PO-CH/NL/0013

PART A

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PART A

1987 BUDGET STATEMENTS

DD's 25 years NAGS 10-5-95

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PART A

STARTS 30-01-87
ENDS 27-02-87

CLOSED
CONTINUED ON:-
PART B

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FROM: M C SCHOLAR
DATE: 30 JANUARY 1987

CHANCELLOR OF THE EXCHEQUER

cc Principal Private Secretary
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Sir Geoffrey Littler
Mr F E R Butler
Mr Wilson
Mr Cassell
Mr Monck
Mr Sedgwick
Mr Odling-Smee
Miss Evans
Mr Cropper
Mr Tyrie
Mr Ross Goobey

Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Sir Angus Fraser - C&E
Mr Knox - C&E

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BUDGET STATEMENT OUTLINE

... I attach - two weeks ahead of last year's schedule - a preliminary outline of your Budget Statement, the work of a number of people in the Treasury.

2. It is very early to fashion this outline, and we may expect much to change before we put a revised outline to you in a week's time and before the first full draft is submitted on Friday 13 February. But the present draft may help to narrow our focus, and it will be useful as we revise it next week to have any comments you or copy recipients may have on any of it.

MCS

M C SCHOLAR

BLO enc: 22 pages

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BUDGET STATEMENT OUTLINE

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Enterprise and employment

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Taxation
- business taxation
- oil
- pensions
- consumer credit tax
- taxes on spending
- income tax

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Conclusion

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Outline

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Economic Background

- For year as whole, output 3% higher than 1985, as forecast at Budget time and above the average for major 7 industrial countries. Economy sluggish in first half of year but pick up in second half led by strong growth in exports and industrial production.

- As expected at the time of the last Budget, lower oil prices and other commodity prices led to low inflation and strong growth in domestic demand - especially consumers' expenditure - in all major economies, including UK. But oil producers and other less developed countries that have had to cope with lower commodity prices reacted more quickly than expected to cut imports.

- As a result exports from developed countries, such as UK, suffered in first half of 1986: industrial production as a result sluggish. More recently signs of a pick up in demand for major countries' exports. Pick up should continue in 1987. World background should be promising for UK, scope for continued growth in UK exports if they remain competitive.

- Have been turbulent times in world financial markets as the three largest economies - US, Japan, Germany -grapple with consequences of large external imbalances. Essential for US to curb its twin deficits. Japan and Germany must operate policy to prevent ever growing current account surpluses. Threat to orderly development of world economy if policy adjustment by these three is inadequate. Slide to more protectionism in US would be disaster.

See what future US trade figs are — and US/EC trade agreement

- Like other major economies UK's domestic demand grew at high rate in 1986, with consumers' expenditure rising by [just under 5 per cent]. Large rises in consumption in the UK and the other major economies were always likely following falls in oil and other commodity prices. But unlikely to occur again on such a scale.

Do we want to stress this?

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maybe say some abt stats + diffs

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- Recent performance of economy has laid basis for rise in investment growth. 1986 continued UK's remarkable productivity performance. Since 1979 manufacturing productivity increased by over 3½% a year, record second only to Japan since 1979.

- For manufacturing industry 1986 was another successful year with output up by x%, productivity up by x% and investment and exports up by x%.

- 1986 loss of half oil revenues severe test for economy and public finances. As I predicted last year UK has survived unscathed: evidence of underlying strength and resilience of economy.

- As forecast in November current account of balance of payments for 1986 in broad balance following cumulative surplus of £21 billion since 1979. Forecast is for current account to move into deficit of £3 billion in 1987. Not surprising following halving of oil price and time needed for adjustment before benefits of lower exchange rate feed through. Net overseas assets now £90 billion, increasing value to balance of payments in future.

- Looking ahead expect 1987 to be a year of steady, balanced growth - above all growth accompanied by falling unemployment. I expect inflation to edge up above 4 per cent. Commitment to squeeze out inflation remains. Need for caution.

do 'blip' — steady 4% but near 5% in summer

- Expect this growth to be balanced with consumer spending rising at a slower rate than 1986, investment growth well above current year, exports expanding more quickly than economy as whole.

- Outstanding opportunities for British industry, from low inflation, highest company profitability for about 20 years, increased competitiveness. But able to seize opportunity only if keeps control of labour costs and spends more on research and development and training.

Recent good ULC figs.

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Monetary Policy

- MTFS provides unchanged framework for prudent financial policies which we shall continue to pursue.

- Policies provide stable and predictable environment for business and for markets.

- MTFS now in place for seven years. Evidently successful. Money GDP growth more than halved, better inflation/output growth split. Greater stability of output growth since 1981 than in 1950s and 1960s or in other countries in 1980s [to be checked].

Need to see what MTFS will say - I don't think this line will wear

- Centrepiece of MTFS is steady reduction in money GDP, as shown in FSBR published today. Implies steady downward pressure on inflation.

- MTFS requires steady reduction in growth of money. Interest rates and fiscal policy the main instruments.

- [Mindful of TCSC request to give more detail about the operation of monetary policy in Budget Speech.] Policy will continue to be operated in very much the same way as over past few years. Assess monetary conditions taking account of all the evidence, and in particular the evidence from the rate of growth of narrow money, from the exchange rate, and from the behaviour of broad money. Will not hesitate to move interest rates if it seems that conditions are becoming either too loose or too tight.

- [Have concluded [arguments, reference to Loughborough Lecture, etc] that given recent behaviour of broad money it is no longer right to seek to set a target for it. But cannot and should not ignore movement of broad money. Will continue to take account of it in future, but in the same way as take account of the exchange rate.] As an important indicator, but with no mechanistic rule]

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- [Switch of emphasis from £M3 to new wider aggregate £M3A), following building societies legislation. Corresponding shift in funding rule.]

- Will continue to set a target for MO. For 1987-88 target will be 2-6%, as indicated in last year's MTFS. [As in past MTFS also shows illustrative ranges for future years.] This means that if MO goes outside this range a presumption of interest rate action unless clear contradictory evidence from other indication.

- MO currently at/near top of this range. Confident that action already taken, and being taken in Budget, will in time bring rate of growth back towards centre of range. [Meanwhile, we will continue to assess monetary conditions on a wider range of evidence, growth of MO clearly limits scope for any early easing in interest rates.]

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Public Sector Borrowing

- Monetary policy must always be supported by appropriate fiscal policy.

- Borrowing in 1986-87 turning out to be lower than expected despite lower oil price for much of year than assumed. [Figures] Lower as a proportion of GDP than any year since [1971-1972]

- Second year of low borrowing. Have been two marked downward steps in PSBR: from about 5% to about 3% in 1981-82, then to about 1½% in 1985-86.

- Able to bring PSBR down while reducing tax burden at same time because of firm control of expenditure. GGE/GDP ratio has been falling since 1982-83. Determined to continue.

- Borrowing needs to be low to support declining money GDP and MO growth paths. Autumn Statement pledge. Now clear that some further reduction in PSBR over medium term is indicated.

Why? Need line on this – buoyant economy, strength of private borrowing etc.

- Also need to take account of prospects for output growth, level of real interest rates, the privatisation programme and path of oil revenues. Above average output growth points to cyclical reduction in PSBR in 1987-88; oil revenues in 1987-88 may be [higher than] [nearly as high as] in 1986-87, then projected to decline at [x%] a year. All this points to a third step down in PSBR in 1987-88 followed by very gradual medium-term decline.

Now at sustainable level

- Therefore providing for PSBR in 1987-88 at [ ]. Very gradual decline beyond that: will be reviewed next year.

Plus change in future as privatisation receipts, oil revenues ↓

- This is cautious and prudent policy. Will help maintain proper balance in economy and keep up the pressure on inflation.

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- There will also be room for modest reductions in taxation. Reflects buoyant revenues (and rise in some average tax rates) in last year or two.

Propose tax reductions amount to [ ].

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Enterprise and employment

- Developments over recent months have further underlined success of Government's policies for stimulating enterprise and employment.

- Over a million jobs since 1983. Vacancies at highest level for 7 years. Self employment up nearly 50 per cent since 1979. And unemployment, including LTU, now on clear downward trend.

- Said last year that employment prospects depend on sustained improvement in performance of business and industry. That is happening. Forecast shows encouraging prospect for further fall in unemployment next year - reflects increasing strength of the enterprise economy. Have removed burdens which destroy rather than create jobs. Benefits of earlier Budget measures continue to flow through. Firms are becoming more flexible and able to respond to challenges of a fast moving and competitive world.

- Government continuing to play its part in ensuring we have a work force that is also equipped and motivated to meet those challenges. Must have right skills and ability to adapt. So employment and training measures directed to helping the unemployed back into work. Concentrating on the young and the long term unemployed. Detail initiatives.

- Benefits from all these initiatives will continue to strengthen over coming year. But with high profits, time for companies to do more on training.

- But also said last year that employment prospects depend critically on pay. Performance here still disappointing. Solution in hands of employers and workers. But Government can promote long term structural reform to tackle rigidity of pay system and give employees a more direct personal interest in company's success. Many companies and their employees have

Some Encouraging signs on settlements

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already developed highly successful partnerships. But other companies' pay systems still too rigid so that in lean times under pressure to lay people off, reluctant to take on.

- Last July published Green Paper on PRP designed to tackle these problems. Warmly welcome the discussion and responses document generated.

- And have now decided to introduce system of tax relief to employees for PRP, and so encourage many more employers to bring these schemes into operation. Response to Green Paper encourages belief that firms will respond to this opportunity. Those who have such schemes generally believe they have worked well and many firms which do not are considering introducing one.

- In considering details have been anxious to ensure offers sufficient flexibility to firms in designing type of scheme which best suits their circumstances. So will, for example, be able to choose level at which scheme operates - whole company or sub-unit; to choose frequency of PRP payment; and to choose between relating PRP pool straightforwardly to a proportion of total profits or to year on year changes in profits which may suit the particular circumstances of some businesses.

- All these and other elements of flexibility will be built in. [Full details being published in ...]

- But perhaps key issue in responses to Green Paper (and no doubt to some of those considering schemes) was level of tax relief. Green Paper suggested one quarter of PRP payments might be eligible. Have now decided to double this to a half. Underlines importance attached to this major new initiative. Not a panacea but will in time further promote flexibility and enterprise in the economy; and so help strengthen employment prospects.

A cost running to £100 million

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Wider Share Ownership

- Benefits of share ownership - individuals given stake in UK industry.

- Remarkable story of success - reversing what many regarded as inevitable decline in number of individual shareholders. We have taken action on three fronts, and all have worked.

- First, enhanced tax relief for employee share schemes.

- Secondly, privatisation:

  - before BG share ownership had doubled, mainly result of BT
  - BG and TSB attracted 3 million shareholders. Since then deepening with BA
  - share ownership trebled since 1979 [dependent on results of Treasury survey]

- Every reason to expect further growth - spreading employee shares and more privatisation - RR, BAA and most of the rest in next Parliament, including BT shares Government still holds.

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Personal Equity Plans

- Thirdly, remarkable impact of PEPS. In last Budget announced radical new scheme of Personal Equity Plans to encourage direct investment in UK equities.

- Details of Scheme developed in conjunction with market practitioners. Came into effect on 1 January 1987.

- Response very encouraging. Over [ ] have applied to become plan managers, including banks, stockbrokers, unit trusts, building societies and investment advisers.

- [Anything which can be said nearer the time about take-up, and in particular, number of first time share-buyers taking out a PEP.]

- Successful launch of Personal Equity Plans clear evidence that Government's aim of creating a share-owning democracy meets aspirations of many men and women.

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Taxation

- Budget continues policy of simplifying tax system and reducing burden of taxation, in order further to release energies for economic growth and wealth creation.

Business taxation

Make more of further simplifications plus continuity certainty

- 1984 reform rationalised taxation of company profits and introduced lower rates of Corporation Tax. UK tax on company profits now [lowest in industrial world] [lowest except for US who have beaten us by one percentage point].

- Profitability of non-North Sea industrial and commercial companies has increased steadily since trough in 1981, when real rate of return 3.2 per cent. In aggregate real rate of return on these companies estimated at 8.6 per cent in 1986 - highest figure since 1973.

- Measures in this year's Budget designed to provide stability and simplicity in the tax system for businesses. Continue thrust of reform initiated in 1984.

- To enable companies to plan ahead, I can announce now that the mainstream rate of Corporation Tax in 1987-88 will, as now, be 35 per cent.

Explain more?

- Have decided [that the time is ripe] to put all companies on same footing for payment of Corporation Tax. Propose that from today all companies and building societies should be liable to pay Corporation Tax nine months after the end of the accounting period on which tax due. Already position for companies established since 1965.

- To reduce effect of change on any one company, propose that change should be phased in over three years.

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- Putting all companies on same payment basis will rationalise system and promote equality of treatment between companies. [Will provide useful smoothing of flow of tax receipts into Exchequer which in turn will help management of the PSBR.]

- Propose also to legislate now for important reform of assessment and collection procedure for Corporation Tax - 'Pay and File'. [Response to Keith Committee whose report pointed up the deficiencies of the present system.] New system will simplify procedure both for companies/tax advisers and the Revenue. Will include provision for mirror-image interest. Streamlining will complement structural reform introduced in 1984.

- Though new system cannot come into effect before computerisation in Revenue complete, early legislation desirable for planning purposes both inside and outside Government.

- Taxation of companies' capital gains currently unduly complicated, involving multiplication by "reducing fraction".

- In addition, have received representations arguing that companies should be allowed to set payments of Advanced Corporation Tax against tax liability on capital gains.

- Much force in argument that little real difference between companies' capital gains and income from other sources.

- Therefore propose to abolish reducing fraction. Henceforth capital gains of large and small companies will be charged at appropriate Corporation Tax rates, with offsets for payment of Advanced Corporation Tax.

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VAT and Small Businesses

- Turn now to measures specifically designed to help small businesses with burden of accounting and record-keeping for VAT. Consultative document on VAT and small businesses, issued last October, unveiled proposals which have been welcomed by representative bodies and individual businessmen alike.

- Therefore propose, with effect from 1 October 1987, optional system of cash accounting for VAT for companies with annual turnover below [£]. Companies will not be liable to pay VAT until they have been paid by their customers.

- Also propose, from 1 July 1988, optional system of annual acounting for VAT which will mean that businesses with annual turnover below [£] will only need to send one return to Customs each year.

- Further propose extention of period within which businesses must notify and be registered for VAT from ten days to one month.

- In addition, propose that special VAT schemes for retailers be improved and simplified in a number of ways.

- Not intending to proceed with compulsory deregistration of traders below VAT threshold, [? nor with withdrawal of retailers' standard method of accounting for VAT]

- Taken together, important package which should make burden of VAT less daunting for smaller firms whose management energies should be concentrated on generating profits.

Oil [policy under review - Mr Cassell will be minuting -what follows is on existing basis]

- [Reference to current state of oil industry, oil price etc.]

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- Propose new cross-field relief for a proportion of expenditure on developing a new field up to point of payback.

- Also propose cross-field relief for research expenditure not specific to a particular field, and thus outside scope of present PRT reliefs.

- Together these measures will help to sustain research and development, important for future of offshore supplies industry.]

Anti-avoidance

- Not possible to reduce overall burden of tax unless law ensures proper amount of tax collected. Propose to tighten up provisions in certain areas to ensure this.

- Treatment of tax credit for foreign withholding tax paid on the interest on loans by banks operating in the UK is unusually generous. Effect is to relieve profits which have nothing to do with the borrowing in question.

- Propose change in these UK tax rules to make them comparable to with those in other countries. Credit for any foreign withholding tax actually paid, or deemed to be paid, on interest received by banks from overseas lending would only be offsettable against Corporation Tax due on turn on relevant loan. For new businesses, change will apply from 1 April 1987; for existing loans effective date will be 1 April 1988.

- Another area where law presently unsatisfactory is tax treatment of dual resident companies. US have already acted. Propose to legislate to deny double deduction for interest payments by dual residents with effect from 1 April 1987. Trading companies would not be affected by the proposed change.

- Present rules on partial exemption for VAT over generous in terms of amount of input tax which can be deducted. Have

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already announced decision to revise rules so that partially exempt businesses put on same footing as other businesses.

On-course betting duty/increase in gaming machine licences

- I propose to abolish on course betting duty while increasing the duty on gaming machine licences.

Pensions

- Consultative document issued last November sets out proposals to extend present tax relief for pensions to new personal pensions foreshadowed in 1986 Social Security Act.

- Following consultation, propose tax reliefs for personal pensions based broadly on present rules for self-employed retirement annuities.

- Also propose special rules, with minimal red-tape, for new simplified types of occupational pension schemes, including money purchase, as well as other measures to allow much greater transferability between different types of pension arrangements.

- In addition, propose new tax relief for employees in occupational pension schemes, who wish to make additional voluntary pension contributions to personal pension outside employer's scheme. Contributions will be subject both to existing limits on employees' contributions and final benefit limits on occupational pension schemes.

- Proposals will be of general benefit to ten million employees who do not belong to occupational pension schemes. Will provide greater pensions choice for all employees, allowing people to take reasonable pension provision with them when they change jobs. Good for mobility and thus for economic performance.

- Widening of pension tax relief only justified if relief properly targetted on provision of adequate pensions.

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- Evidence that present rules can provide excessive tax relief for pensions for highly paid employees. Propose revision of rules to prevent disproportionate amount of tax relief for pensions going to individual employees [will need elaboration in light of Ministerial decisions.]

Charities

Omit?

- Tax measures to help charities in every Budget since 1980. Regime now very generous and, following decision last December to raise ceiling for payroll giving by individuals to £120 a year, must make it clear at outset that do not propose any further tax reliefs for charities in this Budget.

- But the House will want to know latest information on the effects of measures we have taken in successive Budgets. Last year's Budget contained most substantial package of tax reliefs for charities ever. Tax reliefs made not only more generous, but simpler and more flexible. New provisions introduced for payroll giving.

- Value of tax relief approaching £½ billion a year. Government grants to charities running at over £¼ billion a year - up over 75 per cent in real terms since 1979-80. Recorded giving to charities doubled in real terms since 1979.

- Facts and figures show that Government right to focus on encouraging people and companies to give. Response demonstrates widespread support for voluntary sector; and justifies Government's preference for private rather than state action.

Consumer Credit Tax

- Government aim to shift more of tax burden from direct, taxes on individuals to indirect tax where taxpayer can choose not to incur liability - eg by saving rather than spending.

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- Also Government aim to see a more even incidence of indirect tax. Financial services are relatively lightly taxed. International mobility of many such services has limited Government's ability to tax them without driving business offshore. But have concluded there is one financial service where it is right to act: the provision of consumer credit.

Rapid growth, buoyant

- Therefore propose a 5 per cent tax on interest on all credit to individuals except [mortgages/qualifying for Mortgage Interest Relief]/[mortgages on main residence]. To give time to make necessary practical arrangements, new tax will not come into effect until 1 April 1988, except for tax on interest on credit cards which will take effect from 15 August 1987.

- Interest on loans to businesses and the self-employed, to charities, political parties, trades unions, and other corporate bodies [including trusts] will be exempt.

- New tax will, assuming it is passed on consumers, result in a small increase in the effective interest rates for consumer credit to individuals.

- By dampening demand for consumer credit it could be of modest assistance in the operation of monetary policy. Over time it should allow interest rates for industry and business to be a little lower than they would otherwise have been.

- It should also be welcome to those who have expressed concern about the rapid expansion of consumer credit, and the extent to which some individuals may be taking on debts greater than they can service.

- Finally, it will provide a useful source of revenue for the future, and thus leeway for reductions in other taxes.

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Taxes on spending

- Have achieved major success in bringing and keeping down rate of inflation. But now at risk from upward pressures. Essential to contain these to stay on financial course described earlier.

- Therefore propose to increase most excise duties by only 3 per cent - less than would be needed for revalorisation. This means just over ½p on a pint of beer, 16.3p on a bottle of spirits.

This is excessive of 3% on alcohol all that it rejects! Cant we say drink costs more from VAT partially excise tightens?

- There are four exceptions, where I believe that special considerations apply:-

  - Propose increase in duty on cigarettes and cigars equivalent to 3.4p on a packet of 20 cigarettes and 1.9p on a packet of 5 whiffs. This maintains value of duty in real terms - wrong to allow it to decline. But propose no increase in duty on pipe tobacco.

  - Propose restructuring of duties on wine to align them more closely to alcoholic strength. The duty on table wine would increase by 2.4p a bottle. The duty on sparkling wine would go up by 3.9p. The duty on Cyprus sherry and Vermouth would increase by 6.4p and 6.9p a bottle. But the duty on Spanish sherry and port would come down by 5.6p a bottle.

- Present level of oil price allows further shift in balance of motoring taxes between petrol/derv and VED.

  - For cars, propose another standstill on VED. Petrol duty would increase by 5.3p a gallon, to maintain value in real terms and recoup revenue lost through standstill on car VED.

  - [For lorries propose standstill on VED, with derv duty increased by 4.5p a gallon to maintain value and recoup revenue loss]

- There will be no change in the minor oil duties.

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- No changes in rate or coverage of VAT. VAT registration threshold to be revalorised to £21,250.

- Statement of total extra revenue raised by indirect tax changes, compared with what would be raised by straight revalorisation. Overall RPI effect of package [per cent], compared with [per cent] for revalorisation.

Inheritance tax

- Under heading of personal tax will deal with an important proposal to reduce the burden of Inheritance Tax on small estates.

- Propose that threshold should be increased to [£]. Also propose to replace present 7 rate structure with simpler 4 rate structure.

- Effect wil be to stem growth in number of estates liable to Inheritance Tax, and reduced burden of tax on estates below [£].

- [?Anything on business relief]

Income tax

- Finally, I turn to income tax

- Propose 10 per cent increase in value for car benefit scales. Propose no change to car fuel benefit scales.

- Keith Committee pointed to problem of late payment by certain employers of income tax collected under Paye As You Earn and tax paid by sub-contractors.

- To deal with this propose to introduce an interest charge on tax paid late, while a formal assessment has had to be made, with effect from 19 April 1988.

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- Keith also drew attention to payments to directors being left out of base for PAYE calculation, resulting in delays in paying tax. Propose to remedy this by defining more closely what should be included in base for calculating PAYE.

- [Propose legislation on the taxation of Lloyds members to ensure that the normal tax treatment of provision for outstanding liabilities applies to Lloyds' members, in the same way as to insurance companies and other financial traders. These changes will affect the tax treatment of Lloyds Reinsurance to Close and will first apply to premiums paid for the close of the 1985 Lloyds account at 31 December 1987.]

Hope not!

- [Anything on mortgage interest relief]

- Government believes lower rates of tax are good for incentives, stimulus to enterprise. Best chance of increased prosperity for all is to place UK firmly in low tax/high growth league of countries. Main aim of tax reform to move in this direction.

- Have already slashed top rates of income tax, abolished investment income surcharge and brought down basic rate of tax by 4 percentage points since taking office in 1979. Have increased tax threshold - point at which people start to pay tax - by 22 per cent in real terms during same period. Married man's allowance now at highest level in real terms since the war.

- But despite cuts in income tax burden, yield from tax up [per cent] in real terms since 1979. Top 5 per cent of taxpayers paying larger proportion of income tax than in 1979 [pointer to 1988 Budget?].

- For 1987-88, propose to raise main thresholds and allowances by statutory indexation figure of 3.7 per cent [rounded up]

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- Single person's allowance to rise by [£] to [£] and the married age allowance by [£] to [£].

- Single age allowance to rise by [£] to [£] and married age allowance by [£] to [£].

- Age allowance income limit to become [ ].

- The starting threshold for higher rate tax to be increased by [£700] to [£17,901]. The threshold for 45 per cent tax will increase by £200. The thresholds for 50 per cent tax and above to remain unchanged.

- In my last Budget speech, said that I shared aim of my predecessor to reduce basic rate of income tax to no more than 25 per cent. Believe all tax rates need to come down, but give priority to reducing marginal rates for 95 per cent of taxpaying population.

- Cuts in basic rate expensive. Would be imprudent to move to 25 per cent goal at a speed incompatible with prudent long-term financial management.

- But glad to say overall strategy permits me this year to take a further 2p off the basic rate.

- This proposal will reduce marginal rates for overwhelming majority of ordinary taxpayers. Worth [£] a week to a married man on average earnings. Major step towards 25 per cent goal.

- Propose corresponding reduction, to 27 per cent, in Advanced Corporation Tax and small companies rate of Corporation Tax.

- Further milestone on road to simple, low rate structure of income tax. [US experience suggests that cutting top rates of income tax can actually boost tax yield from those with very highest incomes.]

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Copy No. 1 of 9

FROM: S J McMANUS

INLAND REVENUE
CENTRAL DIVISION
SOMERSET HOUSE

4 FEBRUARY 1987

PRINCIPAL PRIVATE SECRETARY (MR ALLAN)

BUDGET STATEMENT : TAXATION SECTION : THIRD DRAFT

The Inland Revenue comments are as follows:

D.2 While we believe it would be extremely difficult if not impossible to disprove what is said in the second sentence, we also think it might be difficult to come up with evidence to support the claims if the Chancellor is challenged.

D.8 Replace "made" in line 2 with "paid out in dividends".

D.11 Insert "up to" before "21 months".

D.18 The reference to companies helped by the APRT measure should be to "medium and smaller" companies.

D.20 On the first of the questions in your covering note of 2 March, we understand Mr Cassell will be advising against including any reference to the cost of the North Sea measures in the Speech. We agree with this advice. We do not think the Speech needs to mention the PRT pricing and valuation measures but to give figures only for the measures in D.19 might be regarded as misleading and in any event the 1987/88

Not if we make clear what we're doing.

cc Mr Cassell
Mr Scholar

Mr Battishill
Mr Isaac
Mr Painter
Mr Beighton
Mr Johns
Mr McManus

and 1988/89 costs are very small. Equally we doubt whether the Speech need say anything about oil companies ACT, where the current position is the current position is that a further submission will be coming forward very shortly.

OK?

D.22 We would prefer "reduce" to "deal with" in the last sentence.

D.23 We suggest:

"Training and retraining are vital to a dynamic, flexible economy. It is most important that there should be no disincentive to training and the acquisition of new work skills by people who are changing jobs. At present training of this kind provided by an employer is a taxable benefit. I propose to take it out of tax."

D.40 We suggest a revised draft as follows:

Agreed

"Fourth, I propose to bring to an end the unsatisfactory tax treatment of members of Lloyd's as it applies to the Reinsurance to Close system, under which Lloyd's syndicates provide for liabilities outstanding at the end of the year. The Government is advised that under the present law tax relief must, in effect, be given in full for Reinsurance to Close premiums regardless of the normal tax rules governing the tax deductibility of provisions for outstanding liabilities. I propose, therefore, to bring the tax treatment of Lloyd's into line with the tax treatment of provisions for outstanding liabilities made by ordinary insurance companies and indeed of similar provision made by other financial traders. I have asked the Inland Revenue to consult urgently with Lloyd's about the details of an equitable scheme on this basis. The new rules will first apply to premiums paid for the Lloyd's account which closes on 31 December this year. The yield will depend on the precise details of the new treatment."

