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PART A

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TASK FORCE BENEFITS IN
KIND

DD'S 25 years NAZIS 10/8/95

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PO -CH /NL/0105

PART A



Inland Revenue

Policy Division
Somerset House

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Could discuss with
these @ Tuesday's
meeting on cars
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TT

FROM: P LEWIS
EXT: 6371
DATE: 16 July 1987

Financial Secretary

[The above submission on car parking is to be released with much better prospects]

BENEFITS IN KIND: CAR PARKING

1. This note seeks your guidance on the way forward on the taxation of the benefit an employee receives where his employer provides a car parking place for him at his normal place of work. You may like to consider it in conjunction with Miss Rhodes' submission of 16 July on the benefits threshold, since the problem it describes would be reduced if the benefits threshold were increased.

below

2. I am afraid that this is another rather tangled problem
- the provision of car parking is very widespread
 - it is taxable, but the present rules give widely varying results, and can be complicated to apply
 - in practice, car parking benefit is frequently not returned by employers and has been picked up in, we think, only a relatively small proportion of cases on compliance work, leading to complaints about unequal treatment

cc Chancellor
 Chief Secretary
 Paymaster General
 Economic Secretary
 Sir P Middleton
 Mr Kemp
 Mr Scholar
 Mr Cropper
 Mr Tyrie

Chairman
 Mr Isaac
 Mr Rogers
 Mr Cherry
 Mr Beighton
 Miss Rhodes
 Mr Northend
 Mr Allen
 Mr J Marshall
 Mr Page
 Mr Brannigan
 Mr Eason
 Mrs Tournoff
 Mr Boyce
 Mr I Stewart
 Mr R Marshall

LEWIS
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FST
16/7

- because of the very large number of cases (about 4.5 million, compared with about 1.8 million people liable on all other kinds of benefits at present) there would be substantial staffing consequences - we estimate at least an extra (600) - if we sought to collect the tax universally
- there would be a broadly corresponding increase in employer compliance (P11D) work
- some sensitive cases are involved: Ministers, MPs, Civil Servants
- the possibility of a charge arising is being increasingly mentioned in the press.

3. It is clear we cannot stop where we are, enforcing the law on only a hit and miss basis. But equally, we could not enforce the present law universally because of its complexity in practice, the varying results it produces, the large number of extra staff required - and the effect on employer compliance burdens and street parking/traffic congestion to the extent that employees gave up their parking spaces. Nor can we simply ignore the liabilities on "de minimis" grounds - many are too large. All this suggests that the position may need to be rationalised for the future through legislative changes. Paragraphs 13 to 32 examine four possibilities.

4. In reviewing employers' operation of PAYE, tax offices have identified a number of cases where car parking benefit has not been returned on forms P11D, and tax has not hitherto been paid. Some companies have now settled the tax for past years; others are disputing the liability in various ways. We have put the latter on ice for the moment. But that - and the fact that we can review only a small number of employers - creates problems of its own. In particular, some companies which have paid up are now (understandably) demanding "fair treatment" across the board. We will need to decide how to deal with current and past liabilities when the way forward is clearer.

What is involved in a car parking benefit?

5. We are not concerned here with a parking space provided for a car which is used exclusively for business purposes - no benefit arises in such cases. Under the present law, however, we are concerned with a car parking space provided for an employee at his normal place of work which he can use privately, for example for a car used for travel between home and work. It is not such an obvious benefit of the job as, for example, the provision of a car, a holiday, or private medical insurance by the employer all of which can be enjoyed away from the workplace. Nevertheless, it is a valuable benefit of the job in so far as it enables the employee to travel between his home and place of work by car which either might not be possible, or would involve more expense, or be less convenient if he had to provide his own parking facilities. The perception of the benefit probably varies widely. In Central London, for example, most employees probably recognise that the provision of a private parking space is a quite valuable perk. But someone working on the edge of a small town where free street parking is easily obtainable might be almost indifferent to the provision of a parking space on his employer's premises.

6. It is very common for employers to provide parking spaces for at least some of their employees at their place of work. The spaces may be on land they own, or included in business premises which are rented, or they may be rented specially in a nearby commercial car park. Where the employer rents a commercial car parking space the cost may be substantial - up to £3,000 a year for a space in central London.

Present taxation provisions

and see 1976?

7. The provision of a car parking space for a director or "higher paid" employee is taxable under the special provisions with which you are familiar in Finance Act 1976. In certain circumstances - where, for instance, parking is authorised by means of some kind of voucher or token, or where the employer reimburses cash paid by the employee, there would also be a charge on people earning less than £8,500.

8. The legislation applying to directors and "higher paid" employees charges the benefit by reference to the cost to the employer of providing it. Where the car parking space is rented, either from a car parking organisation or as part of the business premises, the charge is likely to range from perhaps £200-300 in a country district up to ten times that amount in central London. But where the employer owns the car parking space the charge is by reference to its gross rateable value. Since non-domestic premises were last revalued in 1973 these figures are very much lower than the corresponding current rental values. In central London, the figure might only be £100-200.

9. Even in a straight-forward case, therefore, the measure of the benefit will vary widely depending on the location of the parking space and the means by which it is provided by the employer.

10. Many cases, however, are not straightforward because the parking space is not exclusively reserved for the use of an employee who only uses his car for travel between home and work and who uses it every day. Often more permits are issued than there are spaces because, for a variety of reasons, not all employees will wish to park every day. Loading and unloading of commercial vehicles may on occasions take priority. The public may have access to the car park so there may be little or no benefit which can be regarded as arising from the employment. Then again, many employees bring their cars to work to enable them to be used for business purposes and in such cases some expenses deduction is due to set against the benefit. In short, in large numbers of cases there is not a clear cut, easily established, charge on car parking benefit. Often the individual circumstances have to be examined to establish the amount of the benefit which should be charged to tax.

11. New valuations for all non-domestic properties are to come into effect from April 1990 which will provide a revised basis of charge in England and Wales. But we cannot impose a standstill until 1990; and when 1990 comes, the operational/deregulation/

acceptability problems will be much increased because many benefits which at present could reasonably be regarded as de minimis by reference to 1973 rateable values will be increased to much larger figures which could not be disregarded. This could be the position with many spaces in London used by Ministers, MPs, and officials.

12. Against this background the rest of this note looks briefly at a number of possibilities for change

- exempting the benefit
- introducing a statutory de minimis limit
- introducing a fixed charge
- increasing the car scale charges to reflect parking benefit

Exempting car parking benefits

13. Operationally this would be a clear-cut solution and given the very tight position on resources looks from a purely administrative point of view highly attractive.

14. In support of an exemption it could be argued

- in many cases both the taxable benefit and the perceived benefit is small
- the present rules give unfair results as between spaces owned and rented by the employer
- the benefit can be difficult to quantify
- in many cases it is not a pure benefit, for example where a car has to be used for business purposes during the day

- it would avoid encouraging employees to give up their parking space in favour of public parking, causing road traffic and environmental problems, which would almost certainly happen on a considerable scale if the benefit were taxed
- it would avoid a significant increase in P11D work for employers (already a prime source of "deregulation" complaints) which would be necessary if a charge is enforced.

15. As against that

- an exemption would fly in the face of the Government's general policy on benefits which is to see that they are more fully brought into charge and more effectively taxed, to discourage payment in kind. (Benefits also escape employers' and employees' NIC)
- because of the large number of cases the potential revenue forgone would probably not be insignificant (I say potential because we believe much of it is not now being collected).
- in probably the majority of cases the provision of a parking space is a "pure" benefit.
- it is in many cases quite a valuable one.
- there might be criticism that the main beneficiaries of exemption would be directors and senior employees (typically of City firms) whose parking spaces are provided at substantial cost, mainly as a private benefit, and who are already provided with expensive, perhaps chauffeur driven cars, on which they are not being fully charged to tax because of the level of the car benefit scales. And yet the charge on workplace nurseries, season ticket loans etc would be maintained.

16. Administratively, our strong preference would be exemption (the only staff cost would be a "setting up" cost of less than 25 units). But, if Ministers feel that has to be ruled out, there are three ways in which the charge might be made more practicable - though two would entail some significant staff cost, for which we have no provision, and additional compliance work for employers.

De minimis limit

17. A de minimis disregard of, say, £200 would do something to ease the administrative problems for ourselves and employers. At anything like this level we think a de minimis disregard would have to be statutory - it is not something the Board could introduce under their "care and management" powers. (The assessing tolerance - now increased to £75, equivalent for a basic rate taxpayer of a £280 exemption, involves different considerations and is, in any case, not public knowledge whereas a de minimis limit would need to be, eg to save employer's P11D work.) There is a precedent for a £200 disregard in the legislation relating to the taxation of beneficial loans. The limit was raised to that level in 1980 when interest rates were very high.

18. Disregarding liabilities of £200 or less would take out some of the awkward cases - Ministers, MPs, officials - at least until the 1990 revaluation. But it would highlight the unfairness in the present rules since there would be scarcely any rateable value cases left within the charge to tax. The result would be that almost all parking spaces provided on the employer's own premises would be exempt, while most spaces which were rented would remain liable to tax.

19. In addition, we would be left with all the complexities of the present rules where the circumstances were such that only part of the cost of the parking space should be regarded as a benefit to the employee. This would also make it more difficult to operate the de minimis limit in a good many cases since it would be necessary to enquire about the exact circumstances to see whether the "net" figure was less than £200. This could be

avoided by applying the "de minimis" figure to the "gross" benefit, but this would give arguably inequitable results and leave more cases liable to tax.

20. The revenue cost of this approach would clearly be less than with a total exemption and it would have the advantage of keeping the "big benefit" cases in charge. But it would require extra staff in tax offices (80 to 100) with eventually a similar requirement in the Valuation Office. There would, in addition, be setting up costs of around 130 to 150 staff units.

21. A "de minimis" limit is at best a partial solution; and it could cause environmental problems if people still liable gave up their parking spaces. It would also be only a temporary solution because the 1990 revaluation would be likely to sweep back into charge most if not all of the cases a "de minimis" limit set at a defensible level would exclude. (There might be some scope for increasing its level at that point, but even so the scale of the increase in rateable values is likely to be such that it would be much less effective than before.)

A fixed charge

22. A third possibility would be to introduce a simpler, rough and ready fixed charge for car parking benefit on broadly the same lines as we now have for cars and car fuel.

23. Since costs vary substantially from one part of the country to another there would be a case in principle for having a graduated scale reflecting regional differences. We think, however, that this would be far too complicated in practice and that the only practical approach would be to have a single fixed charge applying nationally.

24. If there were such a charge it could apply - like the benefit scale - only to directors and "higher paid" employees. This could be justified by reference to the general approach of charging benefits more fully on the "higher paid", and would cut out some cases, for example, shop assistants who can park on their employer's premises. But at its present level (£8,500

including benefits and expenses) it is so low - well below average male manual evenings - that large numbers of people not receiving any other benefits would be chargeable, so the administrative burden on the Revenue and employers would still be considerable.

25. A fixed charge could eliminate some, but not all, of the complexities which have to be taken into account at the moment. The basic idea would be that there would be a standard charge of £x added to income if a car parking space were provided by the employer at the normal place of business. It would not matter if the car were brought to the normal place of business partly to enable it to be used for business purposes during the course of the day nor would it matter if the space was, in practice, not used every day. In other words, the broad concept would be that the availability of a parking space at the place of work would give rise to a tax charge, just as the availability of a car for private use triggers the car scale charge.

26. The amount of the charge would clearly be arbitrary. Something in the range of £200 to £300 might be appropriate (tax of £54-£81 for a basic rate taxpayer). The "rough justice" of the system would point to a fairly low level charge (at least on introduction), as also would the need to avoid driving people to on-street parking. An effective charge of only £1 to £1.50 per week might not cause widespread behavioural changes.

27. One objection to this approach is that it would clearly undercharge those cases where a large amount was being paid by the employer for the parking space. At the cost of some additional complication, it would be possible to have special provisions dealing with cases where the employer was paying, say, more than £1,000 a year for a parking space (or, post 1990, the GRV exceeded that amount).

28. We can at present give only broad estimates of the magnitude of the likely tax yield and administrative consequences of a fixed charge. The latest information on the provision of parking spaces by employers is from the 1978-79 National Travel Survey;

but more up-to-date figures should be available later this year. The 1978/79 survey shows that about 4.5 million people earning more than £8,500 a year drive to work and use an employer provided parking space. Of these

- 3.2 million use the space on 5 or more days per week
- 1.3 million use the space for 1 to 4 days per week.

A fixed charge of £200 per space would on that basis - and on the important assumption that there were no behavioural changes - yield about £250 million per year, or about £200 million if a reduced scale applied for part-time use.

29. For a single fixed charge there would be an ongoing staffing requirement of about 120 (assuming the simplest procedures were adopted), with additionally a setting up requirement of about 130-150 units. A scale charge to reflect part-time use would be considerably more complicated to operate, and we estimate the on-going staff requirement to up to 450.

30. I should emphasise

- that these figures are little more than illustrative.
- our Departmental budget contains no resources for this work. If you wished to go ahead, but additional resources were not provided, we should need to agree with you what existing work would be dropped to make resources available for the new charge.

Reflecting Parking Benefit in the Car Benefit Scales

31. A further possibility, which would have the advantage of maintaining the charge on parking benefit (at least in principle) without additional work for employers or the Revenue would be to increase the car benefit scales somewhat above the levels they would otherwise be to take account of car parking benefit.

32. There are, however, serious difficulties with this approach

- it would be a somewhat theoretical exercise since the level of the car scales is itself pretty arbitrary, and it could after a few years become difficult to say that a particular part of the scale was in respect of parking
- as with a fixed charge, the amount would have to be kept small because of the wide variety of circumstances it would need to cover; a further constraint would be that the car scales themselves are so low (£580 for the smallest new cars for next year) that a parking addition of even modest size could look disproportionate
- most difficult of all, people who get company cars and who have parking spaces are, we believe, quite different sets of people. Many people may get one, or the other, but not both. So tackling parking in this way would mean charging many company car users on a benefit they did not receive, while the much larger number of people who have a parking space but no company car would escape tax on it altogether.

Effect of changes in the benefits threshold on car parking options

33. Miss Rhodes' note of 16 July ^{below} looks at a number of options for changing the £8,500 benefits threshold. For convenience we summarise here (paragraphs 34 to 42) the interaction of changes to the threshold on the options for dealing with the car parking problem.

34. For car parking, apart from exempting the benefit, the earliest any change could be introduced would be April 1989 following legislation in 1988. The same timescale applies for the benefits threshold, so changes could be made simultaneously.

35. The broad effect of an increase in the threshold coupled with action to collect tax on parking would be to

- reduce the number of car parking cases liable to tax
- reduce the overall cost of the package and
- erode the staff savings.

36. The broad effect of abolishing the threshold and taxing car parking benefits would be to

- increase the number of parking cases liable to tax
- increase the yield
- increase the staff cost.

37. None of the above applies to the exemption option which would be neutral in terms of its effect on the number of cases and costs.

38. For the others, the extent of the effects varies with the options. Thus a £20,000 threshold coupled with the present rules on parking would reduce the number of cases from 4.5 million to 0.5 million; but as the remaining cases would be just as complicated as they are now, they would make inroads into the staff savings. With no threshold at all for benefits the problems described in paragraph 10 would be considerably intensified. We should have some 7.0 million parking cases bringing the total benefits cases to more than 8 million compared with 1.75 million at present.

39. With an increased threshold a de minimis limit would reduce the number of extra cases even further - but the effect is only temporary until revaluation takes effect. With no threshold a de minimis limit would restrict the number of extra cases to be

dealt with compared with the present position (ie it would confine the charge to those with rented spaces) but again only temporarily.

40. A fixed scale charge is administratively much simpler than the present rules. So if combined with an increase in threshold it would have less impact on the staff figures than operating the present law while still making a useful contribution to the cost of the package. With a threshold of £20,000, the staff savings would be only marginally eroded, while the cost of increasing the threshold would be cut from about £190 million to about £150 million. With no threshold the yield from taxing car parking would be substantial - £400 million - but it would add another 200 to the extra 100 staff requirement if the threshold were abolished; and of course, there would be an increased environmental impact.

41. Increasing the existing car scale has no effect on numbers or staff costs under any of the options for the threshold though it affects the revenue cost/yield. The amount would depend on how much higher the scales were to take account of parking.

Selective threshold

42. The threshold note also looks at the possibility of introducing selective thresholds. How this would affect the car parking options would depend on which side of the fence they fell - ie whether the higher or the lower threshold applied to parking spaces. There are a variety of options here and we can let you have a more detailed note if you would like one.

Summary

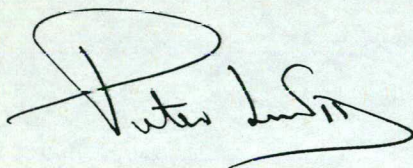
43. For the reasons explained above, we do not think we can continue as we are. If that is agreed, it is a question of making the least unattractive change.

44. If you feel it would be acceptable, exemption would provide a complete solution to the practical problems.

45. If you decide exemption must be ruled out,

- an addition to the car scales is attractive administratively, but very "hit and miss". In substance, it would probably amount to little more than some limited presentational cover for exemption, or a debating point which might be made if the car scales were being raised by more than the recent increases of 10%
- a de minimis limit is of very limited and only temporary help
- a fixed charge is probably just about defensible in principle, and could raise worthwhile amounts of revenue; but it would entail a significant increase in both compliance work for employers and in administration costs for the Revenue. It could also entail environmental problems which you would need to discuss with your Ministerial colleagues (Home Office/Transport).

46. We would, of course, be happy to discuss all this with you.



P LEWIS



Inland Revenue

The Board Room
Somerset House
London WC2R 1LB

[Consider option of absolute threshold for cars & just a raise in 2 to new higher rate threshold for every else]

[Source sized, make staff work less hassle]

FROM: A J G ISAAC

16 July 1987

FINANCIAL SECRETARY

BENEFITS IN KIND: THE £8,500 EARNINGS THRESHOLD

1. I am conscious that this is far from the first time that we have raised with Ministers (Miss Rhodes' minute below) the question of an increase in the £8,500 threshold for taxing certain benefits in kind. I must take responsibility for raising it again, for better or worse.

2. Let me say at once that we all accept the logic of the present policy. My questions are about its practical consequences.

3. First, there are the staff costs. Our PES bid reflects a need for about 1,000 staff; and under existing policy this need will continue to grow. We emphasised the staff cost here in our previous submissions. But I raise it again, against the background of an increasing tension (as I perceive it in our discussions over the past year or so with Ministers on our 1987-88 Estimates provisions and our PES bids) between the staff costs implicit in the Revenue's existing commitments and the money available to fund those costs.

cc Chancellor of the Exchequer
Chief Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Mr Scholar
Miss Sinclair
Mr Cropper

Mr Battishill
Mr Isaac
Mr Lewis
Mr Beighton
Mr Lawrance
Miss Rhodes
Mr Northend
Mr R H Allen
Mr J Marshall
Mrs Tournoff
Mr Boyce
Mr I Stewart
PS/IR

ISAAC
→
FST
16/7

4. Second, there is a correspondingly heavy compliance cost for employers, and a continuing emphasis within Government on deregulation.

5. Third, there is the problem - which we have identified in a number of recent discussions - that the 1976 rules were framed (and are still needed) to handle the (complex and ingenious) tax affairs of the genuinely high paid. As most of us feel, however, they are apt occasionally to produce an element of "overkill", when the policy of "withering on the vine" applies them to the low-paid typist or clerical assistant. This, in turn, risks discrediting the system. And Mr Lewis's note on car parking (also coming up today) vividly illustrates just how widespread the net is with the threshold at its present level.

6. Finally, I have noticed at a number of recent meetings that you have expressed an anxiety that tax offices should not spend relatively large resources chasing relatively small amounts of tax. As I think I have said, I should not want to get this out of proportion. There will always be the occasional (and well publicised) unhappy case. But the overall cost/yield figures are reassuring; and as the figures in Miss Rhodes' note illustrate, it can often be very cost effective to settle with the employer a tax charge on benefits which, even if not individually very large, add up in total to a very large sum. However, an increase in the £8,500 threshold could clearly help with some aspects of this problem - for example, where the typist or clerical assistant is given a taxi home late at night.

7. Miss Rhodes' note offers you a wide choice of options - between a big increase in the threshold across the board to an abolition of the threshold. If I may speak as a "consumer", I think that of the options in the note option B has attractions as

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a "best buy" - holding the present threshold for cars etc, but making a large increase in the threshold for other benefits. However, the decision is very much a political one - and, as Miss Rhodes indicates, you will also want to keep in mind possible increases in the car scale which would offset the revenue cost of some of these options.

CJA

A J G ISAAC



Inland Revenue

Policy Division
Somerset HouseFrom: ANGELA RHODES
Ext: 6303
Date: 16 July 1987

1. MR ISAAC *16.7*
2. FINANCIAL SECRETARY

BENEFITS IN KIND : THE £8,500 EARNINGS THRESHOLDReasons for Review

1. You asked, before the election, for a note about the benefit-in-kind threshold in connection with problems we are currently experiencing with a number of benefits. At the beginning of a new Parliament you will in any event want to review the way forward on the threshold. This note therefore looks at

- (a) where we would stand by the end of this Parliament if the current "wither on the vine" approach were continued
- (b) what the implications would now be for abolishing the threshold
- (c) a number of options for increasing the threshold.

The Chancellor has expressed an interest in a de minimis limit as a means of improving the cost effectiveness of taxing benefits. The implications of this option are briefly considered in Annex 2.

cc: Chancellor of the Exchequer
Chief Secretary
Paymaster General
Economic Secretary
Mr Scholar
Miss Sinclair
Mr Cropper

Mr Isaac
Mr Lewis
Mr Beighton
Mr Lawrance
Miss Rhodes
Mr Northend
Mr R H Allen
Mr J Marshall
Mr Page
Mrs Tournoff
Mr Boyce
Mr I Stewart
PS/IR

2. The threshold has, as a matter of policy, stood at £8,500 since 1979/80. As the value of the threshold falls growing numbers of people receiving non-cash remuneration (which is not always an obvious benefit-in-kind) are being brought within the net and this causes a number of difficulties particularly where the lower paid are concerned. Mr Lewis' note of today's date about car parking is an example of such a problem. An increased threshold would reduce these problems considerably and would also reduce the administrative burden on employers and ourselves. A decision in principle would clearly affect the way we tackle some of these problems and we seek your views as to whether we should work up any of these options as a starter for the 1988 Finance Bill.

Background

3. There is no reason in principle why remuneration in kind should be treated any differently from cash remuneration no matter what the level of total earnings. However under the normal Schedule E rules, tax can only be assessed on a benefit-in-kind where

- the employer meets the employee's pecuniary liability (eg by paying his bills); or
- the benefit can be turned into cash (the charge being by reference to its cash ie second-hand value)

Special rules were therefore introduced in 1948 to tax benefits-in-kind in the hands of directors and higher paid employees. These rules, which were extensively revised in 1976, provide in general that the measure of the benefit is the cost to the employer of providing it though there are some important exceptions. Company cars, for example are charged by reference to a fixed scale rate. The rules are widely drawn. They cover any non-cash remuneration provided for the employee (or his family) by reason of his employment.

4. In 1948, the earnings threshold at which the special rules come into play was fixed at £2,000 (worth around £53,000 now in terms of earnings). It was increased to £5,000 in 1975/76, to £7,500 in 1977/78 and to £8,500 in 1979/80.

5. Leaving the threshold unchanged means that as earnings rise more employees are brought into the tax in respect of non-cash remuneration they receive. When it was introduced in 1979/80 the £8,500 threshold was 67% above average earnings for all full-time employees. By 1984/85, (at 99%) it was just about level with average earnings and is now about 81%. Assuming earnings increase by around 7.5% a year we can expect the threshold to be about 65% of average earnings in 1990/91. So people on comparatively low incomes are now increasingly coming within the charge. The special rules and the static threshold have, however, not reduced the popularity of benefits-in-kind. Nowadays benefits are commonly provided even for relatively junior employees. Part of the reason benefits have remained so popular may well be that the benefit of a company car is still considerably under taxed compared with its true value.

6. Moreover, payment in kind is an important way of avoiding national insurance contributions since neither employer's nor employee's contributions are payable in respect of benefits. The abolition of the upper earnings limit for employers contributions in 1985 has provided a further stimulus to remunerating more senior employees through benefits. If any further changes to the rules for charging national insurance contributions were to be considered there would be obvious implications for benefits and the effects for both the threshold and the car scale rates would need to be taken into account.

Present position

7. We estimate that some 1.75m people will be in receipt of net taxable expenses and benefits in 1987/88. (The figures

quoted in this note exclude people whose only benefit is employer- provided parking spaces. We estimate there are about 4.5m of these in total of whom only around 1 - 1 1/2m are in receipt of other taxable benefits. As Mr Lewis' note points out, the tax on this benefit is largely going by the board). The yield from taxing benefits is expected to be £650m in 1987/88 of which £480m comes from car and car fuel benefit and £50m from medical insurance benefits. The current staff cost is about 1000. Consequently the cost of collection is about 3p in the £. This is rather higher than the current (1986/87) overall departmental cost yield ratio of about 1.68p in the £. This is hardly surprising; the bulk of tax we collect comes in more or less automatically, whereas tax offices have to take some steps to ensure that employers submit P11D returns and that the tax on the benefit declared is brought to account. This staffing figure does not include compliance work which is additional and discretionary (paragraph 13 discusses the compliance aspect).

Why change the threshold?

8. The Government's policy has been that benefits in kind should be taxed no more favourably than cash payments. In principle this is exactly right. On this basis, any threshold is an anomaly and all benefits should be taxed, irrespective of the level of the recipient's earnings. The present policy of allowing the threshold to "wither on the vine" is a practical compromise which recognised the heavy and sudden additional burden which would have fallen on taxpayers, on compliance costs for employers and on the Revenue's administrative costs if the threshold had been abolished.

9. It is impossible to say exactly when the present threshold can be expected to have "withered" completely. By 1990, we estimate that rather less than 10% of people receiving benefits will be below the threshold (compared with around 17% now). By 1995 the numbers are likely to be negligible.

10. A number of factors are, however, now coming together which suggest it would be useful to take stock and consider whether the undoubted logic of the present policy still outweighs its practical consequences.

Compliance Costs

11. First, inflation and real growth in earnings have brought many hundreds of thousands of employees over the threshold. In all we expect some 1.75m people to pay tax on benefits this year of whom 1.35m will be higher paid employees (the rest are directors). If the threshold had kept pace with earnings since 1979 only some 400,000 "higher paid" employees would be liable to tax on benefits this year. Over time, the consequent increase in employer's compliance costs in reporting these benefits and the Revenue's administrative costs is no less heavy than would have resulted from a decision to abolish or cut the threshold.

