CONFIDENTIAL

FROM: L ROUSE
DATE: 6 October 1983

Note of a meeting held in Financial Secretary's room H M Treasury 6 October 1983

Present: Financial Secretary
Mr Reed
Mr Isaac)
Mr Rogers)
Mr Roberts) IR
Mr Martin)
Dr Rouse

IR MANPOWER AND THE BLACK ECONOMY

As a prelude to the meeting on overall Revenue manpower, the Financial Secretary wanted to elaborate on the part of the manpower bid which related to the black economy. Sir Lawrence Airey's minute of 29 September (para 26) put the case for a redeployment of 2,800 (2,500 by April 1988) staff to this area. 200 of these would be needed simply to stand still.

The 2,800 had been broken down by activity in Sir Lawrence's minute to the previous Chancellor of 25 March. The Financial Secretary acknowledged that, if the total finaly agreed was less than 2,800, the optimum allocation between activities might well not be pro-rata. Mr Isaac confirmed this. The sub-totals indicated a minimum credible extra presence in each area. If resources were constrained, the Revenue would prefer to maintain a minimum credible extra effort but in fewer areas. Ghosts and moonlighters should be the prime target.

The Financial Secretary asked the Revenue for their preferred distribution if the eventual figure was $\frac{1}{3}$ or $\frac{2}{3}$ of the bid. On the Basis of a 2,500 Bid by 1988, these were:

Deployment:	Ghosts & Moonlighters		E Compliance		Special Offices		Accounts Invstgn	Total by 1988
	Inspr	TOHG	Inspr	TOHG	Inspr	TOHG	Inspr	
Minimum	120	730	-	-	-	-	200	1050
Intermediate	120	730	70	430	30	5	500	1885
Full	120	730	130	770	60	10	680	2500

The aim would be to maintain the current level of activity, and to be able to respond to probing from the PAC and others by pointing to credibly enhanced activity, at least on ghosts and moonlighters, and on as many other fronts as possible.

Timing Enhanced effort on ghosts and moonlighters could be fully operative by 1986 and in any other areas by 1987-8.

Productivity

Internally generated productivity improvement over the period had been built into the bid figures. Policy events might change the intensity of manpower needed. Some aspects of Keith offered savings (although annual tax returns would have the reverse effect). However, Keith could not make a contribution until 1989-90, which was outside the period. Extra information by employers on P46 forms would also help. Other schemes (deduction at source for casual workers, certification of taxpayers etc) would have obvious manpower implications.

These were unclear, but the agreed figures could be amended as policy changes came into effect.

LYNDA ROUSE

Circulation:
Those Present
Chancellor
CST
EST
MST
Mr Middleton

Mr Bailey
Mr Monger
PS/IR

FROM: E KWIECINSKI
DATE: 6 October 1983

CHANCELLOR

cc CST (with attachment)
EST
Mr Monger
Dr Rouse
Miss Sinclair
Mr R Martin/IR
PS/IR

HENDERSON UNIT TRUST MANAGEMENT LTD

The Financial Secretary has decided that there should be a relieving provision in next years Finance Bill to prevent employees of the above company who participate in its Unit trust scheme from running into an unintended tax charge under S79 of the 1972 Finance Act. The Financial Secretary proposes to announce the decision when the House returns.

... I attach Mr Martin's note of 3 October. The Financial Secretary is content with the details of the proposal and with the PQ/A.

E KWIECINSKI

FROM: NICHOLAS RIDLEY
DATE: 6 October 1983

1. CHIEF SECRETARY
2. CHANCELLOR OF THE EXCHEQUER

FINANCE BILL: STAMP DUTY "COUNCIL HOUSE" SALES

We shall be considering shortly the list of Finance Bill starters. There is however, one minor Stamp Duty proposal on which we need to take a decision now.

In 1981 we removed a Stamp Duty anomaly which was standing in the way of council house sales. This legislation applied not only to sales by local authorities as such but also to sales by a number of named public authorities. The list was supplied by DOE. Ian Gow has recently written to tell me that the Atomic Energy Authority was unfortunately missed off the list. As a result a couple buying their home from the Atomic Energy Authority on the same terms that are available to tenants of other authorities are faced with paying more Stamp Duty than local authority tenants. The Revenue cannot deal with this by concession and the lacuna in the 1981 legislation is holding up a number of sales.

I feel that we must put this problem right as soon as we can and if you agree I will make an announcement to this effect when Parliament reassembles. The amending legislation will be short and non-controversial.

If we do legislate I would propose to add a Regulation making power to the 1981 legislation to avoid the need to have a clause in the Finance Bill each time a name has to be added to the list.

NICHOLAS RIDLEY

FROM: E KWIECINSKI

DATE: 6 October 1983

MR BOSTOCK

cc Mr Unwin
Mr Lovell
Mr Fitchew
Mr Edwards
Mr Gray

EEC AGRICULTURE

... The Financial Secretary has been given the attached paper on EEC agriculture by a young graduate friend of his. He would be grateful for your and copy recipients' comments.

EK

E KWIECINSKI

The governments of member countries in the EEC are determined to reduce the escalating cost of CAP. The major proposal for the Athens Conference is the introduction of supplementary and intensive levies on dairy producers. The reasons behind this are obvious. Support to dairy producers makes up over 40% of the FEOGA budget. There is a surplus of dairy products, (Production 106.8m tonnes, consumption 93.8m tonnes 1980/81) while long-term demand within the EEC is stagnant or declining.

While there are arguments for and against a wide-ranging set of proposals for reform of CAP, here is a consideration of only a small number of specific future developments consistent with the existing policy framework on a community basis.

The major options are:

1) PRICE REDUCTIONS: through target and hence intervention prices.

2) LEVIES (a) based at individual farm level (as in the proposed supplementary aid intensive levies)

(b) based on aggregate farm groupings (as in the co-responsibility levy)

The major difference between general price reductions and levies is that levies can be targeted and discriminatory to one group of producers.

The supplementary levy is based on individual farm output where each producer will pay for every litre of milk produced in excess of 1981 production levels + 1%. Excess output will attract only 25% of target price for liquid milk with no exemptions.