D.40A To meet the questions in 4(d) of your covering note, we suggest the following new paragraph between the existing D.40 and D.41 (which would mean changing "four" to "five" in the penultimate line of D.36):

"Fifth, I also propose, in line with the Keith Committee's recommendations, to reduce the scope for the manipulation of PAYE and sub-contractor deduction schemes, ~~while providing~~ some new safeguards for the contractors and subcontractors. In particular, I propose to introduce an interest charge where a formal assessment is needed to recover amounts due under PAYE. That change will take effect from April ~~1988~~ next year."

to improve the operation of the

is estimated at

and the yield in 1988-89 ~~will be~~ £45 million. ~~in 1988-89~~

D.45 We doubt whether the penultimate sentence is necessary assuming there will be a sweep-up reference to Budget Day press releases somewhere in the Speech. On PRP it has yet to be settled whether there should be a Treasury Press Release, Inland Revenue release or both. — To have two sounds cumbersome + potentially confusing.

E.3 Revise the first half of the fourth sentence to read: "And share ownership, through the encouragement of employee share schemes, under which 1 1/2 million workers have acquired shares or options, compared with less than 1/4 million in 1979; ..." Revise the final sentence to read: "In the first month more than 2,000 people a day took out Personal Equity Plans ..." (This is based on a special survey conducted in January - we shall not be in a position to provide updated figures before the Budget.)

E.6 The figure for line 6 is about 10 million employees.

E.10 We would prefer this paragraph to be moved below E.12 and to quote a net cost taking account of the anti-abuse provisions (which are not costed separately in the FSBR) as follows:

"The net cost of the overall package is estimated at £65 million in 1988-89, but will depend very much on take-up."

E.14 We suggest replacing "tightened" in line 1 with "reformed" (the tax exempt limits were actually increased from £500 to £750).

In the penultimate line, "blatant" would be better than "large scale" because in global terms the amounts were small.

E.15 We suggest replacing "flourish" in line 5 with "operate more economically". At best we think the change is likely to slightly retard a long term decline of the older societies.

E.19 We suggest replacing the last five lines with: "little to help the smallest taxable estates where the family home is the main asset". The smallest estates are not worse off than when CTT was introduced in 1975 - the estates which are are those between £120,000 and £1 million.

E.20 The 1988/89 cost has been revised to £160 million.

E.21 On the basis of payments (including Estate Duty in 1978-79 and CTT in 1987-88) the increase is nearly three times and the real increase over 50 per cent. A better comparison, however, would be accruals: an increase of two and a half times ("more than twice") and a real increase of 30 per cent. If the accruals basis is used, this should be expressed in terms of "for 1987-88" and "for 1978-79".

E.22 We understand the Chancellor wants a short piece in the Speech on two heritage items. We suggest the following paragraph after E.21:

Tax regime much more favourable to heritage now than 1979.

Today

Background. Previous Bgts.

"I also propose two inheritance tax measures to help the heritage. Settled property that is put into a heritage maintenance fund within two years after the death of a life tenant will not be taxed on the death. And I propose to alter the arrangements for acceptance of property in lieu of tax so that at the owner's option the special price will be related to the value of the property at the date of the offer and interest on the tax will cease to run on that date.

First, I am exempting from IHT

G.5 It may be better to omit this as it sits slightly oddly with what follows immediately in G.6: it can scarcely be said that statutory indexation carries the tax-cutting process much further. Applied to the whole of the rest of Section G the point is fair, but in oral presentation the juxtaposition might at least raise a smile.

G.6 Does this need to refer to the indexation percentage? The current rate of inflation is likely to be higher than 3.7% by Budget Day, so that a 3.7% increase may not look very generous.

G.7 At the top of page 3 we suggest substituting "measure" for "concession".

S J McMANUS

PS. I understand Mr Ross Goobey is co-ordinating comments (including those of Inland Revenue) on pensions E.5-E.13.

PPS. Presumably it was a deliberate decision to omit from the Speech any reference to the material in paras 91 and 92 of the draft circulated by Mr Scholar on 27 February. We would have quite liked a reference to the review of Section 79 though we can quite see why the Chancellor may have found this unattractive.

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FROM: M C SCHOLAR
DATE: 5 FEBRUARY 1987

CHANCELLOR OF THE EXCHEQUER

cc Principal Private Secretary
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Sir Geoffrey Littler
Mr F E R Butler
Mr Wilson
Mr Cassell
Mr Monck
Mr Sedgwick
Mr Odling-Smee
Miss Evans
Mr Cropper
Mr Tyrie
Mr Ross Goobey

Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Sir Angus Fraser - C&E
Mr Knox - C&E

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Ms X.
draws

B.L.O.

SECTORAL IMPACT OF THE BUDGET

... I attach a paper, prepared by FP with help from the Revenue Departments.

Ch
Conclusion (para 26-28)
look OK
AA

MCS

M C SCHOLAR

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SECTORAL EFFECT OF CURRENT BUDGET STARTERS

Note by FP, HM Treasury

INTRODUCTION

This note looks at the likely effects of the current Budget package on the corporate sector. The measures considered are:

- reductions in the basic income tax and small companies' corporation tax rates;
- charging corporate capital gains at normal CT rates, with ACT set-off;
- tightening up the VAT partial exemption rules;
- VAT small businesses review;
- aligning CT payment dates at 9 months;
- removing double relief for losses of dual resident companies;
- restricting double taxation relief on foreign loans;
- the North Sea oil taxation package;
- Lloyds - Reinsurance to close;
- minor starters affecting building societies.

2. Estimated costs and yields of these measures are set out in the table at Annex A.

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3. The feature this year common to most of the Budget measures affecting the corporate sector is that their impact is generally more than usually variable between one company and another, even within a given business sector. In some cases, the effects on any given company will also vary substantially from one year to another.

4. Individual measures may, as indicated below, have a significant impact on particular sectors, or on companies with particular shared characteristics. But, generally, there is little systematic interplay between the measures, and this means that there is correspondingly little scope for generalisation about the impact of the Budget package on particular sectors. This note therefore looks at the effects on companies measure by measure, in order to build up a picture of the impact of the current package on the various parts of the corporate sector.

ASSESSMENT OF IMPACT OF INDIVIDUAL MEASURES

Corporation Tax: change in treatment of capital gains

5. For companies above the small companies' taper band for Corporation Tax, the increase in the tax rate from 30 to 35 per cent on capital gains will be mitigated - for those with ACT which they cannot set off against Corporation Tax under current rules - by the wider availability of ACT offset. The impact of both the higher tax rate and the ACT offset can be varied, to an extent, by companies themselves: they will generally be able to choose the time at which they realise chargeable gains and to choose the timing and amount of distributions, so as to regulate the ACT available for set off.

6. Small companies will not generally have sufficient gains to be much affected by the change. Of those that do, those in the small company rate band proper (currently up to £100,000) will pay less tax on their chargeable gains, as well as benefitting from the reduction in the small companies rate on their other income. Some in the next highest band (currently from £100,000-£500,000) may pay more tax on their capital gains. But few will be outright losers, taking account of the tax reduction on their other income.

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7. Outside the small companies sector life companies will be losers when they realise gains although they should, on the Revenue's estimate, be able to cope with the loss. Property companies and investment companies will also tend to lose. The distribution sector, which tends to have few chargeable gains, would be relatively little affected. These areas aside, no clear sectoral pattern emerges.

8. Most companies in most years will not have large, or even any, chargeable gains. Gains on land, fixed plant, ships and goodwill can be 'rolled over' into new acquisitions, unless the company is making net realisations; and some companies will have capital or trading losses available for set-off. But a few companies in all sectors will have to pay more corporation tax on their gains. Losses are relatively more likely

- in sectors with valuable physical assets available for disposal: eg manufacturing and oil companies rather than distribution;

- in companies likely to be in a position to make large net realisations: perhaps larger, older companies (and therefore perhaps in some cases "pre-65" companies adversely affected by the Corporation Tax payments date measure - see below).

9. We have little data on which to evaluate the incidence of the benefit of ACT set-off against tax on gains. But it seems likely to be helpful to a small number of companies with large overseas interests, little or no UK profits and a high dividend policy. These companies have large amounts of ACT available, and little scope for set-off under current rules, since double taxation relief eliminates or reduces the corporation tax payable on their overseas income. Other large - particularly quoted - companies may also display to a lesser extent these characteristics - high dividends, the possibility of large gains, overseas income relatively high as a share of the total - which make the proposal on set-off of ACT against tax on chargeable gains a valuable change for them.

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VAT partial exemption

10. This will have an adverse effect on firms which have a relatively small VAT-exempt business carried on alongside a larger business within the VAT net. It will therefore usually affect exactly those firms which do not have a 'simple' sectoral identity, but carry on a sideline to their main business: for example manufacturing firms letting out space which is not required for their own use. There will also be around 2,000 other businesses - incorporated or unincorporated - who would benefit from the relaxation of the de minimis rules, which would allow them to reclaim all of their input tax.

11. Customs have, however, identified and quantified three instances (amounting to about one-twentieth of the overall yield) where the pattern of side-by-side activity is intrinsic to a particular sector or sub sector. These are:

- brewers (tied houses), which stand to lose about £10m a year (not taking account of the effect on their direct taxes)

- oil companies (tied petrol stations), about £5m

- retailers (shops within shops), about £5m.

Otherwise the firms affected will be primarily those which have a subsidiary activity of property letting, insurance or finance, but whose primary activity could be in any taxable sector. Those in the first of these groups, in particular, are likely to be a heterogeneous collection spread over many sectors. Those whose main business is itself wholly or largely VAT-exempt - eg the clearing banks and large insurance companies - will be little affected because the existing partial exemption rules already deal effectively with them.

VAT small business review

12. There are two main elements in this, cash accounting and relaxation of the rules concerning registration. The extent which

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businesses (whether incorporated of not) will benefit from cash accounting will depend on the proportion of credit sales which they make, and the length of credit they extend. Cash accounting will also give smaller businesses full bad debt relief. The relaxation of the rules concerning registration will help new businesses, and very small businesses which grow over the registration threshold, by giving them up to one month to notify for registration. It is difficult to discern a sectoral pattern in these aspects of the small business package. But retailers as a whole will not benefit from cash accounting, and under the proposals as they stand retailers who makes self-financed credit sales will be worse off as they will lose bad debt relief, although this proposal is currently under review. Also affected adversely will be certain categories of traders from which it is proposed to withdraw or restrict entitlement to use retail schemes - solicitors, accountants, estate agents, and businesses making mixed retail and wholesale supplies.

Corporation Tax payment dates

13. At present, companies established since 1965 pay Corporation Tax nine months after their year end. 'Pre-65' companies pay after a delay which is usually either nine or 12 months, but can be as long as 21 months. It is proposed to align all companies at 9 months, with a 3 year transitional period. Post-65 companies are unaffected, and so "young" and rapidly growing sectors - such as information technology - and those with a high turnover of firms - such as the building trade - will be relatively less affected. Conversely, mature sectors will contain a relatively larger proportion of pre-65 companies. There is also some correlation with size. Most of the largest 100 groups will be affected to some extent, although not all corporation tax payments within a group will necessarily be affected. Reorganisations, or the formation of new subsidiaries since 1965 mean that some profits will already arise in post-65 companies paying after 9 months.

14. Half of the corporation tax paid by the manufacturing and distribution sectors (in total about £4 billion) will be paid by companies with a payment gap of more than 9 months. The average

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payment gap in these sectors is 14 months: so about £2 billion of corporate tax from this sector will eventually be advanced by an average of 5 months. For other industrial and commercial companies and for the financial sector (other than the clearing banks and building societies) less than a quarter of their corporation tax (in total about £3 billion) will be paid by companies with a payment gap of more than nine months. So about £750 million here will be advanced by an average of five months.

15. For 3 of the 4 clearing banks their main UK banking activity will be affected by this change. Other City firms - including in particular all UK branches of foreign banks - will be unaffected. The position for oil companies is mixed: the integrated companies with a longstanding UK presence tend to be affected, although only two oil companies have payment dates of more than twelve months; later entrants, with North Sea interests only, generally are not. Building societies are a special case: most large ones pay more quickly than nine months after their year end at present, and so will gain from the change. Others will be unaffected and some - but none of the largest - will be required to bring their payments forward substantially.

Corporation Tax - Dual Resident Companies

16. This measure (yield estimated at £125m in 1988-89) will affect larger groups of companies, either UK-based with interests overseas (usually in the US); or overseas (usually US) - based companies with interests in the UK. Currently about 170 groups use the device, about two-thirds of them UK-based. Most have only adopted it in recent years. The device has been relatively little used in the financial sector, although in the small number of cases in this sector the figures are very large. Otherwise companies using the device are scattered across the multinational sector. The device has been used for both new acquisitions in the US by UK groups and for the purpose of re-financing existing UK investment in the US to obtain a more favourable tax situation. US groups have used this for the same purpose in reverse, but also for the purpose of obtaining a UK deduction in respect of what is in effect US investment in third countries. In some cases dual residents have been used to finance new investment in the UK, although there is little evidence that any new investment depended on the existence of the device.

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Tax Credit Relief on Overseas Borrowing

17. This measure, which is restricted to the banks, has an estimated yield of £20m in 1988/89. Over time, some or all of this will be passed on to borrowers, as wider gross margins. The effects will be most concentrated for banks specialising in wholesale business (particularly UK branches of foreign banks). This includes the clearers, most of whom will also be affected by the changes to CT payment dates (and who may conceivably also realise chargeable capital gains). But the importance of double taxation relief on tax-withheld foreign borrowing will be proportionately much less for the clearers than, for example, UK branches of foreign banks, who will be unaffected by the change in CT payment dates.

Oil Taxation

18. Accelerated repayment of APRT, worth £310 million to the industry's cash-flow in 1986-87, has already been announced and implemented. The Budget starters relaxing 'crossfield' PRT relief, and the rules for ACT carry back, are currently under review. Detailed figures are given in Annex B.

19. Changes to the PRT pricing and valuation rules might cost the industry between £50-100 million a year (it remains to be decided whether this change will figure in the Budget package, or whether it can be built into the baseline); VAT partial exemption about a further £5 million (falling on those companies with a retail petrol business); and harmonisation of CT payment dates about a further £5 million in each year of the transitional period. On past experience extra tax on chargeable gains might be no more than £5 million a year. But rationalisation and possible withdrawals from the sector, over the next few years may push up this figure. Even a few large disposals - if the gains could be sheltered - could push the extra burden on chargeable gains well above the level suggested by past experience. Against all this, the 10 per cent crossfield allowance for development expenditure is worth about £5 million to the industry in 1987-88, rising thereafter; PRT relief for non-field-specific research

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perhaps £30 million, but only at the turn of the decade; and relaxation to the ACT carryback rules - if it proceeds - perhaps £20 million a year.

20. The incidence of both costs and benefits will vary widely according to the circumstances of individual companies. The larger, integrated companies are more likely to be significantly affected, both for better and worse. Their response to any loss from the pricing and valuation changes may however be muted by the fact that these are anti-avoidance measures designed to reinstate the proper operation of the existing rules.

Lloyds: Re-insurance to close

21. This involves a once-for-all yield of about £150 million (spread over a period of years) plus a continuing annual yield of about £30 million. This will be spread over about 30,000 'names' (of which about 5000 are not UK residents). The extra tax will generally be relatively small as a share of total income and will be to some extent offset by reductions in personal tax rates (this year and possibly also in future years before the extra charge bites in full).

Building Societies

22. The main impact of the Budget on Building Societies will arise from the change in Corporation Tax payment dates. But there are, too, a number of minor starters which will improve the tax rules affecting societies - although none mean any significant quantifiable benefit.

23. Against this, both banks and building societies could face substantial compliance costs if a strong option is adopted to tackle abuse of MIRAS - subsidised 'home improvement' loans. And both banks and building societies may complain about their competitive position, given that the 'composite rate' applying

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to their savings business will not fall in parallel with the basic rate cut until 1988-89. But the building societies made little of this in analogous circumstances last year, and the banks apparently prefer plenty of advance notice.

Unincorporated businesses

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Small companies

25. The great majority of small companies will be clear gainers, from the reduction in the small companies rate of Corporation Tax. They will also gain from the VAT small business changes. Few will have sufficient capital gains to be much affected by the assimilation of corporate capital gains to the standard CT rate scale. Of those that do, some will gain - eg the small company which is winding down and selling off some assets and wishes to distribute the resulting gains to its shareholders. Some - those well into the small companies 'taper rate' and with substantial gains - will lose. But very few are likely to be outright losers overall. Pre-65 companies will lose from alignment of CT payment dates at 9 months: but small companies are more likely than average to be younger than this.

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Conclusion

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27. In a few sectors there will be significant losers arising from one particular measure or package of measures: life companies, the oil sector (although some companies will gain), property and investment companies, brewers. Apart from these sectors, the effects of each starter will be scattered in an unpredicable pattern across sectors. Shipping and farming - sectors which have sometimes created problems in the past - seem generally likely to be little affected one way or the other, or to benefit somewhat overall. Most companies in most years will not lose significantly or at all. But some companies in any sector could lose significantly from one or other starter; and a few, for example in the banking sector, may lose from more than one.

28. The risk of loss under a number of starters may be slightly higher for large established groups with overseas interests. But even in this group the risk of really large losses piling up for a single group is quite small. It is difficult to predict which companies will turn out to be multiple losers, if only because one major ingredient - tax on corporate gains - depends on one-off transactions which have not been made. But there will certainly be some, and they will complain.

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ANNEX A: MAIN TAX MEASURES AFFECTING THE BUSINESS SECTOR

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ANNEX A

MAIN TAX MEASURES AFFECTING THE BUSINESS SECTOR

	Yield+/Cost- £m 1987-88	1988-89
Income tax: self-employed	-120	-240
Small companies' rate	nil	-40
Corporate capital gains	nil	+50
VAT: partial exemption	+300	+400
VAT: small businesses	-115	-35
CT payment dates	nil	+80
Dual resident companies	neg	+125
Double taxation relief on foreign loans	neg	+20
North Sea package	+45	+40
Lloyds - Reinsurance to Close	nil	+35
Building Societies - minor starters	neg	neg
	+110	+405

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ANNEX B: MEASURES AFFECTING OIL INDUSTRY

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ANNEX B

MEASURES AFFECTING OIL INDUSTRY

(+ = cost to the industry)

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£ million

	1987-88	1988-89	1989-90	1990-91
Pricing)) Valuation)	+50-100	+50-100	+50-100	+50-100
CFA	-5	-10	-30	-45
Research	-	-	-	-30
Oil allowance	-	-	-	-
ACT carryback	-20	-20	-20	-20

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Memo

Design and engineering (21 months)	-25	-100	-30	-

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FROM: M C SCHOLAR
DATE: 5 FEBRUARY 1987

CHANCELLOR OF THE EXCHEQUER

cc Principal Private Secretary
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Sir Geoffrey Littler
Mr F E R Butler
Mr Wilson
Mr Cassell
Mr Monck
Mr Sedgwick
Mr Odling-Smee
Miss Evans
Mr Cropper
Mr Tyrie
Mr Ross Goobey

Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Sir Angus Fraser - C&E
Mr Knox - C&E

SECTORAL IMPACT OF THE BUDGET

... I attach a paper, prepared by FP with help from the Revenue Departments.

MCS

M C SCHOLAR

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SECTORAL EFFECT OF CURRENT BUDGET STARTERS

Note by FP, HM Treasury

INTRODUCTION

This note looks at the likely effects of the current Budget package on the corporate sector. The measures considered are:

- reductions in the basic income tax and small companies' corporation tax rates;
- charging corporate capital gains at normal CT rates, with ACT set-off;
- tightening up the VAT partial exemption rules;
- VAT small businesses review;
- aligning CT payment dates at 9 months;
- removing double relief for losses of dual resident companies;
- restricting double taxation relief on foreign loans;
- the North Sea oil taxation package;
- Lloyds - Reinsurance to close;
- minor starters affecting building societies.

2. Estimated costs and yields of these measures are set out in the table at Annex A.

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3. The feature this year common to most of the Budget measures affecting the corporate sector is that their impact is generally more than usually variable between one company and another, even within a given business sector. In some cases, the effects on any given company will also vary substantially from one year to another.

4. Individual measures may, as indicated below, have a significant impact on particular sectors, or on companies with particular shared characteristics. But, generally, there is little systematic interplay between the measures, and this means that there is correspondingly little scope for generalisation about the impact of the Budget package on particular sectors. This note therefore looks at the effects on companies measure by measure, in order to build up a picture of the impact of the current package on the various parts of the corporate sector.

ASSESSMENT OF IMPACT OF INDIVIDUAL MEASURES

Corporation Tax: change in treatment of capital gains

5. For companies above the small companies' taper band for Corporation Tax, the increase in the tax rate from 30 to 35 per cent on capital gains will be mitigated - for those with ACT which they cannot set off against Corporation Tax under current rules - by the wider availability of ACT offset. The impact of both the higher tax rate and the ACT offset can be varied, to an extent, by companies themselves: they will generally be able to choose the time at which they realise chargeable gains and to choose the timing and amount of distributions, so as to regulate the ACT available for set off.

6. Small companies will not generally have sufficient gains to be much affected by the change. Of those that do, those in the small company rate band proper (currently up to £100,000) will pay less tax on their chargeable gains, as well as benefitting from the reduction in the small companies rate on their other income. Some in the next highest band (currently from £100,000-£500,000) may pay more tax on their capital gains. But few will be outright losers, taking account of the tax reduction on their other income.

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7. Outside the small companies sector life companies will be losers when they realise gains although they should, on the Revenue's estimate, be able to cope with the loss. Property companies and investment companies will also tend to lose. The distribution sector, which tends to have few chargeable gains, would be relatively little affected. These areas aside, no clear sectoral pattern emerges.

8. Most companies in most years will not have large, or even any, chargeable gains. Gains on land, fixed plant, ships and goodwill can be 'rolled over' into new acquisitions, unless the company is making net realisations; and some companies will have capital or trading losses available for set-off. But a few companies in all sectors will have to pay more corporation tax on their gains. Losses are relatively more likely

- in sectors with valuable physical assets available for disposal: eg manufacturing and oil companies rather than distribution;

- in companies likely to be in a position to make large net realisations: perhaps larger, older companies (and therefore perhaps in some cases "pre-65" companies adversely affected by the Corporation Tax payments date measure - see below).

9. We have little data on which to evaluate the incidence of the benefit of ACT set-off against tax on gains. But it seems likely to be helpful to a small number of companies with large overseas interests, little or no UK profits and a high dividend policy. These companies have large amounts of ACT available, and little scope for set-off under current rules, since double taxation relief eliminates or reduces the corporation tax payable on their overseas income. Other large - particularly quoted - companies may also display to a lesser extent these characteristics - high dividends, the possibility of large gains, overseas income relatively high as a share of the total - which make the proposal on set-off of ACT against tax on chargeable gains a valuable change for them.

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VAT partial exemption

10. This will have an adverse effect on firms which have a relatively small VAT-exempt business carried on alongside a larger business within the VAT net. It will therefore usually affect exactly those firms which do not have a 'simple' sectoral identity, but carry on a sideline to their main business: for example manufacturing firms letting out space which is not required for their own use. There will also be around 2,000 other businesses - incorporated or unincorporated - who would benefit from the relaxation of the de minimis rules, which would allow them to reclaim all of their input tax.

11. Customs have, however, identified and quantified three instances (amounting to about one-twentieth of the overall yield) where the pattern of side-by-side activity is intrinsic to a particular sector or sub sector. These are:

- brewers (tied houses), which stand to lose about £10m a year (not taking account of the effect on their direct taxes)

- oil companies (tied petrol stations), about £5m

- retailers (shops within shops), about £5m.

Otherwise the firms affected will be primarily those which have a subsidiary activity of property letting, insurance or finance, but whose primary activity could be in any taxable sector. Those in the first of these groups, in particular, are likely to be a heterogeneous collection spread over many sectors. Those whose main business is itself wholly or largely VAT-exempt - eg the clearing banks and large insurance companies - will be little affected because the existing partial exemption rules already deal effectively with them.

VAT small business review

12. There are two main elements in this, cash accounting and relaxation of the rules concerning registration. The extent which

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businesses (whether incorporated of not) will benefit from cash accounting will depend on the proportion of credit sales which they make, and the length of credit they extend. Cash accounting will also give smaller businesses full bad debt relief. The relaxation of the rules concerning registration will help new businesses, and very small businesses which grow over the registration threshold, by giving them up to one month to notify for registration. It is difficult to discern a sectoral pattern in these aspects of the small business package. But retailers as a whole will not benefit from cash accounting, and under the proposals as they stand retailers who makes self-financed credit sales will be worse off as they will lose bad debt relief, although this proposal is currently under review. Also affected adversely will be certain categories of traders from which it is proposed to withdraw or restrict entitlement to use retail schemes - solicitors, accountants, estate agents, and businesses making mixed retail and wholesale supplies.

Corporation Tax payment dates

13. At present, companies established since 1965 pay Corporation Tax nine months after their year end. 'Pre-65' companies pay after a delay which is usually either nine or 12 months, but can be as long as 21 months. It is proposed to align all companies at 9 months, with a 3 year transitional period. Post-65 companies are unaffected, and so "young" and rapidly growing sectors - such as information technology - and those with a high turnover of firms - such as the building trade - will be relatively less affected. Conversely, mature sectors will contain a relatively larger proportion of pre-65 companies. There is also some correlation with size. Most of the largest 100 groups will be affected to some extent, although not all corporation tax payments within a group will necessarily be affected. Reorganisations, or the formation of new subsidiaries since 1965 mean that some profits will already arise in post-65 companies paying after 9 months.

14. Half of the corporation tax paid by the manufacturing and distribution sectors (in total about £4 billion) will be paid by companies with a payment gap of more than 9 months. The average

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payment gap in these sectors is 14 months: so about £2 billion of corporate tax from this sector will eventually be advanced by an average of 5 months. For other industrial and commercial companies and for the financial sector (other than the clearing banks and building societies) less than a quarter of their corporation tax (in total about £3 billion) will be paid by companies with a payment gap of more than nine months. So about £750 million here will be advanced by an average of five months.

15. For 3 of the 4 clearing banks their main UK banking activity will be affected by this change. Other City firms - including in particular all UK branches of foreign banks - will be unaffected. The position for oil companies is mixed: the integrated companies with a longstanding UK presence tend to be affected, although only two oil companies have payment dates of more than twelve months; later entrants, with North Sea interests only, generally are not. Building societies are a special case: most large ones pay more quickly than nine months after their year end at present, and so will gain from the change. Others will be unaffected and some - but none of the largest - will be required to bring their payments forward substantially.

