PO-CH/NL/0103

PART A

SECRET

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PO -CH /NL/0103

PART A

BUDGET 1988 FRINGE BENEFITS

DD's 25 years NARS 10/8/95.

16-2-88

PO -CH /NL/0103

PART A

BUDGET SECRET: TASK FORCE LIST

Inland Revenue

Policy Division
Somerset House

Copy No 2 of 24

FROM: M PRESCOTT
DATE: 12 JANUARY 1988

1. MR LEWIS

2. FINANCIAL SECRETARY

FRINGE BENEFITS TAX: AMBIT AND DE MINIMIS LIMIT FOR SMALL PROVIDERS

1. We are pressing ahead in working up details of the scheme and in preparing instructions for Parliamentary Counsel. Inevitably, there will be various more detailed but still quite important points on which we shall need to consult as we progress, and this note

- explains what we propose concerning the ambit of the tax (ie who shall be liable to FBT, and in respect of what)
- considers the possibility of a de minimis limit for small providers of benefits, and makes recommendations.

AMBIT OF THE CHARGE

2. We are proceeding on the assumption that, with one exception, although the liability for tax on fringe benefits is

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cc PS/ Chancellor
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Scholar
Mr Culpin
Ms Sinclair
Mr Michie
Mr Cropper
Mr Tyrie
Mr Jenkins (OPC)
Mr Isaac
Mr Beighton
Mr Lewis
Mr Prescott
Miss Rhodes
Mr Easton
Mr Northend
Mr Hodgson
Mr Geraghty
PS/IR

being shifted from employees to employers/providers, coverage of the tax will be broadly the same as at present. That is to say, FBT is to apply only in respect of those benefits which would at present be chargeable to income tax under Schedule E in the hands of the recipient. The exception concerns those benefits to which the special rules apply, but which are received by "lower paid" employees. At present such benefits are not taxable; under the new regime they would be, albeit on the provider/employer rather than the employee.

3. We also propose that, normally, it should formally be the provider of the benefit, rather than the employer, who is liable to FBT - though in practice, of course, they will in the great majority of cases be the same person especially as "provider" will be defined as the person at whose cost the benefit is provided. If the liability was formally made that of the employer, there would be difficulties in the case of third party benefits because employers might not be aware of (or might pretend not to know of) what benefits had been received by their employees, or the value of those benefits. This could be a real problem in large groups of companies.

4. In essence, therefore, FBT will apply to any person who provides taxable benefits to another person by reason of that person's office or employment, the emoluments from which are (or would be if there were any) chargeable to income tax under Schedule E. As at present, a charge would also arise where the benefit was provided to someone else being a member of the employee's family or household.

5. It also follows, of course, that FBT will apply to all providers, regardless of the form or legal status of their organisation. Specifically, it will apply to

- sole traders and partnerships in respect of benefits provided to their employees. (FBT will not apply to the self-employed - ie benefits provided to the sole trader or partner himself)

- companies and incorporated associations

- trusts
- charities
- Government Departments, Local Authorities, and other public sector bodies.

Collection of tax from other than providers

6. In most cases the employer and the provider will be the same person, and there will be a "UK presence" such that there will be someone within UK tax jurisdiction from whom we can actually collect the tax owing. But in certain cases, the provider and/or employer may not be resident in the UK, or otherwise have a presence here, such that there would be no one within UK tax jurisdiction from whom FBT could be collected. This could happen where

(a) the provider was also the employer, but there was no UK presence at all

(b) the benefit was supplied by and at the cost of a third party provider who had no UK presence, but where the employer of the person receiving the benefit did have a UK presence

(c) as at (b) above but where the employer did not have a UK presence either

7. We clearly need to cater for these possibilities in the legislation. Otherwise, there would be obvious loopholes and opportunities for abuse - eg the employee of the American Bank working in London and living rent-free in expensive West End accommodation owned (and therefore "provided") by an Isle of Man company.

8. In theory, one option would be to continue in these cases to assess the employees concerned to income tax under Schedule E in respect of any benefits received. But this would entail having to retain all the existing benefits legislation as a

separate charge under Schedule E, just for what in practice is likely to be a relatively small number of employees and office holders. It might also positively encourage just the kind of artificial and contrived arrangement it was designed to catch, bearing in mind that with an FBT rate of 45%-50% benefits provided to basic rate taxpayers will be "overtaxed" compared to the rate at which they would bear tax under Schedule E and so there would be a positive incentive to exploit any loophole that existed in order to get such benefits out of FBT and back into Schedule E.

9. The alternative, therefore, would be to try to recover the FBT from someone other than the provider in these cases. As regards (a) and (c) above, the only other person to whom we could turn is the employee. As regards the cases at (b) we could alternatively turn to the employer. But this might be criticised as unfair in that the benefit in these cases will have been provided by a third party, perhaps even unbeknownst to the employer, and of course it will be the employee - not the employer - who will have benefited.

10. On the other hand, there are precedents already for making the employee liable. Though unusual, this is a situation we confront from time to time already with PAYE with certain kinds of employee including

(a) locally employed staff of foreign embassies in London and of other international organisations with offices here

(b) employees of overseas companies who do not have a presence here (eg someone employed as a sole representative in the UK) and so who cannot be compelled to operate PAYE

11. In these cases, we have had to concede that there is no "taxable presence" in the UK for PAYE purposes, and we are therefore able under the PAYE Regulations to assess the employee directly without the operation of PAYE with the tax being paid in four equal instalments. (There is a second, even smaller group of employees who hold certain types of office or employment for which the normal PAYE procedure is unsuitable but who, in agreement with the Inspector, can be trusted to apply the PAYE tables themselves and then remit the tax to the Collector.)

12. Subject to your agreement, therefore, we propose that in the circumstances described at paragraph 6 there should, where FBT cannot be recovered from the provider, be a provision to enable it to be collected from the employee instead. This may be criticised on the grounds that we shall, thereby, be making the employee liable for someone else's tax, but there seems no way round this. To mitigate matters, however, we also propose (subject to advice from our Solicitor on feasibility) that recourse here should be to the employee in his capacity as agent of the provider whose liability it really is, so at least giving the employee the right to pursue the provider for restitution.

13. Subject to your agreement, we also propose that it should be possible to have recourse to the individual concerned in cases where as a director of a company which becomes insolvent he has contrived to receive benefits free of tax. There is already a parallel provision in PAYE (strictly speaking this relates to employees generally, but in practice we use the Regulation only against directors and almost exclusively when the company of which he is a director becomes insolvent).

SMALL PROVIDERS

14. As noted, FBT will apply to any employer who provides taxable benefits to his employees by reason of their office or employment, the emoluments from which are chargeable Schedule E. But that will include small or occasional providers of small

benefits - eg the occasional lift home at night provided by an employer for his domestic staff - and cases like this could obviously clog up the system and cause a disproportionate amount of work for employers concerned, and ourselves. It is for consideration, therefore, whether there is some reasonably simple and clear cut de minimis rule by which such cases could be excluded from FBT.

15. The options are considered in the note attached. As you will see, we think that there is quite a strong case for such a limit, but that to avoid recreating some of the very problems FBT is supposed to overcome, we believe that this has to be expressed in terms of an exempt amount per employer, rather than per employee. Accordingly, as explained in the note, we recommend that FBT should not apply where

- the total net taxable value of the benefit and expenses payments given by the provider in any year does not exceed £500.

But this de minimis limit would not apply where the benefits were those provided by a company to persons who were directors with a material interest in that or an associated company.

TITLE FOR NEW TAX

16. It seems generally to have been accepted that the new tax shall be known as "Fringe Benefits Tax". We ourselves have nothing better to suggest, and the various alternatives - "Employers' Benefits Tax", "Expenses and Benefits Tax", "Employment Benefits Tax" - all have obvious disadvantages. Nevertheless, this is something that perhaps ought positively to be endorsed by Ministers and not simply go by default, bearing in mind that whatever title is chosen will, for example, become firmly embedded in the legislation itself.

CONCLUSION

17. May we know please if

(a) as regards the ambit of FBT, you are content for us to frame the legislation on the lines described in paragraphs 2 to 5 above, and

(b) to incorporate reserve powers for collecting FBT from employees in the circumstances described in paragraphs 6 (and 13) above and on the basis described in paragraph 12?

(c) as regards "small providers", do you agree with the form and level of our recommended de minimis limit summarised at paragraph 15?

(d) as regards the title, are you content for the tax formally to be known as "Fringe Benefits Tax"?

M PRESCOTT

FBT: "SMALL PROVIDERS"

1. One suggested advantage of an FBT is the ability to include certain small benefits which, for various reasons, may be more difficult to tax under the present employee-based system. On the other hand, FBT will apply to any employer who provides taxable benefits to his employees by reason of their office or employment, and that will include small providers of small benefits - eg the occasional lift home at night provided by an employer for his domestic staff, a trivial benefit given by the small shopkeeper to someone working for him, perhaps part-time, etc. Cases like this could clog up the system and cause a disproportionate amount of work for employers concerned. (Despite its other drawbacks, the P11D threshold will usually have operated to exclude such benefits under the present system). The question is, therefore, whether there is some reasonably simple and clear cut de minimis rule by which such cases could be excluded from FBT.

2. In practice, any such limit would have to be expressed quantitatively - ie in terms of an exempt amount per employee, or per employer, or some combination of the two. It would not be practicable to try defining the particular kinds of situation (ie the type of employer, the type of benefit and the circumstances in which it was provided) where, if the conditions were satisfied, FBT exemption would apply. And even if this were possible, it is highly unlikely that any such rule would be simple or clear cut.

3. One approach would be to have a standard de minimis limit per employer, so that FBT would only apply (but on the full amount) if that limit was exceeded. Any such limit would, of course, be arbitrary but it would need to be set at a level that was

(a) high enough so that genuinely small providers would know - without having to bother to work it out - that they were clearly below the limit, but

(b) not so high that, for an employer with only one or two employees, it would in effect still permit quite sizeable tax-free benefits per employee.

4. This suggests a limit of about, say, £500. To ensure equity of treatment as between one employer and another, it would have to relate to the net taxable amount of the benefit or expense payment - ie the gross value of the benefit less anything contributed by the employee and/or any expenses deduction that he would otherwise be entitled to. In marginal cases - ie at or close to the limit - this would still involve putting the small provider to the trouble of actual working out the value of any benefits provided in order to determine whether or not he was liable - but that would be unavoidable in marginal cases with any such limit. By pitching the figure reasonably high, however, it would be clear enough to most genuinely small providers that they were excluded.

5. Without some further qualification, however, this approach would extend to "one man" companies and enable the controlling director in such a company to award himself still quite sizeable benefits of up to £500, tax free. In order to help target the relief more narrowly on the particular kind of small provider for which it would be intended, therefore, the de minimis limit would not apply in cases involving provision of benefits by a company to a director having a material interest in that or an associated company.

6. An alternative approach would be to have an exempt amount per employee - again relating to the net, taxable amount. This would overcome the particular difficulty at 3(b) above with an employer-related limit. But there are three main drawbacks

(a) there would be an additional burden for employers in determining whether each employee had in aggregate received taxable benefits in excess of the permitted limit; one advantage claimed for FBT is that it saves the employer having to record benefits per employee

(b) introduction of such a limit might encourage tax-free remuneration in kind at least up to the level of the limit. This would add to cost which, with 20m or so employees, could be very high. To contain cost, the limit would have to be set at a very low level but

(c) following on from (b), this would not then help with the primary objective of excluding the genuinely small provider.

7. A third possibility, therefore, would be a combination of the above two approaches. For each employer there would be a de minimis limit of

- say, £500 or

- an amount equivalent to, say, £100 per employee

whichever was the greater.

8. Under the second or third approaches above, the employee-related limit would remove the need for the present benefit-related de minimis limits, such as the £35 limit for Christmas parties. The only statutory benefit-related de minimis limit is the £200 limit for cheap loans, but the Financial Secretary has agreed that this should be dropped anyway.

9. A fourth possibility would be not to have any formal, explicitly stated de minimis limit or rule at all, but to rely instead on administrative practice - with a strong steer to Districts to act pragmatically and flexibly in particular cases

of difficulty. If in the light of experience difficulties remained, instructions to Districts could be refined accordingly and, but only as a long stop, if necessary a statutory approach could then be considered.

10. But there are likely to be questions from the outset about whether there is to be a de minimis limit or rule, and comforting noises about pragmatism and flexibility would not help the small provider who would want to know for certain whether or not in his particular case FBT would apply. Moreover, Ministers would probably wish for presentational reasons to make a virtue of a de minimis limit if there was to be one, by announcing it and building it into the scheme from the outset. This suggests that it would have to be given statutory effect.

Conclusion

11. There are pros and cons for each of these options, and none is ideal. On balance, however, the first option - a de minimis limit per employer - probably comes closest to meeting the desiderata; a simple and clear cut rule that would serve to exclude genuinely small providers of the kind described. To help target relief on the kind of small provider intended, however, this would not apply where the provider was a company and the recipient a director with a material interest in that or an associated company.

ps3/28T **BUDGET SECRET: TASK FORCE LIST**

COPY NO. 15 OF 16.

FROM: J M G TAYLOR
DATE: 13 January 1988

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Scholar
Mr Culpin
Miss Sinclair
Mr Michie
Mr Cropper
Mr Tyrie
Mr Isaac - IR
Mr Lewis - IR
Mr Prescott - IR
PS/IR

FRINGE BENEFITS TAX:
AMBIT AND DE MINIMIS LIMIT FOR SMALL PROVIDERS

The Chancellor has seen Mr Prescott's minute of 12 January.

2. He would be grateful for the views of all Ministers (and would welcome suggestions from other copy recipients) on the name of this tax.

J M G TAYLOR

BUDGET SECRET: TASK FORCE LIST

COPY NO 1 OF 16

FROM: S P JUDGE
DATE: 14 January 1988

PS/CHANCELLOR OF THE EXCHEQUER

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Mr Scholar
Mr Culpin
Miss Sinclair
Mr Michie
Mr Cropper
Mr Tyrie
PS/Inland Revenue
Mr Isaac - IR
Mr Lewis - IR
Mr Prescott - IR

Ch/ We await other suggestions. JF 14/1

FRINGE BENEFITS TAX

The Paymaster General has seen your minute of yesterday to PS/Financial Secretary.

He suggests "Benefits in Kind Tax (BIKT)", but acknowledges that this is simply to provide an acronym with a vowel.

My suggestions are:

"Tax on Perks (TOP)"; and (now the acronym will no longer be needed by others)

"Special Levy on Dubious Perks". 11 e o

S P JUDGE
Private Secretary

016/3650

BUDGET SECRET: TASK FORCE LIST ONLY

Copy No 1 Of 11

FROM: A G TYRIE

DATE: 14 JANUARY 1988

CHANCELLOR

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

Mr Mace - IR

COVENANTS AND MAINTENANCE

The Problem

This all looks very complicated. But the conundrum we are now faced with can be simply put.

One-Parent Benefit (OPB) is disallowed for cohabiting couples. Additional Personal Allowance (APA) is not: it goes to the parent whether he/she is cohabiting or not. So there is a penalty on cohabitation in the benefit system but not in the tax system.

Therefore, if we abolish the APA (make the tax system neutral on whether people have children) we cannot compensate all the APA losers with OPB. OPB would be disallowed for cohabitees. This gives us 150,000 losers (those cohabitees at present receiving APA).

We therefore seem to be faced with a choice of **either** accepting discrimination against cohabitees with children (they won't get the MCA) and only compensating APA losers who are not cohabiting; **or** we can opt to remain 'even-handed' between married and cohabiting parents, go for one of the modified options (keep APA but disallow double doses etc) and accept the knock-on effects for maintenance reform.

It would be a great pity to lose the tax simplification and reform which comes from the package of removal of maintenance

relief, abolition of the APA and increasing the OPB. So, can we keep the show on the road by finding a way to deal with the 150,000 losers?

Some wheezes to keep the radical package

One way could be to change the eligibility for OPB slightly. OPB is really a 'one-parent child benefit addition'. Could we make it payable to single parents even if they are cohabiting but prohibit double claiming with a penalty (loss of eligibility, for example)? This would wipe out the losers. It would cost about £55 million, the price paid for keeping the package intact. The main problem would be that the DHSS use the cohabiting principle for eligibility for other benefits, for example widows' benefit and means tested benefits. So DHSS would oppose this for fear of knock-on effects.

Another way of dealing with the 150,000 losers would be to brazen it out. We could claim that they didn't deserve the money in the beginning. There are some half-baked arguments we could use to justify this. For example, when APA was increased to the value of the MMTA in 1975 it was done in response to the Finer Report. It is fairly clear (although perhaps not crystal clear!) from the Finer Report that the increase in the APA was intended to compensate single parents, not cohabitees. The Report referred to 'the lone parent' and the 'additional expenses involved in going out to work and in bringing up a family single-handed'. Not water-tight, but a line to take.

Less radical options

If you don't think we can wear either of those options in my view we have to start dismantling the package. In that case I think the best route would be to keep the APA and ask the Revenue to police double claimants. We could still keep the maintenance package (probably a la Option 2A). But we would be left with the problem of future unmarried mother losers - in other words those who would lose from the lower value of maintenance payment orders.

The number of losers in this category would be very small. Of the 15,000 annual maintenance orders made for deserted unmarried mothers more than half are on income support. For them means testing makes anything we do on OPB or the APA irrelevant. And of the remaining 7,000 odd a significant number would benefit because maintenance payments are being made free in the hands of the recipient.

So we would be phasing out the losers and letting income support and family credit take the strain. And we would be losing the simplification that comes with the abolition of the APA.

Conclusion

I am still inclined on the radical side on this, but only just. The package as a whole (post UEL decision) would lose even more of its radical glitter if we were seen merely to be tinkering with the Covenants and Maintenance area. Option 2A does look a bit like tinkering. On the other hand, 150,000 ('deserving') losers doesn't look good. I would like to know by how much that number would be reduced by the rest of the budget before finally coming down on one side or the other.

AGT.

A G TYRIE

3975/17

BUDGET SECRET: TASK FORCE LIST

prep.

Copy No 1 of 15 Copies

FROM: P J CROPPER
DATE: 14 January 1988

MR J M G TAYLOR

Ch / See also Miss Sinclair's minute behind. dfs 16/1

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Scholar
Mr Culpin
Miss Sinclair
Mr Tyrie
Mr Isaac IR
Mr Lewis IR
Mr Prescott IR
PS/IR

Agreed EBT & FBT

FRINGE BENEFITS TAX:
AMBIT AND DE MINIMIS LIMIT FOR SMALL PROVIDERS

I would suggest "Employee Benefit Tax".

2. This would have the defensive merit of enabling us to say, when the envious complained about other people's luck, that tax was indeed paid on employees' benefits. Paid, furthermore, at the very high rate of 45/50 per cent. Nobody will understand why that is equivalent to income tax at a mere 25 per cent.

3. EBT is a good sturdy set of initials and the full name is accurately descriptive. The only people who may find it a little demeaning are the directors of proprietory companies.

P J CROPPER

4481/7/PN

BUDGET SECRET: TASK FORCE LIST

COPY NO 1 OF 14
FROM: MISS C E C SINCLAIR
DATE: 15 January 1988
cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Scholar
Mr Culpin
Mr Tyrie
Mr Cropper
Mr Isaac
Mr Lewis - IR
Mr Prescott
PS/Inland Revenue

PS/CHANCELLOR

FRINGE BENEFITS TAX: AMBIT AND DE MINIMIS LIMIT FOR SMALL PROVIDERS

We in FP cannot think of a better name than Fringe Benefits Tax. The same name could be used both in legislation and everyday speech; the initials are easily said; and it is suitably pejorative about benefits.

2. Can I sound a warning note about acronyms? We fell foul of someone else's trademark when we used the initials PEP for Personal Equity Plans, and we had to pay compensation. If Ministers wish to use an acronym for this tax, I think it would be wise for us to check first with the Trade Marks Registry in DTI. That does raise problems of confidentiality, though I suppose we might get round this by simply asking them to check whether anyone else uses the acronym . We need not say what the initials stand for.

3. If we call the tax Fringe Benefits Tax, we would be unlikley to use the initials other than internally (as CT for Corporation Tax etc). In that case I think there would be no problem.

CAROLYN SINCLAIR

020/3650

BUDGET SECRET: TASK FORCE LIST

Copy no 1 Of 4

FROM: A G TYRIE

DATE: 15 JANUARY 1988

CHANCELLOR

cc Mr Cropper

THE BUDGET PACKAGE, FURTHER THOUGHTS

1. The more I think about it the more I think that a slice of health spending in the budget would be disastrous for public expenditure control for the life of this Parliament. As I mentioned, it would set a nasty precedent, and would severely weaken the use we make of 'the language of priorities' in the PESC round. I forgot to mention that it would come on top of the problems generated by a negative PSBR.

2. I remain a strong supporter of 24/40. I am fairly sure you do not want to reopen the UEL question. But I would just point out that with 24p, the UEL at the 7% (contracted out) rate, and phasing, there would be no losers in the kink at all and a number of people would be substantial gainers. What's more, this 'ex-UEL' 24/35 package would leave us in pocket compared with 24/40.

A G.

A G TYRIE

4481/12 /PN

BUDGET SECRET: TASK FORCE LIST

COPY NO 4 OF 5

FROM: MISS C E C SINCLAIR
DATE: 19 January 1988

MR MICHIE

cc Mr Culpin
Mr Riley
Mr A Hudson

FBT: OUTLINE PRESENTATION

It was agreed at Chevening that on Budget Day there might be a booklet on the new Fringe Benefit Tax. This would be included in the standard 'Budget pack'. But it would be aimed primarily at employers.

2. I offered to send the Revenue an outline of what the booklet should contain. I attach a rough first draft.

3. I assume that the booklet would be designed

(a) to help sell the tax to MPs, journalists and employers, (though the last may be a vain hope);

(b) to give employers an early indication of how the tax will work.

If the booklet is to meet (a), it cannot afford to go too far on (b). I assume that at a later stage the Revenue will publish detailed information to be used by employers from 1990-91 onwards eg on the valuation rules.

4. Many of the details of FBT are still in the air, so it will be difficult at this stage for the Revenue to flesh out the sections on administrative costs and valuation. But there are some general points which we could consider now:

(i) The outline is explicitly critical of fringe benefits. Is this sensible, and if so, can we think of additional arguments against them?

(ii) Should we formally scrap P11Ds, because of the odium they attract, and call the returns which will still be needed in respect of individuals (in some cases) something else?

(iii) Can we risk describing the new arrangements as a simplification when employers and their supporters are likely to make a major meal out of any changes in procedures?

(iv) Is it the intention to consult employers before the administrative details are all carved in stone in the Finance Bill?

Points (ii) and (iv) are largely for the Revenue, and I will raise them when I send the outline to Mr Lewis. I think some consultation with employers would be tactically wise, though clearly we have to settle and announce the main features of the tax at the outset.

5. I have promised to send something to the Revenue by the end of the week. It would be very helpful to have comments from you and copy recipients by noon on Friday, 22 January.

CAROLYN SINCLAIR

4481/11/PN

BUDGET SECRET: TASK FORCE LIST

FRINGE BENEFITS TAX

OUTLINE PRESENTATION

Introduction

- Widespread use of fringe benefits by employers primarily a UK phenomenon: not found to same extent either in US or in other EC countries [true?]

- Distortionary and divisive: distortionary because it helps to conceal real level of earnings in the economy, divisive because it encourage "them" and "us" attitudes in businesses.

- [Fringe benefits have no place where pay is freely negotiated and income tax rates are low.]

Present system

- Valuation of fringe benefits in hands of individuals notoriously difficult. Present system seriously undervalues some benefits, notably cars. Result is "tax break" for [1.3] million or so people who receive benefits at cost of all other taxpayers.

- System also requires employers to return P11D form in respect of every employee earning over £8,500, whether he/she receives benefits or not.

Proposals

- Government proposes that, from 1990-91, benefits should be taxed in hands of employers rather than employees.

- The rate of [Fringe Benefits Tax] would be 45 per cent.

The cost of providing benefits would be deductible for calculating profits, but the Fringe Benefits Tax itself would not be deductible.

- Employees would pay no income tax on benefits (any exceptions?]

- Coverage of FBT [broadly as now/or not.]

- Lump sum expense allowances would not be taxed.

- Tax would apply to benefits provided to employees of any incorporated or unincorporated firm, or self-employed/partnerships etc. It would not apply to the self-employed or partners as such.

