chile etc - of their own responsibilities for the preservation of the open world trading system.

Up till now we have seen the GATT as the guarantor of this system. But developing countries are not being drawn into it. So what we need is some sort of institutional "junior GATT". This would be an easier regime than the obligations of the full GATT. But it would formally link the developing countries into the world trading system. And rather like the World Bank/IMF role in macroeconom

policy it could ensure that LDCs followed trade policies beneficial both to themselves and the world economy as a whole.

This junior GATT would not be easy to set up. But I am sure that we need to go beyond exhortations to preserve a free and fair trading system and aim to link the LDC's more firmly into the world trading order.

NICHOLAS RIDLEY

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 7 March 1983

PS/CHANCELLOR

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

THE MORAL HAZARDS OF SOCIAL BENEFITS

The Financial Secretary has seen Mr Robson's note of 2 March and the Economic Secretary's comments of 4 March.

The Financial Secretary agrees that it will be important to discuss these basic problems thoroughly; and to commission someone to look into them with a view to recommending decisions to be taken.

MED
M E DONNELLY

FROM: M E DONNELLY
DATE: 7 March 1983

PS/CHANCELLOR

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

THE SPECIAL COMMISSIONERS OF INCOME TAX (BUDGET STARTER NO.112)

The Financial Secretary has seen Mr Fawcett's submission of 4 March.

He is content with what is proposed. But before authorising the Revenue to show these draft provisions to the Council on Tribunals he would be grateful to know if other Ministers have any comments on these provisions.

MED
M E DONNELLY

COVERING CONFIDENTIAL

FROM: M E DONNELLY
DATE: 7 March 1983

PS/CHANCELLOR

cc Mr Middleton
Mr Robson

TAX POLICY

Attached is a draft minute to the Prime Minister put together by Mr Robson after discussion with the Financial Secretary.

The Financial Secretary thinks this is a very good start, and now suitable for further refinement by the Chancellor before being sent on to No.10.

MED
M E DONNELLY

CONFIDENTIAL

DRAFT MINUTE FROM THE CHANCELLOR TO THE PRIME MINISTER

TAX POLICY

At our recent discussion on mortgage interest relief I said I would let you have a note about tax policy generally.

Our tax policy is based on our economic and political philosophy. Our economic belief is that we should create the environment in which enterprise and wealth creation can flourish. Our political belief is that we should enlarge the role of the individual and diminish the role of the state. We want to encourage personal decision taking, personal responsibility and self reliance. We want to reduce the role of Whitehall.

Against this background we have ~~the~~ three broad aims in tax policy. First, to reduce the burden of tax. This will provide the incentives necessary to encourage enterprise and hard work. Incentives need further improvement at all levels - particularly in relation to the poverty trap and unemployment trap.

Second, to simplify the tax system. We inherited a tax system which was incredibly complex. Tax professionals cannot fully understand it. Most people find it incomprehensible. Complexity means heavy administrative costs both for the private sector and for the Revenue.

Third to take the biases out of the tax system. A wide range of special reliefs have grown up over the years. These discriminate between different activities. They represent layer upon layer of party political prejudices, many of them socialist. Often they produce economic results which are the opposite of what we want.

The three aims are closely linked. If we are to simplify, we must tackle the special reliefs. The reliefs are also very costly. This means rates of tax have to be set correspondingly higher to enable us to raise revenue. For example, if we removed all the various special income tax reliefs and left only the basic personal allowance, the basic rate could be reduced to around 25 per cent or thresholds raised substantially.

The way in which the system directs money and activity into certain activities is quite inconsistent with our aim of enlarging individual choice and responsibility. We give tax reliefs on savings channelled through pension funds and insurance companies worth over £3 billion. As a result people save in these ways rather than investing directly in, say, equities. Institutions now own assets worth £125 billion and this figure is growing. They dominate the equity market. They have grown inefficient on the back of tax reliefs. They invest very little in small businesses. This is not healthy in economic terms. It is directly contrary to our aim of encouraging personal shareholding.

We give tax reliefs of £5 billion for housing. We all agree on the importance of owner-occupation. But directing money into housing in this way means less for commerce and industry. In the end all the relief does is push up the price of houses and of land; in the same way the capital transfer tax relief for agricultural land pushes up land prices.

On corporation tax we give large incentives for investment in plant and machinery. This means we are encouraging firms to employ machines, not people and so we are lengthening the dole queues. We are favouring manufacturing at the expense of the service industries, despite the fact that the latter are the stronger sector of the economy.

These are not just academic points. The multiplicity of reliefs interact in a complicated way which magnifies their effects and so their influence on behaviour. For example, take an individual subscribing directly for equity in a manufacturing company which uses the money to acquire new plant. The present tax system would result in that individual paying tax of around 20 per cent on his return. But, if instead of investing directly the money had been channelled through a pension fund, the investor would end up with his return attracting a subsidy of around 100 per cent rather than tax of 20 per cent. This is a measure of the extent we direct people into institutional savings.

If the individual investor's equity financed the acquisition of a building by a commercial company his return would be taxed at about 100 per cent. The comparison with the 20 per cent tax on his investment in manufacturing plant is a measure of the way in which we direct investment into certain sectors and certain assets.

I doubt if our predecessors intended to produce results like this. There is no economic justification for them. It is also a measure of the complexity of the tax system that it requires a computer to work them out. It is little wonder that companies feel inhibited from taking important decisions until they have had a detailed tax advice.

But the major objection to all this is not the fact that many of the activities we are favouring in this way have little intrinsic merit. Nor is it the large size and erratic nature of the beneifts involved. Nor even the heavy administrative costs such a system imposes on all involved. What is objectionable is the fact the State is intervening selectively at all. It is nannying. It distorts economic decision taking. It erodes personal choice. It inhibits personal responsibility. State intervention in the form of tax reliefs is in many ways as unsatisfactory as state intervention in the form of public expenditure, nationalisation or state controls.

There are, of course, groups in special need to whom it is right to give help, such as the blind and the sick. But the tax system is a very blunt instrument for dealing with a particular problem of this sort. In general they are better tackled through the social security system.

We need to work towards a simple, understandable "low rate, low relief" tax system, leaving individuals free to take their own decisions rather than be guided by the dead hand of past political prejudice and State intervention. Such a system will enable us to reduce rates of tax and rid ourselves of costly beaureaucracy.

I do not pretend this is easy. It requires careful planning and delicate selling. We have been doing a lot of work on this in the Treasury. I see it as something for the next Government. In the meantime we want to avoid as far as possible making the task more difficult by creating new reliefs or by increasing those that already exist. It may be worth having a talk about all this.

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 8 March 1983

PS/CHANCELLOR

cc CST
EST
MST(C)
MST(R)
Mr Robson
Mr Hall
Mr Crawley/IR
PS/IR

MIRAS AND THE BUDGET

The Financial Secretary has seen Mr Crawley's submission of 7 March.

He has made the following comments on Para 14 of Mr Crawley's note:-

14(a) He would prefer the letter to go out on 16 March.

14(b) He thinks the letter should deal with the Budget changes as well as MIRAS/coding (as at Annex A of Mr Crawley's submission).

14(c) He would prefer the illustrative diagram which excludes NIC, because it is simpler.

14(d) He thinks the detailed Questions and Answers note should be attached to the letter to MPs.

14(e) He does not think there should be any reference to MIRAS/coding changes in the Budget speech.

14(f) He thinks that the Revenue Budget Day Press Release on mortgage interest changes probably should include paragraphs on the mechanics of MIRAS/coding changes (as at Annex D of Mr Crawley's submission).

14(g) He would be content for the Revenue (after the letter has been sent) to make use of the Questions and Answers in dealing with Press queries.

He is content with the letter at Annex A, but would add the following sentence at the end of the second paragraph: "Nonetheless the reduction in interest payments still leaves everybody better off", and on page 2, last line he would insert "that" in between "fact" and "their".

He is also content with the illustrative diagrams at Annex B. He has commented that the two diagrams should be regarded as alternatives - his preference is given at (c) above. He points out that the diagrams will be considerably improved when reproduced by the printers.

E KWIECINSKI

~~SECRET~~ OFFICIAL - SENSITIVE

FROM: M E DONNELLY
DATE: 8 March 1983

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Economic Secretary
Sir D Wass
Mr Burns
Mr Littler
Mr Unwin
Mr Middleton
Mr Lavelle Mr Monck
Mr Odling-Smee
Mr Bottrill
Mr Peretz
Mr Riley
Mr Sedgewick
Mr Turnbull
Mr C Bailey

STERLING AND THE ELECTION APPROACH

The Financial Secretary has seen your note of 7 March and Mr Peretz submission of 4 March.

The Financial Secretary generally agrees with the approach suggested by Mr Peretz on how to handle market jitters in the run up to the election.

He has commented that the next election will be very different to previous ones in that it will be the first in which we have both a floating exchange rate and a total absence of exchange controls. In the current international environment capital is infinitely more mobile and sensitive than before. Adding to the "Shore factor" to all this shows why there is such a major risk. Though if the SDP emerge in front of Labour in the polls as the main Opposition party then volatility would probably be smaller-although still there.

The Financial Secretary strongly opposes the suggestion in Mr Harrison's minute of 7 March that temporary exchange controls might have a short term role to play. Because many people might fear that they had returned permanently, their very imposition would cause a massive

~~SECRET~~ OFFICIAL - SENSITIVE

flight of capital. A more likely sequence than that suggested by the Economic Secretary would be:

- opinion polls showing a fall in support for the Tories;
- leading to a massive fall in the exchange rate;
- a consequent massive return of support to the Tories; and
- a substantial return of capital to London.

The Financial Secretary therefore considers that we should from now on seek to connect Labour with causing huge falls in the value of the pound.

M E DONNELLY

BUDGET CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 8 March 1983

MR P J A DRISCOLL/IR

cc PPS
PS/CST
PS/MST(R)
Sir D Wass
Mr Middleton
Mr Moore
Mr Kemp
Mr Robson
Mr French
Mr Hall
PS/IR
Mr Blythe/IR
Mr Isaac/IR

FRINGE BENEFITS - CARS AND PETROL
BUDGET DAY PRESS RELEASE

The Financial Secretary has seen the latest scales for 1984/85 based on a 15% increase over the 1983/84 levels, (your minute of 7 March).

He feels that the 1301cc - 1800cc Car scale is too high and should be reduced to £480; and similarly that the over £21000 original market value scale is too high and should be reduced to £1725.

He is otherwise content with the scales.

He agrees with the Chancellor that the petrol scales should be mentioned in the Budget speech.

E KWIECINSKI

BUDGET CONFIDENTIAL

FROM: M E DONNELLY
DATE: 8 March 1983

MR R MARTIN - IR

cc Mr Robson
Mr French
Mr Graham - Parly Counsel
Mr Isaac)
Mr Blythe)
Mr Hall) IR
Mr Northend)
Mr Kernahan)
Mrs Ayling)

PROFIT SHARING RELIEF

The Financial Secretary has seen your note of 4 March.

On point i of your second paragraph, the Financial Secretary wishes to consider further the current provisions in the 1978 Act to see whether they are sufficiently tight. Generally he considers that there ought to be a pro rata requirement within schemes. It would not be satisfactory for the boss to get say £5000 of relief and the employees only to get £50.

The Financial Secretary is content with the arrangements in your points ii and iii.

MED
M E DONNELLY

BUDGET CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 9 March 1983

PS/CHANCELLOR

cc PS/CST
PS/EST
PS/MST(R)
Mr Robson
Mr French
Mr Graham (Parly Counsel)
Mr Munro/IR
PS/IR

RETIREMENT ANNUITY RELIEF: JOCKEYS

The Financial Secretary has seen Mr Munro's note of 8 March ... (copy attached, top copy only).

He is in favour of giving this small concession which will require only one line in the Finance Bill.

He suggests that it may be right to get Sir Philip Goodhart to propose an amendment, although I understand from the Revenue that (subject to Parliamentary Counsel's approval) it would probably be possible for such straight forward legislation to be included in the first print of the Bill, provided that a quick decision is made.

The Financial Secretary would be grateful for the Chancellor's and Chief Secretary's comments and also to know whether they agree to this concession.

E KWIECINSKI

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

Copy requested 14/3 mm

...3
MR HOPKINSON
PPS EST MST(C)
CST MST(R)
SIR D WASS
SIR A RANKINSON
MR WILDING MR GODBER
MR PESTELL MR SALVESON

The Rt Hon John Biffen MP
Lord President of the Council
Privy Council Office
Whitehall
LONDON
SW1A 2AT

8 March 1983

Dear John,

10 MINUTE RULE BILL - LORD JAMES DOUGLAS HAMILTON

Lord James Douglas Hamilton has put down a motion to introduce a 10 Minute Rule Bill on 16 March:

> 'Housing Associations Tenants' Rights (Scotland): That leave be given to bring in a Bill to amend the Tenants' Rights Etc (Scotland) Act 1980 so as to extend the right to purchase to secure tenants of certain types of housing associations.'

2. The main consideration to be borne in mind is that we decided two or three years ago not to extend the right to buy to housing association tenants in Scotland despite the provisions contained in the Housing Act 1980 in relation to England and Wales. The view we took at the time was that housing associations in Scotland were relatively new and that it could be particularly difficult for community-based associations involved in tenemental rehabilitation to be burdened with the issue of sales to sitting tenants when they were at a very early stage in active development. Our solution to this problem was to establish with the Housing Corporation a policy of voluntary sales: this has admittedly produced very disappointing results, but there are doubts on the level of potential demand to purchase. The voluntary policy is supported by the Scottish Federation of Housing Associations, and we have concluded on balance that the voluntary policy should be continued at this stage. (We can reconsider the need for legislation later.)

It is of course the case that housing association tenants in England and Wales have the right to buy and there is force in the general line of argument Lord James will deploy. Consequently we should not oppose the Bill. I therefore recommend that Ministers should be free individually to vote for the Bill if they so choose but that it should be blocked at Second Reading.

Yours ever,

P

ROYAL COURTS OF JUSTICE
LONDON, WC2A 2LL

01-405 7641 Extn 3201.

8 March 1983

FINANCIAL SECRETARY	
REC.	- 9 MAR 1983
ACTION	Mr. O'Leary/IR
COPIES TO	PPS EST CST MST(A) MST(C) Mr Monger Ms. Seammen Mr. Monroe Mr. Robson Mr. Dreyer/IR PS/IR

Hugh Rossi Esq MP
Minister of State for Social
. Security and the Disabled
Alexander Fleming House
Elephant and Castle
London SE1

Dear Hugh.

STATUTORY SICK PAY: SELF-DEDUCTION BY EMPLOYERS FROM ARREARS OF CONTRIBUTIONS, TAX AND SURCHARGE

I understand that you and Nicholas Ridley have been in correspondence about a point that has arisen on the draft of the Statutory Sick Pay (Compensation of Employers) Regulations. I have not seen this correspondence but you wrote to the Solicitor General about it in December and your officials have now supplied me with details of the point in issue.

Under s9(1) of the Social Security and Housing Benefits Act 1982 you have power to make Regulations entitling an employer who has made a payment of SSP to deduct the amount from his NI contributions payments, except in prescribed circumstances as may be specified in the Regulations. You do not have power to entitle employers to make deductions from PAYE tax or NI Surcharge. You propose that the Regulations should provide, as an excepted prescribed circumstance where there is to be no entitlement to deduct, that the NI contributions payments against which it is sought to deduct SSP are in arrears, (Regulation 2(a) of the proposed Statutory Sick Pay (Compensation of Employers) Regulations). I can assure you that it is legally proper for you to make the Regulations in this form although it is intended as a general rule that the

..../Inland

Inland Revenue will not enforce payment of up to 3 months NI contributions payments arrears where they are satisfied that the employer has a genuine claim to set off SSP payments he has made. I can understand why the Financial Secretary does not wish you to provide a legal entitlement to deductions of SSP payments from arrears of NI contributions. It is a matter of policy between you. Assuming you agree with him, no impropriety is involved. Enforcement of the Regulations governing payment of NI contributions is a matter for the Inland Revenue; it is entirely proper that in deciding whether to bring proceedings for the recovery of arrears they will take into account a genuine claim that SSP has been paid although no legal entitlement to deduct exists (at the end of the day the employer is entitled to this money one way or another from the Government).

By agreeing to this course, you should be clear that you do not give an entitlement as of right for employers to make deductions from arrears. There may be cases where the Inland Revenue mistakenly do not accept that an individual employer has made SSP payments which he has deducted from NI contributions arrears and take enforcement proceedings notwithstanding that the employer is in fact entitled to a refund from you. I assume as it is not part of the argument put to me that this does not conflict with any assurance you have given in Parliament. Your publicity about the arrangements should also reflect this.

Deductions of SSP from PAYE tax and NI Surcharge payments cannot be dealt with in these Regulations. There is no statutory authorisation to permit deductions, but equally it

...../is not

it is not improper for Inland Revenue, in considering how to enforce payment, to take into account that the employer has a separate claim against the Government for the refund of the SSP he has paid.

I am copying this letter to Nicholas Ridley.

Yours ever, Michael

CONFIDENTIAL

Mr Ridsdale
Mr French
Mr Driscoll/IR
PS/IR

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Cecil Parkinson MP
Conservative & Unionist Central Office
32 Smith Square
WESTMINSTER
SW1P 3HH

9 March 1983

Dear Cecil

HOME TO SITE TRAVEL FOR THE CONSTRUCTION INDUSTRY

You sent me this memorandum, apparently from a construction industry body, arguing the case for an extension of the Working Rule Agreements concession to cover free petrol provided for certain employees in the industry who have the use of company cars.

You are probably familiar with the background to the Working Rule Agreements, which are made between employers' representatives and the Unions and provide for agreed conditions of service, including rates of travel and subsistence allowance. For many years the Revenue by extra statutory concession has agreed not to tax the fares, lodgings and other allowances paid to operatives, provided they are reasonable in amount. From 1981 that practice has been extended to cover site based staff employees who are not covered by the Working Rule Agreements but who often receive similar allowances.

The Revenue regard their practice as at least in part concessionary. Where similar payments are made in other industries or where no Working Rule Agreement is in force they are taxed under PAYE. Like all concessionary practices it is continuously under pressure - from those who benefit from it and want it extended, and from those who do not and either call for its withdrawal or for its extension to themselves.

The document you have been sent clearly falls into the former category and follows two meetings at Somerset House and an exchange of letters between the Revenue and the Taxation Committee of the construction industry employers. The Revenue view is, quite simply, that to extend the existing practice to the new car fuel scale charge would go beyond the spirit of their existing practice and

concede explicitly that home to site travel, where the site is the employee's normal place of work, is business travel. Such a concession would obviously have widespread repercussions for many other groups of employers and employees who have a work pattern similar in principle, to those of the construction industry. It would come at a particularly unfortunate time just as the new scale charge was being introduced. This is in itself not a popular measure with those who get free petrol for their private motoring (including between home and work) and a special concession for an industry that is already uniquely favoured (in relation to the Working Rule Agreements) would make it even less so for those who had to pay tax according to the letter for the law.

Even it were open to Treasury Ministers to get involved in the administration of the tax law (which it is not), there are two special factors which would dissuade me from getting the Revenue to change its mind here. The first is that we need to maintain a firm line against perks of all kinds - they are unfair and divisive as well as economically inefficient. The second is that we must avoid legislation by Inland Revenue concession. It is for Parliament to make the law, not the Revenue. The very existence of the Revenue's concessionary practice in relation to the Working Rule Agreements leads to an unsatisfactory state of affairs where the taxpayer has no right of appeal against the Revenue's refusal to extend the concession and the Revenue comes under attack if it simply applies the law. For this reason I think the Revenue are right not to go any further down the path of concession.

I hope this is of some help to you, but if we were to meet in the lobby I would like to have a further word with you about this.

NICHOLAS RIDLEY

From
THE CHAIRMAN OF THE PARTY
The Rt. Hon. Cecil Parkinson M.P.

CONSERVATIVE & UNIONIST CENTRAL OFFICE,
32 SMITH SQUARE,
WESTMINSTER, SW1P 3HH,
Telephone: 01-222 9000

IR

CEP/AM

31st January 1983

Dear John,

FST

I have been asked to pass this on to you.

Yours sincerely,

Alexandra Pennells

Dictated by Cecil Parkinson
and signed in his absence by
his Private Secretary

PS/FST

John Wakeman, Esq., M.P.

DRAFT AJRR/rc, 19.1.83.

Home to Site Travel for the Construction Industry
Definition of Private Mileage for the Purposes of Assessing Car Fuel Benefit

The Revenue have for many years recognised the problems caused the construction industry by its lack of a fixed place of work and have therefore agreed some years ago that travel costs over an initial daily mileage can be reimbursed the individual without deduction of tax.

It was therefore expected that the same principle would be applied in defining business and private mileage for the purpose of charging the individuals with the use of company cars the supplementary car fuel benefit in respect of private mileage. Indeed this basis was agreed with at least one District Inspector responsible for the taxation of employees of a number of major construction companies. However, Somerset House has recently informed the industry that it is not prepared to apply this established principle of definition of travel in the case of company cars and considers that the whole of any journey to site, however far, will be deemed private mileage and thus render the individual liable to the additional tax although he has no actual private mileage at all.

A meeting with the Revenue at Policy Division level has brought no change in the official attitude. The industry is therefore once again faced with positive discrimination against management in comparison to the work force who will continue to have the benefit of tax-free fares. It is this proposed inequality and its additional financial burden that is evoking such strong reaction from the industry, at a time when every effort must be made to expand its activities and thus provide a basis for pulling the country out of recession.

BUDGET CONFIDENTIAL

FROM: M E DONNELLY
DATE: 9 March 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Mr Middleton
Mr Moore
Mr Robson
Mr Turnbull
Mr French
Mr Ridley
Mr Graham - Parly Counsel
Mr Crawley - IR
Mr Stewart - IR
PS/IR

TAX TREATMENT OF DEEP DISCOUNT STOCK

The Financial Secretary has had further discussions with the Revenue on Mr Stewart's submission of 7 March.

In the light of these the Financial Secretary recommends that we go ahead with announcing details of the income deep discount bond with time asymmetry, option (c) in the Financial Secretary's minute of 24 February, in the Budget Speech, along with the fact that we may also be able to provide the capital route and will give fuller details if and when we can. The Revenue are currently giving further consideration to this capital deep discount bond (option (d) in the Financial Secretary's minute) and will report back in due course. This option can then be added at Committee stage.

MED

M E DONNELLY

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 9 March 1983

CHANCELLOR

CC Chief Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Mr Middleton
Mr Monck
Mr Pirie
Mr Ilett
Mr Salveson
Mr Ridley

LEGISLATIVE PROGRAMME 1983-84: TRUSTEE SAVINGS BANKS BILL

The Financial Secretary has commented that he entirely agrees with the Economic Secretary on the need for this Bill. But in the light of the very unsatisfactory discussion at Q(L), about which he has already spoken to you, he doubts whether the EST's suggested letter to the Lord Chancellor would be an effective way of securing a legislative place, let alone having the broader programme properly considered.

The Financial Secretary would be grateful for your advice on this.

MED

M E DONNELLY

CONFIDENTIAL

9 MAR 198

FROM: ECONOMIC SECRETARY
DATE: 9 MARCH 1983

FINANCIAL SECRETARY

cc Chancellor
Chief Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Mr Middleton
Mr Monck
Mr Pirie
Mr Ilett
Mr Salveson
Mr Ridley

LEGISLATIVE PROGRAMME 1983-84
TRUSTEE SAVINGS BANKS BILL

I was disappointed to see from the minutes of the first meeting of QL that the Trustee Savings Bank Bill has not been recommended for a place either in a short or in a normal session beginning in the Autumn of 1983. I have been devoting a good deal of time over the past year to negotiations with the Chairman of the Trustee Savings Banks Central Board on the future of the TSBs; we have established the guiding principles and much of the detail of the TSBs' move into the private sector; the proposals would be ready for legislation by the Autumn; and there is a serious risk that some of the impetus within the TSB movement towards change which has been built up over recent years would be lost if there is a delay in legislation.

2. A further point is that, although this is not strictly speaki a privatisation measure, as the Government is not selling the TSBs and will not be receiving the proceeds of the share subscription, it is fully in accord with our philosophy to help this long-standi and unique organisation to adapt to modern conditions and play an active part in market life by enabling it to reorganise on a Companies Act basis and issue shares to depositors.

3. I hope therefore that you will see your way to challenging QL recommendations, perhaps by writing to the Lord Chancellor in the terms of the attached draft.

GH

CONFIDENTIAL

DRAFT LETTER

From: FINANCIAL SECRETARY

To: THE RT. HON. THE LORD HAILSHAM
LORD CHANCELLOR

cc: Members of QL
Sir Robert Armstrong

LEGISLATIVE PROGRAMME 1983/84
TRUSTEE SAVINGS BANK BILL

I would like to make a further plea for the inclusion of the Trustee Savings Banks Bill in the programme.

The purpose of the Bill is to provide the legislative framework for this large personal bank to transfer to the private sector and issue shares to the public with priority to depositors. This will complete the transition of the TSBs from a privately-controlled but publicly regulated traditional savings bank structure to an independent bank able to compete on equal terms in the market place with the clearing banks. The TSBs have over 8 million depositors, 1650 branches and their net assets exceed £500m.
A substantial business is involved, and delay in legislating could be damaging to the TSBs' commercial interests as they seek to establish themselves fully in retail banking against powerful competition. Although the Bill is not strictly a privatisation measure, because the TSBs do not belong to the Government (or indeed to anybody), and we shall not be getting the proceeds of the share subscription, the proposals are fully in accord with our privatisation programme and our general philosophy.

There is the further point that legislation on the TSBs is necessary for Community reasons before the end of 1985, so that if the Bill does not become law in the next session legislation will become essential in 1984/85.

The proposals to restructure the TSBs are the outcome of a good deal of planning and negotiation both within the TSBs' present loose federal structure and between the TSBs and the authorities. Considerable impetus has built up. and if there is substantial delay before the Bill can be introduced this impetus could be lost, parts of the rather complex agreement reopened, and there will be a risk that commercially sensitive features of the proposals will leak. The sums of money at stake for the TSBs are very considerable and it is in everybody's interest, now that Ministers have reached agreement with the TSBs, that the agreed policy should be implemented as soon as possible.

We did seek a place for the Bill last year, so this year's request will have been no surprise. I would certainly argue that this Bill would be a prime candidate to replace the two local government measures in the programme in the event that they are not in fact ready for the next session; but I would hope that it would now be possible to find a more certain place for the Bill in both the short and the normal programme.

I am sending copies of this letter to John Biffen, Michael Jopling, Janet Young and ? Denham as well as to Sir Robert Armstrong.

Bertie

[N.R.]

FROM: M E DONNELLY
DATE: 9 March 1983

MR ST CLAIR

cc PS/MST(C)
Mr Le Cheminant
Mr C Ward
Mr Salveson
Mr Bristow

ABOLITION OF THE PENSIONS COMMUTATION BOARD

The Financial Secretary has seen your note of 4 March and the Minister of State (C)'s comments of 7 March.

The Financial Secretary would be interested to know the total cash savings from abolition of the Board.

The Financial Secretary has added that this Bill was not discussed at the Q(L) meeting, but almost no Bills were individually discussed. The Financial Secretary is sure that this measure should be added on to the next suitable miscellaneous Bill. No doubt you will advise when a likely candidate becomes available.

MED
M E DONNELLY

BUDGET CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 10 March 1983

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Mr Robson
Mr Hall
Mr Godber
Mr Ridley
Mr Corlett)
Mr Battishill) IR
PS/IR

ASSURED TENANCIES ALLOWANCE: PARTNERSHIPS AS APPROVED BODIES

Following his meeting with the Minister for Housing on 3 March, the Financial Secretary decided that partnerships (individuals) should be excluded from the Assured Tenancies allowance.

The main reasons for this were twofold:-

a) the Assured Tenancies allowance was intended for companies. It was always intended by Treasury Ministers to be a specific and narrow relief given last year on theunderstanding that the scheme should not be widened in subsequent years. The Financial Secretary made this clear to DOE Ministers last year and feels that this had been accepted by them.

b) by giving the relief to partnerships, individuals would be given a route to obtain the allowances simply by joining an "approved partnership".

The Revenue do not think that they could safeguard the legislation from abuse by individuals looking for a tax shelter.

The Financial Secretary did not believe that reliefs for investment in the rented housing sector should be as wide as those for investment in for example, the Small Workshops and Business Start-Up Schemes. He also recognised the implications such a widening would have in

elation to pressure for reliefs to be given to commercial buildings generally.

The Financial Secretary has therefore given the Revenue authority to draft excluding provisions in this year's Bill and also to publicise the decision by way of a Press Release and Resolution on Budget Day.

The Minister for Housing has today written to the Financial Secretary pressing for this decision to be reconsidered by Treasury Ministers ... (copy attached, top copy only).

The Financial Secretary has recently spoken to the Chancellor about this. He remains of the view that we should stand firm. However in view of what Mr Stanley says in the context of the Family Policy Group and Housing Policy generally, he would be grateful to know that the Chancellor still concurs.

EK.

E KWIECINSKI

MANAGEMENT AND PERSONNEL OFFICE
WHITEHALL LONDON SW1A 2AZ

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Mr. Glenbarg/IR
PPS PS/Mist(c) PS/Mist(d)
Mr. Reborn
PS/IR.

D L Willetts Esq
PS/Financial Secretary
HM Treasury

9 March 1983

Dear Willetts,

INLAND REVENUE SCRUTINY PROGRAMME 1982: PAYE END OF YEAR PROCEDURES - ANZ REVIEW

I apologise for not having commented sooner on Mr Anderson's draft report which I read with interest. It gives a detailed coverage of a complex administrative process. The report recommends changes that will result in simplified procedures, the discontinuation of a routine repetitive task and significant savings, in the order of 700 staff or £4m. This is set against additional tasks for employers and for individual taxpayers, some of which may be controversial.

2. The main recommendation is to abolish the Initial Assessment Review. Under the proposed arrangements responsibility for checking taxpayers' affairs would transfer from the Revenue to individual taxpayers. Information taxpayers need to do this would then be made available by the Revenue and distributed by employers along with the P60s. The Report suggests that this would not be a significant burden for employers as P60s must be distributed to all employees in any case, and I strongly support the move for individual taxpayers to take responsibility for their own affairs as appropriate in today's circumstances.

3. A more significant task would be the requirement for employers to complete an additional return to enable the identification of potential higher rate cases. This is likely to prove contentious as the information is already available to the Inland Revenue in the P35 forms. Mr Anderson judges that the additional burden would not be onerous for large or computerised firms. Your Minister will wish to see this checked out and to assess what will be the real burden on small firms. But the savings in public costs are sufficiently attractive to merit serious considerations.

4. Mr Anderson is to be congratulated on a thorough piece of work. His report provides opportunities for substantial savings. Legislation will be required and a strong commitment will be necessary if the savings he has identified are to be achieved.

5. I am copying this to Sir Lawrence Airey and to Mr Anderson.

Yours sincerely,

Clive Priestley

C PRIESTLEY
Head of the Rayner Unit

Your Ref:

Our Ref:

9 March 1983

BASW
British Association of Social Workers

Head Office:
16 Kent Street
Birmingham B5 6RD
Telephone: (021) 622 3911

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
The Treasury
Parliament Street
LONDON SW1P 3HE

Dear Sir Geoffrey

This Association greatly welcomes the interest which the Government is reported to be showing in family policy. We trust that in your budget of the fifteenth of March the measures which you introduce will be designed to strengthen and support those families currently under pressure as a result of the difficult economic situation. We believe that the budget offers an opportunity to construct a positive social policy, recognising the special needs of many vulnerable groups in society. We therefore set out below proposals which we would urge you to consider.

We urge the immediate increase of child benefit to £6.50. No other single measure could make such a significant contribution to the financial position of families with children whose position has progressively worsened relative to childless couples in the course of this administration. We estimate that this would cost £300m per year.

We would urge an increase in the level of tax thresholds, not only in line with inflation but also recovering the ground lost in previous budgets when tax allowances were not raied to a level to compensate for inflation. While raising tax allowances is costly, you may wish to consider the abolition of the married man's allowance and the disallowance of mortgage tax relief at the higher rates of interest as compensatory savings.

We trust that retirement pensions and other social security benefits will maintain their value in line with the rise in the cost of living. It is particularly important as it seems likely that the rate of inflation will increase in the forthcoming year. We would urge you not to recover the monies paid out as a result of wrong estimates of inflation in the previous budget. It is important that the real level of the pension and other benefits should be improved wherever possible.

9 March 1983

We would urge the immediate restoration of the full rate of unemployment benefit. It is a scandal that the Government has not restored the five percent abatement in unemployment benefit nor that this benefit is subject to tax. We estimate that this would cost £15m per year.

In order to secure justice for the long-term unemployed, we would also urge the extension of the long-term rate of supplementary benefit to the unemployed. Now that there are over one million people eligible for the long-term rate of unemployment benefit, a number which is likely to grow in future, there can be no justification for excluding this category of claimants from the long-term rate of benefit. This proposal would cost £110m per year.

The budget also affords an opportunity to remedy a number of injustices in the social security system. We would urge improvements in the level of death grant and maternity grant, which have lost real value substantially under this administration.

A deletion of the normal household duties test in assessment for housewives non-contributory invalidity pension and an extension of medical care allowance to married women caring for dependent relatives would also demonstrate a real determination on the part of the Government to promote family policy and to offer tangible recognition to those who provide community care on a daily basis. This, we estimate, would cost £40m per year.

The Association hopes that you will use the opportunity afforded by the budget of producing a budget that will strengthen family support systems. As social workers, regularly in touch with those in need in society, we believe that the measures set out above would fulfil the Government's strategy in relation to family policy by providing them with the resources to provide for themselves in the community rather than be dependent on public welfare provision.

Yours sincerely

Terry Bamford
Chairman

JC

Department of Employment
Caxton House Tothill Street London SW1H 9NF
Telephone Direct Line 01-213 6670
Switchboard 01-213 3000

Parliamentary under Secretary of State

FINANCIAL SECRETARY
REC. - 9 MAR 1983
ACTION MR TRAYNOR
COPIES TO PPS EST MST C CST MST R
SIR D WASS
MR A BAILEY
MR MERCER
MR WICKS MR WEBB
MR SALVESON

The Rt Hon John Biffen MP
Lord President of the Council
68 Whitehall
LONDON
SW1

March 1983

PRIVATE MEMBERS MOTIONS : FRIDAY 11 MARCH

As you know, Sir Victor Goodhew came top in the ballot for Private Members' Motions for 11 March and is expected to table the following:

> This House, noting the operation of arrangements to secure the health and safety of workers, congratulates the Health and Safety Commission and Executive on the part they have played in improving standards of safety and notes with approval the determination of the Government to maintain this improvement.

We are well aware of the motion and welcome a debate on this subject as Norman Tebbit's Private Secretary indicated in her letter of 18 February to Murdo Maclean. The second motion, to be tabled by Harold Walker, concerns industrial noise and industrial deafness which also comes within my sphere of responsibility. The terms of this resolution are likely to be objectionable and we would prefer therefore were it not to be reached. I would suggest that the first motion ~~be talked~~ out. I am preparing to deal with Sir Victor Goodhew's motion on that basis and, if you agree, I should be grateful if the Chief Whip would make the necessary arrangements.

I am sending copies of this letter to all members of 'L' committee and as the third motion for the day, in the name of Edwin Wainwright, concerns the mining industry, to John Moore.

JOHN SELWYN GUMMER

MANAGEMENT IN CONFIDENCE

FROM: NICHOLAS RIDLEY
DATE: 10 March 1983

CHANCELLOR

cc Minister of State (C)
Mr Middleton
Mr Moore
PS/IR

TAX DISTRICTS: PROPOSED CHANGES IN THE LOCAL OFFICE NETWORK

You asked for my comments on this.

The protests at the announcement of the Collection Office reorganisati attracted less fire than I thought - and what there was came almost entirely on the loss of jobs from job hungry areas of the country. The Unions were quite shirty and a number of MP's wrote in on their behalf - but there has been no follow-up (yet) by way of further PQ's, adjournment debates or second letters.

There are a lot of jobs at stake in the Collection reorganisation, but there are virtually none at stake over the tax districts. I would therefore expect the Unions to protest less over this and in consequence I would expect less protest from MP's.

Where it will be difficult is in remote areas, and also in areas where unemployment is very high. Moving an office and its staff from Pontefract to Wakefield may not lose any jobs overall but if it costs Pontefract 35 jobs, there would be a feeling of continuing decline there.

I think we could argue the latter case satisfactorily, but I would like to see the list of six places losing both Collection and Tax District offices. I think we should consider the remote towns very carefully, and be prepared to remove some from the list for closure, (before we publish it to the Unions) if we think we will eventually have to give way.

I also think we should be ready to answer a PQ, and put a document in the Commons' Library explaining the whole thing at precisely the right moment ie. when the Unions leak the proposals. (This is

what we did with the Collection Office review).

May I discuss these (and other) points with the Revenue and report back to you afterwards?

NICHOLAS RIDLEY

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 9 March 1983

MR C W CORLETT/IR

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

ASSURED TENANCIES ALLOWANCE: PARTNERSHIPS AND SHARED OWNERSHIP

The Financial Secretary was grateful for your note of 9 March.

He has discussed this with the Chancellor, and they agree that the Treasury should hold firm against DoE pressure to extend the Assurance tenancies allowance in these ways.

On partnerships the Financial Secretary is content for you to proceed along the lines of para 6 of your note.

E KWIECINSKI

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 10 March 1983

MR J M CRAWLEY - IR

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Mr Robson
Mr Hall
Mr O'Hare) IR
Mr Stewart)
PS/IR

MIRAS AND THE BUDGET

This note is just to confirm that the Chancellor's office have informed me that he is content to proceed along the lines of the Financial Secretary's recommendations (my note to PS/Chancellor of 8 March).

I passed on orally to Mr O'Hare the Financial Secretary's agreement to the final form of the letter to MPs and the Questions and Answers.

E KWIECINSKI

BUDGET CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 10 March 1983

PS/IR

cc PS/Chancellor
PS/CST
PS/EST
PS/MST(R)
PS/MST(C)
Mr Moore
Mr Robson
Mr Jenkin - Parly Counsel
Mr Beighton/IR

REDUCTION IN THE LENGTH OF THE FINANCE BILL

Ministers have agreed that for reasons of clarity the Business Expansions Scheme legislation should take the form of new provisions in a single Schedule. Unfortunately this will make the legislation substantially longer than originally envisaged perhaps 12 pages in the Finance Bill rather than 6.

In view of this Ministers have been looking at ways of finding some compensating reductions elsewhere in the Bill.

In these circumstances the Financial Secretary considers that starter no.147 - CTT and Discretionary Trusts - should be dropped, unless the Revenue see major drawbacks in this course.

E KWIECINSKI

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 10 March 1983

MINISTER OF STATE (REVENUE)

cc Chancellor
Chief Secretary
Economic Secretary
Sir D Wass
Mr Bailey
Mr Burgner
Mr Lovell
Mr Chivers
Mr Wicks

BRITISH ALCAN

The Financial Secretary has seen Mr Peyton's letter of 1 March and Ms Low's minute of 9 March reporting on the latest position.

The Financial Secretary agrees with the Chancellor's suggestion that ways should be explored to sell - or perhaps even to subsidise - giving Lynemouth pit to Alcan. This could lead to an overall increase in efficiency, by saving the Government money involved in subsidising the NCB's overheads for the pit if Alcan closes; and by providing a real incentive for this pit to increase its productivity. The Financial Secretary appreciates that there may be legal difficulties in such a move; but given that jobs are at stake he feels there is a strong incentive for us to pursue this route vigorously.