Employers

12. Employers are required to report the benefits paid to each of their employees whose earnings are at the rate of £8,500 a year or more inclusive of benefits and expenses on a form P11D. The growth in the number of people liable to tax on benefits places substantial burdens on employers. The costs associated with completing forms P11D have now become the biggest single complaint from employers about their compliance costs for income tax. It is not simply the number of forms that has to be completed that gives rise to complaint, but the detailed and otherwise unnecessary analysis of expenses payments which businesses have to do to enable them to complete the forms properly. Not the least critical of the burdens the P11D requirement place on businesses has been the Deregulation Unit under Lord Young. In consultation with the Unit and representative bodies we are working on a streamlined version of the form P11D which we hope to introduce next year. The new form will be easier to complete but cannot significantly reduce the amount of

record keeping etc required of employers. We can expect the Unit to pursue the Plld burden vigorously in the new Parliament as other easier targets are picked off. A reduction in the Plld population (which would result from an increase in the threshold) would represent a significant easing of the burden on employers.

Revenue

13. By the same token, a reduction in the Plld population would reduce the current staff cost of servicing the system, and thereby ease pressure on running costs. You will also have seen Mr Rogers' submission of 30 June ^{not attached - we have it if you want} setting out the case for more staff on Schedule E compliance work. Pllds represent a major target area for this compliance work. Compliance goes far beyond the routine checking and bringing to account of benefits declared by the employer. It involves examining the whole range of benefits provided by an employer to ensure that the correct amount of tax is being paid. Mr Rogers' submission was of course on the basis that the present Plld threshold would be maintained. On that basis the yield/cost of the extension of compliance work proposed was estimated to be between 7:1 and 12:1. If, however, there were a major increase in the threshold that yield/cost might be marginally reduced. This is because, in undertaking a compliance review, the investigators would have to do much the same work as they do now to identify untaxed benefits, but at the end of the day a smaller number of the employer's staff would actually be liable to tax on them. For example, Option A to this paper consists of increasing the threshold to £20,000. That would reduce the yield/cost range expected from the proposed expansion of compliance work to about 5:1 to 9:1. But it would still compare favourably with other compliance work such as the examination of business accounts and PAYE audit. Apart from Option D, the other options discussed in this paper would not reduce the expected yield/cost range of additional compliance work. It is worth noting that these ratios reflect only the additional yield which can be identified when cases are settled. As a result

of an investigation the employer is likely to maintain a higher level of compliance in subsequent years, and though we do not claim credit for the additional yield in our yield/cost ratios we have good reason to think that if the three or four years following a compliance review were taken into account the yield would double-in other words the yield/cost ratio for Option A would be in the range of 10-20:1. In addition there is a wholly unquantifiable gain from the deterrent effect of our activities upon other employers.

14. Overall, the costs for both employers and the Revenue are far greater than was envisaged a decade ago while at the same time Government policy is to place greater priority in reducing costs in both areas.

Target of the Rules

Directors and higher paid earners

15. The benefit rules were originally drawn up to deal with company directors and other highly paid earners. To deal satisfactorily with these categories the rules need to be very precise and comprehensive. Experience has shown that companies will show enormous ingenuity of finding ways of giving their managing directors and other senior staff substantial benefits (eg a chauffeur-driven Rolls, flat in Mayfair etc) in a way that escapes tax.

Other earners

16. In practice the same quality of safeguard is not needed for the great majority of lower paid employees for whom employers do not generally provide the same kind of tailor-made avoidance packages. However, the fact that exactly the same rules do apply (as the erosion of the threshold brings increasing numbers of lower paid people into the net) lies at the root of many (though not all) of the practical and political difficulties which Ministers now face on benefits in kind. For example, rules are necessary to deal with the case where the director puts his children's nanny on the company payroll but they catch the nurse's

workplace nursery. Rules are also necessary to deal with the case where the company Rolls takes the Chairman home but they catch the teenage typist given a taxi home late at night.

17. To put it in a nutshell, we have now reached the position where we need to consider with Ministers whether the logical pursuit of a logical policy is leading Ministers (and the Department) to results which in practice do more harm than good.

The Options

18. We have identified a number of options which are analysed in more detail below. In the main these look at increasing the threshold for some if not all benefits. Removing the smaller, less productive, but nevertheless time consuming cases from the net, in practice requires an increase in the threshold so that only the genuinely higher paid are included. This would result in significant staff/employer compliance savings but would have a high revenue cost. Most of the yield from benefits, however, comes from company cars, car fuel and medical insurance. A less costly option would be to increase the threshold for all other benefits while leaving it unchanged (or even abolishing it) for cars and medical insurance. This is not quite the departure from the present position it might first appear. Some benefits - eg living accommodation and benefits obtained by vouchers or credit tokens are already taxed on all employees irrespective of their earnings. It would be possible to cut the revenue cost still further by excluding other popular benefits from the increase - beneficial loans for example - but the more exclusions there are, the less savings of staff will be achieved.

19. However, if the present policy of allowing the threshold to "wither on the vine" is continued, another option is to anticipate the outcome by a few years by removing the threshold entirely. We have, therefore, included that option in our analysis. The options are:

- A. increase the threshold to £20,000 for all benefits-in-kind;
- B increase the threshold to £20,000 except for cars, car fuel benefits and private medical insurance where the threshold would remain £8,500;
- C increase the threshold to £20,000 except for cars, car fuel benefits and private medical insurance which would have a nil threshold;
- D revalorise the 1979/80 figure of £8,500 by reference to
 - (i) the retail price index i.e. increase it to £16,400 for 1987/88 or
 - (ii) earnings i.e. to £19,300 for 1987/88.
- E abolish the threshold for all benefits-in-kind.

20. The options have been costed for illustrative purposes on the basis of 1987/88 figures - ie as if the changes were taking place in the current year. They would all involve some transitional staff costs which would vary depending on a number of factors eg the numbers involved and the complexity of the changes. The £20,000 threshold which is used in some of the options represents an attempt to ensure that the "higher-paid" employee is, very broadly, the same as the higher rate taxpayer. The two populations cannot be made to match completely because the point at which a taxpayer starts to pay higher rate tax depends on a number of factors but, because of his personal allowances, will invariably be at earnings above the £17,900 higher rate threshold. A note of caution is necessary. The earliest any changes could be made would be in the 1988 Finance Bill to take effect for 1989/90. If in the meantime the personal allowances and thresholds were to be revalorised and if the percentage change were to be around 5% in each year, the appropriate figure on this

approach would be nearer £25,000 than £20,000. The expected yield and staff costs could also have changed considerably by then. We should be in a position to provide more up-to-date estimates in the autumn.

21. Attached in Annex 1 is a table summarising the revenue and manpower effects of these options and the effect on the number of recipients of net taxable benefits. Again the figures shown are for 1987/88.

Option A - increase threshold to £20,000 for all benefits-in-kind

22. **Effects**

- a. cost - £190m - a reduction of 29%
- b. staff saving - in the range of 375-475 units - a reduction of between 37% - 47%
- c. reduction in numbers of P11Ds - 1 million - a reduction of 57%.
- d. transitional staff cost in the range of 75-100 units.

23. **Advantages**

- Large reduction in numbers of people liable to tax on benefits virtually eliminates benefit problems for basic rate taxpayers.
- Significant reduction in burdens on employers who have to complete forms P11D - less than half as many forms to fill in.
- Results in large manpower savings.

24. Disadvantages

- expensive; an annual loss of revenue of £190m (more than a quarter of present yield)
- stimulates payment in kind not cash, thereby increasing loss of tax (and NIC) beyond figures shown.
- increases pressures to revalorise the threshold annually in line with inflation/increases in earnings.
- disadvantages directors, who are assessed on their benefits (apart from minor exceptions) irrespective of the level of their earnings.

Option B Retain the threshold at £8,500 for car, car fuel benefits and private medical insurance, and increase it to £20,000 for other benefits

25. Effects

- a. cost - £20m - a reduction of 3%
- b. staff saving - in the range of 100-150 units - a reduction of 10%-15%
- c. reduction in numbers of P11Ds - 300,000 - a reduction of 17%.
- d. transitional staff cost in the range of 75-100 units.

26. Advantages

- Significant reduction in the number of people liable to tax on benefits. (Almost a fifth).

- Only a marginal loss of revenue to £20m (3%).
- Virtually eliminates the problems of taxing benefits for basic rate taxpayers.
- Worthwhile staff saving.

27. Disadvantages

The tax treatment of benefits varies with the level of employee's other remuneration and with the type of benefit provided this

- extends existing anomalies in treatment of benefits
- discriminates against recipients of car/car fuel and medical benefits
- stimulates payment in kind not cash for other benefits - with consequent (unquantifiable) losses in tax and NIC.

Option C Abolish threshold for car, car fuel benefits and private medical insurance and increase it to £20,000 for other benefits

28. Effects

- a. yield - £30m - an increase of 5%
- b. virtually no staff savings - in the range of 0-25 units - up to 4%
- c. small increase in numbers of P11Ds - 40,000 - an increase of 2%.
- d. transitional staff cost in the range of 150-200 units.

29. Advantages

- increases the yield from taxing benefits
- virtually eliminates the problems of taxing benefits for basic rate taxpayers.
- no staff cost.

30. Disadvantages are:-

- increase in the number of people liable to tax on benefits
- small increase in burdens on employers
- extends existing anomalies in treatment of benefits
- discriminates against recipients of car/car fuel benefits and medical benefits (which were taxable on all recipients until 1981

Option D - revalorise the 1979/80 threshold of £8,500 by reference to :

(i) the RPI - £16,400 or

(ii) earnings - £19,300

31. Revalorisation by reference to the increase in earnings since 1979 (ie to £19,300) is, in substance, very little different from Option A and the analysis of that Option would broadly apply. The following analysis applies to raising the threshold to £16,400.

32. Effects

- a. cost - £140m - a reduction of 22%

- b. staff savings in the range 275 to 325 - a reduction of 27-32%
- c. reduction in numbers of Pl1D's - 750,000 - a reduction of 43%
- d. transitional staff cost in the range of 75-100 units.

33. The advantages and disadvantages of this option are again much the same as for Option A except that with a smaller increase in the threshold the cost and administrative savings would be less.

Option E - Abolish the threshold for benefits in kind.

34. Effects

- a. yield - £50m - an increase of 8%
- b. staff cost in the range 80-100 units - an increase of 8-10%
- c. increase in numbers of Pl1Ds - 350,000 - an increase of 20%
- d. transitional staff cost in the range of 75-100 units.

35. Advantages

- reduces incentive to remunerate in kind
- brings treatment of payment in kind payment in cash closer together
- ends anomalies in treatment of benefits as between "higher" and "lower" paid

- ends anomalies in treatment of benefits as between directors and other employees/office holders
- small revenue yield.

36. Disadvantages

- increases in numbers liable to tax and adds to employers compliance costs
- increases the problems of taxing benefits on the lower paid
- increases Revenue's manpower costs by about 8%

Comments

37 An increase in the threshold to £20,000 - Option A - (which is about where it would be if it had kept pace with earnings since 1979) so that it is at roughly the point at which taxpayers begin to pay higher rate tax, would effectively solve many of the practical/policy problems that we face on benefits at the moment - ie that rules which were designed to catch the better paid who are by design in part paid in kind are now almost inadvertently catching the less well paid. It would also more or less halve employer's compliance costs with dramatic staff savings for the Revenue. But the price is high - the yield from taxing benefits would fall by some 29% at today's prices.

38. If maintaining the yield from taxing benefits is the decisive factor Option B (maintaining the existing threshold for the most popular benefits while increasing it for the rest) effectively does this - the yield is reduced by only some 3% - while still achieving worthwhile savings for employers and the Revenue. Option C is in effect a 'standstill' option. It removes the most awkward cases from the net at no cost by abolishing the threshold for the most popular benefits. But in so doing it virtually eliminates

the administrative savings. Moreover in removing the threshold for medical insurance, it could appear as a reversal of the change the Government made in 1981 to apply the threshold to medical insurance. Previously this benefit had been taxed regardless of the level of earnings. Treating it as an ordinary benefit would marginally increase the administrative savings and just about breakeven on cost. In many ways Option D is a compromise solution if Option A is too expensive. It achieves some of the savings at slightly lower cost, but as it would still catch a number of basic rate taxpayers, it leaves some of the awkward cases in the net.

39. Another way of reducing the cost of Option A would be to combine the increase in the threshold with a substantial real rise in the car benefit scale. We will of course be minuting you separately on this after the holidays, but some preliminary work we have been doing suggests that even after the increases proposed for next year have taken place, the scale charges will represent less than half the true value of the benefit. This is an improvement of the position in 1979 when at best the scale charge represented about one third of the benefit. But there is still scope for large increases in the scale charges if they are to come anywhere near reflecting the true value of the benefit. We could, if you wish consider how a combination of a significant real increase in the car benefit scales coupled with an increase in the threshold could affect the cost of this option.

40. The implications for the car benefit scale charge would in any event need to be considered for all these options. They have been costed in the assumption that the scale charge is unchanged. A general increase in the threshold would be a good opportunity for a large real increase in the scale rates for those still liable to tax and would cut the cost. With a selective increase in the threshold, the case for raising the car benefit scale can be made on its own merits; but if the threshold for cars were to disappear completely it might seem

harsh to introduce a large rise in the scale charge at the same time.

41. Another point to consider is that a significant increase in the benefit threshold is bound to have behavioural effects, though it is difficult to predict these precisely. It would undoubtedly lead to some increase in the provision of benefits for basic rate taxpayers unless other steps were taken to prevent this. To the extent that this happens there is a further loss of tax and NIC on remuneration paid in kind which would otherwise have been paid in cash.

42. At the other end of the scale, there is the option of removing the threshold completely. With the upward drift of earnings, the present threshold could be expected to have virtually "withered" away by mid 1990s so abolition in 1989 would anticipate the natural outcome by a few years. Abolition of the threshold would intensify the problems we now face in relation to the lower paid and leave employers and ourselves with substantial administrative costs. The yield is not significant (as most people with worthwhile benefits are already in the net) but it contains the stimulus being given to payments in kind.

43. These options have been chosen for illustrative purposes only. But it would be possible, if you wanted, to devise a number of variants with differing manpower and revenue costs - for example a "halfway house" between Options A & B, with a large increase for most benefits and a smaller increase for the more popular benefits.

Conclusion

44. The options discussed in this note all include some alteration to the current threshold for benefits. Removal of the threshold would, in effect, accelerate the present policy of allowing it to wither on the vine. An increase would represent a significant break with policy over the last eight years. The principle of ensuring that remuneration in kind

is treated no more favourably than remuneration in cash has to be balanced against the extra costs (for employers and the Department) in dealing with large numbers of "small" taxpayers and the tricky problems in taxing non-cash remuneration of the lower paid. This is essentially a matter for your judgment and we seek guidance on whether you would like us to pursue any of the above Options - or variants of them - in more detail as a starter for the 1988 Finance Bill.



A M RHODES

£8,500 THRESHOLD : SUMMARY
1987/88 : COST ON EXISTING BASIS

ANNEX 1

	Year	Estimated Revenue Yield £	Staffing Provision (Units)	Estimated No of Recipients Of Net Taxable Benefits (000s)
Maintaining existing threshold	1987/88	650m	1000	1750
£8,500 THRESHOLD : OPTIONS				
Option	Year Change Implemented N.B Illustrative Only *	Revenue Increase/Decrease £	Staffing Effect (Units)	Increase/Decrease In Nos. of P11Ds (Thousands)
A. Increase threshold to £20,000 for all benefits in kind	1987/88	-190m	-375 to -475	-1000
B. Increase threshold to £20,000 for all benefits in kind except for cars, car fuel benefits & private medical insurance where threshold remains at £8,500	1987/88	-20m	-100 to -150	-300
C. Increase threshold to £20,000 for all benefits in kind except for cars, car fuel benefits & private medical insurance - nil threshold	1987/88	+30m	0 to -25	+40
D. Revalorise the 1979/80 figure of £8,500 by RPI to £16,400	1987/88	-140m	-275 to -325	-750
E. No threshold	1987/88	+50m	+80 to +100	+350

*Earliest year for which any changes could be implemented would be 1988/89, with transitional staff costs in that year; ongoing staffing effects not felt before 1989/90.

A DE MINIMIS LIMIT

One possibility for improving the cost effectiveness of taxing benefits in kind, would be to introduce a de minimis limit. Provided the total of benefits and expenses paid by an employer (or on his behalf) did not exceed the specified amount, tax would not be charged on those benefits and no return would be required from the employer. In principle this should remove the smaller cases from the charge saving work for employers with consequential manpower savings for the Revenue as well. There is a precedent for a de minimis limit in the benefits legislation. Under the rules relating to beneficial loans no tax is charged where the benefit of the loan is £200 or less.

In practice, however, unless the limit were set at a fairly high level, the savings would be pretty marginal. Assuming a limit of £300 (this broadly equates to the £75 assessing tolerance for taxpayers generally - equivalent to an exemption of £280 for a basic rate taxpayer) about 23% of all individuals receiving benefits and expenses would be excluded. But of these over one third only receive expenses and have no benefits at all. Anyone who had throughout the year a company car (the most popular benefit) for example would automatically be liable no matter how small the level of their other benefits. Savings to employers would be proportionately smaller because in some cases it would not be obvious whether or not the exemption applied and a return would, therefore, still have to be made.

There are other objections. First, people who receive benefits-in-kind, like all other Schedule E taxpayers, have the benefit of the assessing tolerance of £75 and it is difficult, in principle, to justify an exemption for people who are in part at least remunerated in kind effectively double that available to others who are remunerated in cash

(and those paid in cash only get the benefit of the assessing tolerance if - exceptionally - an assessment is needed). Why, in principle should small amounts of benefits be exempt but not small amounts of savings income? Moreover, the introduction of such a limit would greatly encourage tax-free remuneration in kind (at least up to the level of the limit) which would be difficult to defend, open to abuse and have adverse revenue (and NIC) consequences.



Extract from minutes
of meeting on 21/7

Car parking

14. The Financial Secretary thought there was a strong case for complete exemption for car parking: even a £20,000 threshold would still leave $\frac{1}{2}$ million people liable to tax. The Chancellor agreed that it would be a nonsense for any tax charge to arise on cars parked at an employers' premises: in many cases this would simply mean that the employees parked in the street instead. The position was slightly different where the company had no premises but paid for an employee's parking in a private garage: it would be possible to justify taxing that benefit, for those above the earnings threshold. So the options to be considered were complete exemption, or an exemption limited to parking on an employer's premises.

15. Mr Isaac thought that the second option could cause problems, especially where one car park was occupied by several different employers. He was tempted to the cleaner solution of complete exemption. If we were to do that, he thought legislation in the Finance Bill would be needed. The Chancellor said that he would be grateful for further advice from the Revenue on this; but, subject to that, the provisional decision was to go for total exemption.

NOTE
OF
MTG
EXTRACT
21/7



Inland Revenue

Policy Division
Somerset House

FROM: P LEWIS
EXT: 6371
DATE: 30 JULY 1987

PLB
PT
W. TH ACSA
TL
30/7

1. Mr Isaac
2. Financial Secretary

BENEFITS IN KIND: CAR PARKING

1. As suggested at the Chancellor's meeting on 21 July, the note attached looks at the possibility of a charge limited to car parking away from the employer's premises.

2. As the note explains, such cases could not be neatly divided off from the rest, leading to difficulties of policy, definition, and practice at the borderlines. While recognising that it would mean exempting some large payments which technically could, and many will feel should, be taxed, there seems much to be said for the greater simplicity of a general exemption.

3. We would of course be happy to discuss this with you. Alternatively, if you agree that a general exemption seems the better option, we will let you have a further note, after the holidays, on how to handle past years and the timing of an announcement.

P Lewis
P LEWIS

cc Chancellor
Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Kemp
Mr Scholar
Mr Cropper
Mr Tyrie

Mr Battishill
Mr Isaac
Mr Rogers
Mr Cherry
Mr Beighton
Mr Lewis
Miss Rhodes
Mr Northend
Mr Allen
Mr J Marshall
Mr Page
Mr Brannigan
Mr Eason
Mrs Tournoff
Mr Boyce
Mr I Stewart
Mr R Marshall
PS/IR

LEWIS
→
FST
30/7

BENEFITS IN KIND: CAR PARKING

1. At the Chancellor's meeting on 21 July, discussion narrowed the options to

- a general exemption
- a charge limited to car parking spaces away from the employer's premises.

2. This note discusses the considerations which the second option would raise; and attempts to summarise the main advantages and disadvantages of these two approaches.

Car parking away from the employer's premises

3. The narrowest scope for the charge on this approach would be to confine it to specific payments for car parking spaces away from the business premises. The justification might be that

- while it was reasonable to exempt the generality of cases often involving rough/awkward parking at factory premises, the provision of parking away from the business premises - perhaps undercover spaces in commercial car parks in town centres at considerable cost - is a different matter altogether.
- only in these cases was the employer incurring extra cost specifically to provide a parking space for the employee (as opposed to allowing him to use one which came with the business premises)
- the administration would be simpler for both employer and the Revenue because there was an easily identifiable amount to return and assess, and
- in general, renting a specific car parking space would be likely to be among the most expensive ways of providing parking, thus keeping in charge the largest benefits.

4. We cannot say how many cases would be left within the charge on this basis - but clearly the numbers would be very substantially reduced.

5. The cases remaining within the charge would not necessarily be straightforward to deal with. As explained in paragraph 10 of Mr Lewis's note of 16 July, there are various reasons why, under the present legislation, the charge might be off-set, in whole or in part, by an expenses deduction (for example, where the car is used for business purposes). This would be reflected in the number of staff needed to administer the charge (but we cannot at present estimate how many would be required).

6. Under this approach, the dividing line between liable and non-liable spaces would be an awkward one to defend; and there would be likely to be behavioural changes - and some avoidance devices - to shift spaces into the non-liable category.

7. It would be difficult to say why - as a matter of policy - separately rented parking spaces away from the business premises should be charged but parking spaces leased with business premises should not. What justification could there be for excluding, for example, the (equally or more expensive) underground car park beneath the city centre office block with enough space for only a few senior staff? And there would be many clear anomalies. Where a firm leases a nearby, but not adjacent, piece of land for parking there would be a charge; but the business next door, whose share of the same parking area was adjacent to the business premises, might have it included in the lease of the business premises, thus not triggering the charge. More difficult still would be the case where a business either leasing or owning parking space with its own business premises rented out surplus spaces to the business next door. In such cases there would be differing treatment of spaces within the same car park; employees would have no liability if they could get into their firm's own car park, but would be liable if they parked in the overflow next door.

8. If the charge turned on there being a specific payment solely for a car parking space, there would be an incentive for people to wrap up other services in the same agreement to escape

the charge; and that might not be difficult to do. So the charge would need to apply to payments which related "wholly or substantially" to car parking. That would make it rather more difficult, but not impossible, for businesses to arrange their affairs to escape liability. And it would introduce some uncertainty about whether particular "mixed" payments, were or were not liable, and the need to dissect payments, where there was liability, to arrive at the amount applicable to parking.

9. Such considerations suggest the possibility of extending the charge to all leased parking spaces. A very much larger number of spaces would then be brought within the charge since business premises are commonly leased rather than owned. This approach would

- create another difficult dividing line between otherwise identical spaces which in one case were owned and in another case leased
- greatly increase the number of cases within the charge
- be much more difficult to administer - leaving aside the greater numbers - for both employers and the Revenue because it would frequently be necessary to dissect rental payments for business premises to identify the amount of the rental relating to each parking space.

Car Parking away from the employer's premises: Summary

10. Such a charge would

- tax some of the most obvious and largest benefits from car parking
- in principle provide a clear starting figure for the calculation of the tax liability.
- greatly reduce the number of liable cases.

11. But it would

- be a difficult distinction to defend in principle because it would create clear anomalies. On the one hand it would exempt some obvious large benefits on employers' own premises, and on the other hand charge some very ordinary cases which to the employees concerned would seem indistinguishable from those generally exempted.
- probably lose its simplicity as people started to make wider arrangements to avoid having any specific parking rentals
- remain complicated to operate where the space was other than a "pure" benefit
- have an extra compliance and staff cost (as compared with the present situation) depending on the number of cases and the complexity of the rules which were necessary.

Exemption: Summary

12. A complete exemption would

- let off the obvious - and perhaps large - benefit in cases where there are specific payments
- forgo the revenue yield of a charge on significant payments

13. But it would

- not create a dividing line within the world of car parking which was difficult to defend in principle and to operate in practice
- get rid of the complications of dealing with mixed benefit/business use cases

- not have a staff cost (apart from small transitional costs)
- not increase employers' compliance burdens (as compared with the present)
- avoid altogether any possibility of adverse environmental repercussions.

Effect of large benefits threshold increase

14. If Ministers decide on a large increase in the general benefits threshold

- on the one hand, taxing specific car parking payments would be less troublesome because there would be a reduced number of cases still liable
- on the other, a general exemption would seem less at odds with Government policy on benefits. In particular it would be much more difficult to make adverse comparisons with work-place nurseries, season ticket loans etc because a large threshold increase would take the great majority of sensitive cases out of tax.

A charge limited to large payments for car parking

15. Combined with a large threshold increase, a charge restricted to payments, at or above the rate of (say) £1000 pa would have a very limited coverage. But the same anomalies as between owned and rented spaces would remain; and there would be an increased incentive to composite arrangements which obscured the amount being paid for a parking space. Except for numbers of cases the considerations are much the same as for the broader proposal, but with the addition of a further arbitrary dividing line (the £1000 limit). It seems very doubtful whether retaining this small part of the charge would be worth the hassle.



*ppp M
Pps in?
TL 31/7*

FROM: J J HEYWOOD
DATE: 31 July 1987

PS/CHANCELLOR

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OK?
AA*
*I shd be grateful for
quite visit of Mr
M... & advise
M.*

- cc PS/Chief Secretary
- PS/Paymaster General
- PS/Economic Secretary
- Sir P Middleton
- Mr Kemp
- Mr Scholar
- Mr Cropper
- Mr Tyrie
- Mr Lewis IR
- PS/IR

BENEFITS IN KIND: CAR PARKING

1. The Financial Secretary has read Mr Lewis' submission of 30 July.
2. The Financial Secretary thinks that a general exemption is much the better option and, if the Chancellor agrees, will follow this up after the holidays.

*PS/FST
PS/CH
31/7*

*OK, invited there is
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**JEREMY HEYWOOD
Private Secretary**



FROM: J J HEYWOOD
DATE: 31 July 1987

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Scholar
Mr Cropper
Mr Tyrie
Mr Isaac IR
Miss Rhodes IR

ABOLITION OF EMPLOYEE'S UEL: BENEFITS IN KIND

1. The Financial Secretary read Miss Rhodes' submission of 30 July before going on leave.
2. His initial reaction was that this idea may be worth looking at further. If the Chancellor agrees, the Financial Secretary will pursue this with officials in September.