Administrative arrangements

- P11D forms would be scrapped.

- Arrangements for returning lump sum expense allowance payments - how often?

- Fringe Benefits Tax will be payable quarterly in arrears. Returns will also be made on a quarterly basis.

- ? link with PAYE payments.

Valuation rates

- Valuation rules to help employers calculate the basis for the new tax will be published [well in advance of 1990-91] [date?]

- Anything general which can be said about principles underlying approach to valuation?

PN

BUDGET SECRET: TASK FORCE LIST

Simplification

- New approach will be a substantial simplification for employees, who will no longer have to keep records of benefits received and negotiate on tax liability with the Inland Revenue.

- Should also produce compliance benefits for many employers - latter will be able to dispense with individual P11D returns - can make single quarterly return covering all employees.

- [Anything more to be said on simplification for employers?]

Hope so.

Consultation

- Commitment to consult employers on details of administrative arrangements? - if so, in what timescale?

Conclusions

- Government believe proposed approach will put taxation of benefits on more satisfactory basis - overall costs of running the system will be reduced.

- Amount of additional tax paid by employers ultimately a matter of choice. Employers always have the option of avoiding Fringe Benefits Tax by replacing benefits by cash. Two years on which to renegotiate remuneration packages to achieve this.

RH13.40 BUDGET SECRET: TASK FORCE LIST

COPY NO 5 OF 7

FROM: A P HUDSON
DATE: 20 January 1988

MISS SINCLAIR

cc Mr Culpin
Mr Riley
Mr Michie

FBT: OUTLINE PRESENTATION

Thank you for sending me a copy of your 20 January minute. My views on the general points in your paragraph 4 are as follows:

(i) I am a bit nervous of too much moralizing about fringe benefits. The Government keeps saying it believes in free markets, and that employers must decide what they can afford to pay their staff. The logic of this is that, if they choose to pay fringe benefits, that is up to them.

(ii) Scrapping PllDs sounds a good idea.

(iii) I think we have to present the new arrangements as a simplification, albeit a simplification all round - ie. simpler for employees, simpler for the Revenue, and no worse for employers. Otherwise it is very difficult to explain what we are achieving though FBT that could not have been achieved by other means.

(iv) Consultation sounds sensible to me, but, as you say, it is mainly for the Revenue to advise.

2. On the outline, my only suggestion is for a different approach to the first couple of sections. I attach a draft.

A P HUDSON

ps4/14H

BUDGET SECRET: TASK FORCE LIST

COPY NO. OF .

FBT: DRAFT REVISED OPENING

Introduction

Government proposes to reform taxation of fringe benefits, to make system simpler, fairer, and more comprehensive.

The problem

- Under present regime, fringe benefits are proliferating, and administration increasingly cumbersome.
- Benefits are proliferating mainly because they are under-taxed relative to earnings. Unfair on those who do not get benefits. And divisive, because encourages "them and us" attitude in businesses. Fringe benefits principally a UK phenomenon [if true].
- Administration is cumbersome: employers have to return P11D form for every employee earning over £8,500, whether he/she receives benefits or not; Revenue have to examine them; employee then has to pay tax.
- If no action taken, problem likely to get worse.
- Government has therefore decided on major reform.

42/2.BTW.4374/53

BUDGET SECRET
TASK FORCE LIST

Copy No. 2 of 15

FROM: J J HEYWOOD
DATE: 20 January 1988

MR PRESCOTT IR

cc PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Scholar
Mr Culpin
Miss Sinclair
Mr Michie
Mr Cropper
Mr Tyrie
Mr Jenkins OPC
Mr Lewis IR
PS/IR

FRINGE BENEFITS TAX: AMBIT AND DE MINIMIS LIMIT FOR SMALL PROVIDERS

The Financial Secretary was grateful for your submission of 12 January and is content with all your recommendations, including recommendation (d) on which the Chancellor asked for comment.

JEREMY HEYWOOD
Private Secretary

BUDGET SECRET: TASK FORCE LIST

Copy 13A

PLP

Inland Revenue

Policy Division
Somerset House

COPY NO 15 OF 32

FROM: P LEWIS

DATE: 22 JANUARY 1988

cc Mr. Riley
(130) Mr. Nicholl
Orchard, Pd.

Chancellor

FRINGE BENEFITS

1. Mr Allan's minute of 19 January asked if we would look at a further option for benefits if FBT were not introduced. I am sorry we could not manage a note to the original timetable.

2. The proposition is

- abolish the £8,500 P11D limit
- for the employee, exempt "difficult" benefits eg canteens, sports facilities and workplace nurseries
- for the employer, disallow the cost of the exempt benefits as a business expense in calculating taxable profits.

Abolishing the £8,500 P11D threshold

3. We assume that, if announced in the Budget, this would take effect from the following year (1989/90) to allow time for employers and ourselves to carry out the necessary preparatory work.

---

cc Chief Secretary
Financial Secretary
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Sir P Middleton
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Mr Anson
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Mr Scholar
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Miss Sinclair
Mr Cropper
Miss Evans
Mr Cropper
Mr Tyrie
Mr Call
Mr Battishill
Mr Isaac
Mr Painter
Mr Beighton
Mr McGivern
Mr Lewis
Mr Prescott
Miss Rhodes
Mr Mace
Mr Northend
Mr Hodgson
Mr R H Allen
Mr I Stewart
PS/IR

160

4. The main effects would be

- an increase in the number of taxpayers liable on expenses and benefits of about 250,000 (+ 13%)

- the increase in the number of P11Ds employers have to prepare would be at least as large

- there would be an increased tax yield of about £40m (+ 6%)

- our on-going staff costs would increase by about 80 to 100 units (+ 8% to 10%), with a similar transitional setting up cost next year.

It is perhaps worth nothing that, over the next 4 or 5 years, a large part of these effects would arise in any case on the current policy of letting the threshold "wither on the vine" as increased earnings bring more people over the threshold.

5. The main advantages of this approach are

- it would get rid of the P11D threshold for which there is little justification in principle or equity

- at lower income levels it would reduce the incentive to remunerate in kind rather than cash (but the employer/employee NIC distortion would still remain)

- it would simplify the system by having a single uniform set of valuation rules for all expenses and benefits rather than, as now, separate rules for low paid and high paid employees

- there would be a revenue yield of £40m.

6. The main disadvantages are

- there would be a substantial and much resented increase in employers' compliance costs (P11Ds up 13%+)

- the tax affairs of some 250,000 taxpayers would become more complicated

- a tax increase targeted on the lower paid looks unattractive in the context of the Budget package.

- it could sweep some very small employers of, for example, domestic/part-time employees into the P11D net, and it is less easy than under an FBT to see how they could be kept out (Mr Prescott's recent submission on "small providers").

7. Another disadvantage is that it would be more difficult to make simultaneously a significant increase in the car scales. We estimate that about 150,000 people below the threshold have cars. Under the 25/40 package with reduced NIC rates for lower paid employees they would have widely varying gains, up to £330 pa in some cases but much lower in many others. (The chart from Mr Eason's submission of 14 January attached shows the complex position for earnings - exclusive of benefits - up to £8,500). The tax on a small or medium car - some £150/£200 at the 1988/89 scale rates would in some cases turn the Budget gain into loss if the P11D threshold were removed. Where private petrol is also received (on average in about 60% of car cases) there would be a further £120/£150 to pay on a small or medium car. So in a significant proportion of these 150,000 cases it looks as though there would already be a loss, or only a small gain, before any increase in car scales. Under the 24/40 package with no NIC reductions the position would be even more difficult because the gains at this point of the income distribution are mostly much smaller. (We are of course preparing a separate submission on the general question of increasing the car scales under the present benefits system).

Exempting "difficult" benefits from income tax in the employees hands

8. One of the disadvantages of abolishing the threshold has always been thought to be that it would tend to increase the number of awkward cases (like late night taxis) which would become liable to tax. Exempting a range of "difficult" benefits would reduce but probably not eliminate this problem - it is difficult to foresee these awkward cases until they actually start to arise.

9. It would be possible to work up an exemption covering communally provided benefits such as canteens, sports facilities, car parking and workplace nurseries - but in the recent work on possible exemptions we have not seen much scope for going beyond that. This would get rid of quite a large number of awkward cases already potentially within the system, and whose number would increase with the abolition of the threshold. There would be some difficult choices to make. For example, if the exemptions are general, you exempt directors' dining facilities, sports facilities and parking, however lavish the arrangements; but any dividing line creates additional complication and probably would not always give the "right" result. A generous exemption for canteens would raise the question why there should not be similar generosity for luncheon vouchers.

10. But while a relief of this kind could be a very useful tidying up within the present system, it would not make much difference on the ground for either employees or the Revenue, since most of these benefits are either already largely exempt (canteens) or very small in number (nurseries) or have not yet been widely identified as problems (parking, sports facilities).

Disallowance of the cost of providing exempt benefits

11. A disallowance to the employer is not equivalent to taxing the benefit in the hands of either the employee or the employer. Public sector employers and the large number of private sector employers who pay no tax would not feel a disallowance.

12. Even where the employer is liable to tax there may be significant differences between the employee's and the employer's tax rates so the apparent symmetry between the exemption on the one hand and the disallowance on the other would not hold at a detailed level. For example, canteen facilities might be provided for a part-time employee who was exempt from tax and who did not gain from the exemption but whose (partnership) employer suffered a disallowance at 40%. Conversely, for higher rate employees there would be no question of tax at 40% but for non-taxpaying employers there would be no effective disallowance either.

13. So a disallowance would not be a substitute for a tax, but rather a possible means of raising some revenue from benefits which you could not otherwise tax and you did not wish to exempt altogether.

14. Other points are

- at a practical level, this would reintroduce for employers many of the awkward quantification problems we have been grappling with on FBT. They could indeed be more complicated since a disallowance would, for example, get entangled in the special rules for capital allowances which are available for canteens, sports facilities, nurseries and the like; and it would perhaps look odder for a disallowance than for a charge to have regard only to variable costs. (We have a note in hand discussing these valuation points for FBT - there would be a large read across to this proposal).

- business would argue that it was wrong in principle to disallow relief for business costs and there would, accordingly, be likely to be strong opposition among the business community

15. Overall, there should be a further yield from the exemption/disallowance part of the proposal because in practice, little tax is at present levied on these communally provided

benefits, whereas under the proposals employers would have an effective disallowance if they were paying tax. Given all the uncertainties about the level of provision of benefits of this kind, I am afraid that at the moment we cannot give even a broad estimate of possible yield.

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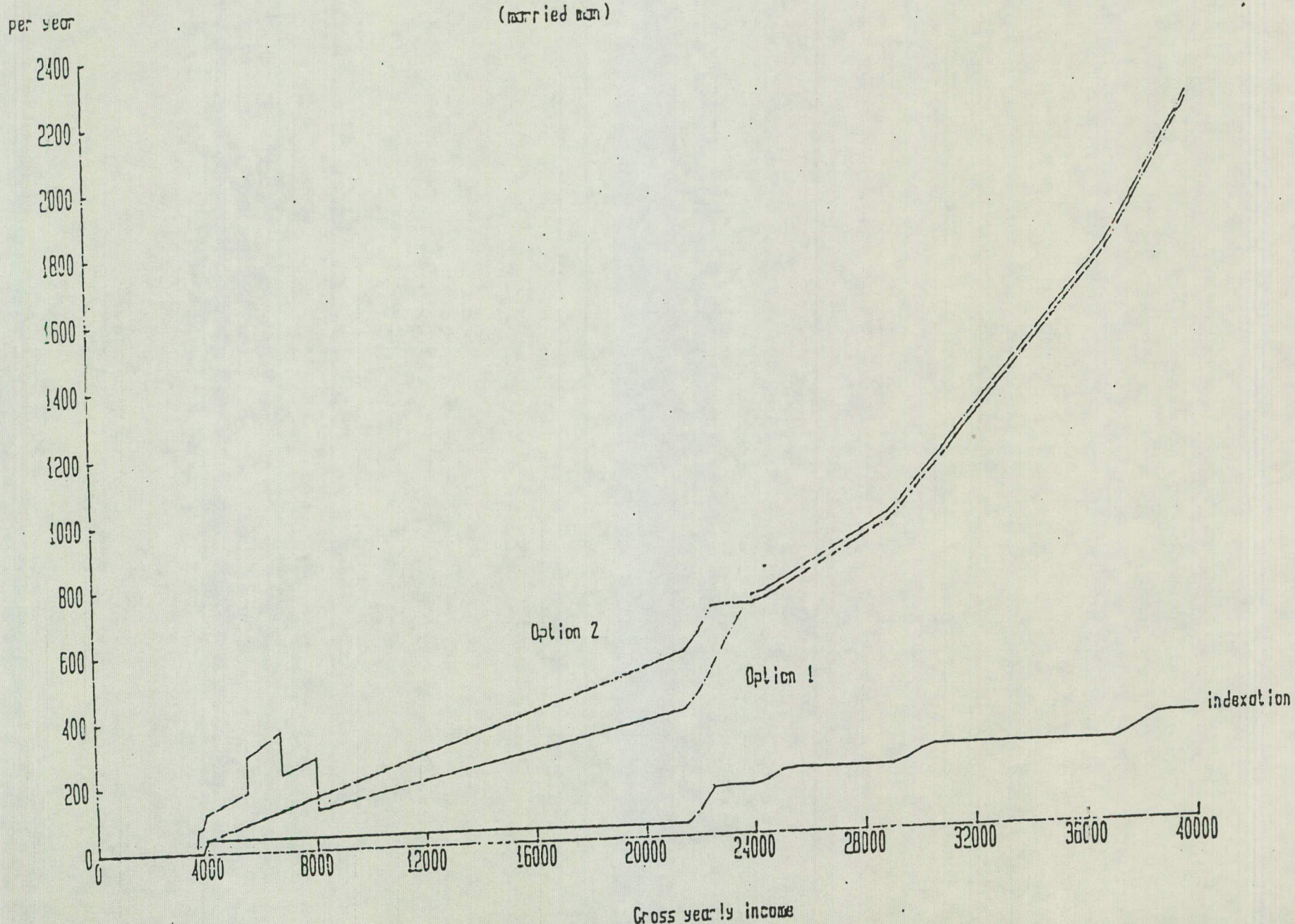
18. Looking at the threshold part of the proposal, there is the familiar balance to be struck between an approach which is right in principle, would be a simplification to the benefits regime and would yield some revenue, against significantly higher employer compliance costs and revenue staff requirements, and increased tax burdens for the lower paid. You have not previously found this combination particularly attractive - and it has the additional disadvantages now of being unhelpful to the main Budget package and impossible to combine with a substantial increase in car scales without making many of those affected into quite significant net losers from the combined income tax changes.

Lisa Miles

for P LEWIS

Change in income after tax and NIC compared with the 1987-88 regime

(married man)



BUDGET SECRET: TASK FORCE LIST

Inland Revenue

Policy Division
Somerset House

COPY NO 1 OF 32.

(Chx copy).

FROM: P LEWIS
DATE: 22 JANUARY 1988

Chancellor

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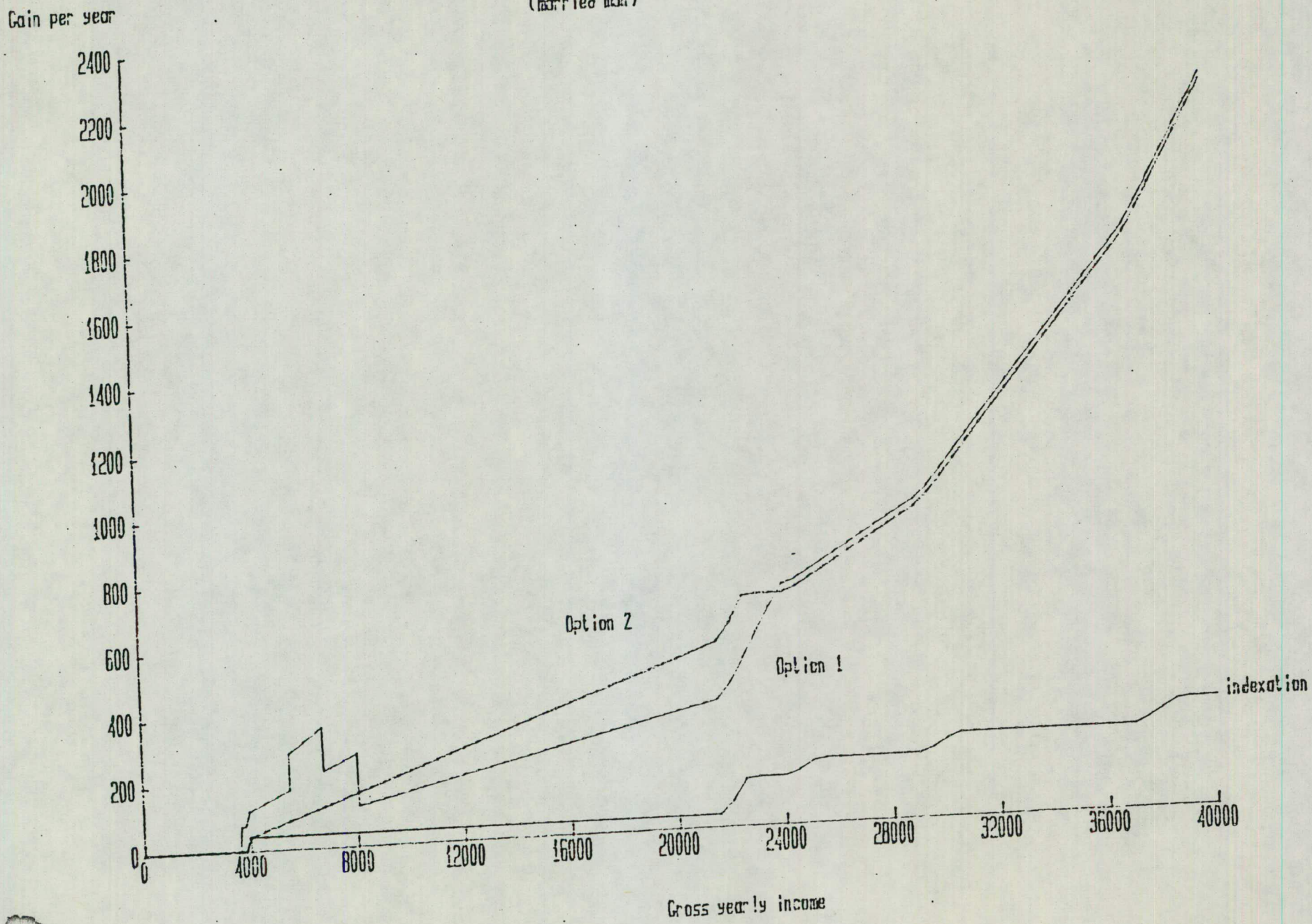
for P LEWIS

Change in income after tax and NIC compared with the 1987-88 regime

(married man)



mjd 1/38A

BUDGET SECRET: TASK FORCE LIST

COPY NO. 21 OF 23.

FROM: A C S ALLAN
DATE: 19 January 1988

MR P LEWIS - 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 Monck
Mr Scholar
Mr Culpin
Miss Sinclair
Mr Michie
Mr Cropper
Mr Tyrie
Mr Call
PS/IR
Mr Prescott IR
Miss Rhodes IR

FRINGE BENEFITS

The Chancellor would be grateful if a further option could be considered as part of what we might do if we did not introduce an FBT. There will surely be very few company cars given to those below the P11D limit - since, as he understands it, the £8500 pa includes the value of the perk. Could we not therefore abolish the P11D limit entirely. Where this caused administrative or other difficulties for perks given to lower-paid employees (eg work place nurseries), we could exempt these benefits from tax in the hands of the employees, while offsetting that by disallowing the cost as a business expense in the hands of the provider. This could also be extended to other benefits which are, in practice, currently exempt in the hands of the employee - eg canteens and sports facilities.

2. I should be grateful for a note on this by Thursday evening, for discussion at the overview meeting next Monday, together with the further note on car scales if we do not proceed with an FBT.

ACSA

A C S ALLAN

COVENANTS & PERKS: POST-OVERVIEW THOUGHTS

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

[illegible]

cc Task Force Circulation

cc [illegible]

* *

Alex

Two urgent notes reqd from IR, with any comments from FP.

(1) If we are to abolish [illegible] covenants, why not go the whole hog & abolish all covenants, as [illegible], by allowing tax relief for individual gifts to charity — either up to a specified limit (I think in the US it is a % of income) or perhaps confined to the basic rate.

(2) If we attack car perks under the existing system,

-2-

CHANCELLOR OF THE EXCHEQUER
HONI SOIT QUI MAL Y PENSE

there will surely be very few company cars ~~given~~ those below the P11D limit — since the £8,500 p.a. includes the value of the perk. Why not, then, abolish the P11D limit entirely? This might be offset, in an oblique way, by exempting workplace nurseries from tax.

We might also pick up Geoff Littler's idea, by ruling that all perks that are exempt

In tax in the hands
of employers should be
disallowed as a
legitimate business
expense in the hands
of the provider.

M.

CHANCELLOR OF THE EXCHEQUER

* *

Pls update these tables to cover the 1988-89 options in time for the overview.

XL

Ch. / Updated tables behind.

18/1

New figures written in

Thanks.