The intensive levy is based on a 4% levy on all milk production where herd production averages more than 15,000 kg a forage hectare. (Production of less than 60,000 kg/pa is exempted).

While the majority of dairy farmers are on small farms, the bulk of milk is produced by a relatively small group of large producers. By hitting this group, production (and hence surpluses) will be curtailed while there will also be the advantage that small and marginal farmers' incomes will not be reduced. This is thought to be desirable for a number of social and economic reasons and would reduce the need for a separate social policy for small farmers.

Ignoring the special needs of the marginal farmer for a moment, the critical question must be: - Would a general reduction in the (intervention/target) price of milk or the use of levies be the more effective in reaching the overriding objective of controlling the rise in production and hence reducing spiralling budgetary costs.

There are strong reasons to suggest that a general price reduction would not work well:

1) Milk yields are rising through genetic and technical advances. A lower price will not affect this trend.

2) There is the possibility that larger farmers will compensate for the lower price by increasing their production unless there is a supplementary levy.

3) Lower prices will send many marginal dairy producers out of business. These are likely to be taken over by larger producers with greater economies of scale who will increase production above that former level. (This happened in W.Germany in 1967 with as a consequence of the application of Common Market policy, prices decreased by 10% but output increased.)

Implications of the Supplementary and Intensive Levies.

The sucess of the proposed supplementary and intensive levies depends

largely upon how farmers, especially large dairy farmers, respond to it. The idea of the proposed levy system in its efforts to reduce overproduction is that the levy will cut into the fat profits of the large milk producer.

He may respond in the following ways.

a) he will turn his attention elsewhere to other agricultural enterprises. (The closest alternative given the type of land is cereal production).

b) he will concentrate more on an input minimising rather than output maximising farming system in an effort to avoid the levy and save money. (The side-effect would be better conservation/environmental farming practices.)

c) he will concentrate on quality rather than quantity eg raising fat content in milk.

The scope here may be limited.

d) he will carry on as before with lower profit margins or short-term losses.

.... or what might happen is that ....

e) he will go bankrupt

This is especially true of farmers with high levels of borrowing. (Which many capital-intensive large-scale farmers have.) The ability to borrow is primarily a function of the farmers collateral (which is effectively land). What is often forgotten is that the price of agricultural land is artifically high as a result of CAP. Make farming, or a type of farming such as large dairy farming, less profitable and the value of the land that is suitable for this type of farming will fall. This means that he has less collateral to cover

high levels of borrowing and he may find it difficult to carry on borrowing at the present rate at a time when his income is falling (and hence his need to borrow is rising). This may result in bankruptcy.

Different types of farming enterprise are closely ralated to each other. An effect of the proposed levies would be a disruption of the beef market. As dairying becomes less profitable for many farmers, much of their dairy stock would be transfered to the beef secto (this is happening all the time with male dairy young stock and culls) lending to a temporary glut of beef.

A more important consideration is that the levies are likely to come into force along with other proposals. Foremost of these is the reduction or stabilisation of the cereal target price. Lower cereal prices would have 2 effects on proposed changes in the dairy sector.

1) The incentive for dairy producers to switch to cereal production would be reduced.

2) The feed costs of dairy producers would fall. This would cushion the dairy producers from some of the harsh effects of the levy. While the levies would still discourage the dairy producers from high levels of production, the cereal price fall would be a net benefit for small/medium dairy farmers and would make the levies more acceptable to the large producer.

Implications of Milk Policy for the UK

The peculiar characteristics of the British position are:-

1) The British agricultural sector is considerably smaller in relation to the whole UK economy than the agricultural sectors of our European partners to their national economies.

2) The British dairy sector has a high percentage of large farms.

The proposed levies would discriminate against the UK dairy sector more than that of other member countries because they hit the large farms.

On the other hand the UK, because of its comparatively small agricultural sector (see 1), stands to gain most by reducing European Agricultural spending.

Despite the discriminatory effect of the proposed levies on the UK dairy sector it is likely that there will be a considerable net benefit to the UK as a whole through 2 factors.

1) A lower level of milk production reduces the milk surplus. Surpluses represent payment of farmers through the budget contributions of member countries for growing products that nobody wants. Smaller surpluses mean lower budget contributions.

2) The lower price paid for excess milk means that the British consumer will get cheaper dairy products than otherwise. This is particularly advantageous to the UK as British Dairy Product consumption per person is higher than most other member countries.

These 2 factors should give a net benefit to UK.

Question: - Given that British dairy farmers are particularly hard hit by the proposed levies; would there be a bigger financial gain if it proposed for general price reductions for milk rather than the proposed levies?

Answer: It has already been suggested that for various reasons a general price reduction may not reduce milk production much. (It would be helpful to have figures here - someone must have researched it, surely?) If this is the case there would be little reduction on budgetary contributions although the price paid by the consumer would be lower. These factors would have to set against the net loss to the

British farmers to find out the the financial gain for the UK of general price reductions. Therefore without figures it is difficult to answer the question.

But I would suggest that levies are more in Britain's interests even in purely the financial aspects, than price reductions per se would be.

Summary:

There is too much milk, member countries cannot afford to carry on supporting it at the present rate. It makes sense to reduce the rate of production by penalising it where most of it is produced - on the large farms.

This especially hits UK dairy farmers. On the other hand Britain stands to gain more by reducing EEC milk support (and agricultural support in general) than most other member states. (A political tradeoff somewhere?)

With a smaller cereal intervention price rise (or a freeze) dairy farmers input costs will be reduced. This would cushion the effect of the proposed levies on them. At the same time it would help to reduce cereal support cost.

MILK FACTS

1980/81 Price and Quantity: Assumptions for Milk

EC common price:	222.6	EUA/t
World price :	91.4	EUA/t
Production :	106.8m	tonnes
Consumption :	93.8m	tonnes
Price elasticity of supply	+1.0	
Price elasticity of demand	-0.5	

1980 national production and consumption levels

country	production	consumption
	(m tonnes)	
W Germany	24.3	23.1
France	27.7	24.9
Italy	10.9	15.0
Netherlands	11.8	4.8
Bel/Lux	4.0	3.9
UK	17.0	18.0
Eire	5.3	1.7
Denmark	5.6	2.4

Source: Some Development Options for the Common Agricultural Policy.

