

PO-CH/NL/0024

PART A

**SECRET**

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PO -CH /NL/0024



PART A

1988 BUDGET - MORTGAGE  
INTEREST RELIEF

PO -CH /NL/0024

PART A

PART A

DD's 28 years NAJ's 203-85

18-2-88



FROM: A W KUCZYS

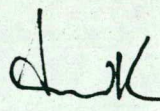
DATE: 10 February 1987

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary  
PS/Economic Secretary  
Sir P Middleton  
Mr Cassell  
Mr Peretz  
Mr Scholar  
Miss Sinclair  
Mr Haigh  
Mr Cropper  
Mr Graham - OPC  
Mr O'Connor - IR  
PS/IR

**MORTGAGE INTEREST RELIEF: BUDGET STARTERS 109 & 172**

The Chancellor has seen Mr O'Connor's minute of 5 February. He would be content for the Revenue to instruct Parliamentary Council to draft on the basis that the limit for 1987-88 should be £30,000 (Mr O'Connor's paragraph 2) and <sup>to</sup> abandon further work.

  
A W KUCZYS

**BUDGET: CONFIDENTIAL**



FROM: A W KUCZYS

DATE: 27 FEBRUARY 1987

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary  
PS/Economic Secretary  
Sir P Middleton  
Sir T Burns  
Mr Cassell  
Mrs Lomax  
Mr Petetz  
Mr Scholar  
Mr M A Hall  
Miss Sinclair  
Mr Murphy  
Mr Cropper  
Mr Bridgeman - BSC  
Mr Pitts - IR  
Mr O'Connor - IR  
PS/IR

**MORTGAGE INTEREST RELIEF: HOME IMPROVEMENT LOAN ABUSE**

The Chancellor has seen your minute of 26 February. He agrees with the Financial Secretary's conclusions. (He has commented that we might also keep the "PAC option" in play, when we come to review the 1988 options.)

A handwritten signature in dark ink, appearing to be "AWK".

A W KUCZYS

mortgage interest  
Relief.

perps to go on  
CH/NY/24  
1988 Budget



CHANCELLOR OF THE EXCHEQUER'S OFFICE: MEETING

<p>SUBJECT</p>	<p>Mortgage Interest Tax Relief</p>
<p>DATE AND TIME</p>	<p>Monday 30 November. 3.45 pm</p>
<p>VENUE</p>	<p><del>Chancellor's Room, Treasury/No. 11/Conference Room/House of Commons</del></p>
<p>PAPERS</p>	<p>Crappier to ChX 23/11. O'Connor to FST 27/11 FST to Ch. 27/11 (see also APH note of 25/11 - to Ch. only)</p>
<p>THOSE ATTENDING</p>	<p>CST FST PMG EST. Mr Cropper Mr Tyrre Mr Call</p> <p style="text-align: right;">cc Mr J. Taylor.</p>





Inland Revenue

Policy Division  
Somerset House

1. ✓ AH  
2. 67.28/9

PMP

CAYLEY  
TO  
PST  
23 SEPT

FROM: M F CAYLEY

DATE: 23 SEPTEMBER 1987

CONFIDENTIAL

*f agree through*

- 1. MR ISAAC *ISA*
- 2. FINANCIAL SECRETARY

TAXATION OF HUSBAND AND WIFE : CAPITAL GAINS EXEMPTION OF PRIVATE RESIDENCE

1. It has been decided to introduce independent taxation for husband and wife - including capital gains tax - in next year's Finance Bill. There is one capital gains aspect on which we would be grateful for guidance.

2. At present an individual's principal private residence is generally exempt from capital gains tax. Unlike unmarried couples (who can get exemption on one residence each), a husband and wife who are living together are entitled to only one such exemption. Where more than one residence is owned an election is available to specify which of the properties should benefit from the exemption. The Green Paper "The Reform of Personal Taxation" [Cmnd 9756] concluded at para 5.24 that: "The Government see no reason to change the present capital gains tax relief that is available on the disposal of a private residence".

- cc
- Chancellor
  - Chief Secretary
  - Minister of State
  - Economic Secretary
  - Mr Scholar
  - Miss Sinclair
  - Mr Cropper
  - Mr Tyrie

- Mr Isaac
- Mr Painter
- Mr Pitts
- Mr Beighton
- Mr Johns
- Mr Hamilton
- Mr O'Connor
- Mr Mace
- Mr Cayley
- Mr C Gordon
- PS/IR



3. As with mortgage interest relief - on which we are submitting a separate note - the problem arises because in certain circumstances an unmarried couple can get more tax relief than a husband and wife. There is however an important distinction.

4. With mortgage interest relief the main tax advantage for unmarried couples lies in the fact that they are at present each entitled to the relief on a maximum loan of £30,000, whereas a husband and wife are only entitled to £30,000 between them. The solution there is to apply, in addition, a £30,000 limit per main residence. This will mean that an unmarried couple living together in one residence will be entitled to exactly the same relief as the married couple living together - both couples will be subject to the £30,000 per residence ceiling.

5. The capital gains issue is different. It is not concerned with how much tax relief two people can get on a property. Rather, it is that a married couple get exemption on one property, whereas two unmarried people can arrange to get it on two. For capital gains tax, therefore, a tax advantage arises only where an unmarried couple have two houses.

6. The number of representations which have been received suggesting that the present capital gains tax principal private residence rules serve to penalise those couples who are married and to encourage couples to live together out of wedlock is fairly small. The purpose of this note is to enquire whether Ministers would wish therefore (as the Green Paper proposed) to keep to the present rules.

7. There are broadly three alternative ways in which the rules could be changed to answer these criticisms. First, the rules for husband and wife could be relaxed to treat them as any other individuals; second, the relief available to non-married couples could be restricted; third, the test as to what actually qualifies as a main residence could be modified.

### Changing the rules for husband and wife

8. Mechanically, it would be fairly straightforward to change the existing legislation to enable a husband and wife each to qualify for a separate residence exemption. This would mean for example that where a husband and wife owned both, say, a town house and a country home, they could arrange things to obtain exemption on both properties (the husband on one and the wife on the other).

9. Such a change would clearly be advantageous to married couples owning more than one property but the move would have to be viewed in the light of the general review of the taxation of husband and wife. Bearing in mind the other proposals - including those on mortgage interest relief under which a husband and wife will continue to benefit from only one upper limit for relief of £30,000 between them - we doubt that a change on these lines would fit easily into the overall reform for husband and wife.

### Restricting the exemption for Unmarried Couples

10. An alternative would be to restrict unmarried couples' exemption to a single residence. The big problem here is to define the circumstances where the restriction should apply.

11. A cohabitation test ("living together as man and wife") has obvious difficulties - it would be unpopular, and establishing whether cohabitation existed would be virtually impossible. A test of this kind was considered for mortgage interest relief by the then Financial Secretary, in 1984 - and ruled out. (Copies of minutes attached for ease of reference). Another option in theory would be an occupancy test: the restriction would apply where two or more people dwell in the same property, irrespective of their relationship. But occupancy may have no connection with ownership, and it would be hard to justify denying, for

example, a London worker exemption on his cottage in the country where he spends weekends and holidays on the grounds that he spends the week as a paying lodger in a London house. So an occupancy test would also be inappropriate.

12. An alternative test would be one of ownership: wherever property was jointly owned the joint owners would be entitled to only one exemption. Any rule focusing on ownership however would be very easy to circumvent. A young sophisticated "yuppy" unmarried couple could ensure that where two properties were owned one was in one name and one in the other. And there would be circumstances where those concerned might not be able to agree on which property should qualify for exemption. For example, two people might jointly own a house in Scotland: for one of them it might be the sole residence, while the other might also have a London home. It would be hard to justify denying the latter the ability to claim exemption on the London property.

13. We have therefore concluded that it would be extremely difficult to tighten up the rules to bring unmarried people into line with the married.

#### Modifying what qualifies as a main residence

14. At present people who reside in more than one property have a completely free choice as to which qualifies for CGT exemption. Where an individual who owns two residences does not make an election the Inspector can already determine which is to be treated as the main residence, on the facts. In practice most people with two homes do not make an election: elections tend to be made only by a minority for whom it is advantageous to claim exemption on what, factually, is not their main residence. This contrasts with the position for mortgage interest relief, where relief is available only on the property which in fact is the main residence. We have therefore considered whether the free election for CGT might be replaced by the factual test used

for mortgage relief. Were this done, one effect would be to place at least some unmarried couples in the same position as their married counterparts. Unlike the previous option, this one would affect the married as well as the unmarried.

15. Again, however, there are a number of drawbacks to this option. For a start, it would often be easy for the unmarried couple to sidestep the tightening up: for example one of them could claim to spend more time at one property and the other, more at the second property - and such claims would be virtually impossible to disprove.

16. Second, mortgage interest relief is a relief against annual income, so one is concerned with what factually is the main residence in a particular year. For capital gains tax there would obviously be problems if it were necessary to review the history of occupation over the whole period of ownership, and, in a minority of cases where two people owned more than one property, what was factually their main residence might have changed several times. This would be especially true where two unmarried people cohabited for a short time and then split up: but it could also be true for the married. It could be difficult to establish the facts, and complex rules would be needed to cater for situations where there had been switches back and forth in which property constituted factually the main residence. The difficulties would tend to be greatest in precisely the sort of case where an election is now made. The practical answer might be to look back at the factual position in only the last, say, 3 or 5 years of ownership - but this would be a solution with pragmatic, not theoretical, justification.

17. Third, a change of this kind would make some married couples with two homes worse off than now, since they would no longer be able to elect to have exemption on whichever home gave the most tax benefit.

18. In addition, it would be for consideration whether a factual test of main residence should be applied with immediate effect. Most of the existing elections are for properties which in reality do not constitute the main residence. To cancel those elections would mean that properties held in the expectation of a tax free sale - perhaps on retirement - would suddenly start to attract liability. There could be no question of a retrospective tax charge and there would be controversy - and some compliance costs - even if Ministers were to impose a tax on only gains accruing after the change. The alternative would be a transitional provision to preserve existing elections. In practice those transitional provisions would probably be required until all such elections had ceased to have any relevance - in many cases on the death of the owner - which would be decades in the future.

#### Conclusion

19. The present rules for the CGT exemption of the principal private residence constitute a (minor) tax penalty on marriage, because an unmarried couple can arrange to obtain exemption on two properties while a married couple cannot.

20. We doubt Ministers would wish to relax the rules to enable married couples to arrange to get exemption on two properties. On the other hand, we have been unable to devise a means of tightening up the rules for the unmarried, to bring them more into line with their married counterparts, in a way which is both practicable and not easily circumvented.

21. It seems to us that, if Ministers wish to alter the rules to bring unmarried couples more into line with the married, they may well consider that the only option worth further pursuit is to remove the CGT free election as to which property is the main residence and substitute a factual test as for mortgage interest relief. But this would be

controversial, would make most two-home couples who now make an election worse off than now, and could well necessitate transitional provisions which could continue for many decades. And even with this change unmarried couples could still often arrange to get exemption on two residences - so in practice the objective of bringing them into line with the married would often not be achieved.

22. Against this background, Ministers may feel that it would be preferable - as the Green Paper suggested - to leave things as they are. We would welcome your guidance on this.

*Michael Cagley*

M F CAYLEY

CONFIDENTIAL



*Prup*

FROM: G R WESTHEAD  
DATE: 24 September 1987

PS/FINANCIAL SECRETARY

*Ch / FST is holding  
a meeting on this on  
5/10. 25 309*

cc

PS/Chancellor  
PS/Chief Secretary  
PS/Paymaster General

**MORTGAGE INTEREST RELIEF: RESIDENCE BASIS**

The Economic Secretary has seen Mr O'Connor's submission of 23 September to the Financial Secretary on the above.

2. The Economic Secretary seems to recall that the Paymaster General's PPS, Mr M Stern MP, himself an accountant, once mentioned that his partnership had developed avoidance schemes ready for the introduction of a £30,000 per residence limit in the last Budget. He thinks it might be worth the Financial Secretary tapping Mr Stern's brain on this issue (particularly paragraph 35), which he notes after all has already been aired in the Green Paper.

*This (below)  
is an issue v. daunting.  
if we look with a compatible  
with a popular taxation?  
attitudes there → Guy Westhead  
instance due to  
(Pse also spk re MIR  
on my own & was s  
later State of the...?)*

*Cloned  
to the  
8/11*

EST  
TO  
PS/FST  
24 SEPT

GUY WESTHEAD  
Assistant Private Secretary

4367/42

TAXATION OF  
HUSBAND + WIFE

CONFIDENTIAL



pwp (on b.f., I think)

B/FST  
TO  
CAYLEY  
28 SEPT

FROM: J J HEYWOOD  
DATE: 28 SEPTEMBER 1987

MR CAYLEY-IR

cc PS/Chancellor  
PS/Chief Secretary  
PS/Paymaster General  
PS/Economic Secretary  
Mr Scholar  
Miss Sinclair  
Mr Cropper  
Mr Tyrie

Mr Isaac-IR  
PS/Inland Revenue

TAXATION OF HUSBAND AND WIFE: CAPITAL GAINS EXEMPTION OF  
PRIVATE RESIDENCE

The Financial Secretary was grateful for your minute of  
23 September.

2. He thinks we should simply leave things as they are.

J.H.

Jeremy Heywood  
Private Secretary





FROM: J M G TAYLOR

DATE: 5 October 1987

~~PS/FINANCIAL SECRETARY~~

cc PS/Chief Secretary  
PS/Economic Secretary  
Sir P Middleton  
Mr Cassell  
Mr Scholar  
Miss Sinclair  
Mr Murphy  
Mr Cropper  
Mr Tyrie  
Mr Jenkins  
Mr Battishill - IR  
Mr Isaac - IR  
Mr O'Connor - IR  
PS/IR

JMGT  
To  
PS/FST  
SOCT

**MORTGAGE INTEREST RELIEF: RESIDENCE BASIS**

The Chancellor has seen Mr O'Connor's submission of 23 September.

2. He has commented that this all looks very daunting. Would doing nothing be compatible with independent taxation? If not, is there any other - simpler - alternative than the residence basis?

A handwritten signature in dark ink, appearing to be 'JMGT'.

J M G TAYLOR

MORTGAGE  
INTEREST RELIEF

CONFIDENTIAL



Inland Revenue

Policy Division  
Somerset House

*OK: M. V. S. 10/10  
see Taylor para 6.*

FROM M A JOHNS  
DATE 8 OCTOBER 1987

*6/10 10/10*

*For (a.m.) tax meeting  
on 12/10  
prop*

JOHNS  
TO  
PST  
8 OCT

FINANCIAL SECRETARY

MORTGAGE INTEREST RELIEF: RESIDENCE BASIS

1. I have now seen the Chancellor's comments (Mr Taylor's note of 5 October). One or two additional comments may be helpful.
2. Literally doing nothing, ie not introducing any special legislation on the mortgage relief ceiling, while introducing independent taxation would mean that husband and wife would become entitled to a £30,000 ceiling each. For married couples this would be tantamount to doubling the present ceiling (as you say in Mr Heywood's note of 5 October) with substantial Exchequer costs (£500m before the inevitable trading up in mortgages) and probable inflationary effects on house prices.

- cc Chancellor of the Exchequer  
 Chief Secretary  
 Economic Secretary  
 Sir P Middleton  
 Mr Cassell  
 Mr Scholar  
 Miss Sinclair  
 Mr Murphy  
 Mr Cropper  
 Mr Tyrie  
 Mr Jenkins (Parliamentary Counsel)

- Mr Battishill  
 Mr Isaac  
 Mr Painter  
 Mr Lewis  
 Mr Beighton  
 Mr Lawrance  
 Mr Cleave  
 Mr Johns  
 Mr Mace  
 Mr Whitear  
 Mr Davenport  
 Mr O'Connor  
 Mr I Stewart  
 PS/IR

3. We imagine the Chancellor means by doing nothing retaining a £30,000 ceiling for married couples as well as for the unmarried. This would require legislation if independent taxation is introduced, not only to set the new joint ceiling but also to lay down rules (on the lines of paragraphs 20-26 of Mr O'Connor's note) about how it was to be allocated between couples and which partner was to be treated as paying the interest, eg from joint accounts. It would be simpler than the residence basis but not without complication.

4. There is certainly no technical reason why this approach is inconsistent with independent taxation, though, by definition it would be treating husband and wife as a couple for this purpose and not as independent. It would be workable, without undue complication. The main drawback would be that, as you say in paragraph 9(i) of your note, at a time when the Government was dealing with the other anomalies in the treatment of husband and wife it would be leaving untouched a large, growing, and (we would guess) the most widely-resented tax penalty on marriage. The presentation of the reform would need to be more narrowly focused on 'independence' without claiming to eliminate the 'tax penalty' as such.

5. The only solution simpler than the residence basis which we can think of is to introduce separate ceilings for husband and wife equal to that for a single person. The problem is that either the ceiling has to be set at £30,000 with the results described in paragraph 2 above or the ceiling has to be reduced for single people. Whether this is acceptable is a straight political issue. There will be losers from the residence basis anyway among single sharers: the question is whether you are prepared to extend the losers to include single non-sharers as well. You would need to consider whether doing so would be inconsistent with the public undertakings which have been given about maintaining the relief. A ceiling of £15,000 per individual would keep married couples as they are but halve the ceiling for single people; a ceiling of £30,000 would mean no

losers but a high cost. Intermediate figures could be chosen - eg £20,000, giving married couples an increase to £40,000 and restricting the losers to single people with mortgages over £20,000. Sharers would lose less than under the residence basis - a ceiling of £60,000 for three young people clubbing together to buy a property could be defended as fairly generous even if less than the £90,000 they get at present - but unmarried couples would be on the same footing as married ones. If you are interested in this approach we can cost various options. The distributional effects would need to be considered in the light of the overall package.

6. The residence basis has the advantages of involving no cost and fewer losers than a no cost reduced ceiling per individual. It is complex at the margins but the complexities affect a minority of taxpayers. If you wanted to retain the residence basis but simplify it, I mentioned at your meeting the option of dropping the proposal to a separate ceiling per taxpayer (paras 27-34 of Mr O'Connor's note). This could mean there was no net yield from the package as two home couples would start to claim double relief (either for themselves or for dependent relatives). The cost would be a little reduced and further simplification achieved if you felt able also to abolish the, obviously sensitive, mortgage interest relief for dependent relative's houses. But at our meeting you did not feel the extra cost of this was worth risking for the limited degree of simplification it offered.

*M. A. Johns*

M A JOHNS

*prop. j. + b.f. with  
them on 9/10*

CONFIDENTIAL

FROM: A G TYRIE

DATE: 5 OCTOBER 1987

FINANCIAL SECRETARY

cc PS/Chancellor  
Sir Peter Middleton  
Mr Cassell  
Mr Scholar  
Mr Murphy  
Mr O'Connor  
Mr Cropper  
Mr CallTYRIE  
TO  
FST  
SOCT

## HOME IMPROVEMENT LOAN INTEREST RELIEF

I saw Mr Heywood's note of 16 September asking for information on the possibility of confining home improvement loan interest relief to borrowers also in receipt of mandatory home improvement grants.

This doesn't look a good idea to me. Home improvement grants are already a pretty wasteful way of improving the housing stock, run, in some cases, by people who don't know who they are giving the money to. I have some experience of the operation in these schemes in Central London. We would be compounding the inadequacies of the home improvement grant allocation. I would have more faith in the Revenue's ability to deter interest relief abuse than the ability of an LA Environmental Health Officer to allocate grants properly.

Unless we are prepared to entertain the absurdity that people would be encouraged to move home rather than make improvements to their own I see no alternative but the retention of relief on home improvement. As for abuse, we have no alternative but to try and frighten off fraudsters by catching a few miscreants (an MP!) and giving as much publicity to it as we dare and if that fails, contemplate an increase in revenue policing.

*Most make  
unbit  
response**to bring in  
members**RJ Johnson*

A G TYRIE

PP



**Inland Revenue**

TASK FORCE SECRET

COPY 1 OF 25

Policy Division  
Somerset House

FROM: B A MACE

DATE: 19 OCTOBER 1987

MACE  
TO  
CIX  
19 OCT

CHANCELLOR OF THE EXCHEQUER

TAX REFORM: INCOME TAX AND NIC

1. Mr Taylor's note to me of 5 October asked for

(a) a version of the table on page 5 of my submission of 29 September showing gainers and losers in cash terms (compared with 1987-88);

(b) a version of the table on page 8 of the submission in terms of percentage distribution.

These two tables are attached (Tables 1 and 2)

2. Mr Taylor's note of 7 October asked for an analysis of Option A (my submission of 29 September) in money-of-the-day terms.

3. As I explained in my previous submission an analysis in money-of-the-day terms of options involving phasing is complex and requires forecasts to be made of earnings and prices some three years from now (on which we would need advice from the Treasury).

cc Financial Secretary  
Sir P Middleton  
Sir T Burns  
Mr Byatt  
Mr Cassell  
Miss Peirson  
Mr Scholar  
Miss Sinclair  
Mr MacPherson  
Mr McIntyre  
Mr G P Smith  
Mr Cropper  
Mr Tyrie

Chairman  
Mr Isaac  
Mr Painter  
Mr Beighton  
Mr Lewis  
Mr Calder  
Mr Mace  
Mr Cayley  
Mr Eason  
Mr Allen  
PS/IR

We would then build the resulting projections into the data for our computer model. We have not yet been able to undertake this work and we think it would be preferable not to do so until up to date economic assumptions are available from the Autumn Statement forecast and until we have incorporated data from the most recent (1985-86) Survey of Personal Incomes into our model (which we shall be doing shortly). Both these developments could significantly affect the results of any money-of-the-day analysis.

4. A money-of-the-day analysis would provide information about the effects of the reform package on receipts in different years in the form usually presented in the Scorecard and the FSBR. But a distributional analysis of gainers and losers on this basis would be more difficult to interpret because the effects of the tax reform would be compounded with economic changes. There is no obvious way in which the changes in tax burden on individuals as a result of the reform could be identified and quantified separately from the changes in the tax burden due to the general growth in incomes and prices. We should need to consider with you the sort of distributional analysis you require.

Small companies rate of Corporation Tax

5. You also asked for an estimate of the cost of reducing the small companies rate of corporation tax to 25 per cent from financial year 1988. The figures are

		£m
1988-89	1989-90	Full year
negligible	55	90

Mortgage Interest Relief

6. Finally you may like to have an approximate indication of the effect on losers from Option A of my 29 September submission if the mortgage interest relief ceiling were reduced to £20,000 per individual but husband and wife were each given their own limit (so that they had a ceiling of £40,000 between them).