Table 13.6d

TAX AND NIC AS % OF INCOME
SINGLE PERSON

Financial Year	Multiple of average earnings (full time males, adult rates, all occupations) 0.5	0.75	1	1.5	2	5	10
1950-51	11.1	14.1	17.2	23.5	26.6	36.3	50.1
1959-60	13.3	16.3	19.6	23.1	24.9	35.9	50.0
1960-61	13.4	16.6	19.9	23.3	25.0	36.5	50.6
1961-62	13.4	17.9	21.5	24.4	25.8	28.8	38.8
1962-63	13.6	18.6	21.9	24.6	26.0	29.0	39.5
1963-64	15.0	19.9	23.4	25.6	26.7	29.5	40.4
1964-65	16.0	21.0	24.0	26.0	27.1	30.1	42.3
1965-66	16.6	21.9	25.0	27.3	28.5	32.8	47.4
1966-67	17.2	22.8	25.4	27.7	28.8	33.5	47.6
1967-68	18.1	23.8	26.1	28.1	29.1	34.2	49.1
1968-69	19.7	25.1	26.9	28.7	29.6	35.6	51.3
1969-70	21.1	25.9	27.9	29.4	30.1	37.0	53.8
1970-71	23.1	27.4	29.3	30.2	30.7	39.3	57.4
1971-72	23.3	26.9	28.5	29.4	29.6	37.9	51.4
1972-73	19.4	24.5	27.1	28.6	29.0	40.7	55.9
1973-74	21.0	25.6	28.0	29.2	29.4	40.1	54.2
1974-75	24.5	29.1	31.4	32.4	32.9	47.2	62.3
1975-76	26.6	31.3	33.6	34.2	36.6	53.4	67.4
1976-77	27.4	31.8	34.1	35.5	37.9	55.4	68.9
1977-78	24.4	29.5	32.1	33.9	35.2	53.3	68.0
1978-79	23.5	28.9	31.5	33.3	33.7	52.2	67.5
1979-80	22.9	27.4	29.7	30.8	30.8	42.8	51.4
1980-81	24.7	28.7	30.7	31.6	32.0	44.3	52.1
1981-82	26.9	30.5	32.3	33.5	34.5	46.4	53.2
1982-83	27.3	31.1	33.0	34.3	34.5	45.9	53.0
1983-84	27.0	31.0	33.0	34.2	34.0	45.1	52.5
1984-85	26.5	30.7	32.7	33.9	33.9	45.3	52.6
1985-86	26.2	30.5	32.6	33.7	33.9	45.5	52.7
1986-87	25.8	29.9	31.9	32.9	33.3	45.7	52.8
1987-88	25.0	28.7	30.5	31.0	32.1	45.9	53.0
88-89 option 1	20.1	27.4	29.0	29.2	29.9	35.9	38.0
option 2	23.5	26.5	28.2	28.3	29.9	36.0	37.5

Table 13.6e

TAX AND NIC AS % OF INCOME
MARRIED MAN WITH NO CHILDREN

Financial Year	Multiple of average earnings (full time males, adult rates, all occupations)						
	0.5	0.75	1	1.5	2	5	10
1950-51	5.9	9.5	12.1	19.3	23.5	35.1	49.5
1959-60	8.1	11.3	14.9	20.0	22.5	34.4	49.0
1960-61	8.4	11.7	15.4	20.3	22.8	35.1	49.8
1961-62	8.6	13.3	17.2	21.5	23.7	28.0	38.0
1962-63	9.0	13.8	17.7	21.8	23.9	28.2	38.7
1963-64	8.5	14.2	18.5	22.4	24.3	28.5	39.5
1964-65	9.4	15.2	19.5	23.0	24.8	29.0	41.5
1965-66	10.3	16.0	20.4	24.3	26.3	31.7	46.5
1966-67	11.0	17.1	21.2	24.8	26.7	32.4	46.8
1967-68	12.2	18.3	22.0	25.4	27.1	33.2	48.4
1968-69	14.2	20.1	23.2	26.2	27.7	34.5	50.6
1969-70	15.4	21.3	24.4	27.1	28.3	36.1	53.1
1970-71	15.9	22.6	25.7	27.8	28.9	38.2	56.6
1971-72	17.2	22.8	25.4	27.4	28.1	36.9	50.7
1972-73	14.0	20.9	24.3	26.8	27.6	39.7	55.3
1973-74	16.2	22.5	25.6	27.6	28.2	39.1	53.7
1974-75	18.8	25.3	28.5	30.5	31.2	46.0	61.5
1975-76	20.9	27.4	30.7	32.3	34.6	52.2	66.7
1976-77	21.0	27.6	30.9	33.3	35.6	54.1	68.2
1977-78	16.2	24.0	28.0	31.1	32.5	51.5	67.0
1978-79	16.0	23.8	27.8	30.8	31.4	50.5	66.5
1979-80	16.0	22.8	26.3	28.5	28.9	41.5	50.7
1980-81	17.9	24.2	27.3	29.4	29.7	42.9	51.5
1981-82	20.8	26.4	29.3	31.4	32.2	45.2	52.6
1982-83	20.8	26.8	29.8	32.2	32.3	44.6	52.3
1983-84	20.1	26.4	29.6	32.0	31.7	43.7	51.9
1984-85	19.3	25.9	29.2	31.5	31.5	43.9	51.9
1985-86	18.9	25.6	29.0	31.3	31.5	44.0	52.0
1986-87	18.9	25.3	28.5	30.6	30.9	44.2	52.1
1987-88	18.9	24.6	27.4	29.0	29.7	44.5	52.3
1988-89							
Option 1	14.5	23.7	26.2	27.3	27.6	35.0	37.5
Option 2	18.1	23.1	25.6	26.5	27.7	35.1	37.5

Table 13.6a

Burden of direct taxation (including NICs) on specimen families at various %s of average earnings (1950-51 to 1987-88)

There's been very up since 1988-89 options

TAX AS % OF INCOME
SINGLE PERSON

Financial Year	Multiple of average earnings (full time males, adult rates, all occupations)						
	0.5	0.75	1	1.5	2	5	10
1950-51	6.1	10.7	14.7	21.8	25.4	35.8	49.9
1959-60	7.0	12.3	16.5	21.0	23.3	35.3	49.7
1960-61	7.4	12.4	16.9	21.3	23.5	35.9	50.3
1961-62	7.3	12.6	17.0	21.4	23.6	27.9	38.3
1962-63	7.6	13.3	17.5	21.7	23.8	28.2	39.0
1963-64	8.7	14.3	18.3	22.2	24.2	28.5	39.9
1964-65	9.7	15.4	19.1	22.8	24.6	29.1	41.8
1965-66	9.5	15.8	19.9	24.0	26.0	31.8	46.9
1966-67	10.2	16.6	20.5	24.4	26.3	32.5	47.1
1967-68	10.9	17.3	21.0	24.7	26.6	33.2	48.6
1968-69	11.7	18.4	21.8	25.2	26.9	34.5	50.8
1969-70	13.2	19.5	22.7	25.8	27.4	36.0	53.3
1970-71	15.4	21.0	23.8	26.5	27.9	38.2	56.9
1971-72	15.9	20.6	23.0	25.4	26.6	36.7	50.8
1972-73	12.3	18.2	21.2	24.2	25.7	39.4	55.2
1973-74	14.2	19.4	22.1	24.7	26.0	38.7	53.5
1974-75	18.0	23.0	25.5	28.0	29.6	45.8	61.6
1975-76	21.1	25.7	28.1	30.4	33.7	52.2	66.7
1976-77	21.6	26.1	28.3	30.6	34.2	54.0	68.2
1977-78	18.7	23.8	26.3	28.9	31.5	51.6	67.2
1978-79	17.0	22.4	25.0	27.7	29.5	50.5	66.6
1979-80	16.4	20.9	23.2	25.5	26.8	41.2	50.6
1980-81	17.9	22.0	24.0	26.0	27.7	42.6	51.3
1981-82	19.1	22.8	24.6	26.4	29.1	44.3	52.2
1982-83	18.5	22.4	24.3	26.2	28.4	43.5	51.7
1983-84	18.0	22.0	24.0	26.0	27.8	42.6	51.3
1984-85	17.5	21.7	23.7	25.8	27.8	42.9	51.4
1985-86	17.3	21.5	23.6	25.8	27.9	43.0	51.5
1986-87	16.8	20.9	22.9	24.9	27.3	43.5	51.6
1987-88	16.0	19.7	21.5	23.3	26.4	43.6	51.8
1988-89							
Option 1	15.1	18.4	20.0	21.7	24.2	33.7	36.8
Option 2	14.5	17.6	19.2	20.8	24.3	33.7	36.9

Table 13.6b

TAX AS % OF INCOME
MARRIED MAN WITH NO CHILDREN

Financial Year	Multiple of average earnings (full time males, adult rates, all occupations)						
	0.5	0.75	1	1.5	2	5	10
1950-51	0.8	6.1	9.6	17.7	22.2	34.6	49.2
1959-60	2.0	7.3	11.8	17.9	21.0	33.8	48.7
1960-61	2.4	7.8	12.4	18.3	21.2	34.5	49.4
1961-62	2.5	8.0	12.6	18.5	21.4	27.1	37.6
1962-63	2.9	8.5	13.2	18.9	21.7	27.3	38.3
1963-64	2.2	8.6	13.4	19.0	21.8	27.5	39.0
1964-65	3.1	9.6	14.6	19.8	22.3	28.0	41.0
1965-66	3.2	9.8	15.4	20.9	23.7	30.7	46.0
1966-67	4.0	10.9	16.2	21.5	24.1	31.4	46.3
1967-68	5.0	11.9	17.0	22.0	24.5	32.2	47.8
1968-69	6.3	13.4	18.1	22.7	25.1	33.5	50.0
1969-70	7.5	14.9	19.2	23.5	25.6	35.0	52.5
1970-71	8.2	16.2	20.2	24.1	26.1	37.1	56.1
1971-72	9.8	16.5	19.9	23.4	25.0	35.7	50.1
1972-73	6.9	14.6	18.5	22.4	24.3	38.4	54.6
1973-74	9.4	16.3	19.7	23.1	24.9	37.7	52.9
1974-75	12.2	19.2	22.6	26.1	27.9	44.6	60.9
1975-76	15.4	21.9	25.2	28.5	31.7	51.0	66.1
1976-77	15.3	21.9	25.1	28.4	31.9	52.6	67.4
1977-78	10.4	18.3	22.2	26.1	28.8	50.0	66.2
1978-79	9.5	17.3	21.3	25.2	27.2	48.8	65.7
1979-80	9.5	16.3	19.8	23.2	24.9	39.8	49.9
1980-81	11.2	17.4	20.6	23.7	25.5	41.2	50.6
1981-82	13.0	18.7	21.5	24.3	26.9	43.1	51.5
1982-83	12.1	18.1	21.0	24.0	26.2	42.2	51.1
1983-84	11.1	17.4	20.6	23.7	25.5	41.3	50.6
1984-85	10.3	16.9	20.2	23.4	25.4	41.4	50.7
1985-86	9.9	16.6	20.0	23.3	25.5	41.6	50.8
1986-87	9.9	16.3	19.5	22.6	24.9	41.8	50.9
1987-88	9.9	15.6	18.4	21.3	23.9	42.2	51.1
1988-89							
Option 1	9.5	14.7	17.2	19.6	22.0	32.8	36.4
Option 2	9.1	14.1	16.6	19.0	22.1	32.8	36.4

4368/48

BUDGET SECRET: TASK FORCE LIST

Copy 10 of 18

FROM: FINANCIAL SECRETARY

DATE: 25 JANUARY 1988

CHANCELLOR

cc: Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Monck
Mr Scholar
Mr Culpin
Miss Sinclair
Mr Michie
Mr Cropper
Mr Tyrie
Mr Call
Mr Isaac - IR
Mr Lewis - IR
Mr Prescott - IR
PS/IR

FBT: COVERAGE

As you suggested I have been looking at ways of constructing a less controversial and less radical FBT coverage package. Perhaps my earlier note (of 22 December) can remain on the table as an attempt to "pick and choose" between which particular benefits should be exempted and which should not, if one were starting with a clean slate. I do not see much point in my attempting to produce an alternative "selective" menu. In this note I identify two broader options:

Option I: setting out - at least for the main collective benefits - a general principle that benefits will be taxable unless:

(i) they are provided on the employer's "own premises";

(ii) and they are made available on similar terms to all employees.

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Option II: sticking as far as possible to existing practice, and enshrining this practice, however anomalous in the new legislation.

Option I

2. Although under this option the aim would be to have a clear structure into which to fit each benefit, the criteria suggested for exemptions - "own premises" and "similar terms" - are by no means as simple or as clear-cut as they might appear. "Own premises" would have to be clearly defined to include premises owned or leased by a company by not rented. Thus, if a sports ground were hired once a week it would not be exempt; if it were leased by a company for a period of years it would be exempt.

3. But leaving aside the detail of how the general principles would be applied in practice, the main implications of option I would be as follows:

(i) **Canteens:** would be exempted if they were available for all employees and if they were on premises occupied by the company.

(ii) **LVs:** would be taxed - the present 15p per day exemption would go.

(iii) **Directors' lunches:** would be taxed on the grounds that they are by definition not available to all.

(iv) **Sports facilities:** would be taxed only if they were off premises. (At present they are in theory taxable.)

(v) **Workplace nurseries:** would be tax-free if they were on premises, (but taxed if the company used the local authority's day nursery).

(vi) **Car parking:** again, as we had already envisaged, this would be exempt on own premises but taxable off-premises.

4. Apart from the pressure to extend exemptions to benefits provided off premises, I think that the main areas of difficulty with this option would be:

(a) Taxing LVs.
(b) Exempting in-house workplace nurseries.

5. We know the arguments for and against (b). I would be prepared to defend it and, of course, it would be widely welcomed by many people. But you may not wish to exempt. If you believe that workplace nurseries on premises should be taxed then I think option I probably falls - its main virtue being that it attempts to draw a logical dividing line between what is in and what is out.

6. (a) is much more difficult. Businesses without canteens, including small businesses without the space available to provide them, would doubtless point out the inequity of exempting canteens but not LVs. I have no knock-down replies. But we could argue that:

(i) The LV exemption is a relic from the past and has no place in a reformed system of lower taxes and fewer tax breaks.

(ii) The existing 15p exemption is tiny, and is frequently ignored by employers who pay more than the limit.

(iii) The alternative to removing the exemption would be to increase the 15p limit. This would look very perverse in the context of a reform which was aiming to tax perks more effectively - LVs are virtually identical to cash and can readily be "cashed out".

(iv) Canteens are very difficult to tax since a proper valuation of the "benefit" would require apportionment of fixed costs and so on.

7. I conclude that option I has some attractions presentationally but would generate at least one major battle.

Option 2

8. The aim here would be to stick as closely as possible to existing practice and to make a virtue of this in the presentation. We would argue that the main benefit was the company car and that we would be using the FBT to launch a staged attack on that. We would also say that the coverage was not set in stone and that once the FBT had been up and running for a year or two (ie in the next Parliament) a change in coverage might be considered.

9. I can see that this might prove to be the least controversial option. It would also make it easier in the future to bring into tax some of the bigger "on premises" benefit if we decided we wanted to. But, on the other hand, it would mean that one would have to defend a fairly arbitrary system simply on the basis that that was the status quo. We would find it more difficult, I think, to defend the FBT itself if we did not use its introduction as the opportunity for some rationalisation of the current messy rules. People would justifiably argue that if the only argument for the FBT was that it made it possible to tax more effectively the company car, then it was a complicated way of meeting this objective.

10. It is because I believe that the very FBT itself may be more difficult to implement under option II than option I that I favour the more rational approach of option I. Under the latter we can expect some awkward rows on coverage to deflect from the case for the FBT itself. Under option II, we might still get rows on coverage, but we would also find it difficult to present the FBT as a major reform of the system as a whole and a move towards a rational and less anomalous tax-base.

Non-collective benefits

11. Although I favour the option I approach for the collective benefits, I do not think that we need necessarily follow it to the letter when it comes to the more minor non-collective benefits. Equally, if we chose the status quo route there are one or two minor benefits that I think will have to be taxed even though they are currently exempt.

12. In particular I think that whether we go for option I or option II we should start to tax:

(i) Provision for the living accommodation of "lower paid" clergymen.

(ii) Heating and lighting bills of "lower paid" clergymen.

(iii) Board and lodging provided for "lower paid" agricultural workers.

(iv) Miners' free coal.

13. These are clearly just an alternative form of remuneration and we cannot possibly justify continuing to exempt them. Moreover in the case of (i)-(ii) above, the definition of "lower paid" will be lost from the legislation when the P11D system is abolished. We do not want to re-invent it just for these cases; nor do we want to extend the exemptions to all clergymen or farm-workers.

Accommodation

14. The major area not yet covered is accommodation: the Revenue will be producing a separate note on the various accommodation benefits. Here the issue is not only whether or not to tax, but also what valuation rules to use if any of them are to be taxed (given the abolition of domestic rates). My provisional view on the coverage is that whilst it would clearly be right to hit, for example, directors' flats, it would be wise to leave janitors, licensees, tied cottages etc well alone in line with existing practice.

NORMAN LAMONT

psl/6A **BUDGET SECRET: TASK FORCE LIST**

COPY NO. 11 OF 12.

FROM: A C S ALLAN
DATE: 25 January 1988

PS/FINANCIAL SECRETARY

cc Sir P Middleton
Mr Scholar
Mr Culpin
Mr Michie
Mr Cropper
Mr Tyrie

Mr Lewis - IR
Mr Prescott - IR
PS/IR

FRINGE BENEFITS TAX: AMBIT AND DE MINIMIS LIMIT FOR SMALL PROVIDERS

The Chancellor has seen your minute of 20 January to Mr Prescott. He agrees that we certainly need a de minimis rule, but he is not sure that the Revenue's is sufficient. We may also need to exclude employers with fewer than a given (small) number of employees. Quite apart from the corner shop, he feels we do not, surely, want to catch the domestic employer with one or two resident staff. He would be most grateful if the Financial Secretary could look at this.

ACSA

A C S ALLAN

BUDGET SECRET - TASK FORCE LIST

Copy No 2 of 14

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

PWP

FROM: P JEFFERSON SMITH
DATE: 26 January 1988

Economic Secretary

cc Chancellor
Chief Secretary
Financial Secretary
Paymaster General
Mr Scholar
Mr Culpin
Miss Sinclair
Mr Cropper

EXCISE DUTY INCREASES : FORTIFIED WINES

1. In the light of the decision at the overview meetings on 18 and 25 January to afford favourable excise duty treatment to spirits, we consider that there is a good case for like treatment of fortified wines paying the above 15% alcohol duty rates.

2. As you will recall, developments over the last few years have distorted the impact of the wine duties structure leaving Spanish sherry as the only important drink paying the middle duty rate of £169 a hectolitre. Port is the major drink in the upper band, which has a duty rate of £194.90 a hectolitre. British sherry, Cyprus sherry, montilla and vermouth pay the lowest rate of £98 per hectolitre. The duty differential between that rate and duty charged on Spanish sherry is some 72% (about 57p a 70cc bottle, with associated VAT); and for port is about 99% (some 78p a 70cc bottle, with associated VAT). The market performance of sherry and

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Internal distribution: CPS
Mr Knox
Mr Whitmore
Mr Allen

BUDGET SECRET - TASK FORCE LIST

330/1/88

port has been relatively poor in the last few years. Although imported products, both the Spanish sherry and the port trades have substantial British interests.

3. The Spanish sherry producers have complained to the EC Commission about the discrimination in our duty system between Spanish sherry on the one hand and British and Cyprus sherries on the other. Part of the complaint, relating to blending of British sherry, is unanswerable and will have to be conceded if or when the Commission take it up with us. But we would want to defend our position in differentiating for duty purposes between wines above and below 15% in alcoholic strength. Narrowing the differential would help.

4. The revenue considerations are comparatively unimportant, since we are dealing with what is now quite a small sector of the drinks market; revalorisation of the fortified wine duties would raise about £5 million. We recommend that these duties are accorded the same treatment this year as spirits, with which they mainly compete, whether this was standstill or a lesser revalorisation than beer and table wines. This would be a modest step towards a less distorted duty structure; and might be seen by the Spanish sherry interests as a move, albeit limited, in the right direction.

P JEFFERSON SMITH

BUDGET SECRET: TASK FORCE LIST

Inland Revenue

Policy Division
Somerset House

COPY NO 19 OF 38.
FROM: P LEWIS
DATE: 28 JANUARY 1988

Chancellor

TAXATION OF FRINGE BENEFITS

1. I attach some further papers, some or all of which you may wish to discuss at your meeting on Friday afternoon.

2. The first three papers (all by Michael Prescott) are inter-linked.

- FBT Coverage: This note follows the Financial Secretary's meeting at the end of last week, and is intended to supplement his note of 25 January by identifying the points on which decisions are needed, depending on the approach adopted.

- Accommodation: This is the remaining area of coverage we have not so far tackled. Because of the demise of domestic rating, some change in the present rules will be needed whether or not FBT is introduced. But if FBT is dropped, the changes could be left until next year.

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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
Miss Sinclair
Mr Sedgwick
Mr Olding-Smee
Miss Evans
Mr Hudson
Mr Michie
Mr Cropper
Mr Tyrie
Mr Call
Mr Battishill
Mr Isaac
Mr Painter
Mr Beighton
Mr McGivern
Mr Lewis
Mr Prescott
Miss Rhodes
Mr Mace
Mr Hodgson
Mr Northend
Mr R H Allen
Mr I Stewart
Mr Geraghty
PS/IR

- Valuation of goods and services: This note is not concerned with the way we should quantify the value of communally provided benefits such as canteens and sports grounds, on which we should need to give you a separate note, if you wished either to include them within the scope of FBT or alternatively disallow their "cost" in calculating taxable profits as discussed in my note of 22 January.

Ch
This one worried me
JA

It is concerned with the even more general case of goods or services which are provided free or cheaply by the employer, for example through staff discount schemes. As Mr Prescott's note explains, some decisions are required for FBT because at present there are differing rules for people above and below the P11D threshold; and it is worth looking at the field generally because the present rules give varying results in differing situations and arguably often do not tax, or fully tax, quite widespread benefits amounting in aggregate to probably significant sums. But, as in the case of coverage, it would be possible to carry over into FBT broadly the present rules if you decided you did not wish to embark on a fresh look at this whole field, important though it is. (One important consideration is that we are increasingly concerned that we are now getting to the point where options must be closed down rather than opened up if there is to be a reasonable chance of getting a properly prepared and comprehensive FBT into the Finance Bill.) Going for broadly the status quo in legislation this year would not, of course, preclude you from having a further look at this important topic later on either in-house or on a consultative basis if you felt there was worthwhile work to be done but not time to do it now.

3. The remaining paper is a note I have done taking a first look at options for cars under the present system. It thus needs to be looked at alongside my note of 22 January on the abolition of the P11D threshold etc, and the work Mr Monck has in hand on the impact of car taxation changes on the motor industry.

P LEWIS

FRINGE BENEFITS TAX: COVERAGE

PRESCOTT → CH Ex 28/1

BUDGET SECRET: TASK FORCE LIST

Inland Revenue

NC/103 *

Policy Division
Somerset House

FROM: M PRESCOTT
DATE: 28 JANUARY 1988

CHANCELLOR

FRINGE BENEFITS TAX: COVERAGE

1. In his note of 25 January the Financial Secretary identified two main options, viz

(a) Option I: "Rationalisation" Adjust the existing exempt/non-exempt boundary for communally provided "social/welfare-type" benefits like subsidised meals, sports facilities and work place nurseries so that there is greater consistency of treatment as between one such benefit and another ("Rationalisation").

(b) Option II: "Status Quo" So far as possible simply replicate coverage under FBT with present coverage, so that benefits which by statute or practice are exempt under the present system would continue to be exempt under FBT ("Status quo")

This note is intended mainly as an aide memoire, to show what the position would be in relation to each of the outstanding points on coverage under either option, and to identify points arising on which decisions would be needed. It also deals with a number of more general related points.

2. Annex A attached provides a check list of the outstanding benefits and expenses payments on which decisions are needed. It is based on the check list attached to my note of 14 January, but for convenience has been expanded to incorporate various other existing exemptions (statutory or concessional) referred to in that note.

3. Part II of the Annex lists all of the "non-contentious" existing statutory or extra-statutory exemptions - ie those which it has been assumed throughout Ministers will want to continue for FBT. If that is agreed, all of those benefits can be ignored for present purposes - they will all continue to be exempt whichever of the above two options is chosen. However, a decision is needed on whether those exemptions currently provided by ESC should be put on to a full statutory basis under FBT, or re-promulgated as concessions.

4. The remaining benefits, the ones we are concerned with here, are those at items 1-8 in the Annex - ie canteens/luncheon vouchers; sports and recreational facilities; work place nurseries; car parking; entertainment and gifts, the various accommodation-related benefits; and miners free coal.

STATUS QUO (Option II)

5. This would mean trying as far as possible to produce exactly the same treatment for each of these benefits under FBT as applies as present.

6. For benefits at present covered by a a statutory exemption, and with certain exceptions (see paragraph 12 below), this would be straightforward; there would simply be a similar statutory exemption under FBT. This would deal with canteens where meals are provided for the staff generally (item 1), third party entertainment (on the grounds that the Government has announced its intention to legislate), and the various statutory exemptions in respect of provided accommodation (item 7 - but excluding 7(a), removals expenses/additional housing cost allowances, which is to be reviewed separately).

7. For benefits like workplace nurseries or non third party entertainment, which at present are both taxable and usually taxed in practice, no action would be required; FBT will apply generally to all benefits, except those explicitly exempted, and

so these benefits would automatically be covered without them being separately identified as such.

8. As regards benefits like sports facilities and car parking which at present are taxable, but not usually taxed in practice, a decision would be needed on whether to bring FBT into line with the present statutory position (ie that these benefits are taxable - in which case no action needed) or with present practice (which usually means not taxing - in which case it would be necessary to decide on the proposed terms of any exemption for these benefits, and to build that exemption in to FBT).

9. Finally, there are those benefits which at present are exempt by extra-statutory concession - directors dining rooms, luncheon vouchers, Christmas parties, removals expenses and excess rent allowances, clergymen's heat and lighting, agricultural workers' accommodation and miners free coal. For all of these (and for the non contentious concessionary exemptions listed in Part II of the Annex) a decision would be needed on whether to carry over the exemption to FBT by

- putting the concession on to a full statutory basis,

- or by withdrawing the existing ESC and promulgating a new one adapted to take account of FBT.

10. The statutory route would be the more defensible given that ESCs ought in principle to be put on to a statutory footing when the opportunity arises, and there would obviously be no difficulty with this as regards the "Part II" concessions. On the other hand, Ministers would presumably not want to put eg the luncheon voucher or miners free coal concessions on to a full statutory basis; but it might look equally odd - and arouse suspicions - if some of these concessionary exemptions were carried forward on a statutory basis and others on a concessionary basis.

11. In addition, however, some change to the present statutory/extra-statutory position on directors' dining rooms seems necessary in any event, because of the nonsensical condition presently linking the exemption for canteens with the exemptions for luncheon vouchers - ie directors' dining rooms are regarded as covered by the statutory exemption for canteens in which meals are provided for the staff generally if other workers either get meals elsewhere on the premises or get LVs that do not exceed 15p a day. We think the right course would simply be to drop this rider. Directors' dining rooms would then only be regarded as covered by the statutory exemption if other staff got fed elsewhere on the premises.