A.E. Buckwell, D.R. Harvey, K.A. Parton, K.J. Thomson.

(Newcastle University)

Useful sources:-

PARTON K.A. (1981)

"Levy policies and EC agricultural surplus".
unpublished paper - Dept. Agric. Eco.
University of Newcastle Upon Tyne.

BERGMAN. D. (1980)

"Possible alternatives to the CAP and their economic consequences."
Paper No.4 given to the Agric Eco Soc Conference. December 1980.

MARSH. J.S. "European agricultural policy: a federalist solution;
New Europe. Winter 27-40

Aside

There are some related points which I haven't covered. Most important: is that I haven't had time to go into detail about the co-responsibility levy and compare its advantages/disadvantages with supplemtnary levies. However the EEC prefers that supplementary levy - probably for good reason.

I have deliberately ignored more radical proposals for changing CAP. I hope to look at these later in a separate set of notes. But directly related to the Milk proposals are the following topics.

- Cost of bureaucracy in implementing proposals

Administration of levies on farm level likely to be greater than for general price reduction or other types of levy (eg co-responsibility). This is the major disadvantage of proposed levy system as it equals more bureaucracy.

- effect on the rest of the world

Reduction of milk surpluses disposed outside EEC. This would please other would-be exporters, especially USA.

- research

The nature of agricultural research in this country based, on raising yield and therefore production, is directly opposed to the government policy aims of reducing, or at least stabilising, production as this is the only way of reducing budget contributions under present CAP system.

*Emphasis should be on minimising input costs rather than maximising output.

- diary imports

New Zealand imports 85,000 tonnes of butter pa.to UK. Part of long-standing agreement.

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 7 October 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State
Mr Robson
Mr F Martin
Dr Rouse
Mr Stewart - IR
Mr Crawley - IR
PS/IR
Mr Caldwell (Parly counsel)

INTEREST RELIEF FOR EMPLOYEE BUY-OUTS: SECTION 24, FINANCE ACT 1983

In committee stage of this year's Finance Bill the Financial Secretary indicated that he was aware of one or two problems with this clause and would consider ways of improving it. Mr Stewart's submission of 30 September (attached, top copy only) discusses the options available. The Financial Secretary was grateful to the EST for his comments of 3 October (also attached).

The Financial Secretary has decided that the following amendments should be made to Section 24:

1) The test of employee control should be relaxed from 75 per cent to over 50 per cent, and should be retro-active to April 83 for those borrowing at the time of the buy-out.

2) Individual holdings should count up to 10 per cent rather than 5 per cent.

3) Husband and wife who are both employees should be counted seperately for the 5%/10% limit.

4) An announcement of the proposed changes should be made in the autumn.

Other than 1) to 3) above the Financial Secretary does not wish to make any further changes in response to the representations made by outside bodies He did though ask the Revenue to keep the situation under constant review in case further changes might be desirable in the future.

E KWIECINSKI

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 7 October 1983

Mr P J DRISCOLL/IR

cc Chancellor
Chief Secretary
Economic Secretary
Minister of State
Mr Middleton
Mr Cassell
Mr Monger
Mr Robson
Dr Rouse
Mr Caldwell (Parly Counsel)
PS/IR

FINANCE BILL 1984: STARTER BENEFITS IN KIND: SCHOLARSHIPS

The Financial Secretary as seen your submission of 5 October.

He is sure that it is right to deal with changes of educational establishment which took place before Budget Day 1983 (para 6 of your note). Equally he is sure that we must give some ground on the "involuntary" change of educational establishment points. He quite likes the compromise: the later {- 6 years from April 1983
- or change of educational establishment

He does though wonder whether 6 years might be too long a period, as most schools last for 5 years and university courses mostly 3 years.

He would be grateful for your justification of the proposed 6 years period before reaching a final decision.

EK

E KWIECINSKI

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 7 October 1983

MR M F CAYLEY/IR

cc Chancellor
Economic Secretary
Minister of State
Mr Cassell
Mr Monck
Mr Pirie
Mr Lomax
Mr Watts
Dr Rouse
PS/IR

OFFSHORE AND OVERSEAS FUNDS

The Financial Secretary has seen your submission of 6 October. He would like a meeting to discuss this, this office will be in touch shortly to arrange it.

His initial comments are:

1) Restrospection must be avoided like the plague. He thinks that no charge should apply on income or gains before 1 January 1984.

2) He thinks we can be tough on future funds - because people do not have to invest them and they have not been trapped in them.

3) He thinks it is very important not to hurt genuine investment funds - and those that distribute could be so called. He would therefore start by excluding full distributors.

4) Some are commodity funds, where presumably gain is all capital - these are different in purpose and nature. The Financial Secretary thinks it would be hard to treat all the gains in such funds as income. He wonders whether commodity speculation profits are treated as trading income at present.

5) He thinks we need to discuss the form of change. He has commented that the ideal way would be to tax all real income as income in the year in which it is rolled up - but this is probably not possible. His main concern is not to damage genuine activities.

E KWIECINSKI

CONFIDENTIAL

NOTE OF A MEETING HELD IN THE FINANCIAL SECRETARY'S ROOM (THE RT HON NICHOLAS RIDLEY) 13 OCTOBER 1983

Those Present: Financial Secretary
Sir G Engle (First Parliamentary Counsel)
Mr Graham (Parliamentary Counsel)
Mr Isaac - IR
Mr Lewis - IR

TAX LEGISLATION

The Financial Secretary had called the meeting to discuss Mr Rowland's proposals for the re-drafting of Tax Legislation. The Prime Minister had taken a personal interest in the matter and would be holding a meeting to discuss it with Financial Secretary and others.

