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PART B

FINANCE BILL 1987

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PART B

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C/content?

CR914

FROM: G MCKENZIE

DATE: 6 April 1987

DMW 6/4/87.

1. MR WALTERS
2. MISS SINCLAIR
3. CHANCELLOR

B 6/4

cc PS/CST
PS/FST
PS/EST
PS/MST
Miss O'Mara
Mr Kalen
Mr Kelly MP

POST BUDGET COMMENTS

We have received a considerable amount of post-Budget letters expressing disappointment at the Government's Budget measures in favour of tax cuts as opposed to higher infrastructure spending (to ease unemployment).

2. I attach a suggested draft reply which we intend to set up on our computer as a standard reply. The draft has been agreed with GEP, MP and EB. We would welcome Ministers approval to the suggested reply.

G McKenzie

G MCKENZIE

DRAFT LETTER

Thank you for your letter of [ ] to [ ] which expressed disappointment at the Government's decision, in this year's Budget, to reduce taxes and not to increase infrastructure spending further as a means of reducing unemployment.

The Government announces its public spending plans at the time of the Autumn Statement, not in the Budget. Last autumn the Chancellor described increased plans for capital spending of around £1 billion in 1987-88 and 1988-89, so that public sector capital spending in total now amounts to over £22 billion a year.

But the projects which this sum finances are justified on their own merits: additional spending on the infrastucture is not an effective way of creating lasting jobs. The best means of ensuring that employment continues to grow steadily is to improve the way in which the economy functions. Lower rates of tax sharpen up incentives and stimulate enterprise, which in turn is the only route to better economic performance. And it is only by improving our economic performance that we will be able to afford to spend more ~~of~~ on public services; and only by improving our economic performance will we be able to create jobs on the scale that we all want to see.

This year's 2p reduction in the basic rate will improve incentives for almost 21 million taxpayers (around 95 per cent of those of working age) whose marginal rate is the basic rate. The increase in personal allowances in the Budget means they are now 22 per cent higher in real terms than in 1978-79 and ~~1½~~ 1.4 million people have been taken out of tax completely, compared with the tax regime the Government inherited, adjusted for subsequent price movements.

On top of this, the Chancellor announced in the Budget that he would be offering a new income tax relief to those who had an element of their pay directly related to the profits of the firm in which they worked. For a married man on average earnings this could be equivalent to anything between a further 1p and 4p off his basic rate of tax. While profit related pay will not in itself solve the unemployment problem, it is a tool which will help British business gradually to overcome a major obstacle to the creation of new jobs - the inflexibility of our labour market.

We therefore have to look at the whole picture. The Government's prudent management of the nation's finances in the past has enabled it this year to increase public spending and improve incentives through tax cuts, while reducing the level of public sector borrowing too. For the future, the Government remains committed to achieving a basic rate of income tax of no more than 25 per cent and to reducing the overall tax burden over the medium term. For the more ~~of their earnings~~ people can retain what they earn to spend as they themselves decide, the more efficiently the economy will perform and the more jobs it will create.

3749/030

88

ECONOMIC SECRETARY TO THE TREASURY

FROM: P D P BARNES
DATE: 6 April 1987

Mr Ross Goobey

PS/CHANCELLOR

AWK 6/4

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
Mr Cropper
Mr Tyrie

Mr Neubert, MP
Mr Lilley, MP

Mr Cayley - IR
Mr Shepherd - IR
Mr McGivern - IR
Mr Munro - IR

POST-BUDGET LOBBYING - COUNTER BRIEFS

The Economic Secretary has seen Mr Ross Goobey's minute to the Chancellor of 3 April.

2. The Economic Secretary had the following comments:-

Lloyds RIC

(i) In the second paragraph, the Economic Secretary suggests deleting the last two sentences.

(ii) In the third paragraph, the Economic Secretary thinks that we should avoid being too categorical, as the details here are still open for negotiation. He suggests deleting "very" in line two, and changing "the same" in the final sentence to "on a comparable basis"

Life Assurance Taxation

3. The Economic Secretary would be grateful for an explanation of what it means, in the third paragraph, to say that most "companies offset management expenses against their capital gains, which are therefore largely sheltered from Corporation Tax."

For Bank Tax Relief on Foreign Interest

(i) In the first paragraph line 2, the Economic Secretary suggests replacing "of" by "for".

(ii) In the second paragraph, the Economic Secretary wondered what is the significance of the last sentence. Some comments since the Budget do not support this asertion. He would like to know which other countries allow relief for witholding tax.

(iii) In paragraph 3, the Economic Secretary thinks that it is a mistake to imply that this measure is being directed against the Japanese. He would therefore prefer to delete the last sentence. However the proportion of such loans made by London-based branches or subsidiaries of overseas banking groups (he thinks this may be about two thirds) might be worth mentioning.

PB

P D P BARNES
Private Secretary

1782.20

RP

FROM: H C GOODMAN

DATE: 6 April 1987

ECONOMIC SECRETARY

cc: PS/Chancellor - 12/2
Mr Scholar
Mr Kelly
Miss Sinclair
Mr Dyer
Miss C Evans
Mr R Evans
Mr Haigh
Mr Watters
PS/IR
PS/C&E
Mr Hyett - T Sol

FINANCE BILL 1987: LOBBY NOTES

I attach the lobby notes for clauses 160 and 161 - repealing the Exchange Control Act. These are to put into the FT on Thursday. Following the usual practice, I have kept these to a few lines only.

H C Goodman

H C GOODMAN

CLAUSE 160 AND PART 12 OF SCHEDULE 21 provide for the repeal of the Exchange Control Act 1947 and the references to it in subsequent legislation. Subsection 3 provides that for capital gains tax purposes adjustment to the market value of assets takng account of exchange controls will cease to have effect except in relation to valuations before the removal of exchange controls in 1979.

CLAUSE 161 provides definitions of gold and foreign currency to replace the references to the Exchange Control Act used in the Banking and Financial Dealings Act 1979.

PUP.

CHIEF SECRETARY TO THE TREASURY

FROM: M C FELSTEAD
DATE: 6 April 1987

MR BRADLEY

cc:
Chancellor
Financial Secretary
Economic Secretary
Minister of State
Mr F E R Butler
Mr Anson
Mr Gilmore
Mr Scholar
Mr Turnbull
Mr Revolta
Miss Sinclair
Miss C Evans

FEES AND CHARGES AND VIRES: FINANCE BILL

This is just to confirm that the Chief Secretary is content with the suggested paragraph for his Second Reading speech* announcing the Government's intention to introduce clauses at Committee Stage of the Finance Bill to deal with defective fees and charges legislation.

* in your minute of 2 April

M C Felstead

M C FELSTEAD
Assistant Private Secretary

4367/013

FINANCIAL SECRETARY TO THE TREASURY

FROM: N WILLIAMS
DATE: 6 APRIL 1987

MR MICHAEL/IR

cc PS/Chancellor
PS/Chief Secretary
Ms Sinclair
Mr Cropper
PS/IR

CAPITAL GAINS: FINANCE BILL PRESS RELEASE

The Financial Secretary was grateful for your minute of 30 March.

2. This is to confirm that he was content with the draft press release attached to your minute.

N Williams

NIGEL WILLIAMS
(Assistant Private Secretary)

RP

FROM: S P Judge

DATE: 6 April 1987

MR BONE - C&E

cc PS/Chancellor
PS/Chief Secretary
Miss Sinclair
Mr Culpin
Miss C Evans
Mr Walters
Mr Dyer
Mr Cropper

PS/Customs & Excise

FINANCE BILL 1987: CUSTOMS LOBBY NOTES

The Minister of State has seen your submission of 2 April and, as I told you on the telephone, is content with the draft Lobby Notes attached.

On Klondykers, the Minister has seen Mr Felstead's note of 3 April. He is in principle content for the **Chief Secretary** to announce these Government amendments at Committee Stage in his Second Reading speech. But in his view this issue should not be referred to until we are confident that the legislation is ready. I spoke to Mr Bolt about this last week, who filled me in on recent progress. I would be grateful for further progress reports as appropriate, so that Ministers can decide whether to refer to Klondykers at Second Reading.

SPJ

S P JUDGE
Private Secretary

37/3070

cc Chancellor
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P. Middleton
Sir T. Burns
Mr F E R Butler
Sir G. Littler
Mr Cassell
Mr Lavelle
Mr Monck
Mr Odling-Smee
Mr Sedgwick
Mr Turnbull
Mrs Lomax
Mr Culpin
Miss O'Mara
Mr Cropper
Mr Ross Goobey
Mr Tyrie

H M Treasury
Parliament Street London SW1P 3AG
Switchboard 01-233 3000
Direct Dialling 01-270 4419

M C SCHOLAR
Under Secretary

W Mackay Esq
Clerk to the TCSC
House of Commons
London SW1

6 April 1987

Dear Bill,

pup

DRAFT REPORT ON THE BUDGET

Interest rates and credit growth

You asked for quick factual comments from us on the draft report you sent to Carys Evans on Friday morning. I thought it right to write to you with my comments on this occasion, because your draft contains an important misunderstanding about the way that monetary policy is operated. The misunderstanding arises in the final sentence of paragraph 16, and in paragraph 17.

2. The draft appears to assume, as stated at the end of paragraph 16, that the Government uses short term interest rates to control the growth of credit. This is not, however, the position. Short term interest rates are set after taking account of an assessment of all the indicators of monetary conditions, of which the growth of credit and broad money is only one. Moreover the aim is not to seek to use interest rates to control the growth of lending or broad money to any particular rate. The aim is to keep monetary conditions, judged as a whole, on track. Changes in interest rates have a wider effect on monetary conditions and on the economy, beyond their effect on the demand for credit.

3. The point was addressed by the Chancellor, the Governor and by officials in answer to questions 199, 136 and 18. It was also covered in the 1986 MTFS, in which as the Committee will recall a target was set for the growth of £M3. Paragraph 2.18 explained that "Experience has shown that a change in short term interest rates is unlikely to alter the growth of £M3 significantly" within the financial year; but such action "clearly affects the tightness of monetary conditions, which is what matters, and this will be likely to show up in the behaviour of M0 and the exchange rate."

4. There are a number of other points which we should make. These are set out below, or (the more detailed points) in the

annex to this letter.

Volume controls on credit

5. Paragraphs 15 and 16 of the draft report seem to contrast the Governor's statement that he "would not be averse" to such controls, with the statements by the Chancellor and officials that with a given fiscal policy, interest rates are the main instrument. In the sentence following the passage from the Governor's evidence quoted in paragraph 15 he made it clear that he did not think that such controls could be made to work, or be policed - a point also made by officials in their evidence.

Louvre Accord

6. Paragraphs 35-41 contain a number of alleged differences between the Governor's view and the Chancellor's view, which do not seem to be supported by the transcripts of their evidence:-

(i) Paragraph 35 says that the Governor's statement suggests very strongly that target ranges for the G6 currencies have been established. The exchange in answer to question 145 was as follows:-

> "Do you think it would have been helpful if explicit target ranges for the currencies had been set at the G6 meeting and published?
>
> Answer: "I do not think so, no."

(ii) Paragraph 38 says the Committee find the Chancellor's explanation of why he preferred not to comment on whether or not target ranges exist was "unconvincing". The draft does not mention that the Governor gave the same explanation (answer to question 145 again):-

> "I think we are more effective in our concerted intervention if we can leave the market guessing about at what moment we come in and out."

(iii) Paragraph 39 says the Governor admitted that in operational terms the Louvre Accord and membership of the ERM are very similar. In fact he made it clear in answer to question 159 that he saw important differences.

(iv) Paragraph 41 suggests a difference between the Governor's and Chancellor's views on what would happen if there were a major structural change in one of the G6 economies. It says that "The Governor told us that a major structural change in one of the economies could release it from its obligations." In fact he said "It would be understood that they would either be released to a degree, or there would be a different reaction from them." (Q.144). The quote from the Chancellor given in this paragraph was in answer to a different question (Q.219): not a question about the conditions in which a country might be released from its obligations under the Accord.

7. One final point, on paragraph 41. There is no contradiction between the Louvre Communique and the selected passage of the Budget speech. The present constellation of exchange rates coupled with the implementation of the policy declarations contained in the Louvre Communique should correct the imbalances referred to. The existence of these imbalances was specifically recognised in the Louvre Communique (paragraph 4: copy of text attached).

Yours sincerely,

Michael Scholar

M C SCHOLAR

Detailed Points

Corrected versions of the chosen quotations are attached.

Paragraph 9

It is important to include the extra sentence about the list of indicators.

It should be made clear that the underlining in the quotation from the FSBR is the Committee's emphasis.

Paragraph 10

The words "if anything" should be inserted at the beginning of the quotation.

Paragraph 11

We do not agree there is "a distinct divergence of views". (See covering letter.)

Paragraph 13

Last sentence. The Chancellor's answer to question 195 is relevant here.

Paragraph 19

Third sentence: £1.5 billion should read £1.4 billion.

Paragraph 22

Fourth sentence. After PSBR delete "including privatisation proceeds", insert after GDP ": it shows both PSBR and privatisation proceeds and the sum of the two."

Paragraph 32

Second sentence: "higher tax take" should read "higher general government receipts".

Paragraph 42

First sentence after Autumn Statement. We suggest adding "in part reflecting revisions to estimates of the invisibles balance in 1986."

GDP." The target range for MO growth in 1987-88 is 2-6%, unchanged from the range indicated in last year's MTFS.

8.The Red Book is more explicit than usual about the role of the exchange rate in monetary policy. Paragraph 2.10 notes that, "at a meeting of Finance Ministers and Central Bank Governors of six major industrial nations in Paris on 22 February, it was concluded that a period of stability would be desirable. Accordingly the UK and other countries represented there agreed to cooperate closely to that end. The MTFS projections assume that there is no major change in either the sterling exchange rate index on the sterling/dollar exchange rate from year to year." While the latter assumption always accompanies each new version of the MTFS, given the Chancellor's post-Budget comments[6] there now seems to be a better justification for assuming that the Government has a more explicit, although unstated, exchange rate target. We return to this question in para ...

9.In seeking guidance on changes in ~~the~~ monetary conditions, the Government continues to place the main emphasis on narrow money. Paragraph 2.14 explains that, "if the underlying growth of MO threatens to move significantly outside its target range in 1987-88 there is a presumption that the Government will take action on interest rates unless other indicators clearly suggest that monetary conditions remain satisfactory" [our emphasis]. We expressed

6. Financial Times, 19 March 1987

interest in the "other indicators" used to assess monetary policy and their role relative to MO in determining possible changes in short term interest rates. Treasury officials told us that in addition to narrow money, broad money and the exchange rate

> "We look at quite a range of evidence. Movements in asset prices – house prices, the stock-exchange ~~prices~~ can produce valuable evidence about monetary ~~positions~~ conditions. The most up-to-date information about inflation itself, which includes producer prices as well as consumer prices. Movements in the oil price which is clearly one of the important factors which affect the exchange rate. ~~appropriate movements in the~~ exchange rate And to some extent movements in the interest rates themselves, and how our rates compare with rates abroad and interest rate differentials." I do not want to give the impression that it is a complete list.

They went on to say that:

> "MO has proved quite a reliable indicator ~~in~~ for a number of years, so we would need some persuading that it was telling us wrong things but, if the range of other evidence said it was giving us a misleading message, then we would do precisely what it says in that paragraph." [2.14]."[8]

10. In previous reports we have expressed doubts about the

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7. Q11
8. ibid

suitability of MO as a leading indicator since there have been occasions on which it appeared to respond to money GDP changes with a lag, rather than leading changes in nominal income. Although in oral evidence the Treasury attempted to refute this claim, referring us to published research which seemed to show that "if anything the evidence is that money GDP follows MO",[9] we are relieved to find that in assessing monetary conditions MO is supplemented by such a range of other indicators.

11.Nonetheless we feel we must continue to exhibit concern about the recent behaviour of some of the indicators used to assess monetary conditions. Our concern is heightened by the fact that there seems to be a distinct divergence of views about their behaviour on the part of the authorities.

12.In our reports both on the 1986 Budget and the Chancellor's Autumn Statement we expressed concern at the build up of personal liquidity, graphically described by the Governor of the Bank of England as an "overhanging glacier of liquidity." The Red Book alludes to the continuing build up of private sector liquidity but gives the impression that the Government felt no particular anxiety about this, together with any future consequences that such a build up might have on the economy. Paragraph 2.15 tells us that:

"Private sector borrowing has been rising and is now

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9. Q3

over 10% of GDP. It has clearly contributed more than public borrowing to upward pressure on real interest rates. These trends are likely to persist, so that broad money growth may continue at around its recent rate, well in excess of the growth rate of money GDP."

13. In oral evidence, however, the Chancellor seemed to argue that the growth in personal bank lending and the upward pressure on interest rates was in some sense a reflection of Government policy in other areas:

> "... if you look at the figures, the growth [of private borrowing] as a share of GDP ~~it~~ is entirely attributable ~~- entirely as a share of GDP -~~ to the ~~grea~~t growth of mortgage~~s~~ borrowing. ~~primarily,~~ This borrowing is primarily, although there is no doubt some equity withdrawal, for the purpose of house-purchase and home improvement. ~~of course.~~ It is part of the Government's policy to encourage home ownership, including the purchase by council tenants of the homes in which they live. Therefore that leads to more mortgages being ~~granted~~ taken out. ~~Therefore,~~ provided that we can contain the monetary consequences of that, which we are doing, and have done - then I do not regard that as a matter of concern."10

However house prices have continued to rise, and they are one of the Government's "other indicators".

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10. Q187

growth of the money supply, such as an unfunded PSBR or an autonomous increase in the demand for consumer credit, the Chancellor told us that:

> "I do not think it is very necessary to distinguish between them since what matters is ~~the~~ overall monetary growth... Whatever the cause of ~~excessive monetary growth or~~ monetary growth which one might consider to be excessive, the only ~~real~~ instrument one has to deal with it is the level of interest rates, particularly short term interest rates".[14]

Sir Peter Middleton concurred that:

> "given ~~the~~ fiscal policy, since we abolished exchange controls and the corset came to an end, the only instrument is interest rates; there is not another one."[15]

We assume from this that the Government bases its approach on funding the PSBR completely, and uses short-term interest rates to control any increase which may take place in the growth of credit.

17. There seems however to be considerable uncertainty about the extent to which bank lending and the demand for credit generally respond to changes in short-term interest rates. The view was put to our predecessor Committee in 1980-81, by Professor Friedman that:

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14. Q184
15. Q187

increase in inflation together with the unrevised planning totals, the spending plans announced at the time of the Autumn Statement could be met. We were told that, "the Government will be seeking to hold those totals."[20] It was pointed out however that the Planning Total might not now be so sensitive to changes in the rate of inflation.

> "One other factor to bear in mind is that when inflation is rising one major source of risk is the fact that social security benefits are linked to inflation. ~~Now, what we have is that~~ The timing of the upratings ~~is such that if~~ now operates by taking the infaltion rate ~~is taken~~ in the year to September ~~that~~ and appl~~ies~~ying it from the following April. ~~so~~ Thus for the coming year the social security benefits have an uprating that has already been ~~tackled~~ settled and whatever ~~is~~ happen~~ing~~s to inflation in the current months will not affect the rate of expenditure during 1987-88. ~~That is a~~ Thus there is a very large chunk which, in effect, is immune from ~~the~~ current movements ~~of~~ in inflation".[21]

Nonetheless past experience suggests that spending is likely to overshoot the Planning Total.

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20. Q99
21. Q100

THE PSBR

21. As discussed in para ..., the expected outturn for the PSBR in 1986-87 is £4 billion, or about 1% of GDP, and the Chancellor announced a similar target for 1987-88. In announcing the PSBR target for 1987-88 the Chancellor said:

> "Since its inception in 1980, the MTFS has indicated a steadily declining path for the PSBR expressed as a percentage of GDP. We have now reached what I judge to be its appropriate destination - a PSBR of 1% of GDP. My aim will be to keep it there over the years ahead. This will maintain a degree of fiscal prudence that, until this year, has been achieved on only two occasions since 1950."[22]

22. We have for some time discussed in evidence with the Treasury the relevance of the PSBR as a measure of the Government's underlying need to borrow when privatisation proceeds are a significant source of finance. In 1987-88, the PSBR target is £4 billion, and privatisation proceeds are expected to total £5 billion. Although the Government continues to frame its fiscal policy in terms of the PSBR, we welcome the fact that they have effectively acknowledged our previous arguments. For example, Chart 2.5 of the Red Book shows the evolution of the PSBR ~~including privatisation proceeds~~ as a percentage of GDP. While we do not wish to pursue this particular issue further with the

: it shows both PSBR and privatisation proceeds and the sum of the two.

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22. HC Deb (1986-87) vol ..., c 818

Government, we note that the Public Sector Financial Deficit, which measures the Government's underlying need to borrow <u>before</u> privatisation proceeds are subtracted from expenditure, is forecast to remain about the same, at 2% of GDP. It is not clear to us why the Government has not reduced the PSBR still further, to below 1%, when the underlying need to borrow exceeds the long run target of 1%. We note the Chancellor's argument[23] that holding the PSBR steady at 1% is the modern equivalent of the balanced budget doctrine. So far as the argument is soundly based, however, we believe it should relate to the larger figure, the Public Sector Financial Deficit and not the PSBR.

23.We are in any case unclear why a PSBR of 1% of GDP is regarded as an "appropriate destination". Officials from the Treasury suggested a number of reasons for maintaining a positive PSBR, principally the contribution which a declining PSBR could make to the Government's money GDP objective:

> "There is clearly a demand for public sector debt and, as long as the economy is growing, there will be some interest in holding debt. That is one argument. Another is that it would be quite consistent with the growth of money GDP that the Government is seeking. ~~and~~ In the very long term of course that is a growth which is equal to the rate of growth of productive potential, and the Government sees no difficulty about

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23. Q172

seeking an extra amount of debt which would match the accumulation of assets to some extent. I do not mean exactly match but taking place in a world where there is also some accumulation of assets this would be a stable and sustainable situation"[24]

and

"The objective of every fiscal policy since the first MTFS in 1980 has been to keep public sector borrowing at a level, and if necessary on a declining trend, which will support ~~the~~ monetary policy. ~~and~~ The role of monetary policy has been to create monetary ~~confidence~~ conditions which will bring about the desired growth of money GDP and in the early days put heavy downward pressure on inflation. We are now saying that the illustrative path of the PSBR over the medium term of 1% of GDP is fully consistent with these broad objectives".[25]

24. The Chancellor gave primacy to the desirability of preventing the ratio of debt to real GDP from rising:

"It has been clear to me throughout my time as Chancellor that 1% of GDP would be an appropriate destination. This was implicit, for example, in the Green Paper "The Next Ten Years: Public Expenditure and Taxation into the 1990s", which I published simultaneously with my first Budget in 1984. If you

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24. Q69
25. Q73

turn to paragraph 55 of that Green Paper, you will see it stated that, "In the period to 1988-89, the PSBR is assumed to follow the illustrative path set out in the MTFS. Thereafter it is assumed to fall further as a share of GDP from 1 3/4% in 1988-89 to 1% in 1993-94". The reasoning behind the 1% equilibrium level implicit in the Green Paper was made rather more explicit in my Lombard Association speech last April, ~~and~~ let me quote from that: 'There is, of course, no scientific formula for determining the 'right' size of of the PSBR ... But, over the medium and longer term, it is clearly important that the amount of public debt, and the burden this imposes, should not rise as a proportion of GDP'.