12. Finally, there is the further technical difficulty over the present statutory or concessionary accommodation-related exemptions listed at 7(c), (d), (f), (g) and (h), which all depend on the present distinction between directors and "higher paid" employees on the one hand, and "lower paid" employees on the other - a distinction that will cease to exist under FBT.

13. Three of these - 7(f), (g) and (h) - are exemptions that apply only to "lower paid" clergymen and agricultural workers and the options, therefore, would be

- drop the exemption for FBT
- extend it to "higher paid clergymen and agricultural workers
- carry the existing lower paid/higher paid distinction forward into FBT, but for this purpose only.

14. We do not have firm figures on the number of clergymen and agricultural workers affected. However

- as regards clergymen (7(f) and (g)) there are about 17,000 Church of England clergymen living in provided

accommodation, of whom 10,000 or so are probably "lower paid" and, therefore, covered by these exemptions. We have no figures for the other religions but it seems plausible to assume that the number affected may be as big again, making a total of 20,000

- as regards agricultural workers (7(h)), we know that about 7½% - or about 27,500 - of the 320,000 or so agricultural workers in England and Wales get provided accommodation. The majority are likely to be "lower paid". Again, therefore, the number of employees affected may be around 20,000.

15. The other two exemptions under this heading, 7(c) and 7(d), work the other way round - the benefit here would not be taxable on the "lower paid" anyway and the present exemption removes or limits the size of the taxable benefit where the recipient is a "higher paid" employee. Here, if the exemptions are to be retained, there would seem to be little objection to generalising them to all employees.

RATIONALISATION (Option I)

16. This approach is primarily concerned with getting the exemption for canteens, sports facilities etc on to a more consistent basis. The idea would be to try under FBT to create an exemption for this kind of communally provided "social/welfare" benefit as a general class of exempted benefit. The two main principles on which the exemption would apply might be

- benefit provided and consumed on the employer's premises,

- provided for and available to the staff generally, and on broadly similar terms.

17. This would make it possible to exempt all such communally provided benefits - not just staff canteens, but sports and recreational facilities provided on the employer's premises, work place nurseries, car parking, and so on. The logic of this approach, however, is that benefits which are not provided and consumed on the employer's premises should be taxed - specifically, therefore, this would mean dropping the present concessionary exemption for luncheon vouchers and taxing any of these benefits (eg car parking) that were provided and consumed "off" the premises.

18. Points arising for consideration include the following

(a) Coverage. Some of the above concepts might need elaboration for purposes of the legislation. They would as stated probably serve effectively to let in the kind of benefits intended such as canteens, recreational sporting facilities, work place nurseries and car parking, while excluding benefits such as the company flat at the office that is available for directors and their wives who want to spend the night in town. Similarly it would in office parties held on the employer's premises while excluding parties etc held outside eg at the local restaurant. But it would be necessary also to decide how to treat eg

- recreational facilities more generally

- other analogous goods and services that might be provided and consumed on the premises - eg free hairdressing.

(b) Meaning of "employer's premises". While in the case of eg canteens or work place nurseries it might be possible to restrict the exemption to cases where the service was provided and consumed on the employer's business premises, this would not necessarily work for sports facilities - eg the company's sports grounds

and club house situated out of town. It would probably be necessary to extend the definition to include facilities owned or leased by the employer for the benefit of the employees. That in turn might bring in to the exemption eg the company-owned hotel, but would this matter if the facility in question was available on similar terms for the benefit of the employees generally?

(c) Where the conditions for exemption are not satisfied, what should be the basis of valuing the benefit in question for FBT purposes? Should it be the full cost, with a proper allowance or indirect cost such as accommodation, or direct cost only?

19. Under this option decisions would also be needed on the accommodation-related exemption (paragraphs 12 to 15 above), and on miners free coal.

M PRESCOTT

ANNEX A

FBT: COVERAGE

	BENEFIT etc	Present position*	Estimated total value of benefit
1.	**Subsidised canteens** where meals provided for staff generally there, or elsewhere on the premises ..	S	£1bn - highly tentative and would need checking carefully, but based on figures quoted by LV Ltd - 6m employees receiving at least one subsidised meal a day at average subsidy of £1.50. Allowing for LV Ltd's estimates of subsidy towards fixed costs as well, figure would roughly treble.
	.. or off the premises if the staff concerned get LVs of not more than 15p a day.	ESC - unpublished	
	Luncheon Vouchers up to 15p a day.	ESC	£20m: Based on LV Ltd figures suggesting ½m employees receive 15p LV per working day.
2.	**Sports facilities** (on premises owned/leased by employer)	T/NT	N/A
3.	**Workplace nurseries**	T	£5m - Based on estimated 2000 places at average cost of £2500
4.	**Carparking** (on premises owned/leased by employer)	T/NT	Estimate that approx 4.5m employees get employer provided parking, on and off premises. Assuming only 50% on own premises (probably higher) and average annual value of, say, £100, total value would be £200m.

*
S = Statutory Exemption
ESC = Exempt by Extra-Statutory Concession
T/NT = Taxable, but not usually taxed in practice eg on de minimis grounds
T = Taxable, and usually taxed in practice.

	BENEFIT etc	Present position*	Estimated total value of benefit
5.	**Entertainment**, provided by		
	(i) third party,	intention to legislate announced 29/9/87	
	(ii) employer	T	
	- except Xmas parties up to £35 a head	ESC	Could be substantial; for example, if 5m employees got benefit of £20 a head, total value of benefit would be £100m
6.	**Gifts under £100** provided by		
	(i) third party	ESC (published 25/9/87)	
	(ii) employer	T	
7.	**Accommodation and related benefits**		
	(a) Removals expenses and additional housing cost allowances	ESC	£800m [These two concessions to be reviewed]
	(b) Provided accommodation where necessary for proper or better performance of duties, and provision customary or for security reasons.	S	[Paper being prepared on possible new valuation rule that will be needed anyway as a result of replacing rates with Community Charge. Paper will also consider these exemptions and whether or not they should be retained.]
	(c) Cost of alterations etc to accommodation provided by reason of employment to director or higher paid employees.	S	
	(d) Expenses of heating, lighting, maintenance etc connected with exempt provided accommodation for directors and "higher paid employees" - taxable benefit limited to 10% of employee's emoluments.	S	"

	BENEFIT etc	Present position*	Estimated total value of benefit
(e)	Payments to clergymen living in provided accommodation owned by a charity/ ecclesiastical corporation in respect of statutory amounts payable payable in connection with property (eg rates, maintenance requirements etc), and	S	"
(f)	... Value, in case of a "lower paid" clergyman, of provision of living accommodation for him in the premises concerned.	S	
(g)	Heating, lighting, etc, bills of "lower paid" clergymen living in and performing duties from accommodation owned/leased by charity or ecclesiastical corporation.	ESC	
(h)	Board and lodging provided to "lower paid" agricultural workers even where they have entitlement to take a higher cash wage in lieu.	ESC	
8.	**Miners free coal**		£40m - estimate based on B. Coal figures for number of recipients and average entitlement.

PART II: OTHER STATUTORY OR CONCESSIONARY EXEMPTIONS

Statutory exemptions

- office accommodation, supplies or services provided for the employee on the employer's business premises and used by the employee solely in the performance of his duties

- expenses incurred in the provision of any benefit, annuity, lump sum, gratuity or similar benefit for the employee or his spouse or other dependents on his retirement or death

- the cost of necessary medical treatment abroad borne by the employer where an employee falls ill or suffers injury while away from the UK in performance of his duties

- cost of retraining borne by an employer for an employee who is about to leave or has recently left his employment (exemption introduced in FA 1987)

- allowances in respect of additional costs necessarily incurred by MPs in staying overnight away from their only or main residence for purposes of performing their Parliamentary duties.

Extra-statutory concessions

- late night taxis

- cost of home to work travel for severely disabled, borne by employer

- extra home to work travel costs borne by employer incurred by employee when public transport disrupted.

- long service awards (eg gold watch)

- expenses of certain externally provided training courses borne by employer.

- benefit of free transfers to and from the mainland for workers on offshore oil and gas rigs or platforms (technically, part of home to work travel)

FRINGE BENEFITS: PROVIDED ACCOMMODATION

BUDGET SECRET TASK FORCE LIST

Inland Revenue

Policy Division
Somerset House

FROM: M PRESCOTT
DATE: 28 JANUARY 1988

FINANCIAL SECRETARY

PRESCOTT 7 FST 28/1

FRINGE BENEFITS: PROVIDED ACCOMMODATION

1. At present, where a charge arises the benefit of living accommodation provided to an employee by reason of his employment is in practice generally measured by reference to the property's rateable value. With the abolition of domestic rates and the introduction of Community Charge the existing domestic Valuation Lists will no longer continue. With or without the introduction of an FBT, therefore, it has become necessary to devise new rules for valuing this benefit.

2. This note looks at the position mainly in the context of an FBT, but much of it would also be relevant if the present employee-based system for taxing benefits remained. There are at present certain exemptions from the charge, and these too are reviewed. This is a preliminary report - we need to do more work on this subject but you asked for an early note.

PRESENT TAX CHARGE

3. Where an employee is provided with living accommodation by reason of his employment he is, unless otherwise qualifying for exemption, liable to tax on the value of the accommodation provided. Unlike many other benefits, this applies whether or not he is a director or a "higher paid" employee.

4. The main charge is in Section 33 Finance Act 1977 which provides that the measure of the benefit for this purpose is the annual value of the property occupied (or the outlay on rent if that is greater) less any rent paid by the employee. Because "annual value" for this purpose is defined in the legislation in the same way as gross value for rating, we have been able as a matter of administrative practice and convenience to accept that

the figure for income tax purposes will usually be the same as the gross rating assessment.

5. Clearly, however, the continued use of 1973 Gross Rating values for England and Wales, and 1978 values for Scotland (by published concession we ignore the 1985 revaluation in Scotland), greatly underestimates the true measure of this benefit - the current open market rental value of the accommodation in question. As an essentially stop gap measure - pending decisions on the future of rates etc - and to counter the worst effects of this, the 1983 Finance Act introduced a supplementary charging provision for more expensive accommodation in what is now Section 33A FA 1977. Where the living accommodation - broadly speaking - costs more than £75,000, there is an additional income tax charge which is determined by applying the "official rate" (used for taxing the benefit of cheap loans) to the amount by which the cost of the premises exceeds £75,000. For this purpose, cost means either

- the market value of the property at the time it was first occupied by the employee concerned if that was more than 6 years after the property was first acquired by the employer, otherwise

- cost to the employer when the premises were first acquired by him.

6. As noted, the additional charge in Section 33A was introduced as an interim measure to help mitigate the increasingly apparent weaknesses of the main Section 33 charge. (It should be noted however, that under these rules also the same value could in certain circumstances be used for many years and so become increasingly outdated.) But they were also designed to counter a particular avoidance device that emerged, in which an employee would sell his own (expensive) house to his employer at its current market value, with an option to buy it back at the same price in, say, 5 years. In this way the employee would in effect get an interest-free loan from his employer, but one which was not caught by the cheap loans provisions. And, under normal

rules the only thing that could be taxed would be the value of the option itself, but that in practice might be difficult to quantify and even where this was possible the value would often be very low. Because the employee was in effect getting an interest free loan from his employer, it seemed appropriate to base this additional charge on an amount determined by applying the "official rate" used for taxing the beneficial loans to the amount by which the cost of the house exceeded the specified level.

NEED FOR CHANGE AND OPTIONS

7. As a flat rate payment, the Community Charge will have no connection with the value of the property in which the person(s) paying it lives. Continued use of Gross Rating value is not, therefore, an option. Even if it was possible to update 1973 rating values for properties where one exists - and so deal with the present undervaluation of the benefit of provided accommodation in those cases - this would clearly not be possible for new accommodation (for which there would be no rating value) or accommodation which was changed substantially (eg warehouses in the Dockland were converted into expensive flats). Nor anyway in practice does there appear to be a single appropriate index which could be used as a cost effective means to update 1973 rating values for existing (unchanged) premises. And there would in any event be questions whether the Valuation Office could even maintain as an acceptable cost the existing Valuation Lists when those lists were being discontinued for virtually all other purposes*

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*Rating values have many different uses outside the basic one of determining the liability to rates - eg housing, landlord and tenant legislation, Rent Acts, etc - serving to fulfil a number of functions. The DOE have recently published a consultative document with proposal for substitute rating values to fulfil these functions. In some cases, however, the proposal is that rating values should continue - at least for a limited period.

Options

8. The true measure of the benefit of provided accommodation is its full open market rental value

9. Where the employer rents rather than owns the property, the rule should simply be to value the benefit by reference to the current full open market rental value of that property - ie the rent he is actually paying so long as it is to an unconnected third party.

10. For provided accommodation owned by the employer the true measure of the benefit is again the current open market rental value and that is the amount on which the charge - under IT or FBT - should be based. But there is then a choice, viz

- assess rental values directly, or
- assess them indirectly on the basis of an appropriate proportion of the current capital value[+] of the premises which will usually be more readily ascertainable.

11. The main advantages of a system based on capital values are

- significantly lower compliance cost for employers, and lower resource implications for the Revenue's Valuation Office, precisely because current capital values are much more easily ascertainable than current rental values. This will be particularly true for eg "one off" properties in the country compared, say, to

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[+]There is also a question whether market value should be by reference of the unencumbered freehold, ie even where the property is held by the employer on say a short lease. This would ensure a more equitable result. So for example two employees occupy identical houses, in one case the employer holds the freehold and in the other he holds a 20-year lease which expires in 3 years time. The value of the accommodation - and therefore the true measure of the benefit - to each employee in any given tax year will be identical but, plainly, the value of the freehold interest would be vastly greater than the value of a rapidly fading leasehold interest.

provision of a flat in Knightsbridge where there may be a deeper rental market for such accommodation. It was of course precisely the lack of any reliable figures for an open market that caused Ministers to base Section 33A on a percentage of capital values and not on rental value directly

- capital values generally in any event are more easily understood than rental values, and they are likely to give rise to less disagreement between employers and the Revenue

12. Two further sets of question then arise concerning

(a) The appropriate percentage to be applied to capital values in order to get the figure for the current measure of the benefit.

(b) The frequency with which capital values should be updated, and the means by which it should be done.

Appropriate percentage

13. While technically there is a relationship between rental values and capital values, in practice there is no simple formula for relating one to the other.

14. One superficially plausible approach might be to regard the employee as having been provided with a notional loan equal to the current capital value, and to measure the benefit by applying a market-related rate of interest to that notional loan. The obvious rate to use would be the "official rate" used for valuing the benefit of cheap loans.

15. But this approach would overstate current rental value - the true measure of the benefit. Factors like the availability of mortgage interest relief and the benefit that accrues to owner occupiers in respect of capital appreciation will invariably in practice work to set a ceiling on current rental values such that

they would fall well short of an amount represented by market rate of interest applied to current capital values. You may recall, for example, that in a recent joint DOE/Treasury/Revenue paper on the tax treatment of private rental accommodation DOE estimated that the rents most tenants would be willing (and able) to pay would give a yield of 4-5%. By contrast the "official rate" is currently 10.5%.

16. Nor is there any other immediately obvious and conveniently available rate - eg the current yield on indexed gilts - which might be regarded as providing a reasonable approximation to rental yields and which, therefore, could be applied to current capital values in arriving at a figure for current rental values.

17. This suggests that the appropriate "rental yield" to be used under an approach based on capital values would have to be determined on an ad hoc basis, as it was in the DOE exercise. What we would be trying to arrive at is the rental yield that would be obtained in the deregulated market. This is only something which can be observed and we would clearly need an input from DOE as well as from the Valuation Office at the time the rate was set. However, though the figure for rental yield will also depend on factors such as rates of income tax, which in turn affect the value of mortgage interest relief, it is likely - assuming continuance of MIR itself etc - to remain reasonably stable for reasonably long periods at a time. Having set a rate (either in the primary legislation, or in statutory instruments), therefore, it should be possible to leave it unchanged for relatively long periods.

Adjusting capital values

18. In principle, capital values would need to be updated annually - especially as they can change substantially from one year to the next. But measuring rental values directly would also point to annual updating.

19. By comparison with the present system - where for many properties we have simply continued to use the 1973 rating value

one year after the next - this will involve far more frequent valuations by employers and, where necessary, more work for the Revenue's Valuation Office in providing and/or confirming such valuations. This problem arises regardless whether we stick with the existing employee-based system or switch to an FBT.

20. We have considered whether, once an initial capital valuation for a property has been established,it would be possible to up-rate that figure annually by reference to some standard, readily-available index, thereby saving the employer (and ourselves) the chore of the need for annual valuations. Unfortunately, there is no single index that would be suitable for this purpose. There are, of course, various indices - eg those published by the Building Societies - but these tend to focus on a particular sector of the market. There would also be obvious difficulties in seeking to use a single index for all provided accommodation bearing in mind the often very substantial differences in house prices not only between one region of the country and another, but within different parts of the same region or - as in London - between one part of the city or town and another.

21. Clearly, however, there is a trade off here between the need for as correct a measure as possible of each individual benefit and the need for administrative simplicity. Though not an index as such, the Valuation Office already publishes twice a year a lot of information about the level of house prices (with separate figures for new and secondhand dwellings, and by type of property) for different regions, and for all the main towns in each region. These figures are in the form of a price range for each type and location of property in question.

22. Even as things stand, therefore, Tax Districts could - at least in straightforward cases - be instructed to accept an employer's capital valuation provided that it fell within the VO's price range for the particular kind of property concerned. (There will be "one off" cases - eg the country manor house for which figures are not produced by the VO and for which, therefore, separate valuations will continue to be needed. But

we would expect few such cases). For subsequent annual upratings, it would simply be a question of the employer obtaining from the Tax District the updated VO figures for the type of property in question - in practice, this would probably mean our having to accept for subsequent years a valuation based on the bottom end of the VO price range. Where the property was "one off" in nature it might be possible to agree some ad hoc arrangement with the employer that obviated the need for annual valuations; for example, the agreement might be for an independent valuation every, say, 5 years with an interim uprating formula using changes in some agreed house price index.

23. A further possibility would be to develop more formal indices for changes in house prices, based on the data produced by the VO. (At present, they do give indicative figures for the percentage change in house prices between one period and a next for each of the main Regions, including Inner and Outer London. It would obviously be worth considering whether these figures - either as they stand, or suitably expended - might serve as a basis for providing indices that could be promulgated to employers to be used for the purpose of the annual uprating of capital values for this purpose.

Transitional arrangements

24. Moving immediately from a valuation of the benefit based on 1973 rating values to one based (directly or indirectly) on current rental values will obviously involved a significant increase for those concerned, and the question arises whether there should be some kind of transitional arrangement to help soften the impact of the change. The three main arguments against this are

(a) the employee would not be affected if this happened at the same time as switching to an FBT (different considerations might, of course, apply if FBT was not introduced)

(b) it would complicate the provisions considerably

(c) it would perpetuate the substantial advantages which most employees with provided accommodation have enjoyed since 1973.

Avoidance device

25. It will also be necessary to reintroduce some kind of anti-avoidance measure to counter the device mentioned at paragraph 6 above and presently deterred by the operation of Section 33A. One way to do this might be to extend the beneficial loan provisions to cover this particular use of provided accommodation, rather than to complicate the accommodation provisions themselves - but there may be possibilities.

EXEMPTIONS FROM THE CHARGE

26. At present an employee living in provided accommodation is exempt from tax on the benefit in any of the following three cases

(a) where it is necessary for the proper performance of his duties that he should reside in the accommodation. This test is a very strict one, and in practice only people like lockgate keepers or caretakers living on the premises would qualify under it;

(b) where the accommodation is provided for the better performance of the duties of his employment, and his is one of the kinds of employment in the case of which it is customary for employers to provide living accommodation for employees. This is a much looser test, and brings in people like nurses, farmworkers, the police and prison officers, clergymen, the armed forces, diplomatic personnel, publicans living above the premises etc etc.

(c) where, there being a special threat to his security, special security arrangements are in force and he

resides in the accommodation as part of those arrangements. This was introduced to deal with a particular problem of eg diplomats or judges living in Northern Ireland or certain Ministers of the Crown where it was necessary for them to live in particular premises that could be made secure.

27. The historical reasons for these exemptions are explained more fully in the Annex. While the third exemption (security) can obviously be justified (though even then the wording of the present exemption is not without difficulty), the first and second - particularly the latter - are much more difficult to justify in strict logic. Though they relate to the employee's duties, the fact remains that an employee with provided accommodation is nevertheless getting a real and possibly substantial benefit and (still in logic) there does not seem to be any really convincing reason why that benefit should escape tax merely because the provision of the accommodation is linked to the performance of the duties. The second exemption might be thought especially difficult to justify - it boils down saying that people should get this benefit because they always have.

28. These exemptions are also a constant source of difficulty because a large subjective element is involved - ie testing what is "necessary" in the case of the first exemption, and what is "a kind of employment", "customary", and "better performance" in the case of the second.

29. We estimate that there could be 110,000 employees receiving rent-free accommodation from their employer who currently come within one of the three exemptions. There are up to a further 100,000 employees who might qualify for exemption on the benefit they receive from paying their employer a reduced market rent. (In contrast there are maybe 90,000 employees who are charged to tax on the benefit of rent-free accommodation, with possibly up to a further 70,000 charged on the benefit received from paying reduced rents).

30. Clearly, to withdraw the exemptions entirely (except the one for security) would bring into the charge many of what would no doubt be represented as "hard cases" - eg low wage farmworkers in tied cottages. This is precisely the area where there has been strong pressure to exempt those in tied cottages from tax where their employer pays the Community Charge (they are presently exempt in respect of the benefit from the payment of rates). Ministers may feel, therefore, that outright withdrawal of the exemption - putting nothing in its place - is simply not feasible politically.

31. One possible alternative might be to withdraw the present exemptions (again, not security) and instead have a general exemption under which a specified amount or proportion of the capital value of the premises would be ignored for purposes of calculating the annual value of the benefit. This amount or proportion would be essentially arbitrary, but the aim would be to try to fix it in such a way that it would operate preferentially in favour of less expensive premises of the kind that might be occupied by those people covered by the present exemptions. We would need to give a lot more thought as to how this might be done if Ministers saw any attraction in this kind of approach. Clearly, however, there would be major disadvantages. The most important of these is that we would thereby be introducing a new partial relief for all those people in receipt of this benefit who at present do not qualify for exemptions. That would seem to be perverse - especially in the context of a switch to FBT.

32. On balance therefore, and largely on pragmatic grounds, Ministers may feel that the best option would be to leave these exemptions as they are.

Other land

33. The existing legislation in Section 33 and 33A FA 1977 only covers the benefit of "living accommodation". There is a separate charge where an employer provides an employee with land - eg an orchard - but that charge only applies to directors and

the "higher paid". The value of the benefit is currently calculated along the lines of Section 33 - ie in practice, we take the rating value. In the context of FBT it would be logical to have a single charge which covered the provision of all land including any accommodtion standing on it.

SUMMARY AND CONCLUSION

34. The present arrangements for valuing the benefits of provided accommodation need to be changed, with or without the introduction of FBT, as a result of the abolition of domestic rates. We could obviously continue with our existing practice - using rateable values - until the introduction of Community Charge, planned for April 1990, and possibly for a while even beyond that, though this would depend on whether Valuation Lists were maintained. And, there would of course increasingly be difficulty as regards new properties or those which had undergone major change and for which, therefore, there was no rateable value. While some decisions (eg on the precise figure for the "appropriate proportion") if the capital values approach is adopted need not be taken until nearer the time, decisions clearly are needed fairly quickly on the new valuation rule itself if this is to be incorporated in to the FBT legislation from the outset. This need to review the valuation rules also provides an opportunity to review the exemptions.

35. There is a lot more work to be done on this. And, as I say, this is going to have to be done quickly. But before we can take matters much farther forward, it would be helpful to have guidance from Ministers on the following points

(a) Is it agreed that the benefit of provided accommodation should continue to be a taxable benefit, either under the existing employee-based system or under an FBT?

(b) Is it agreed that for premises owned or leased by the employer, the measure of the benefit - the annual rental value - should on grounds of administrative

simplicity for employers and the Revenue be based on an appropriate proportion of capital values, rather than on a system requiring assessment of market rental values directly? (Paragraphs 8-12).

(c) Is it agreed that the "appropriate proportion" should be determined on an ad hoc basis, and adjusted as appropriate from time to time? (Paragraphs 13-17).