Corporation Tax - Dual Resident Companies

16. This measure (yield estimated at £125m in 1988-89) will affect larger groups of companies, either UK-based with interests overseas (usually in the US); or overseas (usually US) - based companies with interests in the UK. Currently about 170 groups use the device, about two-thirds of them UK-based. Most have only adopted it in recent years. The device has been relatively little used in the financial sector, although in the small number of cases in this sector the figures are very large. Otherwise companies using the device are scattered across the multinational sector. The device has been used for both new acquisitions in the US by UK groups and for the purpose of re-financing existing UK investment in the US to obtain a more favourable tax situation. US groups have used this for the same purpose in reverse, but also for the purpose of obtaining a UK deduction in respect of what is in effect US investment in third countries. In some cases dual residents have been used to finance new investment in the UK, although there is little evidence that any new investment depended on the existence of the device.

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Tax Credit Relief on Overseas Borrowing

17. This measure, which is restricted to the banks, has an estimated yield of £20m in 1988/89. Over time, some or all of this will be passed on to borrowers, as wider gross margins. The effects will be most concentrated for banks specialising in wholesale business (particularly UK branches of foreign banks). This includes the clearers, most of whom will also be affected by the changes to CT payment dates (and who may conceivably also realise chargeable capital gains). But the importance of double taxation relief on tax-withheld foreign borrowing will be proportionately much less for the clearers than, for example, UK branches of foreign banks, who will be unaffected by the change in CT payment dates.

Oil Taxation

18. Accelerated repayment of APRT, worth £310 million to the industry's cash-flow in 1986-87, has already been announced and implemented. The Budget starters relaxing 'crossfield' PRT relief, and the rules for ACT carry back, are currently under review. Detailed figures are given in Annex B.

19. Changes to the PRT pricing and valuation rules might cost the industry between £50-100 million a year (it remains to be decided whether this change will figure in the Budget package, or whether it can be built into the baseline); VAT partial exemption about a further £5 million (falling on those companies with a retail petrol business); and harmonisation of CT payment dates about a further £5 million in each year of the transitional period. On past experience extra tax on chargeable gains might be no more than £5 million a year. But rationalisation and possible withdrawals from the sector, over the next few years may push up this figure. Even a few large disposals - if the gains could be sheltered - could push the extra burden on chargeable gains well above the level suggested by past experience. Against all this, the 10 per cent crossfield allowance for development expenditure is worth about £5 million to the industry in 1987-88, rising thereafter; PRT relief for non-field-specific research

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perhaps £30 million, but only at the turn of the decade; and relaxation to the ACT carryback rules - if it proceeds - perhaps £20 million a year.

20. The incidence of both costs and benefits will vary widely according to the circumstances of individual companies. The larger, integrated companies are more likely to be significantly affected, both for better and worse. Their response to any loss from the pricing and valuation changes may however be muted by the fact that these are anti-avoidance measures designed to reinstate the proper operation of the existing rules.

Lloyds: Re-insurance to close

21. This involves a once-for-all yield of about £150 million (spread over a period of years) plus a continuing annual yield of about £30 million. This will be spread over about 30,000 'names' (of which about 5000 are not UK residents). The extra tax will generally be relatively small as a share of total income and will be to some extent offset by reductions in personal tax rates (this year and possibly also in future years before the extra charge bites in full).

Building Societies

22. The main impact of the Budget on Building Societies will arise from the change in Corporation Tax payment dates. But there are, too, a number of minor starters which will improve the tax rules affecting societies - although none mean any significant quantifiable benefit.

23. Against this, both banks and building societies could face substantial compliance costs if a strong option is adopted to tackle abuse of MIRAS - subsidised 'home improvement' loans. And both banks and building societies may complain about their competitive position, given that the 'composite rate' applying

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ANNEX A

MAIN TAX MEASURES AFFECTING THE BUSINESS SECTOR

	Yield+/Cost- £m	
	1987-88	1988-89
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Small companies' rate	nil	-40
Corporate capital gains	nil	+50
VAT: partial exemption	+300	+400
VAT: small businesses	-115	-35
CT payment dates	nil	+80
Dual resident companies	neg	+125
Double taxation relief on foreign loans	neg	+20
North Sea package	+45	+40
Lloyds - Reinsurance to Close	nil	+35
Building Societies - minor starters	neg	neg

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ANNEX B

MEASURES AFFECTING OIL INDUSTRY

(+ = cost to the industry)

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£ million

	1987-88	1988-89	1989-90	1990-91
Pricing)) Valuation)	+50-100	+50-100	+50-100	+50-100
CFA	-5	-10	-30	-45
Research	-	-	-	-30
Oil allowance	-	-	-	-
ACT carryback	-20	-20	-20	-20

Memo

Design and engineering (21 months)	-25	-100	-30	-

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BUDGET CONFIDENTIAL

Prop

FROM: MISS C E C SINCLAIR
DATE: 5 February 1987

1. MR SCHOLAR

2. CHANCELLOR

cc Principal Private Secretary
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Sir G Littler
Mr F E R Butler
Mr Wilson
Mr Cassell
Mr Monck
Mr P Sedgwick
Mr Odling Smee
Miss Evans
Mr Cropper
Mr Tyrie
Mr Ross Goobey

Mr Battishill
Mr Isaac - IR
Mr Painter

Sir A Fraser - C&E
Mr Knox

P Graham - Parly' Counse

BUDGET LOLLIPOPS

Mr Allan's minute of 28 January asked FP to coordinate a 'Lollipop' trawl in Revenue, Customs and Treasury. We were asked to cover any ideas put forward last year, but not proceeded with.

2. Since then the Minister of State has considered the proposals put forward in this year's Budget representations from the Charities VAT and Tax Reform Group (CVTRG). A lollipop mini-package of VAT concessions for charities has been provisionally agreed (Miss Ryding's minute of 2 February and Mr Judge's minute of 3 February). The proposals in this mini-package are set out in Annex A.

3. Proposals which were considered last year, but not proceeded with, are set out in Annex B. We have not, however, included proposals put forward again this year by the CVTRG, but implicitly ruled out by Ministers' decisions on the mini-lollipop package

(Mr Jefferson Smith's submission of 29 January refers). We have, included for the sake of completeness, two 'heritage' items (nos 1 and 9 in Annex B) considered last year. Arguably the case for these is not strong, particularly since the Finance Bill is likely to contain a heritage lollipop on Maintenance Funds (Starter 169). On the same basis we put forward, without enthusiasm, student covenants for 17 year olds (no 8 in Annex B). The proposed review of maintenance payments and covenants suggests that this is not a good time at which to introduce this change. Although the Secretary of State for Scotland has pressed for this in the past, he has not included it in his Budget representation this year.

4. New lollipops are set out in Annex C. They reflect trawls of political advisers, Ministers and officials in the Treasury as well as in Customs and Revenue.

5. None are of wide appeal. The proposal to amend the BES rules on film production, the exemption of stockbrokers' commissions from VAT, and the increase in the tax relief limit for friendly societies might have a wider impact than the others. None are expensive: last autumn's exercise on the scope for abolishing taxes ruled out the more expensive lollipops.

6. With the exception of the items in Annex A, we would need to provide further advice on any proposals floated here as possible lollipops. It would be helpful if you could indicate which ones merit further work. There would, of course, be considerable additional work for Parliamentary Counsel if a large number of the items in Annexes B and C were selected.

CAROLYN SINCLAIR

ANNEX A

VAT LOLLIPOPS FOR CHARITIES

1. VAT relief for certain purchases by mountain rescue associations

It has been agreed that we should change the law to apply zero rating to certain location identification equipment used by charitable organisations providing rescue and first-aid services. This would expand the present limited relief for specialised equipment such as ambulances. But it would not go as far as to exempt all expenditure involved in equipping and running mountain rescue schemes, something for which the Patterdale Mountain Rescue Association have lobbied. The relieving Order is now ready to be made and laid. But it has been decided that this fact should be announced in the Budget package. Revenue cost: negligible.

2. Statutory effect for VAT concession on goods donated for export by a charity

Customs have been operating an extra-statutory concession in this area. It is proposed that the concession should be given statutory effect and the fact announced in this year's Budget. Cost negligible.

3. Extension of VAT concession for installation of bathrooms/lavatory facilities for disabled residents in charity homes

At present Customs operate an extra-statutory concession on VAT on the installation of individual bathroom and lavatory facilities for charity-owned homes. It is proposed that this concession should be extended to communal bathroom/lavatory facilities in such homes, and the widened concession put on a statutory base. Cost negligible.

4. VAT relief on welfare vehicles for hospices

The proposal is that last year's concession for passenger vehicles (capable of carrying between 6 and 50 passengers) for charities caring for the blind, deaf and mentally-handicapped be extended to hospices. The revenue cost would be small.

5. VAT relief for listed drugs

The Charities VAT and Tax Reform Group have complained that the relief for medicinal products introduced in last year's Budget was of limited use to medical research charities because most of the chemical products which they used for research are not medicines as defined by the Medicines Act. They are pressing for a relief for all drugs used in medical research. There is, however, difficulty in defining precisely what is a drug. Further relief would therefore have to be based on a list of individual substances. The Minister of State has agreed that Customs should consult in confidence with the DHSS and the Government Chemist on the possibility of drawing up such a list. The aim would be to include those drugs in common use in current medical research. Cost would depend on the range of chemicals covered and whether it was decided to extend the concession to non-charitable, non-profit making research bodies. A comprehensive relief might cost around £3 million.

ANNEX B

BUDGET LOLLIPOPS CONSIDERED BUT REJECTED LAST YEAR

1. CGT and Maintenance Funds NO

The proposal is that on the death of a person who has set up a maintenance fund to support heritage property, the value of assets in the fund should be uplifted to their value at the time of death, to reduce CGT liability on disposal of the assets. Proposed by the heritage lobby (though not this year). Cost of the order of £2 million.

2. VAT relief for welfare provided by charities NO

In the past the Charities, VAT and Tax Reform Group have sought relief from VAT on all purchases by charities in order to perform a social welfare function eg residential care, training for employment, on the grounds that in these activities the charities substitute for, or at least complement, state provision of similar services. Estimated cost could be up to £15 million per year; primary legislation may be required. The difficulties with this proposal are that it would involve Government making a value judgement that certain charitable activities are more "worthy" than others. There would be pressure from the charities whose activities are excluded for similar treatment (Committee stage debate would provide an occasion for such pressure); and there would be a danger that the Commission would object that that relief would be equivalent to new zero rating. The fact that the Charities VAT Reform Group have not included this measure in their current Budget representations suggests that they may appreciate the practical difficulties.

3. VAT relief for suppliers of petrol and lubricating oil to Royal National Lifeboat Institution NO

This was considered in 1984 when VAT relief for the RNLI was extended to lifeboat carriage and launching equipment. The argument against extending relief to petrol and oil was the potential repercussive effects since many other organisations, particularly other charities with high fuel cost, would press hard for similar reliefs. Nothing has changed.

ND

4. **Extension of VAT relief for sales of donated goods by charities**

At present relief is restricted to charities which are primarily concerned with the relief of human distress or animal welfare. Could be extended to other specified worthy charities or to charities generally. Cost not known. But Customs advise that a general relief would include some charities of dubious value and increase the risks of abuse, whereas a limited extension would be bound to increase pressure for further extensions.

ND

5. **VAT and car tax relief for recipients of Mobility Allowance or War Pensioners' Mobility Supplement who use their allowances to buy normal production cars on hire purchase**

This has been rejected in the past on the ground of cost (estimated in 1984 at £2½ million for vehicles currently supplied through Motability, but up to £10 million if Motability supplied vehicles to its capacity and more if the concession had to be extended to other traders) and also the danger of abuse as it would be too easy for the disabled to buy ordinary cars for transfer to friends or relatives or for sale.

6. **Car tax relief on cars supplied to Motability for leasing**

Open to same risk of abuse, but to lesser extent. However, Motability received very generous concessions in 1984 - deliberately overcompensating them for CT changes - which, since they took the form of zero rating for leasing charges, gave considerable extra help to those choosing to lease, not buy, from Motability. As far as we are aware, further concessions are not being sought this year and, if given would increase Motability's privileges compared to those available to the disabled generally. Chancellor decided not to make this further limited concession in 1984 but said then that he would not rule it out for the future. Revenue cost would be about £4m, at present volume of leasing (car tax only as VAT relief already applies).

7. Blind Allowance

The blind allowance is currently £360 and has not been increased since 1981 (when it was doubled). Some 40,000 people benefit (only a third of all those registered blind) at a cost of £5 million a year. Doubling the allowance to £720 would cost about £5 million. But there has been little pressure for such an increase, which would make eventual abolition of what is already an anomalous allowance more difficult.

8. Student covenants - extension to 17 years olds

At present under-18s cannot benefit from tax relief for payments under covenant by parents. The Scottish Secretary has asked in previous years for relief to be extended to 17 year old students (who are more common in Scotland than England and Wales). Cost would be about £1-2 million, with a small staff cost. However the proposal has so far always been rejected because of the difficulties of tampering with the general rules on age of majority, and the risk that it might not be possible to ring-fence the concession to students alone. The Chancellor has agreed that there should be a longer-term review of maintenance payments and covenants (Mr Kuczys' note of 19 January on tax-neutral maintenance payments), and it would be better not to widen the present relief in the meantime.

9. CTT 'douceur' concession

The proposal would extend the present CTT concession applying to sales of heritage assets to specified, generally public, bodies to non-public nature conservancy bodies (such as Royal Society for Nature Conservation, Royal Society for the Protection of Birds, Woodland Trust, and Scottish Wildlife Trust). In the form proposed by Mr Baker, eligible bodies would be specified by the Nature Conservancy Council with the agreement of the Treasury. Cost unquantifiable but could be significant. Previously rejected - difficult to restrict extension to just these bodies.

1 [redacted] CGT and divorce

Assets transferred between divorcing spouses as part of a settlement - eg in exchange for agreement not to pay maintenance - attract CGT. Exemption would be too generous, but alternative of rollover relief raises problems of election which could only be settled by the Courts. Legislation (which should ideally be discussed in advance with the Law Society and the Lord Chancellor's Office) would be complicated, and has been rejected in previous years. There is also an argument for leaving this on one side until the Government has announced its intentions on the taxation of Husband and Wife generally. Revenue effects negligible, however.

ANNEX C

NEW LOLLIPOPS

1. **BES & (films)**

The existing BES relief for the production of films currently requires the company to produce films over three years. The proposal is to relax the requirement on making films for three years, allowing the company both to produce films and to distribute those already made over the three year period. Cost will depend on take up, but is likely to be small.

2. **Exempt stockbrokers from VAT**

Where a stockbroker acts as an agent, ie single capacity, VAT is payable on the commission charge. Following the Big Bang, the stockbroker can act in dual capacity and makes his profit from the difference between his selling price and buying price, on which VAT is not payable. The Stock Exchange's Budget representations contain a plea for exemption of agency commissions, and this has been supported by the SIB. We understand that shortly after Big Bang some 70 per cent of transactions by value were principal deals and therefore exempt from VAT anyway. So there are good arguments for exempting agency deals from VAT also, to avoid distortion of competition. There are no EC complications, since we only tax stockbrokers' commissions under a derogation from the EC Sixth Directive. The main disadvantage would be the revenue loss which, if the proportion of principal dealing has remained at around 70 per cent, we estimate to be of the order of £20 million. Customs would need to discuss the borderline of the exemption with the Stock Exchange, but as the change could be made by Order, the intention to do this could be announced in the Budget speech, followed by consultation and an Order in the summer.

3. **Accrued income share - convertible stocks**

There is a rule in the anti-bond washing provisions in the Accrued Income Scheme to prevent convertible loan stocks from being used for bond washing. Some representative bodies have complained

t[redacted] the convertibles rule is too harsh. There is some substance in this. The rule could be relaxed to meet their point. But some of the anti-avoidance machinery would need to be kept. The question is whether Ministers are prepared

(i) to have **any** legislation on the Accrued Income Scheme (this could provoke a wider debate)

(ii) to face the cost - perhaps £10 million as an order magnitude.

4. **Stock lending and pension funds**

Pension funds and other institutions lend stocks in their possession to market makers for a fee (the market maker subsequently sells on the stock and in due course returns an equal amount to the lender). The proposition is that pension funds should be exempted from tax on their stock lending fees (so as to encourage them to play a bigger part in the stock lending market, and thus contribute to market liquidity). This is raised this year (as last) by the Stock Exchange (and will probably be supported by the Bank). But the Chancellor turned it down firmly last year and the case for action this year is probably weaker than last because the alleged liquidity problems have not materialised.

5. **Professional costs of setting up share option and profit sharing schemes**

The costs (legal and accountancy fees) of setting up share option and profit sharing schemes cannot be set against a company's profits for tax purposes because they are of a capital nature. The accountancy bodies see this as unreasonable, given that Government is keen to encourage companies to set up schemes of this kind.

6. **Disposal receipts in exempt gas fields**

This topic was considered last year but no action was taken. PRT is charged on disposals of field assets, and on the insurance proceeds when they are damaged or destroyed. This is generally

t[redacted] counterpart of the PRT relief given when the assets were acquired or when they are replaced after damage/destruction. But PRT-exempt gas fields are charged on disposals and insurance proceeds even though PRT relief is not available for development or replacement. The industry continues to press the point, particularly the insurance anomaly. In effect, claimants in exempt gas fields can only recover about half of their loss, after PRT. The cost of exempting disposals would be negligible (less than £2m a year). The cost of exempting insurance receipts might be higher, if and when a major accident occurred.

7. **Increase tax relief limit for life assurance business by friendly societies**

Friendly societies can currently engage in the exempt life assurance business provided the sum assured is under £750. The friendly societies themselves argue that such a sum is increasingly inadequate and should be raised. A more attractive solution would be to fix the tax relief to the annual premium, up to a limit of say £100 per annum. This would be welcomed by friendly societies. The Inland Revenue believe the tax loss would be negligible. The Economic Secretary is due to consider in a meeting next week.

BUDGET CONFIDENTIAL

FROM: S J McMANUS

INLAND REVENUE
CENTRAL DIVISION
SOMERSET HOUSE

6 FEBRUARY 1987

PRINCIPAL PRIVATE SECRETARY (MR ALLAN)

BUDGET STATEMENT : TAXATION SECTION : THIRD DRAFT

Since my note of 4 March (not, as typed, February), we have seen the Economic Secretary's comments (Mr Barnes' notes of 4 and 5 March to Mr Scholar). Our only points are on the alternative second sentence proposed for D.40 and the suggested redraft of E.15.

D.40 If the Chancellor wishes to take this line we can confirm that the point of substance the Economic Secretary is making, namely that Lloyd's are the only taxpayers in this position, is correct. But we would suggest a few amendments to take account of the fact that it is the Names who are the traders and the syndicate agents who determine RIC. We also suggest the deletion of "an absolute" [right] as we can challenge the RIC figure where there is evidence that it has not been determined in good faith or where syndicates are "run-off". The sentence would then read:

> "This means that Lloyd's members, through their syndicates, are the only traders within our tax system who have the right to decide on the level of provision for future liabilities to deduct from their pre-tax income, and so in effect to determine their own tax bill."

cc PS/Economic Secretary
Mr Scholar
Mr Battishill
Mr Isaac
Mr Painter
Mr Beighton
Mr McGivern
Mr McManus
PS IR

We suggest that this be included as a new sentence between the second and third sentences in our draft of 4 March.

E.15 We are happy with the Economic Secretary's redraft subject to the following minor factual corrections. Second sentence - substitute "limit" for "limits". Revise third sentence to read: "The existing tax-exempt limit, being based on the sum assured, tends in practice to be more restrictive for the traditional societies, which generally offer much longer term policies." Fourth sentence - substitute "limit" for "limits". Last line, delete "and annuity".

S J McMANUS

3624/022

included in Aide Memoire MF 10/2 prep

FROM: SIR PETER MIDDLETON

DATE: 10 FEBRUARY 1987

MR CROPPER

cc Chancellor
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Mr Scholar
Mr Culpin
Miss O'Mara
Mr Pickering
Mr Ross Goobey
Mr Tyrie

Ch
Good idea. ✓
AA

1987 BUDGET: BACKBENCHERS' BRIEF

I am keen to try as far as possible to smooth workloads in the run-up to the Budget.

One of the exercises which is traditionally - and necessarily - finalised very close to Budget day is the Special Advisers' backbenchers' brief. Parts of this are, clearly, dependent on the final version of the Budget Statement. But we should aim to get more settled at an earlier date than in previous years. To this end I suggest the following timetable:

Tuesday 10 March	1st draft and structure cleared with officials including EB and FP
Thursday 12 March	Draft to Chancellor
Friday 13 March	Chancellor's comments to Special Advisers
Friday 13/Saturday 14 March	Advisers' redraft and EB check contents
Monday 16 March	EB final check (pm) Advisers resubmit to Chancellor for final approval (evening)

I hope that this can be achieved but if you see difficulties I would be grateful to know of them.

P E MIDDLETON

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DC

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FROM: M C SCHOLAR
DATE: 13 FEBRUARY 1987

CHANCELLOR OF THE EXCHEQUER

cc Principal Private Secretary
Chief Secretary (2)
Financial Secretary (2)
Economic Secretary (2)
Minister of State (2)
Sir Peter Middleton
Sir Terence Burns
Sir Geoffrey Littler
Mr F E R Butler
Mr Wilson
Mr Cassell
Mr Monck
Mr Sedgwick
Mr Odling-Smee
Mr Culpin
Miss Evans
Mr Cropper
Mr Tyrie
Mr Ross Goobey

Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Sir Angus Fraser - C&E
Mr Knox - C&E

Ch

Do you want a brief session with Michael to give him any of your own comments? (some of mine on attached).

Main problem is that business balance & enterprise section is very long — want splitting out business (CT etc) from enterprise (PRPetc)?

AA

BUDGET STATEMENT OUTLINE - SECOND DRAFT

... I attach a new version of this outline, revised and re-ordered in accordance with your comments.

2. You asked whether in any recent year the passage giving the fiscal adjustment had been held back until towards the end of the Speech. We have checked the Hansards. In each of the last ten years that passage has been in or around its conventional position - ie after the forecast and before the tax and any public expenditure measures.

3. In the present draft I have placed this passage close to the end of the Speech, to give maximum dramatic effect to the basic rate cut. The difficulty with this approach is that by distancing the fiscal

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adjustment passage from the material on the forecast we undermine the credibility of the revenue projections and of the fiscal adjustment. It would not be good, at this stage in the Speech, to rehearse again the arguments for believing that there will be greatly increased revenues in 1987-88. So there is too much flavour of a rabbit being pulled out of a hat.

4. Next Friday I will submit the first full draft of the Speech. It would be most helpful therefore if people would let me have their comments on this outline as soon as possible next week (and by Wednesday lunchtime at latest).

MCS

M C SCHOLAR

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BL enc: 21 pages

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BUDGET

BUDGET STATEMENT OUTLINE

Introduction

Economic Background

Monetary Policy

Public Sector Borrowing

Business and Enterprise

Savings and Investment

Taxes on spending

Income tax

Conclusion

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Outline
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ECONOMIC BACKGROUND

- Two main themes: sustained track record:
  : strong comparative performance vis-à-vis other countries

- For year as whole, output approaching 3% higher than 1985, as forecast at Budget time and above the average for major 7 industrial countries. Economy sluggish in first half of year but pick-up in second half led by strong growth in exports and industrial production. [Deal with CSO GDP figures if necessary.]

- As expected at the time of the last Budget, lower oil prices and other commodity prices led to low inflation and strong growth in domestic demand - especially consumers' expenditure - in all major economies, including UK. But oil producers and other less developed countries that have had to cope with lower commodity prices reacted more quickly than expected to cut imports.

- As a result exports from developed countries, such as UK, suffered in first half of 1986: industrial production as a result sluggish. More recently signs of a pick-up in demand for major countries' exports. Pick-up should continue in 1987. World background should be promising for UK; scope for continued growth in UK exports if they remain competitive.

- Have been turbulent times in world financial markets as the three largest economies - US, Japan, Germany - grapple with consequences of large external imbalances. Essential for US to curb its twin deficits. Japan and Germany must operate policy to prevent ever growing current account surpluses. Threat to orderly development of world economy if policy adjustment by these three is inadequate. Slide to more protectionism in US would be disaster.

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- Like other major economies UK's domestic demand grew at high rate in 1986, with consumers' expenditure rising by [just under 5 per cent]. Large rises in consumption in the UK and the other major economies were always likely following falls in oil and other commodity prices. But unlikely to occur again on such a scale.

Need to be careful about emphasis -

- Recent performance of economy has laid basis for rise in investment growth. 1986 continued UK's remarkable productivity performance. Since 1979 manufacturing productivity increased by over 3½% a year, record second only to Japan since 1979.

(non-seq)

Is this the right way to introduce this? Comes later in MTFS (including justification for why we've stopped @ PSBR = 1½% GDP).

- Real interest rates remain high in UK: growth of private sector borrowing - contrast with fall in public sector borrowing as a proportion of GDP.

- For manufacturing industry 1986 has another successful year with output up by x%, productivity up by x% and exports up by x%.

- 1986 loss of half oil revenues severe test for economy and public finances. As I predicted last year UK has survived unscathed: evidence of underlying strength and resilience of economy.

- As forecast in November current account of balance of payments for 1986 in broad balance following cumulative surplus of £21 billion since 1979. Forecast is for current account to move into deficit of £3 billion in 1987. Not surprising following halving of oil price and time needed for adjustment before benefits of lower exchange rate feed through. Net overseas assets now £100 billion, increasing value to balance of payments in future.

£2 (LBS today say £2bn, so did Oxford).

- Looking ahead expect 1987 to be a year of steady growth - above all growth accompanied by falling unemployment. I expect inflation to rise to about 5% before falling again. Unit labour costs performance improving, but need to do

Inflation need much more care, tempting blips as in 1985 etc.

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better. Government remains determined to squeeze out inflation.

- Expect this growth to be balanced with consumer spending rising at a slower rate than 1986, investment growth well above current year, exports expanding more quickly than economy as whole.

- Said last year that employment prospects depend on sustained improvement in performance of business and industry. That is happening. Forecast shows encouraging prospect for further fall in unemployment next year - reflects increasing strength of the enterprise economy. Have removed burdens which destroy rather than create jobs. Benefits of earlier Budget measures continue to flow through. Firms are becoming more flexible and able to respond to challenges of a fast moving and competitive world.

- Outstanding opportunities for British industry, from low inflation, highest company profitability for about 20 years, increased competitiveness. But able to seize opportunity only if keeps control of labour costs and spends more on research and development and training.

sits a bit oddly here.

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MONETARY POLICY

- Economy's sustained performance - and turn-around compared with other countries' - demonstrates effectiveness of sound monetary and prudent fiscal policies set in a clear medium term framework. Strong and sustained growth, coupled with a disappearing budget deficit, itself an effective refutation of fine-tuning and neo-Keynesianism.