Over the medium and longer term the Government's objective is zero inflation. It follows that money GDP will then grow at the real rate of growth of the economy, perhaps ~~on~~ an underlying 2½% per cent a year, to be on the safe side. Against that background, a 1% per cent PSBR will ensure that public debt does not rise as a share of GDP. This is the modern equivalent of the balanced budget doctrine. By contrast, to allow the debt/GDP ratio to remain constant on anything other than a zero inflation basis is simply a recipe for accelerating inflation."26

25. With a PSBR at 1% of GDP, the public debt ratio may be

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26. Q172

stable; but the Chancellor has not offered any arguments in favour of this or any other ratio. He has simply stated that he does not want it to continue increasing. The Chancellor acknowledged that this target has been achieved more quickly than anticipated due to two factors, the unexpectedly strong revenue outturn and the contribution of asset sales. However, no reasons have been given why the current debt:GDP ratio is preferable to that which would have obtained if the economy have evolved in line with the 1984 Green Paper, which did not envisage the fall to 1 per cent until 1993-94.

26.Officials from the Treasury admitted a connection between the accumulation of new public assets and the level of borrowing. The Chancellor rejected a more formal analysis of public finances in terms of a government or national balance sheet which considered both public sector assets and liabilities and incorporated the notion of the net worth of the government sector:

> "I do not think it is possible in practical terms to know what the net worth of the public sector is, whereas you do know what public sector debt is.[27]"

27.We conclude that the framework for determining the PSBR in the long term is little more than a rule of thumb. The Chancellor, quite rightly, wishes to avoid a situation in which public debt grows uncontrollably. But beyond that he

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27. Q213

FORECASTING

28. When announcing the planning total increases in the Autumn Statement, the Chancellor implied strongly that the scope for tax cuts was substantially reduced. Indeed, a target for the PSBR of 1 3/4% of GDP without any tax cuts then seemed to be the best the Chancellor was hoping for. He told us that:

> "As I said in the House in the questioning that followed the Autumn Statement, a pound used in additional public expenditure is a pound which is not available for reductions in taxation, unless you are prepared to expand the borrowing requirement, and I have made it clear and explicit that/that I will not do[28]

29. The difference between the situation anticipated in October and that which occurred is due almost entirely to the fact that Government revenue was substantially higher than expected. Non-oil receipts (including interest and dividents) were about £4 billion higher in 1986 than those projected in last year's Budget. £1 3/4 billion of this is due to higher than expected corporation receipts. We asked Treasury officials the reasons for this large forecasting error. There were two reasons:

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28. Second Report, 1986-87 (HC27) para 21

That was one reason.

"One is that I think we underestimated ~~the~~ profits ~~base~~ in the previous year, particularly for financial companies. The other is that following a period when there ~~have~~ has been substantial ~~profits~~ growth~~s~~ of profit over ~~for~~ a number of years, and large profit growth~~s~~ in ~~every~~ each year, it is very difficult to estimate the extent to which previously tax exhausted companies ~~key into~~ begin to pay tax. ~~pay, and~~ I think that the latter is probably one of the ~~most~~ important reasons - or the main reason - why this time last year we underestimated onshore (which is what we are talking about here) Corporation Tax receipts in financial year 1986-87.[29]

30. So far as concerns the movement of companies into tax-paying positions officials said that:

"a good deal of this information becomes available on an aggregate basis, which is what one needs ~~here~~ for ~~doing~~ making forecasts of total Corporation Tax receipts somewhat in arrears".[30]

31. The Inland Revenue explained their forecasting methods for Corporation Tax.

32. The increase in Corporation Tax receipts is expected to continue in 1987-88. Another £1½ billion of the higher tax take in 1986-87 is attributed to a

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X 29. Q10~~4~~5
30. Q108

"I am saying that we did go into the question of currency fluctuations very thoroughly. We did go into the nuts and bolts, but we also agreed we would not reveal those to the market"[32]

"I am not saying whether they [target bands] exist or not. What I am saying is, we do not publish the nuts and bolts of the Paris ~~A~~accord."[33]

36. The Governor said that specific ranges were not even discussed:

"... quite honestly, very little is said between us central bankers, actually, about figures, numbers and money. We have an understanding"[34]

37. We cannot see how the G6 can conclude that existing parities are "about right" without also having in mind bands around these parities which they regard as acceptable. Our scepticism is reinforced by reports that the Japanese Prime Minister has admitted that a target rate of Y150 to the dollar was discussed and agreed by all parties in Paris.[35] Secondly, if central banks do not discuss "figures and numbers" it is difficult to see how they could agree on concerted action when these "acceptable parities" are breached.

38. The Chancellor's reason for not making public the

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32. Q257
33. Q256
34. Q14~~4~~5
35. <u>Daily Telegraph</u> 31 March 1987 p 19

BALANCE OF PAYMENTS

In part reflecting revisions to estimates of the invisibles balance in 1986

42. The forecast ~~for~~ the current account of the Balance of Payments has been revised substantially downwards since the Autumn Statement. The Balance of Payments deficit for 1987 is now forecast at £2.5 billion as compared with the Autumn Statement figure of £1.5 billion. More significantly, for longer term economic prospects, the deficit in trade in manufactures is forecast to increase from £5.5 billion in 1986 to £8 billion in 1987.

43. We believe that assessment is too pessimistic. In the first place, the economy achieved a real improvement in competitivensss in 1986. Moreover, para 3.22 of the Red Book points out that "most of the gain in competitiveness seems likely to be maintained over the year ahead." The January and February 1987 Balance of Payments figures suggest that the 'J-curve effect' is beginning to show. Secondly, the forecast assumes an oil price of US$15 a barrel, which is likely to be low. The price of oil has firmed, and since the UK is an important exporter of oil, there should be a favourable consequence for the Balance of Payments. We are therefore less concerned about the Balance of Payments than a number of other commentators.

3749/041

28

FROM: P D P BARNES
DATE: 7 April 1987

MR WALKER - IR

cc PS/Chancellor 2
PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
Mr Walters

Mr Isaac - IR
Mr Painter - IR
PS/IR

FINANCE BILL: LOBBY NOTES

The Economic Secretary has seen your minute to PS/Financial Secretary of 3 April.

2. The Economic Secretary is content with the notes on the clauses which concern him, except that he would like you to delete the last sentence on the note on clause 32 ("Treasury Press Notice 16 December 1986").

PB

P D P BARNES
Private Secretary

3749/042

Pmp

FROM: P D P BARNES
DATE: 7 April 1987

MS GOODMAN

cc PS/Chancellor 2
Mr Scholar
Mr Kelly
Miss Sinclair
Mr Dyer
Miss C Evans
Mr R Evans
Mr Haigh
Mr Walters

PS/IR

PS/C & E

Mr Hyett - Tsy Sol

FINANCE BILL 1987: LOBBY NOTES

The Economic Secretary was grateful for your submission of 6 April.

2. As we discussed, the Economic Secretary would prefer to delete the second sentence of the note on clause 160.

PB

P D P BARNES
Private Secretary

1 Tony
2 PUP

FROM: D N WALTERS
DATE: 7 APRIL 1987

MR EVANS

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Mr Scholar
Miss Sinclair
Miss Evans
Mr Haigh
Mr Romanski
Mr Walker - IR
Mr Bone - C&E

FINANCE BILL 1987: LOBBY NOTES

... I attach the final version of the lobby notes for the 1987 Finance Bill. As you are aware, the texts have all been cleared with Ministers.

D N Walters

D N WALTERS

FINANCE BILL 1987: BACKGROUND NOTES

CUSTOMS & EXCISE AND TRANSPORT

Clause 1 provides for the introduction of a duty differential (5p per gallon including VAT) in favour of unleaded petrol with effect from 6 pm on 17 March 1987. Further details are given in Customs and Excise News Release 22/87.

Clause 2 and Schedule 1 (Parts I and II) amend the rates of Vehicle Excise Duty (VED) on farmers' goods vehicles over 7.5 tonnes gross weight from 18 March 1987 and on trade licences from 1 January 1988. They also introduce a new tax class for recovery vehicles from 1 January 1988; the rate of duty will be £50 per annum. Details are in Department of Transport Press Notice number 124.

Clause 2 and Schedule 1 (Part III) introduce a number of other changes to VED:

- penalties for VED will be strengthened by preventing convicted VED evaders from avoiding liability for back duty by removing two of the existing defences;

- a minor technical defect in the trade licensing provisions of the Finance Act 1986 will be corrected;

- the penalties applying to certain offences will be clarified and the maximum penalty increased to level 3 on the standard scale (currently £400); and

- the penalty for failure to return a tax disc issued against a cheque subsequently dishonoured will be increased to five times the annual rate of duty payable, if more than £400.

Further information is included in Department of Transport Press Notice number 125.

Clause 3 abolishes the duty on on-course betting with effect from 29 March 1987 and provides for the continuation of existing Customs and Excise control powers.

Clause 4 increases the rates of gaming machine licence duty with effect from 1 June 1987. The new rates of duty are also given in Customs and Excise News Release 23/87.

Clause 5 provides for changes with effect from 1 October 1987 in the arrangements for collection and repayment of gaming machine licence duty. Further information is given in Customs and Excise News Release 23/87. The Clause also enables regulations to be made permitting spare gaming machines to be kept unlicensed in certain circumstances for use in the case of breakdown of other, licensed, machines.

Clause 6 amends the Customs and Excise Management Act 1979 to enable officers of Customs and Excise to enter and inspect premises and goods at approved wharves and transit sheds.

Clause 7 amends the Customs and Excise Management Act 1979 to extend Customs and Excise officers' powers of search of vessels and aircraft to include other vehicles within Customs-controlled zones and installations. These changes will assist action against drug smuggling.

Clause 8 amends the Customs and Excise Management Act to provide exporters of goods within the EC Common Agricultural Policy with greater flexibility as to the date on which they may bring such goods under Customs control at their premises. Under EC legislation this date determines the rate of any refund or charge applicable, so that the provision will enable exporters to take advantage of beneficial rates.

Clause 9 introduces a new section in the Customs and Excise Management Act 1979 to require records to be kept by persons concerned in the importation or exportation of goods. This will facilitate trade by permitting the acceptance in certain circumstances of electronically transmitted customs freight declarations without any supporting paper documentation. The 'paperless entry' facility will be subject to approval, and one of the conditions will be the requirement for importers and exporters to retain, as part of their business records, any necessary supporting documents.

Clause 10 introduces a new section in the Customs and Excise Management Act 1979 to enable the Commissioners to specify the way in which records relating to imports and exports should be provided. It also gives authority for the inspection of such records at the premises of importers and exporters. The aim of the Clause is to provide for the examination of records in cases where freight declarations have been made electronically.

Clause 11 enables regulations to be made permitting schemes for cash accounting and annual accounting by certain businesses. Cash accounting will be introduced on 1 October 1987 (subject to EC approval) and annual accounting in the summer of 1988. Further details are given in Customs and Excise News Release 16/87.

Clause 12 amends the Value Added Tax Act 1983 so as to restrict deductible input tax and to counter tax avoidance. It also enables regulations to be made to secure a fair and reasonable attribution of input tax to taxable supplies and to adjust input tax which has been incorrectly attributed. These measures came into effect on 1 April 1987. Further information is contained in Customs and Excise News Release 17/87.

Clause 13 introduces new provisions allowing the registration for VAT of businesses established in the UK which make no taxable supplies within the UK and of businesses which make only supplies of goods in warehouse. Further details are contained in Customs and Excise News Release 17/87.

Clause 14 amends Schedule 1 to the Value Added Tax Act 1983 to make changes in general registration and deregistration requirements. In particular, it extends the time to notify liability to be registered to 30 days. Further information is given in Customs and Excise News Release 16/87.

Clause 15 introduces a new provision with effect from 1 April 1987 whereby, in certain circumstances, partly-exempt VAT groups will be required to account for VAT on the acquisition of business assets on the transfer of a business (or part of a business) as a going concern. Further details are contained in Customs and Excise News Release 17/87.

Clause 16 gives the Treasury powers to provide by Order for a special scheme applying VAT to tour operators' services. The scheme is intended to take effect from 1 April 1988. The intention to legislate in 1987 was announced on Budget day 1986. Further information is given in Customs and Excise News Release 21/87.

Clause 17 extends the provisions of the Value Added Tax Act 1983 to enable the special valuation rules for taxable supplies between connected persons to apply also to exempt supplies with effect from 1 April 1987. Further information is given in Customs and Excise News Release 17/87.

Clause 18 exempts, with effect from 1 April 1987, the underwriting of and making arrangements for capital issues. This is also mentioned in Customs and Excise News Release 17/87.

Clause 19 deals with the interpretation of chapter II of the Bill and introduces the amendments in Schedule 2.

Schedule 2 has 4 paragraphs

Paragraph 1 amends the VAT Act 1983 with effect from 1 April 1987 to prevent tax avoidance of VAT on imported services by exempt businesses. Further details of the changes are given in Customs and Excise News Release 18/87.

Paragraph 2 extends the provisions of section 23 of the Value Added Tax Act 1983, concerning repayment of tax on supplies made in the UK to those in business overseas, to include goods imported by them into the UK.

Paragraph 3 provides for the immediate VAT registration of the transferee when a registrable business is transferred as a going concern. The transferee will have 30 days in which to notify his liability to be registered.

Paragraph 4 provides for partly-exempt businesses to have a right of appeal to a VAT tribunal about the use of the new partial exemption method.

INLAND REVENUE

* indicates Inland Revenue press notice issued on Budget Day
+ indicates Inland Revenue press notice to be issued on 8 April

*__Clause 20__ sets the charge and rates of income tax for 1987-88, including the new basic rate of 27 per cent. It also provides for changes to the thresholds for the higher rates of tax.

*__Clause 21__ sets the main rate of corporation tax for the Financial year 1987 at 35 per cent (unchanged).

*__Clause 22__ reduces the rate of corporation tax for small companies for the Financial Year 1987 from 29 per cent to 27 per cent.

*__Clause 23__ fixes at 27 per cent the rate at which deductions are to be made from payments to subcontractors in the construction industry who do not hold exemption certificates. The change takes effect from 2 November 1987.

*__Clause 24__ amends, for 1987-88, the date from which the new tax allowances will be put into operation for PAYE. (There is no provision specifying the main personal allowances for 1987-88, since these are automatically increased under the statutory indexation provisions of the 1980 Finance Act.)

*__Clause 25__ sets the 1987-88 mortgage interest relief limit at £30,000 (unchanged).

*__Clause 26__ introduces a new higher level of age allowance for elderly people aged 80 and over on modest incomes. This will be available for the first time in the 1987-88 tax year.

__Clause 27__ ensures that invalid care allowance payable to married women is regarded as their earned income for the purposes of the wife's earned income allowance and wife's earnings election. The provision applies from 1984-85. Unemployment benefit paid to a married woman is to be treated as her earned income for wife's earnings election purposes with effect from 1987-88. Inland Revenue press notice 25 July 1986.

*__Clause 28__ provides for the blind person's allowance to be increased for 1987-88 and subsequent years from £360 to £540, and from £720 to £1,080 for a married couple where both are blind.

__Clause 29 and Schedule 3__ amend the legislation which provides for the taxation of supplementary benefit paid to the unemployed and to strikers to reflect the replacement in 1988 of supplementary benefit by income support.

*__Clause 30__ changes the limit on tax-exempt life or endowment assurance business carried on by friendly societies, with effect from 1 September 1987. The new limit is annual premiums of £100, instead of gross sums assured of £750. The Clause also rectifies a minor loophole in the existing friendly society tax legislation.

*<u>Clause 31</u> increases the limits relating to the tax exemption given to trade unions on their income and capital gains which are used to pay provident benefits to their members. The qualifying limits go up to £3,000 (from £2,400) for lump sum benefits, and to £625 (from £500) for annuities. The new limits apply from 17 March 1987.

Clause 32 increases the limit on charitable donations eligible for relief under the new payroll giving scheme from £100 to £120 a year. It applies from 6 April 1987.

Clause 33 and Schedule 4 enable companies to include in approved share option scheme rules an additional provision in the event of a takeover to permit scheme participants to exchange existing share options for options over shares in the acquiring company. This will operate in respect of takeovers after Budget Day where a change in the scheme rules is approved following Royal Assent. There are also minor technical changes to the "material interest" provisions which govern whether directors and employees qualify to participate in approved share schemes and for interest relief on loans for share purchases. The changes will help the smooth running of the three types of approved share scheme and are already operative.

Clause 34and Schedule 5 makes various amendments to the legislation in the 1970 Finance Act concerning occupational pension schemes, to implement the anti-exploitation measures concerning eg excessive lump sums announced on Budget Day, and applying to arrangements entered into on or after that day. Other measures enable occupational scheme members to obtain full tax relief for additional voluntary contributions (AVCs) paid to a separate pension plan, from October 1987.

Clause 35 provides, with effect from 26 November 1986, relief from tax on business profits for the costs on seconding employees to local education authorities and certain other educational institutions.

+***Clause 36 and Schedule 6*** give tax relief for the cost of retraining in new job skills provided by an employer for employees who are to leave or former employees. The provisions apply to retraining costs incurred on or after 6 April 1987 and ensure that, subject to certain conditions, these costs are deductible in calculating the employer's taxable profits and that the employee is not taxed on them.

Clause 37 and Schedule 7 standardises the date on which corporation tax is payable at nine months after the end of a company's accounting period. Where the interval is longer, there will be transitional arrangements to make the reduction in three equal stages over three years. These will start with the first accounting period beginning on or after 17 March 1987. For certain building societies which at present pay corporation tax less than nine months after the end of the accounting period, the transition will be spread over two years starting with accounting periods ending in the 1989-90 tax year.

***Clause 38** aligns the date on which certain interest and other payments are treated as paid and received for tax purposes where the payment is between companies within a group or otherwise under common control. The new rule applies to payments made on or after 17 March 1987.

***Clause 39** modifies the definition of the meaning of "associate" in Section 303 of the Taxes Act, principally to help maintain the smooth running of approved employee share schemes. It takes effect from 6 April 1986. A consequential change for interest relief on loans for purchasing the company's shares takes effect for loans made after 13 November 1986.

***Clause 40** makes it obligatory, where the statutory conditions are satisfied, for the Inspector to apportion the income of a close company to its shareholders. Apportionment of covenanted payments to charity (and other annual payments) will also be made obligatory. (The Inland Revenue had believed that the existing legislation had this effect but the Court of Appeal said in 1986 that the Inspector's powers were discretionary.) The apportionment changes apply to accounting periods beginning on or after 17 March 1987.

***Clauses 41-43** deal with the tax treatment of the income and capital gains of unit trusts. The changes adjust the tax rules to fit the new regime for unit trusts introduced by the Financial Services Act 1986. The substance of the present tax treatment is unchanged. The new provisions first take effect for distribution periods beginning on or after 1 April 1987 (authorised unit trusts) and 6 April 1987 (other unit trusts).

***Clause 44** makes a minor technical change in the tax treatment of management expenses of investment companies and authorised unit trusts.

***Clause 45** introduces an option for an investor under the Business Expansion Scheme to claim up to one-half of his relief against income of the previous tax year subject to a limit of £5,000 carry back for any year. The relief is available for investments made between 6 April and 5 October inclusive in any tax year from 1987-88 onwards.

***Clause 46** relaxes the conditions for eligibility under the Business Expansion Scheme of a film production company whose income is expected to derive from royalties or licence fees. To qualify the company must either be engaged throughout the three-year qualifying period in the production of films (the previous condition), or in the distribution of films produced in the period. Will apply to shares issued on or after 17 March 1987.

***Clause 47** ensures that a UK resident partner in a foreign partnership is fully chargeable to tax in the UK on his share of the profits of the partnership. It will apply so as to prevent claims to relief from tax for past years.

+**Clauses 48-49 and Schedule 8** prohibit dual resident companies, other than certain trading companies, from surrendering their losses after 1 April 1987 to other members of a UK group under the UK group relief rules. They also limit the application of certain other reliefs where a dual resident investing company is involved in intra-group transactions.

*__Clause 50__ amends the legislation concerning controlled foreign companies (in Schedule 17 Finance Act 1984). With effect from Budget Day, in addition to the existing conditions, an acceptable distribution policy will be satisfied only if a dividend is paid at a time when the company is not resident in the UK.

Clause 51 introduces a degree of flexibility in applying the conditions which an offshore fund must satisfy to qualify as a distributing fund. For account periods which end after Royal Assent, the Inland Revenue will be able to extend the time limit for making distributions and disregard a failure to comply with the investment conditions in Section 95(3), Finance Act 1984 where the Board are satisfied that the failure was inadvertent and was remedied without unreasonable delay.

*__Clause 52__ changes the rules for calculating banks' taxable income from making a loan to a non-resident. Under the new rules any tax credit for foreign withholding tax paid, or deemed to be paid, on the interest they receive may in future be offset only against the UK tax due on the net profit from that loan. The change applies to interest payable on new loans made on or after 1 April 1987. For existing loans, the new rules apply to interest arising on or after 1 April 1988.

*__Clause 53__ imposes restrictions on double taxation relief, which parallel those imposed by Clause 52, for underlying tax on dividends in circumstances where loan interest is effectively remitted as a dividend to a bank operating from the UK. The change applies to interest payable on new loans made on or after 1 April 1987. For existing loans the new rules apply to interest arising on or after 1 April 1988.

*__Clause 54__ permits, subject to conditions including a monetary limit, a company carrying on oil extraction activities in the United Kingdom or on the United Kingdom Continental Shelf (UKCS) to carry back Advance Corporation Tax (ACT) surrendered to it, if the ACT relates to a dividend paid by the surrendering company on or after 17 March 1987. The company to which the surrender is made may carry back the ACT for set off against the corporation tax liability on its oil extraction activities in the previous six years.

*__Clause 55__ enables a member of a 50/50 consortium to surrender ACT to a company with UK or UKCS oil extraction activities which is owned by the consortium. The new rule applies to ACT in respect of dividends paid on or after 17 March 1987.

*__Clause 56__ prevents ACT in respect of certain preference share dividends paid on or after 17 March 1987 being set off against the corporation tax liability on profits from UK or UKCS oil extraction activities. The rule applies to redeemable preference share capital issued by a company which is under the control of another UK resident company, except where the proceeds of the issued share capital is used by the issuing company in carrying on its UK or UKCS oil extraction activities.