7. Looking at the transitional regime for Option A in 1988-89 (with 7 per cent NIC above the UEL), of the total of some 300,000 losers about one-third are married couples claiming mortgage interest relief in excess of £3000 who might be helped at least to some extent by this proposal. (Virtually all the losers paying mortgage interest in excess of £3000 are married couples). If nearly all those married couples were able to take full advantage of the increase in the ceiling (which would be worth about £280 to the basic rate taxpayer) the number of losers might be reduced by up to 100,000. But in practice the reduction in the number of losers would be considerably smaller.

B A Mace

B A MACE



TABLE 1

Option A: Percentage Distribution of Losers and Gainers by Income

Comparison with 1987-88

Lower limit of total income £'000	Loss (£)			Gain (£)			Tax Units (thousands)
	Over 400	200- 400	less than 200	less than 200	200- 400	over 400	
0				100			10,200*
10	-	-	1	57	42	-	8,300
20	2	7	15	14	42	20	1,900
30	1	3	4	10	18	64	530
40	1	1	2	3	5	88	390
<b>All</b>	<b>1/4</b>	<b>3/4</b>	<b>2</b>	<b>72</b>	<b>20</b>	<b>5</b>	<b>21,400*</b>

*Handwritten red annotations:*  
 A bracket under the 'Loss' columns (1/4, 3/4, 2) is labeled with a red '3'.  
 A bracket under the 'Gain' columns (72, 20, 5) is labeled with a red '97'.  
 A red arrow points from the '3' towards the footnote below.

\* An additional 300,000 tax units are included in this distribution compared with the table on page 5 of the submission of 29 September. These are units taken out of tax by indexation of the personal allowances.

*Handwritten red notes:*  
 Over 242  
 of those ~ 720,000 - 735,000  
 bracket 14 92 > 24 = 24  
 156 < 74 = 22

TABLE 2

**Option A (Phased NIC)**  
**Percentage Distribution of Losers\* by Income**

Total Income (Lower limit) £000s	%		
	1988-89	1989-90	1990-91
10	-	-	-
15	2	4	9
20	62	62	57
25	30	27	24
30	4	5	5
35	1	1	2
40	-	1	1
45	-	-	1
50	1	1	1
Total losers (thousands)	305	427	568

\*Compared with 1987-88



Inland Revenue

Policy Division  
Somerset House

FROM: B O'CONNOR

DATE: 27 OCTOBER 1987

*See cover note  
MAY 27/10*

1. MR JOHNS
2. FINANCIAL SECRETARY

**MORTGAGE INTEREST RELIEF: INDIVIDUAL CEILING**  
**STARTER No. 114**

1. At the meeting on 12 October the Chancellor asked for a note comparing a system of mortgage interest relief with a ceiling of £20,000 per individual (and £40,000 for a married couple) with the residence basis and a ceiling of £35,000 per residence.

**EFFECTS**

2. The individual ceiling is essentially a continuation of the present system except that a married couple would qualify for a double ration of relief in the same way as unmarried couples. This would be what would happen if the present system were retained when independent taxation comes into effect in April 1990 but we would envisage the double ceiling for married couples taking more-or-less immediate effect. The single ceiling could be set at any level but, for the purposes of this note, we

cc Chancellor  
Chief Secretary  
Economic Secretary  
Sir P Middleton  
Mr Cassell  
Mr Scholar  
Miss Sinclair  
Mr Murphy  
Mr Cropper  
Mr Tyrie  
Mr Jenkins (Parlia. Counsel)

Chairman  
Mr Painter  
Mr Isaac  
Mr Pollard  
Mr Beighton  
Mr Lewis  
Mr Johns  
Mr Lawrance  
Mr Cleave  
Mr Mace  
Mr Whitear  
Mr O'Connor  
Mr Gray  
Mr Reeves  
Mr Boyce  
Mr I Stewart  
PS/IR

O'CONNOR  
TO  
FST  
27 OCT

are assuming it will be £20,000 as suggested at your meeting. The following table shows how this compares with the residence basis and a £35,000 ceiling:-

	Individual ceiling	Residence basis	Present basis
Single person not sharing	£20,000	£35,000	£30,000
Two persons	£40,000 <i>whether</i> married or unmarried	£35,000 <i>whether</i> married or unmarried	£30,000 if married £60,000 if unmarried
Three persons	£60,000 <i>whether</i> or not two are married	£35,000 <i>whether</i> or not two are married	£90,000 if none married to each other £60,000 if two are married

3. With protection for existing loans there will be no immediate losers under either system. Under the residence basis all potential unmarried sharers who take out new joint loans exceeding £35,000 will lose. The more sharers there are in one residence the higher the loss will be. Married couples and single persons not sharing with existing loans over £30,000 and those taking out new loans over £30,000 will gain from the ceiling increase to £35,000.

4. Under the individual ceiling two unmarried sharers taking out a new loan exceeding ~~£~~40,000 will lose. Three sharers taking out a new loan exceeding £60,000 will lose. In both cases the loss is less than under the residence basis. Married couples with existing loans over £30,000 and those taking out new loans over £30,000 will gain from their entitlement to two ceilings amounting to £40,000. But single persons not sharing taking out new loans exceeding £20,000 will lose.

## ADVANTAGES OF THE INDIVIDUAL CEILING

Simplicity

5. The main advantage is simplicity. None of the apportionment problems of the residence basis arise (see paragraphs 9-19 of my note of 23 September), nor will it be necessary to further define a residence or worry about properties being partitioned. If any possible loss to married couples is to be avoided there will need to be provisions for sharing the relief between married couples (see paragraph 13 below) so the special provisions for the residence basis discussed in paras 20-26 of my earlier note cannot be avoided. There would be advantages of simplification in abolishing the separate reliefs for dependent relatives and separated or divorced spouses' residences but the need to do so would be less than in the case of the residence basis (paras 29-30 of my earlier note). Relief for the dependent relative or divorced spouse's residence would be constrained within the couple's £40,000 limit rather than, as would happen with the residence basis, a separate residence limit becoming available unless special rules are put in to prevent it.

6. The scope for avoidance through second homes will be much reduced. As explained in paragraph 31. of the note of 23 September, cohabiting unmarried couples who each own their own house can easily continue to claim relief on both houses either under the present system or the residence basis. On the individual ceiling basis they will at least be restricted to no more than £20,000 on each home so that in total they will get no more than the £40,000 total applicable to one shared house. Under the residence basis they would get a total of £70,000. The same will apply to married couples who might, under independent taxation, be able to demonstrate that they have separate main residences. There would be less need to specify that married couples must have the same residence.

### Staff and compliance costs

7. In the note of 23 September paragraph 42 we estimated that the residence basis might require 25 to 30 extra staff in 1988-89 to deal with the increased number of doubtful cases. But this estimate was based on a ceiling of £30,000. Increasing the ceiling to £35,000 would produce a small countervailing saving so that the net staff increase would be slightly less. Because of the greater simplicity of the individual ceiling basis we would expect a £20,000 limit (effectively £40,000 for a married couple) to produce a small staff saving. There would be similar economies for MIRAS lenders.

### Effect on sharers

8. The other main advantage of the individual ceiling is that sharers, especially multiple sharers who have come together because setting up home independently is impossibly expensive, would be less harshly treated. £60,000 for three sharers or £80,000 for four would be quite generous although less than the present £90,000 or £120,000. The alternative residence basis is likely to be criticised as unduly harsh for young people clubbing together, imposing a ceiling of £35,000 no matter how many were sharing.

### Equity

9. It is also arguable that, especially under a system of independent taxation it is reasonable for a married couple to be entitled to more tax relief for interest than a single person. This point is particularly telling where both husband and wife have taxable income so that two incomes are chargeable to tax. It is not clear why several people sharing a single residence should have less relief than the same number of people in different residences. And single people generally need less expensive accommodation than families so in many cases the total interest payable by the single person will be less than that paid by a married couple. Parallels may be drawn with the community

charge where the direction of policy is to tax individuals equally rather than by reference to the amount of property occupied. Enabling married couples and other sharers to qualify for additional mortgage interest relief might be felt a reasonable offset for the fact that the single person living alone will be saving more on the conversion from domestic rates to community charge.

#### DISADVANTAGES OF THE INDIVIDUAL CEILING

10. The two major drawbacks of the individual ceiling approach are the greater number of losers and the fact that it was not canvassed in the Green Paper on Personal Taxation and so is more difficult to defend as consistent with the Government's pledges on the preservation of the existing system of mortgage interest relief. There is also a possibility that a system giving a £40,000 limit for married couples would have a greater inflationary effect on house prices than one giving a £35,000 limit, even if there are also more single losers under the former system.

#### Consistency with past undertakings

11. The main statements made by Ministers on mortgage interest relief are annexed to Mr Johns' covering note. Perhaps the most categorical is the Prime Minister's statement on 25 February that the "Conservative party and Government are now the only people who do not want to limit in any way the present system of mortgage interest relief for home buyers". Any change could be criticised as contrary to this statement but the residence basis was canvassed in the Green paper and no-one has yet taken the point that its adoption would be a limitation of the present system. The idea has been widely publicised in the press and it may be felt that people have always been on warning that this change might be made. A reduction in the ceiling for single people, even if defended as an alternative and simpler way of achieving the same end of abolishing a tax penalty on marriage, would come without any forewarning. Although the Green Paper put forward the residence basis as a possible solution it did not

preclude other options. You would need to weigh up carefully whether this would be politically feasible.

### Losers

12. The individual ceiling also involves more losers than the residence basis, although they will lose less than those worst affected by the residence basis. If the reductions only take effect for new loans our estimate of the number of losers on present behavioural patterns is as follows:

	Individual £20,000 ceiling	Residence basis £35,000 ceiling
Total number of losers by April 1989	350,000	70,000
Total number of losers by April 1990	730,000	150,000
Average annual loss:		
single non sharers	£200	-
sharers	£160	£200
all	£210	£200

All the losers under the residence basis will be sharers taking out new loans in a property totalling over £35,000; some will be married couples sharing with others but most will be single. The losers under the individual ceiling basis will be single people.

### Separated, divorced and widowed people

13. As suggested at the Chancellor's meeting the individual ceiling could operate particularly harshly on the spouse left alone in the marital home because of the death or desertion of the partner. In these circumstances we think it would be appropriate for the widower, widow or remaining divorced or separated spouse to be given relief at whatever level applied before the break-up of the marriage. The relief would continue during single occupation of the marital home or for the life of the existing mortgage, whichever shorter. In the case of divorce or separation the spouse who left the marital home would of course be entitled to £20,000 if he or she purchased another



house. There would be complaints that the widow or divorcee would lose out financially if she moved to smaller accommodation but this could be defended as logical - the higher relief would be given so that she was not compelled to move by tax, but if she did then the normal single rules would apply.

#### INDEPENDENT TAXATION

14. As with the residence basis (see paragraphs 20-26 of my note of 23 September) there could be circumstances where the individual ceiling would operate more harshly than the present basis for married couples. If no sharing of the ceiling between spouses was allowed

- where only one spouse paid the interest, then only the single £20,000 ceiling would be available not the normal £40,000 for a couple
- where one spouse was paying tax at a higher rate than the other and both were paying the interest then higher rate relief would be restricted to half the interest. A similar point arises with non-MIRAS loans if one spouse is a non-taxpayer. We would recommend that under both the residence basis and the individual ceiling sharing should be allowed for married couples but not in the case of unmarried sharers. The extent of sharing needs to be reviewed in the light of the treatment of incomes from joint assets (see paragraph 26 of my note of 23 September).

#### EFFECTIVE DATE OF IMPLEMENTATION OF INDIVIDUAL CEILING

15. As mentioned in paragraph 2. this basis is largely a continuation of the present basis and involves little more than a change of ceiling to £20,000. For the period before independent taxation there would have to be special provision to ensure wives get £20,000. It is therefore much easier for lenders to cope with the change than with the residence basis and from their point of view it would be possible to start the individual ceiling basis from an earlier date (perhaps 6 April 1988) than

the 1 August proposed for the residence basis. The same problem would, however, arise of fixing a date which allowed through loans to which borrowers were genuinely committed before the Budget while not allowing a great rush of forestalling. A 1 August start might be too generous in this case as single people can probably organise their purchases and borrowing faster than sharers: 3 months after Budget Day (15 June) might be a compromise. On the other hand, the ceiling must be fixed from 6 April and there would be a ~~slow~~<sup>ceiling</sup> advantage in all the changes taking place on the same day. It would be relatively straightforward to let through everyone who had a firm contract for the purchase of the property concerned if you were prepared to restrict relief for pre Budget commitments to this extent.

#### APPLICATION OF INCREASED CEILING TO EXISTING LOANS

16. Whether the residence basis or the individual ceiling approach is adopted lenders will have to identify whether existing borrowers qualify for the new higher ceiling or for reserved rights. Depending on their administrative systems this could be costly and take a long time, but there would seem no justification for allowing borrowers with reserved rights the additional benefits of the increased ceiling.

## COSTS

17. Although we recommend a 1 August 1988 start for the residence basis, for the purposes of comparative costs, we are showing the estimated cost on the assumption of a 6 April 1988 start for both bases. The figures ignore behavioural effects.

	Individual ceiling £20,000	Residence basis £35,000
1988-89	- £260 million	- £220 million
1989-90	- £285 million	- £290 million

18. With no behavioural changes we estimate that about 1,600,000 new purchase loans will be taken out in 1988-89 divided as shown in the following table:-

Projected numbers of new loans taken out in 1988-89 (thousands)

	all borrowers	singles	married couples	unmarried sharers
Total	1600	390	1130	80
Loans over £30,000	610	120	450	40
Loans over £25,000	935	200	680	55
Loans over £20,000	1275	290	920	65
Loans over £15,000	1450	340	1035	75

## CONCLUSION

19. We understand at the Chancellor's meeting on 20 August he was inclined to favour the residence basis. This keeps down the number of losers and has the merit of being foreshadowed in the Green Paper. The individual basis is simpler, will involve less legislation and is arguably easier to defend in principle but both systems are workable.



B O'CONNOR

CH/EX MTE  
12/10

EXTRACT FROM 'TASK FORCE SECRET DOCUMENT'  
CH/EX MEETING. 12.10.87

Mortgage interest relief

- Improvements

12. The Chancellor thought that ending mortgage interest relief for improvements looked to be the only practical way of whittling down the relief. He thought that relief for improvements was the main vehicle for abuse.

13. Mr Johns said that up to 20 per cent of the relief given for improvements might be an abuse of the proper provisions. He said that the justification for the relief in the past had been to preserve equity between the person who bought a run-down house and the person with a new house, or between the person who wanted to extend a house and the person who bought a bigger house. The Chancellor said that some unfairnesses would have to be

accepted, but that these tended to be exaggerated. For example, the costs of purchase were so much greater than improvements, that withdrawing relief on the latter would have only a marginal effect. Also, the price of run-down houses would fall to reflect withdrawal of improvement relief.

14. The Chancellor thought a viable package could be devised, involving an increase in the mortgage interest relief ceiling, but restricting relief to house purchase. The higher ceiling would have to apply to existing loans, including those for improvements, as well as new loans.

15. Mr Tyrie thought it would be wrong to raise the ceiling for relief. He also thought that the package would be a fillip for property developers. The Chancellor asked for more work to be done on the likely effects of the proposals. There were special reasons for increasing the ceiling as part of the overall package (see paragraph 20 below)



Inland Revenue

SECRET

Policy Division  
Somerset House

From: M A Johns

Date: 27 October 1987

FINANCIAL SECRETARY

**MORTGAGE INTEREST RELIEF**

1. Arising from the Chancellor's meeting on 12 October three notes are attached on the following topics:-

- i. Abolition of improvement loan relief
- ii. Refinements to the residence basis
- iii. The individual ceiling basis and its comparison with the residence basis.

The Chancellor also asked for some information about the distributional impact of the changes in the light of wider proposals; this was provided in Mr Mace's note of 19 October.

cc Chancellor  
Chief Secretary  
Economic Secretary  
Sir P Middleton  
Mr Cassell  
Mr Scholar  
Miss Sinclair  
Mr Murphy  
Mr Cropper  
Mr Tyrie  
Mr Jenkins (Parlia. Counsel)

Chairman  
Mr Painter  
Mr Isaac  
Mr Pollard  
Mr Beighton  
Mr Lewis  
Mr Johns  
Mr Lawrance  
Mr Cleave  
Mr Mace  
Mr Whitear  
Mr O'Connor  
Mr Reeves  
Mr Boyce  
Mr I Stewart  
Mr Gray  
PS/IR

JOHNS  
TO  
FST  
27 OCT



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The basic outline of the scheme is relatively straightforward. Most of the detailed points on which decisions are sought will affect a fairly few people. Early decisions on the main principles would help us and Parliamentary Counsel to get started on drafting; the one or two minor issues which are linked to other aspects of the husband and wife package can be left until later.

2903-07/9

FROM : B O'CONNOR  
23 September 1987

1. Mr Johns
2. Financial Secretary

my 23/9

**MORTGAGE INTEREST RELIEF : RESIDENCE BASIS**

1. At the meeting on taxation of husband and wife on 17 July the Chancellor decided to implement the proposal in the Green Paper to impose a limit of £30,000 per residence for mortgage interest relief. It would apply only to new loans. He thought the £30,000 limit would not necessarily hold and asked for other options to be explored.

2. This note considers some of the detailed points which need to be decided.

- cc. Chancellor  
 Chief Secretary  
 Economic Secretary  
 Sir P Middleton  
 Mr Cassell  
 Mr Scholar  
 Miss Sinclair  
 Mr Murphy  
 Mr Cropper  
 Mr Tyrie  
 Mr Jenkins (Parliamentary Counsel)

- Chairman  
 Mr Painter  
 Mr Isaac  
 Mr Pollard  
 Mr Beighton  
 Mr Crawley  
 Mr Lawrance  
 Mr Cleave  
 Mr Johns  
 Mr Lewis  
 Mr Mace  
 Mr Cayley  
 Mr Whitear  
 Mr Davenport  
 Mr Boyce  
 Mr Reeves  
 Mr I Stewart  
 Mr Gray  
 Mr O'Connor  
 PS/IR

O'Connor  
TO  
FST  
23 SEPT

**BACKGROUND**

3. Since the limit was introduced in 1974 it has applied to the individual taxpayer with a husband and wife counting as one unit. This has meant that a husband and wife living together are restricted to the present limit of £30,000 between them while unmarried co-habitees and other home purchase sharers can have relief on up to £30,000 each. Until recent years this was not regarded as controversial probably because few mortgages exceeded the limit. The substantial rises in house prices, particularly in London and South East England, have changed the picture. The average purchase mortgage advance by building societies in Greater London is now £42,850. We expect that by April 1988 the number of loans over £30,000 for the whole country will be about 1,250,000 (15% of the total).

4. Criticism has concentrated on the disparity of treatment between unmarried and married couples sharing a house. The present arrangements impose a tax penalty on marriage and are criticised as encouraging couples to live together outside marriage. Of the responses to the Green Paper on the Reform of Personal Taxation about half of those who commented on the mortgage interest relief point supported the idea of the residence basis mostly on these grounds.

5. The change will not, however, be universally welcomed and opposition is likely to focus on the increasing number of people, other than cohabiting unmarried couples, who club together to share the purchase of a home. The change will in particular affect some young people setting up house for the first time in high price areas like London and the South East. We are unable to obtain reliable information about the number of unmarried co-habitees or other groups of sharers. Press reports, usually based on information from individual building societies or other mortgage lenders, agree only that the trend towards shared purchase is increasing. Two recent articles are attached. Our best estimate on present behavioural patterns is that about



0,000 new joint loans over £30,000 will be taken out in 1988-89 by unmarried home sharers involving about 80,000 individuals. We think about half of these joint loans will relate to unmarried couples and most of the remainder will be either 2 male or 2 female sharers. The estimated yield from the change would be £3-£10m in 1988/89 and £20-30m in 1989/90 depending on commencement date (see paragraph 41).

**COMPENSATION FOR LOSERS?**

6. The relief being withdrawn is quite valuable for the individuals affected - relief for a basic rate taxpayer on a £30,000 mortgage is worth getting on for £1,000 at current interest rates. This raises the question of whether there should be any compensation for losers. There will in fact be no immediate losers (depending on what is done for those in the pipeline - see paragraphs 36-38 below). For subsequent potential claimants there is no way, even if it were thought desirable, to distinguish unmarried couples from others. That leaves the question of partial compensation through an increase in the ceiling.

**THE LIMIT**

7. The present limit of £30,000 has remained unchanged since the increase from £25,000 in 1983. In previous years, the Chancellor has waited until much nearer the Budget before deciding on the limit. Because there are so many variable factors, house prices, tax rates and thresholds and interest rates it is difficult at this stage to provide a reliable estimate of the cost in 1988-89 of any change. For illustrative purposes, however, we estimate on the basis of present tax rates and a mortgage interest rate of 11.25 per cent that an increase in the limit to £35,000 would cost £230 million in 1988-89 and £320 million in 1989-90. Behavioural changes could push up these figures as borrowers are likely to increase the amount borrowed both for home improvements and on new house purchases if more tax relief is available.

And it will surely simply push up house prices at the margin - benefitting only existing mortgage-holders  
25

8. We imagine that you will not want to decide on the limit for 1988-89 yet. It is obviously very much a political judgement on how far an increase in ceiling would soften the change to a residence basis. But it is very expensive for only a small alleviation of the position of the losers. A £5,000 increase in the ceiling would cost over ten times the yield in 1989-90 of the residence basis (£320m compared with £20-£30m) while only compensating losing unmarried couples with maximum qualifying loans by one-sixth of what they have lost and even less for larger sharing groups.

#### Apportionment of relief

9. If the total loans taken out on a jointly purchased and occupied home exceed £30,000 some method of apportioning the relief between the purchasers will be necessary. The following four main approaches are possible. In most cases all methods will be easily defensible and indeed lead to the same result, but in a few cases the results will be different and each option has its own hard core of difficult cases. A decision is needed on which particular form of rough justice in the exceptional cases is most acceptable.

#### (i) Share of the total loan

10. This would split the ceiling in proportion to the size of the claimants' qualifying loans. For example if three people took equal shares in a joint loan of say £60,000 they would each get relief on the interest paid on one half of their share. This is straightforward enough. But where sharers' loans changed in size over time by different amounts there could be problems. To take again the example quoted in my earlier note of 7 October 1986 (paragraph 12) where there was an initial total loan of £32,000 - A and B each have £14,000 and C has £4,000. Each would get relief on 30/32 of their loan (£13,125 to A and B and £3,750 to C). If C then took out a further separate loan for home improvements of say £4,000 the relief would have to be reapportioned (either because he alone was financing the improve-

ment or because he was short of cash to pay for a jointly financed improvement). This would mean that A and B would have their relief reduced although there had been no change in their own situation. In the extreme case where the parties kept their financial situations confidential from each other, there could be confidentiality problems because A and B would have to be told or could calculate the additional loan to C. There would also be an administrative cost as the original loan would have to be taken out of MIRAS.