MED

M E DONNELLY

FROM: M E DONNELLY
DATE: 11 March 1983

MR ANDREN

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 Lovell
Mrs Hedley-Miller
Mr Chivers
Mr Gordon

COMMUNITY POLICY ON SMALL AND MEDIUM-SIZED ENTERPRISES

The Financial Secretary has seen the attached "action" Programme for a Community Policy on Small and Medium-Sized Enterprises, prepared by the Economic and Social Committee.

He has commented that the idea of state banks providing subsidised equity is not an attractive one. But he would be grateful for officials' assessment of the Report. More generally he wonders what prospects there are of any effective Community initiative in the field of small businesses.

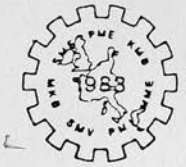
MED

M E DONNELLY

Brussels, 31 January 1983

EUROPEAN ECONOMIC COMMUNITY

EUROPEAN ATOMIC ENERGY COMMUNITY



ECONOMIC AND SOCIAL COMMITTEE

ACTION PROGRAMME for a COMMUNITY POLICY ON SMALL AND MEDIUM-SIZED ENTERPRISES

---

drawn up at the Conference
inaugurating the European Year of
Small and Medium-sized Enterprises,
held on
20 and 21 January 1983
at the
Economic and Social Committee

Presented by
Mr. G. DELEAU
Rapporteur-General

Reprinted by the The Forum of Private Business

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The Conference, comprising delegates from the European institutions and representative socio-economic organisations throughout the Community,

HAVING REGARD TO the European Parliament's Resolution of 19 February, 1982,

HAVING REGARD TO the Economic and Social Committee's Opinion of 26 May, 1982,

WHEREAS SMEs, which account for over 90% of the firms in the Member States, make a vital contribution to economic, social and cultural activity, and particularly to employment, and have a specific and indispensable role to play in the future of a free and democratic European Community,

WHEREAS SMEs can make a decisive contribution in tackling the crisis and the changes confronting the Community, in particular in fighting unemployment, a task considered to be of prime importance by all those with political responsibility,

WHEREAS the Community institutions and the Member State authorities should implement without delay appropriate Community and national policies conducive to the setting-up, development and integration of SMEs in the Community,

WHEREAS a favourable economic and social environment at national and Community level is essential to increase business confidence, stimulate job-creating investment and encourage innovation,

WHEREAS the action programme for a Community policy on small and medium-sized enterprises applies to all SMEs in the industrial, commercial and service sectors, including co-operatives, which have grown in significance over the last few years as a result of the recession,

proposes the following programme and calls for its implementation by the appropriate national and Community authorities.

A. Setting-up and development of SMEs in the Community

The financial promotion of SMEs

1. In view of the difficulties experienced by SMEs in raising capital, particularly in this period of inadequate investment and still excessively high interest rates, a series of measures should be implemented to facilitate SME financing, including:

- provision of finance for the setting-up and continued operation of SMEs, through an expansion of EIB (European Investment Bank) and ECSC (European Coal and Steel Community) loans and an increase in ERDF (European Regional Development Fund) aid and in the volume of NCI (New Community Instrument) allocations;
- simplification at Community and Member State level of financing procedures and the sufficiently decentralised provision of loans on terms at least equivalent to those obtainable on the market by large firms, which should not receive any preferential treatment;
- provision of finance for innovation, as regards both the development and the diffusion of new technologies, in order to stimulate SME potential in this area, by means of adequate support measures co-ordinated at Community level, and in particular through closer co-operation between Community finance instruments; this implies substantial loans for research and development in the economic sectors where SMEs predominate, and the setting up of an industrial innovation and development fund;
- export financing, with appropriate solutions being sought to the general problem of exchange risk cover.

2. It is essential in this connection that the Community institutions should be able to work with suitable national counterparts, so that there will be an optimum apportionment of Community funds, the loan conditions will be met and repayment will be assured. Consequently it is necessary to:

- ensure rapid distribution of Community funds and where necessary encourage the setting-up in each Member State of associations of approved banks and bodies specialising in the financing of SMEs, such as mutual security associations and loan guarantee associations; given the size of the borrowing firms, a system of mutual risk cover can provide a better guarantee for lenders;
- examine the possibility of supplementary security being provided by the Community;
- seek with the banking authorities of the Member States and the representatives of SMEs in the Community an improvement in financing conditions and the harmonisation of these conditions;
- encourage the setting-up, in the Member States where they do not already exist, of financial institutions with the task of providing SMEs, on a temporary basis, with venture or equity capital;
- develop the role of regional stock exchanges and improve the operation of the unofficial market so as to facilitate the placing of SME securities, as part of the modernisation and revitalisation of the European securities market.

The training of managers and workers

3. It is necessary to promote the training of entrepreneurs/managers so that they can adapt better to the changing conditions of economic activity and competition in all its aspects; to this end, the Commission should take stock of existing training facilities and, where necessary, recommend measures in this sphere at both national and Community level; in the context of measures for the training of SME entrepreneurs/managers and staff, consideration should be given to the financing of vocational training schemes organised on a joint basis by groups of SMEs.

4. Given the specific and growing difficulties facing SMEs as regards the vocational training of entrepreneurs/managers and workers, European Social Fund appropriations should be increased and allocated — in accordance with the real needs of the economy — to promote the development of flexible and innovative training for SMEs and make the European Social Fund a more important instrument for the creation of jobs for young people.

Information, advice and assistance for SMEs

5. Although the situation varies from country to country, SMEs are losing considerable opportunities for development because of inadequate information on the economic situation in general and on the state of European and world markets in particular. Advisory and information services should acquire a European dimension. The Commission should therefore take (or encourage) all necessary steps to facilitate SME access to information by way of data banks and new information technologies, as well as conventional means of information, and should promote the development of distribution and software services tailored to the specific needs of SMEs; the public authorities should also encourage the training of entrepreneurs/managers and their assistants to enable them to make the best use of informatic and telematic equipment.

6. In co-operation with the appropriate authorities in the Member States, a system should be devised whereby SME services are grouped together under one roof, so that all information can be obtained and all formalities for the setting-up of SMEs can be completed at the one place.

7. The relevant Commission departments should be given greater resources to enable the Commission to play its co-ordinating and stimulating role in disseminating national experience and statistics on SMEs for the information of this sector.

B. Opening-up of the Community to SMEs

8. It is essential to promote at Community level the effective integration of SMEs in economic and social activity by improving and adapting their legal, fiscal and administrative environment so that they can at last benefit from the opportunities afforded by a large single market.

SMEs have little information on the aids available from the Community, and the Commission should do everything possible to remedy this situation.

The Community market

9. In keeping with the conclusions of the European Council of December 1982, the Council and the Commission should do their utmost to advance more resolutely towards the effective elimination of technical and administrative barriers to trade, the simplification of frontier formalities and the control of direct and indirect national subsidies and other aids, which give rise to distortions of competition that are particularly detrimental to SMEs.

The legal environment

10. The Council should adopt without further delay the Regulation on the establishment of a European co-operation grouping, taking into consideration the rights of workers in the Member States; the Commission for its part should draft a Regulation on the establishment of a European statute for limited liability companies.

11. SMEs need and deserve equal conditions of competition; this entails watchfulness against abuses of dominant positions, whatever their cause.

12. Throughout the Community, public sector procurement should be organised in such a way as to give SMEs a better chance of participating. The Commission should consider the need to submit proposals for Directives to this end as soon as possible. The Commission should take more account of the specific nature of SMEs and provide for their protection in its Regulations on agreements relating to selective distribution and the exemption of certain categories of patent and licence agreements. In general, all forms of SME co-operation should be encouraged, coupled with legal guarantees in respect of anti-trust provisions. Consideration should also be given to the case for a "code of conduct" to be adhered to by large firms in their dealings with SMEs.

The fiscal environment

13. The availability of investment funds will depend largely on the implementation in the Community of an adequate fiscal policy that does not penalise but rather provides incentives. This involves in particular:

- a significant reduction in the taxes on profits ploughed back and in the various taxes on capital invested and the income therefrom;
- tax relief for newly created SMEs and incentive premiums for the setting-up of SMEs;
- the possibility of reasonable amortization on the basis of replacement cost;
- the introduction or extension, as required, in all the Member States of tax arrangements enabling losses and profits to be spread over a number of years;
- allowance by the authorities for the costs (relatively higher than in the case of large firms) incurred by SMEs in complying with tax and other regulations;
- systematic and transparent tax relief for research;
- appropriate tax arrangements where ownership of SMEs passes to heirs or to other persons — legal or natural — who keep the business running.

Wherever possible, the Commission should encourage changes along the above lines in the tax provisions, in particular by calling upon the Member State governments to introduce measures to facilitate self-financing by SMEs and by seeking convergence towards a taxation system harmonised at Comminuty level.

The administrative environment

14. The public authorities should pursue a general policy of simplifying the administrative workload of SMEs so that they can exploit their dynamism and ability to adapt flexibly. In this connection, the tasks assigned to the Business Co-operation Centre in 1973 should be taken as a model in setting up decentralised bodies with sufficient resources to enable them to play an active role as provider of information and co-ordinator of the efforts to simplify administration in SMEs and co-operatives.

15. It is also essential to set up a European Institute for Small and Medium-sized Enterprises with the task of contributing to the formulation of a medium and long-term overall Community policy on SMEs. Scientific studies on the various functions of SMEs should also be undertaken in the EEC as a matter of urgency.

The economic environment

16. The Commission and the Council should view the problems of SMEs in the context of the Community's overall economic policy so that account is taken of SME's diversity and their specific features in connection with matters such as industrial co-operation, competition policy, fiscal policy and commercial policy.

17. The Commission and the Member States are called upon to adopt measures to meet the specific needs of SMEs, such as:

- —inclusion of the SME sector in common industrial investment and research programmes with a view to promoting co-operation and technology transfers between SMEs, as well as between SMEs and large firms, universities and government bodies;
- —access to sub-contracting and patent licencing in all the Member States;
- —making it possible for SMEs to display in an adequate and appropriate way their capabilities in all fields (for example, the organisation of regular exhibitions of products made by SMEs in the Community, and support for Community SME participation in international fairs and fairs in non-member countries);
- —protection for Community SMEs in the area of industrial property; the Community patent convention should be ratified by all the Member States as soon as possible, and it should be made easier for SMEs to obtain a European patent and maintain its validity by lowering the costs;
- —measures necessary in order to pursue an effective campaign against the "parallel economy", which is detrimental to society at large and to SMEs in particular.

The social environment

18. SMEs can play a key role in the creation of jobs in the Community. Without calling into question the social provisions in force in each Member State, account should be taken of the specific features of SMEs, and the necessary legislation should not impede but foster their development.

19. In particular, the Commission should together with the Member States give consideration to the following:

- —the possibility of a more balanced apportionment among firms of the burden of social security contributions so as not to penalise labour-intensive enterprises;
- —the introduction or improvement of basic social protection measures affording SME entrepreneurs coverage against sickness, old age and invalidity, or, pending the implementation of such measures, coverage of the major risks through fiscal or other measures;
- —the need to make allowance, in legislation and collective labour agreements on the adaptation of working time and on working conditions, for the special features of SMEs so that the latter are not hampered in the creation of jobs by excessively rigid rules, particularly concerning recruitment and dismissal.

External relations

20. The European Community can play an important role in the development of SMEs in Third World countries so that these countries can achieve an economic structure and a social environment capable of furthering their development on the basis of existing potential and traditions.

It is therefore important that the Community should encourage the development of SMEs in Third World countries inter alia under the Lomé Convention, and to this end make use of the experience gained and the co-operation machinery available in the Community. It is desirable that SMEs in the Community be stimulated to co-operate with their counterparts in the Third World, not only with a view to fostering trade between Europe and the developing countries but also to enable the latter to develop a balanced economic and social structure.

21. Through its institutions the European Community should make it possible to solve the general problem of aids for the promotion of SME exports by ensuring that these aids are homogeneous, adequate and integrated in a Community framework.

CONFIDENTIAL

DEPARTMENT OF THE ENVIRONMENT
2 MARSHAM STREET
LONDON SW1P 3EB
01-212 7601

MINISTER FOR HOUSING AND CONSTRUCTION

Advise please. Comments to see
NR

10 March 1983

Dear Nr Ridley

Following our meeting of 3 March on extending capital allowances to shared ownership our officials have had a further discussion. I understand that you intend both not to extend capital allowances to shared ownership dwellings, and also to withdraw capital allowances from partnerships approved as assured landlords. We shall want to come backto you on the major question of the extension of allowances to shared ownership dwellings. However my immediate concern is with the withdrawal of allowances from partnerships which I understand you want to announce in the Budget Resolutions.

I consider that such a step would be quite unjustified. The partnership so far approved is in fact a more substantial landlord than many companies that we have approved, and very clearly met our criteria. You will recall that Michael Heseltine, in his letter to Geoffrey Howe of 23 February last year, said that he would accept the limitation of capital allowances to assured tenancies only on the condition that approval was a housing matter solely for him.

I see no reason whatsoever for your view that partnerships should not also receive capital allowance. I think we are all agreed that assured tenancies (leaving aside shared ownership for the moment) should be fully encouraged and indeed extended, and that the scheme is an excellent means of reducing our reliance on public sector rented accommodation. The meeting of the Family Policy Group on 15 February was clear on this. It is also a means of placing an initially small, but gradually increasing, proportion of the private rented sector on market rents - which chimes in entirely with your own views. Some landlords, including clearly respectable ones, prefer to trade as partners rather than companies. As it is our policy to encourage the scheme, they should not be discriminated against.

I recognise that you have always said that the capital allowance scheme for assured tenancies should be a limited one. But the reason for that was the lack of legislative time last year.

In the case of partnerships, you will now need to legislate whether they are to be included or excluded, as the 1982 Act is unclear, so lack of legislative time is not a consideration. That leaves us with policy considerations. There is no taxation policy case that I am aware of for exclusion, as partnerships receive capital allowances in respect of hotels and industrial buildings. And, as far as wider policy considerations are concerned, it is - as I have said - agreed Government policy to encourage assured tenancies.

You are particularly concerned that individuals will move in and out of partnerships solely to strip out the allowances. They would be limited or sleeping partners. This can of course arise equally under other capital allowances, but - if it helped - I would be prepared for our officials to explore ways of avoiding this. When we approve a partnership, we name the approved partners in the approved order. If new partners come in and wish to hold land on behalf of the partnership, then fresh approval is required, and we would look at the respectability of the new partner. Fresh approval would not however be required if a sleeping or limited partner joined the partnership with no intention that he should hold land. In that case, they would not be named in the order. A possible course would be to limit allowances in the Finance Act to those partners actually named in the approval order, and this would seem to remove any doubts you have on the score of tax avoidance.

I should be grateful if you could let me know whether you would be willing to give further consideration to allowing partnerships to retain capital allowances in the light of what I have said above. In the meantime I should make it clear that I have certainly not agreed to the exclusion of partnerships from capital allowances.

/ Whilst I am writing, I am attaching a copy of the minutes of the meeting of 3 March with three particular amendments I would like to see made (paras 4, 14 and 18).

I am copying this letter to Ferdie Mount.

Yours sincerely

PP JOHN STANLEY
(Agreed by the Minister
and signed in his absence)

Mrs Hedley-Miller
Mr Unwin
Mr Lennan
Miss Court
Mr Edwards
Mrs Edwards.

FINANCIAL SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Douglas Hurd CBE MP
Minister of State
FCO
LONDON
SW1

10 March 1983

Dear Douglas

NEW COUNCIL BUILDING

Thank you for your letter of 22 February seeking my agreement to the principle of the purchase, through the Community Budget, of a new Council building in Brussels, payment to be made over the period of construction.

This is an expensive project, and the Community's resources are limited. It is clearly against our interest to advocate any further avoidable strain on those resources. I hope, therefore when this is next discussed in the Foreign Affairs Council, you will not take the lead in advocating a decision to proceed: and, on the contrary, that you will intervene to support any who express hesitation about proceeding with what may appear to outside observers to be an extravagence at a time of stringency. But I accept that the present Council building is already cramped, and will become more so. In the light of the history of the project, I suggest you neither take the lead in condemning it, nor stand out alone against it.

Accordingly, if you are satisfied that there is a consensus among Ministers in favour of the purchase of a new Council building, I agree that the United Kingdom can also give its approval in principle, subject to certain conditions. The conditions are those set out in your letter, namely our satisfaction on the overall cost of the project, the choice of developer and the arrangements for sub-contractors, to which I add two further points which must be made at the Council.

The first is that our agreement at a time when the limit of own resources may be in sight does not mean that the UK accepts that there is a case for an increase in the overall amount of the Community's own resources. The cost must be accommodated within the means available, if necessary at the expense of other expenditure.

My second point is one to which you refer, on the classification of the expenditure. Logically, this should be classified as obligatory expenditure since it would arise out of a contractual obligation entered

into by the Council. As part of the inter-institutional agreement of June 1982, it washowever agreed that the budget line covering construction of buildings should be classified as non-obligatory. The Parliament would no doubt want to stick to the letter of the June agreement, as this would (except perhaps in the first year) increase the base on which their margin of manoeuvre is calculated. But I think that we should still feel free to argue in the Council for classification as obligatory: and I would expect others to have support for this, because of the implications for the overall size of the Budget in an already tight situation.

I agree that there must be further careful scrutiny once we have the Belgian proposals.

I am sending copies of this letter to the recipients of yours.

NICHOLAS RIDLEY

cc Mr Monck
Mr Pirie
Mr Hall
Mr Munro - IR
PS/IR

Treasury Chambers, Parliament Street, SW1P 3AG

D J Elvidge Esq
Chairman of Taxation Committee,
Committee of London Clearing Bankers
C/O Barclays Bank
Bucklersbury House
3 Queen Victoria Street
LONDON
EC4P 4AT

10 March 1983

Dear Mr Elvidge

CONSTRUCTION INDUSTRY TAX DEDUCTION SCHEME: BANK GUARANTEES

I understand that a problem has arisen over the new special certificate which, following legislation in last year's Finance Acts, has been available to certain sub-contractors in the building industry since last December.

One purpose in introducing the new arrangements was to help school leavers. But we also decided to give the special certificate to older sub-contractors who could satisfy all the statutory requirements except the "three year" rule, and who could provide a satisfactory guarantee from their bank.

So far as those guarantees were concerned, I should make it absolutely clear that it was never our intention to intervene in any way in what is essentially a private commercial matter between a bank and its client. We recognised right from the start that not many applicants would be able to satisfy their bank that they were an acceptable risk. Nevertheless, we thought that this might help some people, and would be worthwhile.

I understand from the Revenue that, some clearing banks have been prepared to offer guarantees. But others have indicated that in no circumstances would they be willing to do so, because of certain detailed points arising on the guarantee. The Revenue tell me that they have tried to be as accommodating as possible, but that for various reasons they cannot make all the amendments which have been suggested.

I am not sure whether we are confronted by insoluble problems here or whether there has simply been a breakdown in communcations. I am obviously very concerned that the improvements we made last year might be rendered ineffective in part. I should therefore like to suggest a meeting to discuss this problem. For myself, I should certainly find it helpful to talk with you and some of your committee about the difficulties which you perceive. I should hope

that we could explore what the difficulties are.

If you would be happy with such a meeting may I suggest that you contact my Private Secretary (on 01-233-8703) to fix a convenient time. Perhaps I should add that I would find it most helpful if you would be kind enough to let me have a note in advance of the meeting summarising the main difficulties you see arising from the present arrangements.

Yours sincerely,

Nicholas Ridley

NICHOLAS RIDLEY

Treasury Chambers, Parliament Street, SW1P 3AG

C H de Waal Esq
Office of the Parliamentary Counsel
36 Whitehall
LONDON
SW1A 2AY

10 March 1983.

Dear Mr de Waal

PORTS (REDUCTION OF DEBT) BILL: DRAFT MONEY RESOLUTION

We have only now received a copy of your letter of 10 February to Mr Bellis, enclosing a copy of the draft money resolution for this Bill.

... I attach the resolution initialled by the Financial Secretary.

Yours sincerely

Martin Donnelly

M E DONNELLY
Private Secretary

PORTS (REDUCTION OF DEBT) [MONEY]: Queen's Recommendation signified

Mr Nicholas Ridley

That, for the purposes of any Act of the present Session to make provision for reducing the indebtedness of the Port of London Authori and the Mersey Docks and Harbour Company, it is expedient to authoris

(a) the release of those bodies from their liability to repay money lent to them under section 11 of the Harbours Act 1964 and section 1 of the Ports (Financi Assistance) Act 1981 up to a maximum of £26 million i the case of the Port of London Authority and £36 mill in the case of the Mersey Docks and Harbour Company;

(b) the payment out of moneys provided by Parliament of su not exceeding £22 million for enabling the Port of London Authority to repay a loan or loans guaranteed under section 1 of the said Act of 1981.

NR

10.2.83.

BUDGET CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 11 March 1983

MR C CORLETT/IR

cc PS/Chancellor
PS/CST
PS/MST(C)
PS/MST(R)
Mr Robson
Mr Hall
Mr Godber
Mr Ridley
Mr Corlett)
Mr Battishill) IR
PS/IR

ASSURED TENANCIES ALLOWANCE: PARTNERSHIPS AS APPROVED BODIES

The Financial Secretary has been told of the contents of Ms Rutter's note of 11 March. He has decided that the Budget resolution should take the form of an open ended provision.

He would be grateful for your comments on para 3 of Ms Rutter's note and on Mr Stanley's letter of 10 March.

E KWIECINSKI

RESTRICTED

FROM: M E DONNELLY
DATE: 11 March 1983

NOTE OF A MEETING HELD AT 3.30PM IN THE FINANCIAL SECRETARY'S ROOM TO DISCUSS SOLUTIONS TO THE UK EUROPEAN BUDGET PROBLEM

Those present: Financial Secretary
Mr Unwin
Mrs Hedley-Miller
Miss Court
Mr Edwards
Mr Fitchew
Mr Matthews
Mr Donnelly

Paper were Mr Edwards' note of 2 March; Mr Donnelly's note of 7 March.

The Financial Secretary said that Mr Edwards' paper was a very useful first analysis of the Commission ideas for a new own resource based on agriculture. Some revision to the financing of Community agriculture expenditure offered a useful way of redressing the UK's budget difficulties. It was clear that some fallback financing mechanism to limit net contributions, on the lines of the Chancellor's first option in his 7 February Brussels speech, was necessary. It was a great advantage of this scheme that it wrapped up the necessary protection on both the contributions and the receipts side. But it might be hard to sell to other member states. Politically it was vital also to put forward ideas on reform of CAP financing which appeared to be communautaire and also to follow up the Commission's Green Paper ideas. To do this we needed to look more closely at possible production "keys" which both offered a substantive return to the UK and could also be saleable to other member states. Similarly the Chancellor's first option needed to be further analysed to check on its effect on everyone else in the Community.

Officials agreed that if an agriculture own resource could offer substantial benefit to the UK, the amounts we needed from the financial 'safety net' would be reduced. But the proposed agriculture own resource brought the danger that agricultural expenditure could

ore readily be expanded, because it carried a proportion of its own revenue with it. This would lessen budgetary control over total Community expenditure on the agricultural sector with consequent danger to the UK. Some 'safety net' would continue to be vital.

Discussion turned to the broader problems of agriculture within the Community. The Financial Secretary said that there were only three ways to deal with surpluses: to pay producers to set aside land for other uses; to push down overall price levels; or to tax the over producers on a co-responsibility system. This problem existed in its own right, and must be pursued in parallel with negotiations over the size of the UK budget refunds. In discussion it was pointed out that the ideological resistance to any scheme which could be seen as a renationalisation of the financing of the CAP would be very strong. Even attempting to identify some countries as the producers of the surpluses would be difficult since it was argued that surpluses were a Community rather than a national problem. The French in particular greatly valued their self styled "vocation exportatrice" in agriculture.

It was suggested that a continued effort to keep prices down was necessary. But this had been the UK line for many years and it needed to be supplemented - perhaps with a quota system or through setting intervention price levels related to world price levels. In 1983 there was a real risk of the Community running up against a 1 per cent VAT revenue ceiling; this might be a force for price moderation. But more likely agriculture ministers would simply take their decisions and leave the Community to deal with the budgetary problems later. It was suggested that as part of the budgetary negotiations we should aim to agree some new principles for the financing of future agricultural production, paying more attention to keeping surpluses down.

The Financial Secretary stressed that we needed to be able to propose an agricultural reform which was both sensible and communautaire. Agriculture was not a social service and it was important not to let Community orthodoxy about agriculture be dominated by the French line. Officials warned that it would take many years to put an effective

eform of the CAP into effect: we could not rely on such a reform to solve the budgetary imbalance problem.

Summing up the Financial Secretary said that there were important questions of tactics and presentation involved in the struggle for a solution to our budgetary problems. It was important that we were seen as following a communautaire posture before negotiations became critical. This meant stressing our desire for reform of the financial aspects of the CAP while also of course pursuing the Chancellor's first option. He asked officials for a further submission on how best to tackle the question of agriculture reform in the context of the wider budget negotiations.

MED
M E DONNELLY

Circulation:

Those present
PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir D Wass
Mr Littler
Mr Lovell
Mr Sedgwick

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 14 March 1983

MR BURGNER

cc Chancellor
Chief Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Mr Middleton
Mr Bailey
Mr Morgan
Mr Wicks
Mr Wilson
Mr Broadbent
Mr Grimstone
Mr S Thomas
Mr Ridley

SALE OF SHARES AND ASSOCIATED BRITISH PORTS HOLDINGS (ABPH)

The Financial Secretary has read Mr Broadbent's note and paper of 8 March, and your covering minute of 10 March.

The Financial Secretary found this material most useful and interesting. You are preparing an agenda for a wider meeting looking at all the lessons to be learned from Government share sales. The Financial Secretary looks forward to discussing the ABPH sale in that context.

MED

M E DONNELLY

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 14 March 1983

MR WILDING

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir D Wass
Sir A Rawlinson
Miss Kelley
Mr Monger
Mr F K Jones
Mr Watts
Mr Fawcett - IR
PS/IR
Mr Porter - C&E
PS/C&E

CHARITIES

The Financial Secretary was grateful for your note of 11 March covering Mr Watts minute of 10 March.

Subject to your comments the Financial Secretary proposes to proceed as follows:-

(i) he would like to hold a meeting with officials from Treasury, Revenue and Customs as appropriate to discuss the whole project;

(ii) on the basis of a paper prepared in the light of that meeting he will discuss the whole matter with the Home Secretary. The Financial Secretary agrees that it would better if this could be done before the FPG meeting;

(iii) the task force should then be set up under Treasury chairmanship. It should aim to make progress without legislation in the first instance (except perhaps through changes analagous to those proposed in the Keith Report.)

MED
M E DONNELLY

CC CST
MST(C)
Sir ~~Mr~~ Rawlinson
Mr Mountfield
Mr Chivers
Mr Ilsley
Mr King
Mr Kelly
Mr Salveson

Treasury Chambers, Parliament Street, SW1P 3AG

Sir Donald Kaberry Bt TD DL MP
Chairman of the Select Committee on Industry and Trade
House of Commons
LONDON
SW1A OAA

14 March 1983

Dear Donald

INDUSTRY AND TRADE COMMITTEE

Thank you for your letter of 2 March about the spring Supplementary Estimates for class IV, vote 1.

I share your concern to give the House the maximum possible notice of Supplementary Estimates and as much information about them as practical. I hope you will feel that the practice of sending Supplementaries in proof to select committees in advance of formal presentation and the introduction of the Financial Secretary's Note have both been steps in the right direction.

I also agree with you that the need for Supplementary provision on one subhead should not be used as an excuse for unreasonably delaying the supply of information about other matters within the same Supplementary. Equally, however, I would not want to mislead the House by, for example, making premature estimates of the additional provision that would be needed before all possible offsetting savings had been identified. Supplementaries generally need to be taken as a whole, particularly where cash limits are concerned. As I am sure you will accept, there are special problems with spring Supplementaries because of the tightness of the timetable.

In this particular case, as you are kind enough to acknowledge, there was good reason for the delay in presentation of the main item covered by the Supplementary - the Department of Industry's stockpile of strategic minerals. I understand that we gave you as much advance warning about this as possible, following John MacGregor's comments to the House.

I am sorry that you were not given warning about the possbility that other subheads might be affected by the same Supplementary. I accept that that was wrong, though, as far as I am ware, there was nothing particularly controversial about any of them. I have taken steps to ensure that the mistake is not repeated in the future.

I am copying this letter to the recipients of yours.

Yours ever
Nigel

Miss Court
+ Lennon
Mr Unwin
Mrs Hedley-Miller
Mr Peat
Mr Bray - FCO.

Treasury Chambers, Parliament Street, SW1P 3AG

PS/Government Chief Whip
12 Downing Street
LONDON
SW1

14 March 1983

Dear Murdo,

COURT OF AUDITORS REPORT ON THE 1981 ACCOUNTS

You will have seen the replies from Mr Hurd and the Lord President of the Council to the Financial Secretary's letter of 2 March to Mr Hurd.

We have now heard from Brussels that the Presidency want to take the Council's recommendation as an 'A' point at the Foreign Affairs Council tomorrow. The Financial Secretary therefore wrote to the Chairman of the Scrutiny Committee last Friday (copy attached) seeking his agreement that the UK go along with the recommendation tomorrow. As you can see, the Financial Secretary also undertook to try to hold the debate on the Court's report as soon as possible thereafter.

I have been told this morning by the Clerk to the Scrutiny Committee that the Chairman and some Committee members are in Denmark and he will not therefore be able to reply to the Financial Secretary's letter before the Council tomorrow. In these circumstances, the Financial Secretary has decided that we should agree the Council's recommendation tomorrow.

All this means that the case for an early debate has been reinforced. In the past we have been able to hold the debate before the Council's recommendation is agreed. This year, partly because the Scrutiny Committee did not consider the report until the end of February and partly because the German Presidency has made quick progress towards agreeing the recommendation, we have not been able to do so. Nevertheless, the Financial Secretary hopes the Chief Whip can now propose

a time for an early debate. This would ensure our good relations with the Scrutiny Committee are not damaged. He would hope the debate could take place next week, and failing that, certainly before the Easter recess. He would wish to inform the Chairman of the Scrutiny Committee about the timing of the debate on his return from Denmark later this week.

Yours

Martin

M E DONNELLY
Private Secretary

MANAGEMENT IN CONFIDENCE

FROM: FINANCIAL SECRETARY
DATE: 15 March 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Sir A Rawlinson
Mr Le Cheminant
Mr Robson
Mr Williams
Mr Porteus
Mr Driscoll - IR
PS/IR

TAXATION OF CIVIL SERVICE ALLOWANCES

You asked me, with the two Ministers of State, to look for a solution to this problem which attracted some Press coverage last month. We have two objectives. We want civil servants to be treated neither more nor less favourably than other employees. At the same time any solution must make administrative sense.

I hope that we can quickly dispose of telephone and clothing allowances. The old allowances will be replaced by new taxable allowances negotiated at levels which reflect their taxability. There will be no individual grossing-up. We shall also try to reduce the incidence of such payments. There may be some overall saving.

The fact that these payments are taxable simply reflects the distinction that is drawn between what the Treasury or any other good employer thinks it right to reimburse and what tax law allows to be paid tax-free. We have tried to see whether there is any way in which the effects of that distinction can be reduced. None of the possible approaches we have considered offers hope of an immediate solution.

The Twelve Month Rule

The 'twelve month rule' is the test which the Inland Revenue applies to determine whether employees are 'temporarily' away from their normal place of work or should be regarded as having acquired a new

place of work. It is a generous interpretation - based on judicial dicta - of the Schedule E expenses rule. The Inland Revenue are confident that it would survive a challenge in the Courts. About 1,500 civil servants will now fall on the wrong side of the twelve month rule and are due to start paying tax on their lodging and fares allowances.

To complete the picture, a slightly smaller number (about 1,000) knows as peripatetics, have no fixed place of work. A few others (perhaps 200) have left one fixed base for another and are not due to return. Both these groups receive allowances which have to be regarded as taxable. The twelve month rule is not relevant in their cases and a solution to that problem would not necessarily help them.

If we were operating in a vacuum it would be a straightforward matter to declare that all payments in the categories with which we are concerned should be tax-free. This could be done either administratively or by statute. But in the real world that would mean either giving an unacceptable privilege to public sector employees or opening up a massive and easy way for the private sector to avoid tax.

It might just prove possible to re-formulate the twelve month rule in such a way as to exempt the majority of the payments now in dispute without risking widespread abuse in the private sector. That would mean legislation. I have asked the Inland Revenue to look into that possibility. But such a solution would be some way off and it must be expected that an alternative rule would produce its own crop of anomalies and hard cases. I do not see that as the answer to our immediate problem.

We have concluded therefore that we must, for the time being at least, accept the principle of taxability.

he Allowances

We turned next to the allowances themsleves to see whether the payments made to those seconded to Northern Ireland and elsewhere could, like the clothing and telephone allowances, be rationalised. But we concluded that in the end flat-rate taxable allowances here could be more expensive than the present system and would undoubtedly be criticised as being both too broad brush and too generous for application to public servants. If most were to be fairly treated some would get too much by way of allowances. The present system of lodging, travel and subsistence allowances is cheaper and, because it is based more closely on individual behaviour, more easily defensible. Nonetheless there may well be scope for some reduction in the incidence of detached duty payments. Similarly, the Inland Revenue believe that there will be cases where a closer examination of the facts (and possibly a small change in procedures) may take some peripatetic staff out of the tax net.

Accounting for Tax

Turning to the mechanics of accounting for tax, we looked at the possibility of 'bulk accounting', what the Unions call 'compositing'. Of course from one point of view this idea has its attractions and the Revenue want to look at the possibility of introducing it (by law) in relation to small benefits in kind. But its (concessionary) introduction at this stage for civil servants when it is refused for 'outside' employees would be seen as giving preferential treatment. It would be a serious derogation from the principle that income tax should be calculated on the basis of individual liability. Nor would the idea of the Treasury accounting to the Revenue for a global sum be inherently less ridiculous than that of its applying PAYE to grossed-up amounts. It is still 'left-hand, right-hand'.

Conclusion

We conclude therefore that the proposal to gross-up and tax these allowances is the least unsatisfactory way of dealing with the matter in the short term. It is what other employers do and it can be

chieved at relatively little administrative cost (perhaps 10 staff). The numbers of cases and the amounts are very small - less than 1 per cent of civil servants and less than 4 per cent of the total annual expenditure on travel and subsistence are affected. It is most unfortunate that figures like £m250 have been used when the true total is more like £m10. Treasury officials had virtually agreed with the Departments a set of comparatively simple arrangements and are ready to go ahead - from 1 July if you agree.

This is obviously not an ideal outcome but in this area anything we do is liable to be misunderstood and misrepresented. I think it is important that we ourselves should keep the matter in perspective. This is very much a problem of the margins. Moreover, if we had not moved to apply tax 'Civil Servants' Tax-free Bonanza', 'Whitehall Looks After Its Own' might have been equally unwelcome headlines. Nor has all the Press comment been one-sided. You saw, I believe, the editorial in The Accountant of 17 February a copy of which I append. While containing a number of errors of fact that article, written for a readership of accountants, did not question either the principle of taxation or the practice of grossing-up. It said -

> For the civil service unions to claim that payment of tax on expenses is bureaucratic madness is patently ridiculous. It would be intellectually comparable to say that they should pay no tax or national insurance but get lower salaries.

If you agree I shall prepare a note for you to send to the Prime Minister explaining the decision and in particular emphasising the important principles involved.

NICHOLAS RIDLEY

Omelette facepack

SO IT SEEMS that the Government has only just become aware that Civil Servants have been receiving round sum expense allowances tax free. What is so obviously embarrasing is that it has only come to light because the Civil Service unions are protesting at the method chosen to bring their members in line with the rest of the population.

It appears that there is no expense return comparable to the P11d which private employers are required to complete. So, although the Revenue knew such payments were made it did nothing to tax them until Treasury Minister Nicholas Ridley gave the go ahead last week.

Several matters have still to be settled. Just what figure will be used to gross the payments up to 'pay' the Civil Servants' tax liability? How about those who are brought into higher tax rates? What of those who will be able to claim that expenses are wholly, necessarily and exclusively incurred and so tax relievable under section 189 — they will in effect be getting a pay rise on however much they claim in expenses!

For the Civil Service unions to claim that payment of tax on expenses is bureaucratic madness is patently ridiculous.

It would be intellectually comparable to say that they should pay no tax or national insurance but get lower salaries. Now there's an idea — what about the saving in Civil Service jobs that would mean!

But they ought to consider the long-term effect on the public of what has happened. For in the past years when they were claiming that they ought to be paid a comparable amount to the private sector there was no mention of their tax free perks — £250 million worth of travel and subsistence alone. This must lead us to wonder what else we do not know about.

COVERING CONFIDENTIAL

FROM: M E DONNELLY
DATE: 15 March 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Mr Bailey
Mr Burgner
Mr Morgan
Mr Farrington
Mr Hurst
Mr Harris
(without attachment)

BUS COMPANIES: PRIVATISATION

... The Financial Secretary has approved the attached submission and recommends that the Chancellor write to Mr Howell on the lines proposed. The Financial Secretary thinks it is important not to tolerate further delay in the privatisation plans for bus companies in either England or Scotland.

MED
M E DONNELLY

CONFIDENTIAL

FROM: A F HURST
DATE: 14 March 1983

PB 14/3

1. MR BURGNER
2. FINANCIAL SECRETARY
3. CHANCELLOR

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

BUS COMPANIES: PRIVATISATION

Proposals for privatisation of the Scottish Transport Group were due for discussion in E(DL) late in 1982 but the required paper was not brought forward by the Scots until recently. These proposals proved to be both disappointing and negative but as we were expecting Mr Howell to produce shortly privatisation proposals on National Bus Company we recommended (and you agreed) that we should consider the two bus groups together. My submission dated 18 February outlines this and is attached.

2. The letter dated 8 March 1983 from Mr Howell's office suggesting that consideration should go ahead separately on STG, because of an expected delay on the NBC paper (which we understand will be in order of 2 months) is both disappointing and unwelcome. We understand the merchant bank study, on which Mr Howell's paper will be based, is close to completion and there seems little justification for prolonged delay.

3. It is of course possible for us to go ahead with consideration of the STG paper, although a discussion of it alone is less likely to be fruitful or lead to anything more than at best a fruther Merchant Bank Study. The overall result is likely to be further delay and procrastination.

4. We see great benefit in our previous contention that the bus companies should be considered together. Moreover, there seems little justification for a long delay in bringing forward the NBC paper. We think, therefore, it is worth writing to Mr Howell asking him to bring forward his proposals more quickly. We consider this might preferably come from the Chancellor, as Chairman of E(DL), and would

thus reflect the Government's desire to maintain momentum on this with particular regard to its overall privatisation objectives.

5. A draft letter based on this proposal is attached.

Alan Hurst.

A F HURST

CONFIDENTIAL

DRAFT OF A LETTER FROM THE CHANCELLOR TO MR DAVID HOWELL
SECRETARY OF STATE FOR TRANSPORT

BUS COMPANIES: PRIVATISATION

I have seen the letter from your Private Secretary advising members of E(DL) that your proposals on privatisation for the NBC are to be a little later than we hoped.

I am concerned about the implications of this both in relation to the bus companies and our broader objectives on privatisation. I accept that it is important that we move forward in a considered way but I must ask you to reconsider whether or not it is possible for you to ensure that your proposals for NBC are brought forward more speedily. It is, in my view, particularly important that we consider the two bus groups (NBC and STG) together and we have suffered somewhat from delays already.