The Financial Secretary said that whether Mr Rowland was right or wrong, it seemed that the necessary work involved in redrafting the legislation and the time needed for its passage through Parliament made the proposition wholly impractical and impossible to achieve. He thought that Mr Rowland should be persuaded that his idea though laudable in its objective was simply not on. The Financial Secretary's concern was that by taking a Bill through Parliament just to shorten it you would be giving opportunity to Members to open up new areas of policy for debate, and the potential for changes in the Law.

Parliamentary Counsel said that it would be technically possible to use the normal consolidation method for tidying up the existing legislation. This method had the advantage of not giving the opportunity for changing the law itself. It did not matter how much the language was changed, provided the law was not altered. But, Parliamentary Counsel went on to explain, tax law is so complex that even by removing only one word you run the risk of changing the law itself; although only one person might be affected, nonethless it would still be a change in the law.

Mr Isaac said that a number of outside bodies would no doubt wish to comment on proposed drafting changes for the reasons given by Parliamentary Counsel. He showed the Financial Secretary a 41 page document which had been published by the Consultative Committee of Accountancy Bodies. This document commented on the Company Law Consolidation Bills, and was critical of the modern, direct style adopted. It was agreed that if the public were to think that the Government were deliberately trying to avoid simplifying tax legislation there would be much criticism.

Parliamentary Counsel explained that there was one other possible procedure which the Financial Secretary should be aware of. This was a form of consolidation with amendment. It has only been used a few times since the war, and not at all since 1959: one precedent was the Customs & Excise Act 1952. The procedure is for a draft Bill to be considered by a Departmental Committee, which could then approve or initiate changes in the law. The resulting Bill would, after 2nd Reading, proceed to a Select Committee. After being reported on from the Select Committee it would proceed as a normal public Bill and would be wide open to amendments. If, however, Members (and particularly the Opposition) are prepared to exercise restraint, these can be expected to be confined to drafting amendments and amendments to give effect to suggestions of the Select Committee. This procedure is however very long and time consuming.

It was decided that this method would only work if you could guarantee that every Member would agree not to the various stages of the procedure to try to change the law. In present day conditions, that was out of the question.

It was agreed that whilst it would be possible to improve the drafting of the Taxes Acts, it would take years on each piece of legislation to ensure that the law itself was not changed.

The Financial Secretary said that it was clear that in practice Mr Rowland's suggestions could not be taken on board, but we had to persuade Mr Rowland of this fact. Although the Parliamentary problems

seemed to him conclusive, they could not be used as the exclusive reason for turning down the proposals as it would seem that Parliamentary procedure was blocking what would otherwise be a good idea. Tactically therefore the best course of action to take first would be to point out the technical weaknesses in his attempt redrafts. Parliamentary Counsel added that Mr Rowlands was obsessed with brevity, but that brevity could actually work against comprehensibility, in cases where the subject matter is complex and difficult to understand.

The Financial Secretary indicated that, for the meeting with the Prime Minister, he would need a brief drawing together the earlier papers and the conclusions of the discussion.

T M Stubbington

T M STUBBINGTON

Circulation:

Those Present
PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
Mr Monger
Mr Allen
PS/Chancellor of the Duchy of Lancaster
PS/Lord Chancellor

CONFIDENTIAL

FROM: FINANCIAL SECRETARY
DATE: 14 October 1983

CHANCELLOR

cc PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Mr Middleton
Mr Cassell
Mr Battishill
Mr Monger
Mr Robson
Mr Ridley
Dr Rouse
PS/IR

INCENTIVES TO ENTERPRISE

You asked (Mr Kerr's minute of 21 September) for a note on progress in identifying measures which would lighten the burden that revenue administration places on enterprise, and on means of eliminating any discrimination which may exist against the self-employed within the tax system.

Self-Employed

It is generally accepted that the Schedule D regime is more favourable (eg tax liability based on profits for previous year, tax payable later, less stringent expenses rules) than Schedule E. The Schedule D rules on the basis of assessment alone mean that Schedule D people, in contrast to their Schedule E counterparts, generally pay tax on fewer profits than are actually earned - an advantage that can be worth several £100's a year. Also because Schedule D does not deduct tax at source, it provides some people with more opportunities for tax evasion. These are the main reasons for our problems with the boundary between Schedule D and E. I am deep into this question and I hope a minute will come forward soon with some concrete proposals. I regard this as most important.

Measures to Lighten the Burden of Revenue Administration on Enterprise

Looking at enterprise in the form of small businesses, there are three main strands to their involvement with the tax system:-

i) the company's direct tax liability - income or corporation tax on the businesses profits;

ii) the responsibility as an employer to calculate and account for PAYE tax and NICs on behalf of employees; and

iii) indirect tax liabilities - VAT.

Working from this, the following are the possibilities so far identified in a continuing search:

a) The French 'forfait' type system. This enables the income tax and VAT liabilities of businesses with modest turnovers to be calculated on the basis of a notional profit figure, with the business paying provisional amounts on account until the liability is finalised, when the business has to make up any tax underpaid. We looked at this in late 1981 following a proposal in the so-called Blue-Chips Manifesto ("Changing Gear"), but concluded that it would not reduce compliance costs for small businesses involved in determining their Schedule D and VAT liabilities. It also leaves them in considerable uncertainty as to the amount of tax they will eventually pay. The VAT working part set up by Michael Grylls reached similar conclusions.

b) Self-Assessment. We have in the pipeline work directed towards self-assessment - first for companies and secondly for individuals. This could turn out to benefit businesses, though it is too soon to say. Progress on companies depends on the reaction to the pilot exercise which has been

running. We may have to move step by step. On income tax, simplification is a pre-requisite of self-assessment. We have said that we hope to issue a discussion document on Schedule D where the rules are very varied; but again, the scope for progress depends on how businesses and accountants react to the big changes involved. On Schedule E, we will have to wait until PAYE computerisation is complete and bedded in.

c) Annual Accounting for PAYE. This did not stand up to examination. Our conclusion was that the system would provide doubtful administrative and cash flow advantages for employers; would have very high first-year revenue costs and involve substantial extra staff costs; and that it would be a more difficult system for employers to understand. But we salvaged out of this work the proposal for (d) below.