11. One solution would be to adopt the rule which operates at present to give relief for earlier loans in preference to later ones. In this example A and B would keep their existing ceilings and C would not get an increase. But applying this to different borrowers would be difficult to defend as equitable (the present rule only affects different loans by the same borrower). In the above example C would have £4,250 not qualifying for relief on his total loans of £8,000 whereas A and B would still only be denied relief on £875 out of their much larger loans of £14,000.

12. Changes in the total loan outstanding will also occur when one sharer drops out and is replaced by a newcomer taking out a different amount of loan. The total loan will also change if one or more of the sharers have repayment mortgages while another has an endowment. The capital outstanding on the repayment mortgages will reduce year by year but not necessarily at the same rates but it will remain constant for the endowment mortgage.

13. A rule would be needed to say how joint loans should be split for the purposes of apportioning the ceiling. The present law apportions the amount of the loan in proportion to the interest that each party pays. We would recommend keeping this system - subject to the point discussed in paragraphs 21-26 below - if the share of the loan basis of apportionment is adopted.

**(ii) Share of the total interest**

14. This method would follow the structure of the relief by apportioning the ceiling on the tax relief for interest in proportion to the amount of interest paid by the claimants. It would give the same result as the total loan basis in the vast majority of cases. However it would be more complicated in those cases where the co-owners have separate loans at different interest rates. Where improvement loans as well as purchase loans are involved one co-owner might have two loans at different interest rates in addition to any differences from the rates on his partner's loan. These drawbacks clearly render this method less attractive than the total loan basis.

**(iii) Share of interest in the property**

15. This method was also touched upon in paragraph 12 of my note of 7 October. In essence it goes one step further than simply applying the ceiling to the residence. The £30,000 would be apportioned by reference to an individual's share of the property rather than his share of the loan. For example three people jointly purchasing a property would each have a ceiling of £10,000 regardless of how much each of them borrowed. This approach has the advantage over the share of total loans or total interest bases that it avoids the need for reapportionments on each occasion that one of the co-owners changes his loans or pays off part of the capital on a repayment mortgage. In short the financial arrangements of one co-owner will not affect the relief available to his partners.

16. One consequence, however, of this method is that relief on less than £30,000 could be allowable even though the total loan on the property exceeds £30,000. Take as an example three joint owners, of whom A borrows £20,000 and is restricted to £10,000, but B and C borrow only £5,000 each so that relief is given on a total of £20,000 only. The advantages of this scheme would be lost if there were provision for B's and C's unused allowances to

e transferred to A. If this were allowed we should almost certainly have to allow a transfer back if B or C subsequently increased their loans for improvements. In practice, as existing loans will be protected, we think this possible restriction of relief to less than £30,000 despite loans totalling over £30,000 will only arise in a small minority of cases. Potential sharers will be aware of the rules and will usually arrange their affairs to ensure they obtain the maximum relief. It may be desirable, if this basis is adopted to publicise the position to minimise the number of the unwary who are inadvertently caught.

17. The major difficulty with this approach, however, is over defining and, more important, valuing an interest in property. Firstly people who are not occupying the property, such as a ground landlord could have an interest. This would mean that the sum of the occupiers' interests even if all joint purchasers would be less than 100 per cent so that part of the £30,000 ceiling would be lost. Even among the occupiers problems could arise. One might hold the freehold and therefore have a greater interest than his leasehold partners although all might be paying equal shares of a joint loan. A tenant too could have an interest in the property. Moreover, there could be serious administrative problems for both the Revenue and the taxpayer in valuing interests, in these non straightforward cases.

#### (iv) Per capita share

18. This method is a variation of the share of interest in the property. It seeks to retain the simplicity and advantages of that method outlined in paragraph 15 while overcoming the disadvantages mentioned in paragraph 17. To qualify for relief a claimant has to occupy a property as his only or main residence, pay interest on a loan for the purchase or improvement of that property and have an interest in the ownership of the property. The ceiling would be divided equally among those who occupied the property as their main residence and had an interest in the ownership regardless of what interest if any they paid and regardless of what the value of their interest in the property

as. (The precise legal definition of an interest in property for this purpose will need further consideration but we are hopeful that a workable definition can be arrived at.) There will inevitably be a few cases where one sharer will pay for a larger proportion of the property than his partner(s) and will claim that the method is inequitable but it seems impossible to find a system which is universally fair and simple.

#### Recommendations between the apportionment options

19. The choice seems to us to be between option (i), apportionment by size of the loan, and option (iv), apportionment on a per capita basis. The former ensures that the full £30,000 is always used where there are loans by owner-occupiers on the property totalling £30,000 or more and follows the logic of a ceiling tied to the amount of the loans. The latter, however, is much simpler. There will be a few cases where either part of the ceiling is "wasted" or someone feels their larger share of the property is not being reflected fairly in the loan. But the confidentiality problems and the irritating adjustments where one party changes his loan and affects other people's entitlements to relief which are inherent in the other option would be avoided. As mentioned above, either approach is workable and gives defensible results in the vast majority of cases. It is a matter of judgement which of the options gives the worst rough edges in the exceptional cases; on balance, we think the simpler approach (option iv) might be preferable.

#### Independent taxation

20. The introduction of independent taxation of husband and wife and the residence basis have important implications for the way mortgage interest relief is attributed between husbands and wives. Under the present rules where a wife's income is aggregated with that of the husband it generally makes no difference whether the husband or wife pays the mortgage interest. If, as will usually be the case, the loan is within MIRAS, basic rate relief is allowed whether or not the payer is liable to tax. Aggregation ensures that any relief at the higher rates of tax is also allowed.

21. But a few problems arise on the small number of cases where there is a wife's earnings election and the husband is a higher rate taxpayer. If the husband pays the interest on the home mortgage, even if the wife provides him with some or all of the funds, relief will be available up to the ceiling at the higher rates. If the wife pays any of the interest and she is only a basic rate taxpayer there is a loss of higher rate relief on that interest. Payment of interest out of joint husband and wife accounts can have similar consequences. While the law is not absolutely clear we are advised that, in the absence of contrary supporting evidence, payments from joint accounts should be regarded as deriving equally from the joint account holders. This means that a payment from a husband and wife account should be treated on a 50/50 basis, thus denying the couple higher rate relief on the "wife's share" of the interest. To date this has not caused much difficulty because of the small numbers involved and the fact that we are not usually aware of the precise financial arrangements between husband and wife.

22. Under the proposed independent taxation all wives will become actual or potential taxpayers in their own right. If no special arrangements are made this will have two consequences:

- a. If, as we suggest, the ceiling is shared on a per capita basis between the owner occupiers of the property, then husband and wife will count as two and each will qualify for a ceiling of only £15,000. This will be so, even if the wife does not have a legal share of the property as she will have an equitable interest. So if one partner does not pay any of the interest then the couple will only be able to use half the normal ceiling.
- b. Relief within the ceiling will go to whoever is paying the interest. Where payment is out of a joint account it will be treated as being split 50/50. If one party is a higher rate taxpayer (or both are higher rate

taxpayers but at different rates) then the higher rate relief (or top rate relief) will only be available on the part of the interest paid by the partner concerned. This is the problem which arises at present only in wife's earnings election cases (paragraph 21 above) but would in future arise in many more. If one partner is a non-taxpayer then if the loan is not in MIRAS they will be unable to get any tax relief at all on the part of the interest they pay. If the loan is within MIRAS the relief will be available but it will count as public expenditure, so there will be a considerable increase in the public expenditure component of MIRAS. (We have not been able to estimate the amount as yet.)

23. It would be possible for couples to get round one or other of these problems but not both by choosing particular financial arrangements. The first problem could be avoided by ensuring that each partner paid half the interest even if one had to put the other in funds to do so. The second could be avoided by making sure that the partner paying the higher rate of tax paid the interest (and in particular did not use a joint account). However, these two solutions are incompatible and couples paying at different marginal rates would object that they were being deprived of some of the relief they can at present get and all couples could complain that they were being forced to change their preferred financial arrangements for tax reasons.

24. The only solution we can see to this problem is to allow some transferability or sharing of entitlements to relief between husband and wife. A married couple would be allowed to split the £30,000 ceiling between them in any way they chose and either partner would be able to claim relief for the interest, regardless of who actually paid. Allowing shared entitlement for married couples but denying it to other joint purchasers would give them a marginal advantage but the element of discrimination in favour of marriage could be defended by reference to the Government's basic policy of supporting marriage and the family. We also do not think the element of transferability of mortgage



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Interest relief involved need cause any embarrassment vis a vis the decision not to make personal allowances transferable at present. The special position of husband and wife will be reflected in the personal allowance field by the retention of the married man's allowance; in the mortgage interest relief there is no equivalent and shared entitlement would remove what would clearly otherwise be a significant unintended extra tax burden on couples with one high earner. And the problem would be eased if some other name than "transferability" could be found - perhaps "sharing".

25. We need to do further work on finding a non-bureaucratic way of administering shared entitlement. An election every year would be administratively expensive for the Revenue, taxpayers and lenders. One possibility might be to say that the ceiling will be split in proportion to the interest paid by each partner unless one partner insists on a strict 50/50 split. And we could attribute interest payments to the husband unless a claim for alternative treatment were made. The wife could be allowed unilaterally to claim up to half if she wishes and the couple could be allowed jointly to transfer the rest to the wife if they both agree.

26. The attribution of payments between spouses for mortgage interest relief is however linked to the much wider question of the tax treatment of income from joint assets and accounts on which Mr Mace will be minuting separately. We think it would be preferable to defer a decision on this issue until you have his submission (we hope around mid to late October) since the wider aspects may influence your choice on the appropriate solution. A decision is desirable now on whether to allow sharing of the ceiling because, if you do not think this would be possible, it makes the per capita basis of allocation less attractive. But a decision on the attribution of payments can be deferred; as explained above it would always be possible if shared entitlement were not allowed to say that if a couple want to get full higher rate relief they will have to ensure that the higher earner makes the payments. There would, however, be a substantial increase in public expenditure on account of relief attributed to non-taxpaying wives.

**Should a separate limit per taxpayer be retained?**

27. The present £30,000 limit does not just cover a taxpayer's main residence; it also covers any claims for two subsidiary forms of interest relief - for loans to purchase or improve houses occupied by a dependent relative of the taxpayer and for loans to purchase or improve houses occupied by a divorced or separated spouse.

28. Introduction of a ceiling linked to the residence is likely to provoke suggestions that a taxpayer who has loans on more than one qualifying property should have separate ceilings on each. This would mean that someone could have a separate £30,000 qualifying loan on his or her own house and another on a dependent relative's house and/or a divorced or separated spouse's house. In the case of a married couple both partners could have several qualifying loans and the question would arise of whether a non-separated husband and wife could have different main residences. There is a case for constraining the potential cost (and anomalies) of these additional reliefs by retaining a limit per taxpayer as well as one per residence. There is also a question about whether non-separated husbands and wives should be explicitly treated in law as having the same main residence or whether a similar effect should be obtained by restricting them to a single £30,000 ceiling between them (see paragraph 32).

**Dependent relative**

29. The mortgage interest relief for dependent relatives is anyway something of an anomaly in that it gives tax relief to people who support dependent relatives in one particular way (by financing a separate house) rather than others (eg. by accommodating the relative in their own house or helping them with their rent). A separate submission will be coming forward on the case for withdrawing the personal allowance for dependent relatives. If you decide to do that, it may be appropriate to withdraw the mortgage interest relief for them at the same time.

If not, you may prefer to keep the relief at its present level by retaining a ceiling per taxpayer rather than allowing multiple £30,000 ceilings for the same taxpayer with more than one qualifying residence. We have no information upon which we can estimate the cost of allowing separate ceilings but there would be a risk of escalation over time if, for example, taxpayers bought holiday houses and installed relatives in them. (At present mortgage interest rates a 60 per cent higher rate taxpayer can obtain tax relief of more than £2,000 on the interest on a £30,000 loan.)

### Divorced and separated spouses

30. Similar, if lesser, arguments apply in the case of the relief for properties occupied by divorced or separated spouses. Again the relief favours one particular form of settlement between couples. There would be a tax benefit for divorced couples compared with married couples if one partner could obtain a double tranche of relief only in the former case.

### Second homes

31. There is a purely factual test of which property is a taxpayer's only or main residence for the purposes of mortgage interest relief. Taxpayers with more than one home cannot choose which qualifies for relief (unlike the CGT exemption which will be discussed in Mr Cayley's forthcoming submission). Relief is allowed only on the home where they normally live and the family is housed. But single people each with their own house who come together to cohabit can easily continue to claim relief on both houses. Even if we became aware of their association it would be difficult to prove particularly if they maintained the original separate addresses and perhaps lived in one house during the week and the other at weekends. They could say they were simply guests in each other's houses. It therefore seems to us inevitable that unmarried couples will have to be allowed a separate ceiling on different residences.

32. Under independent taxation it is conceivable that a wife might seek to demonstrate that her main residence differs from that of her husband and claim a second tranche of relief. Obviously if they are living together and the husband is claiming married man's allowance this would be difficult to prove. But, in circumstances where the husband and wife had jobs in different parts of the country, it might be possible to mount a case. Some of these cases might be felt particularly deserving of help, for example, where a husband leaves a depressed area to look for work in a high-cost housing area. But other cases might be felt less deserving of assistance, eg. where a couple has a holiday home where one partner stays for extended periods. It would be very difficult to draw a dividing line between the two sorts of cases.

33. One solution would be to live with the possibility of claims for separate residences by husband and wife (though we would envisage that in this case the ceiling could not be shared as is proposed generally for marital homes at paragraphs 24-26 above). But this could be costly as many two house couples would try to get the benefit of the relief. And it would give rise to contentious disputes at the margin and could be criticised as inequitable by couples who were not able to mount a case for double relief. We have no firm figures but, on present behavioural patterns, we think the cost might be about £20 million. This would increase substantially if there were a significant increase in the number of second homes.

34. Another solution would be (as is the case for capital gains tax; see Mr Cayley's submission) to write into the legislation a stipulation that an unseparated couple must be treated as having the same main residence. Alternatively, a similar effect could be obtained, if a separate ceiling were retained per taxpayer, by applying this ceiling to a married couple rather than giving them £30,000 each. If this is not done and dependent relative mortgage relief is retained it will anyway be quite easy for a wife to get relief for a dependent relative while the husband gets relief for their own home. Either of these approaches

involves a small residual tax penalty on marriage but no solution seems totally free from inequity. On balance we would recommend dealing with the various problems (in paragraphs 27 to 33) by the single solution of a £30,000 limit per taxpayer which would apply to a married (non-separated) couple as well as to single people.

#### Defining a residence

35. It will be necessary to provide a definition of a residence. We think something on the lines of a separate hereditament as used at present in rating law or self contained unit will suffice. There might be some scope for sharers in large Victorian houses to erect partitions and claim they are each living in separate units. This is unlikely to be a major problem.

#### Effective date of implementation

36. Although this change will affect a relatively small number of mortgagors the procedures (eg. forms) will be changed for all taxpayers. To prevent people forestalling the change at all by rushing through shared purchases before the change took effect, it should apply to new loans taken out from the date of the Budget announcement or 6 April 1988.

37. If this course were followed two problems would arise. First there would be strong representations to protect commitments entered into where no formal contract had yet been signed. However these were defined, protection would be a messy and controversial complication creating problems similar to those which arose with the ending of life assurance premium relief. Second, the great majority of mortgage loans are now within MIRAS so that most of the administration is undertaken by building societies and other lenders. Implementation on or before 6 April 1988 will not leave sufficient time for the lenders to absorb and instruct their staff in the new procedures and we will be unable to produce and distribute new forms for completion by borrowers.

38. Previous changes in MIRAS have been announced twelve months in advance to give the lenders ample opportunity to make the necessary changes in their systems. In this case we feel twelve months is too long because this would give people a substantial amount of time to enter into house sharing purchases. A reasonable compromise might be to apply the new rules to all new loans taken out from say 1 August 1988. This would remove the necessity for protecting any commitments entered into before Budget Day because there would be a sufficiently long period for completion to take place. There would be only a fairly limited opportunity for forestalling. It can take a lengthy period for people to come together, find a property and complete a purchase. Consultations with the lenders would be possible and new forms could be produced. 1 August would be after Report Stage and probably Royal Assent so that account could be taken of Finance Bill amendments.

#### Protection of existing loans

39. As noted in paragraph 1 the Chancellor has decided that the change should apply only to new loans. There are a variety of ways in which protection of existing loans can be maintained viz:

- a. for the life of the loan
- b. for a limited period, c.f. in 1974 when relief for interest generally was withdrawn, existing loans were protected for six years, later extended to ten years. Relief was also extended to replacement loans
- c. by phasing out.

40. We feel the simplest method would be the life of the loan. The average life of mortgage loans is less than seven years. It is true that linking protection to the life of a loan will encourage some locking in. Against this home sharers, both co-habitees and other groups tend to be more mobile members of

the population. We think also that the protection should be limited to the existing loan rather than the existing limit. For example two unmarried co-habitees with a loan of £50,000 can at present get relief on a further loan of up to £10,000 for improvements. We suggest that protected borrowers should be restricted by reference to the new rules on any further borrowing. Similarly they should be denied any increases in the limit if the joint existing loans exceed the new ceiling.

#### Yield and staff costs

41. On the basis of a £30,000 ceiling, existing tax rates and a mortgage interest rate of 11.25 per cent, we estimate that the yield from a 1 August 1988 start will be £3 million in 1988-89 and £20 million in 1989-90. A 6 April 1988 start would yield £10 million in 1988-89 and £30 million in 1989-90.

42. The change of basis will undoubtedly produce a number of contentious cases. Many cases of sharers will have to be dealt with outside MIRAS in tax offices and there is bound to be an increase in the number of doubtful cases which MIRAS lenders will refer to us. It is difficult to be precise about the volume but we think it likely that we shall need about 25 to 30 extra staff in 1988-89.

#### Taxpayer's compliance costs

43. The change will not significantly affect taxpayers' own compliance costs but it will put extra burdens on lenders in learning the new rules and issuing new instructions. Once the system is up and running we do not think the increase in burdens will be significant.

#### Points for decision

44. (i) Whether there should be any compensation through an increase in ceiling (paragraph 8). This would be expensive for the amount of relief given and you may prefer to defer a decision until nearer the Budget.

(ii) The basis of apportionment. We recommend the per capita basis described in paragraph 18. This looks the simplest with the least administrative problems. We are still seeking advice to confirm that there will be no snags with property law.

(iii) Whether a married couple should be allowed to share the ceiling between them in whatever proportions they chose (paragraphs 22-26).

(iv) Whether a married couple should be able to transfer between them entitlement to relief on interest regardless of who paid the interest (paragraphs 22-26). We suggest you might defer a decision on this until you have considered the tax treatment of income from joint accounts.

(v) Whether a separate ceiling per taxpayer should be retained (paragraphs 27-34). You may prefer to defer a decision on this until you have decided on the future of tax relief for dependent relatives.

(vi) The effective date of implementation. For the reasons mentioned in paragraph 38 we recommend 1 August 1988.

(vii) The extent of protection of existing loans. We recommend the life of the loan on the basis outlined in paragraph 40.



B O'CONNOR



LONDON DAILY NEWS 16 JULY 87

# TWO UP, TWO DOWN

## What happens when you're single but can't afford to buy a home? LORNA VEE finds how four goes into one mortgage

CLAIRE SOUTH and her boyfriend, Steve Parker, moved into a three-bedroomed maisonette in Bethnal Green with another couple, Jackie Atkinson and Mike Mangnan a month ago. Between them, they had a £10,000 deposit and borrowed £85,000. And they had joined a growing trend.

Nearly 70 per cent of first-time buyers in London need a second income, according to recent figures from the Halifax Building Society. So more and more single people - in groups of twos, threes and fours - are now pooling savings for a deposit, buying a house together and taking advantage of the tax relief.

June Tait, director of the First Time Buyers' Advisory Service, says: "At the beginning of last year, if you were single, earning a decent salary, you might have been able to buy alone. But in a year, house prices have gone up by 26 per cent - there's no way salaries can match that."

Estate agent Michael Steel of Ashton Steel & Day says first-time buyers are an important part of the business. "It's difficult for single people to buy in the area we operate in, West Kensington," he says.

"I've just sold a three-bedroom maisonette close to the Queen's Club for £110,000 to two stockbrokers. For £55,000 each, they wouldn't even get a one-bedroom flat in that area."

Sarah Melliush and school friend Deborah Pearson bought a two-bedroom top floor flat in Clapham three years ago for £36,500. Its value has since doubled.

The only problem they've had was finding the property. "We wanted two bedrooms the same size - and a garden," says Sarah. "We sacrificed the garden." They had a contract drawn up, but didn't discuss what would happen if one went abroad. Sarah did subse-

quently go away for six months, and her room was let out. "Deborah didn't mind, but it could have been a problem."

One major difficulty for would-be sharers is that building societies are not keen to lend money to permutations of more than two people, as Claire South, a nursery teacher, and her three house mates found out.

### Richard was desperate to move

"They told us that from their experience it didn't work," says Claire. Finally, the four found a mortgage from the Halifax, through a broker and Claire's father acted as guarantor.

A different hurdle was overcome by Richard Leeks, an advertising sales director. He bought his first flat with a university friend four years ago in Battersea. "We knew it was a stepping stone. We got a mortgage for £33,000 and put in around £1,000 each. Two years later my £1,000 was worth £6,000 so it was a good way of building up equity."

Richard and John had a contract that said one could sell out within two years depending on the other's circumstances. "But when Richard wanted to leave to buy a flat with his girlfriend, John was changing jobs."

Richard and Alison had set their heart on a flat in Clapham. "I wanted to sell in October, we found a flat in January and didn't exchange contracts until May. It could have been the end of friendship - I was desperate to move out. But I understood John's position," Richard says.