I am certainly content to delay consideration of the STG proposals for a few more weeks and suggest we aim for joint consideration in mid April. Perhaps you would let me know if you see this as acceptable or outline what the difficulties are.

I am copying this letter to members of E(DL), Sir Robert Armstrong and Mr Sparrow.

Covering

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 15 March 1983

MR ISAAC - IR

SELF-EMPLOYMENT

... The Financial Secretary has had a go at the attached redraft of the minute, drawing on your draft, Mr Robson's work and Miss Rutter's note of 7 March.

He would be most grateful for any comments you may have on it.

MED

M E DONNELLY

DRAFT MINUTE

FROM: CHANCELLOR OF THE EXCHEQUER

TO : PRIME MINISTER

SELF-EMPLOYMENT

At a meeting of the Liaison Committee on 10 November 1982, there was some discussion of taxation of the self-employed. Robin Butler's letter of the same date asked for a note on the subject.

[2. We start from the position that although we cannot condone it, the Black Economy has its good side. The CPRS Report on the Black Economy identified some of these features. It can be a nursery for vigorous characters. It offers a way for a firm to set up free from bureaucratic interference form filling and the requirements of legislation. It can offer a stepping stone between employment and self-employment. It is also flexible and free from unionisation.]

3. We [also] start with a firm belief in self-employment. A vigorous small firms sector is a crucial channel for bringing new energy, new enterprise and new initiative into industry and commerce. Self-employment embodies the attitudes

we wish to foster. Individual responsibility, hard work and risk taking are a central part of being self-employed. [It has the additional advantage of being legal.]

4. Our objective is to encourage self-employment. But we must also ensure it is properly taxed and that we avoid as far as possible guerilla warfare between the Revenue and the taxpayer.

BUDGET CONFIDENTIAL

FROM: M E DONNELLY
DATE: 15 March 1983

MR R MARTIN - IR

cc Mr Robson
PS/IR

FINANCIAL SECRETARY'S BUDGET DEBATE SPEECH: WIDER SHARE OWNERSHIP

The Financial Secretary was grateful for your note of 11 March covering some draft paragraphs for this speech.

He has re-cast them in note form as he will be winding up the debate on Wednesday. Perhaps you could provide the missing figures, by close on Tuesday if possible.

MED
M E DONNELLY

WIDER SHARE OWNERSHIP

Encourage employees to own some or all of business

Most dramatic proposal - employee buyouts 75 per cent of shares held by employees

Liberal support - co-operative movement

NFC

Add

1) 10 per cent of salary up to £5,000 or £1,250
[ ] schemes; [ ] employees

2) Share option schemes - £50 per month to £75
[ ] schemes [ ] employees

3) Privatisation - 90,000 employees

Must be open to all

Avoided option schemes for the exclusive few -
except for 5 years to pay the tax

Want this to have all party support

Mrs Hyslop/IK
RSJ/IK.

Treasury Chambers, Parliament Street, SW1P 3AG

Robert Oakeshott Esq
Job Ownership Ltd
9 Poland Street
LONDON
W1V 3DG

15 March 1983

Dear Mr Oakeshott,

JOB OWNERSHIP COMPANIES

Thank you for your further letters of 8 February and 7 March. I have asked the Inland Revenue to look at the revised draft model Articles for a Job Ownership Company.

Your letter of 8 February raises two separate issues which I will deal with in turn. I understand that the advice you received from the Department of Trade concerned the provisions of the Companies Acts which deal with "employee share schemes" as defined in Section 87(1) of the Companies Act 1980. That definition (which makes no reference to any "approval" - contrary to what you suggest in your letter) describes the schemes for which relaxations are provided from some of the rules on the issue and allotment of shares, and on financial assistance for the acquisition of shares. You may of course wish to seek further advice from that Department but the point is that the definition has no bearing on the eligibility for tax relief of profit sharing schemes under the Finance Act 1978.

Second, you query whether a Job Ownership Company might be able to take advantage of these tax reliefs. Application to the Inland Revenue (and their approval) is necessary to secure the tax reliefs available for approved profit sharing schemes. The Revenue have explained that the statutory provisions in the Finance Act 1978 require the annual allocations to employees to be of shares rather than cash and for the shares to be irredeemable. Moreover, now that JOCs are to be close an additional awkwardness would be that an employee is ineligible to receive shares if at that time, or at

ny time within the preceding twelve months he has had a material interest exceeding 25 per cent in the company concerned. Finally, the legislation stipulates that if the company whose shares are being used in the scheme has more than one class of share capital then the majority of the issued shares used in the scheme must be held other than by persons who acquired their shares as employees or by trustees holding shares on their behalf. It seems unlikely that a JOC could ever satisfy this condition.

I think you have accepted right from the beginning that given the proposed structure of a JOC, namely that employees are to be restricted to owning one 'B' share in the company, the 1978 profit sharing legislation would not be appropriate. The Revenue's comments seem to confirm this view.

Yours Sincerely
Eric Kwiecinski
E KWIECINSKI
Private Secretary

FINANCIAL SECRETARY TO THE TREASURY

FROM: M E DONNELLY
DATE: 15 March 1983

MR PERETZ

CC PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir D Wass
Sir A Rawlinson
Mr Middleton
Mr Littler
Mr Unwin
Mr Lavelle
Mr Kemp
Mr Monck
Mr Bailey
Mr Ridley

EMS: LETTER FROM LORD COCKFIELD

The Financial Secretary has seen Lord Cockfield's undated letter on the EMS.

The Financial Secretary has commented that although he personally would favour joining the EMS exchange rate mechanism when conditions were suitable there can be no doubt that the wrong time to join is during what many see as the run up to the election. To join the ERM now could well mean the Government picking up the bill in terms of intervention (or heavy borrowing from other member states) for the effects of irresponsible comments by Peter Shore and others about the level of the exchange rate. No one would be likely to find UK membership of the ERM satisfactory in such circumstances.

MED

M E DONNELLY

JH 225

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

15 March 1983

CHANCELLOR'S SECRETARY
REC. 15 MAR 1983
ACTION MR CHIVERS
PPS EST MST(C)
CST MST(R)
SIR D WASS MR A BAILEY
SIR A RAWLINSON
MR LOVELL MR MORGAN
MR BURGNER MR RICKARD
MR WILSON MR HALLIGAN
MR GRINSTONE MR RIDLEY MR HARRIS

The Rt Hon Nicholas Ridley AMICE MP
Financial Secretary
HM Treasury
Parliament Street
London SW1

Dear Nicholas,

In my letter of 9 February I promised to come back to you on the question of a further sale of British Aerospace shares.

2 The views of the British Aerospace Board are recorded in the attached letter from Sir Austin Pearce. This incorporates advice which the Board have received from Kleinwort Benson. You will see that BAe have come to the conclusion that any early move to sell more of the Government's shareholding could be damaging to the company, its employees and its shareholders, while producing little by way of return to the Government.

3 I do not necessarily see the issue in quite the same political terms as Sir Austin Pearce. But the Board's views are an important factor. We would, I think, need a very strong case to push ahead with a sale in the face of the advice they have given.

4 My own feeling is that we do not have such a case. I note in particular that:

a) since the time of the original flotation, public awareness of the uncertainties over BAe's future projects on both the civil and military sides has increased significantly. In large measure, the "fate" of BAe is perceived as being in HMG's hands - through the decisions on launch aid for the A320 and on future combat aircraft needs. An attempt by HMG to sell more of its share before these issues were resolved, could generate yet further uncertainty. The Government could not, at present, make any clear-cut statement of its future intentions as regards support for BAe's projects;

b) when the original prospectus was prepared in 1980, sales on the civil side remained relatively buoyant. Sir Austin Pearce is quite right in pointing out that the

current sales prospects for BAe's civil products are extremely poor - with consequent implications for BAe's profitability. Major anxieties have been expressed about the 146 and it is well known that the wide-bodied Airbus models (just like those of Boeing) are not selling well;

c) against this unfavourable background, an initiative by HMG to sell a substantial body of shares would be likely to depress the share price (which has already declined relative to general share price movements). Such adverse pressure on the price could be detrimental to BAe's standing with the financial community. It would also be disadvantageous to HMG in terms of the likely proceeds from this sale. The implications for BAe's future ability to raise additional working capital through, for instance, a rights issue would need to be carefully considered; (it is worth bearing in mind that we have a commitment to maintain a minimum 25% Government shareholding: thus, if we ran our shareholding down to that level, we would be obliged to incur new public expenditure if BAe did proceed to a rights issue).

c) the sole benefit from a further sale would be the resulting contribution to the Exchequer. HMG's relationship with the Company was radically altered by the initial flotation. BAe are already firmly in the private sector: their borrowings etc do not count against the PSBR. No "wider" objective would be served by the further disposal.

5 We can, if you wish, commission a professional "second opinion" from a merchant bank. But this would take a little time - and I am frankly not convinced that it would be worthwhile. My own proposal would be that we should take no action now but that we should retain British Aerospace in the list of possible privatisation candidates. We could then review the situation in about a year's time.

6 I am sending a copy of this letter to Members of E(DL).

Yours ever

Paul

LMT

DEPARTMENT OF HEALTH AND SOCIAL SECURITY

Alexander Fleming House, Elephant & Castle, London SE1 6BY
Telephone 01-407 5522

From the Minister of State for Social Security and the Disabled

The Hon Nicholas Ridley MP
Financial Secretary
HM Treasury
Treasury Chambers
Parliament Street
LONDON SW1

FINANCIAL SECRETARY	
REC.	17 MAR 1983
ACTION	Mr DRAPER - IR
COPY TO	PPS EST MSTC CST MSTA Mr MONGER Ms SEAMMON Mr MOORE Mr ROBSON Mr O'LEARY - IR PS/IR

16 MAR 1983

Dear Nicholas,

STATUTORY SICK PAY: SELF-DEDUCTION BY EMPLOYERS FROM ARREARS OF CONTRIBUTIONS

Michael Havers copied to you his letter of 8 March, which answered the questions we had raised with him about the Compensation of Employers Regulations for the statutory sick pay (SSP) scheme.

You will have seen that Michael, to whom I have written separately, was able to give me the reassurance that I was seeking: that there would be no impropriety in my making regulations which did not allow an employer to self-deduct SSP from arrears of contributions when, it was our intention that at least as a matter of administrative practice, he would be permitted to do so. Since I have the reassurance, I agree that the matter comes down to one of policy between you and me. When we met at the end of last year to talk about all this, I accepted the difficulties which explicitly allowing self-deduction from arrears could create for Inland Revenue's collection and enforcement procedures, if it was seen as implicitly condoning a breach of your and our regulations governing the timing of tax and contribution payments. I am therefore making the Compensation Regulations in the form which you wanted, so that the letter of them will not allow self-deduction from contribution payments relating to earnings paid before the beginning of the tax month in which the SSP was paid. Nevertheless it is agreed between us that employers will be allowed to set off SSP against arrears not only of contributions but of PAYE and National Insurance Surcharge which are not covered by the Regulations in order to obviate the need for them to make, and our Departments to pay on, claims for SSP. Of course there will be no question of any encouragement being given to employers deliberately to build up arrears of payments due in order to meet potential SSP claims.

In his letter, Michael also raised a quite separate point about publicity to cover cases where Inland Revenue take enforcement action even though a refund of SSP to an employer may be outstanding.

R2

R.

do not myself think that this is a problem: since Inland Revenue will themselves be making the refund payment on our behalf, they would be bound to know about it, so that the situation, about which Michael was concerned hopefully could not arise. So I have been able to reassure him, in my reply, about this and about the publicity which has already gone out in the form of instructions to employers.

I am grateful for your help in untangling and discussing the rather complex issues which these regulations involve, and I am glad that we seem finally to have resolved them.

HUGH ROSSI

From the Minister

CONFIDENTIAL

17 MAR 1983

MR. FITCHEW
PPS EST NET(C)
CST NET(R)
SIR D WASS MR LOVELL
MR A BAILEY MR KEMP
MR BARRATT MR BINNS
MR MORGAN MR HARRIS

Rt Hon Nicholas Ridley, MP
Financial Secretary
HM Treasury
Parliament Street
London
SW1P 3AG

16 March 1983

Dear Financial Secretary

SALE OF PUBLIC SECTOR ASSETS: MARKET TOWERS

You have received Jeffrey Sterling's final opinion on the prospects for selling Market Towers. I have considered the options before us and have concluded that the right course is to take this property off the market for at least two years.

One new option which Jeffrey Sterling had raised was short leasehold financing. He has now, however, concluded that this would be a very expensive way to raise capital. I know that the Covent Garden Market Authority is also very much against it for a number of reasons including the imbalance between the immediate cash benefit and the longer term loss of rental income. I hope therefore that you can agree that this option is not worth pursuing.

Were we to press ahead with the sale of Market Towers against Jeffrey Sterling's advice, the price we could expect to receive is now being quoted as £11½-12½m. I really do think this would be intolerably low when compared with the £21.7m valuation put on the property by the Authority's agents, let alone the higher figure quoted by the Lambeth District Valuer. Even if we realised a little more than £11½-12½m, I fear that it would still be seen as a distress sale and would attract considerable embarrassing criticism.

A further critical point is that the Authority could well refuse to co-operate in a knock-down sale of this sort. Their agreement to sell Market Towers has been subject to a series of conditions relating to the use to which the sale proceeds are put which I

/accepted with

accepted with Treasury agreement. To fulfil these conditions a minimum sale price of some £16.7m would be necessary and there seems to be no realistic prospect of our attaining such a price at present. I cannot see the Authority being ready to renegotiate the agreement to accept a much reduced price, since it would mean less of their debt being repaid outright from the sale proceeds.

I have examined the alternative course of privatising the Authority and all its assets. With this option, we would still have the problem of attracting realistic bids for Market Towers, with the added problem of seeking to raise a satisfactory price for a wholesale market whose replacement cost was put at £62m when it was valued for insurance purposes in 1981/82.

I see no chance of getting anything near such a figure bearing in mind that the rental income generated by the market is only about £½m per year. The sale price for all the Authority's assets could therefore fall below their present outstanding debt of £21m, meaning that we should have to write off a further sum to add to the £13m written off in 1977.

A means of seeking a higher sale price would be to sell without imposing an obligation to continue the market, allowing the purchaser to take full advantage of the site's development potential. In my view this would be unthinkable when so much public money was invested in this market less than 10 years ago. And as you will be aware, privatisation would involve amending or repealing the four Covent Garden Market Acts, which means that the difficulties of such a move would be exposed to prolonged and critical debate in the House.

Hence my conclusion is that the only acceptable option open to us is to take Market Towers off the market for the time being. This is what Jeffrey Sterling has advised and the Authority's Chairman and agents have recommended. It would avoid the serious shortcomings of the other options, would enable the Authority to take advantage of any improvement in property prices and should also leave the Authority in a better financial position to carry on reviving and repaying their debt.

The Authority have already tentatively indicated to us that they might be able to revive £5.5m of debt this year if Market Towers is not sold. If this were so, the amount of their suspended debt would be down to some £7.1m by the end of 1985 as against a figure of some £9m if they assented to sell Market Towers for £12m (the middle of the price range now being quoted). Moreover, we would still of course be able to sell the Towers at a later date.

I am suggesting no more than taking the Towers off the market for some two years. After that period the decision could be reviewed and the block put back on the market if we judged that we could expect to receive a reasonable price.

A further point to note is that, although it has not found a buyer for Market Towers, the Authority has since June 1979 disposed of

/five separate

five separate assets raising £3.7m. Non payment to the Government.

Finally, the Authority would like to revive some £4m of debt before the end of the month. We are constantly urging them to reactivate debt and I think we should encourage them to go ahead now. But the present arrangements, agreed between us and them for the disposal of the proceeds from the eventual sale of Market Towers, have the effect of inhibiting the Authority, on sound management grounds, from doing so. They need therefore to be assured, before they decide to go ahead, that we should be willing to make appropriate changes in the arrangements. I am asking my officials to discuss the details urgently with the Treasury.

The Authority have a meeting on 22nd March and it would clearly be desirable to let them have by then the assurance they want. They need to know at the same time that we do not intend to pursue short leasehold financing as an option. I hope you will be able to agree that we may tell them this straightaway.

More generally I would welcome an early indication that you can accept my conclusion that we should take Market Towers off the market and review the decision in two years' time.

Copies of this letter go to other members of E(DL) and to Sir Robert Armstrong.

PETER WALKER

(Approved by the Minister and signed in his absence)

COMMERCIAL IN CONFIDENCE

On the basis of these examinations I have come to the conclusion that British Gas' assessment of the Ashdown bids is correct. Ashdown themselves lack sufficient substance and the structure of the bids is such that the risk that BGC might have to inject further funds in order to realise the value of the field is great. In my view, the Ashdown bids therefore fail to meet our basic privatisation aims.

The revised Dorset and RTZ bids have been evaluated on a wide range of assumptions. The returns to the bidders range from under 10% on the more pessimistic cases to about 20% on the most optimistic. In my view, this brings the bids into the range of contention on purely economic and commercial grounds.

It is clear that the market for these assets at the present time has been very thoroughly tested. The RTZ Group only made a small improvement after several attempts and the Dorset Group's final bid is set at a level which resulted in two of the partners in the original consortium withdrawing. Despite wide publicity and an open auction no other bidder has come forward with a structurally sound offer which remotely approaches the Dorest bid. I therefore have little doubt that a sale at this price could be defended as the best the market could produce at this time.

I have, however, considered whether a better price could be achieved by a sale at a later date or in a different form. In particular I asked Warburgs to consider whether a postponement of the sale for a couple of years or so would be likely to produce a better price. On the one hand it is possible that some of the land rights problems and uncertainties over reserves and planning permissions which have depressed the bids might be resolved. On the other hand, this may not happen and the market's perception of oil prices may be no better or even worse than at present. Warburgs have, therefore, concluded that they have no reason to expect that, on retendering in say two years time, a higher price will be realised. I have therefore, concluded that a repeat operation might produce a similar or even worse result.

Another factor which we have to take into account is our wider privatisation policy objectives. Failure to complete the Wytch Farm sale would be a damaging blow to these objectives which, in my view, would only be justifiable if the asset were likely to realise a price significantly below the valuation of the asset and if there were a reasonable probability that this price could be improved on within the next two years or so. In my view, the price bid by the Dorset Group should not be excluded on these grounds. The RTZ bid, on the other hand, is below the economic evaluation of the licence even on pessimistic assumptions.

I am, therefore, proposing to instruct British Gas to proceed with the Dorset bid to completion and to inform Ashdown and RTZ that they are no longer in contention.

The next stage will be for BGC to negotiate the detailed agreement with the Dorset Group on the basis of the broad acceptability of their offer. This will be a complex process since there are many uncertainties and the offer is dependent on certain conditions, one of which, relating to a tax ruling, can probably not be met. This may, therefore, necessitate some restructuring of the bid which will need to be handled very carefully to reduce the risk of the bid being withdrawn. It will also

COMMERCIAL IN CONFIDENCE

crucially depend upon BGC's co-operation. I intend to make it clear to the part-time Members of the Board why we are instructing the Corporation to proceed against the Board's present commercial judgement (which arose out of a meeting which only two of the part-time Members were able to attend) and to seek their wholehearted co-operation both in the negotiations and the presentation of the sale.

I would, therefore, like your and colleagues' agreement to proceeding along these lines. It is important to press ahead swiftly. The RTZ bid is conditional on a response being received this week, and there is a risk that Dorset too may decide to withdraw in present market conditions.

I am copying this letter to our E(DL) colleagues and to Sir Robert Armstrong.

Yours Nigel

NIGEL LAWSON

01 211 6402

COMMERCIAL IN CONFIDENCE

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London
SW1

16th March 1983

WYTCH FARM DISPOSAL

The second round of bidding for British Gas' 50% interest in PL 089, which includes the Wytch Farm oil field, closed at the end of November. Following British Gas' initial advice that none of the bids was acceptable, I had a series of discussions with appropriate bidders aimed at elucidating the reasons for the wide difference between their views of the value of the licence and BGC's. During the course of these discussions it became apparent that these bidders were prepared to improve the level of the bids. I therefore asked BGC to invite revised bids and to evaluate them and reconsider their own evaluation of their licence interest. They have now completed their assessment and submitted their views to me.

Your officials have full details of the bids, which are complex in form, involving an initial cash payment and a flow of future income dependent on the future development of the field. British Gas' conclusions are that none of the four bids is acceptable. The two highest bids were from a company, Ashdown Oil, which was formed specifically to bid for BGC's interest and put together bids which amounted to little more than a complicated financing arrangement with BGC continuing to operate the licence and receive most of the income. British Gas feel that these bids should not be proceeded with, because Ashdown's lack of substance as a company leads to very real doubts about its ability to carry through the contemplated transactions. British Gas have also concluded that they cannot, on commercial grounds, recommend either of the other bids, one from the Dorset Group (5 British independent oil companies) and the other from a small consortium led by RTZ. They are however ready to give effect to the existing Direction and ask whether on wider considerations of policy we wish to direct them to do so.

My officials have been closely involved in British Gas' evaluation of the bids which, because of their form, is a complex question involving examination of a range of different development strategies, taxation assumptions, oil prices and inflation rates. They have also made their own independent evaluation, as have my merchant banking advisors, Warburgs.

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 16 March 1983

MR P J A DRISCOLL - IR

cc Mr Robson
Mr Caldwell - Parly Counsel
Mr Campbell - IR
PS/IR

FINANCE BILL STARTER 134: "MARKS AND SPENCER" ADVICE

At his meeting yesterday the Financial Secretary considered the two detailed options for this item which were outlined in your note of 11 March.

The Financial Secretary decided that "Variation B" should be adopted with the following conditions:-

a) the lower limit for both freehold and leasehold properties should be £75,000; and

b) a prescribed percentage rate in line with the official rate of interest (currently 12%) should be used.

The Financial Secretary asked you to send him a brief note on the scheme for onward transmission to the Chancellor.

E KWIECINSKI

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 16 March 1983

MR P J A DRISCOLL - IR

cc Mr Robson
Mr Caldwell - Parly Counsel
Mr Campbell - IR
PS/IR

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E KWIECINSKI

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 16 March 1983

MR N C MUNRO/IR

cc CST
MST(R)
Mr Moore
Mr Robson
Mr O'Leary/IR
PS/IR

REVIEW OF THE CONSTRUCTION INDUSTRY TAX DEDUCTION SCHEME

The Financial Secretary has seen your submission of 14 March.

He has commented that we should first see the banks and then have an internal meeting to discuss the whole question.

His initial thoughts are that the best way forward may lie through the banks and the possible extension of the guarantee.

E KWIECINSKI

FROM: E KWIECINSKI
DATE: 16 March 1983

MR PRESCOTT - IR
MR A PIRIE

cc PS/Chancellor
Mr Robson

BUDGET REP: THE CO-OPERATIVE DEVELOPMENT AGENCY

... I attach a copy of Mr Ridley's minute of 11 March and of the Co-operative Development Agency's Budget Rep.

The Financial Secretary would be grateful for your comments (respectively) on the two proposals highlighted by Mr Ridley.

EK
E KWIECINSKI

CONFIDENTIAL

FROM: ADAM RIDLEY
11 March 1983

CHANCELLOR

cc CST
PST / Mr Bailey
Mr Moore
Mr Gordon

BUDGET REPS: THE COOPERATIVE DEVELOPMENT AGENCY

Skimming the latest list (12) of Budget representations for this year, my eye was caught by two proposals put forward by the Cooperative Development Agency. These are:

- to allow investment in cooperative businesses to benefit from the business start-up scheme
- to increase the upper limit (now £10,000) of the value of shares which can be held by a member of an Industrial and Provident Society.

There seems to me to be some merit in considering both at some stage in the future and who knows there might be a case even for modification of the Finance Bill to one or other effect even at this late stage. The cost would be utterly negligible in both cases. The benefits could, on the other hand, be considerable, particularly if small cooperatives mushroom as a flexible method of job-creation for the young unemployed, on the lines put forward by the "instant muscle" people on which I have reported to you recently.

2. My reason for supporting the first proposal is self-evident. There are probably not that many cooperatives which are yet in a state to benefit from the start-up scheme (or its successor); but there could well be some, and the prospect of eligibility could be very important. The case for considering the second is that, as I understand it, most (? all) cooperatives are, in fact, "Industrial and Provident Societies". While one tends to think of such bodies being formed by fairly poor individuals, to perpetuate this would be absurd. It is perfectly possible that rather wealthier characters might be attracted by the co-op form of corporate structure, not least in situations like management buyouts. An added point - widely ignored - is that such societies do not pay corporation tax, but a standard 40% profits tax which is, of course, rather lower.

AR

A N RIDLEY

Treasury Chambers, Parliament Street, SW1P 3AG

R Woolf Esq
Chairman
Co-operative Development Agency
20 Albert Embankment
LONDON
SE1 7TJ

9 March 1983

Dear Mr Woolf

You wrote to Geoffrey Howe on 1 March with the representations of the Co-operative Development Agency for the 1983 Budget. He has passed your letter on to me to reply.

I have read your submission with interest and it has also been put before Geoffrey Howe. I can assure you that the points you make will be properly taken into account as the Budget is prepared.

Yours ever

Nicholas Ridley

NICHOLAS RIDLEY

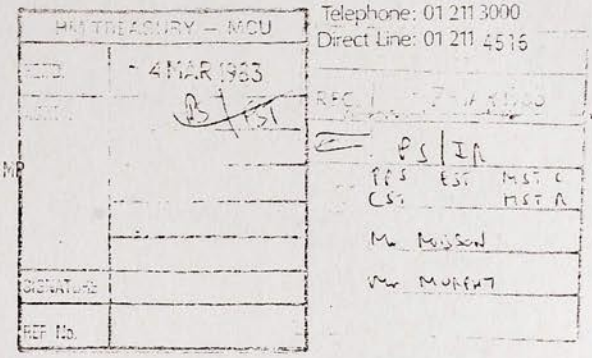
Co-operative Development Agency

20 Albert Embankment London SE1 7TJ

Telephone: 01 211 3000
Direct Line: 01 211 4516

Your Ref:

Our Ref: RW/EO



1 March 1983

Rt. Hon. Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Building
Whitehall
LONDON SW1

Dear Chancellor

SUBMISSION FOR CONSIDERATION IN RELATION TO THE BUDGET FOR 1983/4

The Co-operative Development Agency, in pursuing its task of assisting in the further development of the Co-operative Movement, has taken soundings around this Movement to identify fiscal aspects which we feel worthy of your consideration within next months Budget Statement:-

1. ENTERPRISE ALLOWANCE SCHEME

Our experience is that this scheme has worked reasonably well in the five areas where it has been on trial. We suggest that with certain improvements the scheme should be extended throughout the United Kingdom.

We would like to see the removal of the limit of £40 per week for those unemployed people who are already receiving above that amount in state benefits. Secondly, we recommend that the scheme should allow all unemployed people - not just those in receipt of state benefits - to take advantage of it. And thirdly, we seek a reduction - say to £500 - in the requirement for a significant financial investment in the proposed business. Qualification for the allowance would be better earned through production of a sound business plan which has the endorsement of an approved agency, such as Small Firms Service or a local Co-operative Development Agency.

2. BUSINESS START-UP SCHEME

We are disturbed that there are no references to "co-operative businesses" within existing documentation. While the purpose of the scheme, as it stands, is to help outside investors provide initial risk capital for new companies, the demands for start-up funding in co-operative businesses are equally as great and we feel there is a justifiable case for allowing relief to cover say, long-term venture capital channelled to co-operatives.

3. EMPLOYEE SHARE-OWNERSHIP SCHEMES

We support measures to enable employees to have a positive financial interest in the business within which they are employed.

In the case of earnings ploughed back in to a business and issued to employees in the form of "bonus" shares, we are looking for equality of tax treatment for employees of co-operatives up to the level of that applying to company employees. Company employees incur no tax liability at the time of issue of "bonus" shares and Capital Gains liability may only occur many years later; co-operative employees, on the other hand, incur taxation at their full personal income tax rates on the grounds that their shares are redeemable at short notice. We feel this is an unjustifiable differentiation and that co-operators should also qualify for the concessions first provided to company employees in the Finance Act 1978.

Further, we wish to point out the inequity of allowing interest relief for those individuals buying into partnership or close companies compared with the tax treatment for employees wishing to take a financial stake in the enterprise in which they are employed.

4. CAPITAL GAINS TAX

We believe that in a work-force buy-out situation, in many instances the selling proprietor will not seek to maxmise his selling price in the interests of assisting the new worker-owned business and its difficult early life. We feel it would be reasonable for the sellers sacrifice to be taken into consideration in any assessment for capital gains tax up to say, one-half of the difference between an assessed market price and the actual transaction price.

5. CORPORATION TAX

To assist in the firm development of small co-operative businesses, we support a healthy rate of plough back of net revenue resources compared with their distribution among the members. We feel that relief from corporation tax to the extent of resources ploughed back into indivisible reserves (as in a common ownership model) would do much to assist this situation.

6. INDUSTRIAL AND PROVIDENT SOCIETY SHARE-HOLDING

The upper limit of £10,000 which can be held by a member of an Industrial and Provident Society has reduced in value in real terms to a significant extent over the past few years. We feel the limit should soon come up for review again and to remove the necessity to repeat the process at regular intervals we suggest the limit be allowed to rise in line with annual price inflation.

The rate of interest allowed on members shares within Industrial and Provident Societies is accepted as needing to be sufficient to attract and retain the capital. The rate allowed is specified in each Society's rules and cannot fluctuate, although it may have become increasingly uncompetitive compared with say, a building society investment. We support the view that it would be equitably justified to disregard for income tax purposes a nominal amount of share interest earned by Society members. We feel this move would have a beneficial effect in attracting and retaining share capital within societies, including emerging worker co-operatives.

We trust our submission will receive a sympathetic response.

Yours faithfully

GB

pp RALPH WOOLF

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 17 March 1983

SIR L AIREY - IR

TAX POLICY

The Financial Secretary would be grateful for your comments on the attached draft note on Government's taxation policy.

It is designed to be sent by the Chancellor to the Prime Minister, to highlight and clarify the Government's overall taxation goals.

The Chancellor's preliminary actions, which you may wish to take in account, were:

i) the note might be more explicit about the fact that beneficiaries of specific reliefs feel that these reliefs are good in themselves becauses they are more politically secure than eg lower tax rates.

ii) we must be explicit about the difficulties arising from the number of losers in any reform and the need to proceed slowly on the basis of a carefully understood and accepted approach;

iii) the material might be expanded to refer to the tax and savings group papers that the Prime Minister has already seen.

M E D

M E DONNELLY

CONFIDENTIAL

DRAFT MINUTE FROM THE CHANCELLOR TO THE PRIME MINISTER

TAX POLICY

At our recent discussion on mortgage interest relief I said I would let you have a note about tax policy generally.

Our tax policy is based on our economic and political philosophy. Our economic belief is that we should create the environment in which enterprise and wealth creation can flourish. Our political belief is that we should enlarge the role of the individual and diminish the role of the state. We want to encourage personal decision taking, personal responsibility and self reliance. We want to reduce the role of Whitehall.

Against this background we have ~~the~~ two broad aims in tax policy. First, to reduce the burden of tax. This will provide the incentives necessary to encourage enterprise and hard work. Incentives need further improvement at all levels - particularly in relation to the poverty trap and unemployment trap.

Second, to simplify the tax system. We inherited a tax system which was incredibly complex. Tax professionals cannot fully understand it. Most people find it incomprehensible. Complexity means heavy administrative costs both for the private sector and for the Revenue.

Third to take the biases out of the tax system. A wide range of special reliefs have grown up over the years. These discriminate between different activities. They represent layer upon layer of party political prejudices, many of them socialist. Often they produce economic results which are the opposite of what we want.

The three aims are closely linked. If we are to simplify, we must tackle the special reliefs. The reliefs are also very costly. This means rates of tax have to be set correspondingly higher to enable us to raise revenue. For example, if we removed all the various special income tax reliefs and left only the basic personal allowance, the basic rate could be reduced to around 25 per cent or thresholds raised substantially.

The way in which the system directs money and activity into certain activities is quite inconsistent with our aim of enlarging individual choice and responsibility. We give tax reliefs on savings channelled through pension funds and insurance companies worth over £3 billion. As a result people save in these ways rather than investing directly in, say, equities. Institutions now own assets worth £125 billion and this figure is growing. They dominate the equity market. They have grown inefficient on the back of tax reliefs. They invest very little in small businesses. This is not healthy in economic terms. It is directly contrary to our aim of encouraging personal shareholding.

We give tax reliefs of £5 billion for housing. We all agree on the importance of owner-occupation. But directing money into housing in this way means less for commerce and industry. In the end all the relief does is push up the price of houses and of land; in the same way the capital transfer tax relief for agricultural land pushes up land prices.

On corporation tax we give large incentives for investment in plant and machinery. This means we are encouraging firms to employ machines, not people and so we are lengthening the dole queues. We are favouring manufacturing at the expense of the service industries, despite the fact that the latter are the stronger sector of the economy.

There are not just academic points. The multiplicity of reliefs interact in a complicated way which magnifies their effects and so their influence on behaviour. For example, take an individual subscribing directly for equity in a manufacturing company which uses the money to acquire new plant. The present tax system would result in that individual paying tax of around 20 per cent on his return. But, if instead of investing directly the money had been channelled through a pension fund, the investor would end up with his return attracting a subsidy of around 100 per cent rather than tax of 20 per cent. This is a measure of the extent we direct people into institutional savings.

If the individual investor's equity financed the acquisition of a building by a commercial company his return would be taxed at about 100 per cent. The comparison with the 20 per cent tax on his investment in manufacturing plant is a measure of the way in which we direct investment into certain sectors and certain assets.

I doubt if our predecessors intended to produce results like this. There is no economic justification for them. It is also a measure of the complexity of the tax system that it requires a computer to work them out. It is little wonder that companies feel inhibited from taking important decisions until they have had a detailed tax advice.

But the major objection to all this is not the fact that many of the activities we are favouring in this way have little intrinsic merit. Nor is it the large size and erratic nature of the beneifts involved. Nor even the heavy administrative costs such a system imposes on all involved. What is objectionable is the fact the State is intervening selectively at all. It is nannying. It distorts economic decision taking. It erodes personal choice. It inhibits personal responsibility. State intervention in the form of tax reliefs is in many ways as unsatisfactory as state intervention in the form of public expenditure, nationalisation or state controls.

There are, of course, groups in special need to whom it is right to give help, such as the blind and the sick. But the tax system is a very blunt instrument for dealing with a particular problem of this sort. In general they are better tackled through the social security system.

We need to work towards a simple, understandable "low rate, low relief" tax system, leaving individuals free to take their own decisions rather than be guided by the dead hand of past political prejudice and State intervention. Such a system will enable us to reduce rates of tax and rid ourselves of costly beaureaucracy.

I do not pretend this is easy. It requires careful planning and delicate selling. We have been doing a lot of work on this in the Treasury. I see it as something for the next Government. In the meantime we want to avoid as far as possible making the task more difficult by creating new reliefs or by increasing those that already exist. It may be worth having a talk about all this.

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 17 March 1983

MR BATTERSBY - IR

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (R)
Mr Moore
Mr Robson
Mr Graham - Parly Counsel
Mr Battishill - IR
PS/IR

BUSINESS EXPANSION SCHEME: APPROVED INVESTMENT FUNDS AND CLAIMS PROCEDURE

The Financial Secretary has seen your submission of 15 March. He is much in sympathy with the line proposed and grateful for your constructive approach towards companies, investors and AIFs.

More generally the Financial Secretary would like to discuss this area with Revenue officials. It will be most important to avoid accusations that the BES is being sabotaged by unncessary restrictions after we have published the details. The Financial Secretary is inclined to issue a draft code of procedure for the BES at an early stage, making clear that it depends on Royal Assent being given to the Finance Bill. He also wishes to consider the question of the status of existing AIFs before they receive approval to use the BES.

MED
M E DONNELLY

FROM: E KWIECINSKI
DATE: 17 March 1983

MR J P B BRYCE/IR

cc PS/CST
PS/MST(R)
Mr Robson
Mr Salveson
PS/IR

CAPITAL GAINS TAX: SECTION 13 CGTA

The Financial Secretary has seen your note and attachment of 11 March.

... He is content for you to proceed as suggested. I attach the agreed final version of the PQ and answer. I am arranging for this to be put down.

E KWIECINSKI

DRAFT QUESTION

I ask the Chancellor of the Exchequer whether, in the light of recent judicial criticism, he will bring forward proposals to amend Section 13, CGTA 1979.

DRAFT ANSWER

In practice the relief provided by this Section appears to be operating satisfactorily so far. However, I have asked the Inland Revenue to review the position in greater depth in the light of the comments made by the Courts. As a result I am not proposing to amend the provisions in the forthcoming Finance Bill.

FROM: FINANCIAL SECRETARY
DATE: 17 March 1983

CHANCELLOR

cc Mr Unwin
Mrs Hedley-Miller

COMMUNITY BUDGET: UK OBJECTIVES

I am still not quite happy with this redraft. I would like to add something on the enclosed lines after paragraph 12.

Nor am I quite happy with the omission of the point made so heavily to Sir R Armstrong by C Tugendhat and G Thorn about the need to present the long term solution first and the safety net second. I think we ignore this strong warning at our peril.

MED

pp NICHOLAS RIDLEY

Suggested para 12A

Because of the prospects for agricultural spending, it is likely that the Community will reach the 1% VAT ceiling either this year or next even with no refund being paid to us, or no "safety net" provisions in place. If a "safety net" provision were in place, it would reduce our, (and possibly other) VAT contributions, requiring the 1% ceiling to be raised so that others could pay more than 1%, in order to raise the same total sum. We shall have to be careful that refusing agreement to an increase in the ceiling does not frustrate us from achieving our safety net objective.

cc Mr Bruce-IR
PS/IR

FINANCIAL SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Sir Nicholas Goodison
Chairman
The Stock Exchange
LONDON
EC2N 1HP

17 March 1983

Dear Nicholas

You may recall that last December I announced that the forthcoming Finance Bill would include provisions concerning the calculation of the indexation allowance for capital gains tax purposes. I had been impressed by the argument that a scheme which enabled a form of pooling of shares to be retained would have significant advantages for some taxpayers, and in particular the large institutional investors relying on computers.

I attach a copy of the draft Clause and Schedule giving effect to my announcement. These provisions will appear in due course in the Finance Bill - perhaps with minor alterations. I thought that it would be helpful however for those representative bodies who have pressed for this change to be made to receive the draft provisions in advance of the publication of the Bill.

The provisions are primarily of a technical nature, but there is one point to which I should draw your attention. We have thought it right to limit their availability to companies. It was the administrative implications, in terms of the scale of turnover, of keeping records and in programming computers which were represented to us as the main problems with the existing provisions. These problems do not arise to anything like the same extent for the individual investor. I am anxious therefore to avoid introducing further complication and uncertainty for individuals into what is an already highly complicated part

of the tax system when it does not appear to be necessary. This is essentially an administrative change designed to alleviate a particular problem confined to a relatively small group of taxpayers. Although the tax liability of particular disposals might differ, over a period of years these provisions will produce broadly the same results as the alternative rules in the Finance Act 1982.

Yours ever

Nicholas

NICHOLAS RIDLEY

DRAFT CLAUSE

.-(1) The provisions of Schedule to this Act shall have effect for the purposes of, and in connection with, -

(a) enabling a company to elect that, with respect to disposals after 31st March 1982, each of its holdings of certain securities of the same class which are held by it solely and beneficially and which have been so held for the length of time referred to in that Schedule shall be regarded for the purposes of the Capital Gains Tax Act 1979 as constituting a single asset; and

(b) computing the indexation allowance applicable on a disposal of such a single asset.