Clause 57 permits the Department of Employment to pass on certain limits information provided to it by the Inland Revenue under Section 58 Finance Act 1969 to local authorities for use in formulating local employment policy. The information consists of employer's names and addresses and the numbers of employees they have under PAYE.

***Clause 58** applies to Lloyd's reinsurance to close (RIC) arrangements the normal criteria for the tax deductibility of provisions for outstanding liabilities. The Clause will first take effect for RIC payments in the Lloyd's 1985 account, which closes at the end of 1987.

***Clause 59** extends by five years from 31 March 1987 to 31 March 1992 the period during which capital allowances are available to companies for costs of construction of properties for letting on assured tenancy terms. It also makes provision for effect to be given to certain initial allowances whose benefit might otherwise have been lost.

***Clause 60** deals with the tax treatment of securities traded on new recognised investment exchanges (RIEs) which may be established under the Financial Services Act 1986. The clause provides an enabling power for regulations to be made (after Royal Assent) which will allow securities traded on a new RIE to be treated in the same way for tax purposes as securities traded on the existing Stock Exchange.

+***Clause 61 and Schedule 9** amend the rules for taxing companies' capital gains so that they are taxed at the same rates as companies' income instead of the present 30% effective rate. For small companies the rate will thus be cut to 29% from 17 March 1987 and again to the new 27% small companies rate from 1 april. Companies will be able to set advance corporation tax against corporation tax on gains as well as on income. These changes apply to disposals on or after 17 March 1987. There are transitional arrangements for accounting periods straddling that date.

Clause 62 makes a corresponding change to the special provisions for life assurance companies, so that their gains will be taxed at the normal corporation tax rate of 35%.

Clause 63 makes technical changes to the provisions relating to the set-off of advance corporation tax against corporation tax on income from oil extraction activities. These changes are consequential on the extension to capital gains of the set-off for advance corporation tax and ensure that from 17 March 1987 farmout gains will be included with oil extraction income for the purposes of the restrictions on ACT set-off.

Clause 64 makes minor technical amendments to the provisions relating to the interaction of advance corporation tax and double taxation relief. The amendments reflect the extension to capital gains of the set-off for advance corporation tax.

Clause 65 makes it explicit that established tax law will continue to apply where an investor in a multi-portfolio unit trust switches from one portfolio to another. It prevents doubts about the tax position arising because of a detailed provision in the Financial Services Act.

Clause 66 brings Building Societies within the capital gains regime for groups of companies.

*__Clause 67__ increases from £100,000 to £125,000 the ceiling for capital gains tax retirement relief, with effect from 6 April 1987.

*__Clause 68__ brings, subject to certain conditions, the treatment of over-the-counter futures and options in line with that of traded options and of transactions on recognised exchanges. The main effects are that profits on over-the-counter transactions will always be treated as capital gains unless they arise in the course of trading, and that a capital loss will arise when an over-the-counter options expires without being exercised.

*__Clauses 69 to 106 and Schedule 10__ introduce the new tax regime for personal pension schemes, to apply with effect from 4 January 1988. The new legislation replaces and extends the existing retirement annuity provisions in S.226 et seq of the 1970 Taxes Act, which will cease to have effect for such arrangements made after 4 January 1988. The main provisions are:

*__Clause 69__ defines various terms used in the legislation.

*__Clause 70__ enables the Inland Revenue to approve personal pension schemes subject to certain conditions.

*__Clause 71 to 77__ set out the pension and lump sum benefits which may be provided by approved schemes.

*__Clauses 78 to 81__ outline certain administrative requirements which approved schemes must satisfy.

*__Clauses 82 to 88__ set out the rules governing tax relief for contributions by individual members (whether employed or self-employed) of personal pension schemes.

*__Clause 89__ gives tax relief for any contributions to a personal pension scheme by an employer, in respect of any employee of his who is a member of that scheme.

*__Clause 90__ provides a tax exemption for schemes' investment income and gains.

*__Clause 91__ concerns the tax treatment of annuities paid to members of personal pension schemes.

*__Clause 92__ concerns the 'minimum contributions' which the Secretary of State for Social Services will pay to personal pension schemes which are 'contracted-out' of the State Earnings Related Pension Scheme (SERPS).

*__Clause 93__ enables the Inland Revenue to withdraw approval from personal pension schemes or arrangements in certain circumstances.

*__Clause 94__ imposes a tax charge on certain unauthorised payments to scheme members.

*__Clause 95 and 96__ concern tax relief for contributions to a personal pension scheme. Such contributions by employees will qualify for basic rate tax relief at source.

*__Clause 97__ concerns appeals procedures.

*__Clauses 98, 99 and 103__ cover procedural matters relevant to tax relief for an individual's contributions.

*__Clauses 100 and 101__ concern the Inland Revenue's powers to obtain information about contributions to, and payments by, personal pension schemes.

*__Clause 102__ enables Government Ministers and MPs who are not members of the Parliamentary Pension Scheme to join a personal pension scheme.

*__Clause 104__ introduces transitional provisions for retirement annuity contracts made before 4 January 1988.

*__Clause 105__ concerns applications for approval of personal pension schemes before 4 January 1988.

*__Clause 106 and Schedule 10__ make minor consequential amendments to the Taxes Act.

+*__Clauses 107-122 and Schedule 11__ introduce the new income tax relief for employees who receive profit-related pay (PRP) under registered schemes which link part of their pay to the profits of the business in which they work. Half of PRP will be eligible for tax relief (to be given by the employer through PAYE) up to the point where PRP is the lower of 20 per cent of the employee's total pay or £3,000. These provisions establish the tax relief and the conditions for its operation, define the employers eligible to introduce a registered PRP scheme, stipulate the conditions to be met by such schemes, and prescribe the method by which schemes may be registered. Employers' applications to the Inland Revenue for registration of PRP schemes will be dealt with after the Finance Bill receives Royal Assent.

*__Clauses 123-133, 137__ introduce a new system for the collection of corporation tax known as Pay and File. This will come into effect from a date, not before 31 March 1992, which will be announced nearer the time. Under Pay and File a company will make its own estimate of its corporation tax liability and pay this by its normal due date. It will then have until one year after its accounting date to make its return with automatic penalties if it is late. Where the estimate turns out to be too low, interest will be charged, and where the estimate was too high, interest will be paid on the tax outstanding after the due date.

*__Clause 123__ allows a new style of company return to be introduced for Pay and File and sets a one year time limit for its completion.

*__Clauses 124-126__ set automatic penalties for returns not made within the time limit and provide a right of appeal against the penalty.

*__Clauses 127-131__ provide for interest to be charged on overdue corporation tax and on recoveries of overpayments, for interest to be paid on repayments of corporation tax, income tax and tax credit, and for interest rates to be altered where necessary.

*__Clause 132__ provides for corporation tax to be payable without assessment.

*__Clause 133__ makes the amendments needed to the tax on loans to participators in close companies for Pay and File.

*__Clause 134__ provides enabling powers to introduce regulations applying an interest charge on PAYE paid late in circumstances where the Inspector has formally to determine the amount due; and clarifying the meaning of 'payment' for PAYE purposes.

*__Clause 135__ provides enabling powers to introduce regulations requiring the Inland Revenue to be informed of the change of control of a company holding a '714C' subcontractor certificate; giving the taxpayer a right of appeal against cancellation of a subcontractor certificate; and requiring the production to the Revenue of contractors' records.

__Clause 136__ improves the drafting of the present S.118(2) Taxes Management Act (which provides that a person's failure to do something, such as render a tax return, shall be ignored when there was reasonable excuse for failure) for cases for continuing reasonable excuse.

*__Clause 137__ provides for Pay and File to come into effect on an appointed day which will not be before 31 March 1992.

+__Clause 138__ adjusts the definition of a "unit trust scheme" that applies for stamp duty to match the new Financial Services Act definition. The change takes effect from Royal Assent.

+__Clause 139__ provides for the repeal of the statutory requirement on brokers to issue contract notes. A code governing the issue of contract notes is provided for in the Financial Services Act. The repeal will take effect from a day to be fixed by the Treasury.

+__Clause 140__ extends the stamp duty exemptions that apply to gilt-edged securities and to most categories of loan stock to options to acquire such stock. The change takes effect from 1 August.

+<u>Clause 141</u> The clause redefines foreign currency for the purposes of S.30 Finance Act 1967 (and its Northern Ireland equivalent) which exempts from bearer duty stock expressed in a currency of a territory outside the scheduled territories. The change takes effect from Royal Assent.

+<u>Clause 142</u> makes a technical modification to S.70 Finance Act 1986 which imposed a higher rate of stamp duty on shares transferred to nominee companies acting for clearance systems. The change has a 1 August start date.

+<u>Clause 143</u> corrects a subsection reference in S.82 Finance Act 1986 (stamp duty relief for stock borrowed by market makers). The change takes effect from Royal Assent.

+<u>Clause 144</u> amends S.97 Finance Act 1980 and S.108 Finance Act 1981 which limit the duty payable on a shared ownership lease to take account of recent changes to the shared ownership scheme. The amendments take effect on 1 August.

+<u>Clause 145</u> replaces exemptions from stamp duty granted to the Secretaries of State for the Environment and Transport with a general exemption for all Government Departments. The change takes effect from 1 August.

+<u>Clause 146</u> introduces <u>Schedule 12</u> which contains a number of technical changes to the 1986 stamp duty reserve tax legislation. Most of the changes are deemed always to have had effect. A change which affects the date on which reserve tax is payable on purchases of renounceable letters of allotment takes effect from 1 August.

*<u>Clause 147</u> applies the higher starting point (£90,000) and simplified rate scale for inheritance tax to transfers made on or after 17 March 1987.

*<u>Clause 148</u> abolishes the existing inheritance tax charge on certain transfers made more than seven years before death involving interest in possession trusts (IIP trusts). Transfers to and from IIP trusts will be potentially exempt transfers (PETs) on the same basis as transfers of properly owned absolutely. <u>Schedule 13</u> imposes, in certain circumstances, a special rate of charge where property that has been the subject of a PET on its transfer into an IIP trust becomes held on discretionary trusts in the next seven years and the person who made the PET is still alive. The special rate takes account of any chargeable transfers made by that person in the seven years before he made the PET. The changes apply to transfers made on or after 17 March 1987.

*<u>Clause 149 and Schedule 14</u> also apply to transfers made on or after 17 March 1987. Shares in companies dealt in on the Unlisted Securities Market will be treated for all inheritance tax purposes like shares in companies with a full listing on the Stock Exchange. Business relief is to be increased from 30 to 50 per cent for transfers out of shareholdings of more than 25 per cent in unquoted companies, if the transferor has had that minimum level of holding for at least 2 years. There are also minor changes to the details

of the reliefs for business and agricultural property, and the arrangements for paying inheritance tax by instalments.

*Clause 150 and Schedule 15 exempt settled property from inheritance tax on the death (on or after 17 March 1987) of a person who has an interest in possession in the property - for example, a life tenant - if the terms on which the property is held are altered after the death so that it goes into a heritage maintenance fund within two years (or three years if a Court Order is needed). The rules for charges when property leaves a maintenance fund for non-heritage purposes are altered so that the charge on property formerly held in an interest in possession trust may be based on the cumulated chargeable giving of the former life tenant. This alteration applies to charges arising on or after 17 March 1987.

+*Clause 151 provides that if property is accepted on or after 17 March 1987 in satisfaction of inheritance tax on terms that the value of the property for that purpose is determined as at a date earlier than that of the acceptance, the terms may provide that the tax satisfied will not carry interest from the earlier date.

Clause 152 extends to personal pension schemes the existing inheritance tax reliefs for pension schemes and retirement annuities.

Clause 153 and Schedule 16 enable a company proposing to sell (or appropriate) oil it has produced itself to nominate the proposed transaction to the Inland Revenue within a specified time limit. Where the nominated transaction is in the event fulfilled with the company's own equity production PRT will be based, as at present, on actual sale proceeds (or market value). In other cases, PRT will be calculated by taking account of both nominated prices and the - different - prices the company actually received from the sale of its equity production (and also, where appropriate, market value). These rules apply in respect of deliveries from 1 March 1987). Inland Revenue press notice 9 February 1987.

Clause 154 and Schedule 17 amend the rules, with effect from 1 January 1987, for valuing non-arm's length disposals of oil to reflect market conditions. Monthly market value will be based on the price the oil might have been expected to fetch had it been sold at arm's length for delivery in the relevant month. To obtain this monthly market value, the Schedule provides for an average to be determined by reference to prices obtained in actual arm's length sales. It also applies where market conditions make it inappropriate or impracticable to determine such an average.

Clause 155 and Schedule 18 contain technical provisions, which apply where oil from one field is blended with oil from other fields before being disposed of or appropriated. In such cases, a participator's share of the oil won from the field is taken to be that share of the blend which was allocated to him under an approved allocation system covering that field. This provision will have effect from 1 January 1987.

*__Clause 156 and Schedule 19__ provide for Petroleum Revenue Tax (PRT) relief for certain expenditure on research related to UK or UK Continental Shelf oil extraction activities incurred on or after 17 March 1987, which has not become allowable in a particular field within three years of being incurred. The new relief will be allowed against a participator's PRT liability in the field of his choice.

*__Clause 157 and Schedule 20__ introduce a new PRT cross field allowance. It allows a participator in certain new oil fields to set off against his PRT liabilities in existing fields up to 10 per cent of his qualifying expenditure incurred on or after 17 March 1987 in developing the new field.

*__Clause 158__ has the effect of extending the provision in S.8(6) Oil Taxation Act 1975 which allows participators in oil fields to re-allocate the PRT oil allowance in the final period of utilisation in order to correct imbalance. Where the final period of oil allowance utilisation ends on or after 30 June 1987, participators will have further scope to balance their shares of oil allowance in both the final and penultimate periods.

*__Clause 159__ remedies a defect in the rules for putting matters right where either too much or too little exploration and appraisal expenditure has been allowed for PRT. The provision applies to notices of decisions on expenditure claims given on or after 17 March 1987.

__Clause 160 and Part 12 of Schedule 21__ provides for the repeal of the Exchange Control Act 1947 and the references to it in subsequent legislation.

__Clause 161__ provides definitions of gold and foreign currency to replace the references to the Exchange Control Act used in the Banking and Financial Dealings Act 1979.

__Clause 162__ amends the statutory provisions under which double taxation conventions are made in respect of income tax, corporation tax, capital gains tax and inheritance tax. The amendment meets representations made to the Government by the Select Committee on Statutory Instruments about an apparent mismatch between the wording of the titles, preambles and certain articles in the Statutory Instruments embodying double taxation conventions and the enabling provisions contained in the Taxes Act. By incorporating into the statute a form of words borrowed from the OECD Model Double Taxation Convention, exchange of information between the treaty partners (for the purpose, inter alia, of the prevention of fiscal evasion) is now made explicit.

__Clause 163 and Schedule 21__ make amendments clarifying points of detail and drafting which are necessary to facilitate the consolidation of income tax and corporation tax legislation.

4084/24

RESTRICTED.

1 Tony
2 PUP

FROM: Deputy Parliamentary Clerk
DATE: 7 April 1987

01-270 5006

PS/CHIEF SECRETARY

cc PPS
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Miss C E C Sinclair - FP
PS/IR
PS/HMCE

FINANCE BILL : NOTES ON CLAUSES - COMMITTEE OF THE WHOLE HOUSE (COWH)

Parliamentary Section expects to be in receipt of the Part 1 Notes on Clauses by Wednesday 22 April. Assuming COWH will take place on Wednesday 29 and Thursday 30 April, I would propose placing in the Vote Office the requisite 400 copies of the Notes on those Clauses to be taken on the Floor of the House on the preceeding Thursday, 23 March. This would enable Members to pick up the Notes before the weekend. Members' attention would be drawn to their availability by means of an inspired question:

> '**To ask the Chancellor of the Exchequer** if Notes on those Clauses of the Finance Bill to be taken in Committee of the Whole House will be made available to honourable Members.'

> '**Mr John MacGregor:** Yes. The appropriate Notes on Clauses were placed in the Vote Office earlier today.'

With Second Reading, together with the Committal motion, planned to take place on Wednesday 22 April, the question would need to be tabled the same day in order to alert Members on the Thursday. There is nothing improper in this and the whole House will appreciate having the notes made available as early as possible. In the unlikely event of the House referring the Bill in its entirety to a Standing Committee, the answer to the PQ can easily be amended.

The foregoing is in line with past practice. Is the Chief Secretary content that the same be done this year?

Richard Savage

RICHARD SAVAGE

psl/18A

CONFIDENTIAL

PUP

RTP.

FROM: A C S ALLAN

DATE: 7 April 1987

PS/FINANCIAL SECRETARY

cc Sir P Middleton
Mr Ross Goobey

PENSIONS LEGISLATION IN THE FINANCE BILL

The Chancellor has noted that there seems to be opposition building up to some of the pensions' proposals in the Budget, in particular to the new restrictions on added years and lump sums.

2. He would be grateful if the Financial Secretary could keep a close eye on all this, and could examine carefully the case put forward by the Inland Revenue, so as to make sure that it is publicly fully defensible.

ACSA

A C S ALLAN

1234/1

D
Mast pl.
Cont as →
+ C. Sinclair

FROM: A ROSS GOOBEY
DATE: 7 APRIL 1987

R GOOBEY TO CH/EX 7/4

CHANCELLOR

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Mr Cropper
Mr Tyrie

Mr Neubert, MP H/C
Mr Lilley, MP H/C

<u>Inland Revenue</u>
Mr Cayley
Mr Shepherd
McGivern
Mr Munro

Many thanks.
2. Pse fix a mtg
in due course to cover stage
of play on these points.
N.

POST-BUDGET LOBBYING - COUNTER BRIEFS

I attach a revised version.

pp [signature]

A ROSS GOOBEY

ENC

1. LLOYD'S REINSURANCE TO CLOSE

Is the Revenue being unfair to Lloyd's? Not at all. The point at issue is whether the Revenue should be able to review Lloyd's RIC and apply the normal tax criteria for determining how much should be deductible for tax purposes, or whether Lloyd's figure must be accepted without enquiry. Syndicates should not find it difficult to agree their tax liability with the Revenue if their RIC calculations are based on specific evidence and/or recognised statistical techniques. But it must be right for the Revenue to be able to review, and where necessary adjust, what is currently in effect a self-assessment.

Is this merely a Revenue initiative? No. Ministers firmly believe that it is unacceptable for any taxpayer to be able to determine the amount of a tax deduction without review by the Revenue.

Lloyd's syndicates are different in kind from insurance companies. In some respects yes. But the effect of RIC is in substance similar to the provisions which general insurance companies make for their outstanding liabilities and to the provisions made by Lloyd's syndicates which are "running off". And in each case the methods of calculating residual risk on similar business are comparable. So the tax criteria should be on a comparable basis.

Current position Lloyd's and Inland Revenue have already begun the consultative process in a constructive manner. One possibility being considered is the preparation of guidelines to assist syndicates in calculating the tax deduction in respect of RIC. Mr Alan Lord, Lloyd's Chief Executive, was quoted in the Financial Times of 3 April, as saying he believed that Lloyd's "can reach a satisfactory agreement with the Inland Revenue" and that "it would be quite wrong for Lloyd's to mobilise any lobbying campaign over the issue while talks were in progress".

2. LIFE ASSURANCE TAXATION

Retrospection? No. All CGT changes could be so described, but the event which crystalises the liability is prospective, not retrospective.

Unfair treatment against unit trusts? No. It is open to the life assurance companies to package their product so that the life cover is separate from the unit-linked element (sold as authorised unit trusts) and the individual might benefit from the annual CGT exemption. For operational reasons, the life offices choose not to do this.

Destroys the investment bond market? Not necessarily. Although the potential gains tax liability rises, holders of bonds linked to units still have the option of switching between different funds free of CGT liability and the higher rate taxpayer only pays his higher rate liability on income on encashment.

Affects bonuses of with-profits policies? A very small effect. Policy holders' funds of life assurance companies probably total over £50 billion, of which at least 30% is in gilts, leaving £35 billion in property and equities. If this portion stood at 25% over indexed book cost and was all realised over 5 years, the cost on all life companies would be an additional £70 million a year or 0.14% of their taxable funds. In fact, most companies offset management expenses against their capital gains which are therefore largely sheltered from Corporation Tax.

3. PENSIONS PACKAGE

Will the package obstruct labour mobility? No. It is true that the change in the "uplift" rules will restrict the ability of new members of schemes in the earning of maximum benefit to 20 years instead of the current 10 years. However, this ignores the preserved benefit an individual may have from his previous employment which, for uplift purposes, must be taken into account. In any case, the basic rules for occupational pensions envisage that pension benefits are earned over the working life of the employee, not simply to facilitate a few years of tax-relieved payments into a scheme to produce a tax-advantaged payment out on retirement. Some very highly paid executives had been abusing the final salary and "uplift" rules in order to create large taxfree lump sums and pensions. While some relaxation in the basic rules is appropriate, the ability to fund - with full tax - for a maximum pension after only ten years' service is excessively generous. Most people will move jobs for a number of reasons of which pension benefit is only a part.

The overall package, which includes the introduction of personal pensions, freestanding AVCs, transfers, DHSS changes on the revaluation of deferred pension rights - will help mobility.

Why limit the benefit on freestanding AVCs? If the benefit limit on AVCs was not maintained, it would be possible for an individual in a non-contributory scheme to invest in AVCs and receive substantially more than 2/3 final salary as a benefit - perhaps even more than his final salary. Pension contribution relief was never intended as a tax shelter for investment generally.

Does not the commutation of "added years" AVCs within occupational schemes give an unfair advantage to the public sector? No. Public sector schemes provide for lump sum and pension benefits in fixed proportion; and any AVCs paid to buy added years increase both benefits. Private sector schemes have much greater flexibility:

lump sums are based on final salary and the number of years of service, and the AVC benefit can be (and normally is) taken wholly in lump sum form. It is open to the private sector to provide benefits in a fixed proportion or to allow the purchase of added years through their AVC schemes.

4. BANK TAX RELIEF ON FOREIGN INTEREST

Why act now? Relief has been available, against bank profits as a whole including domestic profits, for withholding tax on the interest earned by UK-resident banks lending to foreign borrowers; this reduces the effective cost of the money lent. As a result, some banks have effectively received an interest rate subsidy on overseas loans from the UK Exchequer. The amount of overseas lending undertaken from the UK has been growing. Henceforward the withholding tax will be only available as a credit against UK corporation tax on the profits of each individual loan.

Weakens London's competitive position? The lending involved is to off-shore borrowers and the funds are usually provided from off-shore sources. The UK-resident bank has merely had a tax incentive to arrange the loan through London rather than elsewhere. After this measure, the London-based bank will not be at a positive disadvantage to other financial centres; after all no other country currently has as low a corporation tax rate.

Who is affected?

The overseas borrower may have previously agreed to a clause which enables the bank to increase the interest rate he pays should this measure be introduced. Two-thirds of such loans are made by overseas -owned banks based in London.

