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PART H

SECRET

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PART H

TAX REFORMS 1987 - 1988
INCLUDING INDEPENDENT
TAXATION, CAPITAL GAIN
TAX AND BENEFITS

DD's 25 years NA33

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PART H

15.3.88

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96

PWP

Inland Revenue

Policy Division
Somerset House

Copy No 2 of 26

FROM: P A MICHAEL
DATE: 23 February 1988

1. MR CAYLEY
2. MR PITTS 23/2
3. FINANCIAL SECRETARY

Ch
We have an item on the Overview Agenda on Monday

CGT REFORM: BUDGET DAY PRESS RELEASE

We would be grateful to know whether you are content with the attached draft Press Release.

PAM
P A MICHAEL

---

cc.	Chancellor	Mr Isaac
	Chief Secretary	Mr Pitts
	Paymaster General	Mr Beighton
	Financial Secretary	Mr Cayley
	Mr Scholar	Mr Hamilton
	Mr Culpin	Mr Mace
	Mr R I G Allen	Mr McManus
	Miss Sinclair	Mr Walker
	Mr Michie	Mr Willmer
	Mr Riley	Mr Michael
	Mrs Burnhams	Mr Lester
	Mr Cropper	PS/IR
	Mr Tyrie	

BUDGET SECRET: TASK FORCE LIST

INLAND REVENUE

Press Release

INLAND REVENUE PRESS OFFICE, SOMERSET HOUSE, STRAND, LONDON WC2R 1LB
PHONE: 01–438 6692 OR 6706

[3x] 15 March 1988

TAXATION OF CAPITAL GAINS: GENERAL CHANGES

In his Budget, the Chancellor proposes a number of reforms in the general regime for the taxation of capital gains. These changes, which will apply to disposals on or after 6 April 1988, are in outline as follows:-

- Only gains or losses accrued since 31 March 1982 will be brought into account.

- The charge to capital gains tax at 30% is to be abolished. Instead, the gains of individuals will be chargeable to capital gains tax at rates equivalent to the rates of income tax that would apply if gains were treated as the top slice of income. Under the Budget proposals, this means that gains will be taxable, along with income, on a two-rate scale of 25% and 40%. Subject to special provisions for accumulation and discretionary settlements, the gains of trustees and personal representatives will be chargeable to capital gains tax at a rate equivalent to the basic rate of income tax.

[As part of these changes it is proposed that for 1988/89 there should be no increase in the annual exempt amount (currently £6,600 for individuals and £3,300 for most trustees).]

Other proposals concerning the taxation of capital gains are dealt with in the appropriate Press Releases.

BUDGET SECRET: TASK FORCE LIST

DETAILS OF THE PROPOSALS

REBASING

Background

1. At present, the charge to capital gains tax (corporation tax as regards the gains of companies) is confined to gains accruing from 6 April 1965. Similarly, only capital losses accruing from that time are allowable against gains.

New base date

2. It is proposed to move the base date forward from 6 April 1965 to 31 March 1982 - the date which already applies for some indexation purposes. Subject to paragraphs 3 and 4 below gains and losses accruing on the disposal of assets held on 31 March 1982 will be computed on the basis that such assets were acquired at their market value on that date. Rebasing will apply to the gains of all taxpayers, whether individuals, trustees, personal representatives or companies.

Example 1

An asset is disposed of at a gain under the present regime of £50,000. The gain since 31 March 1982 by reference to the market value of the asset on that date is £10,000. The chargeable gain will be £10,000.

Special circumstances

3. There will be provisions to ensure that 1982 rebasing does not increase either the amount of a gain or the amount of a loss as compared with what the gain or loss would have been under the present regime (after taking account, where appropriate, the rules for assets held on 6 April 1965). Where there is a gain since 31 March 1982 and a loss under the present regime, or vice versa, the result will be no gain/no loss. Where under the present regime for assets held on 6 April 1965 the disposal would be treated as taking place at no gain/no loss, rebasing will not alter the position.

4. The effect of these proposed rules is illustrated in the following examples. For simplicity, these ignore indexation and any other reliefs or exemptions due.

Example 2

An asset is disposed of at a gain under the present regime of £12,000. The gain since 31 March 1982 by reference to the market value of the asset on that date is £17,000. The chargeable gain will be £12,000.

BUDGET SECRET: TASK FORCE LIST

Example 3

An asset is disposed of at a loss under the present regime of £8,000. The loss since 31 March 1982 by reference to the market value of the asset on that date is £19,000. The allowable loss will be £8,000.

Example 4 (no gain/no loss: assets acquired after 6 April 1965)

An asset is disposed of at a gain under the present regime of £23,000. There is a loss of £13,000 since 31 March 1982 by reference to the market value of the asset on that date. The result will be no gain/no loss.

RATES OF CAPITAL GAINS TAX

Background

5. At present, the chargeable gains of individuals, trustees and personal representatives are chargeable to capital gains tax at 30%. The rate of capital gains tax has remained unchanged since the introduction of the tax in 1965.

Individuals

6. It is proposed that the gains of individuals will be chargeable to capital gains tax at rates equivalent to the rates of income tax that would apply if gains were treated as the top slice of income. Accordingly, and depending on the level of an individual's income, gains will be chargeable at rates equivalent to either the basic rate of income tax, the higher rate of income tax, or partly one and partly the other.

Example 5

An individual has taxable income for 1988/89 (after reliefs and allowances) of £12,000 and gains above the annual exemption of £4,000. When treated as the top slice of income, the gains of £4,000 do not result in the income tax higher rate threshold of £20,000 being exceeded. Accordingly, the gains will be chargeable to capital gains tax at a rate equivalent to the basic rate of income tax.

Example 6

An individual has taxable income for 1988/89 (after reliefs and allowances) of £15,000 and gains above the annual exemption of £11,000. When treated as the top slice of income, the gains of £11,000 result in the income tax higher rate threshold of £20,000 being exceeded. Accordingly, gains of £5,000 will be chargeable to capital gains tax at a rate equivalent to the basic rate of income tax and gains of £6,000 chargeable at a rate equivalent to the higher rate of income tax.

Trustees and Personal Representatives

7. It is proposed that in general the gains of trustees and personal representatives will be chargeable to capital gains tax at a rate equivalent to the basic rate of income tax. The gains of trustees in respect of accumulation and discretionary settlements which are within the scope of the income tax additional rate charge will be chargeable at a rate equivalent to the sum of the basic rate and the additional rate (ie 35%).

Husband and Wife

8. At present, where a husband and wife are living together, the chargeable gains and allowable losses of each spouse are computed and aggregated separately but, in general, the resulting total is assessed on the husband unless an election for separate assessment to capital gains tax has been made. For 1988/89 and 1989/90 the gains of the wife will continue to be assessed on the husband unless an election is made for separate assessment. As now, a husband and wife will share one annual exemption. Their aggregate gains will be taxed ~~at the~~ (broadly as with investment income now) at ~~the~~ rates that would apply if they were the marginal slice of the husband's income.

9. Where a separate assessment election applies, the total tax payable on the married couple's gains will be unaltered, but it will be split up in proportion to their respective chargeable gains.

Example 7

In 1988/89 a wife has gains of £12,200 and the husband has gains of £24,400. A separate assessment election is in force. The annual exemption of £6,600 is split between them proportionately to their gains, so that the wife has exemption on £2,200 and the husband on £4,400, leaving chargeable gains of £10,000 and £20,000 respectively. The total capital gains tax chargeable is £12,000. The tax will be split up as follows:-

Wife's tax: $\frac{£10,000}{£30,000} \times £12,000 = £4,000$

Husband's tax: $\frac{£20,000}{£30,000} \times £12,000 = £8,000$

10. In the year of marriage, or if the married couple are living apart throughout the year, husband and wife are normally treated as two single people. It is not intended to alter these arrangements.

11. There will be special provisions for a year in which a married couple separate or divorce. The effect will be broadly to treat the wife as a single person from the date of separation or divorce.

12. From 6 April 1990, it is proposed that married couples should be taxed independently on their capital gains, with separate annual exemptions, and so different rules will apply. These are described in a separate Press Release.

BUDGET SECRET: TASK FORCE LIST

Underwriters

13. There will be provisions adapting the new proposed rates of capital gains tax to Lloyds Underwriters.

Companies

14. The chargeable gains of companies are chargeable to corporation tax at normal corporation tax rates. This will continue to apply.

LOSSES

15. Realised capital losses carried forward from 1987/88 and earlier years will remain available for carryforward against gains in 1988/89 and subsequent years. The computation of these losses will not be affected by rebasing.

COMMENCEMENT

16. The changes outlined in this Press Release will apply to disposals on or after 6 April 1988. Disposals before that date will continue to be dealt with under the existing regime.

BUDGET SECRET: TASK FORCE LIST

Inland Revenue

Policy Division
Somerset House

Copy No 1 of 17

Many [illegible] like to see the 1 82 statute reforms to @ X, which may contain useful ~~[illegible]~~ arguments for us to deploy against the abolitionists.

FROM: M F CAYLEY
DATE: 24 February 1988

CHANCELLOR

IFS INTERIM REPORT ON CGT

1. The IFS are publishing an interim 79 page report on CGT on 25 February. This is intended as a basis for discussion, rather than as presenting definitive IFS proposals. They have sent me an advance copy, and you may find it helpful to have a brief summary.

2. The report contains a number of useful comments on some of the suggestions that people make for changing the rules. It says that

X (i) abolishing CGT runs into problems of cost, conversion of income into gain, and equity;

(ii) taxing gains at marginal income tax rates would reduce the inequities of the system, but be difficult without a dramatic reduction in the higher rates. But the report adds that "such a reform would not get at the root of the problem with CGT - its complexity";

---

cc.		
	Chief Secretary	Mr Battishill
	Financial Secretary	Mr Isaac
	Paymaster General	Mr Painter
	Economic Secretary	Mr Beighton
	Sir P Middleton	Mr Pitts
	Sir T Burns	Mr Cayley
	Mr Scholar	Mr Michael
		Mr Lester
		PS/IR

(iii) given a CGT, indexation is necessary;

(iv) a tax confined to short-term gains, or tapered down to zero for assets held more than X years, is undesirable: it would be inequitable, lead to lock-in effects, and encourage taxpayers to realise losses before the cut-off point, and gains after .

3. The report goes on to float what is effectively the Budget package:-

(i) abolishing CGT on pre-82 gains;

(ii) have two income tax rates of 25% and 40%;

(iii) tax remaining indexed gains as if they were income, but ring-fence capital losses from income; and

(iv) retain a separate annual gains exemption.

It comments on this:-

"Clearly such a package has much to commend it. It would also seem to be the logical counterpart in the personal sector to the reform made in the 1987 Budget in the corporate sector, which resulted in corporate chargeable gains being taxed at the same rates as trading income.

The main objection to a package such as this is that the key problem which we have identified with CGT is left unremedied, namely its complexity. Still, it cannot be a valid objection to a sensible reform package that it is not perfect. What might be a valid criticism is that there are other, even better, packages on offer."

4. The IFS say that complexity is inherent in <u>any</u> CGT, and stems essentially from the need to link asset disposals with asset acquisitions. They therefore go on to float - as a "preliminary" idea - a complete replacement for CGT - which they term a "capital disposals tax".

5. This has some familiar and some less familiar features. Predictably for the IFS, they float an "expenditure tax" type base: the tax base would be net dissaving in the year. Net dissavings would be treated as the marginal slice of income, but <u>not</u> subject to a basic rate charge. Instead, tax would be charged on net dissavings only in so far as they were above the higher rate threshold, and then only at the <u>difference</u> between the basic and higher rates. The tax base would include pretty well all capital assets, including the home, life assurance, and lump sum payments out of pension schemes.

6. The IFS see this reform as having the following main advantages:-

(i) it removes the complexities resulting from the need to link acquisitions with disposals;

(ii) it avoids locking people into particular assets;

(iii) it removes the fiscal distinction between different types of saving, since all will be treated alike.

7. As one of a number of minor asides, the IFS suggest that a consequential (designed to increase fiscal neutrality) should be reintroduction of Schedule A; and possibly an annual tax on the value of the enjoyment of non-income producing assets like jewellery and works of art, with possibly an exemption for "national heritage" type assets. The latter they see as administratively costly, so they suggest the alternative proposition of treating only a proportion of expenditure on such assets as "saving". Another minor aside is the possibility of exempting all investment income from basic rate tax.

8. The report recognises that the ideas would involve particular difficulties with:-

(i) the treatment of borrowings;

(ii) the transition from the present regime (the biggest problem being how to avoid unduly penalising people who have eg saved via life assurance or a pension scheme in the expectation that the present regime would continue, only to find that the proceeds of their policy or lump sum retirement payments enter into the new tax computation).

On the first, the rules they recommend would involve tax charges on people who have to borrow to meet living expenses; on the second, they have come up with answers that represent ~~s~~ only exceedingly rough justice.

9. As far as unincorporated business are concerned, the IFS suggest ring-fencing the business, and no tax charge as long as funds remain within it: but if the businessman withdrew funds from the business, they would enter into his tax computation. They dismiss cavalierly the acute difficulty of distinguishing between business and personal funds, and the distortions that would result.

10. For companies they put forward three options:-

(i) the familiar IFS idea of a cash flow corporation tax - but they recognise that this is unlikely to appeal to Ministers;

(ii) leaving the corporate capital gains regime alone; and

(iii) abolishing tax on companies' capital gains, except for life assurance and insurance companies (whose gains would simply be treated as income) and possibly with some special (unspecified) regime for property companies.

11. The IFS have (explicitly) not thought through how trusts would fit into their new world, but accept there are a "number of points" to consider.

12. Internationally, the Report recognises complications over how to give double tax relief and how to treat temporary residents. As (another) aside, they suggest briefly a reform of the residence rules.

13. The Report mentions the possibility of abolishing IHT and making death the ultimate dissaving for the transferor (with a corresponding "savings" entry for the legatee) but says that the IFS will be turning to taxes on death in due course.

14. Finally, the IFS have made little effort to assess the behavioural, compliance and administrative implications of their proposal, which would all be substantial.

Summary

15. The IFS interim report suggests that, if CGT is retained, a reform on the lines envisaged for the Budget seems quite sensible: but they would prefer a completely new approach under which CGT would be replaced by an expenditure-type capital disposals tax, with net dissavings being added to income and liable (where appropriate) at the difference between the higher and basic rates - but not at the basic rate.

16. They have clearly run into difficulties on a number of aspects, including the transition to their new world and the treatment of businesses and trusts.

17. We shall include one or two brief questions and answers on the Report in the Budget Brief.

Michael Cayley

M F CAYLEY

mjd 2/1463m

UNCLASSIFIED

FROM: J M G TAYLOR
DATE: 25 February 1988

MR CAYLEY IR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar

Mr Battishill IR
Mr Isaac IR
Mr Painter IR
PS/IR

IFS INTERIM REPORT ON CGT

The Chancellor was most grateful for your minute of 24 February.

JT

J M G TAYLOR

Inland Revenue

Policy Division
Somerset House

FROM: M F CAYLEY

DATE: 25 February 1988

PS/CHANCELLOR (MR TAYLOR)

Thanks. V. useful note. 2. PSG let me know re estimated yield of tax on corporate gains in 1988-89. N.

IFS INTERIM REPORT ON CGT

You asked for a copy of the IFS comments referred to in Paragraph 2(i) of my 24 February note. This is attached (paragraph 15 of the summary immediately below and paragraphs 2.2.1 to 2.2.5 from the full Report).

M F Cayley

M F CAYLEY

---

cc. Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Battishill
Mr Isaac
Mr Painter
Mr Beighton
Mr Pitts
Mr Cayley
Mr Michael
PS/IR

14. A final criterion necessary for assessing tax reform proposals is that the transition from the existing system must be practicable. It is one thing dreaming up a world of better taxes; quite another to take practical steps towards one. The need to ensure practicability and to retain a wider perspective must both govern the search for reforms.

Options for Reform

15. One option which at first sight seems attractive is just to abolish CGT. However, there are several telling objections to doing this. One is the revenue cost. This would be more than the CGT revenue forgone, since the increased incentives to turn income into now untaxed capital gains would almost certainly eat into income tax. Thus new anti-avoidance provisions would be needed - and these would look very much like the existing provisions of CGT. In fact one way of thinking of CGT at present is not so much as a separate tax, but as a massive anti-avoidance provision! The abolition of CGT would also further reduce the extent of equity in the tax system, and generate more tax-induced behaviour.

16. There are a number of possible reforms to CGT which might be explored. One would be to tax all realised gains at an individual's marginal income tax rate. This is the route taken in the USA by the Tax Reform Act of 1986. Although this would reduce the inequities in the system, and the incentive to turn income into capital, it would be a difficult reform to implement in the UK except in conjunction with a dramatic reduction in the higher rates of income tax. Moreover, such a reform would not get at the root of the problem with CGT - its complexity.

17. The indexation provisions are woefully complicated. It would be unfair to abandon indexation altogether, since with average asset holding periods of around 8 years, even modest inflation rates can lead to sizeable inflationary gains. But could the indexation provisions be improved? One remaining inconsistency since indexation was introduced is the fact that pre-1982 gains are still taxed on a nominal basis. This could be removed by extending indexation backwards, or by removing any tax charge on pre-1982 gains. The former course would be higher in compliance costs, and the latter would be higher in revenue costs now. However, abolishing CGT on pre-1982 gains would also be straightforward to achieve, now. This is because present indexation rules already require 1982 valuations of assets, so that little extra work would need to be done now to remove the pre-1982 element from gains when they are realised. Nonetheless, quite apart from the problem of pre-1982 gains, the existing indexation rules are still extremely complex. One reform to them is considered in some detail, namely the creation of an indexation pool, but on balance this would not reduce the complexities significantly.

18. One reform which is frequently canvassed is to implement some kind of tapering relief, or to make a distinction between short- and long-term gains. Such schemes have in common linking the effective tax rate on the gain realised to the holding period of the asset. In our view such schemes are undesirable. Certainly they are an unacceptable proxy for indexation, as they may still result in inflationary gains being taxed while real gains are not and there is little justification for them on other grounds either. They also carry a lock-in distortion: taxpayers will be encouraged to realise losses before the cut-off point, and to hold on to gains until after it.

19. Other reforms considered include some modification of or extension to "rollover" relief for the replacement of business assets. This relief exists to defer any CGT charge when certain capital investments used in a business are replaced. The problem with it though is that through the relief CGT distinguishes between capital investment financed out of a capital gain and investment financed out of earnings: rollover discriminates between the sources of investment. If it is desirable to give some tax relief for investment or saving, it would be more logical to do it without discriminating between the sources of finance in this haphazard way.

2 OPTIONS FOR REFORM

2.1 Introduction

2.1.1 In this chapter we set out to examine some ways of improving capital gains tax. In doing this we tried to avoid two pitfalls. One is that any proposals we come up with will be totally impracticable. On the other hand, there is also a correlative danger that any practicable proposals we make will be merely tinkering. There is no easy course here. What we have done is to try to keep the significant problems before us, whilst not losing sight of the need to ensure that any proposals we make must work, and not create any insurmountable transitional problems.

2.2 Why Not Just Abolish CGT?

2.2.1 If abolishing CGT has its political attractions, it has certain economic ones as well. Supposing that CGT were simply to be repealed and no other tax changes were made, all the complex administrative and compliance problems which the tax gives rise to would disappear, the "locked-in" would be freed, and the taxation of gains would be nearly back where it was in 1962.