(d) Should the requirement be for annual uprating of capital values? (Paragraphs 18-23).

(e) If so, should we pursue further the idea of developing the data already collected by the VO into its specific and more refined indices and that could be used for this purpose?

(f) Should there be transitional arrangements to cushion the hike in measure of the benefit which will occur on the switch over from the present to the future system? (Paragraph 24).

(g) While the existing exemption on "security" grounds obviously needs to remain, should the other two exemptions remain as well? (Paragraphs 26-31).

(h) If not, should they be withdrawn altogether, or replaced with a general exemption of some kind aimed at exempting all "modest" properties?

(i) Is it agreed that anti-avoidance measures are needed to deal with "options"? (Paragraph 25).

(j) Should the proposed separate charge on land be incorporated with the charge for provided accommodation? (Paragraph 32).

M PRESCOTT

SECTION 33 FA 1977 EXEMPTIONS: HISTORICAL BACKGROUND

1. Prior to 1977 the tax treatment of living accommodation provided for employees was governed by two separate sets of rules, one for the lower paid and one for directors and "higher paid" employees.

2. The liability of a lower paid employee depended on his being the occupier of the premises; but, if he occupied the premises merely as the representative of his employer he was not regarded as the occupier and there was no liability. The liability of the higher paid employee did not however rest on whether he was the "representative occupier" but on whether he was required by the terms of his employment to reside in the accommodation provided, and whether it was necessary for him to reside on the premises for the proper performance of his duties.

3. But over the years the developing case law governing representative occupations meant that the definition became a great deal wider than the tests above for exemption applicable to the higher paid. So this distinction became increasingly unworkable. The 1977 provisions were therefore introduced with a view to regularising the position.

4. It was considered in 1977 that an exemption from the charge should continue to be available for those employees who are required to live in certain premises for the purposes of their employment and that the test for this exemption should be one which applied to the "higher paid" and "lower paid" alike. The general principle was that where an employee was obliged to live in the provided accommodation, rather than where he chose, the accommodation could in a sense be regarded not as a benefit but as compensation to the employee for

a disbenefit in undertaking his duties. The test that fulfilled this requirement was whether the occupation of the accommodation was essential for the performance of the duties.

5. There were, however, a good many groups of employees who had hitherto been exempt from tax as representative occupiers who would not be able to meet this first test. A second test was, therefore, introduced under which exemption was available where the accommodation was provided for the better performance of the duties and the employment was of a kind in respect of which it had become customary to provide accommodation. The fact that it had been found necessary through the years to provide houses for such a class and that there was a link between the practice and the performance of the job was regarded as showing that the employee must live in the house to do the job. This test brought in such groups as agricultural workers, school masters in boarding schools and police officers.

6. There remained a few instances where someone in the public service whose security was a risk and was thus provided with accommodation, but the provision of such accommodation did not need meet either of the two previous tests (for example a diplomat, an official in Northern Ireland or a particular minister of the crown). A third test was therefore introduced to cover such people.

VALUATION RULE FOR GOODS AND SERVICES GENERALLY

BUDGET SECRET: TASK FORCE LIST

Inland Revenue

Policy Division
Somerset House

Ch/ Key points summarised in paras 34-40. JF 28/1

FROM: M PRESCOTT
DATE: 28 JANUARY 1988

CHANCELLOR

VALUATION RULE FOR GOODS AND SERVICES GENERALLY

1. Though the existing valuation rules for goods and services generally* could - broadly speaking - be carried over to FBT, the operation and interaction of these rules is not always straightforward and there is a good case for taking this opportunity to consider new, simpler rules. This is all the more important because FBT will be a self-assessed tax on employers/providers and in order to keep the extra administrative burden on them to a manageable level the rules need to be as simple and easy to operate as possible.

PRESCOTT → CH/EX 28/1

PRESENT POSITION

2. Because the present rules for taxing benefits and expenses payments have evolved over a long period and in a piecemeal fashion, there is no single, universally applicable rule; rather, the basis of valuation will depend on whether the benefit in question is covered by the special rules in Finance Act 1976 for taxing benefits and expenses payments received by directors and "higher paid" employees, or by the general Schedule E provisions that apply to all employees, and on whether the goods or services are obtained by a voucher or credit token in which case separate rules governing the provision of benefits in this way may also be relevant. There are also differences between benefits in the form of goods and those in the form of services.

3. Broadly, however, the present position can be summarised as follows

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* (ie excluding benefits such as cars, cheap loans, etc for which special rules apply)

(a) provision of a benefit by means of meeting the employee's pecuniary liability - ie where the employer simply pays the employee's personal telephone or electricity bill, or pays the employee's bill for other goods and services. Here, the measure of the benefit is the cost to the employer. This rule applies to all such benefits, not just to those provided to directors and "higher paid" employees.

otherwise, in the case of **goods**

(b) a charge on goods would arise on all employees under Schedule E on the "second hand" (ie resale) value of those goods in the hands of the employee. This will not necessarily be the same thing as "market value" as normally define for tax purposes. The test here established by the Courts is "not what saves the employee's pocket, but what goes into it". Thus, the value to a Burton's employee of a brand new suit given free will usually be much less than its full retail value, simply because the employee will not be able to sell it privately for the full retail value. Similarly, gifts of wine or spirits may have no taxable value because strictly speaking it would be illegal to the employee to sell them without a licence

(c) the "second hand value" rule under Schedule E is supplanted if the goods are obtained by voucher or credit tokens. The amount of the taxable benefit in this case becomes the cost of the voucher etc plus the cost of the goods to the person providing the voucher

(d) if the individual concerned is a director or "higher paid" employee, and no voucher is used, the benefit of the goods is the cost to the

provider. If second hand value exceeds cost to the provider there could in theory be an additional charge under Section 181 because the FA 1986 provisions only charge the cost if it is not otherwise chargeable as the employee's income. But cost can be said to be an ingredient of second hand value in this situation and in practice the rules resolve as a charge on cost or on second hand value in the employee's hands, whichever is the greater.

in the case of **services**

(e) the benefit of services provided free or at undervalue would not be chargeable under Schedule E because they cannot be converted into money and do not have a "second hand" value

(f) services provided by way of vouchers and credit tokens would be chargeable on all employees in the same way as goods - the cost of the voucher etc plus the cost of the services to the provider

(g) where the individual is a director or "higher paid" employee and the voucher is not used, the chargeable benefit will be the cost of the services to the person providing the benefit.

4. "Cost" to the provider is defined as the amount of expense incurred in or connection with provision of the benefit. Sometimes it will be clear what the "cost" is, sometimes less so. For example

(a) for goods provided free or at undervalue, the "second hand" value will sometimes be higher than cost to the employer so we would not normally in practice need to determine the latter. But in those

cases where this is necessary, "cost" will include an appropriate amount in respect of indirect costs and overheads, not just direct costs.

(b) similarly, in the case of services it will be necessary to include something for indirect costs. We have, for example, resisted arguments that because the marginal cost of providing a free school place to the son of the school master teaching there will be very low, the measure of the benefit is correspondingly low or nil.

NEW RULES UNDER FRINGE BENEFITS TAX

5. Under FBT it will be the provider, usually the employer, who will have to determine the value of the benefit. We therefore need rules that are

(a) standardised, bearing in mind that with FBT there will be no "earnings threshold" so that the same rule will apply regardless whether the benefit is provided to directors and "higher paid" employees, or to "lower paid" employees

(b) as simple as possible, so as to keep the burden on employers to a minimum

(c) actually capable of being operated by the employer (eg do not rely on information which the employer will not have).

6. One immediate conclusion from the above is that the present "second hand value" rule (paragraph 3(b) above) would have to be dropped under an FBT simply because this is not something that the employer could reasonably be expected to know. If we were otherwise to stick with existing valuation rules, therefore, this would mean a reduction in the size of the chargeable amount in those cases where second hand value exceeds cost.

General principles

7. There are three main methods on which benefits might be valued, viz

- the value of the benefit to the individual employee concerned

- "market value" (which might be defined in a number of ways)

- cost to the employer.

(a) Value to employee

8. Arguably, the truest measure in theory is the value to the employee. But this approach will usually be difficult to apply - and in practice is rarely used - because it would necessitate costly and time-consuming work in assessing the value of the particular benefit concerned to the particular individual concerned and at the time and in the particular circumstances that he received it. It would clearly not be practicable to impose this kind of burden on employers under an FBT.

(b) Market value

9. This is in principle a much better measure of the benefit than cost to the employer. (In certain circumstances these may be more or less the same thing - eg where the benefit is goods or services which the employer has bought or paid for on behalf of the employee).

10. Broadly, however, market value can mean either

(a) the price that the employee would have to pay for similar goods or services in the open, retail market as an ordinary member of the public

(b) the lowest arm's length price which the employer would charge his normal customers for similar goods or services.

11. In the case of goods bought and sold by a retailer as part of his normal business, these would be more or less the same thing. This is generally true of services also. But they will not be the same in the case of goods that are produced as part of the employer's normal business and which are normally sold to non-retail customers (ie distributors), or in the case of goods that are sold by the wholesaler where again the price charged to his normal customers will usually be less than the final open market retail price.

(c) Cost to employer

12. Arguably, this is the least satisfactory of the measure of the true value of the benefit to the employee. Moreover, in the case of goods produced or services provided by the employer himself a part of his normal business there will often be considerable scope for argument about what is the true measure of the cost - ie average cost, marginal cost, etc. On the other hand, market value will not always be appropriate, particularly if there is no identical or reasonably similar market - eg motor vehicles where there is a restriction on the use imposed by the employer.

OPTIONS

13. In practice, therefore, there will be a choice between market value (two variants) and cost to the employer, depending on the circumstances. There are four main cases that need to be considered and these, together with the valuation options, are summarised in the table at Annex A.

14. As regards Case A (goods and services which the employer buys from someone else for the employee), the valuation rule for FBT will be cost to the employer. This is broadly the same as under the present system - ie for directors and

"higher paid" employees, or where the employee meets the employee's pecuniary liability. It will also broadly equate to full open market value.

15. As regards Case D (the benefit of services provided by the employer which are not part of his normal business - eg ranging from subsidised canteens to subsidised foreign holidays for the staff and their families), it would in theory be possible to adopt a "market value" rule - ie to value the benefit of a subsidised canteen meal by reference to the price that the employee would have to pay in the open market for a similar meal. In practice, however, it may often be very difficult to determine this if there is not an identical and/or easily ascertainable product or market to use as the comparator. Moreover, under an FBT this task would fall to the employer and this would clearly be inconsistent with the aim of keeping the additional administrative burdens on employers to a minimum.

16. Realistically, therefore, the only alternative is cost to the employer of providing the service in question. Ministers are still considering whether certain benefits in this category - eg subsidised canteens - should be excluded from FBT altogether or, if included in certain circumstances, whether we should exclude from the measure of cost any subsidy in respect of certain indirect costs, particularly those relating to accommodation. In other cases, however, cost here should be taken to mean full average cost - ie including an appropriate amount in respect of indirect costs.

17. That leaves

- goods that are bought and sold as part of an employer's normal business (Case B),

- goods produced or services provided by the employer as part of his normal business (Case C)

for which there are a number of options.

First option: full market value

18. One option would be to adopt full open market value for all goods and services falling into Cases B and C - ie on the grounds that the price which the employee would have to pay as an ordinary member of the public in the open retail market will correctly and objectively measure the true and full value of the benefit concerned. And benefits in this case would then also be treated on a par with the benefits of goods and services which the employer buys from someone else for the employee (Case A).

19. This would, however, mean a very substantial increase in the number of benefits that were chargeable to tax. This is because a full open market value rule would catch

- all staff discounts on goods and services to employees in the retail sector. At present, these discounts would only be caught if the discount was so large as to bring the discounted price down to a level below cost/second hand value, whichever is greater. With over two million employees in the retail sector, and staff discounts being a fairly common feature throughout, this would obviously be a major extension of the tax

- virtually all goods and services produced or provided as part of the employer's normal business, and virtually all goods bought and sold as part of the employer's normal business where the employer is other than a retailer (eg a wholesaler), even if the employee is paying the same arm's length price at which identical goods or services are sold by the employer to his normal customers. This is because that price will nevertheless nearly always still be lower than the full open market retail price for the goods or services. Here too, therefore, there would be a major extension of the tax.

20. A second - albeit lower order - difficulty with this option is that the employer would not always know or be able to ascertain readily the current open, retail market price for the goods or services in question that he was providing to his employees. In the great majority of cases, of course, he would know this - if he was a retailer he would, by definition, know at what price he was selling to the public, and even if he was not the retail price would usually be easily ascertainable (eg Ford Motor Company know what is the retail price of one of their cars). Nevertheless, there would be some cases - especially involving goods that are produced by an employer as part of his normal business for sale to the non-retail market - where there would be difficulties for employers.

Second option: proportion of market value

21. One way of mitigating the effects described at paragraph 19 above would be to adopt a rule under which the measure of the benefit in these cases was not the full open market retail price value, but some specified standard proportion of it - say, 75%.

22. The proportion itself would be an essentially arbitrary number, but it would be pitched at such a level that it was low enough to exclude most staff discounts while not being so low as significantly to undertax the true measure of the benefit. However, even at 75% (and there would seem to be little justification for adopting a lower proportion)

- many staff discounts for employees in the retail sector would still be caught (we do not have figures, but anecdotal evidence suggests that many retail employees get staff discounts in excess of 25% on the retail price)

- a proportionately even greater number of benefits would still be caught in cases where the employer was not a retailer, for the reasons outlined at paragraph 19(b) above.

23. A second difficulty with this approach is that having scaled down the true measure of the benefit in this case, it would be difficult to resist suggestions that we should similarly not pursue the full measure of the benefit in other cases - eg cars, accommodation, cheap loans, and so on.

Third option: the "Antipodean approach"

24. The Australians and New Zealanders have adopted a rather different approach. Their starting position is the recognition that "market value" may mean two different things, as explained at paragraph 10 above, depending on where in the production/distribution chain the provider of the benefit (ie the employer) happens to stand. They seem implicitly to take the view that the correct benchmark for the measure of the benefit is the price which the employee would have to pay as a normal customer of his employer's business, which - unless his employer is a retailer - will not be the same thing as the price he would have to pay as a member of the public for similar goods and services in the retail market.

25. This then leads to a further consideration. To take a simple example, the price that, say, Ford Motor Company charges its normal customers (the distributors) for one of its cars will not be the same as the retail price charged to a member of the public. The retail price will usually be higher because of handling and distribution costs, and the markup added by the wholesaler and/or the retailer. But if the valuation rule was "lowest arm's length price to the provider's normal customers," essentially the same benefit would have a different value solely as a result of where in the production and distribution chain the provider happened to stand - ie whether he was the producer, the wholesaler or the retailer. (A further complication might arise in cases where the producer sold some of his product to wholesalers and retailers, but some direct to final - retail - customers). This, it might be argued, is unfair in the sense that benefits provided at a later stage in the production/distribution chain would attract more tax than those provided at an earlier stage, merely for that reason.

26. One counter argument to this, of course, is that value will have been added - if only in the form of handling and distribution - as the product moves further down the distribution/production chain, and so too therefore will the measure of the benefit have increased. There is also the more fundamental argument that the correct benchmark in all these cases is not what a customer of the employer would have to pay, but the price that the customer as a member of the public would have to pay in the open, retail market.

27. However, if the arguments at paragraphs 24 and 25 are accepted, it then becomes possible to argue that, as regards goods, the solution is to adopt

- "cost to the employer" for goods that are bought and sold as part of the employer's normal business (Case B),

- "lowest arm's length selling price" for goods produced or manufactured by the employer as part of his normal business*

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*There is then the possibility of one further refinement, to cater for the situation - probably fairly unusual - where the employer produces goods as part of his normal business for sale direct to the general public rather than for sale to a wholesaler or a retailer. It would clearly be too cumbersome to try to determine case by case what price was charged by those manufacturers supplying similar goods not to the general public but to wholesalers or retailers, especially as this task under FBT would have to be undertaken by the employer. The alternative, therefore, would be to scale down the retail price in these cases by some fixed proportion. The Australians (but not the New Zealanders) have adopted this further refinement, and the proportion in their case is 75%. They also scale down for services - again to 75% of the lowest arm's length price charged to the employer's normal customers - though the justification for this in the case of services is less obvious. Presumably, however, this was felt to be necessary on the grounds that, having adopted cost to the employer or scaling down for goods, it would be difficult not to do something similar for services.

In a simple two party production/distribution chain where the distributor is also a retailer, the measure of the benefit would then be the same throughout because the price charged by the producer to the retailer would be the same as the price paid by the latter for acquiring the goods. (This begins to break down, of course, if the distributor is a wholesaler not a retailer, or if there are more than two parties involved - ie manufacturer, wholesaler and retailer - but it will still hold as between eg the manufacturer and the wholesaler, or the wholesaler and the retailer).

28. Under the present system the rule for goods in Cases B and C will in most instances be cost to employer or second hand value whichever is greater. For goods bought and sold as part of the employer's normal business, therefore, this option would involve some relaxation in cases where second hand value exceeds cost, and no change in other cases. For goods provided by the employer as part of his normal business, the change would work in the direction of bringing into tax some benefits presently excluded - but this will depend in each case on the precise relationship between lowest arm's length price and cost/second hand value.

29. For services - ie those that are provided as part of the employer's normal business - the above kind of refinement should not in principle be necessary. Unlike goods, there are only two parties involved in the "supply line" for services - the provider of the service and the person to whom it is provided. For services, therefore, the valuation rule could simply be "lowest arm's length price charged by the employer for an identical service provided to his normal customers".

30. This would be a departure from the present system, where the rule for services is cost to the employer. But the present rule is difficult to justify, especially as even under the present system the valuation in the case of goods will usually be something much closer to market value (see paragraph 4(c) above). Moreover cost is not an easy concept,

particularly for services where there is often much wider scope for "marginal cost" arguments.

Fourth option: cost to employer

31. Under the previous option, only goods bought and sold by the employer as part of his normal business would be valued at cost to the employer; goods produced or services provided by the employer as part of his normal business would be valued at lowest arm's length price charged to the employer's normal customers. Under this option, the last two would also be valued at cost to the employer.

32. The present rule for services is cost to the employer, and - generally speaking - for goods it is the higher of cost to the employer or resale ("second hand") value to the employe. Compared to the present system, therefore, this option would involve relatively little change, except in respect of those goods for which the resale value to the employee is higher than cost to the employer and where, therefore, the effect of the change would be to take some benefits out of tax.

33. It is difficult to generalise about whether resale value to the employee will be higher or lower than cost to the employer. There is likely to be enormous variation, depending on the nature of the goods in question. Generally speaking, however, resale value is more likely to exceed cost where the goods in question have a high mark-up and/or are luxury goods, than in cases where they have a low mark-up. For example, the resale value of an expensive fur coat given to an employee by his employer who is a fur coat retailer is still likely to be less than the cost of the coat to the employer. Similarly, the resale value of a Sierra given to an employee of Fords would probably still be less than what it cost Fords to produce (assuming he was in fact free to sell it). On the other hand, for many small, less expensive but perhaps still quite significant goods (eg clothes more generally, electrical

goods, etc etc) the resale value to the employee will almost certainly be less than cost to the employee.

SUMMARY AND CONCLUSION

34. There is a good case for standardising the general benefits valuation rules for FBT, particularly given the need for simple and clear cut rules that can be operated by employers without too much difficulty. The abolition of the "earnings threshold" and with it the need for separate rules that apply to directors and "higher paid" employees will facilitate this.

35. At minimum, the present "second hand value to employee" rule would have to be dropped for FBT, because such a rule could not be operated by employers.

36. There are then a number of different cases that need to be considered.

37. Where the employer simply buys the goods and services from someone else for the employee, or the employee acquires them and the employer pays (**Case A**), the valuation rule would continue to be cost to the employer. This is the current rule for directors and higher paid employees, or where the employer meets the employee's pecuniary liability.

38. Similarly, for services provided by the employer which are not part of his normal business (**Case D**), the rule would - as at present - be cost to the employer. Precisely which costs should be included and which excluded for this purpose in the case of services like subsidised staff canteens that are not otherwise exempted being considered separately.

39. As regards goods bought and sold as part of employer's normal business (**Case B**), and goods produced or services provided by employer as part of his normal business (**Case C**) this note has identified four main options for valuing these benefits under FBT;

- market value: ie value the benefit of all goods here by reference to normal retail price, and all services on the basis of normal arm's length price charged by employers to their ordinary customers (see paragraphs to);

- proportion of market value: as above, but with the measure of the benefit reduced by a standard specified proportion of full market value (paragraphs to);

- "Antipodean approach": cost to employer for goods bought and sold as part of his normal business. Lowest arm's length price charged to normal customers for goods produced or services provided as part of the employer's normal business (paragraphs to);

- cost to employer: ie for goods produced and services provided by employer as part of normal business, and not just for goods bought and sold as part of employer's business. Broadly the present system (in most instances) except where resale or "second hand" value to employee exceeds cost to employer.

40. Some points relevant to consideration of these options include

- is FBT to be regarded as a tax on benefits provided, or on the provision of benefits? If the former, this would tend to point towards rules which measure the true value of the benefit to the employee and, therefore, to market value rules. If the latter, this would tend to point towards cost-based rules

- to the extent that the reason for switching to an FBT is to get the taxation of benefits on to a more rational basis, should this opportunity be taken to move to valuation rules that measure the benefit

more correctly. If so, that too would point towards the market value-type rules

- on the other hand, to the extent that the priority is to get FBT established, with minimal changes in the detailed provisions at this stage (especially any that would be likely to add to what is already likely to be a controversial measure), that would point towards maintaining the status quo and the cost-type rules.

M. Prescott

M PRESCOTT

ANNEX A

ALTERNATIVE VALUATION RULES

	Case	Alternative rules*
A.	Goods and services which the employer buys from someone else for the employee; or which the employee himself acquires but the employer pays for.	Cost to employer (ie expense incurred by him). (Since the employer is buying in the goods or services the cost to him will broadly equate tomarket value and will be easy to ascertain).
B.	Goods bought and sold as part of the employer's normal business.	Cost to employer - ie price paid or lowest arm's length price at which sold to normal customers (ie where employer is a wholesaler). or open market retail price (ie where employer is either a retailer or a wholesaler), or a proportion thereof.
C.	Goods produced, or services provided, as part of the employer's business.	Cost to employer of producing goods or providing services. or lowest arm's length price charged to normal customers or open market retail price or a proportion thereof.
D.	Services provided by the employer which are not part of his normal business (eg staff canteens).	Cost to employer of providing service or price employee would have to pay in open market for similar service.

* less, in all cases, anything paid for the benefit by the employee and the amount of any expenses deduction to which he would be entitled.

PMP

Inland Revenue

Policy Division
Somerset House

FROM: M PRESCOTT
DATE: 28 JANUARY 1988

CHANCELLOR

FRINGE BENEFITS TAX: COVERAGE

1. In his note of 25 January the Financial Secretary identified two main options, viz

(a) Option I: "Rationalisation" Adjust the existing exempt/non-exempt boundary for communally provided "social/welfare-type" benefits like subsidised meals, sports facilities and work place nurseries so that there is greater consistency of treatment as between one such benefit and another ("Rationalisation").

(b) Option II: "Status Quo" So far as possible simply replicate coverage under FBT with present coverage, so that benefits which by statute or practice are exempt under the present system would continue to be exempt under FBT ("Status quo")

This note is intended mainly as an aide memoire, to show what the position would be in relation to each of the outstanding points on coverage under either option, and to identify points arising on which decisions would be needed. It also deals with a number of more general related points.

2. Annex A attached provides a check list of the outstanding benefits and expenses payments on which decisions are needed. It is based on the check list attached to my note of 14 January, but for convenience has been expanded to incorporate various other existing exemptions (statutory or concessional) referred to in that note.

Note - numerous canteens noted - for 12 to 18

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3. Part II of the Annex lists all of the "non-contentious" existing statutory or extra-statutory exemptions - ie those which it has been assumed throughout Ministers will want to continue for FBT. If that is agreed, all of those benefits can be ignored for present purposes - they will all continue to be exempt whichever of the above two options is chosen. However, a decision is needed on whether those exemptions currently provided by ESC should be put on to a full statutory basis under FBT, or re-promulgated as concessions.