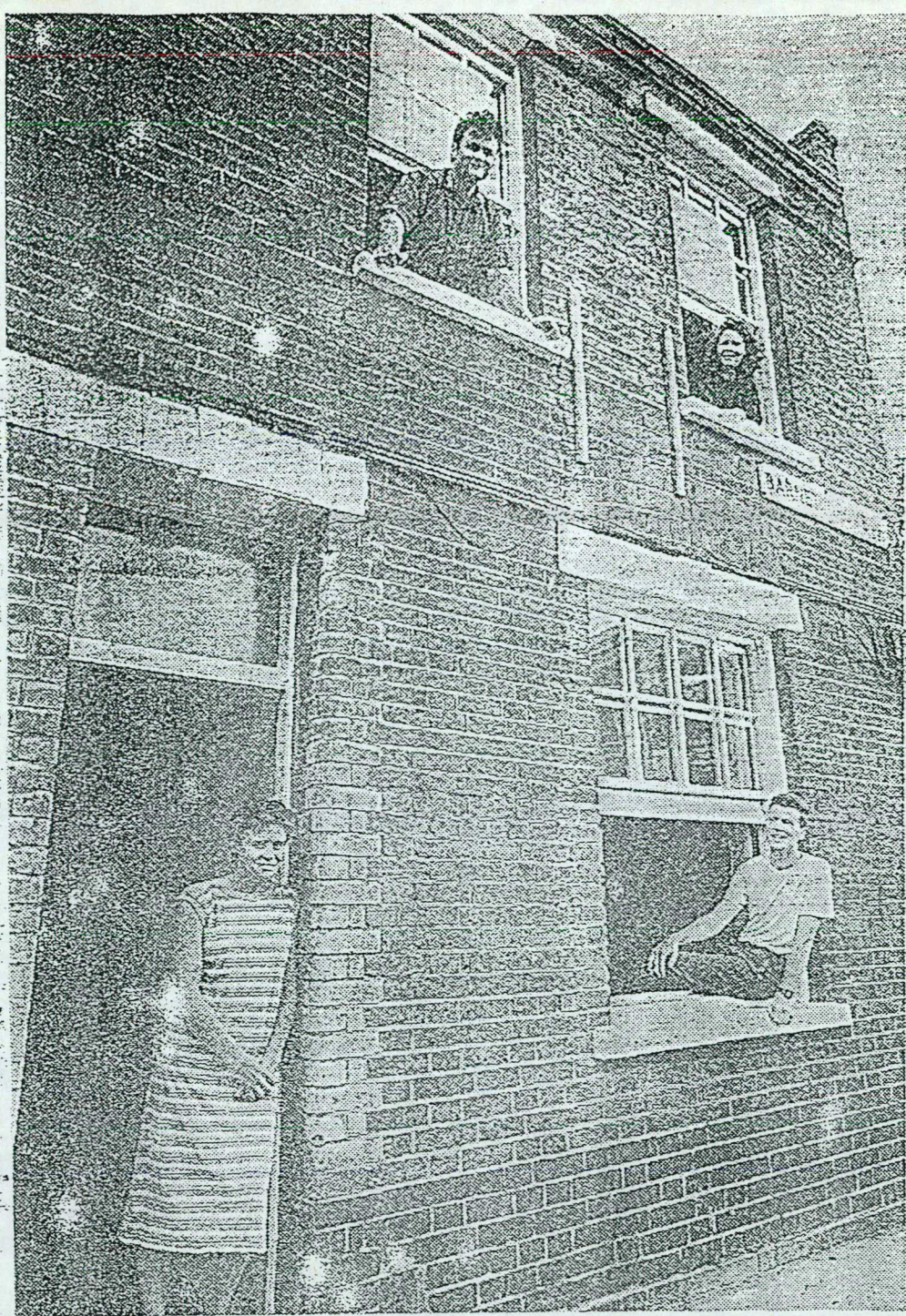
Another issue has recently emerged that particularly concerns men buying together. Some building societies require Aids tests before advancing mortgages. According to the Halifax

### House prices are up 26 per cent

"We've all known each other since we were students," Claire says. "After years of renting, we were sick of pouring money down the drain. Steve and I found we couldn't afford anything, unless we moved far out. We've shared together before so we knew we would get on."



A home of their own: Deborah and Sarah JOHN BURGESS.



Upstairs: Steve Parker, Claire South. Downstairs: Jackie Atkinson, Mick Mangan JUDY GOLDHILL

however. Aids tests are only required for life assurance – and should have nothing to do with mortgages.

What is vital for single people sharing is a formal agreement, drawn up by a solicitor. If one person disappears or dies, the others still have to pay up – so precautions are required.

### A house instead of a tiny flat

Architect Paul Baker sold his house in Oxford when he moved to London. But rather than buy a small flat alone, he and university friend Oliver Stirling, also an architect, together paid £160,000

for a five-storey Georgian house in Kennington.

“The idea is to do it up,” says Paul. “There’s a lot to be done, so if one of us loses motivation, there’ll be a hitch.”

A standard contract aimed at friends buying property together costs about £150. The crucial part concerns selling. It’s a good idea to define a time limit (usually two years) after which either side can sell out.

Paul and Oliver paid £250 for a more complex agreement. “We each got a £30,000 mortgage and put in £50,000,” says Paul. “With so much cash, you’ve got to think about death and wills.”

“If one person dies, who is

responsible for the mortgage? Can the beneficiaries sell out? There are all sorts of questions, and with an agreement we both know where we stand.”

Buying property is a big investment – apart from the practical and financial details, and insurance to protect the individual sharers from a defaulting partner, there is the question of compatibility. If six months after you all move in; you all fall out, it can be a costly exercise in more than friendship.

Claire South, for one, is happy. “We’re not yuppies. We don’t earn much,” she says. “But we have found somewhere we like to live – and it’s ours.”

FIRST-TIME house buyers are a resourceful and persistent lot, according to the latest housing statistics from the Nationwide Building Society.

Faced with daunting house prices in the South-east and falling incomes elsewhere, the Nationwide estimates that more home buyers are pooling their resources and buying homes together — sharing the purchase price and the mortgage.

In its latest report, the North-South Divide, the Nationwide's mortgage manager Mike Sismey says. "Although the gap between North and South is wider now than it has ever been, it is clearly nothing new. What we have seen is the development of new ways of buying houses in the South-east. There has been a huge increase in joint mortgages and in the number of people simply clubbing together to buy a house."

Although the UK as a whole has seen a rise in joint mortgages, with seven per cent more Nationwide borrowers holding joint mortgages than a decade ago, the figures disguise the true reasons behind the uplift.

Predictably, it is in Greater London and the South-east where the real changes have taken place. Since 1977, joint mortgages in London have risen only in line with the national average to 6.5 per cent

**'From documentary and anecdotal evidence at branch level,' said the man from the Nationwide, 'there has been a big increase in the number of people doubling up to pay their mortgage.' Stephen Quirke reports on the boom in joint mortgages**

## Clubbing together under one roof

24  
— five per cent of that increase has been in the past five years. In the South-east, excluding London, the figure is slightly higher with a 9.4 per cent rise.

According to the Nationwide, the reason for the uplift in the South is markedly different from that elsewhere — in the South, house buyers are finding ways around booming house prices by clubbing together to buy their homes. In other parts of the UK, homeowners are being forced into joint mortgages as incomes are squeezed.

Scotland has seen a nine per cent increase in the past decade, the East Midlands almost 12 per cent, the North-west 13 per cent, and Yorkshire almost 14 per cent.

Jeff Wagland of the Nationwide explains the figures:

"From documentary and anecdotal evidence at branch level, there has been a large increase in the numbers of people doubling up to pay their mortgage. While our figures have continued to climb, the marriage rate has remained relatively static, suggesting a rise in joint mortgages among unmarried couples. In other parts of the UK, such as Northern Ireland and the East Midlands, where joint mortgage figures have risen, unemployment is forcing wives to supplement falling household incomes and share the costs of a mortgage."

The advantage of remaining

rowers, "the number of three and four people clubbing together to pay for their home would run only into the hundreds."

Simon Garbett, managing director of Mann and Co. Estate Agents, which has 125 offices in and around the South-east, acknowledged the increase in joint mortgages.

"In the past five years, we have seen a real increase in mixed and same sex couples who have considered clubbing together as the best course of action — and for many of them it works.

"I would be surprised, however, if there has been a growth in the commune living market — groups of three, four, and five people buying a home together."

Martin Sturgis, a senior partner of Sturgis and Son, has noticed the rapidly climbing levels of joint applicants:

"We have had many couples clubbing together to buy a home, but in our experience none from three people. It would be a difficult and almost unmanageable problem to administer finance for three or four people in a move. With two people, there are readily identifiable problem areas and solutions to complications which do arise. If I were a lender, I would be loth to take on more than two borrowers."

single — at least when it comes to housebuying — is plain to see. Unmarried couples are able to claim double the £30,000 limit on Miras (Mortgage Interest Relief at Source) on joint mortgages. Married couples can claim Miras only up to £30,000. There is a likelihood that this may change in next year's Budget when mortgage interest relief is expected to be calculated on the residence rather than the householders.

Yet, according to Nationwide and main London estate agents, reports that up to three, four and five buyers are grouping together to buy homes, are exaggerated. Wagland reveals that of 500,000 Nationwide bor-

b.f. for meeting on 12/10 (a.m.)



FROM: J J HEYWOOD  
DATE: 5 October 1987

PS/CHANCELLOR

- cc PS/Chief Secretary
- PS/Economic Secretary
- Sir P Middleton
- Mr Cassell
- Mr Scholar
- Miss Sinclair
- Mr Murphy
- Mr Cropper
- Mr Tyrie
- Mr Jenkins
- Mr Johns
- Mr O'Connor
- PS/IR

OPC  
IR  
IR

Ch  
For meeting on 12/10  
AT  
MJK  
[Financial Secretary to the Treasury]

PS/EST  
TO  
PS/CH  
5 OCT

**MORTGAGE INTEREST RELIEF : RESIDENCE BASIS**

1. The Financial Secretary has discussed with officials Mr O'Connor's submission of 23 September. He has also seen your note of 5 October.

2. The Financial Secretary has assumed in considering the options in Mr O'Connor's submission that we still wish to remove the tax penalty on marriage inherent in the present rules. He has also assumed that other options such as giving all individuals a separate £30,000 limit, whilst confining interest relief to the basic rate are not runners for the foreseeable future. Mr Scholar would favour something along these lines if it were politically acceptable and affordable.

You discuss with us

**MARRIED COUPLES**

3. At first sight, the Financial Secretary shared the Chancellor's view that this clutch of issues appeared daunting. In particular, he was not attracted to the idea of changing the existing system for married couples (as well as "sharers") and thought the whole reform package looked highly complex for taxpayers.

4. However, it is clear that the introduction of independent taxation necessitates a change in the regime for married couples.

CONFIDENTIAL

If nothing were done, husband and wife would, under independent taxation, each get a limit of £30,000. This would be very expensive and highly inflationary.

5. The Financial Secretary has, therefore, examined whether the proposed change of regime for married couples is the best and, in particular, the simplest approach. Officials have said that for the vast majority of married couples the new arrangements should be no more complicated than the present system and that the complications that *do* arise stem from treating husband and wife as separate taxpayers under independent taxation regardless of the adoption of the residence basis. Moreover, the proposals would ensure that no married couple would lose out except where they themselves are sharing with others - provided they made the appropriate tax-minimising arrangements. The Financial Secretary is therefore content that:

- (i) Married couples should be allowed to share the ceiling between them in whatever proportions they choose;
- (ii) Married couples should be able to transfer between them entitlement to relief on interest regardless of who paid the interest (though the Financial Secretary will have another look at this when he has considered the tax treatment of income from joining accounts.)

SHARERS

6. As far as "sharers" are concerned, the Financial Secretary sees no real alternative to option (iv) in Mr O'Connor's paper - dividing the ceiling equally among those who occupy the property as their main residence and have an interest in the ownership. This would be inequitable in some cases, but the Financial Secretary thinks it is the only practical option.

*or split with*

TAXPAYER LIMITS

7. The issues discussed in Mr O'Connor's paragraphs 27-33 boil down to whether we should change the present system of having an overall limit of £30,000 for all eligible purposes for each

taxpayer. The Financial Secretary thinks we should not change this, whilst recognising that it implies the continued existence of a minor tax penalty on marriage (since in this case a married couple would be treated as one taxpayer).

*James*

DATE OF IMPLEMENTATION/EXISTING LOANS

8. The Financial Secretary agreed with officials that

- (i) The date of implementation should be 1 August 1988;
- (ii) Existing loans should be protected until they are paid back.

*Johnston*

CONCLUSION

9. The Financial Secretary thinks that we need to decide whether or not to press ahead with this reform. He recognises that there will be some vocal opposition from the young people who would have been able to make use of the existing tax position by clubbing together and obtaining multiple reliefs. The Financial Secretary, nevertheless, remains in favour of the "residence basis" because:

- (i) There is a substantial tax penalty on marriage which he thinks should be removed and which would be particularly difficult to defend when independent taxation is being introduced.
- (ii) Although the number of sharers is currently quite small, it is on an upward trend, and the effects on house prices might become increasingly significant.
- (iii) Sharers will still be able to share, and get the advantages of joint purchases, even if the tax reliefs available are reduced.

*J.H.*

JEREMY HEYWOOD  
Private Secretary



Inland Revenue

Policy Division  
Somerset House

TASK FORCE SECRET

At the meeting 9 author implied a £30,000 ceiling make no difference to the transferability arguments. FROM : B O'CONNOR  
This fuller analysis shows there is less need for full transferability but there is no significant \* 27 November 1987

1. Mr Johns
2. Mr Painter 27.11. lost saving to achieve by dropping it.
3. Financial Secretary

may 17/11  
Rb X,  
check  
papers.

MORTGAGE INTEREST RELIEF : STARTER NO.114

1. At the meeting on 19 November the Chancellor asked for details of the estimated costs under the proposed new tax regime of different ceilings on both the residence and individual ceiling bases.

\* i.e.  
rates of  
25% and  
35%.

2. The estimated costs are as follows:-

Residence basis

Ceiling	Cost £ million		
	1988-89	1989-90	
£35,000	- 170 30	- 220	20
£40,000	- 300 200	- 400	200
<del>£50,000</del>	<del>- 460</del>	<del>- 650</del>	

Individual ceiling basis

Ceiling	Cost £ million		
	1988-89	1989-90	
<del>£20,000</del>	<del>- 210</del>	<del>- 240</del>	
£25,000	- 360 280	- 490	290
£30,000	- 430 350	- 620	420

- cc. Chancellor  
 Chief Secretary  
 Economic Secretary  
 Sir P Middleton  
 Sir T Burns  
 Mr Cassell  
 Mr Scholar  
 Miss Sinclair  
 Mr Cropper  
 Mr Tyrie  
 Mr Jenkins (Parliamentary Counsel)

- Chairman  
 Mr Painter  
 Mr Isaac  
 Mr Beighton  
 Mr Lewis  
 Mr Johns  
 Mr Cleave  
 Mr Boyce  
 Mr I Stewart  
 Mr O'Connor  
 PS/IR

## TASK FORCE SECRET

These figures take no account of possible behavioural changes and assume, in accordance with the latest forecast, a mortgage interest rate of 10.25 per cent for both 1988-89 and 1989-90.

3. Table 1 (residence basis) and Table 2 (individual ceiling basis) annexed show the figures in more detail and include the yield from losers (sharers under the residence basis; singles and sharers under the individual ceiling basis) and the cost of married gainers. For comparison purposes the tables also include the estimated cost if the present tax regime continued with indexation of allowances and thresholds. We are still looking into the question of basic rate losers from the whole package. This is a complex and uncertain issue and we will provide a further paper.

### Transferability

4. As explained at paragraphs 24-26 of my note of 23 September and in the later notes of 27 October both the residence and the individual ceiling basis could involve some loss to married couples unless:

- (a) spouses are allowed to split their combined ceiling between them in whatever proportions they choose; and
- (b) the couple can choose which one gets tax relief irrespective of which actually pays the interest.

Moreover unless (b) is allowed the amount of tax relief a married couple gets will depend on the precise arrangements they make for paying the mortgage (whether the man or the woman pays or both pay jointly). To ensure that no portion of the ceiling is forfeited we have suggested that (a) but not (b) should apply to unmarried sharers if a residence basis is introduced. For most unmarried sharers, who pays will generally depend on a genuine difference in their interest in the loan and in cases of purely independent sharers, as discussed at your meeting, it would be inappropriate to ignore this.



TASK FORCE SECRET

**Individual ceiling £30,000**

5. At the meeting you suggested that if the individual ceiling was raised as far as £30,000, there would be no need for transferability because there would be no losers. This is true as far as the (a) type of transferability is concerned. Because each spouse would be entitled to the same ceiling as a married couple, they could still get relief on as much interest as they can at present irrespective of how they arranged their affairs.

6. However, as we explained, type (b) transferability would still be needed for married couples. Otherwise, while they might be able to get relief on the same amount of interest, they might not get it at the same rate of tax. For example, if there is a mortgage of, say, £30,000 and each spouse pays 50 per cent of the interest, each will be allowed relief on £15,000. If only one is a higher rate taxpayer, higher rate relief will only be allowed on his (or her) half as opposed to the full amount at present. Basic rate relief will be given even if one spouse is a non-taxpayer provided the loan is in MIRAS, but there will be a similar problem on the small minority of non-MIRAS loans where one spouse does not pay tax.

7. Married couples could arrange their affairs to ensure there was no loss of relief and it would be possible to say that with such a generous increase there is no need to provide transferability even of type (b). With higher rate tax down to 10 per cent the penalty on adopting the "wrong" financial arrangements would be quite small. On the other hand, as discussed at the meeting, it would be highly desirable to avoid a situation where the amount of tax relief depended on the couple's banking arrangements. It would create a trap for the unwary and the ill-advised and, in any case be more or less impossible for us to police.

TASK FORCE SECRET

8. There is anyway very little saving to be achieved by denying transferability if one assumes that the bulk of couples would arrange their affairs to get round the problem and with higher rate tax at the new lower rates being the only financial difference between the options and affecting fewer couples because of the higher threshold. The saving is so small that we have not been able to quantify it and the costs in paragraph 2. above would, within the inevitable margin of error, be the same whichever basis was adopted for husbands and wives.

9. If full transferability is not given there would have to be special rules applying during the transitional period before independent taxation comes into force when aggregation of husband and wife's tax affairs would continue to apply. We will minute separately on these when the long term arrangements are settled.

**Conclusions**

10. We therefore recommend that if you wish to avoid married couples other than sharers losing from the changes and to avoid the amount of tax relief depending on a couple's banking arrangements, type (b) transferability should be introduced whatever the amount of the ceiling. Type (a) transferability would be necessary unless an individual ceiling of £30,000 was introduced. If you could afford to go that high it could be dispensed with but there would be no significant revenue saving.

**Improvement loans**

X | 11. The cost figures in paragraph 2. and the annexed tables assume the abolition of relief for new home improvement loans. We are setting drafting of Instructions to Counsel on this in hand. We are assuming that the abolition is to relate to owner-occupiers only and not to landlords.

  
B O'CONNOR

T A S K F O R C E S E C R E T

SUMMARY OF COSTS OF CEILING INCREASE AND RESIDENCE BASIS FOR RELIEF TABLE 1

MORTGAGE RATE ASSUMED TO BE 10.25%

£ million

	INDEXED TAX REGIME		TAX REFORM RATES	
	1988-89	1989-90	1988-89	1989-90
<b>£35,000 ceiling</b>				
Cost for singles	-41	-56	-36	-48
Cost for married	-165	-226	-144	-192
Yield from sharers	7	21	6	19
Total	-200	-261	-173	-221
Rounded	-200	-260	-170	-220
<b>£40,000 ceiling</b>				
Cost for singles	-70	-97	-61	-82
Cost for married	-280	-387	-243	-330
Yield from sharers	4	14	4	12
Total	-346	-470	-300	-400
Rounded	-350	-470	-300	-400
<b>£50,000 ceiling</b>				
Cost for singles	-107	-153	-93	-131
Cost for married	-427	-614	-371	-522
Yield from sharers	1	4	1	4
Total	-533	-763	-463	-649
Rounded	-530	-760	-460	-650

SUMMARY OF COSTS OF CEILING PER INDIVIDUAL

TABLE 2

MORTGAGE RATE ASSUMED TO BE 10.25%

	INDEXED TAX REGIME		TAX REFORM RATES	
	1988-89	1989-90	1988-89	1989-90
£20,000 ceiling per individual				
Yield from singles	29	88	26	80
Cost for married	-280	-387	-243	-330
Yield from sharers	4	14	4	12
Total	-247	-285	-213	-238
Rounded	-250	-290	-210	-240
£25,000 ceiling per individual				
Yield from singles	11	35	10	31
Cost for married	-426	-614	-371	-522
Yield from sharers	1	4	1	4
Total	-414	-575	-360	-487
Rounded	-410	-580	-360	-490
£30,000 ceiling per individual				
Yield from singles	0	0	0	0
Cost for married	-499	-726	-433	-618
Yield from sharers	0	0	0	0
Total	-499	-726	-433	-618
Rounded	-500	-730	-430	-620

SUMMARY OF COSTS OF CEILING PER INDIVIDUAL

MORTGAGE RATE ASSUMED TO BE 10.25%

£ million

	INDEXED TAX REGIME		TAX REFORM RATES	
	1988-89	1989-90	1988-89	1989-90
£20,000 ceiling per individual	-250	-290	-210	-240
£25,000 ceiling per individual	-410	-580	-360	-490
£30,000 ceiling per individual	-500	-730	-430	-620



FROM: FINANCIAL SECRETARY  
DATE: 27 November 1987

CHANCELLOR

cc Chief Secretary  
Paymaster General  
Economic Secretary  
Mr Cropper  
Mr Tyrie  
Mr Call

#### MORTGAGE INTEREST TAX RELIEF

I have seen Peter Cropper's minute of 23 November.

2. He identifies a number of objections to his preferred solution of £30,000/£60,000:

- (i) Revenue cost
- (ii) Inflationary effect on house prices
- (iii) Difficult transition
- (iv) Encouraging further indebtedness
- (v) Pushing up interest rates
- (vi) Diverting more money into housing away from entrepreneurial pursuits.

3. I have to say that I find this comprehensive list of objections pretty conclusive. I continue to favour the residence basis. I think the complications of it have been somewhat exaggerated.

4. I can see the neatness and intellectual elegance of the individual ceiling approach. It also dove-tails with the rest of the package. But is it really worth it at the price of a ceiling of £30,000/£60,000? The argument that this is the last adjustment and from now on there will be no further change will be greeted with derision.

TASK FORCE SECRET

TASK FORCE SECRET

5. I fear also that the coherence of the package as a reforming budget, with tax reliefs cut in exchange for lower rates, will be much diminished. We will be attacked by the tax reformers as well as our political opponents. I do not believe that informed commentators will accept the narrowing of relief away from improvements as an adequate quid pro quo for the doubling of the limit.