2.2.2 However, there are at least three reasons why CGT should not just be abolished. One is the revenue cost. Although there is at present an incentive for many taxpayers to channel their investment yields through capital gains, this incentive would be greatly increased if the tax were abolished completely. Therefore, although CGT only raises around £2 billion a year at present, its abolition would certainly cost more than this in terms of income tax revenue forgone. To stop this leakage, anti-avoidance provisions would need to be implemented into income tax – and these provisions would begin to look very like the existing provisions of CGT. In fact one way of thinking of CGT at present is not so much as a separate tax, but as an anti-avoidance provision within income tax. Moreover, if the latest batch of anti-avoidance provisions which have been introduced into income tax (i.e. the accrued income scheme) are a foretaste of what is to come, many would-be advocates of CGT abolition might prefer to keep CGT on the grounds of "better the devil you know".

2.2.3 A second problem is that the straightforward abolition of CGT would increase the dispersion of tax privileges on different forms of saving. We saw in the last chapter the way CGT and income tax together combine to produce a wide spread in tax incentives to save through different media, and the straight abolition of CGT would unquestionably make this problem worse. There is no economic justification whatever for providing tax incentives to invest in assets which yield their returns as capital gains rather than investment income, yet this is just what abolishing CGT would achieve, unless other tax reforms were also made simultaneously.

2.2.4 The third point is simply that to abolish CGT is bound to reduce the extent of horizontal equity in the tax system. It is difficult to make the notion of equity here precise, but the ideal that those who are equally "well off" should pay the same tax is clearly more nearly approached by a tax system which makes the person who lives off capital gains pay some tax, than by a tax system which lets him off completely.

2.2.5 For these reasons, we conclude that capital gains tax should not simply be abolished. This leaves us with three routes: to keep CGT in some form, and play about with it; to abolish CGT and put something else in its place; or to do nothing. For the remainder of this chapter we explore the first route.

2.3 Retaining the CGT Structure

2.3.1 If we are to retain the CGT structure in some form, how might it be improved? There are a number of possibilities which we consider in turn:

a) we look at whether capital gains as computed for CGT purposes could be simply charged to income tax, and the problems this might still leave (Section 2.4);

b) we consider what might be done to reduce the complexity of the indexation provisions of the tax (Section 2.5);

c) we discuss whether the tax should be levied solely on short-term gains, or some tapering relief should be implemented (Section 2.6);

d) we look at the possible extension of reliefs for reinvestment, to reduce the lock-in effect (Section 2.7); and

e) we consider a possible package of CGT reforms (Section 2.8).

2.4 Charging Capital Gains to Income Tax

2.4.1 This proposal takes us in totally the opposite direction from abolition. The argument says that capital gains are just one channel of total income, and there is no rationale for taxing them at a lower rate. This is to challenge the whole basis of the distinction between income and capital, which as we saw in the last chapter is a fundamental building block of the UK tax system. Yet its removal could apparently be achieved extremely easily by just taxing capital gains as computed for CGT, to income tax. This would remove the incentive to channel rewards through capital gains, and greatly increase the degree of horizontal equity in the tax system.

2.4.2 Unfortunately it is not that easy to achieve. For what is required is that the tax rate on *accrued* gains should be the same as that on income. But as capital gains tax is levied on realisation, this would not be achieved by simply adding chargeable gains to income each year. It is in our view clearly impracticable to levy a capital gains tax on accrued gains copy No 1 of 35.

BUDGET SECRET: TASK FORCE LIST

Inland Revenue

Policy Division
Somerset House

FROM: B A MACE

DATE: 25 FEBRUARY 1988

1. MR ISAAC 25.2

2. CHANCELLOR OF THE EXCHEQUER

Thanks. NAW

BUDGET INCOME TAX CHANGES

1. Mr Eason is sending you separately today a submission about an income tax option involving a 10 per cent increase in the main personal allowances. This note deals with two separate points which were raised at the Overview on 22 February.

(a) INCOME WITHDRAWAL BAND FOR AGE ALLOWANCE

1. At the Overview meeting on 22 February we were asked to examine the possibility of reducing the rate at which age allowance is withdrawn where the taxpayer's income exceeds the

---

cc	Principal Private Secretary	Chairman
	Chief Secretary	Mr Isaac
	Financial Secretary	Mr Painter
	Paymaster General	Mr Beighton
	Economic Secretary	Mr Calder
	Sir P Middleton	Mr Lewis
	Sir T Burns	Mr Mace
	Sir G Littler	Mr R H Allen
	Mr J Anson	Mr Eason
	Sir A Wilson	PS/IR
	Mr Byatt	
	Mr Scholar	
	Mr Culpin	
	Mr Sedgwick	
	Mr Odling-Smee	
	Miss Evans	
	Mr Hudson	
	Mr Cropper	
	Mr Tyrie	
	Mr Call	
	Miss Sinclair	
	Mr Riley	
	Mr Unwin (Customs & Excise)	
	Mr Knox (" & ")	

income.txt

aged income limit. (With the present rate of withdrawal of £2 of allowance for every £3 of income above the limit and a basic rate of 25 per cent the effective rate of tax on each £ of income within the withdrawal band would be 41.7 per cent).

2. I am afraid that at this late stage a change in the withdrawal rate is not practicable for 1988-89. The change would require some complex programming changes to our computer systems to enable the reduced age allowance of all taxpayers within the withdrawal band to be recalculated. These changes could not now be completed in time for implementation in 1988-89 along with the other Budget measures.

3. Although the effective rate of tax on an additional £ of income for a taxpayer in the age allowance withdrawal band would exceed 40 per cent for 1988-89 this is not, of course, a rate which is explicitly charged in the income tax rate schedule. If you are content therefore we do not think the age allowance point need constrain you in saying that there is no rate in excess of 40 per cent in the system.

(b) TIMETABLE FOR DECISIONS

4. As you know, in view of the complexity of the Budget package this year we had asked for a final decision on all the income tax allowance and rate changes by Friday 26 February. At the last Overview meeting we undertook to consider whether we could hold the work until a final decision on Monday 29 February and your Private Secretary subsequently told us that you would like to hold the decision further until the Overview meeting on the Monday afternoon. At this stage every additional day until all the decisions are taken compresses the already very tight timetable for completing the preparatory work for the Budget changes. Amongst other things a very large amount of material about the changes has to be prepared and printed either by Budget Day or very shortly afterwards for immediate distribution to tax offices. Work on this cannot begin until all the changes are settled. However, we have reviewed again the work programme and

adjusted it so that, so far as we can judge, we should be able to accommodate, without unacceptable risk, a final decision at the 29 February Overview.

B A Mace.

B A MACE

mjd 2/145Jn

BUDGET SECRET: TASK FORCE LIST

COPY NO. 33 OF 34

FROM: J M G TAYLOR
DATE: 25 February 1988

MR RILEY

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 Monck
Mr Scholar
Mr Culpin
Mr Odling-Smee
Mr Sedgwick
Miss Sinclair
Mr Bredenkamp
Miss C Evans
Mr Hughes
Ms Munro
Mr A Hudson
Mr Cropper
Mr Tyrie
Mr Call

Mr Battishill IR
Mr Isaac IR
Mr Painter IR
Mr Lewis IR
Mr I Stewart IR

Mr Unwin C&E
Mr Knox C&E

CARS AND HOUSES: BEHAVIOURAL EFFECTS

The Chancellor was most grateful for your minute of 23 February and the enclosed papers.

2. He has asked what is the expected effect on M4 of the abolition of home improvement loan relief. I should be grateful for advice.

JT

J M G TAYLOR

BUDGET SECRET - TASK FORCE LIST

INLAND REVENUE
STATISTICS DIVISION
SOMERSET HOUSE

COPY NO 1 OF 38.

FROM: R J EASON

DATE: 25 February 1988

option 10 looks attractive, if you can afford it.
C[illegible] 25-2

1. MR ISAAC

2. CHANCELLOR OF THE EXCHEQUER

EASON TO CX 25 FEB

INCOME TAX OPTIONS - VARIANTS OF OPTION 3

1. Following the overview meeting on 22 February, this note considers some further income tax options. They are based on Option 3 with a basic rate of 25 per cent and a single higher rate of 40 per cent starting at £20,000 taxable income, but each has further increases to personal allowances.

---

cc Principal Private Secretary
Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr J Anson
Sir A Wilson
Mr I Byatt
Mr M C Scholar
Mr R Culpin
Mr P Sedgwick
Mr J Odling-Smee
Miss C Evans
Mr A Hudson
Mr P McIntyre
Mr P Cropper
Mr A Tyrie
Mr M Call
Miss C E C Sinclair
Mr C J Riley
Mr Unwin (C&E)
Mr Knox (C&E)

Chairman
Mr Isaac
Mr Painter
Mr Beighton
Mr Calder
Mr Lewis
Mr Mace
Mr Cayley
Mr Eason
Mr Ko
Miss White
PS/IR

2. The options considered are

- Option 10, in which allowances are increased by 10 per cent: this would give a married man on average earnings £5.24 per week.

- Option 85, in which allowances are increased from 1987-88 levels by 8.5 per cent: this would give a married man on average earnings of £244.70 per week in 1988-89 a gain of £5.02 compared with his gain of £4.88 under Option 3.

We have also looked at an option (Option 74) in which personal allowances are increased by 7.4 per cent (by contrast with Option 3 in which the increases due from indexation of 3.7 per cent are doubled.)

Costs

3. The table below summarises the extra costs of these options compared with Option 3.

Direct Revenue Costs* (£'billion)

	1988-89	**1989-90****	**Full Year at 1988-89 incomes**
last week's scorecard	-4.19	-6.13	
Option 3 compared with indexation	-4.19	-6.09	-5.62
This week's scorecard	-4.31	-6.40	
Additional costs of			
Option 10	-0.38	-0.55	-0.50
Option 85	-0.18	-0.22	-0.20
Option 74	+0.02	+0.03	+0.03

* at pre-Budget levels
** using the latest forecast movement of 4 per cent for indexation.

4. Increasing personal allowances by 10 per cent would therefore add about £380 million to the cost of Option 3 in 1988-89, making the total cost of the income tax package

about £4.6 billion. (This includes about £400 million for the cost of reducing the ACT rate by 2p). The total cost in 1989-90 of Option 10 would be about £6.6 billion. A 8.3 per cent increase in allowances would add about £180 million to the cost of Option 3 in 1988-89. Increasing allowances by 7.4 per cent, rather than double indexation, would save only £20 million in 1988-89.

Levels of Personal Allowances

5. Table 1 attached gives the levels of allowances for Options 10 and 85 and Table 2 gives the real increases since 1978-79, assuming inflation between 1987-88 and 1988-89 is 4 per cent. The principal feature is that a 10 per cent increase would raise the real value of both the single and married man's allowances to 30 per cent more than the 1978-79 levels. The starting point for higher rate tax would be 20 per cent higher in real terms. A 7.4 per cent increase in allowances, compared with Option 3, would reduce all the married allowances and the APA by £10.

6. The real value of the single allowance under either Option 10 or Option 85 will be the highest since 1972-73. The real value of the married men's allowance will be the highest since 1939-40. With forecast earnings for a full-time male at £244.70 in 1988-89, the married man's allowance of £4175 under Option 10 would be 32.8 per cent of average earnings, below the level of 33.5 reached in 1985-86 (which is the peak under this Government) but better than the 1987-88 figure of 31.1 per cent.

7. Table 3 attached gives the gains for a married man at various levels of income under each option. Option 10 would be worth £20 extra per annum, compared with Option 3, for married men liable at the basic rate while Option 85 would be worth £7.50.

Average rates of tax and NIC

8. Tables 4 and 5 show the effects of the options on average rates of income tax and NIC at multiples of average earnings. Option 10 produces lower or the same average rates of tax and NIC for single people as in 1978-79 at all multiples shown in the table. However, for married men, rates were lower in 1978-79 from about 30% to 60% of average earnings.

Numbers of taxpayers and staffing effects

9. The table below sets out the changes in numbers of taxpaying tax units (counting married couples as one), individual taxpayers (counting husbands and wives separately), and higher rate tax-units.

Number of taxpayers

(million)

	Tax units	**Individuals**	**Higher rate tax units**
1987-88	20.89	24.70	1.17
1988-89			
1987-88 tax regime	21.42	25.46	1.50
Indexation	21.17	25.10	1.34
Option 3	20.92	24.75	1.093
Option 85	20.84	24.65	1.088
Option 10	20.75	24.52	1.080

Increases of 8.5 per cent and 10 per cent in personal allowances would reduce the number of higher rate taxpayers by about 5,000-10,000 compared with Option 3. There would, however, be reductions in the number of tax units liable to tax of about 80,000 under Option 85 and 170,000 under Option 10. Both options would, on the latest forecasts of income growth, lead to a small reduction in tax units in 1988-89 compared with 1987-88.

10. Estimates of Inland Revenue staff savings are set out below:

	Manpower Effect	
	April 1989	April 1990
Option 3	-30	-95
Option 85	-45	-120
Option 10	-65	-155

Compared with Option 3, Option 10 offers a useful additional saving of 35 units in April 1989 and 60 in April 1990.

Distributional impact

11. The increases in personal allowances are worth proportionately more at the lowest levels of income. For example, a married man with income of £5,000 would gain 20 per cent more under Option 10 than under Option 3. At £20,000, the improvement is only 5 per cent. The extra relief going to the low income tax units is shown below:

£ billion

	Full Year Costs		
Tax Units with Incomes	Option 3	Option 85	Option 10
below £10,000	0.88	0.96	1.07
£10,000-£25,000	2.17	2.27	2.43
over £25,000	2.67	2.69	2.72

Those with incomes below £10,000 would therefore gain almost £200 million of the extra costs of Option 10.

Summary

12. Compared with Option 3, a similar package with allowances increased by 10 per cent would:

(a) cost about £380 million in 1988-89 and about £550 million in 1989-90;

(b) raise the real value of the single and married man's allowances to 30 per cent more than their value in 1978-79;

(c) give over £5 per week to a married man on average earnings;

(d) avoid any increase in the number of taxpayers between 1987-88 and 1988-89;

(e) produce additional revenue staff savings of 35 units in April 1989 and 60 in April 1990;

(f) give an extra £200 million of relief to tax units with incomes below £10,000 per annum.

An 8.5 percentage increase in allowances would cost £180 million in 1988-89 and £220 million in 1989-90. It would also give over £5 per week to a married man on average earnings and avoid any increase in the number of taxpayers between 1987-88 and 1988-89.

R J EASON

TABLE 1

TABLE 1: LEVELS OF MAIN PERSONAL ALLOWANCES (£)

	1987-88	1988-89 Indexation	1988-89 Option 3 Option 4	1988-89 Option 85	1988-89 Option 10
Single, wife's earned income allowance	2,425	2,515	2,605	2,635	2,675
- increase		+90	+180	+210	+250
Married man's allowance	3,795	3,945	4085 4,095	4,125	4,175
- increase		+150	+300	+330	+380
Additional personal allowance	1,370	1,430	1,490	1,490	1,500
- increase		+60	+120	+120	+130
Single age allowance (65-79)	2,960	3,070	3,180	3,220	3,260
- increase		+110	+220	+260	+300
Married age allowance (65-79)	4,675	4,855	5,035	5,075	5,145
- increase		+180	+360	+400	+470
Single age allowance (80 and over)	3,070	3,190	3,310	3,340	3,380
- increase		+120	+240	+270	+310
Married age allowance (80 and over)	4,845	5,025	5,205	5,265	5,335
- increase		+180	+360	+420	+490
Aged income limit	9,800	10,200	10,600	10,700	10,800
- increase		+400	+800	+900	+1,000

TABLE 2: REAL[1] INCREASE IN PERSONAL ALLOWANCES AND FIRST HIGHER RATE THRESHOLD SINCE 1978-79

TABLE 2

	to 1987-88	to 1988-89[2] under		
		Option 3	Option 85	Option 10
	%	%	%	%
Single and wife's earned income allowance	22.6	26.6	28.1	30.1
Married man's allowance	23.1	27.8	28.7	30.3
Additional personal allowance	24.1	29.7	29.7	30.6
Aged single allowance				
65-70	13.4	17.2	18.6	20.1
80 and over	17.6	21.9	23.0	24.5
Aged married allowance				
65-79	12.2	16.2	17.1	18.8
80 and over	16.3	20.1	21.5	23.2
Aged income limit	22.0	26.9	28.1	29.3
Higher rate threshold	11.4	19.7	19.7	19.7
Starting point for higher rate tax				
- married man	13.3	21.0	21.2	21.4
- single	12.7	20.5	20.7	20.9

[1] Based on changes in the RPI for financial years.

[2] Based on forecast RPI movement of 4 per cent.

Change in income after tax and NIC (£ per year)
compared with indexation
(married man)

TABLE 3

Yearly income(£)	OPTION 3	OPTION 74	OPTION 85	OPTION 10
3,000	0.00	0.00	0.00	0.00
4,000	14.85	14.85	14.85	14.85
5,000	58.60	56.10	66.10	78.60
6,000	78.60	76.10	86.10	98.60
7,000	98.60	96.10	106.10	118.60
8,000	118.60	116.10	126.10	138.60
9,000	138.60	136.10	146.10	158.60
10,000	158.60	156.10	166.10	178.60
15,000	258.60	256.10	266.10	278.60
20,000	358.60	356.10	366.10	378.60
25,000	642.00	638.00	654.00	674.00
30,000	884.75	880.75	896.75	916.75
35,000	1,367.50	1,363.50	1,379.50	1,399.50
40,000	1,935.25	1,931.25	1,947.25	1,967.25
45,000	2,685.25	2,681.25	2,697.25	2,717.25
50,000	3,588.00	3,584.00	3,600.00	3,620.00
60,000	5,588.00	5,584.00	5,600.00	5,620.00
70,000	7,588.00	7,584.00	7,600.00	7,620.00
80,000	9,588.00	9,584.00	9,600.00	9,620.00
90,000	11,588.00	11,584.00	11,600.00	11,620.00
100,000	13,588.00	13,584.00	13,600.00	13,620.00

Change in income after tax and NIC (£ per year)
compared with the 1987-88 tax regime
(married man)

Yearly income(£)	OPTION 3	OPTION 74	OPTION 85	OPTION 10
3,000	0.00	0.00	0.00	0.00
4,000	55.35	55.35	55.35	55.35
5,000	99.10	96.60	106.60	119.10
6,000	119.10	116.60	126.60	139.10
7,000	139.10	136.60	146.60	159.10
8,000	159.10	156.60	166.60	179.10
9,000	179.10	176.60	186.60	199.10
10,000	199.10	196.60	206.60	219.10
15,000	299.10	296.60	306.60	319.10
20,000	399.10	396.60	406.60	419.10
25,000	833.25	829.25	845.25	865.25
30,000	1,123.50	1,119.50	1,135.50	1,155.50
35,000	1,623.50	1,619.50	1,635.50	1,655.50
40,000	2,268.75	2,264.75	2,280.75	2,300.75
45,000	3,019.00	3,015.00	3,031.00	3,051.00
50,000	4,019.00	4,015.00	4,031.00	4,051.00
60,000	6,019.00	6,015.00	6,031.00	6,051.00
70,000	8,019.00	8,015.00	8,031.00	8,051.00
80,000	10,019.00	10,015.00	10,031.00	10,051.00
90,000	12,019.00	12,015.00	12,031.00	12,051.00
100,000	14,019.00	14,015.00	14,031.00	14,051.00

TABLE 3

Table 4

TABLE 4

NIC AS % OF INCOME
SINGLE PERSON

Multiple of average earnings
(full time males,adult rates, all occupations)