002/3292

RESTRICTED

88

FROM: JILL RUTTER
DATE: 8 April 1987

MR SAVAGE - Parliamentary Section

cc: Principal Private Secretary/2
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Miss C E C Sinclair - FP

PS/IR
PS/HMCE

FINANCE BILL: NOTES ON CLAUSES - CWH

The Chief Secretary has seen your minute of 7 April. He is happy for you to make the notes available and put down the question as you proposed.

Jill Rutter

JILL RUTTER
Private Secretary

4367/024

RP

FINANCIAL SECRETARY TO THE TREASURY

FROM: N WILLIAMS
DATE: 8 APRIL 1987

MR WALKER - IR

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Mr Walters
PS/IR

FINANCE BILL: LOBBY NOTES

1. The Financial Secretary was grateful for your minute of 3 April attaching the Revenue's Lobby notes on clauses.

2. This is to confirm that both the Financial Secretary and Minister of State were content with the notes for which they are responsible. (Mr Barnes' minute of 7 April recorded the EST's comments.)

NWilliams

NIGEL WILLIAMS
(Assistant Private Secretary)

3749/050

FROM: P D P BARNES
DATE: 8 April 1987

MR MCKENZIE

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
Miss O'Mara
Miss Sinclair
Mr Walters
Mr Kalen

POST BUDGET COMMENTS

The Economic Secretary has seen your submission to the Chancellor of 6 April.

2. The Economic Secretary thinks that there might be an advantage in including a new third paragraph along the following lines:-

"Taking the expenditure plans announced in the Autumn Statement together with the Budget, the outcome is that of the extra £10 billion of resources available to the government for 1987-88, we have allocated some £4½ billion to increase public expenditure, £3 billion to reducing the Government's need to borrow, in order to keep the public finances in good order, and £2½ billion to reducing taxation."

PB

P D P BARNES
Private Secretary

4077/15

RESTRICTED

PS/Chancellor

1 Terry
2 RUP

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 4520

Miss Sarah Straight
Office of the Government
Chief Whip
12 Downing Street
LONDON
SW1

8 April 1987

Dear Sarah,

FINANCE BILL : SECOND READING

You agreed it would be helpful if I were to set out my understanding of the proceedings and mechanics associated with the Bill's Second Reading, now scheduled for Wednesday 22 April.

2. The Chief Secretary will open Second Reading for the Government with the Financial Secretary winding up the debate. The Committal Motion - splitting Committee Stage of the Bill between Committee of the Whole House (CWH) and Standing Committee - will be taken immediately after Second Reading, and be moved by the Financial Secretary.

3. I am advised that both Murdo Maclean and Peter Graham (PCO) will be attending the meeting with the Chief Secretary tomorrow (Thursday 9 April) to settle, among other things, the terms and tabling arrangements for the Committal and Procedural Motions (the latter sets out the order in which CWH will consider those clauses to be taken on the Floor of the House). Clearly, the aim will be to have the text of the Committal Motion appearing on the Order Paper for Wednesday 22 April. The Procedural Motion, however, can either be tabled to appear on the Order Paper for Wednesday 29 April (currently, the Bill's first day in CWH); or, if preferred, it can be moved without notice at the start of proceedings in Committee (in past years the Financial Secretary has covered this item of business).

4. Finally, we expect that the TCSC will publish their report on the Budget the day before Second Reading. If this is confirmed, I assume you will wish to add the usual rubric in italics beneath the text of the Committal Motion on the 'Orders of the Day' for Wednesday 22 April, to draw attention to this report. Possibly along the following lines:

"The Treasury and Civil Service Select Committee has reported on the Budget, in its Sixth Report, House of Commons Paper No. 293 of Session 1986-87".

I hope you find the foregoing helpful. If there are any changes following the Chief Secretary's meeting tomorrow, we can be in touch again.

Yours ever,

Brian Dyer

B O DYER
Parliamentary Clerk

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
Mr Scholar
Miss Sinclair
Mr Walters

015/3292

Blf with revised version

CHIEF SECRETARY TO THE TREASURY

FROM: JILL RUTTER

DATE: 9 April 1987

PS/CHANCELLOR 2

cc:
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Miss O' Mara
Miss Sinclair
Mr Walters
Mr Kelan
Mr G McKenzie
Mr Ross Goobey
Mr Tyrie
Mr Kelley MP

POST BUDGET COMMENTS

The Chief Secretary has seen Mr McKenzie's minute of 6 April. He is not at all happy with standard reply proposed. He thinks ~~Since~~ it is wrong to focus simply on "infrastructure" and notes that nowhere does the draft refer to the aggregate increase in expenditure in the Autumn Statement of £4¾ billion.

2 The Chief Secretary thinks a much more promising approach would be to have a draft based on the "hat trick".

3 He suggests that Mr Ross Goobey or Mr Tyrie might like to work an improved draft up as a matter of urgency. This could draw on speeches on this theme made since the Budget.

Jill Rutter

JILL RUTTER
Private Secretary

CE12a

FROM: MISS C EVANS
DATE: 10 APRIL 1987

CHIEF SECRETARY

cc Chancellor of the Exchequer
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr Cassell
Mr Monck
Mr Kemp
Mr Scholar
Mr Turnbull
Mr Odling Smee
Mr Burgner
Mr Hawtin
Mr Sedgwick
Mr Riley
Miss Sinclair
Mr M Williams
Mr Gray
Mr Instone
Miss O'Mara
Mr Culpin
Mr Bottrill
Mr Hudson
Mr Cropper
Mr Ross Goobey
Mr Tyrie

PS/IR
Mr Walker - IR
PS/C&E
Mr Bone - CE

Miss C. Evans

C.

You may like to glance at this, though ~~[illegible]~~ I can't see anything to object to in it. Much of it restates the Budget Speech, with clause numbers attached.

AH

I have not made my comments on this, since the CST will certainly want to do a great deal of work on it. But I would start advice by saying [illegible] anything else X. The TSC judgment distinct from our forecasts, usually in a disagreeable direction, and it is our invariable practice either to ignore or dismiss their judgments, and to stick to our own. We would be very ill advised to

FINANCE BILL: SECOND READING DEBATE

... I attach a draft speech. This incorporates the economic material you have asked for, political sections contributed by Mr Ross Goobey and Mr Tyrie and the main clauses in the Finance Bill. We estimate that it is about <u>30 minutes in length</u> which is probably 50 per cent too long. The speech could be shortened by slimming down the economic and political sections and perhaps omitting the long section on pensions (which the Financial Secretary could use in his winding up speech).

At least, I should think.

2. I should appreciate comments/amendments from copy recipients by close next Monday please.

(Apart from this [illegible] short-term opportunistic reasons now [illegible] then we will pick this up (ie, risks, the approach in the first place) [illegible]

Carys Evans

MISS C EVANS

CE12

CHIEF SECRETARY'S SPEECH FOR SECOND READING DEBATE
FIRST DRAFT

1. I beg to move, that the Bill now be read a Second time.

2. The Finance Bill gives effect to the Budget presented by my right hon Friend the Chancellor six weeks ago. That Budget was set in the context of a steadily growing economy and strong public finances. These favourable circumstances, the fruits of the success of our prudent and consistent economic policies, have enabled us in our plans for 1987-88 to combine a £4.7 billion increase in expenditure, a £3 billion reduction in public sector borrowing and a £2.6 billion reduction in taxes. The continued strength and vigour of the British economy gives the lie to the increasingly desperate attacks by hon Members opposite. They simply cannot stomach the clear evidence of our success, evidence which has been further reinforced by the economic indicators since the Budget

3. [To be updated in light of statistics published before 22 April: The February trade figures show that British exporters are grasping the opportunities which the Chancellor mentioned in his Budget speech. Manufacturing exports are 8 per cent higher than a year ago and overall non-oil exports up by 11 per cent. Between January and February unemployment fell by 44,000

- the largest monthly fall on record.] The CBI March enquiry showed industry's order books and output expectations at their highest levels since the information has been sought in this way.

4. With remarkable consistency the indicators show that following nine Budgets under this Government the British economy is stronger than at any time since the War. One key test of the growing confidence which exists in British industry is the amount of new equity being raised for investment - investment which will produce profits and jobs. In 1986 companies raised £8 billion in new equity on the Stock Exchange, eight times the amount they raised in 1979. And this does not include the finance raised through the unlisted securities market which did not exist in 1979, nor through venture capital funds which last year raised more than 20 times more finance than in 1979. Indeed the growing vitality of the UK venture capital industry is a particularly encouraging development. Venture Capital investment in the UK is now higher as a proportion of GDP than in the US. A recent report by the British Venture Capital Association highlights the rate of growth of the industry in recent years. It has taken the US venture capital industry more than 25 years to reach its present size; in the UK a large part of the industry's growth has taken place during the past 5 years. Venture capital is a long term discipline - its growth under this Government is clear evidence of investors' confidence in the future prospects for British industry.

5. This is also illustrated by the high level of overseas investment in the UK in recent years, reflecting the increased profitability of British industry, which in 1985 was at its highest level since 1964. In the last two years overseas investment in the UK has amounted to almost £24 billion. Even with this growth in inward investment the UK has increased its net asset position to an estimated £110 billion by the end of 1986. At 28 per cent of GDP this is the highest recorded level since the war. It compares with the level of £80 billion at the end of 1985 and £12 billion at the end of 1979. As a result of this healthy position earnings from interest, profits and dividends were over £4 billion in 1986 and will continue to make an important contribution to the balance of payments in the future.

6. Within the generally favourable climate for industry which I have outlined I have been particularly struck by the direct reports I have received of the strength of the construction industry. New orders for 1986 were up 7 per cent on 1985. Private sector output rose particularly strongly in 1986 with commercial work increasing 14 per cent and private housing output rising 10 per cent on 1985 levels. In 1986 repair and maintenance output was up on the previous year and housing repair and maintenance reached a record level of £4.9 billion. I could go on.

7. The construction industry is strong under this Government because the economy is strong. The Party opposite has pressed all along for a 'short term fix' of increased public spending in construction. Their blinkered approach prevents them from seeing the extent of the private sector-led recovery taking place at the moment. Nor can Labour see behind them, back to their record of meddling with the micro-economy, bursts of spending to solve short-term problems paid for later in higher unemployment and inflation. Indeed, so strong is this recovery, that if the Government did follow the advice of the Party opposite and spark off a public sector spending binge in the construction industry, we would expect to see skill shortages and bottlenecks. Skill shortages are already apparent and the Government and industry have reacted by making more places available for training. The CITB have produced a plan for 4,000 more people to be trained for the construction industry. 3,000 are being trained through the new 2-year YTS scheme.

8. Most galling of all for the Party opposite is that the strength of the current market in building supply products comes as a result of fulfilling another Government objective - spreading owner-occupation. More people owning their own homes has meant an expansion of property renovation, maintenance and improvements. The Budget has given more money back to the people who earn it without having to resort to irresponsible public borrowing. This

will give a further boost to the building supply industry and create more jobs because it releases people's individual demand for home improvement.

9. Like its predecessors this Budget is designed to further improve the performance of the economy and hence the prospect for jobs. Since 1979 it has been a cardinal element of the Government's policy that tax reductions is the single most effective measure available to it to stimulate enterprise and release wealth creating energies throughout the economy. The measures in the Finance Bill will consolidate and extend the now well established lines of reform which we have followed since 1979 as well as enacting new measures to improve the micro economic environment so as to strengthen further the prospect for growth which lies ahead.

10. The response to the Budget demonstrates that my rt Hon Friend's proposals have been widely welcomed. This positive reaction has not been confined to those with a direct interest in the Budget measures. The prudent and balanced proposals put forward by the Chancellor have strengthened the confidence of the financial markets so ~~with the result~~ that base rates ~~have~~ fell ~~fallen~~ by $\frac{1}{2}$ per cent the day after ~~since~~ Budget day, following an earlier $\frac{1}{2}$ per cent reduction the previous week. Base rates are now a full one per cent lower than they were at the beginning of the year. The majority of banks and building societies have announced a reduction of $1\frac{1}{4}$ per

cent in mortgage rates. This will be of direct help to the eight million homeowners with a mortgage loan.

11. Members will have received the response to the Budget contained in the report by the Treasury and Civil Service Committee published yesterday. [Now is not the time to consider the report in detail since it makes no comment on the tax changes in the Budget but concentrates on the conduct of monetary policy and the PSBR. The Government will respond to the Committee's recommendations in due course. ~~But the Committee does make one significant observation which is relevant to the economic prospect which I have outlined above. The Committee believe that the Treasury forecast of the balance of payments will prove too pessimistic in the light of the Committee's assessment of the real improvement in the competitiveness of the economy in 1986 and of the prospect for the oil price.~~]

X

12. In reviewing the setting for this year's Finance Bill let us contrast the climate of confidence created by this Government with the prospect offered by the opposition parties. Although I want today to concentrate on the measures introduced in this Bill to improve the micro-economic environment, the supply-side, I cannot allow the occasion to pass without noting that the [rt hon Gentleman for Sparkbrook has had to try to cure another attack of economic indigestion, no doubt a result of an uneconomic lunch, by addressing a City audience on

his own macro-economic plans]. (might be possible to update this with a more topical reference eg to the Austin Mitchell minority report which may be published with the TCSC report).

13. Fear not, says he, the so-called jobs programme can be paid for by an increase in the basic rate of income tax of 2p for all 24 million taxpayers and an extra £3½ billion of borrowing. All those other pledges which total £34 billion and many of which he confirmed only (last) Saturday in Southampton, will have to wait for extra resources generated from growth. Well, don't hold your breath.

14. Under Labour, we have never had six successive years of growth averaging nearly 3 per cent. So the spending plans of the hon Member for Oldham West and his colleagues are unlikely ever to be achieved even in the unimaginable circumstances of a Labour government.

15. However, the rt hon Gentleman's speech in the City leaves one question unanswered. Since the Government's plans include an annual £5 billion from the proceeds of the return of nationalised industries to the competitive sector, the rt hon Gentleman must tell us this. Is he planning a £5 billion cut in public spending, a continuation of the privatisation programme, increased borrowing or higher taxes? There are no other alternatives and I will gladly give way to receive an answer.

16. On the micro-economic or supply-side measures which all three Opposition parties wish to introduce, there is infinite confusion. How are business incentives to be improved by voting against income tax cuts? How will the interventionist British Investment Bank choose winners which markets cannot? "I am very sceptical about industrial strategies to improve economic performance". Not my words, they come from a book called "Monetarism or Prosperity?" published in 1980 and authored by the hon Member for Dagenham.

17. The Opposition parties are squabbling again over division of the bearskin to which my hon Friend the Member for Brighton Pavilion so memorably referred.* This Finance Bill is more concerned with making us more prepared to meet the competition in catching it in the first place.

["**BEAR JOKE** Two hunters were woken in their tent in the middle of the night by the sound of a bear tearing at the canvas. As they scrambled from their sleeping bags one of the hunters paused to put on his running shoes.

"What on earth are you doing? You'll never outrun a bear."

"I don't have to outrun a bear, I only have to outrun <u>you</u>."]

* Hansard extract attached

18. But let us spend no more time on the opposition parties' policies since it becomes daily clearer that they will never be implemented. In this year's Finance Bill the most important change, because it affects every taxpayer, is the reduction in the basic rate of income tax to 27 per cent in clause 20 . This continues our steady progress towards the goal of a basic rate of not more than 25 pence in the pound, which my rt Hon Friend the present Foreign Secretary set in 1979. Starting from the 33p rate which we inherited in 1979 we are now well over half way towards our goal, and shall soon have reached a basic rate which is equivalent to the reduced rate band introduced by the party opposite. Once again we have designed our income tax proposals so as to concentrate the benefit on the overwhelming majority of ordinary taxpayers and as last year we have structured the changes so that those with the highest incomes do not benefit disproportionately. We have also provided a measure of extra relief for those aged 80 and over and for blind people - these measures are contained in Clauses 26 and 28.

19. The cut in the basic rate improves incentives for everyone, including unincorporated businesses and the self employed, whose marginal rate is the basic rate. That is nearly 21 million taxpayers of working age - 94 per cent of the total. The cumulative effect of the income tax reductions since we took office is substantial. The burden of income tax is now £12 billion

lower than it would have been had the regime we inherited simply been adjusted in line with inflation.

20. The Budget debates provided further evidence, were any needed, that the vital benefits of lower income tax cuts would be lost if the Labour Party were ever given the opportunity of implementing their policies. Whatever confusion there may be about the remainder of their proposals one thing is clear, a Labour government would mean much higher taxes, their plans to spend £34 billion would mean at least doubling the basic rate of income tax. Nevertheless they have no inhibitions about accusing us of increasing the tax burden. It is hard to take them seriously on this - I could go on at length about the increase in real take home pay experienced at all income levels under this Government compared with the poor record of the last Labour Government. But I have asked my rt hon Friend the Financial Secretary to deal with this subject in his wind-up speech. Characteristically the position of the SDP and Liberal parties on income tax reductions is more confused. They intend to vote against this clause but are not necessarily committed to reversing the 2p cut. Fortunately they will never be in a position to resolve their dilemma.

21. As well as their major beneficial impact on incentives tax cuts are good for industry because they offer higher take home pay without adding a penny to industry's costs. For a married man on average earnings

the rate and allowance changes combined mean nearly £4 a week extra in pay packets, which is equivalent to a 2.7 per cent pay increase. As this Government has repeatedly made clear the future performance of the economy, and thus the prospect for jobs, depends critically on the ability of British industry to keep control of its costs. The Government's success in bringing down inflation has substantially reduced the justification for pay increases which are not earned by better performance. This year's income tax reductions provide further help to employers in their efforts to control labour costs.

22. We have done this more specifically with the new tax relief for profit related pay which is contained in Clauses 107 and 122 of the Finance Bill. The significance of this new measure has been widely recognised. It will reinforce the steps the Government have already taken to make the labour market work more flexibly and increase the common interest and involvement of employers and employees in the success of their companies. It is designed to tackle the 'them and us' attitude which has bedevilled so many of our businesses for so long. But it has the vitally important extra dimension of providing automatic flexibility with labour costs. The relief proposed could be equivalent to a further 4p reduction in the basic rate of tax for a married man on average earnings whose company takes maximum advantage of the scheme. As the Chancellor has

said the scheme is not a panacea but it represents an important challenge to British management to play their part in bringing about changes in the operation of the labour market which could radically improve the prospect for jobs. I hope they will take up the challenge and I am glad to report that the level of interest shown in the scheme is very encouraging - some [2,700] firms have already registered their interest with the Inland Revenue.

23. The Bill contains an important clause on training which I would like to draw to the attention of the House. The importance of training and retraining to the success of the economy is well understood. At present expenditure by employers on training for people who are changing jobs is liable to be taxed as a benefit in kind in the hands of the employee. Clause 36 will make this expenditure on training for a new job or business opportunity free of tax.

24. A key component of our strategy to improve the performance of the economy has been a coherent set of measures to help small businesses. The Finance Bill contains a number of clauses specifically targetted on this sector and these have been among the most widely welcomed provisions in the Budget. Perhaps the most important is Clause 11, which will enable businesses whose annual turnover is less than £$\frac{1}{4}$ million to account for VAT on the basis of cash paid and received. More

than half of all traders registered for VAT fall into this category. This Clause also provides for the option of annual accounting which will enable small companies to send only one return a year to Customs. Taken with the other VAT measures in this field, not all of which are to be implemented by way of primary legislation in this Bill, this represents a substantial package of reforms for small businesses. Cash accounting will overcome the twin VAT problems associated with late payment of bills and with bad debts. Annual accounting will provide a means of assisting cash flow and of reducing the form-filling burden. And, of course, the turnover ceilings which my rt Hon Friend proposed in his Budget are much higher than those in the original consultation document. I am pleased to observe that these measures have been supported on all sides of the House, as well as by many spokesmen for small businesses.

25. In addition to the VAT package the Bill contains a number of other clauses which will be of considerable benefit to the small business sector. Clause 22 will reduce the small businesses rate of corporation tax to 27p, 15 percentage points below the level we inherited in 1979. The large increase in the starting point for inheritance tax contained in Clause 47 and the other inheritance tax changes we propose, as well as the increased retirement relief from capital gains tax contained in Clause 67 will all make it easier to pass on a flourishing family business to the next generation.

26. I would now like to draw the attention of the House to a number of clauses concerned with the collection of Corporation Tax. The purpose of these measures is to build upon the major reform of the corporation tax regime which we introduced in 1984 and to make the collection of the tax simpler, fairer and more effective. Clauses 123-133 introduce a new streamlined method of assessment and collection known as Pay and File. This has been generally welcomed by the business community. Because computerisation is required the new arrangements cannot take effect before the early 1990s. The reason for legislating now is to give taxpayers and their advisers a firm basis on which to plan. Clause 61 will provide for companies' capital gains to be charged at the appropriate corporation tax rate thus removing the complicated adjustment which is needed under present arrangements. For small companies this will mean a cut of 3 percentage points in the rate charged on capital gains. I know that a number of hon Members have expressed concern about the impact of this measure on life assurance companies. The Government considered very carefully whether the change should extend to capital gains earned for holders of life assurance policies. In the end we concluded that it would not be appropriate to make such gains an exception. My rt Hon Friend will return to this in his wind-up speech.

We propose that companies should be able to benefit from ACT set off against their liability to tax on capital gains. This will be of considerable benefit to many companies. A further streamlining measure is contained in Clause 37 which will rationalise payment dates for corporation tax, bringing all companies on to a 9 month payment basis and stopping a potentially costly abuse.

27. The Bill contains measures of benefit to the North Sea oil sector. These closely targetted measures are designed to help mitigate the effect of the recent oil price fall on the development and research which is so vital for the future prosperity of the industry. Clause 157 will allow companies to have up to 10 per cent of the costs of developing certain new fields set against their petroleum revenue tax liabilities in existing fields, until such time as the income of those new fields exceed the costs incurred. The significance of this measure was highlighted by BP in giving evidence to the Energy Select Committee last month. BP estimated that this relief would increase the rate of return on fields by up to 20 per cent. Clause 156 will provide a new relief against PRT for spending on research into United Kingdom oil extraction that is not related to any particular field. These measures have been welcomed by the industries themselves and by others with an interest in the continued vigour of activity in the North Sea.

28. Within our continuing programme of tax reduction and reform it is the Government's policy to eliminate unintended or unjustified tax breaks which cause rates of tax generally to be higher than they otherwise would need to be. We see no justification for asking the majority

of taxpayers to subsidise the few who benefit in this way. The Bill contains a number of clauses designed to remove opportunities for tax avoidance of this kind.