J.H.

JEREMY HEYWOOD
Private Secretary

TASK FORCE SECRET

PS/FST
→
PS/CH
31/7

CONFIDENTIAL



FROM: A C S ALLAN

DATE: 3 AUGUST 1987

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Kemp
Mr Scholar
Mr Cropper
Mr Tyrie
Mr Lewis - IR
PS/IR

BENEFITS IN KIND: CAR PARKING

The Chancellor has seen your minute to me of 31 July, and Mr Lewis' submission of 30 July. He would be grateful for quick views from other Ministers and advisers.

ACS

A C S ALLAN

ACSA
→
PS/FST
3/8



FROM: J M G TAYLOR

DATE: 3 August 1987

PS/FINANCIAL SECRETARY

cc: CST
PMG
EST
Mr Scholar
Mr Cropper
Mr Tyrie
Ms Rhodes
PS/IR

ABOLITION OF EMPLOYEE'S UEL - BENEFITS-IN-KIND

The Chancellor has seen Ms Rhodes minute of 30 July. He would be grateful for the Financial Secretary's advice in due course.

2. He has commented that this idea would have to be presented - along with other benefits-in-kind measures, notably the raising of the P11D threshold - as part of an overall benefits-in-kind package. If it were presented as part of the reform package, there would be undesirable pressure to allow tax reliefs against employee NICs.

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

J M G TAYLOR

JMGT
→
PS/FST
3/8

CONFIDENTIAL



FROM: S P JUDGE
DATE: 4 August 1987

PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Kemp
Mr Scholar
Mr Cropper
Mr Tyrie
Mr Lewis - IR
PS/IR


BENEFITS IN KIND : CAR PARKING

The Paymaster General has seen your minute of 3 August to PS/Financial Secretary.

2. He has commented that, all in all, the case for a general exemption seems commanding, but it reinforces the desirability of a substantial increase in the car benefit scales.

3. He adds that if we go for a general exemption, the case for an upwards revision of the benefits threshold is strengthened.

4. (I do not think that Customs need to see this correspondence; they are in contact at official level about the interaction between Revenue scales and Customs' VAT petrol scale - see the note of the Paymaster's meeting on 28 July).


S P JUDGE
Private Secretary

PS/PMG
→
PPS
4/8

CONFIDENTIAL

FROM: P J CROPPER
 DATE: 4 August 1987

CHANCELLOR

cc Chief Secretary
 Financial Secretary
 Paymaster General
 Economic Secretary
 Sir P Middleton
 Mr Kemp
 Mr Scholar
 Mr Tyrie
 Mr Lewis IR
 PS/IR

BENEFITS IN KIND: CAR PARKING

You invite quick views on car parking.

2. I do not find the idea of a distinction between cars parked on the employer's premises and cars parked in "rented accommodation" a very attractive one. It does not seem to depend on anything except administrative convenience.

3. I am not yet convinced of the case for a big across-the-board increase in the threshold for benefits. Except, again, as an administrative convenience. The alternative may be to retain a universal charge, but only include certain nominated benefits - such as a company car, private health, assistance with education and housing costs, cheap loans, holidays and one or two others. In such a line-up I would not bother with car parking at the place of work. It is not a benefit that can be converted to cash and - except in a narrow number of city centre situations - it is not a very valuable benefit.

4. If we did decide to go for a sharply increased income threshold for benefits treatment, without specific exclusions above that level, parking would probably have to stay in. Even there I would see some case for specifically excluding it on the grounds that space for one's car should no more

CROPPER
 →
 CH/EX
 4/8

pay tax than space for putting one's waste-paper basket or one's bottom. But then, of course, one would start getting into trouble with the people who pay £1,500 for a season ticket from Guildford and get no help with their travel-to-work costs.

1 again 5. I do not really think that this issue can be decided in isolation from our more general policy on benefit charges. 10



P J CROPPER

CONFIDENTIAL

FROM: A G TYRIE

DATE: 4 AUGUST 1987

CHANCELLOR

*Example for all
cases. I would
have a further note
on the basis to consider
the whole situation
revenue of authority
anyway & tax.*

cc Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Kemp
Mr Scholar
Mr Cropper
Mr Lewis

TYRIE
→
CH/EX
4/8

BENEFITS IN KIND: CAR PARKING

You asked for views.

2. I agree with the Financial Secretary's conclusion. I cannot see any point in trying to collect revenue from 'self regulating' minor benefits, that is, where the employer cannot in general use them as a tax avoiding means of remuneration and where the employer is himself seeking to minimise the benefit.

AGT.

A G TYRIE

TASK FORCE SECRET



b.f. with advice.

Copy No. ² of 8 Copies

FROM: GUY WESTHEAD

DATE: 7 August 1987

MISS RHODES - IR

cc: PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Mr Scholar
PS/IR

ABOLITION OF EMPLOYEE'S UEL - BENEFITS-IN-KIND

The Economic Secretary has seen your minute of 30 July. There were a couple of points which he found confusing, on which he would be grateful for a further explanation.

2. Firstly, on your paragraph 15, the Economic Secretary wondered whether the charge could not more simply be set at 9 per cent of total benefits and expenses directly. Second, he was puzzled by paragraph 5 (b) of your note.

Guy Westhead.

GUY WESTHEAD
Assistant Private Secretary

PS/EST
→
RHODES
7/8



prop

FST

The more I look @ this line in the programme on the 1

A simpler way of reducing the taxation of profits is to have a more liberal change in the way we calculate a more liberal

Can you simplify it?

Overall package, with a view to avoid overall losses so far as possible.

Can you examine this alternative - looking at what the effect of the...

CONFIDENTIAL



1. Julie
pl. wj. a mb.
2. b.f. 3/89

FROM: J M G TAYLOR
DATE: 12 AUGUST 1987

JMGT
→
PS/CST
12/8

PS/CHIEF SECRETARY

cc PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Kemp
Mr Scholar
Mr Cropper
Mr Tyrie
Mr Lewis - IR
PS/IR

BENEFITS IN KIND: CAR PARKING

The Chancellor was grateful for all contributions to this correspondence. He will hold a further meeting after the break to consider the whole inter-related nexus of automotive benefits and tax.

J M G TAYLOR



Inland Revenue

Policy Division
Somerset House

FROM: ANGELA RHODES

438-6303

DATE: 13 AUGUST 1987

ECONOMIC SECRETARY

ABOLITION OF EMPLOYEE'S UEL - BENEFITS-IN-KIND

1. Your Private Secretary's note of 7 August asks for a further explanation of a couple of points in my note of 30 July.

Amount of the Charge

2. First, you asked whether the charge could be more simply set at 9% of the benefits. The aim of the suggested charge is to collect, through the income tax system an amount equal to 9% of benefits-in-kind received in lieu of NIC. The difficulty about charging 9% directly on the benefits received is that there is no means of collecting it through the existing tax system and separate and special charging provisions would have to be introduced to identify, measure and impose the charge. There would be a number of problems with this - including the additional costs for employers and ourselves. A number of schemes on these lines were considered when the employer's UEL was abolished, but in view of the complications were rejected by Ministers.

3. The present proposal involves collecting the charge using the existing assessment/collection machinery. If an amount equal to 9% of the benefits received were to be deducted from the individual's PAYE code (or included his tax assessment) the result would be that tax at his marginal rate would be collected on that amount. The actual amount collected would vary with the taxpayer's marginal rate but it would be less than 9% of the benefits received.

cc Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Paymaster General
Mr Scholar
Mr McPherson
Mr McIntyre

Mr Battishill
Mr Isaac
Mr Lewis
Mr Beighton
Mr Mace
Mr Northend
Mr R H Allen
Mr Eason
Miss Rhodes
PS/IR

*Ch
you didn't see
the letter you refer to
leave
MH*

4. The point is perhaps best illustrated by a simple example. A higher paid employee has taxable benefits of £1000. His marginal rate is 40%. If tax were simply charged on 9% of the benefits (£90) the amount collected would be £36. To collect £90 with a marginal rate of 40% a restriction of £225 has to be made - this applies whether the amount is collected during the year under PAYE or by means of a Schedule E assessment after the end of the year.

Aggregate benefits

5. You also asked about paragraph 5(b) of my note. The point here is again that what we were looking at was in effect a tax charge on benefits not actual NIC - so we were interested in the total amount paid by the employer. Benefits-in-kind and expenses payments are however taxable in the hands of the employee, so employers make separate returns (form P11D) for each employee showing the gross benefit. These are followed up individually and the employer does not know the amount actually chargeable for each employee. Even if this difficulty could be ignored, getting the sum total of all benefits paid would impose an additional burden (and therefore additional costs) on employers on top of existing procedures. The compliance costs of returning benefits-in-kind is already a frequent source of complaint by businesses.



ANGELA RHODES

CR
→
LEWIS
25/8



FROM: CATHY RYDING
DATE: 25 August 1987

MR LEWIS - Inland Revenue

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Kemp
Mr Scholar
Mr Cropper
Mr Tyrie
PS/IR

BENEFITS IN KIND: CAR PARKING

As you know we are in the process of setting up a meeting on this subject for some time in September. I should be grateful if you would provide an annotated agenda.

Nigel
Can we have another go at fixing the meeting. When we tried a few weeks ago, lots of people were out of the office + their diaries unavailable. This may still be the case, but could we have a go please?

CR

CATHY RYDING

CR 26/8

SINCLAIR
15/9

BNM9

TASK FORCE SECRET

COPY NO 1 OF 14 COPIES

Suppose this is the way to give our current policies, we are likely to give this to you, Smith looks like we are pointing at the wrong direction.

FROM: MISS C E C SINCLAIR
DATE: 15 SEPTEMBER 1987

CHANCELLOR OF THE EXCHEQUER

cc Financial Secretary
Sir Peter Middleton
Mr Cassell
Mr Monck
Mr Scholar
Mr G P Smith
Mr Michie
Miss Hay
Mr Cropper
Mr Tyrie
Mr Isaac - IR
Mr Painter - IR

*Ch
Michael raised this @ your meeting with him at the Butlerhill - see my subsequent memo to B/P/S below AA*

I am not sure we will get to all the questions in Annex B. What do IR think?

TAXATION OF BENEFITS IN KIND

Against the background of recent submissions on benefits in kind, we in FP have been looking at the way these are taxed in Australia and New Zealand. The approach adopted there seems to have a number of attractions. I attach a note at Annex A on the main features.

2. Both Australia and New Zealand tax employers on the value of the benefits in kind which they give: no attempt is made to tax the benefits in the hands of employees. In each country the system was introduced recently as part of a wide-ranging tax reform package aimed at broadening the tax base, reducing/eliminating shelters and reducing rates of tax. This is very much in line with your own thinking, and an approach on these lines to the taxation of benefits could sit rather well with the rest of your reform proposals.

3. In the longer term, if all tax is ultimately borne by individuals, it should not matter who pays tax on benefits in kind (though there will be some distributional consequences). At present employers can deduct the cost to them of most benefits in kind before their profits are assessed for tax; benefits are then taxed in the hands of individuals (unless they are specifically relieved). The antipodean approach simply reverses this.

turns it on its head?!

SINCLAIR
CH/EX
15/9

4. It has a number of attractions:

- (i) Acting directly on the employer makes it easier to discourage benefits in kind. At present these are attractive because the employer does not pay NICs on them (as he does on pay); because the post-tax cost of benefits to the employer may be less than the post-tax value to the employee, certainly in the case of cars. A specific tax on benefits could make pay look more attractive.
- (ii) The rate of tax could be adjusted to reflect different objectives eg discouragement of benefits in kind, equality of tax treatment with pay, which bears NICs. It could solve the problems generated by the removal of the UEL identified in Miss Rhodes' submission of 30 July.
- (iii) It could resolve or ease the problems currently associated with taxing benefits in the hands of individuals: separate de minimis thresholds, extra-statutory concessions, unrealistically low car scales (it would be politically easier to set these at realistic levels if companies rather than individuals paid the tax).
- (iv) The staff intensiveness of the PIID system makes it difficult to imagine that taxing benefits in the hands of employers would be worse for the Revenue: at present a PIID is generated for each director and 'higher' paid employee, whereas under the proposed system, a single return covering all directors and employees would be made.
- (v) Depending on the level of the rate and coverage of the tax, it could yield revenue, certainly as compared with the proposal to disregard tax on benefits in kind where earnings are less than £20,000.

5. Against this a number of points can be made:

- (i) Employees who do not receive benefits in kind could feel aggrieved if those who do paid no tax on them. (Arguably this grievance is there already to some extent eg because

people who get cars are undertaxed on the real value.) The extent of this worry depends on the employers' response to the tax. If it effectively discouraged benefits in kind, the strength of the point would be reduced.

(ii) There would clearly be short-term frictional costs for employers in moving to any new system. The consequences for them of the system once up and running are less clear cut. On the one hand, an employer would no longer have to provide P11D returns for each employee, which should simplify administration. Against that, however, the employer paying an expense allowance would for the first time need to ascertain for direct tax purposes what proportion of that allowance was spent on business and so not taxable as a benefit, and what proportion was spent on private goods and services. Under the present rules, it is for the employee to agree with his Tax Inspector the genuine expense element of an allowance (his employer having returned the full amount on a P11D). However, the employer would not be required to establish the business expenditure on an employee-by-employee basis. Given that most businesses exercise reasonable controls over employee expenditure, the determination of the business element should not present an insurmountable problem. It is noted that both Australia and New Zealand faced these same problems: both allow for the value of benefits to be abated in respect of the element which relates to business use.

(iii) It would be unpopular with employers - but it would always be open to the latter to avoid, or at least minimise, the tax on benefits by switching to pay instead.

6. Benefits in kind have no place in an era of low income tax rates. This is why a measure which can be used to discourage their use, as well as taxing them effectively where they persist, looks logical in the context of your overall strategy. The benefit culture is widespread and deep-rooted in the UK. It has recently been given a slight fillip by the abolition of the employers' UEL. It would be

*This was
Tony B's
worry.*

given a further boost by abolition of the employees' UEL. It may require a radical change, on Australian/New Zealand lines, to shift behaviour and reverse the trend to ever more benefits.

8. It would be possible to limit Australian/New Zealand treatment to the most significant benefits - perhaps cars, cheap loans, medical insurance and education. This would be in line with Mr Cropper's suggestion in his minute of 4 September and would be relatively simple if other benefits were simply ignored for tax purposes. Or coverage could be drawn more widely. Both Australia and New Zealand have a de minimis limit, and both have certain exemptions.

9. Two points from the Australian experience are worth noting. First, they looked at the UK system for taxing benefits in kind - clearly more effective than the one they had - but rejected it as being too staff intensive for the tax authorities and too burdensome for employers/tax payers. Second, the fuss made by Australian employers about the new system reflected the fact that previously they did not have to make returns about the benefits given to individual employees - they had nothing equivalent to PIID. In the UK the existing system puts a burden on employers already.

10. There would inevitably be difficulties in changing overnight to such a system - transitional arrangements seem essential, with the full scheme being phased in. Some rough justice is bound to be involved - but arguably it already is in the case of taxation of cars.

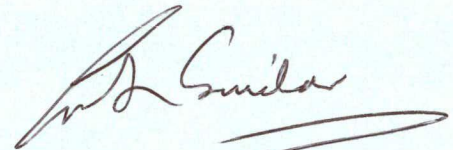
11. An alternative approach, on which you have asked for advice, is simply to disallow expenditure on benefits against Corporation Tax. This looks less attractive to us on a number of counts. First companies with enough tax losses (eg nationalised industries), and companies whose UK tax liability is covered by double tax relief, would not be affected and for them the incentive to give benefits in kind would remain as strong as ever. Second, you would not have the same freedom to adjust the effective rate of tax (the point in paragraph 4(ii) above). For these reasons, deducting tax from employers looks more promising than disallowing the value of benefits against Corporation Tax.

Can't immediately find bill dig out Am.

But Australian system require 16/7 clause of 1974

12. To sum up, taxing the value of benefits in the hands of employers rather than employees would be another piece of taxation at source (admittedly on a broad brush basis, without fine tuning for individual rates); would provide a tool for discouraging benefits and encouraging a simpler system of cash remuneration; could thus counteract the effect of abolishing the employees' UEL; would sit well in a low rate/minimal exemption package (other options, such as raising the PIID threshold to £20,000 would look odd in such a package); and might be used to raise revenue. If you think the idea is worth pursuing, Annex B lists the kind of questions which would need - discreetly - to be put to the Australian/New Zealand authorities.

??



MISS C E C SINCLAIR

NEW ZEALAND FRINGE BENEFITS TAX - (FBT)STRUCTURE OF FBT

The FBT is imposed on taxable fringe benefits, provided by or on behalf of an employer to an employee. It is charged at a rate of 45 per cent of the value of the benefits and is payable by the employer on a quarterly basis. The cost to the employer of providing fringe benefits is deductible for company tax purposes but the FBT payable on those benefits is not deductible.

2. An anti-avoidance provision operates so as to deem an employer/employee relationship between any two parties entering into an arrangement designed to avoid FBT.

3. There are three main categories of benefits :

(i) Motor vehicles

these are valued on a quarterly basis broadly equivalent to around 24% of the cost price of the vehicle per annum, adjusted for any expenditure incurred by the employee.

(ii) Low interest loans

ie any loan at an interest rate less than the "prescribed" interest rate. The taxable value is the difference between the interest which would have accrued at the prescribed rate less the interest actually accruing in the quarter.

(iii) Free, subsidised or discounted goods and services

the benefit on any such goods and services is liable to FBT if it is provided to the employee at less than the cost to the employer. Taxable value is cost of goods or services to employer less cost to employee.

A general exemption of \$50 per employee per quarter applies to benefits in this category. Goods and services enjoyed on the employer's premises (eg canteen meals) are also exempt, as is expenditure wholly incurred on sending an employee on a (wholly) business trip.

4. There are special rules and exemptions applying to certain types of benefit, such as school fees, insurance and certain travelling allowances. In addition, certain benefits provided instead of cash allowances, are exempted from FBT. Such allowances may be assessable as employee's income depending on the circumstances.

ADMINISTRATION OF FBT

5. Each quarter an employer must make a declaration of the value of taxable benefits subdivided among the three main categories. This summary must then be supported by schedules giving details of the benefits provided. This information need not relate to particular employees except in relation to low interest loans, or where the \$50 'de minimis' exemption is claimed. Payment falls due 20 days after the end of the quarter. Additional 10 per cent is charged on late payments (which must be paid within 14 days of the IR notice). A further 10 per cent is charged on any unpaid amount outstanding at the end of each succeeding period of 6 months.

AUSTRALIA FRINGE BENEFITS TAX - (FBT)BACKGROUND

After bottom of the basket scandal

The FBT was a component of the wider ranging tax reform package of 1985 designed to improve the fairness of the Australian tax system by curtailing the scale of avoidance and evasion. The ^{previous} existing law on benefits called for subjective valuations to be made on an individual employee basis and there was no obligation on employers to report benefits provided. There was widespread underreporting by employees and effective policing of the system would have required a heavy investment of resources. The difficulties in collection, combined with high personal income tax rates, provided a powerful incentive for high income groups to seek part of their remuneration in the form of fringe benefits.

2. The Government's aim was to stop up this tax loss (estimated at about \$700m) and thus improve the fairness of the system. They saw the options open to them as two-fold:

(a) The UK route:

- introduce valuation rules replacing subjective valuation of fringe benefits;
- introduce compulsory reporting of fringe benefits by employers and collect tax on benefits through PAYE system (ie PIIID equivalent).

(b) Employer-based (New Zealand) route

3. The UK route was perceived to offer the fairest option (ie tax employees at their marginal rate); but against this, the New Zealand route was perceived as:

- simpler for taxpayers
- less onerous on employer/authorities administration

The balance of advantage was seen as lying with the employer-based route as being less disruptive and administratively cheaper. In introducing the FBT the Minister put this more strongly saying "there is no practical alternative".

STRUCTURE OF FBT

4. The basic structure of the FBT follows that of New Zealand. It is charged at 49% on the total value of taxable fringe benefits provided by an employer (the Corporation Tax rate is also 49%). It is charged on an annual basis (and is self-assessed), but quarterly payments are made on account (based on a proportion of the previous year's liability).

5. The main categories of benefit are:

(i) Vehicle and related benefits

vehicles are valued on one of two bases: "statutory formula" method or "actual operating cost" method (the latter involves detailed record keeping), adjusted for expenditure by the employee. There are complex rules governing "vehicle related" benefits.

(ii) Other benefits

this category covers certain specified benefits and a "catch-all" subcategory of benefit.

There are specific rules covering the valuation of the following benefits (and any allowable offsetting reductions):

- (i) loan benefit;
- (ii) debt waiver benefit;
- (iii) housing benefit;
- (iv) living away from home benefit;
- (v) board benefits, airline transport benefit, property benefits, entertainment benefits.

7. Other benefits fall within the "residual benefit" category. Broadly speaking these are valued on a "cost to the employer" basis.

8. These valuations and exemption provisions make for detailed legislation, with the Fringe Benefits Tax Assessment Act 1986 running to one hundred and sixty seven sections. The New Zealand system, in contrast, sets out to tax selected high profile benefits rather than attempting to be a 'catch-all'.

POINTS TO RAISE IN RELATION TO THE FRINGE BENEFITS TAX - (FBT)

- Are employers obliged to advise the revenue authorities of benefits in kind which escape the FBT? eg: benefits which are specifically exempted as being 'not taxable', or benefits which are liable to income tax (the latter category being covered in the UK by the P.U.L.D System).
- Has there been any discernable change in behavioural pattern by employers since the introduction of the tax? For example: has there been an increase in the cash proportion of the average remuneration package?
- What has been the revenue impact of the introduction of FBT?
 - Has the more complete taxing of the total earnings package led to an upward pressure on wage demands?
 - Both the New Zealand and Australian Fringe Benefits Tax contain a number of exemptions and provisions for netting off expenditure of the employee from gross value. Have there been any indications that these have been abused? If so, in what way? An indication as to the overall effectiveness of the new tax would be helpful.
 - What proportion of employer's returns are audited.
 - Burdens on business: is the FBT seen by the business community as placing too great an administrative burden upon them? An article on the Australian FBT described it as "complex to administer and difficult to comply with". It then went on to say "Simplicity is not always possible in a taxing law, but it is undoubtedly a more desirable feature for such laws to be understood and accepted by those whom they affect".

*has (in Australia):
wages for most
employees fixed
centrally by
Arbitration Commission
in relation to
price rises.*

- The New Zealand FBT has been described as being 'selective' in comparison with the Australian system in that it taxes selected high profile benefits as opposed to trying to be a 'catch-all' provision. Is this a fair description? : could we have examples to confirm this description?

- Is the Government satisfied that their FBT strikes a reasonable balance between the legitimate interests of all parties involved ie employers/employees/revenue authorities?

- Have there been any discernable changes in employment patterns as a result of the introduction of FBT? eg have those businesses which offer "perks" as an important component of the remuneration package found it more difficult to attract staff?

- Has any particular sector of the business community been adversely affected as a result of the introduction of FBT? eg the motor car industry suffering a fall in demand for cars.

Do we need to know all this?



COPY NO 15 OF 16 COPIES

FROM: A C S ALLAN
DATE: 16 September 1987

MISS C E C SINCLAIR

cc PS/Financial Secretary
Sir P Middleton
Mr Cassell
Mr Monck
Mr Scholar
Mr G P Smith
Mr Michie
Miss Hay
Mr Cropper
Mr Tyrie

Mr Isaac - IR
Mr Painter - IR
PS/IR

TAXATION OF BENEFITS IN KIND

The Chancellor was most grateful for your minute of 15 September, proposing a radical change to taxing employers on the value of the benefits in kind which they give.

2. He feels that, given our current benefits in kind problems, which are likely to grow, this is something which should be pursued as a matter of urgency. He would be grateful for Inland Revenue views.

3. He was not sure whether we needed to approach the Australians and New Zealanders to ask all the questions in Annex B. What do the Inland Revenue think?

ACSA

A C S ALLAN

ACSA
→
SINCLAIR
18/9



b.f. 30/9
of

FROM: P LEWIS

DATE: 25 SEPTEMBER 1987

Financial Secretary

TAXATION OF BENEFITS IN KIND

1. At your meeting on 16 September, you asked for some information about benefits in kind to serve as a background for the current consideration of various possible changes.

2. I attach notes as follows

- Current basis of charge: this note summarises the basis on which benefits and expenses are currently charged, and in particular explains the differing positions of "directors and higher paid employees" and other employees.

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

Chairman
Mr Isaac
Mr Painter
Mr Rogers
Mr Pollard
Mr Beighton
Mr Lewis
Mr Corlett
Mr McGivern
Mr Cherry
Mr Matheson
Mr Crawley
Mr Northend
Mr Allen
Mr Weeden
Mr Bush
Mr Page
Mr Martin
Miss Rhodes (o/r)
Mrs Tournoff
Mr Hood
Mr Toye
Mr Boyce
Mr I Stewart
PS/IR

LEWIS
→
FST
25/9

- Distribution of benefits: this note analyses, in as much detail as we have, the main types of benefit (number of recipients and amounts) by reference to income ranges for 1983/84 and 1987/88; and gives an indication of how the number of recipients of benefits has changed since 1980/81.

- Use of staff: this note explains how we currently handle benefit-in-kind liabilities.

3. Mr Heywood's minute of 22 September (to Miss Rhodes) asked when the results of the latest survey on benefits would be available. The results of the 1985/86 survey are being analysed and, wherever possible, already reflected in part in the estimates and forecasts we are now producing (eg the 1987/88 distribution of benefits given in the note attached). The completion of the checking of the data and the production of analyses is likely to take several weeks yet; but it might be possible to produce more quickly certain analyses of the 1985/86 results if you were to indicate which particularly interested you. However, the general picture emerging so far is not significantly different from the projections we have been making from the previous (1983/84) survey data.

4. You also noted (paragraph 3 of Mr Heywood's minute) the large number of people with small amounts of taxable expenses. The table you were considering gave the taxable amounts, not the tax due, so the average tax payable would be nearer £20 than £60. As with other small, isolated, amounts of income, we would not make an assessment specially to collect this amount of tax; but in many cases a coding adjustment would be made so that the tax is collected automatically through PAYE deductions.

5. We would, of course, be happy to discuss this with you, or to provide any further information which is available.



P LEWIS

BENEFITS-IN-KIND: SUMMARY OF CURRENT BASIS OF CHARGE

A BENEFITS CHARGEABLE ON ALL EMPLOYEES AND DIRECTORS

"Ordinary benefits"

1. The ordinary rules of Schedule E applicable to all employees charge emoluments, which are defined as all "salaries, fees, wages, perquisites and profits whatsoever". A benefit is chargeable under this definition where

a. it can be converted into money (the money's worth principle)

or

b. the employer meets an employee's obligation to pay a third party for something (the pecuniary liability principle).

