PO CH/GH/0173
PART. A

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PART. A

APPROACH TO THE
1979 BUDGET.

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Item 5
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BUDGET

SECRET

MASTER

MR STOWE

Top copy on Econ. Policy, May 1979

P. G.

10 DOWNING STREET

From the Private Secretary

24 May 1979

Dear Tony,

The Prime Minister held a meeting at 1800 hours this evening with the Chancellor of the Exchequer and the Chief Secretary to discuss the Budget. They had before them the Chancellor's further minute of 23 May.

The Prime Minister said that she remained extremely worried about the price consequences of the Chancellor's proposals, and the effect they might have on pay negotiations in the coming winter. She wondered whether there were not other ways of meeting the Chancellor's objectives on the income tax front than through increasing VAT to 15 per cent. In particular, there seemed no reason why the income tax reliefs could not be made effective from Budget Day rather than being backdated to the beginning of the financial year. Taxpayers would not expect such backdating and the revenue savings would be very substantial. The revenue savings would be about sufficient to enable the VAT increase to be confined to 12½ per cent. It appeared from the figures attached to the Chancellor's minute as if the taxpayer would be getting considerably more in tax relief than he would be paying out in higher indirect taxes. She recognised that there were administrative difficulties, but it ought to be possible to overcome them. The Prime Minister went on to ask whether all the options for raising revenue had been fully considered. One possibility which she had in mind was the replacement of the VAT element in the petrol tax by a straight duty: this would bring in

/ additional

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additional revenue because there would be no VAT offset on business purchases and the RPI effect would be small.

The Chancellor said that, in his view, making the tax reliefs effective from Budget Day, and not backdating them, raised insuperable difficulties. Not to backdate them would destroy the cumulative method on which the PAYE system was based. As for the argument that the taxpayer appeared to be getting back more than he would be paying in indirect taxes, the Chancellor explained that this was not so in terms of purchasing power. Because of the three-month lag in VAT collection, much more had to be given to the taxpayer in tax reliefs in year one than the revenue which would accrue to the exchequer in order to leave his real disposable income roughly unchanged. It was therefore essential to increase VAT to 15 per cent if his income tax objectives were to be met. In any case, a 15 per cent rate of VAT would be needed in 1980/81, and it could well be more difficult politically to raise the rate again in the second year than it was to move straight to 15 per cent immediately. He had considered various other revenue raising options, including increasing Advance Corporation Tax. But he had concluded that ACT was not a runner because company liquidity, notwithstanding the short run cash flow improvement resulting from the VAT increase, would remain tight; and although he was willing to consider the possibilities further, he did not think there was much likelihood of finding significant additional revenue without either affecting the RPI or damaging business confidence (as would happen, for example, if the NIS were increased again). In order to mitigate the RPI effects, he was disposed not to increase the specific duties on alcohol and tobacco: revalorisation of these duties would reduce the PSBR by only £200 million, while they would increase the RPI by 0.6 per cent. In this way, the price rises in the Budget would be confined to the VAT increase and the increase in petrol duty, and the total

/ effect would be

effect would be 3.6 per cent - which would be marginally less than the 3¾ per cent RPI effect of Mr. Healey's first Budget. This excluded any increases in prescription and school meal charges; in order to keep within the 3¾ per cent margin, he thought there was a strong case for not announcing any such increases in the Budget.

The Chief Secretary added that the switch to indirect taxes which the Chancellor was proposing was essential to his overall strategy - both in terms of achieving his minimum income tax objectives and in terms of keeping the PSBR within reasonable limits in 1980/81. There was of course a risk that there would be industrial repercussions, and the industrial situation in the winter would not be easy; but in his view the Government was more likely to face industrial trouble in its second and third years of office. Hence, it was better to get the large price increase out of the way early. Once a VAT rate at 15 per cent had been achieved, there would be no need to raise VAT again in the life of the present Parliament; the only further indirect tax increases that would be needed would be the revalorisation of specific duties. A further argument for making the major shift to indirect taxes was that this would result in less tax evasion. Although the immediate effect of the Budget would be inflationary, the overall Budget stance was decidedly deflationary; and indeed on the conventional presentation, the Budget would be shown as having a significant contractionary effect on the economy. The Chancellor said that in presenting this it would be necessary to point out that, with the current prospects for the PSBR, any Budget - whether presented by a Conservative or Labour administration - would have had to be deflationary.

The Prime Minister then asked whether the Chancellor was satisfied with the PSBR forecast. She understood that there was a wide margin of error in it, and wondered whether the Chancellor was happy with the underlying assumptions. The Chancellor replied that there was indeed a wide margin of error, but he was reasonably satisfied that the forecasters had done a good job. He would be considering whether there was any possibility of adjusting the forecast down, but he did not think there was much scope for this. As for the correct size of the PSBR, he was subject to conflicting advice. On the one hand, there were those who were pressing him to go back on his pre-election commitment; on the other hand, it was clear that even with a PSBR of just under £8½ billion, there was a real risk that interest rates would stay high. On the whole, he felt it essential to aim for a PSBR below £8½ billion. The Prime Minister agreed.

Summing up, the Prime Minister said that she reluctantly agreed to the Chancellor's main proposals. This would mean increasing VAT to 15 per cent and increasing petrol duty by 15 per cent, and excluding any increases on tobacco and drink. At the same time, it would be worth forgoing any increase in prescription charges and any increase in the school meal charge over and above that announced by the previous administration. The Department of Education and the Department of Health and Social Security would have to find offsetting savings to meet the Chief Secretary's public expenditure requirements. The Chancellor should consider the possibility of any further measures which would bring in revenue without affecting the RPI - including replacing VAT on petrol with a higher petrol duty still. These could be used to provide further improvements in the income tax package.

Yours ever,

Tim Lankester

A. M. W. Battishill, Esq.,
H.M. Treasury.

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CONFIDENTIAL 28/5

The Chancellor of the Exchequer
The Chief Secretary
The Financial Secretary
The Minister of State (C)
Sir D Wass
Sir L Airey
Sir A Rawlinson
Sir F Atkinson
Mr Byatt
Mr Littler
Mr F Jones
Mr Unwin
Mr Corlett
Mr Griffiths
Mr Hood
Mr Mortimer
Mr J Taylor

Mr D Lovelock - Customs & Excise
Sir W Pile - I/Revenue

MINISTER OF STATE (LORDS)

ESTIMATING TAX CHANGES

When we spoke this morning you asked for a quick note about the revenue effects of VAT and specific duty changes compared with reductions in the income tax. For illustrative purposes you suggested a number of tax packages, and these have been used as a basis for this note. In the time available it was not possible to discuss these with Customs or Inland Revenue, but the estimates are largely culled from the post-election briefing. They do not imply any preference on the part of officials for the composition of one package compared with the other, and in some instances the individual tax changes would involve problems which would call for detailed consideration before they could be regarded as serious possibilities.

2. The starting point of our discussion was the Brief (B10), on the Tax Ready Reckoner. You queried our estimates of the low revenue effects stemming from a VAT change, and suggested that if the income tax reductions were taken into account the revenue implications would look significantly better. There are a number of problems that arise here, some of them conceptual, but some of them a reflection of the short comings of using a ready reckoner approach. The main points seem to be:

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- The full year revenue effect of tax changes show broadly the effect on demand for the goods in question covered by the tax changes or on the revenue of the income tax changes, assuming income remains the same. This is a somewhat artificia concept since it takes no account of the indirect consequences of the tax changes. These effects are widespread through the economy, influencing both the level of incomes and of overall demand for all goods and services. Thus the yield from standard rate VAT at 8 per cent is estimated this year to be £5,025m. But this includes VAT payments by Central Government and deducting these, and allowing for other necessary adjustments, the yield is estimated to be £4,800m. If the standard rate was increased to 10 per cent it is estimated to add an additional £1,000m in a full year. (25 per cent of the estimate yield is £1,200m - the difference of £200m reflects largely the estimated shift in demand from goods taxed at the standard rate). But allowing for consumers response to rising prices, possible effects on wage costs and so on, the overall demand effects could be larger. This accounts for the smaller revenue gain associated with the PSBR change.

- As you rightly argue if income tax reductions are made simultaneously then the effect on demand would be offset to some extent. With the ready reckoner the indirect tax change can be added to the effect of the income tax reduction. But this is a first approximation, and the net PSBR effect may look very different from that suggested by the ready reckoner.

- You also expressed concern about how the changes would look in the Financial Statement and Budget Report (FSBR). The conceptual basis for the FSBR figures will reflect broadly what you have in mind. The <u>post</u> Budget revenue figures are based on the level of activity predicted for the economy in 1979/80. In contrast to the ready reckoner these estimates show our best view of the yield from indirect tax changes and will pick up any rise in demand stemming from income tax reductions, as well as other relevant changes in the Budget. This does not dispose of the problem that the FSBR figure for indirect tax changes in 1979/80 may look exceptionally low. Much depends on the size of the income tax reductions.

3. For the moment you agreed to examine the possibilities solely in terms of full year revenue, which is the recommendation we make in the brief on the Tax Ready Reckoner. As I said at our discussion it is reasonable to add the results together to get some broad approximation of where a package may be heading. But a computer run is needed as ideas about the shape of the Budget harden.

THE PACKAGES

4. On VAT you suggested three possibilities: unification at 10 per cent, 12½ per cent and 15 per cent. On the specific duties we might assume revalorisation based on the price change April 1978 to April 1979. For this purpose we have assumed slightly more - a figure of 10 per cent. The attached table shows the revenue effects of the indirect tax increases. It should be borne in mind that revenue and prices will be marginally higher because of the compounding effect of the increased VAT rate on the higher rates of specific duties.

5. There are a number of problems about some of these options - a 15 per cent standard rate VAT for example would be a very massive increase in one jump and there could be some serious industrial implications, especially for the car industry. But these and other

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matters rising on the possibilities will be taken further in the discussions to come.

6. On the income tax the attached table shows the sort of income tax packages which might be afforded on these varying assumptions about indirect tax increases. In each case alternative (a) is based on £500m extra, and alternative (b) on £1,000m extra which is added to the estimated full year yield from the indirect tax changes - as you suggested.

7. The changes shown in the table are the changes compared with the 1978/79 rates and levels, and subsume the alterations contained in the caretaker Finance Act, also following your instructions.

8. The figures represent broad measures of magnitude. Specific packages of course will need to be costed on a much more precise basis. And, as this note emphasises, since the packages are conceived in full year revenue terms the PSBR effect is likely to be significantly different - especially in 1979/80 - for reasons explained and illustrated in Brief B10.

AHL

A H LOVELL
FPG
8 May 1979

INDIRECT TAX CHANGES

Specific Duties: 10% increase (2)	1979/80 FULL YEAR REVENUE	1979/80 (1) REVENUE RECEIPTS	RPI IMPACT PER CENT
Road fuels	200	150	0.1
VED (3)	115	85	0.1
Alcoholic drink	125	90	0.2
Tobacco products (4)	125	85	0.3
	565	410	0.7
VAT			
Unification at 10% (5)	875	435	0.8
Unification at 12½%	2250	1125	2.1
Unification at 15%	3350	1775	3.5
Totals (6)			
VAT 10 per cent package	1440	845	1.5
VAT 12½ per cent package	2815	1535	2.8
VAT 15 per cent package	3915	2185	4.2

(1) Assumes June start
(2) Excludes rebated oil
(3) VED increase could be added to petrol duty to produce this additional revenue

(4) 10 per cent increase specific duty only
(5) No offset for petrol loss
(6) These estimates do not allow for the additional revenue stemming from the increased VAT on the higher level of the specific duties.

INCOME TAX CHANGES

	VAT 10 per cent case		VAT 12½ per cent case		VAT 15 per cent case	
	%	increase	%	increase	%	increase
	(a)	(b)	(a)	(b)	(a)	(b)
Basic Personal Allowance	15	20	20	20	25	27
Higher Rate Thresholds	10	10	20	20	25	27
Increase in IIS threshold (£)	-	500	500	500	1000	1000
Basic Rate (P)	-	-	-1	-2	-2	-2
Top Rates of Tax	-	-	-	-	Abolish 83% rate	Top rate to 60 per cent.

CH/EX. REF. NO. B(79)1
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NOTE OF A MEETING HELD IN THE CHANCELLOR OF THE EXCHEQUER'S ROOM AT THE TREASURY AT 11.00 A.M. ON WEDNESDAY, 9TH MAY, 1979

Present:

Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Minister of State (Commons)
Minister of State (Lords)
Sir Douglas Wass
Sir Anthony Rawlinson
Sir Lawrence Airey
Mr. Couzens
Sir Fred Atkinson
Mr. Lovell
Mr. Unwin
Sir William Pile)
Mr. J.M. Green) Inland Revenue
Mr. Lovelock)
Mr. Phelps) Customs and Excise
Mr. Adam Ridley

PREPARATIONS FOR THE BUDGET

The Chancellor outlined his general approach to the preparation of his first Budget, distinguishing between proposals which he wished to see implemented immediately and those which should await a later Finance Bill. The following records the main conclusions and points made in discussion. The Chancellor began by making four points:

(a) Monetary Targets. He aimed to reduce the current monetary target from 8-12 per cent to 7-11 per cent.

(b) PSBR. The lower monetary target should be supported by a PSBR reduced to no more than £8 billion for 1979/80.

(c) Exchange Control. The Chancellor wished to make some early relaxation in exchange control.

(d) Presentation. The Budget should be presented in the context of a longer term programme of stabilisation, though the Chancellor thought it inadvisable to be committed publicly to medium term targets for the money supply and PSBR.

Public Expenditure

2. The Chancellor said the aim should be to achieve maximum savings in public expenditure in the current financial year. Ministers would need to be assured that all actual or contingent public expenditure claims had been identified and allowed for in forecasting the PSBR. The Chancellor

invited the Treasury to confirm that the existing forecasts took account of all outstanding public expenditure claims.

3. The Chancellor then went on to identify the following aspects of the Government's policy on public expenditure:

(a) there should be a greater emphasise than so far identified by officials on savings in revenue rather than capital expenditure;

(b) there was a predisposition to leave spending Ministers free to decide how to achieve savings within their own programmes;

(c) public sector disposals would have an important part to play. The Government's policy should be presented not as doctrinaire denationalisation nor as the disposal of surplus assets but as a genuine means of reducing the PSBR. There should be four elements:

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(i) Public sector land:

(ii) Sales of council houses;

(iii) Readily disposal assets (e.g. shareholdings in BP; the NEB etc.); and

(iv) Some private participation in public corporations. This would require legislation and would not be for the Budget.

The Chancellor invited

Sir Anthony Rawlinson to prepare, in consultation with other departments as necessary, advice on (i) and (ii) above; and

Sir Lawrence Airey to prepare advice, after similar consultation, on (iii) and (iv) above.

4. Charges. The Chancellor said that, whilst it remained a legitimate objective to raise public service charges to more realistic levels, this might have to take second place to the immediate need to embark upon a substanital switch from direct to indirect taxation this year. Ministers would probably wish to endorse the announced 5p increase in school meal charges; other increases would need to be carefully examined for their effects upon the RPI.

Taxation

5. Within the limits of politically acceptable price increases, the Chancellor said he would wish to make the maximum possible switch from indirect to direct taxation in his first Budget. The late Budget also imposed particular constraints this year. Since any increases in indirect taxes could not be made effective until after Budget Day he asked whether there existed any means by which reductions in income tax could operate from a current date rather than back-dated to 6th April. Sir William Pile said that, with an annual tax, splitting the year in this way

was not a feasible proposition. The Chancellor

invited Sir William Pile to re-examine the feasibility of making income tax changes effective from a current date.

6. The Chancellor then went on to identify the following proposals.

7. Income Tax

(i) He wished to eliminate the reduced rate band this year, if this could be linked with attainment of a 25 per cent basic rate over 2 years.

(ii) He wished, if possible, to reduce the top rate on earned income to 60 per cent this year. This should have priority over widening other higher rate bands. The latter could be left until 1980, when he might wish also to introduce formal indexation of the higher rate structure.

(iii) Personal allowances. Thresholds should be raised by more than the amounts included in the caretaker Finance Act. Within the available revenue, the amount of the increase would be determined by the need to "buy out" the loss of the reduced rate band, keep clear head room above the national insurance retirement pension and offset the effects on prices of the proposed switch to indirect taxation.

(iv) Basic rate. Subject again to available revenue the Chancellor said he would like to cut the basic rate by up to 3p this year.

(v) Age Allowance. The Chancellor wished to consider abolishing the ceiling (and marginal provisions) for the age allowance. The cost would be £80 or £90 million.

(vi) Investment Income Surcharge. The Chancellor was inclined to raise the surcharge threshold to £4,500 (or to £4,000 or £5,000 if administratively simpler), at the same time withdrawing the specially favourable provisions for the elderly. He also favoured a suggestion by the Financial Secretary that a doubling of the threshold justified removing the 10 per cent rate of surcharge on the first £500 of surchargeable investment income. This might point to raising the threshold to £5,000.

(vii) War Widows' Pensions. The Chancellor confirmed his wish to remove the residual tax liability on war widows' pensions at a cost of some £6 million. This should be included in the Budget.

(viii) Charities. The Chancellor said he would wish to consid the consequences for charities of reducing income tax and increasing indirect taxes. Sir William Pile said that the Inland Revenue had a note in preparation.

(ix) Interest Relief. The Chancellor said he did not wish to restore interest relief in toto. However, the Finance Bill should make provision for a temporary extension of the 6-year transitional period for interest relief in the Finance Act 1974.

8. Businesses. The Chancellor said he was disposed to consider two changes:

(i) raising the profits limits for the rate of corporation tax paid by small companies; and

(ii) assuming the legislation was not over-lengthy and complicated, provide for some arrangement for a rolling programme to write off past stock relief.

9. Other direct matters

(i) Petroleum Revenue Tax. The Chancellor said he was inclined not to disturb the changes already foreshadowed in rates of PRT. The Minister of State (Commons) would consider whether any further changes in PRT should be introduced this year.

(ii) Discretionary Trusts. The transitional arrangements for capital distributions needed to be extended for at least one year.

(iii) Stamp Duty on Houses and Land. The Chancellor regarded action on the £15,000 threshold as of greater priority than raising the £25,000 limit for mortgage interest relief. Stamp duty relief should be included in the Budget.

(iv) Development Land Tax. The Chancellor said he wished, if possible, to reduce the current rates of DLT; or at least extend beyond 31st March 1980 the current transitional rates. The Minister of State (Lords) would consider the case for other changes in DLT, including raising the £10,000 exemption level.

(v) Capital Transfer Tax. The Chancellor said he was looking to make an early easement in the burden of CTT - both in the starting points and in the tax scales. He had in mind larger changes than those canvassed in the Revenue brief (B13(c)). The Minister of State (Lords) would consider a possible package with the Inland Revenue.

(vi) Capital Gains Tax. The Chancellor said he wanted to remove the inflationary element from the taxation

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of capital gains either by tapering or indexing them. He personally preferred indexation. After a short discussion, Ministers agreed that it was best to leave changes in CGT until a later year.

(vii) Benefits in kind. After a brief discussion, the Chancellor indicated that he was willing to consider proposals from the Inland Revenue to deal with the loophole in the 1971 legislation on car leasing and the provision of petrol as a benefit in kind. In a longer time scale he was not unsympathetic to a more substantial review of the benefits in kind legislation.

National Insurance Surcharge

10. The Chancellor said he would not wish to make any changes in NIS this year. In a longer time scale re-consideration of the NIS might be necessary in the context of decisions to phase out employment subsidies. He agreed that officials should inform DHSS that there would be no change in the Budget.