Fin Year	0.1	0.2	0.3	0.4	0.5	0.6	0.7	0.8	0.9	1	1.5	2	5	10
1978-79	0.0	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	5.6	4.2	1.7	0.8
1987-88	0.0	5.0	7.0	7.0	9.0	9.0	9.0	9.0	9.0	9.0	7.7	5.8	2.3	1.2
1988-89	0.0	5.0	7.0	7.0	9.0	9.0	9.0	9.0	9.0	9.0	7.5	5.6	2.2	1.1

TAX AS % OF INCOME
SINGLE PERSON

Multiple of average earnings
(full time males,adult rates, all occupations)

Fin Year	0.1	0.2	0.3	0.4	0.5	0.6	0.7	0.8	0.9	1	1.5	2	5	10
1978-79	0.0	0.0	8.0	13.1	17.0	19.7	21.6	23.0	24.1	25.0	27.7	29.5	50.5	66.6
1987-88	0.0	0.0	8.7	13.3	16.0	17.9	19.2	20.2	20.9	21.5	23.3	26.4	43.6	51.8
1988-89														
Indexation	0.0	0.3	9.2	13.7	16.3	18.1	19.4	20.3	21.1	21.7	23.4	26.9	44.0	52.0
Option 3	0.0	0.0	7.9	12.2	14.8	16.5	17.7	18.6	19.3	19.9	21.6	24.1	33.6	36.8
Option 74	0.0	0.0	7.9	12.2	14.8	16.5	17.7	18.6	19.3	19.9	21.6	24.1	33.6	36.8
Option 85	0.0	0.0	7.7	12.1	14.6	16.4	17.6	18.5	19.2	19.8	21.5	24.1	33.6	36.8
Option 10	0.0	0.0	7.5	11.9	14.5	16.2	17.5	18.4	19.2	19.7	21.5	24.0	33.6	36.8

TAX + NIC AS % OF INCOME
SINGLE PERSON

Multiple of average earnings
(full time males,adult rates, all occupations)

Fin Year	0.1	0.2	0.3	0.4	0.5	0.6	0.7	0.8	0.9	1	1.5	2	5	10
1978-79	0.0	6.5	14.5	19.6	23.5	26.2	28.1	29.5	30.6	31.5	33.3	33.7	52.2	67.5
1987-88	0.0	5.0	15.7	20.3	25.0	26.9	28.2	29.2	29.9	30.5	31.0	32.2	45.9	53.0
1988-89														
Indexation	0.0	5.3	16.2	20.7	25.3	27.1	28.4	29.3	30.1	30.7	30.9	32.5	46.2	53.1
Option 3	0.0	5.0	14.9	19.2	23.8	25.5	26.7	27.6	28.3	28.9	29.1	29.7	35.9	37.9
Option 74	0.0	5.0	14.9	19.2	23.8	25.5	26.7	27.6	28.3	28.9	29.1	29.7	35.9	37.9
Option 85	0.0	5.0	14.7	19.1	23.6	25.4	26.6	27.5	28.2	28.8	29.0	29.7	35.9	37.9
Option 10	0.0	5.0	14.5	18.9	23.5	25.2	26.5	27.4	28.2	28.7	29.0	29.6	35.8	37.9

Income levels where 1988-89 options exceed average rates for 1978-79 are shown in blocks.

BUDGET SECRET - TASK FORCE LIST

Table 5

NIC AS % OF INCOME
MARRIED MAN

Multiple of average earnings
(full time males,adult rates, all occupations)

Fin Year	0.1	0.2	0.3	0.4	0.5	0.6	0.7	0.8	0.9	1	1.5	2	5	10
1978-79	0.0	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	5.6	4.2	1.7	0.8
1987-88	0.0	5.0	7.0	7.0	9.0	9.0	9.0	9.0	9.0	9.0	7.7	5.8	2.3	1.2
1988-89	0.0	5.0	7.0	7.0	9.0	9.0	9.0	9.0	9.0	9.0	7.5	5.6	2.2	1.1

TAX AS % OF INCOME
MARRIED MAN

Multiple of average earnings
(full time males,adult rates, all occupations)

Fin Year	0.1	0.2	0.3	0.4	0.5	0.6	0.7	0.8	0.9	1	1.5	2	5	10
1978-79	0.0	0.0	0.0	5.1	9.5	13.4	16.2	18.3	20.0	21.3	25.2	27.2	48.8	65.7
1987-88	0.0	0.0	0.0	5.6	9.9	12.7	14.8	16.3	17.5	18.4	21.3	23.9	42.2	51.1
1988-89														
Indexation	0.0	0.0	0.0	6.1	10.3	13.0	15.0	16.5	17.7	18.6	21.4	24.4	42.7	51.3
Option 3	0.0	0.0	0.0	4.9	8.9	11.6	13.5	14.9	16.1	17.0	19.6	21.8	32.7	36.4
Option 74	0.0	0.0	0.0	4.9	8.9	11.6	13.5	15.0	16.1	17.0	19.6	21.8	32.7	36.4
Option 85	0.0	0.0	0.0	4.7	8.8	11.5	13.4	14.9	16.0	16.9	19.6	21.7	32.7	36.3
Option 10	0.0	0.0	0.0	4.5	8.6	11.3	13.3	14.7	15.9	16.8	19.5	21.6	32.7	36.3

TABLE 5

TAX+NIC AS % OF INCOME
MARRIED MAN

Multiple of average earnings
(full time males,adult rates, all occupations)

Fin Year	0.1	0.2	0.3	0.4	0.5	0.6	0.7	0.8	0.9	1	1.5	2	5	10
1978-79	0.0	6.5	6.5	11.6	16.0	19.9	22.7	24.8	26.5	27.8	30.8	31.4	50.5	66.5
1987-88	0.0	5.0	7.0	12.6	18.9	21.7	23.8	25.3	26.5	27.4	29.0	29.7	44.5	52.3
1988-89														
Indexation	0.0	5.0	7.0	13.1	19.3	22.0	24.0	25.5	26.7	27.6	28.9	30.0	44.9	52.4
Option 3	0.0	5.0	7.0	11.9	17.9	20.6	22.5	23.9	25.1	26.0	27.1	27.4	35.0	37.5
Option 74	0.0	5.0	7.0	11.9	17.9	20.6	22.5	24.0	25.1	26.0	27.1	27.4	35.0	37.5
Option 85	0.0	5.0	7.0	11.7	17.8	20.5	22.4	23.9	25.0	25.9	27.1	27.3	34.9	37.5
Option 10	0.0	5.0	7.0	11.5	17.6	20.3	22.3	23.7	24.9	25.8	27.0	27.3	34.9	37.5

Income levels where 1988-89 options exceed average rates for 1978-79 are shown in blocks (see graphs for complete range of incomes).

mjd 2/147Jn

spare.

BUDGET SECRET: TASK FORCE LIST

COPY NO. 23 OF 23

FROM: J M G TAYLOR

DATE: 25 February 1988

MR CAYLEY IR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Mr Byatt
Mr Scholar
Mr Culpin
Mrs Lomax
Mr Odling-Smee
Miss Sinclair
Mr Riley
Mr Cropper

Mr Battishill IR
Mr Isaac IR
Mr Painter IR
PS/IR

CGT: COMPARISON WITH US FOR HIGHER RATE TAXPAYERS

The Chancellor was grateful for your minute of 22 February. As you say, this provides useful defensive material.

J M G TAYLOR

CGT ANNUAL EXEMPTION

CALEY TO CX 25 FEB CGT ANNUAL EXEMPTION

Inland Revenue

Policy Division
Somerset House

9/8/82 - col 755
See 1982 Budget Spch
go down to £6,000 at least
only counterarg is compliance
– para 12 – how valid is this?

Copy No 1 of 30

FROM: M F CAYLEY
DATE: 25 February 1988

1. MR PITTS

I have added a note at the end. 25/2

2. CHANCELLOR

CGT ANNUAL EXEMPTION

1. At Overview on 22 February, we were asked to look again at the possibility of reducing the CGT annual exemption, rather than just freezing it for the next few years.

2. Before looking at possible figures, there are one or two general points which it may be worth mentioning.

3. The arguments for a reduction would be that:-

(i) the exemption is high compared with income tax allowances and will effectively be doubled for some married couples when independent taxation comes in;

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cc. Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir G Littler
Sir T Burns
Mr Anson
Mr Byatt
Mr Scholar
Mr Culpin
Mrs Lomax
Mr Odling-Smee
Mr Ilett
Mr Riley
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Battishill
Mr Isaac
Mr Painter
Mr Beighton
Mr Pitts
Mr Cayley
Mr Gonzalez
Mr Boyce
Mr Michael
Mr Quinn
PS/IR

(ii) the exemption is widely exploited for tax planning: reducing it reduces the scope for this;

(iii) the justification for it has been mainly administrative - to avoid staff and compliance costs on a relative large number of disposals where relatively little tax would be collected - and keeping people out of CGT is the "ultimate simplification"; the case for a threshold as high as £6,600 is reduced by rebasing and independent taxation;

GH 1982 Budget spch

(iv) in 1982 the exemption was raised from £3,000 to £5,000, and this was stated to be explicitly because of the failure to give indexation relief for pre-1982 gains. That reason disappears with rebasing.

4. On the other hand:-

(i) a reduction in the exemption will create more losers from the reform - including people who do not pay tax now and who will not therefore be net beneficiaries from other aspects of CGT reform;

(ii) it will add to administrative and compliance costs by adding to the CGT paying population, and will increase the number of people whose investment etc decision may be affected by CGT;

(iii) the reason given for the £2,000 increase in the exemption in 1982 has by now been largely forgotten in the outside world.

<u>When might the exemption be cut?</u>

5. There are in principle two years when the exemption might be cut:-

(i) 1988-89, at the same time as rebasing. This has the advantage that a lot of people will be benefiting from income tax rate reductions, rebasing and/or (if basic rate taxpayers) a CGT rate reduction: against this, there will be a sizeable proportion who will see no offsetting net benefit from the rest of the CGT package - including most higher rate taxpayers.

(ii) 1990-91, at the same time as independent taxation. This runs into two difficulties. First, it makes the independent taxation package less generous. Second, and perhaps more important, some 40 per cent of the CGT population are single people and trusts who will see no benefit from independent taxation, and there will also be some married couples who will see no benefit from it because of the split of gains between the spouses. It would therefore be difficult to link a cut in the exemption with the independent taxation reform.

Is that a difficulty?

6. You may feel that, if the exemption is to be cut, the balance of argument points to reducing it in 1988-89 rather than 1990-91, and then perhaps freezing it until after independent taxation comes in. The alternative of reducing it in stages over the next two years looks unattractive because we will be announcing no new major offsetting benefits from other CGT changes for 1989-90: the good news on CGT which is being announced will come in for 1988-89 (rebasing etc) and 1990-91 (independent taxation).

<u>Effect of possible cuts: key figures</u>

??

7. We suspect that you would regard a cut of less than about £1,000 as not worthwhile and hard to present. We have looked at the possibility of cutting the exemption to £5,500; £5,000; and £4,500 (for comparison, if the present exemption were revalorised it would at current rates of inflation be some £7,600 by 1990-91, so in real terms an exemption of £5,000 in that year would be a cut of about a

third.) The following table summarises the key figures, which assume as a base CGT reformed on the lines proposed for the Budget but with a £6,600 (frozen) exemption. The table assumes the new exemption level would be frozen and that (as now) the exemption for most trusts would be half that for individuals. The figures are provisional: we would need to do more work on them (and think further about whether the standard behavioural assumptions we use are appropriate here) if you decided to proceed with a reduction in the exemption. The figures do not allow for likely forestalling. They suggest that, on 1990/91 accruals, a cut to £5,000 would broadly offset the cost of independent taxation.

	Exemption		
	£6,000 £5,500	£5,000	£4,500
Effect on yield (accruals)			
1988/89	+£20 +£m30	+£m40	+£m50
1989/90	+£30 +£m50	+£m70	+£m90
1990/91	+£40 +£m60	+£m80	+£m110
Effect on taxpayer numbers			
1988/89	+25,000	+35,000	+50,000
1989/90	+30,000	+50,000	+70,000
1990/91	+40,000	+60,000	+90,000

Staffing

8. Allowing for the unlocking effects of rebasing, and - in due course - independent taxation, the CGT reform is likely to be not far off staff neutral with an exemption frozen at £6,600. If the reduced exemption were frozen at £5,500 until 1990-91, our extra staff need might build up to some 60 over the next few years; if at £5,000, to some 100; and if at £4,500, to some 150. The build up would begin in 1989-90. It would stem from the extra number of taxpayers, who would be paying only fairly small amounts of tax: the lower the exemption, the greater the proportion of the CGT population with small liabilities.

Gainers and losers

9. Although we cannot put precise figures on this, our previous work suggest that, with a £6,600 exemption, there could well be as many losers as gainers from the reform - and the losers would probably include most higher rate taxpayers currently paying CGT. Cutting the exemption would increase substantially the number of losers:-

who gains from the package as a whole

(i) most of those between the new and present exemption levels would benefit little or nothing from rebasing and would be likely to be losers;

(ii) some people a little way over £6,600 would become losers;

(iii) those who are losers with a £6,600 exemption would lose more.

10. In the short term, any sizeable cut in the exemption could thus mean that a majority of current CGT payers would be losers - plus a lot of people who do not pay tax now. The maximum extra loss is set out in the following table:-

Exemption Level	Maximum Extra Loss
£5,500	£440
£5,000	£640
£4,500	£840

Thus, a higher rate taxpayer with gains of £6,600 would pay no tax now, but would pay £840 if the exemption were £4,500.

11. Come 1990-91, independent taxation will offset any cut in the exemption for some of the 60% or so of the CGT population who are married. How much will depend on how far gains are split between the spouses, and how far people are willing to transfer assets to their spouse to maximise use of their exemptions. But even if most married couples arrange their affairs in the most tax-efficient way, a sizeable proportion will still be losers compared with the present system - and independent taxation will not of course help trusts and the single.

Compliance

12. For those brought into tax by the cut in exemption, the burden of compliance would increase, because they would have to do full CGT computations whereas they will often do none or only abbreviated computations now. There would also be a group below the new exemption who would have to do more work to establish that no tax was payable. Some people who do not now seek professional assistance on capital gains might feel a need to do so: the fees they paid would in some cases exceed any tax that was payable, and the numbers for whom this was so would increase the lower the exemption was set, because of the shape of the gains distribution.

Forestalling

13. A cut in the exemption from 1988-89 would increase forestalling activity, adding to activity in the markets between Budget Day and 6 April. The likelihood is that much of the extra forestalling would be by people below the current exemption, so little extra revenue might result.

Comparison with other countries

14. Other major countries do not have a high separate capital gains exemption. This is one of the reasons why it is possible to argue that, even for higher rate taxpayers, the post-Budget tax burden will generally be less than in other major countries such as the USA. Even if the exemption were cut to, say, £4,500, this would still be true - but the proportion of people who would pay more tax in the UK than in eg the USA would increase.

Freezing the Exemption

15. The provisional decision so far has been to freeze the exemption at £6,600 for at least the next three years. This itself implies a cut in real terms of some £1,000 by 1990-91 at current rates of inflation.

Michael Cayley

M F CAYLEY

NOTE BY D.Y. PITTS

BUDGET SECRET : TASK FORCE LIST

There seems no obvious 'right' level for 1990-91. Independent taxation will provide an opportunity to reduce the amount for the married - but not for the single and trusts. That underlay the present decision only to 'freeze' the amount.

The peg for reducing lies in rebasing, ie now. The amount was once put up by £2,000 to allow for pre-1982 nominal gains, so now it can go down again. But the £2,000 increase went to everyone - not only the pre-1982-ers. Having got used to it, they won't like losing it. But it would be 'just'.

To soften the blow, you could take £1,000 off in each of 1988/89 and 1989/90 (though it wouldn't stop complaints when 1989/90 comes). Depending whether you thought that enough, you could then either freeze for a while or start indexing in 1990/91.

This would increase Revenue staff needs by 150 or so in due course, but with a cost-yield ratio which might well be not out of line with the latest for CGT as a whole. And the yield could roughly pay for the CGT costs of independent taxation in 1990/91. (If people adjusted their disposals to a more substantial extent than allowed for in order to keep within the new limit, the figures of taxpayers and staff costs could go down.)

There would be increased 'compliance' costs for thousands of small(ish) taxpayers. And the reduction would come at a time when you are increasing the CGT rate by a third for those gains which will be wholly taxed at the higher rate.

D.

D Y PITTS

BUDGET SECRET: TASK FORCE LIST

Inland Revenue

Policy Division
Somerset House

P. LEWIS TO CX 25 FEB CAR SCALES

Note that the original method was chosen in order [illegible] Brown's part: [illegible]

COPY NO / OF 35.
FROM: P LEWIS
DATE: 25 FEBRUARY 1988

Chancellor

BENEFITS-IN-KIND: CAR SCALES FOR 1989/90

1. At the Overview on Monday you raised a question mark over announcing the car scales for 1989/90 in this year's Budget. This note

- explains the advantages of having the car scales announced in advance

- looks at the position if an announcement about 1989/90 were deferred until next year's Budget

- discusses an intermediate option of announcing an increase of "at least 10%" in the Budget for 1989/90.

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cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Sir A Wilson
Mr Byatt
Mr Monck
Mr Scholar
Mr Culpin
Mr Sedgwick
Mr Odling-Smee
Miss Sinclair
Mr Riley
Miss Evans
Mr Cropper
Mr Tyrie
Mr Call
Mr Unwin
Mr Knox

Mr Battishill
Mr Isaac
Mr Painter
Mr Lewis
Miss Rhodes
Mr Northend
Mr R H Allen
Mr I Stewart
Mr Fraser
PS/IR
Mr Beighton

(Lewis is constitutionally incapable of brevity

A <u>Announcing car scales a year in advance</u>

2. This has been the normal pattern since the present legislation was introduced in 1976. In brief, it

- minimises the work of taxing car benefits in the Revenue

- minimises the compliance work for employers who provide cars

- provides a degree of certainty about the taxation regime for the car industry and for employees about to be given a car or changing their company cars.

- allows the changes to be made by an "out of season" Treasury Order rather than in the Finance Bill (or an Order immediately after Budget Day).

3. Most of the tax on car benefits is collected through PAYE coding adjustments. The scale charge is deducted from the allowances otherwise due to produce a lower code number which, in most cases, ensures that the correct additional amount of tax in respect of the car is collected during the course of the year through extra PAYE tax deductions.

4. We have to notify employers and employees of any change in PAYE code numbers for the next tax year a month or two in advance so that they can be operated as soon as the new tax year begins. If car scales are announced in advance we can take into account the new scale charge for the following year when we carry out this annual recoding work in January. This will mean that the right PAYE code can operate from the start of the tax year.

5. At the end of the tax year the employer sends us a P11D with brief details of the car or cars the employee has used so that we can check whether any adjustment is needed. But he will not have to handle any coding adjustment during the year on account of changes to the car benefits scales.

B Car scales not announced in advance

6. In summary, the picture here is largely the obverse of paragraph 2

- rather more work for the Revenue and employers, particularly if PAYE codes have to be implemented non-cumulatively

- less notice of changes for the car industry and company car users

- higher profile Finance Bill legislation, with discussion in Committee of Whole House (or a Treasury Order immediately after the Budget) and either way the risk of disruption to the whole Budget implementation programme if changes were forced on the Government.

Is it any quicker to amend now?

7. If the car scales are not announced in advance we could not get the right figure into the following year's codes in the annual PAYE recoding before the start of the year. We would need instead to carry forward the old scale figure to the next year's code. We would then need - as is proposed this year - to amend all the 1.3 million codes with car benefits during the course of the Budget recoding.