2. Assets which the employee can sell are money's worth within (a). The employee is charged on the second hand value. Thus if the employee is given a car or TV by his employer he is charged on what he could sell it for.

3. Any discharge of an employee's debt by the employer falls within (b). Thus if the employer pays his employee's gas bill the employee is chargeable on the amount paid by the employer.

Benefits obtained by vouchers or credit tokens

4. To combat various ways of avoiding a charge or full charge the vouchers legislation which charges all employees was introduced in 1975. Broadly speaking, where an employee obtains money, goods or services by using a voucher or credit token (eg a credit card) supplied by his employer, he is not charged on the realisable value of the goods or services (which, as in the case of the second-hand suit, might be much less than its value to him) but on the cost to the employer of providing both the voucher or credit token and the money, goods or services obtained by its use.

5. Common examples of what are charged under these provisions are railway tickets, holidays and goods of any description. Many retail stores like Marks and Spencers and Argos sell vouchers which employers give to their employees who can select what they like from the range of goods sold including food. The voucher rules supplant any charge that could arise under the "ordinary benefits" rules above.

Living accommodation

6. All employees are charged on the value of living accommodation provided for them by their employer (unless it is "job related", like No 10 Downing Street). The rateable value is

taken as the amount chargeable. There is a further charge on houses costing over £75,000 based on the excess of the cost of providing the accommodation over £75,000 multiplied by the official rate of interest.

B DIRECTORS AND THE "HIGHER PAID"

7. The benefits chargeable on directors and the "higher paid" under the 1976 legislation are

"accommodation, entertainment, domestic or other services, and other benefits and facilities of whatsoever nature"

except where the cost of providing the benefit is already fully chargeable under the general rules (Section A above).

8. Specific exemptions from charge are the provision of pensions, canteen meals and medical treatment overseas where the need for it arises while the employee is working abroad.

9. The charge is generally on the amount it costs the employer to provide the benefit, but there are exceptions.

10. The main benefits chargeable and the amount of the charge are

- a. Medical insurance (BUPA, PPP etc) - the cost to the employer
- b. Provision of a car available for private use - a scale charge
- c. Provision of fuel for private use - a scale charge
- d. Interest free loans or loans at less than the official rate of interest - the difference between the official rate and the interest paid
- e. Loans released or written off - the amount written off etc
- f. The tax of a director with a "material interest" in a company paid by the company but not deducted from this remuneration - the amount of the tax
- g. Shares in a company acquired at undervalue (not otherwise chargeable to tax) - an amount based on a notional loan obtained from the employer
- h. Certain scholarships - the cost of providing the scholarship

- i. Assets bought for employees such as cars, yachts, TVs - cost to the employer
- j. Transfers of depreciated assets such as yachts, TVs - market value (but there are special rules if the asset has already been used privately)
- k. Private use of assets owned by the employer such as yachts and land (but not living accommodation or cars) - The annual value of use. In the case of land - the ratable value. In other cases 20% of market value when private use began.

11. Where there is an overlap with a charge in Section A of this note -

- the voucher legislation exhausts the charge. No charge arises under the higher paid legislation.
- but in other cases there is in principle a mixed charge. For example in the case of a suit not provided by way of a voucher, the second-hand value is charged under the money's worth principle and the difference between that figure and the cost to the employer is charged under the higher paid legislation. (In practice, of course, only a single figure (cost) would be charged).

12. A benefit may be provided for an employee by way of an expenses payment. If an employee is paid expenses for which he cannot obtain an offsetting deduction under the Schedule E expenses rule (expenses incurred wholly, exclusively and necessarily in the performance of the duties of the employment), he is effectively charged on the cost of the benefit. Thus if the employer paid for the employee's home to work travel in the employee's car, he would be taxed on what the employer paid. The commonest benefits taxed in this way are travelling and subsistence expenses.

BENEFITS IN KIND: DISTRIBUTION AND GROWTH

1. As you anticipated, we cannot readily give you exactly the sort of figures you have in mind, but I hope the tables attached will give the broad picture.
2. Table A: analyses benefits and expenses for 1987/88 into seven main categories and five income ranges. As mentioned in the cover note, these figures already take account, to some extent, of the results of the 1985/86 survey.
3. Table B: gives broadly the same information for 1983/84 but vouchers and beneficial loans are not separately identified.
4. Table C: attempts to look back a little further (to 1980/81) in terms of the number of directors and "higher paid" employees receiving the main types of benefit. It adds a little more perspective, but a good many of the figures for earlier years are not available. The threshold was £8,500 throughout this period, and some of the increase in recipients is the result of rising incomes taking more people above the threshold, rather than the provision of benefits becoming more common. For example, we estimate that about 60% of the increase in recipients between 1981/82 and 1983/84 was due to rising incomes.
5. So far we have not been able to obtain any information about the number of employers within the P11D system. I will let you have later any worthwhile information we obtain.
6. As you will see from the 1987/88 analyses, the category "other benefits" is quite large. It includes items such home telephones and subscriptions, and a large number of differing kinds of benefits which are covered in the "sweep up" item, (18), on the P11D (attached to Mr Isaac's submission of 23 September). More information about this category may become available when the analysis of the 1985/86 survey has been completed.

TABLE A

PROVISIONAL ESTIMATES OF THE DISTRIBUTION OF EXPENSES AND BENEFITS IN 1987-88 BY
LEVEL OF GROSS EARNINGS (INCLUDING EXPENSES AND BENEFITS)

Range of earnings (incl. expenses and benefits)	-----COMPANY CARS-----				:	-----FREE FUEL-----				:	-----PRIVATE MEDICAL INSURANCE-----				:	-----NET TAXABLE EXPENSES-----			
	Numbers thousands	Amount of benefit £ m	Tax on benefit £ m	Average amount of benefit £	:	Numbers thousands	Amount of benefit £ m	Tax on benefit £ m	Average amount of benefit £	:	Numbers thousands	Amount of benefit £ m	Tax on benefit £ m	Average amount of benefit £	:	Numbers thousands	Amount of benefit £ m	Tax on benefit £ m	Average amount of benefit £
under £10000	208	149	40	716	:	125	77	21	616	:	80	21	6	263	:	1	0	0	
£10000 to £15000	282	200	54	709	:	200	119	32	595	:	118	36	10	305	:	75	8	2	107
£15000 to £20000	290	182	51	628	:	197	126	35	640	:	221	56	16	253	:	31	11	3	355
£20000 to £25000	156	112	41	718	:	91	56	19	615	:	107	31	11	290	:	8	7	2	875
over £25000	259	243	126	938	:	160	119	61	744	:	167	69	30	413	:	14	57	22	4071
TOTAL	1195	886	312	741	:	773	497	168	643	:	693	213	73	307	:	129	83	29	643
					:					:					:				
					:					:					:				
					:					:					:				
					:					:					:				
Range of earnings (incl. expenses and benefits)	-----VOUCHERS-----				:	-----BENEFICIAL LOANS-----				:	-----OTHER BENEFITS-----				:	-----TOTAL EXPENSES AND BENEFITS-----			
	Numbers thousands	Amount of benefit £ m	Tax on benefit £ m	Average amount of benefit £	:	Numbers thousands	Amount of benefit £ m	Tax on benefit £ m	Average amount of benefit £	:	Numbers thousands	Amount of benefit £ m	Tax on benefit £ m	Average amount of benefit £	:	Numbers thousands	Amount of benefit £ m	Tax on benefit £ m	Average amount of benefit £
under £10000	33	7	2	212	:	0	1	0		:	28	4	1	143	:	243	259	70	1066
£10000 to £15000	4	1	0	250	:	0	0	0		:	94	24	6	255	:	479	388	104	810
£15000 to £20000	35	9	3	257	:	14	3	1	214	:	81	54	15	667	:	474	441	124	930
£20000 to £25000	10	1	0	100	:	5	3	1	600	:	84	35	13	417	:	232	245	87	1056
over £25000	19	4	2	211	:	17	25	13	1471	:	95	93	40	979	:	317	610	294	1924
TOTAL	101	22	7	218	:	36	32	15	889	:	382	210	75	550	:	1745	1943	679	1113

NOTES

1. These figures cover directors and higher paid employees only.
2. The estimates are based on projections from data collected in the 1983-84 survey, projected forward to 1987-88. The projection factors have been adjusted to take account of some provisional results from the 1985-86 survey.

TABLE B

RECIPIENTS AND TAXABLE VALUE OF MAIN CATEGORIES OF EXPENSES/BENEFITS IN 1983-84 BY SCHEDULE E INCOME

Schedule E income bands	Cars		Fuel		Private medical insurance		All expenses		Other benefits		All expenses/ benefits			
	(£)	000's	£m	000's	£m	000's	£m	000's	£m	000's	£m	000's	£m	Average Amount £
0- 8,500		87	40	48	22	3	...	1	...	40	4	102	68	667
8,500-10,000		90	29	55	20	39	4	48	4	39	1	179	59	330
10,000-12,500		142	57	62	25	101	11	82	9	105	15	328	117	358
12,500-15,000		125	51	93	42	125	16	11	2	70	33	208	143	686
15,000-20,000		180	79	101	45	118	17	16	6	112	31	264	178	673
20,000-25,000		103	55	57	31	63	11	9	4	47	17	133	117	880
Over 25,000		121	78	30	47	81	18	15	44	66	64	137	252	1,839
TOTAL		848	390	495	233	531	78	181	69	478	165	1,352	934	691
Amount as % of total amount			42		25		8		7		18		100	

TABLE C

COMPARISON OF NUMBERS OF RECIPIENTS OF TAXABLE EXPENSES/BENEFITS IN 1980/81, 1981/82, 1983/84, 1985/86 AND 1987/88 (THOUSANDS)

Expense/benefit	Excluding married women				Including married women	
	1980/81	1981/82	1983/84	1985/86 (provisional)	1985/86 (provisional)	1987/88 (forecast)
Car	648	791	848	935	1023	1195
Fuel	N/A	N/A	495	606	672	773
Entertainment	N/A	36	12	*	*	12
General expenses	N/A	N/A	55	*	*	55
Travelling and subsistence	N/A	91	121	*	*	121
Private medical insurance	314	N/A	531	611	627	693
Educational assistance	5	N/A	2	N/A	N/A	N/A
Vouchers	N/A	73	71	*	*	101
Beneficial loans	30	N/A	37	*	*	36
Others	N/A	N/A	381	*	*	382
TOTAL	815	1073	1352	1510	1613	1745

* These figures were collected in the 1985/86 expenses and benefits survey and will be available later.

BENEFITS IN KIND: USE OF STAFF

1. The use of staff on benefits in kind work falls under three main headings

- Programme work: By this we mean the work which is carried out in all tax offices of receiving and examining P11Ds and expenses claims, and making coding adjustments and assessments as necessary. It is essentially the run-of-the-mill work on benefits.
- Compliance work - employer reviews: These are done by staff who specialise in compliance work and look at the whole range of benefits provided by a particular employer.
- Compliance work - individuals: These are reviews of an individual employee's liability which are carried out in tax districts as part of their normal case work.

2. Because programme work and individual compliance work are fully integrated with all the other work which goes on in tax offices in handling the tax liabilities of employees, it is not possible to say precisely how many staff are used in those ways. Moreover the figure will vary over time as the number of P11D cases increases year by year, and according to the current workstate and pressures in tax offices which may result in the curtailment of examination and compliance work which might otherwise have been done. Our best estimate of the current staff cost of these aspects of benefits work is about 1,000, out of the total staff of about 23,000 on Schedule E work. (Of the other 22,000 staff in tax offices, about 13,000 work on Schedule D, and the remainder on Claims, CT, IGT, NIC and other work).

3. In contrast, the staff employed on employer based compliance work can be given precisely because this work is a distinct and separate task. The figures are as follows:-

	<u>TO (HG)</u>	<u>Inspector</u>
85/86	161	40
86/87	100	33

Programme Work

4. It is estimated that some ml.75 people will be in receipt of net taxable expenses and benefits in 1987/88. Many of these will receive a mix of different kinds of benefits and/or expenses. Broadly, P11Ds break down as follows.

	<u>Number of P11Ds</u>
Main benefits: car, fuel, private medical insurance	1,090,000
Other benefits: educational assistance, vouchers, beneficial loans, others	165,000

Main benefits/other benefits	238,000
Expenses: entertainment, general, travel and subsistence	191,000
Main benefits/expenses	48,000
Expenses/other benefits	3,000
All categories	<u>15,000</u>
	1,750,000

5. All these forms are examined and, if there are taxable benefits, assessments need to be raised on the employee or his code number reviewed and if necessary adjusted. There may be queries to be followed up beforehand. Changes of employment where a car is provided, for example, may create in-year code changes. Benefits work is also done during the annual and Budget coding exercises. In short, staff on programme work are required to service the benefits system by processing the information that is supplied and taking action where necessary.

6. The yield from taxing benefits is expected to be £m650 in 1987/88. The cost of collection - exclusive, of course, of employers' costs - is about 3p in the pound, which is slightly higher than the current (1986/87) overall Departmental cost/yield ratio of about 1.68p in the pound. This reflects the fact that tax from benefits - unlike the bulk of Schedule E tax we collect - does not come in automatically.

Employer Reviews

7. Districts plan their work in this field, drawing up a programme of compliance reviews and setting targets for the number of reviews they expect to settle in the coming year and identifying the type of review they intend to carry out in each case. For example, the review might involve a comprehensive examination of the range of rewards provided by a selected employer to his employees. On the other hand, as might be the case with a large employer, the review might be limited to one aspect such as the provision of cheap loans or the reimbursement of expenses.

8. To assist tax offices in the planning and organisation of their compliance work, guidance notes have been issued to appropriate staff covering all aspects of District organisation and compliance casework. Management notes emphasise that this work calls for the application of much common sense and a sense of proportion and tax offices are asked to refer cases to Head Office, before action, where sensitive or contentious issues might be involved.

9. The reviews are carried out by specialised compliance staff who are normally TO(HG) grade. In addition, Inspectors are involved in organising and managing the work, in giving advice on complex issues and dealing with the largest and most important cases. The reduction in the resources deployed on this work compared with earlier years (see paragraph 3) reflects staff shortages and the competing demands of other District work.

10. During 1986/87 4986 reviews were settled - as the following figures show, not all of them related to benefits and expenses. The settled cases brought in additional tax and NIC of £44.7 million comprising

- Additional benefits and disallowed expenses	£28.7m
- Additional tips	£ 1.4m
- Application of PAYE	£ 9.8m
- Others	£ 4.8m

Nothing is included in these figures for either the increased yield in future years from employers who have been reviewed or for the more general deterrent effect on other employers. Taking these factors into account, we think the average overall cost/yield ratio of this work is about 1:20.

11. Resources are available to examine only a very small proportion of employers. During 1986/87 only 0.46% of employers were reviewed (in 1985/86 the figure was 0.60%). Put another way, only 1 in every 200 employers can be reviewed in any year. There is scope for much higher levels of cost-effective activity - hence our PES bid for additional resources for Schedule E Compliance work.

Reviews of Individuals

12. These reviews are done as part of normal casework by the allocation officer responsible for dealing with all aspects of the tax affairs of the individual concerned. While the resources used on this aspect of casework are not recorded, details are reported of the number of adjustments (over £150 tax) made.

13. During 1986/87 there were 9645 adjustments bringing in additional tax of £10.5m. The average tax yield per case was £1,078. Typical examples would be excessive expenses claims, and benefits to directors of close companies not returned, or not fully returned. (Schedule E compliance work often also brings to light cases where PAYE has not been properly operated, giving rise to a further tax yield not included in the figures above.)

PAYE Audit

14. PAYE Auditors visit employers and examine their records to ensure that taxable emoluments are fully recorded and that tax is properly deducted. By April 1988 we aim to have filled the complement of some 1,000 posts authorised for this task - resources permitting. PAYE Auditors are based mainly in local Collection offices and their role is the effective policing of the PAYE system.

Conclusion

15. The benefits legislation with its provisions for the reporting and taxation of benefits-in-kind and expenses payments is designed to supplement and to maintain the integrity of the Schedule E/PAYE system and to deter avoidance. In turn, Schedule E Compliance work, and PAYE Audit, maintain the integrity of the benefits legislation and the accompanying P11D

system and deal with any underlying failures in the operation of PAYE. As such, these activities are fundamental to the operation of the Schedule E legislation which brings in the bulk of the income tax receipts.



Handwritten signature

FROM: J J HEYWOOD
DATE: 1 October 1987

MR LEWIS IR

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

PS/IR
→
LEWIS
1/10

TAXATION OF BENEFITS IN KIND

1. The Financial Secretary was grateful for your note of 25 September which he found very interesting.

Handwritten initials J.H.

JEREMY HEYWOOD
Private Secretary



Mr Scholar

There is one aspect of the
proposed switch ^{of} the taxations
of benefits in kind from the
employee to the employer
which has already
occurred to me. What
happens with those employees
who are not liable to tax
(eg HMG)? I assume they
must still pay the new
tax, otherwise there will be some
in clear disadvantage of
the private sector.

Yr.

~~TASK FORCE SECRET~~**CONFIDENTIAL**Copy No. **11** of **12** Copies

FROM: J M G TAYLOR

DATE: 5 October 1987

MR ISAAC

cc: CST
 FST
 PMG
 EST
 Mr Scholar
 Mr Cropper
 Mr Tyrie
 Mr Battishill
 PS/IR

TAX ON BENEFITS IN KIND

The Chancellor has seen your minute and enclosure of 23 September. He would like you to set in hand further work, including a fact-finding visit to the Antipodes. He thinks that a Treasury representative should accompany the Revenue on this visit.

2. He has a number of comments and questions on the papers.
 - (i) He notes (last indent of paragraph 9 of the paper) that, other things being equal, there would be a lightening of the relative tax burden on high paid employees, compared with middle management and the lower paid. He wonders about the effect on this of abolishing the P11D threshold.
 - (ii) The impact of an employer based tax on small employers would need to be considered carefully.
 - (iii) On the rate of tax (paragraph 15 (i) of the paper), he would prefer to collect more tax than the present system, especially if the problems for small firms can be overcome.

JMG-T
 →
 ISAAC
 5/10



- (iv) He has noted your initial thinking about excluding lump sum expense allowances (paragraph 22 of the paper). He would like, in due course, to know more about how we should handle these.
- (v) He has noted the choice between a formal tax on the employer or a tax in respect of the employee paid by the employer (paragraph 24 of the paper). He has asked what the position is in Australia and New Zealand.
- (vi) He has commented that it would be too late to leave implementation until Phase 1 of BROCS is available (paragraph 31 (b)).
- (vii) Annex A should list which benefits and expenses come within the potential scope of the new charge and which remain in the existing P11D system (paragraph 1 of annex A).

JMGT

J M G TAYLOR

EXTRACT FROM TFS
DOCUMENT.

MEETING RECORD 12.10.87

MTG
RECORD
EXTRACT
12/10

29. The Financial Secretary said he had considerable reservations about raising the LEL. This needed to be assessed in the context of the objectives of NIC reform. These included reducing the "unemployment trap", reducing the cost of labour, and relieving the tax burden. The Chancellor said the main objectives were to reduce the burden on the low paid, and the "unemployment trap". Raising the LEL particularly helped towards these objectives.

30. In further discussion, it was noted that raising the LEL had an inconclusive effect on the size of the "black economy". It was also noted that, under the reform, some single people would still pay income tax although they would no longer be liable for NICs.

31. The Chancellor noted that if the employers rates were set at the scale 0:7:9:10.45, the cost in the first full year would be reduced to around £½ billion. This option should be examined further. A fallback option with a 2 per cent lower rate band should also be considered. Other ways of juggling with the bands, at similar cost, should also be pursued. Mr Scholar undertook to take this forward. He would report back to the Chancellor in time for the opening of discussions with Mr Moore. This would be soon after the Autumn Statement.

Further work

32. The Chancellor noted that it was planned to hold further meetings to discuss capital gains tax, and benefits-in-kind. The more general proposal about switching taxation of benefits in kind to employers should be examined with the additional burden on businesses in mind. The Chancellor wished to hold further meetings on: the effect of the overall package on small businesses and the



self employed; on overall winners and losers; on NICs for the self employed. He also looked forward to the paper setting out the economic rationale behind the proposals.

A handwritten signature consisting of the letters 'A P' followed by a vertical line and a horizontal line.

A P HUDSON

A handwritten signature consisting of the letters 'J M G' followed by a vertical line and a horizontal line.

J M G TAYLOR

13 October 1987

Circulation

Those present*
Chief Secretary
Paymaster General
Economic Secretary
PS/IR

(*Mr McIntyre and Mr Macpherson: paragraphs 25-31 only)

CONFIDENTIAL

bf 23 / 11



FROM: J M G TAYLOR
DATE: 19 October 1987

MR SCHOLAR

BENEFITS IN KIND

The Chancellor has said there is one aspect of the proposed switch in the taxation of benefits in kind from the employee to the employers which has only belatedly occurred to him. What happens with those employers who are not liable to tax (eg HMG)? He assumes they must still pay the new tax, otherwise this would be seen as clear discrimination against the private sector.

2. I should be grateful for advice.

A handwritten signature, likely of J M G Taylor, consisting of stylized initials.

J M G TAYLOR

A/CAR
BENEFIT SCALE

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Inland Revenue

Policy Division
Somerset House

A CAR BENEFIT SCALE

1. The benefit of a company car which is available to a director or "higher paid" employee for private use is charged to tax by reference to a fixed scale. A separate scale charge applies where fuel is provided for private journeys. The car and car fuel scales are set for a year at a time and announced a year in advance. In accordance with normal practice the scale charges to apply for 1989/90 would be announced in the 1988 Budget.
2. Mr Allan's note of 4 September asks us to look at the scope for levying a more realistic charge on car benefits as a means of reducing the under-taxation on benefits-in-kind. The Chancellor has also asked us to look at the possibility of levying the charge on benefits on employers. Mr Isaac's note of 20 October discusses such a charge, which would include company cars and car fuel for private motoring. However even with an employer-based tax we assume that the charge on cars would continue to be determined by reference to a fixed scale.
3. Consideration needs to be given now to the appropriate level of charge for 1989/90. This could be
 - either a transitional year under the old system to a new employer-based tax starting in 1990/91
 - or the normal charge to be announced in this Budget if in the event you decide not to introduce an employer tax.
4. More generally, you will wish to consider whether you can formulate now a broad strategy on the taxation of cars for the

rest of this Parliament. If you decide to go for realistic scales they will almost certainly need to be phased in over a period. In that event, you may wish to consider announcing this year your long-term programme - as you did for CT rates in 1984.

5. This note therefore begins by discussing what the correct measure of benefit should be and then looks at the options for change. It also considers some subsidiary points - a possible separate scale charge for diesel cars and a lower scale charge for cars with an annual business mileage in excess of 30,000 miles which the Chancellor asked us to consider.

The Present Scales

6. The car scale charge depends mainly on the size (engine capacity) or value of the car, its age and the amount of business use. If the employee does 18,000 or more business miles in a year the scale charge is reduced by one half; if he does 2,500 or less business miles the charge is one and a half times the normal level. (The one and a half rate also applies to second and subsequent cars supplied to the employee and/or his family.) There are also separate scales for cars which do not have conventional cc rated engines - eg cars with rotary engines and electric cars - and for expensive cars.

7. The main scale charges for this year and those for next year announced in your last Budget are set out below:

Size/Value of car	Scale Charge	- Cars under 4 years old
	1987/88	1988/89
Up to 1400 cc	525	580
1401 - 2000 cc	700	770
Over 2000 cc	1100	1210
Cars with an original cost £19,250-£29,000	1450	1595
Cars with an original cost exceeding £29,000	2300	2530

8. What this means in terms of weekly tax payments for a basic rate taxpayer in 1988/89 (using the current 27 per cent basic rate) is as follows:-

Engine Size/Value of Car	Weekly tax £
1400 cc or less	2.72
1401 - 2000 cc	3.63
Over 2000 cc	5.71
Cars with an original cost £19,250 - £29,000	7.53
Cars with an original cost exceeding £29,000	11.94

9. It is almost universally acknowledged that the car scales at their present levels fall well short of the true benefit of having a car available for private use. Among the representative bodies the Society of Motor Manufactures and Traders (perhaps not surprisingly) are almost alone in dissenting from this view. Whilst most bodies accept that the present charges are too low they make the point that realistically they can only be increased when tax rates are being cut. This is a fair point, but there are timing problems. While proposals to cut rates and increase scale charges can be announced as part of a package, because the scale charges are announced a year ahead the impact will not be felt until a year after the corresponding cuts have taken place.

10. Since 1979 the scale charges have been increased by more than the general rate of inflation - as part of a policy of gradually increasing them to a more realistic level. The increases have been broadly as follows

1981/82	1982/83	1983/84	1984/85	1985/86
20%	20%	20%	15%	10%
1986/87	1987/88	1988/89		
10%	change in breakpoints plus 10%	10%		

Even so, the scale charge, as a proportion of the proper valuation of the benefit (on the basis discussed in paragraph 12) has risen only a little from about 30% to about 42% in 1988/89.

Measuring the benefit

11. Ministers have indicated that they would like to see a larger increase so as to bring the scale charge much closer into line with the actual benefit. Underlying this, however, is how the benefit received is to be quantified. The aim of the benefits legislation is to secure as far as possible parity of treatment between those paid in cash and those paid partly in cash and partly in kind - generally by charging tax on what the employee would have had to pay if he had to provide the benefit from his own pocket. In most cases, the cost to the employer is the most convenient means of measuring the benefit provided. But in some cases - eg cars, living accommodation, cheap loans a different measure is used.

Approach A - 50% standing charges

12. The 1976 benefits legislation provided for the benefit of a company car available to a director or higher paid employee for private use was to be charged to tax by reference to a fixed scale. The legislation was silent however as to the basis on which the scale should be drawn up, and although there was in 1976 and there has been since a good deal of public discussion about the level of the scale charges there has been little on the conceptually correct basis for calculating the charge. One approach, which was published in a 1979 consultative document and on which our annual submissions to Ministers have been based is to use (with some downward adjustments) the Schedule of estimated standing and running costs produced by the AA each year. The formula we have used is to take - broadly - half the standing costs shown in the AA Schedule (in recognition that a company car may be used both for business and privately), and running costs for 8,000 miles - the National Travel Survey in 1978/1979 showed the average private mileage for company cars was 8760 miles a year. We understand that the provisional results of the 1985/86 survey which have yet to be published will show this is now just under 9000. (This compares with average business mileage in company cars of 6240 miles in 1978/1979 and 7200 miles in 1985/86.) Annex A gives the latest figures

published by the AA. This approach is similar in principle to the approach we adopt for the self-employed, where we apportion the motoring costs to reflect the amount of business/private use, so that tax relief is only given in the costs attributable to business use.