6. Obviously scrapping mortgage interest relief is not on and the commentators have got used to that. But I do not see that this means we have to do a sharp about-turn and march off in the opposite direction from the thrust of our policy on mortgage interest relief over the recent past.

7. In my view it would be disastrous to introduce a £60,000 ceiling for married couples. It would doubtless very quickly feed through into house prices thus defeating any objective which might underlie the proposal. The very last thing we need to do at present is push house prices in the South-East any higher and give a further sharp incentive for ownership at the expense of renting.

8. I think it is misguided to argue that such a step would represent a "realistic re-alignment with higher house prices". The latter are simply a reflection of existing tax reliefs and if we made those any more generous then house prices would rise even further.



NORMAN LAMONT

TASK FORCE SECRET

## COMPATIBILITY WITH PAST STATEMENTS

2. Each of the attached notes covers proposals which will involve some potential losers. To what extent they can be defended against Government commitments to mortgage interest relief is a matter of political judgement. For ease of reference recent statements are attached in the Annex. The abolition of home improvement relief can be defended as not affecting "home buyers". The residence basis can be defended on the grounds that it was canvassed in the Green Paper (although some of the statements of commitment are more recent than that). The individual ceiling might <sup>- though this could be very difficult -</sup> be defended on the grounds that it is a change of amount not system and is another way of dealing with the tax penalty on marriage identified in the Green Paper. The more changes are made in total the more criticisms of inconsistency there are likely to be whatever the merits of each proposal.

## ABOLITION OF HOME IMPROVEMENT LOAN RELIEF

3. This will give us a useful simplification, save perhaps 150 staff in 1988-89, and remove a much criticised source of abuse. We do not judge that in practice it will change behaviour much either by causing people to move rather than extend or by causing them to sell to developers rather than improve themselves because our (admittedly scanty) information suggests that most improvement loans are relatively small and for marginal improvements rather than substantial works. But there will be criticisms that it is inconsistent to penalise improvement compared with new purchase, there will be hard cases and it will be seen as discouraging upgrading of existing housing stock and the inner city initiative. We imagine for this last reason you will want to leave landlords with tax relief on improvements but you will want to consider the presentational problems of doing so.

4. You will need to identify the main presentational thrust to defend the change. We would suggest simplifying and targeting the relief on home buyers as the main theme rather than

preventing abuse - otherwise it looks as if you are punishing the innocent with the guilty.

#### RESIDENCE BASIS OR INDIVIDUAL CEILINGS

5. An individual ceiling is simpler and arguably more equitable (why should people get more relief if they live separately than together?). It is, however, harder to square with past commitments as it was not canvassed in the Green Paper, and it creates more losers. But they do not lose as much as those worst affected by the residence basis and in either case existing loans would be protected. I understand that the Chancellor expressed a preference for the residence basis at his meeting on 20 October.

#### SIMPLIFYING THE RESIDENCE BASIS

6. We have concluded that people will generally be able to readjust their affairs so they do not lose out if you simplify by abolishing the dependent relative and separated/divorced spouse reliefs.

7. On the allocation of the relief between sharers we do not think complete equivalence between married and unmarried sharers can be achieved. There are two main options:

- to allow complete flexibility so that either partner can claim relief up to the £35,000 ceiling regardless of the amount each pays; or
- to restrict relief for each party to the amount of interest they pay but allow them to transfer across to the other partner any unused portion of the ceiling (apportioning the residence ceiling on a per capita basis).

8. For married couples it would be necessary to adopt the former approach (which would give the higher earning spouse higher rate relief regardless of who paid the interest) if you wish to ensure that no married couple, apart from those sharing with others, loses from the change. You are likely to have to



set a more restrictive rule about the tax treatment of income received - taxing the spouse who receives it and not allowing transferability to optimise use of personal allowances and rates. Mr Mace will be submitting on this shortly, but we do not think this difference of approach matters. But we think that far fewer non married sharers will operate a common household budget than married couples which makes it inappropriate to allow them to optimise higher rate relief by transfer of relief from a person who does not pay interest to one who does. So we recommend the more limited flexibility of allowing transfers of unused ceiling between them. As the other side of the same coin, we think it is justifiable (and it would prevent both Exchequer cost and difficult disputes) to say that a married couple can only have relief for their joint main residence and not for different main residences each.

#### TIMETABLE FOR DECISIONS

9. The timetable for decisions is largely set by drafting needs. Successful implementation of the changes will be largely in the hands of the MIRAS lenders and we will need to ensure our communications with them are effective. But we assume you will not wish to consult them in advance of the Budget. Forestalling alone would seem to rule this out. If there was no other drafting to be done decisions could no doubt be left until the end of January. But there will be many other projects competing for Parliamentary Counsel's attention. The residence basis will be quite complicated to draft and we would like to get on with Instructions in December at the latest and during November if at all possible. Otherwise there is a risk of mistakes being made in the rush. This means that a decision between the residence basis and individual ceilings is needed by mid to end November at the latest. Decisions on the ceiling and on home improvement loans will be simpler to draft. The former can be left until around the end of February and the latter to around the start of February. <sup>- though you will be aware of our anxieties about any late pursuits on Parliamentary Counsel</sup> But to the extent that choices on the residence basis depend on these decisions it would be desirable to have a clear picture of where we are going when we start to draft the former. In particular there could be problems if you go for

transferability of the ceiling between non married sharers and then decide not to proceed with abolition of relief for home improvement loans.

#### CONSULTATION WITH DEPARTMENT OF ENVIRONMENT

10. These changes, especially, the changes to home improvement loans, have implications for housing policy more generally. You will need to consider whether to consult Mr Ridley and, if so, when.

*— absolute help for rents accounts*

#### REVENUE AND ADMINISTRATIVE COSTS

11. The exchequer costs and yields of these proposals are:

	1988/89	1989/90
Abolition of relief for home improvement loans	+ £100 million	+ £250 million
Residence basis and £35,000 ceiling	- £220 million	- £290 million
Individual £20,000 ceiling	- £260 million	- £285 million

*→ 7160m*

*→ 735m*

*? cost of min 725,000 (Eilyr)?*

12. The staff costs have still to be finalised. We estimated the cost of the residence basis at 25-30 assuming the present ceiling. But if the ceiling goes up the staff cost will be reduced. The staff cost of the individual ceiling basis will be even less. Against this, as mentioned, abolition of relief for home improvement loans would save 150 staff. The lenders will face the bulk of the administrative cost from the changeover because of the MIRAS system. We do not know what the costs will be but they could be considerable especially in the first year and particularly for the residence basis.

*M.A. Johns*

M A JOHNS

**PRIME MINISTER**

"I am happy to repeat what I have frequently said from this Despatch Box and shall be saying many times in the future. So long as I am here, tax relief on mortgages will continue." (Hansard 25 July 1985 col 1301.)

"As my hon Friend is well aware under this Government the present system of mortgage tax relief will continue. I believe that ours is the only party which stands four square behind the system." (Hansard 31 October 1986.)

"Conservative party and Government are now the only people who do not want to limit in any way the present system of mortgage interest relief for home buyers." (Hansard 25 February 1987.)

**MR MCGREGOR AS CHIEF SECRETARY**

"We have no intention of changing the system of mortgage interest relief." (Hansard Standing Committee G 15 May 1986 col 119.)

**FINANCIAL SECRETARY**

"The Government see nothing wrong in allowing relief at the higher rates of tax as the natural consequence of our progressive tax system. If tax system on mortgages is to continue - the Opposition have promised to continue it - it is reasonable that it should apply to borrowers at all rates of tax." (Report Stage Hansard 17 July 1986 col 1257.)

**"THE NEXT MOVES FORWARD" CONSERVATIVE MANIFESTO**

We will keep the present system of mortgage tax relief.

COPY NO 2 OF 19  
 FROM: MISS C E C SINCLAIR  
 DATE: 2 November 1987

FINANCIAL SECRETARY

cc / Chancellor  
 Chief Secretary  
 Economic Secretary  
 Sir P Middleton  
 Mr T Burns  
 Mr Cassell  
 Mr Scholar  
 Mr Riley  
 Mr Murphy  
 Miss Hay  
 Mr Cropper  
 Mr Tyrie  
  
 Mr Jenkins  
 Parliamentary Counsel  
 Mr Painter  
 Mr Isaac - IR  
 Mr Johns - IR  
 PS/IR

*CC Computer*

**MORTGAGE INTEREST RELIEF**

We in FP see considerable attractions in the individual ceiling as opposed to the residence basis (Mr O'Connor's two minutes of 27 October and Mr Johns' of the same date).

2. Arguments for the individual ceiling are:

- (i) It would remove the tax penalty on marriage.
- (ii) It would be simple - cutting through the problems of apportioning relief and determining the main residence. This would help taxpayers, MIRAS lenders and the Revenue (who would get some small staff savings).
- (iii) It would be kinder to sharers than the residence basis.
- (iv) It would continue the present system, except that a married couple would qualify for a double portion of relief. This means that the legislation would be simple, and arguably the change would be consistent with pledges to continue the present system of mortgage interest relief.

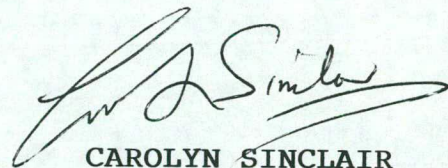
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 2 NOV

TASK FORCE SECRET

- (v) It would be very popular with the majority who would benefit - including those who would otherwise lose from the abolition of the employees' UEL, and who would not benefit from other independent taxation changes until 1990. Virtually all losers from the Budget package who have mortgages in excess of £30,000 are married couples.

3. Arguments against:

- (i) It would hurt more people than the residence basis - by £210 a year on average. The Revenue propose protection for separated, divorced and widowed people as long as they do not move house.
- (ii) It was not the option canvassed in the Green Paper - but that spoke only of the residence basis as one way of removing the tax penalty on marriage. (Paragraph 5.16. "One approach might therefore be to apply mortgage interest relief to the residence rather than to the individual taxpayer....") The individual ceiling could be presented as a simpler way of achieving the same objective.
- (iii) It would increase the cost of MIR - a major objection - but so would restricting relief to the residence. The cost difference is minimal: £285 million for a £20,000 individual ceiling in 1989-90 compared with £290 million for the residence basis (at £35,000).

  
CAROLYN SINCLAIR



FROM: FINANCIAL SECRETARY  
DATE: 16 November 1987

CHANCELLOR

cc Chief Secretary  
Paymaster General  
Economic Secretary  
Sir P Middleton  
Sir T Burns  
Mr Cassell  
Mr Scholar  
Mr Riley  
Miss Sinclair  
Mr Murphy  
Mr Cropper  
Mr Tyrie  
Mr Painter IR  
Mr Johns IR  
Mr O'Connor IR  
PS/IR

**MORTGAGE INTEREST RELIEF (BUDGET STARTERS 114 AND 115)**

I have considered Mr O'Connor's three submissions of 27 October, Mr Johns' note of 27 October and Miss Sinclair's minute of 2 November. I think that this issue is the trickiest one we have yet had to consider.

**Home Improvement Loans**

2. I recognise that you favour abolition - a measure which will eliminate abuse and produce useful Revenue and lender staff savings. However:

- (i) I think it will be criticised as being at odds with our policy of encouraging the renovation of older properties.
- (ii) If we do go ahead, I think we need to get better information on the type of loans currently in existence. This information might aid presentation.

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3. Assuming that we do abolish home improvement relief, I recommend:-

- (i) **Relief for Landlords:** this should provisionally be retained, subject to the conclusions of Mr Cassell's Working Group; — report will reach you shortly
- (ii) **Consultations with DoE:** these should take place in the context of consideration of the Working Group's conclusions.
- (iii) **Protection of Existing Loans:** there is little awkwardness in allowing existing improvement borrowers to benefit from any increase in the general £30,000 ceiling. This should therefore be allowed.
- (iv) **Implementation Date:** this should be 6 April 1988.

Residence Basis

4. On the assumption that the residence basis goes ahead, I believe that we should allow transferability of unused portions of relief between unmarried sharers (as well as for married couples as already agreed). But I agree with officials that it would not be appropriate to go further than this for unmarried sharers.

5. For married couples the proposal is (paragraph 3 of Mr O'Connor's submission) that not only would they be allowed to split their combined ceiling between them in whatever proportions they chose (so that there were no unused part of the ceiling); but also they would be able to choose which partner got tax relief regardless of who paid the interest. I think that to give unmarried sharers the latter flexibility would be unjustified. As Mr O'Connor says this would "open up the idea that people could generally sell their tax reliefs to others who could make better use of them."

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6. This additional flexibility, of course, is necessary for married couples to ensure that no married couple (except when sharing with others) is worse off under the new proposals than under the current regime. But I am less worried about sharers losing - since that would be one objective of the reform. Moreover, sharers would only be in a relatively disadvantaged position if at least one (but not all) were a higher rate taxpayer (or, as is rare, where one is a non-taxpayer and the loan is out of MIRAS). If all sharers are basic rate or all are higher rate taxpayers this additional flexibility is not necessary to make full use of the threshold.

Dependent Relatives and Divorced and Separated Spouses

7. At present people can get tax relief (up to £30,000 to the extent they have not used up their threshold in buying or improving their own home) for the purchase or improvement of houses for dependent relatives, divorced or separated spouses. I agree with officials that this relief should be abolished in the Budget. At the price of allowing the dependent relative to own part or all of the purchased house, anyone wishing to help a relative in this way will still be able to do so. The relative will take out the loan and the original taxpayer will simply pay for the relative's net interest direct to him rather than to the lender.

8. I think that the similar capital gains tax relief for second homes occupied by a dependent relative should also be abolished (Mr O'Connor's paragraph 16).

Married Couples with Two Homes

9. As far as married couples with two homes are concerned, I favour Option (b) - the introduction of a specific rule in the legislation that an unseparated couple can only have one main residence for the purposes of claiming relief (ie. married couples should not get two slugs of residence-based relief, even if they have two residences).

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Individual Ceiling

10. Although the Revenue maintain that the residence basis and its consequential are practicable and uncomplicated for the large majority of taxpayers, I am conscious that this approach would be much less simple than the individual ceiling proposal, for taxpayers, lenders and the Revenue alike.

11. As you know, I do put great weight on the virtue of simplicity in the tax system, particularly given the sprawling - though necessary - complications inherent in independent taxation. As I see it, the balance sheet for the residence basis/individual ceiling choice is as follows:

(i) Residence Basis

- \* removes the tax penalty on marriage (by hurting future sharers)
- \* was foreshadowed in the Green Paper
- \* does not hurt single people except sharers (by the same token it treats single people identically to married couples)

(ii) Individual Ceiling

- \* removes the tax penalty on marriage (but allows multiple sharers more relief than married couples)
- \* is manifestly equitable - an equal slice of relief for each individual, married or not.
- \* is relatively simple for everyone.
- \* hurts all single people who wish to borrow in the future (but these will, in general, benefit most from the community charge)
- \* hurts future sharers - but not by as much as the residence basis.
- \* was not foreshadowed in the Green Paper (but nor was independent taxation).

SECRET

- \* under certain assumptions about the level of the threshold might help more on the wider package (but a significant increase in the ceiling would be inconsistent with our general stance on mortgage interest relief).

12. On this last point, if we went for £20,000 per person, it would

- cost?
- (i) Not provide any sort of compensation for future single borrowers; and
  - (ii) Require an increase for married couples up to £40,000. This is not at all desirable in itself.

13. I think that the effect on single people is the decisive consideration and that there would be a strong feeling, well justified, that the Conservative Party had gone back on its undertakings. It is a pity that we cannot help sharers more, but this is a small group.

14. Finally, although I favour the residence basis I do think it is essential that we keep it as simple as we can. Officials assure me that the new system should be no more complicated for married couples once it is operational.

A.H.

ff. NORMAN LAMONT

SECRET

## TASK FORCE SECRET

FROM: A G TYRIE

DATE: 18 NOVEMBER 1987

COPY NO 1 OF 4

CHANCELLOR

cc Financial Secretary  
Mr Cropper

## MORTGAGE INTEREST RELIEF

Individual Ceiling versus Residence Basis

92  
1. I am a firm supporter of the individual ceiling approach. This would not just remove the tax penalty on marriage it would create a tax advantage of marriage - one earner couples would be allowed to double up their relief whereas one earner sharers would not. (At least, this would be the position if we follow the Revenue's advice: Mr O'Connor's note, 27 October, paragraph 14).

2. Other advantages are simplicity, there would be less discouragement to new sharers and there would be a bit of help for married kink losers (the increase of their ceiling from £30,000 to £40,000).

3. Most of all I am attracted to the individual ceiling approach because it leaves the way open to subsequent radical reform of the treatment of savings - a ration of savings etc. At some stage (perhaps it will be your successor) the Government will have to redress the absurd imbalances generated by excessive relief to provide for retirement and home ownership - hardly the hallmark of a risk-taking entrepreneurial society.

4. The political problems would be "why change the system", "why no mention in the Green Paper", and single losers. On "why change the system" we could argue that the introduction of independent taxation forced our hand. We had to do something. On "why no mention in the Green Paper" we have to use the same

defence for the independent taxation proposal as a whole. Our version of independent taxation was not mentioned in the Green Paper - we are announcing our modified proposals in the light of the lukewarm response to transferable allowances.

5. On single losers, do you want to consider changing stamp duty as a general sweetener to compensate them under an individual ceiling? For example, turning the £30,000 cliff edge into a threshold would be worth £300 on a purchase of £30,000. This would roughly compensate the lost relief on £10,000 which single people would suffer, but only, of course, in the year of purchase. The benefit would go to all purchasers but targetting a stamp duty sweetener on single people would add complexity and might be difficult to police.

6. I am less wedded to the rates at £20,000/£40,000. We will need to pitch this at the lowest level which the Prime Minister would be prepared to wear. That might be £17,500/£35,000. It might, regrettably, turn out to be £25,000/£50,000!

7. The main argument for the residence basis is that mortgage interest relief is a housing subsidy and therefore should be based on houses, not people. It looks as if most of the technical problems with moving to a residence basis with independent taxation (transferability of unused portions of relief etc) could be overcome. I am not opposed to the residence basis but I think the advantages with the individual ceiling listed above are substantial, despite some political contentiousness.

#### Home Improvement Loans

8. Politically, abolishing home improvement loans could cause as much trouble as introducing an individual ceiling. We would be beset by political hard cases: granny/invalid extension etc. Improvement in the housing stock is also a trendy political issue at the moment and the removal of home improvement relief would be seen as a step in the wrong direction. Many would

TASK FORCE SECRET

argue that the case for home improvement relief was stronger than relief for purchase. In our keenness to guard our flank from allegations of abuse of home improvement relief we may open up another more vulnerable flank.

9. An alternative that has been floated would be to limit home improvement relief to those eligible for home improvement grants. I think this would be a very unwise idea. As I mentioned in a note to the Financial Secretary last month we would be compounding the inadequacies of the system for allocating home improvement grants. These are generally allocated by the local authority environmental health officer. As many in local government will tell you, the system is certainly not always fair and sometimes corrupt.

10. So I think it may be worth reconsidering the decision to abolish relief on home improvement. We may have to fall back on terror tactics to deal with abuse: try and give publicity when we catch a few and, possibly, contemplate an increase in revenue policing, also with a fanfare of trumpets.

*Aut.*

A G TYRIE



**NOTE OF A MEETING HELD IN THE CHANCELLOR'S ROOM  
HM TREASURY AT 3.00PM ON THURSDAY, 19 NOVEMBER 1987**

Present

Chancellor  
Chief Secretary  
Financial Secretary  
Economic Secretary  
Sir P Middleton  
Sir T Burns  
Mr Cassell  
Mr Scholar  
Miss Sinclair  
Mr Cropper  
Mr Tyrie  
Mr McIntyre (Item 2)  
Mr Macpherson (Item 2)

Mr Isaac - Inland Revenue  
Mr Mace - Inland Revenue  
Mr Johns - Inland Revenue

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**MORTGAGE INTEREST RELIEF: AND NICs**

Item 1: Mortgage interest relief

Papers: Financial Secretary's minute to the Chancellor of 16 November; Miss Sinclair's minute of 2 November to the Financial Secretary; Mr Johns' minute of 27 October to the Financial Secretary; Mr O'Connor's submissions of 27 October to the Financial Secretary

Opening the discussion, the Chancellor said the most important question was whether to provide the relief on a residence basis or on the basis of individual ceilings. The more one examined the issues, the more difficult the residence basis became. He found himself increasingly inclined towards the individual ceiling. The main problem with the individual ceiling was that of the "single losers", though the magnitude of this depended on the level at which the ceiling was set. A second problem with individual



ceilings was its compatibility with Government election pledges. Individual ceilings would, however, fit well with the introduction of the community charge (which would be introduced in the same year). The Chancellor noted that the Financial Secretary had concluded in favour of the residence basis, because of the "single losers" problem. He saw a strong case himself for abolishing the relief on home improvement grants. This would release resources which could be used to mitigate the problems elsewhere. His preliminary conclusion was that there were thus two main choices: either home improvement loans could continue to attract relief, and the residence basis introduced; or home improvement relief could be abolished, and an individual ceiling of £25,000 or £30,000 introduced.

2. Mr Johns confirmed that the overall cost of the two packages would be the same in the short-term. But in the longer-term individual ceilings of £30,000 would encourage behavioural changes which would add to the cost. In practice, married couples could take advantage of transferability because mortgage interest relief entitlement was not confined to those with title to property, but could be enjoyed by all those with an interest.

3. The Financial Secretary said that he was not convinced by the premise that the residence basis was too complicated. Moreover, introduction of the individual basis and hence an increase for married couples up to £60,000 would sit oddly with the overall theme of the package, which was to abolish reliefs. Nor would it provide an exact trade-off with the loss of home improvement relief. The Chancellor commented that the increase could be explained in terms of a once-for-all hike, to abolish the distinction between married and unmarried couples.

4. Sir T Burns said that the individual ceiling was an elegant and logical solution to the problem thrown up by independent taxation. It would be much less harsh on young people clubbing



together to buy a house than the residence basis. Although this was still a minority phenomenon, it was likely to grow. The residence basis would also leave a bias against marriage, as co-habitees would be able to have tax relief on mortgages on two properties. To balance a high individual ceiling, he suggested that relief on the individual basis could be restricted to the basic rate. The Chancellor said this would raise a new dimension of political controversy, and provide only a small saving in the cost of the relief, given the proposed reductions in the top rate of income tax.

5. The Economic Secretary doubted whether the increase in individual relief would placate the main losers from abolition of home improvement loans, ie builders, and those who had purchased second hand properties with a view to improvement. The Financial Secretary also noted that across-the-board relief of £60,000 per couple could never be clawed back, and obstructed moves towards the level treatment of savings. Mr Isaac noted that, on the other hand, the individual basis was more consistent with independent taxation.