29. Clause 12 is the main clause of a package which tightens up the rules on the deduction of VAT input tax as they apply to businesses and, in particular, groups of associated businesses - whose activities are in part exempt from VAT. This is designed to prevent distortion of trade and to combat tax avoidance, since the old rules were excessively generous and were being exploited on a growing scale. The new rules contain generous relief provisions for small businesses; around 2,000 have creased to be treated as partly exempt. Special arrangements for calculating deductible input tax have been made with individual traders and trade associations to deal with problems peculiar to particular industries, such as brewers' tied houses. Although it might be too much to expect that those directly affected would welcome these anti-avoidance measures, they have generally been accepted as fair and necessary and they have drawn approving comment in the trade press.

30. Clauses 48 and 49 will prevent companies in multinational groups which enjoy dual residence from securing tax relief twice on one and the same interest payment. Clause 50 ensures that the controlled foreign companies legislation is not side stepped by moving the residence of the foreign company to the UK before payment

of a dividend. Clauses 52 and 53 will end the present excessively generous treatment of tax credit relief for foreign withholding tax paid on interest on bank loans. In future banks will be able to offset this tax credit only against tax on the profit on the relevant loan, and not more widely. Another in this group of measures is Clause which will enable the Revenue to charge interest in cases where an employer does not apply PAYE properly and a formal assessment has to be made to recover the tax. Taken together these measures amount to a significant contribution to a fairer and more effective tax system. I hope they will receive support from all sides of the House.

31. The Bill contains a measure affecting the tax treatment of members of Lloyd's syndicates. Clause 58 will change the tax treatment of reinsurance to close to bring it into line with that of comparable provisions made by insurance companies and other traders. The Chancellor said in his Budget speech that the Revenue would have discussions with Lloyd's about the details of the legislation and these are already underway.

32. The Bill contains a number of clauses which will bring about important and far reaching changes in the pattern of pensions provision. They form part of a strategy to widen the coverage of non-State pension provision and give individuals far more flexibility and

choice in the way they provide for their retirement. These measures will reduce employees' reliance on the State for their provision in old age and will remove a significant obstacle to job mobility. The effect will be to extend the tax advantages for retirement provision much more widely.

33. Clauses 69 to 106, and Schedule 10, introduce the tax regime for the new personal pension schemes, which will be available from next January. This legislation is based on the present, broadly similar, retirement annuities provisions enacted over thirty years ago. In addition to being brought up to date, the new measures also incorporate a number of new features which have been widely welcomed. In particular, it will in future be possible for employees to contract-out of the State Earnings Related Pension Scheme through a personal pension. Clause 92 provides the necessary procedures to achieve this result.

34. Clause 71 enables a much wider range of pension providers to carry on new pensions business. Hitherto, insurance companies and certain friendly societies have enjoyed a virtual monopoly of personal pension business. In future banks, building societies and unit trusts will also be able to enter this market: a proposal which has been widely welcomed as improving the choice open to individuals.

35. Another important change is made by clause 79, which enables transfer values to be paid into or from a personal pension scheme. This will permit much greater transferability than is now possible between different types of pension arrangements. Again, this has been warmly welcomed as a helpful development.

36. Clause 34 and Schedule 5 propose a number of changes in the present rules for occupational schemes. It contains the provisions needed to give effect to the Budget Day announcement that, from next October, members of occupational schemes will be able to make additional voluntary contributions to a pension plan completely separate from their employer's scheme, up to the tax approval limits on contributions and benefits. This development has been widely welcomed in principle, although some commentators have argued that the limits on benefits should not apply to such 'free-standing AVCs'. We do not accept this, since it would undermine the fundamental rule that occupational pension benefits should be limited, in order to keep the cost of the tax reliefs within manageable proportions.

37. Other changes tighten up the detailed provisions in order to counter exploitation of the tax reliefs, in particular by certain very high earners. I have seen suggestions that these changes will restrict job mobility, particularly among senior executives. I understand the argument, although this would generally be

only one of the many factors which influence the decision to move. But such criticisms ignore the fact that, if an individual qualifies for maximum benefits after as little as ten years service, any 'retained benefits' from earlier employments must be taken into account. And they ignore the effect of the overall reforms package on this problem. In particular, the proposed changes relating to personal pensions, additional voluntary contributions and trasferability (together with the DHSS changes on the revaluation of deferred pension rights) will greatly ease the present pensions barriers to labour mobility.

38. These are some of the main changes in a continuing process of pensions reform which was initiated by my Rt Hon Friend the Secretary of State for Social Services over three years ago. The proposals in this year's Finance Bill build on, and extend, the changes made in recent Social Security legislation, and provide a better pensions deal for millions of employees - and the self-employed - in this country.

39. I turn next to the set of clauses designed to improve the system of inheritance tax in order to benefit modest estates and small businesses. Clause 147 will increase the threshold from £71,000 to £90,000 and simplify the rate structure from seven rates to four. As a result the number of estates liable to inheritance tax will be cut by roughly a third. Clause 148 will extend exemption from tax to lifetime gifts between individuals

involving settled property where there is an interest in possession. Clause 149 introduces the provisions which will increase business relief from 30 to 50 per cent for substantial minority holdings of over 25 per cent in unquoted companies; it will also make the inheritance tax treatment of shares in companies dealt in on the unlisted securities markets the same as for companies with a full Stock Exchange listing.

40. I commend particularly to the House Clause 160 which repeals the Exchange Control Act 1947. The controls themselves were, of course, dismantled in 1979 and no-one can seriously lament their passing. Even the party Opposite, who in other ways are committed to restoring the disastrous policies of the 1970s have said that they will support this repeal. The effects of removing the controls have been wholly beneficial. But the Act itself has hitherto remained on the statute book, and for as long as it does so there could be uncertainty -however unrealistic - that it might be reimposed, which would be damaging.

41. Clause 3 abolishes the on-course betting duty. This has been widely welcomed by the major bodies connected with horse and greyhound racing, and I am sure that the Clause will attract wide cross-bench support. The revenue cost of abolition will be offset by Clause 4, which restores the gaming machine licence duty to its value in 1982, when it was last increased.

42. I know that all sides of the House will extend support to Clause 1 which introduces a rebate of duty for unleaded petrol. The measure has been welcomed by many outside bodies, and already there are clear indications that sales of unleaded petrol, and the number of outlets selling it, are increasing.

43. I know that the House will also welcome the clauses in the Bill which will extend VAT relief for charities. They follow the very substantial charities' package in last year's Budget and I commend them to the House.

44. I should also like to draw to the attention of the House a number of measures which the Government intends to introduce at Committee Stage. I have been consulting departments on the implications of a query raised by the Joint Committee on Statutory Instruments. This concerned the vires of levying fees and charges for services provided by departments, in particular the range of activities which make up the cost of provision. [Reference to Klondykers] I propose to introduce legislation at Committee Stage to deal with these matters.

[CONCLUSION]

FIN. BILL TALKS WITH OPPOSITION

001/3292

FROM: JILL RUTTER
DATE: 10 April 1987

PRINCIPAL PRIVATE SECRETARY

cc:
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir Peter Middleton
Mr Cassell
Mr Scholar
Miss Sinclair
Miss C Evans
Mr Walters
Mr Haigh
Ms Goodman
Mr Romanski
Mr Cropper
Mr Tyrie
Mr Ross Goobey

PS/IR
PS/C & E

Mr Graham - Parliamentary Counsel
Mr Neubert MP
Mr MacLean - Chief Whip's Office

FINANCE BILL: DISCUSSIONS WITH THE OPPOSITION

The Chief Secretary discussed today with Mr Gould and Dr MacDonald the passage of the Finance Bill. Also present were the Financial Secretary, the Economic Secretary, Mr Neubert MP, Murdo MacLean and Mr Graham (Parliamentary Counsel).

2 Second Reading would take place on 22 April.

3 Committee of the Whole House would take place on 29th and 30th April.

4 It was agreed that the following clauses should be debated:

29 April

Clauses 20 and 23 - Charge of income tax for 1987-88; deduction rate for subcontractors in construction industry - the Opposition requested this. They envisaged this as a major debate on personal tax.

Clauses 21 and 22 - Charge of Corporation Tax for financial year in 1987; Corporation Tax: Small Companies rate.

30 April:

Clause 11 - accounting for and payment of tax - requested by the Government.

Clause 147 - Inheritance tax rates - requested by the Opposition.

Clause 160 - Abolition of enactments related to Exchange Control - requested by the Oppostion.

Clause 18 - Issue of securities - requested by the Opposition.

Clause 33 and Schedule 4 - Employee Share Scheme - requested by the Opposition.

Clause 45 - BES: carry back of relief - requested by the Opposition.

5 The Opposition did not envisage a late session on the Thursday. There was unlikely to be any division after the Exchange Control provisions, if they, in the event, decided to oppose them. Mr Gould said he envisaged a debate of about 2 hours on Exchange Control.

6 The Chief Secretary told the Opposition it was for their decision whether Clauses 18, 33 and 45 should be taken on the Wednesday or the Thursday. I will confirm with the Opposition what their final verdict is before Mr Graham drafts the motion dividing the clauses between the two days.

7 It was generally expected that the Standing Committees would start in the following week, although it was noted that there was a problem with local elections on 7 May. The Opposition would consider further, but we should for the present plan on the basis that Standing Committee will start on 5 May.

8 The Chief Secretary would like to discuss with the Chancellor the allocation of clauses between Ministers.

JILL RUTTER
Private Secretary

001/3292

FROM: **JILL RUTTER**
DATE: **10 April 1987**

PS/CST TO PPS 10/4

PRINCIPAL PRIVATE SECRETARY /2

cc:
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir Peter Middleton
Mr Cassell
Mr Scholar
Miss Sinclair
Miss C Evans
Mr Walters
Mr Haigh
Ms Goodman
Mr Romanski
Mr Cropper
Mr Tyrie
Mr Ross Goobey

PS/IR
PS/C & E

Mr Graham - Parliamentary Counsel
Mr Neubert MP
Mr MacLean - Chief Whip's Office

C/See Para 8.

The CST would like to discuss with you at some point the allocation of clauses between ministers.

CR 10/4

Right. This [illegible] need [illegible] discussed, as also the present handling of X.

FINANCE BILL: DISCUSSIONS WITH THE OPPOSITION

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Jill Rutter

JILL RUTTER
Private Secretary

Janet - Ask ~~C Evans~~ C Evans (~~Cathy~~ CO/S) ~~Alex?~~

COMMITTEE OFFICE
HOUSE OF COMMONS
LONDON SWIA OAA
01-219 5766 (Direct Line)
01-219 3000 (Switchboard)

PS [illegible] the ~~SPE~~ CFR of this ASAP

TREASURY AND CIVIL SERVICE COMMITTEE

PRESS NOTICE

The Budget

The Sixth Report of the Treasury and Civil Service Committee, entitled The 1987 Budget will be published at noon on Wednesday 22 April 1987, when a Press Conference will be held in Committee Room 8 at the House of Commons.

The Report will be published as HC293, with Confidential Final Revise copies avialable on the usual basis from room 309, St Stephen's House, Embankment, SW1, after noon on Tuesday 21 April.

International Credit and Capital Markets

The Fifth Report of the Committee, entitled International Credit and Capital Markets, will be published at noon on Tuesday 28 April 1987, when a Press Conference will be held in Committee Room 8 at the House of Commons.

The Report will be published as HC84, with Confidential Final Revise copies available on the usual basis from room 309, St Stephen's House, Embankment, SW1 after noon, on Monday 27 April.

The Estimates

The Committee will take evidence from Treasury officials and from officials of other Chancellor's Departments on the Estimates on Monday 27 April at 4.45 pm in Committee Room 8.

cc Chancellor 12/2
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir G Littler
Sir T Burns
Mr Cassell
Mr Scholar
Mr Sedgwick
Mr Odling Smee
Mr Turnbull
Mr H Evans
Mr Peretz
Mrs Lomax
Mr Culpin
Miss O'Mara

D F HARRISON
Clerk

10 April 1987

PWP

FROM: S J DAVIES
DATE: 13 APRIL 1987

MISS C EVANS

cc : Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr Cassell
Mr Monck
Mr Kemp
Mr Scholar
Mr Turnbull
Mr Odling-Smee o/r
Mr Burgner
Mr Hawtin
Mr Sedgwick
Mr Riley
Miss Sinclair
Mr M Williams
Mr P Gray
Mr Instone
Miss O'Mara
Mr Culpin
Mr Bottrill
Mr Hudson
Mr Cropper
Mr Ross Goobey
Mr Tyrie

FINANCE BILL: SECOND READING DEBATE

1. EA have a two comments on the draft speech you circulated on 10 April.

2. We would prefer not to pick out the TCSC's views on the forecast for the current account as in your paragraph 11. There have been times in the past, and there will doubtless be occasions in the future, when the TCSC have suggested that some aspects of the Treasury's forecasts are too optimistic, and on these occasions we have not and will not want to give any weight to the TCSC's forecasting abilities. Quoting the TCSC's view in the way you propose will immediately raise the question whether our view now is that our own forecast for the current account is wrong - a view which the forecasters do not, in fact, hold.

cm
ce-finbl

3. The point about the lack of six successive years of growth under Labour (paragraph 14) is a weak one, as neither the 1964-1970 administration nor the 1974-1979 administration lasted a full six years (but growth in the six years 1965 to 1970 inclusive averaged 2.6 per cent, which is not that far off "nearly 3 per cent"). What was drawn attention to at Budget time was the steadiness of growth over recent years (which compares favourably with the whole of the post-war period), more than its overall average rate (which compares favourably only with the 1970s). For example, in the Budget Briefing see BB1, Positive (ii). "Forecast Suggests economy will have unbroken growth at annual rate of approaching 3 per cent from 1981 H1 to 1988 H1... This will be longest period of steady growth UK has known since War".

S J DAVIES

Abbey Life House PO Box 33
80 Holdenhurst Road Bournemouth
BH8 8AL

Telephone 0202 292373

Abbey Life

ML Hepher
Chairman and Managing Director

FINANCIAL SECRETARY
REC. 15 APR 1987
ACTION MR CAYLEY IR
COPIES TO PPS CST EST
Sir P. Middleton
MR Scholar
MRS Lomax PS/IR

28

The Rt Hon N Lamont
Financial Secretary to the Treasury
Her Majesty's Treasury
Parliament Street
London SW1P 3AG

13 April 1987

Dear Mr Lamont

FINANCE BILL: CAPITAL GAINS ON LIFE OFFICES

As you will already know there is serious concern at the Chancellor's proposals to discriminate against life assurance policyholders.

The Chancellor proposes to change the treatment of capital gains in life funds from the present 30% personal Capital Gains Tax rate to the 35% Corporate Tax rate. This means that policyholders will be put at a serious disadvantage against other forms of collective savings such as unit trusts.

We are at a loss to understand the thinking behind this proposal. For some years the Government has used the phrase "level playing fields" to justify the removal of advantages previously enjoyed by various financial industries. Indeed, the level playing field justification was used for the removal of life assurance premium relief in 1984.

However, it seems to me that the effect of the Chancellor's current proposal is to tilt the playing field against the life assurance industry. Many policyholders have entrusted their savings to us long term, for example, to fund the purchase of their own homes.

I very much hope that you would feel able to support the views of the life industry on behalf of its policyholders and persuade the Chancellor to withdraw the relevant clauses in the Finance Bill. I look forward to your comments.

Yours sincerely

Michael Hepher

Michael L Hepher

Abbey Life Assurance Company Limited
Registered in England No. 710383
Registered Office
80 Holdenhurst Road, Bournemouth, BH8 8AL

CE9

(Gave Carys Evans my own comments on (a))

Andrew . PWP

FROM: MISS C EVANS
DATE: 13 APRIL 1987

FINANCIAL SECRETARY

12/2

cc Chancellor of the Exchequer
Chief Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Cassell
Mr Scholar or.
Mr Odling-Smee a) only
Mr Sedgwick a) only
Mr Riley a) only
Miss Sinclair
Mr M Williams c) only
Mr Culpin
Miss O'Mara
Mr Cropper
Mr Ross Goobey
Mr Tyrie

PS/IR
Mr Mace a) only
Mr Munroe e) only
Mr Cayley d) only
Mr Eason a) only
Mr Walker

PS/C&E a) only
Miss French a) only

SECOND READING DEBATE: WIND-UP SPEECH

... I attach material for your speech as follows:

(a) Burden of Tax

(b) Inheritance Tax

(c) Oil

(d) CGT and Life Assurance Companies

(e) Pensions

2. The material on pensions is for defensive use if these points are used in debate. For a more positive presentation we have suggested that you use the pensions section of the Chief Secretary's speech (paras 33-38) if the Chief Secretary agrees that this could be left out of the opening speech.

3. It is has not been possible to clear this material widely. Accordingly I should be grateful if copy recipients could let me have comments by close tomorrow so that we can let you have a revised version on Wednesday. This will include a line to take on Labour's claims about plans to increase VAT, in the light of the Chancellor's response to the line to take suggested by the Minister of State for the replies to the letters from Mr Gould and others.

Carys Evans

MISS C EVANS
5170 93/1

CE37

SECOND READING DEBATE - WIND-UP SPEECH

BURDEN OF TAX

Mr Speaker many hon Members will be as surprised as I was by the Labour Party's decision to choose the burden of tax as a theme to attack the Government in this debate. Bereft of all other arguments they cling to this although a dispassionate observer might think this approach was something of an own goal for a party committed to creating ~~a~~ higher spending, higher borrowing, and higher tax taxation economy. [Their position is riddled with contradictions.] On the one hand they intend to vote against the income tax reductions contained in the Finance Bill and they are committed to reversing them if they came to power. They accuse us of seeking to bribe people by cutting taxes. Then in the same breath they ~~argue~~ suggest that taxes are too high and they revert to their latest favourite theme - the burden of tax.

2. [How can we take them seriously when <u>they</u> accuse <u>us</u> of increasing the tax burden?] We have cut the basic rate from 33p to 27p. We have increased personal allowances by 22 per cent in real terms, bringing the married man's allowance to its highest real level since the war and taking 1.4 million people out of tax compared with simply indexing the regime we inherited from Labour. Over the life of the last Labour Government the basic rate went up from 30p to 33p and personal allowances actually fell in real terms. The Labour Government before that increased the basic rate by six old pence in the pound and abolished reduced rates.

3. [But still Labour accuse us of increasing the tax burden.] They overlook the fact that what really matters to people is how much better off they are ie the increase in take home pay, real take home pay after taking account of inflation. The record is absolutely clear and it demolishes the opposition's case. At all multiples of average earnings real take home pay has increased by substantially more under this Government than under the previous Labour Government. For a man on average earnings with 2 children real take home pay has gone up by over 21 per cent since 1978-79. For the same man real take home pay went up by less than 1 per cent between 1973-74 and 1978-79 - hardly any increase at all. And the comparison holds for low earners

as well. For the man with 2 children on half average earnings between 1978-79 and 1987-88 real take home pay went up by 17.5 per cent. This compares with only 4 per cent under Labour. But what about the people at the bottom - those whom Labour claim to defend? For this group too, the bottom decile of the earnings distribution, real take home pay has increased by more under this Government than under Labour. The plain fact is that under the last Labour Government living standards hardly rose at all for many people and actually fell for single people at all multiples of average earnings.

4. Ordinary people understand this comparison, they understand that they are better off under this Government. Let me take just one example. A married couple, employed as a teacher and a nurse, will have seen their real take home pay increase by 36 per cent since 1978-79, compared with just 4 per cent between 1973-74 and 1978-79. I could go on.

5. Faced with these facts Labour seek to divert attention to the burden of tax. This Government has reduced taxes in every Budget since 1981. We are committed to continuing to reduce taxes. I ask the House to consider what the position would be without the reductions we have made. The burden of income tax and national insurance contributions today is lower for all family types, at all levels of income, than it would be if we had simply indexed Labour's regime. For a married man on average earnings with 2 children an indexed Labour regime would mean paying £4.85 a week more in income tax and national insurance contributions.

6. One thing is absolutely clear. Whatever Labour may say about the burden of tax under this Government - it would be much, much higher if they were in office. Their spending commitments amount to £34 billion - to raise this from income tax would mean at least doubling the basic rate.

7. I could go on at length about the contradictions in Labour's position. But I turn now to the impact of this year's Finance Bill, which is the subject of this debate. The overall impact of the Bill is to reduce taxes in 1987-88 by £2.6 billion. As a result of the implementation of the Bill the percentage of earnings taken in income

tax, NIC and indirect taxes will fall for everyone, except perhaps the very highest paid. The Budget reduces the burden of tax. As a result of the income tax changes alone a married man on average earnings will be £3.87 a week better off. A primary school teacher married to a nurse will be better off as a couple by £7.59 a week. People whose mortgage rates come down next month will gain a further benefit. A married man with no children on average earnings with an average mortgage will be £5.37 a week better off as a result of the Budget changes and the fall in mortgage interest rates. The cut in the basic rate to be effected by Clause 20 will benefit all taxpayers.

if raised

8. [Members opposite have seen cause for criticism in the fact that the lowest 34 per cent of taxpayers received only 12 per cent of the total reduction in income tax. The explanation for this is simple. The bottom 34 per cent contributed only 9 per cent of the total income tax take in 1986-87 - in other words they have received a share of the reduction which is greater than their contribution to the total.]

9. Mr Speaker, the Government welcomes the Labour Party's conversion to the cause of those who seek to reduce the burden of tax. We agree that the tax burden is still too high and we intend to continue to reduce it when prudent to do so. Tax reduction is a cardinal element of the Government's policy. We believe that cutting taxes is the single most effective measure available to us to stimulate enterprise and improve the prospect for output and jobs. As my rt hon Friend the Chancellor said in his Budget speech there is now a worldwide consensus on the economic desirability of tax reform and tax reduction, and in particular, the reduction of income tax. We are reducing income tax without any increases in indirect tax rates and the Red Book indicates scope for further reductions in taxation in each of the next three years. The Government remains committed to the prudent reduction of the overall burden of taxation. We are the only party with such a commitment.

INHERITANCE TAX

Threshold and Rate Bands

In recent years much has been done to remove some of the worst features of what is now inheritance tax. The changes made last year, including the exemption of lifetime gifts between individuals, marked another significant stage in this process. But nonetheless, the yield of the tax continues to rise in real terms and many small estates, where the main asset is the family home, have been pulled into the tax. To help in these cases, Clause 147 increases the threshold from £71,000 to £90,000 from Budget Day. This will give the greatest proportionate benefit to those estates which are least likely to have benefited from the reliefs introduced in recent years. It will reduce the number of estates that would have paid the tax by a third. The Clause also simplifies the rate structure by reducing the rate bands from seven to four. This also provides a worthwhile reduction in tax for estates of all sizes.

Business Relief

A number of changes are proposed in inheritance tax business relief. The main ones are that from Budget Day, the relief for minority holdings of more than 25 per cent in unquoted companies will be increased from 30 per cent to 50 per cent. At the same time, shares in Unlisted Securities Market companies will be treated for all inheritance tax purposes in the same way as shares in companies which are fully listed. The effect of these changes will be to improve the relief where it is really needed - where the shares on which the liability arises - being unquoted - are not easily marketable. The relief helps in these circumstances to maintain confidence and continuity in the business. Thanks to the development of the USM market, the same difficulties do not arise with shares which are dealt in there.