[Terry drafting]

- We shall continue to follow the prudent financial policies laid down in successive versions of the MTFS. They provide stable and predictable environment for business and for markets.

- Centrepiece of MTFS is steady reduction in money GDP, as shown in FSBR published today. Set out what the 1987-88 targets will be.

Justify/ explain profile

- MTFS requires steady reduction in growth of money. Interest rates and fiscal policy the main instruments.

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PUBLIC SECTOR BORROWING

- Monetary policy must always be supported by appropriate fiscal policy.

- Borrowing in 1986-87 turning out to be lower than expected despite lower oil price for much of year than assumed. [Figures] Lower as a proportion of GDP than any year since [1971-1972]

- Second year of low borrowing. Have been two marked downward steps in PSBR: from about 5% to about 3% in 1981-82, then to about 1½% in 1985-86.

- Able to bring PSBR down while reducing tax burden at same time because of firm control of expenditure. GGE/GDP ratio has been falling since 1982-83. Determined to continue.

- Borrowing needs to be low to support declining money GDP and MO growth paths. Autumn Statement pledge. Now clear that some further reduction in PSBR over medium term is indicated.

- Also need to take account of prospects for output growth, level of real interest rates, the privatisation programme and path of oil revenues. Above average output growth points to cyclical reduction in PSBR in 1987-88; oil revenues in 1987-88 may be [higher than] [nearly as high as] in 1986-87, then projected to decline at [x%] a year. All this points to a third step down in PSBR in 1987-88 followed by very gradual medium-term decline.

- Therefore providing for PSBR in 1987-88 at [ ]. Very gradual decline beyond that: will be reviewed next year.

- This is cautious and prudent policy. Will help maintain proper balance in economy and keep up the pressure on inflation.

Need something here about why revenue (*) buoyant in 1986-87 and PSBR arithmetic (*ie CT, VAT etc not IT).

If it's cyclical then why does it stay down in MTFS?

^ Linking passage: Glad to say that this £3 billion cut in the PSBR does not destroy the scope for some net reduction in taxation.

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BUSINESS AND ENTERPRISE

VAT and Small Businesses

- First, measures specifically designed to help small businesses with burden of accounting and record-keeping for VAT. Consultative document on VAT and small businesses, issued last October, unveiled proposals which have been welcomed by representative bodies and individual businessmen alike.

- Therefore propose, with effect from 1 October 1987, optional system of cash accounting for VAT for companies with annual turnover below [£250,000]. Companies will not be liable to pay VAT until they have been paid by their customers. This gives small businesses automatic bad debt relief. The proposal is subject to our obtaining the necessary derogation from the EC Sixth Directive on VAT, [for which I am applying today.]

2½ × level in consultative doc etc.

- Also propose, from 1 July 1988, optional system of annual acounting for VAT which will mean that businesses with annual turnover below [£] will only need to send one return to Customs each year.

- Further propose that period within which businesses must notify and be registered for VAT should be extended from ten days to one month.

- In addition, propose that special VAT schemes for retailers be improved and simplified in a number of ways.

- Not intending to proceed with compulsory deregistration of traders below VAT threshold, [? nor with withdrawal of retailers' standard method of accounting for VAT]

See Customs submission (withdrawn)

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- Taken together, important package which should make burden of VAT less daunting for smaller firms whose management energies should be concentrated on generating profits.

Corporation tax measures

- To enable companies to plan ahead, I can announce now that the mainstream rate of Corporation Tax in 1987-88 will be unchanged at 35 per cent.

- Have decided that the time is ripe to put all companies on same footing for payment of Corporation Tax. Propose that from today all companies and building societies should be liable to pay Corporation Tax nine months after the end of the accounting period on which tax due. Already position for companies established since 1965.

- To reduce effect of change on any one company, propose that change should be phased in over three years.

Stop tax avoidance? (Should it be in this section or later?)

- Putting all companies on same payment basis will rationalise system and promote equality of treatment between companies. [Will provide useful smoothing of flow of tax receipts into Exchequer which in turn will help management of the PSBR.]

- Propose also to legislate now for important reform of assessment and collection procedure for Corporation Tax - 'Pay and File'. [Response to Keith Committee whose report pointed up the deficiencies of the present system.] New system will simplify procedure both for companies/tax advisers and the Revenue. Will include provision for mirror-image interest. This streamlining will complement structural reform introduced in 1984.

- Though new system cannot come into effect before computerisation in Revenue complete, early legislation desirable for planning purposes both inside and outside Government.

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- Taxation of companies' capital gains currently unduly complicated, involving artifical reduction of the amount of indexed gain on which Corporation Tax levied.

- In addition, have received representations arguing that companies should be allowed to set payments of Advanced Corporation Tax against tax liability on capital gains.

- Much force in argument that little real difference between companies' capital gains and income from other sources.

- Therefore propose to rationalise system. Henceforth capital gains of large and small companies will be charged without reduction at appropriate Corporation Tax rate, with offset for payment of Advanced Corporation Tax.

- [Increase in ceiling for small companies' rate of corporation tax?]

No

Oil

- [Reference to current state of oil industry, oil price etc.]

- Legislation passed at the end of last year to provide for earlier repayment of Advanced Petroleum Revenue Tax to help oil companies' finances. Reference to price and valuation changes already in effect; these changes designed to ensure that amount of tax intended under North Sea regime actually gets paid. [Reference to ring-fence ACT proposals?]

- Now propose new cross-field relief for a proportion of expenditure on developing a new field up to point of payback.

- Also propose cross-field relief for research expenditure not specific to a particular field, and thus outside scope of present PRT reliefs.

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- Together these measures will help to sustain research and development, important for future of offshore supplies industry.

Profit related pay

Encouraging signs but....

- Employment prospects depend critically on pay. Performance here still disappointing. Solution in hands of employers and workers. But Government can promote long term structural reform to tackle rigidity of pay system and give employees a more direct personal interest in company's success. Many companies and their employees have already developed highly successful partnerships. But other companies' pay systems still too rigid so that in lean times under pressure to lay people off, reluctant to take on.

- Last July published Green Paper on PRP designed to tackle these problems. Warmly welcome the discussion and responses document generated.

- And have now decided to introduce system of tax relief to employees for PRP, and so encourage many more employers to bring these schemes into operation. Response to Green Paper encourages belief that firms will respond to this opportunity. Those who have such schemes generally believe they have worked well and many firms which do not are considering introducing one.

- In considering details have been anxious to ensure they offer sufficient flexibility to firms in designing type of scheme which best suits their circumstances. So will, for example, be able to choose level at which scheme operates - whole company or sub-unit; to choose frequency of PRP payment; and to choose between relating PRP pool straightforwardly to a proportion of total profits or to year on year changes in profits which may suit the particular circumstances of some businesses.

- All these and other elements of flexibility will be built in. [Full details being published in ...]

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- But perhaps key issue in responses to Green Paper (and no doubt to some of those considering schemes) was level of tax relief. Green Paper suggested one quarter of PRP payments might be eligible. Have now decided to double this to a half. Underlines importance attached to this major new initiative. Not a panacea but will in time further promote flexibility and enterprise in the economy; and so help strengthen employment prospects. Full year cost of this measure could exceed £100 million.

Anti-avoidance

- Not possible to reduce overall burden of tax unless law ensures proper amount of tax collected. Propose to tighten up provisions in certain areas to ensure this.

- Treatment of tax credit for foreign withholding tax paid on the interest on loans by banks operating in the UK is unusually generous. Effect is to relieve profits which have nothing to do with the borrowing in question.

- Propose change in these UK tax rules to make them comparable to those in other countries. Credit for any foreign withholding tax actually paid, or deemed to be paid, on interest received by banks from overseas lending would only be offsettable against Corporation Tax due on turn on relevant loan. For new businesses, change will apply from 1 April 1987; for existing loans effective date will be 1 April 1988.

- Another area where law presently unsatisfactory is tax treatment of dual resident companies. US have already acted. Propose to legislate to deny double deduction for interest payments by dual residents with effect from 1 April 1987. Trading companies would not be affected by the proposed change.

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Keith

- Keith Committee pointed to problem of late payment by certain employers of income tax collected under Pay As You Earn and tax paid by sub-contractors.

- To deal with this propose to introduce an interest charge on tax paid late, while a formal assessment has had to be made, with effect from 19 April 1988.

- Keith also drew attention to payments to directors being left out of base for PAYE calculation, resulting in delays in paying tax. Propose to remedy this by defining more closely what should be included in base for calculating PAYE.

Lloyds

- Propose legislation on the taxation of Lloyds members to ensure that the normal tax treatment of provision for outstanding liabilities applies to Lloyds' members, in the same way as to insurance companies and other financial traders. These changes will affect the tax treatment of Lloyds Reinsurance to Close and will first apply to premiums paid for the close of the 1985 Lloyds account at 31 December 1987.

Car benefit

- Propose 10 per cent increase in value for car benefit scales. Propose no change to car fuel benefit scales.

Business Expansion Scheme

- Confirmed last year that Business Expansion Scheme would continue indefinitely in view of its outstanding success.

- Last year's changes improved the targeting of the scheme and as a result, more BES money is now going into the type of higher risk venture for which the scheme was designed.

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- Scheme now on generally satisfactory basis. But propose two measures which should improve it still further:

  - Received a number of representations about the tendency of the present rules to encourage "bunching" of BES investments at the end of the financial year. This can make it difficult for a company to raise BES finance at other times. To alleviate this, propose optional carry-back of BES relief for investments made in the first half of the tax year subject to a limit of half of the amount, or £5,000, whichever is the lower. Measure will take effect for investments made after 5 April 1987.
  - Film industry have pointed out difficulty caused by present rules requiring a company to engage in the production of films throughout a three year period in order to qualify for BES investment. Propose to relax this requirement to make it easier for independent film companies to benefit from BES investment.

Wider Share Ownership

- Benefits of share ownership - individuals given stake in UK industry.

- Remarkable story of success - reversing what many regarded as inevitable decline in number of individual shareholders. We have taken action on three fronts, and all have worked.

- First, enhanced tax relief for employee share schemes.

- Second, privatisation
- Third, personal equity plans

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- Employee share schemes are spreading. Propose 2 measures to facilitate this in special circumstances:

  - as previously announced, propose to amend the "material interest" test for employees and directors in close companies;
  - propose to enable employees in a company which is taken over to exchange their existing share options under an approved scheme for options over shares in the acquiring company.

- [Propose that review should be made, with help of outside experts, of effect of Section 79 of the 1972 Finance Act on tax treatment of employee-acquired shares. Aim of review improvement and simplification consistent with underlying purpose of provision, which is to counter tax avoidance.]

- Privatisation

- Before BG share ownership had doubled, mainly result of BT
- BG and TSB attracted 3 million shareholders. Since then deepening with BA
- Share ownership trebled since 1979 [dependent on results of Treasury survey]

- Every reason to expect further growth. Privatisation will continue - RR, BAA and most of rest in next Parliament, including BT shares Government still holds.

Personal Equity Plans

- Personal equity plans (PEPs), announced in last Budget as radical new scheme to encourage direct investment in UK equities, have had remarkable impact.

- Details of Scheme developed in conjunction with market practitioners. Came into effect on 1 January 1987.

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- Response very encouraging. Over [ ] have applied to become plan managers, including banks, stockbrokers, unit trusts, building societies and investment advisers.

- [Anything which can be said nearer the time about take-up, and in particular, number of first time share-buyers taking out a PEP.]

- Successful launch of PEPs clear evidence that Government's aim of creating a share-owning democracy meets aspirations of many men and women.

Coda to business and enterprise section

- Sum up measures to help business and enterprise: 1984 reform rationalised taxation of company profits and introduced lower rates of Corporation Tax. UK tax on company profits now [one of lowest in industrial world] [lowest except for US who have beaten us by one percentage point].

- Profitability of non-North Sea industrial and commercial companies has increased steadily since trough in 1981, when real rate of return 3.2 per cent. In aggregate real rate of return on these companies estimated at 8.6 per cent in 1986 - highest figure since 1973. [?Major factor in buoyant Corporation Tax receipts.]

- Measures in this year's Budget will provide stability and simplicity in the tax system for business and enteprise. Continue thrust of reform initiated in 1984.

- US tax reform package welcomed because it closes tax loopholes and removes distortions. UK position radically different. None of the tax breaks or distortions being abolished by the US tax reform package exist here, except for double deductability of interest by dual resident companies. Acting now to remedy this. No need to be defensive about UK record on tax reform: have abolished 4 unnecessary taxes as well as cutting the effective rates of [most] [all] direct taxes.

This doesn't fit here.

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SAVINGS AND INVESTMENT

Pensions

- Consultative document issued last November sets out proposals to extend present tax relief for pensions to new personal pensions foreshadowed in 1986 Social Security Act.

- Following consultation, proposed tax reliefs for personal pensions based will be based broadly on present rules for retirement annuities.

- Also propose special rules, with minimal red-tape, for new simplified occupational pension schemes (final salary or money purchase) as well as other measures to allow much greater transferability between different types of pension arrangements.

- In addition, new proposal to allow employees in occupational pension schemes, to make additional voluntary contributions (AVCs) outside employer's scheme. As with existing in-scheme AVCs, contributions will be subject both to present limits on employee contributions and final benefit limits.

- Proposals will be of general benefit to 10 million employees who do not belong to occupational pension schemes. Will provide greater pensions choice for all employees, allowing people to take reasonable pension provision with them when they change jobs. Good for mobility and thus for economic performance.

- Widening of pension reliefs only justified if relief properly targeted on provision of adequate pensions. So some new safeguards to discourage exploitation of very generous reliefs, particularly for certain highly paid employees. Details set out in consultative document published today. But certain measures will need to come into effect from today to avoid forestalling.

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Inheritance tax

- Propose to improve targetting of IHT business relief by increasing rate of relief for substantial holdings in unquoted companies, and in future treating minority holdings in USM companies in the same way as those in companies with full listing.

- But main proposal is a substantial increase in inheritance tax threshold from £71,000 to £90,000, and to simplify structure by reducing from 7 rates of tax to 4.

- Effect will be to reduce number of estates liable to IHT by about a third, and give worthwhile reductions in tax at all levels, particularly on smaller estates.

Capital Gains Tax for individuals

- Propose to increase threshold to [ ], an increase which will maintain the 1986-87 value in real terms [?increase in retirement relief ceiling, small part disposal relief.]

[**Friendly Societies**

- The present limit on tax exempt life assurance businesses by friendly societies is outdated. Therefore propose new type of limit, by reference to annual premium rather than sum assured. In future tax relief for life assurance provided by friendly societies will be available on premiums up to £100 a year.]

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TAXES ON SPENDING

On-course betting duty/increase in gaming machine licences

I thought this was going with excise duties

- I propose to abolish on course betting duty while increasing the duty on gaming machine licences.

VAT

- No changes in rate or coverage of VAT. VAT registration threshold to be revalorised to £21,250.

- Present rules on partial exemption for VAT over generous in terms of amount of input tax which can be deducted. Have already announced that rules are to be changed so that partially exempt businesses put on same footing as other businesses.

- Tax measures to help charities in every Budget since 1980. Regime now very generous.

- Value of tax relief approaching £½ billion a year. Government grants to charities running at over £¼ billion a year - up over 75 per cent in real terms since 1979-80. Recorded giving to charities doubled in real terms since 1979.

Do we need all this?

- Facts and figures show that Government right to focus on encouraging people and companies to give. Response demonstrates widespread support for voluntary sector; and justifies Government's preference for private rather than state action.

- Last year's Budget contained most substantial package of tax reliefs for charities ever. Tax reliefs made not only more generous, but simpler and more flexible. New provisions introduced for payroll giving. Announced last December that ceiling for payroll giving by individuals would be raised to £120 a year.

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- Arguably no case for further tax relief for charities. But following representations from Charities VAT and Tax Reform Group, prepared to agree to certain additions to the VAT concessions which were, exceptionally introduced last year. Propose
  - to apply zero rating to certain equipment used by charitable rescue and first-aid services to find injured people;
  - to extend to welfare vehicles operated by hospices the zero-rating applied last year to vehicles used by charities to transport the deaf, blind or mentally handicapped;
  - [to extend zero-rating to listed drugs commonly used in medical research;]

-

In addition propose to put on a statutory basis present extra statutory concessions relieving from VAT goods donated for export by a charity; and the installation of bathrooms and lavatories for disabled residents in charities homes.

- [On another front, propose relief from car tax on cars supplied to Motability for leasing]

Excise duties

- [Passage to follow in light of decisions.]

Income tax: introduction

- Finally, I turn to income tax

- Government believes lower rates of tax good for incentives, stimulus to enterprise. Best chance of increased prosperity for all is to place UK firmly in low tax/high growth league of countries. Main aim of tax reform to move in this direction.

- Have already slashed top rates of income tax, abolished investment income surcharge and brought down basic rate of tax

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by 4 percentage points since taking office in 1979. Have increased tax threshold - point at which people start to pay tax - by 22 per cent in real terms during same period. Married man's allowance now at highest level in real terms since the war.

- Despite cuts in income tax burden, yield from tax up [per cent] in real terms since 1979. Top 5 per cent of taxpayers paying larger proportion of income tax than in 1979. [amplify - pointer to 1988 Budget?]

- For 1987-88, propose to raise main thresholds and allowances by statutory indexation figure of 3.7 per cent [rounded up]

- Single person's allowance to rise by [£] to [£] and the married age allowance by [£] to [£].

- Single age allowance to rise by [£] to [£] and married age allowance by [£] to [£].

- Age allowance income limit to become [ ].

- [Glad to be able to announce special changes to allowances for two very deserving groups:
  - blind allowance will rise to ;
  - widows' bereavement allowance will rise to .]

- [The starting threshold for higher rate tax to be increased by £700 to £17,901. The threshold for 45 per cent tax will increase by £200. The thresholds for 50 per cent tax and above to remain unchanged.]

Scope for tax reductions: income tax rates

- In my last Budget speech, said that I shared aim of my predecessor to reduce basic rate of income tax to no more than 25 per cent. Believe all tax rates need to come down, but

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give priority to reducing marginal rates for 95 per cent of taxpaying population.

- Cuts in basic rate expensive. Would be imprudent to move to 25 per cent goal at a speed incompatible with prudent long-term financial management.

I think this is quite good line.

- Revenue effect of tax measures so far announced will be [£ million]. Have already announced borrowing requirement of [£ billion]. Glad to say that, taking account of all of this and of the forecast for 1987-88, have room for total tax reduction of [£ billion]. So overall strategy permits me this year to take a further 2p off the basic rate.

- This proposal will reduce marginal rates for overwhelming majority of ordinary taxpayers. Worth [£] a week to a married man on average earnings. Major step towards 25 per cent goal.

- Propose corresponding reduction, to 27 per cent, in Advanced Corporation Tax and small companies' rate of Corporation Tax. Latter will mean that small companies and unincorporated sector will see a significant reduction in their tax liability. Together with the simplifying measures on VAT make this a Budget for small businesses, which are crucial for growth and employment.

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I will discuss with CST @ 4.55 pm. I don't mind this route.

Ch

Do you want to allocate responsibilities to Ministers now?

HA

? Give CST B + F (part).

MR 10/94

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FROM: SIR PETER MIDDLETON
DATE: 13 FEBRUARY 1987

CHANCELLOR

ALLOCATION OF RESPONSIBILITIES

Because this is a relatively straightforward Budget, it is not easy to both preserve Ministerial responsibilities and secure an even distribution of work. Work falls into the following blocks:

(A) Macro Economics, Monetary Policy, Fiscal Stance
- MTFS
- Monetary Policy
- Fiscal Stance

(B) Individuals: Income
- Income Tax
- Mortgage Interest Relief
- Car and Fuel Benefits
- Green Paper Transferable Allowances

(C) Individuals: Saving and Investment
- Pensions
- Inheritance Tax
- Personal Equity Plans

(D) Business
- Corporation Tax Changes
- Dual Residence
- Small and Unincorporated Companies

(E) North Sea Tax Regime

(F) Enterprise and Employment
- Profit Related Pay
- Employee Share Schemes
- Wider Share Ownership

(G) The City
- General issues relating to the Budget and the City
- Lloyds
- Tax Credit Relief for Banks
- Stamp Duty

(H) Keith

Ch
This is the (Ministerial Responsibilities) part Peter mentioned on the phone — main issue is what CST does

AA

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(I) VAT

- Partial Exemption Rules
- Small Business Package
- Charities
- Increase in Threshold

(J) Excise Duties

- Petrol, Derv etc
- VED
- Alcohol
- Tobacco

(K) Minor Starters: each junior Minister has a clutch for which he has been responsible so far.

On normal responsibilities the allocation would go

Chancellor A
FST B, C, D, E (part F)
EST G,H
MST (part F) I J

This leaves the CST out of it and the FST with the bulk of the work. It would make sense to give the MST the whole of F. If you wanted to spread the load further you could consider giving the Chief Secretary C and maybe D. Or you could leave the CST out and give C to the EST who is not very heavily involved.

... You might like to have a word; I attach last years list.

P E MIDDLETON

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Chief Secretary

Employment measures
- Expansion of Community Programme
- Extension of Counselling and Job Start Schemes
- New Workers Scheme
- Enterprise Allowance Scheme

Enterprise measures
- Loan Guarantee Scheme
- Enterprise Allowance Scheme
- Profit Sharing
- Capital Transfer Tax

Staffing implications of Budget

Financial Secretary

Budget and individuals
- Personal Tax Green Paper
- Income tax changes (whether any or none)
- NIC changes (if any)
- Car and fuel benefits
- Mortgage interest relief
- Overseas travel expenses
- Employee Share Schemes

Budget and business
- Business Expansion Scheme
- Final phase of 1984 corporate tax changes
- Mines and oil wells allowances
- North Sea tax regime (but not effect of oil price fall on North Sea tax revenue)
- Agricultural buildings and minor business tax changes
- Unitary tax
- Effect of Budget on small and unincorporated businesses

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Keith Report

Minor starters of which Financial Secretary has so far been in charge

Economic Secretary

Savings and investment
- Stamp duty
- City revolution: tax consequentials
- Pension fund surpluses
- Savings Plan
- Capital Gains Tax

Minor starters of which Economic Secretary has been in charge so far

Minister of State

Charities etc
- Higher rate relief
- Company giving
- Payroll giving
- VAT
- Abuses
- Pension relief for Nazi victims

Excise duties + VAT
- petrol, derv and minor oils
- VED
- Alcoholic drinks
- Tobacco duty
- Increase in VAT threshold

VAT and motoring

Minor starters of which Minister of State has so far been in charge

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FROM: M C SCHOLAR
DATE: 13 FEBRUARY 1987

CHANCELLOR OF THE EXCHEQUER

cc Principal Private Secretary
Chief Secretary (2)
Financial Secretary (2)
Economic Secretary (2)
Minister of State (2)
Sir Peter Middleton
Sir Terence Burns
Sir Geoffrey Littler
Mr F E R Butler
Mr Wilson
Mr Cassell
Mr Monck
Mr Sedgwick
Mr Odling-Smee
Mr Culpin
Miss Evans
Mr Cropper
Mr Tyrie
Mr Ross Goobey

Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Sir Angus Fraser - C&E
Mr Knox - C&E

B.L.O.

BUDGET STATEMENT OUTLINE - SECOND DRAFT

... I attach a new version of this outline, revised and re-ordered in accordance with your comments.

2. You asked whether in any recent year the passage giving the fiscal adjustment had been held back until towards the end of the Speech. We have checked the Hansards. In each of the last ten years that passage has been in or around its conventional position - ie after the forecast and before the tax and any public expenditure measures.

3. In the present draft I have placed this passage close to the end of the Speech, to give maximum dramatic effect to the basic rate cut. The difficulty with this approach is that by distancing the fiscal

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adjustment passage from the material on the forecast we undermine the credibility of the revenue projections and of the fiscal adjustment. It would not be good, at this stage in the Speech, to rehearse again the arguments for believing that there will be greatly increased revenues in 1987-88. So there is too much flavour of a rabbit being pulled out of a hat.

4. Next Friday I will submit the first full draft of the Speech. It would be most helpful therefore if people would let me have their comments on this outline as soon as possible next week (and by Wednesday lunchtime at latest).

MCS

M C SCHOLAR

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BUDGET STATEMENT OUTLINE

Introduction

Economic Background

Monetary Policy

Public Sector Borrowing

Business and Enterprise

Savings and Investment

Taxes on spending

Income tax

Conclusion

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ECONOMIC BACKGROUND

- Two main themes: sustained track record:
  : strong comparative performance vis-a-vis other countries

- For year as whole, output approaching 3% higher than 1985, as forecast at Budget time and above the average for major 7 industrial countries. Economy sluggish in first half of year but pick-up in second half led by strong growth in exports and industrial production. [Deal with CSO GDP figures if necessary.]

- As expected at the time of the last Budget, lower oil prices and other commodity prices led to low inflation and strong growth in domestic demand - especially consumers' expenditure - in all major economies, including UK. But oil producers and other less developed countries that have had to cope with lower commodity prices reacted more quickly than expected to cut imports.

- As a result exports from developed countries, such as UK, suffered in first half of 1986: industrial production as a result sluggish. More recently signs of a pick-up in demand for major countries' exports. Pick-up should continue in 1987. World background should be promising for UK; scope for continued growth in UK exports if they remain competitive.

- Have been turbulent times in world financial markets as the three largest economies - US, Japan, Germany - grapple with consequences of large external imbalances. Essential for US to curb its twin deficits. Japan and Germany must operate policy to prevent ever growing current account surpluses. Threat to orderly development of world economy if policy adjustment by these three is inadequate. Slide to more protectionism in US would be disaster.

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- Like other major economies UK's domestic demand grew at high rate in 1986, with consumers' expenditure rising by [just under 5 per cent]. Large rises in consumption in the UK and the other major economies were always likely following falls in oil and other commodity prices. But unlikely to occur again on such a scale.

- Recent performance of economy has laid basis for rise in investment growth. 1986 continued UK's remarkable productivity performance. Since 1979 manufacturing productivity increased by over 3½% a year, record second only to Japan since 1979.

- Real interest rates remain high in UK: growth of private sector borrowing - contrast with fall in public sector borrowing as a proportion of GDP.

- For manufacturing industry 1986 has another successful year with output up by x%, productivity up by x% and exports up by x%.

- 1986 loss of half oil revenues severe test for economy and public finances. As I predicted last year UK has survived unscathed: evidence of underlying strength and resilience of economy.

- As forecast in November current account of balance of payments for 1986 in broad balance following cumulative surplus of £21 billion since 1979. Forecast is for current account to move into deficit of £3 billion in 1987. Not surprising following halving of oil price and time needed for adjustment before benefits of lower exchange rate feed through. Net overseas assets now £100 billion, increasing value to balance of payments in future.

- Looking ahead expect 1987 to be a year of steady growth - above all growth accompanied by falling unemployment. I expect inflation to rise to about 5% before falling again. Unit labour costs performance improving, but need to do

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better. Government remains determined to squeeze out inflation.