(2) In section 88 of the Finance Act 1982 (identification of securities etc, disposed of: general rules) after subsection (5) there shall be inserted the following subsection:-

"(5A) If an election had been made under Schedule to the Finance Act 1983, securities disposed of shall be identified with securities comprised in a holding, within the meaning of paragraph 4 of that Schedule rather than with securities of a description specified in paragraph 1(2)(b) thereof."

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SCHEDULE

CAPITAL GAINS: ELECTION FOR POOLING

Interpretation

1.-(1) In this Schedule -

(a) "the principal Act" means the Capital Gains Tax Act 1979;

(b) "the 1982 Act" means the Finance Act 1982;

(c) "the qualifying period" has the meaning assigned to it by section 86(1)(b) of the 1982 Act; and

(d) "relevant allowable expenditure" has the meaning assigned to it by subsections (2)(b) and (3) of section 86 of the 1982 Act.

(2) For the purposes of this Schedule, "qualifying securities" are securities, as defined in section 88(9) of the 1982 Act. which are neither -

(a) gilt-edged securities, as defined in Schedule 2 to the principal Act; nor

(b) securities which on 6th April 1965 were held by the company making the election concerned and which, disregarding the effect of sections 88 and 89 of the 1982 Act, would for the time being be excluded from the effect of section 65 of the principal Act by virtue of subsection (1)(b) of that section.

Election for pooling

2.-(1) An election under this Schedule shall be made by notice in writing to the inspector not later than the expiry of two years from the end of the accounting period in which the first relevant disposal is made or such further time as the Board may allow.

(2) For the avoidance of doubt it is hereby declared -

(a) that where a company makes an election under this Schedule with respect to qualifying securities which it holds solely and beneficially, that election does not apply to qualifying securities which it holds in another capacity; and

(b) that an election under this Schedule is irrevocable.

(3) Subject to paragraph 3 below, in this paragraph the "first relevant disposal", in relation to an election, means the first disposal after 31st March 1982 by the company making the election of qualifying securities which are held by it solely and beneficially.

Effect of election

3.-(1) The provisions of this paragraph have effect where an election is made under this Schedule.

(2) The election shall have effect with respect to all disposals after 31st March 1982 of qualifying securities held solely and beneficially by the company making the election.

(3) For the purposes of the principal Act, qualifying securities -

(a) which are of the same class. and

(b) which have been held by the company making the election for such a length of time that, on a disposal of them, the disposal would not be regarded as occurring within the qualifying period.

shall be regarded as indistinguishable parts of a single asset (in this paragraph referred to as a holding) diminishing or growing on the occasions on which some of the securities of the class in question are disposed of or additional securities of the class in question which have been previously acquired become held as mentioned in paragraph (b) above.

(4) Without prejudice to the generality of sub-paragraph (3) above, a disposal of securities in a holding, other than the disposal outright of the entire holding, is a disposal of part of an asset and the provisions of the principal Act relating to the computation of a gain accruing on a disposal of part of an asset shall apply accordingly.

(5) In accordance with the preceding provisions of this paragraph, where an election is made under this Schedule, the holding shall come (or, as the case may be, shall be treated as having come) into being -

(a) on the first anniversary of the first acquisition of qualifying securities of a particular description; or

(b) if Part II of Schedule 13 to the Finance Act 1982 applies so that "the holding" for the purposes of this paragraph consists of or includes what is "the holding" or "the reduced holding" referred to in paragraph 8 or paragraph 9 of that Schedule, on 1st April 1982

(6) In its application to a holding, subsection (1) of section 86 of the 1982 Act (conditions for the existence of the indexation allowance) shall have effect as if the condition in paragraph (b) (the qualifying period) were always fulfilled.

(7) Shares or securities of a company shall not be treated for the purposes of this Schedule as being of the same class unless they are so treated by the practice of The Stock Exchange or would be so treated if dealt with on The Stock Exchange.

The 1982 identification rules

4.-(1) The provisions of sections 88 and 89 of, and Part II of Schedule 13 to, the 1982 Act shall have effect for determining whether qualifying securities have been held as mentioned in paragraph (b) of sub-paragraph (3) of paragraph 3 above but, subject to that, those provisions shall not apply to securities forming part of the single asset referred to in that sub-paragraph.

(2) Any reference in sub-paragraph (1) above to qualifying securities includes a reference to a single asset consisting of qualifying securities which continued in existence on and after 1st April 1982 by virtue of paragraph 8 or paragraph 9(3)(a) of Schedule 13 to the 1982 Act.

The indexation allowance

5.-(1) Where an election has been made under this Schedule, the following provisions of this Schedule have effect in place of the provisions of section 87 of the 1982 Act for the purpose of computing the indexation allowance on a disposal to which section 86 of that Act applies of the single asset (in the following provisions of this Schedule referred to as "the holding") which by virtue of paragraph 3(3) above results from the election.

(2) On any disposal of the holding falling within sub-paragraph (1) above, other than a disposal of the whole of it, -

(a) the unindexed and indexed pools of expenditure shall each be apportioned between the part disposed of and the remainder in the same proportions as, under the principal Act, the relevant allowable expenditure is apportioned; and

(b) the indexation allowance is the amount by which the portion of the indexed pool which is attributed to the part disposed of exceeds the portion of the unindexed pool which is attributed to that part.

(3) On a disposal falling within sub-paragraph (1) above of the whole of the holding, the indexation allowance is the amount by which the indexed pool of expenditure at the time of the disposal exceeds the unindexed pool of expenditure at that time.

6.-(1) Subject to sub-paragraph (2) below, in relation to the holding, the unindexed pool of expenditure is at any time the amount which would be the aggregate of the relevant allowable expenditure in relation to a disposal of the whole of the holding occurring at that time.

(2) Where any item of the relevant allowable expenditure referred to in sub-paragraph (1) above was incurred after the time at which the securities to which it relates were acquired, it shall not be taken into account for the purpose of determining the unindexed pool of expenditure at any time before the expiry of the period of twelve months beginning on the date on which it was incurred; but at the expiry of that period the unindexed pool of expenditure shall be increased, subject to sub-paragraph (3) below, by the addition of a sum equal to it.

(3) If, before the expiry of the period of twelve months referred to in sub-paragraph (2) above, there is a disposal of any of the securities to which the item of relevant expenditure referred to in that sub-paragraph relates, only the portion of that expenditure which is attributable to the securities which are not so disposed of shall be added to the unindexed pool of expenditure by virtue of sub-paragraph (2) above.

(4) If, by virtue of any enactment, any item of the relevant allowable expenditure referred to in sub-paragraph (1) above falls to be reduced by reference to a relevant event, within the meaning of paragraph 4 of Schedule 13 to the 1982 Act, occurring after the time at which the securities to which it relates were acquired, that reduction shall not be taken into account for the purpose of determining the unindexed pool of expenditure until the expiry of the period of twelve months beginning on the date of the relevant event in question.

(5) If, before the expiry of the period of twelve months referred to in sub-paragraph (4) above, there is a disposal of any of the securities to which the item of relevant expenditure referred to in that sub-paragraph relates, the amount by which the unindexed pool of expenditure falls to be reduced at the expiry of that period shall itself be reduced so that only that portion of the reduction which is attributable to the securities which are not so disposed of shall then be made in the unindexed pool of expenditure.

(6) Subsection (5) of section 87 of the 1982 Act (date on which expenditure was incurred) and any provision of Schedule 13 to that Act which, in particular circumstances, displaces that subsection shall apply for the purposes of sub-paragraph (2) above as they apply for the purpose of computing the indexation allowance in accordance with that section.

7.-(1) The provisions of this paragraph have effect, subject to paragraphs 9 and 10 below, for determining, in relation to the holding, the indexed pool of expenditure at any time.

(2) The indexed pool of expenditure shall come into being at the time that the holding comes into being and shall at that time consist of the aggregate of -

(a) the unindexed pool of expenditure at that time; and

(b) any indexation allowance, calculated in accordance with section 87 of the 1982 Act, which would have applied to a disposal of the whole of the holding at that time.

(3) Any reference in the following provisions of this Schedule to an operative event is a reference to any event (whether a disposal, the expiry of a period of twelve months from an acquisition or otherwise) which has the effect of reducing or increasing the unindexed pool of expenditure attributable to the holding.

(4) Whenever an operative event occurs, -

(a) there shall be added to the indexed pool of expenditure the indexed rise, as calculated under paragraph 8 below, in the value of that pool since the last operative event or, if there has been no previous operative event, since the pool came into being; and

(b) if the operative event results in an increase in the unindexed pool of expenditure then, in addition to any increase under paragraph (a) above, the same increase shall be made to the indexed pool of expenditure;

(c) if the operative event is a disposal resulting in a reduction in the unindexed pool of expenditure, then, whether or not it is a disposal to which section 86 of the 1982 Act applies, the indexed pool of expenditure shall be reduced in the same proportion as the unindexed pool is reduced; and

(d) if the operative event results in a reduction in the unindexed pool of expenditure but is not a disposal, the same reduction shall be made to the indexed pool of expenditure.

(5) Where the operative event is a disposal to which section 86 of the 1982 Act applies, -

(a) any addition under paragraph (a) of sub-paragraph (4) above shall be made before the calculation of the indexation allowance under paragraph 6 above; and

(b) the reduction under paragraph (c) of that sub-paragraph shall be made after that calculation.

8.-(1) At the time of any operative event, the indexed rise in the indexed pool of expenditure is a sum produced by multiplying the value of that pool immediately before the event by a figure expressed as a decimal and determined, subject to sub-paragraphs (2) and (3) below, by the formula -

$$\frac{RE - RL}{RL}$$

where -

RE is the retail prices index for the month in which the operative event occurs; and

RL is the retail prices index for the month in which occurred the immediately preceding operative event.

(2) If RE, as defined in sub-paragraph (1) above is equal to or less than RL, as so defined, the indexed rise is nil.

(3) If the figure determined in accordance with the formula in sub-paragraph (1) above would, apart from this sub-paragraph, be a figure having more than three decimal places, it shall be rounded to the nearest third decimal place.

Transfers on a no gain/no loss basis

9.-(1) This paragraph applies in any case where -

(a) a company (in this paragraph referred to as "the first company") disposes of securities to another company, (in this paragraph referred to as "the second company") which has made an election under this Schedule, and

(b) the disposal is one to which section 267 or section 273 of the Taxes Act applies (transfers on a company reconstruction etc. and within a group of companies to be on a no gain/no loss basis), and

(c) the disposal by the first company takes place outside the qualifying period.

(2) Nothing in this paragraph affects the operation of paragraph 2 of Schedule 13 to the 1982 Act, but paragraph 3 of that Schedule shall have effect subject to the provisions of this Schedule.

(3) On the disposal referred to in sub-paragraph (1) above (which is the initial disposal within the meaning of the said paragraph 3) -

(a) the consideration for the disposal shall become part of the second company's indexed pool of expenditure; and

(b) so much of that consideration as does not consist of the indexation allowance on the disposal shall become part of the second company's unindexed pool of expenditure.

Consideration for options

10.-(1) If, in a case where sub-paragraph (4)(b) of paragraph 7 above applies, the increase in the unindexed pool of expenditure is, in whole or in part, attributable to the cost of acquiring an option binding the grantor to sell (in this paragraph referred to as "the option consideration"), then in addition to any increase under paragraph (a) or paragraph (b) of sub-paragraph (4) of paragraph 7 above, the indexed pool of expenditure shall be increased by an amount equal to the indexed rise in the option consideration, as determined under sub-paragraph (2) below.

(2) The indexed rise in the option consideration is a sum produced by multiplying the consideration by a figure expressed as a decimal and determined, subject to sub-paragraphs (3) and (4) below, by the formula -

$$\frac{RO - RA}{RA}$$

where -

RO is the retail prices index for the month in which falls the first anniversary of the date on which the option is exercised; and

RA is the retail prices index for the month in which falls the first anniversary of the date on which the option was acquired or, if it is later, March 1982.

(3) If RO, as defined in sub-paragraph (2) above, is equal to or less than RA, as so defined, the indexed rise is nil.

(4) If the figure determined in accordance with the formula in sub-paragraph (2) above would, apart from this sub-paragraph, be a figure having more than three decimal places, it shall be rounded to the nearest third decimal place.

Supplementary

11. All such adjustments shall be made, whether by way of discharge or repayment of tax, or the making of assessments or otherwise, as are required to give effect to an election under this Schedule.

[12. This Schedule shall be construed as one with the principal Act.]

Mr Bryce
PS/IR

FINANCIAL SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

J P Hough Esq
Secretary
The Consultative Committee
of Accountancy Bodies
PO Box 433
Chartered Accountants' Hall
Moorgate Place
LONDON
EC2P 2BJ

17 March 1983

Dear Mr Hough

You may recall that last December I announced that the forthcoming Finance Bill would include provisions concerning the calculation of the indexation allowance for capital gains tax purposes. I had been impressed by the argument that a scheme which enabled a form of pooling of shares to be retained would have significant advantages for some taxpayers, and in particular the large institutional investors relying on computers.

I attach a copy of the draft Clause and Schedule giving effect to my announcement. These provisions will appear in due course in the Finance Bill - perhaps with minor alterations. I thought that it would be helpful however for those representative bodies who have pressed for this change to be made to receive the draft provisions in advance of the publication of the Bill.

The provisions are primarily of a technical nature, but there is one point to which I should draw your attention. We have thought it right to limit their availability to companies. It was the administrative implications, in terms of the scale of turnover, of keeping records and in programming computers which were represented to us as the main problems with the existing provisions. These problems do not arise to anything like the same extent for the individual investor. I am anxious therefore to avoid introducing further complication and uncertainty for individuals into what is an already highly complicated part

of the tax system when it does not appear to be necessary. This is essentially an administrative change designed to alleviate a particular problem confined to a relatively small group of taxpayers. Although the tax liability of particular disposals might differ, over a period of years these provisions will produce broadly the same results as the alternative rules in the Finance Act 1982.

Yours ever,

Nicholas Ridley

NICHOLAS RIDLEY

FROM: M E DONNELLY
DATE: 17 March 1983

PS/INLAND REVENUE

cc PS/Chancellor
PS/Minister of State (R)
Sir D Wass
Mr Hall
Mr Moore
Mr Robson

INLAND REVENUE EFFICIENCY

In view of some comment in the press and elsewhere on relations between Ministers and the Inland Revenue, you may like to be aware of comments made by the Financial Secretary in an Adjournment Debate on 15 March.

The Financial Secretary said:

> "I want to make it clear that in the vast majority of cases the Inland Revenue serves the taxpayer extremely well. The Inland Revenue is as sensitive as I am to the need to make that service universally acceptable..."

and

> "We have made continued progress in reducing the number of forms and returns with which small businesses have to deal. It is only fair to pay tribute to the Inland Revenue in that context. The Inland Revenue has greatly reduced the amount of paper work and the complication of the paper work..."

MED
M E DONNELLY

that an allowance might be given towards the cost incurred by small and medium sized firms in complying with tax and other regulations is one possibility.

The subject of the private employer is a hobby horse of mine. I take as an example a highly qualified young lady who has benefited from a university training for one of the professions. She may work a year or two and then meet the man of her choice and get married. Before long she will start a family. Now she may not have any bent towards or interest in housework and looking after children. She wants to follow her profession and would like to have someone to look after the house and the children—there are plenty of people with such skills and inclination—but she is not allowed to do that because she cannot set the wages of such a person off against taxation.

Perhaps she is married to a thrusting young executive and lives in a surburban house with a large garden. Perhaps they will have benefited from the mortgage advantages announced in the Budget today. Perhaps neither her husband nor her has the time or inclination to look after the garden but wants to see it looking well and thus keep up the tone of the neighbourhood. Therefore, they would like to employ a gardener. There may be an unemployed man down the road who would love to be a gardener but they are unable to employ him for the simple reason that they cannot set off his wages against taxation.

Therefore, that young couple will pay the housekeeper and the gardener in cash. There will be no record and thereby thrives the black economy. I am led to believe that the black economy is estimated to be 5 per cent. of the GNP. Not only can they not employ a gardener and set off his wages against taxation, but a factory down the road with large grounds which employs five gardeners to cut the grass about three times every week can do so with the blessing of the Inland Revenue.

Surely at this time of high unemployment we should allow all wages paid to be tax deductible. I am certain that thousands of jobs could be created overnight if we took that relatively simple step. Surely we have departed from the "Upstairs, Downstairs" mentality when it was thought to be demeaning to work for a private employer. The Government have done much to return this country to sanity. I hope that what I suggest will be the next step.

9.36 pm

The Financial Secretary to the Treasury (Mr. Nicholas Ridley): I congratulate my hon. Friend the Member for Banff (Mr. Myles) on his good fortune in getting the Adjournment debate. It was even more fortuitous that he got it on Budget night. He raised most important issues, to which I shall refer. I thank him for what he said about the Budget. We shall return to those matters in the rest of the week. I am grateful for his welcome to the proposals of my right hon. and learned Friend the Chancellor of the Exchequer.

There is no difference between my hon. Friend and the Government on the importance of small employers and people starting up on their own, beginning to take on employees and, from there, going ahead to expand. That is absolutely essential to the Government's strategy. I think that my hon. Friend will agree that over the years we have done an enormous amount to make that easier for people who have the enterprise and skill to set up on their own.

My hon. Friend may know that I was the Minister responsible for small businesses in 1971 when the Bolton report was first published. We stripped away the impediments and difficulties that Mr. Bolton saw at the time, yet now, 12 years later, it is incredible how many more difficulties have been found and stripped away and how it is a continuing operation to improve the position of small business men. One never seems to reach a position where all is satisfactory.

So true is that that in some ways we have in the Budget anticipated my hon. Friend's speech. My right hon. and learned Friend announced the extension of the loan guarantee scheme, the increase of the registration ceiling for VAT to £18,000 and, perhaps even more important, the business expansion scheme, which my hon. Friend will find to be the greatest help to small businesses, particularly those that want to expand, and which assistance is unique in the Western world to those who want to get equity to expand their businesses.

In some ways my hon. Friend has anticipated my speech tomorrow because if I have the good fortune to catch Mr. Speaker's eye, Mr. Deputy Speaker, I shall conclude the debate on the Budget measures. I wanted to say a little about annual accounting for VAT, which my hon. Friend and many others have said is suitable for simplifying the life of small business men. We have also looked carefully at annual accounting for pay as you earn, which I should dearly like, but the cost in terms of revenue delay and the complications of doing so are such that it is not immediately possible for us to contemplate doing it.

What I have been able to distil out of that study is the possibility of encouraging employers to pay their employees net of tax. If my hon. Friend will bear with me I shall expand on that subject tomorrow. That is a useful way forward for small employers who find life too complicated.

My hon. Friend also raised a number of matters which impinge on the complications of taking on employees. I am sure that my hon. Friend will accept that some of those matters are not for me—for example, the statutory sick pay scheme, census information and the activities of wages councils—but he will also accept that my right hon. and hon. Friends who deal with those matters are active in trying to find ways of simplifying and improving the situation.

We have made continued progress in reducing the number of forms and returns with which small businesses have to deal. It is only fair to pay tribute to the Inland Revenue in that context. The Inland Revenue has greatly reduced the amount of paperwork and the complication of the paperwork with which the small business man is asked to deal. PAYE and national insurance contributions have given cause for a great deal of thought in the Treasury. I have spent a great deal of my time trying to find ways of simplifying the system. At the heart of the system—this is what we must try to preserve—is the fact that PAYE raises about £45 billion revenue and covers 1 million employers throughout the country. It is an extremely efficient method of raising tax. Indeed, it is the envy of the world because it is so simple to administer and costs so little to raise the money. But my hon. Friend was absolutely right to say that it depends on employers to administer it. On so many aspects of PAYE, the onus is on the employer to get the sums right and to pay up the money. I absolutely accept that an argument can be made for the Government to reimburse or assist with compliance costs. This matter will come before the House when we consider the report on the powers of the Revenue

[Mr. Nicholas Ridley]

departments, which is soon to be published. If concessions are made to cover employers' costs in administering the tax system, tax must be increased elsewhere in order to recoup that money. It is a vicious circle.

The burden is greatest for the smallest employers. They cannot always afford computers and modern office machinery, although those are becoming cheaper. In most parts of the country accountants can now be found to do payrolling at a modest cost to employers. The accountants will set up the system, will check it at the end of the year and, if necessary, will administer the monthly figures that have to be returned. As I will explain if I catch Mr. Speaker's eye tomorrow, the employment of net-of-pay techniques can be helpful in this respect.

We have been simplifying the income tax system. The first simplification was to take child allowances out of codings and to substitute child benefit. More recently, life assurance premiums have been taken out of codings and on 4 April mortgage interest relief will be taken out of codings. Those two will then both be reimbursed at source. Gradually and step by step, the coding of income tax is becoming ever more simple. Indeed, for those in work it is a question only of whether they are married or single or are earning wives. In due course, if we succeed in solving the riddles involved in the Green Paper on the taxation of husbands and wives, which is before the House, it may be possible to simplify even still further. That basic simplification of the coding system and of income tax allowances has been part of the Government's strategy to make the system simpler. We hope to proceed further with that to make it easier for people to administer. That is one side. The other side is the extent to which they comprehend what is required of them. My hon. Friend is quite right in saying that many small businesses find it almost impossible to understand what is required.

I have asked the Inland Revenue to produce a new leaflet. My hon. Friend may say that there are too many leaflets already, but I think that a new leaflet, designed specifically for the first-time employer and setting out the details very clearly, will be an asset. I have a first draft of this and perhaps my hon. Friend would like to see it. When we have a completed draft we shall let him have a copy of it because I should welcome his comments and those of the small businesses with which he has discussed this issue to make sure that we get it as intelligible and simple as possible.

In addition, there is a general review of stationery and forms—we would welcome his comments on that too—to ensure that anybody who wants to devote the majority of his time to running his business properly can in a few minutes understand what is required of him in terms of calculating PAYE and national insurance contributions.

My hon. Friend mentioned that some of his small business constituents had not had the courtesy of a letter from the Inland Revenue. I am sorry about that. He also said that there had been some delay in replying to correspondence. If he would let me have particulars of any discourtesy or delay on the part of tax inspectors I should be only too pleased to follow the matters up. I want to make it clear that in the vast majority of cases the Inland Revenue serves taxpayers extremely well. The Inland Revenue is as sensitive as I am to the need to make that service universally acceptable, and the only that we can do that is by seeing that specific instances of slipshod or discourteous behaviour or delay are brought to my attention so that I can have them investigated.

The problem of the simplification of the PAYE and national insurance contribution systems can be solved only in the context of further and more deep-seated reforms of those systems. We are constantly pushing to simplify, to explain and to make things easier. I think that my hon. Friend would be reassured to know that the Government are not content with that. We are constantly looking at ways of making the burden on the small firms easier to stand and the regulations easier to comply with.

The level of that burden, of course, is a different matter. It depends on how much revenue my right hon. and learned Friend the Chancellor of the Exchequer has to raise, but I should not like my hon. Friend to think that what he has said falls on deaf ears. The Government are acutely sensitive to the need to solve the problems that he has put before the House this evening.

My hon. Friend asked whether certain expenses could be deducted from corporation tax for small businesses just setting up. He instanced the worthy technological woman who marries and has a family and then wants to get back to her calling and to have somebody to look after the children. This is perhaps the most deserving case in the spectrum that this problem throws out. We must start with the law. The law says that the expenses of a business are allowable against practical profits only if they are incurred for the purpose of earning the profits of the business. Those words have been tested over many decades, and they do not include expenses of the sort that my hon. Friend has in mind.

Expenses such as domestic help so that one can go out to work, or assistance with child care so that the wife can leave the children and go out to work, come into the category of putting one in a position of being able to carry on a business. That is quite different from expenses incurred for the purposes of earning a profit. For instance, the cost of travelling from home to work is necessary to put one into the position of being able to carry on a business. One might say that having to wear clothes is an expense incurred in going to work, but it is an expense necessary to carry on a business rather than for the purpose of earning profits. The same is true of minding the garden.

My hon. Friend must appreciate how difficult it would be to draw a line. If the basic distinction between the two definitions that I have given were altered, the line would have to be drawn in a new place. I could claim that to go to work I have to travel, that I must have a house from which to travel and somebody to mind my garden and my children. I might even claim that it is necessary for me to have food and clothing to be in a position to go to work. That comes close to including all expenses of the good life. Clearly, one cannot exempt all those expenses from tax.

Where would the limit be? My hon. Friend argues from the case of the deserving young wife in a small business and he makes a compelling argument. One might argue, however, that for those who are self employed or who employ fewer than 10 people all those expenses should be tax deductible. Or should it be based on the type of work that they perform? Either system creates great difficulties. It may be argued that if one is at work all day it is necessary to employ a butler to uncork one's claret. Is that to be allowable against tax? Such a system comes close to being a butler's charter and my hon. Friend touched on the historical difficulties involved in that type of rule.

We are not doctrinaire or dogmatic about this. We breached the rule about business expenses in the Finance Act 1982, which allowed companies to second members of staff on full pay to enterprise agencies and for this still to count against corporation tax. My right hon. and learned Friend the Chancellor announced today that the same concession would apply to staff seconded by tax-paying companies to work for charities. I think that my hon. Friend would agree, however, that the House as a whole would find both those cases acceptable. I am not sure that it would find the employment of child minders, gardeners or, at the extreme, more fanciful characters so acceptable.

My argument is therefore not based on a doctrinaire objection. It is simply very hard to see where the line could be drawn and held. I suspect that wherever my hon. Friend suggests it should be drawn the cost might become very heavy.

For those reasons, we have not felt able to take the step that my hon. Friend advocates. The concept of the personal allowance is designed to take into account, broadly speaking, the domestic and family responsibilities of taxpayers. There are three categories of personal allowance—the married man's allowance, the wife's earned income allowance and the working single parent's allowance. They are supposed, each in its rather rough justice fashion, to compensate people for the expense of not staying at home and minding the children or looking after the spouse or the garden but going to work instead. That is the origin of the personal allowance. I do not claim that personal allowances fit every circumstance—far from it—but that is how the tax system, as we have it, seeks to take care of the sort of problem that my hon. Friend has raised.

Before my hon. Friend can force the logic of his argument upon the Government, he must deal with the problems of definition and of helping the people that he and I might want to help without helping many people that both he and I would agree were not deserving of the help of the taxpayer because of what they seek to do.

I repeat that I am grateful to my hon. Friend for bringing these matters to the attention of the House. I hope that I have shown the deep thought and consideration that we have given to them already. I hope that he will continue to give us the benefit of this views, despite the fact that, although I can go with him almost the whole way on the first half of what he said, I find difficulties about accepting the second half of his argument.

Question put and agreed to.

Adjourned accordingly at four minutes to Ten o'clock.

CONFIDENTIAL

FROM: FINANCIAL SECRETARY
DATE: 18 March 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Sir A Rawlinson
Mr Middleton
Mr Moore
Mr Monger
Mr Robson
Ms Seammen
Mr Munro) IR
Mr O'Leary)
PS/IR

PENSION SCHEMES: PROPOSED 'TRANSFER CLUB'

You will recall that Michael Pilch of the NAPF raised this at a meeting last September, and said that the Revenue were taking an unhelpful attitude towards this proposal. You asked me to consider this question, in the light of the Revenue's submission dated 25 January.

The 'transfer club' is designed to help independent TV workers who move from one company to another. The idea is that service with the old company should be paid for by, and counted as, service with the new company for pension purposes.

Two problems have arisen. First, although such transfers of accrued pension rights are possible, difficulties may arise where the old scheme provides less generous benefits than the new scheme. Some people will still lose out (to an extent). But the solution here is in the hands of the TV companies: they can bring their schemes into line with each other.

Second, such transfers can only apply to the basic pension entitlement (ie 1/60th final pay for each year of service). They do not apply for the 'uplifted sixtieths' rule, whereby employees with 10 or more

years service with the final employer may receive the maximum two-thirds pension. In cases where final service is less than 10 years, a smaller uplifted pension may be paid, on a sliding scale. No one therefore loses out completely, although some will not get the maximum two-thirds pension.

This second point does arise as the result of the Revenue's rules, but I do not think they have taken an unreasonable line. Both the 'transfer club' and the 'uplifted sixtieths' have themselves only evolved because of Revenue discretion, in an attempt to mitigate, as far as possible, the early leaver problem. The Revenue do not feel that they can depart any further from the spirit of the 1970 legislation on occupational pension schemes.

We are still considering the implications of the OPB Report on early leavers. More generally, work is continuing on my review of the tax treatment of pensions and savings. I think this particular question would best be considered in the context of both these reviews.

... If you agree, I attach a draft letter for you to send to Michael Pilch.

pp Eric Kerr

NICHOLAS RIDLEY

PS 22/66/81

DRAFT LETTER TO MR MICHAEL PILCH, NAPF, FROM THE CHANCELLOR

You will recall that when I met you and your NAPF colleagues last autumn, you mentioned a particular point about which you were concerned. This was the refusal by the Inland Revenue to approve the pension rights 'transfer club' in the precise form proposed by the Independent Television Companies Association.

As you probably know, I had some correspondence with Willie Whitelaw on this subject about a year ago, in which I upheld the Revenue's decision. But, in view of the concern which we all feel about the 'early leaver' problem, and the importance of encouraging any constructive attempts to find a solution, I felt the matter should be looked at again. I therefore asked the Revenue for a full report on the issues at stake and, more generally, on the role of their Superannuation Funds Office in administering the 1970 legislation as a whole.

This report took some time to prepare and this is why it has taken so long to get back to you. I am sorry for the delay.

As I understand the position, the Revenue have already indicated that they would be prepared to approve almost all the features of this 'transfer club'. There are however two aspects which they have declined to accept.

The first point concerns the valuation of the deferred benefit which is transferred from the old scheme to the new one. I understand this benefit is valued on an actuarial basis, and converted into a number of 'added years' which the sum would buy in the new scheme. As you know, this is the standard approach. But the problem arises that, because of certain crucial differences

between the various pension schemes run by the commercial TV companies, the number of 'added years' will often not equal the actual years of service up to the time when the employee changes jobs.

This is unfortunate, but I do not think the problem is the result of over-restrictive law or Revenue practice. The Revenue tell me that, if all the schemes involved were identical, there would be no objection to 'added years' and actual years being the same in all cases for the purposes of calculating the basic scale pension entitlement. In these circumstances, they would view the 'transfer club' in the same light as industry-wide 'centralised' schemes. The remedy here is in the hands of the companies themselves.

The second point at issue concerns the 'uplifted sixtieths' rule where individuals have less than ten years service with their final employer. As you know, this rule enables an employer, if he wishes, to provide an enhanced retirement benefit for an employee, instead of the normal one-sixtieth final salary for each year of service, up to a maximum of forth (ie two-thirds). As a result, individuals with ten or more years of service with their final employer may receive a maximum two-thirds retirement benefit. Those with less than ten years may also receive a small uplifted benefit, on a sliding scale. The difficulty, so far as the 'transfer club' is concerned, is that where an individual changes jobs late in his career, he cannot apply the 'added years' to make up the ten years needed for the 'uplifted sixtieths' rule. Added years can be ysed only for calculating the basic scale pension

of one sixtieth for each year of service.

The Revenue accept that, as a result of this, some individuals will not be able to obtain the maximum two-thirds pension. However, they feel that they have already gone as far as they can in using their discretionary powers to relax the statutory requirements in the 1970 legislation. The 'uplifted sixtieths' rule and the 'transfer club' are both possible only through Revenue discretion, and have both evolved in an attempt to mitigate as far as possible the problem of the 'early leaver'. But the Revenue do not consider that they could depart any further from the spirit of the 1970 legislation.

We are still considering what should be done to help the 'early leaver', in the light of the OPB Report. It may be that we shall decide, in the end, that the best solution is something based on the 'transfer club' principle although, to ensure that all early leavers benefited, we should probably have to allow aggregation of service with all employers. But such an approach would raise its own difficulties (it was not a recommendation of the OPB Report).

There is nothing to stop the companies concerned from changing the rules of their pension schemes to enable their employees to gain the full possible benefit from the transfer club. We welcome all constructive attempts to solve the problem of the early leaver. However in my view it is essential that whatever is done should, if at all possible, command general support as the best solution to this difficult problem. To move any further towards unlimited aggregation at this stage would prejudice our consideration of the whole issue, and I do not think this would be desirable.

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 18 March 1983

MR CHIVERS

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (R)
PS/Minister of State (C)
Sir D Wass
Sir A Rawlinson
Mr Bailey
Mr Lovell
Mr Burgner
Mr Morgan
Mr Rickard
Mr Wilson
Mr Grimstone
Mr Halligan
Mr Ridley
Mr Harris

BRITISH AEROSPACE: LETTER FROM SECRETARY OF STATE FOR INDUSTRY

The Financial Secretary has seen Mr Jenkin's letter of 15 March.

The Financial Secretary considers that it will be difficult to go against Mr Jenkin's advice. But equally there will always be some reasons for avoiding an immediate sale. The Financial Secretary is inclined to reply suggesting that we aim for a further sale before the end of March 1984, assuming that the election has taken place by then.

The Financial Secretary would also be grateful for advice on whether we can limit our current commitment to always continue to hold 25 per cent of the shares.

MEI

M E DONNELLY

FROM: M E DONNELLY
DATE: 18 March 1983

MR FITCHEW

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (R)
PS/Minister of State (C)
Sir D Wass
Mr Bailey
Mr Burgner
Mr Kemp
Mr Lovell
Mr Morgan
Mr Binns
Mr Harris

SALE OF PUBLIC SECTOR ASSETS: MARKET TOWERS

The Financial Secretary has seen Mr Walker's letter of 16 March.

The Financial Secretary agrees that in current circumstances we must take Market Towers off the market. But he would be grateful for advice about the reactivation of Market Towers Government debt; and also about the broader questions of the future of the Covent Garden Market Authority, as set out in my minute to you of 2 March.

MED

M E DONNELLY

CONFIDENTIAL

FROM: NICHOLAS RIDLEY
DATE: 21 March 1983

CHANCELLOR

cc CST
EST
MST(R)
Mr Moore
Mr Robson
Mr Godber
Mr Ridley
Mr Graham (Parly Counsel)
Mr Corlett) IR
Mr Battishill)
PS/IR

ASSURED TENANCIES ALLOWANCE: PARTNERSHIPS

I have seen Mr Corlett's submission of 16 March (copy attached, top copy only).

I think we should legislate to exclude partnerships and it may be necessary to see John Stanley again. I am not in favour of him using his department's vote for this tax relief. It would mess up our tax system and would detract from investment in the Business Expansion Scheme.

I would be grateful for your views.

p/p NICHOLAS RIDLEY

CONFIDENTIAL

FROM C W CORLETT
INLAND REVENUE
POLICY DIVISION
SOMERSET HOUSE

16 March 1983

18 MAR 1983

1. MR BATTISHILL

2. FINANCIAL SECRETARY

ASSURED TENANCIES ALLOWANCE: PARTNERSHIPS

1. You asked (Mr Kwiencinski's minute of 11 March) for comments on Mr Stanley's letter of 10 March and the Chancellor's questions on it (Ms Rutter's minute 11 March).

DOE's acceptance that partnerships were excluded

2. The Chancellor asked whether the DOE knew or agreed beyond doubt last year that partnerships were excluded. The answer is categorically yes. They were fully aware that the assured tenancies allowance was intended only for companies (liable to corporation tax), and was not intended for individuals, or partnerships of individuals, (liable to income tax). Partnerships are "transparent" for tax purposes and liability and allowances attach to the individual members, not the partnership as such.

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cc Chancellor of the Exchequer
Chief Secretary
Economic Secretary
Minister of State (R)
Mr Moore
Mr Robson
Mr Godber
Mr Ridley

Mr Graham (Parliamentary Counsel)

Mr Green
Mr Rogers
Mr Battishill
Mr Painter
Mr Walton
Mr Lawrance
Mr Skinner
Mr Corlett
Mr Elmer

PS/IR

3. We were left in no doubt, last year, both at your meeting with Mr Stanley, and our meetings with his officials, that the DOE view at that time was that only companies could and would be approved. This is confirmed by the terms in which Mr Stanley wrote to Nigel Broakes on 16 April 1980, when he said that housing legislation "excludes individuals and effectively limits the field to those who pay corporation tax". You approved the introduction of the new capital allowance on that basis, and the legislation was drafted with only companies in mind. A reference in the legislation to income tax - which has created uncertainty as to whether a partnership may claim the allowance as matters stand at present - was inserted only because DOE told us that they might conceivably want to designate foreign companies (who are liable to income tax here and not corporation tax) as approved bodies. The fact that this provision was intended for companies was made clear in the drafting instructions, all of which were seen by the DOE. The Revenue Press Notice last year referred, in conformity with DOE legislation, to approved "bodies".

Policy issues

4. The Chancellor's second question is concerned with the policy implications of an extension to partnerships.

5. Mr Stanley makes three points here:

i. Government policy is to encourage the construction of properties for letting as assured tenancies

That is so. But the issue for Treasury Ministers last year, and this, is the extent to which that in itself justifies preferential Exchequer support via the tax system over other kinds of economically and socially desirable activities

which do not attract tax relief. Last year's agreement was on the basis of a very narrowly-drawn scheme for 5 years, and therefore a limited Exchequer commitment - estimated at the time to rise to a maximum of £m5 a year.

ii. Other capital allowances are available freely to individuals (and therefore partnerships)

Again this is true: where they are due at all (eg for industrial buildings, plant and machinery, scientific research, hotels), capital allowances are normally available to all businesses, whether or not incorporated. The restriction on the assured tenancies allowance is in that sense unique. But this was because it was specifically recognised - as part of the understanding with DOE Ministers under which the new allowance was introduced - that the scheme would not be available to the personal tax shelter market, because DOE approval was limited to bodies only.

As you recongised at the time, there is little doubt that, if these allowances do become freely available to partnerships, they will prove highly attractive to high rate taxpayers. As the result of Government action in the 1980 Finance Bill, individuals are now largely excluded by the leasing rules from using the leasing of plant and machinery for tax shelter purposes; and investment in individual industrial buildings tends to be on too large a scale. But the success of the small workshop scheme - which requires relatively small blocks of investment of up to £50,000 or so - and the fact that it has been

openly marketed in the press as an attractive tax shelter, is an indication of the extent to which such arrangements can suck in funds rapidly from the personal sector.

More specifically, an individual investing in an assured tenancy dwelling, with a marginal liability of 75 per cent, would receive back in tax repayments up to 60 per cent of his investment within 12 months, and a further 15 per cent over the next 5 years. (This contrasts with a lower recovery rate of only about 40 per cent within 12 months and 12 per cent in the next 5 years for companies paying 52 per cent CT; and roughly 30 per cent and 8 per cent for companies paying at the (new) 38 per cent rate.) And all this for an asset that was unlikely to depreciate. If he sold the dwelling, he would be liable to a balancing charge, in which case the tax benefit would represent an interest-free loan. But, providing the property was held for more than 25 years, there would - as the scheme stands at present - be no balancing charge, and the allowance would become an outright grant.

iii. <u>The legislation could contain provisions to prevent the allowance being abused by tax avoiders</u>

Mr Stanley is here seeking to deal with the point (which you made to him at your meeting) about individuals moving in and out of partnerships to strip out the capital allowances. He suggests limiting the allowances to the "approved" members of the partnership.

There are two points to make. First, there is the question whether or not it would in practice be possible to carry through a provision under which the allowances were due to the 4 partners in whom the land was legally vested (the legal limit is 4) when perhaps up to 20 had contributed to the cost of constructing the property. But, second, and more important, this proposal would anyway not deal with the problem because Mr Stanley's approach would be based on housing, not tax, criteria; a person intent on stripping out the allowances could well be perfectly sound on housing grounds from DOE's point of view, and therefore be among the 4 "approved" names.