4. The remaining benefits, the ones we are concerned with here, are those at items 1-8 in the Annex - ie canteens/luncheon vouchers; sports and recreational facilities; work place nurseries; car parking; entertainment and gifts, the various accommodation-related benefits; and miners free coal.

STATUS QUO (Option II)

5. This would mean trying as far as possible to produce exactly the same treatment for each of these benefits under FBT as applies as present.

6. For benefits at present covered by a a statutory exemption, and with certain exceptions (see paragraph 12 below), this would be straightforward; there would simply be a similar statutory exemption under FBT. This would deal with canteens where meals are provided for the staff generally (item 1), third party entertainment (on the grounds that the Government has announced its intention to legislate), and the various statutory exemptions in respect of provided accommodation (item 7 - but excluding 7(a), removals expenses/additional housing cost allowances, which is to be reviewed separately).

7. For benefits like workplace nurseries or non third party entertainment, which at present are both taxable and usually taxed in practice, no action would be required; FBT will apply generally to all benefits, except those explicitly exempted, and

so these benefits would automatically be covered without them being separately identified as such.

8. As regards benefits like sports facilities and car parking which at present are taxable, but not usually taxed in practice, a decision would be needed on whether to bring FBT into line with the present statutory position (ie that these benefits are taxable - in which case no action needed) or with present practice (which usually means not taxing - in which case it would be necessary to decide on the proposed terms of any exemption for these benefits, and to build that exemption in to FBT).

9. Finally, there are those benefits which at present are exempt by extra-statutory concession - directors dining rooms, luncheon vouchers, Christmas parties, removals expenses and excess rent allowances, clergymen's heat and lighting, agricultural workers' accommodation and miners free coal. For all of these (and for the non contentious concessionary exemptions listed in Part II of the Annex) a decision would be needed on whether to carry over the exemption to FBT by

- putting the concession on to a full statutory basis,

- or by withdrawing the existing ESC and promulgating a new one adapted to take account of FBT.

10. The statutory route would be the more defensible given that ESCs ought in principle to be put on to a statutory footing when the opportunity arises, and there would obviously be no difficulty with this as regards the "Part II" concessions. On the other hand, Ministers would presumably not want to put eg the luncheon voucher or miners free coal concessions on to a full statutory basis; but it might look equally odd - and arouse suspicions - if some of these concessionary exemptions were carried forward on a statutory basis and others on a concessionary basis.

11. In addition, however, some change to the present statutory/extra-statutory position on directors' dining rooms seems necessary in any event, because of the nonsensical condition presently linking the exemption for canteens with the exemptions for luncheon vouchers - ie directors' dining rooms are regarded as covered by the statutory exemption for canteens in which meals are provided for the staff generally if other workers either get meals elsewhere on the premises or get LVs that do not exceed 15p a day. We think the right course would simply be to drop this rider. Directors' dining rooms would then only be regarded as covered by the statutory exemption if other staff got fed elsewhere on the premises.

12. Finally, there is the further technical difficulty over the present statutory or concessionary accommodation-related exemptions listed at 7(c), (d), (f), (g) and (h), which all depend on the present distinction between directors and "higher paid" employees on the one hand, and "lower paid" employees on the other - a distinction that will cease to exist under FBT.

13. Three of these - 7(f), (g) and (h) - are exemptions that apply only to "lower paid" clergymen and agricultural workers and the options, therefore, would be

- drop the exemption for FBT

- extend it to "higher paid clergymen and agricultural workers

- carry the existing lower paid/higher paid distinction forward into FBT, but for this purpose only.

14. We do not have firm figures on the number of clergymen and agricultural workers affected. However

- as regards clergymen (7(f) and (g)) there are about 17,000 Church of England clergymen living in provided

accommodation, of whom 10,000 or so are probably "lower paid" and, therefore, covered by these exemptions. We have no figures for the other religions but it seems plausible to assume that the number affected may be as big again, making a total of 20,000

- as regards agricultural workers (7(h)), we know that about 7½% - or about 27,500 - of the 320,000 or so agricultural workers in England and Wales get provided accommodation. The majority are likely to be "lower paid". Again, therefore, the number of employees affected may be around 20,000.

15. The other two exemptions under this heading, 7(c) and 7(d), work the other way round - the benefit here would not be taxable on the "lower paid" anyway and the present exemption removes or limits the size of the taxable benefit where the recipient is a "higher paid" employee. Here, if the exemptions are to be retained, there would seem to be little objection to generalising them to all employees.

RATIONALISATION (Option I)

16. This approach is primarily concerned with getting the exemption for canteens, sports facilities etc on to a more consistent basis. The idea would be to try under FBT to create an exemption for this kind of communally provided "social/welfare" benefit as a general class of exempted benefit. The two main principles on which the exemption would apply might be

- benefit provided and consumed on the employer's premises,

- provided for and available to the staff generally, and on broadly similar terms.

17. This would make it possible to exempt all such communally provided benefits - not just staff canteens, but sports and recreational facilities provided on the employer's premises, work place nurseries, car parking, and so on. The logic of this approach, however, is that benefits which are not provided and consumed on the employer's premises should be taxed - specifically, therefore, this would mean dropping the present concessionary exemption for luncheon vouchers and taxing any of these benefits (eg car parking) that were provided and consumed "off" the premises.

18. Points arising for consideration include the following

(a) Coverage. Some of the above concepts might need elaboration for purposes of the legislation. They would as stated probably serve effectively to let in the kind of benefits intended such as canteens, recreational sporting facilities, work place nurseries and car parking, while excluding benefits such as the company flat at the office that is available for directors and their wives who want to spend the night in town. Similarly it would in office parties held on the employer's premises while excluding parties etc held outside eg at the local restaurant. But it would be necessary also to decide how to treat eg

- recreational facilities more generally

- other analogous goods and services that might be provided and consumed on the premises - eg free hairdressing.

(b) Meaning of "employer's premises". While in the case of eg canteens or work place nurseries it might be possible to restrict the exemption to cases where the service was provided and consumed on the employer's business premises, this would not necessarily work for sports facilities - eg the company's sports grounds

and club house situated out of town. It would probably be necessary to extend the definition to include facilities owned or leased by the employer for the benefit of the employees. That in turn might bring in to the exemption eg the company-owned hotel, but would this matter if the facility in question was available on similar terms for the benefit of the employees generally?

(c) Where the conditions for exemption are not satisfied, what should be the basis of valuing the benefit in question for FBT purposes? Should it be the full cost, with a proper allowance or indirect cost such as accommodation, or direct cost only?

19. Under this option decisions would also be needed on the accommodation-related exemption (paragraphs 12 to 15 above), and on miners free coal.

M PRESCOTT

ANNEX A

FBT: COVERAGE

	BENEFIT etc	Present position*	Estimated total value of benefit
1.	**Subsidised canteens** where meals provided for staff generally there, or elsewhere on the premises ..	S	£1bn - highly tentative and would need checking carefully, but based on figures quoted by LV Ltd - 6m employees receiving at least one subsidised meal a day at average subsidy of £1.50. Allowing for LV Ltd's estimates of subsidy towards fixed costs as well, figure would roughly treble.
	.. or off the premises if the staff concerned get LVs of not more than 15p a day.	ESC - unpublished	
	Luncheon Vouchers up to 15p a day.	ESC	£20m: Based on LV Ltd figures suggesting ½m employees receive 15p LV per working day.
2.	**Sports facilities** (on premises owned/leased by employer)	T/NT	N/A
3.	**Workplace nurseries**	T	£5m - Based on estimated 2000 places at average cost of £2500
4.	**Carparking** (on premises owned/leased by employer)	T/NT	Estimate that approx 4.5m employees get employer provided parking, on and off premises. Assuming only 50% on own premises (probably higher) and average annual value of, say, £100, total value would be £200m.

*S = Statutory Exemption
ESC = Exempt by Extra-Statutory Concession
T/NT = Taxable, but not usually taxed in practice eg on de minimis grounds
T = Taxable, and usually taxed in practice.

	BENEFIT etc	Present position*	Estimated total value of benefit
5.	**Entertainment**, provided by		
	(i) third party,	intention to legislate announced 29/9/87	
	(ii) employer	T	
	- except Xmas parties up to £35 a head	ESC	Could be substantial; for example, if 5m employees got benefit of £20 a head, total value of benefit would be £100m
6.	**Gifts under £100** provided by		
	(i) third party	ESC (published 25/9/87)	
	(ii) employer	T	
7.	**Accommodation and related benefits**		
	(a) Removals expenses and additional housing cost allowances	ESC	£800m [These two concessions to be reviewed]
	(b) Provided accommodation where necessary for proper or better performance of duties, and provision customary or for security reasons.	S	[Paper being prepared on possible new valuation rule that will be needed anyway as a result of replacing rates with Community Charge. Paper will also consider these exemptions and whether c not they should be retained.]
	(c) Cost of alterations etc to accommodation provided by reason of employment to director or higher paid employees.	S	
	(d) Expenses of heating, lighting, maintenance etc connected with exempt provided accommodation for directors and "higher paid employees" - taxable benefit limited to 10% of employee's emoluments.	S	"

	BENEFIT etc	Present position*	Estimated total value of benefit
(e)	Payments to clergymen living in provided accommodation owned by a charity/ ecclesiastical corporation in respect of statutory amounts payable payable in connection with property (eg rates, maintenance requirements etc), and	S	"
(f)	... Value, in case of a "lower paid" clergyman, of provision of living accommodation for him in the premises concerned.	S	
(g)	Heating, lighting, etc, bills of "lower paid" clergymen living in and performing duties from accommodation owned/leased by charity or ecclesiastical corporation.	ESC	
(h)	Board and lodging provided to "lower paid" agricultural workers even where they have entitlement to take a higher cash wage in lieu.	ESC	
8.	**Miners free coal**		£40m - estimate based on B. Coal figures for number of recipients and average entitlement.

PART II: OTHER STATUTORY OR CONCESSIONARY EXEMPTIONS

Statutory exemptions

- office accommodation, supplies or services provided for the employee on the employer's business premises and used by the employee solely in the performance of his duties
- expenses incurred in the provision of any benefit, annuity, lump sum, gratuity or similar benefit for the employee or his spouse or other dependents on his retirement or death
- the cost of necessary medical treatment abroad borne by the employer where an employee falls ill or suffers injury while away from the UK in performance of his duties
- cost of retraining borne by an employer for an employee who is about to leave or has recently left his employment (exemption introduced in FA 1987)
- allowances in respect of additional costs necessarily incurred by MPs in staying overnight away from their only or main residence for purposes of performing their Parliamentary duties.

Extra-statutory concessions

- late night taxis
- cost of home to work travel for severely disabled, borne by employer
- extra home to work travel costs borne by employer incurred by employee when public transport disrupted.
- long service awards (eg gold watch)
- expenses of certain externally provided training courses borne by employer.
- benefit of free transfers to and from the mainland for workers on offshore oil and gas rigs or platforms (technically, part of home to work travel)

BUDGET SECRET TASK FORCE LIST

Inland Revenue

Policy Division
Somerset House

FROM: M PRESCOTT
DATE: 28 JANUARY 1988

FINANCIAL SECRETARY

FRINGE BENEFITS: PROVIDED ACCOMMODATION

1. At present, where a charge arises the benefit of living accommodation provided to an employee by reason of his employment is in practice generally measured by reference to the property's rateable value. With the abolition of domestic rates and the introduction of Community Charge the existing domestic Valuation Lists will no longer continue. With or without the introduction of an FBT, therefore, it has become necessary to devise new rules for valuing this benefit.

2. This note looks at the position mainly in the context of an FBT, but much of it would also be relevant if the present employee-based system for taxing benefits remained. There are at present certain exemptions from the charge, and these too are reviewed. This is a preliminary report - we need to do more work on this subject but you asked for an early note.

PRESENT TAX CHARGE

3. Where an employee is provided with living accommodation by reason of his employment he is, unless otherwise qualifying for exemption, liable to tax on the value of the accommodation provided. Unlike many other benefits, this applies whether or not he is a director or a "higher paid" employee.

4. The main charge is in Section 33 Finance Act 1977 which provides that the measure of the benefit for this purpose is the annual value of the property occupied (or the outlay on rent if that is greater) less any rent paid by the employee. Because "annual value" for this purpose is defined in the legislation in the same way as gross value for rating, we have been able as a matter of administrative practice and convenience to accept that

the figure for income tax purposes will usually be the same as the gross rating assessment.

5. Clearly, however, the continued use of 1973 Gross Rating values for England and Wales, and 1978 values for Scotland (by published concession we ignore the 1985 revaluation in Scotland), greatly underestimates the true measure of this benefit - the current open market rental value of the accommodation in question. As an essentially stop gap measure - pending decisions on the future of rates etc - and to counter the worst effects of this, the 1983 Finance Act introduced a supplementary charging provision for more expensive accommodation in what is now Section 33A FA 1977. Where the living accommodation - broadly speaking - costs more than £75,000, there is an additional income tax charge which is determined by applying the "official rate" (used for taxing the benefit of cheap loans) to the amount by which the cost of the premises exceeds £75,000. For this purpose, cost means either

- the market value of the property at the time it was first occupied by the employee concerned if that was more than 6 years after the property was first acquired by the employer, otherwise

- cost to the employer when the premises were first acquired by him.

6. As noted, the additional charge in Section 33A was introduced as an interim measure to help mitigate the increasingly apparent weaknesses of the main Section 33 charge. (It should be noted however, that under these rules also the same value could in certain circumstances be used for many years and so become increasingly outdated.) But they were also designed to counter a particular avoidance device that emerged, in which an employee would sell his own (expensive) house to his employer at its current market value, with an option to buy it back at the same price in, say, 5 years. In this way the employee would in effect get an interest-free loan from his employer, but one which was not caught by the cheap loans provisions. And, under normal

rules the only thing that could be taxed would be the value of the option itself, but that in practice might be difficult to quantify and even where this was possible the value would often be very low. Because the employee was in effect getting an interest free loan from his employer, it seemed appropriate to base this additional charge on an amount determined by applying the "official rate" used for taxing the beneficial loans to the amount by which the cost of the house exceeded the specified level.

NEED FOR CHANGE AND OPTIONS

7. As a flat rate payment, the Community Charge will have no connection with the value of the property in which the person(s) paying it lives. Continued use of Gross Rating value is not, therefore, an option. Even if it was possible to update 1973 rating values for properties where one exists - and so deal with the present undervaluation of the benefit of provided accommodation in those cases - this would clearly not be possible for new accommodation (for which there would be no rating value) or accommodation which was changed substantially (eg warehouses in the Dockland were converted into expensive flats). Nor anyway in practice does there appear to be a single appropriate index which could be used as a cost effective means to update 1973 rating values for existing (unchanged) premises. And there would in any event be questions whether the Valuation Office could even maintain as an acceptable cost the existing Valuation Lists when those lists were being discontinued for virtually all other purposes*

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*Rating values have many different uses outside the basic one of determining the liability to rates - eg housing, landlord and tenant legislation, Rent Acts, etc - serving to fulfil a number of functions. The DOE have recently published a consultative document with proposal for substitute rating values to fulfil these functions. In some cases, however, the proposal is that rating values should continue - at least for a limited period.

Options

8. The true measure of the benefit of provided accommodation is its full open market rental value

9. Where the employer rents rather than owns the property, the rule should simply be to value the benefit by reference to the current full open market rental value of that property - ie the rent he is actually paying so long as it is to an unconnected third party.

10. For provided accommodation owned by the employer the true measure of the benefit is again the current open market rental value and that is the amount on which the charge - under IT or FBT - should be based. But there is then a choice, viz

- assess rental values directly, or
- assess them indirectly on the basis of an appropriate proportion of the current capital value[+] of the premises which will usually be more readily ascertainable.

11. The main advantages of a system based on capital values are

- significantly lower compliance cost for employers, and lower resource implications for the Revenue's Valuation Office, precisely because current capital values are much more easily ascertainable than current rental values. This will be particularly true for eg "one off" properties in the country compared, say, to

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[+]There is also a question whether market value should be by reference of the unencumbered freehold, ie even where the property is held by the employer on say a short lease. This would ensure a more equitable result. So for example two employees occupy identical houses, in one case the employer holds the freehold and in the other he holds a 20-year lease which expires in 3 years time. The value of the accommodation - and therefore the true measure of the benefit - to each employee in any given tax year will be identical but, plainly, the value of the freehold interest would be vastly greater than the value of a rapidly fading leasehold interest.

provision of a flat in Knightsbridge where there may be a deeper rental market for such accommodation. It was of course precisely the lack of any reliable figures for an open market that caused Ministers to base Section 33A on a percentage of capital values and not on rental value directly

- capital values generally in any event are more easily understood than rental values, and they are likely to give rise to less disagreement between employers and the Revenue

12. Two further sets of question then arise concerning

(a) The appropriate percentage to be applied to capital values in order to get the figure for the current measure of the benefit.

(b) The frequency with which capital values should be updated, and the means by which it should be done.

Appropriate percentage

13. While technically there is a relationship between rental values and capital values, in practice there is no simple formula for relating one to the other.

14. One superficially plausible approach might be to regard the employee as having been provided with a notional loan equal to the current capital value, and to measure the benefit by applying a market-related rate of interest to that notional loan. The obvious rate to use would be the "official rate" used for valuing the benefit of cheap loans.

15. But this approach would overstate current rental value - the true measure of the benefit. Factors like the availability of mortgage interest relief and the benefit that accrues to owner occupiers in respect of capital appreciation will invariably in practice work to set a ceiling on current rental values such that

they would fall well short of an amount represented by market rate of interest applied to current capital values. You may recall, for example, that in a recent joint DOE/Treasury/Revenue paper on the tax treatment of private rental accommodation DOE estimated that the rents most tenants would be willing (and able) to pay would give a yield of 4-5%. By contrast the "official rate" is currently 10.5%.

16. Nor is there any other immediately obvious and conveniently available rate - eg the current yield on indexed gilts - which might be regarded as providing a reasonable approximation to rental yields and which, therefore, could be applied to current capital values in arriving at a figure for current rental values.

17. This suggests that the appropriate "rental yield" to be used under an approach based on capital values would have to be determined on an ad hoc basis, as it was in the DOE exercise. What we would be trying to arrive at is the rental yield that would be obtained in the deregulated market. This is only something which can be observed and we would clearly need an input from DOE as well as from the Valuation Office at the time the rate was set. However, though the figure for rental yield will also depend on factors such as rates of income tax, which in turn affect the value of mortgage interest relief, it is likely - assuming continuance of MIR itself etc - to remain reasonably stable for reasonably long periods at a time. Having set a rate (either in the primary legislation, or in statutory instruments), therefore, it should be possible to leave it unchanged for relatively long periods.

Adjusting capital values

18. In principle, capital values would need to be updated annually - especially as they can change substantially from one year to the next. But measuring rental values directly would also point to annual updating.

19. By comparison with the present system - where for many properties we have simply continued to use the 1973 rating value

one year after the next - this will involve far more frequent valuations by employers and, where necessary, more work for the Revenue's Valuation Office in providing and/or confirming such valuations. This problem arises regardless whether we stick with the existing employee-based system or switch to an FBT.

20. We have considered whether, once an initial capital valuation for a property has been established,it would be possible to up-rate that figure annually by reference to some standard, readily-available index, thereby saving the employer (and ourselves) the chore of the need for annual valuations. Unfortunately, there is no single index that would be suitable for this purpose. There are, of course, various indices - eg those published by the Building Societies - but these tend to focus on a particular sector of the market. There would also be obvious difficulties in seeking to use a single index for all provided accommodation bearing in mind the often very substantial differences in house prices not only between one region of the country and another, but within different parts of the same region or - as in London - between one part of the city or town and another.

21. Clearly, however, there is a trade off here between the need for as correct a measure as possible of each individual benefit and the need for administrative simplicity. Though not an index as such, the Valuation Office already publishes twice a year a lot of information about the level of house prices (with separate figures for new and secondhand dwellings, and by type of property) for different regions, and for all the main towns in each region. These figures are in the form of a price range for each type and location of property in question.

22. Even as things stand, therefore, Tax Districts could - at least in straightforward cases - be instructed to accept an employer's capital valuation provided that it fell within the VO's price range for the particular kind of property concerned. (There will be "one off" cases - eg the country manor house for which figures are not produced by the VO and for which, therefore, separate valuations will continue to be needed. But

we would expect few such cases). For subsequent annual upratings, it would simply be a question of the employer obtaining from the Tax District the updated VO figures for the type of property in question - in practice, this would probably mean our having to accept for subsequent years a valuation based on the bottom end of the VO price range. Where the property was "one off" in nature it might be possible to agree some ad hoc arrangement with the employer that obviated the need for annual valuations; for example, the agreement might be for an independent valuation every, say, 5 years with an interim uprating formula using changes in some agreed house price index.

23. A further possibility would be to develop more formal indices for changes in house prices, based on the data produced by the VO. (At present, they do give indicative figures for the percentage change in house prices between one period and a next for each of the main Regions, including Inner and Outer London. It would obviously be worth considering whether these figures - either as they stand, or suitably expended - might serve as a basis for providing indices that could be promulgated to employers to be used for the purpose of the annual uprating of capital values for this purpose.

Transitional arrangements

24. Moving immediately from a valuation of the benefit based on 1973 rating values to one based (directly or indirectly) on current rental values will obviously involved a significant increase for those concerned, and the question arises whether there should be some kind of transitional arrangement to help soften the impact of the change. The three main arguments against this are

(a) the employee would not be affected if this happened at the same time as switching to an FBT (different considerations might, of course, apply if FBT was not introduced)

(b) it would complicate the provisions considerably

(c) it would perpetuate the substantial advantages which most employees with provided accommodation have enjoyed since 1973.

Avoidance device

25. It will also be necessary to reintroduce some kind of anti-avoidance measure to counter the device mentioned at paragraph 6 above and presently deterred by the operation of Section 33A. One way to do this might be to extend the beneficial loan provisions to cover this particular use of provided accommodation, rather than to complicate the accommodation provisions themselves - but there may be possibilities.

EXEMPTIONS FROM THE CHARGE

26. At present an employee living in provided accommodation is exempt from tax on the benefit in any of the following three cases

(a) where it is necessary for the proper performance of his duties that he should reside in the accommodation. This test is a very strict one, and in practice only people like lockgate keepers or caretakers living on the premises would qualify under it;

(b) where the accommodation is provided for the better performance of the duties of his employment, and his is one of the kinds of employment in the case of which it is customary for employers to provide living accommodation for employees. This is a much looser test, and brings in people like nurses, farmworkers, the police and prison officers, clergymen, the armed forces, diplomatic personnel, publicans living above the premises etc etc.

(c) where, there being a special threat to his security, special security arrangements are in force and he

resides in the accommodation as part of those arrangements. This was introduced to deal with a particular problem of eg diplomats or judges living in Northern Ireland or certain Ministers of the Crown where it was necessary for them to live in particular premises that could be made secure.

27. The historical reasons for these exemptions are explained more fully in the Annex. While the third exemption (security) can obviously be justified (though even then the wording of the present exemption is not without difficulty), the first and second - particularly the latter - are much more difficult to justify in strict logic. Though they relate to the employee's duties, the fact remains that an employee with provided accommodation is nevertheless getting a real and possibly substantial benefit and (still in logic) there does not seem to be any really convincing reason why that benefit should escape tax merely because the provision of the accommodation is linked to the performance of the duties. The second exemption might be thought especially difficult to justify - it boils down saying that people should get this benefit because they always have.

28. These exemptions are also a constant source of difficulty because a large subjective element is involved - ie testing what is "necessary" in the case of the first exemption, and what is "a kind of employment", "customary", and "better performance" in the case of the second.

29. We estimate that there could be 110,000 employees receiving rent-free accommodation from their employer who currently come within one of the three exemptions. There are up to a further 100,000 employees who might qualify for exemption on the benefit they receive from paying their employer a reduced market rent. (In contrast there are maybe 90,000 employees who are charged to tax on the benefit of rent-free accommodation, with possibly up to a further 70,000 charged on the benefit received from paying reduced rents).

30. Clearly, to withdraw the exemptions entirely (except the one for security) would bring into the charge many of what would no doubt be represented as "hard cases" - eg low wage farmworkers in tied cottages. This is precisely the area where there has been strong pressure to exempt those in tied cottages from tax where their employer pays the Community Charge (they are presently exempt in respect of the benefit from the payment of rates). Ministers may feel, therefore, that outright withdrawal of the exemption - putting nothing in its place - is simply not feasible politically.