- Expect this growth to be balanced with consumer spending rising at a slower rate than 1986, investment growth well above current year, exports expanding more quickly than economy as whole.

- Said last year that employment prospects depend on sustained improvement in performance of business and industry. That is happening. Forecast shows encouraging prospect for further fall in unemployment next year - reflects increasing strength of the enterprise economy. Have removed burdens which destroy rather than create jobs. Benefits of earlier Budget measures continue to flow through. Firms are becoming more flexible and able to respond to challenges of a fast moving and competitive world.

- Outstanding opportunities for British industry, from low inflation, highest company profitability for about 20 years, increased competitiveness. But able to seize opportunity only if keeps control of labour costs and spends more on research and development and training.

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MONETARY POLICY

- Economy's sustained performance - and turn-around compared with other countries' - demonstrates effectiveness of sound monetary and prudent fiscal policies set in a clear medium term framework. Strong and sustained growth, coupled with a disappearing budget deficit, itself an effective refutation of fine-tuning and neo-Keynesianism.

- We shall continue to follow the prudent financial policies laid down in successive versions of the MTFS. They provide stable and predictable environment for business and for markets.

- Centrepiece of MTFS is steady reduction in money GDP, as shown in FSBR published today. Set out what the 1987-88 targets will be.

- MTFS requires steady reduction in growth of money. Interest rates and fiscal policy the main instruments.

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PUBLIC SECTOR BORROWING

- Monetary policy must always be supported by appropriate fiscal policy.

- Borrowing in 1986-87 turning out to be lower than expected despite lower oil price for much of year than assumed. [Figures] Lower as a proportion of GDP than any year since [1971-1972]

- Second year of low borrowing. Have been two marked downward steps in PSBR: from about 5% to about 3% in 1981-82, then to about 1½% in 1985-86.

- Able to bring PSBR down while reducing tax burden at same time because of firm control of expenditure. GGE/GDP ratio has been falling since 1982-83. Determined to continue.

- Borrowing needs to be low to support declining money GDP and MO growth paths. Autumn Statement pledge. Now clear that some further reduction in PSBR over medium term is indicated.

- Also need to take account of prospects for output growth, level of real interest rates, the privatisation programme and path of oil revenues. Above average output growth points to cyclical reduction in PSBR in 1987-88; oil revenues in 1987-88 may be [higher than] [nearly as high as] in 1986-87, then projected to decline at [x%] a year. All this points to a third step down in PSBR in 1987-88 followed by very gradual medium-term decline.

- Therefore providing for PSBR in 1987-88 at [ ]. Very gradual decline beyond that: will be reviewed next year.

- This is cautious and prudent policy. Will help maintain proper balance in economy and keep up the pressure on inflation.

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BUSINESS AND ENTERPRISE

VAT and Small Businesses

- First, measures specifically designed to help small businesses with burden of accounting and record-keeping for VAT. Consultative document on VAT and small businesses, issued last October, unveiled proposals which have been welcomed by representative bodies and individual businessmen alike.

- Therefore propose, with effect from 1 October 1987, optional system of cash accounting for VAT for companies with annual turnover below [£250,000]. Companies will not be liable to pay VAT until they have been paid by their customers. This gives small businesses automatic bad debt relief. The proposal is subject to our obtaining the necessary derogation from the EC Sixth Directive on VAT, [for which I am applying today.]

- Also propose, from 1 July 1988, optional system of annual acounting for VAT which will mean that businesses with annual turnover below [£] will only need to send one return to Customs each year.

- Further propose that period within which businesses must notify and be registered for VAT should be extended from ten days to one month.

- In addition, propose that special VAT schemes for retailers be improved and simplified in a number of ways.

- Not intending to proceed with compulsory deregistration of traders below VAT threshold, [? nor with withdrawal of retailers' standard method of accounting for VAT]

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- Taken together, important package which should make burden of VAT less daunting for smaller firms whose management energies should be concentrated on generating profits.

Corporation tax measures

- To enable companies to plan ahead, I can announce now that the mainstream rate of Corporation Tax in 1987-88 will be unchanged at 35 per cent.

- Have decided that the time is ripe to put all companies on same footing for payment of Corporation Tax. Propose that from today all companies and building societies should be liable to pay Corporation Tax nine months after the end of the accounting period on which tax due. Already position for companies established since 1965.

- To reduce effect of change on any one company, propose that change should be phased in over three years.

- Putting all companies on same payment basis will rationalise system and promote equality of treatment between companies. [Will provide useful smoothing of flow of tax receipts into Exchequer which in turn will help management of the PSBR.]

- Propose also to legislate now for important reform of assessment and collection procedure for Corporation Tax - 'Pay and File'. [Response to Keith Committee whose report pointed up the deficiencies of the present system.] New system will simplify procedure both for companies/tax advisers and the Revenue. Will include provision for mirror-image interest. This streamlining will complement structural reform introduced in 1984.

- Though new system cannot come into effect before computerisation in Revenue complete, early legislation desirable for planning purposes both inside and outside Government.

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- Taxation of companies' capital gains currently unduly complicated, involving artifical reduction of the amount of indexed gain on which Corporation Tax levied.

- In addition, have received representations arguing that companies should be allowed to set payments of Advanced Corporation Tax against tax liability on capital gains.

- Much force in argument that little real difference between companies' capital gains and income from other sources.

- Therefore propose to rationalise system. Henceforth capital gains of large and small companies will be charged without reduction at appropriate Corporation Tax rate, with offset for payment of Advanced Corporation Tax.

- [Increase in ceiling for small companies' rate of corporation tax?]

Oil

- [Reference to current state of oil industry, oil price etc.]

- Legislation passed at the end of last year to provide for earlier repayment of Advanced Petroleum Revenue Tax to help oil companies' finances. Reference to price and valuation changes already in effect; these changes designed to ensure that amount of tax intended under North Sea regime actually gets paid. [Reference to ring-fence ACT proposals?]

- Now propose new cross-field relief for a proportion of expenditure on developing a new field up to point of payback.

- Also propose cross-field relief for research expenditure not specific to a particular field, and thus outside scope of present PRT reliefs.

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- Together these measures will help to sustain research and development, important for future of offshore supplies industry.

Profit related pay

- Employment prospects depend critically on pay. Performance here still disappointing. Solution in hands of employers and workers. But Government can promote long term structural reform to tackle rigidity of pay system and give employees a more direct personal interest in company's success. Many companies and their employees have already developed highly successful partnerships. But other companies' pay systems still too rigid so that in lean times under pressure to lay people off, reluctant to take on.

- Last July published Green Paper on PRP designed to tackle these problems. Warmly welcome the discussion and responses document generated.

- And have now decided to introduce system of tax relief to employees for PRP, and so encourage many more employers to bring these schemes into operation. Response to Green Paper encourages belief that firms will respond to this opportunity. Those who have such schemes generally believe they have worked well and many firms which do not are considering introducing one.

- In considering details have been anxious to ensure they offer sufficient flexibility to firms in designing type of scheme which best suits their circumstances. So will, for example, be able to choose level at which scheme operates - whole company or sub-unit; to choose frequency of PRP payment; and to choose between relating PRP pool straightforwardly to a proportion of total profits or to year on year changes in profits which may suit the particular circumstances of some businesses.

- All these and other elements of flexibility will be built in. [Full details being published in ...]

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- But perhaps key issue in responses to Green Paper (and no doubt to some of those considering schemes) was level of tax relief. Green Paper suggested one quarter of PRP payments might be eligible. Have now decided to double this to a half. Underlines importance attached to this major new initiative. Not a panacea but will in time further promote flexibility and enterprise in the economy; and so help strengthen employment prospects. Full year cost of this measure could exceed £100 million.

Anti-avoidance

- Not possible to reduce overall burden of tax unless law ensures proper amount of tax collected. Propose to tighten up provisions in certain areas to ensure this.

- Treatment of tax credit for foreign withholding tax paid on the interest on loans by banks operating in the UK is unusually generous. Effect is to relieve profits which have nothing to do with the borrowing in question.

- Propose change in these UK tax rules to make them comparable to those in other countries. Credit for any foreign withholding tax actually paid, or deemed to be paid, on interest received by banks from overseas lending would only be offsettable against Corporation Tax due on turn on relevant loan. For new businesses, change will apply from 1 April 1987; for existing loans effective date will be 1 April 1988.

- Another area where law presently unsatisfactory is tax treatment of dual resident companies. US have already acted. Propose to legislate to deny double deduction for interest payments by dual residents with effect from 1 April 1987. Trading companies would not be affected by the proposed change.

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Keith

- Keith Committee pointed to problem of late payment by certain employers of income tax collected under Pay As You Earn and tax paid by sub-contractors.

- To deal with this propose to introduce an interest charge on tax paid late, while a formal assessment has had to be made, with effect from 19 April 1988.

- Keith also drew attention to payments to directors being left out of base for PAYE calculation, resulting in delays in paying tax. Propose to remedy this by defining more closely what should be included in base for calculating PAYE.

Lloyds

- Propose legislation on the taxation of Lloyds members to ensure that the normal tax treatment of provision for outstanding liabilities applies to Lloyds' members, in the same way as to insurance companies and other financial traders. These changes will affect the tax treatment of Lloyds Reinsurance to Close and will first apply to premiums paid for the close of the 1985 Lloyds account at 31 December 1987.

Car benefit

- Propose 10 per cent increase in value for car benefit scales. Propose no change to car fuel benefit scales.

Business Expansion Scheme

- Confirmed last year that Business Expansion Scheme would continue indefinitely in view of its outstanding success.

- Last year's changes improved the targeting of the scheme and as a result, more BES money is now going into the type of higher risk venture for which the scheme was designed.

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- Scheme now on generally satisfactory basis. But propose two measures which should improve it still further:

  - Received a number of representations about the tendency of the present rules to encourage "bunching" of BES investments at the end of the financial year. This can make it difficult for a company to raise BES finance at other times. To alleviate this, propose optional carry-back of BES relief for investments made in the first half of the tax year subject to a limit of half of the amount, or £5,000, whichever is the lower. Measure will take effect for investments made after 5 April 1987.
  - Film industry have pointed out difficulty caused by present rules requiring a company to engage in the production of films throughout a three year period in order to qualify for BES investment. Propose to relax this requirement to make it easier for independent film companies to benefit from BES investment.

Wider Share Ownership

- Benefits of share ownership - individuals given stake in UK industry.

- Remarkable story of success - reversing what many regarded as inevitable decline in number of individual shareholders. We have taken action on three fronts, and all have worked.

- First, enhanced tax relief for employee share schemes.

- Second, privatisation
- Third, personal equity plans

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- Employee share schemes are spreading. Propose 2 measures to facilitate this in special circumstances:

  - as previously announced, propose to amend the "material interest" test for employees and directors in close companies;
  - propose to enable employees in a company which is taken over to exchange their existing share options under an approved scheme for options over shares in the acquiring company.

- [Propose that review should be made, with help of outside experts, of effect of Section 79 of the 1972 Finance Act on tax treatment of employee-acquired shares. Aim of review improvement and simplification consistent with underlying purpose of provision, which is to counter tax avoidance.]

- Privatisation

- Before BG share ownership had doubled, mainly result of BT
- BG and TSB attracted 3 million shareholders. Since then deepening with BA
- Share ownership trebled since 1979 [dependent on results of Treasury survey]

- Every reason to expect further growth. Privatisation will continue - RR, BAA and most of rest in next Parliament, including BT shares Government still holds.

Personal Equity Plans

- Personal equity plans (PEPs), announced in last Budget as radical new scheme to encourage direct investment in UK equities, have had remarkable impact.

- Details of Scheme developed in conjunction with market practitioners. Came into effect on 1 January 1987.

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- Response very encouraging. Over [ ] have applied to become plan managers, including banks, stockbrokers, unit trusts, building societies and investment advisers.

- [Anything which can be said nearer the time about take-up, and in particular, number of first time share-buyers taking out a PEP.]

- Successful launch of PEPs clear evidence that Government's aim of creating a share-owning democracy meets aspirations of many men and women.

Coda to business and enterprise section

- Sum up measures to help business and enterprise: 1984 reform rationalised taxation of company profits and introduced lower rates of Corporation Tax. UK tax on company profits now [one of lowest in industrial world] [lowest except for US who have beaten us by one percentage point].

- Profitability of non-North Sea industrial and commercial companies has increased steadily since trough in 1981, when real rate of return 3.2 per cent. In aggregate real rate of return on these companies estimated at 8.6 per cent in 1986 - highest figure since 1973. [?Major factor in buoyant Corporation Tax receipts.]

- Measures in this year's Budget will provide stability and simplicity in the tax system for business and enteprise. Continue thrust of reform initiated in 1984.

- US tax reform package welcomed because it closes tax loopholes and removes distortions. UK position radically different. None of the tax breaks or distortions being abolished by the US tax reform package exist here, except for double deductability of interest by dual resident companies. Acting now to remedy this. No need to be defensive about UK record on tax reform: have abolished 4 unnecessary taxes as well as cutting the effective rates of [most] [all] direct taxes.

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SAVINGS AND INVESTMENT

Pensions

- Consultative document issued last November sets out proposals to extend present tax relief for pensions to new personal pensions foreshadowed in 1986 Social Security Act.

- Following consultation, proposed tax reliefs for personal pensions based will be based broadly on present rules for retirement annuities.

- Also propose special rules, with minimal red-tape, for new simplified occupational pension schemes (final salary or money purchase) as well as other measures to allow much greater transferability between different types of pension arrangements.

- In addition, new proposal to allow employees in occupational pension schemes, to make additional voluntary contributions (AVCs) outside employer's scheme. As with existing in-scheme AVCs, contributions will be subject both to present limits on employee contributions and final benefit limits.

- Proposals will be of general benefit to 10 million employees who do not belong to occupational pension schemes. Will provide greater pensions choice for all employees, allowing people to take reasonable pension provision with them when they change jobs. Good for mobility and thus for economic performance.

- Widening of pension reliefs only justified if relief properly targeted on provision of adequate pensions. So some new safeguards to discourage exploitation of very generous reliefs, particularly for certain highly paid employees. Details set out in consultative document published today. But certain measures will need to come into effect from today to avoid forestalling.

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Inheritance tax

- Propose to improve targetting of IHT business relief by increasing rate of relief for substantial holdings in unquoted companies, and in future treating minority holdings in USM companies in the same way as those in companies with full listing.

- But main proposal is a substantial increase in inheritance tax threshold from £71,000 to £90,000, and to simplify structure by reducing from 7 rates of tax to 4.

- Effect will be to reduce number of estates liable to IHT by about a third, and give worthwhile reductions in tax at all levels, particularly on smaller estates.

Capital Gains Tax for individuals

- Propose to increase threshold to [ ], an increase which will maintain the 1986-87 value in real terms [?increase in retirement relief ceiling, small part disposal relief.]

[**Friendly Societies**

- The present limit on tax exempt life assurance businesses by friendly societies is outdated. Therefore propose new type of limit, by reference to annual premium rather than sum assured. In future tax relief for life assurance provided by friendly societies will be available on premiums up to £100 a year.]

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TAXES ON SPENDING

On-course betting duty/increase in gaming machine licences

- I propose to abolish on course betting duty while increasing the duty on gaming machine licences.

VAT

- No changes in rate or coverage of VAT. VAT registration threshold to be revalorised to £21,250.

- Present rules on partial exemption for VAT over generous in terms of amount of input tax which can be deducted. Have already announced that rules are to be changed so that partially exempt businesses put on same footing as other businesses.

- Tax measures to help charities in every Budget since 1980. Regime now very generous.

- Value of tax relief approaching £½ billion a year. Government grants to charities running at over £¼ billion a year - up over 75 per cent in real terms since 1979-80. Recorded giving to charities doubled in real terms since 1979.

- Facts and figures show that Government right to focus on encouraging people and companies to give. Response demonstrates widespread support for voluntary sector; and justifies Government's preference for private rather than state action.

- Last year's Budget contained most substantial package of tax reliefs for charities ever. Tax reliefs made not only more generous, but simpler and more flexible. New provisions introduced for payroll giving. Announced last December that ceiling for payroll giving by individuals would be raised to £120 a year.

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- Arguably no case for further tax relief for charities. But following representations from Charities VAT and Tax Reform Group, prepared to agree to certain additions to the VAT concessions which were, exceptionally introduced last year. Propose
  - to apply zero rating to certain equipment used by charitable rescue and first-aid services to find injured people;
  - to extend to welfare vehicles operated by hospices the zero-rating applied last year to vehicles used by charities to transport the deaf, blind or mentally handicapped;
  - [to extend zero-rating to listed drugs commonly used in medical research;]

-

In addition propose to put on a statutory basis present extra statutory concessions relieving from VAT goods donated for export by a charity; and the installation of bathrooms and lavatories for disabled residents in charities homes.

- [On another front, propose relief from car tax on cars supplied to Motability for leasing]

Excise duties

- [Passage to follow in light of decisions.]

Income tax: introduction

- Finally, I turn to income tax

- Government believes lower rates of tax good for incentives, stimulus to enterprise. Best chance of increased prosperity for all is to place UK firmly in low tax/high growth league of countries. Main aim of tax reform to move in this direction.

- Have already slashed top rates of income tax, abolished investment income surcharge and brought down basic rate of tax

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by 4 percentage points since taking office in 1979. Have increased tax threshold - point at which people start to pay tax - by 22 per cent in real terms during same period. Married man's allowance now at highest level in real terms since the war.

- Despite cuts in income tax burden, yield from tax up [per cent] in real terms since 1979. Top 5 per cent of taxpayers paying larger proportion of income tax than in 1979. [amplify - pointer to 1988 Budget?]

- For 1987-88, propose to raise main thresholds and allowances by statutory indexation figure of 3.7 per cent [rounded up]

- Single person's allowance to rise by [£] to [£] and the married age allowance by [£] to [£].

- Single age allowance to rise by [£] to [£] and married age allowance by [£] to [£].

- Age allowance income limit to become [ ].

- [Glad to be able to announce special changes to allowances for two very deserving groups:
  - blind allowance will rise to ;
  - widows' bereavement allowance will rise to .]

- [The starting threshold for higher rate tax to be increased by £700 to £17,901. The threshold for 45 per cent tax will increase by £200. The thresholds for 50 per cent tax and above to remain unchanged.]

Scope for tax reductions: income tax rates

- In my last Budget speech, said that I shared aim of my predecessor to reduce basic rate of income tax to no more than 25 per cent. Believe all tax rates need to come down, but

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give priority to reducing marginal rates for 95 per cent of taxpaying population.

- Cuts in basic rate expensive. Would be imprudent to move to 25 per cent goal at a speed incompatible with prudent long-term financial management.

- Revenue effect of tax measures so far announced will be [£ million]. Have already announced borrowing requirement of [£ billion]. Glad to say that, taking account of all of this and of the forecast for 1987-88, have room for total tax reduction of [£ billion]. So overall strategy permits me this year to take a further 2p off the basic rate.

- This proposal will reduce marginal rates for overwhelming majority of ordinary taxpayers. Worth [£] a week to a married man on average earnings. Major step towards 25 per cent goal.

- Propose corresponding reduction, to 27 per cent, in Advanced Corporation Tax and small companies' rate of Corporation Tax. Latter will mean that small companies and unincorporated sector will see a significant reduction in their tax liability. Together with the simplifying measures on VAT make this a Budget for small businesses, which are crucial for growth and employment.

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FROM: M C SCHOLAR
DATE: 20 FEBRUARY 1987

CHANCELLOR OF THE EXCHEQUER

cc Principal Private Secretary
Chief Secretary (2)
Financial Secretary (2)
Economic Secretary (2)
Minister of State (2)
Sir Peter Middleton
Sir Terence Burns
Sir Geoffrey Littler
Mr F E R Butler
Mr Wilson
Mr Cassell
Mr Monck
Mr Sedgwick
Mr Odling-Smee
Mr Culpin
Miss O'Mara
Miss Sinclair
Miss Evans
Mr Cropper
Mr Tyrie
Mr Ross Goobey

Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Beighton - IR
Mr McManus - IR
Sir Angus Fraser - C&E
Mr Knox - C&E
Mr Wilmott - C&E
Mr Bone - C&E

BUDGET STATEMENT: FIRST DRAFT

I enclose a first draft of the Budget Statement. This follows the outline you saw last weekend, and takes account of points which have been made to me following your request at Monday's overview meeting.

2. This draft is, as always at this stage, the work of many hands. In the time available there has been little time for editing or clearance and I am afraid that there are some inconsistencies and probably some errors too. The drafting is uneven and still requires in places a good deal more work. But I hope that this first version will give you a feel for the shape of the Statement and will provide a basis for further work next week.

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3. One or two points of detail:-

(a) The business and enterprise section (which is perhaps on the long side) starts with VAT and small businesses, as you suggested at our discussion last week. This works well, except that it is perhaps a little odd to come to the main Corporation Tax rate after all these details.

(b) The Revenue have suggested moving Pay and File from its present position in the section on streamlining Corporation Tax to a new subsection on tax reform which starts off with all the Keith measures, at the end of Business and Enterprise.

(c) It might be best to omit the paragraphs on US tax reform (p 33). If so, we should certainly keep Pay and File where it is.

(d) Customs think that VAT partial exemption (p 39) would sit more comfortably in the anti-avoidance section than in its present home, taxes on spending. I am inclined to agree.

4. Last year you spoke for 1 hour 16 minutes. You suggested that this year we might aim for about 1 hour. The present draft is about one hour in length.

5. I enclose, too, a suggested peroration by Mr Ross Goobey.

MCS

M C SCHOLAR

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BUDGET STATEMENT: FIRST DRAFT

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Introduction

1. The setting for the Budget this year is more favourable than it has been for many years. We are entering our seventh year of steady growth, in what is now our accustomed place at the top of the international league table. We are entering our fourth year in which this steady growth has been combined with low inflation. And we are entering one more year in which the public finances are sound and strong.

2. These are the fruits of the Government's determination to hold to our policies of sound money and free markets. I gladly reaffirm these policies today. They provide the only sure basis for more jobs and lasting, productive, jobs.

3. I shall begin by reviewing the economic background to the Budget. I shall then deal with monetary policy and with the fiscal prospect this year and next. Finally I shall propose some changes in taxation designed to assist in achieving our economic objectives. As usual, a number of press releases, filling out the details of my proposals, will be available from the Vote Office as soon as I have sat down.

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Economic Background

4. I begin with the economic background.

5. The first estimates for growth in 1986 show output some [2½-2¾] per cent higher than in 1985. We have experienced steady growth at just under 3 per cent - with only minor deviations one way or the other - since the beginning of 1981. This remarkable period of growth is an enormous improvement on the traumas and poor performance of the mid and late 1970s. Indeed it compares very well with the best growth performance in earlier periods.

Best since '73. Contrast not so much on growth as on what went with it. Inflation etc.

6. It is worth examining the lessons of this recent period of successful growth.

It has coincided with a sharp fall in inflation.

It has occurred as the Government has pursued progressively tighter fiscal and monetary policies - with the PSBR in 1986-87 [at £4½ billion] the lowest as a share of GDP since 1969-70.

This will be a key announcement. Make more of it.

Because the Government has not succumbed to the pressure from many quarters for an artificial

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fiscal stimulus, which would inevitably carry with it the risk of a rise in inflation, the prospect is for satisfactory growth to continue in 1987 and beyond without a rise in underlying inflation.

Worth developing this point a bit more.

7. In short the recipe for sustained growth and falling inflation is the very opposite of the conventional neo-Keynesian wisdom of the late 1960s and 1970s, which is still all too evident in certain parts of this House.

8. Our growth performance in 1986 was achieved against a difficult world background. There were already signs of a mild slowdown in the world economy towards the end of 1985. One of the first consequences of the fall in the oil price at the beginning of 1986 was for certain oil producers to cut their imports from developed countries like the UK. Other less developed countries reacted in a similar way in response to falls in other commodity prices.

forecast in last year's Budget speech,

9. As I expected at this time last year the lower oil price led to lower inflation in the developed countries and boosted domestic demand. We have heard a lot in recent months about domestic demand - and private consumption in particular - growing at an unhealthily high rate in the UK. The critics seem unaware both that the growth of domestic demand in 1986 in the other economies

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of the major 7 appears to have been higher than in the UK, and that high consumption growth in the developed economies was an expected and quite justified consequence of the fall in the oil price.

10. While exports from countries such as the UK suffered from the contraction in OPEC and LDC markets in the first half of 1986, there now appears to have been a pick up in exports from developed countries in the second half of the year. This renewed growth in developed countries' exports has contributed to a marked improvement in industrial output in most of these countries during the second half of 1986. There are reasonable grounds for expecting world demand for developed countries' exports to continue to grow in 1987. The growth of markets for UK exports of manufactures should rise from [2½] per cent in 1986 to [3½] per cent in 1987. GNP in the major economies is likely to rise at [2½] per cent in 1987, the same as in 1986.

Goes from details about others to key points.

11. While in some ways the world economy has adjusted well to the large fall in the oil price at the beginning of last year, there are undoubtedly very real risks to its satisfactory performance. There has been considerable turbulence in foreign exchange markets as the three largest economies - the United States, Japan and Germany - grapple with major external imbalances that adversely affect other economies.

Perhaps better to start with imbalances, then turbulence, danger of protection, then G5/6/7, then need for lasting progress

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12. It is essential that the US takes further steps to control its budget deficit, which in turn will help to reduce its large current account deficit. Similarly both Japan and Germany must adopt policies first to prevent their very large current account surpluses growing further, and then to ensure their reduction.

13. The reduction in the large external imbalances in the three major economies is essential to ensure the continuation of low inflation and steady growth, which has been such a major achievement of the international economy in recent years. Above all a slide into protectionism in the US and elsewhere would be a disaster for the world economy and major trading nations such as the UK.

Say more?

14. [Reference to G5/G7 talks.]

15. Turning to the UK economy the prospect is for a year of steady, balanced growth. It is clear that the growth of consumers' expenditure in 1986 - at just under 5 per cent - was given a temporary boost by the lower oil price and the fall in other commodity prices. The probable fall in the growth of consumers' expenditure in 1987 is likely to be matched by the welcome rise in investment that industrial surveys clearly signal.

Better to major on investment here: Over upswing, consumption + investment balanced; last yr, the exception; this yr, back to trend.

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Something to indicate that manuf'g is only 25% of economy.

16. The manufacturing sector in particular is set for faces a good year, continuing following its improved performance during the second half of 1986. In the year to the fourth quarter of 1986 exports of manufactures grew by 9½ per cent and productivity by over 4 per cent, while its wage costs rose by just over 3½ per cent.

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17. Indeed the UK's overall productivity performance has been particularly strong in the last few years. In the 1960s and 1970s the UK was at the bottom of the international productivity league. Productivity performance was particularly bad in the period after 1973, with manufacturing productivity in the UK growing on average at a mere ¾ per cent a year. Since 1979 the average growth of productivity for the economy as a whole has been higher than in any of the other major 7 economies in the period since 1979, averaging 3½ per cent a year. That is indeed an achievement. All the signs are that 1987 will see a continuation of the recent strong performance of manufacturing industry, with exports, output, and productivity growing at very satisfactory rates.