6. The Chief Secretary agreed that home improvement relief should be abolished. He would also like to see abolition of landlords' improvement relief. He doubted whether relief of £60,000 per couple could be defended, however, and he preferred the residence basis. Mr Painter noted that there would be difficulty in removing landlords' home improvement relief, both because it was a legitimate offset against income, and also because of the Government's policy stance towards improving housing stock. The Chief Secretary confirmed that he would still be in favour of removing the relief for householders even if it were maintained for landlords, although he recognised that this would amplify considerably the political difficulties of abolishing the relief.





7. The Paymaster General agreed with the Chief Secretary's view on abolishing home improvement relief. But he preferred the individual ceiling. Miss Sinclair noted that the relief for company landlords would have to be retained. The Chancellor said this meant that it would also need to be kept for private landlords. We should therefore need to be more generous to home owners.

8. After further discussion, the Chancellor summed-up that there was agreement to remove relief for home improvement loans. Opinion was divided between a residence basis and an individual basis for the relief. He invited Mr Johns to provide further advice and costings on: a £40,000 limit on the residence basis; a £25,000 (for individuals) and £50,000 (for couples) ceiling with full sharing on an individual basis; a £30,000 (for individuals) and £60,000 (for couples) ceiling without full sharing on an individual basis. He also invited Sir T Burns to provide advice on the impact of these changes on the housing market. He noted that he would need to discuss these matters, along with Mr Cassell's separate report, with the Secretary of State for the Environment.

9. The Chancellor noted that the treatment of married couples with two homes would need to be considered once the question of residence basis versus individual basis was settled. He otherwise agreed with the recommendations on minor points in the Financial Secretary's note.

#### Item 2: NICs

Papers: Mr McIntyre's submission of 18 November; Miss Sinclair's minute of 18 November; Mr McIntyre's second note of 18 November; Mr Scholar's minute of 18 November; Mr Mace's submissions of 17 November.

10. The Chancellor said that, at the lower end, Option C should now be dropped. Option F (without variations) should be retained as the main option for the package.

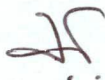


11. The Chancellor said it seemed necessary to retain a shadow UEL, both for benefits and for contracted out rebates. The term "upper earnings limit" ought, however, to be dropped, and the figure redefined as a multiple of the LEL.

12. The Chancellor invited Mr McIntyre to quantify the public expenditure savings arising from the loss of benefits to the lower paid. These should be taken into account for Scorecard purposes. Mr Macpherson said these amounted to roughly £50 million.

13. The Chancellor said there was a political problem with the treatment of the self-employed. Tax relief should either run all the way up the profits scale, or not at all. In discussion, it was agreed that there were attractions to abolishing tax relief. But this had been done in the past, and had had to <sup>be</sup> reintroduced. It would be essential to compensate losers if tax relief were withdrawn again. One way might be to cut Class 2 or Class 4 contributions; another might be to raise the LPL. It was also noted that there were various options for restructuring. Option 2 (paragraph 21 of Mr McIntyre's paper) had attractions; an alternative might be to merge Class 2 and Class 4 contributions. Mr Isaac noted that merging Classes 2 and 4 would require substantial changes to the national insurance rules.

14. The Chancellor invited Mr Scholar to provide further advice on the various options. The Chancellor's own discussions with Mr Moore would be in two parts: early consultation on NICs at the lower end, and the APA; and later consultation (perhaps next February) on the remainder of the issues. It would be important to consult DHSS circumspectly, to ensure security. Mr McIntyre would propose an aide memoire for the first meeting, in consultation with Mr Scholar

  
J M G TAYLOR

23 November 1987

Circulation

Those present

(Mr Macpherson and Mr McIntyre - Item 2 only

Paymaster General

Mr Battishill



**NOTE OF A MEETING HELD IN THE CHANCELLOR'S ROOM  
HM TREASURY AT 3.00PM ON THURSDAY, 19 NOVEMBER 1987**

Present

Chancellor	Mr Isaac - Inland Revenue
Chief Secretary	Mr Mace - Inland Revenue
Financial Secretary	Mr Johns - Inland Revenue
Economic Secretary	
Sir P Middleton	
Sir T Burns	
Mr Cassell	
Mr Scholar	
Miss Sinclair	
Mr Cropper	
Mr Tyrie	
Mr McIntyre (Item 2)	
Mr Macpherson (Item 2)	

NOTE  
OF  
MTG  
19/11

**MORTGAGE INTEREST RELIEF: AND NICs**

Item 1: Mortgage interest relief

Papers: Financial Secretary's minute to the Chancellor of 16 November; Miss Sinclair's minute of 2 November to the Financial Secretary; Mr Johns' minute of 27 October to the Financial Secretary; Mr O'Connor's submissions of 27 October to the Financial Secretary

Opening the discussion, the Chancellor said the most important question was whether to provide the relief on a residence basis or on the basis of individual ceilings. The more one examined the issues, the more difficult the residence basis became. He found himself increasingly inclined towards the individual ceiling. The main problem with the individual ceiling was that of the "single losers", though the magnitude of this depended on the level at which the ceiling was set. A second problem with individual



ceilings was its compatibility with Government election pledges. Individual ceilings would, however, fit well with the introduction of the community charge (which would be introduced in the same year). The Chancellor noted that the Financial Secretary had concluded in favour of the residence basis, because of the "single losers" problem. He saw a strong case himself for abolishing the relief on home improvement grants. This would release resources which could be used to mitigate the problems elsewhere. His preliminary conclusion was that there were thus two main choices: either home improvement loans could continue to attract relief, and the residence basis introduced; or home improvement relief could be abolished, and an individual ceiling of £25,000 or £30,000 introduced.

2. Mr Johns confirmed that the overall cost of the two packages would be the same in the short-term. But in the longer-term individual ceilings of £30,000 would encourage behavioural changes which would add to the cost. In practice, married couples could take advantage of transferability because mortgage interest relief entitlement was not confined to those with title to property, but could be enjoyed by all those with an interest.

3. The Financial Secretary said that he was not convinced by the premise that the residence basis was too complicated. Moreover, introduction of the individual basis and hence an increase for married couples up to £60,000 would sit oddly with the overall theme of the package, which was to abolish reliefs. Nor would it provide an exact trade-off with the loss of home improvement relief. The Chancellor commented that the increase could be explained in terms of a once-for-all hike, to abolish the distinction between married and unmarried couples.

4. Sir T Burns said that the individual ceiling was an elegant and logical solution to the problem thrown up by independent taxation. It would be much less harsh on young people clubbing



together to buy a house than the residence basis. Although this was still a minority phenomenon, it was likely to grow. The residence basis would also leave a bias against marriage, as co-habitees would be able to have tax relief on mortgages on two properties. To balance a high individual ceiling, he suggested that relief on the individual basis could be restricted to the basic rate. The Chancellor said this would raise a new dimension of political controversy, and provide only a small saving in the cost of the relief, given the proposed reductions in the top rate of income tax.

5. The Economic Secretary doubted whether the increase in individual relief would placate the main losers from abolition of home improvement loans, ie builders, and those who had purchased second hand properties with a view to improvement. The Financial Secretary also noted that across-the-board relief of £60,000 per couple could never be clawed back, and obstructed moves towards the level treatment of savings. Mr Isaac noted that, on the other hand, the individual basis was more consistent with independent taxation.

6. The Chief Secretary agreed that home improvement relief should be abolished. He would also like to see abolition of landlords' improvement relief. He doubted whether relief of £60,000 per couple could be defended, however, and he preferred the residence basis. Mr Painter noted that there would be difficulty in removing landlords' home improvement relief, both because it was a legitimate offset against income, and also because of the Government's policy stance towards improving housing stock. The Chief Secretary confirmed that he would still be in favour of removing the relief for householders even if it were maintained for landlords, although he recognised that this would amplify considerably the political difficulties of abolishing the relief.



7. The Paymaster General agreed with the Chief Secretary's view on abolishing home improvement relief. But he preferred the individual ceiling. Miss Sinclair noted that the relief for company landlords would have to be retained. The Chancellor said this meant that it would also need to be kept for private landlords. We should therefore need to be more generous to home owners.

8. After further discussion, the Chancellor summed-up that there was agreement to remove relief for home improvement loans. Opinion was divided between a residence basis and an individual basis for the relief. He invited Mr Johns to provide further advice and costings on: a £40,000 limit on the residence basis; a £25,000 (for individuals) and £50,000 (for couples) ceiling with full sharing on an individual basis; a £30,000 (for individuals) and £60,000 (for couples) ceiling without full sharing on an individual basis. He also invited Sir T Burns to provide advice on the impact of these changes on the housing market. He noted that he would need to discuss these matters, along with Mr Cassell's separate report, with the Secretary of State for the Environment.

9. The Chancellor noted that the treatment of married couples with two homes would need to be considered once the question of residence basis versus individual basis was settled. He otherwise agreed with the recommendations on minor points in the Financial Secretary's note.

#### Item 2: NICs

Papers: Mr McIntyre's submission of 18 November; Miss Sinclair's minute of 18 November; Mr McIntyre's second note of 18 November; Mr Scholar's minute of 18 November; Mr Mace's submissions of 17 November.

10. The Chancellor said that, at the lower end, Option C should now be dropped. Option F (without variations) should be retained as the main option for the package.



11. The Chancellor said it seemed necessary to retain a shadow UEL, both for benefits and for contracted out rebates. The term "upper earnings limit" ought, however, to be dropped, and the figure redefined as a multiple of the LEL.

12. The Chancellor invited Mr McIntyre to quantify the public expenditure savings arising from the loss of benefits to the lower paid. These should be taken into account for Scorecard purposes. Mr Macpherson said these amounted to roughly £50 million.

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J M G TAYLOR

23 November 1987

Circulation

Those present

(Mr Macpherson and Mr McIntyre - Item 2 only  
Paymaster General

Mr Battishill



COPY NO. 2 OF 3 COPIES

FROM: A P HUDSON

DATE: 25 November 1987

**CHANCELLOR****MORTGAGE INTEREST RELIEF**

I have read the various recent papers on this tricky subject.

2. The approach of a personal ceiling, on the £30/60,000 basis, has a number of attractions:

- (a) it is clearly consistent with independent taxation, and the community charge;
- (b) no losers;
- (c) it is the only option that is clearly not inconsistent with pledges made by the Prime Minister and others.

3. But it has a number of disadvantages:

- (a) we need to see the cost;
- (b) we also need a proper evaluation of the effect on the housing market, and hence the cost in five years' time;
- (c) it would add significantly to the bias in favour of investment in housing, rather than other things, particularly equities. The couples who would benefit from the extra relief are probably already shareholders in a small way. But they are the sort of people who we need to branch out beyond the privatisation stocks, if we are to deepen share ownership;
- (d) the politics are obviously for you to judge. But over much of the country, most people will be unaffected, because their mortgages are below £30,000 anyway. And the Opposition would no doubt make great play of the big gains for a few rich people, compared to the "cuts" in housing benefit and child benefit.





4. We have to do something: it would be very odd to introduce Independent Taxation without tackling this tax penalty on marriage.

5. In principle, I think the right answer is to go for the residence basis with the ceiling at £30,000.

(a) The logic is that mortgage interest relief is designed to help people buy their homes: therefore one home should get one slice of relief.

(b) It tackles the tax penalty on marriage.

(c) It reduces, rather than increases, the scope of the relief.

(d) For all but a few, the system would remain unchanged.

6. Given protection for existing loans, the only actual losers are sharers who move house, still as sharers. I suspect these are few and far between. Most of the unmarried couples that I know have married after a while, in spite of the tax penalty. And the other groups of sharers break up, typically as one or more gets married.

7. People who intend to buy as sharers are relative losers - they will get less relief than they would do under the present system. Arguably, that does not matter. In principle two sharers, whether cohabiting or not, should get the same relief as a married couple anyway.

8. The better arguments for giving higher relief to sharers apply equally to married couples.

(a) The cost of flats and houses for two people is more than for a single person. True, but not twice as much. This points to a residence basis with a ceiling of £30,000 for single people, and, say, £40,000 for couples of any kind (or larger groups).



(b) In London and the South-East, people are often forced to share because they cannot afford to buy on their own. Married couples who are in that position have to manage with £30,000 relief anyway. And, in theory, if sharers have less purchasing power, prices will adjust. But if the point has to be addressed, the answer can be the same as above.

9. In summary, I think we should go for the residence basis with a £30,000 ceiling. This should be presented in a low-key way, as a measure to tackle the tax penalty, which won widespread support in the Green Paper. If we come under pressure - before or after the Budget - the fallback should be £40,000 for couples.

#### Home Improvements

10. If we abolish relief for home improvements, we shall need to get the positive arguments lined up. The ones I can see are that it would release more money for home buyers, and/or across-the-board tax reductions; and that home improvement needs no stimulus from the Government - people are keen to do it because they have a better home, and, as the value of their home increases, the capital gain is tax-free.

11. The prevalence of abuse could also be deployed, but people will argue that this should be tackled head on - the Inland Revenue are usually keen enough to tackle abuse wherever they see it!

A handwritten signature in black ink, appearing to be 'A P HUDSON'.

A P HUDSON

COPY NO. 1 OF 3 COPIES

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A P HUDSON

## TASK FORCE SECRET

COPY...No. of 9 COPIES

FROM: P J CROPPER  
DATE: 23 November 1987

CHANCELLOR

cc Chief Secretary  
Financial Secretary  
Paymaster General  
Economic Secretary  
Mr Tyrie  
Mr Call*post fix  
1/2 of MM: a  
advises to discuss  
this note.*MORTGAGE INTEREST TAX RELIEF

I have thought long and hard about this, and cannot see an easy answer.

2. We must, I think, accept that a straight switch to a personal ceiling to mortgage interest tax relief on a £30/£15,000 basis, or even a £40/£20,000 basis, would contravene the spirit of past undertakings. There are many single people, often not affluent and not always young, who buy property to live in. Consider the unmarried school teacher or the widow. It would be hard enough to say "Only £15,000 for you" at the outset of a career; doubly difficult for somebody who has had £30,000, then moves to another district, or moves into a smaller house following widowhood, and is told "You only get £15,000 this time".

3. I see some difficulty about going over to a residence basis, with a limit of £30,000 or even £40,000. An increasing number of younger people, particularly in London, are now having to share properties costing £100,000 and upwards. To be restricted to a half, third or quarter of £30,000 would be pretty irritating. I would as a matter of fact discourage any youngster of mine from co-ownership. If the happy household goes sour, or breaks up, it can be very difficult to sell a one third share of a Victorian villa in, say, Clapham. But for some it is "needs must".

TASK FORCE SECRET

4. If there is no overwhelming case for a switch to a residence basis, my conservative mood and nature tells me not to recommend it. There are enough changes going on already, one way or another. The Revenue say they can manage it, but have we asked enough questions of the lawyers and of the building societies? Would unforeseen consequences start coming out of the woodwork if we made such a fundamental new start?

5. The proposal I find myself driven to is a personal ceiling on a £60/£30,000 basis. This would, I am sure, be attacked on a number of grounds, for example:-

(i) revenue cost

(ii) inflationary effect on house prices

(iii) difficult transition, with pressure from existing married mortgagors to be allowed to re-mortgage up from £30,000 to £60,000.

6. On the other hand, there would be a reasonable case in favour, for example:-

(a) no losers to complain

(b) realistic re-alignment with higher house prices

(c) easier to disallow tax relief on cost of improvements - though this would not be consistent with the generalised relaxation of limits

(d) compatible with an eventual move to the personal ration of savings (Andrew Tyrie's point).

Above all, such a move would be compatible with a long run movement towards tax relief on all personal borrowing. I have always felt that Lord Barber's regime was the right

TASK FORCE SECRET

one and that the present treatment of interest is wrong. If people have to pay tax on their rent, interest and dividend incomes, why on earth should they not get tax relief on their parallel outgoings? Symmetry demands it. At present we treat persons as businesses when it suits us and not when it doesn't.

7. I do of course understand the danger of any precipitate movement of this kind for monetary policy. I recall the studies that were carried out on the increasing loan-worthiness of an increasingly valuable housing stock. I am also aware of the almost religious concern being expressed in some quarters about the way innocent citizens are being tempted to their doom by Barclays Bank and others. Furthermore I am aware that this proposal would push up interest rates and make even worse the already serious tendency in this country for money to go into housing rather than manufacturing plant.

8. Despite all that, a switch to £60/£30,000 seems to me to be a move in a legitimate direction. And it is the only option that would not stir up political protest on a scale that could swamp any advantage we might hope to secure among the womens' lobbies, for the switch to independent taxation itself.



P J CROPPER





New & H. M. M. -

FW mtg.

Ch.

IR have not yet supplied the figures relating the MIR ceiling to movements in the RPI (i) from its introduction (ii) since its increase to £30,000. I shall get these on Monday a.m.

25

26  
/11

Ch

Back papers in meeting folder in box in London.

AA

ORAL  
THURSDAY 26 NOVEMBER

Scot Nat - Banff and Buchan

MR ALEX SALMOND

ADDITION TO NOTES FOR SUPPLEMENTARIES

What would ceiling be if indexation applied?

Indexation by RPI to Dec 1987  
December to December figures

Since 1974 when £25,000 ceiling  
introduced

£104,000

Since 1983 when ceiling increased  
to £30,000

38,000



B O'CONNOR  
26 November 1987

## TASK FORCE SECRET

Copy No 1 Of 9

FROM: A G TYRIE

DATE: 30 NOVEMBER 1987

CHANCELLOR

cc Chief Secretary  
 Financial Secretary  
 Paymaster General  
 Economic Secretary  
 Mr Cropper  
 Mr Call



## MORTGAGE INTEREST RELIEF

After the rates of income tax our decisions here will have the most political impact. It will also greatly affect the presentation of independent taxation.

Initially I saw the residence basis as both presentable and workable (although I came down on the individual ceiling basis because of its positive attractions, see my earlier note). I still think it could be made to work but, having thought about it a bit more, I now think that residence basis would be exceedingly difficult to present:

i. The tax penalty on marriage remains. Two individuals owning their own homes (as is increasingly the case) who came together to marry would lose half their relief. The residence basis would severely weaken any claims that we were finally tackling tax penalties on marriage. A smaller but important 'stimulus to cohabit' would remain. Our change would be seen not to be on a 'one residence per individual' but a 'one residence per individual and couple' basis.

The alternative, of giving one lump of residence relief per individual would be patently absurd. This would mean that a couple could buy two halves of a semi-detached house, each claim £40,000 worth of relief, but be unable to knock the two halves together.

ii. How do we explain the contradiction that at the very time we introduce independent taxation we would remove the most important personal tax relief from individuals and base it on couples?

iii. The apparent complexities of the residence basis would blow a hole in our claim that this budget package made for simpler taxes.

By contrast, to present the individual ceiling, I see the neat and simple line: 'we are keeping the present system of mortgage interest relief, (our Manifesto pledge) and we are removing the tax penalty on marriage inherent in the old system'. That looks exceedingly attractive.

The only major problem, I think, would be the Revenue cost. Mr O'Connor's note (27 November) estimates that the £30,000/£60,000 proposal would cost £130 million more than the £40,000 residence proposal in 1988/89, rising to £220 million extra in the following year.

AGT.

A G TYRIE

CONQUEROR



Ch.

M.I.R.

I spoke to Mr O'Connor about the figures in his note of 27 November, and those in Mr Johns' note of 27 October.

2. The figures are on different bases.

The Johns figures are compared with:

- (i) present tax rates and thresholds;
- (ii) a figure for mortgage interest of 11.25%.

The O'Connor figures are compared with:

- (i) tax rates of 25% and 35%, and a threshold of £25,000;
- (ii) a mortgage interest figure of 10.25%

The O'Connor figures also include, for comparison (first column in the table) costs compared with the current regime but with indexation of thresholds and a mortgage interest rate of 10.25%.

3. All the figures assume abolition of relief for home improvement loans.

→  
30/11

TASK FORCE SECRET

Copy No. 1 of 3 Copies

FROM: P J CROPPER  
DATE: 30 November 1987

CHANCELLOR

MORTGAGE TAX RELIEF

Weekend ruminations, not copied round.



P J CROPPER

conqueror

III

TASK FORCE SECRET

MORTGAGAGE TAX RELIEF: INDIVIDUAL  
ALLOWANCE v RESIDENCE BASIS

1. If revenue cost were the sole criterion, the Residence Basis would be preferred. It would be very difficult to pitch the individual allowance at less than £60/£30,000 or, at the outside, £50/£25,000 because of the loss to single people living alone. It would be less difficult to pitch the residence basis at £40,000 or even £30,000, and let the unmarried sharers go hang.
  
2. If one were looking to minimise disruption, one would stay with the individual allowance. A mortgage is taken by a person: building societies know persons as mortgagors. To switch to the residence basis would introduce a new concept for tax purposes and complexities would almost certainly arise in the conversion of mortgagor-based data to a residence tax system. (Although I am not confident of predicting what they would be.) Certainly when the tax office came to apportion tax relief it would have to start with the Building Society's end year statement setting out the name of the mortgagor, the amount of the outstanding loan to him and the amount of interest he has paid during the preceding year. Where two (unmarried) people had taken out mortgages on the same residence, I suppose it would be for them to declare the fact to the Inland Revenue: it would be no concern of the tax office. Miras would continue, presumably, to give full tax relief to each of the mortgagors up to the full residence limit. It would be for the Inland Revenue to claw back a chunk of tax relief from each of those mortgagors if it were subsequently found that they were sharing a residence. Whereas in the individual allowance case each mortgage would produce its own end-year statement which would be automatically applicable to the tax affairs of an identifiable individual.



TASK FORCE SECRET

3. This is all complex stuff, which Revenue and Building Societies might be able to sort out. Nonetheless there would be conceptual problems of transition, which one would not choose to incur if all things were equal. One also asks, of course, what Nabarro-like complexities might arise over the definition of a residence, with so much tax relief at stake. Doors built half-way up staircases, separate gas meters, telephones etc.
4. On "moral" grounds, the residence basis would involve a clear discouragement to marriage. Let two single people live separately in two residences: they get two full allowances. Now let them come together unmarried: they can continue to keep two homes going and get two full allowances. But then let them marry: presumably they lose one of the allowances. Whereas with the individual allowance, each would get an allowance while they lived separately, each would get one when they moved in to live together, and they would continue to get one each after they were married.
5. Most people would think it reasonable for a married couple, or two people living together, to get more tax relief than a singleton on his or her own. This does not happen under the new system: it would not happen under the residence basis: it would happen with individual allowances.
6. Or would it happen, where a married couple owned two homes? I own a house in Tonbridge and a flat in Kennington. Would we, under the residence basis, get one allowance for me and one for my wife, provided she technically owned the one residence and I the other? That would be bliss for the Sir Terence Burns's with their Welsh cottage. Or would there be a rule of one residence per married couple? If that were the case then it would clearly be best to remain unmarried, one owning the town house and the other the country cottage.