To prevent individual investors moving in solely for the benefit of the capital allowances, and then quitting the partnership (possibly in favour of a new partner), we should require a provision under which balancing charges would be made each time a partner disposed of the whole or part of his interest in the property. Some quite tricky legislation would be involved, but it could be done. (It might also be necessary to consider whether, at the same time, we would need to legislate similarly for the IBA generally.) The legislation would need to be got ready for introduction at Committee (or, at worst, at Report).

6. The central issue, therefore, is whether Treasury Ministers now see the assured tenancies scheme as having such political priority that it warrants turning the assured tenancy allowance into a brand-new personal tax shelter, in direct competition, for example, with the small workshop scheme and the business start-up scheme. The effect could well be more than just marginal. It is difficult to estimate the potential Exchequer exposure; but the cost could be as much as £m11 annually for each 1,000 new dwellings

constructed in the year. It follows that if the extension to partnerships were to result in 10,000 extra dwellings a year (over and above those that would otherwise be built by approved companies), the cost could be as much as £m110 annually, for as long as the allowance continued. The cost would fall rapidly after the allowance's termination in 1987, and would be subject to reduction in so far as partners quitted and became liable to balancing charges.

Next steps

7. How best to proceed is very much a matter for your political judgment.

8. If you decide to stand fast on resisting any extension to partnerships, your strong cards are the potential cost and the unjustifiable selectivity in favour of investment in this type of housing as compared with investment in many other equally (or more) worthy assets.

9. If, on the other hand, you feel that you cannot avoid further negotiation with Mr Stanley, you could make it clear that monetary and fiscal constraints leave no room for additional reliefs of this order. If this were a public expenditure matter, Housing Ministers would presumably have to find the additional cost within their programme, or make a bid against the contingency reserve for what is effectively a new policy issue. If, therefore, they continue to press the case for tax relief, you could insist that further consideration of an extension to partnerships could take place only on the basis of a prior understanding that the assured tenancies allowance was treated as a tax expenditure, the cost of which (or at least part of the cost of which) would have to be found by the DOE from within its housing public expenditure provision. This would apply equally to the proposal to extend it to shared

ownership - on which, if we understood Mr Stanley correctly, he hinted at such an offer at your recent meeting.

10. Either way, we shall need to sort the matter out soon since it will be necessary either to legislate partnerships out (the drafting for which is virtually complete) or to bring them in on a proper basis (on which no drafting has yet been done).

11. We are, of course, at your disposal if you wish to discuss this further.

C W CORLETT

FROM: E KWIECINSKI
DATE: 21 March 1983

MR ROBSON

SEIF EMPLOYMENT

The Financial Secretary has seen Mr Isaac's submission (attached).

He would be grateful if you would go through this draft minute again.

His main concerns are:

1) that the old paragraphs 35 and 36 should stay, and

2) that paragraph 43 should be left out.

He would be grateful if you would produce a final version to go the Chancellor as soon as possible.

E KWIECINSKI

From: A J G Isaac

THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

18 MAR 1983

18 March 1983

FINANCIAL SECRETARY

SELF-EMPLOYMENT

1. I have marked in the attached draft some suggestions for the draft note to the Prime Minister, which Mr Donnelly sent me on 16 March.

2. For the most part, I hope that they are self-explanatory.

Introductory paragraphs

3. Mr Green and I thought very hard about how much these paragraphs, dealing with the black economy, contributed to the main argument. Mr Donnelly tells me, however, that the Prime Minister may be expecting something on this. I have tried my hand at trying to put the point in paragraph 2 in a more positive way. In particular, there might be advantage in getting rid, once for all, of any notion that the black economy is somehow peculiar to Schedule D. In the same vein (though I have not used these words in the revised draft) we should not lose sight of the point that classifying a man as Schedule D does not, of itself, make him an entrepreneur.

Paragraph 7

4. I speak subject to correction. However, I thought that the main pressure, reflected in the manifesto, came from people who were clearly Schedule D; who believed that the Revenue Departments enforcement of Schedule E was too strict;

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c Minister of State (R)

Mr Green
Mr Battishill
Mr Blythe
PS/IR

and who (like the NFSE) thought that we were in fact too lax in our enforcement of the black economy within Schedule E. They were the small traders, rather than the casuals.

5. I have also suggested a slight qualification in the reference to Keith. As I have said, some of its recommendations could give us (and Customs) considerable difficulty.

Paragraph 23

6. An individual is, of course, entirely free to choose whether he should be employed or self-employed. Where he is not free, is to choose to be treated as self-employed for tax purposes (Schedule D), when he is not in fact self-employed.

Paragraph 26

7. I have suggested an additional sentence, to avoid the possible implication that there is anything unusual, in there being no statutory definition of "self-employment", and to provide a context for the reference to the Courts in paragraph 27 following.

Conclusions

8. Originally, I had in mind a pretty short passage on conclusions. (Paragraphs 27 and 28 of my earlier draft), concentrating on the positive aspects of what the Chancellor has decided to do. However, this is very much for your judgment.

9. If you decide on the longer version, both Mr Green and I felt that paragraph 44 sat rather uneasily with the rest of the draft.

10. Nevertheless, if you wish to retain the reference to the business start-up scheme, we have offered a revised draft. It seems to us that the present draft carried a possible

implication that, in this year's Budget, the Chancellor had "at last" achieved Ministerial control over the business start-up scheme. Such an implication would hardly do justice to the many hours which the Chancellor himself, as well as Mr Rees, spent in discussing the details of the business start-up scheme both before the 1980 Budget announcement and during the subsequent Finance Bill discussion. As I think you know, the allegation that "Ministers propose but Revenue dispose" was well established before 1980. Before the Chancellor decided to go ahead with the scheme for the 1980 Budget, he was well aware that the critics would describe it as "a good idea ruined by bureaucratic restrictions" (the precise words were correctly forecast in the pre-Budget discussions). And he, and Treasury Ministers at the time, settled the details of the scheme in that knowledge.

C+CS

A J G ISAAC

PS. Paragraph 35

I have omitted the reference to Keith here. We shall, of course, be discussing the merits of the recommendations with you in due course. In this particular context, this recommendation, however, if you accept it, would make it more attractive - not less attractive - for people to dress up employment as self-employment, and claim Schedule D accordingly.

REVISED DRAFT MINUTE

FROM: CHANCELLOR OF THE EXCHEQUER

TO: PRIME MINISTER

SELF-EMPLOYMENT

1. At a meeting of the Liaison Committee on 10 November 1982, there was some discussion of taxation of the self-employed. Robin Butler's letter of the same date asked for a note on the subject.

2. We start with a firm belief in self-employment. A vigorous small firms sector is a crucial channel for bringing new energy, new enterprise and new initiative into industry and commerce. Self-employment embodies the attitudes we wish to foster. Individual responsibility, hard work and risk taking are a central part of being self-employed.

3. People sometimes talk as if a move into self-employment was almost the same thing as a move into the black economy. Few things could be further from the truth, or more offensive to the self-employed themselves. In practice, of course, both the self-employed and the employed are to be found in the black economy. As you will remember, it was indeed the National Federation of the Self-employed who took the Inland Revenue to the House of Lords, arguing that the Revenue were not being sufficiently rigorous - and even-handed - in dealing with Fleet Street employees.

4. Our objective is to encourage genuine self-employment. For this purpose, we need to ensure that both self-employment and employment are properly taxed. And we must avoid guerrilla warfare between the Revenue and the taxpayer about the dividing line between the two.

5. At present there are reports of guerrilla warfare between employment (Schedule E) and self-employment (Schedule D).

6. We are under pressure from those who say these boundaries are inadequately policed. They see this as leading to unfairness and to loss of revenue. Against that we have those who say that the policing is oppressive, costly and destructive of initiative and enterprise.

7. We said in the Manifesto that we would make a thorough review of the enforcement procedures of the Revenue Departments. This led to the setting up of the Committee under Lord Keith of Kinkel. I have recently received the first volume of their report. It is to be published on March 23. I am minuting you separately on its content and handling. Suffice to say that overall it recommends some tightening of enforcement procedure, though combined with greater safeguards for taxpayers. It links this recommendation with what the Committee sees as a lack of even handedness in the present position.

8. This means the Keith Report lines up alongside a series of comments and recommendation from the PAC on the need to tighten enforcement and alongside many of the recommendations in the CPRS Report on the black economy.

9. The PAC's 12th Report 1980-81 expressed support for strong action to deter tax evasion by casual workers and pressed for legislation to counter evasion by agency workers. It also pointed in the direction of using stiffer sanctions against those self-employed taxpayers who are late in filing returns to the Revenue. More generally they said that it was important the Department "should be seen to be making strenuous efforts to reduce and contain the black economy".

10. In their 22nd Report, 1981-82, the PAC expressed disappointment with progress on casuals and agency workers. They went on to make some unhelpful comments on the black economy. They regretted that the Revenue was not allowed to examine taxpayers records on a random basis. They hoped Keith would recognise the strength of the case for heavier penalties for tax evasion. They interpreted evidence they received as suggesting strongly the need for substantially more investigation staff in the Revenue. They recommended that the use of staff on such work should not be restricted by our manpower policy.

11. The CPRS Report contains a pretty trenchant statement (paragraph 6.6 of its conclusions) of the case against the black economy. It went on to make a series of recommendations designed to improve the effectiveness of enforcement work.

12. I have set this out at some length as evidence that the pressures on us are by no means all in one direction. In part it is in the nature of things that there should be two opposing camps on an issue of this sort.

13. What is especially unsatisfactory is that at least part of the problem arises from a genuine lack of clarity about what is legitimate and what is not. This particularly arises on the boundary between Schedules D and E. In the great majority of cases the dividing line is clear. The practising barrister is self-employed, the Civil Servant is not. But the uncertainty at the margin can lead to surprise and criticism when the Revenue's view turns out to differ from that of the citizen.

14. The problems this cases are magnified as there can be so much at stake.

15. For example, if the individual is treated for tax as self-employed, he gets paid without deduction of tax. He can claim more generous deductions for expenses. He pays tax in arrears. And he can get a "tax holiday" for many months when he switches from employed to self-employed status.

16. Again, if the businessman hires a self-employed person, rather than an employee, he does not have to apply PAYE. He does not have to pay NIC or NIS. He does not have to pay sick pay, holiday pay, redundancy money or pension.

17. There can also be important implications for social security, VAT and employment protection legislation.

18. For all these reasons, both "employers" and "employees" can find it very attractive for the "employee" to be treated as self-employed. Overall there is heavy pressure for self-employed treatment.

19. At the same time, these very factors which make Schedule D treatment attractive to the taxpayer involve substantial costs for the Exchequer. The costs of administering Schedule D are per capita very much higher than those of administering PAYE - even taking account of compliance costs for employers. Tax collected under PAYE mostly reaches the Exchequer. Payments made without deduction of tax do not always do so.

20. Nicholas Ridley and John Wakeham have been giving long and hard consideration to the position. This has taken time and explains the delay in getting this note to you.

21. They have considered the ~~problem~~ possibility re- of defining employment and self-employment, so as to ensure that the tax system does not discourage people from moving from employment to self-employment, and to remove as far as possible the uncertainty that exists at present on the dividing line between the two.

22. First, they considered whether we are, in principle, trying to draw the boundary between Schedules D and E in the right place. The present tax rules ask the basic question:

"Are you in business on your own account?

Or are you working for somebody else?"

We think this is about right. We encourage people to move into self-employment precisely because of the virtues of self reliance and enterprise which go with being "in business on your own account".

23. On the face of it there would be great attractions in allowing an individual to choose whether he is to be taxed either under Schedule D or Schedule E. But this would require the tax treatment of the two to be much more in balance.

24. I doubt if we can bring the two schedules, D and E, entirely into line. The fact is that the Schedule E person - drawing a weekly or monthly pay cheque - is just not in the same position as the self-employed businessman who has to take his own business decisions, carry his own expenses, and wait until the end of the year to add up his net profit (or loss). In many cases there are genuine commercial reasons why the Schedule D man should have a less rigorous tax regime than his neighbour on Schedule E.

25. The balance may not at present be quite right. This is something we will look at again in the light of progress towards self assessment.

26. What we can and must do is try and resolve the problems caused by the uncertainties of definition at the margin. There is no statutory definition of "employment" or

"self-employment" for tax purposes. As elsewhere in the tax system, this is, in the last resort, left for the Courts to judge on the facts of the individual case.

27. In practice, we can isolate 8 criteria which the Courts have used to help decide whether a taxpayer is or is not "in business on his own account". These are set out in Appendix A. They leave difficult cases at the margin. Hence our problem.

28. We have looked at ways in which we could introduce greater certainty for the citizen. Broadly, these are:

(a) a new statutory definition based on the existing criteria.

(b) a new statutory definition based on some simpler (and perhaps less arduous) test.

(c) a clear re-statement in simple terms of what self-employment under the existing law entails. This would be coupled with a procedure under which the Revenue could give an authoritative ruling. Such a ruling would have to be open to challenge in the Courts.

A statutory definition based on the existing criteria

29. I do not think anything would be achieved by incorporating into the legislation the criteria at Appendix A.

30. Three reasons. First, the legislation would be long, with extensive definitions of individual words and phrases. Second, many of the conditions would have to be heavily qualified. Third, a whole new body of case law would spring up concerned with themeaning of peripheral phrases such as "control" and "financial risk"; because of these there would still be uncertainty at the margin.

A statutory definition based on a new test

31. This looks attractive as a way of encouraging enterprise and independence. The problem is to find a new formula which focuses on those who genuinely wish to be enterprising.

32. Nicholas Ridley and John Wakeham have considered possible new "criteria" which would provide a simple and easily understood answer to the question whether an individual was or was not "in business on his own account". For this purpose the definition would need:

- to bring within Schedule D anyone who has the enterprise and independence to go into business on his own account; and

- keep within Schedule E those who are doing nothing more nor less than a straightforward job of work for an employer.

There is no profit in encouraging those - like the Fleet Street casuals - who would like to enjoy the benefits of Schedule D - no deduction of tax etc - without the responsibilities of genuine self-employment.

33. One possibility would be to define self-employment as involving no entitlement to paid holidays, sick pay, redundancy pay or an occupational pension. It might also be a requirement that the individual shows he has made some provision of his own for some or all of these benefits.

34. People enjoying all these benefits are unlikely to be self-employed. But the converse does not follow. Many even amongst full-time employees, do not enjoy them all. And there would be still greater difficulties in relation to short term, intermittent or one off engagements. This is the area where the problem of definition is currently acute. As already mentioned the PAC are alert to the existing evasion in this area.

Hmrc 35

→

~~I wish to~~

How keep to sub 36.

35. I am also conscious that starting afresh with a new definition could lead to more litigation at a new margin and this could mean it would take years for the rules to settle down.

A clear re-statement of existing law

36. It is not enough to say that the great majority of cases is clear, or that real life is complex and does not fall neatly into tidy bureaucractic compartments. There is genuine uncertainty at the margin. Often this cannot be resolved for quite some time. This is a real problem. I have been considering a two-pronged attack.

37. First, issuing a leaflet setting out in clear layman's terms what self-employment entails. This would remove a lot of the mystery. An early draft of such a leaflet is at Appendix B. Clearly more work needs to be done on it.

38. Second, I am exploring the idea of introducing a "mechanism" under which interested parties could seek a binding determination from the Inspector of Taxes of the correct position in advance. Such a determination would have to be made within a set time limit - say 30 days - and would be open to appeal. The Revenue might require 180 staff per 100,000 requests for determination. It would need primary legislation in a Finance Bill. The outline of such a scheme is at Appendix C.

39. Even on this we will need to proceed with care. The self-employed would rather have uncertainty than the wrong kind of certainty.

Conclusion

40. Our basic objective is to encourage genuine self-employment and to provide an environment in which enterprise can flourish. At the same time we are under pressure from those who wish to see tax enforcement strengthened and from those who wish to see it restrained. The Keith Report is going to be prayed in aid by both sides, but particularly by those who wish to see a strengthening.

41. Our task is made harder by the genuine uncertainty that exists in certain important areas, particularly the dividing line between employment and self-employment. I see little prospect at present of achieving anything worthwhile by redrawing the dividing line either where it now is or in some other place. It would be right to improve understanding of the present law and to make administration more accessible to the citizen. The proposed leaflet and clearance procedure should go some way towards this. Properly handled this should also reduce the problems we face of accusations that the Revenue are harrasing the self-employed and small businessman.

42. Looking further ahead, we shall continue to examine the possibility of finding a simpler and more relaxed definition of self-employment and of dealing with the problems of casuals.

43. Finally, one rather separate point. I know you share my general concern about the continuing press reports along the lines that Ministers propose but the Revenue disposes. This has been a particular problem in relation to the business start-up scheme, though there are plenty of examples before that of critics attributing to the Revenue the responsibility for Ministers' decisions of which they (the critics) disapproved. The major extension of the business expansion scheme, which I announced in my Budget, should help to defuse criticism in this particular area.

for myself I agree that this is irrelevant & could be left out

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

From the Minister

The Hon Nicholas Ridley AMICE MP
Financial Secretary to the Treasury
Great George Street
London SW1

21 March 1983

ACTION	MR FITCHEW
COPY TO	PS/CHANCELLOR PS/FST PS/CST PS/MST(C) PS/MST(R) SIR D WASS SIR A RAWLINSON MR A BAILEY MR LOVELL MR RIDLEY MR BINNS MR HARRIS

Dear Financial Secretary

I am writing to you about a further matter arising from our decision to dispose of the assets of the Land Settlement Association.

Certain of these assets consist of houses occupied by staff or former staff of the Association. In the main, the individuals concerned (about 100 or so in all) do not have security of tenure, since they benefit from service occupancies. There are however exceptions (eg the agricultural workers), where if a private landlord were involved security could be claimed. There are other cases where the situation is by no means clear, and this is particularly so in the case of the retired staff of the Association who have been given licences to occupy.

I am sure you would agree that in cases of doubt we should not rely on the exercise of Crown exemption, which in theory we would be entitled to do. Equally, I hope you would accept that we should wherever possible avoid having to evict LSA employees. It is one thing to make someone redundant, which will be the case with all of the 200 or so LSA staff; but it is another to deprive them of their homes at the same time.

I have therefore been giving a great deal of thought to ways of disposing of these quite valuable assets and at the same time dealing fairly with the staff concerned, many of whom have given long and loyal service to the LSA. I had originally thought of a straight-forward discount arrangement similar to that which applies to council house sales. But this would I think have been too generous and would also have given too great a benefit to those who by chance occupy the more expensive properties. As an alternative, I would like your authority to proceed with an arrangement which offers a form of discount but at the same time offers an incentive to staff to vacate their properties voluntarily where they are either unwilling or unable to buy. We also need to take special measures for the lower-paid staff, who even under the arrangements I am proposing might well find it difficult to buy or find alternative accommodation.

/In detail, ...

In detail, my proposals are based on the assumption that the individual houses are worth £20,000 on a vacant possession basis (a modest assumption) and that we should be thinking in terms of a discount of between 15% and 33% off the vacant possession price, depending on length of service. On this basis, the following offers would be made to staff occupying LSA houses:

(a) <u>all weekly paid staff who do not enjoy security of tenure</u> (up to 50 in number) to be offered the following alternatives:

(i) the opportunity to purchase the house they occupy at a discount from the open market price with vacant possession. The discounts would be in the range of £3,000 - £7,000 using the following formula:

up to 5 years service	£3,000
5-10 years service	£4,000
10-15 " "	£5,000
15-20 " "	£6,000
20 or over	£7,000

(ii) if they are unable or unwilling to buy at the discounted price they should be offered a secure statutory tenancy, under the Rent Act, of a similar house of the Minister's choice. This would provide security of tenure but allows flexibility to achieve rational disposals. It would be made clear to all weekly paid staff that this would be an alternative to (i).

(b) <u>Provincial administrative staff</u>, ie monthly paid pensionable employees (31 in number) who occupy their houses on strict service licences, to be offered the same range of discounts as weekly paid staff either on the house they occupy or another house of the landlord's choice. These are the higher paid employees whose conditions of service and occupancy are quite explicit. It has been fully understood by such employees that they are required to give vacant possession on resignation or retirement. Certainly these staff should not be considered economically vulnerable and it is difficult to make any case for any further preferential treatment.

Linked to the proposals in the previous paragraph, I suggest that we should offer a further option to all staff. For a number of reasons individuals may not specifically wish to purchase the house they occupy but equally would not wish to forego the opportunity of

/profiting from ...

profiting from the discount arrangements. It would be helpful to such tenants, and indeed to us, to be able to offer a cash sum as an incentive to obtain vacant possession. There would be some merit in linking this "key money" to the level of discount but, because we would need to bear the costs of finding an alternative purchaser albeit at full vacant possession value, it would be preferable not to offer the full service discount. I therefore propose making an across the board offer of £3,000, enhanced by half the long-service additions listed above to occupiers offering vacant possession.

Staff who did not purchase houses at the discounted value could in the main be expected to fall into the weekly paid category and thus would be given a fully protected tenancy. Any salaried staff not able to purchase would be relatively few and they at least would have a cash sum of £3,000 or more to add to their relatively higher redundancy payments. A minimum of a twelve month shorthold occupancy could also be offered to ensure that alternative housing could be found without undue hardship.

Those occupiers not wishing to purchase and thus having been granted a statutory tenancy should be offered no guarantee of purchasing their house from the Ministry at tenanted value. These properties should be offered for sale, subject to tenancy, as an investment at auction or by tender. Individual houses would not necessarily be offered as separate lots and thus occupiers might well find it difficult to purchase at a price lower than the Ministry's original offer which they had rejected.

Some retired LSA staff also occupy LSA houses (up to 22 in number), and these should be offered similar arrangements. But those staff who have left LSA employment before my announcement and are occupying LSA houses either as squatters or under short-term licences should not be offered favourable treatment; these staff include those dismissed on disciplinary grounds and those made redundant because of their inefficiency.

These arrangements would I feel be fair to all concerned but would at the same time enable us to undertake a reasonably quick and tidy disposal of the LSA estates. The alternative could well be long drawn out and unpleasant action to evict relatively low paid and long-service staff, with the inevitable adverse criticism of the Government. This we need to avoid at all costs.

It is difficult to work out the net costs of these proposals. If we take as an average some £5,000 per house, we could be thinking in terms of some £½ million. But in practice the net costs would be substantially less, since unless we were to rely on Crown exemption we could by no means guarantee obtaining full vacant possession

/value in all ...

value in all cases; even where we were able to do so, the cost could well be significant. The "key money" element could also be regarded as a substitute for a disturbance or transfer allowance, which the LSA staff could legitimately argue for on the grounds that it is my decision that has led to their having to move house. I can however assure you that the proposals which I have outlined will not meant that we will need to reduce our estimate of the overall receipts from the disposal of the LSA estates, as set out in my letter to you of 11 November 1982; I would also expect that the "key money" expenditure in 1983/84 would be contained within approved cash limits.

I hope you can agree to these proposals. An early response would be much appreciated.

I am copying this letter to Leon Brittan.

Yours sincerely

Robert Lara

for PETER WALKER
(Approved by the Minister
and signed in his absence)

FROM: NICHOLAS RIDLEY
DATE: 22 March 1983

CHANCELLOR

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

FINANCE BILL: BENEFITS IN KIND

We agreed that legislation should be introduced to take effect from April 1984 which will counter the abuse where directors occupy company houses rent-free or at a peppercorn rent. I have had second thoughts about the proposals outlined at Annex F of Mr Driscoll's submission of 11 February and this minute describes the basis on which I have now asked for the legislation to be drafted.

The Revenue proposal was to introduce a new measure of the benefit where the house cost more than £100,000 freehold (£75,000 leasehold). For houses costing more than that the charge to tax would have been based on the higher of (a) gross annual value, etc., (the existing "Section 531" charge); and (b) a percentage of cost. But this proposal has two basic flaws: firstly, I think £100,000 is too high; and secondly, there would be too great disparity between the man occupying a £99,000 house (paying a tax on an annual value of say £1,000) and the man occupying a £101,000 house (paying tax on say £12,000).

I have therefore asked the Revenue to draft on the following basis:

- the existing Section 531 charge will apply to all properties;

- but for all properties (leasehold or freehold) costing over £75,000 there will be a "surcharge";

- the surcharge will be based on [12] per cent of cost less £75,000

This will ensure a smooth gradation:

- the man in a £74,000 house paying tax on say £800;

- the man in a £76,000 house paying on say £820 (Section 531) plus £120 (ie (£76,000 - £75,000) X $\frac{12}{100}$ = £940;

- and the man in a £276,000 house paying on say, £2,000 (Section 531) plus £24,120 (ie (276,000 - £75,000) x $\frac{12)}{100}$ = £26,120.

The figure of £75,000 and the 12 per cent rate are matters for judgement but I hope you can agree that they represent a reasonable starting point for the first print of the Bill.

I gather that Derek Rayner has spoken to Leon about our proposed measure. Although Derek says he never favoured the scheme he was concerned that:

a) our proposals would force companies to compensate their employees by paying higher salaries, which he thinks would be damaging in social terms; and

(b) that the people affected, particularly the relatively junior Directors, should be given reasonable time to get out of their current commitments.

On (a), it is likely that those involved will rearrange their affairs to take account of the new regime. It will be for the companies themselves to judge the appropriate level of remuneration now required, although this need not necessarily mean an increase in salaries. Our basic approach must surely be that all emoluments in whatever form are taxed on an equal footing.

On (b), our proposals are due to take effect from 6 April 1984, which means that those involved will have a year to reorder their affairs. I think this is an adequate and reasonable amount of time.

NR

NICHOLAS RIDLEY

FROM: M E DONNELLY
DATE: 22 March 1983

CHANCELLOR

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

INLAND REVENUE AND GOVERNMENT INTENTIONS: LEEDALE v LEWIS

The Financial Secretary has read Mr Isaac's submission of 9 March, and discussed it with Revenue officials.

The Financial Secretary is concerned about the issues arising from this case. He would welcome the chance to discuss it briefly with you, and perhaps other interested colleagues. In view of the deadline imposed by end of the financial year a final decision will need to be made in the next day or so.

MED
M E DONNELLY

CONFIDENTIAL

Mr Ritchen
Mr Burns
Chancellor
CST
EST
MST(R)
MST(C)
Sir D Wood
Mr Ridsdale
Mr Howell
Mr Burgner
Mr Kemp
Mr Morgan
Mr C Scott
Mr Harris

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Peter Walker MP
Secretary of State for Agriculture, Fisheries
and Food
MAFF
Whitehall Place
LONDON
SW1A 2HH

22 March 1983

Dear Peter

SALE OF PUBLIC SECTOR ASSETS: MARKET TOWERS

Thank you for your letter of 16 March.

I agree that the option of short leashold financing for Market Towers should not be pursued further.

I also agree that the CGMA should be allowed to reactivate some £4.2m of suspended NLF debt before the end of this month; I understand that some £3.5m of this would be attributed to Market Towers. I note that this would have an effect on the terms of the Financial Agreement reached between the Government and the CGMA in 1980 dealing with the sale proceeds of Market Towers. Our officials discussed this last week. I accept, of course, that the sale costs and separation costs should remain a charge on gross sale proceeds. The 1980 Financial Agreement also said that some £7m of active debt would be repaid out of the sale proceeds. This is the condition that we need to have redrafted and I understand that our officials have reached agreement, which I endorse, that the condition should be amended to refer to "paying off £13.3m of NLF debt, including all active debt attributed to Market Towers".

I agree with you that we should accept Jeffrey Sterling's advice and take Market Towers off the market for a period. I suggest, however, that we should review the situation after a period of 12 months to see if the state of the property market would justify a further effort to sell then. This agreement is also subject to the fuller examination of the privatisation option which I propose below.

You also mention the option of full privatisation. Although I recognise that there will be difficulties in going down this route, I would like to see a full examination of it before reaching final conclusions. I have accordingly asked my officials to get

in touch with yours with a view to preparing an agreed note about the implications of privatisation. I hope this can be produced within the next month or so.

Copies of this letter go to other members of E(DL) and to Sir Robert Armstrong.

Yours ever,

Nicholas

NICHOLAS RIDLEY

Chancellor
CST
EST
MST(R)
MST(C)
Sir D Wass
Mr Middleton
Mr Bailey
Mr Bourne
Mr Pearson
Mr Ridley
Mr Harris
Mr Sims-IR
Mr Eason
MS N Wood

FINANCIAL SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON
SW1

22 March 1983

Dear Nigel

WYTCH FARM DISPOSAL

I have been asked to reply to your letter of 16 March to Geoffrey Howe.

I agree that the market for the assets has been thoroughly tested and that the Dorset bid appears to be the best available at present. However, as you mentioned, there are many uncertainties in the further negotiations that you envisage between BGC and Dorset. They include uncertainty on the various tax assurances which Dorset has sought as a condition of its bid. The most important of these relates to the treatment of the net revenue interest payments. The Revenue, on the basis of the information available to them so far, has already advised your officials that these payments would not be allowable as a deduction for corporation tax. These payments are a significant part of the overall offer and I think two points arise.

First, I understand that your officials and advisers have evaluated Dorset's bid on the basis that the net revenue interest payments would be an allowable expense for corporation tax purposes but have taken into account the implied reduction in overall corporation tax receipts. It the bid has to be restructured on the basis that these payments would not be allowable, it will be important to ensure that the value of the bid to the public sector is not thereby reduced.

Second, there is, as you recognise, the risk that the outcome of further negotiations on these matters might lead to the bid being withdrawn. I question whether in these circumstances it is prudent to tell RTZ that it is no longer in contention, as opposed to keeping its bid on the table (if that is possible) for further consideration if - contrary to our hopes - negotiations with Dorset

were to break down. I accept that this depends on your being able to secure some improvement in RTZ's present offer. I agree however that Ashdown's offer is unacceptably structured, and that they should be given a firm negative now.

So far as tax matters generally are concerned, the Revenue is ready to give what assistance it can in relation to the points raised by Dorset and has already suggested that the best course might be detailed discussions between the group and the Oil Taxation Office. I understand however that the legal position on net revenue interest payments seems pretty clear.

No doubt you will consult colleagues again when the final shape of the bid is clearer.

I am copying this to E(DL) colleagues and to Sir Robert Armstrong.

Yours ever
Nicholas

NICHOLAS RIDLEY

(COVERING) MANAGEMENT IN CONFIDENCE

FROM: E KWIECINSKI
DATE: 22 March 1983

PS/CHANCELLOR
(Ms. Rutter)

cc PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir D Wass
Sir A Rawlinson
Mr Le Cheminant
Mr Robson
Mr Williams
Mr Porteous
Mr Driscoll/IR
PS/IR

TAXATION OF CIVIL SERVICE ALLOWANCES

... As requested in your minute of 17 March, I attach a draft minute for the Chancellor to send the Prime Minister.

E KWIECINSKI

MANAGEMENT IN CONFIDENCE

DRAFT MINUTE FROM THE CHANCELLOR TO THE PRIME MINISTER

PRIME MINISTER

TAXATION OF CIVIL SERVICE ALLOWANCES

You were much concerned about this problem which attracted some press coverage last month. John Townend raised it with you at Question Time on 1 March and with me on 24 March.

We have two objectives. We want Civil Servants to be treated neither more nor less favourably than private sector employees. At the same time any solution must make administrative sense.

Telephone and clothing allowances are undoubtedly taxable under the law as it stands. We will replace the existing ones by new taxable allowances negotiated at levels which reflect their taxability. There will be neither individual nor precise grossing-up. We shall also try to reduce the number of such payments. There may be some overall saving.

On the other allowances, there remains a difference between what the Government or any other good employer thinks it right to reimburse, and what tax law allows to be paid tax-free. I have tried to see whether there is any way in which the effects of that difference can be reduced - by changing either the law or the nature of the allowances. None of the possible approaches considered seems a good way forward.

The Tax Rules

If Government were operating in a vacuum it would be a straightforward matter to declare all payments in the categories with which we are concerned to be tax-free. This could be done either administratively or by statute. Of course the Government would not be tempted to pay bogus allowances in order to reduce civil servants' tax liability. But that would mean either giving an unacceptable privilege to public sector employees, or if extended to the private sector opening up a massive and easy way for employers and employees to compound to reduce tax paid.

It might just prove possible to re-formulate the tax rules in such a way as to exempt the majority of the payments now in dispute for both the public and the private sector. That would mean legislation. We are looking into that possibility. But such a solution would be some way off and an alternative rule would produce its own crop of anomalies and hard cases. It cannot be an immediate answer to our problem.

I fear that we must, for the time being at least, accept the principle of taxability.

The Allowances

I have considered whether the payments made to those seconded to Northern Ireland and elsewhere could, like the clothing and telephone allowances, be rationalised. But flat-rate taxable allowances could be more expensive than the present system and would undoubtedly be

iticised as being both too broad-brush and too generous for application to public servants. If most were to be fairly treated some would get too much by way of allowances.

The present system is cheaper and, because it is based more closely on individual behaviour, more easily defensible. But there may be scope for some reduction in the incidence of detached duty payments and a closer examination of the facts by the Inland Revenue (coupled possibly with a small change in procedures) may take a few of the staff concerned out of the tax net.

Accounting for Tax

I have looked at the possibility of "bulk accounting" for tax, what the Unions call "compositing". From one point of view this idea has its attractions - we may want to look at the possibility of introducing it (by law) in relation to small benefits in kind. But to introduce it now as a concession to Civil Servants when it is refused for "outside" employees would be to give preferential treatment. Moreover to do this for large allowances, as opposed to more general benefits in kind would be a serious derogation from the principle that income tax should be calculated on the basis of individual liability. And for the Treasury to account to the Revenue for a global sum would be inherently even more difficult to justify than for it to apply PAYE to grossed-up amounts.

Conclusion

I conclude therefore that grossing-up and taxing is the least unsatisfactory way of dealing with these allowances in the short term.

ivate employers do it. Relatively little administrative cost (perhaps 10 staff) is involved. The numbers of individuals and the amounts of money are very small - less than 1 per cent of Civil Servants and less than 4 per cent of total annual expenditure on travel and subsistence. It is most unfortunate that figures like £m250 have been used. The true total is more like £m10.

This is obviously not an ideal outcome. But in this area anything we do is liable to be misunderstood and misrepresented. We should ourselves keep the matter in perspective. It is very much a problem of the margins. Moreover, if we had not moved to apply tax, "Civil Servants Tax-free Bonanza" might have been an equally unwelcome headline. It would have been indefensible to have allowed tax-free payments to Civil Servants to continue once liability was established.

Treasury officials have virtually agreed with the Departments a set of comparatively simple arrangements and are ready to go ahead - from 1 July if you agree.

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 0002
SWITCHBOARD 01-212 7676

From the
Parliamentary Under Secretary of State

Rt Hon Nicholas Ridley MP
Financial Secretary to
the Treasury
HM Treasury
Parliament Street
LONDON SW1

23 March 1983

Dear Nicholas,

TAXATION AND THE SELF-EMPLOYED

Since a discussion I had with John Wakeham following a meeting at No 10 on 2 November, we have been giving quite a lot of thought here to the various tax problems that can arise for the self-employed and particularly for those on the margin between employment and self-employment. We have also been considering whether anything could be done to reduce the administrative burden placed on the small businessman who has to assume responsibility for the calculation and collection of tax from any people he may employ on an irregular or casual basis.

The prospect that emerges is an accelerating trend away from steady 5-day-a-week work for a single employer towards more flexible part-time employment and self-employment. I am convinced that the rapid advances now being made in information technology will mean that new working arrangements like the networking scheme recently introduced by Rank Xerox will become quite widespread within the next 5 years. I happened to hear the other day, for example, that Thomas Cook are thinking along the same lines. The substantial increase in franchising indicates a trend along similar lines. If our assessment is right we could soon find ourselves with a system of tax law and practice that was not designed for such a rapidly changing pattern of working arrangements and which is not easily able to cope with it.

Officials here have already had a preliminary meeting with Mr Battishill and they tell me that the Inland Revenue are well aware of the potential problems and are indeed already studying them at the request of Treasury Ministers. Since some complex and important issues will need thorough examination, I wonder whether you would agree that an inter-departmental group of officials from the Treasury, Inland Revenue, Industry and perhaps the CPRS might be set up to prepare a report for Ministers with all reasonable speed.

Yours ever,

JOHN MACGREGOR

CONFIDENTIAL

Foreign and Commonwealth Office

London SW1A 2AH

From The Minister of State

22 March 1983

FINANCIAL SECRETARY

REC.	24 MAR 1983
ACTION	MR R H WILSON
COPIES TO	PPS EST MST(C) CST MST(B)
	SIR D WASS
	MR A BAILEY
	MR BURGNER
	MR MORGAN
	MR A M WHITE

CHIEF SECRETARY

REC.	23 MAR 1983
ACT	FST

Dear Kenneth

CABLE AND WIRELESS: PROPOSED SHARE ISSUE

Leon Brittan's letter of 21 March comments on the question whether HMG should take 50% of the proposed new shares.

The assurances given to overseas governments in 1981, at the time Cable and Wireless was privatised, as I pointed out in my letter of 18 March, make it desirable to continue our majority shareholding in the company. The assurances were particularly relevant to Hong Kong and Bahrain. For various reasons we now believe these two governments are likely to accept without too much difficulty a dilution in HMG's shareholding from a majority holding to a minority, but controlling,one. But we can expect several other Governments to show more concern. Some may make difficulties for Cable and Wireless. However in view of Leon Brittan's arguments against HMG buying further Cable and Wireless shares I am prepared to accept the proposed issue of the shares being placed with financial institutions.

In view of the consultations with overseas Governments before privatisation, we need at least to inform those Governments of this move, and to try to reassure them. The haste with which this decision has had to be taken, coupled with the commercial sensitivity of the proposed deal, has precluded prior consultations. We will now brief posts to take the matter up with the Governments concerned as soon as it becomes public on Thursday 24 March.

I am sending copies to Leon Brittan and to Sir Robert Armstrong.

Yours sincerely,

(BELSTEAD)

Kenneth Baker Esq MP
Minister of State for Industry & Information
Department of Industry
Ashdown House

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 23 March 1983

MR BATTISHILL-IR

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (R)
Mr Moore
Mr Prescott-IR
PS/IR
Mr Graham - Parly Counsel

BUSINESS EXPANSION SCHEME: APPROVED INVESTMENT FUNDS

The Financial Secretary discussed this question with you and other officials on 21 March.

It was agreed that in future all funds wishing to take advantage of the Business Expansion Scheme would be required to have Revenue approval. Only approved funds would be allowed to invest less than £500 in each company for each investor. This latter provision would be reviewed when the BES had been running for some time.

MED
M E DONNELLY

FROM: M E DONNELLY

DATE: 23 March 1983

MR BATTISHILL

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
Mr Moore
Mr Prescott-IR
PS/IR
Mr Graham - Parly Counsel

BUSINESS EXPANSION SCHEME: APPROVED INVESTMENT FUNDS - ERRATUM

My note to you of 23 March.

The first sentence of the second paragraph is incomplete. It should read:

> 'It was agreed that in future all funds wishing to take advantage of the freedom from the £500 minimum investment limit under the Business Expansion Scheme would be required to have Revenue approval'.

I would be grateful if copyees would note this correction.

MED

M E DONNELLY

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 23 March 1983

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Mr Moore
Mr Robson
Mr Godber
Mr Ridley
Mr Graham-Parly Counsel
Mr Corlett) IR
Mr Battishill)
PS/IR

ASSURED TENANCIES ALLOWANCE: PARTNERSHIPS

The Financial Secretary has seen your minute of 22 March.