31. One possible alternative might be to withdraw the present exemptions (again, not security) and instead have a general exemption under which a specified amount or proportion of the capital value of the premises would be ignored for purposes of calculating the annual value of the benefit. This amount or proportion would be essentially arbitrary, but the aim would be to try to fix it in such a way that it would operate preferentially in favour of less expensive premises of the kind that might be occupied by those people covered by the present exemptions. We would need to give a lot more thought as to how this might be done if Ministers saw any attraction in this kind of approach. Clearly, however, there would be major disadvantages. The most important of these is that we would thereby be introducing a new partial relief for all those people in receipt of this benefit who at present do not qualify for exemptions. That would seem to be perverse - especially in the context of a switch to FBT.

32. On balance therefore, and largely on pragmatic grounds, Ministers may feel that the best option would be to leave these exemptions as they are.

Other land

33. The existing legislation in Section 33 and 33A FA 1977 only covers the benefit of "living accommodation". There is a separate charge where an employer provides an employee with land - eg an orchard - but that charge only applies to directors and

the "higher paid". The value of the benefit is currently calculated along the lines of Section 33 - ie in practice, we take the rating value. In the context of FBT it would be logical to have a single charge which covered the provision of all land including any accommodtion standing on it.

SUMMARY AND CONCLUSION

34. The present arrangements for valuing the benefits of provided accommodation need to be changed, with or without the introduction of FBT, as a result of the abolition of domestic rates. We could obviously continue with our existing practice - using rateable values - until the introduction of Community Charge, planned for April 1990, and possibly for a while even beyond that, though this would depend on whether Valuation Lists were maintained. And, there would of course increasingly be difficulty as regards new properties or those which had undergone major change and for which, therefore, there was no rateable value. While some decisions (eg on the precise figure for the "appropriate proportion") if the capital values approach is adopted need not be taken until nearer the time, decisions clearly are needed fairly quickly on the new valuation rule itself if this is to be incorporated in to the FBT legislation from the outset. This need to review the valuation rules also provides an opportunity to review the exemptions.

35. There is a lot more work to be done on this. And, as I say, this is going to have to be done quickly. But before we can take matters much farther forward, it would be helpful to have guidance from Ministers on the following points

(a) Is it agreed that the benefit of provided accommodation should continue to be a taxable benefit, either under the existing employee-based system or under an FBT?

(b) Is it agreed that for premises owned or leased by the employer, the measure of the benefit - the annual rental value - should on grounds of administrative

simplicity for employers and the Revenue be based on an appropriate proportion of capital values, rather than on a system requiring assessment of market rental values directly? (Paragraphs 8-12).

(c) Is it agreed that the "appropriate proportion" should be determined on an ad hoc basis, and adjusted as appropriate from time to time? (Paragraphs 13-17).

(d) Should the requirement be for annual uprating of capital values? (Paragraphs 18-23).

(e) If so, should we pursue further the idea of developing the data already collected by the VO into its specific and more refined indices and that could be used for this purpose?

(f) Should there be transitional arrangements to cushion the hike in measure of the benefit which will occur on the switch over from the present to the future system? (Paragraph 24).

(g) While the existing exemption on "security" grounds obviously needs to remain, should the other two exemptions remain as well? (Paragraphs 26-31).

(h) If not, should they be withdrawn altogether, or replaced with a general exemption of some kind aimed at exempting all "modest" properties?

(i) Is it agreed that anti-avoidance measures are needed to deal with "options"? (Paragraph 25).

(j) Should the proposed separate charge on land be incorporated with the charge for provided accommodation? (Paragraph 32).

M PRESCOTT

SECTION 33 FA 1977 EXEMPTIONS: HISTORICAL BACKGROUND

1. Prior to 1977 the tax treatment of living accommodation provided for employees was governed by two separate sets of rules, one for the lower paid and one for directors and "higher paid" employees.

2. The liability of a lower paid employee depended on his being the occupier of the premises; but, if he occupied the premises merely as the representative of his employer he was not regarded as the occupier and there was no liability. The liability of the higher paid employee did not however rest on whether he was the "representative occupier" but on whether he was required by the terms of his employment to reside in the accommodation provided, and whether it was necessary for him to reside on the premises for the proper performance of his duties.

3. But over the years the developing case law governing representative occupations meant that the definition became a great deal wider than the tests above for exemption applicable to the higher paid. So this distinction became increasingly unworkable. The 1977 provisions were therefore introduced with a view to regularising the position.

4. It was considered in 1977 that an exemption from the charge should continue to be available for those employees who are required to live in certain premises for the purposes of their employment and that the test for this exemption should be one which applied to the "higher paid" and "lower paid" alike. The general principle was that where an employee was obliged to live in the provided accommodation, rather than where he chose, the accommodation could in a sense be regarded not as a benefit but as compensation to the employee for

a disbenefit in undertaking his duties. The test that fulfilled this requirement was whether the occupation of the accommodation was essential for the performance of the duties.

5. There were, however, a good many groups of employees who had hitherto been exempt from tax as representative occupiers who would not be able to meet this first test. A second test was, therefore, introduced under which exemption was available where the accommodation was provided for the better performance of the duties and the employment was of a kind in respect of which it had become customary to provide accommodation. The fact that it had been found necessary through the years to provide houses for such a class and that there was a link between the practice and the performance of the job was regarded as showing that the employee must live in the house to do the job. This test brought in such groups as agricultural workers, school masters in boarding schools and police officers.

6. There remained a few instances where someone in the public service whose security was a risk and was thus provided with accommodation, but the provision of such accommodation did not need meet either of the two previous tests (for example a diplomat, an official in Northern Ireland or a particular minister of the crown). A third test was therefore introduced to cover such people.

55/3650

BUDGET SECRET: TASK FORCE LIST ONLY

Copy no 1 of 3

FROM: A G TYRIE
DATE: 28 JANUARY 1988

CHANCELLOR

A FRINGE BENEFIT TAX?

I attach my last word on why we shouldn't have an FBT! I would prefer that it is not circulated more widely because of the sensitivity of two of the points in the conclusion.

AGT.

A G TYRIE

051/3650

BUDGET SECRET: TASK FORCE LIST ONLY

Copy no 1 Of 3

FROM: A G TYRIE

DATE: 28 JANUARY 1988

CHANCELLOR

A FRINGE BENEFIT TAX?

You know that I think an FBT is implementable. You also know that I don't think it's worth the candle. This note is one last go at explaining why.

An FBT would be worth having either if it brought about a better tax system or if there were clear political benefits, or both.

A better tax system?

We would have a better tax system if:

- we were able to extend the coverage;
- we were able to jack up car scales;
- in aggregate the compliance burden was significantly reduced;
- we got back to cash or at least neutrality.

Coverage. I agreed with your conclusion in prayers last week. Any substantial widening of the coverage could make the passage of the Finance Bill extremely difficult. What's more, the interval between announcement and implementation would almost certainly force us to pledge that no extension of the coverage was planned for this Parliament.

Nor do I think that, some 5 to 8 years hence, it would be particularly easy to extend coverage of an FBT. Even if we could, justifying an FBT to ourselves by saying that some future Government could reap the benefit looks a pretty weak argument.

So the decisions we take now on coverage really count for a lot. There are three options:

- Coverage could be dramatically broadened, but as you have said, this would be taking on too much.

- We could go for a modest increase in the coverage. But this would leave us exposed on specific items unless we could find some rough and ready yardstick (on-site/off-site perks etc) to justify our decisions. But we can't find one (or even a few which contradict themselves only slightly!) The Financial Secretary's notes set out the detailed problems we have come up against.

- We could keep existing coverage. But in doing this we would still have to give a public airing to some pretty extraordinary anomalies in the existing system, many of which we would be loath to justify. We would have to explain, for example, the existing exemption for directors canteens in committee, and many other tricky ones.

Cars. When we had kink losers an FBT was an attractive route to get the scales up. But now we are retaining the UEL that argument falls.

In fact (particularly in view of electoral timing) I see every advantage in getting the car scales up this year. We are all agreed that with an FBT there would be a delay. But without an FBT I do not see why we could not just hike up the car scales in 1988-89. It would be a bit messy and would mean legislation rather than merely using the existing statutory instrument. But the increase would be sweetened by the tax cuts in 1988-89 and there should be no losers.

Unless we could be sure of further cuts in the basic rate in 1989-90 an increase in the car scales would create losers for that year, making the hike in scales that much more unpopular.

Compliance. I won't rehearse the arguments again. Suffice to say that, as far as one can tell, the administrative work would stay at roughly the same size, but it would be switched from the Revenue to employers. What they gained from the end to P11Ds they would lose with the FBT.

Neutrality/getting back to cash. Crucially, we would not get back to cash even on items already taxed. With the rate of an FBT at 45 percent we would not be removing the incentive to pay benefits for higher rate tax payers. The present incentive would be virtually unchanged at 8%, against 9% under the present regime (at a 40% top rate). This incentive would increase further if we reduced CT, as we would intend to do. Also, the incentive would be 21% for non-tax paying institutions. (See Mr Lewis' note of 14 January.)

We could not therefore claim even a step towards neutrality for higher rate payers. And higher rate payers are a key group:

they constitute more than half the total yield under the present regime.

Nor do I think we would have any prospect of ever getting to neutrality, except, perhaps, by substantially reducing higher rates of personal taxation in later budgets, and I do not think this would be politically feasible. I don't believe we could subsequently put an FBT rate up.

In my view, it is the mistaken belief that neutrality is almost within our grasp that has led the FBT's proponents to oversell it.

The Politics

The case for a Conservative Government inventing a new tax has to be very strong. We are supposed to be abolishing them. Messy though it is, the treatment of benefits seems to be a case of 'an old tax is a good tax'. In this highly sensitive area we at least have a system which is understood, in which some of the worst wrinkles are ironed out, and to which people are reconciled. (What's more, there does seem to be some, albeit tenuous, doctrinal credibility about a system which taxes individuals on the benefits they receive.)

Most of the political 'presentational' advantages seem to crumble in one's fingers:

- Getting at rich men's perks? This an FBT certainly does not do. The incentive to pay in kind would remain virtually unchanged for 40% taxpayers. And by sticking

with existing coverage a new tax could be seen as entrenching those perks.

- The corporation tax offset looks sexy? Although I am sure we could buy out the aggro at a price I am equally sure companies would rather do without the compliance burden, and particularly the initial burden of learning a new tax. In any case, the logical offset for an FBT is not lower CT rates (some companies may have little or no profits; and non-taxpaying institutions do not benefit) but employers' NICs. This point would not be lost on the CBI, IOD etc.

- Car scales fairer? But we could act on them anyway.

- The budget would look sparse without an FBT? But this is a pretty prickly stocking filler!

Against this the political and presentational disadvantages seem overwhelming:

- The small business lobby would be round our necks for years.

- I am sure we would hit a lot of nasty and unforeseen rocks and shoals. Every time the Financial Secretary calls a meeting we seem to uncover a few.

- I think the conclusion of the backbenches would be that we had expended enormous political capital without having grasped a clear political prize.

Conclusion

Only by claiming that we are creating a better tax system could we justify the political hassle of an FBT to our own supporters. We could not claim neutrality, nor could we claim a reduction in the overall compliance burden. So, it seems to me, only by extending coverage could we claim that we had moved to a better system. And, rightly, we have ruled that out, too.

How did we get into this mess?

First, I think, because we have lost a sense of perspective on fringe benefits. We don't have a massive problem. We have a car problem which, whatever route we take, we can't solve but only ameliorate. We have a subsidiary problem with the PllD threshold which is catching more employees as wages rise. We seem to underestimate the value of the existing, albeit imperfect, fringe benefit tax system which, in this highly sensitive area, is generally accepted.

Secondly, I feel we became obsessed with fringe benefits because the Revenue flooded us with awkward cases last year. They are close to arguing that it would be unconstitutional to carry on with the existing system and exempt awkward items with extra statutory concessions. I think we should stamp on this firmly and, if it proves necessary, challenge the Board's assertion that we need to put all the ESC's on a statutory basis.

Thirdly, the interest of several Treasury officials in the FBT has been fuelled by the Revenue's initial reluctance to

take the FBT route seriously. The decision on fringe benefits has to some extent become a matter of personal pride for several officials both in the Treasury and the Revenue. That is why both sides have dug their heels in. It is very regrettable.

An alternative to an FBT. I don't think enough work has been done on this. I don't think we need everything on a statutory basis. Very provisionally, I would construct a package along the following lines:

- Raise the P11D limit to, say £12,000 or £15,000. This would give us a staff saving.

- Exempt those benefits which are 'self-regulating', that is, which companies have a strong incentive to try and suppress themselves.

- Exempt on-site canteens but tax luncheon vouchers.

I suspect we are exaggerating the flack that would come from abolishing luncheon vouchers. There is, after all, only 15p per day worth of untaxed benefits. As for canteens, I am half convinced by the argument that there is a legitimate case for their provision. They keep staff available on-site, they also probably reduce the length of the average lunch break.

- Jack up car scales to 50% (possibly even more for low business mileage users).

[One route I would certainly not take would be to disallow the cost of exempt benefits as a business expense in calculating tax or profits. That would stir up, albeit in miniature, some of the opposition we would get to an FBT.]

This alternative package wouldn't bring us neutrality, and it would still leave us with some awkward committee debates on coverage. But there would be some clear political advantages. We could point to a large increase in yield (on the back of car scales), a Revenue staff saving, some reduction in the compliance burden, and some minor simplification and tidying up. Not bad.

A G TYRIE

?? if FBTD limit jacked up significantly, you lose a lot of tax revenue

BUDGET SECRET: TFL

PWP

FRINGE BENEFITS

29 January. C et al.

Cars - Income Tax Options (PL 28 Jan)

C — Can we act this yr? 2 advantages:
(a) get money sooner
(b) ~~give money away~~ ↓ otherwise give money away yr one, claw it back yr 2.

PJC — Also good time: bus. profits flowing well.

C — Presentational q'n of whether we express it as a % of current 87-8 rate or of rate already set for 88-9.

RPC — ① Worried about accusation of bad faith?
② What is Lab doing to the Stgg Order? - Sought to debate it, but out of time. Lab wanted to raise PILD limit.

C — PILD limit

Main problem is people with coy cars at low incomes. Limits size of hike. But could raise PILD limit, + then have bigger hike.
Need more info on options: increases of ≥ 75% + ≤ 100%.
Then envisage back to 10% annual increases, from a higher base.

Revang Table B: increases of ~~50~~ - 75 - 100 % on 87-8 levels, to be implemented ~~in~~ in 88-9, on 88-9 incomes, with range around average, + description of losers. Options 2 + 3.

Longer Term

C — Don't want to set a target. Say something like "one-off increase to get a more realistic basis for taxing coy cars. But still undertaxed. Presumption: that continue in future as have done in past."

C — Revised decision: say nothing unless pressed.

10% increase in 1989-90.

Over

Perks

Leave where it is.
FST — Raise limit for business mileage?
C — No change.
And no change for "tool of the trade" cars.

Expensive Cars & CAs

Want to look more fully at basic scales, and act on CAs, where there is a legit grievance. Go as far as we can towards abolition, & recoup revenues as much as poss of revenue through scales on expensive cars & undertaxed in hands of employee.
NB ceiling not raised since 1979.

FBs generally

2 problems:

(a) LV concession – absurd. Shd get rid of it. Can we do so alongside a rationalisation of tax'n of food benefits generally.
(b) difficult cases – remaining ones are car parking and sports grounds

Next mtg, 5 Feb or Monday 8th overview.

Inland Revenue

Policy Division
Somerset House

FROM: M PRESCOTT
DATE: 28 JANUARY 1988

CHANCELLOR

VALUATION RULE FOR GOODS AND SERVICES GENERALLY

1. Though the existing valuation rules for goods and services generally* could - broadly speaking - be carried over to FBT, the operation and interaction of these rules is not always straightforward and there is a good case for taking this opportunity to consider new, simpler rules. This is all the more important because FBT will be a self-assessed tax on employers/providers and in order to keep the extra administrative burden on them to a manageable level the rules need to be as simple and easy to operate as possible.

PRESENT POSITION

2. Because the present rules for taxing benefits and expenses payments have evolved over a long period and in a piecemeal fashion, there is no single, universally applicable rule; rather, the basis of valuation will depend on whether the benefit in question is covered by the special rules in Finance Act 1976 for taxing benefits and expenses payments received by directors and "higher paid" employees, or by the general Schedule E provisions that apply to all employees, and on whether the goods or services are obtained by a voucher or credit token in which case separate rules governing the provision of benefits in this way may also be relevant. There are also differences between benefits in the form of goods and those in the form of services.

3. Broadly, however, the present position can be summarised as follows

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* (ie excluding benefits such as cars, cheap loans, etc for which special rules apply)

(a) provision of a benefit by means of meeting the employee's pecuniary liability - ie where the employer simply pays the employee's personal telephone or electricity bill, or pays the employee's bill for other goods and services. Here, the measure of the benefit is the cost to the employer. This rule applies to all such benefits, not just to those provided to directors and "higher paid" employees.

otherwise, in the case of goods

(b) a charge on goods would arise on all employees under Schedule E on the "second hand" (ie resale) value of those goods in the hands of the employee. This will not necessarily be the same thing as "market value" as normally define for tax purposes. The test here established by the Courts is "not what saves the employee's pocket, but what goes into it". Thus, the value to a Burton's employee of a brand new suit given free will usually be much less than its full retail value, simply because the employee will not be able to sell it privately for the full retail value. Similarly, gifts of wine or spirits may have no taxable value because strictly speaking it would be illegal to the employee to sell them without a licence

(c) the "second hand value" rule under Schedule E is supplanted if the goods are obtained by voucher or credit tokens. The amount of the taxable benefit in this case becomes the cost of the voucher etc plus the cost of the goods to the person providing the voucher

(d) if the individual concerned is a director or "higher paid" employee, and no voucher is used, the benefit of the goods is the cost to the

provider. If second hand value exceeds cost to the provider there could in theory be an additional charge under Section 181 because the FA 1986 provisions only charge the cost if it is not otherwise chargeable as the employee's income. But cost can be said to be an ingredient of second hand value in this situation and in practice the rules resolve as a charge on cost or on second hand value in the employee's hands, whichever is the greater.

in the case of services

(e) the benefit of services provided free or at undervalue would not be chargeable under Schedule E because they cannot be converted into money and do not have a "second hand" value

(f) services provided by way of vouchers and credit tokens would be chargeable on all employees in the same way as goods - the cost of the voucher etc plus the cost of the services to the provider

(g) where the individual is a director or "higher paid" employee and the voucher is not used, the chargeable benefit will be the cost of the services to the person providing the benefit.

4. "Cost" to the provider is defined as the amount of expense incurred in or connection with provision of the benefit. Sometimes it will be clear what the "cost" is, sometimes less so. For example

(a) for goods provided free or at undervalue, the "second hand" value will sometimes be higher than cost to the employer so we would not normally in practice need to determine the latter. But in those

cases where this is necessary, "cost" will include an appropriate amount in respect of indirect costs and overheads, not just direct costs.

(b) similarly, in the case of services it will be necessary to include something for indirect costs. We have, for example, resisted arguments that because the marginal cost of providing a free school place to the son of the school master teaching there will be very low, the measure of the benefit is correspondingly low or nil.

NEW RULES UNDER FRINGE BENEFITS TAX

5. Under FBT it will be the provider, usually the employer, who will have to determine the value of the benefit. We therefore need rules that are

(a) standardised, bearing in mind that with FBT there will be no "earnings threshold" so that the same rule will apply regardless whether the benefit is provided to directors and "higher paid" employees, or to "lower paid" employees

(b) as simple as possible, so as to keep the burden on employers to a minimum

(c) actually capable of being operated by the employer (eg do not rely on information which the employer will not have).

6. One immediate conclusion from the above is that the present "second hand value" rule (paragraph 3(b) above) would have to be dropped under an FBT simply because this is not something that the employer could reasonably be expected to know. If we were otherwise to stick with existing valuation rules, therefore, this would mean a reduction in the size of the chargeable amount in those cases where second hand value exceeds cost.

General principles

7. There are three main methods on which benefits might be valued, viz

- the value of the benefit to the individual employee concerned

- "market value" (which might be defined in a number of ways)

- cost to the employer.

(a) Value to employee

8. Arguably, the truest measure in theory is the value to the employee. But this approach will usually be difficult to apply - and in practice is rarely used - because it would necessitate costly and time-consuming work in assessing the value of the particular benefit concerned to the particular individual concerned and at the time and in the particular circumstances that he received it. It would clearly not be practicable to impose this kind of burden on employers under an FBT.

(b) Market value

9. This is in principle a much better measure of the benefit than cost to the employer. (In certain circumstances these may be more or less the same thing - eg where the benefit is goods or services which the employer has bought or paid for on behalf of the employee).

10. Broadly, however, market value can mean either

(a) the price that the employee would have to pay for similar goods or services in the open, retail market as an ordinary member of the public

(b) the lowest arm's length price which the employer would charge his normal customers for similar goods or services.

11. In the case of goods bought and sold by a retailer as part of his normal business, these would be more or less the same thing. This is generally true of services also. But they will not be the same in the case of goods that are produced as part of the employer's normal business and which are normally sold to non-retail customers (ie distributors), or in the case of goods that are sold by the wholesaler where again the price charged to his normal customers will usually be less than the final open market retail price.

(c) Cost to employer

12. Arguably, this is the least satisfactory of the measure of the true value of the benefit to the employee. Moreover, in the case of goods produced or services provided by the employer himself a part of his normal business there will often be considerable scope for argument about what is the true measure of the cost - ie average cost, marginal cost, etc. On the other hand, market value will not always be appropriate, particularly if there is no identical or reasonably similar market - eg motor vehicles where there is a restriction on the use imposed by the employer.

OPTIONS

13. In practice, therefore, there will be a choice between market value (two variants) and cost to the employer, depending on the circumstances. There are four main cases that need to be considered and these, together with the valuation options, are summarised in the table at Annex A.

14. As regards Case A (goods and services which the employer buys from someone else for the employee), the valuation rule for FBT will be cost to the employer. This is broadly the same as under the present system - ie for directors and

"higher paid" employees, or where the employee meets the employee's pecuniary liability. It will also broadly equate to full open market value.

15. As regards Case D (the benefit of services provided by the employer which are not part of his normal business - eg ranging from subsidised canteens to subsidised foreign holidays for the staff and their families), it would in theory be possible to adopt a "market value" rule - ie to value the benefit of a subsidised canteen meal by reference to the price that the employee would have to pay in the open market for a similar meal. In practice, however, it may often be very difficult to determine this if there is not an identical and/or easily ascertainable product or market to use as the comparator. Moreover, under an FBT this task would fall to the employer and this would clearly be inconsistent with the aim of keeping the additional administrative burdens on employers to a minimum.

16. Realistically, therefore, the only alternative is cost to the employer of providing the service in question. Ministers are still considering whether certain benefits in this category - eg subsidised canteens - should be excluded from FBT altogether or, if included in certain circumstances, whether we should exclude from the measure of cost any subsidy in respect of certain indirect costs, particularly those relating to accommodation. In other cases, however, cost here should be taken to mean full average cost - ie including an appropriate amount in respect of indirect costs.

17. That leaves

- goods that are bought and sold as part of an employer's normal business (Case B),

- goods produced or services provided by the employer as part of his normal business (Case C)

for which there are a number of options.

First option: full market value

18. One option would be to adopt full open market value for all goods and services falling into Cases B and C - ie on the grounds that the price which the employee would have to pay as an ordinary member of the public in the open retail market will correctly and objectively measure the true and full value of the benefit concerned. And benefits in this case would then also be treated on a par with the benefits of goods and services which the employer buys from someone else for the employee (Case A).

19. This would, however, mean a very substantial increase in the number of benefits that were chargeable to tax. This is because a full open market value rule would catch

- all staff discounts on goods and services to employees in the retail sector. At present, these discounts would only be caught if the discount was so large as to bring the discounted price down to a level below cost/second hand value, whichever is greater. With over two million employees in the retail sector, and staff discounts being a fairly common feature throughout, this would obviously be a major extension of the tax

- virtually all goods and services produced or provided as part of the employer's normal business, and virtually all goods bought and sold as part of the employer's normal business where the employer is other than a retailer (eg a wholesaler), even if the employee is paying the same arm's length price at which identical goods or services are sold by the employer to his normal customers. This is because that price will nevertheless nearly always still be lower than the full open market retail price for the goods or services. Here too, therefore, there would be a major extension of the tax.