All of these problems are avoided with an individual allowance - provided that the married woman has enough income to set her allowance off against.

7. If we went for the individual allowance, people would have to be allowed to transfer unused portions to their spouses. Would we allow them to make an election at any time, whichever way they liked? Or would it be obligatory for the wife's individual allowance to be set against her taxable income first, before any transfer were made?
8. As a postscript, we will surely have to look again at the whole question of re-mortgaging. It is quite possible to have a £15,000 mortgage outstanding on a £150,000 house, just because one bought it in 1971. To get that up to £30,000 at present, one is obliged to move house or build a swimming pool. Otherwise one "forfeits" tax relief on £15,000 of loan. If the basis were switched to a residential ration of say £40,000 or an individual allowance of twice £30,000 for a married couple, it would be anomalous and unjust if people with "old" mortgages were still limited to a £15,000 ration while the people moving in next door got £40,000 or £60,000.
9. All of which goes to show that we should either abolish mortgage interest tax relief completely, or do an Anthony Barber and make all loan interest payments allowable. Either can be justified on fiscal principle: they happen to be based on different fiscal principles, but then there is more than one set of fiscal principles available to the reformer. A comprehensive expenditure tax would mean taxing loan interest payments: a comprehensive income tax would allow relief on interest payments, but would involve the reintroduction of Schedule A. With a return to Schedule A one could dispense with the Community Charge: how about that?

P J C 

30/11/87



COPY NO. 2 OF 3 .

FROM: J WILLIAMS

DATE: 2 December 1987

MR A G TYRIE

**MORTGAGE INTEREST RELIEF**

The Chancellor has seen and was grateful for your minute of 30 November.

A handwritten signature in cursive script, reading 'Julian Williams', with a long horizontal flourish extending to the right.

J WILLIAMS

CONFIDENTIAL



FROM: J J HEYWOOD  
DATE: 2 December 1987

MR JOHNS - IR

cc PS/Chancellor  
PS/Chief Secretary  
PS/Paymaster General  
PS/Economic Secretary  
Mr Scholar  
Mr Culpin  
Mr Cropper  
Mr Tyrie  
PS/IR

**MORTGAGE INTEREST RELIEF**

The Chancellor has asked the Financial Secretary to follow up two questions:

- i) What was the detailed breakdown of responses to the Green Paper section on mortgage interest relief?
- ii) If a residence basis were introduced how would we get round the scope for avoidance via "partitioning"?

2. I would be grateful for a note covering both points.

J J HEYWOOD  
PRIVATE SECRETARY



SECRET

FROM : B O'CONNOR  
7 December 1987

- 1. Mr Johns *seen in draft* ✓
- 2. Financial Secretary

**MORTGAGE INTEREST RELIEF : STARTERS 114 AND 115**

**RESIDENCE BASIS**

1. In your note of 2 December you asked about the breakdown of responses to the Green Paper on the Reform of Personal Taxation and the question of partitioning residences.

**Green Paper**

2. The responses to the Green Paper can be broken down into three categories:-

**(a) Consultation period : individuals**

129 individuals responded to the section on mortgage interest relief of which 114 wished to see an end to the tax penalty on mortgage. Within this 114 the position was:-

Support for the Green Paper approach	65
Support for giving married couples double the limit for single persons	15
Opposed to the residence basis	5

- 
- |                                    |              |
|------------------------------------|--------------|
| cc. Chancellor                     | Chairman     |
| Chief Secretary                    | Mr Painter   |
| Paymaster General                  | Mr Isaac     |
| Economic Secretary                 | Mr Johns     |
| Sir P Middleton                    | Mr Beighton  |
| Sir T Burns                        | Mr Cleave    |
| Mr Scholar                         | Mr Mace      |
| Mr Culpin                          | Mrs Willetts |
| Miss Sinclair                      | Mr Reeves    |
| Mr Riley                           | Mr I Stewart |
| Mr Cropper                         | Mr Boyce     |
| Mr Tyrie                           | Mr O'Connor  |
| Mr Jenkins (Parliamentary Counsel) | PS/IR        |

SECRET

**(b) Post consultation period : individuals**

166 letters have been received from individuals as follows:-

Against the tax penalty on marriage	154
of which:	
specifically pro residence basis	19
in favour of double the single person limit	18
Opposed to residence basis (letters from sharers)	14

**(c) Post consultation period : national organisations**

24 of the 53 organisations who responded commented on mortgage interest relief. 22 of the 24 supported the view that the tax penalty on marriage should be removed but only 8 supported the residence basis. 11 either specifically opposed the residence basis or suggested married couples should be allowed double the single person's limit.

**Partitioning**

3. As I mentioned at paragraph 35 of my note of 23 September it will be necessary to provide a definition of a residence if Ministers decide to introduce the residence basis. It will then be a question of fact whether a particular "residence" is within the definition.

4. You favoured the view (paragraph 9 of your note of 16 November) that married couples should be restricted to one residence. This means that problems with partitioning would be confined to unmarried sharers.

5. It seems unlikely that an unmarried male and female living together and acting for most purposes as though they were married would attempt to partition a house and claim they had separate residences. The possibility cannot be ruled out entirely but, in practice, such attempts would probably be confined to cases of economic rather than sexual sharing.

SECRET

6. The average small house is not readily capable of easy or cheap conversion into say two self-contained flats each with bathrooms and kitchens. We would not envisage separate bedrooms with other facilities shared ranking as two residences. On the other hand large Victorian houses can be partitioned relatively inexpensively. These are the type of houses favoured by multiple sharers who stand to lose most heavily under a residence basis. There will therefore be considerable incentive for this small group to maximise any scope for partitioning. There is no obvious reason for concern where there is genuine subdivision into separate accommodation; but certainly if the residence basis is adopted it will have to be recognised that there will be some artificial partitioning which we cannot disallow.

7. The definition of residence is a matter which we shall be discussing with Parliamentary Counsel when we instruct him to draft. The forthcoming abolition of domestic rating will probably preclude any reliance on the rating law reference to "hereditament". In any event we understand much of the definition of "separate hereditament" derives from case law rather than statutory law.

**IMPROVEMENT LOANS**

8. The decision to abolish relief for new improvement loans taken out by owner occupiers has raised one or two minor points on which we need your guidance.

9. Broadly the present legislation provides for relief on interest paid on a loan which is applied to:-

- (a) purchasing an estate or interest in land

SECRET

- (b) improving or developing the land, or buildings on the land including payments in respect of maintenance or repairs by reason of dilapidation attributable to a period before the estate or interest was acquired, and including expenditure incurred for street works other than works of maintenance or repairs.

10. Legally the word "land" can include buildings and chattels affixed to the land so that simply deleting references to improvements would not necessarily preclude relief for work such as extensions. We are therefore aiming to restrict relief to loans applied to the purchase of a plot of land and an existing property or to the purchase of an empty plot and the cost of building a new property.

11. A further point can arise in circumstances where a plot and dilapidated property are purchased with the intention of completely demolishing the dilapidated property and building a new house. We think there is a good case for allowing relief in respect of a loan to finance the cost of the new house but this could be attacked as encouraging the destruction rather than restoration of possibly heritage properties.

12. In the context of abolishing improvement loan relief we feel that there is no case for retaining the provisions for repairing prior dilapidations or the cost of street works. Both are similar to improvements although it is true, in the case of street works, that the individual householders often have little control over what the local authority does.

**Points for decision**


- (a) whether relief should be restricted to the purchase of land with an existing residence or the purchase of an empty plot and the cost of construction of a house for occupation as the main residence



SECRET

- (b) whether relief should be allowed for the cost of a residence replacing one which is being completely demolished
- (c) whether relief should be abolished for the cost of repairing dilapidations attributable to prior periods
- (d) whether relief should be abolished for street works.

We would recommend relief in cases (a) and (b) but not (c) or (d)



B O'CONNOR

SECRET

CHANCELLOR

FROM: A G TYRIE

DATE: 8 DECEMBER 1987

cc Chief Secretary  
 Financial Secretary  
 Paymaster General  
 Economic Secretary  
 Sir P Middleton  
 Sir T Burns  
 Mr Scholar  
 Mr Culpin  
 Mr O'Connor -IR  
 Mr Cropper  
 Mr Call

*WAS:*

**MORTGAGE INTEREST RELIEF: PARTITIONING**

*behind*

I have seen Mr O'Connor's note of 7 December. I don't think that partitioning should weigh heavily in our decision between the residence basis and individual ceiling approach.

There may be the odd difficult case but we should be able to find an adequate definition that distinguishes between the tax fiddle and legitimate house conversion. The building societies/banks and insurance companies already have fairly strict tests. The building societies need them to protect the security of their loan, the insurance companies need them to limit their liability, for theft insurance for example. I think we should be able to work out a definition on the basis of these current practices. The removal of definitions for rating purposes should not trouble us over much.

If people were prepared to go to the length of converting their house into separate flats (to a level which satisfied both lenders and insurance companies) I think we would have to pay two doses of relief. Since the property would have been converted into two residences we couldn't complain. But the number of genuinely awkward cases would, I think, be very small.

There are good arguments in favour of the individual ceiling. But I think this is not one of them.

*R. Johnson*

*JP*

A G TYRIE



*[Handwritten signature]*

FROM: J M G TAYLOR

DATE: 10 December 1987

MR TYRIE

- cc Chief Secretary
- Financial Secretary
- Paymaster General
- Economic Secretary
- Sir P Middleton
- Sir T Burns
- Mr Scholar
- Mr Culpin
- Mr Cropper
- Mr Call
- Mr O'Connor - IR

**MORTGAGE INTEREST RELIEF: PARTITIONING**

The Chancellor has seen and noted your minute of 8 December.

*[Handwritten signature]*

J M G TAYLOR

SECRET

*Handwritten initials: J J*

**FROM: J J HEYWOOD**  
**DATE: 16 December 1987**

**MR O'CONNOR IR**

cc **PS/Chancellor**  
 PS/Chief Secretary  
 PS/Paymaster General  
 PS/Economic Secretary  
 Sir P Middleton  
 Sir T Burns  
 Mr Scholar  
 Mr Culpin  
 Miss Sinclair  
 Mr Riley  
 Mr Cropper  
 Mr Tyrie  
 Mr Jenkins OPC  
 Mr Johns IR  
 PS/IR

**MORTGAGE INTEREST RELIEF: STARTERS 114 AND 115  
 RESIDENCE BASIS**

The Financial Secretary has now read your submission of 7 December. He has also seen Mr Tyrie's note of 8 December.

2. The Financial Secretary agrees with your recommendations on the minor points for decision. He also agrees with Mr Tyrie's observations.

*Handwritten initials: J H*

**JEREMY HEYWOOD**  
**Private Secretary**

SECRET



*pp. p.*

FROM: J J HEYWOOD  
DATE: 25 January 1988

PS/CHANCELLOR

cc PS/Chief Secretary  
PS/Economic Secretary  
Sir P Middleton  
Sir T Burns  
Mr Scholar  
Mr Culpin  
Miss Sinclair  
Mr Riley  
Mr Cropper  
Mr Tyrie  
Mr Jenkins OPC  
Mr Johns IR  
Mr O'Connor IR  
PS/IR

*Agreed.*

**MORTGAGE INTEREST RELIEF : RESIDENCE BASIS TWO HOME PROBLEM**

The Financial Secretary has discussed Mr O'Connor's minute of 18 January with Mr Tyrie and officials.

2. The Financial Secretary agrees with Mr O'Connor that there is no practical or effective way of preventing cohabiting unmarried couples from getting relief on two residences.

3. The alternative to introducing a cohabitation rule for unmarried couples would be to allow married couples with two residences to claim double relief - provided that they were genuinely living apart. Strictly speaking, there would remain a tax penalty on marriage unless this sort of relaxation were introduced.

4. But the Financial Secretary thinks that this would again be unpoliceable. In practice it would be difficult for the Revenue to stop all two-home married couples from claiming a double slice of relief regardless of whether there were in reality two separate residences.

**BUDGET SECRET: TASK FORCE LIST**

5. The Financial Secretary's conclusion is that we should not worry too much about this minor de facto tax penalty on marriage. He thinks that if anyone raises the issue we can point to the more favourable transferability rules for married couples. For most couples these will ensure that the new mortgage interest relief rules system will be generally favourable to married couples.

9.12

**JEREMY HEYWOOD**  
Private Secretary

**BUDGET SECRET: TASK FORCE LIST**



**Inland Revenue**

Policy Division  
Somerset House

**BUDGET SECRET TASK FORCE LIST**

*pmf*

FROM : B O'CONNOR  
18 January 1988

*I agree May 18/1 ✓*

- 1. Mr. Johns
- 2. Financial Secretary

**MORTGAGE INTEREST RELIEF : RESIDENCE BASIS  
TWO HOME PROBLEM**

1. At Chevening you were asked to investigate whether there was any scope for countering abuse by co-habitees claiming mortgage interest relief on two principal residences. This note considers the possibilities.

2. The mortgage interest relief rules impose a factual test to determine a claimant's only or main residence. If two or more homes are owned, relief is allowable only on the home where the claimant normally lives. He or she cannot choose to have relief on the second home even if there is no outstanding mortgage on the main residence.

- 
- cc. Chancellor  
 Chief Secretary  
 Economic Secretary  
 Sir P Middleton  
 Sir T Burns  
 Mr Scholar  
 Mr Culpin  
 Miss Sinclair  
 Mr Riley  
 Mr Cropper  
 Mr Tyrie  
 Mr Jenkins (Parliamentary Counsel)

- Chairman  
 Mr Painter  
 Mr Isaac  
 Mr Johns  
 Mr Beighton  
 Mr Cleave  
 Mr Mace  
 Mr O'Connor  
 PS/IR

## BUDGET SECRET TASK FORCE LIST

### Married couples

3. Under the present rules the ceiling of £30,000 is linked to the taxpayer. Aggregation means that a husband and wife must share this ceiling between them. We have successfully resisted one or two attempts by unseparated married couples to claim that they each have separate or only main residences. In extreme cases, where, for example, the husband purchases a house near his work in a different part of the country a plausible case can sometimes be mounted particularly if there are no children living with the wife. However there is only a limited incentive to mount this sort of claim because, if successful, the £30,000 ceiling would have to be shared not only between the husband and wife but also between the two homes.

4. The residence basis coupled with independent taxation will provide a greater incentive for spouses to claim they each have separate residences. They will then both be able to claim relief up to the ceiling. To counter this we recommended including a rule that unseparated married couples are restricted to relief on only one only or main residence (paragraph 17 of my note of 27 October).

### Unmarried couples

5. We see no possibility of introducing such a rule in the case of co-habitees or other sharers. There are several circumstances where unmarried couples might obtain relief on two homes eg.

i. Two people each purchasing a home decide to co-habit. If they continue to own the two houses relief will continue on the separate mortgages unless they voluntarily tell us or the lenders in the case of MIRAS loans that they are no longer entitled to two tranches of relief. Even if we became aware that they were cohabiting it would usually be impossible to prove that they were other than guests in each other's houses.



## BUDGET SECRET TASK FORCE LIST

ii. Two co-habitees with a mortgage in the name of one of them purchase a second home in the name of the partner. The partner completes a claim form certifying that he/she has no other relievable loan and that the property will be the only or main residence. Normally such a loan would qualify for MIRAS and basic rate relief up to the ceiling would be given by deduction at source. If we became aware of the facts and, say both parties worked in London and the second home was in Scotland, we might be able to challenge the relief claim successfully. On the other hand if it was within commuting distance of London, say in Brighton, it would be difficult for us to convince an appeal body that the Brighton house was not the second partner's principal residence.

### **Extent of problem**

6. The numbers of people able to take advantage of this loophole will be small. The majority of second homes are owned by married couples and they will be denied relief. They are unlikely to take the step of divorce or legal separation simply to obtain further mortgage interest relief. Many co-habitees will have a mortgage in their joint names and will only be able to get relief on a second home if they make fraudulent claims. But there will be an incentive for co-habitees to arrange their affairs in future so that each of two homes are in their separate names. While we can challenge extreme cases we will not be able to stop all abuse. (And there will be a grey area of genuine doubtful cases.)

### **Greater generosity to married couples?**

7. An alternative, if your main concern is equal treatment for married and unmarried couples, would be to be slightly more generous to married couples. You could drop the proposed explicit rule (paragraph 4 above) that a married couple can only have one main residence and rely on an appeal body to judge whether, on the


## BUDGET SECRET TASK FORCE LIST

facts, there is one residence or two. On past experience, we would expect that the majority of two home couples could still be denied relief but there would be some extra cost and more scope for argument (and therefore administrative cost for the Revenue). There is always going to be a greater inherent independence, and therefore scope for two home claims, for unmarried couples but this cannot be avoided. As I said in my earlier note we think the rule that married couples can only have one residence can be presented as the corollary of the greater flexibility on transfer of relief which they have on that residence. But if you were prepared to accept the (unquantifiable) tax and administrative cost, that rule could be dispensed with.

### Conclusion

8. If partners do not marry there is no obvious way in which they can be treated other than single persons for tax purposes. As the residence basis gives a single person the same ceiling of mortgage interest relief as a married couple or any other number of sharers it is inevitable that, in appropriate circumstances, co-habitees and other sharers will exploit their single status.

9. An unseparated married couple will, whatever the precise rules, give rise to the presupposition that they have the same residence. We recommend to avoid dispute and cost that this rule should be made explicit in legislation, but it could be dispensed with if you prefer. Both types of couple would then be judged on the facts, but unmarried couples would have a greater likelihood of getting relief on a second home either by proving their case or because we were unaware of the facts.



B O'CONNOR



COPY NO. 16 OF 17.

FROM: J M G TAYLOR

DATE: 27 January 1988

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary  
PS/Economic Secretary  
Sir P Middleton  
Sir T Burns  
Mr Scholar  
Mr Culpin  
Miss Sinclair  
Mr Riley  
Mr Cropper  
Mr Tyrie  
  
Mr Jenkins - OPC  
Mr Johns - IR  
Mr O'Connor - IR  
PS/IR

**MORTGAGE INTEREST RELIEF: RESIDENCE BASIS TWO HOME PROBLEM**

The Chancellor has seen your minute of 25 January. He agrees with the Financial Secretary's view that there is no practical or effective way of preventing co-habiting unmarried couples from getting relief on two residences. He also agrees that if anyone raises the issue we can point to the more favourable transferability rules for married couples.

A handwritten signature in dark ink, appearing to be 'J M G Taylor'.

pp J M G TAYLOR

## BUDGET SECRET: TASK FORCE LIST

COPY NO 1 OF ~~17~~ COPIES

From: SIR PETER MIDDLETON

Date: 1 February 1988

CHANCELLOR

cc Chief Secretary  
 Financial Secretary  
 Economic Secretary  
 Paymaster General  
 Sir T Burns  
 Mr Byatt  
 Mr Scholar  
 Mr Culpin  
 Mr Odling-Smee  
 Mr Riley  
 Miss Sinclair  
 Miss Hay  
 Ms Munro  
 Mr Michie  
 Mr Ford

*Handwritten in red ink:*  
 Mark  
 Nov v. [unclear]  
 [unclear]

SUBSIDISED MORTGAGES

... Even though we are no longer proposing to go ahead with the FBT  
 I thought that you and your Ministerial colleagues might like to  
 see this piece of work by Mr Riley, and Mrs Holmans' Annex. The  
 latter is of course of interest in other contexts - not least  
 regional pay.



P E MIDDLETON

FROM: C J RILEY  
DATE: 27 JANUARY 1988

SIR PETER MIDDLETON †

cc Sir T Burns  
Mr Byatt  
Mr Scholar  
Mr Culpin  
Mr Odling-Smee  
Miss Sinclair  
Miss Hay  
Ms Munro  
Mr Michie  
Mr Ford

**SUBSIDISED MORTGAGES**

Your meeting on 14 January considered the issue of subsidised mortgages and commissioned advice on possible Budget measures to deal with the problem. This note responds to that request, and circulates further material prepared by Stephanie Holmans.

**The present treatment**

2. It is necessary to distinguish between mortgages below and above the £30,000 ceiling.

**(i) Under £30,000**

3. The present treatment is as follows:

- mortgage interest relief (MIR) is available on interest payments in the usual way;
- the subsidy element (ie the difference between interest payments at subsidised and market rates) is not subject to income tax;
- neither employee nor employer NICs are payable on the subsidy;
- the subsidy affects the company's CT liability like any change in costs.

The present treatment is thus neutral as far as income tax is concerned. Employees do not pay income tax on the subsidy, but neither do they receive MIR; the two cancel out. The real problem arises because NICs are not payable on the subsidy; as with other benefits it is this which gives benefits an edge over equivalent salary payments.

**(ii) Over £30,000**

5. The treatment of the first £30,000 is as in (i) above. For the tranche above £30,000:

- the subsidy is subject to income tax;
- MIR is not available on the interest.

The NIC and CT treatment are as before.

**The scale of the problem**

6. The revised version of Stephanie Holmans' Annex A, attached, sets out the details. To summarise:

- the number of subsidised mortgages might be around 260,000, about 3¼% of all mortgages outstanding;
- the average subsidised mortgage is about £24,000, yielding total subsidised mortgage debt of a little over £6 billion.
- the total net value (to employees) of the subsidy on these mortgages is estimated to be about £270 million;
- the loss of revenue on the existing stock under present arrangements, is estimated at about £40 million.\*

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\* The loss could be as high as £70 million if companies giving subsidised mortgages do not pay CT, because none of the loss of NICS would be clawed back by higher CT.

7. It is very unlikely that the phenomenon of subsidised mortgages has added greatly to the growth of average house prices in recent years. But it may well have exacerbated the differential between prices in the south east and elsewhere; subsidised mortgages may account for over 10% of all mortgages in the South East (compared with about 3% nationally), and may have grown especially rapidly in recent years with the boom in City employment. One could argue that this is sufficiently damaging to labour mobility to warrant separate action on subsidised mortgages. But in any event there is a case for taking action on benefits generally to eliminate the NIC advantage which they currently enjoy.