He saw the Secretary of State for the Environment and the Minister for Housing last night and informed them that the Treasury had decided to legislate to exclude parnterships from the assured tenancies allowance scheme. The DoE ministers insisted that before a final and conclusive decision was taken they should be allowed to discuss this further with the Chancellor.

In the circumstances the Financial Secretary agreed that the exclusion provisions should be left out of the first print of the Finance Bill. He advised Mr King and Mr Stanley that it remained his intention to legislate and that this would mean a Government New Clause in Standing Committee - politically a less desirable alternative.

The Financial Secretary suggests that the Chancellor might like to have an early meeting with DoE ministers in order to try and finally resolve the problem.

E KWIECINSKI

FROM: M E DONNELLY
DATE: 23 March 1983

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir D Wass
Mr Kemp
Mr Moore
Mr R I G Allen
Mr Peretz
Mr Robson
Mr G Smith
Mr Ridley
Mr Harris

FINANCIAL SECRETARY'S PRESS HANDOUTS: FRIDAY 25 MARCH

The Financial Secretary would be grateful for the Chancellor's approval of the two draft press handouts attached. The Bicester handout is for release at lunchtime on 25 March; the Cheltenham one for use the same evening. Perhaps Mr Allen could provide the missing figures.

It would be helpful to have any comments on these handouts by noon on Thursday 24 March.

MED

M E DONNELLY

DRAFT PRESS RELEASE FOR FINANCIAL SECRETARY: BICESTER 25 MARCH

No one should doubt that this has been a budget for business. It is the fifth Conservative budget pursuing a strategy for business success and so for fuller employment. It continues our successful policies to achieve lower inflation and lower interest rates. Both lower inflation and lower inflationary expectations, with which come lower interest rates, are essential for businesses to start up and grow. Moreover, the fact that personal tax thresholds are to rise by $2\frac{1}{2}$ times the rate of inflation will provide a major boost to incentives and should allow and encourage further moderation in pay settlements, so lowering industry's costs.

Since 1979 the burden of tax on business has in part been transferred to people. The 1981 budget judgement not to index thresholds in line with inflation had to be taken in order to reduce government borrowing and so allow interest rates to fall, benefiting industry and jobs. A further factor which had to be taken into account at that time was the exchange rate. The effect of the rise in sterling in 1980 and 1981 was to squeeze companies' incomes and correspondingly increase those of people. It was right, therefore, to shift some of the tax burden from the former to the latter.

It is important for us to remember how large that shift has been. If businesses carried the same share of total taxes in 1983-84 as they carried in 1978-79 they would, for the coming year, be paying £3 billion more than is now forecast. Moreover,

the net benefits to private business and industry overall in a full year of the measures announced last Autumn and in this budget together amount to some 1¼ billion.

This budget has again concentrated on helping the small and medium sized businesses which will be the source of tomorrow's jobs. We cut the small companies rate of corporation tax to 38 per cent and reduced the marginal rates of tax. The various measures introduced to help small firms, include a major extension of the Business Start-Up Scheme to transform it into the Business Expansion Scheme. The Loan Guarantee Scheme is to be extended. Our commitment to wider ownership through profit sharing and share option schemes is shown by new measures in these areas too. Another technology and innovation package and measures to help the North Sea Oil industry - both crucial for tomorrow's jobs - will be of special importance.

The latest ½ per cent cut in the National Insurance Surcharge for private sector employees from the 1st of August is in addition to the 1 per cent cut from the 1st of April announced last Autumn. And it will mean that we have slashed the rate of Labour's job tax from 3½ per cent as it was when we came to office to 1 per cent now.

And all of this has been done within the limits of a responsible fiscal and monetary policy aimed at lower inflation and lower interest rates in the medium term. It was possible because the Government has pursued over years of great political and

economic difficulty a strategy for recovery which has won the confidence of markets and people alike.

Handout for speech by Nicholas Ridley at the Annual General Meeting of Cirencester Tewkesbury Conservative Association on Friday 25 March at 8.00pm at the Lilleybrook Hotel Cheltenham

In this budget we have been able to expand our measures to help small and medium sized businesses still further. We have perhaps done more this time than in any previous budget. They are estimated to cost £[ ]m this year, but £[ ]m next year, when the reliefs work through. In addition the help to industry large and small is very great. Together with the Autumn Statement, this years cost cutting measures for industry will lop £1¼bn off its tax bills. Add to that the fall in interest rates and the exchange rate, and we can see what a transformed environment for industry there will now be. Industry has improved its productivity by 14% by its own efforts over the last 2 years, and with the recent fall in the value of the pound its international competitiveness has increased by 20% since 1980. This is the only real way to get more jobs.

Indeed, if Industry had to pay the same share of taxes as it paid in 1978/79, we could expect it to pay £3bn more this coming year in taxes than it is actually going to have to pay. That is the measure of the help we have given it. But the converse of that has been that people have had to pay more tax, to make up for what industry does not have to pay. All the more welcome therefore was our ability to increase personal

allowances for income tax by 8½% more than the rate of inflation. Some 1¼ million people will be taken out of the tax net entirely. Next year, personal tax thresholds will be higher in real terms than when the government came to office. And most people will pay a smaller proportion of their incomes in tax and National Insurance Contributions in 1983-84 than 1982-3. Incentives for work and effort will be strengthened across the board. People, not governments are the engine of re covery. And by making it more worthwhile for people to work, this budget will contribute to the higher productivity and the lower wage costs which alone can price our goods back into world markets and our people back into jobs.

There are other kinds of tax cuts on offer. Unlike ours, they are "unearned". They are paid for out of non existent money. Those are Socialist tax cuts, which both Labour and the Alliance favour in varying degrees. They both live in the fantasy world of huge reflationary packages and mind-boggling runs through econometric models where miracles are possible. But in the real world, as confidence in a Labour or Alliance Government slumped and as government borrowing swelled, cuts in taxes would be replaced by panic tax increases. That, after all is the origin of Labour's and the Liberals jobs tax, the National Insurance Surcharge, which the last government introduced and increased and which we have just slashed again for the third time in barely 12 months.

Spoof money for reflating does have to come from somewhere. You can print it - that causes inflation, which we have just conquered with such pain and grief, and which in itself loses more jobs. You can tax more - but that drives firms into bankruptcy which loses jobs too.

You can borrow it - that puts up interest rates which discourages investment and expansion and can also drive firms to the wall - which loses jobs too.

In the long run all of these so-called packages would cost the nation more jobs than they create.

The responsibly financed personal tax cuts in our budget will also tackle another aspect of Labour's unwelcome legacy: the poverty trap. For 30 years or so governments have raised social security benefits broadly in line with incomes but tax thresholds only more or less in line with prices. And then to limit the growing cost to the Exchequer, means testing was widely used. The result is that for many low paid workers it just does not pay to seek employment.

Labour and the Alliance, true to their traditions of learning and forgetting nothing, want to tackle that by spending more - when the roots of the problem lie in government spending too much. Labour wants to spend £6bn more: the Alliance, as always moderate, only £[ ]bn more/ Our approach by contrast shown in this budget is to hold down public spending so as to raise tax thresholds and leave workers with more of what they earn. To do otherwise makes the poverty trap worse.

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 23 March 1983

PS/CHANCELLOR

cc Minister of State (R)
Mr Middleton
Mr Moore
Mr Robson
Mr Isaac - IR
PS/IR

SELF-EMPLOYMENT

... The Financial Secretary has approved the attached redraft of the note on self-employment to be sent to the Prime Minister. He was most grateful for the helpful comments from FP and the Inland Revenue, and commends this draft to the Chancellor.

MED
M E DONNELLY

DRAFT MINUTE

FROM : CHANCELLOR OF EXCHEQUER
TO : PRIME MINISTER

SELF-EMPLOYMENT

At a meeting of the Liaison Committee on 10 November 1982, there was some discussion of taxation of the self-employed. Robin Butler's letter of the same date asked for a note on the subject.

2. We start with a firm belief in self-employment. A vigorous small firms sector is a crucial channel for bringing new energy, new enterprise and new initiative into industry and commerce. Self-employment embodies the attitudes we wish to foster. Individual responsibility, hard work and risk taking are a central part of being self-employed.

3. We also start from the position that the Black Economy has valuable aspects. The CPRS Report on the Black Economy identified some of these. It can be a nursery for small vigorous firms. It offers a way the firm's can set up free from bureaucratic interference, from form filling and the requirements of legislation. It can offer a stepping stone between employment and self-employment. It is also flexible and free from unionisation.

4. People sometime talk as if a move into self-employment was almost the same thing as a move into the black economy. Few things could be further from the truth, or more offensive to many of the self-employed themselves. In practice, of course, both the self-employed and the employed are to be found in the black economy. As you will remember, it was indeed the National Federation of the Self-employed who took the Inland Revenue to the House of Lords, arguing that the Revenue were not being sufficiently rigorous - and even-handed - in dealing with Fleet Street employees.

5. Our objective is to encourage genuine self-employment. For this purpose, we need to ensure that both self-employment and employment are properly taxed. And we must avoid guerrilla warfare between the Revenue and the taxpayer

6. At present there are reports of guerrilla warfare on the boundary between employment (Schedule E) and self-employment (Schedule D) and on the boundary between the taxed economy and the Black Economy.

7. We are under pressure from those who say these boundaries are inadequately policed. They see this as leading to unfairness and to loss of revenue. Against that we have those who say that the policing is oppressive, costly and destructive of initiative and enterprise.

8. We said in the Manifesto that we would make a thorough review of the enforcement procedures of the Revenue Departments. This led to the setting up of the Committee under Lord Keith of Kinkel. I have recently received the first volume of their report. It is to be published on March 23. I have minuted you separately on its content and handling. Suffice to say that overall it recommends some tightening of enforcement procedure, though combined with greater safeguards for taxpayers. It links this recommendation with what the Committee sees as a lack of even handedness in the present position.

9. This means the Keith Report lines up alongside a series of comments and recommendations from the PAC on the need to tighten enforcement and alongside many of the recommendations in the CPRS Report on the black economy.

10. The PAC's 12th Report 1980-81 expressed support for strong action to deter tax evasion by casual workers and pressed for legislation to counter evasion by agency workers. It also pointed in the direction of using stiffer sanctions against those self-employed taxpayers who are late in filing returns to the Revenue. More generally they said that it was important the Department "should be seen to be making strenuous efforts to reduce and contain the black economy".

11. In their 22nd Report, 1981-82, the PAC expressed disappointment with progress on casuals and agency workers. They went on to make some unhelpful comments on the black economy. They regretted that the Revenue was not allowed to examine taxpayers records on a random basis. They hoped Keith would recognise the strength of the case for heavier penalties for tax evasion. They interpreted evidence they received as suggesting strongly the need for substantially more investigation staff in the Revenue. They recommended that the use of staff on such work should not be restricted by our manpower policy.

12. The CPRS Report contains a pretty trenchant statement (paragraph 6.6 of its conclusions) of the case against the black economy. It went on to make a series of recommendations designed to improve the effectiveness of enforcement work.

13. I have set this out at some length as evidence that the pressures on us are by no means all in one direction. In part it is in the nature of things that there should be two opposing camps on an issue of this sort.

14. What is especially unsatisfactory is that at least part of the problem arises from a genuine lack of clarity about what is legitimate and what is not. This particularly arises on the boundary between Schedules D and E. In the great majority of cases the dividing line is clear. The practising barrister is self-employed, the Civil Servant is not. But the uncertainty at the margin can lead to surprise and criticism when the Revenue's view turns out to differ from that of the citizen.

15. The problems this causes are magnified as there can be so much at stake.

16. For example, if the individual is treated for tax as self-employed, he gets paid without deduction of tax. He can claim more generous deductions for expenses. He pays tax in arrears. And he can get a "tax holiday" for many months when he switches from employed to self-employed status.

17. Again, if the businessman hires a self-employed person, rather than an employee, he does not have to apply PAYE. He does not have a pay NIC or NIS. He does not have to pay sick pay, holiday pay, redundancy money or pension.

18. There can also be important implications for social security, VAT and employment protection legislation.

19. For all these reasons, both "employers" and "employees" can find it very attractive for the "employee" to be treated as self-employed. Overall there is heavy pressure for self-employed treatment.

20. At the same time, these very factors which make Schedule D treatment attractive to the taxpayer involve substantial costs for the Exchequer. The cost of administering Schedule D are per capita very much higher than those of administering PAYE - even taking account of compliance costs for employers. Tax collected under PAYE mostly reaches the Exchequer. Payments made without deduction of tax do not always do so.

21. Nicholas Ridley and John Wakeham have been giving long and hard consideration to the position. This has taken time and explains the delay in getting this note to you.

22. They have considered the possibility of re-defining employment and self-employment, so as to ensure that the tax system does not discourage people from moving from employment to self-employment, and to remove as far as possible the uncertainty that exists at present on the dividing line between the two.

23. First, they considered whether we are, in principle, trying to draw the boundary between Schedules D and E in the right place. The present tax rules ask the basic question :

> "Are you in business on your own account?
> Or are you working for somebody else?"

We think this is about right. We encourage people to move into self-employment precisely because of the virtues of self reliance and enterprise which go with being "in business on your own account".

24. On the face of it there would be great attractions in allowing an individual to choose whether he is to be taxed either under Schedule D or Schedule E. But this would require the tax treatment of the two to be much more in balance.

25. I doubt if we can bring the two schedules, D and E, entirely into line. The fact is that the Schedule E person - drawing a weekly or monthly pay cheque - is just not in the same position as the self-employed businessman who has to take his own business decisions, carry his own expenses, and wait until the end of the year to add up his net profit (or loss). In many cases there are genuine commercial reasons why the Schedule D man should have a less rigorous tax regime than his neighbour on Schedule E.

26. The balance may not at present be quite right. This is something we will look at again in the light of progress towards self assessment.

27. What we can and must do is try and resolve the problems caused by the uncertainties of definition at the margin. There is no statutory definition of "employment" or "self-employment" for tax purposes. As elsewhere in the tax system, this is, in the last resort, left for the Courts to judge on the facts of the individual case.

28. In practice, we can isolate 8 criteria which the Courts have used to help decide whether a taxpayer is or is not "in business on his own account". These are set out in Appendix A. They leave difficult cases at the margin. Hence our problem.

29. We have looked at ways in which we could introduce greater certainty for the citizen. Broadly, these are :

(a) a new statutory definition based on the existing criteria.

(b) a new statutory definition based on some simpler (and perhaps less arduous) test.

(c) a clear re-statement in simple terms of what self-employment under the existing law entials. This would be coupled with a procedure under which the Revenue could give an authoritative ruling. Such a ruling would have to be open to challenge in the Courts.

A statutory definition based on the existing criteria

30. I do not think anything would be achieved by incorporating into the legislation the criteria at Appendix A.

31. Three reasons. First, the legislation would be long, with extensive definitions of individual works and phrases. Second, many of the conditions would have to be heavily qualified. Third, a whole new body of case law would spring up concerned with the meaning of peripheral phrases such as "control" and "financial risk"; because of these there would still be uncertainty at the margin.

A statutory definition based on a new test

32. This looks attractive as a way of encouraging enterprise and independence. The problem is to find a new formula which focuses on those who genuinely wish to be enterprising.

33. Nicholas Ridley and John Wakeham have considered possible new "criteria" which would provide a simple and easily understood naswer to the question whether an individual was or was not "in business on his own account". For this purpose the difinition would need :

- to bring within Schedule D anyone who has the enterprise and independence to go into business on his own account; and

- keep within Schedule E those who are going nothing more nor less than a straightforward job of work for an employer.

There is no profit in encouraging those - like the Fleet Street casuals - who would like to enjoy the benefits of Schedule D - no deduction of tax etc - without the responsibilities of genuine self-employment.

34. One possibility would be to define self-employment as involving no entitlement to paid holidays, sick pay, redundancy pay or an occupational pension. It might also be a requirement that the individual shows he has made some provision of his own for some or all of these benefits.

35. People enjoying all these benefits are unlikely to be self-employed. But the converse does not follow. Many even amongst full-time employees, do not enjoy them all. And there would be still greater difficulties in relation to short term, intermittent or one off engagements. This is the area where the problem of definition is currently acute. As already mentioned the PAC are alert to the existing evasion in this area.

36. The Keith Committee considered the position on casuals. They have recommended a scheme of deduction of tax at source at half the basic rate. This could remove much of the present uncertainty for the employer/principal. It would also reduce one of the factors - deferral of tax - which encourages people to seek self-employed status.

37. I will be examining the Keith's proposal and consider whether this could be a way forward. I am conscious that the starting afresh with a new definition could lead to more litigation at a new margin and this could mean it would take years for the rules to settle down.

A clear re-statement of existing law

38. It is not enough to say that the great majority of cases is clear, or that real life is complex and does not fall neatly into tidy bureaucractic compartments. There is genuine uncertainty at the margin. Often this cannot be resolved for quite some time. This is a real problem. I have been considering a two-pronged attack.

39. First, issuing a leaflet setting out in clear layman's terms what self-employment entails. This would remove a lot of the mystery. An early draft of such a leaflet is at Appendix B. Clearly more work needs to be done on it.

40. Second, I am exploring the idea of introducing a "mechanism" under which interested parties could seek a binding determination from the Inspector of Taxes of the correct position in advance. Such a determination would have to be made within a set time limit - say 30 days - and would be open to appeal. The Revenue might require 180 staff per 100,000 requests for determination. It would need primary legislation in a Finance Bill. The outline of such a scheme is at Appendix C.

41. Even on this we will need to proceed with care. The self-employed would rather have uncertainty than the wrong kind of certainty.

Conclusion

42. Our basic objective is to encourage genuine self-employment and to provide an environment in which enterprise can flourish. At the same time we are under pressure from those who wish to see tax enforcement strengthened and from those who wish to see it restrained. The Keith Report is going to be prayed in aid by both sides, but particularly by those who wish to see a strengthening.

43. Our task is made harder by the genuine uncertainty that exists in certain important areas, particularly the dividing line between employment and self-employment. I see little prospect at present of achieving anything worthwhile be redrawing the dividing line either where it now is or in some other place. It would be right to improve understanding of the present law and to make administration more accessible to the citizen. The proposed leaflet and clearance procedure should go some way towards this. Properly handled this should also reduce the problems we face of accusations that the Revenue are harrasing the self-employed and small businessman.

44. Looking further ahead, we shall continue to examine the possibility of finding a simpler and more relaxed definition if self-employment and of dealing with the problems of casuals.

45. Finally, one rather separate point. I know you share my general concern about the continuing press reports along the lines that Ministers propose but the Revenue disposes. This has been a particular problem in relation to the business start-up scheme, though there are plenty of examples before that of critics attributing to the Revenue the responsibility for Ministers' decisions of which they (the critics) disapproved. The major extension of the buiness expansion scheme, which I announced in my Budget, should help to defuse criticism in this particular area.

PS/Chancellor
PS/CST
PS/EST
PS/MST(R)
PS/MST(C)
Mr Monger
Mrs Sommerville
Mr Morris
Mr Beveridge
Mr O'Heavy/IR
Mr Draper/IR
PS/IR

Treasury Chambers, Parliament Street, SW1P 3AG

Hugh Rossi MP
Minister for Social Security
and the Disabled
DHSS
Alexander Fleming House
Elephant and Castle
LONDON
SE1 6BY

23 March 1983

Dear Hugh

STATUTORY SICK PAY

Thank you for your letter of 16 March.

I am sorry the setting-off of sick pay against arrears of contributions has been such a difficult problem. I am glad that between us we have managed to solve it. Although we cannot in all instances provide for this as a matter of law I confirm that the Revenue will wherever this is practical allow employers to set-off SSP against arrears of contributions, PAYE and NIS. Provided the employer has made a claim the Revenue would, as you say, know of a surplus in a later month at the time they were taking any enforcement action. There appears to be no need for any extra publicity on this point.

Thank you Yours ever

NICHOLAS RIDLEY

FROM: M E DONNELLY
DATE: 23 March 1983

PS/CHIEF SECRETARY

cc PS/Chancellor
PS/Economic Secretary
PS/Minister of State (R)
PS/Minister of State (C)
Sir D Wass
Mr Bailey
Mr Lovell
Mr Mountfield
Mr Kemp
Mr Burgner

SEVERN BARRAGE

The Financial Secretary has seen Mr Webb's submission of 21 March. The Financial Secretary shares officials' scepticism about the Government taking on any financial commitment whatever related to this project. The Financial Secretary has an interest in that his constituency would be effected by this project; from this stand point he also wishes to point out that the environmental consequences would be most deleterious.

ME

M E DONNELLY

FROM: M E DONNELLY
DATE: 23 March 1983

MR NEILSON

cc Mr Burgner
Mr Morgan
Mr Grimstone
Ms Gane
Mr Harris

EMPLOYMENT EFFECTS OF PRIVATISATION

You submitted a draft section of a letter to be sent by the Department of Employment to Jim Graigen MP. The Financial Secretary is broadly content with the draft, but suggests the attached redraft of the first paragraph. He also considers that it would be helpful to mention the specific case of the National Freight Company, as an example of a case where privatisation has produced increase efficiency and profits (or even if this is in fact the case - increased jobs). Perhaps you would consider how best this might be done.

MED
M E DONNELLY

EMPLOYMENT EFFECTS OF PRIVATISATION - REDRAFT OF FIRST PARAGRAPH

"There is no need for the Department of Employment to be consulted formally on the possible employment effects of our major privatisation proposals. This is because the effects of privatisation on employment are indirect. Full exposure to market forces increases the pressure on enterprises to cut costs and improve cost efficiency. In the short term this may lead to some shake out or redeployment of excess labour. But equally, privatisation allows enterprises to raise investment capital freely on the markets. This, together with the improved performance resulting from increased exposure to market forces lays the foundation for a lasting increase in jobs.

MANAGEMENT IN CONFIDENCE

FROM: E KWIECINSKI
DATE: 24 March 1983

PS/CHANCELLOR

cc Minister of State (C)
Mr Middleton
Mr Moore
Sir L Airey)
Mr Gracey) IR
Mr Roberts)

TAX DISTRICTS: PROPOSED CHANGES IN THE LOCAL OFFICE NETWORK

Further to your minute of 11 March, the Financial Secretary has now discussed this matter with the Revenue.

The discussion centred on two broad aspects:-

1) the effect of office closures on the public

a) Towns losing both a Collection office and a Tax District office - the Financial Secretary is satisfied that this situation has been kept to a minimum. There are now only three towns where this is likely to arise - Alnwick, Stockton and Pontypool, all of which have good access to offices less than twenty miles away.

b) The effect on remote areas - the Financial Secretary is satisfied that the position of remote and outlying communities will not be worsened by the proposals.

2) Announcing the changes

The Financial Secretary has decided that the proposals should be announced by way of a Parliamentary question and answer. The timing of this will be important and he suggests that it should be done at about the same time as the staff and the Unions are informed of the proposals (probably the week commencing 11 or 18 April). The answer to the PQ, will emphasise that (i) the changes will not have any significant effects on staff numbers, (ii) but will give savings in administration and accommodation costs, and (iii) the implementation

of the scheme will be spread over a period of years.

A copy of the Inland Revenue's detailed report and a covering note bringing out the potential changes in the network resulting from the report will be placed in the House of Commons' library. An Inland Revenue press release giving the text of the PQ and answer will be issued on the same day.

The Financial Secretary would be grateful to know whether the Chancellor is content with this course of action.

E KWIECINSKI

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 24 March 1983

PS/CHIEF SECRETARY

cc PS/Chancellor
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir D Wass
Sir A Rawlinson
Mr Wilding
Mr Judd
Mr Perry
Mr Ridley

PAC DRAFT REPORT ON NON-COMPETITIVE CONTRACTS

... The Financial Secretary wishes to bring the attached draft PAC on non-competitive contracts to the attention of the Chief Secretary.

Sir Albert Costain spoke to the Financial Secretary about this draft report. He was concerned that if published in its present form it will lead to severe criticism of the Government for allowing £150 million of excess profits to be paid on non-competitive contracts.

The Financial Secretary provided Sir Albert with the suggested amendments marked in manuscripts on the copy attached. Debate on this report has now been postponed until Wednesday 30 March; the deadline for putting down further amendments is Monday 28 March.

MED
M E DONNELLY

PAC 6

DRAFT PAC REPORT

Treasury Minute of 15 December 1982 (Command 8759)

Pricing and post-costing of non-competitive contracts

C 48, 80-82 paragraphs 0-56

33 In our Sixteenth Report of Session 1981-82 we examined the 1980 report by the Review Board for Government Contracts on the arrangements agreed with industry in 1968 for pricing non-competitive contracts. The Treasury Minute of 15 December 1982 noted our views and confirmed that they had been brought to the attention of the Board for consideration in connection with their fundamental review of the 1968 arrangements. We have since taken further evidence from the Treasury and MOD.

paragraph 39

34 In our Report we had expressed concern that in 1980 the Review Board had recommended, and the Treasury had accepted, that the target profit rate on government contracts should continue at 20 per cent on capital, which had been the rate since October 1977, rather than be reduced to a rate appropriate under the principle of comparability (that is, that profits made by government contractors should be broadly comparable with those being earned by industry generally). We were also paragraph 40 concerned that the Board's calculations had assumed a 15 per cent rate of inflation, ~~and that with~~ the fall in inflation (to 11 or 12 per cent at the time of our

examination) this would provide contractors with a return on equity which was significantly more than the Review Board themselves had considered justified.

687-697

35 MOD told us in our latest examination that, even assuming inflation had been at 15 per cent, the decision to retain the 20 per cent target profit rate rather than to reduce it to 17 per cent was equivalent to an extra charge on the defence budget of about £30 million a year. However, at the current rate of inflation of around 5 per cent, the 20 per cent rate was giving contractors a real rate of return of about 11 per cent on equity, compared with the 3.7 per cent return intended by the Review Board. This was costing the defence budget up to £75 million a year, representing profits over and above those thought reasonable by the Board.

6th Report 981-82 vidence 948

36 As regards the Review Board's fundamental review of the 1968 arrangements, MOD had told us in February 1982 that they hoped the Board would at least produce an interim if not a full report within 6 to 9 months, that is by November 1982 at the latest. We regret therefore that in the event the Departments concerned did not submit their evidence until then; and that the Board are not now expected to issue their report until towards the end of 1983. In the meantime contracts are continuing to be priced at the very generous target profit rate of 20 per cent on capital, although inflation has continued to fall.

685; 705

37 We find it disturbing that the arrangements accepted following the 1980 review should have proved to involve such heavy additional costs to the Exchequer and excessive profits to contractors. This unsatisfactory state of affairs will not [now] be remedied until the completion of possibly lengthy negotiations following the Review Board report promised by the end of this year. The Treasury were not content with the position but explained that the Government had decided not to seek an immediate adjustment to the profit rate on the grounds that it would have been premature and would probably have disrupted the main review. besides upsetting an arrangement freely made and operated without such adjustments over the previous three year periods.

Q 698-699

38 We acknowledge that it has not been the practice in the past to change the target profit rate during the three-year currency of an agreement. And of course a return to a lower, more acceptable, profit rate would have been opposed by industry, as the Treasury pointed out. Nevertheless we are surprised that the Government has allowed the present situation to continue without serious challenge, given the level of the windfall profits involved [and the fact that in their 1980 report the Review Board themselves expected to see some changes in the profit rate calculations within the three year period.]

It is true that it might have been impossible to negotiate and might have meant a return to the pre-QTS situation.

Review Board Report on Third General Review paragraph 28

have see para 45

this was on the basis that the next main review might be brought forward to base its formula on CCA.

Q 699; Q 721

39 The Treasury pointed out that though it could certainly be argued that the present position was very favourable to industry, there had been times in the past where it had been equally clearly unfavourable;

there had been swings and roundabouts over the years. However, more detailed assessments subsequently supplied to us showed ~~such general assurances in a very different light.~~ that A close overall balance was indeed maintained from 1970 up to the end of 1977 (with defence contractors being allowed total target profits of £842 million compared with profits of £835 million calculated on the basis of comparability with other manufacturing industry) and that this situation continued in 1978 and 1979. But the position in 1980 and 1981 showed an overwhelming swing in the contractors' favour; in these two years the target profits allowed were some £150 million more than ~~were~~ can now be seen to have been merited on grounds of comparability. The sharp decline in the average profitability of manufacturing industry which gave rise to these differences was forecast at the time of the Review Board's 1980 review, and the more recent decision not to adjust the profit rate will in practice have meant the continuation of similar, or even larger, excessive levels of profit.

in contracts worth more than £5½ billion

40. We are extremely concerned that target profits from 1980 onwards have been running at a rate of £75 million a year in favour of the defence contractors. These will continue pending the outcome of the present review. We strongly recommend therefore that the Treasury and MOD should take any necessary action to ensure that the Review Board report on the current review is delivered with the minimum further delay, and to complete the subsequent

negotiations on the new arrangements as a matter of urgency. We again urge the restoration of the principle of comparability in these negotiations; and we trust that the profit rate calculations will this time properly reflect inflation factors and that provision will be made for review during the period of the agreement if there is a significant change in the underlying assumption in this or other areas.

SECTION III—THE OBJECTIVE OF THE PROFIT FORMULA

Background

27. The objective of the profit formula, as it was expressed in the Profit Formula Agreement, is 'to give contractors a fair return on capital employed; that is to say a return equal on average to the overall return earned by British industry'. The current target rate of return on capital employed is 20 per cent on an historic cost basis.

28. As was recognised by the Public Accounts Committee in its Sixth Report (Session 1978–79), there are considerable problems involved in applying a historic cost-based profit formula in a period of high inflation. Those problems had to be faced when we reported both in 1974 and in 1977, and they are still with us today. However, consensus has now emerged, in the shape of SSAP16,* on a method of inflation accounting which will be implemented in the accounts of large companies published after 1st January 1981. As long ago as 1976 a Working Party, consisting of representatives of Government and contractors, was established to consider the practical problems of injecting inflation accounting into the pricing of Government contracts, and to make recommendations regarding the changes required in the Government accounting conventions and appropriate transitional arrangements. The Working Party will now be directing its efforts to the specific problems for resolution in the context of SSAP16. It is essential that this important task be carried out with urgency so that the switch to inflation accounting may be made as quickly as possible. Some delay will inevitably be caused by the need to assemble information about the profitability of U.K. manufacturing industry expressed on a current cost accounting basis to provide guidance for the necessary revision of the profit formula. We expect, nevertheless, that it should be possible to make the change before the Board would in the ordinary way be due to conduct the next triennial Review.

29. This should therefore be the last General Review which will be conducted on the basis of historic cost accounting. Moreover, if the switch to inflation accounting is implemented with maximum possible speed, the recommendations made in this Report should be operative for less than the normal three year period. The transition to inflation accounting will involve a complete revision of the profit formula. We have therefore come to the conclusion that any major restructuring of the existing formula would be inappropriate at the present stage. The benefit likely to derive from changes amounting to no more than fine-tuning has to be weighed against additional work and delays that would be caused.

*Statement of Standard Accounting Practice, number 16: Current Cost Accounting; issued in March 1980 by the bodies comprising the Consultative Committee of Accountancy Bodies.

The Contentions of Government and Industry

30. We have sought and obtained the views of both Government and industry on the question whether (and if so, how) the historic cost-based target rate of return, as presently constituted, needs to be changed in order to achieve the objective of the formula.

31. The submissions made to us on behalf of the Government have reiterated that the principle of comparability (i.e. a return on capital employed 'equal on average to the overall return earned by British industry') should be the paramount consideration. Our attention was drawn in this connection to the Sixth Report of the Public Accounts Committee (Session 1978–79). In paragraph 33, the Committee urged that 'the Government should make clear [to the Board] that they regard the principle of comparability as fundamental for determining profits allowed to an industry which has a large and assured market provided by public funds; and that any problems which might emerge concerning the viability of the defence industry should be dealt with by means other than an adjustment of the profit formula'. The Government's contention was that, in urging strict adherence to the comparability principle, the Government were 'not seeking a target rate of profit which would be so low as to damage the long-term prospects of contractors' businesses'. The implication must be that in the Government's view strict application of the comparability principle would not in present circumstances pose any problem concerning the viability of the defence industry.

32. In support of the Government's argument that there should be the strictest possible adherence to comparability with recent earnings, it was correctly pointed out that there had, prior to 1977, been a tendency for contractors' actual earnings on risk work to be somewhat higher than the prevailing target rate. But, as will have been seen (paragraph 21), the tendency during 1975–78 has been for the level of contractors' actual earnings on risk work to be somewhat below the existing target rate.

33. The views of industry were, as they have been in the past, that a fair return on capital employed must be such as is adequate to maintain the defence industry in an efficient and viable state. Particularly at a time when the profits earned by British manufacturing industry stand at what is generally accepted to be an unhealthily low level, application of the comparability principle cannot, argued the J.R.B.A.C., afford the proper measure of a fair return. Emphasis was also placed upon the burden imposed on contractors engaged in the defence industry by expenditure on research and development—a burden inherent in the nature of their businesses and far heavier than that incurred by the generality of U.K. manufacturing industry. (The implications of certain specific proposals made by the J.R.B.A.C. in this connection are considered eparately in paragraphs 73–75 below).

Principles to be Applied

34. We summarised as follows, in paragraph 54 of our 1977 Report, the general principles in the light of which the profit formula should in our opinion be reviewed:—

(*a*) In normal circumstances, the principle of comparability with the rewards of British industry should be observed. This is a concept which is basic to the Profit Formula Agreement and it should not be departed from without very good reason. But it is necessary to be clear what is meant by the principle of comparability. The Government are correct when they submit that the Profit Formula Agreement equated a fair return for non-competitive Government work with the average return of British industry. This was a reasonable equation to make in the economic climate of 1968. It is also correct that, for the purpose of establishing the 1968 formula, the parties agreed to place reliance upon the average return of U.K. manufacturing industry over a past period, viz. the seven years 1960–66. But it is not, in our view, correct to treat the Profit Formula Agreement as implying that, for the purpose of future review of the formula, the *past* performance of U.K. manufacturing industry should always be the decisive yardstick.

(*b*) Rather, the principle of comparability involves that the reward for non-competitive Government work should be, so far as possible comparable with the average level of reward which it is reasonable to expect may be earned by U.K. manufacturing industry in a period in the future during which the formula will operate. It would be reasonable to start by looking at the level of past reward earned by U.K. manufacturing industry but this, although indicative, will not of itself afford a necessarily reliable yardstick for the future. A view must be taken upon the normality or otherwise of the period which has yielded that level of reward, and this must be supplemented by a judgment about whether or not conditions in the future are likely to be broadly comparable with those of the earlier period.

(*c*) The principle of comparability must, furthermore, be subject to an over-riding concern that the defence industry shall remain in an efficient and viable condition. It would be wrong to adhere strictly to the principle of comparability if this led to a result which conflicted with that paramount concern.

We continue to believe that those principles afford sound guidance. Their application, and the weight to be given to each, must involve an exercise of judgment in the light of the situation obtaining at the time when a particular Review comes to be made.

Discussion

35. Our decision in 1977 to recommend a rate of return of 20 per cent was based, in part, upon evidence that a recovery in the level of profits of U.K. manufacturing industry would be likely to emerge in 1977 or 1978, accompanied by a fall in the rate of inflation from the high level which had prevailed in the years 1974–76 (19.9, 23.2 and 16.6 per cent respectively). Although it subsequently appeared that there was a recovery in the level of profitability in 1976* and the rate of inflation was contained below 10 per cent in the years 1977 and 1978, neither of these improvements has been sustained.

*See paragraph 37 below.

36. The situation in which we have undertaken the present Review is bedevilled by economic conditions more threatening and by uncertainties more severe than those which were apparent in 1977. That is the background against which we have to ask ourselves whether it would be appropriate to adopt a basis of comparability akin to that upon which the formula was originally based.

37. The rate of return earned by U.K. manufacturing industry over the most recent five years for which figures are available has been as follows:—

	Average rate of return on capital (historic cost basis)
	%
1973	17.4
1974	17.0
1975	15.5
1976	18.8
1977	17.2
Average	17.2

The indications* are that the average rate of return of U.K. manufacturing industry has since fallen somewhat below the 17.2 per cent level to which it dropped back in 1977. Current forecasts argue that in the short term there could well be a further sharp decline.

38. Application of the principle of comparability, paying due regard to recent past performance and likely future trends, would therefore suggest a target rate of return of 17 per cent at the very most, i.e. a reduction of the present target rate by at least three percentage points.

39. We repeat that we would not think it right to adhere strictly to the principle of comparability if to do so would produce a target rate of return which was in our judgment manifestly inadequate. So we must consider whether a target rate of return of the order of 17 per cent would be manifestly inadequate. In our previous Reports we tested the matter by converting the historic cost-based return on capital into a real net return on equity, i.e. after allowing for interest and tax payments and for the sums required to maintain the capital of the business intact in real terms. We adopt the same approach on this occasion.

40. We estimate that a 17 per cent rate of return on capital on an historic cost basis is likely to be equivalent in 1981 to a rate of real net return on equity of *1.2 per cent*.
The critical factor in determining the real net return on equity in such an estimate is the assumed rate of inflation. The foregoing estimate is based upon the assumption (which follows recent Government forecasts) that inflation in 1981 will fall to 15 per cent. A two percentage point change in the rate of in-

*The official source of comprehensive information on the profitability of U.K. manufacturing companies which forms the basis for the figures in the above paragraph has temporarily ceased to be available. More recent statistics based on National Accounts sample data, which are not directly comparable, show a declining trend after 1977.

flation would affect the estimated real net return on equity by some 1.5 percentage points; so if a 17 per cent rate of inflation were to be assumed, the estimated real net return on equity would become minus 0.3 per cent.

41. It would in our view be wrong, in pursuit of the principle of comparability, to reduce the present 20 per cent target rate of return to 17 per cent or less when this would be likely to yield so minuscule a rate of real net return on equity. The picture presented is one which would in our judgment be irreconcilable with the paramount consideration that the defence industry should remain in an efficient and viable condition in the interests of Government and contractors alike. In short, we believe that a target rate of the order of 17 per cent would be manifestly inadequate. The consequence of applying such a rate would in our view be damaging, not simply in the short term, but also to the long term prospects of businesses which must keep in the van of technological advance.

42. It should not be overlooked in this connection that a target rate of return of 17 per cent would yield a rate of no more than 14 per cent for non-risk work. Those contractors whose work is predominantly of the non-risk type would effectively be condemned to a near certainty of loss, in real terms, on their Government work.

43. In previous Reviews we have taken a 5 to 6 per cent rate of real net return on equity as a yardstick of a fair rate of return. This would in present conditions indicate a target rate of return of 23 to 25 per cent on a historic cost basis. The J.R.B.A.C. advocated a target rate of at least that order.
The 5 to 6 per cent yardstick was derived from the experience of U.K. manufacturing industry over the years 1960–72, a period of relative stability which contrasts sharply with the conditions with which industry has subsequently has to contend. In the economic climate that is likely to prevail over the next two years or so, the strong probability must be that U.K. manufacturing industry as a whole will be operating near to the brink of a nil real rate of return on equity, and that only a little worsening would be needed to force it over that brink.

44. We have had to ask ourselves whether it would be right in these circumstances to stick to our previous yardstick of a 5 to 6 per cent rate of real net return on equity. We have concluded that it would be impossible to justify a differential in favour of Government contractors of as much as 5 to 6 per cent in terms of real net return on equity.