20. A second - albeit lower order - difficulty with this option is that the employer would not always know or be able to ascertain readily the current open, retail market price for the goods or services in question that he was providing to his employees. In the great majority of cases, of course, he would know this - if he was a retailer he would, by definition, know at what price he was selling to the public, and even if he was not the retail price would usually be easily ascertainable (eg Ford Motor Company know what is the retail price of one of their cars). Nevertheless, there would be some cases - especially involving goods that are produced by an employer as part of his normal business for sale to the non-retail market - where there would be difficulties for employers.

Second option: proportion of market value

21. One way of mitigating the effects described at paragraph 19 above would be to adopt a rule under which the measure of the benefit in these cases was not the full open market retail price value, but some specified standard proportion of it - say, 75%.

22. The proportion itself would be an essentially arbitrary number, but it would be pitched at such a level that it was low enough to exclude most staff discounts while not being so low as significantly to undertax the true measure of the benefit. However, even at 75% (and there would seem to be little justification for adopting a lower proportion)

- many staff discounts for employees in the retail sector would still be caught (we do not have figures, but anecdotal evidence suggests that many retail employees get staff discounts in excess of 25% on the retail price)

- a proportionately even greater number of benefits would still be caught in cases where the employer was not a retailer, for the reasons outlined at paragraph 19(b) above.

23. A second difficulty with this approach is that having scaled down the true measure of the benefit in this case, it would be difficult to resist suggestions that we should similarly not pursue the full measure of the benefit in other cases - eg cars, accommodation, cheap loans, and so on.

Third option: the "Antipodean approach"

24. The Australians and New Zealanders have adopted a rather different approach. Their starting position is the recognition that "market value" may mean two different things, as explained at paragraph 10 above, depending on where in the production/distribution chain the provider of the benefit (ie the employer) happens to stand. They seem implicitly to take the view that the correct benchmark for the measure of the benefit is the price which the employee would have to pay as a normal customer of his employer's business, which - unless his employer is a retailer - will not be the same thing as the price he would have to pay as a member of the public for similar goods and services in the retail market.

25. This then leads to a further consideration. To take a simple example, the price that, say, Ford Motor Company charges its normal customers (the distributors) for one of its cars will not be the same as the retail price charged to a member of the public. The retail price will usually be higher because of handling and distribution costs, and the markup added by the wholesaler and/or the retailer. But if the valuation rule was "lowest arm's length price to the provider's normal customers," essentially the same benefit would have a different value solely as a result of where in the production and distribution chain the provider happened to stand - ie whether he was the producer, the wholesaler or the retailer. (A further complication might arise in cases where the producer sold some of his product to wholesalers and retailers, but some direct to final - retail - customers). This, it might be argued, is unfair in the sense that benefits provided at a later stage in the production/distribution chain would attract more tax than those provided at an earlier stage, merely for that reason.

26. One counter argument to this, of course, is that value will have been added - if only in the form of handling and distribution - as the product moves further down the distribution/production chain, and so too therefore will the measure of the benefit have increased. There is also the more fundamental argument that the correct benchmark in all these cases is not what a customer of the employer would have to pay, but the price that the customer as a member of the public would have to pay in the open, retail market.

27. However, if the arguments at paragraphs 24 and 25 are accepted, it then becomes possible to argue that, as regards goods, the solution is to adopt

- "cost to the employer" for goods that are bought and sold as part of the employer's normal business (Case B),

- "lowest arm's length selling price" for goods produced or manufactured by the employer as part of his normal business*

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*There is then the possibility of one further refinement, to cater for the situation - probably fairly unusual - where the employer produces goods as part of his normal business for sale direct to the general public rather than for sale to a wholesaler or a retailer. It would clearly be too cumbersome to try to determine case by case what price was charged by those manufacturers supplying similar goods not to the general public but to wholesalers or retailers, especially as this task under FBT would have to be undertaken by the employer. The alternative, therefore, would be to scale down the retail price in these cases by some fixed proportion. The Australians (but not the New Zealanders) have adopted this further refinement, and the proportion in their case is 75%. They also scale down for services - again to 75% of the lowest arm's length price charged to the employer's normal customers - though the justification for this in the case of services is less obvious. Presumably, however, this was felt to be necessary on the grounds that, having adopted cost to the employer or scaling down for goods, it would be difficult not to do something similar for services.

In a simple two party production/distribution chain where the distributor is also a retailer, the measure of the benefit would then be the same throughout because the price charged by the producer to the retailer would be the same as the price paid by the latter for acquiring the goods. (This begins to break down, of course, if the distributor is a wholesaler not a retailer, or if there are more than two parties involved - ie manufacturer, wholesaler and retailer - but it will still hold as between eg the manufacturer and the wholesaler, or the wholesaler and the retailer).

28. Under the present system the rule for goods in Cases B and C will in most instances be cost to employer or second hand value whichever is greater. For goods bought and sold as part of the employer's normal business, therefore, this option would involve some relaxation in cases where second hand value exceeds cost, and no change in other cases. For goods provided by the employer as part of his normal business, the change would work in the direction of bringing into tax some benefits presently excluded - but this will depend in each case on the precise relationship between lowest arm's length price and cost/second hand value.

29. For services - ie those that are provided as part of the employer's normal business - the above kind of refinement should not in principle be necessary. Unlike goods, there are only two parties involved in the "supply line" for services - the provider of the service and the person to whom it is provided. For services, therefore, the valuation rule could simply be "lowest arm's length price charged by the employer for an identical service provided to his normal customers".

30. This would be a departure from the present system, where the rule for services is cost to the employer. But the present rule is difficult to justify, especially as even under the present system the valuation in the case of goods will usually be something much closer to market value (see paragraph 4(c) above). Moreover cost is not an easy concept,

particularly for services where there is often much wider scope for "marginal cost" arguments.

Fourth option: cost to employer

31. Under the previous option, only goods bought and sold by the employer as part of his normal business would be valued at cost to the employer; goods produced or services provided by the employer as part of his normal business would be valued at lowest arm's length price charged to the employer's normal customers. Under this option, the last two would also be valued at cost to the employer.

32. The present rule for services is cost to the employer, and - generally speaking - for goods it is the higher of cost to the employer or resale ("second hand") value to the employe. Compared to the present system, therefore, this option would involve relatively little change, except in respect of those goods for which the resale value to the employee is higher than cost to the employer and where, therefore, the effect of the change would be to take some benefits out of tax.

33. It is difficult to generalise about whether resale value to the employee will be higher or lower than cost to the employer. There is likely to be enormous variation, depending on the nature of the goods in question. Generally speaking, however, resale value is more likely to exceed cost where the goods in question have a high mark-up and/or are luxury goods, than in cases where they have a low mark-up. For example, the resale value of an expensive fur coat given to an employee by his employer who is a fur coat retailer is still likely to be less than the cost of the coat to the employer. Similarly, the resale value of a Sierra given to an employee of Fords would probably still be less than what it cost Fords to produce (assuming he was in fact free to sell it). On the other hand, for many small, less expensive but perhaps still quite significant goods (eg clothes more generally, electrical

goods, etc etc) the resale value to the employee will almost certainly be less than cost to the employee.

SUMMARY AND CONCLUSION

34. There is a good case for standardising the general benefits valuation rules for FBT, particularly given the need for simple and clear cut rules that can be operated by employers without too much difficulty. The abolition of the "earnings threshold" and with it the need for separate rules that apply to directors and "higher paid" employees will facilitate this.

35. At minimum, the present "second hand value to employee" rule would have to be dropped for FBT, because such a rule could not be operated by employers.

36. There are then a number of different cases that need to be considered.

37. Where the employer simply buys the goods and services from someone else for the employee, or the employee acquires them and the employer pays **(Case A)**, the valuation rule would continue to be cost to the employer. This is the current rule for directors and higher paid employees, or where the employer meets the employee's pecuniary liability.

38. Similarly, for services provided by the employer which are not part of his normal business **(Case D)**, the rule would - as at present - be cost to the employer. Precisely which costs should be included and which excluded for this purpose in the case of services like subsidised staff canteens that are not otherwise exempted being considered separately.

39. As regards goods bought and sold as part of employer's normal business **(Case B)**, and goods produced or services provided by employer as part of his normal business **(Case C)** this note has identified four main options for valuing these benefits under FBT;

- market value: ie value the benefit of all goods here by reference to normal retail price, and all services on the basis of normal arm's length price charged by employers to their ordinary customers (see paragraphs to);

- proportion of market value: as above, but with the measure of the benefit reduced by a standard specified proportion of full market value (paragraphs to);

- "Antipodean approach": cost to employer for goods bought and sold as part of his normal business. Lowest arm's length price charged to normal customers for goods produced or services provided as part of the employer's normal business (paragraphs to);

- cost to employer: ie for goods produced and services provided by employer as part of normal business, and not just for goods bought and sold as part of employer's business. Broadly the present system (in most instances) except where resale or "second hand" value to employee exceeds cost to employer.

40. Some points relevant to consideration of these options include

- is FBT to be regarded as a tax on benefits provided, or on the provision of benefits? If the former, this would tend to point towards rules which measure the true value of the benefit to the employee and, therefore, to market value rules. If the latter, this would tend to point towards cost-based rules

- to the extent that the reason for switching to an FBT is to get the taxation of benefits on to a more rational basis, should this opportunity be taken to move to valuation rules that measure the benefit

more correctly. If so, that too would point towards the market value-type rules

- on the other hand, to the extent that the priority is to get FBT established, with minimal changes in the detailed provisions at this stage (especially any that would be likely to add to what is already likely to be a controversial measure), that would point towards maintaining the status quo and the cost-type rules.

M PRESCOTT

ANNEX A

ALTERNATIVE VALUATION RULES

	Case	Alternative rules*
A.	Goods and services which the employer buys from someone else for the employee; or which the employee himself acquires but the employer pays for.	Cost to employer (ie expense incurred by him). (Since the employer is buying in the goods or services the cost to him will broadly equate tomarket value and will be easy to ascertain).
B.	Goods bought and sold as part of the employer's normal business.	Cost to employer - ie price paid or lowest arm's length price at which sold to normal customers (ie where employer is a wholesaler). or open market retail price (ie where employer is either a retailer or a wholesaler), or a proportion thereof.
C.	Goods produced, or services provided, as part of the employer's business.	Cost to employer of producing goods or providing services. or lowest arm's length price charged to normal customers or open market retail price or a proportion thereof.
D.	Services provided by the employer which are not part of his normal business (eg staff canteens).	Cost to employer of providing service or price employee would have to pay in open market for similar service.

* less, in all cases, anything paid for the benefit by the employee and the amount of any expenses deduction to which he would be entitled.

ps3/81T

BUDGET SECRET: TASK FORCE LIST

COPY NO. 20 OF 21 .

MINUTES OF A MEETING HELD IN THE CHANCELLOR'S ROOM, HM TREASURY, AT 2.00PM ON FRIDAY, 29 JANUARY 1988

Those present

Chancellor of the Exchequer
Financial Secretary
Sir P Middleton
Sir T Burns
Mr Monck
Mr Scholar
Mr Culpin
Miss Sinclair
Miss G C Evans
Mr Michie
Mr Cropper
Mr Tyrie
Mr Call

Mr Battishill - IR
Mr Isaac - IR
Mr Prescott - IR
Ms Rhodes - IR

TAXATION OF FRINGE BENEFITS

Papers: Mr Lewis's minute and enclosures of 28 January; Mr Monck's minute of 28 January; Financial Secretary's minute of 25 January; previous papers.

The Chancellor was grateful for the papers submitted for the meeting. He had reflected carefully on the issues raised both in these and in earlier papers. The time had come to reach a conclusion on the direction of work relating to the taxation of fringe benefits. As work on the proposed FBT had developed, the net advantage of introducing it had become more and more marginal, to the point where it seemed too small to justify the necessary upheaval. He had therefore concluded, with some regret but with no hesitation, that it would not be right to pursue the FBT further in this Budget. He was most grateful for all the work that had been done.

2. The Chancellor proposed that the meeting should concentrate on options for maximising the take from conventional taxation of cars. He had two preliminary questions. First, was it possible to make the new scale charges effective from 1988-89? This would mean that higher receipts would be available from year 1 rather than year 2; and the increase in taxation of cars could be matched with the reductions elsewhere in the package. Mr Cropper noted a third advantage: it would be easier to introduce this increase at a time when company profits were buoyant.

3. Mr Lewis said it would be possible to make this change in 1988-89. There would be an administrative cost: the Statutory Instrument for 1988-89 had been laid, and the increases coded out in individual tax assessments. These would need to be revised. Mr Battishill said that legislative procedures might mean that the increase could not be implemented until the Finance Bill received Royal Assent. These points would need to be examined further.

4. The Chancellor said that, subject to further examination of the administrative costs, we should proceed on the basis that the increase would take place in 1988-89. Earlier statements, at the time the 10 per cent increase in 1988-89 was announced, should also be examined to ensure that nothing was said which could be held to contradict this action.

5. The Chancellor's second question related to the P11D limit. If that were raised to £10,000, it might permit a larger increase in the car scales. Could this increase the revenue take in comparison to maintaining the threshold at £8,500? An increase in the P11D limit would, of course, need to apply to all benefits. The Chancellor invited the Financial Secretary to look further at this.

6. The meeting considered the issues in Mr Lewis's paper of 28 January ("Cars - income tax options"). On the main options, the

Chancellor said that further work should concentrate only on options 2 and 3, and only on increases of 75 per cent and 100 per cent in the scale charges. Table B of Mr Lewis's paper should be re-calculated on the basis of implementing the changes in 1988-89. Variants should be examined, and a range of changes around the averages. The further work should identify who the losers would be, and what levels of income they enjoyed. The Chancellor invited the Financial Secretary to take this forward.

7. On the longer-term, the Chancellor said planning should assume an increase of 10 per cent in 1989-90. This figure should not be revealed unless pressed.

8. On special cases, it was agreed to leave the taxation of second business cars on the present basis. It was noted that the "2,500 business miles" limit was virtually unenforceable, and moreover, that the rule was itself curious since it was the private use of the car whence the benefit was derived. There was a case for increasing the mileage limit; but such an increase would also give rise to threshold problems. It was, therefore, agreed to leave taxation of these cars on the present basis. It was also agreed not to alter the taxation for "tool of the trade" cars.

9. On the taxation of expensive cars, the Chancellor noted that the taxing of the benefit should be reviewed in conjunction with the capital allowance rule for such cars. There was a case for combining a larger increase in the taxation of the benefit of these cars with some easing of the capital allowance rules. Some raising of the capital allowance ceiling might be appropriate. The Chancellor invited the Financial Secretary to consider this further.

10. The Chancellor said that he did not think the industrial considerations in Mr Monck's minute of 28 January pointed clearly against an increase in the taxation of company cars. The numbers

might turn out to be rather pessimistic. Moreover, he had told Lord Young of his intention to make a swingeing increase in the taxation of cars and Lord Young had not demurred. There was no need to check the figures further with the Department of Trade and Industry.

11. The meeting considered briefly the taxation of other benefits. The Chancellor was minded to retain the exemption for canteens, but remove it for luncheon vouchers and directors' dining rooms. A scale charge might be a possibility for taxing the benefit of directors' dining rooms. The Financial Secretary was invited to consider this further, in conjunction with the Paymaster General.

12. The Chancellor also invited the Financial Secretary to look further at the taxation of other benefits. The Financial Secretary noted that it had been agreed to exempt entirely car parking and sports grounds.

J M G TAYLOR

2 February 1988

Distribution

Those present
Chief Secretary
Paymaster General

FROM: J J HEYWOOD
DATE: 9 February 1988

MR McINTYRE

cc PS/Chancellor
PS/Chief Secretary
Mr Scholar
Mr Culpin
Miss Peirson
Mr Cropper
Mr Tyrie
Mr Call
Mr Mace IR
PS/IR

APA FOR MEN WITH INCAPACITATED WIVES

This subject was discussed at Prayers yesterday morning and I understand the Chief Secretary expressed the view that, on top of Social Security Act changes, the abolition of the APA for men with incapacitated wives would be very difficult indeed presentationally.

2. The Chancellor's view was that disability should be treated through the benefits system and not the tax system. He asked the Financial Secretary to look at the possibility of converting the APA for men with incapacitated wives into a benefit. Could you provide an urgent note on this?

JEREMY HEYWOOD
Private Secretary

FROM: J P MCINTYRE
DATE: 16 February 1988

FINANCIAL SECRETARY

cc Chancellor
Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Anson
Mr Kemp
Mr Scholar
Mr Culpin
Miss Peirson
Miss Sinclair
Mr Gibson
Mr Portes
Mr Cropper
Mr Tyrie
Mr Call
PS/IR
Mr Mace I/R

MCINTYRE → FST 16/2

APA FOR INCAPACITATED WIVES: CONVERSION TO BENEFIT

You asked (Mr Heywood's minute of 9 February) for advice on whether the APA now available to the husbands of incapacitated wives with dependent children could be converted into benefit.

2. I think we start from the premise that any conversion option would also have to cover wives of incapacitated husbands in order to avoid sex discrimination problems.

3. I attach a minute by Mr Portes which describes one way of achieving conversion. It would involve paying one parent benefit (OPB) to those whose spouses qualify for the severe disablement allowance (and pass the 80 per cent disability test for SDA) and who have dependent children. This is the closest we can come (although we have not consulted DHSS who might have better ideas) to replicating the APA arrangements for this group without creating a new benefit; the latter is obviously something we would want to avoid.

4. The logic of using OPB is that the active parent is in a position very like that of the single parent in effectively having single-handed responsibility for bringing up the child, because his/her partner is very severely disabled.

5. There are two possible variants. First, OPB could be given only to new SDA claimants meeting the 80 per cent test, with existing APA recipients retaining their allowance (ie getting transitional protection). Second, the existing APA claimants could also be switched to OPB (we can probably assume that they would all pass the 80 per cent test given the tightness of the rules on eligibility for APA).

6. The net extra costs would be up to £5 million (if we switched existing APA claimants to OPB); there would also be extra tax payments of £3½ million on this basis. The SDA 80 per cent test is a good deal less stringent than the current test for APA, and so the extra cost would include some deadweight though this is very hard to estimate.

Disadvantages

7. Leaving aside the direct costs, these are:

a. Would not avoid losers. OPB is £4.90. So under both variants, all new claimants would lose £2.50 a week compared with current APA entitlement of £7.40. If no transitional protection, existing claimants would actually lose £2.50. We might therefore get worst of both worlds - extra costs and flak from disability groups.

b. Could stimulate higher take-up of SDA because of its added value as passport to OPB;

c. Could add to existing pressures on DHSS to reduce 80 per cent disability test for SDA, again because of additional value to claimants;

d. Would represent significant extension to use of OPB in allowing claims by couples - might be seen by pressure groups as opening door to further extensions;

e. In adding to numbers getting OPB (and possibly SDA), would make decision to means test these benefits more difficult;

f. Would probably need primary legislation to change OPB rules.

8. Disadvantage (a) would be particularly strong at present, because the disability pressure groups are aware that the OPCS survey of their needs is to be published later this year. Any losses for the disabled arising from tax measures could increase pressure for more generous benefits when the survey results are known. There is also the point that the very severely disabled are among the losers from the social security reforms being introduced in April. Although DHSS have now announced that up to £5 million a year will be put into a special fund (to be run by the Disablement Income Group) for this group, the issue remains sensitive. Most of the losers from the social security reforms would be different people from those affected by a switch from APA to OPB (because most if not all would have insufficient income to take advantage of APA). But this would not be of much help in presenting the decision. The criticism could still be made that it was another government decision which reduced the help available for the severely disabled.

Conclusions

9. Conversion to benefit is possible, subject to any problems which DHSS might identify. But there would be the disadvantages set out in paragraph 7 and 8 above.

10. The options are therefore:-

(a) Conversion to benefit, subject to DHSS agreeing the scheme. Implementation would be in April 1989 or April 1990,

depending on the timing of the primary legislation which would probably be needed.

(b) Retain APA for husbands of totally incapacitated wives with dependent children, but be prepared to extend APA to wives in the same position if pressed on the sex discrimination issue.

11. In view of the disadvantages of conversion, (b) appears more attractive.

JM

J P MCINTYRE

BUDGET CONFIDENTIAL

FROM: J D PORTES
Date: 16 February

See attached minute JDP 16/2

1. MR MCINTYRE ✓

2. FINANCIAL SECRETARY

APA FOR MEN WITH INCAPACITATED WIVES

You asked for a note on the possibility of converting this allowance into a benefit, given the presentational difficulties of outright abolition.

A possible benefit solution

2. It might be possible to achieve this through an extension of One Parent Benefit (OPB) to anyone who is married to a recipient of Severe Disablement Allowance (SDA), and who is responsible for the care of a dependent child. The logic behind this would be simple; someone with dependent children married to an SDA recipient is likely to have to take full responsibility for bringing up the child, just like an ordinary OPB recipient.

PORTES FST 16/2

3. Miss Dyall's paper (8 October 1987) makes it clear that the IR test of total incapacity needed to qualify for APA is at least as strict as SDA - probably substantially stricter. Hence any loser from abolition should benefit from such an extension of OPB, and there would be windfall gainers.

4. SDA goes to about 260,000 people at present. Over half also claim means-tested benefits. There are several qualifying routes to SDA. The easiest relate to incapacity for work, and receipt of mobility or attendance allowance. The more difficult test is that of 80 per cent disablement. SDA originated as a replacement for non-contributory invalidity pension.

Number of recipients and cost

5. DHSS estimate up to 40,000 SDA claimants may have dependent children. This is based on FES data. This is probably on the high side, since there are only 22,000 married women recipients of SDA under 50, and only 2,300 SDA claimants actually get a child dependency addition at the moment. The 'flow rate' is about 7 per cent, so it is possible there might be up to 3,000 new recipients of SDA with dependent children a year. These would not all necessarily be married. This figure is also likely to be reduced because the 'easy' qualifying route for married women SDA claimants (for former non-contributory invalidity pension recipients) has now been closed.

6. One way of limiting the cost of conversion would be to require that these new recipients of OPB passed the SDA 80 per cent disability test (it is still possible to qualify for SDA in other, less restrictive ways). For illustration, a typical 80 per cent disablement would be an arm amputated just below the shoulder. This would reduce the deadweight simply to those who were 80 per cent or more disabled but not 'totally incapacitated' according to the definition for APA purposes. Perhaps only 50 to 75 per cent at most of those currently on SDA are 80 per cent disabled or more.

7. If we follow the logic of para 2 above, it would be difficult to justify giving these claimants a different rate of OPB to that received by 'normal' OPB claimants. This is £4.90 per week, contrasting with their loss of £7.40 per week (with basic rate tax at 27 per cent).

8. If the APA for this group was abolished immediately, the extra tax revenue would be about £3.5m. If 40,000 SDA claimants became entitled to OPB, the gross cost would be about £10m. However much of this would be clawed back, since OPB is taken into account for those (over half of SDA recipients) on means-tested benefits. So the possible net benefit cost might be about £5m. This approach would however involve an immediate loss of up to £2.50 per week for former APA recipients.

9. Another approach would be to give transitional protection for those already claiming APA. Then only new SDA claimants, or those who have children while already on SDA (likely to be a fairly small group) would be entitled to OPB. This would avoid losers but would be inconsistent as between new and already existing SDA claimants, some of whom would not have the APA. If there were 3,000 new claimants a year, the gross cost could then be about £0.7m in the first year, rising eventually to up to £10m. The possible net cost might be about £0.4m in the first year.

10. The benefit costings above would be reduced (perhaps by 25 to 50 per cent) if the more severe 80 per cent test was imposed. This would also reduce the possible 'take-up' problem below.

Drawbacks

11. It is possible a new 'passported' extension to SDA would raise take-up. DHSS may wish to weaken the 80 per cent disablement test in the current review of disability benefits.

Conclusion

12. If a benefit solution were felt to be the best way of tackling the problem, an SDA 'passport' would probably be the best option. If it was restricted to those who qualify for SDA through 80 per cent disablement, it would be reasonably well targetted on the losers from abolition, though there would still be windfall gaineers and OPB extension would not cover the full loss. It would not be without its drawbacks, and might well cost more than the extra revenue gained. It would probably be simpler and more logical to have no transitional protection, so current APA recipients would still lose up to £2.50 per week.

J D PORTES