### Possible action

#### (a) If FBT goes ahead

8. The Chancellor has decided that FBT, if it is introduced, should extend to subsidised mortgages. However an FBT at 45% would not be sufficient to offset the advantage currently enjoyed by benefits in the case of higher rate taxpayers. Also, because the FBT is non-deductible, non-CT taxpaying companies would continue to have an incentive to pay benefits even to employees taxable at the basic rate and in the kink, though few if any companies in the Financial Services sector are currently tax exhausted. At first sight, therefore, FBT would not deal fully with the subsidised mortgage problem; although as with other benefits it would help.

9. But there are important differences between subsidised mortgages and other benefits, because ~~the~~ mortgages below £30,000:

- the value of subsidised mortgages to employees is less than the cost of providing them to their employers, because the Government claws back some of the MIR it would have given on interest at the market rate;
- the subsidy element ~~it would have given on interest at the market rate~~ is not at present subject to income tax, and so unlike other benefits the income tax liability cannot be cut when FBT is introduced.

10. In order for a given FBT rate to be equivalent to the same effective rate on subsidised mortgages as on other benefits, and not a higher rate, it would be necessary to:

- levy FBT on the net benefit to the employee, rather than the gross benefit paid by the company; and
- make the cost to the company equal to the net benefit to the employee by effectively reimbursing the company for the difference in MIR between the market and subsidised rates of interest. (The company would already be receiving repayment of MIR at the subsidised rate.) This could be done by an abatement of FBT or by repaying MIR to the company at the market rate rather than the subsidised rate.

These propositions are demonstrated in Annex B.

11. It would therefore be possible to tax subsidised mortgages more heavily than other benefits, without adopting a higher FBT rate, by levying it on the gross subsidy and/or continuing to pay MIR to companies at the subsidised rate. The neutral FBT rates for different categories of taxpayer under different assumptions are set out in the table below.

Neutral FBT rates for a CT-paying company

	<u>Non-kinky basic rate taxpayer</u>	<u>Kinky basic rate taxpayer</u>	<u>Higher rate taxpayer</u>
<u>Subsidised mortgages</u>			
FBT on gross subsidy, MIR payments at subsidised rate	17	7	7
FBT on net subsidy, MIR payments at subsidised rate	22	9	11
FBT on net subsidy, MIR payments at market rate	44	31	55
<u>Other benefits</u>	44	31	55



12. If the aim is to discriminate against subsidised mortgages, rather than simply eliminating the present bias in their favour, an FBT of 45% would more than suffice if either of the above methods were adopted. Doubtless informed commentators would spot the discrimination and complain; we would need a good justification for it.

**(b) If there is no FBT**

13. If FBT is not introduced the scope for action on subsidised mortgages will depend on what, if anything, is done to correct the present NIC bias in favour of benefits as opposed to cash.

14. Consideration has been given to ways of applying NICS to benefits, but no practical solution has yet been found. One option put forward last summer was for a tax charge in lieu of employees' NICs which would have gone some way to reduce the present bias in favour of benefits. But the Chancellor was not attracted to this idea, and it was in any case superseded by FBT.

15. Other options would be:

(i) to apply income tax to the mortgage subsidy, as is presently the case with other benefits. This would lead to a non-neutrality in income tax treatment, and would be difficult to justify in principle not least because other benefits would be income tax neutral. But it would (more than) offset the present NIC advantage.

(ii) to levy a separate tax on the mortgage subsidy.

16. Neither of these options is very attractive. (i) is messy, but would be effective - indeed it would be overkill. The trouble is that informed commentators would be able to argue that we had tackled the problem in the wrong way - an income tax solution to a NIC problem. (ii) would be seen as taking a sledgehammer to crack a

ut; the subsidised mortgage problem is not sufficiently widespread or damaging to warrant a separate tax.

Conclusion

17. The subsidised mortgage problem arises because, as with other benefits, NICs are not payable on them.

18. If FBT goes ahead it would not solve the subsidised mortgage problem completely, but it would help. If it were felt worthwhile, there are ways of loading the FBT onto subsidised mortgages more heavily than on other benefits.

19. If FBT does not go ahead there is probably little we can do. Although it might be worth asking the Chancellor again if he would like to take another look at the idea of a charge in lieu of NICs. But it is too late now to do this for the 1988 Budget.



C J RILEY

**ESTIMATE OF NUMBER OF HOUSEHOLDS WITH  
SUBSIDISED MORTGAGES, AMOUNT OF DEBT AND  
AMOUNT OF SUBSIDY**

I. Number of Mortgages

Hay Management Consultants' survey showed that subsidised mortgages are found in the financial sector (somewhat narrowly defined). The most recent estimate of the number of employees in this sector is shown in Table 1.

Table 1 Employees in Financial Sector: Great Britain  
March 1987

	(thousands)		
	Males	Females	Totals
Banking and bill discounting (814)	191.4	215.7	407.1
Other financial institutions (815)	54.3	81.2	135.5
Insurance (excluding social security (82)	126.5	112.4	238.8
<u>Totals of above</u>	<u>372</u>	<u>409</u>	<u>781</u>

Note: Figures in brackets denote groups according to the 1980 Standard Industrial Classification. All companies in the Hay's sample categories of Banking, Insurance and other Financial fall into these SIC groups.

Source: Department of Employment Gazette, September 1987

2. The numbers of part-time employees were last estimated for June 1986. If there were the same proportions of part-time employees in March 1987 as in June 1986 (men and women separately in each of the three groups in Table 1) the number of full-time employees, at March 1987 would be:

**Table 2 Full Time Employees March 1987**

	Total	Men	Women
Banking and bill discounting	350,000	180,000	170,000
Other financial institutions	107,000	49,000	58,000
Insurance	220,000	124,000	96,000
<u>Total</u>	<u>677,000</u>	<u>353,000</u>	<u>324,000</u>

3. Hay MC report a number of exclusions for eligibility for subsidised mortgages.

4. The commonest minimum ages for eligibility are 23 years or 21 years. The 1981 Census (Economic Activity Tables, Tables 10A and 10B) showed the following proportion of employees under age 21 or age 23 (estimated)

**Table 3 Proportion of Employees Under Age 21 and 23 (per cent)**

	Banking & Finance		Insurance	
	Men	Women	Men	Women
Under 21	12	27	7	23
Under 23	18	38	12	32

5. If the percentages in Table 3 are deducted from the totals in Table 2, the numbers that remain are:

	<u>21 or over</u>	<u>23 or over</u>
Banking and finance	368,000	329,000
Insurance	189,000	174,000
<u>Total</u>	<u>557,000</u>	<u>503,000</u>

6. A length of service criterion is also frequently applied. 1 year or 2 years is the commonest period. Information from the 1986 Labour Force Survey about household heads' length of time with the

present employer, cross-analysed by age and sector, shows that of household heads who were employees in banking, finance and insurance aged 20-59 (too few people aged 60 and over have mortgages to be relevant here), 15 per cent had been with their employer less than one year, and 25 per cent less than 2 years. The combination of a minimum age of 21 and minimum service of 1 year would give 473,000 eligible employees; 23 years of age and 2 years minimum service would give 377,250. Averaging the two would give 425,000 in round terms.

7. Hay MC say that 64 per cent of employees eligible for subsidised mortgages actually have them. 64 per cent of 425,000 is 272,000. Some rounding downwards seems called for as the Hay MC sample consists mainly of large firms. Small firms such as exist in insurance broking may not have such benefits. A rather notional 5 per cent deduction on this account from the combined total would give 260,000, about 3¼ per cent of all mortgages outstanding.

## II Amount

8. The median average amount of subsidised mortgage loan according to Hay MC is £24,000. The total subsidised mortgage debt is estimated to be about £6¼ billion.

## III The Value of the benefit from subsidised mortgages

9. The interest rates clustered round 4 per cent and 5 per cent, with 5 per cent being the most frequently quoted rate. If market rates are taken to be 10½ per cent, detailed calculation arrives at a figure of about £270 million for the value to employees of the benefit in kind from the reduced mortgage rate on their loans.

## V Loss of Tax/NICs

10. Calculations of loss of income tax and national insurance contributions on subsidised mortgages have been made for four categories of employee:

1. earnings below UEL, mortgage below £30,000
2. earnings above UEL, mortgage below £30,000
3. earnings below UEL, mortgage above £30,000
4. earnings above UEL, mortgage above £30,000

11. For each of these categories, the total tax/NIC loss was estimated by the following series of calculations:-

- a. the net of tax value of the subsidised mortgage benefit to employees;
- b. the gross salary which would be of equal value to (a);
- c. income tax, employee and employer NIC due on this gross salary;
- d. the value of additional MIR at the market interest rate for all mortgage amounts at or below £30,000 was deducted from the income tax loss estimated in (c); in addition, for mortgages above £30,000, the income tax which would have been levied on the benefit from the subsidised mortgage amount in excess of £30,000 was deducted;

12. The following assumptions have been made, drawing on data from the Hay MC Survey:-

- There are 260,000 subsidised mortgages (see I above).
- Average size of loan is £24,000
- Average loan below £30,000 (including £30,000 of those mortgages above £30,000) is £22,640

- Average value of excess loan over £30,000 is £17,750
- 19% of mortgages are for more than £30,000
- The subsidised interest rate is 5% and the Inland Revenue "market" rate is 10½%.

13. In the absence of information about the income distribution of employees with subsidised mortgages, the calculations assume employees are basic rate income taxpayers only. Thirty five per cent of employees with subsidised mortgages are assumed to have earnings above the UEL (rather higher than the proportion for building society borrowers). Employee NIC has been taken as 9% for contracted-in employees and 7% for contracted out; employers' NIC has been taken as 10.45% and 6.35% respectively for employees below the UEL; and 10.45% for all employees above the UEL.

14. The results of the calculations are summarised below:

Loss of income tax and NICs on subsidised mortgages

	<u>£ million</u>				
	<u>Mortgage Below £30K</u>		<u>Mortgage Above £30K</u>		<u>Total</u>
	<u>earnings below UEL</u>	<u>earnings above UEL</u>	<u>earnings below UEL</u>	<u>earnings above UEL</u>	
<u>Income tax (net)</u>					
All contracted-in	7.9	-	1.1	-	9.0
All contracted-out	6.1	-	0.9	-	7.0
<u>Employee NIC</u>					
All contracted-in	21.6	-	3.2	-	24.8
All contracted-out	16.3	-	2.4	-	18.7
<u>Employer NIC</u>					
All contracted-in	25	11.8	3.7	1.8	42.3
All contracted-out	15.5	11.8	2.3	1.8	31.4
<u>Total Tax/Nic</u>					
All contracted-in	54.5	11.8	8.0	1.8	76.1
All contracted out	37.9	11.8	5.6	1.8	57.1

The total tax/NIC loss is estimated at £76m if all employees are contracted-in, and £57m if they are all contracted out. Assuming half contracted in, the loss is:

	£m
Income Tax (net)	8
Employee NIC	22
Employer NIC	37
	<hr/>
	67
	<hr/>

16. The main part of the loss is NIC, especially employers NIC which is lost in all four cases. There is no loss of employee NIC for employees earning above the UEL; and no net loss of income tax for those employees because they forego additional MIR on mortgages below £30,000, and pay income tax on the part of the benefit from subsidised mortgages above £30,000. For employees earning below the UEL, their receipt of subsidised mortgages in lieu of salary results in a loss of employee NIC of around £22m and the corresponding small amount (£8m) of net income tax.

17. Subsidised mortgages also affect companies' corporation tax liability. If companies provided mortgages at the market rate, rather than the subsidised rate, and gave their employees a compensating salary increase, their CT liability would be affected in two ways:

- i. they would pay CT on the additional interest received from employees
- ii. payments of additional gross salary and employers' NIC would be deductible for CT purposes.

The net effect is that CT payments would fall, by about £25m if all companies were CT-paying.



Summary

18. The total tax loss from subsidised mortgages, including CT as well as income tax and NICs, is estimated around £40m if all companies are CT paying, and £70m if no companies are CT-paying. It is considered, however, that these figures may be an underestimate because the coverage of subsidised mortgages may be wider than assumed.

**ANNEX B: FBT TREATMENT OF SUBSIDISED MORTGAGES**

1. An employer can give benefits to employees in the form of a subsidised mortgage or some other benefit. We consider how FBT should be applied to mortgages if the aim is to ensure that for a given value of benefit to the employee, the cost to the employer is the same, whichever form the benefit takes.

2. Suppose the employer wishes to give a benefit to the value of £1000 to a basic rate employee.

**For other benefits:**

3. The cost to the employer comprises two elements:

(i) the cost of the benefit itself, net of reduced liability to corporation tax

$$\text{ie } £1000 \times (1 - 0.35) = £650$$

**plus**

(ii) the FBT

$$\text{ie } £1000 \times 0.45 = £450$$

$$\text{Total cost to employer} = £1100$$

**For subsidised mortgages**

4. To give the employee a benefit worth £1000, the employer must give him  $£1000/(1-0.25) = £1333$ , because the employee foregoes mortgage tax relief on the higher interest payments.

5. So the cost to the employer is

(i) the cost of the subsidised mortgage itself

$$£1333 \times (1 - 0.35) = £866$$

plus

(ii) the FBT

$$\begin{aligned} \pounds 1333 \times 0.45 &= \pounds 600 \\ \text{Total cost to employer} &= \pounds 1466 \end{aligned}$$

6. To make this equal to the total cost of other benefits (£1100), both elements of the cost must be reduced - multiplied by  $1100/1466 = 0.75 = 1 - 0.25$ .

Thus the cost to the employer of the subsidised mortgage becomes

(i) The cost of the benefit itself

$$\begin{aligned} \pounds 1333 \times (1 - 0.25) \times (1 - 0.35) \\ = \pounds 1000 \quad \quad \quad \times (1 - 0.35) = \pounds 650 \end{aligned}$$

ie the cost to the employer before CT or FBT must equal the net benefit to the employee.

plus

(ii) the FBT

$$\begin{aligned} \pounds 1333 \times (1 - 0.25) \times 0.45 \\ = 1000 \times 0.45 = 450 \end{aligned}$$

ie FBT is charged on the net subsidy to the employee.

7. For a company which is not paying corporation tax, exactly the same argument follows.

8. For an higher rate employee, neutrality between different types of benefit requires that the net subsidy from subsidised mortgages is calculated at the individual's marginal rate. For the employee to enjoy £1000 worth of benefit, the employer would have to give him  $1000/(1-0.40) = \pounds 1667$ .

If the adjustments set out in paragraph 6 above were made only at the basic rate of tax, the cost to the employer would be

$$(i) \quad \pounds 1667 \times (1 - 0.25) \times (1 - 0.35) = \pounds 813$$

plus

$$(ii) \quad \pounds 1667 \times (1 - 0.25) \times 0.45 = \pounds 563$$

$$\text{Total cost to employer} = \pounds 1376$$

So subsidised mortgages would be relatively over-taxed for higher rate taxpayers under these arrangements.

FROM: E P KEMP  
27 January 1988

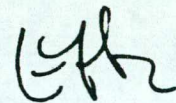
MRS S K HOLMANS

cc Sir Peter Middleton  
Sir T Burns  
Mr Anson  
Dame Anne Mueller  
Mr Byatt  
Mr Hawtin  
Mr C W Kelly  
Mr Odling-Smee  
Mr Spackman  
Mr Gilhooly  
Mr Instone  
Mr Parsonage

**SUBSIDISED MORTGAGES**

Thank you for sending me a copy of your fascinating note of 25 January to Mr Byatt.

2. The interesting figure is, I suppose, the per head (or per mortgage if that is all we can get) subsidy. This seems to work at around £1,300 per annum or say £26 per week gross. "Banking, finance, insurance, business service and leasing" earning are shown in the NES at a bit over £15,000 per annum. So if I have got this arithmetic right the mortgage subsidy looks as though it represents a perk worth nearly 10 per cent.



E P KEMP

FROM: MRS S K HOLMANS  
DATE: 1 February 1988

MR KEMP

cc Sir Peter Middleton ←  
Sir T Burns  
Mr Anson  
Dame Anne Mueller  
Mr Byatt  
Mr Hawtin  
Mr C W Kelly  
Mr Olding-Smee  
Mr Spackman  
Mr Gilhooly  
Mr Instone  
Mr Parsonage

### SUBSIDISED MORTGAGES

Thank you for your minute to me of 27 January.

2. Your calculations somewhat overestimate the importance of the average subsidy on these mortgages. The annual average subsidy, gross of income tax and employees' NICs, on the average (median) subsidised mortgage of £24,000 is around £1,500, which is more than your £1,300, which was grossed up only for income tax.

3. However, the average salary level of those employees in the financial sector in receipt of these mortgages will be in excess of the around £15,000 current average earnings of non-manual <sup>male</sup> workers in this sector, since the youngest employees, those with short service, and those in the lowest paid jobs, will not be eligible.

4. Unfortunately there is no information on the salary distribution of the subsidised mortgage borrowers. If we take out the lower quartile of financial sector earnings, we get an average earnings figure for those remaining of just under £18,000. On ~~these~~ earnings, the percentage mortgage subsidy is around 8 per cent. I think that this is a more realistic assessment of

the relative importance of the subsidy than 10 per cent, which would represent an extreme upper limit, with all employees receiving subsidies, or 5 per cent (which assumes an improbably high average salary for subsidised borrowers of £30,000).

*Stephanie K Holmans*

MRS S K HOLMANS



COPY NO. 16 OF 17.

FROM: J M G TAYLOR

DATE: 2 February 1988

PS/SIR PETER MIDDLETON

cc PS/Chief Secretary  
PS/Financial Secretary  
PS/Paymaster General  
Sir T Burns  
Mr Byatt  
Mr Scholar  
Mr Culpin  
Mr Odling-Smee  
Mr Riley  
Miss Sinclair  
Miss Hay  
Ms Munro  
Mr Michie  
Mr Ford

**SUBSIDISED MORTGAGES**

The Chancellor was grateful for Sir Peter Middleton's minute of 1 February, and the enclosed note by Mr Riley together with Mrs Holmans' Annex. He has commented that this does not look very promising.

A handwritten signature in black ink, appearing to be 'JMG'.

J M G TAYLOR





FROM: J M G TAYLOR

DATE: 15 February 1988

MR JOHNS - INLAND REVENUE

cc PS/Chief Secretary  
PS/Financial Secretary  
PS/Paymaster General  
PS/Economic Secretary  
Sir P Middleton  
Sir T Burns  
Sir G Littler  
Mr Anson  
Sir A Wilson  
Mr Byatt  
Mr Scholar  
Mr Culpin  
Mr Sedgwick  
Mr Odling-Smee  
Miss Sinclair  
Mr Riley  
Miss Evans  
Mr Hudson  
Mr Cropper  
Mr Tyrie  
Mr Call  
Mr Unwin - C&E  
Mr Knox - C&E  
Mr Jenkins (Parly Counsel)  
Mr Battishill - IR  
Mr Painter - IR  
Mr Isaac - IR  
Mr Beighton - IR  
Mr O'Connor - IR  
PS/IR

**MORTGAGE INTEREST RELIEF: CEILING**

The Chancellor has seen your minute of 12 February. He confirms that he does not expect to raise the mortgage interest relief ceiling from £30,000.

A handwritten signature in dark ink, appearing to be 'J M G Taylor'.

J M G TAYLOR



## Inland Revenue

 Policy Division  
 Somerset House
 Am

*Ch/ If I may say so,  
 an admirable  
 piece of work.*

 FROM M A JOHNS  
 DATE 18 FEBRUARY 1988

FINANCIAL SECRETARY

*mpw  
 18/2*

## RESIDENCE BASIS - COMMENCEMENT DATE

You asked for a note on why we had proposed a commencement date of as late as 1 August 1988 for the mortgage interest relief residence basis. This was discussed in paragraphs 36-38 of Mr O'Connor's note of 23 September 1987 and agreed on 5 October (Mr Heywood's note).

The main considerations pointing in the direction of a delayed start date are the need to allow time for the lenders to introduce new procedures and the need to avoid catching transactions in the pipeline. The main consideration pointing in the direction of an early start date is the need to minimise forestalling.

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cc Chancellor of the Exchequer Chief Secretary Paymaster General Economic Secretary Mr Scholar Mr Culpin Miss Sinclair Mr Murphy Mr Cropper Mr Tyrie Mr Jenkins (OPC)	Mr Painter Mr Beighton Mr Johns Mr O'Connor Mrs Willetts PS/IR
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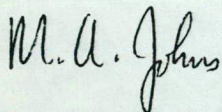
We now depend heavily on the banks and building societies to operate the vast bulk of mortgage interest relief through MIRAS. Twelve months notice has been given for previous changes to MIRAS (which have been less complicated than the present changes - eg the application of MIRAS to over £30,000 loans). We have to produce and issue new forms. The lenders have to adapt their computer systems, devise new procedures, disseminate them to their staff, train them and so forth. This, as we know from our own experience is very time-consuming for large dispersed organisations. There are likely to be substantial complaints from the lenders this year anyway on the burdens being placed on them.

In the case of home improvement loans we think the lenders should be able to cope with a 6 April start date because it is just a matter of giving no relief at all for new home improvement loans. Even here there will be problems - eg on loans largely for purchase but with some improvement element; and there will be no amended forms immediately available - but we think it should be possible. Anything later than 6 April would create an enormous incentive to forestalling - people could rush through improvements very fast indeed. And 6 April should enable loans in the pipeline on Budget Day to be cleared. In the case of relief for dependent relatives and divorced and separated spouses there is not as great a risk of forestalling but again it is a question of refusing relief altogether for particular purposes so 6 April should be feasible.

But the residence basis is far more complex. The lenders need procedures to identify sharers (including rules for saying when there is one residence and when two), procedures for dividing the ceiling up between sharers and operating a part ceiling, dealing with applications for transfers of unused ceiling and so forth. It is highly likely that even by 1 August many of them will only have partially effective systems and we would expect you to come under pressure to extend rather than reduce the period. However, we would not recommend such an extension because it would open up the way to considerable forestalling. It clearly takes time to

set up sharing purchases but even with 4½ months notice there could be quite a scramble. The lenders will have (as on past changes) to sort problems out after the commencement date. 1 August is the best compromise we can propose in the absence of consultation with the lenders (which is clearly impossible).

It also has the merit that the residence basis would not have to be operated until after the Finance Bill has received Royal Assent. This has practical advantages - lenders would not have to unscramble arrangements already made if the provisions were amended during debate. It also has drafting advantages - we should need a Provisional Collection of Taxes Act resolution to operate an earlier commencement date. This raises the problem that the resolution has to be absolutely right by Budget Day and the clause resting on the resolution cannot be amended without the resolution lapsing and a new one having to be tabled. This would involve considerable difficulties. Parliamentary Counsel has advised that it is unlikely that a resolution could be adequately drafted now.



M A JOHNS