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Link: this is a growth point, not a manuf'g one.

18. This strength was all the more remarkable because it was maintained in a difficult year in which the UK economy adjusted to the large fall in the oil price. The public finances in particular suffered a reduction of

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Make more of this.

just over half the revenues from the North Sea. But because the underlying industrial performance of the UK economy is much stronger than in earlier years the economy weathered this storm, as it has weathered other storms in recent years which in earlier times would have led to crisis and catastrophe. Indeed the Government's finances have markedly strengthened not because I raised tax rates to make good the loss of oil revenues, but because the sustained growth of the economy has produced a higher level of non-oil revenue than anyone expected.

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19. In our projections for future years we have, in the light of all the uncertainties, kept unchanged the assumption we adopted last year of a $15 oil price.

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20. Real interest rates are high in the UK, in large part because in a growing economy private sector credit demand is so buoyant. The recent level of real interest rates has not prevented strong growth of demand and output. By continuing to keep a very firm control on public finances we shall ensure that the Government does not - as governments have all too often in the past - add to pressure on real interest rates.

21. As forecast at the time of the Autumn Statement in November, the current account of the balance of payments was in broad balance in 1986. This follows a cumulative

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current account surplus of £21 billion since 1979, which enabled the UK to build up a large net stock of overseas assets during the period when oil prices were high and North Sea output rising to its peak.

22. On present prospects there is likely to be a current account deficit of [£2 billion] in 1987. It is not at all surprising that the UK should experience a small deficit on this scale - equal to approximately ½ per cent of GDP - following the immediate loss of over £4 billion net exports of oil as a result of the fall in the oil price. In time the fall in the exchange rate that followed the drop in the oil price should lead to an improved non-oil trade performance. The UK's large stock of net overseas assets will provide a lasting contribution to the current account in the future.

Figures.

23. Inflation is likely to rise for a time during the middle of this year to a little above 5 per cent. But it should thereafter fall, to [4½] per cent in the final quarter of the year. Short term changes in inflation, such as those experienced in 1986 and likely in 1987, are predictable fluctuations around an unambiguously downward trend. The Government remains determined to squeeze inflation out of the system altogether and will take whatever action is needed to achieve this overriding aim.

Make C's point about each peak being lower than the last?

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We want a cheer here. Write this up a bit.

24. To sum up the prospect, we can look foward to a year of balanced growth in 1987 with consumers' expenditure lower and investment growth higher than last year. Exports are likely to grow significantly faster than the economy as a whole.

Order of 25-27? Looks like a v. scanty treatment of unemployment here.

25. Unemployment should continue to fall gradually, as it has done since the middle of last year. In last year's Budget I said that employment prospects depended on a sustained improvement in the performance of business and industry. That sustained improvement in economic performance has occurred and is continuing.

26. I do not believe that this improvement would have occurred were it not for the stability and soundness of the Government's overall management of the economy, together with our policies to encourage enterprise, efficiency, and flexibility. From the beginning the Government has taken action to promote competition, incentives, and free markets, and to press ahead with deregulation and privatisation. All these measures, enacted in successive Budgets and other legislation, are now bearing fruit, and we see the proof of this on all sides - not least in the success of British industry in international markets.

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Mention pay?

27. British industry now has an outstanding opportunity as a result of low inflation, rapidly rising productivity, and the highest profitability for 20 years. If it will take a firm grip on its costs, and make room for its crucially important spending on R and D and training, its present successes should mark the beginning of a new era of pre-eminence in domestic and international markets alike.

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Monetary policy

28. We shall continue to follow the prudent financial policies laid down in successive versions of the medium term financial strategy. They provide a stable and predictable environment for markets and for business: a framework that permits the economy to grow steadily while giving a guarantee against a return to rising inflation, and the industrial and market instability which comes with that.

29. The centrepiece of the strategy is the Government's commitment to achieve a steady reduction in inflation and the growth of money GDP. This requires tight control of monetary conditions, using short-term interest rates as the main instrument of policy.

30. Last year I set target ranges of 2 to 6 per cent for narrow money, MO, and 11-15 per cent for a measure of broad money, £M3. The target range for MO next year will again be 2 to 6 per cent, as indicated in last year's MTFS. For broad money, on the other hand, a rapid rate of growth has proved consistent with monetary conditions which have continued to bear down effectively on inflation. Indeed, as I have explained at length on several occasions, the growth of broad money has become increasingly difficult to interpret, both at home and

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abroad. I have concluded that the behaviour of broad money is now too uncertain for it to be sensible to set a target range for it next year. But although interpretation is difficult, it is still important to monitor closely the growth of liquidity in the economy. We will take the behaviour of the various measures of broad money carefully into account in assessing monetary conditions and setting interest rates.

31. We will also continue to take account of the other financial indicators, and in particular the exchange rate, which can provide a good guide to policy when other indicators are hard to interpret. Decisions on short term interest rates will continue to be made after a careful assessment of all the evidence of monetary conditions.

32. I have one change to announce in the arrangements which are used for financing the Government's borrowing. Following last year's changes in the structure of the gilts market, the Bank of England has been conducting consultations on the possibility of carrying out an experimental series of gilts auctions in 1987-88. I can now announce that this experiment will go ahead [with the first auction to be held in May(?)]. The Bank of England will be announcing details [later today/in the week]. Auctions will supplement the traditional methods of

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selling gilts by tender and through the operation of taps, and they will provide fixed points during the year at which known amounts of Government stock can be sold. I believe this will mark an important improvement in the techniques available for financing the Government borrowing requirement.

33. I will say no more about monetary policy, except once more to repeat what I have said on a number of occasions in the past: that while the changes which have swept through financial markets world-wide in recent years have necessarily altered, and complicated, the techniques of monetary management, there has been no change whatever in the essence of the Government's policy. We continue to attach the highest priority to sound money.

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Public Sector Borrowing

34. An important component of the success of the MTFS has been the reduction in the level of public sector borrowing. It looks as though borrowing in 1986-87 is turning out to be considerably lower than the £7 billion I expected at the time of last year's Budget. I now expect an outturn for the financial year as a whole of only [ ]. This is a little below 1½ per cent of GDP, a lower percentage than in any year since 1969-70. Moreover the same comparison would still hold if the PSBR were adjusted for privatisation proceeds.

35. This makes 1986-87 the second successive year in which the PSBR has been at about 1½ per cent of GDP. There have now been two marked downward steps in the PSBR since 1979. In 1981-82 it was reduced from 5 per cent to about 3 per cent, where it stayed for the next four years. And then in 1985-86 it fell to 1½ per cent.

36. Meanwhile - to the great surprise of those who think that economic growth can result only from fiscal expansion - output has risen, as I have indicated, at a steady 3 per cent a year. Indeed its rise began in 1981 just as the PSBR was taking its first big step down - and just as we were being told that it could not rise, given

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declining public borrowing. The truth is that strong and sustainable output growth depends on a healthy and productive private sector. And this is most likely to thrive when the Government is restricting its own demands on the economy.

37. It is not only the borrowing requirement that this Government has been reining back. Government expenditure as a proportion of GDP has also been falling since 1982-83. This has eased the burden on the private sector by permitting a reduction in taxes. And it has enabled us to sustain a remarkable loss of oil revenues from last year's oil price fall without raising non-oil tax rates or borrowing.

38. I intend to continue this successful fiscal strategy. The Public Expenditure White Paper published in January showed a continued decline in Government expenditure relative to GDP over the next three years. Some further reduction in borrowing over the medium term is also required to support the declining path of money GDP growth.

39. For the year ahead, borrowing plans need to take account of a number of factors. North Sea revenues are expected to be [unchanged from the 1986-87 level] in 1987-88, and then to decline gradually. The rate of

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growth of output and the revenues it brings may be a little higher over the next year or so than can be sustained over the medium term. With real interest rates high, all this points to a reduction in borrowing next year then little further change over the medium term.

40. I am therefore providing for a PSBR in 1987-88 of £[ ] billion or [ ] per cent of GDP. The figures for later years will be set in future Budgets, but the illustrative path in the Red Book shows the PSBR remaining at [ ] per cent of GDP.

41. This is a cautious and prudent policy. It will create more room for private sector demand without putting pressure on inflation or interest rates. It will provide a very necessary margin for safety. And it will improve the balance in the economy, between the public and private sectors, between the domestic economy and the balance of payments, and between consumption and investment.

Careful. We've already said these are balanced.

42. It will not, unfortunately, allow room for the substantial reduction in taxation to which this Government attaches such importance. That is regrettable, but necessary, for we are determined, as we have been for the past eight years, to take no risks with inflation, and no risks with our management of the public finances.

43. I turn now to my proposals for changes in taxation.

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Business and Enterprise

44. First, the taxation of business and enterprise.

Redraft. This sounds v. boring to start with. e.g. "Small bus. v important. Want to ease their tax affairs. Last autumn..." - ACSA

45. The Government last autumn made a series of proposals on accounting and record-keeping for VAT which will have an important impact on a crucial sector of the economy - small businesses. These measures have been welcomed by representative bodies and individual businessmen alike.

ACSA

46. I therefore propose that with effect from 1 October 1987, there should be an optional system of cash accounting for VAT for companies with an annual turnover ~~below~~ of up to £250,000. Companies will account for VAT on basis of cash paid and received. Because they will not be liable to pay VAT until they have been paid by their customers, which this will ease their cash-flow problems, as well as giving them automatic bad debt relief - a relief for which they have long argued.

47. The proposal is subject to our obtaining the necessary derogation from the EC Sixth Directive on VAT; [I am applying for this today.]

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48. In addition, I propose an optional system of annual accounting for VAT which will mean that businesses with an annual turnover below £250,000 will be able to make payments on account and send only one return a year to Customs. This change will come into effect in the second half of 1988.

49. In future the period within which businesses must notify and be registered for VAT will be extended from ten days to one month.

50. I also propose that the special VAT schemes for retailers should be changed in a number of ways in order to make simpler schemes available to more small and medium-sized businesses.

51. But there are two matters on which the representations I have received persuaded me it would not be right to proceed as suggested in our autumn consultative document. I shall not be going ahead with the proposal for compulsory deregistration of traders below the VAT threshold; or with the proposal to withdraw the standard method of accounting for VAT used by retailers.

52. I propose to increase the VAT registration threshold to £21,300 in line with the maximum permitted under

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existing European Community law arguing vigorously in Brussels for flexibility to set a higher limit.

53. Overall, the proposals which I have just outlined will help ease the burden of VAT on smaller firms whose management energies should be concentrated on generating profits. The thicket of controls, regulations and form filling will be made more penetrable.

54. I turn now to larger companies, specifically those liable to pay Corporation Tax at the main rate.

55. I have received a number of representations about the help it gives to companies to have advance notice of the Corporation Tax rate for the year ahead.

56. Accordingly I can announce now that the main rate of Corporation Tax in 1987-88 will be unchanged at 35 per cent.

57. The reformed system of Corporation Tax which I introduced in my 1984 Budget has now been in force since the beginning of the present financial year. I propose this year to complete this reform with a number of measures to streamline the administration of Corporation Tax.

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JHK

ACSA: Chancellor

C: 58 + 59 too long.

58. At present there is an anomalous situation whereby companies established before 1965 can ~~have accounting periods of different lengths for their liability to Corporation Tax;~~ pay CT up to 21 months after the end of the period on which it is due; but companies established since 1965 must ~~all account for~~ pay the tax within nine months ~~after the end of the period on which it is due.~~

59. This difference in the treatment of companies no longer has any justification. I propose, therefore, that all companies and building societies should be liable to pay Corporation Tax nine months after the end of the accounting period on which the tax is due. This will be more equitable between companies than the present regime; it will rationalise the arrangements for collecting Corporation Tax from companies; and it will smooth the flow of tax receipts into the Exchequer, which in turn will help management of the PSBR. A quite separate, but important, reason for changing the present arrangements is that they are open to abuse which could put the timing of a substantial proportion of the Corporation Tax yield at risk. There will be a transitional period during which the change will be phased in.

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60. I also propose to legislate now to pave the way for a new method of collecting Corporation Tax, to be known as Pay and File. Under Pay and File companies will estimate ~~and pay~~ themselves and pay their tax liabilities on the normal due

At present, where a company's tax liability cannot be finalised by the ~~normal~~ time payment is due - as will often be the case - there is a laborious process involving ~~estimated~~ the Inland Revenue making an estimated assessment and the company appealing against it.

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date, without ~~the need for the Inland Revenue to make thousands of estimated assessments or for companies to appeal against them.~~ any trigger from the Inland Revenue. Tax liabilities will be finally settled once companies submit their returns and accounts. ~~The new system will include provision for interest payments by the Inland Revenue where tax is overpaid; and parallel provision for interest payments by companies where tax is underpaid.~~

Where it turns out that the company's initial payment was too high, the Revenue will pay interest on the excess; where the initial payment was too low, the company will pay interest.

61. This new ~~method~~ approach was set out in a consultative document on the recommendations in the Keith Committee Report issued in December. It was generally welcomed both by business and by tax specialists.

62. The introduction of Pay and File is part of a wider programme of streamlining tax collection, including major developments in the Inland Revenue's computer systems, which will not be completed for some years. But by legislating now, we ~~shall be able to meet the request made by many~~ are giving taxpayers and their advisers ~~that they should have~~ on which to plan a firm basis, and a lengthy period to prepare for the implementation of ~~this important~~ the new scheme.

63. As a further streamlining measure, I propose a change in the taxation of companies' capital gains. At present this is unduly complicated, involving an artificial adjustment of the amount of the gain on which Corporation Tax is charged.

ACSA: mention fractions

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C:
"Not so: this is a separate change."

64. The change I am proposing will also meet the numerous representations I have received that companies should be allowed to set payments of Advance Corporation Tax against tax liability on capital gains.

65. There is much force in the argument that there is little real difference between companies' capital gains and income from other sources.

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66. I therefore propose to rationalise and simplify this part of the Corporation Tax system. With effect from [today], the capital gains of large and small companies will be charged, without adjustment, at the appropriate Corporation Tax rate. At the same time, companies will be allowed to set payments of Advance Corporation Tax against their tax liability on capital gains.

B.L.O.

Bit stark, esp after the warnings on tax cuts. Also, ~~Barg~~ does Pay-e File contribute to this yield?

67. These three measures to streamline the Corporation Tax system are expected together to yield about £255 million in 1988-89.

Within the business sector, the oil industry has faced a year of adjustment.

68. ~~I turn now to the oil industry.~~ My Rt Hon Friend the Secretary of State for Energy and I have followed closely the effect on the industry of ~~last year's sharp~~ the fall in the oil price and subsequent developments. ~~While the industry itself is~~ oil companies are generally confident about the longer

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but they have

term prospects, ~~it has~~ suggested that ~~in~~ in essentially the short-term the trough in activity could mean the loss of ~~lose it~~ some of the capacity in our offshore industry, in Scotland and elsewhere, which will certainly be required in the longer ~~term~~ run.

69. Last autumn, I introduced legislation to bring forward the repayment of over £300 million of Advance Petroleum Revenue Tax. That has already helped companies with cash flow difficulties. I also announced, last November, proposals, on pricing and valuation, to protect the revenue flow under the existing system.

Omit?

70. I now propose two new Petroleum Revenue Tax reliefs. With effect from today, participators in oil fields may elect to have up to 10 per cent of the costs of developing new oil fields, until payback, set against their Petroleum Revenue Tax liabilities in other fields. I am also proposing to give ~~a new~~ relief for ~~certain~~ research expenditure on oil extraction, ~~This is research~~ which is not related to a particular field, and so is not at present allowed for Petroleum Revenue Tax.

71. [Reference to ring-fence ACT?]

ACSA:
Need to be careful not to overplay v. small changes.

72. These measures should, over the next two years or so, help both the oil companies themselves and those in Scotland and elsewhere for whom they generate work.

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73. I turn now to profit-related pay.

74. I suggested last year that it might be possible to introduce changes to the tax system which would run with the grain of, and reinforce, efforts to break up the rigidity of the pay system in this country.

75. I pointed last year to two considerable advantages of arrangements which relate pay to profit. First, they lead to a closer identification of employees with the companies in which they work. Second, they make costs more flexible in the face of changing market conditions and hence help to make employment more stable.

76. My remarks led to a lively debate and last July we published a Green Paper on profit related pay. I warmly welcome the discussion and responses that the document generated. Those firms who already have profit-related pay schemes generally believe they have worked well. And many others are considering introducing them.

77. I have decided that the time is right to introduce a system of tax relief for employees in qualifying profit-related pay schemes. This should encourage many more firms to bring these schemes into operation. I have decided that this innovation should apply, at least initially, only to the private sector, as the Green Paper envisaged.

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ACSA

Bit stern.

78. It will of course be necessary for certain specific requirements to be met before tax relief is payable, and for schemes to be registered with the Inland Revenue before the profit year begins. But I have been anxious to keep the administration simple and to ensure that firms have as much flexibility as possible in designing schemes which suit their circumstances.

Looks too much like a bribe.

79. Perhaps the key issue in response to the Green Paper -and no doubt to some of those considering whether to introduce schemes - is the level of tax relief. The Green Paper suggested that one quarter of PRP payments might be eligible. I have now decided to double this to a half. This will mean that for someone on average earnings receiving 5 per cent of pay as PRP, the tax relief will be equivalent to 1p off the basic rate of income tax. It underlines the importance the Government attaches to this major new initiative. It will take time for the cost to the Exchequer to build up and its size will clearly depend on take-up but full year costs could exceed £100 million by the end of the decade.

Drafting

80. Profit related pay is not a panacea, but I believe it will help tackle ~~some~~ one of the deep-seated problems of the UK economy by promoting greater flexibility and enterprise, and so help further to strengthen the prospects for employment. I hope that both sides of

Help! I thought we'd abolished them.

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industry will now respond enthusiastically to this opportunity as we look forward to the 1990s. Full details of the tax relief scheme will be published in the forthcoming Finance Bill.

Tax avoidance

81. The Government's aim is to reduce taxes overall. But hand in hand with this we aim also to ensure that tax is collected fairly and effectively and that the law enables the right amount of tax to be collected. I have a number of proposals to make today in this regard.

82. First, I propose to tackle the present over-generous treatment of tax credit for foreign withholding tax paid on interest on bank loans. The effect of the present rules is to give tax relief on profits unrelated to the loan which produced the interest in the first place. Here our rules will be made comparable to those operating in other countries. Credit for any foreign withholding tax actually paid, or deemed to be paid, on interest received by banks from overseas lending will be able to be offset only against the Corporation Tax due on the turn on the relevant loan. For new loans, the change will apply from 1 April 1987. The effective date for existing loans will be 1 April 1988.

83. Second, I propose to deny the double deduction of interest payments by dual resident companies, with effect

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from 1 April 1987. The proposed change follows on the action taken in this area by the United States last year, to which I shall return in a moment. Trading companies will not be affected.

84. Third, I propose legislation on the taxation of Lloyd's to ensure that the normal tax treatment of provision for outstanding insurance liabilities applies to Lloyd's members in the same way as to insurance companies and other financial traders. These proposals will affect the tax treatment of Lloyd's Reinsurance to Close and will first apply to premiums paid for the close of the 1985 Lloyd's account at 31 December 1987. The new arrangements will be phased in over a three year period.

C. (f 85-86)
"must these be in?"

85. Fourth, I propose a change to deal with certain cases where there is serious delay in paying tax due under PAYE and sub-contractors' deduction schemes. Following the approach recommended by the Keith Committee, I am proposing to introduce an interest charge where tax is paid late following a formal assessment. This change will take effect from April 1988.

86. Fifth, it is quite common for payments to directors to be left out of the base for PAYE calculations. This also leads to delay in paying tax. I propose to remedy this by defining more closely what should be included in

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the base for calculating PAYE. Again, this will meet a recommendation of the Keith Committee.

87. All these measures will help to ensure that the right amount of tax is paid by all taxpayers. There is no reason why the bulk of taxpayers, both individual and corporate, should subsidize the few who are able to reduce their tax bill through accidental features or weaknesses in existing tax law.

ACSA : jerby change here.
"loses thread.
Rag bag of odds + ends".

88. I need to set the 1988-89 car and car fuel benefit scales for those with company cars. I propose a 10 per cent increase in the car benefit scale charges. I propose no change to the car fuel benefit scales which are now also used for VAT purposes.

89. [I am glad to be able to announce now that I propose to give statutory effect to two extra-statutory concessions whereby training costs incurred by employers and employees can be offset against tax liability. Training is vital in a dynamic and resilient economy. The tax system is already helping here, and this measure is designed to ensure that this fact becomes more widely known.]

90. Last year I was glad to confirm that the Business Expansion Scheme would continue indefinitely in view of

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its outstanding success. The changes made to the Scheme in 1986 have improved its targeting, with the result that more BES money is now going into the type of higher risk venture for which the Scheme was designed.

91. The scheme is now on a generally satisfactory basis. But to improve it still further, I propose two changes.

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92. The first is a measure to deal with the problem of year-end bunching, about which a number of people have made representations. I propose that, for investments made in the first half of the tax year, the investor should be able to opt for part of the relief to be given for the previous year. This measure, which will apply to investments made after 5 April 1987, should make it easier for companies to raise BES finance throughout the year.

B.I.O.

93. The second is a relaxation of the rules to make it easier for independent film companies to benefit from BES investment. I believe that this will be widely welcomed in the film industry.

94. The Business Expansion Scheme has done much to encourage high risk share ownership. More generally, the Government has given a major boost to wider share share ownership through action on three fronts: employee share

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schemes, privatisation and the introduction of Personal Equity Plans.

95. The growth in employee share schemes since 1979 has been remarkable. We started with about 30 schemes. Now there are over 1,200, open to all employees and covering more than 1¼ million workers.

96. I have already taken steps to amend the "material interest" test for employees and directors in close companies, to facilitate the adoption of employee share schemes in such companies.

97. I now propose a further measure to assist employee share schemes in special circumstances. In future employees in a company which is taken over will be able to exchange their existing share options under an approved scheme for options over shares in the acquiring company.

98. I am further arranging for a review, with the help of outside experts, of the effect of Section 79 of the 1972 Finance Act on the tax treatment of employee-acquired shares. The aim of the review will be to improve and simplify the rules, consistent with the underlying purpose of countering tax avoidance, so as to allow greater flexibility and encouragement to enterprise.

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99. Privatisation brings many benefits for the economy at large, as well as for the industries privatised and their consumers. Not the least of these benefits is the breakthrough we have been able to make in wider share ownership.

100. As the House knows, the British Telecom sale in 1984 brought a step-change in the number of share-owners. Over 2 million people applied, and around half of them had never owned shares before. Subsequent sales consolidated this success, and British Gas proved another landmark for wider share ownership. 4½ million applications were received on behalf of 5 million people, the largest number of applications ever received in a flotation anywhere in the world.

ACSA: ? BA.

101. I am particularly glad that employees have seized the chance to become shareholders - sometimes, it must be said, against the advice of their trades unions. About 90 per cent of the employees in the privatised companies floated on the stock market have become shareholders.

ACSA: ? BA again

102. The success of these policies has been clear for some time, but estimates of current shareholder numbers have differed. I therefore commissioned, in conjunction with the Stock Exchange, a major survey of individual shareholders. This indicates that there are now

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[ ] million individual shareholders in the UK, [and confirms that shareholder numbers have trebled since 1979].

103. But we are not going to stop there. There is a great deal of scope, not only for further widening of share ownership but also for existing shareholders to add to their portfolios. Our measures to promote employee share schemes and our plans for further privatisation sales will continue to play an important part in this.

104. The Personal Equity Plan Scheme announced last year is a major new stimulus to the spread of share ownership. Already over [ ] have applied to become plan managers, including banks, stockbrokers, unit trusts, building societies and investment advisers. And there are [ ] PEP holders, including [ ] people who previously had not owned shares directly.

105. PEPs are now successfully launched, and going well. In time they, with the other measures we will have taken, will alter the landscape of attitudes to saving, investment and share-ownership in Britain.

106. All the tax proposals I have just put forward are concerned in one way or another with business and enterprise. They continue the thrust of the reforms we have introduced in successive Budgets.

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Not right at all.

C. Omit.

107. The US tax reform package has been much commented upon and welcomed, for closing tax loopholes and removing distortions. Yet on the structure of business taxation the US is essentially following the approach we adopted here in 1984. Otherwise, the US reform is substantially concerned with removing shelters which do not exist in the UK. One exception to this is the double deductibility of interest by dual resident companies, which as I have already said, we like the US are now acting to remedy. With this measure are linked the other measures I have just announced to produce a fairer and more effective tax system. They are part and parcel of the continuing programme of tax reform which we are pursuing.

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108. The size of any reform is related to the size of the problems it tackles. There is no need whatever for us to be defensive about the UK record on tax reform. Besides reforming the business tax structure in 1984 and this year we have abolished four unnecessary taxes and cut the rates of most of the remaining direct taxes.

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Savings and investment

WSO measures first.

109. In my last Budget, I promised to bring forward proposals for the tax treatment of the new personal pensions which will be introduced from 1 January 1988. Accordingly, we published a consultative document last November. This proposed that the tax reliefs for personal pensions should be broadly in line with the arrangements applying to retirement annuities.

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110. The consultative document also outlined other important reforms in the pensions field. Employers will be able to set up simplified occupational schemes with minimum red tape. There will be much greater transferability between different types of pension scheme.

B.I.O.

111. These proposals have been welcomed, and I now propose to put them into effect.

112. These important and innovative reforms will widen the pensions choice for millions of working people. They will be of particular benefit to the 10 million employees in this country who do not belong to occupational pension schemes.

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113. I have decided, however, to go beyond the proposals in the consultative document in a further, important, way. I propose to allow members of occupational schemes to top up their pension through additional voluntary contributions to a separate plan of their own choice. They will be able to top up their pension in this way right up to the present tax approval limits.

114. This proposal, together with those in the consultative document, will make it easier for people to take their pensions with them when they change jobs. This will be good for labour mobility and for independence. In future people will have more control over their provision in old age.

115. But these improvements can be justified only if they are properly used. Some new safeguards are necessary to discourage exploitation, particularly by certain very highly paid employees. My proposals to deal with abuses of this kind - some of which are to come into effect immediately - are described in a further consultative document published today.

ACSA/C: Must be more specific.

116. On inheritance tax I propose a substantial increase in the threshold from £71,000 to £90,000 and a significant simplification of the structure by reducing the number of rates of tax from seven to four. The

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effect will be to reduce the number of estates liable to IHT by about a third, and to give worthwhile reductions in tax at all levels, particularly on smaller estates.