Indirect Taxes

11. VAT. The Chancellor said that the Government's taxation strategy depended on getting a substantial extra yield from VAT. He was inclined to increase the standard and higher rates to a new 15 per cent uniform rate if the price effects could be tolerated. In discussion, it was suggested that the Chancellor might wish to considered both the compounding effects on particular prices of increases in VAT and specific duties, and also possibly the industrial effects on the motor car industry (including implications for changes in the car tax). The Chancellor agreed that the Treasury should consult the Department of Industry in confidence at official level.

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Specific Duties

12. Although specific duties had not generally been increased for two years, the Chancellor thought it would be sufficient this year to restore them to April 1978 levels. He saw no reason to exclude alcohol or tobacco duties; noted EEC considerations affecting the duty on wine; he would wish to take a considered view in the light of advice from Customs and Excise. The Chancel

invited Mr. Lovelock to prepare advice on a package of increases in specific duties for his consideration.

Motoring Taxes

13. The Chancellor did not wish to proceed with the switch from VED to petrol duty: it seemed to promise only modest staff savings for the loss of an important source of revenue. He noted, however, that too little time remained before the Budget for necessary consultation with the Civil Service department and the Ministry of Transport. VED should be left unchanged this year. He would consider options for increasing the duties on petrol and derv on advice from the Customs and Excise. The Chancellor

invited Mr. Lovelock to prepare a note.

Other Taxation Matters

14. Taxation of the Family. The Chancellor said Ministers would wish to proceed with early publication of a Green Paper on this subject. This would be reaffirmed in his Budget statement.

Miscellaneous Matters

15. Among other issues for later consideration, the Chancellor mentioned the tax treatment of the National Heritage, Forestry, Charities; VAT simplification; profit-sharing and wider

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share ownership; and the Wilson Committee recommendations on small businesses.

Royal Commission on Gambling (The Rothschild Commission)

16. This was also an important area for later consideration, particularly the scope for raising more revenue from casinos. The Chancellor agreed that it was not a matter for action in his first Budget.

Social Security Benefits

17. The Chancellor identified the following matters for early consideration.

(a) Pensioners. Steps would need to be taken to help pensioners meet the higher cost of living resulting from the switch to greater indirect taxation. The choice was between an improved pension uprating in November; an enlarged Christmas bonus; or some combination of the two. Social Security Ministers would have views.

(b) Families. There might also be a similar case for a further increase in child benefit, though arguably less strong than for pensioners because most childrens' goods were zero-rated for VAT.

(c) Taxation of short-term benefits. The Minister of State (Lords) had been considering possible approaches in advance of computerisation. Differential uprating of long and short term social security benefits might also have a part to play in redressing the imbalance between income in and out of employment.

Finance Bill

18. In a brief discussion, Ministers generally agreed that the Finance Bill would probably have to be taken wholly on the floor of the House this year. The length of the Bill would need to be contained. Some minor matters were essential including, for example, matters consequential on the ending of child tax allowances; and on the UK/US double taxation treaty. The Government's supporters would press for action on other matters e.g. retirement annuities. It would be helpful if the two revenue departments would prepare early submissions on the possible minor starters in their respective fields. These would be considered by the Financial Secretary in conjunction with the two Ministers of State.

Prices Index

19. The Chancellor said that, in Opposition, the Government had given thought to ways of developing an index parallel to the RPI which could take account of the effect of changes in income tax on family income. Mr. Adam Ridley had taken the lead in this. It would be useful if officials would consider, with the help of the CSO, how best to make progress in this area. The Chancellor

invited Sir Douglas Wass to set work in hand.

Conclusions

20. Sir Douglas Wass suggested that officials should prepare an illustrative package of indirect tax changes, with their estimated price effects, for the Chancellor's consideration. The Chancellor agreed.

(A.M.W. BATTISHILL)
9th May, 1979

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Mr. Littler

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Copy for Mr Griffiths
CONFIDENTIAL Mr Coveney. ←

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CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir D Wass
Sir F Atkinson
Sir L Airey
Mr Couzens
Sir A Rawlinson
Mr Littler
Mr Lovell COPY FOR
Mr Shepherd
Mr Odling-Smee

Chairman, Inland Revenue
Chairman, Customs & Exci

PREPARATIONS FOR THE BUDGET

Following the meeting with you yesterday we thought you would find it helpful, as a very approximate first "sighting shot", to have a quick costing of the proposals for the Budget that you outlined to us.

2. The results are brought together in the Table attached. This shows the effects of the various changes compared with the forecast which has been presented to you (which itself, of course, is currently being revised). The tax and public expenditure changes that we have assumed are summarised in Annexes A and B respectively. We have necessarily had to use some discretion at this stage in interpreting the details of your proposals.

3. I have to stress that this is a very quick and broad exercise, and that the figures should not be pressed too far. To get a picture quickly we have had to use the ready reckoners and there has not been time to do a full simulation. The individual components of the package are not additive, and a full analysis will require a run on the computer.

4. However, with these necessary caveats, the main points to emerge are as follows:-

(i) The package reduces the PSBR by some £900 million - ie from the forecast figure of £10 billion to just over £9 billion, or about £1 billion short of your target;

(ii) the package has a strong deflationary effect - real GDP is reduced by 2.2% percentage points in Q1 1980, giving negative growth between this year and next, and there is a substantial reduction in employment;

(iii) the effect on the RPI (mainly indirect taxes) is over 4.5%.

5. The table does not show the effect on interest rates but in the first year this would be likely to be small. Nor would the assumption of a fixed exchange rate make much difference in the first year.

JBU

J B UNWIN

10 May 1979

Economic Effects Of The Package

All estimates assume a floating exchange rate

Changes in:		Public Expenditure	Indirect Tax	Income Tax	Other Inland Revenue	Total
Full year cost (£m)			-4,280	3,175	390	
First year cost (£m)		-1,565	-2,305	2,410	160	-1,300
PSBR (£m):	79/80	-1,420	-1,800	2,160	160	-900
	80/81	-1,450	-2,800	2,990	360	-900
Real GDP (%):	80 Q1	-0.5	-2.4	0.7	-	-2.2
	81 Q1	-0.5	-3.2	1.0	-	-2.7
RPI (%): Impact		0.2	4.4	-	-	4.6
	80 Q1	0.1	4.4	0.2	-	4.7
	81 Q1	-	6.0	-0.1	-	5.9
Employment (thous):	80 Q1	-50	-190	70	-	-170
	81 Q1	-90	-430	140	-	-380
	82 Q1	-100	-550	170	-	-480

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ANNEX A

TAX PACKAGE

For the purpose of this first "sighting shot" the specific duties have been increased by 10 per cent throughout, apart from the rebated oil duty where 0.5p was added to the existing level of 25p a gallon - equivalent to an increase of 20 per cent and representing revalorisation over 2 years.

2. Each of the indirect taxes will be reviewed separately, and attention drawn to any special considerations where these are relevant:

- the effect of the combination of VAT and specific duty changes on prices may bear particularly heavily on some industries, the whisky industry for example.

- Raising standard rate VAT to 15 per cent might also cause difficulties for some industries. A separate study on the implications of an increase of this order for the car industry is under way in consultation with Department of Industry and Customs and will be ready early next week.

- A provision for a 10 per cent rise in VED on cars is included, but this revenue sum can be raised by an additional increase of about 5 per cent to the petrol duty over and above the 10 per cent assumption. (The Minister of Transport will be recommending an increase in VED on heavy commercial vehicles which would yield somewhere between £25-40m.)

3. The post election briefing on these taxes discusses the taxes in detail. The points made in the briefs will be further amplified

in a series of submissions now being prepared. Work is in hand on the distributional effects of the indirect and income tax changes on different family types at varying levels of income.

4. The large difference between the full-year and part-year revenue effect for VAT reflects in part the late Budget, but is also because of the 2½ month lag by traders before VAT receipts are paid to the Exchequer. This is reflected in the relatively low PSBR effect. With VAT at 15 per cent the payments lag is estimated to be £750m. It represents an immediate cash flow advantage to the company sector and unless VAT is reduced becomes a permanent rise in their liquidity.

FPG

10 May 1979

ANNEX A

~~BUDGET SECRET~~ C

INDIRECT TAX PACKAGE

	1979/80 Full Year Revenue £m	1979/80 Receipts £m	RPI per cent
VAT			
15 per cent unification	3580	1790	3.5
Specific Duties: 10 per cent increase			
Road fuels	205	155	0.1
VED:			
Cars	90	65	0.1
Commercial vehicles	25	20	-
Alcoholic drink	135	100	0.2
Tobacco	200	135	0.5
Rebated Oil (0.5p increase) = 20 per cent	50	40	-
Total Specific Duties	705	515	0.9
Grand Total	4285	2305	4.4

ANNEX A

BUDGET C

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INCOME TAX PACKAGE 9 MAY 1979

	1978/79	Current Value 1979 F.A.I.	Proposed Value	Change	Costs £m Full Year	Costs £m First Year
Single allowance (and wife's earned income allowance)	985	1075	1205	+130	530	440
Married allowance	1535	1675	1875	+200	755 770	630
Additional personal allowance		600	670	+70	10	5
Age allowance (single)	1300	1420	1590	+170	50 45	40
Age allowance (married)	2075	2265	2535	+270	65 55	55
Age allowance income limit		4400	Abolish 5000		150 30	120
Lower rate		25%	30%	(Abolish)	-900 865	-755
Basic rate		33%	30%	-3%	1,410 1375	1,400
Higher rates	35% 40%	-	10,000			
	40%	8,000	-			
	45%	9,000	12,000			
	50%	10,000	15,000			
	55%	11,000	20,000		900 850	450
	60%	12,500	25,000			
	65%	14,000				
	70%	16,000	Abolish			
	75%	18,500				
	83%	24,000				
Investment income surcharge - ordinary rate - exemption limit		1,700	—			
15% threshold		2,250	5,000		115	
65s and over - exemption limit		2,500	—		205 90	25
15% threshold		3,000	5,000			
TOTAL					3,175 3005	2,410

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	79/80	full year
COMPANY TAXATION		
small profits limits - increase to revalorise	4	7
stock relief: — write off first 2 years, with 6 year rolling period thereafter	—	50 *
— temporary dips (excess over 20%)	35	— †
— 10% profit restriction for unincorporated businesses		30 ‡
CTT : £50,000 threshold and rate changes	60	200
discretionary trusts - extend transitional period	—	10 §
DLT : 60% flat rate w.e.f. 12 June	1	5
STAMP DUTY: £25,000 threshold and corresponding increases of £10,000 in other scale points	60	85
INTEREST : extension of transitional provisions for pre-'74 loans	small	
PRT	130 yield	

1979/80 costs assume, where relevant, changes w.e.f. Budget day.

* £m40 in 1980/81; full year cost later

† a once for all cost of £m45 - 35 in 79/80
10 in 80/81

‡ £10m in 1980/81

§ 1980/81 cost

ANNEX B

Reductions in Public Expenditure

	Ex ante saving in 1979/80 (£ million)
Disposal of assets (mainly BP shares)	750
Reduction in the contingency reserve (social security payments)	300
Other reductions:	(£m at 1979 Survey prices)
Capital expenditure (mostly housing investment, some motorway investment)	320
Special employment measures	100
NEB and Community Land Scheme purchases	70
British Rail fares	50
LA rents and prescription charges	60
Total	600

Notes

1. The other reductions are slightly different from those shown in the Annex to the draft Cabinet paper, because they are intended only to provide a fairly realistic breakdown of an illustrative cut of £600m at 1979 Survey prices; they are not precise estimates of specific proposals for reductions.

2. Some of the reductions in programmes will lead to a reduction in underspending rather than a reduction in actual expenditure. In arriving at the first year cost estimates in the table some allowance has been made for this in the case of capital expenditure and special employment measures.

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462/79

Board Room
H M Customs and Excise
King's Beam House
Mark Lane London EC3R 7HE

PA

cc Chief Secretary
Financial Secretary
Minister of State - Lords
Minister of State - Commons
Sir D Wass
Sir L Airey
Mr Littler
Mr Lovell
Mr Unwin
Mr Griffiths
PS/Inland Revenue

CHANCELLOR OF THE EXCHEQUER

CUSTOMS AND EXCISE TAXES

1. At your meeting yesterday, you gave us an indication of your probable intentions in relation to our taxes and it was agreed that we should provide you with notes on the effects and implications of raising the specific duties by 10%. These should be available tomorrow. We thought that you would probably not want a further substantive note on VAT but there are two Departmental points we ought to put to you before you make the choice between 12½% and 15%. Neither is in any way decisive in that choice.

2. As I said at the meeting, we very much welcome the idea of unification. There is no doubt that the trading community (especially smaller traders) regard a return to a single positive rate as quite the most desirable measure of VAT simplification; and (other things being equal) our control effort should benefit from a reduction in the number of rates.

3. If you decide on 15%, however, the very large gap which would then exist between our zero- and our standard-rates is bound to give a strong impetus to pressures for additional reliefs. No other EEC Member State has a gap of 15% between its reduced and its standard rate (though admittedly there is a 14% gap in the Netherlands and Denmark has a 20.25% rate across the whole field of non-exempt goods and services). The pressures would probably arise even with a unified 12½% rate; they would be virtually inevitable with a 15% rate. They might well be greatest (a) in areas where the borderline between zero- and standard-rating is difficult to defend (eg "convenience" foods such as confectionery and soft drinks, and building repairs and maintenance), (b) on behalf of "near-essential" items such as household goods and clothing and (c) for "worthy" causes such as the arts and tourism. If zero-rating were refused (on grounds of cost and EEC obligations), the demand might be diverted into a campaign for a reduced rate - which, if conceded, would not only nullify the basic objective of simplification but in our view would produce a more complicated tax than we have with our existing higher rate.

4. Secondly, unification at 10% would have enabled us to make modest staff savings without reducing our present control effort. The savings would have been smaller with a rate of 12½%. Unification at 15% would make our control effort more rather than less difficult. This is simply because the extra revenue involved and (again) the gap between the zero- and the standard-rate would give a greater incentive to all forms of evasion and delay.

5. The purpose of this note is not to try to dissuade you from going for unification at 15% if you consider that this is an essential part of your Budget strategy, and certainly not to encourage you to contemplate concessions by way of extra zero-ratings (contrary to EEC obligations) or the

introduction of a reduced positive rate. But I thought it would be right to bring these points to your attention before you reached a decision because they do seem particularly relevant to a 15% rate.

6. Early next week we will give you a note on dates of implementation of changes in our taxes. Forestalling is a factor but it differs in significance from case to case.

DM

10 May 1979 D A LOVELOCK

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Board Room
H M Customs and Excise
King's Beam House
Mark Lane London EC3R 7HE

JM

1. JT

2. CWC

cc Chief Secretary
Financial Secretary
Minister of State (Commons)
Minister of State (Lords)
Sir D Wass
Sir L Airey
Mr Littler
Mr Lovell
Mr Unwin
Mr ~~Corlett~~
Mr Griffiths
Mr Todd
Mr Ridley
PS/Inland Revenue

CHANCELLOR OF THE EXCHEQUER

OIL DUTIES AND A POSSIBLE VAT "BLOCKING" PROVISION

This is the note I promised at this morning's Budget meeting about oil duties and the possibility of a blocking provision for business use. You indicated at the meeting that you did not propose to consider such a change in respect of derv (and rebated oil) because of its importance for industrial costs. Part A deals with blocking; Part B deals with duty.

A. Present position

2. Petrol is currently charged with VAT at 12½% which represents 10p in this week's 90p price of a typical gallon of petrol. Under your Budget proposals the rate will become 15% (12p exclusive of factor price and duty changes) from 18 June. Excise duty is currently charged at 30p. A person registered for VAT purposes may deduct or reclaim any VAT (but not excise duty) paid on purchases of petrol for the purpose of his taxable business.

3. A registered VAT trader who uses a car for both business and private purposes may treat as deductible input tax only the VAT paid on his "business" petrol. He may calculate the proportion of business use or, if this is not practicable, make a fair and reasonable estimate. In practice, the deductions for petrol are difficult to control, and there can be no doubt that a significant amount of petrol for private motoring manages to get an illegal benefit.

Practicalities of a change

4. There is no practical reason why a provision denying businesses the right to take input tax credits for petrol could not be introduced as a Budget measure. Similar provisions exist for cars. Finance Bill legislation would not be required. Section 3(9) of the Finance Act 1972 as amended provides for the non-deductibility provisions to be made by Order (Affirmative Resolution), and the widely-cast provisions of the Section would certainly encompass an Order for petrol. There is a ready-made definition of petrol in Group 8 of the present Higher Rate Schedule, and this could be used for the purposes of a new Order. It would have to be all petrol used by all business users: there could be no halfway house. The control effort required to police a blocking provision would represent no significant additional effort to that which we already envisage for VAT at 15%. We envisage that an Order would come into effect on Monday 18 June, together with the new 15% rate of VAT.

EEC implications

5. The EEC position is governed by the Sixth VAT Directive which provides in effect that, prior to the agreement on common EEC rules, Member States may retain those exclusions already in existence when the Directive came into force. However, subject to consultation, Member States are entitled to add to existing provisions "for cyclical economic reasons". If you wished to introduce a blocking provision for petrol, we feel that we ought

to be able to justify it on these grounds; and while there might be complaints from the Commission about lack of advance consultation, these could no doubt be answered by reference to the urgency and the need to prevent forestalling.

Price revenue and RPI effects

6. The price effect of a blocking Order would, of course, be to bring the price to the business consumer up to the same level (currently 90p on a typical gallon) as that paid by the private motorist. The revenue effects (based on an assumed price of £1.05p a gallon in the second half of the year) would be:-

1979-80 full year revenue	+ £250m
1979-80 revenue receipts	+ £125m

There would be no impact effect on the RPI, but there would be a secondary effect as the increased cost of petrol to business users fed through into prices. We estimate that the effect on the RPI might be 0.2% over time.

The case for a blocking provision

7. As we understand it, the case for a blocking provision rests primarily on revenue and on energy conservation considerations There could be a case too on transport policy grounds - discouraging the excessive use of business cars, especially in urban conditions. The price elasticities of demand for petrol were explained in the joint Customs and Excise and official Treasury note of 23 May on petrol duty and demand. There is scope for argument whether the elasticities are the same for business as for all motoring, but for want of anything better in the circumstances we have used the standard short- and long-run elasticities, (- 0.2 and - 0.4 respectively). These would imply annual savings in petrol consumption as follows:

	Volume saving (million gallons)	Per cent reduction (all petrol consumption)
Short-run	60	1%
Long-run	120	2%

The long-run effects would come through after all adjustments to business car use have taken place. The rate of saving will then continue at this level, so that the accumulated saving over several years could be considerable.

Disadvantages

8. Business costs. The revenue gain from the proposal would reflect an addition to business costs. This addition would not be limited to expenditure on motor cars, but would extend to other business expenditure on petrol, for example, delivery vans, taxis etc (which amount to about one-third of all "business use" of petrol). The implications would no doubt be unwelcome to the distributive trade, while the taxi trade (mainly provincial - the traditional London cab is usually driven by derv) could be a particularly sensitive area because of the time it normally takes for their increased costs to be reflected in provisions for increased charges.

9. Apart from specialised trades such as taxis, the effect of the non-deductibility provision would be selective and would no doubt give rise to complaints from those sectors most hardly affected. In the time available we have not been able to undertake a detailed examination of where these difficulties would arise.

10. Effects on the car market. A major effect of a non-deductibility provision for petrol would be to alter the balance of taxation between petrol- and diesel-driven vehicles. This would be of particular importance for business cars.