Interest in Possession Trusts

Last year, we abolished the charge on outright gifts between individuals so as to encourage lifetime giving. This year, in

Cluase 148 and Schedule 13, we are taking the reform a stage further by exempting gifts by individuals into interest in possession settlements and terminations of interests in possession in favour of individuals. This should be of much help to small family businesses and farms, many of which are held in that kind of trust. We are however still concerned, as we were when the possibility of this extension was discussed in Committee upstairs last year, that the new exemption should not be abused; and the legislation includes safeguards against that. [These take the form of a protective rate of charge to be imposed if property is passed to a discretionary trust through a temporary interest in possession while the creation of that interest remains potentially exempt.] This new relief does not apply to discretionary trusts and the charges on them will remain as protection for the death charge itself.

omit square brackets to shorten if necessary

The Heritage

Thanks to the efforts of this Government, the tax regime for the nation's heritage has been much improved. There are two further changes this year. First, we are exempting from inheritance tax settled property that is put into a heritage maintenance fund within two years after the death of a life tenant - or within three years if a Court Order is needed. [At present, that is only possible if the necessary arrangements are made while the life tenant is alive - which can be a time-consuming and expensive process. In future, it will be possible to make the arrangements after the death. This should encourage the creation of maintenance funds and reduce the risk of expensive calls on the National Heritage Fund.]

Second we are improving the arrangements for acceptance in lieu of tax. These arrangements are a most valuable form of protection for the heritage. In future owners will have the choice of either the present system or an arrangement under which no interest would be charged between the dates of the offer and the acceptance, but the tax satisfied would be based on the market value at the date of the offer and not, as now, at the date of acceptance.

OIL PACKAGE

My rt Hon Friend has outlined the Clauses designed to benefit the North Sea oil sector. I welcome this opportunity to expand on how these fit in with the Government's overall approach to the sector.

It is now a well-known fact of history that at the beginning of last year the oil price fell sharply. To prophesy doom then was to overreact. The oil price has come back - from the lowest point of $8½ to around $ today. The industry, with admirable resilience, has more than survived. Production from existing sources has continued at a high level. The search for new sources has gone. on.

! L

But there has been a cutback in new activity. This is having a harmful effect, not least on jobs in the offshore supplies industry. It is not within the Government's power to reverse economic tides. But this is a tide which it is widely hoped will flow back later. Activity will pick up again, new orders be generated. And in the meantime, there is an undoubted problem. The immediate future of the oil price remains uncertain; and decisions on some new developments are being delayed.

One reason for this delay was cash-flow difficulties of the smaller partners in possible new projects. As early as last autumn, we took action on this with a carefully targetted measure. We brought forward the repayment of some £300 million of Advance Petroleum Revenue Tax. This has now been paid back to the companies.

But there is another reason why a decision to go ahead with a project might be delayed. It may no longer be clear that the project is going to be sufficiently profitable. Ought we to do anything about that? This is less obvious. We do not wish to introduce fiscal incentives for companies to go ahead with uneconomic projects.

We think it would be right however to give some help in the present situation to increase the post-tax profitability of new developments. We propose that for the purposes of Petroleum Revenue Tax a participator in a new offshore oil-field outside the Southern Basin should be allowed, if it wishes, to set up to 10 per cent of qualifying development expenditure in that new field against its profits in another field. The expenditure is that which would qualify for 'uplift' if relieved in its own field.

The aim has been to set this relief at a level which will give a useful benefit without making fields economic after tax which would not be so pre-tax.

The industry had given us a number of suggestions for ways in which they might be helped in the present difficulty, and can say that they have generally welcomed [in their evidence to the Energy Select Committee] this cross-field allowance.

But this is not an industry which just sits back and hopes for Government help. It has already been acting vigorously to reduce costs. It is these cost reductions which are so important in securing new development work. Our own contribution here is to remedy a gap in the rules for giving Petroleum Revenue Tax relief for research related to oil extraction activities.

The potential impact of these proposals is far greater than the cost figures shown in the Financial Statement for 1987-88 and 1988-89. The figures there can only be estimates: the actual cost will depend on how companies respond. But more importantly, much of the incurring of the expenditure and the impact of this on tax receipts comes later; but the measures themselves will enable early decisions to be taken and so orders to be advanced. The cost will build up, and in due course could benefit the industry by over £100 million in a year. The value of orders advanced will of course be much greater than that.

FINANCE BILL SECOND READING DEBATE: WIND-UP SPEECH

IMPACT ON LIFE ASSURANCE COMPANIES

I have listened carefully to the points made in this debate about the implications for life assurance of the new arrangements we propose for the taxation of companies' capital gains.

The Government did consider very carefully whether the change proposed in Clause 67 should extend to capital gains earned for holders of life assurance policies. In the end, we concluded that it would not be appropriate to make such gains an exception. I believe that was the right decision. There will of course be an opportunity for full debate in Finance Bill Committee but I am able to deal with the key points in this debate.

The main point at issue is the impact of the tax payable on policyholders' gains. This should be much less than has been suggested. There are two main reasons for this. First, a sizeable proportion of policyholders' funds is invested in gilts and other assets outside the CGT net. Second, gains earned for policyholders are largely - in some cases wholly - sheltered from tax by deductions, in particular for management expenses. Much of such tax as the life companies pay on their gains is on profits earned for shareholders and does not affect policyholders' funds. The Inland Revenue cannot, for reasons of confidentiality, give me figures for individual companies, but they have told me that a number of major companies' computations show for 1985 no tax liability on policyholders' gains, and the first indications from the 1986 figures now beginning to be submitted suggest that the same may be true for 1986. Thus I believe that the effect of the change on the tax payable on policyholders' gains has been exaggerated. The evidence suggests that the impact should generally be marginal compared with the huge value of life assurance funds.

Accordingly we see no reason why the changes should undermine the competitiveness of life assurance as some Members have suggested. Some companies have, I know, increased the provision they set aside for possible future tax on gains, and as a result reduced somewhat the returns to policyholders. The extent to which companies make such provision varies widely. A few make none on the basis that they expect no tax liability on policyholders' gains in the foreseeable future. Most set aside a provision that is heavily discounted to reflect the fact that any liability will in general not arise for some years and then be heavily offset by management expenses. It is entirely a matter for each company to determine what effect the new regime will have on the level of provision they make for possible future tax. But, as I have said, in practice the impact of the change on life companies' tax liabilities should be relatively marginal. Thus we do not believe that there will be any substantial implications for the competitiveness of life assurance.

We have received a number of representations on this issue and I have discussed it with the Association of British Insurers. I have taken careful note of the points made in this debate which we can consider further in Committee.

SECOND READING DEBATE: PENSIONS PACKAGE: DEFENSIVE POINTS

LABOUR MOBILITY

Some Members have suggested that the package will obstruct labour mobility This is not the case. It is true that the change in the "uplift" rules will restrict the ability of new members of schemes in the earning of maximum benefit to 20 years instead of the current 10 years. However, this ignores the preserved benefit an individual may have from his previous employment which, for uplift purposes, must be taken into account. In any case, the basic rules for occupational pensions envisage that pension benefits are earned over the working life of the employee, not simply to facilitate a few years of tax-relieved payments into a scheme to produce a tax-advantaged payment out on retirement. While some relaxation in the basic rules is appropriate, the ability to fund - with full tax relief - for a maximum pension after only 10 years' service is an excessively generous concession. Most people will move jobs for a number of reasons of which pension benefit is only a part.

Moreover, other pensions changes, personal pensions, AVCs, transfers, DHSS changes on the revaluation of deferred pension rights - will help mobility.

AVCs

Why limit the benefit on freestanding AVCs? If the benefit limit on AVCs was not maintained, it would be possible for an individual in a non-contributory scheme to invest in AVCs and receive substantially more than 2/3 final salary as a benefit - perhaps even more than his final salary. Pension contribution relief was never intended as a tax shelter for investment generally.

'In-scheme' AVCs have always been subject to the benefit limits; and scheme managers should review the scope which people have to pay AVCs within those limits in order to guard against excessive levels of contribution. There seems no reason why a broadly similar procedure should not apply for free-standing AVCs - with the scheme member obtaining the relevant information from his scheme and passing it on to the AVC provider.

Does not the commutation of "added years" AVCs within occupational schemes give an unfair advantage to the public sector? No. Public sector schemes provide for lump sum and pension benefits in fixed proportion; and any AVCs paid to buy added years increase both benefits. Private sector schemes have much greater flexibility: lump sums are based on final salary and the number of years of service, and the AVC benefit can be (and normally is) taken wholly in lump sum form. It is open to the private sector to provide benefits in a fixed proportion or to allow the purchase of added years' through their AVC schemes.

[Although the public service schemes do have index-linking (a much reduced advantage in periods of low inflation) and "added years", the death in service and other benefits are usually substantially inferior to the private sector. In any case, this Budget also introduces PRP, which is not available in the public sector (nor are share options).]

CE19

Andrew

FROM: MISS C EVANS
DATE: 14 APRIL 1987

CHIEF SECRETARY

cc Chancellor of the Exchequer
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr Cassell
Mr Monck
Mr Kemp
Mr Scholar
Mr Turnbull
Mr Odling Smee
Mr Burgner
Mr Hawtin
Mr Sedgwick
Mr Riley
Miss Sinclair
Mr M Williams
Mr Gray
Mr Instone
Miss O'Mara
Mr Culpin
Mr Bottrill
Mr Hudson
Mr Cropper
Mr Ross Goobey
Mr Tyrie

PS/IR
Mr Walker - IR
PS/C&E
Mr Bone - CE

C.

~~Still~~
Much the same as the previous draft.
Still prodigiously long.

AH

* ~~Drafting~~

~~or CST's statement draft soonish.~~

SECOND READING DEBATE: DRAFT SPEECH

... I attach a revised draft which takes on board the comments received on the draft I circulated on 10 April. I should add a couple of points.

2. As you requested I have inserted a passage responding to concern about Clause 58 (Lloyd's). This is the material prepared for the Financial Secretary's wind-up speech. The Revenue suggest that there is not enough scope in this topic for the Financial Secretary to return to the Clause in winding up but they stand ready to produce a further piece if the Financial Secretary would like to do so.

3. Mr Davies would prefer to omit the reference to Labour's growth record in paragraph 14, for the reasons explained in his minute of yesterday.

Carys Evans

MISS C EVANS

CHIEF SECRETARY'S SPEECH FOR SECOND READING DEBATE
SECOND DRAFT

1. I beg to move, that the Bill now be read a Second time.

2. The Finance Bill gives effect to the Budget presented by my right hon Friend the Chancellor six weeks ago. That Budget was set in the context of a steadily growing economy and strong public finances. These favourable circumstances, the fruits of the success of our prudent and consistent economic policies, have enabled us in our plans for 1987-88 to combine a £4.7 billion increase in expenditure, a £3 billion reduction in public sector borrowing and a £2.6 billion reduction in taxes. The continued strength and vigour of the British economy gives the lie to the increasingly desperate attacks by hon Members opposite. They simply cannot stomach the clear evidence of our success, evidence which has been further reinforced by the economic indicators since the Budget

3. [To be updated in light of statistics published before 22 April: The February trade figures show that British exporters are grasping the opportunities which the Chancellor mentioned in his Budget speech. Manufacturing exports are 8 per cent higher than a year ago and overall non-oil exports up by 11 per cent. Between January and February unemployment fell by 44,000

- the largest monthly fall on record.] The CBI March enquiry showed industry's order books and output expectations at their highest levels since the information has been sought in this way.

4. With remarkable consistency the indicators show that following nine Budgets under this Government the British economy is stronger than at any time since the War. One key test of the growing confidence which exists in British industry is the amount of new equity being raised for investment - investment which will produce profits and jobs. In 1986 companies raised £8 billion in new equity on the Stock Exchange, eight times the amount they raised in 1979. And this does not include the finance raised through the unlisted securities market which did not exist in 1979, nor through venture capital funds which in 1985 raised more than 40 times more finance than in 1979. Indeed the growing vitality of the UK venture capital industry is a particularly encouraging development. Venture capital investment in the UK is now higher as a proportion of GDP than in the US. A recent report by the British Venture Capital Association highlights the rate of growth of the industry in recent years. It has taken the US venture capital industry more than 25 years to reach its present size; in the UK a large part of the industry's growth has taken place during the past 5 years. The venture capital industry looks to the long term - its growth under this Government is clear evidence of investors' confidence in the future prospects for British industry.

5. This is also illustrated by the high level of overseas investment in the UK in recent years, reflecting the increased profitability of British industry, which in 1985 was at its highest level since 1964. In the last two years overseas investment in the UK has amounted to almost £24 billion. Even with this growth in inward investment the UK has increased its net asset position to an estimated £110 billion by the end of 1986. At 28 per cent of GDP this is the highest recorded level since the war. It compares with the level of £80 billion at the end of 1985 and £12 billion at the end of 1979. As a result of this healthy position earnings from interest, profits and dividends were over £4 billion in 1986 and will continue to make an important contribution to the balance of payments in the future.

6. The strength of the recovery is widely spread across the economy. I will mention only a few of the success stories. The office machinery and data processing sector increased its output between 1981 and 1986 by 201 per cent. The output of the electronic consumer goods sector rose by 167 per cent over the same period. I have been particularly struck by the direct reports I have received of the strength of the construction industry. New orders for 1986 were up 7 per cent on 1985. Private sector output rose particularly strongly in 1986 with commercial work increasing 14 per cent and private housing output rising 10 per cent on 1985 levels. In 1986 repair and maintenance output was up on the previous year and housing repair and maintenance reached a record level of £4.9 billion. I could go on.

7. The construction industry is strong under this Government because the economy is strong. The Party opposite has pressed all along for a 'short term fix' of increased public spending in construction. Their blinkered approach prevents them from seeing the extent of the private sector-led recovery taking place at the moment. Nor can Labour see behind them, back to their record of meddling with the micro-economy, bursts of spending to solve short-term problems paid for later in higher unemployment and inflation. Indeed, so strong is this recovery, that if the Government did follow the advice of the Party opposite and spark off a public sector spending binge in the construction industry, we would expect to see skill shortages and bottlenecks. Skill shortages are already apparent and the Government and industry have reacted by making more places available for training. The CITB have produced a plan for 4,000 more people to be trained for the construction industry. 3,000 are being trained through the new 2-year YTS scheme.

8. Most galling of all for the Party opposite is that the strength of the current market in building supply products comes as a result of fulfilling another Government objective - spreading owner-occupation. More people owning their own homes has meant an expansion of

property renovation, maintenance and improvements. The Budget has given more money back to the people who earn it without having to resort to irresponsible public borrowing. This will give a further boost to the building supply industry and create more jobs because it releases people's individual demand for home improvement.

9. Like its predecessors this Budget is designed to improve further the performance of the economy and hence the prospect for jobs. Tax reduction is the single most effective measure available to the Government to stimulate enterprise and release wealth creating energies throughout the economy. The measures in the Finance Bill will consolidate and extend the now well established lines of reform which we have followed since 1979 as well as enacting new measures to improve the micro economic environment so as to strengthen further the prospect for growth which lies ahead.

10. The response to the Budget demonstrates that my rt Hon Friend's proposals have been widely welcomed. This positive reaction has not been confined to those with a direct interest in the Budget measures. The prudent and balanced proposals put forward by the Chancellor have strengthened the confidence of the financial markets with the result that base rates have fallen by ½ per cent since Budget day, following an earlier ½ per cent reduction the previous week. Base

rates are now a full per cent lower than they were at the beginning of the year. The majority of banks and building societies have announced a reduction of 1 per cent in mortgage rates. This will be of direct help to the eight million homeowners with a mortgage loan.

11. Members will have received the response to the Budget contained in the report by the Treasury and Civil Service Committee published today. [Now is not the time to consider the report in detail since it makes no comment on the tax changes in the Budget but concentrates on the conduct of monetary policy and the PSBR. The Government will respond to the Committee's recommendations in due course.]

12. In reviewing the setting for this year's Finance Bill let us contrast the climate of confidence created by this Government with the prospect offered by the opposition parties. Although I want today to concentrate on the measures introduced in this Bill to improve the micro-economic environment, the supply-side, I cannot allow the occasion to pass without reference to Labour's macro economic plans (might be possible to refer to the Austin Mitchell minority report which may be published with the TCSC report).

13. Fear not, says he, the rt hon Member for Sparkbrook the so-called jobs programme can be paid for by an increase in the basic rate of income tax of 2p for all 25 million taxpayers and an extra

£3½ billion of borrowing. All those other pledges which total £34 billion and many of which he confirmed only (last) Saturday in Southampton, will have to wait for extra resources generated from growth. Well, don't hold your breath.

14. Under Labour, we have <u>never</u> had six years of steady economic growth ~~of~~ averaging almost 3 per cent a year, we have not, since the Second World War had a lower basic or standard rate of income tax and no Labour government since the war has even reduced unemployment.

15. Since the Labour Party is committed to ending the successful privatisation programme, can the rt hon Gentleman confirm that the total increase in Government borrowing he admits to for his so-called "jobs package" is not £3½ billion as he claims, but £8½ billion? I gladly give way.

16. Such an increase in borrowing is bound to make the price of borrowing higher. This sits oddly with the claim opposite that interest rates are too high.

17. On the micro-economic or supply-side measures which all three Opposition parties wish to introduce, there is infinite confusion. How are business incentives to be improved by voting against income tax cuts? How will the interventionist British Investment Bank choose winners which markets cannot? "I am very sceptical about

industrial strategies to improve economic performance". Not my words, they come from a book called "Monetarism or Prosperity?" published in 1980 and authored by the hon Member for Dagenham.

18. The Opposition parties are squabbling again over division of the bearskin to which my hon Friend the Member for Brighton Pavilion so memorably referred*. This Finance Bill is more concerned with making us more prepared to meet the competition in catching it in the first place.

[**"BEAR JOKE** Two hunters were woken in their tent in the middle of the night by the sound of a bear tearing at the canvas. As they scrambled from their sleeping bags one of the hunters paused to put on his running shoes.

"What on earth are you doing? You'll never outrun a bear."

"I don't have to outrun a bear, I only have to outrun <u>you</u>."]

19. But let us spend no more time on the opposition parties' policies since it becomes daily clearer that they will never be implemented. In this year's Finance Bill the most important change, because it affects every taxpayer, is the reduction in the basic rate of income tax to 27 per cent in clause 20. This continues our steady progress towards the goal of a basic rate of not

*Hansard extract attached

more than 25 pence in the pound, which my rt Hon Friend the present Foreign Secretary set in 1979. Starting from the 33p rate which we inherited in 1979 we are now well over half way towards our goal, and shall soon have reached a basic rate which is equivalent to the reduced rate band introduced by the party opposite. Once again we have designed our income tax proposals so as to concentrate the benefit on the overwhelming majority of ordinary taxpayers and as last year we have structured the changes so that those with the highest incomes do not benefit disproportionately. We have also provided a measure of extra relief for those aged 80 and over and for blind people - these measures are contained in Clauses 26 and 28.

20. The cut in the basic rate improves incentives for everyone, including unincorporated businesses and the self employed, whose marginal rate is the basic rate. That is nearly 21 million taxpayers of working age - 94 per cent of the total. The cumulative effect of the income tax reductions since we took office is substantial. The burden of income tax is now £12 billion lower than it would have been had the regime we inherited simply been adjusted in line with inflation.

21. The Budget debates provided further evidence, were any needed, that the vital benefits of lower income tax cuts would be lost if the Labour Party were ever given the opportunity of implementing their policies. Whatever

confusion there may be about the remainder of their proposals one thing is clear, a Labour government would mean much higher taxes, £34 billion would mean at least doubling the basic rate of income tax. Nevertheless they have no inhibitions about accusing us of increasing the tax burden. It is hard to take them seriously on this - I could go on at length about the increase in real take home pay under this Government compared with the poor record of the last Labour Government. But I have asked my rt hon Friend the Financial Secretary to deal with this subject in his wind-up speech. Characteristically the position of the SDP and Liberal parties on income tax reductions is more confused. They intend to vote against this clause but are not necessarily committed to reversing the 2p cut. Fortunately they will never be in a position to resolve their dilemma.

22. As well as their major beneficial impact on incentives tax cuts are good for industry because they offer higher take home pay without adding a penny to industry's costs. For a married man on average earnings the rate and allowance changes combined mean nearly £4 a week extra in pay packets, which is equivalent to a 2.7 per cent pay increase. As this Government has repeatedly made clear the future performance of the economy, and thus the prospect for jobs, depends critically on the ability of British industry to keep control of its costs. The Government's success in bringing down inflation has substantially reduced the

justification for pay increases which are not earned by better performance. This year's income tax reductions provide further help to employers in their efforts to control labour costs.

23. We have done this more specifically with the new tax relief for profit related pay which is contained in Clauses 107 to 122 of the Finance Bill. The significance of this new measure has been widely recognised. It will reinforce the steps the Government have already taken to make the labour market work more flexibly and increase the common interest and involvement of employers and employees in the success of their businesses. It is designed to tackle the 'them and us' attitude which has bedevilled so many of our businesses for so long. But it has the vitally important extra dimension of providing automatic flexibility with labour costs. The relief proposed could be equivalent to a further 4p reduction in the basic rate of tax for a married man on average earnings whose employer takes maximum advantage of the scheme. As the Chancellor has said the scheme is not a panacea but it represents an important challenge to British management to play their part in bringing about changes in the operation of the labour market which could radically improve the prospect for jobs. I hope they will take up the challenge and I am glad to report that the level of interest shown in the scheme is very encouraging - some [2,700] firms have already registered their interest with the Inland Revenue.

24. The Bill contains an important clause on training which I would like to draw to the attention of the House. The importance of training and retraining to the success of the economy is well understood. At present expenditure by employers on training for people who are changing jobs is liable to be taxed as a benefit in kind in the hands of the employee. Clause 36 will make this expenditure on training for a new job or business opportunity free of tax.

25. A key component of our strategy to improve the performance of the economy has been a coherent set of measures to help small businesses. The single most important measure in this year's Finance Bill is the cut in the basic rate of income tax for unincorporated businesses including the self employed to 27p in the £. For small companies Clause 22 similarly reduces the rate of CT to 27 per cent, 15 percentage points below the level we inherited in 1979. The Bill contains a number of other clauses specifically targetted on this sector and these have been among the most widely welcomed provisions in the Budget. Clause 11 will enable businesses whose annual turnover is less than £¼ million to account for VAT on the basis of cash paid and received. More than half of all traders registered for VAT fall into this category. This Clause also provides for the option of annual accounting which will enable small companies to send only one return a year to Customs. Taken with the other VAT measures in this

field, not all of which are to be implemented by way of primary legislation in this Bill, this represents a substantial package of reforms for small businesses. Cash accounting will overcome the twin VAT problems associated with late payment of bills and with bad debts. Annual accounting will provide a means of assisting cash flow and of reducing the form-filling burden. And, of course, the turnover ceilings which my rt Hon Friend proposed in his Budget are much higher than those in the original consultation document. I am pleased to observe that these measures have been supported on all sides of the House, as well as by many spokesmen for small businesses.