13. The table below compares the actual scale charges for 1987/88 with the 'realistic' charge based on the formula described in paragraph 12.

Size or value of car	A "Real" Scale Charge 1987/88 50% of Standing Costs	B Actual Scale Charge 1987/88	B as per cent of A
Up to 1400 cc	1357	525	38.7
1401 - 2000 cc	1646	700	42.5
Over 2000 cc	2626	1100	42
Cars with an original cost £19,250 - £29,000	3778	1450	37.7
Cars with an original cost exceeding £29,000	5834	2300	39.4

14. In practice it is not possible to make quite such a direct comparison because the AA figures for 1987 did not become available until after the 1987/88 car scale charges had come into force. The next figures will not become available before mid-April 1988 by which time the scales for 1989 will have been announced. The 1989/90 rates have therefore to reflect the 1987 AA figures. To prevent these being too out of date we adjust the AA figures to take account of estimated increases in motoring costs in the intervening years. On the assumption that these costs might be expected to increase by around 5% a year we would add 10% to the 1987 figures to arrive at an estimate for 1989.

Approach B - 100% of Standing charges

15. Looked at from the point of view that the charge should be based on the extra expenditure an employee would have if he were to buy the benefit himself there is a good case for taking into account the whole of the standing charges. If the employee does not have a company car, or if he is unable to use it for private motoring, he would have to bear the whole of the cost of providing a car for his private use, irrespective of how much private mileage he did. The true comparison is therefore with the full cost of providing the car.

16. There are a number of arguments which might be put against using the full cost of providing a car

- Discouraging the use of company cars might be damaging to the British car industry.
- Some (though by no means all) company cars have a substantial business use and some apportionment of the standing charges is appropriate to take account of that.
- The employee might be provided with a bigger or better car than he would otherwise choose.
- To the extent that the car is used for business (or to get to work - though this is of course private motoring so far as the tax system is concerned) the employee might have to provide a second car for his family's use.

17. These objections are likely to be made to any proposal to increase the car scale charge to a more realistic level. The first two are already advanced by the SMMT against the current scale charges. None carries much conviction.

18. The most important argument is probably the industrial one - when the scales are raised, company cars tend to become less

attractive, and if employees buy their own cars instead they are on average more likely to purchase foreign cars. So, the argument runs, increases in the car scales are prejudicial to the British motor industry.

19. While there is something in this argument its success depends entirely on companies having a preference for British cars; the scales themselves are neutral in this respect. It has never been true at the top end of the market where foreign and foreign-built cars have always been strongly represented. It is becoming progressively less true of the lower and middle ranges of car fleets, particularly as there is now a strong trend to allow the employee freedom of choice in his car, and not apply many "British made" restrictions. Moreover many cars, popular with corporate fleets eg the Ford Fiesta, Granada, Escort XR3i perceived as British are made abroad. The Treasury's Industry Division will no doubt have a view on this.

20. The other arguments can be dealt with quite briefly.

- The answer to the point that the car may also be used for business is in paragraph 15 - ie if a car is available for private use the employee is spared the whole of the cost of providing his own car. Moreover, evidence from the National Travel Survey suggests that the average private mileage of a company car is higher than that of a privately-owned car, so there is nothing inherently unfair about charging the whole cost.
- So far as the bigger/better argument is concerned, the plain fact is that the employee actually gets the benefit of the better car and that is what he should pay tax on. In principle the argument is no different from other 'prestige' benefits an employee may get - eg he may be required to join an expensive golf or country club. But the benefit is still the actual cost of joining that club, not the club he would otherwise have joined and no-one seriously argues otherwise.

- The remaining argument that an employee with a company car may still need a second car is not convincing. The same is true of the employee who has to use his own car for business or who needs it to get to work.

21. The scale charges based on 100% of standing charges using the AA's Schedule of estimated costs for 1987 is set out below. For comparison the table also shows the charges for 1987/88 and the percentage of the full charge which the 1987/88 scales represent.

Size or value of car	A 'Real' Scale charge 1987/88 - 100% AA Standing Charge	B Actual Scale Charge 1987/88	B as percentage of A
Up to 1400 cc	2239	525	23.4
1401 - 2000 cc	2743	700	25.5
Over 2000 cc	4443	1100	24.7
Cars with an original cost £19,250 - £29,000	6714	1425	21.2
Cars with an original cost over £29,000	10,596	2300	21.7

On this basis most cars are generally charged at about a quarter of their real value, but the most expensive cars at a little over a fifth of the value are rather more generously treated.

22. Most management consultants seem to take the view that this is the right basis for calculating the value of a company car to an employee. Annex B gives recent figures produced by PA Personnel Services Top Management Remuneration Services, and Income Data Services Top Pay Unit. On the whole they are rather higher than the equivalent figures in the previous paragraph.

Approach C - Actual Cost

23. Using the AA Schedule which looks at the annual costs of running a car is an appropriate way of measuring the benefit to an individual of having a company car. But is not the only way. The alternative is to look at the cost to the employer in providing the car.

24. On the face of it this may seem a more appropriate method if the benefit is to be charged on the employer. An employer may buy the cars or hire them (and it seems hiring is becoming increasingly popular) and some will be able to negotiate better terms than others. So even if we were to switch to an employer tax a scale charge based on average employers' costs would be necessary if both employers and the Revenue were not to spend a disproportionate amount of time and effort in determining the charge and if it were to be collected in year. We do not have enough information to say precisely what the charges would be. However we do not think the basic figures from which a scale would need to be constructed would be significantly different from the AA's figures. The cost to the employer would include all the items in the AAs Schedule and while it is arguable that the employer could negotiate discounts not available to individuals there are counter-balancing factors to bear in mind. For example the AA figures assume straight-line depreciation over eight years (ie at 12 1/2% a year). In practice a car depreciates most rapidly in its early years - by as much as 50% in the first 3 years.

25. With an employer-based tax, the charge could be the actual cost to the employer (rather than an average cost). But there might be additional pressure for apportioning the cost of a car between "business" and "private" use (as happened before 1976) on the footing that the employer should only pay the benefits tax on the cost to him of providing the benefit. Any such pressure would have to be firmly resisted. It would be an administrative nightmare, and it would move further away from neutrality between cash and benefits since the value of the private use subject to tax would vary depending on the extent of business use.

The Options for the Scale Charge

26. It is clear that car benefits are at present substantially under-taxed and that there is room for a considerable increase in the scale charges. While this would no doubt provoke some reaction from the SMMT and some of the 1.35 million people who pay tax on the benefit, there is no doubt that there is a widely held view that company cars ought to be taxed more realistically.

27. Ministers are familiar with the arguments for increasing the scale charges. Very briefly raising the charges

- increases the yield from benefits in kind
- does not add to the employers' compliance cost or the Revenue's staff costs
- is consistent with Governments general aim of not providing a tax advantage for benefits in kind
- is one area where there is wide agreement that the tax base is too small and there are no insuperable difficulties in broadening it.

28. There is a choice between three strategies for increasing the charges to a more realistic level.

- First, a steady edging up of the levels year by year. In effect this is a continuation of the strategy of the last 10 years or so. The drawback is that it is a very slow process - the scales have increased as a proportion of the proper valuation of the benefit by only about 1 1/2% a year since 1980 (see paragraph 10) and it is not clear what target we are aiming at.
- Second - the occasion of a major tax reform could be used as an opportunity to set a target for reaching a realistic scale charge and moving progressively towards it (and, if you wished, legislating for it). (The length of transitional period eg over 4 or 6 years would be a matter for judgment.)

- Third is a "big bang" strategy - a one step move to the full charge. This would result in massive increases - 125% (approach A) or 300% (approach B). An increase of this magnitude would be unexpected and controversial and is probably more than can be achieved in one year.

One general point to bear in mind in assessing the options is that they all involve quite significant percentage increases because we are starting from such a low base. Considering the figures in terms of extra tax per week sometimes puts a different perspective on them.

29. There are obvious attractions in settling on the second strategy which would follow the pattern of your CT reforms. It puts everyone on warning of the period within which they can expect cars to be fully charged. The initial charge can be much smaller than the "big bang" approach, yet it would ensure a realistic level was reached; and subsequent year's charges would already be "in the system" so far as future Budgets were concerned if you legislated at the start. However, you might prefer the more flexible approach of settling the rate for a year at a time. For illustrative purposes therefore we have looked at a number of possible increases in the range of 10 - 100%. The resulting scales and the effect on the yield is set out in the tables below. For ease of comparison the "true" scales are shown - these are the AA figures adjusted by 10% to take (broadly) into account increases in motoring costs to 1989.

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Size & Value of car	1989/90	1989/90		1989/90 + 10%	1989/90 + 25%	1989/90 +50%	1989/90 + 75%	1989/90 + 100%
	1988/89 Scale	full charge - 100% standing charge	full charge - 50% standing charges					
Up to 1400 cc	580	2463	1492	638	725	870	1015	1170
1401 - 2000 cc	770	3017	1810	847	963	1155	1348	1540
Over 2000 cc	1210	4887	2888	131	1513	1815	2118	2420
Cars with original cost £19,250-£29,000	1595	7385	4155	1755	1994	2393	2791	3190
Cars with original cost over £29,000	2530	11656	6417	2783	3163	3795	4428	5060

30. The tax yield arising from the taxation of company cars in 1989-90 is on the basis of an indexed regime with current tax rates, estimated to be about £370 million. Examples of the additional yield which would arise for 1989-90 if the scale charges were increased in the range 10% to 100% are:

<u>Percentage increase in scale charges</u>	<u>Additional yield (£ million)</u>
10%	+40
25%	+100
50%	+200
75%	+300
100%	+400

Due to lags in the receipt of tax deducted through PAYE, only about 88% of the additional yield would be received in 1989-90 with the remainder in 1990-91.

31. If the scale charges were increased by 125%, the additional yield could be up to £1/2 billion whereas if the scale charges were increased by 300% to represent the full value of the car, the additional yield could be up to £1.2 billion.

These costings assume no behavioural changes in the provision of company cars although, given the magnitude of this increase in the scale charge, there could be some trading down to smaller cars and an overall reduction in the number of company cars. If Ministers wish to pursue options of very high increases in the scale charge, we will have to do some further work on behavioural changes.

32. It is apparent from the tables above that even with an increase of 100% the resulting charges would still fall some way short of the true benefit using the present formula and considerably short if the true measure is taken as including 100% standing charges. Given that Ministers are in favour of bringing the scale charges more closely into line with the actual benefits there is a good case for an increase at the upper end of the scale. This is however a matter for your judgment, bearing in mind other components of the personal tax package. We recognise that Ministers may wish to take only a provisional view at this stage and delay a firm decision until the shape of that package is decided. (The range of options set out above is not exhaustive. We can of course provide the necessary figures for other options if Ministers wish.)

OTHER MATTERS

(a) Expensive cars

33. Separate, higher scale charges apply for more expensive cars. We recommend that the cash thresholds for these cars (currently £19,250 and £29,000) should be frozen for 1989/90 as they have been for 1987/88 and 1988/89. In the past these thresholds have sometimes been increased by the same percentage as the car scales themselves. But the effect of this has been to undertax the benefit on such cars relative to the treatment of those cars ruled by engine capacity. Freezing the thresholds helps to correct this.

34. The most expensive cars are generally provided for the highest paid. A possibility to consider, is to apply a higher

rate of increase for expensive cars - eg a 100% increase compared with 75% increase generally. This could be justified by reference to the relative undertaxation of these cars and also perhaps if in the context of the package as a whole the highest earners were getting the biggest breaks.

35. There is a further point. If you accept that the "business use" argument justifies the 50% standing charge approach for most cars on the basis that a person doing a high mileage needs a comfortable car, it does not apply to the most expensive cars eg Porsches - which are self-evidently perks.

(b) Mileage thresholds

36. The scale charges provide for a higher rate (1 1/2 times the normal rate) of charge to apply where 2500 or less business miles are driven a year and/or second cars and a lower rate (1/2 the normal rate) where business mileage is more than 18000 miles. Few representations are made on this point. However earlier this year a taxpayer suggested in correspondence that the scale charge should be reduced to one quarter of the normal rate where the business mileage exceeds 30,000 miles. You asked us to consider this as a possible starter combined with a real hike in the scale rates (Mr Kuczys note of 13 May 1987).

37. At the time we had no information as to how many people do that amount of mileage. However the provisional results of the latest National Travel Survey suggest around 100,000 company cars (or about half the cars doing over 18,000 business miles) are involved. The arguments in favour of making this change are

- the cost is not particularly high - about £m 10 on the current scale charges and about £m 20 on the approach A formula.

- it is a small sweetener if the charges are to be raised steeply.

38. There are however some strong arguments against it

- it presupposes that cars with a high business mileage do less private mileage. There is no firm evidence to support this view.
- at the margin, mileage rules encourage unnecessary/inefficient business use of a car to clock up the qualifying mileage
- it is an added complication. If the charge is to be transferred to employers it may be necessary to simplify the charge and remove the present mileage rules.

39. If you accept the argument in paragraph 15, the benefit of having a car provided for private use is much the same no matter how many business miles are driven. On this logic therefore there is a good case for getting rid of these separate rules. Under that approach the 1 1/2 times charge on low mileage/second cars would certainly need to go if the scale charges approach a full valuation of the benefit assuming that included 100% of standing charges. Up to that point however there is a good case for the higher charge on the basis that the car is a pure perk, and the case remains valid if you accept the approach in para 12, and base the charge for mixed business/private cars on 50% of standing charges.

40. If the charge is to be transferred to employers there is in addition a strong operational case for getting rid of the special mileage rules, especially if the tax is to be collected in year - the employer would not know until after the end of the year how many people are affected or what in consequence his liability is. In any event the employer would incur additional compliance costs if he had to agree not to be dependent on his employee's business mileage records in order to calculate his own liability to tax. Accordingly we recommend against introducing a lower charge for

cars doing more than 30,000 business miles a year. It is for consideration whether the present mileage-related scales should be retained, particularly if the charge is transferred to employers.

(c) Older Cars

41. There is a lower charge for cars over 4 years old. We recommend that the breakpoint for age of car should remain unchanged and that we should maintain broadly the same relativity as at present. (The charges for older cars are about 1/3 lower than for newer cars). This is an area which gives rise to little complaint.

(d) Cars without a regular cc engine

42. We recommend that the cash thresholds for cars without a regular cc engine (rotary engined and electric powered cars) should be frozen for 1989/90 as they were for 1987/88 and 1988/89.

43. There are virtually no such cars in existence. An alternative would be to abolish the separate scales altogether. (This with the corresponding fuel scale would get rid of 2 of the present 5 scales.) Such cars as there are would then fall to be charged by reference to the cc equivalent or assigned to some arbitrary point in the ordinary scales. This might require a small legislative change.

(e) Diesel Cars

44. During the year there has been a small number of representations (9 in all) suggesting that there should be a separate, lower scale charge for diesel cars. It is interesting to note that neither of the main representative bodies - the SMMT or the United Commercial Travellers' Association (UCTA) is among them.

45. The case that is put for a lower scale charge is that diesel cars generally have larger engine capacities than their petrol driven equivalents and should therefore fall into a lower scale charge. This is not universally true however. A 1.6 diesel car may have as its equivalent a 1.3 petrol car and therefore be in a higher band; but a 1.8 diesel car may be the equivalent of a 1.6 petrol car and fall in the same band. Other arguments put forward are that diesel cars are more economical in terms of fuel economy and lower running costs than petrol driven cars and that employers should be given a positive incentive to provide diesel cars.

46. It is not clear these arguments have much force. In choosing to buying a diesel car, taxpayer normally pays more (as well as getting a bigger engine) than for the petrol equivalent, and in return enjoys lower running costs. There is no obvious reason why this choice should not reflect in the ordinary scale rates. Certainly this is an element of fine tuning which could not be justified when the cars are so undervalued.

47. The table below (based on the 1987 AA Schedule) shows the realistic scale charge for a diesel car at both 50% x 100% standing charges together with the current scale charges.

Size of Engine	1988/89 Scale Charge	1988/89 Charges increased by 100%	1989/90 Adjusted AA figure 50% Standing Charges	1989/90 Adjusted AA figures (100% Standing Charges)
Up to 2000 cc	770	1540	1590	2615
Over 2000 cc	1210	2420	2128	3586

Unless therefore the 1988/89 scale charges are increased by more than 100%, diesel cars are not being charged more than their full value. It may be that in some cases the amount of undercharge is less than for petrol cars but this is not a good reason for increasing the undercharge on diesel cars. We do not therefore recommend a separate scale for diesel cars unless Ministers

- (a) propose an increase in scales generally of more than 100% and
- (b) decide that the correct charge should be based on 50% (rather than 100%) of the standing charges.

Summary

48. The points on which we would welcome your guidance are:

- (a) do you agree that the Schedule of costs produced by the AA should form the basis against which we should judge whether the scale charges are realistic (para 12); if so
- (b) should the charges be based on 50% (Approach A) or 100% (Approach B) of the standard charges as calculated by the AA (paras 12-15) if not
- (c) should we attempt to construct a scale based on the cost to the employer of providing the car Approach C (paras 23-25)
- (d) over what period should the car scale charge be increased to the "true" level
- (e) if the scale rate for 1989/90 only is to be covered should an increase of between 10-100% be made (para 29)
- (f) should the thresholds for more expensive cars remain unchanged (para 33)
- (g) should the scale charge on expensive cars be at the same or a higher rate than for other cars (para 34)
- (h) should a new lower rate for cars doing over 30,000 business miles be introduced (paras 36-40) if not

- (i) should the separate rates for cars doing less than 2,500 business miles and more than 18,000 business miles be retained (para 39)
- (j) should the breakpoint for the lower charge for older cars remain at 4 years (para 41)
- (k) should the cash threshold for cars without a regular cc engine capacity remain unchanged (para 42)
- (l) should a separate scale be introduced for diesel cars (paras 44-47).

April 1987

ANX
A

 AA Technical Services

PETROL CARS

SCHEDULE OF ESTIMATED STANDING AND RUNNING COSTS

	Engine Capacity (cc)					
	Up to 1000	1001 to 1500	1501 to 2000	2001 to 3000	3001 to 4500	
Standing Charges per annum (£)						
a Car Licence	100.00	100.00	100.00	100.00	100.00	
b Insurance	356.60	402.50	484.90	750.00	1013.80	
c Depreciation	662.87	919.79	1135.87	2194.77	2946.50	
d Interest on Capital	424.24	588.67	726.96	1404.65	1885.76	
e Garage/Parking	208.00	208.00	208.00	208.00	208.00	
f Subscription	39.25	39.25	39.25	39.25	39.25	
	1790.96	2258.21	2694.98	4696.67	6193.31	
Cost per mile (in pence)						
10,000	17.910	22.582	26.950	46.967	61.933	
5,000	35.820	45.164	53.900	93.934	123.866	
15,000	11.940	15.055	17.967	31.311	41.289	
20,000	8.955	11.291	13.475	23.483	30.967	
Running Cost per mile (in pence)						
g Petrol *	4.350	4.971	5.800	7.909	8.700	
h Oil	0.388	0.388	0.413	0.456	0.745	
i Tyres	0.458	0.573	0.705	1.295	1.692	
j Servicing	0.736	0.736	0.736	0.961	1.434	
k Repairs & Replacements	4.418	4.677	5.466	8.270	10.278	
	Pence	10.350	11.345	13.120	18.891	22.849
* At £1.74 per gallon (38.3 per litre). For every penny more or less add or subtract						
		0.025	0.028	0.033	0.045	0.050
Total Cost Per Mile - based on 10,000 miles						
Standing Charges		17.910	22.582	26.950	46.967	61.933
Running Costs		10.350	11.345	13.120	18.891	22.849
	Pence	28.260	33.927	40.070	65.858	84.782

NOTES

THIS SCHEDULE IS ONLY INTENDED AS A GUIDE. THE FIGURES QUOTED ARE AVERAGE ONLY AND WHERE POSSIBLE MEMBERS SHOULD MAKE ADJUSTMENTS TO SUIT THEIR INDIVIDUAL CIRCUMSTANCES.

- a Car Licence £100.00
- b Insurance - Average rates for a fully comprehensive policy. No allowance is made for no-claim discount.
- c Depreciation - Based on average car prices when new, a mileage of 10,000 per annum, and assuming an economical life of 80,000 miles or eight years. In the case of high annual mileage and secondhand vehicles the depreciation should be assessed individually.
- d Interest on Capital - New Car Value is invested at 8% per annum. This element must be adjusted in the case of secondhand vehicles according to the prices paid.
- e Garage/Parking £4.00 per week.
- f AA Membership Subscription including Relay.
- g Petrol £1.74 per gallon - * See overleaf.
- h Engine Oil - Allowance is made for variable consumption throughout the car's life and the cost of replacement after oil changes.
- i Tyres - Estimated tyre life of 30,000 miles
- j Servicing - General servicing as recommended by the manufacturers. In the case of older motor cars servicing costs may be more.
- k Repairs and Replacements - Estimated on a basis of total cost of repairs, replacements and renovations over eight years or 80,000 miles at an average labour charge of £18.40 per hour, inclusive of VAT. However this figure can only be accurately assessed by the individual owner, as repair costs will vary even with identical models.

The contents of this publication, produced by the AA as part of its service to members, are believed to be correct at the time of printing, but the current position may be checked through the AA.

1. INCOME DATA SERVICES
TOP PAY UNIT REPORT ON
COMPANY CARS (OCTOBER 1987)

<u>VALUE OF CAR TO EMPLOYEE</u>					
VAUXHALL ASTRA 3 DR 1000 cc	AUSTIN MONTEGO 1.6 cc	FORD SIERRA 1.6	FORD SIERRA 2.0	ROVER STERLING 2.5	BMW 735i ASE
£	£	£	£	£	£
2,700	3,300	3,500	3,900	7,100	13,700

2. PA PERSONNEL SERVICES

Approximate Retail Price	Typical Make/Model	Value of Benefit
£		£
Up to 7500	Escort 1.4GL, Orion 1.6L, Sierra 1.6L, Maestro 1.6L, Metro 1.3L, Cavalier 1.3L, Nova 1.3GL, Golf 1.6CL, Peugeot 309 1.3GL	2,900
7501-9000	Capri 2.0 Laser, Sierra 1.6GL, BMW 316, Montego 1.6HL, Cavalier 1.6GL, Passatt 1.8CL, Scirocco 1.6GT, Rover 216S	3,150
9001-11500	Granada 2.0L, Sierra 2.0Efi Ghia, Cavalier 2.0iCD, Audi 80 1.8S, BMW 320i, Renault 25GTS, Volvo 240GL	4,600
11501-14000	Granada 2.0i Ghia, Audi 100CC, BMW 520i, Mercedes 190, Rover 2.6VDP, Rover 820i, Volvo 740GLE	5,800
14001-17000	Granada 2.4i Ghia, Audi 100CD, BMW 528i, Jaguar XJ6 2.9, Mercedes 2500, Rover 825i, Volvo 740 Turbo	6,700
17001-21000	2.9i Scorpio, BMW 732i, Jaguar XJ6 3.6, Lotus Esprit S3 Coupe, Mercedes 300D, Porsche 924S Coupe, Volvo 760GLE	7,600
Over 21000	Audi Quattro, BMW 735i, Daimler 5.3 Double-Six, Ferrari 328 GTS, Jaguar XJ-SC 3.6, Mercedes 500 SE, Rolls Royce Silver Spirit, Porsche 911 Turbo	9,500

ANX
B

B/CAR FUEL
CHARGES



Inland Revenue

CONFIDENTIAL Policy Division
Somerset House

B CAR FUEL SCALE CHARGES - SCHEDULE E AND VAT

- This note has been agreed with Customs and Excise -

1. Until 1986/87 the car fuel scale was the same as the car benefit scale and it was increased by whatever percentage increase was decided for car benefits. Unlike the car benefit scale, however, the level of the car fuel scale was by 1986/87 becoming close to (and in some cases even exceeded) the true measure of the average benefit of free fuel provided for private motoring.

2. With effect from 6 April 1987 the car fuel benefit scale charge has applied for the purposes of assessing VAT on petrol purchased by businesses but used for private motoring. This replaced an arrangement whereby an apportionment of petrol expenses had to be agreed between the local VAT officer and the business. The scale charge approach is a simpler and more efficient way of doing this and will also yield more tax because, due to the lack of evidence about the extent of private use, apportionments under the old system were generally far too low.

3. Though there are differences between the populations to which the Schedule E and VAT scales respectively apply these scales are being used to measure essentially the same thing - the benefit of free fuel for private motoring.

Scale charge for 1988/89

4. The car fuel benefit scale currently in force is as follows:

Size of Car	Scale Charge (£)
1400 cc or less	480
1401-2000 cc	600
Over 2000 cc	900

As by 1986/87 the car fuel benefit scale was getting a bit on the high side, having regard to the actual cost of fuel for standard amounts of private motoring and petrol prices had fallen rather than risen in 1986, Ministers decided to peg the 1988/89 charge at the 1987/88 level. The standard mileage on which these calculations were based is 8,000 miles a year; but the most recent national travel survey suggests that average private employee mileage is now nearer 9,000 miles per annum. On the VAT side, where the scales apply to many self-employed people, average private mileage is lower.

Scale charge for 1989/90

5. Given that the present scale charge is broadly at (or a little above) the true measure of the benefit, and that it applies for VAT as well as Schedule E, it is right in principle that any changes should mainly reflect changes in the price of fuel. It is also a condition of the EC derogation authorising the scale charge arrangement for VAT purposes that the scale should be adjusted in line with the cost of fuel (though the Commission have agreed that there need be no adjustment when there are only minimal petrol price changes).

6. The price of petrol has remained reasonably steady over the last 12 months at around £1.75 a gallon, but recent events make it more than usually difficult at the moment to predict the future trend of prices. The price of fuel would have to go well beyond £2 per gallon to justify an increase in the scale charges while they continue to be calculated, as previously on 8,000 private miles. No increase seems required unless, by the Budget, prices have risen to significantly more than £2 per gallon.

7. The question is, rather, whether there is any case for a decrease, given that the scales are at the moment a little on the high side. On the Schedule E side we see no need for this. There have been virtually no complaints that the level of the scale charge is too high. There may be several reasons for this

- the average private mileage on which the scales are based is now probably on the low side
- even at its present rate, the actual cost to the employee (the scale charge at his marginal rate of tax) is still generally much less than the cost of buying petrol from taxed income
- if the employee feels the charges are too high they can be avoided by reimbursing the employer the full cost of petrol provided for all his private motoring
- free fuel will generally only be provided with a company car. Given the unrealistically low car benefit scale the two together still represent a good bargain.