As you know, the outlook for the UK car manufacturing sector is poor, and any measure which weakened profitability could prove very damaging. The company car market has remained much more loyal to UK-manufactured cars than has the private car market, but this loyalty could be subjected to considerable strain if a substantial operational advantage was provided for diesel cars through VAT. At present, virtually no diesel cars are manufactured in the UK, but output has been increasing elsewhere, especially in France and Germany. There could be a high degree of risk that with only a fairly short lead time a VAT advantage could result in substantial additional imports of diesel cars aimed at the company market.

CONCLUSIONS

11. Our conclusions are as follows:-

(a) There are no legal or practical difficulties in the way of introducing a provision removing the existing VAT deductibility of petrol for business use.

(b) Such a measure would have advantages in terms of the additional revenue, energy conservation and, possibly, transport policy.

(c) On the other hand, the effects on business costs are likely to be considerable and uneven. In addition, the incentive given to switching to diesel-driven vehicles could damage the UK motor industry and encourage imports. This course would hit industry more, and be more unpopular with them, than any of the contemplated duty increases.

(d) The proposal would be to some extent a leap into the dark. We feel that it would require more careful consideration than we have so far been able to give it. We therefore recommend no action this year, but if you were to feel that the possibility warranted further consideration, we suggest that this could most usefully be carried out in the context of taxation and transport policy as a whole prior to the 1980 Budget.

Part B (over)

OIL DUTIES

12 Following the decisions at this morning's meeting, we are now going ahead with printing three versions (Packages E,F and G) of a combined notice covering the excise duties on petrol, derv and rebated oil. Now that we shall not be printing notices on drinks or tobacco, we can, if need be, process all three versions. We should need to know your decision between them by close of Thursday, 31 May. I attach a re-worked version of the table showing the figures for each package on the assumption of a 15% rate of VAT. You will wish to bear in mind that all our figuring is still on the basis of petrol costing 90p a gallon, so it will need to be re-worked for the Budget presentation.

Package E (4½p on petrol, 4½p on derv and ¼p on rebated oil) would mean a 15% increase in the excise duty on petrol, an increase of about 10% in the pump price, and, if there were an order making VAT on petrol non-deductible, a 21.5% increase in the effective price of petrol for business and commercial use (cars and vans). There would be a 12.9% increase on derv duty, and a 10% increase on rebated oil duty. The full year revenue effect of the excise duty package would be £325 million. It would leave the differential between the petrol and derv duties unchanged.

Package F (7p on petrol, 4½p on derv, ¼p on rebated oil) would mean a 23.3% increase in the excise duty on petrol, an 11.2% increase in the pump price, and, if there were an order making VAT on petrol non-deductible, a 25.1% increase in the effective price to business and commercial users. It would mean a 12.8% increase in the excise duty on derv, and a 10% increase on rebated oil duty. The full year revenue effect of the package would be £455 million. It would cut the differential between the petrol and derv duties to 2½p a gallon. Compared with

Package E, the extra revenue would be £130 million in a full year (£105 million in 1979-80) at an RPI cost of 0.1%.

Package G (7p on petrol, 7p on derv, ½p on rebated oil) would have the same implications for petrol as Package F. It would mean a 20% increase in the duties on derv and rebated oil. The full year revenue effect of the package would be £515 million. It would, like package E, leave the differential between the petrol and derv duties unchanged. Compared with Package F the extra revenue would be £60 million in a full year (£45 million in 1979-80) with no extra RPI cost - because most of the additional burden would fall on industry.

13. You may feel, in the light of this note, which we have drawn up in consultation with Mr. Lovell, that Package F represents the best combination of revenue, energy conservation and industrial considerations. Non-deductibility of VAT might be left for later consideration.

D.A.LOVELOCK

ANNEX (VAT at 15%)

Package	E			F			G		
	Petrol	Derv	Rebated oil	Petrol	Derv	Rebated oil	Petrol	Derv	Rebated oil
Duty increase	$4\frac{1}{2}$	$4\frac{1}{2}$	$\frac{1}{4}$	7	$4\frac{1}{2}$	$\frac{1}{4}$	7	7	$\frac{1}{2}$
Pump price change (petrol only)	7.2	-	-	10.1	-	-	10.1	-	-
1979 - 80 full year revenue (£m)	235	65	25	365	65	25	365	100	50
1979-80 revenue receipt (£m)	180	50	20	275	50	20	275	75	40
RPI impact effect	0.2	Nil	negligible	0.3	Nil	negligible	0.3	Nil	negligible

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A

Board Room
H M Customs and Excise
King's Beam House
Mark Lane London EC3R 7HE

cc Chief Secretary
Financial Secretary
Minister of State - Lords
Minister of State - Commo.
Sir D Wass
Sir L Airey
Mr Littler
Mr Lovell
Mr Unwin
Mr Griffiths
Mr Ridley
Mr Cropper
PS/Inland Revenue

CHANCELLOR OF THE EXCHEQUER

DEADLINES FOR BUDGET DECISIONS ON CUSTOMS AND EXCISE TAXES

1. I minuted yesterday about the deadlines for Budget decisions on our taxes. This further note explains in more detail the consequences if you are unable to let us have a decision on the rate of VAT by the end of this week.

2. As I explained yesterday, the root of our difficulty is the need to print complex notices for the benefit of our officers and the trade under conditions of great secrecy. The printing capacity is limited to 12 notices and the distributional capability (which becomes relevant by Thursday 31 May) to 10 notices. As shown in the annex to yesterday's note, we have proposed a programme of eight notices, one dealing with each of the main taxes included in your provisional Budget package.

3. If, as I trust we may, we can regard the decision to increase each of the drinks duties by 10% as firm (paragraph 4 of my

earlier note) this accounts for three of our notices and provides us with some scope for re-examination of the rest of our printing programme. If you are unable to let us have the VAT decision by the end of the week (still from our point of view much the best option) or, which in practical terms comes to much the same thing, by early on Tuesday morning, we propose to expand and modify the programme as follows:-

(a) an extra notice on VAT at 12½%;

(b) either some reconstitution of the Budget proposals on tobacco which could stand if VAT were 15% or 12½% or an extra notice to provide a different package for tobacco under 12½% VAT than that already provided for 15% VAT. We are providing a separate note on these policy alternatives; and

(c) a rearrangement of the material on the three oil duties (petrol, derv, rebated oil) to combine them into a single notice. We avoided this in our earlier plan because separate notices for each duty allows greater flexibility between them. However, combining them will allow up to four packages, each to be taken in its entirety. Abortion up to the morning of Budget Day, as described in our earlier note, would then have to apply to the complete group. Some of these packages could possibly apply either for 15% or for 12½% VAT, but it is unlikely that we could keep all of them open beyond Thursday 31 May. Again we are providing a separate note on the policy possibilities.

4. If the narrowing of options were delayed beyond 31 May, our practical difficulties would attain serious proportions. By the morning of Friday 1 June the process of enveloping notices for distribution to some 500 points around the country will be fully under way, and 10 notices is all that can be coped with at that stage. If we had not received firm decisions we could well be forced to abandon the usual notice procedure for some duties, and to do the best we could using in-house printing and involving a larger number of staff in sorting and despatch. We have not relied on in-house printing before and unforeseen difficulties might arise. Certainly because of the greater numbers of staff involved there would be an increased risk to security; and the longer decisions were delayed, the greater the risk - which is always inherent in rush jobs - of mistakes. If the relevant notices failed to reach their intended destinations, this could result in an appearance of muddle and provoke criticism. Although we would, of course, attempt to find ways of reducing these risks to negligible proportions, the more the timetable is squeezed, the less we could guarantee to avoid these problems. We strongly recommend against this course.

5. To sum up.

1. Our strongly preferred option is for a decision on the VAT rate (not because of the VAT notices but because the VAT rate profoundly affects the figuring on the tobacco and oil packages) by, at latest, early Tuesday 29 May. This would enable us to retain an adequate number of excise options.

2. Failing this, we can provide a set of options for whittling down not later than close of 31 May, the selection to be in the light of your decision on the notes referred to in paragraph 3(b).

DAL

D A LOVELOCK

FINANCIAL SECRETARY TO THE TREASURY

COPY NO. 17 OF 24

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Minister of State (c)
Minister of State (1)
Sir D Wass
Sir F Atkinson
Sir L Airey
Mr Couzens
Sir A Rawlinson
Mr Littler
Mr F Jones
Mr Dickson
Mr Unwin
Mr Lovell
Mr Monck
Mr Griffiths
Mr Corlett
Miss O'Mara

Chairman Inland Revenue
Chairman Customs and Exci
Mr de Waal
Parliamentary Counsel

THE BUDGET AND FINANCE BILL

Last week's Budget starters meeting, during which I considered some of the possibilities for the Finance Bill with the two Ministers of State (you will be receiving a note of the meeting shortly) left a number of decisions unresolved pending submissions. A further Ministerial meeting will probably be necessary, but you may find it helpful to have my own conclusion now.

General

Before going into the specific proposals, I should like to make the general observation that I really do believe that, because of the shortage of time and lateness of the Budget and the fact that the Budg will implement the central manifesto pledge on the tax front, we will be readily excused any failure to implement this year lesser items whi have been pressed on us in the past and the case for which in general we have accepted. Indeed, politically speaking, there is a good case for deferral of such items since if we include them this year they will be eclipsed by the fundamental change of direction and will lose most of their impact.

Specific measures

1. Petroleum Revenue Tax

The Revenue submission of 10 May makes it clear that this is a highly complex subject, affecting not merely the rate of PRT itself, but a host of other matters including "uplift", the oil allowance, "coincidence", payments between fellow licencees, exemption of BNOC from PRT, valuation, metrication and unilateral relief. The Revenue list as one of their options (iii, in paragraph 23, page 11) dropping the entire package for the 1979 Finance Bill, and announcing that a further review of the fiscal regime was being being made in consultation with the companies. They add, however, that this will cost £130 million this year. However, this loss only arises if the 1979 Finance Bill were to make the changes retrospective to 1 January 1979. It seems to me inconceivable that we could agree to retrospection going back to an announcement made by a previous Government in a previous parliament - and an announcement, moreover, which, although we had not rejected it we had not specifically endorsed either. If this is agreed, then there is no loss of revenue whatever from excluding the PRT package from the 1979 Finance Bill.

My recommendation, therefore, is that the only thing we should do in this year's Finance Bill is to end the PRT exemption of BNOC. It will be necessary to do this in order to go ahead with the sale of BNOC assets on the right basis. Beyond that, I believe that we should announce in the Budget speech a further review of the fiscal regime in consultation with the oil companies - leading, not to inclusion of package in the 1980 Finance Bill, which would be too long a delay and might also result in some loss of revenue, but to separate legislation this autumn. You will recall that PRT was introduced not as a Finance Bill but in separate legislation - the Oil Taxation Act. What I am recommending is an Oil Taxation (amendment) Bill this autumn.

I think it might be helpful to have David Howell's reactions to this proposal as soon as possible.

2. Stamp duty on house purchase

You will recall that, during last week's Budget strategy meeting, I

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suggested that we should do nothing this year on stamp duty but promise action in the next Budget. This suggestion was provisionally rejected - largely, so far as I can recall, because the Revenue claimed that this would have a disastrous effect on the housing market as everyone would defer their house purchases for a year. I am agreeably surprised to find that the Revenue have now changed their mind: in their submission of 11 May (paragraph 7) they recommend a modest £5,000 rise in the threshold this year, with an undertaking "to raise the threshold again substantially next year". In the light of the Revenue's change of heart, I would repeat my recommendation that we do nothing this year coupled with an explicit undertaking to raise the threshold next year. There is no real point in having two bites at this cherry. Moreover, insofar as there is any small effect on the housing market, it would be in the direction of depressing, to some extent, the expected rise in house prices over the coming year, which might be no bad thing.

3. Taxation of Crown Servants working overseas

I strongly recommend that we do nothing this year. The political difficulties of introducing a measure whose main beneficiaries are not only Civil Servants but also Ministers are difficulties that we should be crazy to court at a time when there is going to be (presumably a Boyle-inspired increase in MP's and Minister's pay (and the Civil Servants are not doing too badly either). In any event, we surely want to review the 30 day rule - a fiscal absurdity made necessary by high marginal rates of taxation. If we were going to do anything this year - and I am not recommending this but it should be considered - it would be the abolition of the 30 day rule as a logical consequence of the reductions in the higher tax rate. However, I am well aware that it might be more sensible to conduct a thorough review of the taxation of overseas earnings before taking any decisions of this kind.

4. Car leasing

It does seem to me that this should be probed further. In paragraph 16 of the Revenue note of 10 May, it is stated that the problems of forestalling have precluded any direct consultation with the industry. Yet in paragraph 4 of the same note the Revenue state that the legislation proposed has been so widely expected that the forestalling has already, in effect, occured. Again, in paragraph 8, they say that the blocking of this loophold would be equivalent to a price rise of 5 per cent in the cost of a car, which they reckon (no doubt quite rightly) would not have a significant effect on demand. Yet the Customs and Excise were horrified at our suggestion of an increase in VAT on cars from 8 per cent to 15 per cent, on the grounds that this would have devastating effects on the motor industry. While I am sure that the Customs' fears are exaggerated, it does seem to me worth asking whether we would be wise to clobber the motor industry by these two measures in the same Finance Bill - and of the two it is clear which is essential and which is not. If, however, it is decided that the motor industry is strong enough to bear both burdens, then the Revenue's recommendations seem sensible, with the exception of the proposed (paragraph 18) increase of the £5,000 limit to £8,000. All such limits are highly arbitrary, and I would prefer to see them scraped altogether unless the cost of doing so would be significant. However, I feel in my bones reluctant to rush into this without more consultation.

5. Benefits in kind: provision of fuel for private motoring

I agree with Peter Rees: I would not touch this with a barge pole this year. Apart from the highly relevant point he has raised (his Private Secretary's note of 11 May), this anomaly arose as a result of the new legislation on the taxation of car benefits which we criticis at the time as likely to cause all sorts of nonsenses, and which we will certainly want to review in the context (heaven preserve us) of a review of benefits in kind legislation generally. The Revenue submission of 10 May points out that a consultative paper has already been prepared on an inter-departmental basis on the taxation of car benefits. We will want to see this before coming to a final view. The submission also suggests that the legislation should not come into effect until April 1980: if we start consultations immediately - announcing this in the 1979 Budget - and are able to reach a conclusic later in the year enabling us to annouce an intention to legislate in 1980, I do not see why the April 1980 implementation date need be frustrated by not having it in this years Finance Bill.

6. Stock Relief

I think we must do this. Of the Revenue's recommendations in paragra 32 of the 10 May submission, it seems to me that (a) is essential and (b) seems a sensible compromise between doing nothing on dips and going much further while (d) is a highly attractive (and well justifie sweetner for small businesses which are not getting much specifically out of this Budget. I see no need to bother about (c) this year.

7. Rebated oil duty

I don't know whether this is at all practicable; but, if it is, inste of an increase of 10 per cent in the rebated oil duty all round, I wo much rather see no increase at all in the duty on heavy fuel oil (whic adds directly to industrial costs) coupled with a 20 per cent inrease in the duty on gas oil. It would, incidentially, for what it is wort bring us much nearer to the EEC pattern.

8. Rate of VAT

I do not believe that, in political terms, the borderline problems between zero and 15 per cent are appreciably greater than the borderlin problems between zero and 12½ per cent VAT. As for the comparison with other EEC member states, I detect a touch of sophistry in Mr Lovelock's note of 10 May. I cannot see anything in this paper to cause us to reject 15 per cent.

9. Tobacco products duty

Of the five recommendations in paragraph 9 of Mr Lovelock's note of

11 May, I agree with (a) and (e). I am happy with (b) as far as pipe tobacco is concerned, but I am more than a little apprehensive of the gratuitious amunition we will give to the Opposition - and to the cartoonists - by a sharp increase in cigarette taxes coupled wit no increase in cigar taxation. As to (c) this seems fine on the basis of the 15 per cent VAT scenario. Finally, as to (d) I am well aware of the industry's strong lobbying in favour of a decrease in the ad valoram duty on cigarettes in return for a compensating incre in the specific duty. However, the main reason they want this is be the ad valoram element of the tax intensifies price competition - ha a complaint we would wish to uphold. If, however, the resulting pric competition really would lead to a loss of revenue, then of course t charge will make sense; but this surely needs to be investigated furt since it is unusual, to say the least, to find an industry pressing a higher burden of taxation. As you will appreciate, behind my reservations lie my worries about the need to increase the specific duties each year unless and until we can index them. If we can inde them soon, then I am quite happy to see a high specific element; but if there are problems about indexation then surely we want to keep the specific element as small as possible.

10. Alcholic drinks duties

I agree with all three of Mr Lovelock's recommendations in paragraph However, recommendation (c) - no duty deferment - should, I would strongly suggest, be coupled with a very sympathetic statement that you are looking into this with great understanding with a view to possible legislation later. The industry's case is a strong one, and it would please the Scots, but this is clearly not the year to accep an unnecessary once-for-all bulge in the PSBR.

11. Petrol and derv duties

I agree with three of Mr Lovelock's recommendations contained in paragraph 9 but not with (b). Bearing in mind the line we took in Opposition, and the reasons why we took it, it would be political inept to impose an additional duty increase of 1.7p per gallon over and above the "standard" 10 per cent rate of increase to compensate for the failure to increase the £50 VED.

together with the unchanged level of car tax, should be explained away,- if these decisions need to be explained away at all - by a recognition that the motor industry (and the motor car buyer) are having to bear a particularly sharp increase in VAT from 8 per cent to 15 per cent (not to mention the additional impact of any change we may make on car leasing - see above). Customs' argument (paragraph 7) that without this extra 1.7p we would be widening the differential between petrol and derv from 5p to 5.5p per gallon cannot be taken seriously: the differential remains exactly the same in both proportionate and real terms.

NIGEL LAWSON
14 May 1979

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MINISTER OF STATE TREASURY

Ms. C.

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BUDGET ~~SECRET~~

CONFINDENTIAL.

CHANCELLOR OF THE EXCHEQUER

c.c. Chief Secretary
Financial Secretary
Minister of State (C)
Sir D. Wass
Sir L. Airey
Sir A. Rawlinson
Sir F. Atkinson
Mr. Byatt
Mr. Littler
Mr. F. Jones
Mr. Lovell — 32/1
Mr. Unwin
Mr. Corlett
Mr. Griffiths
Mr. Hood
Mr. Mortimer
Mr. J. Taylor

Mr. D. Lovelock - Customs and Excise
Sir W. Pile - Inland Revenue

VAT: ESTIMATES OF YIELD

1. The latest estimate for the full year yield of the increase in VAT is £3580m.

An arithmetical calculation based on the estimated total yield for the current year would give a figure exceeding £4700m. as the yield of the increase.

There is therefore a gap of more than £1100m.

2. Part of this - possibly £400m. - represents the additional tax which would be paid by Central Government. Strictly speaking this is an item of expenditure, not a deduction from revenue.

3. The bulk of the discrepancy - some £765m. - represents the loss of revenue consequent upon reduced demand due to the increase in the tax or switching to non-taxable items of expenditure.

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MINISTER OF STATE TREASURY

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This figure appears to have been calculated on the assumption that the increase in VAT is a net increase in taxation, which would reduce consumers' income pro tanto and therefore lead to a fall in expenditure and corresponding reduction in revenue.