8. To do this we would need - as for this year - the new car scales to be in the Finance Bill, to be covered by a PCTA resolution, and, to avoid so far as possible any delay to the whole Budget recoding if the new scales were opposed, to have the provisions taken in Committee of Whole House. Alternatively, if the Budget timetable permitted, and you did not mind the possibility of an extra debate, the change could be made by Treasury Order taking effect before 6 April. Either way, a higher Parliamentary profile to the changes seems unavoidable.

NB.

9. The administrative advantages for the Revenue in having advance notice of the car scales are now less important than they used to be. With COP, a large part of the coding review for cars

can be done automatically and if we know well in advance that the scales are going to be altered in the Budget the extra Budget recoding work can be largely balanced by a corresponding saving on the annual recoding. The same is broadly true of employers who would have fewer code changes in April and more in May/June. (The position this year is different because both we and employers will need to do the work twice over because of the late change). Nonetheless, it is probably marginally more efficient to make the changes during the annual recoding; and this saves any complaints (of the kind we have about personal allowances) that code numbers with one set of allowances or scale charges have hardly been sent out before a new set has been announced in the Budget for the forthcoming year. In addition, adding cars to the Budget recoding work may mean a somewhat later implementation date for the Budget changes since we need to give employers sufficient time to take on board the much larger number of code changes.

Non-cumulative codes

10. All this assumes, however, that there is no difficulty in making a downward adjustment to codes in the middle of a tax year on account of new car scales. This can only be done easily when the tax reductions announced in the Budget are sufficient to offset the increase in tax resulting from the increased car scales. If that is not the case, there will either be an especially heavy tax deduction when the new car scales are implemented to collect the tax under-deducted since the start of the tax year; or we will need to put some or all of the codes containing car benefits on to a non-cumulative basis so that a large initial deduction is avoided. But this automatically creates a tax underpayment for every company car user. A further coding adjustment would then be needed for the following year to collect this underpayment. All this inevitably increases the risk of muddle and complaint - and creates extra work.

11. With the large increase in car scales you are making this year, the scope for further significant increases without running into the complications of non-cumulative codes is becoming more

limited. For example, if you were thinking in terms of a 25% increase for 1989/90 the scale charge for an over 2000cc car would go up by £550. If you were only revalorising personal allowances by (say) 4%, the allowance for a single person or a married woman would go up by only about £100. At a basic rate of 25%, that would mean extra tax of over £100 during the year, with perhaps £15 to £20 payable by the time Budget codes are implemented. For weekly paid people this extra tax could cause a substantial fall in net income in that week. So there would be a choice to be made between either operating codes (or some group of codes) non-cumulatively to avoid the big tax deduction, with the disadvantages described in paragraph 10; or avoiding the problems of non-cumulation at the expense of a higher than normal tax deduction for company car holders at the time when others are receiving Budget repayments.

Not a vast amount

Summary

12. Paragraph 11 in effect envisages losers as the standard case. But if it would be your intention - as this year - only to increase the car scales within (broadly) the limits of the other tax reductions being made, the problem of non-cumulative codes in paragraphs 10 and 11 would disappear. In that event the administrative arguments (for the Revenue and employers) are marginal. The disadvantages of not knowing in advance for the car industry and employees, and of the higher profile, riskier Finance Bill (or Treasury Order after the Budget) route would remain.

C Announcing an increase of "at least [10%]" for 1989/90

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13. This option looks as though it might be the worst of all worlds.

14. So far as Revenue administration is concerned, the conclusion of the preceding paragraphs is that - if we can avoid the non-cumulative problem - there is relatively little to choose between advance announcement and announcement in the Budget for the immediately following year. Announcing "at least [10%]"

this is the critical point

would not help for two reasons. First, we should have no authority to issue revised codes incorporating a [10%] increase before the start of the tax year simply on the strength of a Ministerial announcement about future intentions. So if any employee or body of employees objected and required their codes to be amended we might have to reduce the car adjustment to the existing statutory scale. Second, if we make a provisional increase of 10%, and you then decide in the Budget to make a bigger increase we - and employers - are back in the same situation as this year of doing the work twice over, once in the annual recoding and once in the Budget recoding.

would they?

15. This approach also looks unattractive from the point of view of the car industry and employees. It would be highlighting rather than removing uncertainty.

16. It would also make the "high profile" route of Finance Bill legislation or Treasury Order immediately after the Budget almost inevitable. Even if you decided, in the run up to the Budget, that 10% was the right figure, you might not wish to disclose your hand by making a Treasury Order in advance of the Budget.

<u>The way forward in the 1988 Budget</u>

17. The conclusion from this seems to be that

- if you wished to keep your options open for 1989/90, <u>and</u>

?

- you are envisaging that car scale increases would be made broadly within the scope of offsetting tax reductions, <u>and</u>

- you are content to follow the Finance Bill (or Treasury Order after the Budget) route, with its Parliamentary implications and its potential risks for the implementation timetable for the whole package of Budget changes there is no reason why you should not defer decisions on 1989/90 until next year.

18. You are expecting that this year the criticism from the car industry of the increased scales for 1988/89 will be sharpened by the short notice of the change. That might be muted somewhat if you revert to the previous practice for 1989/90 of making announcements in advance. Conversely, it is likely to be increased if the industry sees that much shorter notice of changes will become the regular pattern in the future.

19. You will also need to consider what can be said, perhaps in the Budget Speech or Budget Debates, about your approach for the future. Announcing a 10% increase for 1989/90 in the Budget would itself have signalled pretty clearly that

- you did not regard the doubling of the scales this year as the end of the road

- the previous pattern of relatively small increases above the rate of inflation was likely to be re-established. The prospect of settling down again into the old pattern would probably have been some reassurance to the car industry.

20. If you have nothing specific to announce for 1989/90, you will want to consider how to answer the questions that will undoubtedly be pressed as to your future intentions. (In your Budget speech you may wish to say that, even after the doubling in 1988/89, car scales are still far too low; but that will not necessarily imply any particular course of action in the future since the under-valuation of cars has long been recognised). One possibility would be

- to indicate that you thought it appropriate in the future to reserve decisions on car scales to the immediately preceding Budget, as for other income tax changes

- given the continuing under-valuation of cars you wished to assess the increase appropriate in the future having regard to the other tax changes being made for that year, and

- (if you wished) to indicate that future increases would in any event be at least 10%. (But at a minimum you will wish to dispel any possible impression that, after the jump in 1988/89, there would be no further increases)

w: prefer there would be further acceptance of undertakings

21. We have not been able to find any Ministerial undertaking about announcing car scales in advance made since 1979 so there appears to be no impediment of that kind if you wished to change your practice. (In fact, there has been little recent Parliamentary debate on the income tax treatment of cars since recent changes have all been by Treasury Order, and have never been debated.)

<u>Points for decision</u>

i. Do you wish to go ahead with an announcement of a <u>firm 10% increase</u> in the car scales for 1989/90?

ii. If not, do you wish to announce an increase of <u>"at least 10%"</u>? (In that case, how will you present your approach to future car scale changes?)

iii. Or do you wish to say <u>nothing about the size of the 1989/90 increase?</u> If so, what is to be the line in the Budget and Finance Bill debates on

- why you have changed your practice on advanced announcements, and

- your general approach to car scale changes for future years?

Peter Lewis

P LEWIS

Inland Revenue

Policy Division
Somerset House

Not on formal agenda

COPY NO 1 OF 34.
FROM: P LEWIS
DATE: 25 FEBRUARY 1988

Chancellor

P11D THRESHOLD: NUMBER OF EMPLOYEES LIABLE TO TAX ON BENEFITS

1. At the last Overview you asked for a note on how many employees would be relieved from paying tax on benefits-in-kind by the increase in the P11D threshold, taking into account also the increase in the car scales.

1988/89

2. We expect the direct effect of the increase in the P11D threshold and the car scale increases to be a reduction of about 100,000 in the number of people above the P11D threshold.

3. The total number will come down from about 1.85 million to about 1.75 million, a reduction of just over 5%.

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cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Sir A Wilson
Mr Byatt
Mr Monck
Mr Scholar
Mr Culpin
Mr Sedgwick
Mr Olding-Smee
Miss Sinclair
Mr Riley
Miss Evans
Mr Cropper
Mr Tyrie
Mr Call
Mr Unwin
Mr Knox
Mr Battishill
Mr Isaac
Mr Painter
Mr Beighton
Mr Lewis
Miss Rhodes
Mr Northend
Mr R H Allen
Mr I Stewart
PS/IR

LEWIS TO CX 25 FEB P11D THRESHOLD

4. There will also be some behavioural effects through the increase in the car scales. On the analysis in Mr Riley's note of 23 February, which envisages a reduction in company cars for private use of about 100,000 spread over 3 years, there might be an additional P11D reduction of about 20,000. People will, of course, remain within the "P11D population" if they drop their company cars but nevertheless continue to have other taxable benefits.

5. Since these estimates of changes to the P11D population are all fairly uncertain, we would suggest using in the Budget presentation a rounded figure of "about 100,000".

Future years

6. Earnings growth is likely, over a period of perhaps 3 years, to increase the number of people with benefits above the P11D threshold to about the same level it would have been in 1988/89 had the threshold continued at £8,500. However, the reduction in the "P11D population" as a result of the increase in the threshold will of course continue because the number of people liable with the threshold at £10,000 will for many years be lower than it would have been if the threshold had stayed at £8,500.

Benefits chargeable on all employees

7. Certain benefits, for example goods which can be turned into cash, or goods and services obtained through vouchers, are chargeable to tax on all employees. Some of the people who fall out of the P11D field as a result of the threshold increase may nevertheless continue to be chargeable in this way. To that extent, the net reduction in the total number of people liable on benefits will be rather smaller than the figures suggested above. However, we would expect this effect to be quite marginal.

Peter Lewis

P LEWIS

mjd 2/150Jn

CONFIDENTIAL

FROM: J M G TAYLOR
DATE: 26 February 1988

MR MACE IR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr J Anson
Sir A Wilson
Mr Byatt
Mr Scholar
Mr Culpin
Mr Sedgwick
Mr Odling-Smee
Miss Evans
Mr Hudson
Mr Cropper
Mr Tyrie
Mr Call
Miss Sinclair
Mr Riley

Mr Unwin C&E
Mr Knox C&E

Mr Battishill IR
Mr Isaac IR
Mr Painter IR
PS/IR

BUDGET INCOME TAX CHANGES

The Chancellor was grateful for your minute of 25 February. He has noted both of the points that you made.

J M G TAYLOR

BUDGET SECRET : TASK FORCE LIST Copy No 1 of 23.

Inland Revenue

The Board Room
Somerset House
London WC2R 1LB

It is a pity that this was not volunteered by IR tradition, but had to be extracted by me. In the circs, & subject to views of FST, I wd favour leaving the rate unchanged this yr - some poetic justice - & making a change in the context of the outcome of the overall life assurance review package in 1989. It may well help flush out & substantiate them. And it is not wholly clear what the right rate wd be, given the new 2-tier CGT.

FROM: T J PAINTER
DATE: 26 FEBRUARY 1988

CHANCELLOR OF THE EXCHEQUER

CGT REFORM : UNIT TRUSTS AND MUTUAL LIFE OFFICES

Mr Beighton in his note, behind is responding to your question about the implications of the CGT changes for policy holders because, as he says, it links into the wider review of life assurance which he is coordinating.

2. His note gives, if I may say so, full weight to the complaints the life industry can be expected to make - vigorously - if the special 30% rate for policy-holders is left unchanged. And he recognises that <u>if</u> you wanted to meet their objections, you might prefer to do so from the outset, in the Budget, rather than under pressure.

---

cc. Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Odling Smee
Mr Scholar
Mr Culpin
Mr Cropper
Mr Battishill
Mr Isaac
Mr Painter
Mr Pollard
Mr Beighton
Mr Deacon
Mr Pitts
Mr Newstead
Mr Cayley
Mr Haigh
PS/IR

3. But you would have good grounds for resisting pressure for a further special recognition of this one aspect of the treatment of life company gains in the context of broader changes to the CGT rates and base and you could distinguish the situation from last year's. In particular

- life companies should look at the whole CGT package, including rebasing, from which they stand to benefit significantly;

- last year what was in prospect was an increase in rate which would have applied to existing policies. This year the rate is not being reduced but in respect of existing policy holders the tax charge is still the same as when they marketed the products;

- as it is, in aggregate the industry pays considerably less tax on gains than it deducts from policy holders; and

- (see para 9(i)), the 30% rate is a reasonable holding provision pending the outcome of the review which is now taking place and on which the Government will be consulting.

4. This last point is particularly relevant: this one aspect of the matter cannot sensibly be looked at in isolation. The whole issue has to be examined in all its - complicated - detail. For this we need the consultative document. Mr Beighton also reports on what is happening here. Progress has not been as fast as we had hoped but it really is a fiendishly difficult topic not only as regards the technical tax issues but the underlying insurance law and practice. Indeed that is the main reason it has not been tackled systematically over the years. And we have, as you know given priority to other matters. But if we can now proceed on the basis he suggests the document will be out before these issues are likely to come up in Standing Committee - it would I fear be rash to promise it before Second Reading - and Ministers will then find it easier to put the topic in its wider context.

5. Finally, Mr Beighton is proposing that we should now show the draft document in its present state to DTI, copying to FP and FIM divisions, while revising it within Somerset House to reflect the Budget changes.

T J PAINTER

BUDGET SECRET : TASK FORCE LIST

INLAND REVENUE
CENTRAL DIVISION
SOMERSET HOUSE

FROM : L J H BEIGHTON
DATE : 26 February 1988

1. MR PAINTER 26.2.

2. CHANCELLOR OF THE EXCHEQUER

CGT REFORM : UNIT TRUSTS AND MUTUAL LIFE OFFICES

1. Mr Taylor asked in his note of 15 February addressed to Mr Cayley about the implications of the proposed changes in the rate at which capital gains tax is to be charged. I am responding because the issues raised are covered by the review of the taxation of life assurance, and I report our progress on that later in this note.

Background : The present position

2. When a life company pays out on a policy it deducts an amount to allow for capital gains tax liability - set at 30% - on the gains attributable, directly or indirectly, to the investments made with the policy holder's premiums. If it did not do so it would be unfair to later generations of policy holders or (in the case of proprietary companies) its shareholders who would at some time have to bear the capital gains tax paid by the company. The actual

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cc Chief Secretary	Mr Battishill
Financial Secretary	Mr Isaac
Paymaster General	Mr Painter
Economic Secretary	Mr Pollard
Sir P Middleton	Mr Beighton
Sir T Burns	Mr Deacon
Sir G Little	Mr Pitts
Mr Odling Smee	Mr Newstead
Mr Scholar	Mr Cayley
Mr Culpin	Mr Haigh
Mr Cropper	PS/IR

practice on this varies among life offices, but many deduct amounts in respect of policy holder gains at only a little less than the full 30% (there may be some minor discounting in recognition of the delay before the company actually pays over the tax). To the extent that life assurance is a means of saving, a direct comparison can be - and indeed is - made between this consequence for the policy holder as a policy holder and the impact which the tax would have on him as a direct investor. At present, the direct investor benefits from the personal exempt allowance of £6,600 and only to the extent that he is not thereby exempted does he pay tax at 30%. But the policy holder suffers the same tax deduction from his benefits whatever his personal capital gains tax position might be. The absence of a neutral tax treatment for gains is one of the industry's more important complaints about the existing regime.

3. There is a further wrinkle. Realised gains attributable to policy holders are charged on the company at 30% and those attributable to the shareholders at the normal corporation tax rate of 35%. The technical basis for the apportionment between policy holders' and shareholders' gains has some uncertain effects and the industry has drawn attention to defects highlighted by what was done last year. These defects can result in what are in fact policy holders' gains being apportioned to and charged as though they were shareholders' gains. We have been saying to the industry that we suspect that you would be unwilling to revisit this subject pending the outcome of the review.

4. However, as may be expected with life assurance, the story is rather more complicated than that. Opportunities to shelter tax are available to life offices which are not open to personal investors investing directly. Life offices, for example, can bring investment appreciation into account and effectively pay it out as benefits to policy holders without having to realise the underlying assets and suffer capital gains tax liability. In addition, some offices obtain exemption for the capital gains they do make by holding their assets at one remove in a unit trust under the management of an associated company thus getting exemption from capital gains tax. In other cases, the life office has large amounts of deductible

expenses on hand mainly generated by obtaining and managing new business but immediately available to set against income and gains of existing business. In fixing the amount deducted from policy holders on payment of benefits, however, the company cannot assume that this level of expenses will always be available and so it must disregard it. The effect of all this is that relatively few companies actually pay tax on their gains and only a small proportion of the monies deducted from policy holders has reached the Exchequer.

5. So the position is far from satisfactory. Many policy holders are paying far more in recognition of tax than they would on alternative investments but much of what they pay is not reaching the Exchequer. This is one of the major areas to be tackled in the review of life assurance.

<u>Implications of the Budget capital gains tax proposals</u>

6. Against this background the line of attack of the life industry might be that, not only will the policy holder continue not to benefit from the CGT exempt threshold (at whatever level that may be set), but the very large majority of them will be liable to income tax (and hence to capital gains tax if they made any gains) at basic rate only, 25%. So that to continue the charge on policy holder gains at 30% would be unreasonable: it should not be necessary to wait for the outcome of the review for the position to be remedied.

7. On a more detailed point, the companies might say that a policy holder liable to higher rate income tax at 40% could, in certain circumstances, end up effectively suffering tax at up to 40.5% on a non-qualifying policy (very broadly a qualifying policy is one with a term exceeding 10 years, regular premiums, and a minimum sum assured). In these cases, on top of the deduction for capital gains tax, there may be a further charge (under the chargeable events rules) of 15% on the net payment, i.e. a policy holder gain of 100 would suffer a deduction (probably discounted) of 30 for capital gains tax and the balance of 70 would bear tax of 10.5 making a total of 40.5. Indeed, when the anomaly referred to in paragraph 3 applies so that the policy holder gain is effectively charged at

35%, the overall charge could be not far short of 45%.

8. The industry might add (at least in private) that what is likely to happen is that the capital gains tax proposals will not result in the non-taxpaying life companies beginning to pay tax, but in the collection of more tax from companies already paying tax. In general, these are likely to include the mature companies at the more respectable end of the market.

9. Against these arguments Ministers could very well respond that -

i. Last year's fixing of the rate at 30% was no more than a holding provision pending a full review. There is no simple answer within the present system of taxing life companies and no single rate, 25%, 30%, or any other, can provide a wholly logical or fair result.

ii. Against a background in which the capital gains tax rate changes (as opposed to rebasing) are going to increase the yield it would be odd to reduce the rate on policy holder gains. (Conversely, the possibility of an increase in the rate would appear to be ruled out by the terms of last year's statement that it would be held at 30% rather than increased to 35% pending the outcome of the life assurance review.) In any event, some policy holders will be higher rate payers or would be brought into higher rate if their share of the life assurance gains were brought into account.

iii. The point about non-qualifying policies is less significant in practice than in theory. Not only do the figures take no account of discounting but in practice taxpayers generally are able to ensure that policies are not encashed when they are subject to higher rate tax. Up to 5% a year of the premiums paid can be withdrawn without any tax arising and it is this feature which is one of the major selling points of single premium bonds.

iv. Life companies are going to be major beneficiaries from CGT rebasing. The companies will doubtless pass the benefit on to current policy holders with pre-1982 policies. However where policy holders have already been paid out and a deduction has already been made in respect of unrealised pre-1982 gains the companies will get a windfall benefit and to that extent their tax reserves will not be required. This should go a long way towards compensating them for the need to set up new reserves on post-1982 gains at 30% rather than at the lower figure they would like.