26. In addition to these measures the Bill contains a number of other clauses which will be of considerable benefit to the small business sector. The large increase in the starting point for inheritance tax contained in Clause 147 and the other inheritance tax changes we propose, as well as the increased retirement relief from capital gains tax contained in Clause 67 will all make it easier to pass on a flourishing family business to the next generation.

27. I would now like to draw the attention of the House to a number of clauses concerned with the collection of Corporation Tax. The purpose of these measures is to build upon the major reform of the corporation tax regime which we introduced in 1984 and to make the collection of

the tax simpler, fairer and more effective. Clauses 123-133 introduce a new streamlined method of assessment and collection known as Pay and File. This has been generally welcomed by the business community. Because computerisation is required the new arrangements cannot take effect before the early 1990s. The reason for legislating now is to give taxpayers and their advisers a firm basis on which to plan.

28. Now that we have brought the main CT rate down from 52 to 35 per cent we believe that the case for a differential rate on gains is no longer justified. Clause 61 therefore provides for companies' capital gains to be charged at the appropriate corporation tax rate thus removing the complicated adjustment which is needed under present arrangements. For small companies this will mean a cut of 3 percentage points in the rate charged on capital gains. At the same time we propose that companies should be able to benefit from ACT set off against their liability to tax on capital gains. This will be of considerable benefit to many companies. I know that a number of hon Members have expressed concern about the impact of these changes on life assurance companies. The Government considered very carefully whether the change should extend to capital gains earned for holders of life assurance policies. In the end we concluded that it would not be appropriate to make such gains an exception. My rt Hon Friend will return to this in his wind-up speech. A further streamlining measure is

contained in Clause 37 which will rationalise payment dates for corporation tax, bringing all companies on to a 9 month payment basis and removing the scope for a potentially costly abuse.

29. The Bill contains measures of benefit to the North Sea oil sector. These carefully designed measures will give the oil companies and offshore supply industry an opportunity to adjust to the oil price fall, and help mitigate its effect on development and research. Clause 157 will allow companies to have up to 10 per cent of the costs of developing certain new fields set against their petroleum revenue tax liabilities in existing fields, until such time as the income of those new fields exceed the costs incurred. Clause 156 will provide a new relief against PRT for spending on research into United Kingdom oil extraction that is not related to any particular field. These measures should reduce the likelihood that the trough in orders to the offshore supplies industry could result in undue loss of capacity for which opportunities could be expected to arise late. They have been welcomed by the industries themselves and by others with an interest in the continued vigour of activity in the North Sea.

30. Within our continuing programme of tax reduction and reform it is the Government's policy to eliminate unintended or unjustified tax breaks which cause rates of tax generally to be higher than they otherwise would need

to be. We see no justification for asking the majority of taxpayers to subsidise the few who benefit in this way. The Bill contains a number of clauses designed to remove opportunities for tax breaks of this kind.

31. Clause 12 is the main clause of a package which tightens up the rules on the deduction of VAT input tax as they apply to businesses and, in particular, groups of associated businesses - whose activities are in part exempt from VAT. This is designed to prevent distortion of trade and to combat tax avoidance, since the old rules were excessively generous and were being exploited on a growing scale. The new rules contain generous relief provisions for small businesses; around 2,000 have ceased to be treated as partly exempt. Special arrangements for calculating deductible input tax have been made with individual traders and trade associations to deal with problems peculiar to particular industries, such as brewers' tied houses. Although it might be too much to expect that those directly affected would welcome these anti-avoidance measures, they have generally been accepted as fair and necessary and they have drawn approving comment in the trade press.

32. Clauses 48 and 49 will prevent companies in multinational groups which enjoy dual residence from securing tax relief twice on one and the same interest payment. Clause 50 ensures that the controlled foreign companies legislation is not side stepped by moving the

residence of the foreign company to the UK before payment of a dividend. Clauses 52 and 53 will end the present excessively generous treatment of tax credit relief for foreign withholding tax paid on interest on bank loans. In future banks will be able to offset this tax credit only against tax on the profit on the relevant loan, and not more widely. Another in this group of measures is Clause 134 which will enable the Revenue to charge interest in cases where an employer does not apply PAYE properly and a formal assessment has to be made to recover the tax. Taken together these measures amount to a significant contribution to a fairer and more effective tax system. I hope they will receive support from all sides of the House.

33. I turn now to Clause 58 which deals with the tax treatment of members of Lloyd's syndicates. This measure is designed to bring the tax treatment of reinsurance to close into line with that of comparable provisions made by insurance companies and other traders. A number of Hon Members have expressed concern about the impact of this Clause on Lloyd's. The basic point at issue is a simple one. Should the Revenue be able to review Lloyd's RIC and apply the normal tax criteria for determining what should be deductible for tax purposes? Or must Lloyd's figures be accepted without enquiry? The effect of the present law is that the normal tax criteria do not apply. So RIC is automatically deductible in full, without review. This put Lloyd's members in the unique

position of being able to determine their own tax liability as far as RIC is concerned. The Government do not consider it right that this situation should be allowed to continue. The purpose of the legislation is simply to ensure that RIC figures can be examined against the sort of tax criteria that already apply to comparable provisions made by insurance companies, and other traders [- including members of Lloyd's syndicates which are "running off" their business.]

34. Having established the principle that RIC should be subject to review for tax purposes, it is very important that the rules should apply equitably in practice. That is why the Chancellor announced in his Budget speech that there would be immediate consultation with Lloyd's. The consultation process is already well under way, on a constructive basis. I am sure this is the best way of achieving a solution which removes the present anomaly but takes account of Lloyd's understandable concerns.

35. The Bill contains a number of clauses which will bring about important and far reaching changes in the pattern of pensions provision. They form part of a strategy to widen the coverage of non-State pension provision and give individuals far more flexibility and choice in the way they provide for their retirement. These measures will reduce employees' reliance on the State for their provision in old age and will remove a significant obstacle to job mobility. The effect will be

to extend the tax advantages for retirement provision much more widely.

36. Clauses 69 to 106, and Schedule 10, introduce the tax regime for the new personal pension schemes, which will be available from next January. This legislation is based on the present, broadly similar, retirement annuities provisions enacted over thirty years ago. In addition to being brought up to date, the new measures also incorporate a number of new features which have been widely welcomed. In particular, it will in future be possible for employees to contract-out of the State Earnings Related Pension Scheme through a personal pension. Clause 92 provides the necessary procedures to achieve this result.

37. Clause 71 enables a much wider range of pension providers to carry on new pensions business. Hitherto, insurance companies and certain friendly societies have enjoyed a virtual monopoly of personal pension business. In future banks, building societies and unit trusts will also be able to enter this market: a proposal which has been widely welcomed as improving the choice open to individuals.

38. Another important change is made by clause 79, which enables transfer values to be paid into or from a personal pension scheme. This will permit much greater transferability than is now possible between different

types of pension arrangements. Again, this has been warmly welcomed as a helpful development.

39. Clause 34 and Schedule 5 propose a number of changes in the present rules for occupational schemes. It contains the provisions needed to give effect to the Budget Day announcement that, from next October, members of occupational schemes will be able to make additional voluntary contributions to a pension plan completely separate from their employer's scheme, up to the tax approval limits on contributions and benefits. This development has been widely welcomed in principle, although some commentators have argued that the limits on benefits should not apply to such 'free-standing AVCs'. We do not accept this, since it would undermine the fundamental rule that occupational pension benefits should be limited, in order to keep the cost of the tax reliefs within manageable proportions.

40. Other changes tighten up the detailed provisions in order to counter exploitation of the tax reliefs, in particular by certain very high earners. I have seen suggestions that these changes will restrict job mobility, particularly among senior executives. I understand the argument, although this would generally be only one of the many factors which influence the decision to move. But such criticisms ignore the fact that, if an individual qualifies for maximum benefits after as little as ten years service, any 'retained benefits' from

earlier employments must be taken into account. And they ignore the effect of the overall reforms package on this problem. In particular, the proposed changes relating to personal pensions, additional voluntary contributions and trasferability (together with the DHSS changes on the revaluation of deferred pension rights) will greatly ease the present pensions barriers to labour mobility.

41. These are some of the main changes in a continuing process of pensions reform which was initiated by my Rt Hon Friend the Secretary of State for Social Services over three years ago. The proposals in this year's Finance Bill build on, and extend, the changes made in recent Social Security legislation, and provide a better pensions deal for millions of employees - and the self-employed - in this country.

42. I turn next to the set of clauses designed to improve the system of inheritance tax in order to benefit modest estates and small businesses. Clause 147, which I have already mentioned in the context of small businesses will increase the threshold from £71,000 to £90,000 and simplify the rate structure from seven rates to four. As a result the number of estates liable to inheritance tax will be cut by roughly a third. Clause 148 will extend exemption from tax to lifetime gifts between individuals involving settled property where there is an interest in possession. Clause 149 introduces the provisions which will increase business relief from 30 to 50 per cent for

which I have already mentioned in the context of small businesses substantial minority holdings of over 25 per cent in unquoted companies; it will also make the inheritance tax treatment of shares in companies dealt in on the unlisted securities markets the same as for companies with a full Stock Exchange listing.

43. I commend particularly to the House Clause 160 which repeals the Exchange Control Act 1947. The controls themselves were, of course, dismantled in 1979 and no-one can seriously lament their passing. Even the party Opposite, who in other ways are committed to restoring the disastrous policies of the 1970s have said that they will support this repeal. The effects of removing the controls have been wholly beneficial. But the Act itself has hitherto remained on the statute book, and for as long as it does so there could be uncertainty -however unrealistic - that it might be reimposed, which would be damaging.

44. Clause 3 abolishes the on-course betting duty. This has been widely welcomed by the major bodies connected with horse and greyhound racing, and I am sure that the Clause will attract wide cross-bench support. The revenue cost of abolition will be offset by Clause 4, which restores the gaming machine licence duty to its value in 1982, when it was last increased.

45. I know that all sides of the House will extend support to Clause 1 which introduces a rebate of duty for

unleaded petrol. The measure has been welcomed by many outside bodies, and already there are clear indications that sales of unleaded petrol, and the number of outlets selling it, are increasing.

46. I should also like to draw to the attention of the House those measures which the Government intends to introduce at Committee Stage. I have been consulting departments on the implications of a query raised by the Joint Committee on Statutory Instruments. This concerned the vires of levying fees and charges for services provided by departments, in particular the range of activities which make up the cost of provision. [Reference to Klondykers] I propose to introduce legislation at Committee Stage to deal with these matters.

47. Mr Speaker the Finance Bill contains a range of new proposals to encourage enterprise, efficiency and flexibility which will further improve the prospect for output and jobs. These measures will consolidate and extend the programme of reform which we have followed steadily and successfully since 1979. This programme has contributed in no small measure to the present vigour of the British economy which is entering its seventh year of steady growth. The Finance Bill is designed to reinforce this prospect. I commend it to the House.

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CHIEF SECRETARY to the Treasury
REC. 15 APR 1987
ACTION Mr D. Walters
COPIES TO CX FST MST EST Mr Cassell Mr Butler Mr Scholar Mrs Sinclair Miss C Evans Mr Cooper Mr Tyrie Mr Ross Goobey PS/IR, PS/C+E

Miss Jill Rutter
PS/Chief Secretary to the Treasury
H M Treasury
Parliament Street
SW1

15 April 1987

Dear Jill,

FINANCE BILL

On two of the outstanding Finance Bill topics, namely, fees and charges and "Klondykers" I have been given to understand that the Chief Secretary is likely to give advance notice of the new provisions when he speaks on Second Reading of the Finance Bill.

Whether or not advance notice is given of any provision is, of course, entirely a political matter and not for me. The question that does arise for me is, of course, whether I can deliver the goods. Assuming a normal Committee Stage, I do not see why we should not be able to get the new clauses ready in time - though it has to be said that there still seems to be some doubt as to the precise scope of what is wanted on fees and charges. What I would stress, however, is that I am talking about a "normal Committee Stage". If, for some reason, proceedings were brought to an abrupt conclusion, I doubt if we would be ready with these new clauses. Nevertheless, it is quite possible that, in those circumstances, Ministers would not want to be introducing new Government clauses.

Yours sincerely,

Peter Graham

PETER GRAHAM

CONFIDENTIAL

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Telephone Direct line 01 210 6609
Switchboard 01 210

CHIEF SECRETARY
REC. 16 APR 1987
ACTION
COPIES TO CX FST MST EST
Sir Peter Middleton
Mr Cassell Mr Scholar
Miss Sinclair Mrs C Evans Mr Walker

28

Miss J Rutter
PS/Chief Secretary to the Treasury
H M Treasury
Parliament Street
SW1

15 April 1987

Mr Haigh Ms Goodman
Mr Romanski Mr Cropper
Mr Tyrie Mr Ross Goobey
PS/IR, PS/C+E

Dear Jill,

FINANCE BILL: COMMITTEE OF THE WHOLE HOUSE

Your minute of 10 April (Discussions with the Opposition) records the provisional ordering of proceedings in CWH. Notwithstanding paragraph 6 of your minute, I thought it would be helpful to have a draft reflecting the provisional order: this is enclosed.

A copy of this note and of the enclosure goes to Murdo Maclean.

Yours sincerely,

PETER GRAHAM

Enc

138/3

DRAFT

COMMITTEE OF THE WHOLE HOUSE

FINANCE BILL (CLAUSES 11, 18, 20, 21, 22, 23, 33, 45, 147 AND 160

AND SCHEDULE 4

Mr Chancellor of the Exchequer

To move, That the order in which proceedings in Committee of the Whole House on the Finance Bill are to be taken shall be Clause 20, Clause 23, Clause 21, Clause 22, Clause 11, Clause 147, Clause 160, Clause 18, Clause 33, Schedule 4 and Clause 45.

X/2

CONFIDENTIAL

FROM: L C HUNT

DATE: 15 April 1987

1. MR S J DAVIES SJD 15/4

2. CHANCELLOR OF THE EXCHEQUER

cc PS/Chief Secretary
Sir P Middleton
Sir T Burns
Mr Monck
Mr Sedgwick
Mr Scholar
Mr Culpin
Mr Gray
Miss O'Mara
Mr Dodds
Mr MacAuslan
Mr Patterson
Mr Stern
Mr Siraut
Mr Tyrie

MONTHLY NOTE ON UNEMPLOYMENT TRENDS

1. The numbers covered by special employment measures that are currently affecting the UK unemployment count are given below, together with our estimate of their direct effect on the March 1987 adult unemployment count:[1]

		Numbers covered	Effect on the count
Job Release Scheme	(JRS)	25,000	22,000
Job Start	(JOB)	6,000	2,000
New Workers Scheme	(NWS)	34,000	6,000
Community Programme	(CP)	254,000	237,000
Community Industry	(CI)	10,000	5,000
Enterprise Allowance Scheme	(EAS)	80,000	27,000
TOTAL		409,000	299,000

[1]The Young Workers Scheme (YWS) has recently been running down and the number covered is now below 500. Since the effect of this scheme on the count is now negligible it has been omitted from the table.

2. The estimated number covered by the Youth Training Scheme (YTS) is 400,000, which is estimated to have reduced the adult unemployment count by 127,000 in March 1987, making such allowances as we can for seasonal factors.

3. The number contacted by 12 February 1987 under the national Restart Scheme was 1,291,000 and had increased to 1,438,000 by 12 March 1987. The Department of Employment's assessment is that Restart has reduced the unemployment count by a little under 10,000 per month on average over the past eight months. We are using an estimate of 65,000 for the effect on the level of the March unemployment count.

4. The Department of Employment believe that the stricter tests of availability for work of new claimants introduced from 1 November 1986 are an increasingly important factor. Department of Employment say that it reduced the unemployment count by about 20,000 between February and March 1987. This is based upon the pattern of reduced inflows and a reduction in those unemployed with short duration over the past few months. However the Department of Employment admit that it is particularly difficult to assess the precise effect of availability testing. There certainly was a large fall in inflows in March compared with a year ago, but the inflows in March 1986 had been quite high. We are using an estimate of 7,000 which is calculated from the results of local pilots from a small number of offices last Summer and Autumn (ie it is not based at all on the evidence of the fall in inflows). If further months continue to show very large falls in inflows, however, we will need to consider revising our estimates.

5. Table 1 shows the monthly changes in adult unemployment, and the effects on the adult count of SEMS, YTS, Restart and Availability Testing. Estimates are given to the nearest thousand; but it should be clear that they cannot be regarded as accurate to the nearest thousand.

6. Table 2 shows the trends in adult unemployment before and after SEMS, YTS, Restart and availability testing. It can be seen that on this analysis the trend excluding all effects is negative for the three and six months ending February and March 1987. It should be stressed once again that this analysis depends crucially on the estimated effects of Restart and Availability Testing and the seasonal adjustment of YTS.

Lester Hunt

LESTER HUNT
EA1

TABLE 1

MONTHLY CHANGES IN ADULT UNEMPLOYMENT EMPLOYMENT AND TRAINING MEASURES, RESTART AND AVAILABILITY TESTING[1]

(000s, seasonally adjusted)

	UK adult unemployment	SEMS and YTS effect on adult unemployment	RESTART and AVAILABILITY effect on adult unemployment[2]
1986 March	38	- 7	0
April	2	- 7	0
May	5	- 7	0
June	14	- 7	0
July	4	- 7	0
August	- 4	- 4	- 10
September	- 26	- 3	- 10
October	- 26	- 5	- 6
November	- 21	- 9	- 9
December	- 26	- 11	- 15
1987 January	- 1	- 6	- 15
February	- 45	- 3	- 14
March	- 30	- 3	- 12

1. A negative sign reflects an increasing impact of a scheme on the unemployment count and a positive sign a declining impact of a scheme on the unemployment count.

2. It is assumed that all the effects of Restart and availability testing are on adult unemployment. However, a small proportion may in fact affect school leavers.

CONFIDENTIAL

TABLE 2

UNEMPLOYMENT TREND (000s)

	Average change in UK adult unemployment	Average change excluding SEMS and YTS	Average change excluding SEMS, YTS, Restart and Availability
Over 3 months ended:			
1986 March	22	29	29
April	16	23	23
May	15	22	22
June	7	14	14
July	8	15	15
August	5	11	14
September	- 9	- 4	3
October	-19	-15	- 6
November	-25	-19	-11
December	-25	-17	- 7
1987 January	-16	- 8	5
February	-24	-17	- 3
March	-25	-22	- 8
Over 6 months ended:			
1986 March	13	19	19
April	13	20	20
May	15	22	22
June	15	22	22
July	12	19	19
August	10	16	18
September	- 1	5	8
October	- 6	0	4
November	-10	-4	2
December	-17	-10	-2
1987 January	-18	-11	0
February	-24	-18	- 7
March	-25	-19	- 7

RH12.40

UNCLASSIFIED

6f.21.

APH to PS/CST 15/4

FROM: A P HUDSON

DATE: 15 April 1987

PS/CHIEF SECRETARY

cc PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Mr Cassell
Mr Scholar
Miss Sinclair
Miss C Evans
Mr Walters
Mr Haigh
Ms Goodman
Mr Romanski
Mr Cropper
Mr Tyrie
Mr Ross Goobey
PS/IR
PS/C&E
Mr Graham - Parly Counsel
Mr Neubert MP
Mr MacLean - Chief Whip's Office

FINANCE BILL: DISCUSSIONS WITH THE OPPOSITION

The Chancellor has seen your 10 April minute.

2. He does indeed want to discuss the allocation of clauses, and we are putting this on the agenda for Prayers on 22 April. The Chancellor will also want to discuss the handling of the debate on personal tax.

APH

A P HUDSON

CF 45

FROM: MISS C EVANS
DATE: 16 APRIL 1987

FINANCIAL SECRETARY

cc Chancellor of the Exchequer
Chief Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Cassell
Mr Kemp, Mr Monck
Mr Scholar or
Mr Odling-Smee a) only
Mr Sedgwick "
Mr Riley, Mr Mowl "
Miss Sinclair
Mr G P Smith a) only
Mr M Williams b) only
Mr Culpin
Miss O'Mara
Mr Scotter a) only
Mr Cropper
Mr Ross Goobey
Mr Tyrie
PS/IR
Mr Mace a) only
Mr Munroe c) only
Mr Eason a) only
Mr Walker
PS/C&E c) only
Miss French "

C.

You may like to check you are happy with the line on burden of tax. It looks broadly OK to me. Oil + pensions look pretty standard.

I agree with yr three main marginal comments. On the burden of tax, 2 additional points: 1st, we have always [illegible] [illegible] to put taxes up [illegible] because they had left us a massive & unsustainable PSBR. There is no need to resile from this line. 2nd, we have [illegible] (see [illegible] Paper of 1984) of burden of tax [illegible] non-N Sea. [illegible]

SECOND READING DEBATE 22 APRIL: WIND-UP

... I attach revised versions of the material submitted under cover of my minute of 13 April as follows:

(a) Burden of Tax

(b) Oil

(c) Pensions

2. The burden of tax material raises a few issues of which you should be aware. First you will note that we have revised the statement in paragraph 7 of the previous draft that:

'As a result of the implementation of the Bill the percentage of earnings taken in income tax, NIC and indirect taxes will fall for everyone except perhaps the very highest paid.'

[illegible] (see over)

~~He stood strongly [illegible]~~

~~points~~

He said he'd go into the BC

Dominion' where each answer laws

to how questions' he strongly

and to the ghana' brush-off

(he said which taxes, they would push

Dems up'd: the US 'Just in' submission)

write the new "that' he

heard all these "started ago" allegations

in 1983, too. Nothing new.

No.

~~[illegible]~~

This was based on the presentation given in answer to the Jack Straw PQ on March 27 (OR Vol 113, cols 310-338). The reason for the change is the uncertainty about the position of one earner couples with 2 children on half average earnings for whom we cannot estimate the burden of indirect taxes. The difficulty is that for this group the statement above relies on the presentation in the Jack Straw PQ which treats child benefit as part of gross income. This is inconsistent with our normal basis of calculation (which treats child benefit as a negative income tax) used in the figures we have sent to the House of Commons library and which Dr Owen has quoted. On our basis the burden of income tax and NICs increases for this group between 1986-87 and 1987-88 and we cannot say whether the non increase in indirect taxes has been sufficient to offset this. I attach (not to all) a note from Mr Scotter which explains the point in more detail. The revised draft suggests two new alternative forms of words both of which get round this point.

3. I should also mention that the statement in paragraph 7 that 'The Budget is designed to reduce the burden of tax' can be substantiated as a general statement (ie applying to the burden of tax as a per cent of personal income or as per cent of GDP) only by comparing the burden in 1987-88 with what it would have been without the Budget measures. We cannot claim that the burden as a per cent of GDP has fallen by comparison with 1986-87 since the reduction between the 2 years is only 0.2 percentage points (table 6.2 on page 57 of the FSBR).