8. The picture is not quite so simple from the VAT point of view. It should be noted that for VAT purposes the scales apply to all businesses, unlike the Schedule E scales which do not affect sole traders and partners. Since the charges were introduced there has been considerable criticism, mainly from small businesses, with the self employed featuring largely among those complaining. Farmers have been particularly vociferous. The points made are that the private mileage implied by the scale charge often exceeds the actual private mileage and sometimes total mileage. The point is also made that in some cases VAT relief is being denied on any business mileage whatsoever; and an amount of tax is being charged which demonstrably exceeds the true amount due. While these complaints ignore the benefit of the deduction of input tax incurred on repairs, maintenance and leasing charges, there is nevertheless some substance to them. Mr Maxwell-Hyslop MP has been a leading opponent of the scale charges.

9. In July this year Mr Jefferson Smith put a note to the Paymaster-General which suggested four possible ways of dealing with this criticism:

- (a) to reduce the scale by 10%
- (b) to introduce a reduced scale applying to sole proprietors and partnerships only
- (c) to waive the scale charge where the taxpayer claimed only 50% of the input tax on purchases of road fuel (a suggestion put forward by Mr Maxwell-Hyslop)
- (d) to maintain the status quo

10. On balance the paper recommended maintaining the status quo. At a meeting to discuss it the Paymaster-General asked us to consider a further option - reducing the fuel scale charge by 10% and increasing the car scale to recoup the difference.

10 per cent reduction in the scale

11. We estimate that a cut of 10% in the scale charge would result in a loss of about £20 Schedule E tax in 1989/90. It would require an increase of about 5% in the car scales to make good this loss (over and above the increase Ministers decide should otherwise be made to the car scales). This does not take account of the loss of VAT (self-employed and companies) resulting from the change - which it is estimated would cost about a further £10m in a full year and which would require a further increase in the scale charges of about 2 1/2% to recoup.

12. This might go some way towards meeting the complaints from the self-employed, though it would do little in the more extreme cases. Arguments on the other side are

- taking account of the latest figures for employees' average private mileage the scale charges are broadly right at present fuel prices
- if the trade-off between reduced fuel scales and increased car scales was made explicit, employees who get company cars but not free fuel might feel they were being treated unfairly, even though the car scales continued to under-tax car benefit

13. We understand from Customs that after a temporary abatement during the Parliamentary recess, criticism of the scheme in MP correspondence remains at a high level. Officers in the field continue to face criticism. On the other hand there have been few complaints from the corporate sector. They too would benefit from an across the board reduction.

14. While criticism from some sectors of the VAT scale has been running at a high level it is by no means universal and is small in comparison with the total number of small businesses affected. And it is only to be expected where a benefit which has for many years been substantially undertaxed starts to be taxed on a more realistic - and inevitably somewhat broad brush - basis. The scheme has so far been in operation for little more than 6 months so Ministers may feel it is still early days to form a firm conclusion that changes should be made for VAT. The present criticism may turn out to be a small tail wagging a large dog.

15. Ministers will wish to weigh up the pros and cons, but on balance our recommendation is that the present scale should remain unchanged for 1989/90. However there is no need to take a firm decision at this stage. This could wait till nearer the Budget, though some provisional indication of your views would be helpful. We are assuming that Ministers will want to stick to the present practice of announcing both scale charges a full year in advance in the Budget. It would be possible to delay the announcement (of both scales) until the summer - for operational reasons they would need to be in place by the end of 1988 at latest. Since rates have in the past been announced in the Budget a failure to do so could only cause questions and speculation. A later announcement gains little extra time and would be likely to attract more attention.

Separate Diesel Fuel Scale

16. We have raised the possibility of a separate car scale for diesel cars - but recommended against it. There is a stronger case for a diesel fuel scale since diesels are generally significantly more economical and diesel is cheaper than petrol.

Nevertheless we recommend against such a scale because

- there have been very few representations on the point
- according to the 1985/86 National Travel Survey diesels still represent only about 2.5% of company cars (although on the basis of figures for new company car registrations this percentage is likely to be increasing)
- the fuel scales inevitably group cars with widely differing fuel economy together, so diesels are not the only cars with well below average costs
- introducing a diesel fuel scale would encourage representations for a diesel car scale; and more generally for elaborating scale charges.

Employer-based charge

17. Car-fuel benefit charge is one which could readily be transferred to employers. In practice, we do not think this need result in a change in the main rules for measuring how the benefit is charged. The amount of petrol an employer provides for private motoring will vary widely and using a scale charge which is a fairly accurate reflection of the average cost of private motoring would undoubtedly be the simplest means of charging the benefit.

18. The earliest starting date for an employer-based tax looks like being 1990/91 - the fuel scale for which would normally be fixed next year.

Summary

19. We would welcome your guidance on the following points:

- (a) should there be no increase in the present fuel scale charge - unless petrol prices rise significantly beyond £2 per gallon by the Budget (para 6)?

- (b) should there be a decrease in the fuel scale?
If the fuel scale is reduced, should the cost be recouped by an increase in car benefit scales (paras 7-15)?
- (c) should the car and car fuel scale charges for 1989/90 continue to be announced together, a year in advance, at Budget time (para 15)?
- (d) should a separate scale for diesel fuel be introduced (para 16)?
- (e) if the charge on the benefit is transferred to employers, should the current scale charge continue to provide the measure and the benefit (subject to a review of the detailed rules) (para 17)?

C/OTHER
AUTOMOTIVE
MATTERS

CONFIDENTIAL



Inland Revenue

Policy Division
Somerset House

C OTHER 'AUTOMOTIVE' MATTERS

1. In addition to the car and car fuel benefit scales there are a number of other car-related questions to consider. The most important of these is car parking but two other issues which we have not previously brought to your attention are the provision of car phones and company cars to members of the same family working for the same business. Apart from car parking neither issue is pressing at the moment but this seems an opportune time to raise them.

CAR PARKING

2. A number of options for dealing with the problem of the benefit of free parking provided by an employer were discussed in Mr Lewis' notes of 16 and 30 July. The Chancellor sought the quick views of other Ministers and advisers (Mr Allan's note of 3 August). The general consensus was in favour of an exemption, though Mr Cropper had some reservations and suggested the issue should not be decided in isolation from the more general policy on benefit charges.

3. There have been no significant developments in the meantime. Although there has been some comment in the press over the last few months this has not so far taken off, no doubt because we have suspended action on the cases which had been brought to our attention. But we cannot do this indefinitely. Open cases will eventually have to be settled and we have outstanding correspondence, (which has raised the possibility of Judicial Review) which will have to be answered. This is not, as yet, a matter of interest to the representative bodies, though one body, the London Amenity & Transport Association (LATA) has raised the matter, suggesting a rather complicated scale charge.

Employer-based tax

4. In our earlier notes on this subject we have recommended an exemption for car parking and others who have commented have in general agreed. This was, however, in the context of an employee-based tax. If a large part of the benefit charge generally is to be transferred to the employer there is perhaps a somewhat stronger case for a charge on employers since it would fit in better with the general system. But many of the practical difficulties we have identified in looking at the facts and circumstances of each space would remain

- not all spaces are wholly a benefit: some would be supplied wholly for business reasons, others partly so and this would have to be taken into account;
- for many employers with on-site facilities the cost of providing the space would not be readily ascertainable; but anomalies would arise if such spaces were exempted and only spaces away from the employer's premises were chargeable.

If the employer were to be liable, for the reasons already suggested, a special fixed charge would probably be the only practical way of quantifying the charge. Other difficulties, for example environmental considerations, would remain.

CAR TELEPHONES

5. There have been a number of articles in the Press drawing attention to a possible benefit charge where a car telephone is supplied by an employer. The evidence so far is that the accountancy profession sees a potential charge here and not that the Revenue has sought to collect tax. However, following the press speculation we have been receiving a growing number of enquiries on this point and given that the number of car telephones is expected to increase rapidly it will be necessary to give guidance to the profession and to local offices soon. A Statement of Practice should be all that is necessary to clarify the position.

The tax position

(a) Company Cars

6. Where the telephone is included in the cost of the car there is no separate benefits charge if it is used privately. The normal car scale charge will run and the telephone will only affect the scale charge if it pushes the total cost over the threshold for more expensive cars (£19,250 and £29,000) at which higher charges apply. This applies whether the manufacturer offers the telephone as an optional extra or the customer simply arranges for the car dealer to fit the telephone for him (this treatment already applies to radio/cassette players).

7. Where, however, the telephone is acquired and fitted separately the question is whether it is a separate asset giving rise to a separate charge within the benefits legislation in relation to any private use. If so, the charge would be the private use proportion of

- the greater of the "annual value" of the car telephone (the legislation provides rules for ascertaining this) or the rent or hire paid by the employer; and
- the total of any other expenses incurred by the employer eg the installation charge, monthly subscription and call charges.

8. There is a provision in the benefits legislation (S62(1)FA 1976) which provides that where the car benefit scale charge applies no further charge arises to any benefit in connection with the car (apart from the provision of a driver). In practice we think the Courts would take the view that the provision of a telephone which is installed in the car and cannot be used separately from the car would be exempt from a separate charge by virtue of this provision.

9. There is another point to consider where a car telephone is used for business purposes, the employee would be entitled under

the normal Schedule E rules for a deduction for the business calls he makes. With this in mind some accountants have advised employers to make it a condition of installing a car telephone that it is used for business calls only. Given the cost of such calls many employers would do this as a matter of course. Where there is no private use there could in any event be no question of a charge arising. In practice private use could be difficult to establish especially if this is forbidden by the employer.

(b) Private Cars

10. There is also the question of a telephone supplied in non-company cars. In practice these are likely to be rare. However it could be that a local authority (or other public body) sees the need for some of its officials to have car telephones. Provision of a telephone in these circumstances would be a benefit, though to the extent that it was used for business the employee would be able to claim an offsetting deduction.

11. Car telephones are expensive to install and it is unlikely that many employers would supply one in a private car except for business purposes. There is a parallel with the telephone provided in an office which is exempt where it is used solely for business. In practice private use is disregarded on cost effectiveness grounds. In principle the same treatment should apply to car telephones.

Statement of Practice

12. With the growing use of car phones and with increasing interest in the tax position where they are supplied, we think, if you agree, clarification of the tax treatment would be helpful. What we suggest is a Statement of Practice saying that that no separate charge arises where a car phone is supplied for use in a company car to which the scale charge applies. The Statement could also say that in practice we accept that no charge arises where an employer provides an employee with a car telephone for business use.

An early statement should prevent this becoming an unnecessary problem. If you agree, we will prepare a draft for your approval.

CARS FOR FAMILY MEMBERS

13. This is a very minor issue which we mention here simply because we are looking at the whole range of car benefits. Though not controversial, it is exactly the sort of detail we would need to consider if we transfer the charge on benefits to employers and that is another reason for mentioning it now.

14. Put very simply the point arises where two (or more) members of a family - usually a husband and wife - work for the same company and both are provided with cars.

15. The benefits legislation provides that where an employer provides a car for a member of a director or higher paid employee's family, the car is deemed to be provided by reason of the director/employee's employment. There is also provision that where an employee is liable to a scale charge on more than one car the charge on the second (and subsequent) car is to be at one and a half times the normal rate. What these rules prevent is the charge to tax on a company car (or cars) being avoided by the simple expedient of making it available to the employee's spouse or other member of the family - in most cases of course that person will not be an employee of the same company.

16. Where members of the same family work for the same employer, but only one of them is a director or higher-paid the result is the same. Only the higher paid employee is liable to the charge, so second and subsequent cars are charged at the higher rate. There is, in theory, an exception - where the lower paid person can show that his/her car was supplied by reason of the employment and not family relationship. The charge would be restricted to the normal rate. This situation seldom arises in practice.

17. The position becomes complicated if they are all directors or higher paid. Each is then liable at the normal rate on his/her own car and at the higher rate on the others' car. Thus a couple are strictly liable to 5 times the normal rate on 2 cars ($2 \times 1 + 1 \frac{1}{2}$). In practice where these circumstances apply we assess each member of the family on the benefit of his or her own car. Strictly this is a concession, and ought to be published.

Next Steps

18. The next steps depend on decisions on the broader issues. If charge is transferred to employers there would be a case for requiring employers to pay tax on each car provided for an employee and/or members of his family at the normal rate. Higher or lower rates are a complication which if possible we would want to do without. Moreover, as Paper A points out if the scale charges are to be increased to a realistic level the need for a higher rate goes.

19. You will no doubt want to defer a decision on this subsidiary point until decisions on the basis of charge and the level of the scales have been decided. If the result is

- (a) a switch to an employer based system, and/or
- (b) an increase to realistic scale charges,

the question of the level of charge on multiple car families could be swept up. If not, the present concessionary treatment, if it is to continue, should be published.

20. Summary

The points for decision are

Car Parking

- (i) should the benefit be exempted or subject to a fixed scale and

- (ii) should the charge be left with employees or transferred to employers.

Car Telephones

- (iii) May we issue a statement of practice clarifying the treatment of car telephones installed in company and private cars.

Cars for family members.

- (iv) If decisions on more substantive issues do not resolve the position where an employer supplies more than one car to the same family our present concessionary practice should be published.



£8,500 earnings threshold

EXTRACTS FROM
MINUTES OF
MEETING OF 21 JULY

Cars, taxis, petrol, car parking etc

13. The Chancellor said that these issues straight away raised the question of raising the £8,500 threshold. With considerable reluctance, he had come to the view that we would be unable to find a way through these problems without a substantial increase. That would certainly help the position on taxis (and - incidentally - on workplace nurseries). The new, higher threshold must also apply to private medical insurance: there could be no question of treating that more harshly. The Chancellor asked for a note on various options for what the new higher threshold might be: it should be at least enough to ensure no basic rate taxpayer was caught, but could be higher.

Company cars

16. For company cars (and related petrol) the Chancellor thought there were two options: either a nil threshold with existing scale charges, or the new higher threshold with much steeper scale charges. He asked the Inland Revenue to prepare a paper on the advantages of each option. The Financial Secretary thought the nil threshold would be much less unpopular; there were few people earning less than £8,500 who had company cars. But this option would produce no staff savings for the Revenue, whereas a higher earnings threshold which did apply to cars would produce substantial savings.



Inland Revenue

Policy Division
Somerset House

LEWIS
→
CH/EX
20/10

Ch/ This is the clutch of pps.
Mr Isaac promised. Do you
agree with the procedural suggestions
at 'X' + 'Y' below?

FROM: P LEWIS
DATE: 20 OCTOBER 1987

Chancellor of the Exchequer

25
21/10

BENEFITS IN KIND: TAX ON EMPLOYERS, AND CARS
MEETING MONDAY 26 OCTOBER, AT 3 O'CLOCK

1. This meeting was arranged some time ago to deal with the whole clutch of outstanding issues on cars - the car scales, the car fuel scales, car parking etc. Angela Rhodes will be sending you shortly papers on these issues, and an annotated agenda.

2. Meanwhile, Mr Isaac has sent you today further notes on an employer based tax.

3. Unless there is time for a meeting on the employer tax this week, you may like to consider whether it would be preferable for Monday's meeting to take first the new papers on the employer tax (I imagine the cast list would be much the same).

4. The case for doing so is twofold. First, that is the more important and urgent topic if there is to be a quite substantial piece of legislation prepared for the 1988 Finance Bill. Second, the approach to all the open issues on benefits is coloured - to a greater or lesser extent - by whether the tax is, in form, to continue to fall on the employee, or to be paid by the employer.

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mr Scholar
Mr Cropper
Mr Tyrie

Mr Battishill
Mr Isaac
Mr Painter
Mr Beighton
Mr Lewis
Miss Rhodes
Mr Prescott
PS/IR

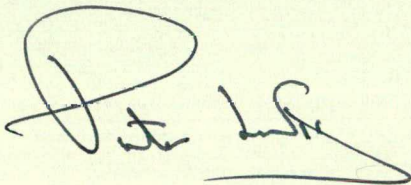
5. Miss Rhodes' papers will raise a large number of issues and I doubt if there would be time to have a full discussion of them all, as well as the employer tax. We will probably do well if we can cover in the time available

- the employer tax
- the main issues on car scales
- (possibly) car parking ??

6. That would leave two further groups of issues (which you might wish to invite the Financial Secretary to consider initially).

7. First, the car fuel scales. These are now used for VAT as well as income tax purposes. The particular interests of Customs (and the Paymaster) in the VAT aspects might best be handled at a separate meeting.

8. Second, there is a group of secondary issues relating to cars and the car scales. These probably merit a separate meeting to themselves - and we might need to provide further advice on some of them in the light of your approach to the employer tax and the main car scales.



P LEWIS



Inland Revenue

The Board Room
Somerset House
London WC2R 1LB

FROM: A J G ISAAC
20 OCTOBER 1987

ISAAC
→
CH/EX
20/10

CHANCELLOR OF THE EXCHEQUER

AN EMPLOYER-BASED TAX ON BENEFITS IN KIND

1. I attach a further note on this subject, for your promised meeting.
2. In this (again more highly classified) covering note, I try to pick out a few main questions, and relate them to the wider Budget options.
3. First, can we achieve your objectives, by a staged approach (along the lines of paragraphs 3 to 22 of the note), under which we should tackle in the first instance a relatively small number of high yielding benefits (and possibly some other much less important, but very straightforward benefits), which do not seem likely to pose severe compliance problems either for employers (including in particular the small employer) or the Revenue? Would this leave sufficient scope for further work, and consultation with employers, on the scope for extending the base of the new tax subsequently?

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mr Scholar
Mr Cropper
Mr Tyrie

Mr Battishill
Mr Isaac
Mr Painter
Mr Beighton
Mr Lewis
Miss Rhodes
Mr R H Allen
PS/IR

4. Would this also be consistent with keeping the 1988 legislation within a manageable scale?

yes
5. Second, do you regard it as essential that employers should make payments of tax "in-year"? Or alternatively, would you be prepared to accept an "end-year" payments basis? That would be easier for employers to operate from the outset - but it would mean a transitional year in which the Exchequer would receive no tax on the benefits involved (perhaps £500 million or so under the "staged approach") either from employers or from employees.

(but what else are things?)
6. Third, should we plan on the basis of a 1990-91 start? So far as we can see, this is the earliest possible date for an "in-year" system - either for employers or for the Revenue. We have considered whether it would be possible to bring forward the starting date for an "end-year" system (in which employers would need to keep records from April 1989, but not need to make payment until after April 1990). On the basis of the work so far, we believe that this could well cause considerable difficulties for some (though probably not all) employers; and it would also carry serious risks for our own BROCS and other programmes. If you wish, we should of course put in hand some further work, to see if there is any way of reducing the difficulties and risks to a manageable level; and if so, at what cost. However, the eventual conclusion may be that a 1989/90 start is not realistically practicable, for an "end-year" system, as it is not for an "in-year" system.

7. Fourth, the rate of tax will obviously be crucial, if the scheme is not to encourage employers to provide additional tax privileged benefits for their high paid employees. The wider Budget context looks likely to open up new options here. Thus, at the present top rates of tax, you would need a "tax exclusive" rate of 150%, if you wished to avoid giving the most high paid employees a new tax privilege for benefits in kind; and this would imply - even with coverage restricted to the main benefits - a massive increase (some £1,300 million) compared with the present overall tax burden on benefits. If the top rate of

tax comes down to 35%, the flat rate of the "employer's tax" needs to be no more than 54% to achieve income tax neutrality as between cash and benefits for the high paid. This implies an increased yield of about £130m compared with the present regime (with effective income tax rates ranging between nil and 60%/150%). Would something of this kind be acceptable, with tax on some benefits rising moderately, whilst tax on cash salary and wages (and other benefits) falls sharply?

8. Would you wish to go further, and claw back some or all of the present NIC advantage for benefits? For example:-

- if you abolish the employee's NIC UEL, you would need an employer's benefit tax rate of around 80% (yielding an additional £450m compared with the present system), if you wished to be sure that there was no new incentive (taking tax and NIC together) for employers to pay benefits instead of cash to the high paid;
- if, at the extreme, you wish to aim for total "neutrality" for the high paid (covering tax and both employer's and employee's NIC) you would need an employer's rate of around 100% (yielding perhaps an additional £700m).

9. All this takes no account of the yield from any possible effective widening of the tax base. Some possibilities are touched on in Annex C; and we shall be letting you have a note shortly on raising the car scales to a more realistic level.

10. For the next steps, you have spoken to the Australian Treasurer about a visit by a small team, and we are writing to our opposite numbers in Australia and New Zealand.

11. Meanwhile, in the light of your decisions on the main questions raised in this note, do you see the options discussed here as offering scope for an employer-based tax which would fit in with your wider Budget strategy for 1988? And are you content

with the implications for the consequent switch in the tax burden from employees to employers; and do you want to see further work on the implications for the treatment of the self-employed?

Yes

Yes?

A J G ISAAC

conqueror

MI



Inland Revenue

The Board Room
Somerset House
London WC2R 1LB

Handwritten in red:
Mum What
Lynn ~ 1981

FROM: A J G ISAAC
20 October 1987

CHANCELLOR OF THE EXCHEQUER

AN EMPLOYER-BASED TAX ON BENEFITS IN KIND

1. We had a very brief word about this at the end of your meeting on 12 October. You suggested a meeting, and I said we should very much welcome that. Meanwhile, this note reports the result of some further work here, following your note of 5 October, together with some at least initial answers to the questions in that minute.

POSSIBLE FIRST STEPS

2. As we see it, a number of factors come together.
- Legislation.
 - Compliance implications for employers generally.
 - Implications particularly for small employers.

cc	Chief Secretary	Mr Battishill	Mr Deighton
	Financial Secretary	Mr Isaac	Mr Bush
	Paymaster General	Mr Painter	Mr Nield
	Economic Secretary	Mr Rogers	Mr Northend
	Sir P Middleton	Mr Pollard	Mr R H Allen
	Mr Cassell	Mr Matheson	Mr Prescott
	Mr Scholar	Mr Cherry	Mrs Tournoff
	Mr Cropper	Mr Calder	Mr I Stewart
	Mr Tyrie	Mr Beighton	Mr M J Hodgson
	Mr Jenkins (Parl Counsel)		PS/IR
			Mr. Lewis
			Miss Rhodes.

ISAAC
→
CH/EX
20/10

- Operational implications for the Revenue.
- Scope for consultation.

I bring these factors together in paragraphs 20 to 22 below, to suggest a possible next step forward.

Legislation

3. The Australian legislation runs to over 160 Finance Bill clauses and over 140 (happily smaller) pages of legislation. However, the Australians started from scratch. We already have legislation on the statute book, imposing the substantive charge to tax.

4. We have not yet discussed the possibilities with Parliamentary Counsel. On the face of it, however, it ought to be a less massive task, to switch the legislation from an employee base to an employer base, and to make only those adaptations in the charge necessary for that purpose; and it might be possible to shorten the legislation further by (possibly controversial) use of regulations. As against that, the present legislation has been built up piecemeal over successive Finance Bills and amendment across the board would be unlikely to be wholly straightforward. For example, (and simply by way of a guess, for illustration), if we had a broad based tax, and could cut the legislation down to something like one-third of the Australian total, that could add up to 40 pages or so: still a formidable late addition to an already heavy Finance Bill. A more narrowly targeted tax might be more manageable.

Compliance implications for employers

5. There are two main bundles of issues here, concerning what employers might be asked to do, and when they might be asked to do it.

6. On the coverage, our provisional view is that it should not present employers generally with any intolerable compliance problems,* if the tax included the "pure" benefits, on the lines of paragraph 21 of my note to you of 23 September. That might include cars, fuel, medical expenses and insurance, and (perhaps) accommodation; and perhaps a few other similar but smaller items. As I said in that note, the employee is very unlikely to substantiate a claim that these costs were incurred "wholly, exclusively and necessarily in the performance of his duties"; and possibly rules for this purpose could be written into the legislation. You might also need to eliminate the threshold and simplify the rules further (paragraph 11 of my covering minute) even at the cost of some additional rough justice. If that were done, however, the employer's responsibilities here would simply be to record the expenses, add them up, and pay over the relevant tax to the Revenue. He would not need to negotiate with his employees about their individual circumstances, or eligibility for tax relief.

7. By contrast, there are obvious potential compliance problems for employers in the intermediate range of benefits (paragraph 23 of my earlier main note).

- At present, the employer's responsibilities are simple. He has to record, and report on the P11D, that he has (say) sent an employee and his wife on a visit to California,⁽ⁱ⁾ or paid motor mileage allowance of (say) £1 a mile to an employee who has done 10,000 miles of business motoring.⁽ⁱⁱ⁾ It is then a matter for the employee (not the employer) to negotiate with the

*They would, of course, still face the "tax shift".

(i) An expense which may in principle not be allowable for tax

(ii) An expense for a purpose which may in principle be allowable but which may be of amount so great that it contained a taxable element of profit.

Revenue whether the wife's visit was a genuine business expense, not a personal freebee, or whether the employee's costs really added up to as much as £1 a mile.

- Under an employer-based tax, the employer would have to take that judgment for himself. If he chanced his arm - and if his error was picked up on PAYE audit or otherwise, he - not the employee - would be liable to make good the tax lost.

The Australians seem to have persuaded their employers to shoulder this responsibility (this is one of the things which we would want to discuss with them). But past experience suggests that it would present great problems and indeed British employers would strenuously resist it. This is the main area where we would see virtue in prior consultation - rather than risk bringing forward legislation in 1988 which (as happened in 1981) the Government is subsequently forced to withdraw.

8. On timing, our experience is that employers generally (some of course could manage it faster) need to be given at least 12 months to make substantial changes in their PAYE procedures. Thus, if legislation is on the Statute Book by the summer of 1988, with any detailed regulations following that Autumn, employers generally would not be in a position to pay the new tax in 1989/90, and some could well be in difficulty if they were asked to set up an appropriate new recording system from the beginning of 1989/90, even if they did not need to make payment until the following financial year.

9. There may also be a rather wider point. To the extent that employers, in the interim period

- either cut benefits and raise cash remuneration to escape the new tax

- or maintain benefits and cut cash remuneration (as compared with what it would otherwise have been) to claw back the cost of the new tax

there may be a period of turbulence in pay settlements, and there may be advantage in allowing a reasonable period for adjustment.

Small employers

10. As we see it, the position of small employers might be in some ways more difficult than that of employers generally, but in other ways perhaps a little easier. (For the sake of completeness, we have considered the possibility that there might be different rules for large and small employers; but the complications here make this look most unattractive).

11. On compliance, the issues for small employers look to be much the same as those for bigger employers, but writ large. Thus, we do not at present foresee intolerable problems for a narrowly targeted tax on the pure benefits. But small employers would probably have less ready access to in-house professional advice if they were required to operate an employer-based (and therefore self-assessed) tax on other more debatable benefits.