4. In fact we propose an overall reduction in taxation so that consumers' incomes will be increased not reduced. It is possible however that the April increases in personal allowances, worth about £1 billion, have already been taken into account in calculating the total yield of VAT on the existing basis. If this has been done, then on the basis of the figures in Mr. Unwin's paper of 10th May, the new proposals to be announced in the coming Budget would represent an increase in taxation of £1100m. in a full year but a reduction of £100m. in the current year.

5. Even on this basis I have the utmost difficulty in believing that the net effect of the package would be to reduce consumers' expenditure or result in switching to non-taxable items to such an extent that £765m. of revenue is lost.

6. There is a clear parallel between this point and the other point which has been raised namely that it is claimed that the package would reduce total activity by 2.2% by Q1 1980 and by 2.7% by Q1 1981.

Arthur Cockfield

(LORD COCKFIELD)

15th May, 1979.

IMPLICATIONS OF AN INCREASE IN THE STANDARD RATE OF VAT FOR THE CAR INDUSTRY

The Chancellor at his meeting of 9 May authorised us to consult officials in the Department of Industry about the implications for the UK car manufacturing industry of unification of the VAT standard and higher rates at 12½ or 15 per cent. This note which has been prepared with the help of officials from Customs and Excise, the Department of Industry and the Industrial Policy Division of the Treasury, reflects the outcome of these consultations. It examines briefly the prospects for the car industry in the coming year, outlines the history of and Government commitments over the car tax, and considers the likely implications for the car industry of an increase in the VAT rate. It concludes that there is little case for any preferential tax treatment for cars.

INDUSTRY PROSPECTS FOR 1979

2. The number of new passenger car registrations in the UK in 1978 was 1.59 million with an estimated total value of £4-5 billion. Import penetration in 1978 was 49.3 per cent by number of registrations, and although value figures are not available, the percentage import penetration by value was probably of the same order of magnitude. Business purchases of cars are estimated to be around 60 per cent of total registrations with a higher percentage by total value. Exports accounted for 40 per cent of the 1.22 million cars produced in the UK last year.

3. The immediate prospects for the UK car industry are not very good. Demand for cars continues to be buoyant, over 5 per cent up on the same period last year, but import penetration has now reached 55 per cent so far this year. Sales of UK-produced cars have fallen by 12 per cent. Ford, the market leader, is now importing more than half of all its cars sold in the UK, and accounts for more than a quarter of all car imports. Although car production in March was higher than in any month of 1978

.../

except March, in the first quarter it was down 9 per cent over first quarter 1978.

4. The prospect is worst for BL. Its market share has already slipped 2 per cent from last year's level of 23.5 per cent, which is also the budget figure for 1979, and with no major improvement this year to their ageing volume-car range they are going to be hard put to keep their share above 20 per cent. Sales in the first four months have fallen 8 per cent against the same period last year, and all the evidence suggests that inspite of buoyant demand conditions sales are limited by lack of demand for these cars in contrast to the situation over the past year or so when supply was the major constraint. On balance loss of market share in 1979 poses a greater threat than a reduction of overall sales because of the need to avoid dealer defections before introduction of the Mini replacement in late-1980. On a forecast market in 1979 of 1.6 million cars, a BL market share held at its current level of 21.07 per cent implies a £39 million shortfall in its targeted profit before tax of £84 million.

CAR TAX

5. We assume that any action to compensate (whether wholly or partially) for the increase in car prices due to the increase in VAT would be effected by means of the car tax. Car tax was introduced in 1973 as part of the changeover from purchase tax to VAT (the VAT standard rate by itself not being sufficient to maintain the revenue from cars). The 10 per cent rate, which is charged on the wholesale value of new cars, has remained unchanged since its introduction. There are no regulator powers covering the car tax, and Mr Barber in 1972 made it clear that it was not the Government's intention to use the tax as an economic regulator. There was no compensating change in car tax when Mr Healey reduced the VAT standard rate from 10 per cent to 8 per cent in 1974. The tax is estimated to raise about £500 million in the full year 1979/80. The total tax burden (car tax

and VAT) on the tax-exclusive retail price of cars is 17 per cent. If car tax is left unchanged at 10 per cent this would rise to about 22 per cent if VAT were unified at 12½ per cent and to just under 25 per cent if VAT were raised to 15 per cent. A reduction in car tax sufficient to compensate for the price effects of a VAT increase to 12½ per cent would cost £250 million, and 15 per cent £430 million.

EFFECTS ON THE CAR MARKET OF INCREASING VAT

6. The demand for cars is influenced by a wide range of factors including quality and design and also changes in consumer taste. But the overall level of demand for cars is governed primarily by two economic factors: the price of cars relative to other goods and services and the level of real disposable income. An increase in the taxes levied on cars will increase the price of cars and this by itself can be expected to lead to some shift of demand towards other goods and services and possibly some increase in the level of savings. An increase in the general level of prices also reduces real disposable income and this in turn also affects demand. If the only change is an increase in the tax on cars, the effect on real incomes in aggregate will be small enough to be disregarded. If however there are substantial tax changes affecting incomes as well as prices the impact of the package as a whole is likely to outweigh any affects arising solely from changes in relative prices.

7. In considering the effect of changes in a tax such as VAT we therefore have to consider separately two possible effects: the <u>substitution effect</u> and the <u>income effect</u>. The substitution effect is the reduction in demand due to substitution away from say cars into all other goods purely as a result of the higher relative price of cars. The response of demand to a change in relative prices is measured by a price elasticity which is the ratio of the percentage change in demand to the percentage change in relative price. The income effect is the change in demand for cars due to the change in real disposable incomes resulting from the price increase. A measure of this response

is given by the income elasticity; that is the percentage change in demand for cars resulting from a given percentage change in real disposable incomes.

8. For the purposes of this assessment we have assumed that the change in VAT rates would form part of a demand-neutral fiscal package - that is, one which would have no contractionary or reflationary effects on the economy as a whole. This means that the income effects can be ignored. We have however considered in paragraph 11 the implications of relaxing this assumption. A further qualification that needs to be borne in mind is that cars are not a homogeneous product. Changes which affect the demand for cars may not have the same effect, for example, on the demand for Rolls Royces as on the demand for Minis. If car prices rise relatively to prices generally or if real incomes fall there could be a trading down from more expensive to cheaper models even if the number of cars purchased is unchanged.

9. The effect on the demand for cars following an increase in tax rates, as explained in paragraph 7 above, depends upon the price elasticity of demand. The price elasticity of demand for new cars has proved difficult to estimate in recent years. Demand for cars has been influenced by a wide range of factors including petrol price changes and the growth of demand by the business sector and for replacement. There is however a broad consensus that the price elasticity of demand for cars is small, probably -0.5 or less. The price effect of a VAT change (as indeed any other price change) needs to take account of the change in the price of the good in question relative to other prices - clearly if all prices rise by the same percentage the price effect would be entirely neutralised. If VAT is unified at 12½ or 15 per cent the price of cars relative to other goods varies according to the VAT treatment of the other goods, as shown in the following table:

	12½% unified VAT	15% unified VAT
Price of cars relative to:		
Standard-rated goods	0	0
Higher-rated goods	+4.2%	+4.2%
Zero-rated goods	+4.2%	+6.5%

10. On this basis there should be no substitution between cars and other standard-rated goods since their prices rise by the same percentage. Standard-rated goods other than cars themselves account for about 40 per cent of consumers' expenditure. Any substitution is likely to be mainly into higher-rated goods which are mostly consumer durables; but these account for only 6 per cent of consumers' expenditure so that the scope for substitution is limited. Zero-rated goods covering "essential" items such as food, fuel and housing cover about 30 per cent of consumers' expenditure, and again substitution out of cars into such goods is likely to be small. The remainder of consumers' expenditure (about 20 per cent) is "exempt" for VAT purposes, which means that VAT is paid on inputs but not reclaimable on final output. Such goods will also rise in price with a VAT increase, although the precise percentage increase is impossible to estimate. Taking all these factors into account, and given that our overall elasticity estimate is a maximum, the effect of the unification of VAT at 12½ per cent or even 15 per cent on the demand for cars is likely to be less than 1 per cent.

11. Given that car import penetration is now well over 50 per cent, it may be argued that any reduction in car demand would fall disproportionately on imported cars since the reduction would be most likely to occur among private purchasers, whose propensity to buy foreign cars is higher than that of fleet operators. The UK industry is not generally in a position to absorb any of the VAT increase. It is possible that some importers, intent on increasing their share of the UK market, might try to do this, though it seems reasonable to assume that in general imports are already taking advantage of whatever

scope they have to price their cars competitively. Finally, it may be noted that VAT does not enter into the price of exports.

EFFECTS OF OTHER POSSIBLE MEASURES

12. As was explained in paragraph 8, the estimates in the previous section of this note relate only to the substitution effects of a VAT change and take no account of changes in real incomes. Estimates of the income elasticity of demand for cars suggests that this is a much more important factor. It is thought to be somewhere above unity; that is to say, if real income rises by 1 per cent demand for cars would increase by rather more than this percentage. It follows that much will depend on the overall impact of the Budget on economic activity and growth over the coming year. The composition of the Budget may also influence the demand for cars. Reductions in the higher rates of income tax leading to some redistribution of income to higher income earners could stimulate demand for more expensive cars and for second cars. On the other hand, proposals to change the taxation of car leasing or car benefits would tend to work in the opposite direction.

13. Increases in the price of petrol could also have an important influence on the demand for cars, in particular by encouraging a switch of demand towards more fuel-economical and smaller-engined cars. UK industry, BL in particular, is at its weakest in the small/medium car market. This is also the less profitable end of the market for UK manufacturers: margins are much higher on more lavishly equipped cars at the top end of ranges. A 15 per cent VAT rate would in itself raise the price of petrol by about 2p a gallon and this takes no account of possible changes in the petrol duty and in the level of factor prices.

CONCLUSION

14. Our main conclusion is that an increase in VAT on cars in the context of a unification of the standard and higher rates

of VAT would not be expected to reduce the overall demand for cars by more than about 1 per cent, equal to about £40-50 million sales at 1978 prices. Within this estimated fall in demand, we have not found it possible to assess the share of the decline in sales that would fall on the British car manufacturers. Clearly a reduction in total car sales will not be helpful to BL. On the other hand, the main constraint on BL sales is the lack of demand for its volume models and there is a danger that any further stimulus to car sales would simply encourage still more imports, reducing BL's market share still further. We conclude therefore that the revenue loss involved in a reduction of car tax could not be justified by the very marginal and uncertain benefits that might accrue to British car manufacturers and to BL in particular. We recommend accordingly that, if VAT is increased in the Budget, cars should be treated no differently from other goods subject to the VAT standard rate.

H M GRIFFITHS
FP2
16 May 1979

BUDGET SECRET

456/79

P/S

MINISTER OF STATE TREASURY

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CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Minister of State (L)
Sir Douglas Wass
Sir Lawrence Airey
Mr Littler
Mr Lovell
Mr Unwin
Mr Griffiths
PS/Customs and Excise

BUDGET 1979: TOBACCO PRODUCTS AND ALCOHOLIC DRINKS DUTIES

I have been considering how we should deal with four outstanding minor issues in the field of tobacco and alcoholic drinks duties. These are:

a. The possibility of varying an increase in duty as between cigars, cigarettes and pipe tobacco;

b. The appropriate balance of specific and ad valorem duties on tobacco;

c. The possibility of making special provisions in the case of 'made' (English) wine;

d. The possibility of making special provisions in the case of cider.

My conclusions are as follows.

First, I feel there is there is a good case for exempting pipe tobacco from the proposed general increase in duty of 10%.

The revenue cost would be modest - some £5 million. Against this, 40% of pipe smokers are pensioners who are likely to benefit least from cuts in direct tax; pipe tobacco manufacturers are concentrated in areas of high unemployment; and the effects of the proposed VAT increase alone will bear hard on the industry which has not had any easy time in recent years. I do not feel there is as good as case for exempting cigars and I do not recommend we do so. But I do suggest we should exempt pipe tobacco.

Second, I believe that for this year at least there are good arguments for maximising the specific element within tobacco duty and having a lower ad valorem element. I accept that a higher specific element reduces the buoyancy of the revenue but the solution to this is to index it. Time does not allow indexing this year. But given the strong arguments of the industry in favour of higher specific duties and the EEC dimension (the EEC are pressing for specific duties to be reduced as part of harmonisation policy, and should we implement specific duties well below the permissable maximum of 55% they might point to this as an argument for reducing the limit). I feel the best way forward is to have a higher specific element in the current year and to review the arguments in detail over the coming year with a view to indexing specific duties next year. For this year I would therefore endorse official's recommendations that the ad valorem element should be reduced to 21% (assuming a VAT rate of 15%) with a compensating additional loading on the specific element bringing it to some 53%.

Third, I do not think there is a case for special action on made wine. At present the duty is charged at rates slightly below the

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corresponding rates on table wines. This small differential can be justified on the grounds of encouraging British industry, and the disproportionate increase necessary to eliminate the differential would probably cause more trouble than it is worth. I therefore recommend that the proposed 10% duty increase should be simply applied to this duty as to wine.

Finally, I think there is a case for exempting cider from the proposed duty increase. The industry was badly affected by the introduction of duty in 1976 and adverse conditions since then have made matters worse. A 10% increase in duty amounts to 0.3p a bottle and given its de minimis nature (the revenue cost will be negligible, perhaps £1 million) I recommend no duty increase on cider.

PR.

PETER REES
17 May 1979

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NOTE OF A MEETING HELD IN THE CHANCELLOR OF THE EXCHEQUER'S ROOM, H.M. TREASURY AT 10.30 AM ON FRIDAY, 18TH MAY, 1979

Present:

Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Minister of State (Commons)
Minister of State (Lords)
Sir Douglas Wass
Sir Anthony Rawlinson
Sir Lawrence Airey
Sir Fred Atkinson
Mr. Lovell
Mr. Unwin
Mr. Shepherd
Mr. Ridley
Mr. Cropper

Sir William Pile)
Mr. J.M. Green) Inland Revenue

Mr. D.A. Lovelock)
Mr. A.J. Phelps) Customs and Excise

PREPARATIONS FOR THE BUDGET

The Chancellor said he would like to have before the weekend an up-to-date picture of the Budget arithmetic in the light of Cabinet decisions on public expenditure and the further review of his proposed tax package. This should identify, on the best available information, the likely PSBR; agreed reductions in public expenditure (including an estimate for sales of assets); and the consequences of his decisions on direct and indirect taxation. The provisional "sighting shot" in Mr. Unwin's minute of 10th May should be revised for the weekend. The public expenditure figures in particular would need to be increased on account of

(a) the additional 1 per cent squeeze on central Government pay cash limits agreed by Cabinet;

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(b) the £300 million cut in RSG; and

(c) the £500 million addition to specific cuts agreed in Cabinet.

Against that:

(d) the £300 million reduction in the contingency reserve would need reconsideration in the light of the Chancellor's discussion of Social Security with the Secretary of State.

Mr. Unwin was invited to be guided accordingly.

2. Announcement about cash limits. The Chancellor pointed to the difficult situation arising in relation to the negotiations on teachers' pay. These were compounded by the ignorance of the local authorities and the teachers' unions of the proposed cut in the RSG. He was increasingly persuaded that he should include an announcement in his speech in the Economic Debate on 22nd May. The Lord President's meeting on 21st May with the Civil Service Staff Side was an additional factor. On the other hand, the RSG cut was intended to apply generally and there were dangers in linking it too directly with pay issues.

The Chancellor invited Sir Anthony Rawlinson to consider what he should say about the RSG and cash limits in his speech in the Debate on the Address on 22nd May.

3. Disposal of assets. The Financial Secretary hoped to have replies from Colleagues before the weekend, or on 21st May at latest. He was aiming at a higher figure than originally envisaged. The position of BNOC was particularly important. The Chancellor reported strong support in the Cabinet for ensurin

CHANCELLOR OF THE EXCHEQUER

a widely based dispersal of shares, not just to institutional investors. It was noted that this might be most easily accomplished for BP shares, by arrangements in relation to over-subscription which ensured priority for smaller bids.

Indirect Taxes

4. The Chancellor noted that final decisions on indirect taxes needed to take account both of revenue considerations and politically acceptable limits to the increase in the RPI. In respect of the latter, the Prime Minister considered the maximum to be 3¾ per cent. Since the RPI effect of the provisional package was larger than that, it was necessary to consider how it could be re-shaped to limit the RPI increase to 3½ per cent. The choices seemed to be between:

(a) VAT of 12½ per cent combined with (broadly) 10 per cent increases in specific duties; or

(b) maintaining the 15 per cent VAT, whilst dropping the specific duty increases in whole or in part.

5. In favour of (a), it was suggested that an increase to 15 per cent went beyond public expectations, and would be highly unpopular; that there were good non-revenue arguments for increasing specific duties (e.g. on tobacco and petrol); and that there would be criticism if the Chancellor increased a wide range of prices through a substantial VAT increase, and made no change in the specific duties. In favour of (b) ~~it was~~ argued that increases in specific duties ~~were~~ regressive whereas VAT was mildly progressive (though not widely acknowledged as such); that cigarettes and drink etc. would stand to bear a significant price increase through VAT, whether or not specific duties were changed (e.g. 6p on a package of cigarettes; 2¼p on a pint of beer; and 28p on

a bottle of whisky, with a 15 per cent VAT); and that drinks and tobacco were particularly heavily RPI-weighted. It was also suggested that VAT increases in successive years, (e.g. to 12½ per cent this year; and 15 per cent next year) would be extremely unwelcome to industry and doubtful politically

6. A number of other points were made. The Chief Secretary argued in favour of keeping to the original proposals, despite their price consequences; it was clear that the Chancellor would need to raise the maximum amount of revenue to achieve his PSBR target. The benefit in public reception was hardly likely to be commensurate with the loss in revenue. On the other hand, very large price increases could reflect adversely on the next wage-round. Of the range of indirect taxes only derv, VED and the duty on rebated oil had insignificant price effects (but important industrial implications). An ACT surcharge, though neutral in relation to prices, was thought to be ruled out for other reasons.

7. Summing up this part of the discussion, the Chancellor said he preferred to hold to the provisional decision on a 15 per cent VAT, trimming back on the specific duties as necessary.

8. Against that background, the meeting went on to review decisions on the specific duties.

9. Tobacco duty.

(a) Balance of specific and ad valorem duties. The Chancellor took note that this had been decided by the Minister of State (Commons) (his minute of 17th May to the Chancellor).

CHANCELLOR OF THE EXCHEQUER

(b) Pipe Tobacco. The Minister of State (Commons) rehearsed the case, on employment and distributional grounds, for excepting pipe tobacco from the proposed increase in duty. After a short discussion, Ministers decided that no exception should be made.

10. Alcoholic Drinks. Only the cider duty remained to be settled. The Chancellor agreed that the duty should not be increased this year.

11. Rebated Oil Duty. The Financial Secretary did not wish to press this year his suggested distinction between heavy fuel oil and the duty on gas oil. A 10 per cent increase in duty on both types of oil was agreed.

12. VED

(a) Structure. The Chancellor confirmed his intention to make no changes in the structure of VED this year.

(b) Petrol Duty. The Chancellor took note of the conclusions in Mr. Lovell's minute of 16th May. After a short discussion, the Chancellor confirmed his intention to increase the petrol duty if possible by 4½p on a gallon.

(c) Commercial Vehicles. The Chancellor decided on (i) a 10 per cent increase in the duty on derv (3½p on a gallon) and (ii) a 10 per cent increase in VED on commercial vehicles (rather than a graduated charge related to size).

Ministers took note that these proposals would not be unacceptable to the Ministry of Transport; and would help to remove the present differential between the duties on derv and petrol.