?

4. The speech on the burden of tax relies heavily on the increase in real take home pay. I attach a defensive line which seeks to counter the point that we are making a virtue of high pay increases which we normally criticise as the cause of high unemployment. Also included is a defensive line on the increase in the tax burden as a per cent of GDP since 1978-79, (detailed figures on this are contained in Budget brief CC3) and on the Opposition's allegations on VAT.

4. The material on pensions has been written as a fairly long positive piece for use if the Chief Secretary decides to omit paragraphs 36 to 41 of this speech.

5. I should be grateful if copy recipients could let me have any comments as soon as possible on Tuesday please.

Carys E

MISS C EVANS

FROM: I SCOTTER
DATE: 14 APRIL 1987

MISS EVANS

cc: Mr G P Smith

SECOND READING DEBATE: WIND-UP SPEECH

I told you that I have doubts about the statement that "As a result of the implementation of the Bill, the percentage of earnings taken in income tax, NIC and indirect taxes will fall for everyone, except perhaps the very highest paid" (para 7) which was derived from the figures in the Jack Straw PQ. I think that we should use something like "fall for all those for whom we can make estimates".

2. The reason for this caution is that although we might be able to substantiate the statement on one basis of calculation - that used for the Jack Straw PQ - we could not on our normal method of calculation. The question mark surrounds one earner couples with two children at half average earnings for whom we cannot estimate indirect taxes.

3. On the Jack Straw presentation, their income tax and NIC as a percentage of income goes down from 16.7 per cent to 16.6 per cent between 1986-87 and 1987-88. Given that indirect taxes were not increased in the Budget, we could reasonably conclude that their percentage of earnings taken in income tax, NIC and indirect taxes had also fallen.

4. The Jack Straw presentation counts child benefit as part of gross income for the calculation. We normally count child benefit as a negative income tax so that we can make comparisons with 1978-79 (when we still had child tax allowances). On that basis the percentage taken in income tax and NIC, less child benefit, has increased from 5.6 per cent to 5.9 per cent. Income tax has gone down as a percentage of earnings, but so has child benefit (by more), because it has been increased in line with prices, not earnings. We cannot say whether the non-increase in indirect taxes has been sufficient to offset the rise in proportion taken in income tax, NIC and child benefit.

5. The difficulty is that figures on our normal basis have been sent to the House of Commons Library and Dr Owen has already quoted from them (but in a different context). To be absolutely watertight, the FST's argument needs to be restricted to those earning between ¾ and 1½ times average earnings for whom we can make direct estimates.

IAN SCOTTER

CE37

15 April revise

SECOND READING DEBATE - WIND-UP SPEECH

BURDEN OF TAX

Mr Speaker many hon Members will be as surprised as I was by the Labour Party's decision to choose the burden of tax as a theme to attack the Government in this debate. Bereft of all other arguments they cling to this although a dispassionate observer might think this approach was something of an own goal for a party committed to creating a high spending, high borrowing, high tax economy. Their position is riddled with contradictions. On the one hand they intend to vote against the income tax reductions contained in the Finance Bill and they are committed to reversing them if they came to power. They accuse us of seeking to bribe people by cutting taxes. Then in the same breath they argue that taxes are too high and they revert to their latest favourite theme - the burden of tax. They really must be desperate.

2. The tax burden ~~concept~~ can be measured in various different ways. But what really matters to ordinary people is whether or not they are better off ie what happens to their real take home pay after taking account of inflation. The record is absolutely clear and it demolishes the opposition's case. At all multiples of average earnings real take home pay has increased substantially under this Government. Under the last Labour Government living standards hardly rose at all for many people and actually fell for single people at all multiples of average earnings. For a man on average earnings with 2 children real take home pay has gone up by over 21 per cent since 1978-79. For the same man real take home pay went up by less than 1 per cent between 1973-74 and 1978-79 -hardly any increase at all. And the comparison holds for low earners as well. For the man with 2 children on half average earnings between 1978-79 and 1987-88 real take home pay went up by 17.5 per cent. This compares with only 4 per cent under Labour. But what about the people at the bottom - those whom Labour claim to defend? For this group too, the bottom decile of the earnings distribution, real take home pay has increased by more under this Government than under Labour.

3. Ordinary people understand this comparison, they understand that they are better off under this Government. Let me take just one example. A married couple, employed as a teacher and a nurse, will have seen their real take home pay increase by 36 per cent since 1978-79, compared with just 4 per cent between 1973-74 and 1978-79. I could go on.

4. Faced with these facts Labour seek to divert attention to the burden of tax. This Government has reduced taxes in every Budget since 1981. We are committed to continuing to reduce taxes. I ask the House to consider what the position would be without the reductions we have made. The burden of income tax and national insurance contributions today is lower for all family types, at all levels of income, than it would be if we had simply indexed Labour's regime. For a married man on average earnings with 2 children an indexed Labour regime would mean paying £4.85 a week more in income tax and national insurance contributions.

I think this is dangerous. The overall tax burden, as % of GDP, has gone up. ✓✓

5. [How can we take them seriously when they accuse us of increasing the tax burden?] We have cut the basic rate from 33p to 27p. We have increased personal allowances by 22 per cent in real terms, bringing the married man's allowance to its highest real level since the war and taking 1.4 million people out of tax compared with simply indexing the regime we inherited from Labour. During the last Labour Government the basic rate went up as high as 35p and personal allowances actually fell in real terms. The Labour Government before that increased the standard rate by six old pence in the pound and abolished reduced rates.

6. One thing is absolutely clear. Whatever Labour may say about the burden of tax under this Government - it would be much, much higher if they were in office. Their spending commitments amount to £34 billion - to raise this from income tax would mean at least doubling the basic rate.

7. I could go on at length about the contradictions in Labour's position. But I turn now to the impact of this year's Finance Bill, which is the subject of this debate. The overall impact of the Bill is to reduce taxes in 1987-88 by £2.6 billion. As a result of the

implementation of the Bill the percentage of earnings taken in income tax will fall for everyone, except perhaps the very highest paid. We have made no increase in indirect taxes or in the rates of national insurance contributions. [alternative version: As a result of the implementation of the Bill the percentage of earnings taken in income tax, NIC and indirect taxes will fall for everyone for whom we can make estimates.] This is a Budget designed to reduce the burden of tax. As a result of the income tax changes alone a married man on average earnings will be £3.87 a week better off. A primary school teacher married to a nurse will be better off as a couple by £7.59 a week. People whose mortgage rates come down next month will gain a further benefit. A married man with no children on average earnings with an average mortgage will be £5.37 a week better off as a result of the Budget changes and the fall in mortgage interest rates. The cut in the basic rate to be effected by Clause 20 will benefit all taxpayers.

8. [Members opposite have seen cause for criticism in the fact that the lowest 34 per cent of taxpayers received only 12 per cent of the total reduction in income tax. The explanation for this is simple. The bottom 34 per cent contributed only 9 per cent of the total income tax take in 1986-87 - in other words they have received a share of the reduction which is greater than their contribution to the total.]

9. Mr Speaker, the Government welcomes the Labour Party's conversion to the cause of those who seek to reduce the burden of tax. We agree that the tax burden is still too high and we intend to continue to reduce it when prudent to do so. Tax reduction is a cardinal element of the Government's policy. We believe that cutting taxes is the single most effective measure available to us to encourage enterprise and improve the prospect for output and jobs. As my rt hon Friend the Chancellor said in his Budget speech there is now a worldwide consensus on the economic desirability of tax reform and tax reduction, and in particular, the reduction of income tax. We are reducing income tax without any increases in indirect tax rates and the Red Book indicates scope for further reductions in taxation in each of the next three years. The Government remains committed to the prudent reduction of the overall burden of taxation. We are the only party with such a commitment.

CE2

BURDEN OF TAX: DEFENSIVE BRIEFING

TAX AS PER CENT OF GDP

Burden of tax as per cent of GDP increased since 1978-79 (from 33.8 to 38.0 - FSBR estimate for 1987-88)?

When we came to power public borrowing had reached over 5 per cent of GDP. The increase in tax as a per cent of GDP seen up to 1981-82 was necessary in order to reduce the PSBR to levels consistent with reducing inflation. Since then the burden has been ~~more or less stabilised~~ reduced. We are committed to reducing it when prudent to do so. Now that we have brought borrowing down to 1 per cent of GDP, and with continued restraint in public spending, the Red Book shows a clear prospect of reductions in the tax burden in each of the next three years.

"more or less stabilised" sounds like a euphemism for "gone up more slowly" which isn't the case. ✓

REAL TAKE HOME PAY

The Government is taking credit for high real take home pay - how is this consistent with calls for pay restraint?

We are not arguing for lower real wages. We are simply making the obvious point that increases in real wages must reflect higher productivity so that we do not price ourselves out of jobs. The strong healthy economy that we have created will allow real wages to continue to grow, unless of course a change of Government puts at risk all that we have achieved.

Shd say more about jobs, & ~~perf~~ performance-related pay eg PRP. ✓

VAT PLANS — Max Hastings

Government planning VAT increases to fund direct tax cuts? EC plans to sweep away zero rate?

These allegations are purely fanciful. My rt Hon Friends the Prime Minister and the Chancellor have denied them repeatedly, firmly and publicly. These scare stories show how desperate the opposition must be to distract attention from their own disastrous policies.

~~Hon Members are aware of the EC Commission's rights to make proposals. But the Treaties also state unambiguously that decisions on tax matters must have a unanimous vote by the Council of Ministers. The UK's right to veto unacceptable proposals is absolute. We await the Commission's proposals - they may or may not contain suggestions affecting our zero rate. Whatever they contain there will be ample opportunity to debate them in this House.~~

The Labour Party is clearly desperate to put up a smokescreen to hide the fact that we are the party of lower taxation and they are the party of higher taxation.

We heard all this stuff and nonsense in 1983...

The Finance Bill provides for cuts in income tax without increasing indirect taxation. The Red Book fiscal adjustment projections show that, with continued restraint in public spending, reductions in the burden of tax will be possible in each of the next three years, and these do not depend on increases in indirect taxes.

CE15

15 April revise

This para won't do at all. Now that $18 is the new OPEC price! [illegible] look v. foolish [illegible] of it [illegible], and will look plainly mistaken @ $18: the problem is not profitability at $18 but (a) the [illegible] & (b) [illegible]

OIL PACKAGE

My rt Hon Friend has outlined the Clauses designed to ease the taxation of oil production, development and research.

It is now a well-known fact of history that at the beginning of last year the oil price fell sharply. To prophesy doom then was to overreact. The oil price has come back - from the lowest point of $8½ to around $[18] today. The industry, with admirable resilience, has more than survived. Production from existing sources has continued at a high level. The search for new sources has gone on.

No?

But there has been a cutback in new activity. This is having a harmful effect, not least on jobs in the offshore supplies industry. It is not within the Government's power to reverse economic tides. The price may well go back up again ~~It is widely hoped that the price will improve later~~ - but in the meantime there is a problem. Decisions on some new developments are being delayed and this is likely to result in a loss of capacity which will be needed again when activity picks up.

One reason for the delay in new developments could have been cash-flow difficulties of the smaller partners in possible new projects. As early as last autumn, we took action on this with a carefully targetted measure. We brought forward the repayment of some £300 million of Advance Petroleum Revenue Tax. This has now been paid back to the companies.

But there is another reason why a decision to go ahead with a project might be delayed. It may no longer be clear that the project is going to be sufficiently profitable. We do not of course wish to introduce fiscal incentives for companies to go ahead with uneconomic projects. But we think it would be right however to give some help in the present situation to increase the post-tax profitability of new developments. We propose that for the purposes of Petrolcum Revenue Tax a participator in a new offshore oil-field outside the Southern Basin should be allowed, if it wishes, to set up to 10 per cent of qualifying development expenditure in that new field against its profits in another field. The expenditure is that which would qualify for 'uplift' if relieved in its own field.

The uncertainty: having seen it go to $9, people are not yet confident it will stay @ $18. NL.

The aim has been to set this relief at a level which will give a useful benefit without making fields economic after tax which would not be so pre-tax.

The industry had given us a number of suggestions for ways in which they might be helped in the present difficulty, and [while they would have liked more] they have generally welcomed this cross-field allowance.

But this is not an industry which just sits back and hopes for Government help. It has already been acting vigorously to reduce costs. It is these cost reductions which are so important in securing new development work. Our own contribution here is to remedy a gap in the rules for giving Petroleum Revenue Tax relief for research related to oil extraction activities.

The potential impact of these proposals is far greater than the cost figures shown in the Financial Statement for 1987-88 and 1988-89. The figures there can only be estimates: the actual cost will depend on how companies respond. [But more important, much of the incurring of the expenditure and the impact of this on tax receipts comes

(use if needed)

later; but the measures themselves will enable early decisions to be taken and so orders to be advanced. The cost will build up, and in due course could benefit the industry by over £100 million in a year. The value of orders advanced will of course be much greater than that.]

PENSIONS

The Bill contains important and far-reaching changes for private pensions. These proposals are part ~~the outcome~~ of a major strategy which has two main objectives.

Widening the pensions choice

Our first priority is to widen the coverage of private pension provision. Only in this way can we ensure that ordinary working people will enjoy an adequate income in retirement.

Much has already been done. Many employers have established occupational pension schemes for their staff, with the help of generous tax reliefs. My rt hon Friend [the Chancellor] has repeatedly made it clear that he proposes no fundamental changes in the present system.

As a result, over 10 million people are members of occupational schemes. And the benefits promised by these schemes are good enough to enable all but about a million of these people to be contracted-out of the State Earnings Related Scheme (SERPS).

An increasing number of people - currently 5 million - are receiving pensions from occupational schemes. Under this Government, there has been a steady improvement in the real income of pensioner households.

But more can be done. There are still some 10 million employees who are not in an occupational scheme and who make no private provision for retirement. A central feature of our strategy is to bring private pensions within the reach of these people, and so to reduce still further the total reliance on the State, a problem which - I might add - many of our competitor nations will be faced with in the next century.

Personal pension schemes

We shall do this through the new personal pensions developed by my rt hon Friend, the Secretary of State for Social Services. These will be available to all employees who are not in an occupational scheme, to employees who choose to opt out of their occupational scheme, and to the self-employed.

Clauses 69 to 106, and Schedule 10, introduce the tax regime for these schemes, which will be available from next January. This legislation is based on the present, broadly similar, retirement annuities provisions enacted over thirty years ago. In addition to being brought up to date, the new measures also incorporate a number of new features which have been widely welcomed. In particular, it will in future be possible for employees to contract-out of the State Earnings Related Pension Scheme through a personal pension. Clause 92 provides the necessary procedures to achieve this result.

We now propose further improvements in the rules, in order to make personal pensions more attractive. In particular, we shall allow people to have more than one personal pension plan - subject to no limit on ultimate benefits, only to a limit on contributions - which can be made by the employee, by the employer, or by both. This will enable risks to be spread, and choice to be greater

Wider range of providers

In addition, Clause 71 enables a much wider range of pension providers to carry on new pensions business. Hitherto, insurance companies and certain friendly societies have enjoyed a virtual monopoly of personal pension business. In future banks, building societies and unit trusts will also be able to enter this market: a proposal which has been widely welcomed as improving the choice open to individuals.

A further major reform - which will also help to widen the pensions coverage - is the new simplified occupational pension scheme. This will help the many small employers who would like to provide for their staff, but who have been put off by the administrative complexity of designing and administering a full occupational scheme, and the open-ended cost of providing final salary related benefits.

The new simplified schemes, as their name suggests, will provide basic benefits. This makes for simple documents and quick and easy tax approval of the scheme. To make things even easier, we propose to offer standard 'off the peg' schemes to any employer who wants to set up a scheme without having to go through an intermediary.

Additional voluntary contributions

In addition the Bill contains important measures for members of existing occupational pension schemes. Clause 34 and Schedule 5 contain the provisions needed to give effect to the Budget Day announcement that, from next October, members of occupational schemes will be able to make additional voluntary contributions to a pension plan completely separate from their employer's scheme, up to the tax approval limits on contributions and benefits. This development has been widely welcomed in principle, although some commentators have argued that the limits on benefits should not apply to such 'free-standing AVCs'. We do not accept this, since it would undermine the fundamental rule that occupational pension benefits should be limited, in order to keep the cost of the tax reliefs within manageable proportions.

Taken together, these changes will dramatically increase the freedom of all people to choose how to provide for their retirement.

Job Mobility

A further purpose of our reforms is to remove - as far as possible - the pension obstacles to job mobility. The House will be well aware of the 'early leaver' problem: the person who changes jobs in mid-career and whose pension expectations are in consequence much reduced.

There is no quick and easy solution to this problem. But the very existence of the new pension opportunities I have just described will have the additional advantage of greatly reducing its worst impact.

Personal pensions and 'free-standing AVC' schemes will mean that, when someone changes his job, he will be able to take some or all of his pension with him.

Transfer values

One further reform will improve the picture still further. Clause 79 enables transfer values to be paid into or from a personal pension scheme. This will permit much greater transferability than is now possible between different types of pension arrangements. Again, this has been warmly welcomed as a helpful development.

The changes we have proposed do not increase the already generous tax regime for retirement provision, but simply extend it potentially to every employee. I am confident that these reforms will greatly improve the pension position and the freedom of choice of all employed and self-employed people in this country.

Exploitation of tax reliefs for pensions

These improvements can only be justified if the tax reliefs for pensions are not abused. In general, of course, they are not: the vast majority of pension schemes and arrangements are concerned only with genuine provision for retirement. But we have felt it necessary to impose some limited restrictions, to guard against misuse of the tax reliefs - particularly by a small number of very high earners. The legislation is contained in Schedule 5. The tax rules for pensions were never intended simply as a tax-sheltered medium for investment generally - with scope for the postponement (and for lump sums, complete elimination) of a tax liability.

These restrictions will have no impact whatever on the vast majority of pension scheme members: for ordinary working people the scope for abuse has never been available. But for a few highly paid people, the new rules will ensure that the tax reliefs are used only for their originally intended purpose.

I have seen suggestions that these changes will restrict job mobility, particularly among senior executives. I understand the argument, although this would generally be only one of the many factors which influence the decision to move. But such criticisms ignore the fact that, if an individual qualifies for maximum benefits after as little as ten years service, any 'retained benefits' from earlier employments must be taken into account. And they ignore the effect of the overall reforms package on this problem. In particular, the proposed changes relating to personal pensions, additional voluntary contributions and transferability (together with the DHSS changes on the revaluation of deferred pension rights) will greatly ease the present pensions barriers to labour mobility.

Conclusion

These are some of the main changes in a continuing process of pensions reform which was initiated by my rt hon Friend the Secretary of State for Social Services over three years ago. The proposals in this year's Finance Bill build on, and extend, the changes made in recent Social Security legislation, and provide a better pensions deal for millions of employees - and the self-employed - in this country.

SOVEREIGN

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FINANCIAL SECRETARY
REC. 21 APR 1987
ACTION Miss M. A Hill / IR
COPIES TO PPS, Mr. Scholar
Mr. M. Williams Mr. Haigh
Mr. Cropper
PS/IR.

PMT/mab.87.126

16 April 1987

Rt Hon Norman Lamont MP
Financial Secretary to the Private Secretary
Treasury
Parliament Street
London SW1

Dear Minister

1987 FINANCE BILL - PRT CHANGES

We have noted the amendments to existing PRT legislation proposed in the 1987 Finance Bill and in particular the change outlined in clause 157 thereof which allows 10% of certain development costs to be offset against PRT chargeable on other fields.

While we consider that this is a positive proposal which will encourage the development of certain marginal fields, we would have expected the relief to benefit fields such as Emerald for which we are currently preparing an Annex B and will shortly be submitting a plan to our partners for a development decision. Unfortunately the financing method being considered for the development of the Emerald Field, which was conceived prior to the recent Budget, precludes the claiming of this new relief due to the narrow construction of "development costs" in the draft Bill, a discrimination which we believe was not intended.

Rather than through direct project finance in the conventional manner, the funding for development of Emerald will be obtained through the field contractors who will charter or lease the field production facility to the field participants.

Since, as the Bill is presently drafted, only upliftable expenditure is defined as that for which the 10% offset is available, certain categories of lease payments, including those relating to provision of production facilities, are excluded. All lease payments are allowable against PRT. We do not believe that the relief was intended to exclude the leasing or hiring of assets, the purchase or construction of which would have qualified for supplement.

To address this inequity we would suggest clause 157 of the Finance Bill be amended on these lines:

> "For the purposes of this Section, there shall be deemed to be expenditure qualifying for supplement any expenditure in hiring an asset if expenditure in acquiring or constructing that asset would have qualified for supplement by virtue of sub-section (5) of Section 3 of the principal Act."

The relevant expenditure should qualify whether incurred before or after commencement of production. We believe that wording along the above lines achieves this objective.

In summary we believe such a drafting change will direct the new relief to include all the fields where the benefits are needed regardless of financing and on whose development the UK's future self sufficiency may well rely. We would also emphasise that in the current economic climate, conventional bank project finance would not be available for many oil projects such as Emerald and the charter arrangement contemplated is an important step forward in maintaining UKCS activity and the employment of British fabrication yards and services.

Yours sincerely

David Biggins

D Biggins
Managing Director

cc: Rt Hon A Buchanan-Smith MP

ps4/10H

UNCLASSIFIED

PLP

FROM: A P HUDSON
DATE: 16 April 1987

PS/CHIEF SECRETARY

cc Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Cassell
Mr Monck
Mr Kemp
Mr Scholar
Mr Turnbull
Mr Odling Smee
Mr Burgner
Mr Hawtin
Mr Sedgwick
Mr Riley
Miss Sinclair
Mr M Williams
Mr Gray
Mr Instone
Miss O'Mara
Mr Culpin
Mr Bottrill
Miss C Evans
Mr Cropper
Mr Ross Goobey
Mr Tyrie

PS/IR
Mr Walker - IR
PS/C&E
Mr Bone C&E

FINANCE BILL: SECOND READING DEBATE

The Chancellor has seen the first draft of the Chief Secretary's speech attached to Miss Evans' 10 April minute. He has not yet seen the revised draft.

2. He has not been through it in detail, since the Chief Secretary will clearly want to do a great deal of work on it. His only comment has in fact already been taken on board in the revised draft. This was to advise strongly against saying anything like the second half of the original paragraph 11, commenting on the TCSC's comments on the forecast of the balance of payments.

The Chancellor notes that the TCSC frequently dissent from our forecasts, usually in a disagreeable direction, and that it is our invariable practice either to ignore or dismiss their forecasts and to stick to our own. We would be very ill-advised to depart from this for short-term opportunistic reasons. Nor is there any need: others will pick this up, if, indeed, it appears in the first place.

APH

A P HUDSON