45. A compromise on lines which must necessarily be pragmatic is in our view the appropriate solution in order to tide over the relatively short period which should elapse before the switch to inflation accounting takes place. We consider that retention of the existing 20 per cent target rate of return would provide that solution. On the assumption that the rate of inflation will fall to 15 per cent by 1981, we estimate that the rate of 20 per cent would be equivalent to a real net return on equity of 3.7 per cent. A rate of return of that order would arguably be insufficient to sustain a healthy defence industry in the long term; but it is, we believe, a rate of return which the industry should be able to live with in the

short term, without thereby endangering its long term prospects or undermining its ability to attract the capital needed to sustain the necessary level of technical enterprise and achievement.

Recommendation

46. We recommend therefore that the target rate of return in the profit formula should for the present remain at its current level of 20 per cent on a historic cost basis.

RESTRICTED

FROM: M E DONNELLY
DATE: 24 March 1983

MR LENNON

cc Mr Unwin
Mrs Hedley-Miller
Mr Edwards
Miss Court
Mr Peet
Mr Hayden

COMMONS DEBATE ON EUROPEAN COURT OF AUDITORS REPORT

The Financial Secretary was most grateful for the briefing which you and Mr Hayden provided before and during Monday's debate.

He has commented that this is the second year in which we have debated this report separately from other EC documents. In view of the form of Monday's debate he wonders if it might not be more constructive in future to debate this report along with other documents. Perhaps you would bear this in mind for next year.

After the debate the Financial Secretary was approached by Mr Spearing MP. Mr Spearing spoke during the debate (Hansard 22 March Cols 688-691) and requested a letter from the Financial Secretary dealing with the Council's reaction to the Court of Auditors' report. The Financial Secretary would be grateful if you could provide him with a draft on this point, also explaining to Mr Spearing how the discharge system works.

MED

M E DONNELLY

NOTE OF A MEETING HELD IN FINANCIAL SECRETARY'S ROOM H M TREASURY 24 MARCH 1983

Present at meeting: Financial Secretary
Mr Driscoll) IR
Mr Savage)
Mr Gau)
Mr Tempin) Independent Programme Producers
Mr Kentish) Association

MEETING WITH THE INDEPENDENT PROGRAMME PRODUCERS ASSOCIATION (IPPA)

The Financial Secretary invited Mr Gau to open the discussion. Mr Gau commented that IPPA represented fledgling film-making companies in the independent sector. They had been greatly encouraged by the present Government through the start of the new Channel 4. However the "new" system for taxing their workforce they were being told to use by the Inland Revenue would discourage expansion and make life very difficult for the new companies. The old system was very good for the industry: companies could hire the best people for short contracts, invoice and pay them gross. The "new" system was very complex: some people would be on PAYE, others would be exempt from PAYE. It would have two effects: a) it would give enormous administrative problems to the companies and b) it would have a profound psychological effect on the industry. The workforce if paid under PAYE would want all the other benefits of employment - this would put up industry's costs and/or would shrink the pool of available experienced workers. At the very least IPPA were seeking a transitional period for the industry to adjust to the "new" system.

The Financial Secretary commented that the Revenue were not proposing a "new" system. They were merely applying the law as it had always been. Perhaps they had been too relaxed in allowing Schedule D treatment in the past but that was no reason to let it continue where it was found to be wrong in law. The law is quite plain - to be taxed under Schedule D one has to be in business on one's own account. Did IPPA dispute the fact that the workers involved were employees?

Mr Gau commented that the problem seemed to centre on whether or not all freelance workers were "in business on their own account." Clearly the companies regarded their freelance workers as self-employed.

Mr Kentish commented that the Revenue's new interpretation of the law would require the companies to give detailed individual consideration of the status of each worker hired. This would be considerable burden to be undertaken at such short notice and would be terribly complicated.

Mr Savage pointed out that the Revenue had been discussing this question with the industry since 1981, and that the complications resulted from representations made by the industry.

Mr Driscoll added that after the Revenue had completed its review in the industry and had found most workers within it to be employees they could have imposed normal PAYE procedures based on the Employers guide, backed up by a PAYE audit sweep. But they had not done this. In order to help the Industry they had consulted widely and devised a modified system. There would be one centralised office to deal with the Industry, and there would be no threat of widespread Regulation 29 determinations by local Inspectors. Also the Revenue had conceded that workers on contracts of less than a week's duration would not be subject to PAYE.

The Financial Secretary commented that it was for the individual worker to test his tax status before the Commissioners if he disagreed with the Inspector's decision. He added that many of the workers seemed to want the best of both worlds: they wanted to pay Class 1 NICs (which are normally paid by people on Schedule E) to get better state benefits, yet they wanted to be taxed under Schedule D.

In conclusion he commented that the care and management of the Revenue was an administrative question which he was not empowered to interfere with. He did however hope that the Revenue's comments would help to calm the industry's fears about the future regime.

E KWIECINSKI

Circulation:

PS/Chancellor
PS/MST(R)
Mr Robson
Mr Driscoll - IR
Mr Savage - IR
PS/IR

CONFIDENTIAL

FROM: M E DONNELLY
DATE: 24 March 1983

NOTE OF A MEETING HELD AT 9.30AM ON 24 MARCH IN THE FINANCIAL SECRETARY'S ROOM TO DISCUSS CHARITIES

Those present: Financial Secretary
Mr Fawcett - IR
Mr Porter) C&E
Ms Caplan)
Mr F K Jones
Mr P Rayner
Mr L Watts

Papers before the meeting were: Mr Fawcett 2 March,
Financial Secretary 3 March
Mr Watts 10 March
Mr Wilding 11 March
Mr Donnelly 14 March

The Financial Secretary said that the aim of the meeting was to look at the roles of the Revenue and the Charities Commission in terms of administering the law as it currently stood; and to produce conclusions which could then be put to the Home Secretary. He asked why there was no Charities Commission in Scotland, Wales or Northern Ireland. How were its functions performed in those areas? The Revenue said that there were proportionately less charities outside England, since large ones tended to work nationally. But bodies wishing to claim tax relief simply wrote to the relevant Revenue office asking to be treated as a charity. The Revenue office then decided whether the organisation merited tax relief under existing law as a charity, and if so provided this relief. Decisions could be challenged in the courts if there was disagreement. In contrast charities in England would apply to the Charities Commission if they wished to register while at the same time writing to the Inland Revenue to request tax relief. The Revenue and the Charities Commission co-operated to the extent of exchanging details on newly registered charities; but the decision on whether or not to grant tax relief was taken solely by the Revenue.

The Financial Secretary asked about the role of the Charities Commission. Officials said that in practice it was largely an advisory body aiding charities in drawing up their deeds etc. It also provided some "consumer protection" by checking that the funds were used for the specific charitable purpose of the charity. The Revenue, conversely, were only concerned that the funds were used for some charitable purpose. The Commission could also investigate complaints against charities; though these could be taken up directly with the courts, as was the case in Scotland.

The Financial Secretary said that it was important to separate the tax status of charities, the Revenue's concern, with the advice and consumer protection roles currently performed by the Charities Commission. He wondered whether there was a role for the Revenue in tightening the criteria used to give charitable status. The Revenue said that they were bound to simply interpret the law as it stood. They could not make evaluative judgements between different qualifying charities. The Financial Secretary said that this meant there was no easy way of distinguishing charities which could, say, be given VAT relief as a special concession. Customs officials agreed. The estimates they had already produced of the cost of refunding VAT to charities already included the assumption that there would be close co-operation with the Revenue; and even then their cost estimates were probably on the conservative side.

Summing up, the Financial Secretary said that working within existing legislation there was no easy way of distinguishing between worthy and less worthy bodies with charitable status. The question of the distribution of responsibilities between the Revenue and the Charities Commission clearly merited further study. He would draw up a paper on which he would be grateful for Revenue comments. This could be sent to the Chancellor for his views, and then serve as a basis for discussion between the Financial Secretary and the Home Secretary on the future role of the Charities Commission. In view of discussions taking place in the Family Policy Group and elsewhere, it would be useful to take this exercise on as quickly as possible, and aim to send something to the Home Secretary before the Easter Recess.

The meeting ended at 10.45am.

MED

M E DONNELLY

Circulation:

Those present
PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir D Wass
Mr Middleton
Sir A Rawlinson
Mr Wilding
Miss Kelley
PS/IR
PS/C&E

COMMERCIAL IN CONFIDENCE

FROM: M E DONNELLY
DATE: 24 March 1983

SIR D WASS

cc Mr Bailey
Mr Monger
Mr Wilson
Mr Hosker - T.Sol

CABLE AND WIRELESS: HONG KONG ACQUISITION

The Financial Secretary has seen your note of 23 March and Mr Wilson's note to you of the same date.

As I told your office last night, the Financial Secretary is content for the placement to go ahead at a discount of the order of 5%.

The Financial Secretary has commented that since we have made a considerable profit on our shareholding since the company was orginally placed on the market, and given that such a discount would seem to be standard commercial practice, it must be reasonable to go ahead.

MED
M E DONNELLY

FROM: M E DONNELLY
DATE: 24 March 1983

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (R)
PS/Minister of State (C)
Sir D Wass
Sir A Rawlinson
Mr Wilding
Mr Monger
Mr Gordon
Mr Rayner
Mr Ridley
Mr Harris
Mr Coleman

OPTICIANS MONOPOLY

The Financial Secretary has seen Mr Coleman's note of 18 March.

He has commented that this is all extremely unsatisfactory. Lots of reports are produced but nothing actually gets done. The DHSS review of NHS ophthalmic services seems to be a case in point. It is not clear why DHSS ministers should be "less than enthusiastic" about this review, as Mr Coleman suggests. The Financial Secretary feels that a ministerial meeting is needed to get to the bottom of the problem of Government inactivity in this area.

M E DONNELLY

CONFIDENTIAL

FROM: E KWIENCINSKI
DATE: 25 March 1983

PS/CHANCELLOR

cc MST(R)
Mr Middleton
Mr Moore
Mr Robson
Mr Isaac-IR
PS/IR

SELF-EMPLOYMENT

The Financial Secretary has been having some further thoughts on the Chancellor's draft note on self-employment to be sent to the Prime Minister.

He has seen the Minister of State (R)'s note of 24 March. He too is uneasy about paragraph 3 of the minute. He discussed this with Sir Lawrence Airey yesterday, who made the point (most forcibly) that if this minute ever leaked the Chancellor's tacit approval of the black economy could cause a political storm, and have a severe effect on staff morale in the revenue departments. The Financial Secretary was sympathetice to this view.

... The Financial Secretary has received the attached note from Mr Isaac (attached, top copy only.) He agrees with Mr Isaac's comments and suggests that paragraph 36 should be deleted.

E KWIECINSKI

FROM: E KWIECINSKI
DATE: 25 March 1983

MR P N HAYDEN

cc - Miss Court
Mr Lennon
Miss Wright

COURT OF AUDITORS: EXPLANATORY MEMORANDUM ON DRAFT COUNCIL RECOMMENDATION

The Financial Secretary has seen your minute of 24 March.

Before signing the explanatory memorandum the Financial Secretary would like to see the draft recommendation, and the comments of the Council.

He has commented that this ties up with the letter being prepared for Mr N Spearing MP. He thinks that Mr Spearing feels we should not have taken it as an 'A' point. He would like to see the draft reply to Mr Spearing.

E KWIECINSKI

MANAGEMENT IN CONFIDENCE

FROM: E KWIECINSKI
DATE: 25 March 1983

MR F K JONES

cc CST
EST
MST(C)
MST(R)
Sir D Wass
Sir A Rawlinson
Mr Wilding
Mr Le Cheminant
Mr Mountfield
Mr Judd
Mr St Clair
Mr N J King
Mr Farrington
Mr Harris
Miss J Kelley

PRIVATISATION OF HGV TESTING

The Financial Secretary has seen the Secretary of State for Transport's letter of 23 March. He remains dubious about the advantages of all this, but on balance he is in favour of having a try. He is not clear whether a £2.5m offer would be too much but it does seem a lot to him.

He wonders whether Lloyds will be present at the negotiations. He has commented that they should be as its their future involved.

E KWIECINSKI

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 25 March 1983

MR R R MARTIN/IR

cc PS/Chancellor
PS/Minister of State (R)
Mr Robson
Mr Martin) IR
Mr Blythe)
PS/IR

EMPLOYERS/EMPLOYEES

The Financial Secretary was grateful for your submission of 21 March.

He is content for you to proceed along the lines of paragraph 14 of your note.

He has made the following detailed comments:-

1) He thinks it would be an excellent idea for you to visit three or four firms who run these schemes; and also for you to now involve the DHSS.

2) He fully understands the difficulties that may be encountered, as detailed in paragraph 5 of your note.

3) On 6 a) of your note - he thinks that usually the employee should get the repayment.

On 6 b) - he thinks the employee should normally pay the tax.

4) He confirms that his view is as expressed in para 7 of your note.

5) He thinks we should resist being drawn into discussion between employers and employees.

6) He agrees with your comments in paragraph 9.

7) He understands your concern at paragraph 11.

E KWIECINSKI

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 25 March 1983

MR J B UNWIN

CC Chancellor
Mr Littler
Mr Lavelle
Mrs Hedley-Miller
Mr Fitchew
Mr Peretz
Mr Peet

EMS REALIGNMENT: AGRI-MONETARY CONSEQUENCES

The Financial Secretary has seen your note to the Chancellor of 24 March.

He has commented that this question arose when he took the Chancellor's place at last Monday's meeting (21 March). Mr Ortoli put forward the two possibilities of either:-

a) the green ECU
or b) that sterling should not be brought back into the ECU

Nobody responded to this suggestion and nothing was decided. The Financial Secretary did not say anything. Stoltenberg contented himself with getting agreement to the communique, as now recorded. But there was no endorsement or rejection of either of the Ortoli suggestions. In other words there was no agreement that there should be a change in the rules.

E KWIECINSKI

FROM: E KWIECINSKI
DATE: 28 March 1983

MR L J H BEIGHTON/IR

cc Chancellor
Chief Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Sir A Rawlinson
Miss Kelley
Mr Moore
Mr Faulkner
Mr Robson
Mr Lusk) IR
Mr Corlett)
PS/IR

MINISTER FOR THE ARTS' LETTER OF 14 FEBRUARY 1983

The Financial Secretary has seen your note of 24 March covering Mr Tracey's submission of the same date. He has made the following comments:-

Mr Channon's first proposal

He agrees with Mr Tracey that as an ideal solution the National Heritage Memorial Fund should handle acceptance in lieu. He thinks we should put this idea forward to Mr Channon. He is content with official advice here, but as this is very much a public expenditure issue he would welcome the Chief Secretary view's before proceeding.

Mr Channon's Second proposal

He would like for us to discuss this with the Revenue. He has commented that it is odd to do the Business Expansion Scheme for risky investment, and then to be so restrictive on even more risky investments in the theatre. I will be in touch shortly to arrange a meeting.

Mr Channon's third proposal

He agrees that we should stand firm on this. It seems a bad way to help to him.

EK.
E KWIECINSKI

FROM: E KWIECINSKI
DATE: 28 March 1983

MR M F CAYLEY/IR

cc Chancellor
Chief Secretary
Economic Secretary
Minister of State (R)
Mr Robson
Mr Reed
Mr Taylor Thompson/IR
PS/IR

INTERNATIONAL FISCAL ASSOCIATION CONGRESS 1985

The Financial Secretary has seen your note of 25 March.

He thinks this seems like a good deal and does not think we should be too grudging about paying for our turn every 10 years.

However before agreeing to this he would like a further note on how the money is going to be obtained and how it will be presented to Parliament. Also there is the question of how the press would react if they got hold of the story.

He looks forward to your further comments.

E KWIECINSKI

FROM: E KWIECINSKI
DATE: 28 MARCH 1983

PS/CHIEF SECRETARY

c.c. PPS
PS/EST
PS/MST (C)
PS/MST (R)
Mr Chivers
Mr Kent
Mr Barley
Dr Freeman
Mr Lovell
Mr St Clair
Mr Tatham
Mr Halligan
Mr Pickering
Mr R Smith

PRIVATISATION OF THE COMPUTER AIDED DESIGN CENTRE

The Financial Secretary has seen Mr Kent's submission of 25 March (attached, top copy only).

2. In view of the public expenditure implications of this privatisation the Financial Secretary would be grateful for the Chief Secretary's comments. He himself remains to be convinced that this is a good deal and will be discussing this urgently with officials when he has the Chief Secretary's views.

E KWIECINSKI

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 28 MARCH 1983

PS/CHIEF SECRETARY

c.c. Chancellor
Financial Secretary
Minister of State (R)
Minister of State (C)
Sir Douglas Wass
Mr Middleton
Mr Moore
Mr Kemp
Mr Robson
Mr Griffiths
Mr Hall
Mr Salveson
Mr Ridley
Mr Harris
Mr F Martin
PS/Inland Revenue
PS/Customs & Excise
Mr Graham/Parly Counsel

FINANCE BILL: MEETING WITH THE OPPOSITION

The Financial Secretary has seen Mr Martin's note to the Chief Secretary of 25 March.

2. He thinks that there is scope to advance the dates of 2nd Reading, Committee of the Whole House, and Standing Committee quite considerably.

He would like Mr Martin to produce the fastest time-table possible.

E KWIECINSKI

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 28 March 1983

PS/ECONOMIC SECRETARY

c.c. PS/Chancellor
PS/CST
Mr Middleton
Mr Monck
Mr Robson
Mr Peretz
Mr Turnbull
Mr Ward
Miss Noble
Mr Stewart/IR
Mr Mill TBE

DEEP DISCOUNT BONDS: IMPLICATIONS FOR NON CORPORATE BORROWERS

The financial Secretary has seen Mr Turnbull's note to the Economic Secretary of 25 March.

2. He has commented that this is a difficult issue. He would be inclined to concede this for local authorities and bulldogs, because he thinks it does look so discriminating.

3. He fears that not to do so would lead to endless argument and pressure, and we would then look weak and/or foolish if we eventually did have to give way.

E KWIECINSKI

CONFIDENTIAL

NOTE OF A MEETING HELD AT H M TREASURY AT 11.00am, MONDAY 28 MARCH 1983

Present at meeting: Financial Secretary
Mr Robson
Mr Lusk/IR
Mr Bryce/IR

TAX TREATMENT OF SELF CATERING INDUSTRY

The Financial Secretary opened the discussion by commenting that Ministers were coming under renewed pressure, since the Budget, to make tax concessions to those involved in running self catering holiday accommodation. He was certainly sympathetic to the person who had once run a small hotel and since fashions had changed had sold the hotel to move into self catering, only to find that the tax treatment of their income had changed.

He commented that in order of importance the tax reliefs most wanted were:

a) CGT roll-over and retirement reliefs
b) Capital allowances - either for new buildings or for equipping existing properties

c) relief from the IIS

He added that one solution would be to erect a new definition of "self-catering" and for the purposes of the above reliefs, deem this to be a "trading" activity. He did however recognise that there would be enormous difficulties in such an approach both in devising a workable definition and in resisting pressure from other activities (such as farm letting) for similar reliefs. If forced by political pressure to go down the special reliefs route the Financial Secretary would want to limit the damage by for example giving only the CGT reliefs. Mr Bryce commented that there would be problems in giving the CGT roll-over relief. It would be an entirely new

departure to give his relief to a non trading activity, and would probably produce pressure to give a similar relief for dealing in shares. Any legislation would be lengthy and unrealistic with many conditions. Mr Robson commented that one could look at the problem in three different contexts:- a) the tax treatment of income from property generally b) Taxation of the Tourism industry as a whole and c) by looking at the rationale for the difference between the tax treatment of investment and trading activities. He thought it would be preferable to have a coherent long term plan for taxation of the tourism industry generally ((b) above).

In summing up the discussion the Financial Secretary commented that he would continue to hold the line against any change in the tax treatment of self-catering accommondation. However there was a danger that political pressure for a change could prove irresistible. If concessions were inevitable he would wish to give the least damaging ones possible. In view of this he asked the Revenue to send him a further note on:-

a) the consequences of deeming self- catering business a trading activity.

and b) the possibility of setting up a wider study group on the taxation of tourism generally.

E KWIECINSKI

Circulation:

Those Present
PS/Chancellor
PS/CST
PS/EST
PS/MST(R)
PS/MST(C)
Mr Middleton
Mr Moore
PS/IR

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 29 March 1983

PS/CHIEF SECRETARY

cc Chancellor
Minister of State (C)
Minister of State (R)
Sir D Wass
Mr Middleton
Mr Moore
Mr Kemp
Mr Robson
Mr F Martin
Mr Griffiths
Mr Hall
Mr Salveson
Mr Ridley
Mr Harris
PS/IR
PS/C&E
Mr Graham - Parly Counsel
Mr Maclean - Whips Office

FINANCE BILL: MEETING WITH THE OPPOSITION

The Financial Secretary has seen your note to Mr Martin of 25 March.

He thinks that the aim of the splitting negotiations should be to confine the debate to two (or three) days on the floor of the House. This would mean accepting most of the Opposition requests, and not putting any of our own preferred clauses down for debate on the floor.

He has commented that no doubt they will take Income Tax, and perhaps NIS (although he cannot see much mileage in that for them). He cannot quite see what else they will want to take, and as there is so little juicy material for them it might be possible to squeeze them to two days on the floor.

E KWIECINSKI

MANAGEMENT IN CONFIDENCE

FROM: E KWIECINSKI
DATE: 29 March 1983

PS/CHIEF SECRETARY

cc Chancellor
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Sir A Rawlinson
Mr Moore
Mr Fraser - C&E
Sir L Airey - IR
PS/IR

CIVIL SERVICE MANPOWER AFTER 1984
COUNTERING TAX FRAUD AND EVASION: THE BLACK ECONOMY

The Financial Secretary has seen Sir Lawrence Airey's two submissions of 25 March: 1) to the Chief Secretary on Civil Service Manpower after 1984 and 2) to the Chancellor on the Black Economy.

He has commented that they are both fascinating and deal with some very important and difficult issues.

He would very much like to study the papers over Easter and report back with his detailed comments shortly afterwards.

Would the Chief Secretary be content for him to take this on board?

E KWIECINSKI

Chief Secretary
Economic Secretary
MST C
MST R
Sir D Wass
Sir A Rawlinson
Mr Bailey Mr Fitchew
Mr Kitcatt Mr Binns
Mr Lovell Mr Ridley
Mr Burgner Mr Harris

Treasury Chambers, Parliament Street, SW1P 3AG

Rt hon Peter Walker MBE MP, Secretary of State
Department of Agriculture, Fisheries and Food
Whitehall Place
LONDON SW1A 2HH

28 March 1983

Dear Secretary of State,

LAND SETTLEMENT ASSOCIATION: HOUSING

Thank you for your letter of 21 March suggesting a package of measures in respect of LSA houses occupied by current or retired LSA staff.

As I am sure you will recognise, there are a number of objections which can be made against these proposals. It is, I think, clear that the arrangements you have in mind must mean that the Exchequer will be foregoing a proportion of the receipts which it could reasonably have expected to secure from the sale of LSA assets. More seriously, concessions of the sort you propose have not to our knowledge been made elsewhere within Government when occupational housing has been disposed of; on the contrary, such cases as we have been able to identify point in the direction of disposal at the market price. It would therefore be most unwelcome if the LSA case were to be quoted as a precedent elsewhere. This is particularly so in the case of your proposal that in the last resort security of tenure should be offered to the weekly-paid tenants.

I recognise, however, that there are arguments for treating the LSA as a special case. There is as I understand it, reason to believe that some of the weekly-paid staff could have rights to secure occupancy which might be validated by the courts. There is also the comparison which the LSA employees are making, albeit without justification, between their position and that of the growers. More important,

It is in all our interests to complete the arrangements for winding-up the LSA as soon as possible so that the exercise can then be carried through smoothly. In this context I recognise the need for you to be able to respond to the criticisms that are being made both inside and outside Parliament of our plans to close down the LSA and their implications for both tenants and employees.

Having considered your proposals carefully I am prepared to accept them subject to the following provisos:

(a) your officials should try to secure the employees' agreement without offering the "security of tenure" option. In other words, the initial offer should be confined to discounts on the houses or the "key money". Only if it is absolutely vital to get agreement would I be happy to add this to the package;

(b) the long-service enhancement contained in the discounts and in the "key money" should be reduced by any long-service elements in the redundancy payments to be made to the same employees;

(c) the cost of the "key money" expenditure in 1983-84 is contained within approved cash limits;

(d) no improvements are made on your package which I think is as far as the Government can reasonably go in all the circumstances;

(e) your officials provide mine with the schedule of the outcome in due course.

I note your comments that the cost of the discounting arrangements means that the estimate of overall receipts from the disposal of the LSA estates does not need to be changed. But I should point out, for the record, that this is only because of the approximate nature of the forecast made some time ago. There is a cost to the exchequer and to the extent there is this cost the overall receipts will be that much lower.

Yours Sincerely

Nicholas Ridley

NICHOLAS RIDLEY

seen and approved by the Financial Secretary, signed in his absence.

Treasury Chambers, Parliament Street, SW1P 3AG

C H de Waal Esq
Office of Parliamentary Counsel
36 Whitehall
LONDON SW1A 2AY

28 March 1983

Dear de Waal,

DATA PROTECTION BILL

... I enclose a copy of the Money resolution and the ways and means resolution for this Bill, duly initialled by the Financial Secretary.

Yours sincerely,

E Kwiecinski
Private Secretary

DATA PROTECTION [MONEY]: Queen's Recommendation signified

Mr Nicholas Ridley

That, for the purposes of any Act of the present Session to regulate the use of automatically processed information relating to individuals and the provision of services in respect of such information, it is expedient to authorise -

(a) the charging on and issue out of the Consolidated Fund of any sums required for paying a salary to, or paying (or making payments towards the provision of) a pension, allowance or gratuity to or in respect of, the Registrar appointed under that Act;

(b) the payment out of moneys provided by Parliament of -

(i) the expenses of the Registrar;

(ii) any expenses incurred by the Secretary of State in respect of the Tribunal established by that Act or the members of that Tribunal;

(iii) any expenses incurred by a government department in complying with the requirements imposed by that Act on data users and persons carrying on computer bureaux;

(c) any increase attributable to that Act in the sums which are payable out of such moneys under any other Act.

2 3 82

WAYS AND MEANS

Mr Nicholas Ridley

Data Protection

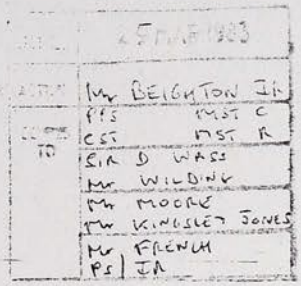
That any Act of the present Session to regulate the use of automatically processed information relating to individuals and the provision of services in respect of such information may -

(a) require the payment of fees in connection with the registration under that Act of data users and persons carrying on computer bureaux ; and

(b) provide for the payment of those fees and of other sums into the Consolidated Fund.

NR

15 3 83



HOUSE OF LORDS,
SW1A 0PW

7/184/01

29 March 1983

My dear Nicky,

In my letter of 25 February I promised to write to you and George Younger about the probate fee threshold for small estates and whether an official inquiry is needed into delays in winding-up estates.

With regard to the probate fee threshold, your proposal implies that you wish to raise the "excepted estate" value in the Capital Transfer Tax (Delivery of Accounts) Regulations 1981 from £25,000 to £30,000 or even £40,000. This would have a detrimental effect on probate fee income if the fees for estates above £25,000 continued to be charged ad valorem. But I would be willing to amend the Probate Fees Order to create a further band for a flat rate fee to be charged up to a maximum level of £40,000, since this would neutralise the effect of raising the "excepted estate" threshold. If you would like to proceed in this way, the details can be worked out by our officials.

I have given further thought to your suggestion of an inquiry, but I do not believe that the result would justify expending the necessary resources. Your proposal to raise the threshold level of "excepted estates" would be itself an important step in the simplification of administration since it would relieve up to 30,000 estates each year from the need to produce a revenue account. As you have pointed out, the size and nature of the estate, the complexity of dispositions and the need to deal with income, capital transfer and capital gains taxes, where these apply, and on occasion disputes giving rise to litigation or the need to

/negotiate a

The Right Honourable
Nicholas Ridley, AMICE,
Financial Secretary to the Treasury,
H.M. Treasury,
Parliament Street,
LONDON, S.W.1.

negotiate a compromise, all tend to make winding-up slower and more complicated than the beneficiaries would wish. But I do not see how this can be avoided, save by changes in the imposition of taxes. While the creation of deeds of family arrangement may also delay winding-up, this facility was instituted in the interest of the beneficiaries; but I have no reason to oppose any changes which you may consider desirable. Such matters as these, which hinge upon the incidence of taxation and the requirements of the Revenue are properly your concern, and I do not feel that my Departmental interests are sufficiently touched to warrant intervention.

I agree that dilatoriness on the part of personal representatives, and more particularly solicitors, is an important cause of delay. The Law Reform Committee in their Twenty-third Report to me made some useful suggestions for dealing with the problems encountered with personal representatives, and I hope to give effect to these recommendations, amongst others, in a Trusts Bill in due course. But the Law Reform Committee took the view that the remedies available to beneficiaries to deal with dilatoriness are adequate and an additional remedy, such as giving a statutory right to be given information periodically, would not be helpful.

I am not convinced that there is no scope for bringing about improvements in the efficiency of solicitors, and it might be desirable to press the Law Society to implement the recommendations of the Royal Commission on Legal Services to create a code of professional standards which would bring greater discipline to this and other areas of solicitors' work. The Solicitor General is about to enter into discussions with the profession on a number of topics concerning value for money in legal aid, and the need for professional standards is likely to be amongst the matters discussed. This might be backed by amending the Solicitors Act 1974 to allow a beneficiary to have the bill of a solicitor administering an estate subjected to scrutiny, and where the solicitor is found to have been inefficient or tardy all or part of his remuneration might be disallowed. But this will require further thought, and I doubt that anything could be done before the 1984/85 Session.

I am sending a copy of this to George Younger.

yrs:

L.

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 29 March 1983

MR A J C EDWARDS

cc PPS
Chief Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Mr Littler
Mr Unwin
Mrs Hedley-Miller
Miss Court
Mr Peet

RELATIONS WITH THE EUROPEAN PARLIAMENT

The Financial Secretary has seen the Minister of State (Foreign and Commonwealth Office)'s letter of 24 March.

He agrees with the two broad lines of approach suggested by Mr Hurd.

He would be grateful if you could draw up a programme for him for this summer - of his visits to Strasbourg and of MEPs coming to London.

E KWIECINSKI

Treasury Chambers, Parliament Street, SW1P 3AG

S C Laws Esq
Office of Parliamentary Counsel
36 Whitehall
LONDON
SW1A 2AY

29 March 1983

Dear Laws

PUBLIC RECORDS (AMENDMENT) BILL

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

Yours sincerely

E KWIECINSKI
Private Secretary

PUBLIC RECORDS (AMENDMENT) [MONEY]: Queen's Recommendation signified

Mr Nicholas Ridley

That, for the purposes of any Act of the present Session to provide for the transfer of certain records in the custody of the Registrar General to the Public Record Office, it is expedient to authorise the payment out of money provided by Parliament of any increase attributable to that Act in the sums payable under any other Act out of money so provided.

14 3 83

Treasury Chambers, Parliament Street, SW1P 3AG

Mr J P E Taylor
Messrs Coopers & Lybrand
Abacus House
Gutter Lane
Cheapside
LONDON EC2V 8AH

30 March 1983

Dear Sir,

Business Expansion Scheme - Approved Investment Funds
Existing Fund:- 1st Basildon Fund
2nd Basildon Fund

You may find it helpful to have the enclosed copies of the Press Releases issued today to coincide with the publication of the Finance Bill.

Two particular points should be noted in addition to what is said in the Press Releases about approved investment funds -

i. Managers of funds which have received approval for the purposes of the Business Start Up Scheme will need to seek approval for any new funds which they propose to establish for investment under the Business Expansion Scheme;

ii. Where managers of an existing approved fund wish to invest under the Business Expansion Scheme, funds raised under the terms of the Business Start Up Scheme, and propose to change the prospectus of the fund or other arrangements with investors to allow them to do so, they are asked to write to Inland Revenue, Technical Division (Business Expansion Scheme), Room 91, New Wing, Somerset House indicating what they have in mind.

The Inland Revenue will, in any event, be contacting managers of existing approved funds in due course to consider what changes are necessary to present administrative arrangements in the light of paragraph 19(3) and (4) of Schedule 5 of the Finance Bill.

Yours faithfully,

NICHOLAS RIDLEY

cc PS/Chancellor
CST
CST
MST(R)
MST(C)
Sir D Wass
Sir A Rawlinson

Treasury Chambers, Parliament Street, SW1P 3AG

Mr Bailey
Mr Burgner
Mr Morgan
Mr Richard
Mr I P Wilson
Mr Chivers
Mr Grimstone
Mr S R Thomas
Mr Ridley
Mr Harris

Mr Lovell
Mr Hallis

Secretary of State for Industry
Department of Industry
Ashdown House
123 Victoria Street
LONDON
SW1E 6 RB

30 March 1983

Dear Patrick

BRITISH AEROSPACE: FURTHER SALE OF SHARES

Thank you for your letter of 15 March. I have also seen a copy of your secret minute of 23 March to the Prime Minister about British Aerospace's 1982 results which will be published today.

The news will obviously hit the share price badly and I would agree that it would not be sensible to make a further sale at the moment. However, I do not believe that it need preclude consideration of a further sale rather earlier than the year that you suggest. The market, after an initial adverse reaction, may come to believe that British Aerospace is a reasonable medium-term investment: a recovery stock in other words. Having got a lot of bad news out of the way in 1982 the company's profits will probably bounce back in 1983 and the market may take account of this after the initial impact of the 1982 results.

I would, therefore, suggest a further review of sale prospects in six month's time. In the meantime I agree that a "second opinion" is not necessary.

I am sending a copy of this letter to E(DL) Members.

Yours ever
Nicholas

NICHOLAS RIDLEY

FINANCIAL SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Hodgson Martin Ventures Ltd
4A St Andrew Square
EDINBURGH EH2 2BD

30 March 1983

Dear Sirs,

Business Expansion Scheme - Approved Investment Funds
Existing Fund:- Northern Venture Capital Syndicate (1)
Northern Venture Capital Syndicate (2)

You may find it helpful to have the enclosed copies of the Press Releases issued today to coincide with the publication of the Finance Bill.

Two particular points should be noted in addition to what is said in the Press Releases about approved investment funds -

i. Managers of funds which have received approval for the purposes of the Business Start Up Scheme will need to seek approval for any new funds which they propose to establish for investment under the Business Expansion Scheme;

ii. Where managers of an existing approved fund wish to invest under the Business Expansion Scheme, funds raised under the terms of the Business Start Up Scheme, and propose to change the prospectus of the fund or other arrangements with investors to allow them to do so, they are asked to write to Inland Revenue, Technical Division (Business Expansion Scheme), Room 91, New Wing, Somerset House indicating what they have in mind.

The Inland Revenue will, in any event, be contacting managers of existing approved funds in due course to consider what changes are necessary to present administrative arrangements in the light of paragraph 19(3) and (4) of Schedule 5 of the Finance Bill.

Yours faithfully,

NICHOLAS RIDLEY

FINANCIAL SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Messrs Ernst & Whinney
37. Melville Street
EDINBURGH EH3 7JL

30 March 1983

Dear Sirs,

Business Expansion Scheme - Approved Investment Funds
Existing Fund:- Creative Capital Fund

You may find it helpful to have the enclosed copies of the Press Releases issued today to coincide with the publication of the Finance Bill.

Two particular points should be noted in addition to what is said in the Press Releases about approved investment funds -

i. Managers of funds which have received approval for the purposes of the Business Start Up Scheme will need to seek approval for any new funds which they propose to establish for investment under the Business Expansion Scheme;

ii. Where managers of an existing approved fund wish to invest under the Business Expansion Scheme, funds raised under the terms of the Business Start Up Scheme, and propose to change the prospectus of the fund or other arrangements with investors to allow them to do so, they are asked to write to Inland Revenue, Technical Division (Business Expansion Scheme), Room 91, New Wing, Somerset House indicating what they have in mind.

The Inland Revenue will, in any event, be contacting managers of existing approved funds in due course to consider what changes are necessary to present administrative arrangements in the light of paragraph 19(3) and (4) of Schedule 5 of the Finance Bill.

Yours faithfully,

Nicholas Ridley

NICHOLAS RIDLEY

FINANCIAL SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Mr G D Dean
Electra Risk Capital PLC
Electra House
Temple Place
Victoria Embankment
LONDON WC2R 3HP

30 March 1983

Dear Sir,

Business Expansion Scheme - Approved Investment Funds
Existing Fund:- Electra Risk Capital
Electra Risk Capital II

You may find it helpful to have the enclosed copies of the Press Releases issued today to coincide with the publication of the Finance Bill.

Two particular points should be noted in addition to what is said in the Press Releases about approved investment funds -

i. Managers of funds which have received approval for the purposes of the Business Start Up Scheme will need to seek approval for any new funds which they propose to establish for investment under the Business Expansion Scheme;

ii. Where managers of an existing approved fund wish to invest under the Business Expansion Scheme, funds raised under the terms of the Business Start Up Scheme, and propose to change the prospectus of the fund or other arrangements with investors to allow them to do so, they are asked to write to Inland Revenue, Technical Division (Business Expansion Scheme), Room 91, New Wing, Somerset House indicating what they have in mind.

The Inland Revenue will, in any event, be contacting managers of existing approved funds in due course to consider what changes are necessary to present administrative arrangements in the light of paragraph 19(3) and (4) of Schedule 5 of the Finance Bill.

Yours faithfully,

NICHOLAS RIDLEY

FINANCIAL SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Messrs Bird Semple & Crawford Heron
249 West George Street
GLASGOW
G2 4RB

30 March 1983

Dear Sirs,

Business Expansion Scheme - Approved Investment Funds
Existing Fund:- Kyle Fund (1)
Kyle Fund (2)

You may find it helpful to have the enclosed copies of the Press Releases issued today to coincide with the publication of the Finance Bill.

Two particular points should be noted in addition to what is said in the Press Releases about approved investment funds -

i. Managers of funds which have received approval for the purposes of the Business Start Up Scheme will need to seek approval for any new funds which they propose to establish for investment under the Business Expansion Scheme;

ii. Where managers of an existing approved fund wish to invest under the Business Expansion Scheme, funds raised under the terms of the Business Start Up Scheme, and propose to change the prospectus of the fund or other arrangements with investors to allow them to do so, they are asked to write to Inland Revenue, Technical Division (Business Expansion Scheme), Room 91, New Wing, Somerset House indicating what they have in mind.

The Inland Revenue will, in any event, be contacting managers of existing approved funds in due course to consider what changes are necessary to present administrative arrangements in the light of paragraph 19(3) and (4) of Schedule 5 of the Finance Bill.

Yours faithfully,

NICHOLAS RIDLEY

Treasury Chambers, Parliament Street, SW1P 3AG

Mr D G Bean
Bean Bower & Co Ltd
521/535 Royal Exchange
MANCHESTER M2 7EW

30 March 1983

Dear Sir,

Business Expansion Scheme - Approved Investment Funds
Existing Fund:- Risk Sheltered Venture Participations Fund

You may find it helpful to have the enclosed copies of the Press Releases issued today to coincide with the publication of the Finance Bill.

Two particular points should be noted in addition to what is said in the Press Releases about approved investment funds -

i. Managers of funds which have received approval for the purposes of the Business Start Up Scheme will need to seek approval for any new funds which they propose to establish for investment under the Business Expansion Scheme;

ii. Where managers of an existing approved fund wish to invest under the Business Expansion Scheme, funds raised under the terms of the Business Start Up Scheme, and propose to change the prospectus of the fund or other arrangements with investors to allow them to do so, they are asked to write to Inland Revenue, Technical Division (Business Expansion Scheme), Room 91, New Wing, Somerset House indicating what they have in mind.