Recommendation

10. There may well be pressure from the life companies to reduce the rate on policy holder gains. If you were to decide to meet them then - although there would be no logic in any figure - we would recommend that the rate be fixed at 25%. It would also be sensible at the same time to deal with the technical difficulty referred to in paragraph 3 above, presumably with effect from the introduction of the provision last year. At first sight we do not think that the latter would require more than a page in Finance Bill: whether it could be done in time for the publication of the Bill would depend on the overall pressure on Parliamentary Counsel. The cost of the rate change is very difficult to estimate because it would depend on the extent to which life companies have to realise gains, but on the evidence of past years it might be in the range £m10 to £m30 in 1989/90 (rather less than half of that in 1988/89). As explained above the benefit to policy holders would be rather greater.

11. However, for the reasons given we think you could very reasonably leave the present 30% rate on policy holder gains unchanged. Clearly the arguments will be more easily paraded when they can be set out fully as part of the review. Any reduction directly benefitting policy holders might then be balanced by action to secure that more gains than at present actually come into

effective charge.

<u>Treatment of capital gains in the draft consultative document</u>

12. One major topic which we propose to canvass in the consultative document is that linked life business should be removed from the special tax regime for life companies and treated in the same way, mutatis mutandis, as unit trusts. If this were possible (and there are difficulties which the document will explore) it would remove the capital gains tax problem at the point where it is most acute because the direct comparison between life policies and competitor products is closest.

13. As for the remainder, the consultative document will explore the possibility of a radical solution which would charge the income and gains attributable to policy holders by reference to the change in the year in the total company funds attributable to policy holders. This would overcome all the problems inherent in the present system, including those relating to policy holder gains, but only at the expense of creating a raft of new ones. If this radical approach proves unacceptable the only alternative will be to patch the present system. We would propose to do this inter alia by ensuring that all gains realised by life companies are brought into charge to tax and possibly - as a halfway house to the more radical approach - by charging tax when gains are recognised in the accounts drawn up for Companies Acts purposes whether or not they are realised. In either event the rate of capital gains tax then levied would have to be fixed at a level (inevitably decided on a somewhat arbitrary basis) to take account of the varying rates of capital gains tax (0%, 25%, 40%) which would be paid by policy holders if they invested directly.

<u>Timing of consultative document</u>

14. We are still pressing ahead as fast as possible with preparing the consultative document. It is, however, a highly complex subject and the drafting has proved even more difficult than we had expected at the time of my minute to you of 26 November. Inevitably we have had to bring into this work people directly involved in the Budget

preparations, to which priority has had to be given. I am afraid that as a result we have fallen behind the timetable I previously set out: moreover, now that it is clear that there is no possibility of getting the document ready for issue substantially before the Budget it needs to be recast to take account of some of the changes which are being proposed.

15. We have now nearly completed a working draft on the pre-Budget basis and if you are content we suggest that the next step would be to let the Department of Trade and Industry see it in this form. We would send copies to FP and FIM at the same time. We have been careful to avoid any proposal which would strike at the solvency of companies, especially given the difficulties into which some of them are falling (e.g. Mr Haigh's note about United Kingdom Provident Institution and London Life) but the DTI have a proper concern here which we ought to take into account. We have already discussed the matter extensively with the Government Actuary's Department (who are our own advisers on these matters) and the DTI will doubtless want to consult them also. In addition the DTI will be concerned - as of course we have been - that our proposals provide a fair measure of taxation in respect of policy holders in relation to other types of, broadly similar, investment.

Not seen here

16. While this is being done we are proposing to recast the present draft to take account of the Budget changes when they have been finally settled. On that basis we should hope to have a further draft which we could show you towards the end of next month and, provided that you were broadly content, would hope to issue it after Easter. But experience has brought home just how difficult this matter is proving to be and, while we shall make every endeavour to keep to this timetable, I would be reluctant to be too firmly pinned to it.

17. As our work has progressed we have been increasingly coming to the view that there are likely to be a number of different issues to be tackled separately and that the radical overall solution mentioned above may not be feasible. If that is so it has implications for the timing of the legislation: you would be able, if you wished, to spread any action which you decided to take over

more that one year. Even if therefore, as looks increasingly likely, action over the whole field is not going to be possible in 1989 it may be open to you to tackle some aspects of the matter then if you wished. Alternatively, you could leave over action on a wider range of issues until 1990.

LJHB

L J H BEIGHTON

FINANCIAL SECRETARY TO THE TREASURY

COPY NO. 1 OF 17

PS/CHANCELLOR

FROM: J J HEYWOOD
DATE: 29 February 1988

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Odling-Smee
Mr Scholar
Mr Culpin
Mr Cropper
Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Beighton - IR
PS/IR

Agreed

CGT REFORM: UNIT TRUSTS AND MUTUAL LIFE OFFICES

Further to your minute of today, the Financial Secretary has read Mr Painter's minute and Mr Beighton's note of 26 February and has commented that he does not see how we can change the rate in advance of the outcome of the review of life assurance.

2. The Financial Secretary has also questioned how it arises that many policy holders are paying more tax than they would on alternative investments, but that much of the tax paid does not reach the Exchequer. He would be grateful for a clarification of this.

JJH

JEREMY HEYWOOD
Private Secretary

mjd 2/147Jn

BUDGET SECRET: TASK FORCE LIST

COPY NO. 22 OF 23

FROM: J M G TAYLOR

DATE: 25 February 1988

MR CAYLEY IR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Mr Byatt
Mr Scholar
Mr Culpin
Mrs Lomax
Mr Odling-Smee
Miss Sinclair
Mr Riley
Mr Cropper

Mr Battishill IR
Mr Isaac IR
Mr Painter IR
PS/IR

CGT: COMPARISON WITH US FOR HIGHER RATE TAXPAYERS

The Chancellor was grateful for your minute of 22 February. As you say, this provides useful defensive material.

J M G TAYLOR

PDPG/88/8.

COPY 1 OF 8

BUDGET SECRET: TASK FORCE LIST

ECONOMIC SECRETARY TO THE TREASURY

FROM: P D P BARNES
DATE: 26 February 1988

PS/CHANCELLOR OF THE EXCHEQUER

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Mr Cropper
Mr Tyrie
Mr Call

CGT ANNUAL EXEMPTION

The Economic Secretary has seen Mr Cayley's submission to the Chancellor of 25 February.

The Economic Secretary thinks that we should leave the exemption well alone. His view is that only Tories concentrate on the details of CGT and that they hate it to an astonishing degree. He thinks that they would not welcome a reduction in this limit and that it would not placate the egalitarians either.

PB

P D P BARNES
Private Secretary

FROM: MRS R LOMAX
DATE: 26 February 1988

CHANCELLOR

cc: Financial Secretary
Economic Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Mr Peretz
Mr Ilett
Mr Cropper
Mr Cayley, IR
PS/IR

Thanks:

CGT PACKAGE

You asked for further material on the market consequences of the effect of the CGT on higher rate taxpayers; and, separately, whether we knew anything about the extent of market distortions in those countries who tax short-term gains at a higher rate than long-term gains.

Short term gains tax

2. Taking the second question first, the answer is that there is virtually no hard information immediately to hand, either here, in the Bank, or at Inland Revenue. I will, if you wish, continue digging; in the meantime here are a couple of obvious points. The objection to a higher rate of tax on short-term gains is that it leads to tax manipulation and hence loss of revenue. In market terms, the main effect is likely to be locking in (except to the extent that investors sell to realise short-term losses), thereby impairing market liquidity. Manipulation and dislocation of markets were cited as arguments for abolishing the US dual system of capital gains tax.

3. The same points can be illustrated from our own experience. As you know, there was a separate tax on short-term gains between 1962 and 1965, which yielded virtually nothing. Between 1965 and 1971 short-term gains were taxed as income, and there was

a flat rate tax on long-term gains: again, the yield was negligible, less than £10 million. More recently, you will recall that until 1986 we had in effect, a short term capital gains tax on gilts; more precisely, gilts were only exempt from CGT if they were held for more than a year. My memory is that this led to various kinds of manipulation. CGT on gilts was finally abolished altogether because of the interaction with indexation which further increased the scope for tax manipulation. After a year, an investor had the choice of establishing an indexed loss, if the market had fallen or, if the market had risen, avoiding a taxable gain by holding the security for a further day.

Higher rate taxpayers

4. I have discussed this again with the Bank, and we still take the view that the CGT package is unlikely to have any very marked impact on equity prices, or yields, for the reason mentioned in our earlier note: that higher-rate taxpayers account for a relatively small share of the equity market (less than 15 per cent of equities, by value), and an even smaller proportion of market turnover. Moreover, the package has effects which go in different directions.

5. Clearly, however, higher-rate taxpayers will have less incentive at the margin to engage in activities that yield a capital gain, and more incentive to go for income. This will, for example, make share option schemes rather less attractive. (This is one reason why FIM has advised against introducing a linkage with all employee schemes this year.) No doubt there will be complaints from those industries who rely heavily on reimbursing their senior employees with paper: we had a foretaste at Lord Young's Seminar on the City earlier today, when one (American) participant cited CGT as a significant drag on London's appeal to international securities houses. (It is however at least debatable whether such houses are wise to encourage this ethos in their employees, after recent scandals.)

6. Activities where the prospect of capital gains figure large include: management buy-outs, takeovers, and floating small

companies. All of them are activities which have thrived mightily in the last few years, and where activity may anyhow be much more subdued in the immediate future, thanks to the stock market collapse. We think it unlikely that a change affecting only higher rate taxpayers (ie not companies or institutional investors) could be plausibly held to have a major impact. This applies to the gilt market (where the effect is in principle favourable) as well as the equity market (where it is not).

7. The Bank remain of the view that the most significant effect of the Budget package will be a shift into high interest, capital-certain assets - an effect which may owe more to the reduction in income tax rates at the top end than to the change in the CGT regime.

RL

RACHEL LOMAX

COPY NO 12 OF 13

FROM: J M G TAYLOR

DATE: 29 February 1988

MRS LOMAX

cc PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Mr Peretz
Mr Ilett
Mr Cropper
Mr Cayley - IR
PS/IR

CGT PACKAGE

The Chancellor was grateful for your minute of 26 February.

J M G TAYLOR

FROM: M M COURTNEY

DATE: 29 February 1988

Ch / See

CHANCELLOR

Thanks. X & Y are the two those to go for Budget speech, I reckon.

cc: PPS
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Sir A Wilson
Mr Scholar
Mr Culpin
Mrs Lomax
Mr Odling-Smee
Mr Sedgwick
Mr Pickford
Mr Riley
Miss Sinclair
Mr Scotter
Miss Evans
Mr Hudson
Mr Cropper
Mr Tyrie
Mr Call

Mr Battishill IR
Mr Isaac IR
Mr Painter IR

EFFECTIVE RATE OF CAPITAL GAINS TAX

Mr Taylor's minute of 22 February to Mr Culpin asked if the first table in his note of 18 February, which showed the average annual gain on shares for various periods, could be redone with 1987 substituted for 1986. The table below does this. Since share prices were considerably higher on average in 1987 than in 1986, the average annual gains over periods ending in 1987 tend to be slightly higher than over periods ending in 1986.

Average annual gain on shares (%)

Period	(a) Nominal	(b) Real	40% of column (b) as % of column (a)
1945-1987	9.0	2.1	9
1965-1987 — X	11.2	1.9	7
1969-1987	11.3	0.9	3
1979-1987 — Y	19.6	11.1	23
1983-1987	23.9	18.4	31

Mark Courtney

M M COURTNEY

CHANCELLOR OF THE EXCHEQUER

Ch.

You asked about the estimated tax yield on corporate CGT in 88-89.

This is:

1) £1600 m. (on a receipts basis)

2) £1700 + m (on an accruals basis)

[illegible]

29/12

relevant to Budget brief, since (arguably) abolition of CGT would lose this yield, too.

G42a/CD/1535/008

Copy No. 1 of 29

FROM: M M COURTNEY
DATE: 29 February 1988

Ch / See

CHANCELLOR

Thanks. X & Y are the two [illegible] for Budget [illegible] I [illegible]

cc: PPS
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Sir A Wilson
Mr Scholar
Mr Culpin
Mrs Lomax
Mr Odling-Smee
Mr Sedgwick
Mr Pickford
Mr Riley
Miss Sinclair
Mr Scotter
Miss Evans
Mr Hudson
Mr Cropper
Mr Tyrie
Mr Call

Mr Battishill IR
Mr Isaac IR
Mr Painter IR

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1979-1987 — Y	19.6	11.1	23
1983-1987	23.9	18.4	31

Mark Courtney
M M COURTNEY

Copy No. 2 of 29

FROM: M M COURTNEY
DATE: 29 February 1988

CHANCELLOR

cc: PPS
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Sir A Wilson
Mr Scholar
Mr Culpin
Mrs Lomax
Mr Odling-Smee
Mr Sedgwick
Mr Pickford
Mr Riley
Miss Sinclair
Mr Scotter
Miss Evans
Mr Hudson
Mr Cropper
Mr Tyrie
Mr Call

Mr Battishill IR
Mr Isaac IR
Mr Painter IR

EFFECTIVE RATE OF CAPITAL GAINS TAX

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1969-1987	11.3	0.9	3
1979-1987	19.6	11.1	23
1983-1987	23.9	18.4	31

Mark Courtney

M M COURTNEY

RJ4.49

UNCLASSIFIED

FROM: J M G TAYLOR

DATE: 29 February 1988

MR CAYLEY - INLAND REVENUE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
PS/IR

IFS INTERIM REPORT ON CGT

The Chancellor was most grateful for your minute of 25 February, enclosing a copy of the IFS' comments to which you refer in your earlier note. He has commented that this is very useful indeed.

J M G TAYLOR

CHANCELLOR OF THE EXCHEQUER

I am aware of this, of course

Ch.

Your (real) question, behind.

2. Mr Cayley tells me that this was not, in fact, an Administration proposal - indeed, the President did not like it. The reasons given by those Congressmen who put it forward were:

(a) taxing only a proportion of long term gains led to undesirable locking-in;

(b) it was exploited as a loophole;

(c) revenue was unnecessarily lost.

3. He is happy to amplify this, if you like - shall I ask for a note? No.

The answer, for our purposes, is (b).

1/3

Inland Revenue

Policy Division
Somerset House

COPY NO 1 OF 16.

What I want is the justification for this gains change.

From: D Y Pitts

Date: 29 February 1988

Ch/

I do not recall you asking for this at all. What you did ask for was what had been said to the Congress in justification for the Capital tax reforms in the US. I will phone.

AT 29/2

CHANCELLOR

CGT REFORM : USA

?

You asked (your meeting this morning) why the USA assimilated chargeable gains with income tax in their reform.

They didn't. They have always taxed gains (previously - but not now - only a proportion of long term gains) as income. We are not stitching gains into the income tax structure because, unlike USA, we do have a different gains system and assimilation would take many pages of rather pointless legislation.

Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Culpin
Miss Sinclair
Mr Cropper

Mr Battishill
Mr Isaac
Mr Beighton
Mr Pitts
Mr Cayley
Mr Michael
PS/IR

But it's only a matter of structure. The USA, like us, have umpteen pages of special rules underlying the basic computation of gains (which is then taxed as income).

D Y PITTS

COPY NO 7 OF 19

FROM: J M G TAYLOR
DATE: 29 February 1988

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Odling-Smee
Mr Scholar
Mr Culpin
Mr Cropper
Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Beighton - IR
PS/IR

CGT REFORM: UNIT TRUSTS AND MUTUAL LIFE OFFICES

The Chancellor has seen Mr Painter's minute of 26 February, and Mr Beighton's enclosed note.

2. Subject to the views of the Financial Secretary, he would favour leaving the rate unchanged this year, and making a change in the context of the outcome of the overall life assurance review package in 1989. It may well help to have a sweetener then. And it is not wholly clear what the right rate would be, given the new two-tier Capital Gains Tax.

J M G TAYLOR

COPY NO 13 OF 13

FROM: J M G TAYLOR
DATE: 29 February 1988

MRS LOMAX

cc PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Mr Peretz
Mr Ilett
Mr Cropper
Mr Cayley - IR
PS/IR

CGT PACKAGE

The Chancellor was grateful for your minute of 26 February.

J M G TAYLOR

COPY NO 18 OF 19

FROM: J M G TAYLOR
DATE: 29 February 1988

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Odling-Smee
Mr Scholar
Mr Culpin
Mr Cropper
Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Beighton - IR
PS/IR

CGT REFORM: UNIT TRUSTS AND MUTUAL LIFE OFFICES

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2. Subject to the views of the Financial Secretary, he would favour leaving the rate unchanged this year, and making a change in the context of the outcome of the overall life assurance review package in 1989. It may well help to have a sweetener then. And it is not wholly clear what the right rate would be, given the new two-tier Capital Gains Tax.

J M G TAYLOR

RJ4.58

CONFIDENTIAL

FROM: J M G TAYLOR

DATE: 1 March 1988

MR COURTNEY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Sir A Wilson
Mr Scholar
Mr Culpin
Mrs Lomax
Mr Odling-Smee
Mr Sedgwick
Mr Pickford
Mr Riley
Miss Sinclair
Mr Scotter
Miss Evans
Mr Hudson
Mr Cropper
Mr Tyrie
Mr Call
Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR

EFFECTIVE RATE OF CAPITAL GAINS TAX

The Chancellor was grateful for your minute of 29 February. He has commented that "1965-1987" and "1979-1987" are the two lines to use for Budget briefing.

JT

J M G TAYLOR

COPY NO 32 OF 32

FROM: J M G TAYLOR
DATE: 1 MARCH . 1988

MR CAYLEY - 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 C Evans
Miss Sinclair
Mr Riley
Mr Cropper
Mr Tyrie
Mr Call

Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Beighton - IR
Mr Pitts - IR
PS/IR

Mr Unwin - C&E
Mr Knox - C&E
PS/C&E

CGT EXEMPTION LIMIT

The Chancellor has confirmed that the CGT exemption limit should be set at £5,000 (indexed) in the Budget.

J M G TAYLOR

BUDGET SECRET: TASK FORCE LIST

Inland Revenue

Policy Division
Somerset House

FROM: B A MACE

DATE: 1 MARCH 1988

COPY NO 1 of 38.

CHANCELLOR OF THE EXCHEQUER

MAIN INCOME TAX CHANGES: 1988-89

1. For the record I attach a table setting out the personal allowances, thresholds and rates which you decided at yesterday's Overview meeting. We have now put in hand the work needed to implement these figures.

2. We shall let you have the full revised costing of these changes as quickly as we can.

B A Mace

B A MACE

---

cc
Principal Private Secretary
Chief Secretary
Financial Secretary
Paymaster General
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 Evans
Mr Hudson
Mr Cropper
Mr Tyrie
Mr Call
Miss Sinclair
Mr Riley
Mr Unwin (Customs & Excise)
Mr Knox (" & ")
Mr Jenkins
(Parliamentary Counsel)

Chairman
Mr Isaac
Mr Painter
Mr Beighton
Mr Calder
Mr Lewis
Mr Mace
Mr R H Allen
Mr Eason
Mr J C Jones
Mr A J O'Brien
PS/IR

458.txt

Table

INCOME TAX: ALLOWNACES AND RATES FOR 1988-89

Allowances (1987-88 figures in brackets)

Single allowance/wife's earned income allowance	£ 2,605	(£2,425)
Married allowance	£ 4,095	(£3,795)
Additional personal allowance/widow's bereavement allowance*	£ 1,490	(£1,370)
Single age allowance (age 65-79)	£ 3,180	(£2,960)
Married age allowance (age 65-79)	£ 5,035	(£4,675)
Single age allowance (age 80 and over)	£ 3,310	(£3,070)
Married age allowance (age 80 and over)	£ 5,205	(£4,845)
Age allowance income limit	£10,600	(£9,800)

Rates

Basic rate: 25 per cent

Basic rate limit: £19,300

Single higher rate: 40 per cent

*Equal to difference between married and single allowances.