Possible Modifications

13. The Chancellor concluded that work should proceed on the basis of a choice between the following alternative tax packages:

(a) a 15 per cent VAT plus the full range of specific duty increases already decided; and

(b) the same package less the increases in the duties on tobacco and alcohol.

Miscellaneous Direct Tax Matters

14. Car Léasing. After a short discussion the Chancellor authorised the inclusion of legislation on the lines of the Inland Revenue minute of 10th May to close the existing loophole.

15. PRT. The main outstanding point related to retrospection. The Minister of State (Commons), on revenue considerations, had reluctantly acquiesced in retrospection to 1st January 1979. The Chancellor said he would like to see a note of the arguments. Subject to that, the package could go forward on that basis.

16. Stock Relief. This still remained to be considered.

17. Development Land Tax. Ministers were agreed that the rate should be reduced to 60 per cent. The Inland Revenue had suggested raising the exempt slice from £10,000 to £20,000. The Minister of State (Lords) considered this inadequate in the context of the Government's commitment to repeal the Community Land Act; he favoured increasing the exempt slice to £50,000 at least, despite the loss of revenue involved. Sir William Pile thought this called into question the future viability of DLT. The Chancellor decided that

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(a) the exempt slice should be increased to £50,000;

(b) the rate should be reduced to 60 per cent;

(c) the proposed structural review should still proceed after the Budget.

18. Stamp Duty. The Chancellor decided to defer a final decision on raising the threshold for the duty on transfers of land and property.

19. Benefits in kind: Petrol. The Chancellor confirmed that he did not want to take action on this in the current Finance Bill.

20. Taxation of people working overseas. Mr. Green suggested that Ministers might wish to consider ending the present partial exemption for overseas earnings as a counterpart to the proposed reduction in the top rates of income tax. Both the Financial Secretary and the Minister of State (Lords) supported this. The Chancellor asked Sir William Pile to provide a note.

Income Tax Structure

21. The meeting considered the Minister of State (Lords) minute to the Chancellor, Budget: Tax Arithmetic and Sir William Pile's minute of 17th May on income tax packages. The Chancellor confirmed three preliminary points:

(a) the higher rate scale should begin at 40 per cent rather than 35 per cent;

(b) the age allowance ceiling should be increased to £5,000, accompanied by a statement of intention to abolish the ceiling altogether in 1980;

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(c) the investment income surcharge threshold should be raised to £5,000 for all taxpayers.

22. Reduced rate band. The Minister of State (Lords) said that the proposal to "buy out" the reduced rate band had two advantages: administrative savings for the Inland Revenue and provision of a substantial increase in tax thresholds. But there could be awkward distributional effects unless there was room for more than equivalent increases in personal allowances. With the reduction in basic rate limited to 30 per cent this year he concluded that the balance of advantage lay in not buying out the reduced rate band this year but in increasing personal allowances. He favoured package 3 in the Inland Revenue note, but with a basic rate of 30 per cent. (Table 2 annexed to his minute). The reduced rate could then be bought out in 1980 at considerably less cost - either by going straight to a basic rate of 25 per cent or to an intermediate basic rate of 27½ per cent. In favour of this approach, an immediate increase in personal allowances

(a) would enable the Government to improve on the indexation provided in the caretaker Finance Bill;

(b) would provide a somewhat better distributional balance in the gains to high and low income groups; and

(c) would keep the tax threshold ahead of the single pension.

23. Summing up this part of the discussion the Chancellor said he was attracted by this approach. The balance of advantage seemed to him to argue against buying out the reduced rate this year and in favour of an increase in personal allowances coupled with a reduction in the basic rate to 30 per cent. Planning should therefore proceed on the basis

of Package 3, with the basic rate reduced from 33 per cent to 30 per cent. This should be included when Mr. Unwin revised the first "sighting shot".

Capital Taxes

24. After a brief discussion, Ministers agreed that CTT changes should be deferred until the following year. The Chancellor's Budget statement should include an intention to review CTT before his next Budget.

Conclusion

25. The Chancellor invited Mr. Unwin to prepare, in the light of the discussion, a revised version of the tables attached to his minute of 10th May.

(A.M.W. BATTISHILL)
18th May, 1979

Circulation

Those present
Mr. Littler

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BUDGET - ~~SECRET~~ Confidential

Mr Lovett
Mr McKee
Mr Stratton

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494/79

Board Room
H M Customs and Excise
King's Beam House
Mark Lane London EC3R 7HE

MINISTER OF STATE (COMMONS)

cc Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Minister of State (Lords)
Mr Ridley
Mr Cropper
Mr Lovell
Mr de Waal - Parly Counsel

VAT - TAX POINT PROBLEMS

... I attach a note on certain problems which will arise as a result of the increase in both the existing positive rates of VAT to 15%.

2. In brief the position is that, to facilitate the prompt collection of VAT, we have rules governing the point at which tax becomes payable and the rate at which it is charged. These are designed to be compatible with day-to-day business practices but inevitably they give rise to problems when the rate is changed. Broadly speaking the result is that if the change is downwards the customer stands to benefit if the normal rules remain unmodified; but he stands to lose if the change is upwards.

3. In the present case, we are faced with an increase in the rate from 8% (in the majority of cases) or 12½% to 15% - a sizeable increase which will tend to exacerabate these problems. The note identifies the areas of difficulty which can be foreseen.

4. It has always been clear that telephone bills could be a problem and the current industrial action* will make matters

*by the Post Office staff

worse. We have assumed that Ministers would wish to do something to mitigate the harshness of the existing law in this area, and our estimate of about ½ page for the VAT content of the Finance Bill made allowance for this. We seek authority to instruct Parliamentary Counsel accordingly.

5. For the rest, it is now clear that the change from the existing structure to a unified 15% rate of VAT will cause many transitional problems in relation to monthly garage bills and other similar credit arrangements. It may be possible to deal with some of these by legislation (at the cost of adding to the Finance Bill); others may have to be left to sort themselves out. The annexed note outlines the problem and seeks authority to investigate the legislative possibilities with Parliamentary Counsel.

6. I should emphasise that there will be no difficulty over the vast majority of cash and credit transactions; we are concerned here with a minority of transactions, which could however give rise to a lot of complaint. When you have decided what legislative action to take (if any), we shall need to consider the question of publicity arrangements.

7. In the meantime we shall of course be glad to discuss further if you should so desire.

AJP

29 May 1979 A J PHELPS

INCREASE IN THE RATE OF VAT

Ministers should be aware that the proposed unification of VAT at 15% next month will give rise to difficulties in certain areas because of the effect of the rules governing the time of supply ("tax point") for VAT purposes. These rules assume special significance at a change of rate since the rate of tax chargeable is that in force when the tax point occurs. As a result some people will have to bear tax at the increased rate on goods or services which were actually supplied to them before the increase came into effect.

2. The provisions relating to tax point (embodied in Section of the Finance Act 1972 as amended) are mainly designed to deal with the normal circumstances in which the rate of tax remains stable, and in particular to prevent people delaying payment artificially; they do this by defining the date on which tax becomes chargeable and hence in which accounting period it must be accounted for. The tax point also, as stated above, determines the rate of tax to be charged. The basic rule is that the tax point occurs when the goods are delivered or the services performed; but in order to accommodate normal business practices, while conforming with EEC requirements, provision is made for this to be varied in certain circumstances. Thus if the person making the supply issues a tax invoice within 14 days after the basic tax point, the date of the invoice becomes the tax point (the Commissioners of Customs and Excise may extend the 14 day period on request from individual traders). The basic tax point is also overridden by an advance invoice or payment to the extent of the amount invoiced or paid. For continuous supplies, such as television rentals, the tax point

is the date of invoicing or payment, whichever is the earlier. Finally, where a trader cannot operate the normal rules the Commissioners may, at his request, determine a special tax point.

3. The original 1972 Finance Bill proposals, which were based largely on purchase tax practice, did not contain the 14 day invoice rule; but following representations from industry and commerce, and consultation with trade bodies, the Bill was amended at Report Stage (OR 11 July 1972, Vol 840, Col 1456/61) to provide for this. The result is that in many areas the date of invoice determines the tax point and hence the rate of tax to be applied.

4. Because the rate of tax charged is that in force at the tax point, which as we have said may not coincide with the actual time of supply, anomalies are bound to arise when the rate of tax is charged. This has always been recognised but it was widely expected in the early days that the rate would be varied both up and down by relatively small amounts, so that the position would be accepted as a matter of swings and roundabouts. However, as it has turned out there has only been one change in the standard rate - a reduction from 10% to 8% -- while the introduction of the higher rate did not give rise to the same problems because of its coverage and the fact that 16 days' notice was given before it took effect. Given that on this occasion there will be a substantial rise in the standard rate, against the background of a declared policy of switching from direct to indirect taxation which suggests that it is unlikely to be reversed in the forseeable future, complaints can be expected.

5. It should be emphasised that no difficulties are likely to arise in the majority of cases. Transactions between

businesses which can reclaim input tax can be expected to cause little trouble. And as regards the public, there will be no difficulties over ordinary cash or credit card purchases, which account for the great bulk of transactions.

6. There will, however be a number of problem areas (including possibly some which we may not have foreseen because we have no previous experience of an increase in the standard rate). The more important ones are discussed below.

Telephone Services

7. Telephone bills are issued each month to about one third of the subscribers. They take the form of tax invoices for three month periods covering charges for calls made during the preceding three months (up to the time of the last meter reading, together with a quarterly rental charge for the three months period starting on the first day of the month in which the bill is issued. Because the Post Office do not know on what dates their invoices are actually sent out, they have a special tax point. This is the date on which the computer run covering a batch of invoices begins, under normal conditions about a week after the last meter reading. Thus under the present rules the increased rate would be charged in full on the bills due to be issued in July, and would apply to calls made in the three months period up to the last meter reading, during nearly all of which the present 8% rate was in force. Bills due to be sent out in August and September would be similarly affected, though to a lesser extent. Thus all of the 12 million residential subscribers would have some cause for complaint.

8. The problems indicated above would be greatly aggravated on this occasion because of the Post Office computer strike,

which has delayed the issue of bills. No bills have been sent to residential subscribers since 10 April. This means that if the present rules are unchanged, when bills are eventually sent out subscribers will be charged tax at the increased rate on calls made as long ago as February.

9. We have discussed with the Post Office, on a contingency basis, what might be done to alleviate the position. They have satisfied us that it would be impracticable to apportion their bills so that VAT would be charged at the correct rate before and after the change. This would mean reprogramming their computer, which would be a major task taking many months. If some special concession is to be made, therefore, the only practicable course seems to be to defer the application of the increase until the whole of the period covered by the bills falls after the date of change. In theory this might be done by postponing the increase until the bills due to be sent out in October, but this would interfere with the Post Office's plans for catching up on the arrears caused by the strike, and so would delay the collection of tax. Hence we recommend that if Ministers decide to make a concession on the lines suggested, the increased rate should apply from the bills due to be sent out in November.

10. Such a concession would, of course, involve some discrimination in favour of telephone subscribers as against the generality of consumers who would have to bear the extra VAT from the date of the increase. The net cost, assuming a VAT rate of 15%, would be of the order of £8-9 million. (The calculations are as follows. Gross revenue from VAT on telephone bills is running at about £225m a year; if the rate were put up from 8% to 15% the increase in a full year would be about £197m. A loss of four months of this increase (by

postponing the effective date from July to November) would amount, under the present rules, to £66m. However at least 60% of the total is accounted for by services supplied to registered traders, who can reclaim input tax, so the net amount is reduced to £26m. If the calculation were based, however, not on the tax due to be collected on bills issued under the present rules, but on the actual calls and rentals before and after the change of rate, the net amount of tax lost would appear as only £8-9 million.)

11. We should be grateful for an early decision on whether you wish to offer a concession on these lines. Prima facie, any such concession would require legislation in the Finance Bill (which would have to apply to the independent Hull telephone system as well as the Post Office); but subject to Parliamentary Counsel's views, it looks as if this could be achieved fairly simply and without exceeding our estimate of about ½ page for the VAT change.

Other Supplies

12. Garages Many garages invoice their credit customers at the end of the month and have the last day of the month as a special tax point, imposed at their request by direction of the Commissioners. If there is a change of rate in mid-month all deliveries on credit in the part of the month prior to the change will carry the increased rate. This problem arose both when the standard rate of tax was applied to petrol (April 1974) and when the higher rate became applicable (November 1974). On both occasions we made extra-statutory concessions to enable traders to limit the extra VAT to supplies actually made after the respective changes. As the increases applied only to petrol, no other traders were affected.

13. Since petrol is currently taxed at $12\frac{1}{2}\%$ the problem for garages will be less acute than it was in 1974 but in view of the earlier precedents they will expect similar treatment. Moreover on this occasion there will be other traders in an analogous position. It is possible that the position could be alleviated by a Finance Bill amendment which would have a similar effect to the concession given to garages in 1974, but apply more generally whenever the rate is changed.

14. Account Customers Although garages might be expected to make the running in pressing for concessions, similar difficulties could arise in a number of areas where goods delivered or services rendered are not paid for at once, but on an invoice sent out subsequently. Apart from retail schemes (dealt with below) we can distinguish three main categories:-

i. Invoices sent out within 14 days
If, for example, a trader delivers or repairs a piece of household equipment before the rate of VAT goes up, and issues an invoice after the increase, but still within 14 days (or whatever extended period has been allowed), tax will be chargeable at the higher rate (cf paragraph 2 above). The difficulties can in fact be avoided in this type of case if the trader delays issuing his bills until after the end of the 14 days (or extended period) or notifies the Commissioners that he elects to use the basic tax point, or if the customer pays in advance. But even if they are aware of these possibilities, many traders may find it inconvenient to disturb their normal accounting routine.

ii. Special tax points

Where, as in the case of the garages, a trader has a special tax point at the end of an accounting period imposed at his request by the direction of the Commissioners he cannot avoid the difficulties by delaying the issue of invoices, and the only recourse may be for the customer to pay in advance.

iii. Continuous supplies

Where supplies are continuous the general rule is that a tax point occurs when a tax invoice is issued or payment made. This applies, for example, to television rentals (discussed below), cleaning contracts, building and construction work and in many other areas. If the tax goes up before the invoice is issued or payment made a similar situation arises to those discussed above. Again, the difficulties might be avoided by issuing an invoice or paying on account just before the increase, but this seems unlikely to happen in the majority of cases.

It might be possible to alleviate, but not entirely avoid, many of these difficulties by legislating to provide for apportionment on the lines suggested in paragraph 13 above.

15. Retail Schemes The position on supplies by retailers generally is rather different. This is because most shopkeepers use retail schemes under which they calculate their output tax by reference to their gross takings. On a change of rate they calculate tax at the old rate on their takings up

to the date of the change; they then calculate tax at the new rate on their cash takings from the date of the change onwards. The practical effect is that an apportionment is achieved between the old and new rates and, in general, tax point difficulties do not arise. There will, however, be some exceptions. For example, if a monthly bill is issued to an account customer at the end of June, the subsequent payment will attract tax at the new rate even though the bill includes supplies made in early June when the price quoted included tax at only 8%. This will impose an extra burden on the retailer, although the purpose of the retail scheme is to provide a practical way of assessing the tax due without linking individual sales to the payments received, thereby minimising the accounting requirements. It is hard to see what could be done to avoid this.

16. <u>TV Rentals</u> Payments for television rentals are made in advance, normally at monthly, quarterly, half-yearly or yearly intervals, and the tax point is the time when payment is received. At present the higher rate of 12½% applies generally to television rentals, but following a successful Conservative amendment at the Report Stage of the 1975 Finance Bill which extended the higher rate to these supplies, rentals under contracts entered into before 16 April 1975 remain subject to the standard rate of 8%. There are three potential problems here:

i. complaints from consumers now being taxed at 8% about the increase they will have to bear when the standard rate is raised. There seems to be no case for relief here.

ii. the risk of forestalling by consumers making advance payments (perhaps in collusion with the rental companies) before the increased rate comes into force. There appears to be no way of avoiding this, but the tax lost will probably not be very great,

iii. the possible losses suffered by rental companies who will have to account for tax at the increased rate on payments received after the change (including late payments) but who will not have collected the extra tax from their customers because their contracts provide for a tax inclusive rental. The contracts of the main rental companies enable them to pass on increases in VAT, and the Finance Act 1972 (Section 42) also provides for the adjustment of contracts following a tax change. However, in practice there may be a delay before the companies can adjust their rentals and they stand to lose money. But it is very doubtful whether there is any case for attempting to relieve them.

17. Hire Purchase Where goods are bought on hire purchase the tax point is normally the time when the copy agreement (in the form of a tax invoice) is issued to the customer. However, many retailers selling on hire purchase use retail schemes under which they account for tax by reference to their gross takings. Most retailers operate their hire purchase schemes through finance houses, when no problem arises, but if a retailer using a retail scheme operates his own hire purchase

he must include the instalment payments in his gross takings for the day he receives them. This means that any instalments received after the tax has gone up will bear VAT at the increased rate. The suppliers in turn may try to get the instalment payments by the customer increased. There are therefore likely to be complaints of unfair treatment from both shopkeepers and purchasers. However there seems little that we can do to help.

18. Barristers The tax point for barristers (and advocates in Scotland), is, as Treasury Ministers will know, the earliest of the following times:

a. when the fee is received;

b. when a tax invoice is issued;

c. when the barrister ceases to practise.

Solicitors are frequently late in paying fees, and barristers, who cannot sue for payment, do not normally issue tax invoices before they receive the fees. This may mean that they will have to account for tax at the increased rate in respect of briefs undertaken while the standard rate still stood at 8%. If they seek to avoid this by issuing tax invoices before the increase they may then have to account for tax on fees they have not yet received and which may subsequently be reduced in negotiation. We see no way of resolving this dilemma as the law stands, but the difficulties might possibly be alleviated by an amendment on the lines envisaged in paragraphs 13-14 above.

Conclusion

19. A big increase in the rate of VAT which seems unlikely to be reversed will highlight a number of anomalies which might

have attracted little attention if the pattern had been, as earlier expected, one of small changes both up and down. Apart from the special problem of telephone bills, there is some flexibility in the rules which could enable taxpayers - if they were aware of the possibilities - to minimise the adverse effects, for example by making an advance payment or obtaining an invoice before the rate goes up. However, there will remain a lot of cases where traders and/or consumers will feel that they have been treated inequitably.

20. As indicated above, legislation to deal with the problem of telephone bills should be fairly simple. We should be grateful for your authority to instruct Parliamentary Counsel accordingly.

21. For the rest, any changes to the law needed to deal with the problems outlined in paragraphs 12-18 above would prima facie be technically complicated; and we should like authority to approach Parliamentary Counsel to consider how this might best be achieved before making firm recommendations to Ministers.

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Board Room
H M Customs and Excise
King's Beam House
Mark Lane London EC3R 7HE

Mr Barrett

Mr Sutherland.
Mrs Barrett should see in connection with some work she has in hand. CW

MINISTER OF STATE (Commons)

cc Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Minister of State (Lords)
Mr Ridley
Mr Cropper
Mr Lovell

AREAS MOST SUBJECT TO PRESSURE FOR RELIEF FROM VAT

You asked for an outline of the main areas of pressure to relieve particular goods or services from VAT. I attach a note which outlines the main arguments on some of the more contentious issues, and mentions more briefly a few matters of ritual protest or more limited concern.

2. While any increase in the standard rate must clearly fan the flames of complaints by individual pressure groups, I would call your attention particularly to certain areas of more widespread public concern:-

a. convenience goods;

b. building repairs and maintenance;

c. the theatre; and

d. charities and churches.