12. As against that, the small employer might, if anything, face a smaller problem from the shift in the tax burden (paragraphs 6 to 10 of my earlier note). In the archetypal small company, the main benefits will be paid to the controlling directors. In this kind of company, it is perhaps a matter of formal accounting, rather than real substance, whether the tax is paid by the company, or by the directors.

Operational considerations for the Revenue

13. The simplest operational course (and in the circumstances probably the only viable course) would be to let employers pay the new tax - and require our accounts offices to bring it to account for all immediate practical purposes as if it were PAYE.

The employer would, however, be required on his end of year return to report his liabilities to us under the separate heads of PAYE and benefit tax; and we would then sort out the final accounting accordingly.

14. The main risk here is that we should need to bring a new tax into account at precisely the same time as, or shortly after, we are changing from the existing accounting system to the first phase of BROCS. That is the sort of thing which the textbooks and our private sector consultants tell us that a prudent business seeks never to do. If implementation of BROCS were to suffer in consequence, the costs are potentially very high, in disturbance to the flow of revenue, public expenditure savings forgone, and in the general credibility of the Revenue's systems.

15. Thus, we have looked at the implications if you wished to aim for a 1989/90 "end year" system, with employers keeping records for 1989/90 (but see paragraph 8 above) and paying the tax for that year soon after the start of 1990/91. This would be precisely the time at which the accounts offices and local collection offices were switching over to phase 1 of BROCS (and there are associated changes to COP which affect local tax offices as well). This will in any event be a delicate and testing period. We should be adding a new operational job of some magnitude - we think there are over 200,000 employers who pay benefits - at the same time, together with the need to deal with the confusion, questions, complaints and general hassle that are bound to accompany the first instalment of a new and potentially controversial tax on employers. It must be a high risk strategy. If you wish to keep it in play, we should need to do some further work to see if it is possible to reduce the risk to manageable size.

16. The more promising alternative would be to bring in the tax for 1990/91. This might be either "in-year" - with instalment payments made by employers beginning in, say, June 1990 (in a lump sum alongside PAYE, with no supporting documentation) - or on an "end-year" basis, with the first payments being made after

April 1991. On either basis, the different Revenue offices involved would not feel the full impact of the new tax until after April 1991, when phase 1 for BROCS should (we hope) be in place.

Consultation

17. We imagine that you will wish to plan on the assumption that employers would not welcome the new tax.

- They would face at least a formal - and very large - shift in the tax burden, off the shoulders of their employees on to their own shoulders.
- It would reduce the number of P11D forms they needed to complete - even a narrowly targeted tax might reduce numbers by some half. But they would, of course, need to keep the records necessary for the new tax.. And the P11D system would inevitably remain in place for other benefits and expenses. It is difficult to see this as a net reduction in their compliance costs.

✓ As we see it, this makes it the more necessary to do what we can to ensure that compliance costs of the new system are not unnecessarily high or a fortiori impracticable.

discuss
18. We ourselves see a strong case for consulting employers, before committing the Government to firm proposals (for example) to

- extend the new tax to the "intermediate" benefits (paragraph 7 above) or perhaps to other benefits which are not now taxed (luncheon vouchers? miners' coal? directors' dining rooms?). How would employers see themselves taxing these? How far would they see a need for prior negotiation - perhaps on a triangular basis with employees and tax offices?

19. On a rather different aspect, it seems to us that employers could benefit in two respects from a reasonable interval between legislation and implementation.

- Operationally, to put the new payment systems in place (paragraph 8 above).
- In salary and wage negotiations (paragraph 9 above and paragraph 7(b) of my earlier note). Where the employer knows that he is going to take over a substantial tax liability from his employees, he may have an opportunity at least to withhold or reduce any salary/wage increase which he would otherwise have awarded in his next pay review.

Summary

20. Pulling these considerations together, we see possible scope for a staged approach to an employer-based tax.

21. In the first stage, employers would pay a narrowly targeted tax, focused on the pure benefits. This would minimise their potential compliance costs. Even so, it would affect 1.4m employees, reduce the number of P11Ds (on the present basis) by about 60% and simplify almost half the remainder. A 1990/91 start looks possible. The legislation might be of a manageable length for the 1988 Bill (we have not yet consulted Parliamentary Counsel).

22. The second stage might then be to consult employers on broadening the base of the tax to include some or all of the "intermediate" benefits, if you wish; and/or to bring new benefits within the charge to tax; and/or to seek for other simplifications in the system.

OTHER ASPECTS

? discuss
MCS

Basis of tax

23. In principle, the tax might either be deductible to the employer, or non-deductible.

24. In favour of a non-deductible tax, it can be argued that

- the Australian ^{law} tax is non-deductible; ~~that is not?~~
- other things being equal, a non-deductible tax can yield more revenue, for lower nominal rates;
- benefits in kind (NB: unlike cash wages and salaries) would then entail the same cost for all employers.

25. In favour of a deductible tax, it can be argued that

- this is the only consistent basis on which one can judge whether the new tax is more onerous, or less onerous, than the present system;
- similarly, it is the only consistent basis on which one can judge the neutrality of the tax: whether there is a tax advantage or disadvantage to an employer in paying in benefits rather than cash;
- it is the correct approach in principle (benefits are part of the costs which an employer faces, in recruiting and motivating his workforce);
- refusing to allow employers a deduction could therefore add unnecessary aggravation to what may in any event be a controversial charge.

26. In this note, as in my earlier note, I make the working assumption that the tax will be deductible for employers.

Subject to any new thoughts from the Australians and New Zealanders, our provisional inclination is that this will in practice be the better approach.

Rates of tax

27. You asked for more information about the changes in the relative burden of tax. There are three main classes of employees concerned:

- People liable for higher rate income tax.
- People liable to basic rate income tax on benefits.
- People in receipt of "1976" benefits below the P11D threshold.

Annex A gives further details of the numbers in each class and the amount of revenue at stake. You will see that

- 80% of the yield comes from three main benefits;
- approximately half of the yield comes from higher rate taxpayers;
- as one would expect, the problem of "other" (tailor-made) benefits is concentrated disproportionately amongst the higher paid.

28. It may help to illustrate the incidence more generally of the change to a flat rate charge, to note that if:

- i. the tax were confined to cars, fuel, and medical insurance
- ii. the P11D threshold was abolished, and

- iii. the tax were introduced on a revenue neutral basis, then
- the tax burden for higher rate taxpayers would fall by about £100 million;
 - the tax bill for people now paying basic rate income tax on benefits would rise by about £40 million;
 - the tax bill for people in receipt of "1976" benefits below the P11D threshold would rise by about £60 million.

All these figures are on an ex ante basis. That is, they make no assumptions about behavioural effects. In practice, the behavioural effects could be large but asymmetrical. That is, benefits (like wages) could be more or less "sticky" downwards (unlike the Antipodes we are not imposing a new tax where effectively none now exists). But we see considerable scope for expansion in the provision of benefits for the higher paid, if it became more attractive (in post-tax terms) to substitute benefits for cash salary.

Overall yield of tax

29. We give below some estimates of the possible yield of the new tax, on certain assumptions about rates, again on an ex ante basis. Annex B explains how the figures are calculated.

30. You have indicated that you would in principle be prepared to consider some increase in the yield. The following table gives a crude "ready reckoner" of additional yields at various rates of tax, corresponding to the marginal rates of higher rate tax. Thus, you need a rate of 150% (tax exclusive) to maintain the present tax charge for a top rate income tax payer at 60%, a

tax rate of 100% to correspond with the present tax charge for a 50% taxpayer, and so forth.*

Illustrative Tax Rates and Yields

Rate of tax paid by employers on benefits (a)	150%	100%	67%
Equivalent to income tax charge on employees at marginal rate of (b)	60%	50%	40%
Additional yield of narrowly targeted tax (c) £m	1130	570	190
Further yield if P11D abolished £m	210	140	100

- (a) tax exclusive, deductible against CT, or IT (Sched D)
- (b) tax inclusive " " " " "
- (c) cars, fuel, medical etc insurance.

31. None of these figures takes account of employer's and employee's NIC - payable on cash but not on benefits.

Lump sum expenses allowances, etc

32. You asked how we should handle these. In effect, we envisage that we should retain the present system.

- Thus, for example employers (if they did not have a dispensation) would continue to return on P11Ds their payments of motor mileage allowance. If the rate was higher than we would normally accept (if it was, say, £1 a mile), or the benefit appeared questionable on other grounds, we would take up the matter direct with

* See illustration in my earlier note.

the employee. Any tax would be collected from him either through adjustment to his PAYE coding, or by direct collection. (But it might be possible to introduce an employer-based system for mileage allowance - see Annex C).

- If (for example) the employer paid a lump sum representational allowance of say £10,000, he would in principle apply PAYE from the outset. The employee would make a claim to the tax office for expenditure allowable under the normal Section 189 rules. Again, this would be reflected in his PAYE coding, or a tax repayment.

Tax on employer or employee?

33. You asked about the Australian and New Zealand approach. So far as we can see, the Australian and New Zealand taxes are both separate (non-deductible) taxes on the employer, and are not regarded as employee taxes which are collected through the employer. We could explore the position in more detail - for example, national accounts classification - when we visit the Australians.

34. Though this is not necessarily decisive for the eventual classification, you will have seen that we envisage (paragraph 13 above) it being essential for operational purposes that the tax should be paid by the employer in a lump sum which includes PAYE.

List of benefits

35. You asked for a more detailed classification of benefits. A preliminary analysis is given in Annex C.

[LON]

A J G ISAAC

Number of recipients and amount of gross and net benefits and tax yield on
benefits - 1987-88

Basic Rate Taxpayers
Directors & Higher Paid Employees

Type of Benefit	Gross		Net		Tax Yield (£ million)
	Number of Recipients (thousands)	Amount (£ million)	Number of Recipients (thousands)	Amount (£ million)	
Cars	858	614	844	584	158
Fuel	544	337	544	337	91
Private Medical insurance	478	129	450	119	32
Expenses	334	495	149	34	9
Vouchers	78	17	77	17	5
Beneficial loans	11	5	9	4	1
Others	302	197	257	94	25
Total	1,344	1,793	1,292	1,188	321

ANNEX A

Jonathan

fn

morning

M. Schar rang about the benefits in kind meeting, to suggest we expanded the cast, since it had turned from being a technical meeting on automotive benefits to a 2nd Reading debate on the move to an employer-based tax. He suggests we need a cast more like that for the 12 Oct tax reform meeting, with different representation at the lower end.

uncertainties about how the proposed EC regime would mesh with national competition policies and the precise circumstances in which it might be applied.

Beyond that, though, there are more fundamental reasons for questioning whether Mr Sutherland is right to try to force the pace now. The most important is that EC governments still cannot agree on what they want from a Community merger policy.

Opinions are divided over whether the main emphasis should be on maximising competition or on facilitating industrial rationalisation through EC-wide and national mergers. West Germany favours the former goal, while Britain, France and Italy, in varying degrees and for different reasons, tend towards the latter.

Court of Justice among others—for slow and sometimes sloppy procedures. The commission is also unavoidably subject to a wide range of political pressures which do not always mesh easily with the interests of competition policy. In particular, there are obvious tensions between the commission's increasingly hard line on trade with Japan and maintaining the free access to the EC market which Mr Sutherland considers an important criterion for judging mergers.

Some would argue that the collegiate nature of the Commission enables such conflicting priorities to be reconciled efficiently. However, it is noteworthy that in the US and West Germany, the two countries with the most vigorous competition policies, anti-trust agencies

TASK FORCE SECRET

FROM: A TYRRE
DATE: 29/10/87
COPY NO 1 OF 5

CHANCELLOR

*Ms Propriet -
IR Committee?*cc Financial Secretary
Mr Cropper**EMPLOYER TAX ON BENEFITS IN KIND**

In general I am much less convinced that the whole benefits in kind area needs a radical shake up than I was a few months ago. PIIDS are a burden and car scales (but not petrol scales) are too low, but beyond these most of our problems have been caused by Revenue inspired absurdities. (In this context I notice that car parking is back in the Revenue paper!) As you know I think we should exempt these absurdities if they are 'self regulatory', that is, if the employer is himself trying to clamp down on them.

2. So having started out keen as mustard for an Employer tax I have reluctantly come round to the view that if we cannot get substantial simplification a new tax is not worth the candle. Neutrality would be the prize. But if we can get there only at the cost of an increased employer burden and probably at least as much complexity (running a new system as well as keeping the PIID's) I don't think it's worth it. The revenue yield is an important but not vital consideration.

3. Car Scales. The greater part of the increased yield would come from increased car scales. On these, the advantage with introducing an employer based system is that it would serve as a distraction, making it much easier to jack up the car scales. The Inland Revenue paper offers two possible targets for increases in scale rates to aim at. Option A would represent around a 250% increase, option B around a 400% increase.

4. But if we stick to a tidying up operation (increased car scales and exemption where appropriate) I don't think we could get away with increases of remotely this size. We would have to stick to salami tactics. So we would lose the increased yield as well as neutrality.

TASK FORCE SECRET

5. However, I do have one proposal which could increase the yield substantially and which I think is politically feasible, with or without an employer-based tax. Those who cannot show at least, say, 2500 miles' business driving (why not make it 5000?) could pay a new scale at, say, Option A rates. This would replace the one and half times' scale provision which we already have for those driving less than 2500 miles. The Revenue already collect the necessary information.

I think that, particularly with a higher floor of 5000 miles, commodity brokers in the City, directors' wives, and the like would find it very difficult to show that kind of business mileage and a significant number of people who have company cars would be caught. People would cheat their mileage but they do that already. The Revenue have been asked to look at this proposal.

AGT.

A G TYRIE



Inland Revenue

Policy Division
Somerset House

Copy no 1 of 18

FROM: P LEWIS

DATE: 22 OCTOBER 1987

LEWIS
→
CH/EX
22/10

Chancellor of the Exchequer

CAR BENEFITS

1. I attach three papers (more widely circulated than this note) by Miss Rhodes on

- a: Car benefits
- b: Car fuel
- c: Car parking and other topics.

2. I also attach (immediately below) an annotated agenda which seeks to identify the main points for discussion and decision.

3. If there is not time to cover all this ground on Monday, it would be best to concentrate on the first paper which raises the main issues.

4. Customs have agreed the car fuel paper, and Treasury have seen all the papers in draft.

5. The papers take into account - in a preliminary way - the possible introduction of an employer tax. They do not take into account the main IT/NIC package for 1988. Since all three proposals entail, or may entail, phasing or timing points, it may be helpful to summarise the timetables:-

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Scholar
Mr Cropper
Mr Tyrie

Mr Battishill
Mr Isaac
Mr Painter
Mr Beighton
Mr Lewis
Miss Rhodes
Mr Mace
Mr Eason
PS/IR

	1988/89	1989/90	1990/91
Main package	Phased proposals affecting all three years for announcement in 1988 Budget		
Employer benefits tax			Start date April 1990?
Car scales	Already announced	For announcement 1988 Budget	Possibly for announcement in 1988 Budget in connection with employers tax and/ or phasing toward realistic levels

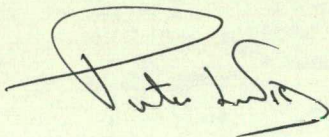
6. The first note touches briefly on the possibility that you might wish to decide and announce (and possibly legislate also) next year figures for the main car scales for four years ahead to phase in scale charges at a more realistic level. If you wished to do this and introduce an employers tax the increased scale figures would apply to employees for only one year (1989/90) until the employer tax started. A further option would thus be to have a different increase for the last year employees would bear the tax, and to defer the start of phasing until the employer tax came into operation. This would avoid awkward interactions with the main package - see next paragraph - but you would then need to consider how switching the tax to the employer, coupled with a programme for increasing the tax base, would be presented in the context of the impact of the rest of your Budget on business.

7. If, on the other hand, you decided against the introduction of an employer tax, phasing increased car scales in would need to be considered solely against the background of the main package. On this the main points seem to be

- the prospect of significant tax reductions would offer the ideal launching pad for more realistic car scales

- but the timing is awkward because people would enjoy their tax reductions in 1988/89 before having to start to pay on increased scale charges in 1989/90.
- increased car scales would produce some further losers, and increased losses, from 1989/90 (the top of the present basic rate band, where most of the losers from the main package fall, probably contains a lot of company car people - there are about 300,000 in the income range £18,000 to £25,000)
- if you decide against any significant change in the general approach, special action on expensive cars might nevertheless be a possibility (their users will in general have large gains from the package, they are mostly pure perk, and these cars are particularly undervalued - but there are also special industrial considerations)

8. Insofar as the tax continues to fall on the employee, we would, of course, need to marry up, as far as possible, the distributional analysis of any possible changes to which you were attracted here with the analyses of the main package.



P LEWIS

CARS: ANNOTATED AGENDA

CAR SCALES (PAPER A)

1. Do Ministers share the general perception that company cars are now taxed at a small fraction of their real value to the employee? (Para 6-22 and Annex B)

2. If so, do we continue with the present strategy, of raising the scale rates by something more than indexation each year. (Little progress to date in reaching realistic levels - para 10). Or does the 1988 Budget (through the main package or the introduction of the employer tax) provide an opportunity for something more radical (para 28)?

3. If Ministers wish to pursue a more radical approach, what should be the target?

- ~ Scale rate charges, reflecting 50% of standing charges (paras 12-14). (Do Ministers believe it is right in principle to mitigate the full cost charge to recognise a proportion of business use etc?)
- ~ Scale rates reflecting full standing charges (paras 15-22)
- ~ Employers' actual (average) costs, including interest charges? (paras 23-25)

4. If Ministers decide on a target, how should it be approached? In one "big bang"? Or in stages? If by stages, how quickly (paras 28-32)?

5. What should be the change for the first year now in issue, 1989/90?

6. If Ministers define a target to be approached through phasing, should the target and phasing be

- a. announced
- b. legislated

in 1988 (para 29)?

Mileage Rules (paras 36-40)

7. Should there continue to be a "surcharge" for very low business mileage cars, second cars, etc so long as the main scale rate is set at a level reflecting less than 100% of standing charges? But not otherwise? Should the "surcharge" remain at 50%?

8. Do "tool of trade" arguments justify the continuation of a 50% reduction for very high business mileage cars? If so, should something more be done for exceptionally high business mileage cars (say 30,000 miles per annum)?

Expensive Cars (paras 33-35)

9. Should there be a larger increase for expensive cars, if the scale rates are pitched at a level reflecting less than 100% of standing charges ("Tool of trade" argument hardly runs, large element of personal choice, relationship to package)? But not otherwise?

Industrial aspects (paras 18 and 19)

10. How much weight should now be placed on the familiar argument that preferential tax rates for company cars support British car industry? Does this justify:

- a. setting scale rates at less than 50% - or less than 100% - of standing charges? and/or
- b. a longer phasing in period?

11. Do Ministers wish to "fine tune" the limits for expensive cars, in the context of current market prices between competing British and foreign makes?

Diesel Cars (paras 43/46)

12. Do Ministers agree that there is at present little case for a special scale of diesels?

Cars without a regular cc engine (paras 41/42)

13. (It is) worth tidying up the provisions by repealing this scale?

An employer-based tax

14. How far would a change to an employer-based tax alter the balance of arguments above? Would it make increases easier, blurring any precise comparison between increased charges and benefits, and improving (from 1990/91) instead of worsening the balance of losers and gainers from the Budget package? Or, would increases be more difficult, adding further to employers' costs, which would be increased anyway by the new charge?

15. At the more detailed level, would it remain best to stay with a scale rate charge for cars? Or would an employer-based tax significantly and sufficiently reduce the cost and complexity of basing the tax charge on actual costs? (Simplicity versus accuracy.)

16. Would it also be necessary (to reduce employers' compliance costs) to drop the special rules for high and low business mileage cars? But not the special rules for second cars and cars for the employee's family?

17. If the employer-based tax comes in in 1990/91, would this be an argument for postponing any major change until then? Or for making at least a significant first step in 1989/90?

CAR FUEL CHARGE (Paper B)

18. Is the balance of argument in favour of holding the fuel charge at its present level for 1989/90? Or reducing it by (say) 10%, forgoing about (£30 million) of the yield from the increase in the car scales? (Is it agreed that the present fuel charge is probably a little high, but not wildly so? How much weight should be placed on the VAT problems with the self-employed?)

19. Are the considerations much the same if we have an employer-based tax?

OTHER CAR TOPICS (Paper C)

Car Parking (paras 2-4)

20. Do Ministers remain of the view that the balance of advantage probably lies in exempting car parking? (Difficulty of identifying "private" benefits enjoyed by individuals, as against "business" use; difficulty of identifying employers' actual costs, large numbers of small benefits, as well as a small number of large benefits; the risk of driving cars on to the streets).

21. Would an employer-based tax alter the balance of the arguments? (No longer need to identify individual beneficiaries, and no need to tackle large numbers of small beneficiaries. Other issues much the same.)

Car Telephones (paras 5-13)

22. These are expensive and growing rapidly in number. Should we issue a statement of practice clarifying the tax position - in effect, private use would not lead to an additional tax charge?

Family Cars (paras 13-20)

23. This is simply a point to note, until the wider issues are resolved.



Inland Revenue

Policy Division
Somerset House

FROM: MISS A M RHODES

DATE: 22 OCTOBER 1987

- Ch/ You may like to glance at these, but not put them into the meeting folder. The annotated version (Hinged) happens to be point for decision on car benefits. At the meeting you could perhaps take these in order after the main discussion on an employer-based tax.*
1. Mr Isaac *seen in draft*
 2. Chancellor of the Exchequer

BENEFITS-IN-KIND - CAR, CAR FUEL AND OTHER 'AUTOMOTIVE' BENEFITS

1. Mr Taylor's note of 12 August records your decision to hold a further meeting to consider all "car related" benefits together. Mrs Ryding's note of 25 August asks us to prepare an agenda for this meeting which has been fixed for 26 October.

2. Since then you have also asked us to look at the possibility of transferring the charge on benefits from employees to employers (Mr Allen's note of 4 September). Mr Isaac's note of 20 October, discusses that option, and Mr Lewis has suggested (20 October) that you may wish to discuss the employer tax first on 26 October, possibly limiting discussion of these items.

3. The following three notes are attached:

- A Car Benefit
- B Car Fuel Benefit
- C Other automotive matters

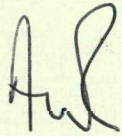
cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Kemp
Mr Scholar
Mr Cropper
Mr Tyrie

Mr Battishill
Mr Isaac
Mr Lewis
Mr Beighton
Mr Northend
Mr R H Allen
Miss Rhodes
Mr R Martin
Mr I Stewart
Mrs Tournoff
Mr Parker
PS/IR

RHODES
→
CILEX
22/10

which deal with the car issues in some detail. While their starting point is the present employee-based system they go on to take a preliminary look at the implications for the benefits concerned under an employer-based system.

4. There is one point to make in relation to an employer based tax which could not conveniently be made in the paper and that is in those circumstances should the charge be attached to the provision of a car and not the status of the recipient - in other words, should the threshold effectively disappear.



MISS A M RHODES

TASK FORCE SECRET

COPY NO 1 OF 16 COPIES

FROM: M C SCHOLAR
DATE: 28 OCTOBER 1987

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Cassell
Mr Kemp
Mr Riley
Miss Sinclair
Mr Michie
Mr Isaac - IR
PS/IR**BENEFITS-IN-KIND: EMPLOYER-BASED TAX**

The questions raised in Mr Isaac's Task Force Secret note of 20 October about the rate and coverage of the tax need to be considered against the objectives of the change which we are contemplating.

2. I take it that these objectives are:

- (i) to achieve greater neutrality between payment in cash and in kind, and to avoid creating a new incentive for the latter through the removal of the UEL;
- (ii) to make a break with the present system, under which the Revenue are obliged to tax increasing numbers of controversial benefits-in-kind;
- (iii) reduce compliance costs;
- (iv) reduce Revenue staff costs;
- (v) if possible, bring in some additional revenue.

(vi) reduce extent of payment in kind

SCHOLAR
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CH/EX
28/10

Rate of Tax

Say ~~50%~~ 45% - 50% non-deductible / deductible (see 45%)

3. It may be helpful to summarise the possibilities on all the different bases in the Revenue's papers

Rate of employer-tax required to achieve neutrality between cash and kind

A Basic rate (25%) taxpayer

	tax rate if deductible for CT (tax exclusive)	tax rate if* non-deductible for CT (tax exclusive)	tax rate on grossed up amount of benefit (tax inclusive)
A1 income tax neutral	33	21	25
A2 income tax/employee NIC neutral	52	34	34
A3 income tax/employee and employer NIC neutral	67	44	40

B Higher rate (35%) taxpayer

	<i>deductible</i> tax rate if for CT (tax exclusive)	<i>non-deductible</i> tax rate if for CT (tax exclusive)	tax rate on grossed up benefit (tax inclusive)
B1 income tax neutral	54	35	35
B2 income tax/employee NIC neutral	79	51	44
B3 income tax/employee and employee NIC neutral	97	63	49

*This rate would be neutral for tax-paying companies only. For tax-exhausted companies it would produce a disincentive against benefits relative to cash.

4. If we go for a tax rate equivalent to the new top rate of income tax plus employers' and employees' NIC (line B) we ensure that no-one would be better off receiving payment in kind than in cash. We thus appear to score well on objective (i). But we at the same time cause basic-rate taxpayers to be worse off receiving payment in kind than in cash. This should not, perhaps, concern us too much, since this would be a largely voluntary tax: few employers need - if given enough notice of the new arrangements - pay in kind rather than in cash.

5. But we could stop well short of this, as the Australians have done. They set their Fringe Benefits Tax at the same rate as Corporation Tax - 49 per cent; effectively higher than their income tax rates up to A\$35,000, but below the rate of 67 per cent which would be needed to achieve neutrality for their highest rate taxpayers. If we went for a rate somewhere between lines A3 and B2 we would be taxing benefits more harshly than cash for basic rate taxpayers, but less harshly for those on the higher rate. This would, no doubt, cause some switching from cash into kind for the highest paid. But they are a minority; and Mr Keating told you that there had been a marked reduction in benefits following the introduction of the tax, and he mentioned no problems about the different impact of the tax on different types of taxpayers.

Presentation

6. It might be possible to present the rate of tax as lower than the tax-exclusive and CT-deductible rates quoted in Annex B to Mr Isaac's longer paper. But we would join the Revenue in arguing in favour of deductibility, unless the presentational arguments against the higher rate of tax that would be necessary were regarded as decisive, or examination of the Australian tax (which is non-deductible) suggests that there are arguments which we have overlooked. And it would clearly not be plain sailing to present the rate on a tax-inclusive basis.

Coverage

7. Mr Isaac's proposals on coverage are designed to protect employers' compliance costs (objective (iii)) but they do not score well on objective (ii) because he envisages leaving all the non-targeted benefits exactly as they now are, to be covered by the PIID system.