RJ4.59

BUDGET CONFIDENTIAL

FROM: J M G TAYLOR

DATE: 1 March 1988

MR CAYLEY - INLAND REVENUE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
PS/IR

CORPORATE CGT

In response to a question from the Chancellor, you kindly supplied the information that the estimated yield of tax on corporate gains in 1988-89 was £1600 million (on a receipts basis). The Chancellor has commented that this is relevant to Budget briefing, since (arguably) abolition of CGT would lose this yield, too.

J M G TAYLOR

COPY NO 31 OF 32

FROM: J M G TAYLOR
DATE: 1 MARCH. 1988

MR CAYLEY - 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 C Evans
Miss Sinclair
Mr Riley
Mr Cropper
Mr Tyrie
Mr Call
Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Beighton - IR
Mr Pitts - IR
PS/IR
Mr Unwin - C&E
Mr Knox - C&E
PS/C&E

CGT EXEMPTION LIMIT

The Chancellor has confirmed that the CGT exemption limit should be set at £5,000 (indexed) in the Budget.

J M G TAYLOR

BUDGET SECRET: TASK FORCE LIST

Inland Revenue

Policy Division
Somerset House

FROM: B A MACE
DATE: 1 MARCH 1988

COPY NO 2 of 38.

CHANCELLOR OF THE EXCHEQUER

MAIN INCOME TAX CHANGES: 1988-89

1. For the record I attach a table setting out the personal allowances, thresholds and rates which you decided at yesterday's Overview meeting. We have now put in hand the work needed to implement these figures.

2. We shall let you have the full revised costing of these changes as quickly as we can.

B A Mace

B A MACE

---

cc Principal Private Secretary
Chief Secretary
Financial Secretary
Paymaster General
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 Evans
Mr Hudson
Mr Cropper
Mr Tyrie
Mr Call
Miss Sinclair
Mr Riley
Mr Unwin (Customs & Excise)
Mr Knox (" & ")
Mr Jenkins
(Parliamentary Counsel)

Chairman
Mr Isaac
Mr Painter
Mr Beighton
Mr Calder
Mr Lewis
Mr Mace
Mr R H Allen
Mr Eason
Mr J C Jones
Mr A J O'Brien
PS/IR

458.txt

Table

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Age allowance income limit	£10,600	(£9,800)

Rates

Basic rate: 25 per cent

Basic rate limit: £19,300

Single higher rate: 40 per cent

*Equal to difference between married and single allowances.

INLAND REVENUE
STATISTICS DIVISION
SOMERSET HOUSE

COPY NO 1 OF 39

FROM: R J EASON

DATE: 2 March 1988

Thanks. Given the consistency with last year's FSBR, pls use the Table 2 order throughout. 2.1 takes it that the allowance referred to @ X & the further adjustment @ Y are still unknown. N

1. MR CALDER ✓ JRC 2/3
2. CHAIRMAN ✓ Seen in draft.
3. CHANCELLOR OF THE EXCHEQUER

BUDGET INCOME TAX PACKAGE

1. This note follows discussion at Monday's overview meeting and gives costs and further information about the main income tax package for the Budget, as set out in Mr Mace's note of 1 March.

---

cc Principal Private Secretary
Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr J Anson
Sir A Wilson
Mr I Byatt
Mr M C Scholar
Mr R Culpin
Mr P Sedgwick
Mr J Odling Smee
Miss C Evans
Mr A Hudson
Mr P McIntyre
Mr P Cropper
Mr A Tyrie
Mr A Call
Miss C E C Sinclair
Mr C J Riley
Mr C Mowl
Mr Unwin (C&E)
Mr Knox (C&E)

Chairman
Mr Isaac
Mr Painter
Mr Beighton
Mr Calder
Mr Lewis
Mr Mace
Mr Cayley
Mr Eason
Mr Ko
Miss White
PS/IR

Direct Revenue Costs

2. The direct revenue costs are given in the attached tables. They are measured against an indexed base. In Table 1 the costs are estimated as they have been in recent scorecards with the basic rate cut made before the basic rate limit is increased. In Table 2, the basic rate limit is increased first. This is consistent with the presentation in last year's FSBR. The result is that the cost of the basic rate cut is larger and the cost of increasing the basic rate limit is correspondingly smaller. I have included the line for abolition of minor personal allowances.

3. The basis of the estimates is now the 1985-86 Survey of Personal Incomes with projections to later years incorporating X an allowance for the widening of the earnings distribution (mentioned in Mr Culpin's cover note to the scorecard of 26 February). The 1986 and 1987 New Earnings Surveys show that the distribution continued to widen after 1985-86. We have incorporated this and, after discussion with Treasury Y economists, agreed a moderate amount of further widening over the forecast period. The costs are also based on forecast post-Budget income levels.

4. I regret that we were not able to make these changes earlier. Their overall effect is that costs have increased compared with two weeks ago, particularly for the higher rate elements in the package, but this is partly offset by your decision to restrict the increase in the basic rate limit to £19,300.

Number of Taxpayers

5. Estimates of the effects on numbers of taxpayers are set out below:

	Numbers of taxpayers Tax Unit liable	Individuals liable	(thousands) Higher rate tax units
1987-88	20,407	24,050	1,200
1988-89			
1987-88 tax regime	21,366	25,388	1,571
indexation	21,088	24,970	1,406
Budget package	20,844	24,607	1,276
Budget package compared with:			
-1987-88	437	557	76
-indexation	-244	-363	-130
-retaining 87-88 regime	-522	-781	-295

6. The Budget package will therefore lead to reductions of about 520,000 tax units, 780,000 individual taxpayers, and 300,000 higher rate tax units compared with making no changes in allowances or thresholds for 1988-89. There will nonetheless be increases in all the groups compared with the actual levels in 1987-88. These estimates are based on projections of 1985-86 SPI data and therefore differ slightly from those in earlier submissions. The impact of allowing for differential growth in earnings is to increase the number of higher rate taxpayers and reduce the total number of taxpayers.

7. We shall now prepare a new version of the specimen income Press Release taking account of these final decisions. We shall also incorporate your preferred version of the two presentations of the costs in the Press Release and the FSBR.

RJE

R J EASON

BUDGET SECRET - TASK FORCE LIST

TABLE 1

MAIN PROPOSALS	Cost(-) or Yield(+) in £ million 1988-89	1989-90	1990-91	1991-92
1 Double indexation of allowances	-690	-895	-945	-995
2 Abolition of minor personal allowances	+10	+10	+10	+10
3 Reduce basic rate of IT to 25p	-2550	-3170	-3290	-3515
4 Increase basic rate limit to £19,300	-85	-150	-165	-180
5 Abolish higher rates of IT above 40p	-995	-2150	-2530	-2810
Total 1 to 5	-4310	-6355	-6920	-7490

TABLE 2

MAIN PROPOSALS	Cost(-) or Yield(+) in £ million 1988-89	1989-90	1990-91	1991-92
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BUDGET SECRET - TASK FORCE LIST

INLAND REVENUE
STATISTICS DIVISION
SOMERSET HOUSE

COPY NO 2 OF 39

FROM: R J EASON

DATE: 2 March 1988

1. MR CALDER R 2/3
2. CHAIRMAN Seen in draft.
3. CHANCELLOR OF THE EXCHEQUER

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Paymaster General
Economic Secretary
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Sir T Burns
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Mr J Anson
Sir A Wilson
Mr I Byatt
Mr M C Scholar
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R J EASON

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Total 1 to 5	-4310	-6355	-6920	-7490

Inland Revenue

Policy Division
Somerset House

Thanks. These appear, however, to be somewhat overstated for a year 4: the exemption slice will continue to be revalued each year — & the next indexation will be 1989 (not 1990). N.

Copy No 1 of 30

FROM: M F CAYLEY
DATE: 2 March 1988

PS/CHANCELLOR

CGT EXEMPTION LIMIT: EFFECT OF DECISION ON COMPARISONS WITH USA

1. In paragraph 3 of my 22 February note "CGT: Comparison with US higher rate taxpayers", I said that with a £6,600 annual exemption, ignoring indexation and rebasing, a higher rate taxpayer would have to have gains of £22,000 (looking at Federal tax alone) or over £48,000 (bringing in typical US State and local taxes) to be paying more tax on gains here following the Budget than he would in the USA.

2. The Chancellor may be interested to know that with a £5,000 exemption, the crossover point becomes over £16,500 (comparing with Federal tax only) and over £36,000 with typical State and local taxes brought in. Indexation

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cc. PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Mr Byatt
Mr Scholar
Mr Culpin
Mrs Lomax
Mr Odling-Smee
Miss Sinclair
Mr Riley
Mr Cropper
Mr Battishill
Mr Isaac
Mr Painter
Mr Beighton
Mr Calder
Mr Pitts
Mr Cayley
Mr Gonzalez
Mr Mace
Mr Michael
Mr Quinn
Mr Lester
PS/IR

relief will of course in practice push up the crossover point; and so will rebasing for those with pre-82 gains.

3. Even with the lower exemption, it remains true that the vast majority of higher rate payers will pay less than they would in the USA.

4. Assuming the exemption is revalorised in 1990, the crossover points will double in real terms for those married couples who arrange their affairs in the most tax-efficient way, to maximise use of their separate exemptions.

Michael Cayley

M F CAYLEY

BUDGET SECRET - TASK FORCE LIST

INLAND REVENUE
STATISTICS DIVISION
SOMERSET HOUSE

COPY NO 1 OF 17

FROM: R J EASON
DATE: 4 March 1988

1. MR CALDER
2. CHANCELLOR OF THE EXCHEQUER

Thanks. We sh'd clearly use the Table 2 basis. NL.

BUDGET INCOME TAX PACKAGE

1. As requested by Mr Allan today, I attach a table showing the FSBR costs of the Budget income tax changes. Table 1 is based on economic forecasts with full differential earnings (as in my submission of 2 March) and Table 2 restricts differential earnings to the changes shown in the 1986 and 1987 New Earnings Surveys. No further widening of the income distribution is assumed after the first half of 1987-88.

2. The effects of this restriction are shown below Table 2. The costs of the income tax changes would fall by £20 million in 1988-89 and £75 million in 1989-90. The fall is greater

---

cc	PS/Financial Secretary	Chairman
	Sir P Middleton	Mr Isaac
	Sir T Burns	Mr Painter
	Mr Scholar	Mr Beighton
	Mr Culpin	Mr Lewis
	Mr Odling-Smee	Mr Calder
	Mr Riley	Mr Eason
	Miss C Evans	Mr Mace
	Miss Sinclair	Miss White
	Mr Cropper	Mr Ko
		PS/IR

in later years as the restriction applies over more years. The restriction reduces the costs of the higher rate reductions but increases the costs of the basic rate cut because more income is at the centre of the distribution.

3. In considering the alternative methods, you may find it helpful to see the attached figures for the differential growth in 1986 and 1987 and the forecasts agreed between Treasury economists and ourselves last November. The economists expected some further relative gain in 1987-88 for the higher paid following the stock market decline because of company profit growth. In 1989 and beyond, they expected the differential to stabilise in line with historic averages.

what?

4. If you decide to adopt differential earnings up to only the 1987 New Earnings Survey, there should be a corresponding fall in the income tax forecast for 1988-89 and beyond as we shall be forecasting less income subject to higher rate tax. The fall will be less than £100 million in the first year but rather more subsequently.

helps PSBR forecast

R J EASON

TABLE 1

FORECAST* DIFFERENTIAL EARNINGS

MAIN PROPOSALS	Cost(-) or Yield(+) in £ million 1988-89	1989-90	1990-91	1991-92
1 Double indexation of allowances	-690	-895	-945	-995
2 Abolition of minor allowances	+10	+10	+10	+10
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4 Reduce basic rate of IT to 25p	-2560	-3190	-3310	-3540
5 Abolish higher rates of IT above 40p	-995	-2150	-2530	-2810
Total 1 to 5	-4310	-6355	-6920	-7490

TABLE 2

WITHOUT FORECAST* DIFFERENTIAL EARNINGS

MAIN PROPOSALS	Cost(-) or Yield(+) in £ million 1988-89	1989-90	1990-91	1991-92
1 Double indexation of allowances	-690	-895	-945	-995
2 Abolition of minor allowances	+10	+10	+10	+10
3 Increase basic rate limit to £19,300	-75	-125	-135	-145
4 Reduce basic rate of IT to 25p	-2570	-3200	-3330	-3570
5 Abolish higher rates of IT above 40p	-965	-2070	-2395	-2615
Total 1 to 5	-4290	-6280	-6795	-7315
Effect of forecast differential earnings growth	+20	+75	+125	+175

* Forecast beyond the 1987 New Earnings Survey.

DEVIATIONS OF PERCENTAGE GROWTH RATE
FROM MEDIAN

FEMALES

DATE	LOWER QUARTILE	LOWER DECILE	MEDIAN	UPPER DECILE	TOP FIVE
1986	-0.09	-1.27	0	3.43	4.04
1987	-0.56	-1.32	0	1.20	0.58
1988	-0.56	-1.00	0	0.00	0.00
1989	-0.56	-1.00	0	0.00	0.00
1990	-0.56	-1.00	0	0.00	0.00
1991	-0.56	-1.00	0	0.00	0.00
1992	-0.56	-1.00	0	0.00	0.00

MALES

DATE	LOWER DECILE	MEDIAN	UPPER DECILE	TOP FIVE
1986	-1.05	0	1.14	2.19
1987	-1.24	0	1.62	2.41
1988	-1.20	0	1.50	2.00
1989	-1.20	0	0.80	1.30
1990	-1.20	0	0.80	1.30
1991	-1.20	0	0.80	1.30
1992	-1.20	0	0.80	1.30

Inland Revenue

Policy Division
Somerset House

FROM: MISS R A DYALL

DATE: 4 MARCH 1988

PWP

FINANCIAL SECRETARY

INDEPENDENT TAXATION

1. At your meeting on 25 February you considered what organisations you should write to or see after the Budget about the proposals on Independent Taxation. The organisations suggested were

- The Conservative Women's National Committee
- The Equal Opportunities Commission (EOC)
- The Women's National Commission (WNC)

2. We suggest that you write to Dame Joan Seccombe the Conservative vice chairman with responsibility for women and Lady Platt, Chairman of the EOC on Budget Day, offering each a meeting, and enclosing further information about the proposals in the form of Treasury and Inland Revenue press releases.

Conservative Women's National Committee

3. Dame Joan Seccombe has not taken up the reform of personal taxation with Ministers since her appointment but the attached press article suggests that her personal preference could be for transferable allowances and removal of the tax penalties on

---

cc	Chancellor	Mr Isaac
	Chief Secretary	Mr Lewis
	Paymaster General	Mr Beighton
	Economic Secretary	Mr Mace
	Mr Culpin	Mr O'Connor
	Miss Sinclair	Mr Stewart
	Mr Cropper	Miss Dyall
	Mr Tyrie	PS/IR
	Mr Call	

marriage. We understand the Conservative Women's National Committee withdrew their support for transferable allowances in November 1986, in favour of "individual personal taxation" with carers' allowances. Mr Cropper may have views on their likely reaction to the Budget proposals.

Equal Opportunities Commission

4. Baroness Platt raised the reform of personal taxation last summer with the Home Secretary who passed on the EOC's views to the Chancellor (Mr Hurd's letter of 2 July attached). Baroness Platt subsequently wrote directly to the Chancellor on 11 November last year (copy attached) asking for a meeting early this year on this and other issues. The Chancellor replied on 1 December refusing a meeting. The Equal Opportunities Commission support mandatory separate taxation with cash benefits so are likely to welcome some elements of Independent Taxation (independence and privacy for married women) but not others (the married couple's allowance, for example). (Baroness Platt is leaving the EOC in May. Her successor will be Mrs Joanna Foster.)

Women's National Commission

5. Mrs Angela Rumbold, the Minister of State for Education and Science is co-chairman of the WNC (with Mrs Janet Jones MP) and represents them on the Ministerial Group on Women's Issues. We are suggesting in a separate note to the Paymaster General that as the Treasury representative on the Group he might write to fellow-members about the Independent Taxation proposals, so there seems no need for you to write to Mrs Rumbold separately. We would not recommend offering the WNC a meeting at this stage as Mrs Rumbold will have an opportunity to express their views at the next meeting of the Ministerial Group. If they subsequently press for a meeting you can reconsider the position at that stage.

6. We have considered whether there are any other organisations to which a direct approach would be helpful and I attach a list

of those bodies which commented on the 1986 Green Paper. None of them stands out as an obvious candidate for an approach. Although we would not otherwise have suggested them you may, however, wish to write (but not offer a meeting) to the Family and Child Protection Group (FCPG) as they came to see you so recently (1 March). They favoured transferable allowances but should welcome the removal of the tax penalties on marriage and the married couple's allowance.

7. I attach draft letters to Baroness Platt and Dame Jill Knight who led the FCPG delegation. I understand that Mr Cropper had it in mind to draft a letter to Dame Joan Seccombe.

Robina Dyall

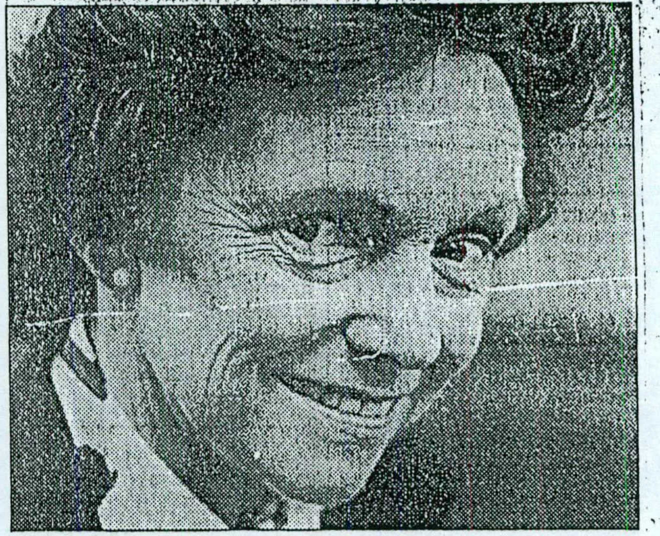
MISS R A DYALL

THE TIMES 14.10.1987.

Tory talent-spotter

From this week Conservative women have a new vice-chairman – and she's got tax reforms to bolster family life firmly in her sights

Ros Drinkwater



Support for the envelope-stickers: Dame Joan Seccombe

Anyone who claims to be able to spot a Tory lady at 400 yards would be told to look again by Dame Joan Seccombe. The new Tory vice-chairman in charge of women — she takes up her appointment this week — refused my invitation to describe the typical Tory female, protesting: "There is no such thing nowadays." And she should know — last week she spent much of her time gazing down at thousands of Tories as she chaired the party conference in Blackpool.

She had nothing but praise for the women there: "They came over as very knowledgeable . . . there is a vast array of talent we must make much more use of, and it is heartening to see the wide variety of backgrounds from which our women come today."