117. Last year by abolishing the iniquitous Capital Transfer Tax lifetime charge I exempted outright lifetime gifts made more than seven years before the donor's death - to encourage lifetime giving. This year, as a further encouragement to lifetime giving, I am extending the exemption to lifetime gifts made for a limited period of time. I am also increasing the rate of IHT business relief for substantial holdings in unquoted companies, while in future minority holdings in USM companies will be treated in the same way as those in companies with a full listing. This will concentrate business relief where it is most needed: to avoid loss of family control and forced sales to raise cash to pay the tax.

118. I propose to increase the annual exempt amount of capital gains from £6,300 to £6,600. I am also increasing the amount of capital gains relieved from tax on retirement from £100,000 to £125,000.

119. In my 1984 Budget I reformed the limits that apply to tax exempt life assurance issued by friendly societies. I did so because certain societies had widely abused the privileges traditionally enjoyed by the

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friendly society movement. These societies were set up purely for commercial reasons, far removed from the mutual self-help role which the movement has sponsored for decades.

120. I now propose a further change. Societies will in future be able to offer tax-exempt policies based on annual premiums of up to £100. Again, this is intended to improve the position of the older, long-established societies, who will be able to operate economically, without effectively changing the position of commercial societies.

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Taxes on spending

121. [Introduction setting scene - depends on decision on excise duties.]

122. [Excise duties - passage in light of decisions.]

Later.

123. In last year's Budget I announced that I had decided to introduce a duty differential in favour of unleaded petrol, to offset its higher production costs. I can now announce that the differential will be 5 pence. This means that unleaded petrol should be cheaper at the pump than 4 star leaded petrol, encouraging the switch to less polluting fuel. The measure will take effect from 6 o'clock this evening.

SECRET

ACSA: →
"Sorry that my choice of Budget Day I disappointed some HMs who would ~~have~~ otherwise have been at Cheltenham for the Champion Hurdle. But..."

124. Following changes to the regulations for betting shops, whose effect has been to tilt the balance of advantage towards off-course betting compared with on-course betting, and in the light of concern about declining attendances at race courses, I have decided to abolish from today the duty on on-course betting. At the same time I propose to increase the duty on gaming machine licences.

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To avoidance section.

125. There will be no changes in the rate or coverage of Value Added Tax. But I have one change here to announce - a change which has already been the subject of extensive consultation.

126. Where businesses are carrying out activities some of which are liable to VAT and some of which are not, the present rules are over-generous on the amount of input tax which can be deducted. We have already announced that the rules on VAT input tax deductions are to be revised so as to curb tax avoidance and prevent distortion of competition. The proposals could have had an unintended impact on certain sectors and, following exchanges with those concerned, I now propose arrangements which will be reasonable in their impact on all sectors while safeguarding the position of the Exchequer.

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127. Last year I introduced a very significant package of new tax reliefs to encourage charitable giving. These included the new payroll giving scheme which starts next month. As I announced before Christmas, I propose to increase the limit on donations under the scheme to £120 a year.

128. We now have a very generous tax regime for charitable giving, and I know charities will not expect any further major reliefs on this front this year. But

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Bit grudging!

following representations from the Charities VAT and Tax Reform Group, I am prepared to agree to certain additions to the VAT concessions which were introduced last year.

129. I propose to extend VAT relief to welfare vehicles used by hospices to transport the terminally ill; to specialised equipment used by mountain rescue and first aid services; to the donation of goods for export to a charity; to installing or adapting lavatory or bathroom facilities in charity residential homes for the disabled; [and to drugs and chemicals supplied to charities and directly used in medical research].

130. [I also propose relief from car tax on vehicles supplied to Motability for leasing]

SECRET

B.L.O.

Income tax

131. Finally I turn to income tax.

132. Lower rates of tax are good for incentives and a stimulus to enterprise. The best chance of increased prosperity for all will come when the UK is placed firmly in the league of countries with low taxation and high growth. Our [tax reform] strategy has been to move as quickly as is prudently possible in this direction.

ACSA: Aren't we there?

I know what's meant, but it sounds contradictory.

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133. We have already made a very substantial reduction in the top rate of income tax, reducing it from the penal level of 83 per cent under the previous Government to 60 per cent. Since we took office in 1979 we have abolished the investment income surcharge and brought down the basic rate of tax by 4 percentage points. During the same period we have increased the basic tax thresholds by 22 per cent in real terms taking 1.4 million people who would otherwise be liable out of income tax altogether. The married man's allowance now stands at its highest level in real terms since the war.

134. Despite these tax reductions top rate taxpayers are now paying a larger proportion of the total than before. In 1978-79 the top 5 per cent of taxpayers were contributing 24 per cent of the total yield of income tax, but in the current year that figure has risen to 27 per cent.

135. Meanwhile I propose for 1986-87 to raise the main personal allowances in line with the statutory indexation provisions.

136. The single person's allowance will therefore rise by £90 to £2,425 and the married man's allowance by £140 to £3,795.

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137. Similarly the single age allowance will rise by £110 to £2,960 and the married age allowance by £170 to £4,675.

Over 80s.

138. The age allowance income limit becomes £9,800.

139. The blind allowance was last raised in 1981 when it was increased by £180 to its present level of £360. For 1986-87 I am proposing a further £180 increase in the allowance taking it to £540. ~~I am very pleased to announce this extra measure of help for a deserving group.~~

140. Turning to the rates of income tax, I believe that all the income tax rates need to come down if we are to remain competitive with those countries which are now making substantial reductions, particularly in their top rates. But this year I intend to give priority to a further reduction in the basic rate since it is the marginal rate for 95 per cent of the taxpaying population.

141. In my ~~last~~ Budget speech last year I said that I shared the aim of my predecessor to reduce the basic rate of income tax to no more than 25 per cent. That remains my objective.

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C.
"Clearly can't do that this yr But... 2p.

142. But reductions in the basic rate are expensive. It would be wrong to move to our goal of a 25 per cent basic rate more quickly than is prudent.

Need to see number to see if this approach will work.

143. The revenue cost of all the tax measures I have so far announced will be [£ million] in 1987-88. I have already announced that I am providing a borrowing requirement of [£4 billion] for 1987-88. Taking account of all of this, and on a cautious view of forecast revenues and expenditure in 1987-88, I am glad to say that I have room for a total tax reduction of some [£2 billion next year]. I am therefore taking 2p off the basic rate in 1987-88.

ACSA : repetitions

144. This reduction, to a basic rate of 27 pence in the pound, brings down marginal rates for the overwhelming majority of ordinary taxpayers. The cut in the rate will be worth over £3 per week to a married man on average earnings.

C.
To thresholds section

145. The threshold for the 40 per cent rate will be raised in line with statutory indexation to £17,900 and the threshold for the 45 per cent rate will go up by £200 [to £20,400]. The thresholds for the 50 per cent, 55 per cent and 60 per cent rates will remain at their 1986-87 levels.

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146. The income tax changes I have announced today will take effect under PAYE on the first pay day after 17 May.

147. The reduction in the basic rate to 27 per cent will, of course, mean a similar reduction in Advance Corporation Tax.

148. I also propose to reduce the small companies' rate of corporation tax to 27 per cent in line with the new basic rate. This change, together with the reduction in income tax, will mean that small companies and the unincorporated sector will see a significant fall in their tax burden. This Budget, therefore, gives the best possible help to small businesses, which are so crucial for future growth and employment.

Peroration

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~~But~~
Build up a bit.

N.B. C at meeting pointed out that AC7 is automatic, small cogs is discretionary.

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Peroration

The Government has/is now realised/realising the dream of Governments for over twenty years: vigorous but steady and balanced growth, low inflation, increases in public expenditure in priority areas, a change in the unemployment trend and lower tax rates. To those who espouse alternative economic policies I would make the comment: if it isn't broken, don't fix it. The onus of proof of the economic policies which are on offer has shifted more firmly still onto those who want change. In my view it is no coincidence that, by concentrating on control of expenditure and lower tax rates, this Government has set free the latent spirit of enterprise and we are reaping that harvest in higher revenues and a buoyant economy. Any return to higher spending and higher taxes would risk the vicious circle of lower revenues forcing lower public spending and we would all suffer, the poor perhaps the most.

ACSA: Add declining share of GDP.

Then international flavour.

Others have espoused our policies.

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Hy 2. PWP.

COPY NO 1 OF 9

FROM: M C SCHOLAR
DATE: 25 February 1987

MR A P HUDSON Mr Scholar

As before.

AHH 26.2.

cc Mr Cassell
Miss Sinclair
Mr Haigh
Mr Cropper
Mr Ross Goobey

Mr Johns - IR

BUDGET STATEMENT: REDRAFT

My minute of earlier today.

2. I attach the rest of the section allotted to me. I would be grateful for comments as soon as possible tomorrow.

MCS

M C SCHOLAR

I wouldn't include this. Is it such a hill point?

13. I need to set the 1988-89 car and car fuel benefit scales for those with company cars. I propose a 10 per cent increase in the car benefit scale charges. I propose no change to the car fuel benefit scales [which are now also used for VAT purposes.] nor to equivalent scales used for VAT.

- the ~~8th~~ 8th successive year that these have gone up ahead of inflation.
OR - the 6th successive year that these have gone up by 10 per cent.

14. [The Government has done much in past years to promote training as a means of encouraging flexibility and enterprise throughout the economy.] It is particularly important that there should be no disincentive for people who are likely to be changing jobs, ~~which might hold them back from acquiring~~ to acquire new [work] skills. ~~I propose therefore a change in the law so that training of this kind will not be treated as a taxable benefit which the employee has received.~~

Training and retraining are vital to a dynamic, flexible economy. This is all the more true as technology changes the skills required of the workforce.

At present, training of this kind provided by an ~~the~~ employer is treated as a taxable benefit. I propose to take it out of tax.

15. I turn now to profit-related pay.

16. I suggested last year the possibility of introducing changes to the tax system which would run with the grain of, and reinforce, efforts to break up the rigidity of the pay system in this country.

Revenue before the profit year begins. But I have been anxious to keep the administration simple as possible.

I received a number of representations about the level of tax relief.

This seems a bit flat to me.

21. ~~Perhaps the key issue in response to the Green Paper -and no doubt to some of those considering whether to introduce schemes - is the level of tax relief.~~ The Green Paper suggested that one quarter of ~~PRP payments~~ a person's profit-related pay might get tax relief. I have now decided to double this to a half. ~~This will mean that~~ for someone on average earnings, receiving 5 per cent of their pay as PRP, the tax relief will therefore be equivalent to ~~1p~~ a penny off the basic rate of income tax. That underlines the importance the Government attaches to this major new initiative. ~~It will take time to build up~~ Depending on take-up but the full year cost ~~to the Exchequer~~ could well ~~exceed~~ build up to over £100 million by the end of the decade.

22. Profit related pay is not a panacea. But ~~I believe~~ it will be of practical help ~~tackle some~~ in tackling one of the deep seated problems of the UK economy by promoting greater flexibility in pay [and enterprise], and so help further to strengthen the prospects for employment. I hope that ~~both sides of industry~~ employees and management alike will now respond enthusiastically to this opportunity as we look forward to the 1990s.

[Does the effect really go much beyond pay rigidity? Do we admit to the other "deep seated problems"?]

Savings and Investment

23. I now turn to savings and investment

24. First, share ownership. This Government has given a major boost to wider share ownership through action on three fronts: employee share schemes, privatisation, and the introduction of Personal Equity Plans.

25. The growth in [approved] employee share schemes since 1979 has been remarkable. We started with about 30 schemes. Now there are over 1,200 open to all employees, ~~which cover more than~~ covering some 1½ million workers in over 10,000 companies.

[Figure confirmed by IR for Orals today.]

26. I took steps last autumn to amend the "material interest" test for employees and directors in close companies, to [facilitate the adoption of] [make it easier for such companies to introduce] employee share schemes [in such companies].

27. I now propose a further measure to assist these schemes. In future, employees in a company which is taken over will be able to exchange their existing share options under an approved scheme for options over shares in the acquiring company.

28. I am, also instituting further, arranging for a review, with the help of outside experts, tax practitioners (?) of the effect of Section 79 of the 1972 Finance Act, which deals with the tax treatment of employee-acquired shares outside approved schemes. The aim of the review will be to improve and simplify the rules, consistent with the underlying purpose of countering tax avoidance, so as to allow greater flexibility and encouragement to enterprise.

29. Privatisation brings a wide range of benefits for the economy at large, as well as for the industries privatised and their consumers. Not the least of these benefits is the breakthrough we have been able to make in wider share ownership.

30. As the House knows, the British Telecom sale in 1984 brought a step-change in the number of share-owners. Over 2 million people applied, and around half of them had never owned shares before. Subsequent sales consolidated this success, and Last year's sale of British Gas proved another landmark for wider share ownership. 4½ million applications were received on behalf of 5 million people, the largest number of applications ever received in a flotation anywhere in the world.

31. I am particularly glad that employees have seized the chance to become shareholders - sometimes, it must be said, against the advice of their trades unions. ~~About~~ No fewer than 90 per cent of the employees in the privatised companies floated on the stock market have become shareholders.

32. The success of these policies has been clear for some time, but estimates of ~~current~~ the number of shareholders ~~numbers~~ have varied ~~differed~~. I therefore commissioned, in conjunction with the Stock Exchange, a major survey of individual shareholders, ~~This indicates that~~ and have recently received the results. The survey shows that there are now [ ] million individual shareholders in the UK, ~~[and confirms that shareholder numbers have trebled since 1979]~~. [This is fully three times the number in 1979.]

33. But we are not going to stop there. There is a great deal of scope, not only for further ~~widening of share ownership~~ increasing still the number of people owning shares, but also for existing shareholders to add to their portfolios. Our measures to promote employee share schemes and our plans for further privatisation sales will continue to play an important part ~~in this~~.

34. The Personal Equity Scheme is already beginning to show impressive results. Already over [ ] have applied to become plan managers, including banks,

stockbrokers, unit trusts, building societies and investment advisers. And there are [ ] PEP holders, including [ ] people who previously had not owned shares directly.

35. PEPs are now successfully launched, and going well. In time they, with the other measures we ~~will~~ have taken, will alter the landscape of attitudes towards saving, investment and share-ownership in ~~Britain.~~ this country.

Pensions

37. I turn now to pensions.

37. In my last Budget, I promised to bring forward proposals for the tax treatment of the new personal pensions which are to be introduced from 1 January 1988, and ~~Accordingly, we published~~ a consultative document was published last November.

38. Personal pensions are [an] important [development] in three ways. First, they will enable employees - if they so wish - to opt out of their employers' schemes and instead make their own arrangements. Second, they will be a new opportunity to the millions of employees who at present do not belong to an occupational scheme. And Third, people may, again if they so wish, use them to contract out of SERPS.

39. As foreshadowed in last year's Budget ~~last year~~, and in the consultative document ~~we published some four months ago,~~ I now propose to extend to these new personal pensions the same favourable tax treatment that ~~has been enjoyed by~~ applies to retirement annuities.

40. I also propose to implement other important and innovative reforms contained in the consultative document, which have been widely welcomed.

41. Employers will be able to set up simplified occupational schemes with the minimum of red tape. This will be particularly good news for many small employers who have been discouraged by the complexity and open-ended commitment of a full-blown final salary scheme. And there will be much greater scope for transferring between different types of pension scheme.

42. I intend to go beyond my original proposals in one further, important way. I propose new arrangements which will allow members of occupational schemes to make additional voluntary contributions with full tax relief to a separate plan of their own choice instead of, as now, being restricted to plans within their employer's schemes. They will be able to top their pensions right up to the present tax approval limits.

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COPY NO 8 OF 9

FROM: M C SCHOLAR
DATE: 25 February 1987

MR A P HUDSON

cc Mr Cassell
Miss Sinclair
Mr Haigh
Mr Cropper
Mr Ross Goobey

Mr Johns - IR

BUDGET STATEMENT: REDRAFT

My minute of earlier today.

2. I attach the rest of the section allotted to me. I would be grateful for comments as soon as possible tomorrow.

MCS

M C SCHOLAR

26/COM/

the donor's death. This year I can go further. I propose to extend the exemption on similar terms to gifts involving settled property in which there is an interest in possession, though this will not apply ~~but not~~ to discretionary trusts.

51. The proposed changes in rates and bands will help businesses. But I propose to go further by increasing business relief for shares in unquoted companies. The rate of relief for substantial minority holdings in such companies will be increased from 30 per cent to 50 per cent. To reflect the progress of the unlisted securities market, in future all holdings in USM companies will be treated like those with a full listing. These changes will concentrate relief on assets which do not readily provide funds to pay the tax or which could only do so at the risk of damaging the business.

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COPY NO 4 OF 11 COPIES
REF NO:- F 87 14

FROM: A P HUDSON
DATE: 25 February 1987

MR SCHOLAR

cc Mr Cassell
Mr Allan
Mr Cropper
Mr Ross Goobey
Miss Sinclair
Mr Johns IR
Mr Wilmott C&E

BUDGET STATEMENT: REVISED DRAFT

1. Following the Chancellor's meeting on Monday (23 February), we agreed to split the editing of the speech as follows, using the Chancellor's revised order:-

(1) **Business and Enterprise**

(a) Corporation Tax
- main rate (paras 54-56);
- capital gains (63-66);
- Pay and File (60-62).

APH (b) Oil (68-72)

(c) Small businesses (45-53)

(d) Anti-avoidance
- homily (81)
- VAT partial exemption (125-6);
- Dual-resident companies (83);

MCS
- CT payment dates (58-59);
- banks (32);
- Lloyds (84).

(e) Miscellaneous
- BES (90-93);
- company cars (88);

MCS
- training (89);
- PRP (73-80).

(2) **Savings and Investment**

(a) Wider Share Ownership (94-106);

MCS (b) Pensions (109-115);

(c) CGT and friendly societies (118-120);

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(d) Inheritance Tax (116-117).

(3) **Taxes on Spending**

(a) Specific duties (121-124);

APH (b) VAT (127-130).

(4) **Income Tax**

APH Reordered as follows: 131-133, 135-137, 138, 145, 139, 141, 142, 147, 148, 144, 146.

2. This covers the great majority of paragraphs. Of the rest:

- 44, 57 and 87, are linking passages which may be used or redrafted as appropriate;
- 67 will need to be fitted in somewhere, perhaps at the end of the anti-avoidance section;
- 85-86, 107-108, and 134 have been dropped;
- and 140 will have to be redrafted within the income tax section.

3. I attach the sections which fell to me. As far as possible, I have made manuscript amendments to the original draft, hence the amount of manuscript.

4. The income tax section, in particular, is far from right. I have followed the Chancellor's order, but am not sure it comes over well.

A P HUDSON

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C7 RATE

I turn now to my proposals for changes in taxation.

Business and Enterprise

Corporation Tax

we don't want to tax enterprise!

A1. First, the taxation of business and enterprise.

A2. The central objective of my business tax reforms, has been to remove or reduce obstacles to business success. The national insurance surcharge and the development land tax have gone altogether. The reformed system of corporation tax came fully into effect last April, and for the past year, the rate of tax on company profits has been lower here than in any major industrial nation, though the Americans are now set to emulate us. This has sharpened the incentive for companies to improve their performance and profitability, to the benefit of employees, customers, shareholders, and the nation as a whole.

A3. During the transition to the new system, companies had advance notice of the main rate of Corporation Tax for the year ahead. This helped companies them considerably in their forward planning, and I intend, as far as possible, to continue the practice of fixing the rate in advance.

(Old 56) A4. Accordingly, I can announce now that the main rate of Corporation Tax in 1987-88 will be unchanged at 35 per cent.

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COMPANY CAPITAL GAINS

(Old 63) A5. I also have a further measure of streamlining to propose. The present system of taxing companies' capital gains is unduly complicated: gains are charged to corporation tax, but the amount of the gain is first adjusted by a certain fraction so that the effective tax rate is the same as on individuals' capital gains. But I see much force in the ~~argument~~ view that there is ~~little~~ less real difference between companies' capital gains and their income from other sources.

(Old 66) A6. I therefore propose to rationalise and simplify this part of the Corporation Tax system. With effect from [today], the capital gains of large and small companies will be charged without adjustment at the appropriate Corporation Tax rate.

(Old 66,64) A7. At the same time, I am proposing to enable companies to set payments of Advance Corporation Tax against their tax liability on capital gains. This remedies a longstanding grievance which has been the subject of numerous representations, and will be of particular help to ... [IR to provide...]

(Old 67) A8. Together, these measures are expected to yield about £50m in 1988-89, and £90m in a full year.

~~Then Pay and File, old 60-62 as amended.~~

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PAY AND FILE

(Old 60) 60. I also propose to legislate now to pave the way for a new method of collecting Corporation Tax, to be known as Pay and File. At present, many company accounts are not received in time to agree the tax liability before payment is due. So there is a laborious process of an estimated assessment from the Inland Revenue and an appeal from the company. Under Pay and File companies will estimate their tax liabilities themselves, and pay on the normal due date, without the trigger of an estimated assessment. Tax liabilities will be finally settled once companies submit their returns and accounts. Where it turns out that the company's initial payment was too high, the Revenue will pay interest on the excess; where the initial payment was too low the company will pay interest.

(Old 61) 61. This new approach was set out in a consultative document on the recommendations in the Keith Committee Report issued in December. It was generally welcomed both by business and by tax specialists.

(Old 62) 62. The introduction of Pay and File is part of a wider programme of streamlining tax collection, including major developments in the Inland Revenue's computer systems, so Pay and File will not come into force until the early 1990s. But by legislating now we are giving taxpayers and their advisers a firm basis on which to plan, and a lengthy period to prepare for the implementation of the new scheme.

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OIL

Within the company sector, the oil industry has faced a year of adjustment, a difficult year.

68. ~~I turn now to the oil industry~~. My Rt Hon Friend the Secretary of State for Energy and I have followed closely the effect on the industry of ~~last year's sharp~~ the sharp fall in oil price in late 1985 and early 1986 and subsequent developments. ~~While~~ the industry itself is generally confident about its longer term prospects, but companies have ~~it has~~ suggested that in the short-term the trough in activity could mean the loss of ~~lose it~~ some of the capacity in our offshore industry, in Scotland and elsewhere, which will certainly be required in the longer ~~term~~ run.

69. Last autumn, I introduced legislation to bring forward the repayment of over £300 million of Advance Petroleum Revenue Tax. That has already helped companies with cash flow difficulties. I also announced, last November, proposals, on pricing and valuation for PRT purposes, to protect the revenue flow under the existing system.

Omit?

MAJ 25.2.

70. I now propose two new Petroleum Revenue Tax reliefs. First, with effect from today, participators in oil fields may elect to have up to 10 per cent of the costs of developing new oil fields, until payback, set against their Petroleum Revenue Tax liabilities in other fields. Second, I am ~~also~~ proposing a new relief for certain research expenditure on oil extraction. This is research which is not related to a particular field, and so is not at present allowed for Petroleum Revenue Tax.

I am worried about the section (but don't quite know what I suggest).

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71. [Reference to ring-fence ACT?]

[Any progress? ~~AHH~~]

72. ~~T~~these measures ~~should~~ will give a measure of help, over the next two years or so, ~~help~~ both to the oil companies themselves and to those in Scotland and elsewhere for whom they generate work.

Together,

N.B. Mr Alban ~~was also~~ thought we needed to be careful not to overplay the changes. I think this is OK.

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BUDGET SPEECH

Small Businesses

The growth of the small business sector has been one of the most encouraging developments of the 1980s. Between 1983 and 1985, 550 new businesses, on average, were created each week. Small businesses have a vital role to play in the economy, not least in job creation. The Government has introduced a wide range of measures to help this sector, and, through the deregulation exercise, to make it easier for small businesses to get on with the job of making profits.

Representative bodies have often drawn attention to the difficulties some small businesses experience with VAT, both with its impact on their cashflow and with the record-keeping required. I therefore authorised Customs & Excise to issue a consultative document last autumn proposing certain changes, which have been broadly welcomed by representative bodies and individual businessmen alike.

One of the proposals that received the widest welcome was that for an optional system of cash accounts for businesses with a turnover of up to £100,000. Indeed, there were many requests for this option to be available more widely.

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~~45. The Government last autumn made a series of proposals on accounting and record-keeping for VAT which will have an important impact on a crucial sector of the economy - small businesses. These measures have been welcomed by representative bodies and individual businessmen alike.~~

46. I therefore propose that with effect from 1 October 1987, [there should be an optional] system [of cash accounting for VAT], for companies with an annual turnover ~~below~~ up to £250,000. Companies will account for VAT on the basis of cash paid and received. ~~Because~~ [they will not ~~be liable~~ have to pay VAT until they have been paid by their customers, ~~this~~ which will ease their cash-flow problems, as well as giving them automatic ~~bad debt~~ relief for bad debts. ~~relief for which they have long argued.~~]

47. The proposal is subject to our obtaining the necessary derogation from the EC Sixth Directive on VAT; ~~[I am applying for this today.]~~ I am applying for this today.

48. ~~In addition~~, I propose an optional system of annual accounting, ~~for VAT~~ which will mean that businesses with an annual turnover below £250,000 will be able to make payments on account and send only one return a year to Customs. This change will come into effect in the second half of 1988.

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I have two further changes to propose here. First,

49. ~~In future~~, in the period within which businesses must ~~notify and~~ apply to be registered for VAT will be extended from ten days to ~~one month~~. thirty days.

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50. ~~I also propose that~~ the special VAT ~~simpler~~ schemes for retailers ~~should~~ will be changed ~~in a number of ways in order to make simpler schemes available to~~ so that more small and medium-sized businesses ~~can take advantage of the simpler schemes~~ are able to benefit.

are these part of the consultation or new proposal?

51. But there are two matters on which the representations I have received have persuaded me it would not be right to proceed as suggested in our autumn consultative document. I shall therefore not be going ahead with the proposal for compulsory deregistration of traders below the VAT threshold; nor with the ~~proposal to withdraw~~ withdrawal of the standard method of accounting for VAT used by retailers.

For the coming year,

52. I propose to increase the VAT registration threshold itself to £21,300, ~~in line with~~ the maximum permitted under existing European Community law. ~~arguing~~ I shall continue to argue vigorously in Brussels for flexibility to set a higher limit.

53. ~~Overall~~, The proposals which I have just outlined will help ease the burden of VAT on smaller firms whose management energies should be concentrated on generating profits. [The thicket of controls, regulations and form filling will be made more penetrable.]

go further, in some respects, than those published in the autumn. They

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Taxes on Spending

121. [Introduction setting scene - depends on decision on excise duties.]

122. [Excise duties - passage in light of decisions.]

123. In last year's Budget I announced that I had decided to introduce a duty differential in favour of unleaded petrol, to offset its higher production costs. I can now announce that the differential will be 5 pence. This means that unleaded petrol should be cheaper at the pump than 4 star leaded petrol, encouraging the switch to less polluting fuel. The measure will take effect from 6 o'clock this evening.