The proposed rise in the standard rate to 15% could well give rise to disproportionate representations for relief in these areas. In some cases pressure could be for the institution of a new reduced rate of tax as a next-best option to the preferred zero-rating.

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BUDGET - SECRET

3. The main general arguments against granting further VAT reliefs are:-

a. VAT was designed as a broad-based tax and reliefs should be limited to those which can be justified on the most stringent social or economic grounds.

b. Any reliefs pose difficulties of definition and interpretation with consequent "Nabarro-type" anomalies, and most give rise to risks of repercussions in allied or equally "deserving" areas.

c. Cost: any other than the most marginal change must be measured critically against the cost to the Exchequer at a time when the Chancellor is looking for more revenue from indirect taxation.

d. EEC constraints: the EEC Sixth Directive on VAT, which provides the framework for harmonisation of VAT coverage within the Community, limits our scope for movement on zero-rating. In practice we are allowed to retain our existing zero rates for the foreseeable future, but may not extend them except by way of marginal adjustments.

... 4. The attached note gives the best possible estimate of the cost of zero-rating in each case (representing full-year 1979-80 cost with a unified rate of 15%) and of the RPI effect.

AJP

31 May 1979 A J PHELPS

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ANNEX

AREAS MOST SUBJECT TO PRESSURE FOR RELIEF FROM VAT

1. Convenience foods - cost £400m, RPI 0.4%

Most foods are currently zero-rated, but chocolates and sweets, ice cream, soft drinks, crisps and similar snack foods have been standard-rated since 1 April 1974. This category of foods had been subject to purchase tax, and the first intention of the Conservative Government when introducing VAT (in the Finance Act 1972) was to continue to tax them. At the last moment they were relieved from VAT by Mr Barber in his 1973 Budget, only to be brought into the tax by Mr Healey in 1974. They are regarded as "less essential" foods, although their nutritional value is not denied. The food industries' lobby is well organised and very vocal, and sees the discrimination as anomalous. There is no doubt that the distinction would be increasingly difficult to justify the higher the standard rate were to rise above 8% or 10%. Zero-rating for the category as a whole would remove awkward administrative borderlines and would make a 0.4% reduction in the RPI and 1.9% in the Food Index (even more with an increase in the standard rate); but, as will be seen, the cost would be very great - and any attempt to cut this down by relieving some "convenience foods" but not others would be bound to create fresh, and very difficult, borderline problems.

2. Building repairs and maintenance - cost up to £300m, RPI 0.3%

New construction was zero-rated on social grounds, and building alteration work by analogy; repairs and maintenance, on the other hand, were considered a less deserving social priority, particularly in view of the difficulties of distinguishing essential repairs from more discretionary work such as redecoration.

Pressure for relief is constant from within the industry and from householders and others facing large repair bills, and falls into one or more of the following categories:

a. relief for special types of building (historic houses, churches, etc);

b. relief for the more expensive repair jobs (underpinning, reinstatement after fire damage, rewiring etc); and

c. relief for work fitting in with current Government policies elsewhere (eg rehabilitation of older housing stock).

The potential cost of £300m is split roughly 50-50 between VAT on contractors' work and that on purchases of materials for similar DIY work, which we see as a most likely repercussion. Cost is the main argument we use against representations for relief, together with the point that it would be difficult to extend relief selectively to particular types of work or to particular classes of building without the risk of repercussions elsewhere. More generally, grant aid is available for repair and allied work (eg local authority improvement and repair grants, HBC grants for historic houses, the recently-introduced scheme for historic churches in use) and selective schemes of this nature can more accurately direct available resources to where they are most needed than a blunt instrument like VAT.

Construction and repairs is a contentious and administratively difficult area of the tax, and for the past two years we have been carrying out a review of our policy and holding discussions with the industry. We are unlikely to be able to draw conclusions from this review for some months yet, but because of the cost of overall relief for repairs and the repercussive effects of more limited concessions, further zero-rating is unlikely to figure in any recommendations we may make.

3. Bloodstock (cost guesstimate £2m for racehorse sales, and £4m for training services)

From the beginning of VAT UK bloodstock interests have campaigned for relief on sales of racehorses. We do not consider the owning and racing of horses to be a "business" activity for VAT purposes, unlike breeding, training and dealing: as a result, tax accumulates as horses change hands between traders registered for VAT and private owners who are not. Successive Governments have resisted pressure for relief on the ground that horseracing is a leisure activity, but the grievance of the industry is heightened by unfair competition resulting from "incorrect" VAT treatment in the main competitor countries, France and Ireland.

The EEC Sixth Directive should have equalised treatment between the countries, but in fact France has continued her practice of taxing bloodstock sales at the (minimal) carcass value, and exempts training services as a "liberal profession". Ireland exempts sales of racehorses from VAT under a transitional derogation, and has contrived to give training services favourable treatment under a special scheme for small farmers.

Our views on these "non-communautaire" practices are well known in Brussels, and we shall continue to press them: at the appropriate juncture we may need to seek Ministers' active involvement in representations. We believe that many of the bloodstock industries' complaints could be satisfied without recourse to zero-rating if international competition could be restored to a fair basis.

4. Charities and churches - cost unquantifiable

Comparatively few charities are above the registration threshold, since we regard their charitable and welfare activities as not being "business" and therefore as outside the scope of the tax. This is in line with the EEC exemption for welfare and social security services. Charities do, however, have to bear tax on their purchases to the extent that it cannot be offset against taxable activities, and we receive many representations from the organisations themselves and from the public that charities (including churches) should not have to bear VAT.

There are already some reliefs of special benefit to charities (such as zero-rating of the sale of donated goods eg in Oxfam shops, and relief for medical research and treatment equipment bought for donation to hospitals with charitable funds), and we feel we have probably gone as far as is compatible with the broad base of the tax. The Government will, however, come under consistent pressure here, notably in the light of the recent recommendation by the independent committee chaired by Lord Goodman that charities be allowed to reclaim any VAT on purchases where this exceeded £25 per year.

5. Theatre and the arts (cost: theatre £12½m, arts unknown)

There has been persistent pressure since the beginning of VAT to zero-rate theatre admissions, to assist the theatre's ailing finances and thus encourage its role as a major tourist attraction etc. The main arguments against relief are that:

a. there could be repercussive effects on the cinema and other arts, and on sports admission charges;

b. most relief would go to the most successful shows, including the sensational and distasteful; and

c. assistance can best be given selectively through Arts Council grants, which already recognise the VAT liabilities of the subsidised theatre.

The EEC's Sixth Directive makes no provision to relieve the theatre or arts beyond a vague exemption for "certain cultural services", which we cannot implement until there is an agreed definition. We understand, however, that the Chancellor of the Duchy has been reported in the press to be thinking of proposing amendments to the Sixth Directive to ensure more favourable treatment for the arts.

6. Insulating materials (cost modest)

Insulating materials installed by builders during construction or alteration work are zero-rated, but DIY sales are taxable. We have resisted relief on grounds including the existence of a DoE grant scheme for first-time insulation and the unlikeliness of VAT's having a disincentive effect: the £5-10 VAT on DIY materials cannot deter householders from work offering annual fuel savings many times this.

The persistent pressure from within Government (Departments of Environment and of Energy) and from outside on this issue typifies representations we have in other areas of the tax where VAT is seen to counteract the push of other Government policies (eg house repairs, thermally efficient boilers) but where a concession might be of no more than presentational value.

7. Exports of services (cost varies according to relief granted)

Zero-rating for exported services currently depends under the terms of the EEC's Sixth Directive on the type of service involved and whether the customer is located in the EEC or outside. All exporters would naturally like their exported services to be zero-rated in all circumstances, but particular pressure points include:

- services of independent sound recording producers
- tuition of overseas students
- warehousing charges
- agents' services to principals
- telex-relay services
- "running repairs" to containers
- subscriptions of overseas members
- keep charges for horses imported for breeding

8. Bad debts (cost: up to £50m)

Although pressure for an extension of bad debt relief seems recently to have slackened, Ministers may well face a renewed campaign by the accountancy bodies and others dissatisfied with the scope of the current scheme.

In response to continuous complaints and following a consultation exercise a scheme for relief of VAT on bad debts was provided with effect from October 1978. To simplify control procedures, the scheme was limited to formal insolvencies (bankruptcy or creditors' winding-up), but there has been strong pressure from the accountancy bodies and others to extend it to any bad debt.

With a formal insolvency it is relatively easy to define bad debts and to avoid abuse: on the other hand the main obstacles -

other than cost - to across-the-board relief for any bad debt lie in knowing which debts are genuinely bad (as opposed to being delayed payments) and in preventing abuse through collusion. Moreover, the current scheme allows us to ignore any eventual dividend paid to creditors because in formal insolvencies this tends to be small: with a wider scheme we should have to build in a mechanism to recover a VAT element on dividends and late payments. This would apply equally if the present relief were extended only to receiverships and similar informal insolvencies, as dividends tend to be higher in such cases.

9. Miscellaneous

There are other areas, some of them hardy perennials, where representations for VAT relief can be expected but can more readily be resisted:

a. Pet foods - pressure would grow if "convenience foods" were relieved, though the two categories are not inseparably linked (and the 1972 Finance Act always contemplated that pet foods would be taxed). Cost £100m; RPI possibly 0.1%.

b. DIY housebuilders' and voluntary bodies' building schemes - for administrative and control reasons these one-off schemes provide relief only for the construction of new buildings. There is periodic pressure to cover also the extension and conversion of new buildings. Cost unquantifiable.

c. Agricultural rents - some pressure to single these out for zero-rating instead of the present exemption for rents in general, to allow the tax on repairs and maintenance to be recovered by landlords. Cost guesstimate about £5m.

d. Tourism - relief claimed for tourist and holiday accommodation, etc in view of foreign earnings potential. Cost high.

e. Sanitary protection for women - on grounds of sexual discrimination. Cost £10m; RPI 0.1%.

f. The Disabled - many essential aids for the disabled are currently zero-rated, but representations are frequently made about

   i. spares for and repairs to the zero-rated appliances - cost guesstimate £10m;

   ii. conversion of cars to hand controls - cost guesstimate £½m;

   iii. Motability - this voluntary organisation providing cars for the disabled on favourable leasing terms would find an increase in the standard rate critical to its viability. We understand that Mobility Allowance is shortly to be raised, and this may alleviate some of the pressure.

g. Fringe medicine - osteopaths, acupuncturists etc. Cost unquantifiable.

1/9

CONFIDENTIAL

FINANCIAL SECRETARY TO THE TREASURY

FPCS 96

Ms Barrett

Mr Griffiths

PS/MINISTER OF STATE - COMMONS

cc Principal Private Secretary
PS/Chief Secretary
PS/Minister of State - Lords
~~Mr Lovell~~
Mr Ridley
Mr Cropper
PS/C+E

AREAS MOST SUBJECT TO PRESSURE FOR RELIEF FROM VAT

The Financial Secretary has seen Mr Phelps' minute of 31 May which outlines the areas where the Government is likely to face criticism on this year's Budget package. He has commented that some of these will need serious consideration - but that action must clearly wait for next year. He feels that it would be dangerous to do more than promise to "look at" these pressure points now.

P.C. DIGGLE
OF
4/6/79

PCD

P C DIGGLE
4 June 1979

15/212

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~~BUDGET : SECRET~~

CHANCELLOR OF THE EXCHEQUER

CH/EX REF NO B(79)33

COPY NO 14 OF 22 COPIES

cc Chief Secretary
Financial Secretary
Minister of State (Lords)
Minister of State (Common
Sir Douglas Wass
Sir Lawrence Airey
Sir Anthony Rawlinson
Sir Fred Atkinson
Mr Couzens
Mr Unwin
Mr Littler
Mr Lovell
Mr Corlett
Mr Mortimer
Miss O'Mara
Mr Cropper
Mr Ridley

PS/INLAND REVENUE

BUDGET PERSONAL TAX CHANGES: IMPLEMENTATION

1. The Chancellor has considered your minute of 5th June on the timetable for implementing the personal tax changes to be introduced in the Budget.

2. He has observed that your proposals appear to be in line with expectations. I think you may take it, therefore, that unless other Treasury Ministers dissent, these proposals have the Chancellor's approval.

A M W BATTISHILL

6th June 1979

BUDGET SECRET 496/79

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Mr Lovell

Mr Sibbett

PS/CUSTOMS AND EXCISE

cc Chancellor
Chief Secretary
Financial Secretary
Minister of State (L)
Mr Lovell
Mr Ridley
Mr Cropper

AREAS MOST SUBJECT TO PRESSURE FOR RELIEF FROM VAT

The Minister of State was grateful for Mr Phelp's minute of 31 May outlining those areas which may be most subject to pressure for relief from VAT. He has also seen the comments of the Chief Secretary and the Financial Secretary recorded in their respective Private Secretary's minutes of 4 June.

In the light of these latter minutes, the Minister of State feels he should make clear that he is not concerned with conceeding any relief in the areas outlined in Mr Phelp's minute but with considering how best the inevitable pressures for relief can best be met. Thus, on the question of charities for example, he has already asked (my minute of 4 June) for comments on the Goodman Report with a view to considering what position the Government should take up if pressed to implement the recommendation to exempt charities from VAT.

Having read Mr Phelp's minute the Minister of State has also asked whether it might be possible to fend off pressure from the Bloodstock Lobby by means of a publicised démarche to the EEC Commission about French and Irish practices in this field. I should be grateful for a note on this possibility.

RJB

R J BROADBENT
6 June 1979

8/214

3/10

99

Board Room
H M Customs and Excise
King's Beam House
Mark Lane London EC3R 7HE

PRIVATE SECRETARY TO THE MINISTER OF STATE (C)

Ms Corrett

Mr Griffiths

cc Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Minister of State (L)
Mr Ridley
Mr Cropper
Mr Lovell
Mr de Waal - Parly Counsel

VAT - TAX POINT PROBLEMS

1. In the last paragraph of your minute of 30 May you asked whether tax point problems had generated much debate in earlier Finance Bills when the rate of VAT was changed.

2. The only Parliamentary debate in which this issue arose followed the application of the higher (25%) rate of VAT to television rentals, under the April 1975 Budget proposals. The increased rate took effect from 1 May, 1975 and under the tax point rules all television rental payments made on and after that date attracted the 25% rate irrespective of the date of contract.

3. The propriety of applying the increased rate to pre-existing contracts was the subject of fairly lengthy debates at Committee and Standing Committee Stages of the ensuing Finance Bill (OR 15 May 1975 Vol 892 Col 824/845; OR 19 June 1975 Standing Committe H Col 274/317). It was argued that this had "retrospective" implications, and also that it discriminated against hirers as compared with those who had been able to purchase television sets outright at the old rate of VAT. The subject was raised again at Report Stage when a successful Conservative amendment had the

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effect that from 1 August 1975 the Standard (8%) rate was restored for TV rentals, payable under contracts entered into before Budget Day 16 April 1975 (OR 17 July, 1975 Vol 895 Col 1741 and 1793/1822). It should be emphasised that the effect of the amendment was to apply the standard rate, rather than the higher rate, to payments under these contracts. It did not purport to freeze the rate at 8% indefinitely.

4. On the substance of the matter the Minister of State has seen the first drafts produced by Parliamentary Counsel. We are now discussing with him a few minor amendments to deal with points which have arisen.

AJP

6 June 1979 A J PHELPS

FPCS 101

Mr Lovell

Mr Sullivan

PS/MINISTER OF STATE (COMMONS)

cc Principal Private Secretary
PS/Chief Secretary
Mr Lovell
Mr Ridley
Mr Cropper
PS/Customs and Excise

AREAS MOST SUBJECT TO PRESSURE FOR RELIEF FROM VAT

The Minister of State (Lords) has seen Mrs Diggle's minute of 4 June and commented as follows:

> "Perhaps I might also make the point that in the end the Purchase Tax was destroyed inter alia by erosion of the base. We must try very hard not to let this happen with the VAT.
>
> On a minor point I am sceptical about the claimed nutritional value of sweets: I understood they contributed to dental decay and obesity."

Richard Stutely

N R STUTELY
Assistant Private Secretary
6 June 1979

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MR PHELPS - CUSTOMS & EXCISE

cc Chancellor
Chief Secretary
Financial Secretary
Minister of State (L)
Mr Ridley
Mr Cropper
Mr Lovell
Mr De Waal - Parliamentary Council

VAT: TAX POINT PROBLEMS

The Minister of State was grateful for the information contained in your minute of 6 June about interest in this subject generated in Parliamentary Debates.

RJB

R J BROADBENT
7 June, 1979

CHOLES
LETTER OF
7/6/79

Mr Lovell
Mr Griffiths

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MINISTER OF STATE (COMMONS)

cc Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Minister of State (Lords)
Mr Ridley
Mr Cropper
Mr Lovell

VAT - TAX POINT PROBLEMS

You asked for a short note on prophylactic measures which might be taken to mitigate the difficulties which will arise from the apportionment provision to be included in the Finance Bill and Budget Resolutions.

2. Such measures must essentially take the form of publicity, designed to ensure that traders understand and so far as possible take advantage of the new provision. We had in mind the following:-

(i) A reference in the Chancellor's Budget speech (see draft of 6 June, paragraph 1.4), supplemented by briefing for the Press conference and enquiries that evening.

(ii) A fuller statement by a Treasury Minister later in the Budget debate. This would explain that the Government had done what they could to meet the problem by introducing the new provision but that they had to leave

BUDGET-SECRET

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the option to apportion (or not) to the trader, who might be constrained by his accounting system: it was therefore up to customer and supplier to settle between them what should actually be done in each case.

(iii) More detailed factual information to be provided in a Press notice (draft circulated by Mr Young on 6 June) and in a leaflet which will be sent to trade associations and made available to traders in Local VAT Offices from 17 June. Press advertisements planned for Friday 15 June and Sunday 17 June will draw attention to the leaflet.

3. If you are content we will suggest a form of words for (ii) as part of our briefing for the debate.

H Scholes

7 June 1979 H SCHOLES

17/110

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PS/MINISTER OF STATE - COMMONS

cc Principal Private Secretary
PS/Chief Secretary
PS/Minister of State - Lords
Sir Douglas Wass
Sir Lawrence Airey
Mr Littler
Mr Lovell
Mr Ridley
Mr Griffiths
Mr Todd
Mr Cropper
Miss O'Mara
Mr P G Davies
PS/Customs and Excise
PS/Inland Revenue

BUDGET PRESENTATION: CUSTOMS' AND REVENUE PRESS NOTICES

The Financial Secretary has reflected on the Customs' minute of 6 June and has seen your note of 7 June.

He has decided that the strictly factual information for which he had asked concerning VAT and the tax on petrol should be published as part of the Treasury press notice.

He believes that, in future, the Customs and Excise should be prepared to co-operate on the preparation of Treasury Budget press notices on the same basis as, he understands, the Inland Revenue has always done; and is surprised to discern the marked difference of approach that at present exists between the two Revenue departments in this respect.

PCD

P C DIGGLE
8 June 1979

4/110

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8 June 1979

MINISTER OF STATE (COMMONS)

Mr Barrett FPCS Mr Salter

Internal copies
CPS
Mr Phelps
Solicitor
Mr Freedman
Mr Jeddere-Fisher
Mr Howard
Mr Phillips

cc Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Minister of State (Lords)
Mr Ridley
Mr Cropper
Mr Lovell

F.P.C.S.
14 JUN 1979

BUDGET DEBATE - TAX POINT PROBLEMS

In my minute of 7 June I suggested that it would be helpful for a Treasury Minister to make a statement during the course of the Budget Debate about the apportionment provisions to be included in the Finance Bill and Resolutions. If, as I understand is likely, you will be winding up on one of the days, that would afford a convenient opportunity.