Nigel Lawson seemed impressed, too, when several female delegates pointed out the "idiocy" of the current system of taxation of women. Seccombe, now 57 and married for 37 of those years, is "absolutely committed to tax reforms". Like her predecessor, Emma Nicholson, now Conservative MP for Devon West and Torridge, she feels that the present tax laws are too heavily weighted in favour of the working wife. "The present system, which allows a working wife to earn her own tax-free element while the stay-at-home wife cannot do this, is unfair. I do not want to see any reform that discourages the wife and mother from being able to make a choice in favour of staying at home."

She made the decision to give up work as a physiotherapist when she married, and still believes now "that children and families benefit from the woman being at home, and if we see a need to adjust income tax to encourage women to make such a choice, then that is all to the good".

She is unhappy about the favourable tax position of those unmarried homeowners who can claim individual tax relief on a joint mortgage, "both because it erodes marriage as an institution, and because women invariably lose out when such relationships break down". But, for those women who *do* work, and have a family, she claims to have nothing but admiration. She would support equal treatment for them in allowing tax relief for nannies and child-minders: "I would prefer to see the children of working wives properly looked after; there is nothing worse for family life than unhappy latch-key children."

She raised her two sons in the West Midlands, and worked behind the scenes in the 1955 general election; then in the Sixties her solicitor husband became a Birmingham city councillor. "My role then was largely supportive, with my husband at the forefront of political activity, and myself in the background, but gradually I became more involved in the affairs of the local Conservative Association." She was always a Tory: "As a little girl I went with my mother to vote. I expected it to be exciting, but it wasn't. When war broke out, and the family endlessly discussed Churchill, I knew I was a Tory."

With hindsight, she says she does perhaps regret not going for a parliamentary career; "but nevertheless new opportunities were offered, culminating in my election as chairman of the National Union in April of this year." She became a JP in 1968 and was made a Dame in 1984 for political and public services.

One of her principal roles in her new job is to go around the country visiting constituencies and talent-spotting, both for potential parliamentary candidates, and for women who can offer the Tory Party something useful, perhaps as local councillors or sitting on a national body. There were no such talent spotters when she was climbing up the ladder, she remembers: "You had to make it by getting on with the job in hand." She feels, too, that the many thousands of unsung heroines — the envelope-stickers and jumble sale organizers, for instance — equally deserve her support and encouragement.

Does she also think it is her job to push for changes in the law to benefit women? "Not at all. I do not believe in revolution, and I regard legislation in this field as largely counter-productive. I also believe that women in other political parties are too often obsessed with what they call women's issues. We want to involve women in discussing *all* issues."

She has been described as both "formidable" and "supremely elegant"; the latter she says is preferable to being described as scruffy, and the former she dismisses as simply a reflection of the old-fashioned notion that any woman who is successful must be formidable. Despite her obvious distaste for positive discrimination she notes wryly the dilemmas facing potential women candidates: "If you're not married, people wonder why. If you *are* married, they want to know when you're going to have children. And when you have children, they think you'll be too old before you'll be of much use to the party. It is difficult."

Elizabeth Hodder

REC. -3 JUL 1987
ACTION: MR MACE IR
COPIES TO: PS/CX CST PMG EST
SIR P. MIDDLETON
MR CASSELL MR SCHOLAR
MISS SINCLAIR MR CROPPER PS/IR

FOR REPLY BY THE CHANCELLOR.

QUEEN ANNE'S GATE LONDON SWIH 9AT

2 July 1987

Dear Nigel,

INDIVIDUALISATION OF THE TAX SYSTEM

During a recent visit to the Equal Opportunities Commission, Baroness Platt and her colleagues raised with me their concern about the present system of taxation. They reported that women's organisations were in unanimous agreement with the Commission that the introduction of an independent system of taxation was imperative at an early date, although opinions differed as to ways in which this should be achieved. You may recall that the Commission submitted evidence in response to the Green Paper on the reform of personal taxation: a further copy of this is enclosed for ease of reference.

I undertook to pass on the Commission's views to you and I should very much like to be able to tell them how your mind is now moving. The Commission is naturally concerned to see early progress. Can you tell me how things stand?

Yours,

Douglas.

BAM 3/7

...QUER
03 JUL 1987
EST

The Rt Hon Nigel Lawson, MP

Equal Opportunities Commission
Overseas House
Quay Street Manchester M3 3HN

Telephone 061-833 9244

Equal Opportunities Commission

From The Baroness Platt of Writtle,
C.B.E., D.L., M.A., C.Eng., Hon.D.Sc.,
F.R.Ae.S., Hon.F.I.Mech.E.
Chairman.

BP/EMM

11 November 1987

Mr Mace IR
FST, Mr Cassell
Mr Scholar, Miss Sinclair
Mr Cropper, PS/IR

The Rt. Hon. Nigel Lawson, MP.
Chancellor of the Exchequer,
The Treasury,
Parliament Street,
LONDON.
SW1P 3AG

Dear Mr Lawson

The Commission submitted a comprehensive and fully argued response to the Green Paper "The Reform of Personal Taxation". We feel that the paper expressed the Commission's concerns about the reform of taxation very fully and accordingly, although we asked for a meeting with you and your colleagues, we did not at that time press for it to follow-up the arguments.

We are, however, aware that you are giving considerable further thought to the method by which reform might be accomplished, and we repeat the hope expressed in our response that this will lead to a further period of consultation on alternative methods of reform before legislation is finally introduced.

The Commission itself however feels that the introduction of a measure of reform to remove what is regarded by all sides as an indefensible present system of taxation of married women is a matter of urgency. We also consider that any reform should be compatible with the following principles:- that it should be non-discriminatory, administratively simple, and that it should be neutral in effect as regards the individual decision of women whether or not to seek paid employment. The latter is one of the Commission's fundamental concerns. We feel deeply that individual married women should be able to choose whether they take paid employment or not, according to their individual circumstances, quite irrespective of the taxation system.

The effect of the taxation system on the position of working women has of course many ramifications, and perhaps also we could discuss such matters as the taxation of workplace nurseries and the proposal for an allowance against the cost of childcare.

I hope very much we can arrange a meeting as soon as possible after Christmas.

Yours sincerely

Platt of Writtle

Baroness Platt of Writtle

London Office: 1 Bedford Street, WC2E 9HD Telephone: 01-379 6323

ORGANISATIONS RESPONDING TO 1986 GREEN PAPER

1. Association of British Chambers of Commerce
2. Association of County Councils
3. Association of Independent Businesses
4. Association of Women Solicitors
5. Birmingham Chamber of Industry and Commerce
6. Bristol Chamber of Commerce and Industry
7. Bristol Junior Chamber
8. British Federation of University Women
9. British Federation of University Women—NE Association of Women Graduates
10. British Institute of Management
11. Chartered Association of Certified Accountants
12. Child Poverty Action Group
13. City Women's Network
14. Civil Service Pensioners' Alliance, Stratford-on-Avon
15. Confederation of British Industry
16. Conservative Family Campaign
17. Conservative Political Centre
18. Co-operative Union Ltd.
19. Country Landowners Association
20. East Surrey constituency Conservative party
21. Equal Opportunities Commission
22. Equal Opportunities Commission for Northern Ireland
23. Fawcett Society
24. Gingerbread
25. Glasgow Chamber of Commerce
26. Inland Revenue Staff Federation
27. Institute of Administrative Accountants
28. Institute of Chartered Accountants (England and Wales)
29. Institute of Chartered Accountants (Scotland)
30. Institute of Cost and Management Accountants
31. Institute of Directors
32. Institute of Taxation
33. Jubilee centre, Cambridge
34. Law Society
35. Law Society of Scotland
36. Leicester city council
37. Liberal party
38. London Borough of Lewisham
39. London Chamber of Commerce
40. Low Pay Unit
41. Managerial, Professional and Staff Liaison group
42. Married Women's Association
43. Merseyside Chamber of Commerce and Industry
44. Monday Club
45. National Association of Teachers in Further and Higher Education
46. National Board of Catholic Women
47. National Chamber of Trade
48. National Children's Bureau
49. National Consumer Council
50. National Council for One Parent Families
51. National Council of Women of Great Britain
52. National Farmers Union
53. National Federation of Post Office and British Telecom Pensioners
54. National Federation of Self-Employed and Small Businesses Ltd.
55. National Federation of Women's Institutes
56. Order of Christian Unity
57. Public Service Pensioners Council
58. Sevenoaks Working Mothers Association
59. Sheffield Christian Constituency Movement
60. Taxpayers Society
61. Trades Union Congress
62. United Kingdom Federation of Business and Professional Women
63. United Kingdom Federation of Business and Professional Women, Rugby
64. War Widows Association of Great Britain
65. Women in BP
66. Women in Management
67. Women's Forum Northern Ireland
68 Women's National Commission

BUDGET CONFIDENTIAL

The Baroness Platt Of Writtle CBE
Chairman
Equal Opportunities Commission
Overseas House
Quay Street
MANCHESTER M3 3HN

INDEPENDENT TAXATION

As you will have heard, the Chancellor of the Exchequer announced in his Budget speech that the Government propose to introduce a system of Independent Taxation of husband and wife, from April 1990. I know that this will be of particular interest to the EOC which has taken such an active part over recent years in the debate about the reform of personal taxation.

Under the new system a married woman's income and capital gains will no longer be deemed to belong to her husband for tax purposes. She will be treated as a taxpayer in her own right and be able to enjoy complete privacy and independence in her tax affairs.

This is a fundamental change of particular significance for women; but it is also part of a package of measures intended to remove the tax penalties on marriage. I enclose copies of Treasury and Inland Revenue press releases which describe the new system of Independent Taxation in more detail and outline the action the Government propose to take on tax penalties.

When the EOC has had an opportunity to study the proposals, I should be happy to meet and talk to you about them. I suggest your office contacts my private secretary to arrange a convenient date.

NORMAN LAMONT

Enclosures: Treasury press releases on Independent Taxation and Covenants and Maintenance
Inland Revenue press releases on Independent Taxation, Tax Penalties on Marriage, Mortgage Interest Relief, Covenants and Maintenance

466.txt

Dame Jill Knight, DBE, MP
House of Commons
LONDON SW1A OAA

FAMILY AND CHILD PROTECTION GROUP

When you came, with other members of the Group, to see me on 1 March you expressed concern about the tax penalties on marriage and the encouragement they seemed to give for people to live together unmarried.

I am sure that the Group will have welcomed the Chancellor's announcement in his Budget speech that the Government propose to remove the tax penalties on marriage and introduce a system of independent taxation of husband and wife from April 1990. As a result a married couple will no longer pay more tax than two single people simply because they are married. A married woman will have a full personal allowance which can be set against either earned or savings income and there will also be a new married couple's allowance.

These proposals demonstrate the Government's support for marriage and the family, and our determination to remove discrimination against marriage from the tax system.

I enclose copies of Treasury and Inland Revenue press releases, describing the changes in greater detail, which the Group may find of interest.

NORMAN LAMONT

Enclosures: Treasury press release on Independent Taxation
Inland Revenue press releases on Independent Taxation and Tax Penalties on Marriage

468.txt

PWP

Inland Revenue

Policy Division
Somerset House

FROM: C GORDON
EXT: 6739
DATE: 4 MARCH 1988

1. ~~MR PITTS~~

2. PAYMASTER GENERAL

CAPITAL GAINS TAX BS 265 : RETIREMENT RELIEF
BUDGET DAY PRESS RELEASE

1. I attach a revised draft of the Budget Day Press Release (my earlier note of 23 February to the Financial Secretary refers).

2. We have amended the main descriptive part of the Release to take account of your comments and would be grateful to know if you are content.

C GORDON

---

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Mr Scholar
Mr Culpin
Miss Sinclair
Mr R I G Allen
Mr Michie
Mr Riley
Mr Burnhams
Mr Hudson
Mr Cropper
Mr Tyrie

Mr Isaac
Mr Pitts
Mr Beighton
Mr Cayley
Mr Hamilton
Mr Mace
Mr McManus
Mr Walker
Mr Willmer
Mr Michael
Mr Lester
PS/IR

INLAND REVENUE

Press Release

INLAND REVENUE PRESS OFFICE, SOMERSET HOUSE, STRAND, LONDON WC2R 1LB
PHONE: 01–438 6692 OR 6706

[3x] 15 March 1988

CAPITAL GAINS TAX: RETIREMENT RELIEF

The Chancellor proposes in his Budget a further extension of the capital gains tax retirement relief. This relief which is designed to reduce the tax burden on individuals selling up on retirement is available to people who

- dispose of their business when aged 60 or above, or
- who retire earlier on ill-health grounds.

On top of the existing exemption of gains up to £125,000, relief is to be extended to 50% of gains between £125,000 and £500,000. The additional relief will be available where the disposal takes place on or after 6 April 1988.

Since 1984 the limit for full relief has been increased from £50,000 to the present level. The change now proposed will give further help to small businessmen planning for retirement, and so increase entrepreneurial incentives.

NOTES FOR EDITORS

1. Following last year's Budget increase in the ceiling, the capital gains tax retirement relief provides an exemption of up to £125,000 of gains on the disposal of a business or of shares in a family company for individuals aged 60 or above and those retiring earlier on grounds of ill-health. Where the disposal takes place on or after 6 April 1988 it is proposed to give a further relief of 50% on gains between £125,000 and £500,000. As now, the maximum relief will be available to an individual who has been running his business for at least 10 years. Those who have been running the business for at least one year but less than 10 will, as now, be entitled to a proportion of the maximum relief (10 per cent for each full year of ownership). The maximum available relief on a disposal is reduced to the extent that any relief has been given on previous disposals.

2. The following examples show how the relief will work:

/Example

Example (a): A (age 65) disposes of his business, which he has been running for 20 years, on 1 May 1988. The gain after indexation is £250,000. He has had no earlier retirement relief.

		£
Gain	:	250,000
Amount available for full relief	:	125,000
Amount available for 50% relief: 250,000 - 125,000	:	125,000
Amount of relief available: 125,000 + (50% x 125,000)	=	187,500

Gain	:	250,000
- retirement relief	:	187,500
Chargeable gain		62,500
		=======

Example (b): B (age 65) disposes of his business, which he has been running for 6 years, on 1 May 1988. The gain after indexation is £250,000. He has had no earlier retirement relief.

		£
Gain	:	250,000
Width of "full relief band" 125,000 x 60%	:	75,000
Width of "50% relief band" (500,000 - 125,000) x 60%	:	225,000

(ie relief available at 50% on gains between £75,000 and £300,000)

Amount available for full relief	:	75,000
Amount available for 50% relief: 250,000 - 75,000	:	175,000
Amount of relief available: 75,000 + (50% x 175,000)	=	162,500

Gain	:	250,000
- retirement relief	:	162,500
Chargeable gain		87,500
		=======

P.W.P

IOD

THE VOICE OF BUSINESS LEADERS

For further information contact:

Gordon Leak: 01 839 1233 Ext. 2282 (Office)
C89 273 265 (Home)

Felicity Bull: 01 839 1233 Ext. 2285 (Office)
01 241 1920 (Home)

EMBARGO: 0001hrs. SUNDAY 6 MARCH 1988

PRESS RELEASE

Ch – Mark Call [illegible] would like to see this – helpful stuff, esp. 'X', overleaf. [illegible] 8/3

Tell Milan – NA:-

BUSINESS NEEDS A BUDGET BOOST - IOD

Chancellor of the Exchequer Nigel Lawson is warned today that confidence among business leaders about the future prospects of their companies and the UK economy has been checked and needs a boost from a bold Budget.

A pre-Budget Business Opinion Survey by the Institute of Directors shows that 86 per cent of directors say their companies are still doing "very well" or "fairly well".

But the number of business leaders who feel "more optimistic" about their companies prospects than they were six months ago has fallen from 61 per cent to 59 per cent.

Confidence about the UK economy in general has gone into sharper decline with 31 per cent saying they are "less optimistic" in the February survey compared with 21 per cent in December and only 4 per cent last October.

The survey, conducted in the first two weeks of February, shows 77 per cent of directors reporting an increase in the volume of their business over the past six months - three points down since December. There has also been a three point fall in the number recording higher profits.

Ten per cent of direcors now report that the trend in the volume of their business is down, compared with 6 per cent in December and 17 per cent reported lower profits compared with 12 per cent in December.

BUDGET CONFIDENTIAL

FROM: A C S ALLAN
DATE: 7 March 1988

MR RILEY

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Scholar
Mr Culpin
Mr Odling-Smee
Mr Sedgwick
Mr S Davies
Miss Sinclair
Mr Mowl
Miss C Evans
Ms Munro
Mr Scotter
Mr Cropper
Mr Tyrie
Mr Call
Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Calder - IR
Mr Eason - IR
Mr Weeden - IR

HIGHER RATE TAX REFORM: INDIRECT EFFECTS ON REVENUE

The Chancellor was most grateful for your very interesting note of 4 March. On balance, he agrees with you that since the numbers are - inevitably - highly speculative, there is a strong case for not incorporating them in the published FSBR costings, given the uncertainties involved. But they are useful as background.

ACSA

A C S ALLAN

COPY NO. 7 OF 9.

FROM: A P HUDSON
DATE: 8 March 1988

PWP

MR CULPIN

cc Mr R I G Allen
Miss Sinclair
Mr Pickford
Miss Simpson
Mr McManus - IR

NUMBER OF TAXES ABOLISHED

I think it would be worth somebody producing a definitive list of the number of taxes which the Chancellor has abolished.

2. By my reckoning, the score is now five sizeable taxes (IIS, NIS, DLT, CTT on lifetime gifts, and Capital Duty), and two other ones (on-course betting duty, and UTID). There is a case for counting Schedule B, though it seems odd to count a tax which actually costs us money. And there may be other minor ones that I have forgotten.

3. I did wonder about Supplementary Petroleum Duty and APRT. Mr McManus tells me that these were indeed abolished by this Government - but were also introduced by this Government, so there is not much to boast about.

4. If you agree that this would be useful, perhaps FP could check my list. And subject to what Mr Pickford and Miss Simpson think, it could then go in a suitable place in the Budget Brief.

APH

A P HUDSON

BUDGET SECRET: TASK FORCE LIST

COPY NO. 24 OF 24.

FROM: J M G TAYLOR
DATE: 7 March 1988

MR CAYLEY - 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
Mr Byatt
Mr Scholar
Mr Culpin
Mrs Lomax
Mr Odling-Smee
Miss Sinclair
Mr Riley
Mr Cropper
Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Beighton - IR
PS/IR

CGT EXEMPTION LIMIT:
EFFECT OF DECISION ON COMPARISONS WITH USA

The Chancellor was grateful for your minute of 2 March.

2. He has commented that the exempt slice will continue to be revalorised each year - ie the next revalorisation will be in 1989, not 1990 (cf. your paragraph 4).

J M G TAYLOR

INLAND REVENUE
STATISTICS DIVISION
SOMERSET HOUSE

Ch
Which one do you prefer?
AA

COPY NO 1 OF 20.

FROM: J R CALDER
DATE: 7 March 1988

Neither. The following, pls:
Income Tax (proposals)
CGT
Rebasing for individuals & trusts
Exempt amount
Charging gains @ income tax rates
Income Tax & CGT
Independent taxation in 1990
Income Tax & CT
Rebasing gains (other proposals)

CHANCELLOR OF THE EXCHEQUER

CAPITAL GAINS PROPOSALS: SCORECARD AND FSBR

See Annex A

1. The latest scorecard shows the capital gains proposals in the order adopted for table 4.1 of the FSBR in Miss Sinclair's minute of 2 March. You made no comment on this ordering in Mr Allan's minute of 4 March. This order (which differs from the previous scorecard ordering) puts the four proposals next to each other in the FSBR table. In commenting on an earlier version of Chapter 4 of the FSBR (Mr Allan's minute of 26 February) you asked for the proposals to be closer/next to each other.