124. ~~Following~~ Recent changes to the regulations for betting shops, ~~whose effect has been to tilt~~ have tilted the balance of advantage towards off-course betting compared with on-course betting, ~~and in the light of~~ which has contributed to concern about declining attendances at race courses, I have therefore decided to abolish from ~~today~~ 29 March the duty on on-course betting. ~~At the same time~~ In addition, I propose to increase the duty on gaming machine licences, which has remained unchanged since 1982. Taken together, these measures are broadly revenue-neutral

~~Today~~ I hope this will help to console those Hon Members who, but for my choice of Budget Day, would have spent today at Cheltenham watching the Champion Hurdle.

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128. We now have a very generous tax regime for charitable giving, and I know charities will not expect any further major reliefs ~~on this front~~ this year. But following representations from the Charities VAT and Tax Reform Group, I have decided to make ~~am prepared to agree to~~ certain additions to the VAT concessions which were introduced last year.

129. I propose to extend VAT relief to (2) certain welfare vehicles used by hospices to transport the terminally ill; to (5) specialised location & identification equipment used by mountain rescue and first aid services; ~~to the donation of goods for export to a charity;~~ (1) to installing or adapting lavatory or bathroom facilities in charity residential homes for the disabled; [~~and~~ (3) to drugs and chemicals supplied to charities and directly used in medical research]; (4) goods donated for export by a charity for relief of distress or animal welfare; and.

~~130. [I also propose relief from car tax on vehicles supplied to Motability for leasing]~~

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Income Tax

131. Finally I turn to income tax.

132. Lower rates of tax are good for incentives and a stimulus to enterprise. The best chance of increased prosperity for all will come when the UK is placed firmly in the league of countries with low taxation and high growth. [Our tax reform strategy has been to move as quickly as is prudently possible in this direction.]

133. We have already made a very substantial reduction in the top rate of income tax, reducing it from the penal level of 83 per cent under the previous Government to 60 per cent. ~~Since we took office in 1979~~ We have abolished the investment income surcharge and brought ~~down~~ the basic rate of tax down from 33 per cent to 29 per cent. ~~by 4 percentage points. During the same period we have increased~~ The ~~basic~~ main tax thresholds ~~by~~ are now 22 per cent higher in real terms than in 1979, taking 1.4 million people ~~who would otherwise be liable~~ out of income tax altogether. The married man's allowance ~~now~~ stands at its highest level in real terms since the war.

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135. ~~Meanwhile~~ I propose for 198~~6~~7-8~~7~~8 to raise the main personal allowances in line with the statutory indexation provisions.

136. The single person's allowance will therefore rise by £90 to £2,425 and the married man's allowance by £140 to £3,795.

137. Similarly, the single age allowance will rise by £110 to £2,960 and the married age allowance by £170 to £4,675.

138. The age allowance income limit will ~~becomes~~ £9,800.

138A. I propose, however, to give an extra increase in the age allowance to people aged 80 and over. For them, the age allowance will be raised by twice the amount of the increase due under indexation so that, for the very elderly, the single age allowance will be £3,070 and the married age allowance, £4,845. Up to ½ million very elderly single people and married couples will benefit from this new provision and the extra increase in the allowance will take some [25,000] of them out of income tax altogether.

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FOR
As to the higher rates,

145. The threshold for the 40 per cent rate will be raised in line with statutory indexation to £17,900 and the threshold for the 45 per cent rate will go up by £200 [to £20,400]. The thresholds for the 50 per cent, 55 per cent and 60 per cent rates will remain at their 1986-87 levels.

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person's

139. The blind allowance was last raised in 1981 when it was increased by £180 to its present level of £360. For 1987-88, I am proposing a further £180 increase ~~in the allowance taking it~~ to £540. ~~I am very pleased to announce this extra measure of help for a deserving group.~~

B.L.O.

last year, I reaffirmed

141. In my ~~last~~ Budget speech ~~I said that I shared~~ the aim ~~of~~ set out by my predecessor in 1979, to reduce the basic rate of income tax to no more than 25 per cent. That remains my objective.

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142. But reductions in the basic rate are expensive. It costs well over £1 billion to reduce the rate by one percentage point. There is clearly no possibility of achieving the goal of a 25 per cent basic rate this year. But I can take a further useful step towards that. I am therefore taking 2 pence off the basic rate for 1987-88.

147. The reduction in the basic rate to 27 per cent will, of course, mean a similar reduction in Advance Corporation Tax.

148. As a further measure to help small businesses, I have decided also to reduce the small companies' rate of corporation tax to 27 per cent. Following the proposals I announced earlier, this rate will also apply to small companies' capital gains, which are currently taxed at 30 per cent. The changes to income tax and corporation tax will mean a significant fall in the tax burden on small companies and the unincorporated sector. This gives the best possible incentive to small businesses, which are so crucial for future growth and employment.

144. [This reduction, to a basic rate of 27 pence in the pound, brings down marginal rates for the overwhelming majority of ordinary taxpayers.] The cut in the rate will be worth over £3 per week to a married man on average earnings.

146. The income tax changes I have announced today will take effect under PAYE on the first pay day after 17 May.

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[New paragraph] The total cost of the income tax changes will be some [£2 billion] in 1987-88, and the overall cost of the measures I have announced today will be £x billion. The PSBR for 1987-88 will therefore be [£4 billion].

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COPY NO 1 OF 11 COPIES

REF NO:- F 87/4

FROM: A P HUDSON

DATE: 25 February 1987

MR SCHOLAR

cc Mr Cassell
Mr Allan
Mr Cropper
Mr Ross Goobey
Miss Sinclair
Mr Johns IR
Mr Wilmott C&E

BUDGET STATEMENT: REVISED DRAFT

1. Following the Chancellor's meeting on Monday (23 February), we agreed to split the editing of the speech as follows, using the Chancellor's revised order:-

(1) **Business and Enterprise**

(a) Corporation Tax
- main rate (paras 54-56);
- capital gains (63-66);
- Pay and File (60-62).

APH (b) Oil (68-72)

(c) Small businesses (45-53)

(d) Anti-avoidance
- homily (81)
- VAT partial exemption (125-6);
- Dual-resident companies (83);

MCS
- CT payment dates (58-59);
- banks (32);
- Lloyds (84).

(e) Miscellaneous
- BES (90-93);
- company cars (88);

MCS
- training (89);
- PRP (73-80).

(2) **Savings and Investment**

(a) Wider Share Ownership (94-106);

MCS (b) Pensions (109-115);

(c) CGT and friendly societies (118-120);

(d) Inheritance Tax (116-117).

(3) **Taxes on Spending**

(a) Specific duties (121-124);

APH (b) VAT (127-130).

(4) **Income Tax**

APH Reordered as follows: 131-133, 135-137, 138, 145, 139, 141, 142, 147, 148, 144, 146.

2. This covers the great majority of paragraphs. Of the rest:

- 44, 57 and 87, are linking passages which may be used or redrafted as appropriate;
- 67 will need to be fitted in somewhere, perhaps at the end of the anti-avoidance section;
- 85-86, 107-108, and 134 have been dropped;
- and 140 will have to be redrafted within the income tax section.

3. I attach the sections which fell to me. As far as possible, I have made manuscript amendments to the original draft, hence the amount of manuscript.

4. The income tax section, in particular, is far from right. I have followed the Chancellor's order, but am not sure it comes over well.

A P HUDSON

CT RATE

I turn now to my proposals for changes in taxation.

Business and Enterprise

Corporation Tax

A1. First, the taxation of business and enterprise.

A2. The central objective of my business tax reforms has been to remove or reduce obstacles to business success. The national insurance surcharge and the development land tax have gone altogether. The reformed system of corporation tax came fully into effect last April, and for the past year, the rate of tax on company profits has been lower here than in any major industrial nation, though the Americans are now set to emulate us. This sharpens the incentive for companies to improve their performance and profitability, to the benefit of employees, customers, shareholders, and the nation as a whole.

A3. One consequence of the phasing-in of the new system was that companies had advance notice of the main rate of Corporation Tax for the year ahead. This helped companies considerably in their forward planning, and I intend, as far as possible, to continue the practice of fixing the rate in advance.

(Old 56) A4. Accordingly, I can announce now that the main rate of Corporation Tax in 1987-88 will be unchanged at 35 per cent.

COMPANY CAPITAL GAINS

(Old 63) A5. I also have a further measure of streamlining to propose. The present system of taxing companies' capital gains is unduly complicated: gains are charged to corporation tax, but the amount of the gain is first adjusted by a certain fraction so that the effective tax rate is the same as on individuals' capital gains. But I see much force in the ~~argument~~ view that there is ~~little~~ less real difference between companies' capital gains and their income from other sources.

, with current Corporation Tax rates, x

(Old 66) A6. I therefore propose to rationalise and simplify this part of the Corporation Tax system. With effect from [today], the capital gains of large and small companies will be charged, without adjustment, at the appropriate Corporation Tax rate.

(Old 66,64) A7. At the same time, I am proposing to enable companies to set payments of Advance Corporation Tax against their tax liability on capital gains. This remedies a longstanding grievance which has been the subject of numerous representations, and will be of particular help to ... [IR to provide...]

(Old 67) A8. Together, these measures are expected to yield about £50m in 1988-89, and £90m in a full year.

~~Then Pay and File, old 60-62 as amended.~~

PAY AND FILE

(Old 60) 60. I also propose to legislate now to pave the way for a new method of collecting Corporation Tax, to be known as Pay and File. At present, many company accounts are not received in time to agree the tax liability before payment is due. So there is a laborious process of an estimated assessment from the Inland Revenue and an appeal from the company. Under Pay and File companies will estimate their tax liabilities themselves, and pay on the normal due date, without the trigger of an estimated assessment. Tax liabilities will be finally settled once companies submit their returns and accounts. Where it turns out that the company's initial payment was too high, the Revenue will pay interest on the excess; where the initial payment was too low the company will pay interest.

(Old 61) 61. This new approach was set out in a consultative document on the recommendations in the Keith Committee Report issued in December. It was generally welcomed both by business and by tax specialists.

(Old 62) 62. The introduction of Pay and File is part of a wider programme of streamlining tax collection, including major developments in the Inland Revenue's computer systems, so Pay and File will not come into force until the early 1990s. But by legislating now we are giving taxpayers and their advisers a firm basis on which to plan, and a lengthy period to prepare for the implementation of the new scheme.

OIL

Within the company sector, the oil industry has faced a year of adjustment.

68. ~~I turn now to the oil industry~~. My Rt Hon Friend the Secretary of State for Energy and I have followed closely the effect on the industry of ~~last year's sharp~~ the sharp fall in the oil price and subsequent developments. ~~While~~ the industry itself is generally confident about the longer term prospects, ~~it has~~ but companies have suggested that in the short-term the trough in activity could ~~lose it~~ mean the loss of some of the capacity in our offshore industry, in Scotland and elsewhere, which will certainly be required in the longer ~~term.~~ run.

69. Last autumn, I introduced legislation to bring forward the repayment of over £300 million of Advance Petroleum Revenue Tax. That has already helped companies with cash flow difficulties. [I also announced, last November, proposals, on pricing and valuation for PRT purposes, to protect the revenue flow under the existing system.]

Omit?

MAJ 25.2.

70. I now propose two new Petroleum Revenue Tax reliefs. First, with effect from today, participators in oil fields may elect to have up to 10 per cent of the costs of developing new oil fields, until payback, set against their Petroleum Revenue Tax liabilities in other fields. Second, I am ~~also~~ proposing a new relief for certain research expenditure on oil extraction. This is research which is not related to a particular field, and so is not at present allowed for Petroleum Revenue Tax.

71. [Reference to ring-fence ACT?]

[Any progress? ~~AHH~~]

Together,

72. ~~T~~These measures ~~should~~ will give a measure of help, over the next two years or so, ~~help~~ both to the oil companies themselves and to those in Scotland and elsewhere for whom they generate work.

N.B. Mr Allan ~~was a bit~~ thought we needed to be careful not to overplay the changes. I think this is OK.

BUDGET SPEECH

Small Businesses

The growth of the small business sector has been one of the most encouraging developments of the 1980s. Between 1983 and 1985, 550 new businesses, on average, were created each week. Small businesses have a vital role to play in the economy, not least in job creation. The Government has taken a wide range of measures to help this sector, and, through the deregulation exercise, to make it easier for small businesses to get on with the job of making profits.

Representative bodies have often drawn attention to the difficulties some small businesses experience with VAT, both with its impact on their cashflow and with the record-keeping required. I therefore authorised Customs & Excise to issue a consultative document last autumn proposing certain changes, which have been broadly welcomed by representative bodies and individual businessmen alike.

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46. I therefore propose that with effect from 1 October 1987, there should be an optional system of cash accounting for VAT for companies with an annual turnover ~~below~~ up to £250,000. These companies will be able to account for VAT on the basis of cash paid and received. ~~Because~~ they will thus not ~~be liable~~ have to pay VAT until they have been paid by their customers, ~~this~~ which will ease their cash-flow problems, as well as giving them automatic ~~bad debt~~ relief for bad debts. ~~a relief for which they have long argued.~~

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47. The proposal is subject to our obtaining the necessary derogation from the EC Sixth Directive on VAT; ~~[I am applying for this today.]~~ I am applying for this today.

48. ~~In addition,~~ To help small businesses with the handling of VAT, I propose an optional system of annual accounting, ~~for VAT~~ which will mean that businesses with an annual turnover below £250,000 will be able to make payments on account and send only one return a year to Customs. This change will come into effect in the second half of 1988.

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COPY NO 11 OF 11 COPIES

REF NO:- F 87/14

FROM: A P HUDSON

DATE: 25 February 1987

MR SCHOLAR

cc Mr Cassell
Mr Allan
Mr Cropper
Mr Ross Goobey
Miss Sinclair
Mr Johns IR
Mr Wilmott C&E

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(7 RPAT

I turn now to my proposals for changes in taxation.

Business and Enterprise

Corporation Tax

A1. First, the taxation of business and enterprise.

A2. The central objective of my business tax reforms has been to remove or reduce obstacles to business success. The national insurance surcharge and the development land tax have gone altogether. The reformed system of corporation tax came fully into effect last April, and for the past year, the rate of tax on company profits has been lower here than in any major industrial nation, though the Americans are now set to emulate us. This sharpens the incentive for companies to improve their performance and profitability, to the benefit of employees, customers, shareholders, and the nation as a whole.

A3. One consequence of the phasing-in of the new system was that companies had advance notice of the main rate of Corporation Tax for the year ahead. This helped companies considerably in their forward planning, and I intend, as far as possible, to continue the practice of fixing the rate in advance.

(Old 56) A4. Accordingly, I can announce now that the main rate of Corporation Tax in 1987-88 will be unchanged at 35 per cent.

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COMPANY CAPITAL GAINS

(Old 63) A5. I also have a further measure of streamlining to propose. The present system of taxing companies' capital gains is unduly complicated: gains are charged to corporation tax, but the amount of the gain is first adjusted by a certain fraction so that the effective tax rate is the same as on individuals' capital gains. But I see much force in the ~~argument~~ view that, with current Corporation Tax rates, there is ~~little~~ less real difference between companies' capital gains and their income from other sources.

(Old 66) A6. I therefore propose to rationalise and simplify this part of the Corporation Tax system. With effect from [today], the capital gains of large and small companies will be charged, without adjustment, at the appropriate Corporation Tax rate.

(Old 66,64) A7. At the same time, I am proposing to enable companies to set payments of Advance Corporation Tax against their tax liability on capital gains. This remedies a longstanding grievance which has been the subject of numerous representations, and will be of particular help to ... [IR to provide...]

(Old 67) A8. Together, these measures are expected to yield about £50m in 1988-89, and £90m in a full year.

~~Then Pay and File, old 60-62 as amended.~~

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PAY AND FILE

(Old 60) 60. I also propose to legislate now to pave the way for a new method of collecting Corporation Tax, to be known as Pay and File. At present, many company accounts are not received in time to agree the tax liability before payment is due. So there is a laborious process of an estimated assessment from the Inland Revenue and an appeal from the company. Under Pay and File companies will estimate their tax liabilities themselves, and pay on the normal due date, without the trigger of an estimated assessment. Tax liabilities will be finally settled once companies submit their returns and accounts. Where it turns out that the company's initial payment was too high, the Revenue will pay interest on the excess; where the initial payment was too low the company will pay interest.

(Old 61) 61. This new approach was set out in a consultative document on the recommendations in the Keith Committee Report issued in December. It was generally welcomed both by business and by tax specialists.

(Old 62) 62. The introduction of Pay and File is part of a wider programme of streamlining tax collection, including major developments in the Inland Revenue's computer systems, so Pay and File will not come into force until the early 1990s. But by legislating now we are giving taxpayers and their advisers a firm basis on which to plan, and a lengthy period to prepare for the implementation of the new scheme.

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Within the company sector, the oil industry has faced a year of adjustment.

68. ~~I turn now to the oil industry~~. My Rt Hon Friend the Secretary of State for Energy and I have followed closely the effect on the industry of ~~last year's sharp~~ the sharp fall in the oil price and subsequent developments. ~~While~~ the industry itself is generally confident about the longer term prospects, but companies have ~~it has~~ suggested that in the short-term the trough in activity could mean the loss of ~~lose it~~ some of the capacity in our offshore industry, in Scotland and elsewhere, which will certainly be required in the longer ~~term.~~ run.

69. Last autumn, I introduced legislation to bring forward the repayment of over £300 million of Advance Petroleum Revenue Tax. That has already helped companies with cash flow difficulties. [I also announced, last November, proposals, on pricing and valuation for PRT purposes, to protect the revenue flow under the existing system.]

Omit?

MAJ 25.2.

70. I now propose two new Petroleum Revenue Tax reliefs. First, with effect from today, participators in oil fields may elect to have up to 10 per cent of the costs of developing new oil fields, until payback, set against their Petroleum Revenue Tax liabilities in other fields. Second, I am ~~also~~ proposing a new relief for certain research expenditure on oil extraction. This is research which is not related to a particular field, and so is not at present allowed for Petroleum Revenue Tax.

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71. [Reference to ring-fence ACT?]

[Any progress? ~~AHH~~)

72. ~~T~~These measures ~~should~~ will give a measure of help, over the next two years or so, ~~help~~ both to the oil companies themselves and to those in Scotland and elsewhere for whom they generate work.

Together,

N.B. Mr Allan ~~was a bit~~ thought we needed to be careful not to overplay the changes. I think this is OK.

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BUDGET SPEECH

Small Businesses

The growth of the small business sector has been one of the most encouraging developments of the 1980s. Between 1983 and 1985, 550 new businesses, on average, were created each week. Small businesses have a vital role to play in the economy, not least in job creation. The Government has taken a wide range of measures to help this sector, and, through the deregulation exercise, to make it easier for small businesses to get on with the job of making profits.

Representative bodies have often drawn attention to the difficulties some small businesses experience with VAT, both with its impact on their cashflow and with the record-keeping required. I therefore authorised Customs & Excise to issue a consultative document last autumn proposing certain changes, which have been broadly welcomed by representative bodies and individual businessmen alike.

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~~45. The Government last autumn made a series of proposals on accounting and record-keeping for VAT which will have an important impact on a crucial sector of the economy - small businesses. These measures have been welcomed by representative bodies and individual businessmen alike.~~

46. I therefore propose that with effect from 1 October 1987, there should be an optional system of cash accounting for VAT for companies with an annual turnover ~~below~~ to £250,000. These companies will be able to account for VAT on the basis of cash paid and received. ~~Because~~ they will thus not ~~be liable~~ have to pay VAT until they have been paid by their customers, ~~this~~ which will ease their cash-flow problems, as well as giving them automatic ~~bad debt~~ relief for bad debts. ~~relief for which they have long argued.~~

Omit?

47. The proposal is subject to our obtaining the necessary derogation from the EC Sixth Directive on VAT; ~~[I am applying for this today.]~~ I am applying for this today.

48. To help small businesses with the handling of VAT, ~~In addition~~, I propose an optional system of annual accounting, ~~for VAT~~ which will mean that businesses with an annual turnover below £250,000 will be able to make payments on account and send only one return a year to Customs. This change will come into effect in the second half of 1988.

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I have two further changes to propose here. First,

49. In future, the period within which businesses must apply to notify and be registered for VAT will be extended from ten days to one month. thirty days.

Second, the rules for

50. I also propose that the special VAT schemes for retailers should will be changed in a number of ways in order to make simpler schemes available to so that more small and medium-sized businesses can take advantage of the simpler schemes are able to benefit.

51. But there are two matters on which the representations I have received persuaded me it would not be right to proceed as suggested in our autumn consultative document. I shall not be going ahead with the proposal for compulsory deregistration of traders below the VAT threshold; nor with the proposal to withdraw all of the standard method of accounting for VAT used by retailers.

For the coming year,

52. I propose to increase the VAT registration threshold itself to £21,300, in line with the maximum permitted under existing European Community law. arguing, vigorously in Brussels for flexibility to set a higher limit.

I shall continue to argue

53. Overall, The proposals which I have just outlined will help ease the burden of VAT on smaller firms whose management energies should be concentrated on generating profits. [The thicket of controls, regulations and form filling will be made more penetrable.]

go further, in some respects, than those published in the autumn. They

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Taxes on Spending

121. [Introduction setting scene - depends on decision on excise duties.]

122. [Excise duties - passage in light of decisions.]

123. In last year's Budget I announced that I had decided to introduce a duty differential in favour of unleaded petrol, to offset its higher production costs. I can now announce that the differential will be 5 pence. This means that unleaded petrol should be cheaper at the pump than 4 star leaded petrol, encouraging the switch to less polluting fuel. The measure will take effect from 6 o'clock this evening.

124. ~~Following~~ Recent changes to the regulations for betting shops, ~~whose effect has been to tilt~~ have tilted the balance of advantage towards off-course betting compared with on-course betting, ~~and in the light of~~ which has contributed to concern about declining attendances at race courses, I have therefore decided to abolish from ~~today~~ 29 March the duty on on-course betting. ~~At the same time~~ In addition, I propose to increase the duty on gaming machine licences, which has remained unchanged since 1982. Taken together, these measures are broadly revenue-neutral

~~Today~~ I hope this will help to console those Hon Members who, but for my choice of Budget Day, would have spent today at Cheltenham watching the Champion Hurdle.

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127. Last year I introduced a very significant package of new tax reliefs to encourage charitable giving, ~~These~~ in particular ~~included~~ the new payroll giving scheme which starts next month. As I announced before Christmas, I propose to increase the limit on donations under the scheme to £120 a year.

128. We now have a very generous tax regime for charitable giving, and I know charities will not expect any further major reliefs ~~on this front~~ this year. But following representations from the Charities VAT and Tax Reform Group, I ~~am prepared to agree to~~ have decided to make certain additions to the VAT concessions which were introduced last year.

129. I propose to extend VAT relief to (2) certain welfare vehicles used by hospices to transport the terminally ill; to (5) specialised equipment (location or identification) used by mountain rescue and first aid services; ~~to the donation of goods for export to a charity;~~ (1) to installing or adapting lavatory or bathroom facilities in charity residential homes for the disabled; [~~and~~ (3) to drugs and chemicals supplied to charities and directly used in medical research]; (4) goods donated for export by a charity for relief of distress (or animal welfare); and.

~~130. [I also propose relief from car tax on vehicles supplied to Motability for leasing]~~

I have no changes to announce in the rate or coverage of Value Added Tax, except concerning charities. //

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Income Tax

131. Finally I turn to income tax.

132. Lower rates of tax are good for incentives and a stimulus to enterprise. The best chance of increased prosperity for all will come when the UK is placed firmly in the league of countries with low taxation and high growth. [Our tax reform strategy has been to move as quickly as is prudently possible in this direction.]

133. We have already made a very substantial reduction in the top rate of income tax, reducing it from the penal level of 83 per cent under the previous Government to 60 per cent. ~~Since we took office in 1979~~ We have abolished the investment income surcharge and brought ~~down~~ the basic rate of tax down from 33 per cent to 29 per cent. ~~by 4 percentage points. During the same period we have increased~~ The ~~basic~~ main tax thresholds are now ~~by~~ 22 per cent higher in real terms than in 1979, taking 1.4 million people ~~who would otherwise be liable~~ out of income tax altogether. The married man's allowance ~~now~~ stands at its highest level in real terms since the war.

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135. ~~Meanwhile~~ I propose for 1986-87 to raise the main personal allowances in line with the statutory indexation provisions.

136. The single person's allowance will therefore rise by £90 to £2,425 and the married man's allowance by £140 to £3,795.

137. Similarly, the single age allowance will rise by £110 to £2,960 and the married age allowance by £170 to £4,675.

138. The age allowance income limit will be ~~comes~~ £9,800.

138A. I propose, however, to give an extra increase in the age allowance to people aged 80 and over. For them, the age allowance will be raised by twice the amount of the increase due under indexation so that, for the very elderly, the single age allowance will be £3,070 and the married age allowance, £4,845. Up to ½ million very elderly single people and married couples will benefit from this new provision and the extra increase in the allowance will take some [25,000] of them out of income tax altogether.

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As to the higher rates,

145. The threshold for the 40 per cent rate will be raised in line with statutory indexation to £17,900 and the threshold for the 45 per cent rate will go up by £200 [to £20,400]. The thresholds for the 50 per cent, 55 per cent and 60 per cent rates will remain at their 1986-87 levels.

person's

139. The blind allowance was last raised in 1981 when it was increased by £180 to its present level of £360. For 1986-87, I am proposing a further £180 increase ~~in the allowance taking it~~ to £540. ~~I am very pleased to announce this extra measure of help for a deserving group.~~

last year, I reaffirmed

141. In my ~~last~~ Budget speech ~~I said that I shared~~ the aim ~~of~~ set out by my predecessor in 1979, to reduce the basic rate of income tax to no more than 25 per cent. That remains my objective.

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142. But reductions in the basic rate are expensive. It costs well over £1 billion to reduce the rate by one percentage point. There is clearly no possibility of achieving the goal of a 25 per cent basic rate this year. But I can take a further useful step towards that. I am therefore taking 2 pence off the basic rate for 1987-88.

147. The reduction in the basic rate to 27 per cent will, of course, mean a similar reduction in Advance Corporation Tax.

148. As a further measure to help small businesses, I have decided also to reduce the small companies' rate of corporation tax to 27 per cent. Following the proposals I announced earlier, this rate will also apply to small companies' capital gains, which are currently taxed at 30 per cent. The changes to income tax and corporation tax will mean a significant fall in the tax burden on small companies and the unincorporated sector. This gives the best possible incentive to small businesses, which are so crucial for future growth and employment.

144. [This reduction, to a basic rate of 27 pence in the pound, brings down marginal rates for the overwhelming majority of ordinary taxpayers.] The cut in the rate will be worth over £3 per week to a married man on average earnings.

146. The income tax changes I have announced today will take effect under PAYE on the first pay day after 17 May.

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[New paragraph] The total cost of the income tax changes will be some [£2 billion] in 1987-88, and the overall cost of the measures I have announced today will be £x billion. The PSBR for 1987-88 will therefore be [£4 billion].

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