d) Net of Tax Pay. We discussed this recently and agreed to proceed with the issue of special taxable pay tables and accompanying documentation to help companies to use the method though, of course, it may only suit a few and is, if anything, more complex than conventional PAYE.

e) Help on PAYE Generally. There have been two major simplifications since 1979. The abolition of the lower rate band in 1980 enabled the PAYE tax tables to be reduced from over 400 to under 30 pages; and the adoption of MIRAS this year has removed the need to give mortgage interest relief through PAYE coding for the great majority of mortgagors. At the same time the Revenue have taken a number of steps to help employers operate

the PAYE system generally. In 1982 they made a change to lighten the end-of-year work by introducing a three-part self-copying form which provides the necessary information for the Collector and for employees as part of one process. They also engaged a specialist design team at the University of Reading, to help to standardise and improve the presentation and layout of the forms and explanatory material for employers who operate PAYE, and this year a new leaflet will be introduced to guide the "first-time" employer through the system.

f) Combining NIC and IT into NICIT. You were far from enthusiastic about this, but I will continue to pursue the subject. It probably holds the greatest potential for simplifying and lightening the burden - but it is a major upheaval. It has been put forward now by Professor Sandford as one way that might give some help in reducing employers' compliance costs, in a research study just completed and due for publication in the near future. He will bring out the (embarrassingly) high compliance costs for small firms of applying PAYE and NIC. We can expect renewed pressure as a result of this and I have asked Inland Revenue to give further thought to our defences and to Sandford's other proposals for reducing compliance costs. I believe we are eventually going to be forced towards some form of NICIT, but I will need more time to give you a full report on the topic.

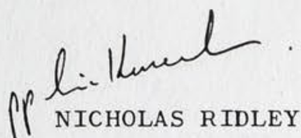
g) Annual Accounting for VAT. This was the subject of a consultation exercise earlier this year, but was roundly turned down by small businessmen despite its cash flow advantage to

traders (which would have meant a one-off £200-£300 million revenue cost) and its simplification consequences. Like the Revenue, Customs and Excise have tried to ease the burden of the present system, with a further simplification of the VAT return form in 1982 and improved leaflets for traders.

Looking at enterprise defined more broadly, the work on self-employed and casual workers may be relevant. The trouble is that the simplest way to lighten the burden of administration is to excuse people from paying tax. But our problem is that too many people who should pay tax do not pay it at present. To design a watertight system for Schedule D and casuals could help a lot with revenue receipts - could even simplify people's lives because they could not evade - but would cause political problems. I will be reporting on this whole subject soon, but the above is a trailer!

I am also continuing to look at the Construction Industry (714) tax deduction scheme. We have taken positive action here by introducing the 714s school leavers and bank guarantee certificate. Work is in hand on the 3 year employment rule which is one of the qualifications for a 714 certificate. Again, I will report on this in the near future.

In short, we have examined or are currently examining the more obvious ways of lightening the burden of tax administration on enterprise. And of course we have done a lot for small businesses and enterprise generally since 1979. At root we face the basic tension that, if we are to collect the tax properly due in an efficient way that minimises our costs, the employers and small businesses that engage in activities which give rise to tax liabilities are going to have to bear some burden. But I am sure that we should continue the search to minimise this burden and I would welcome any thoughts you or colleagues might have.



NICHOLAS RIDLEY

COMMERCIAL IN CONFIDENCE

FROM: E KWIECINSKI
DATE: 14 October, 1983

PS/CHANCELLOR

cc PS/Chief Secretary
PS/EST
PS/Minister of State
Mr Middleton
Mr Bailey
Mr Anson
Mr Cassell
Mr Judd
Mr Monck
Mr G Morgan
Dr Rickard
Mr Robson
Mr R H Wilson
Mr Chivers
Mr Pirie
Mr I P Wilson
Mr Hosker - Treasury Solicitor

ARRANGEMENTS FOR APPOINTING ADVISERS TO WORK ON PRIVATISATION

The Financial Secretary has seen Mr Williams' submission of 7 October and the Economic Secretary's comments of 11 October.

2. He generally agrees with what the EST says. However he thinks we should consider whether a bank adviser should be allowed to be an underwriter at all - let alone the lead underwriter. The Financial Secretary thinks that our adviser should have no interest at all in getting a low price, which is what underwriters want. He has commented that we should pay the adviser for his services and then invite syndicates of underwriters to meet our advisers to discuss prices.

EK

E KWIECINSKI

CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 14 October, 1983

MR P J A DRISCOLL / IR

cc Chancellor of the Exchequer
Chief Secretary
Economic Secretary
Minister of State
Mr Middleton
Mr Cassell
Mr Monger
Mr Robson
Dr Rouse
Mr Caldwell (Parliamentary Counsel) (2)
Mr Blythe/IR
PS/IR

FINANCE BILL 1984: STARTER
BENEFITS IN KIND: SCHOLARSHIPS

The Financial Secretary was grateful for your note of 12 October.

2. He is now content to accept 6 years as the length for the transitional period.

EK

E KWIECINSKI

FROM: E KWIECINSKI
DATE: 14 October, 1983

MR B O DYER

cc Mr Hopkinson
Mr Salveson
Mr Smith TOA

GIFT OF LAND TO LEEDS CITY COUNCIL

The Financial Secretary has seen your note of 7 October. He has commented as follows:

"Why cannot a restrictive covenant of the necessary type be placed on the land for all time? - the National Trust is doing just that constantly. Can we not make a purchaser enter into a covenant which only allows him to sell to another purchaser with a further restriction? With such a restrictive covenant we could raise £17,000 which as a Treasury Minister I believe we should have."

EK

E KWIECINSKI

MANAGEMENT IN CONFIDENCE

FROM: E KWIECINSKI
DATE: 14 October 1983

MR GRACEY - IR

cc Chancellor
Minister of State
Mr Middleton
Mr Monger
PS/IR

TAX DISTRICTS: PROPOSED CHANGES IN LOCAL OFFICE NETWORK

The Financial Secretary was grateful for your submission of 14 October.