2 We suggest it would be helpful if you were able to work in a passage (perhaps in response to a pre-arranged question by a Government supporter) on the following lines:-

"The Government was concerned that a big increase in VAT on this occasion might cause special problems for certain transactions where the legal tax point, which determines the rate of tax applicable, falls on or after 18 June but the supplies to which it relates were in fact made wholly or in part before that date. For this reason my Rt Hon friend has proposed the special transitional provisions which the House has approved in the Budget Resolution.

These fall into two parts. The first, in sub-clause (3) of the VAT Resolution, is concerned with the particular problem of telephone bills, which has recently been aggravated

/by industrial

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by industrial action affecting the Post Office computer. If nothing were done, all of the 12 million residential subscribers would be liable to pay tax at 15% on calls made before 18 June, in some cases going back as far as February. It would not in this instance be practicable to avoid the difficulty by apportioning the tax as between calls made before and after 18 June, since this would require reprogramming of the computer which would take several months. The new clause therefore provides that the 15% rate will not apply to bills issued before November.

The more general provisions, contained in sub-clauses(4) and (5), will allow traders, at their option, to account for tax at the old 8% or 12½% rates, as appropriate, on supplies made before 18 June, but for which the tax point occurs later. We naturally hope that traders will take advantage of this provisi whenever possible, but we concluded we could not reasonably require them to do so; in some instances they may find it impracticable to adjust their accounting system for the purpose We must therefore leave it to them to settle with their customers exactly how far they can go, consistently with the la as it now stands, in each case.

The detailed application of the provisions may be a little complicated in some cases and Customs and Excise have accordingly prepared a leaflet explaining the arrangements whic is available on application at Local VAT Offices. Traders who are likely to be affected should make a point of obtaining a copy."

... 3 I attach a fuller note which draws on more detailed material intended for briefing officials. Although this is rather lengthy you may find it helpful in preparing for other questions which might arise.

HScholes

H SCHOLES

BUDGET DEBATE - TAX POINT PROBLEMS

It would be helpful if the Minister could include a reference to these problems, and to the effect of the provisions included in the Budget Resolution, in his winding up speech in the Budget Debate. The objective is to ensure that traders understand the provisions ar take advantage of them so far as possible, and to get across the message that while the Government has taken what steps it could to mitigate the difficulties, it must be left to traders and their customers to settle between them whether they exercise the option to apportion tax.

2 The provisions included in the Resolution are:-

> "(3) Sub-paragraph (1)(b) above does not affect the rate of tax on any supply of telephone services provided by the Post Office or the District Council of Kingston upon Hull by means of their public switched telephone exchange systems, being services in respect of which the Post Office or the Counc issue a tax invoice which includes a rental charge for a rental quarter beginning before 1 November 1979.
>
> In this sub-paragraph "tax invoice" has the same meaning as in section 7 of the said Act of 1972.
>
> (4) Where a supply in fact made wholly or partly before the said 18 June, or a supply with, apart from the other provisions of the said section 7, would be treated as so made by sub-secti (2) or (3) of that section, is treated under those other provisions as made on or after that date, the person making the supply may account for and pay tax on the supply or, as the cas may be, on the relevant part of it as if the rate of tax had nc been increased by paragraph (1)(b) above.
>
> (5) Where a person avails himself of sub-paragraph (4) above in relation to a supply in respect of which he is required by regulations to issue a tax invoice, any provision of the regulations requiring the amount of tax chargeable or the rate of tax to be stated in the invoice shall be construed as referr to the amount and rate that apply by virtue of that sub-paragraph."

3 Because the Minister will be winding up, his speech will in the main have to take the form of a response to speeches by Members. T ensure that he has a reasonable opportunity to get his points across it might be helpful to arrange for Government supporters to raise th matter first. Possible questions which might be asked include:-

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i) While the provisions included in the Resolution are clearly designed to ensure fair treatment for taxpayers, and hence are to be welcomed, can the Minister explain in more detail the difficulties they are intended to meet.

ii) Why have provisions of this sort not been thought necessary before?

iii) Why are they only temporary?

iv) Why is there separate provision for telephone bills? Are not telephone subscribers being given an undue advantage compared with other consumers?

v) How will the provisions work in other cases?

vi) How can consumers be sure that traders will take advantage of the new provisions for apportionment? Would it not have been better to make them mandatory rather than optional?

vii) If traders decline to apportion bills can consumers help themselves, eg by paying in advance before 18 June?

viii) Do the provisions apply to retailers operating special retail schemes?

ix) What will be the effect on television rentals?

Obviously there will not be time to deal with many of these questions in any depth, but the following paragraphs suggest material which the Minister could draw on as necessary. The most important question to be answered is vi).

Reasons for the provisions.

4 The rate of tax to be charged on any transaction is that in force at the "tax point" (which also determines the accounting period in which tax must be accounted for). This is normally the

time when goods are delivered or services performed, but where payment is made on an invoice issued subsequently the tax point may be the date of the invoice or the date of payment (whichever comes first). /The statutory provisions, which are complicated, are contained in section 7 of the Finance Act 1972 as amended and in the Value Added Tax (General) Regulations 1977, Part IV./ If the tax point for supplies in fact made wholly or in part befor 18 June falls on or after that date tax would, under the normal rules, be chargeable at 15%. The new provisions make special arrangements for telephone bills and will allow other traders, if they wish, to account for and pay tax at the old rate on the relevant part of the supply.

Why have provisions not been made before now?

5 It was generally expected in the early days that the rate would be adjusted both up and down by small amounts, so that consumers would gain on the swings what they lost on the roundabou In these circumstances the extra accounting work for traders would not have been worth while.

Why only temporary?

6 The Government have no immediate plans for a further increase in VAT, and we thought it right to see how the arrangements work out on this occasion before proposing any permanent provisions.

Telephone bills?

7 There are 15 million telephone subscribers (12 million residential). It would not be feasible, without lengthy preparation, to programme the computer to apportion the tax; moreover Post Office billing is in arrears as a result of industria action. In this special case the only way of avoiding unfairness to subscribers is to defer the application of the increase so that the whole period covered by the bills will fall after 18 June. /November rather than October has been selected so as to avoid interfering with the Post Office plans for catching up on the arrears./

Other cases

8 The following examples illustrate the effect of the general provisions:-

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i) If a tax invoice which creates a tax point is issued on or after 18 June for a repair to a washing machine which was in fact carried out before that date, tax may be accounted for at the old rate of 12½% on that repair.

ii) If a garage issues a monthly tax invoice at the end of June which creates a tax point for supplies made during that month, VAT on any items on the invoice (petrol, repairs) in fact supplied before 18 June may be accounted for at the old rate.

iii) If a supply of construction work takes place partly before and partly on or after 18 June the supplier may apportion the tax he accounts for between the 8% and the 15% rate on an appropriate basis eg related to measurable work.

iv) Where supplies are continuous eg contract cleaning and payment is made periodically, tax for the period including 18 June may be apportioned on a time basis or by some other appropriate means.

... Guidance on these arrangements is given in a leaflet (copy annexed) available from Local VAT Offices, and traders who may be affected should obtain a copy.

<u>How can consumers be sure traders will take advantage of the provision?</u>

9 The new provision has been drafted to give traders the <u>option</u> of apportioning the tax in the way described. It would not have been practicable to <u>require</u> them to do so. The tax point arrangements have been designed to fit in with normal business practice and some traders may find it impracticable to alter their normal accounting systems to take advantage of the new provision. We naturally hope that they will do so whenever possible but this must be left for traders and their customers to settle between them. If people have entered into transactions which they have not yet paid for and fear they may have to pay more VAT, they should take the matter up with their supplier.

Payment in advance

10 It is true that if a payment is made before 18 June it will only attract tax at the old rate. It may of course cause difficulty in some cases for suppliers if customers pay in advance before receiving bills so that it would be better to take advantage of the new apportionment provisions whenever possible. [Consumers may be able to avoid tax by paying in advance for supplies they will not receive until after 18 June. It would seem undesirable for Ministers to publicise this so we suggest the above answer be given only if specifically asked.]

Retail schemes

11 The apportionment arrangements described will not of course apply to the majority of goods bought in shops, which are paid for at the time. For credit sales under the special retail schemes retailers will be able to apportion tax if they use the optional definition of gross takings (under which the record of gross takings includes at the time of supply the total amount, including VAT, payable by customers for taxable goods or services for which they have not actually paid at that time.) Retailers using the standard definition, under which gross takings include payments received (but not sums owing but not yet received) will not be able to apportion. These schemes have been designed to simplify retailers' accounting arrangements by avoiding the need to link individual transactions with payments received and they could not readily be adapted to provide for apportionment. The effect may be that some retailers will have to account for tax at 15% when they have only charged their customers 8% or 12½%. This is unfortunate but it is hard to see what could have been done to avoid it. In practice only a small proportion of a retailer's sales is likely to be affected in this way (many retailers who supply a lot of goods on credit are likely to use the optional definition of gross takings), and retailers will gain an offsetting benefit to their cash flow as a result of the increase in the rate.

Television rentals

12 TV rental payments made on or after 18 June will attract tax

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at 15%. Apportionment will not normally apply because the rentals are payable in advance. However if payments made on or after 18 June are late, part of the period covered may fall before 18 June, and in that case the rental company may account for tax on that part at the old rate.

Customs and Excise

8 June 1979

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BUDGET—SECRET

VALUE ADDED TAX

Leaflet No 716/1/79

H.M. CUSTOMS AND EXCISE

THIS LEAFLET MODIFIES THE RULES IN NOTICE No 716 (VAT: CHANGES IN THE TAX RATES)

VAT: INTRODUCTION OF 15% RATE: MODIFICATION OF THE CHANGE OF RATE RULES

1. **General.** When a rate of VAT is changed the normal rule is that the rate of tax to be charged is that in force at the tax point (Notice No 716 (VAT: Changes in the tax rates, April 1976), paragraph 7 (*a*)). However, in the Budget proposals introduced on 12 June 1979 this rule has been modified to enable traders, if they wish, to account for tax at the old 8% or 12½% rates, as appropriate, on supplies made *before* 18 June 1979 but for which the tax point would occur later. General guidance on the effect and application of this modification is given below.

2. **Single supplies—invoices for single items.** Where a supply of goods has been made or performance of a service has been completed before 18 June 1979, the supplier may account for VAT at the old rate, even though the legal tax point would occur on or after that date. For example, if a tax invoice which creates a legal tax point is issued on or after 18 June for a repair to a washing machine which was in fact carried out before that date, tax may be accounted for at the old rate on that repair.

3. **Single supplies—invoices for several items (*eg* monthly invoices).** Where several items are included on an invoice issued on or after 18 June 1979, the supplier may account for tax at the old rate on any of the items which were in fact supplied before 18 June, even though the legal tax point would occur on or after that date. For example, if a garage issues a monthly tax invoice at the end of June which creates a tax point for supplies made during that month, VAT on any items on the invoice (petrol, repairs) in fact supplied before 18 June may be accounted for at the old rate(s). VAT on items supplied on or after 18 June must be accounted for at the new rate.

4. **Single supplies of services taking place over a period.** If a single supply of a service takes place partly before and partly on or after 18 June (*eg* conveyancing, construction work) the supplier may account for tax at the old rate on that part of the supply which was carried out before 18 June and at the new rate on the part that is carried out on or after that date. Apportionment in such cases should be on the basis of measurable work or in accordance with the supplier's normal costing or pricing arrangements.

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BUDGET—SECRET

5. **Continuous supplies.** Where services are supplied for a period for a consideration which is determined or payable periodically, and a tax invoice is issued or a payment is made on or after 18 June for a payment period which commenced before that date, it may be practicable for the supplier to apportion on the basis described in paragraph 4. In some cases, as for example where such services are charged for at a flat rate (per day, per week, etc.) payable in arrear, it may be appropriate to apportion on a time basis. But other methods may be used if they will produce a more accurate apportionment.

6. **Other supplies with special tax point arrangements.** The same principles also apply to other supplies whose tax points are governed by the VAT (General) Regulations 1977 (*eg* retention payments) and to supplies for which the tax point has been prescribed in special directions issued by the Commissioners of Customs and Excise. Suppliers may account for VAT at the old rate on all or that part of any supply which was in fact effected before 18 June 1979.

7. **Traders using retail schemes.** These arrangements apply also to credit sales under special retail schemes used in conjunction with the *optional* definition of gross takings. However, they do *not* apply otherwise to traders using the special retail schemes.

8. **Tax invoices and payments in advance of the basic tax point.** If a supplier issues a tax invoice or receives a payment before 18 June 1979 for supplies which take place on or after that date the normal rules will apply: VAT will be chargeable at the old rate to the extent of the amount invoiced or paid before 18 June.

9. **Effect of section 33 (2) of the Finance Act 1972.** Traders are reminded that section 33 (2) of the Finance Act 1972 provides that where an invoice shows a supply of goods or services as taking place with tax chargeable on it, the amount shown on or included in the invoice as tax is recoverable from the person issuing the invoice.

June, 1979 TMG 37/142/04 **Leaflet No 716/1/79**

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F.P.C.S.
15 JUN 1979

FPCS
Ms Donnett

Board Room
H M Customs and Excise
King's Beam House
Mark Lane London EC3R 7HE

Mr Suffield

PS/Minister of State (Commons)

cc Principal Private Secreta
PS/Chief Secretary
PS/Minister of State (L)
Mr Lovell

BUDGET DEBATE SPEECH

I attach speaking notes for the Minister of State's use in the Budget debate on the following topics:

i) VAT interest payments;
ii) an alternative package (12½% VAT plus action on tobacco and alcoholic drinks);
iii) VAT forestalling;
iv) petrol, and
v) casino gaming.

I am copying the notes to other Treasury Ministers so that they can drawn on them also if necessary.

12 June 1979

R M NEWBY
Private Secretary

9/218

VAT INTEREST PAYMENTS

Over recent weeks considerable concern has been expressed about the disruption of VAT repayments which resulted from the Civil Service industrial action and the suggestion has been made that the increased financial burden which this placed on many traders should be mitigated, at least in part, by the payment of interest on the delayed repayments.

On the question of repayments the position is that, apart from a small percentage which have been found to need special scrutiny, all the 400,000 repayment claims which accumulated during the industrial action have now been dealt with by Customs and Excise.

As for interest, Customs and Excise have not made any such payments because they do not have any legal powers to do so. Nor do they have power to charge interest when traders are late with their payments of tax. This is not the first time that interest payments have been proposed, but so far it has always been decided that the cost and administrative complications involved would be unacceptably great.

In the face of our determination to simplify the tax system and reduce the bureaucracy, these arguments have much force. Nevertheless I have asked the Commissioners of Customs and Excise to have a further look at this area to see whether there is anything which should be done.

WHY NOT LESS ON VAT/MORE ON EXCISE DUTIES

I turn now to a [particular] criticism which has been made of my r.h.f's Budget. This is that the VAT rates should have been unified at 12½% rather than 15% and that further revenue could then have been raised by increasing the excise duties on tobacco and on alcoholic drinks.

[Some critics have argued that such a course would have had beneficial effects on health through discouraging excessive consumption of cigarettes and alcoholic drinks, which is socially harmful.

This is not the time and place to enter into a debate on the social aspects. Questions as to the role of taxation for social purposes raise complex issues. I have listened with interest to the points made by hon Member(s) and we shall be taking them into account in forming our views over the coming months.

But] let me answer this criticism by reference to my r.h.f's revenue requirement. The simple answer is that a 12½% rate of VAT plus revalorisation increases in the tobacco and drinks duties would not have given him enough revenue. I will illustrate. 15% VAT will bring in additional revenue of a little over £2 billion in the financial year and nearly £4.2 billion in a full year. If we had unified VAT at 12½% <u>and</u> also raised the specific duties on tobacco and drinks by 20% [– that is, to have restored them, more or less, to their values of two years ago –], the yield would have been about £1,800 million in 1979/80 and about £3,400 million in a full year. That is to say, we would have been as much as £800 million short of the revenue target in a full year. This would have had considerable implications for my r.h.f's freedom of action in future years when he hopes to propose further reductions in direct taxation which we believe will provide a further stimulus on the road to economic recovery.

Moreover, in the meantime, the 20% increases in the excise duties on top of the VAT increase would have put up the price of a typical packet of 20 cigarettes by about 10p, a pint of beer by over 3p and a bottle of whisky by about 90p. In some quarters this might be regarded as a good thing. But I think it will be generally realised that such price increases coming all at once would not only have imposed a heavy burden on the consumer, not least the moderate drinker: they would have had considerable implications for industry and for employment. And, while falling a long way short of the revenue requirement, such a package would have raised the RPI by about $3\frac{1}{4}$ per cent - that is, only a little less than the 15% VAT which is so much more revenue productive in a full year.

VAT FORESTALLING

There have already been suggestions that the delay to next Monday in introducing the new 15% VAT rate will lead to substantial forestalling. However, I do not believe it would have been right to have made the change earlier. The $1\frac{1}{4}$ million VAT registered traders, and especially the 300,000 or so retailers, have a lot of work to carry out when a change is made in the VAT rate. It would impose a very onerous burden to suggest that the repricing of stock, and in some cases a complete stocktake, could be undertaken in a shorter period or, most importantly, without the clear week-end we have provided. We all know from the press that a considerable amount of forestalling took place before my r.h.f's Budget. I am afraid that some degree of further forestalling is the inevitable price we have to pay if we are to give traders a proper opportunity to make their necessary arrangements.

PETROL

It has been suggested that an increase in the duty on petrol at a time when prices are already rising sharply will bear very hardly on those for whom a car is an essential means of transport. However, priority must be given this year to energy conservation and to the revenue. As my r.h.f pointed out in his Budget Statement, VAT is already charged on petrol at 12½%, and the 15% rate on its own would therefore have represented only a very small price increase for an item where a reduction in consumption is essential. The effect of the combined 10p a gallon price rise resulting from the duty and the VAT increases will be to encourage further restraint in consumption, among regular users as well as the week-end motorist. The Budget changes are necessary and are an earnest of our determination in this matter.

/If pressed on <u>rural motorists</u>: Figures from the National Travel survey suggest that the rural motorist does only about 10% more mileage in a year than his urban counterpart. On the other hand, because of less congested road conditions, the rural motorist is likely in return to obtain a rather higher mileage to the gallon. I believe most motorists now recognise the need for restraint and will respond responsibly./

/If pressed on <u>derv</u>: We recongise that the increase in the duty on derv will be passed through into road freight transport costs. However, it will represent no more than a 1 per cent addition to such costs. We believe this is a modest price to pay in the interests of energy conservation, which is as essential in the road transport industry as it is elsewhere./

GAMBLING

Another suggestion which was first made by the r.h.m. for Leeds East ~~suggested~~ in the debate on the Queen's Speech on 22 May is that my r.h.f. should have raised more revenue from the gambling duties, particularly the gaming licence duty on casinos. The recent Royal Commission on Gambling headed by Lord Rothschild recommended that the duty on casinos should be increased six- or eight-fold - but, I should emphasise, as part of a complex package for reform of the casino gaming laws, extending beyond taxation We will certainly be undertaking a careful review of the duty, and as a first step discussions are already taking place between Customs and Excise officials and representatives of the casino industry.