The Inland Revenue will, in any event, be contacting managers of existing approved funds in due course to consider what changes are necessary to present administrative arrangements in the light of paragraph 19(3) and (4) of Schedule 5 of the Finance Bill.

Yours faithfully,

NICHOLAS RIDLEY

Treasury Chambers, Parliament Street, SW1P 3AG

Messrs Coopers & Lybrand
Abacus House
Gutter Lane
Cheapside
LONDON EC2V 8AH

30 March 1983

Dear Sirs,

Business Expansion Scheme - Approved Investment Funds
Existing Fund:- The Colgrave Fund - ref. NS 810/2129
Oak Venture Fund - ref. TC 2129

You may find it helpful to have the enclosed copies of the Press Releases issued today to coincide with the publication of the Finance Bill.

Two particular points should be noted in addition to what is said in the Press Releases about approved investment funds -

i. Managers of funds which have received approval for the purposes of the Business Start Up Scheme will need to seek approval for any new funds which they propose to establish for investment under the Business Expansion Scheme;

ii. Where managers of an existing approved fund wish to invest under the Business Expansion Scheme, funds raised under the terms of the Business Start Up Scheme, and propose to change the prospectus of the fund or other arrangements with investors to allow them to do so, they are asked to write to Inland Revenue, Technical Division (Business Expansion Scheme), Room 91, New Wing, Somerset House indicating what they have in mind.

The Inland Revenue will, in any event, be contacting managers of existing approved funds in due course to consider what changes are necessary to present administrative arrangements in the light of paragraph 19(3) and (4) of Schedule 5 of the Finance Bill.

Yours faithfully,

NICHOLAS RIDLEY

2058

FINANCIAL SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Andrew Bowden MBE MP
House of Commons
LONDON
SW1A OAA

30 March 1983

Dear Andrew

GOVERNMENT SHARE SALES

Thank you for your letter of 28 February asking for my comments on this letter from Mr H W C Jeffrey about the sale of Government shares and the interest of the small investor.

In the case of the two issues mentioned in Mr Jeffrey's letter (ABP and Britoil) there were two main points which may have affected the small investor's chances. The first was the method of sale used and the second the degree of investor interest shown between the two issues.

As the ABP sale was a fixed price offer it was not possible to make special provision at the time of offer for the small investor, as was done with the tender arrangements for Britoil, without prejudicing the sale or altering the likely structure of applications. Nevertheless, with this type of issue particular groups' interests may be enhanced or protected at the time of allocation.

In the event, in the case of ABP, the level of subscription was so high that whatever allocation policy was adopted there would have been relatively few successful applicants. This suggests that the degree of interest shown in any particular share issue has an overriding effect on the success or failure of potential investors. Even with the tender arrangements for Britoil and the special provisions for the small investor, if the offer had been over-subscribed on the same scale as ABP then a ballot would have been necessary.

Mr Jeffrey will I hope be reassured to know that we are keeping under review the methods of sale to be used for the future. In whatever decision we come to as to the most suitable method of sale the interests of the small investor will certainly continue to play a significant part in our deliberations.

I hope that Mr Jeffrey has more success in our future offers of Government shares.

NICHOLAS RIDLEY

~~SECRET~~ OFFICIAL - SENSITIVE

FROM: FINANCIAL SECRETARY
DATE: 30 March 1983

CHIEF SECRETARY

cc Chancellor
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir A Rawlinson
Mr Pestell
Mr Mountfield
Mr Culpin
Mr Hart
Mr Hopkinson

LONG TERM PUBLIC EXPENDITURE: DOE PAPER

Tom King's paper has a great deal of meat in it.

The central problem sticks out like a sore thumb: what are to be the powers of local authorities and what is our degree of control over their finances? Even the attractive idea of only treating RSG as Central Government spending, and letting the rest of LA spending count as for trading (like Nationalised Industries), while entirely logical, leaves one more worried still as to how that £22 billion of LA spending would be controlled: with hundreds of different Authorities, many of them hostile, and none of them commercial, (like NIs are at least supposed to be).

Thus the major savings foreseen - on contracting out and privatisation, housing subsidies, recreation and many other LA services, might become even more difficult to obtain.

We really must <u>force</u> LAs to contract out or privatise, along the lines of DLO legislation. I believe we should develop policies whereby for nearly everything they would have to obtain tenders, and justify placing them, to the Audit Commission.

The other major point concerns housing. The value of subsidies to private ownership are not much greater than those to public ownership. There should be less subsidy to private housing, if we are to save any more on public housing. We have got to tackle MIR one day, and at the same time not go down the road of tax subsidies to private rented housing. We must tackle rent restriction in this area in order to give equality of treatment between private ownership, public rented and private rented sectors.

NICHOLAS RIDLEY

JH 3c7

OFFICIAL - SENSITIVE

(D.B. Lloyd 21/3/83)

23 MAR 1983

ACTION FST 23/3.

TOTAL COPIES 3

COPY No 2

REC	24 MAR 83
ACTION	MR CHIVERS
COPIES TO	PPS CST SIR D WASS SIR A RAWLINSON MR A BAILEY MR LOVELL MR BURGNER MR RIDLEY

PRIME MINISTER

BRITISH AEROSPACE

The preliminary announcement of British Aerospace's 1982 results is due to take place on 29 March. The results will, I fear, be disappointing. Sir Austin Pearce has warned me informally that, while the profit before exceptional items will be £80 million (compared with £70 million last year), his auditors have insisted on an additional write-off of £100 million. This is to reflect, inter alia, the increased risk of cancellation of orders during the current recession in the civil aircraft market. The net effect is that BAe will show a final loss of £20 million. This will be the first time that BAe (either as a nationalised corporation or as a private sector company) has made a loss. The market reaction will inevitably be adverse. Although BAe will pay a dividend out of its reserves, we can expect the share price to decline.

2 BAe's business remains buoyant in the fields of military aircraft, missiles and space technology: but the market for its civil products has become severely depressed. Neither the 146 airliner nor the wide-bodied Airbus aircraft (for which BAe makes the wings) are selling well. BAe is not alone in facing this problem. The US manufacturers are likewise faced with sharply reduced demand - although they have managed to dispose of a reasonable number of second-hand aircraft through secure

~~MARKET SENSITIVE~~ OFFICIAL - SENSITIVE

price cutting and leasing (and they enjoy the "cushion" of massive US military orders). The upturn in the civil market may not come until 1984 or 1985, so that BAe's 1983 results may also be affected.

3 None of this will be helpful in the context of our broad privatisation objectives. There will be criticism from our political opponents - not least because BAe will have to envisage site closures (certainly Hurn, possibly Prestwick and one of the Manchester works) in order to reduce outgoings. But some rationalisation of BAe's plants is probably overdue: and increased cost-consciousness will ultimately be beneficial. I fear, however, that for the time being we shall have to abandon any thought of selling more of the Government's shareholding in BAe.

4 I am copying this to Sir Geoffrey Howe.

PJ

P J

23 March 1983

Department of Industry

FROM: E KWIECINSKI
DATE: 30 March 1983

PS/CHANCELLOR

cc PS/Economic Secretary
Mr Gordon
Mr Robson
Mr Ridley
Mr Prescott - IR
Mr Wilson - RFS
PS/IR

BUDGET REP: THE CO-OPERATIVE DEVELOPMENT AGENCY

The Chancellor asked for the Financial Secretary's comments on this Budget rep, following Mr Ridley's note to him of 11 March. The Financial Secretary has seen Mr Saunders' note of 28 March.

He has commented that from what Mr Saunders says, it does seem as if the present arrangements for co-ops are about right: the BES is hardly possible under their constitution, and the £10,000 limit seems to be about right.

The Financial Secretary thinks that we have done a great deal with our employee buy-out schemes for this sort of organisation, and we should now just see how it goes.

E KWIECINSKI

MANAGEMENT IN CONFIDENCE

FROM: E KWIECINSKI
DATE: 30 March 1983

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir D Wass
Sir A Rawlinson
Mr Le Cheminant
Mr Robson
Mr Williams
Mr Porteous
Mr Driscoll - IR
PS/IR

TAXATION OF CIVIL SERVICE ALLOWANCES

The Financial Secretary has seen Mr Driscoll's minute of 29 March which I commissioned in response to Miss Rutter's minute of 24 March.

The Financial Secretary suggests that the additional paragraph should be amended to read:-

> "The present problem goes back to 1979 when the Inland Revenue became aware that the Civil Service Department was paying tax-free to Civil Servants a number of types of expense allowances which in the private sector were being taxed in accordance with the law. The dilemma for the Treasury - as paymaster for the Civil Service - and now for Ministers is whether simply to allow the value of these allowances to be reduced by taxation as they undoubtedly should be under the law as it stands or to pay allowances, which after tax, meet the reasonable extra expenses incurred."

E KWIECINSKI

MANAGEMENT IN CONFIDENCE

FROM: E KWIECINSKI
DATE: 30 March 1983

PS/CHANCELLOR

cc Minister of State (C)
Mr Middleton
Mr Moore
Sir L Airey)
Mr Gracey) IR
Mr Roberts)
PS/IR

TAX DISTRICTS: PROPOSED CHANGES IN THE LOCAL OFFICE NETWORK

The Financial Secretary has seen your minute of 24 March.

He will now proceed as suggested in paragraph 2 of my note to the Chancellor of 24 March.

He agrees with the Chancellor that it would be a good idea to write to interested back-benchers, and will do so on the day the PQ is answered.

E KWIECINSKI

FROM: E KWIECINSKI
DATE: 30 March 1983

PS/CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Sir A Rawlinson
Mr Burns
Mr Bailey
Mr Kemp
Mr Traynor
Mr Mercer
Mr Ridley
Mr Harris

POSSIBLE WHITE PAPER ON EMPLOYMENT POLICY

The Financial Secretary has seen Mr Bailey's submission to the Chancellor of 29 March.

He has commented that our objective must be to distance the Government from responsibility for both employment and unemployment. Also he thinks we need to be more optimistic about the long term future.

E KWIECINSKI

CONFIDENTIAL

FROM: E WIECINSKI
DATE: 30 March 1983

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir D Wass
Mr Bailey
Dr Freeman
Mr Lovell
Mr St Clair
Mr Chivers
Mr Kent

PRIVATISATION OF THE COMPUTER AIDED DESIGN CENTRE (CADC)

The Financial Secretary met Mr Kenneth Baker this morning to discuss the proposed privatisation of the Computer Aided Design Centre.

The Financial Secretary explained his concern that the Government was pressurised by ICL into an unfavourable deal for the sale of CADC. The latest offer involved a net cost to the Government of £5.8 million over three years. If CADC had reasonable commercial prospects ICL should be prepared to make a better offer; while if it did not, it might be cheaper to close it down rather than to privatise it.

The Financial Secretary pressed Mr Baker on the possible alternatives of:

a) closing the CADC down; or

b) delaying privatisation beyond the announced date of 1 April in order to allow the CADC to improve its performance under new management and make itself more marketable, and to give other investors a chance to come forward with offers for it.

Mr Baker said that this privatisation had to be seen as the sale not of a growing concern but of a non-commercial research establishment with some commercial potential. ICL's bargaining position was very strong because of the terms of the contract under which they at present ran the centre, because of their close involvement in it and because their's was the only firm offer which the Department had received. ICL had made a few concessions in negotiation. But Mr Baker said he believed that the deal now proposed was acceptable and he would be prepared to defend it publicly. It would involve a net saving of £4 million in public expenditure over the next three years, and the £3 million to be offered in grant support to cover CADC's early trading losses would be repaid (up to two-and-half times) if the CADC earned profits. The CADC would be eligible for £1.75 million of Selective Assistance for projects in any case.

Mr Baker doubted whether closure would be a feasible alternative. Though it would cost less (some £3 million in all) it would be inconsistent with the Government's objectives for the promotion of R&D, and it would mean the loss of an important element in the UK's computer software capability. The Government would face strong criticism.

Delay of the privatisation would be politically embarrassing. The Government's intention to privatise on 1 April was widely known. The staff, who were the Centre's main asset, were already becoming restive. Mr Baker doubted whether there would be any advantage in this course. The Department would not be able to improve CADC's performance without introducing a new hard-headed management team. It would be hard to withdraw from the current contractual arrangements with ICL and install new management without in effect taking over the ICL personnel at present working for the Centre.

Hambros, who have been advising DOI, said that they had contacted 54 prospective purchasers at the beginning of the exercise, and all but Prime and ICL (and possibly the US General Electric) had dropped out. Prime were not interested in leading a consortium and there had been no firm expression of interest from GE. Hambros doubted whether any other investors would come forward if the privatisation were now delayed. The Government might end up with the same solution at greater cost.

Summing up the Financial Secretary said that he was persuaded that there was now no sensible alternative to the privatisation proposal, though he was not convinced that the deal was a fair one in terms of the balance of risk between the Government and ICL. In giving his approval he asked Mr Baker to tighten up the repayment provisions on the transitional support to give the Government the best possible chance of receiving a return: this would also help the support to be presented in a positive way. He also asked the Department to avoid if possible any indemnity being given to the privatised company in respect of staff redundancy claims.

E KWIECINSKI

cc PS/Chancellor
Mr Littler
Mrs Healey-Miller
Miss Court
Mr Lennon
Mr Hayden

Treasury Chambers, Parliament Street, SW1P 3AG

Mr W F S Ricketts
Private Secretary
10 Downing Street
LONDON
SW1

30 March 1983

Dear Willie,

COURT OF AUDITORS' REPORT ON THE EUROPEAN COMMUNITY BUDGET 1981

You asked Jill Rutter for a more "robust and outraged" letter for the Prime Minister to send to Mr Jack Straw MP.

... The Financial Secretary commends the attached redraft of the letter to the Prime Minister.

Yours sincerely

E KWIECINSKI
Private Secretary

DRAFT LETTER FROM: THE PRIME MINISTER

TO : JACK STRAW ESQ MP
House of Commons

EUROPEAN COURT OF AUDITORS' REPORT ON THE EUROPEAN COMMUNITY BUDGET 1981

On 22 March during Prime Minister's Question Time you raised the subject of financial mismanagement in the European Community. You asked what attitude the Government takes about the lack of control of the Community Institutions.

Let there be no doubt that this Government wholeheartedly supports the Court of Auditors in exposing malpractices and incompetence. As the Financial Secretary said in the debate on 21 March the UK was instrumental in setting up this body and developing it. Furthermore this Government introduced the annual debate on the Court of Auditors' report, as a means of heightening public awareness of any malpractice. Whether the UK makes a substantial financial contribution to the Community or not we are equally adamant that standards of propriety and management must be as high as we expect and attain in our own affairs.

The fact remains that the responsibility for action on the report lies primarily in the Community despite all that this Government has done to urge more effective action. The most telling way in which we can support the Court's assiduousness

is to follow up points made, not just in direct response to the reports on annual budgets, but also to ensure constant vigilance in Council working groups and Committees. In particular when future budgetary provision is sought the institutions' record in implementing past budgets is one factor the UK and other like-minded member states consistently take into account. We shall also when revision of the Financial Regulation is discussed again, do our best to ensure that it is tightly drafted to meet the audit requirements which the Court of Auditors have identified.

In the short time left to him for winding up in the debate the Financial Secretary replied on some specific points. He referred for example to the steps taken by the UK and Irish Governments to tighten up customs control on the border to reduce the possibility of fraudulent manipulation of MCA's. We are aware that not all member states are so conscientious in reducing scope for irregularities and frauds. Our record puts us in a good position to urge our partners to introduce reforms.

Many of the examples of mismanagement which you and other Members quoted from the Report concern administrative expenditure by the Commission and the European Parliament. It is up to these bodies to put their own houses in order. Publicity is the only weapon here: I am sure that we would be wrong to try and supervise expenditure by such bodies directly. At a time when member states are exercising high standards of discipline in their domestic budgets such disclosures are an affront to Community taxpayers particularly those who are net contributors. The Financial Secretary has sent copies of the Official Report

of the debate on 1981 Report to the Chairman of the European Parliament's Budget Control Committee and to the Budget Commissioner. The sense of outrage expressed in the debate will reinforce the UK's efforts in Council Committees to improve financial management.

Caxton House Tothill Street London SW1H 9NA
Telephone Direct Line 01-213 6400
Switchboard 01-213 3000

REC. -5 APR 1983

ACTION: M. AJC Edwards
COPIES TO: PS/ PS/ Mst C
PS/ PS/ Mst R
Mr Middleton
Mr Littler
Mr Lavelle
Mrs Hedley-Miller
Miss Court
Mr Peet
Mr Salveson

The Rt Hon Francis Pym MC MP
Secretary of State for Foreign and
Commonwealth Affairs
Foreign and Commonwealth Office
Whitehall
LONDON SW1

31 March 1983

Dear Secretary of State

COUNCIL DOCUMENT 10235/82: COMMISSION OPINION ON THE REVIEW OF THE EUROPEAN SOCIAL FUND

COUNCIL DOCUMENT 10675/82: VOCATIONAL TRAINING POLICIES IN THE 1980s

The House of Commons Select Committee on European Legislation etc has recommended that the above documents raised questions of political importance and should be further considered by the House. I should therefore be grateful for Legislation Committee's agreement to the holding of a debate.

The Commission Opinion on the European Social Fund and the related draft Decision and draft Regulation proposed substantial changes in both the scope and the operating procedures of the Social Fund, which are described more fully in the explanatory memorandum (10235/82) submitted to Parliament by my Department on 23 November 1982. The United Kingdom broadly supports the proposals put forward by the Commission in this document, the underlying aim of which is to enable the Fund to tackle as effectively as possible the current high levels of unemployment throughout the Community.

The Council Document on Vocational Training Policies published in October 1982 puts forward proposals and guidelines for the development of training policies, which are set out more fully in the explanatory memorandum (10657/82) submitted to Parliament by my Department on 9 December 1982. Much of what is proposed is in line with United Kingdom policy on training, in particular in the priority given to preparing young people for work, in the general emphasis on improving the quality and availability of training throughout working life, in the importance attached to training people wishing to set up in business, and in the stress laid on relating training provision to local needs.

The United Kingdom is putting the guarantee of training to minimum age school leavers into practice through the new Youth Training Scheme in Great Britain and the Youth Training Programme in Northern Ireland.

The two documents are now receiving consideration in the Council's Social Questions Working Group. The Commission proposals on the European Social Fund will be on the agenda of the Labour and Social Affairs Council, and the German Presidency hope to submit the document on Vocational Training Policies for approval by the Joint Meeting of Employment and Education Ministers. The Councils are likely to be held on the 2-3 June. I therefore suggest that the debate should take place either late in April or in the first half of May. A 1½ hour debate on the floor of the House after 10pm would appear to be the most suitable.

I suggest that the motion should be:

> "That this House takes note of both the European Community Document numbered 10235/82 comprising a Commission opinion and implementing measures for the review of the European Social Fund, and the Explanatory Memorandum of 23 November 1982, and of the European Community Document numbered 10675/82 setting out proposals and guidelines for the development of training policies and of the Explanatory memorandum of 9 December 1982 and welcomes the Government's intention to seek agreement on the basis of these Commission proposals to more effectively use the Social Fund to help resolve the labour market problems of the Community more effectively than hitherto, and to ensure that its training policies continue to develop to match the best practice in the Community".

I hope that it will be possible for legislation Committee to deal with this request at its meeting on 20 April.

I am copying this letter to the Chancellor of the Duchy of Lancaster and to members and secretaries of OD(e) and the Legislation Committee and to Sir Robert Armstrong.

Yours Sincerely

Jeffrey Evens

/Approved by the Secretary of State and signed in his absence/

SCOTTISH OFFICE
WHITEHALL LONDON SW1A 2AU
TELEPHONE 01-

PRIVATE SECRETARY

- 5 APR 1983

MR F R JONES
PPS EST MST C
CST MST R
SIR D WASS
SIR A RAWLINSON
MR BAILEY
MR KITCATT
MR LOVELL
MR MONGER
MR MOUNTFIELD
MR PESTELL
MR BARNETT
MR CHIMSTONE
MR MORGAN
MR WICKS
MR K WILSON
MR RIDLEY
MR HARRIS

The Rt Hon Nicholas Ridley MP
Financial Secretary of the Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

31 March 1983

PRIVATISATION: SUSTAINING THE MOMENTUM

You sent George Younger a copy of your letter of 17 March to Peter Walker asking for details about privatisations during this Parliament.

With reference to the Annex to E(DL)(28)8 enclosed with your letter, I should make 2 points. First, as regards the Scottish Electricity Boards, the Energy Bill, which makes possible a private stake in energy generation, is now in the Lords. Secondly, there will be further discussion of privatisation in relation to the Scottish Transport Group in E(DL) in April: any action would be for the next Parliament.

For completeness, I should perhaps mention one other area of 'privatisation'. Most of the Secretary of State's Lowland agricultural estates and some crofts in the Highlands have been disposed of. If you wish to have more details, no doubt your officials can be in touch with mine.

I am copying this letter to the recipients of yours.

Yours sincerely

ALEX FLETCHER
Agreed by The Minister
and signed in his absence

HOME OFFICE
QUEEN ANNE'S GATE LONDON SW1H 9AT

30 March 1983

Dear John

PRIVATISATION: SUSTAINING THE MOMENTUM

I am responding on behalf of the Home Secretary to the Financial Secretary's letter of 17 March to the Minister of Agriculture, Fisheries & Food, which was copied to the Home Secretary.

The Directorate of Telecommunications remains the only possible candidate within the Home Secretary's areas of responsibility for full privatisation but, as I said in my letter of 22 November it would not be feasible, save at very great risk, to contemplate any radical change in present responsibilities until completion of the frequency conversion programme in 1989. I should, therefore, be grateful if you would delete the reference to the possibility of privatisation in the next Parliament, leaving simply the comment in the final column of the schedule.

As to the Radio Regulatory Department, it has become clear in the course of preparation of the Home Office response to the Chief Secretary's letter of 7 January about Civil Service numbers after 1984, that we could not privatise any element of the Radio Regulatory Department in accordance with the definition in paragraph 2 of the Financial Secretary's letter. What we are talking about is the possibility of contracting out some work and even this cannot be decided upon until Dr Merriman has completed his review of the Department. The reference to RRD should, therefore, be deleted.

I am copying this letter to the Private Secretaries to members of the Cabinet and to Richard Hatfield (Cabinet Office).

Yours sincerely

John Walters

C. J. WALTERS

E. J. W. Gieve, Esq.

Minister of State
for Local Government

Department of the Environment
2 Marsham Street London SW1
Telephone 01-212 3434

FINANCIAL SECRETARY

REC.	- 5 APR 1983
ACTION	Mr D GREEN - IR
COPIES TO	PPS EST MST C CST MST R SIR A RAWLINSON Mr MOORE Mr ROBSON Mr CULPIN PS/IR

My Ref: B/PSO/31621/83

30 MAR 83

Dear Nick,

INLAND REVENUE RAYNER SCRUTINY: VALUATION OFFICE VISITS TO THE PUBLIC

Thank you for your letter dated 28 February, proposing a pilot study to test the proposal in a Rayner Scrutiny report on visits made to the public by staff of the Valuation Office.

I wholly agree that we should not consider implementing the recommendations which touch on the work of the Valuation Office in either of the Rayner scrutinies, until we have reached conclusions on our review of the future of the rating system. But I doubt whether even then a pilot study on the use of plans in place of site visits would be worthwhile. The problems of valuation from plans are of course for you and the Valuation Office to assess. But it is clearly essential that for such a purpose, the plans should be both comprehensive and accurate. It is not clear to what extent, if any, the Rayner Scrutiny officer took account of the initiatives that we have taken and continue to take, to reduce the number of operations which require local authorities to hold plans for planning or building control purposes.

The General Development Order means that considerable extensions and other alterations, as well as certain minor changes of use, can be made without obtaining further planning permission. Nor, where a plan is deposited with the authority in conjunction with a planning application, is there any guarantee that the development will be carried out in full. In particular areas, notably new towns and enterprise zones, major developments can take place without an application for planning permission.

Our Housing and Building Control Bill may mean that, where a private sector alternative to local authority building control is used, authorities will receive no more than formal notification of many projects of alteration and extension, and certainly not full plans. To those many legitimate cases where the local

authority will have no plans to pass on to the Valuation Officer, we must add those where development is carried out without proper applications being made or permissions obtained. You mention in particular section 21 of the Local Government Act 1974. Whilst some minor alterations and certain central heating installations are subject to building control, in practice notifications are hardly ever made to authorities on such installations.

Where plans are deposited with local authorities for building control purposes, there is no legal requirement to build precisely in accordance with the plans. Indeed, we are told that development on the ground is much less likely to conform to plans than not. There is no way of telling whether the plans do accord with what has happened on the ground without a site visit.

I believe that in view of these problems, working from plans alone might leave us with even more anomalies and inequities than exist at present. I am sure also that you are right in saying that a requirement to provide additional plans, whether or not direct to the Valuation Officer, would be resented by many of those applying for planning permission or for building control purposes. So even if the local authorities were willing to co-operate, I am inclined to think that a pilot study would not be worth the manpower that would have to be devoted to it and that we should have no adequate answer to the criticisms that would be made of the basis of such a study.

Yours Sincerely,
Jim

LORD BELLWIN

The Rt Hon Nicholas Ridley MP

FROM: FINANCIAL SECRETARY
DATE: 31 March 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Mr Monger
Mr Moore Mr. Robson.
Mr Coleman - or
Mr D Board
Mr Stewart)
Mr Gray) IR } without attachment.
PS/IR

TAX TREATMENT OF ADOPTION ALLOWANCES

... I enclose a paper by Mr Gray on whether these allowances should be taxable. I have held two meetings with the Revenue and the Treasury, and feel we need wider consideration of these issues.

I see four categories of children:-

1) fostered children;

2) normal children borne to their parents;

3) children adopted voluntarily by parents;

4) the children relevant to this scheme whose parents would receive adoption allowances.

Categories 2, 3 and 4 receive Child Benefit.

Categories 1 and 4 receive, or are to receive, allowances to compensate for the expense of bringing up the child.

I see no difficulty with foster allowances being offset by the expenses of keeping the child. That is within the tax law. I do see great difficulty with allowing parents to claim expenses against an allowance for these adopted children. If one can claim against tax

for the expenses of bringing up a Category 4 adopted child, then why not for a Category 3 adopted child? And why not for a normal (Category 1) child? Adopted children are in a totally different category to fostered children. One is meant to adopt for love, not money.

We are doing our best to make all social benefits taxable, and I am fearful of making an exception here, especially with the above possible ramifications on other adopted and ordinary children.

Against this, the children in question are all in Local Authority care, or are already being fostered. They do not sound very loveable. Most are handicapped, either physically or mentally or both. To get them adopted will save money, because both fostering and keeping in care are said to cost more than the adoption allowances. To gross up the adoption allowances to allow for tax is messy, and may tip the financial advantage against getting the children adopted. The problem would be at its most acute where parents already fostering a child agreed to adopt: the allowance would suddenly become taxable (although Child Benefit would be payable).

We can expect violent protest from social groups if we insist the allowances are taxable.

There are two other points:-

1) DHSS will not give any undertakings about the size of adoption allowances, not even that they will be reduced by the amount of Child Benefit receivable. Theoretically, rich parents adopting can get princely allowances tax free.

2) Inland Revenue want to make adoption allowances tax free by extra-statutory concession. I am convinced that if we do exempt them from tax we should legislate to that effect.

Conclusion

I fear that it would be politically unwise not to give way; but we should seek stronger assurances from DHSS on the level of and method of

calculating the allowances. In particular, Child Benefit should always be allowed for. And if we do give way, we should legislate from 4 April 1983 in this year's Finance Bill.

I have asked the Revenue in responding to the Select Committee not to go beyond setting out the present position which is that these allowances are taxable.

pp Eric Kemp

NICHOLAS RIDLEY

From: A C GRAY

INLAND REVENUE
POLICY DIVISION
SOMERSET HOUSE

17 March 1983

1. MR STEWART ✓ I agree with Mr Gray's recommendation.
2. MR CRAWLEY See my note at end of Mr Gray's
3. FINANCIAL SECRETARY

SOCIAL SERVICES COMMITTEE : ENQUIRY INTO CHILDREN IN CARE

Tax treatment of payments to foster parents and of adoption allowances

1. The House of Commons Social Services Committee are currently studying the subject of children in care. In the context of encouraging the integration of such children into a family, whether through fostering out or by adoption, the tax treatment of

(A) payments to foster parents by local authorities etc and

(B) adoption allowances

has been raised. The Committee has asked for a Revenue submission on the subject.

2. This note seeks Ministers approval of our submission to the Committee. The established system of (in practice mostly tax free) payments to foster parents is straightforward and uncontroversial and is set out in the first part of the attached draft. But the introduction of adoption allowances is a more

cc Mr Rayner (Tsy) FT2

Sir Lawrence Airey
Mr Green
Mr Rogers
Mr Painter
Mr Crawley
Mr Stewart
Mr Parker
Mr Lusk
Mr Mace
Mr Gray
Miss Rhodes
Mr Willmer

difficult issue. Our conclusion is to recommend that these allowances be made exempt from tax. The rest of this note sets out the background and justification for this.

Adoption allowances

3. The 1975 Children Act introduced substantially new arrangements for the adoption of children through local authorities and other approved adoption agencies. One particular innovation of that Act was Section 32, which enables adoption agencies to submit schemes for the Secretary of State for Social Services approval, whereby cash allowances may be paid to adopters in cases where the child would otherwise probably remain in care throughout his childhood. (Such allowances were previously unlawful). However, Section 32 was only brought into force in February 1982 and so it is only recently that the appropriate tax treatment of these allowances has become a live issue as local authorities etc have begun to submit adoption allowance schemes.

4. The amount of allowances payable in individual cases is not laid down by the Act, nor is it prescribed centrally by the DHSS; this is a matter for the agency, taking into account individual need. But adoption agencies are required to satisfy themselves that the child would not otherwise readily be adopted without the payment of an allowance, taking account of the adoptive family's resources. Schemes so far approved seem broadly to have taken the corresponding level of the foster care payment for children boarded out as a guideline for the level of the (full) basic adoption allowance (foster care allowances vary considerably but the present average is around £33 a week per child). The Government are not providing any additional funds specifically to help finance payment of these allowances.

Tax treatment

5. In tax terms adoption allowances are different by nature to foster care payments. The latter are in the main reimbursements of expenses incurred by the foster parent in looking after a child who is not his own, but the responsibility of the local authority;

to the (limited) extent that there may be any additional "reward" element in foster care payments this will be treated as (taxable) profits of a trade or profession under Case I or II of Schedule D. But even though intended to cover similar costs of maintaining a child, payments like adoption allowances received by a parent in respect of his own (adopted) child would be taxable if regarded as "annual payments". Broadly, payments are regarded as annual payments if they are recurrent, are made under a legal obligation and are what the Courts have held to be pure income profit in the hands of the recipient. Each local authority/adoption agency allowance scheme has to be looked at on its merits here. But, although there are differences of detail, the schemes so far submitted to us have been broadly similar and on the basis of existing law, our legal advice is that the basic adoption allowances at least would be annual payments. (This may not apply to special payments to meet special expenses, for example for handicapped children, but generally the bulk of the payment will consist of sums to provide for the child's ordinary upkeep).

Annual payments are taxable under Case III of Schedule D on the full amount received, without any deduction, and are subject to deduction of tax at source. We have confirmed this treatment to DHSS and to local authorities concerned.

Reaction

6. The strong and unanimous reaction to this from local authorities, the National Foster Care Association and the British Agencies for Adoption and Fostering, has been that to impose tax in such circumstances would prejudice the adoption allowance scheme at birth. They have strongly pressed for effective exemption for these allowances. In support of exemption they have made the following points:-

(1) Adoption agencies are having to fund these allowances from existing resources. They cannot afford to "gross up" allowances to reflect the tax that would be payable by the recipient.

(2) The adoptive family will always be means tested and an allowance

will be payable only where it is judged that the family would not otherwise be able to cope financially with adoption.

(3) These payments are intended to do no more than take account of the expense of maintaining the child. In this they are similar in spirit and substance to foster parent payments and will generally be set at no higher a level. It is emphasised that, unlike foster care payments in certain circumstances, adoption allowances will not contain any "reward" element.

(4) In many cases, the adopters will be the existing foster parents of adopted children. So they would be faced with switching from receiving a tax-free sum of money for looking after the children, to entitlement to the same gross sum, or even slightly less, but which will be fully taxable and from which tax will have been deducted at source. This "financial penalty" is likely to deter these families, who would otherwise be a main source of adopters.

(5) Finally, these schemes are experimental, to be monitored, and subject to renewal by Parliament after 7 years. Unfavourable tax treatment could prevent this experiment in finding further ways of giving children in care a real home, being given a proper chance.

DHSS officials strongly support the case for exemption and have indicated to us that their Minsiters feel likewise. DHSS have also takensteps, by regulation, to ensure that families receiving supplementary benefit and housing benefit would not have those benefits reduced because of adoption allowances received.

Recommendation

7. We feel that there is a good deal of force in the argument for exemption. These allowances will be paid only to provide necessary financial assistance to enable adoption to take place, and will

often replace an existing foster care payment which is effectively tax-free in most cases. A number of schemes have been approved and are ready to go ahead. But adoption agencies have so far held back, and some may be reluctant to embark on schemes if exemption is not granted. Strong pressures from DHSS, local authorities and from childrens' care bodies generally would develop publicly for a concession if we insisted on maintaining the existing line. Public and political opinion would be unsympathetic to a hard line on this matter of 'family concern'.

Cost

8. The cost of exempting these allowances is difficult to estimate and probably largely theoretical. It would depend partly on the numbers and levels of adoption allowance payments - and these will vary between adoption agencies. But to the extent that adopters are at present receiving untaxed foster care payments the extra cost to the Exchequer would be nil or negligible. So in theory, if adoption allowances were taxable these could be an Exchequer gain. However in practice adoption allowances might be unlikely to develop to any extent if they remained taxable.

NB. For their costing purposes DHSS have assumed an initial full year take-up of 1,200 children rising to 1,700 to 1,900 allowances in payment at a peak during the 7 year period.

Form of exemption

9. Statutory cover would clearly be appropriate for any permanent exemption of these payments. But given their experimental nature it might be appropriate, at least initially, to provide this via an Extra Statutory Concession. (DHSS supplementary benefit disregard is also introduced on the same experimental basis as the adoption allowance itself). This would also relieve us of the need to seek space at this late stage in this year's Finance Bill. At this stage we suggest that the exemption could cover adoption allowances so far as they do no more than meet the basic costs of maintaining the child. We can then see how the system develops in practice - eg whether some payments do include also a reward element which ought to be taxable.

10. It would seem appropriate to issue a Press Release on this and a concession will of course have to be notified to the Comptroller and Auditor General.

11. If the Financial Secretary is content with our recommendation it would seem a suitable occasion to announce this to the Select Committee, and our submission to the Committee has been drafted on this basis.

A C GRAY

I agree that these allowances should be exempted. It would be very difficult to justify different treatment from foster care allowances, and to incur the charge that adoption was as a result being inhibited. Normally our preference would be for legislation rather than a new extra statutory concession (given the PAC's criticism of ESC's and their pressure to reduce the number). Legislation during this year's Finance Bill is certainly an option (although it might be a little tricky to find statutory language which would effectively exclude any 'reward' element if that were to arise); but the experimental nature of the scheme (over a 7 year period) gives a reasonable excuse for deferring legislation, and operating initially by ESC, if that course is preferred. But the case for legislation should probably be in any case reviewed as a starter for next year's Finance Bill.

J M CRAWLEY

TAX TREATMENT OF (A) FOSTER-CARE ALLOWANCES AND (B) ADOPTION ALLOWANCES

NOTE BY INLAND REVENUE FOR SOCIAL SERVICES COMMITTEE

(A) FOSTER-CARE ALLOWANCES

Introduction

1. Profits or gains of any description are liable to tax unless the tax laws provide a specific exemption. The tax system is not called upon to make a moral judgment according to the nature of the activities; for example there is no question of exempting from tax the profits of a particular activity because it is regarded as worthy or socially desirable.

2. In principle therefore foster parents are taxable on any profits they derive from fostering children ie to the extent that the income they receive exceeds the expenses they incur in looking after the children in their care. For tax purposes, fostering allowances can be divided into two broad categories. First there are payments which are designed to reimburse the foster parent for the expenses of caring for the child. These payments - the majority are in this category - do not give rise to a liability to tax. Second there are payments which recognise or reward the particular skills of the foster parent. These payments are professional income and are within the charge to tax under Case I or II of Schedule D.

3. Discussions between the Inland Revenue and the National Foster Care Association about the tax treatment of payments to foster parents have established that fostering allowances can comprise three separate elements. The tax position of each element is set out in the following paragraphs.

BASIC BOARDING OUT ALLOWANCES (NON TAXABLE)

4. The ordinary boarding rates ("basic boarding out allowances") paid by local authorities and other fostering agencies are designed to cover the expenses involved in caring for the child. Where the foster parent receives fostering allowances at these rates (this includes the majority of foster parents) there is no liability to tax and the foster parent is not required to report the payments to the Tax Inspector.

ADDITIONAL ALLOWANCES (NON TAXABLE)

5. In special schemes for disadvantaged or handicapped children additional or enhanced allowances may be paid to foster parents to reimburse the extra cost of looking after children with special needs. There is no liability to tax on these payments. Again foster parents are not required to include them in their tax returns. To avoid the need for foster parents to keep detailed records of their expenditure the paying agency and the foster parent will generally agree where appropriate what proportion of the total payment represents reimbursement of additional costs. In other cases the foster parent may keep her own records to establish the amount of allowable expenditure she has incurred in looking after the child.

REWARD ELEMENT (TAXABLE)

6. Some fostering allowances include payments over and above the reimbursement of the costs of looking after the child. These payments are designed to recognise the particular skills of the foster parent in looking after a handicapped or difficult child and to reward the professional nature of their care. They represent professional income in return for services and as such are liable to income tax as earned income under Case I or II of Schedule D. In determining the tax liability the foster parent is entitled to the same personal allowances and reliefs as any other taxpayer. Since it is usually the foster mother who receives the payments wife's earned income allowance (currently £1565; Budget proposes £1785 for 1983/84) is available and it is only where her total earned income in the year exceeds this amount that tax is payable.

TAX YIELD

7. The yield is thought to be very small. Liability to tax may arise only where the fostering allowances include a reward element (paragraph 6). The Revenue understand that the majority of payments exclude this element. Where a reward element is paid most will be covered by the wife's earned income allowance. It is therefore only in the minority of cases where the taxable payments are substantial, or there is other earned income that an actual charge to tax will arise.

B. ADOPTION ALLOWANCES

1. Section 32 of the 1975 Children Act enables adoption agencies to introduce schemes to make cash payments (adoption allowances) to people in order to help them afford to adopt children in care. These schemes are subject to approval by the Secretary of State for Social Services. A number of schemes have now been approved though none, we understand, has yet been implemented.

2. For tax purposes such payments to adopters for children who become part of their family are not earnings from an employment or from a trade or profession and would be taxable only if considered as "annual payments". There is no statutory definition of annual payments but broadly payments have been held by the Courts to be annual payments if they are recurrent (capable of being paid over more than one year), are paid under a legal obligation, and are regarded as wholly income in the hands of the recipient. It is therefore necessary to examine each case on its facts to see whether these conditions are satisfied. But from the adoption allowance schemes proposed so far, it appears that in general the basic adoption allowances (though probably not special payments for children with special needs) would technically be taxable as annual payments.

3. However, as these allowances are in practice broadly comparable to fostering allowances the Inland Revenue will not seek to tax them where they do not contain any "reward" element.