He is content with:-

i) the draft Parliamentary Question and Answer (to be dealt with on Monday 24 October);

ii) the draft press release - which includes the text of i.;

iii) the draft note about the changes and statements of the final plans to be placed in the House of Commons Library;

iv) the alternative form of words for the final paragraph of the letter to be sent to MPs where a District is to be closed.

I will arrange for the PQ to be answered on 24 October.

E KWIECINSKI

CHANCELLOR

FUTURE OF PENSIONS

You asked for a short paper on a practical way forward on this issue.

1. I recognise that we have not decided what to do about SERPS. But whatever we do about it - keep it, modify it, or abolish it, I would like to find a practical way forward to deal with the problems of excessive tax relief, portability, and ownerships. It is a development of the scheme attached to my minute to Sir G Howe ... of 6 May 1983, a copy of which I enclose.

2. Contracted in contributions, and self-employed contributions to the State Scheme are not tax deductible. Let them remain so as at present.

3. Contracted out occupational pension contributions, should be compulsory up to the level of the contracted-in contribution rate. They should be paid out of post tax income by employees. Employers should be required to match employees' contributions in the same ratio as for NIC contributions as at present. These contributions should be tax deductible for employers and not treated as benefits in kind for the employee. In other words the different treatment of contributions for contracting-in and -out would be abolished; thus would secure

equality of treatment for all, and compulsory contributions out of taxed income for all.

4. Any employee who wished to could in addition in future save up to (say) 5% of his income over and above the statutory requirement in 2 and 3 above, out of his pre-tax income; provided:

   a) It was put in a personal, portable Trust with Trustees etc.

   b) It was held in trust until retirement or a given age (60 or 65?).

   c) Employers could, at their discretion make a contribution to a personal pension trust of up to the same yearly amount as the employee subscribes. This would be deductible for CT purposes, and not treated as a benefit in the hands of the employee. The employer's contribution must not exceed the employee's.

5. To deny tax relief for contracted-out NICs saves [£1.2bn]? It can only be guess work to estimate how much it would cost to give tax relief on voluntary contributions over and above the statutory NIC. If we thought it appropriate we could give it at a different rate - eg at 15% as in respect of premiums to Life Assurance Policies.

6. Existing pension rights in occupational schemes would be frozen at the start date insofar as they related to pensions over and above the guaranteed minimum pension. Funds would have to pay members, on

retirement, only so much over the GMP as they were obligated to do by their contribution record at the time of the starting date.

7. It is next necessary to consider the tax treatment of the income to occupational pension funds. Under this treatment they would have statutory contribution levels, and statutory levels for the eventual pensions resulting. The more we tax them, the higher the contributions would have to be: and this is unfair as against those contracted-in. Under this scheme there is no case for taxing the funds' income. But there would be a saving here because the funds would be no bigger than was necessary for the GMP.

8. What should be the taxation treatment of the income within a personal pension trust? At present there are a number of such "Trusts" - for director/controllers. The income is tax free. There are also retirement annuities, where the income is taxed at the "pegged-rate" of 37½% in the hands of the Life Company. I suggest that we should tax all such income in personal pension trusts, and in retirement annuity funds, at the same rate; the Inland Revenue are now proposing 30% instead of 37½%.

9. Finally time is the question of the tax treatment of the emerging benefits. Pensions, from whatever source - state, annuity, or personal trust, - should be taxed as earned income as at present. The difficulty arises on Lump sums. For state pensions, commutation is not possible, so the problem does not arise. For "personal" pensions, I think there should be a flat rate tax on commutation, recognising the fact that tax is denied to the Exchequer if it takes

place. I do not see the justification for income tax treatment: the more you save the higher the rate of tax incurred is a bad principle. I suggest something like a 20% flat rate tax.

NICHOLAS RIDLEY

This note summarises the main factors involved in examining pension schemes and outlines a possible new approach.

The Main Factors

2. There are four aspects of the current arrangements for pensions which can give rise to concern :

(a) the disadvantages suffered by the "early leaver" from an occupational pension scheme. These are inequitable in themselves and can inhibit job mobility;

(b) the cost of tax reliefs for pension schemes;

(c) the increase in the burden of pensions as both the State earnings related pension scheme and occupational pension schemes mature;

(d) the need to give individuals greater freedom to determine their own pension provision.

These aspects do not have to be tackled at the same time - or on the same timescale - but it is important to bear in mind the links between them.

3. It is probably best to start by examining how the new State pension scheme fits into this picture.

4. The scheme matures in the late 1990s. People retiring after that date will have built up full entitlement to earnings related pensions. This pension will be in excess of the Supplementary Benefit level. This applies to those contracted into the State scheme and to those contracted out. In the case of the latter, the employer has to provide a guaranteed minimim pension (GMP) at least equal to the State earnings related pension.

5. When the State scheme matures the vast bulk of the population will no longer suffer an early leaver problem. The earnings related element - both for contracted in and contracted out - will be revalued in line with his average earnings up to the point of retirement - no matter how many times an employee changes jobs. The earnings related element is related to earnings up to the upper earnings limit (UEL), currently £235. The UEL is, and will no doubt

6. But there remains the early leaver problem until the State scheme matures. And we will continue to have an early leaver problem after 1998 for people with earnings above the UEL whose pension rights above this level will not be protected. Such people include middle-managers, who are a vocal group and who may be particularly important in the context of job mobility. They are also the group most likely to want and to be able to take advantage of a greater freedom in determining their own pension provision.

7. The simplest way of dealing with the early leaver problem both in the period up to 1998 and beyond is to ensure that all preserved rights in an old scheme are revalued at least in line with prices or possibly with average earnings (as applies to the GMP). But if this is not to involve an overall increase in the resources devoted to pensions by occupational schemes (which is arguably undesirable) then there must be redistribution of resources between early leavers and stayers. The Government's current position is that it looks for an early response from the pensions industry. Only a change along these lines would provide that immediate improvement in the position of early leavers which is so desirable. No amount of ingenuity can create for early leavers resources which their own pension scheme is not willing to give.