I don't, of course, know what view the r.h.g. took of the potential of the gaming licence duty when he was in office. However, perhaps I should remind him that the present full year yield of the duty is £5 million. There may well be a case for a substantial increase - and, as I have said, we shall examine this carefully before next year's Budget. But I should be misleading the House if I were to pretend that it could offer any significant contribution to the cure for the nation's economic ills.

cc Chancellor of the Excheque
Chief Secretary
Financial Secretary
Minister of State (L)
Mr Lovell
Mr Griffiths
Mr Kalen

Mr Lovelock (Customs & Exc

MINISTER OF STATE (C)

MINISTER OF STATE'S SPEECH IN BUDGET DEBATE

There are three ways of measuring the incidence or impact of VAT on households at different income levels.

First of all one can simply express VAT paid as a proportion of gross income. If this is done, VAT will have a regressiv profile through the earnings or income distribution. This is what one might expect intuitively since the household savings ratio ~~issues~~ rises as incomes rise.

However, it makes more sense to express VAT paid in terms of family disposable income. Under a progressive income tax system the profile will now tend to be less regressive.

Suppose now that we choose to express VAT paid as a proporti of family expenditure. There are at least two very good reasons for preferring such an approach.

(i) A given percentage increase in VAT affects the RPI in the same way as an equivalent rise in the general rate of inflation. This price increase deflates or reduces the overall purchasing power of disposable income; namely expenditure plus savings. It is reasonable to assume that the savings if spent would be used to purchase the same or a similar basket of goods. It is sensible, therefore, to use the proportion of VAT ~~as~~ in expenditure as a basis for comparison. Since savings rise with income, the use of income as a base introduces a bias towards regressivity. This is because the rising tax content which could be imputed to savings is ignored.

(ii) In practice, typical family patterns tend to be more stable than income. This is because on average, expenditure adjusts to changes in income over time. Again, in the typical case where disposable income is rising, the use of this base will introduce a bias again towards regressivity.

You should bear in mind that the issue is controversial and you may be challenged. In my minute of 12 June I referred to the previous Chancellor's approach, which was also based on the expenditure concept.

Douglas Todd

D Todd
13 June 1979

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Board Room
H M Customs and Excise
King's Beam House
Mark Lane London EC3R 7HE

Mr Burnett FPCS

PS/MINISTER OF STATE (COMMONS)

cc Principal Private Secretary
PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State (L)
Sir Douglas Wass
Sir Lawrence Airey
Mr Littler
Mr Lovell
Mr Ridley
Mr Griffiths
Mr Todd
Mr Cropper
Miss O'Mara
Mr P G Davies
PS/Inland Revenue

F.P.C.S.
14 JUN 1979

BUDGET PRESENTATION: CUSTOMS' AND REVENUE PRESS NOTICES

PS/Financial Secretary copied to us her minute of 8 June to you about Budget Press notices.

There has clearly been a misunderstanding, caused no doubt by the speed with which the exchanges last week between the offices concerned had to take place. Needless to say, there was never any suggestion of our refusing to co-operate with the Treasury on this matter; and of course we recognise that it is always for Ministers to decide finally what is to be published and in what form. Our minute of 6 June was concerned with three points, with particular regard to the traditional Customs and Excise Budget notices:-

a. The introduction of material of the kind suggested would represent a marked departure from our practice under all previous Administrations. We did not suggest that this would rule it out - we simply wanted to ensure that the implications were fully considered.

b. Our small Press Office is not well-equipped to deal with the sort of enquiries which seemed likely to arise. It is equipped to deal with the technical and operational effects of changes

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in our taxes i.e. the traditional content of our Press Notices but would not necessarily be able to cope with the wider questions which normally come to the Treasury Press Office.

c. Time was very short if the notices we had already prepared were to be significantly revised and still be ready for Budget day.

Against this background we specifically suggested that we should co-operate with the Treasury in determing how best to put out the sort of material the Financial Secretary wanted this year. For the future we suggest that Ministers may wish to look at the whole question of Budget publicity. It goes without saying that we should be glad to join in such a study.

13 June 1979

R M NEWBY
Private Secretary

578/79

cc: Mr. Hancock
Mr. Lovell

FPCJ
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For information:
Sir Lawrence Airey
Mr. Ridley

NOTE OF MEETING
- ATTACHMENT NOT FOUND

MR. WICKS

ENERGY MATTERS

I believe that you and Mr. Lovell have seen a note on the discussion of energy matters at the Chancellor's morning meeting of 20th June. A copy is attached for Mr. Hancock.

2. It would now be helpful to have your advice, in the form of an annotated agenda on the areas such a meeting should cover. This will be an internal Treasury meeting, comprising both Ministers and officials.

MAH

(M.A. HALL)
21st June, 1979

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Board Room
H M Customs and Excise
King's Beam House
Mark Lane London EC3R 7HE

PS/MINISTER OF STATE (COMMONS)

cc Principal Private Secretary
PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State (Lords)
Mr Lovell
Mr Griffiths

VAT INCREASES ON BEER AND PETROL

There have been a number of complaints in the licensed trade press that the Budget price increase of "approximately 2p" on a typical pint of beer quoted by the Chancellor in his Budget Statement was too low; and we have received enquiries from the Chancellor's Office about this. We feel it might be useful for the Minister of State to be prepared to deal with this point in his wind-up speech on Second Reading tomorrow. A draft speaking note is attached, in case the Minister of State thought it advisable to deal with the point.

For completeness, we have also included a paragraph on petrol. We should make it clear that in this case the trade has not complained about the Budget Speech, but many garages have added more than 10p to the pump price, no doubt reflecting the excess of demand over supply. If pressed, the Minister of State might like to draw on the speaking note, but we would advise against any fuller discussion of the price situation.

26 June 1979

M J ELAND
Private Secretary

EFFECTS ON PRICES OF VAT INCREASES

1. BEER

There have been a number of comments about my r.h.f's statement in his Budget Speech that as a result of the VAT increase, the price of a pint of beer would rise by "approximately" 2p. Since there have been press reports of increases ranging from 2p to 4p a pint, or even more, it has been argued that the 2p quoted by r.h.f. was somewhat misleading. I cannot accept this. Calculations of the effects of the VAT increase on beer prices were based on our best efforts to determine typical, country-wide prices. The typical price we assumed in our Budget calculations was 36p a pint. On this basis the VAT increase works out at just over 2.3p a pint. /Chancellors of the Exchequer traditionally include an estimate to the nearest penny of increases in prices of such items as beer as a result of excise duty changes. I do not think it was unreasonable for my r.h.f. to do so this year in relation to the VAT increase./ My r.h.f's estimate of "approximately 2p" was thus correct to the nearest penny. To have quoted a higher figure could have encouraged some licencees to have increases prices of cheaper beers by substantially more than was justifiable. /If pressed on London prices: I am sure that the many Hon Members who, like myself, have not so long ago spent many week in their constituencies away from the capital are no doubt well aware that saloon bar prices in London pubs are scarcely typical of the country as a whole./

2. PETROL

/Doubt has also been cast in the debate/ on my r.h.f's statement that the tax increase on a gallon of petrol would be about 10p. Press reports have indicated price increases in some cases of 12p to 14p. Price increases of this order reflect the decisions of the retailers concerned to improve their margins, which in many cases were depressed in the price-cutting period of 1977-78. I must emphasise that only 10p or so of any price increase can be directly attributed to the effects of the tax changes.

Mr Barnett
FPCS

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Board Room
H M Customs and Excise
King's Beam House
Mark Lane London EC3R 7HE

MINISTER OF STATE (C)

cc Chancellor
Chief Secretary
Financial Secretary
Minister of State (L)
Sir Douglas Wass
Sir Lawrence Airey
Mr Littler
Mr Lovell
Mr Kemp
Mr Unwin
Mr Griffiths
Mr Ridley
Mr Cropper
PS/Inland Revenue

VAT INCREASE: ANOMALIES AND HARDSHIPS

At our meeting with you on 20 June we discussed anomalies and hardships arising from the increase in VAT to 15%. I attach a note providing the further information you requested on various points.

2. The note mentions, on concert etc tickets, that we have asked the DES whether the special problems of organisers of cultural events could be met by direct subvention from the Arts Council. Our latest information is that the DES believe that it might be practicable but the cost could be a stumbling block, and the official Treasury would strongly oppose any increased provision for the arts. We will report further as soon as possible.

3. On vending machines, we have given what information we have about the size of operators, since you expressed interest in this at our meeting. You may also have intended to ask about the

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intervals at which machines are emptied. On this, we understand that cigarette machines are emptied at intervals of two to six weeks. We have no information about other machines which we believe may vary widely.

H Scholes

29 June 1979

H SCHOLES

DRAFT

ANOMALIES AND HARDSHIPS ARISING FROM THE INCREASE IN VAT

Television rentals

1. You asked us to consider, as a fallback position, the possibility of providing that the rate of VAT charged on TV rentals and other leased assets should be that in force at the time the asset was leased.

2. Hirings of goods are treated as continuous supplies of services, and Regulation 18 of the VAT (General) Regulations 1977 (SI 1977, No.1759) provides that the tax point for these occurs when a payment is received or a tax invoice is issued, whichever is the earlier. Since TV rental firms do not normally issue tax invoices, the tax point is almost invariably the time of payment, and the 15% rate applies to all payments received on or after 18 June 1979.

3. It is considered that a concession of the kind suggested could probably only be implemented by an amendment providing that VAT on TV sets being hired under contracts entered into before Budget Day (12 June) should continue to be chargeable at the 8% or 12½% rate as the case may be. (We suggest that it would be inequitable to confine such a concession to the 8% rate only.) There is a precedent for this in the Conservative amendment carried at Report Stage of the Finance (No.2) Bill 1975, which, with effect from 1 August 1975, restored the standard rate for rentals payable under contracts entered into before 16 April 1975 (Budget Day). However, it should be noted that it restored the standard rate, not an actual (e.g. 8%) rate of tax.

4. We would strongly recommend against any such concession for several reasons.

   a) The cost to the Exchequer could be substantial. There are about 12 million TV sets on hire, of which perhaps as many as half are still hired under pre-16 April 1975 contracts.

These would continue to attract VAT at 8% instead of 15%. There could also be pressure for extension of the concession to other goods, adding further to the cost.

b) There are also about 12 million private telephone subscribers. The telephone service is also a continuous supply of services. It could be argued that the telephone is more essential than a TV set and that it would be inequitable that it should bear more VAT than hirings under many TV contracts.

c) The 15% rate is already being charged under the Provisional Collection of Taxes Act. Any amendment having retrospective effect would therefore involve this Department and hiring firms in making repayments. This would be administratively complex and any amendment should preferably take effect from a forward date (say, Royal Assent) as in 1975. However, as we know from our experience in 1975, this would probably provoke a great volume of complaint from those who had already renewed their rentals (especially annual rentals) while the 15% rate was in force.

d) It would mean that rental firms would have to operate three rates of VAT (assuming that the concession extended to the 12½% rate: 8%, 12½%, 15%). This would create difficulties for businesses and would deprive them of the administrative benefit to be derived from the restoration of the single rate.

e) It would be detrimental to the television industry, since it would positively discourage consumers from entering into fresh contracts (essential when a set is changed). This would reduce demand for new sets.

f) It is likely that the considerations at c, d, and e, above weigh strongly with the television industry and account for the fact that we have received no representations from them for such a concession.

Note

You asked about the hiring life of sets. Our last information was that the average life of a set on hire was about 10 years, but a set would normally be hired out more than once in its life-time. It has been estimated that the average duration of a contract is about 4 to 5 years.

Retailers

1. Retailers operate the special retail schemes with the standard definition of gross takings under which they account for VAT by reference to their gross (cash) takings in a quarter. This saves them the work of having to document individual transactions. It also confers automatic bad debt relief and significant cash flow benefits (since they do not have to pay over the tax to this Department until, on average, about 2½ months after they have collected it from customers). In effect their cash takings measure the value of their supplies in a period. Tax point considerations have no relevance.

2. However a minority of retailers (some departmental stores and others with substantial sales on account) use a variation of the schemes (the optional definition of gross takings) under which they include the price of goods supplied on HP or credit in their gross takings at the time of supply (the tax point). Use of the optional definition dates from the inception of VAT in April 1973 when it was made available so that retailers with substantial credit sales did not have to account for VAT on money received after 1 April for sales made before then. It should be noted that traders using the optional definition have to account for VAT on the whole price of HP and other credit goods, when the tax point occurs. Also, they do not enjoy bad debt relief on such sales and they obtain less cash flow benefit than standard definition users.

3. The concession in Clause 1 (4) of the Finance Bill permits traders to account for tax at the old rate on supplies in fact made before 18 June 1979 even though the legal tax point may occur on or after that date. This concession had to be extended to retailers using the optional definition, since they are involved with tax points; but it could not apply to the great majority who use the standard definition of gross takings since, as stated, tax point considerations have no relevance to them.

4. However some standard definition users (e.g. furniture retailers) do make some credit sales, and there have been protests at their exclusion from the benefit of the tax point concession. But there is one way of alleviating their difficulties. Under the law as it stands (set out in our Notice No.727, which is issued to all retailers), retailers may account for tax in the normal way on transactions which are individually documented and recorded. We are therefore informing traders who ask whether it is open to them to account for VAT in the normal way on supplies on credit, that it is open to them to do so, provided they can meet the necessary documentation and record-keeping requirements. By so doing they can obtain the benefit of the tax point concession for their credit sales. Retailers who complain that the increase in rate has imposed an unfair burden on them are being similarly advised, though it is being pointed out to them that by so doing they lose some of the advantages of the retail schemes. The Retail Consortium have also been informed.

Concert etc. tickets

1. The problem arises where tickets for post - 18 June concerts and other events, but bearing a VAT - inclusive price, based on the old 8% rate, have been sent to agents for sale. It is impractical for promoters to require agents to amend prices to take account of the 15% VAT rate and they stand to make losses. You asked for consideration to be given to a temporary concession for cultural events such as the Edinburgh and Buxton Festivals.

2. Except where tickets have been paid for before 18 June the 15% rate applies to admissions to events taking place on and after 18 June and there is no scope within the VAT legislation for granting a concession in respect of pre-printed tickets held by agents.

3. In our view this is really a pricing problem and others, e.g. some retail shops, have been in the position of having to sell at the old rate because they were unable to re-price all their stocks in the period between announcement and implementation of the change. We consider therefore that introduction of a special provision to enable promoters to account for VAT at 8% on admissions charges to events for which pre-priced tickets had been sent to agents earlier could not be justified. On the narrower question of a concession for cultural events, this would raise difficulties of definition and problems would arise over borderline cases. Furthermore, the extent to which promoters of particular events have been disadvantaged and the scope they may have to help themselves will vary considerably (in some cases, for instance, it should be possible to surcharge tickets at the door).

4. In the circumstances we consider that, if necessary, the better course would be to deal with the special problems faced by the organisers of cultural events by direct ~~subscription~~ subsidy by the Arts Council and we have written to the Department of Education and Science to ask them to consider urgently whether it would be feasible to give a subsidy limited to making good actual losses which the organisers could prove were attributable to the increase in VAT.

Cigarette Vending Machines

1. You asked for information on average turnover rates for cigarette vending machine companies. Our information is rather limited in this respect.

2. There is no separate VAT trade classification for vending machine operators, and we do not have any relevant statistical information. However, we know that the National Association of Cigarette Machine Operators (NACMO) has about 290 members who operate about 150,000 machines. Five large firms account for about 60% of the market. We understand that the average turnover of the smaller operators is about £½m per annum, although there will obviously be variations. We do not know whether all or most traders belong to NACMO, and so it is possible that there could be some traders with very low turnovers outside NACMO.

Holidays

1. As we explained, there have been problems over returnable deposits paid for holidays. Normally, where payment is made in advance for a supply, the rate of VAT to be charged is that in force at the time of payment. But a returnable deposit does not become an advance payment until the booking or other contract is made firm. Normally, it is in the interest of suppliers that deposits should not be treated as advance payments, otherwise they would have to account for VAT on deposits at the time they received them and obtain a credit of tax later for deposits refunded. However we have agreed that in view of the impact of the increase from 8% to 15%, such deposits received before 18 June 1979 may be regarded as advance payments, provided the benefit is passed on to customers.

2. The British Tourist Authority, the Association of British Travel Agents, and the major holiday firms have been informed accordingly. For various reasons Butlins were not keen to have the concession when it was first given and asked us to withdraw it. Their version of events put out in the Evening Standard was misleading.

Mail Order Firms

1. Some of the large mail order firms selling goods through agents on long-term credit operate the retail schemes with the standard definition of gross takings (see note on Retailers). Some sell through as many as 500,000 agents (mostly householders). Where they provide their own financing (as some of these mail order firms do) they have to include instalment payments in their gross takings, as and when they receive them. Thus instalment payments received on or after 18 June will bear the 15% rate and they stand to make a substantial loss.

2. Two such firms (Freemans, Clapham Rd., SW9, and Grattan Warehouses, Bradford) have represented that they should be given the benefit of the concession (Clause 1(4) of the Finance Bill) whereby traders may account for VAT at the old rate on supplies in fact made before 18 June even though the tax point occurs afterwards.

3. However this concession does not apply to traders using the standard definition of gross takings for the reasons explained in the note on "Retailers". Even if the concession could be extended to these mail order firms, it would be of doubtful benefit to them since they would then have to account for tax on all outstanding instalments at one go (optional definition users have to include in their gross takings the whole cash price of goods sold on HP or other credit terms at the time when the tax point occurs).

4. You asked whether it would be practicable to deem that the tax point for goods supplied by such mail order houses should be the date at which the goods were passed to agents. It is considered that this would be impracticable for the following reasons:

a) Tax point considerations have no relevance where the standard definition of gross takings is used.

b) If such a concession could and did apply to these mail order houses it would mean that they would have to account for tax on goods much earlier than they do at present. Goods may be with agents for some months before they are sold.

Also, since quite a proportion are returned unsold to the Mail Order House, they would have to claim credits of tax on these. Altogether traders using such a provision would stand to suffer a considerable cash flow disadvantage.

<u>Cleaners</u>

1. Cleaners etc. have a problem because under a Practice Code agreed with the Office of Fair Trading they are obliged to charge customers only the price quoted at the time the goods are handed in for cleaning.

2. We have been able to meet their problems by permitting them to take out of the retail scheme certain transactions in the transitional period and account for VAT on them in the normal VAT way (see item on Retailers) on the under~~taking~~standing that the necessary records to support normal VAT accounting are held. In order to apply those arrangements it has been necessary to determine the time of performance of service for transactions being accounted for in the normal way. We have done so as follows:

a) <u>Same day cleaning</u> - time of performance is the time when the cleaning is booked.

b) <u>Longer-term cleaning and repairs</u> - time of performance is the time when the goods are ready for collection by the customer.

c) <u>Laundries</u> - time of performance is the time when the laundry has been packed ready for collection by or delivery to the customer.

The trade association has been informed that where these events occurred before 18 June 1979, cleaners and laundries may account for VAT at the old rate provided the necessary records are held.

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FPC

Mr Bonett

MR SCHOLES - CUSTOMS & EXCISE

cc Chancellor
Chief Secretary
Financial Secretary
Minister of State
Sir D Wass
Sir L Airey
Mr Littler
Mr Lovell
Mr Kemp
Mr Unwin
Mr Griffiths
Mr Ridley
Mr Cropper
PS/Inland Revenue

VAT INCREASE: ANNOMOLIES AND HARDSHIPS

The Minister of State has seen your minute of 29 June and has noted the further information provided on the various points raised at the recent meeting on this subject. I think it can be taken that for the present no further action is required on the various points raised and I will forward your original draft reply to Mr Haas' letter of 14 June for signature.

RJB

R J BROADBENT
3 July, 1979

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