---

cc PS/Financial Secretary
PS/Sir P Middleton
Mr Scholar
Mr Culpin
Mr Odling-Smee
Miss Sinclair
Miss C Evans
Mr Riley
Mr Scotter
Mr Isaac
Mr Pitts
Mr Cayley
Mr Gonzalez
Mr Quinn
Mr Ko
Mr Heggs
Mr McManus
Mr Calder
PS/IR

This ordering of the CGT measures is closest to the Budget Speech, & should be followed in Table 1.1 as well as 4.1.

2. In the current ordering, rebasing comes first, followed by assimilation to income tax for individuals and trusts and finally the exempt amount. The previous scorecard ordering was: exempt amount, assimilation, rebasing. Annex A sets out the scorecard figures on both bases.

3. If you wish the FSBR table to follow the **previous** scorecard order, we could move the section headed **capital gains tax** up immediately after the first section, **income tax.** The third section would be **income tax and capital gains tax** (containing independent taxation) and the following section would be **income tax and corporation tax.** Companies' rebasing would move to the top of this section. Annex B shows how this would look in outline. This arrangement has the advantage of introducing the CGT proposals before independent taxation, but there would be seven items between the two rebasing lines. An alternative would be make **capital gains tax** the third section. This would bring the rebasing items closer; but independent taxation would come before the CGT proposals.

4. We should be grateful for early confirmation of the present FSBR ordering of the capital gains proposals or an indication that you wish to change the order to one of the two ways suggested in para 3 above.

JR

J R CALDER

ANNEX A

ANNEX A

Capital Gains Proposals

£ million

	1988-89	1989-90	1990-91	1991-92
current scorecard order				
rebase to 1982				
- for companies	-25	-235	-490	-590
- for individuals as trusts	neg	-55	-150	-200
add gains to income and tax at IT rates	+70	+65	+75	+120
CGT exempt amount	neg	+15	+35	+50
TOTAL	+45	-210	-530	-620
previous scorecard order				
CGT exempt amount	neg	+30	+45	+50
add gains to income and tax at IT rates	+70	+70	+55	+80
rebase to 1982				
- for individuals and trusts	neg	-75	-140	-160
- for companies	-25	-235	-490	-590
TOTAL	+45	-210	-530	-620

ANNEX B

ANNEX B

FSBR ordering of gains proposals following previous scorecard order.

Income tax

[proposals]

Capital gains tax

Annual exempt amount
Charging gains of individuals and trusts at income tax rates
Rebasing gains of individuals and trusts to March 1982
Retirement relief
Building and Cooperative Society shares
Homes provided for dependent relatives

Income tax and capital gains tax

Independent taxation of income and chargeable capital gains of husband and wife from 1990-91
Business Expansion Scheme [ ]
Business Expansion Scheme [ ]
Personal Equity Plans [ ]

Income tax and corporation tax

Rebasing capital gains of companies to March 1982
[Other proposals]

FROM: J J HEYWOOD

DATE: 8 March 1988

MISS R A DYALL - IR

cc PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Culpin
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Call
PS/IR

INDEPENDENT TAXATION

The Financial Secretary was most grateful for your minute of 4 March and was content with the draft letters.

2. The Financial Secretary does not intend to see the WNC. Mr Cropper has agreed to provide a draft letter to Dame Joan Seccombe.

J J HEYWOOD
Private Secretary

CONFIDENTIAL

12/11

CHANCELLOR OF THE EXCHEQUER'S OFFICE: MEETING

SUBJECT	TAX REFORM
DATE AND TIME	THURSDAY 12 NOVEMBER 3.00 → 5.00PM
VENUE	Chancellor's Room, Treasury~~/No.11/Conference Room/House of Commons~~
PAPERS	
THOSE ATTENDING	FST SIR P. MIDDLETON SIR T. BURNS MR CASSELL MR SCHOLAR MR CROPPER MR TYRIE MR BATTISHILL MR ISAAC MR MACE MR CAYLEY } I/R MISS SINCLAIR MR RILEY MR SCOTTER MR CALDER MR GONZALEZ } I/R CC MR BYATT MR ALLAN

Alex — Are you content to go ahead with this meeting on 12/11. from 3-5 pm without Mr Byatt?

Julie
9/10

Tony pl
confirm for 12/11.

CHANCELLORS MEETING

CONFIDENTIAL

BF TONY

5/10

1. SUBJECT Tax Reform - 2hrs

2. LOCATION. HMT.

Tony check Mace on Wed then I'll spk to Alex. Julie 5/10.

JULIE MR MACE RETURNS ON 7/10 SHALL I KEEP IT TILL THEN [illegible]

TONY 5/10

CAST LIST	'PHONE NO'	DATE + TIME 12/11 3.00-5.00	11/11 2.00-4.00	13th		
FST.		✓	✓			
Pem.		✓	✗			
Sir T.B.		✓	✓ P			
Byatt.	5135	WASHINGTON				
Cassell.	5181	✓	✓			
Scholar.	5264	✓	✓			
Cropper.		✓	✓			
TR → Battishill	2541 6615 (6384)	CHANCELLOR [illegible] VISIT IN TELFORD	[illegible] ✓	13th		
Isaac * ~~KKKK~~	2541 6678 (6430)	✓	✓			
Mace.	2541 6546	✓	✓	WEDNESDAY.		
Cayley.	2541 7427	✓	✓			

* to be invited to bring statistician.

PAPERS

MTG NOTICE SENT :

CONFIDENTIAL.

BUDGET SECRET: TASK FORCE LIST

COPY NO. 12 OF 13

FROM: A C S ALLAN
DATE: 8 March 1988

MR CALDER - IR

cc PS/Financial Secretary
PS/Sir P Middleton
Mr Scholar
Mr Culpin
Mr Odling-Smee
Mr Riley
Miss Sinclair
Miss C Evans
Mr Scotter

PS/IR

CAPITAL GAINS PROPOSALS: SCORECARD AND FSBR

The Chancellor was grateful for your minute of 7 March. The ordering he wishes used for table 4.1 (and table 1.1) follows that in the Budget Speech:

Income Tax

[Proposals]

CGT

Rebasing for individuals and trusts
Exempt amount
Charging gains at income tax rates
....

Income Tax and CGT

Independent taxation in 1990
....

Income Tax and CT

Rebasing gains
...

2. He would be grateful for a revised version of your Annex A with the ordering on this basis.

ACSA

A ~~C S~~ ALLAN

ps3/25T

BUDGET SECRET: TASK FORCE LIST

COPY NO. 8 OF 9 .

FROM: J M G TAYLOR
DATE: 10 March 1988

PS/FINANCIAL SECRETARY

cc Mr Scholar
Mr Culpin
Mr Cropper
Mr Pitts - IR
Mr Cayley - IR
PS/IR

CGT: GENERAL CHANGES

The Chancellor has noted that the press release on CGT sets out (paragraph 3) provisions to ensure that 1982 rebasing does not increase either the amount of a gain or the amount of a loss as compared with what the gain or loss would have been under the present regime.

2. He does not recall Ministers taking an explicit decision on this. He would be grateful if the Financial Secretary could consider the provisions in question afresh, in case there is a need to amend in Committee.

J M G TAYLOR

BUDGET SECRET: TASK FORCE LIST

INLAND REVENUE
STATISTICS DIVISION
SOMERSET HOUSE

COPY NO 1 OF 20

FROM: J R CALDER
DATE: 10 March 1988

PPS/CHANCELLOR (MR ALLAN)

CAPITAL GAINS PROPOSALS: SCORECARD AND FSBR

1. The version of Chapter 4 of the FSBR attached to Miss Sinclair's submission of 9 March incorporated the ordering of the capital gains proposals in your minute to me of 8 March.

2. I attach a table similar to those in Annex A of my minute of 7 March, setting out the figures as they would appear in the final scorecard. The reordering has not affected the costs of the individual items compared with the first of the two tables - headed current scorecard order - in Annex A of my previous minute.

J R CALDER

---

cc PS/Financial Secretary
PS/Sir P Middleton
Mr Scholar
Mr Culpin
Mr Odling-Smee
Miss Sinclair
Miss C Evans
Mr Riley
Mr Scotter
Mr Isaac
Mr Pitts
Mr Cayley
Mr Gonzalez
Mr Quinn
Mr Ko
Mr Heggs
Mr McManus
Mr Calder
PS/IR

Copy No. 1 of 8

FINANCIAL SECRETARY TO THE TREASURY

FROM: FINANCIAL SECRETARY
DATE: 11 March 1988

CHANCELLOR

cc Mr Scholar
Mr Culpin
Mr Cropper
Mr Pitts IR
Mr Cayley IR
PS/IR

Ch/ This follows a meeting which the FST had on this, following your comments.
25 11/3

Note @ end.

CGT: GENERAL CHANGES

I have looked again at the point you raised on CGT (Mr Taylor's minute of 10 March). This was referred to in Mr Cayley's minute of 1 July (paragraph 11) and I recall discussing it with the Revenue at the time.

2. Special measures are required to avoid rebasing creating some unfairnesses. For example without such measures a person currently sitting on a loss could end up paying tax on a gain he had not made (and if he were a higher rate taxpayer, he would face a tax rate of 40% and a lower annual exemption).

3. An extreme (but not impossible) case would be where a company's share price had collapsed in the early 1980s and had since recovered:

Acquisition Cost	:	1000
1982 Value	:	150
Disposal Value	:	900

4. If rebasing were applied to this case, with no special provisions, a loss of 100 would unexpectedly and unjustifiably be turned into a gain of 750.

5. The special provisions ensure that:

(i) where the gain since 1982 is greater than the gain the taxpayer has actually had, it will be restricted to the lower figure (with a mirror image provision for losses); and

(ii) where there is a gain since 1982 but a loss over the life of the asset (as in my example) or vice versa, these will be neither a gain nor a loss.

6. There were broadly similar rules in 1965 - though rather more complicated because we were not then operating within an existing tax - and I am sure the outside world will expect provisions of this kind. If we did not have them, we would lose some of the credit for rebasing.

Not precisely the same in '65, tho', so the Press Release won't cross-refer.

JF 11/3

M

NORMAN LAMONT

OK. But the FST has confined himself to the cases where the 'special measures' work to the taxpayer's advantage. There will equally be cases where they work to the taxpayer's disadvantage: eg example 4 in the IR press release.

N.

COPY NO 9 OF 9

FROM: J M G TAYLOR

DATE: 14 March 1988

PS/FINANCIAL SECRETARY

cc Mr Scholar
Mr Culpin
Mr Cropper
Mr Pitts - IR
Mr Cayley - IR
PS/IR

CGT: GENERAL CHANGES

The Chancellor has seen the Financial Secretary's minute of 11 March.

2. He is content to leave matters as they are. But he notes that the Financial Secretary has confined himself to the case where the "special measures" work to the taxpayer's advantage. There will equally be cases where they may work to the taxpayer's disadvantage: eg example 4 on the Inland Revenue press release.

J M G TAYLOR

NB See comment on next page (other direct passim)

INLAND REVENUE

Press Release

INLAND REVENUE PRESS OFFICE, SOMERSET HOUSE, STRAND, LONDON WC2R 1LB
PHONE: 01–438 6692 OR 6706

CGT: GENERAL CHANGES

[3x] 15 March 1988

TAXATION OF CAPITAL GAINS: GENERAL CHANGES

This will remove all liability to CGT on inflationary gains

The Chancellor proposes in his Budget a major reform in the general regime for the taxation of capital gains. The changes, which will apply to disposals on or after 6 April 1988, are:-

- only gains or losses accrued since 31 March 1982 will be brought into account.

- the charge to capital gains tax at 30% is to be abolished. Instead gains will be chargeable to capital gains tax

  - for individuals, at the rates that would apply if they were the top slice of income;

  - for trustees of accumulation and discretionary settlements, at a rate equivalent to the basic plus additional rate;

  - for other trustees and for personal representatives, at a rate equivalent to the basic rate of income tax.

Companies' capital gains will continue to be taxed at corporation tax rates.

As part of these changes it is proposed that for 1988/89 the annual exempt amount should be reduced from £6,600 to £5,000 for individuals and from £3,300 to £2,500 for most trustees.

Other proposals concerning the taxation of capital gains are dealt with in the appropriate Press Releases.

/DETAILS OF THE PROPOSALS

DETAILS OF THE PROPOSALS

REBASING

Background

1. At present, the base date for capital gains tax and corporation tax on companies' gains is 6 April 1965. This means that the tax charge is confined to gains accruing from 6 April 1965 and that only capital losses accruing from that time are allowable against gains.

New base date

2. It is proposed to move the base date forward from 6 April 1965 to 31 March 1982 - the date which already applies for some indexation purposes. Subject to paragraphs 3 and 4 below gains and losses accruing on the disposal of assets held on 31 March 1982 will be computed on the basis that such assets were acquired at their market value on that date. Rebasing will apply to the gains of all taxpayers, whether individuals, trustees, personal representatives or companies.

Example 1

An asset is disposed of at a gain under the present regime of £50,000. The gain since 31 March 1982 by reference to the market value of the asset on that date is £10,000. The chargeable gain will be £10,000.

Special circumstances

This is [illegible] not. When was it agreed?

3. There will be provisions to ensure that 1982 rebasing does not increase either the amount of a gain or the amount of a loss as compared with what the gain or loss would have been under the present regime (after taking account, where appropriate, of the rules for assets held on 6 April 1965). Where there is a gain since 31 March 1982 and a loss under the present regime, or vice versa, the result will be no gain/no loss. Where under the present regime for assets held on 6 April 1965 the disposal would be treated as taking place at no gain/no loss, rebasing will not alter the position.

4. The effect of these proposed rules is illustrated in the following examples. For simplicity, these ignore indexation and any other reliefs or exemptions due.

Example 2

An asset is disposed of at a gain under the present regime of £12,000. The gain since 31 March 1982 by reference to the market value of the asset on that date is £17,000. The chargeable gain will be £12,000.

/Example Three

Example 3

An asset is disposed of at a loss under the present regime of £8,000. The loss since 31 March 1982 by reference to the market value of the asset on that date is £19,000. The allowable loss will be £8,000.

Example 4 (no gain/no loss: assets acquired after 6 April 1965)

An asset is disposed of at a gain under the present regime of £23,000. There is a loss of £13,000 since 31 March 1982 by reference to the market value of the asset on that date. The result will be no gain/no loss.

RATES OF CAPITAL GAINS TAX

Background

5. At present, the chargeable gains of individuals, trustees and personal representatives are chargeable to capital gains tax at 30%. The rate of capital gains tax has remained unchanged since the introduction of the tax in 1965.

Individuals

6. It is proposed that the gains of individuals will be chargeable to capital gains tax at rates equivalent to the rates of income tax that would apply if gains were treated as the top slice of income. Accordingly, and depending on the level of an individual's income, gains will be chargeable at rates equivalent to either the basic rate of income tax, the higher rate of income tax, or partly one and partly the other.

Example 5

An individual has taxable income for 1988/89 (after reliefs and allowances) of £12,000 and gains above the annual exemption of £4,000. When treated as the top slice of income, the gains of £4,000 do not result in the income tax higher rate threshold of £19,300 being exceeded. Accordingly, the gains will be chargeable to capital gains tax at a rate equivalent to the basic rate of income tax. (ie 25 per cent)

Example 6

An individual has taxable income for 1988/89 (after reliefs and allowances) of £15,000 and gains above the

/annual exemption

annual exemption of £11,000. When treated as the top slice of income, the gains of £11,000 result in the income tax higher rate threshold of £19,300 being exceeded. Accordingly, gains of £4,300 will be chargeable to capital gains tax at a rate equivalent to the basic rate of income tax and gains of £6,700 chargeable at a rate equivalent to the higher rate of income tax.(ie 40 per cent)

Trustees and Personal Representatives

7. It is proposed that in general the gains of trustees and personal representatives will be chargeable to capital gains tax at a rate equivalent to the basic rate of income tax. The gains of trustees in respect of accumulation and discretionary settlements which are within the scope of the income tax additional rate charge will be chargeable at a rate equivalent to the sum of the basic rate and the additional rate (ie 35%).

Husband and Wife

8. At present, where a husband and wife are living together, the chargeable gains and allowable losses of each spouse are computed separately but, in general, the resulting total is assessed on the husband unless an election for separate assessment to capital gains tax has been made. For 1988/89 and 1989/90 the gains of the wife will continue to be assessed on the husband. Under the reform, this means that the couple's aggregate gains will be taxed (broadly as with investment income now) at the rates that would apply if they were the marginal slice of the husband's income. As now, a husband and wife will share one annual exemption.

9. Where a separate assessment election applies, the total tax payable on the married couple's gains will be unaltered, but it will be split up in proportion to their respective chargeable gains.

Example 7

In 1988/89 a wife has gains of £10,000 and the husband has gains of £30,000. A separate assessment election is in force. The annual exemption of £5,000 is split between them proportionately to their gains, so that the wife has exemption on £1,250 and the husband on £3,750, leaving chargeable gains of £8,750 and £26,250 respectively. The total capital gains tax chargeable is £12,000. The tax will be split up as follows:-

Wife's tax : $\frac{£8,750}{£35,000} \times £12,000 = £3,000$

Husband's tax: $\frac{£26,250}{£35,000} \times £12,000 = £9,000$

/10. In the year

10. In the year of marriage, or if the married couple are living apart throughout the year, husband and wife are normally treated as two single people. It is not intended to alter these arrangements.

11. For a year in which a married couple separate or divorce, the wife is treated in effect as a single person from the date of separation or divorce. The detailed rules will be adapted to take account of the abolition of the flat 30 per cent rate of capital gains tax.

12. From 6 April 1990, it is proposed that married couples should be taxed independently on their capital gains, with separate annual exemptions, and so different rules will apply. These are described in a separate Press Release.

Underwriters

13. There will be provisions adapting the new proposed rates of capital gains tax to Lloyds Underwriters.

Companies

14. Capital gains of companies will continue to be chargeable to corporation tax at normal corporation tax rates. The special 30% rate of corporation tax on gains which life assurance companies earn for their policyholders will remain unchanged pending the review of life assurance taxation announced on 3 July 1987.

LOSSES

15. Realised capital losses carried forward from 1987/88 and earlier years will remain available for carryforward against gains in 1988/89 and subsequent years. The computation of these losses will not be affected by rebasing.

COMMENCEMENT

16. The changes outlined in this Press Release will apply to disposals on or after 6 April 1988. Disposals before that date will continue to be dealt with under the existing regime.

Not at all a satisfactory way to proceed. The provisions in question should have been formally put to the FST for his consideration — esp since I question their wording @ the time. He will need to consider afresh how, in case there is a need to amend in Cttee.

2. Is Mr Cayley saying that the treatment he is proposing is precisely analogous to that which applied when the tax was first introduced in 1965? If so, the Press Release should say so.

N

CHANCELLOR OF THE EXCHEQUER

Ch.

CGT.

You asked about the "no gain/loss" provision.

2. The question is posed in para 11 of Mr Cayley's note, below ("Top flagged "A"). Your marginalia queried whether this was necessary. Mr Kuczys' reply of 10 July (flagged B) however, did not touch on the point, & the Revenue therefore assumed that you agreed that it was necessary.

3. These seem to be the only references to the provision in the papers.

[initials]

10/3