8. There could be considerable advantage for some early leavers in creating a system of portable pensions. These would be designed essentially for the high flyers who expected to be mobile. Such schemes would not give immediate relief to early leavers. But they would enable people who expected to be mobile to start building up, perhaps in a personal trust, pension rights which would be independent of job changes. This would also fulfill the objective of greater freedom in determining ones own pension provision. Insofar as these portable pensions attract tax relief, the government would have a legitimate right to place certain conditions on the trust - otherwise we would just be creating a new indiscriminate tax shelter for savings.

A Possible new approach

9. In designing a scheme it is as well to start by identifying the State's interest in pension provision. There seem to be two aspects :

(a) a practical interest in encouraging people to make provision for themselves in order to relieve the State of the burden that would otherwise fall on it - particularly in the form of expenditure on Supplementary benefit. At present about 1.7 million pensioners (out of a total of some 9 million) get Supplementary Benefit at

(b) a social concern to encourage savings generally and particularly savings in a form which avoided a sharp drop in income after retirement.

10. Historically the second objective has predominated. But today it is arguably of less relevance. Most people are well aware of the desirability of providing for themselves and their family in retirement. They do not need the State's ecnouragement. This suggests the State's main interest now is to keep pensioners off Supplementary Benefit.

11. Against this background the first issue is the extent to which any scheme should be compulsory. The logic above suggests contributions should be compulsory up to the level required to provide a pension in excess of Supplementary Benefit.

12. This approach is reflected in the State scheme. As already mentioned, when the scheme matures the State will provide a pension for those contracted in which is in excess of Supplementary Benefit. This leads to the proposition that contributions should be compulsory for employers and employees up to the nic contracted in rates.

13. As now, there should be scope to contract out of the State scheme as long as the employer continues to provide the guaranteed minimum pension. For the contracted out the position would be :

(a) compulsory contracted out contributions to the state scheme by employer and employee; and

(b) compulsory contributions by employer and employee equal to the excess of the contracted in rate over the contracted out rate. This would differ from the present position under which there is no requirement that contribution must be made up to nic contracted in rates - only that the scheme provides the GMP. These contributions could be paid into any one of :

(i) the state scheme - so effectively contracting back in
(ii) an occupational scheme run by the employer
(iii) the employee's personal trust. This would provide portability for those who wanted it.

14. Contributions in excess of the contracted in rate would be voluntary. These contributions could be paid into :

(a) an occupational scheme
(b) the employees personal trust.

It would probably be necessary to legislate to ensure that companies did not - as they do now - effectively impose membership of a company scheme as a condition of employment.

Tax Treatment

15. The second issue is the way these arrangements should be taxed. The present tax treatment of pensions is as follows :-

(a) State pensions

NIC are made out of post-tax income by the employee. Employers' nic are deductible for tax purposes, and are not treated as taxable benefits in kind in the hands of the employee. State pensions are subject to income tax.

(b) Occupational pensions and retirement annuities

Employees' contributions (if paid) enjoy tax relief, within certain limits. Employers' contributions are treated in the same way as employers' nic. Income and gains accumulated in the funds are exempt. Pensions are subject to income tax (apart from the tax-free lump sum).

The objective of a 'portable pension' is already possible for the self-employed who have taken out retirement annuity contracts.

16. It is difficult to give a precise estimate of the overall cost of the present tax reliefs for occupational pensions but on one assumption the figure would very broadly be in the region of £2 billion, with a further £$\frac{1}{2}$ billion for retirement annuity schemes. (On other, equally valid, assumptions, the figuure could be much higher or much lower.)

17. The historical justification for the tax reliefs for occupational pension and retirement annuity arrangements rests on the points in paragraph 9 above. It would be possible to introduce the new portable pension without disturbing the present tax arrangements at all. But arguably the historical justification for such preferential tax treatment for pensions is less valid now than in the past, and there is a good case at least for reviewing the tax position.

18. So far as the State pension is concerned, there seems no reason to change the present arrangements. There is a good case in equity for extending them to the compulsory contributions which employees and employers would make, as proposed in paragraph 13(b) above; if this were not done there would be a tax incentive to contracting out which would be hard to justify. On this basis employees would no longer obtain tax relief for such contributions, but the position of the employer would remain the same as now.

19. So far as the voluntary contributions made by employees, as described in paragraph 14 above, are concerned, it could be argued that there is even less reason for these to attract tax relief. The State has no obvious reason to encourage people to make voluntary contributions, since their compulsory contributions will provide an adequate pension on retirement. Moreover, in principle the fewer tax reliefs that are given for pension arrangements, the less the State needs to be concerned about imposing conditions on pension schemes. (In practice, the trade off is not quite so straightforward : even without relief for employees' contributions, pensions would still be attractive since the tax charge in respect of employers' contirbutions would in effect be deferred for many years. It would therefore be necessary to maintain some restrictions to safeguard the Exchequer.)

20. Withdrawal of relief for employees' pension contributions could yield in the order of £1100m assuming that all employees would continue to contribute at the same level as they do now. To prevent a switch to non-contributory pension schemes, it would be necessary to require some sharing of total contributions between employer and employee (possibly in the same ratio as nic contributions).

21. It may be too large a step to withdraw all the present tax advantages. Payments into occupational schemes and into personal trusts could attract :

(a) a preferential or zero rate of tax for fund income and capital

(b) allowing lump sums to be paid free of tax. This relief could be restricted by placing a limit on the extent to which pension rights could be commuted into a lump sum. At the moment $\frac{1}{3}$ of pension rights can be taken as a lump sum.

An arrangement for a preferential rate of tax for fund income could be similar to the "pegged rate" of corporation tax paid by life companies. This pegged rate - currently 37½ per cent - could be changed to suit the political needs of the time.

22. There are attractions in looking for greater neutrality between pensions and life assurance schemes; for example removing tax relief for employees pension contributions would point to the removal of life assurance premium relief. This would save over £½ billion. It could to some extent be compensated for by reducing the pegged rate.

23. In logic tax relief for retirement annuities ought also to be brought into line with the scheme desribed above. This would involve splitting the premiums into two parts. The part analogous to the employee's contribution would not get tax relief. The part analogous to the employer's would continue to do so. This arrangement might save about half the current tax relief of around £½ billion on these schemes.

Conclusion

24. The State's main interest in encouraging personal pension provision is to keep pensioners off Supplementary benefit. By the end of the century the new State scheme will achieve this.

25. This means the State has little interest in encouraging the provision of larger pensions. It points to the sort of arrangements described in paragraphs 13 and 14 above. A scheme based on these principles would remain viable even if the stated earnings related scheme is scrapped.

26. Judged against the concerns described at the outset of this note, the proposed scheme would :

(a) deal with the problem of early leavers except for those with existing rights in occupational schemes;

(b) lead to tax savings of £1100 million on employee's contributions to occupational schemes and, possibly, of over £½ billion in

respect of life assurance premium relief and, say, £200 million in respect of retirement annuity schemes. This could finance a substantial increase in tax thresholds and or reduction in rates;

(c) by reducing tax subsidisation of pensions, lead to a reduction in pension provision and so a reduction in the overall burden of pensions;

(d) give individuals some more freedom in respect of their pension provision.

PERSONAL AND CONFIDENTIAL

FROM: E KWIECINSKI
DATE: 17 October 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State
Mr Middleton
Mr Monger
Mr Watson
Dr Rouse
Mr Isaac/IR

TAX AND SOCIAL SECURITY: A NEW SYSTEM

... I attach a discussion paper prepared by the (ex) Financial Secretary.

He hopes the ideas contained within it will be pursued vigorously in the coming months.

EK

E KWIECINSKI

THE INTERFACE BETWEEN TAX AND SOCIAL SECURITY

I want to suggest a new concept to see if it can be developed into an improved and simplified system.

I start with the concept of a person's "needs". A definition of "needs" is now much money he or she needs to live modestly above the poverty level, taking into account that person's circumstances. [This is the direction in which our Social Security system is taking us

Social Security identifies the following "needs"

A. A basic amount of money for each single person

B. An increase of [X]% on top of that for married (or cohabiting persons).

C. An addition for children, depending on number and age.

D. An addition for housing costs and rates.

E. Various extra additions for special groups (heating, disabled etc)

If these "needs" are added up, we get a different "needed" income for each person/ couple. Supplementary Benefit makes up their income to that level.

It seems to me to follow that taxable capacity should only begin for each individual/couple on income in excess of their "needs". We should make up the income up to the level of their "needs", and charge tax on every pound of income over their "needs".

But for those in work there are cetain extra "needs" which those out of work do not have. They are the expenses involved in earning their income - tools, travelling (in some cases) etc.

There are other allowances against tax which we provide at present - the main ones are the APA, Wife's earned income allowance, and Age Allowance. These are more in the nature of incentives than "needs".

There is also Morgage Interest Relief. This brings up the whole question of housing costs and how to fit them into this idea. They are a major cause of the poverty/unemployment traps. Equally we allow taxpayers to deduct mortgage Interest. We either have to say housing is a "need" and both should be counted towards a person's needs: or we have to say that housing should be paid for out of a person's means, and then for neither form part of his "needs". To do this would mean increasing the basic "needs" amount to cover housing - and abolishing MIR. We cannot do the latter. Moreover there is no need to give single people living with their parents, or sharing their housing costs with others, the same amount as householders. Therefore I think housing should be a "need" - this may mean giving taxpayers in rented accommodation relief against tax for rent.

I hope we can aoblish all expenses for tools, cothing etc. Travel to work costs can also play a part in the "traps", but it would be unwise to acknowledge them as a "need".

On this basis the "needs" are:

- single or couples personal allowances.
- an allowance for children according to number and age
- housing costs, rent or MIR.

My suggestion is to compute the "needs" for each person or couple, and to determine their income. If the "needs" exceed the income, Social Security makes up the income to the level of the needs. If the income exceeds the needs, each pound of excess is taxable.

By these means we avoid having to pay people in excess of their actual needs: and we can tax people after taking account of their needs which vary widely at the bottom end of the scale according to circumstances.

We sweep up all existing social security benefits except pensions. There will be of course be special cases like the blind, the disabled, diabetics etc, for whom special extra "need" allowances can be made. There may also be special tax reliefs which we wish to keep as incentives - BES, borrowing to buy shares, may be examples. But I hope we could take the opportunity to do away with LAPR, Foreign Earnings relief, and the minor personal reliefs.

It would be for consideration also to see what we should do about the APA and wifes earned income relief. It would also be right to take a careful look at the elderly to see whether Age Allowance should be retained, modified, or scrapped. All of these would to some extent depend on the figures.

We would by these means abolish the traps, and have a clearly defined frontier between tax and Social Security, and greatly simplify the whole structure.

There are major difficulties too!

First would be the "cost". This would come from extra take up of benefit. But equally tax thresholds would be lowered for those with the lowest needs. Also Child benefit becomes a tax allowance for those whose income exceeds their needs. No doubt we could work out the cost, when we had decided which reliefs to abolish.

There would be on other major cost. If the definition of "needs", have no spare income, and cannot be asked to pay direct taxes. They cannot be asked to contribute to the National Insurance Fund. This means that Social payments and retirement pensions must all be paid for by the taxpayer - those whose means exceed their needs.

Tax should start on the first £1 of income above a persons needs. But it would have to be an income tax type threshold for the reason given above. One could introduce our NICIT scheme here - the first band of income could be called Social Welfare Tax, and could, be at quite a high rate - 25 or 30% even - after all we have catered for peoples' needs! At a certain point up the income scale, Income Tax would start at a higher rate than SWT, with higher rates still beyond that.

Equally we could stay with the present system of Income Tax and NIC - but it would be difficult to retain the present NIC type threshold. This is another reason why the initial rate of tax could be quite high. I do not want to pursue the NICIT arguments further here because we could either do it, or not, under this system.

The other drawback could be staff numbers. I cannot guess whether the large staff savings in DHSS would equal the extra Tax staff needed to determine everyone's "needs". We already code whether they are married, or single, DHSS take account of children; UHB is already assessed, MIR is dealt with at source. The more tax reliefs we get rid of in the process of the "upheaval" the more tax staff we can save.

Could this suggestion be studied please?