8. Two alternatives occur to us:-

either (i) abolish the PIID, and rely entirely on the employer-tax. On the face of it it is not unreasonable to expect employers to know what proportion of the payments (whether in cash or subsistence, representation or

whatever) they make to their employees represent genuine business expenses - so a self-assessing system policed by audit ought not to be impossible. But if the 1981 experience, and the wish to protect employers' compliance costs particularly, rules this out, we will need a residual PIID to cope, at the minimum, with expenses.

or (ii) an employer-tax on selected high profile perks, say cars, fuel and medical insurance (which between them account for over 80 per cent of the tax on benefits); but with a 'catchall' provision, which would tax any benefit(s) received by an individual totalling in excess of, say, £500 apart from specifically excluded benefits (eg parking, goods consumed on employers' premises, third party entertainment, late night taxis etc); together with a residual PIID to cope with expenses.

MCS

M C SCHOLAR

*Must back our
hand this to page.
i.e. further hand for 'win' (over)
pages;
All for expenses as i
over the page.*

CONFIDENTIAL



FROM: J M G TAYLOR
DATE: 19 October 1987

MR SCHOLAR

BENEFITS IN KIND

The Chancellor has said there is one aspect of the proposed switch in the taxation of benefits in kind from the employee to the employers which has only belatedly occurred to him. What happens with those employers who are not liable to tax (eg HMG)? He assumes they must still pay the new tax, otherwise this would be seen as clear discrimination against the private sector.

2. I should be grateful for advice.

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

J M G TAYLOR

JMGT
→
SCHOLAR
19/10

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108
/10



FROM: FINANCIAL SECRETARY
DATE: 28 October 1987

CHANCELLOR

cc Mr Scholar
Mr Cropper
Mr Tyrie

EMPLOYER TAX ON BENEFITS-IN-KIND

I held a meeting yesterday to discuss the recent Revenue papers on this subject, prior to your own meeting later this week. I am afraid I think a good idea is in danger of being completely ruined by being made unnecessarily complex. Having been in favour of this tax I am now very doubtful about it.

2. There are perhaps two main objectives for us in the taxation of benefits-in-kind:

- (i) To simplify the system, and thereby to ease the compliance burden particularly on employers, from whom we receive endless complaints;
- (ii) To remove the present incentives to payment in kind (for those earning less than £8,500, and for others due to the NIC position).

3. I put a lot of weight on objective (i). Indeed if we cannot bring in a new system which is much simpler than the present one, my preference would be for staying with the present system but sharply increasing the P11D threshold (and exempting the irritating benefits such as car parking and so on).

4. As to "simplification" I have in mind two things:

- (i) Reducing the compliance costs for employers;
- (ii) Reducing Inland Revenue involvement and hence manpower.

TASK FORCE SECRET

TASK FORCE SECRET

5. On (i) it seems fairly clear that the new employer-based tax (EBT) would not score well. If we confined its scope to a narrow range of "pure benefits" as the Revenue strongly advise, we would be in a position where two systems ran together simultaneously - the EBT and the PllD. There would be a 60% reduction in the number of PllDs each year, but offsetting that we would be introducing a new tax for employers to assess and pay.

6. Of course, if we did not confine the scope of the EBT to "pure benefits", but extended it to all non-exempted benefits, then this would dramatically increase the employers' problems since they would - according to the Revenue - have to establish from employees what proportion of their expenses, for instance, was spent on non-allowable purposes.

7. But it is not entirely clear whether the Revenue will save much staff even if the employer compliance burden is increased. Estimates will not be forthcoming until the EBT is more clearly defined. What is clear is that fewer clerical man hours will be spent on PllD work and more on company audit work.

8. The Revenue advise, and I have no reason to doubt this, that the EBT will be extremely unpopular with employers:-

(i) Their compliance costs will rise;

(ii) They will face - at least in the short-run - a substantial increased tax burden.

9. This latter point brings me on to the most difficult issue of all - the appropriate tax rate. If we want to increase the tax-take from benefits-in-kind, to prevent a new tax incentive for higher rate taxpayers to be paid in kind and (in extremis) to close the NIC distortion, then this would point to a very high rate of tax indeed (between 54% and 100%). With a very high rate, of course, the provision of benefits to basic rate

TASK FORCE SECRET

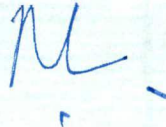
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disturbance)

TASK FORCE SECRET

taxpayers would become prohibitively expensive. I would have thought that many people and many employers would consider this inequitable.

10. On the other hand, if we are governed by the basic rate taxpayer's position, and set a lower rate, the Revenue strongly argue that a substantial new incentive will be created for higher rate taxpayers to be paid in kind. The Revenue believe that this would bring a flood of new benefits-in-kind and tax avoidance on a vast scale. I am sceptical about that. I note that the Australians tax benefits at the corporation tax rate.

11. Lastly, whatever we do on the EBT, I do not think that we should allow the Revenue to bring back car parking, third party entertainment and taxis on to the agenda; I can't think why car parking is mentioned yet again.



NORMAN LAMONT

TASK FORCE SECRET



Inland Revenue

TASK FORCE SECRET

Copy No 2 of 18

The Board Room
Somerset House
London WC2R 1LB

FROM: A J G ISAAC
28 October 1987

FINANCIAL SECRETARY

BENEFITS IN KIND: RATE OF EMPLOYER BASED TAX

1. I have been thinking further about the tension (discussed in my original note of 23 September) between

- the behavioural consequences if the rate of employer tax on benefits was less than the equivalent of the top rate of income tax. As I said, this would mean adding a new tax advantage for benefits, on top of a new 9% employee's NIC advantage (with the abolition of the UEL), on top of the existing employer's (10.45%) NIC advantage. I said that I foresaw significant - and perceptible - behavioural changes, if we set market forces operating in this way - above all amongst the very high paid, where the scope for this kind of distortion is notoriously greatest.
- the perceived unfairness, if the rate of tax was penal for basic rate taxpayers, going beyond "neutrality". You yourself saw this as a matter both of presentation, and of substance.

cc Chancellor of the Exchequer
Chief Secretary
Economic Secretary
Sir Peter Middleton
Mr Cassell
Mr Scholar
Mr Cropper
Mr Tyrie

Mr Battishill
Mr Isaac
Mr Beighton
Mr Lewis
Mr Weeden
Mr Prescott
Miss Rhodes
Mr I Stewart
PS/IR

ISAAC
→
FST
28/10

2. On reflection, it occurs to me that it might be possible to resolve this tension - or at least reduce it to a manageable level - by bringing more positively into the calculation the NIC (employee's and employer's).

3. To recapitulate, I think everyone agrees that the fundamental principle should be "neutrality": that the cost to the employer should be the same, and the advantage to the employee should be the same, whether the employee's remuneration takes the form of cash or a benefit in kind.

4. Following the 1988 Budget, it will cost approximately £670 in tax and NIC to put £1,000 (after tax and NIC) into the pockets of a basic rate (25%) employee (for the calculation, see illustration at Annex A). Thus, there is a cast iron argument in principle for a "tax exclusive" rate of 67% for an employer based tax on benefits, in order to achieve neutrality between cash and benefits for basic rate taxpayers - though this does, of course, mean clawing back the present NIC advantage for benefits.

5. For a taxpayer at the new highest rate of income tax (35%), we should (as I said in my earlier note) need an employer tax rate of

- (i) 54% to ensure that there was no new tax advantage (on top of the two NIC advantages) for benefits for the highest paid and
- (ii) just under 79% to ensure that there was no new tax and NIC advantage for benefits for the very highest paid on top of the existing advantage for employer's NIC).
- (iii) nearly 100% to achieve full neutrality, as at paragraph 4 for the basic rate taxpayer.

6. Thus, as I see it:

- A "tax exclusive" rate in the region of 70% could be justified as both going no further than achieving "neutrality" with cash salary for basic rate taxpayers (paragraph 4) and ensuring that there was little or no new tax/NIC advantage for benefits paid to higher rate taxpayers (paragraph 5(ii)).

- A "tax exclusive" rate in the region of 75% could probably be justified in terms of achieving broad "neutrality" for taxpayers overall.

7. If you think that it would help with the presentation to show these figures on a "tax inclusive" basis (following the precedent of VAT and income tax itself) these figures would be in the region of 41% and 43% respectively.

CLC

A J G ISAAC

Tax and NIC costs of paying £1,000 in net
(post tax and NIC) wages to a basic rate taxpayer

Assuming basic rate income tax of 25% (tax inclusive rate)
 employee's NIC of 9% (tax inclusive rate)
 employer's NIC of 10.45% (tax exclusive)

(a)	Gross wage	£1,515	
(b)	<u>Less</u> income tax at 25%		-379
(c)	employee's NIC at 9%		-136
	Net wage to employee (a-b-c)	£1,000	
(d)	Employer's NIC (10.45% of £1,515)		-158
	Total tax and NIC (b+c+d)		-673

CONFIDENTIAL

FROM: R G MICHIE
DATE: 20 OCTOBER 1987

1. MR SCHOLAR
2. MR J M G TAYLOR

*For BIK mtg
M..*

BENEFITS IN KIND

Your note of 19 October indicates that the Chancellor has asked for clarification of the position of employers who are not liable to tax eg HMG: the Chancellor assumes that they must still pay the new tax, otherwise this would be seen as clear discrimination against the private sector. That view must be right.

2. In Australia, the FBT legislation provides for the exemption of only three categories of employer:

- . public benevolent institutions; (neither are defined in
- . religious institutions;)Australian BIK law)
- . international organisations: employers who are exempt from tax because of legislation granting international immunities are also exempt from FBT on benefits provided to their employees. Organisations established under international agreements which oblige Australia to grant general tax exemption are similarly exempt (eg UNESCO).

3. Apart from these exemptions, FBT applies irrespective of whether the employer is exempt for Australian income tax purposes. This means that schools, universities, hospitals, clubs, societies, trade unions, local councils, government departments and authorities are all liable for FBT on benefits provided to employees.

We should record this point at Monday's meeting. If we go, in the first instance, for a limited coverage scheme it will have little impact on public sector employees; and the fact that they are not liable to tax will be of little consequence if we treat the tax as a withholding-type tax paid (like PAYE) by the employer in respect of the employees.

R. George Michie
R G MICHIE

M.L. 22/10

MICHIE
→
JMG
20/10

Number of recipients and amount of gross and net benefits and tax yield on
benefits - 1987-88

Higher Rate Taxpayers
Directors & Higher Paid Employees

Type of Benefit	Gross		Net		Tax Yield (£ million)
	Number of Recipients (thousands)	Amount (£ million)	Number of Recipients (thousands)	Amount (£ million)	
Cars	359	316	352	302	154
Fuel	230	160	230	160	77
Private medical insurance	246	96	243	94	41
Expenses	137	320	32	48	20
Vouchers	24	5	23	4	2
Beneficial loans	29	29	28	28	14
Others	152	168	126	118	50
Total	463	1,094	453	755	358

Number of recipients and amount of gross and net benefits and tax yield on
benefits - 1987-88

All
Directors & Higher Paid Employees

Type of Benefit	Gross		Net		Tax Yield (£ million)
	Number of Recipients (thousands)	Amount (£ million)	Number of Recipients (thousands)	Amount (£ million)	
Cars	1,217	930	1,196	886	312
Fuel	773	497	773	497	168
Private medical insurance	724	225	693	213	73
Expenses	471	815	181	82	29
Vouchers	102	22	100	21	7
Beneficial loans	39	34	37	32	15
Others	454	366	383	212	75
Total	1,807	2,888	1,745	1,943	679

Calculation of employer tax rates and yieldsExample of how figures in paragraph 29 calculated

Employee marginal rate		60%
Equivalent tax exclusive rate for employer		150%
Tax base (cars, fuel, medical insurance, 1987/88)	1596	
Tax payable by employer (gross)	2394	
Less CT/IT relief (estimate)	712	
Tax paid by employees	553	1265
Net yield		<u>1129</u>

Table of tax rates and yields

(The top half of this table is given in paragraph 29)

Tax exclusive employer's tax rate	150%	110%	67%
Equivalent employee marginal rate	60%	50%	40%
Additional yield - narrowly targeted	1130	570	190
Additional yield - " without P11D threshold	1340	710	290
Additional yield - all benefits	1370	690	230
Additional yield - " without P11D threshold	1580	830	330

ANX
B

CLASSIFICATION OF BENEFITS

This annex attempts a preliminary classification of the main benefits according to the relative ease or difficulty of bringing them within an employer based tax. Before taking a final view it would be necessary to examine each benefit in detail

- because the picture can be substantially complicated by subsidiary rules, or because the main rules have to apply to a very wide variety of circumstances
- to consider whether the switch from employee to employer taxation requires a change of approach
- to see whether any simplification is possible to ease employer compliance work.

A: LEADING CANDIDATES

- i. Car benefits (46% of current yield)
- ii. Car fuel benefit (25%)

These are prime candidates for inclusion, both because of the amounts of tax involved and because they are already based on broad-brush scale charges which turn on relatively few factors nearly all of which will generally be easily within the employers knowledge. Some further simplification may be possible with an employer-based charge.

- iii. Private medical insurance (11%).

This should normally be straightforward as specific payments for the insurance would be chargeable (less any payments made by employees).

- iv. Living accommodation

The charge here is more complicated - rateable value, with an extra charge for houses costing more than £75,000; and there is an exemption for "representative occupiers". The basis of charge will need to be changed as rateable values are phased out. Depending on the timing of that, and the start date of the new tax, the charge could either be introduced initially on the present basis, or from the outset on some new basis. As a large, easily identifiable benefit it should be suitable for inclusion, provided the new charging rules are kept reasonably simple.

- v. Other benefits

There is a group of other benefits under this heading which, collectively, do not produce a great yield, although they may be of substantial importance for individual taxpayers. They include

- a. payment of subscriptions, for example to sporting or social clubs
- b. payment of purely private bills, for example gas or electricity bills
- c. new or used assets (or goods) given free (or cheaply) to employees (either purchased directly by the employer or through vouchers)
- d. private use of assets other than cars and living accommodation

In each case there is a clear benefit and the amount of the charge is generally calculated in a straightforward way.

B: POSSIBLE CANDIDATES

i. Beneficial loans (2%)

The basic concept is simple - a tax charge on the difference between the interest which would have been payable at a prescribed official rate and the interest actually payable. But there are complications - many small cases, some of which will be below the £200 exemption limit; alternative bases of calculating the amount of the loan outstanding on which the interest calculation is based; and interactions with mortgage interest relief, the close company provisions, and PAYE. This looks a doubtful candidate, unless the rules could be considerably simplified.

ii. Shares acquired at under value

There are several complex provisions involved, and links to the beneficial loans provisions. Again, simplification looks a pre-condition.

iii. Scholarships

The problem here is that an exemption is available in certain circumstances, and the scholarship payments are usually made by trustees rather than the employer himself.

iv. Directors PAYE tax paid by the company and not deducted from his remuneration

This is an anti-avoidance provision which may be too complicated to include.

v. Loans released or written off

Arguably these are really "cash" remuneration which should continue to be chargeable on the employee rather than through the benefit tax.

C: ITEMS PROBABLY EXCLUDED

Expenses payments

Many of the expenses payments currently made are wholly allowable as genuine business expenses. Some are fully chargeable, for example if the employer pays the cost of home to work travel. Others are chargeable in part, for example where the occasion is wholly a business one but the expenses payments do more than cover the costs, or where there are mixed business and private purposes, for example the overseas visit which includes a holiday element. Lump sum/round sum payments are also often partly allowable and partly chargeable.

It might be possible to bring in the few payments which are wholly chargeable. But it would be very difficult to bring in the mixed case since they depend on the facts and circumstances of the individual case.

D: ITEMS WHERE AN EMPLOYERS TAX MIGHT ENABLE THE TAXATION TREATMENT TO BE CHANGED

There are a considerable number of problem areas with the present benefits charge where it might be possible to adopt a different approach with an employer base charge. Many raise complex and contentious issues which would need a good deal of further study. In brief, the topics we have identified so far are as follows

Car parking. With an employer based charge, the idea of a scale charge for parking spaces, levied on the employer, might be worth a further look. Alternatively, charging only specific payments for parking spaces fits rather better with an employer than an employee based tax.

Subsidised meals/sporting facilities/workplace nurseries

ii. These are all inhouse benefits which are generally provided for all or whole groups of employees rather than benefits specific to individual employees. Work place nurseries are chargeable at present, but the other two are not. In principle they should be chargeable; and a single charge on the employer is easier than a charge on a large number of individual employees who have enjoyed the benefits provided to widely varying degrees. But even so a special profit and loss type calculation would be needed to produce the aggregate benefit chargeable on the employer.

Luncheon vouchers

iii. Easy to charge in practice on the employer; but difficult to do while subsidised meals exempt.

Miners coal

iv. In practice cash is now received in lieu, which would make it difficult to include in the new benefits tax. Its introduction would, however, provide an occasion for considering the withdrawal of the ESC, thus taxing this cash in the same way as other earnings.

Removal expenses/additional housing costs

v. If Ministers decided to withdraw the existing concessions, these should be easier to tax on the employer.

Third party entertainment and gifts

vi. Charging the employer could be looked at again - but even that seems likely to be messy.

Mileage allowances

vii. Many of these are now paid at rates which exceed the amounts allowable for tax purposes - some deliberately to provide a "profit element". Even if paid solely in respect of business journeys, therefore, there is a taxable element which (subject to de minimis limits) has to be taxed individually at present. An employer tax opens up the possibility of prescribing acceptable tax free business mileage rates in advance, and getting the employer to operate the benefits tax automatically on any excess.

Late night taxis

viii. Under an employer based system, the need for the new ESC is less apparent.

Incentive scheme prizes

ix. There is already a special (voluntary) taxation at source scheme for these. It might be possible to make it more effective with an employer based tax.

C O N F I D E N T I A L

PDP
P2

FROM: P D P BARNES
DATE: 29 October 1987

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Sir P Middleton
Mr Scholar
Mr Cropper
Mr Tyrie

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

PS/EST
→
PS/CH
29/10

CAR BENEFITS : IFS STUDY

The Economic Secretary has seen Mr Lewis's submission to the Chancellor of 27 October.

2. The Economic Secretary thinks that the AA scales may have been somewhat high because:

- (i) They included parking - a separate issue;
- (ii) They included AA Membership, which may not be paid by the employer;
- (iii) They ignore the affect of inflation on resale value. The Economic Secretary think the calculations should assume that the car is resold after, say, 4 years. The resale value will reflect market depreciation in real terms plus inflationary appreciation. The Economic Secretary thinks that the IFS use of real interest rates is roughly equivalent to valuing depreciation in this way.

PB

P D P BARNES
Private Secretary



Inland Revenue

Policy Division
Somerset House

Copy no 2 of 19.

FROM: P LEWIS

DATE: 30 OCTOBER 1987

Financial Secretary

CAR BENEFITS

1. This note looks at three points arising out of your meeting on 28 October

- what "realistic" car scales would look like if phased in over a period of years
- the extent to which the present low business mileage rule would fully charge the "perk" car, if the general scales reflected only 50% of standing charges
- the interaction of phased car scales with the main package, assuming the introduction of an employer tax in 1990.

Phasing to realistic levels

2. The table attached

- looks at scales reflecting 50% of standing charges and running costs of 8,000 miles reached by 1992/93

cc Chancellor
Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Scholar
Mr Cropper
Mr Tyrie
Mr Call

Mr Battishill
Mr Isaac
Mr Beighton
Mr Lewis
Miss Rhodes
Mr Mace
Mr Eason
Mr I Stewart
PS/IR

LEWIS
→
FST
30/10

- assumes (as we discussed with you) a 10% increase only in 1989/90 followed by phasing over three years to reach the target level
- considers the implications if either you retain the present system or introduce an employer tax from 1990/91 (charged at the illustrative rate of 75% - exclusive - discussed in Mr Isaac's note of 28 October)
- shows, for all the years concerned, both the amount of the scale charge and the year by year increase in tax it implies (at 1989/90 prices.)
- assumes, at this stage, no extra charge on all "perk" cars (see paragraph 7 below) or very expensive cars.

3. There are two main possible approaches to phasing

- equal increases in the amount of the scale
- equal percentage increases in the scale.

The percentage approach means that the absolute amount of the increase in the scale rises each year. Accordingly the increase in the first year is substantially lower than it would be if the scales were increased by equal amounts each year; and correspondingly higher in the third year. For example, on the equal increase basis, for cars in the middle band (1,400 to 2,000 cc) the annual rise would be about £320 in each of the three years, as compared with figures on the percentage approach starting at £245 and rising in the third year to £405.

4. The table attached adopts the percentage approach. The percentage increase required over the three years to get to "realistic" scales is slightly different for each scale band because the extent of the present under-taxation varies somewhat. On average, the annual increases are about 30%, and all lie between 28% and 34%.

5. The effects on weekly tax liabilities of this approach for the ordinary run of cars in 1990/91 (the first year of phasing) is as follows:-

	<u>Engine Size</u>		
	Up to 1,400 cc	1,400-2,000	Over 2,000 cc
<u>Employee (present system)</u>			
25% taxpayer			
Total tax	4.09	5.24	8.27
Increase in 1990/91	1.01	1.18	1.88
35% taxpayer			
Total tax	5.72	7.34	11.58
Increase in 1990/91	1.41	1.65	2.63
<u>Employer-based tax (75% tax exclusive, after CT relief at 35%)</u>			
Total tax	7.97	10.22	16.13
Element applicable to 1990/91 increase in scales	1.97	2.30	3.66

The figures relating to the employer-based tax reflect both the increase in the car scales and a tax rate fixed at a level to claw back some of the NIC anomaly.

Changes in Monetary Costs up to 1992/93

6. At your meeting we discussed the desirability of not only announcing, but also legislating, in 1988 the figures through to 1992/93, if changes of this kind were to be made, on the pattern of the 1984 CT reforms. If this were to be done, account would need to be taken of the changes in motoring costs likely to occur between 1987 (the date of the AA costs on which these figures are based) and 1992/93. (In looking at the appropriate scale figures for 1989/90 we have already increased the 1987 AA figures by 10% to allow for price increases between April 1987 and April 1989.) Annex 2 looks briefly at the options.

"Perk" cars

7. Mr Tyrie suggested at your meeting that if you went for car scales based on 50% of standing charges, there was a strong case for a full charge (with 100% standing charges) on those cars which were primarily "perks" as opposed to "tools of the trade".

8. This distinction is recognised at present by the rule which increases the scale charge by 50% for any car which is used for less than 2,500 business miles, including all second cars and cars provided for the employee's family.

9. In the context of a tax on employers, we have suggested that consideration should be given to dropping this rule - and the corresponding rule which reduces the scale charge by 50% if the business mileage exceeds 18,000 - to reduce employers' compliance burdens; so you may wish to consider consultation before reaching a final view on imposing a liability on employers based on their employees' business mileage. (The position of second cars, and cars for the employees family, is less difficult). Subject to that, if you wish to retain heavier taxation of "perk" cars there are two (at least) possible approaches.

10. First, the existing 50% surcharge approach could be continued. How this would compare with scales taking into account 100% standing charges would vary slightly from band to band depending on the mix of standing charges to running costs. But, in the central band (1,400 to 2,000 cc) a 50% surcharge would, in 1992/93, give a scale charge of £2,715, as compared with a charge of just over £3,000 with 100% standing charges and £1,810 with 50% standing charges. In other words, the existing system would achieve broadly the right result.

11. An alternative approach would be to prescribe separate scales for "perk" cars. This would be more precise and make it clearer what you were doing. By breaking away from the existing system it would also make it easier to drop the 50% discount for cars with over 18,000 business miles, if you wished to do so. The arguments for doing that are

- the "tool of the trade" argument is already fully recognised in the reduced 50% standing charges scale
- the 18,000 mile rule is the more troublesome one in compliance terms.

Interaction with the main package

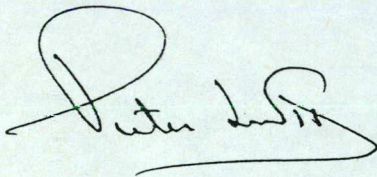
12. My note of 22 October mentioned (paragraph 7) that increased car scales would produce some further losers, and increase losses, from 1989/90 because there were about 300,000 people with company cars in the income range £18,000 to £25,000, broadly the top of the present basic rate band where most of the losers in the main package fall.

13. We can now give a broad indication of how gainers and losers from the main package might be affected by changes in the car scale charges. If the tax regime in 1989/90 is a higher rate of 36% and an NIC charge above the UEL of 8% (the second year of a three year transition to a 35% higher rate and a NIC charge of 9%) there might be broadly 400,000 cash losers compared with 1987/88. (This assumes 1988/89 income levels - Mr Mace's submission of 29 September 1987). Our present estimate is that about 75,000 of these might have company cars. *

14. If you are contemplating an increase of only 10% to the scale charges in 1989/90 - on the grounds that it is the last year before the start of an employer tax - this would involve an extra tax liability of typically only about £20. This would marginally increase the losses of the existing 75,000 losers with company cars; and marginally reduce the gains of the existing 1.3m gainers with company cars, tipping a very small number from gain into loss.

* We hope to be able to give firmer estimates when we have developed links between the model used for costing new tax packages and the Expenses and Benefits model which includes company cars.

15. The position of the employee in the following year, 1990/91 when the employer tax starts depends on the extent to which his pay is lower than it would otherwise have been to offset the employer tax on his car. If there were no pay reduction, the employee would gain from no longer having to pay income tax on the car scale figure (NIC is unaffected). Thus there would be increased gains to the existing 1.3m gainers with company cars; and reduced losses for the 75,000 existing losers. The change in liability would be much larger than in the previous year - about £200 for a typical car - turning most of the existing losers into net gainers. But the position would be less favourable to the extent that employers had already by 1990/91 shifted some of the burden to employees through pay reductions.

A handwritten signature in black ink, appearing to read 'Peter Lewis', with a large, stylized initial 'P'.

P LEWIS

ALL AMOUNTS IN £

	-----Size and value of car-----				
	under 1400cc	1401- 2000cc	over 2000cc	Cars with original cost: £19250 to £29000	over £29000
1988-89 scale charge	580	770	1210	1595	2530
Target scale charge for 1992-93 (at 1989-90 prices)	1492	1810	2888	4155	6417

1989-90					
Scale charge set at 1988-89 levels plus 10%	640	845	1330	1755	2785
Additional tax payable (£/week) as a result of increase in scale charge between 1988-89 and 1989-90					
by a basic rate (25%) taxpayer	0.29	0.36	0.58	0.77	1.23
by a higher rate (36%) taxpayer	0.42	0.52	0.83	1.11	1.77

ANNUAL PERCENTAGE INCREASE TO RAISE 1989-90 SCALE CHARGE TO THE TARGET LEVEL BY 1992-93 (AT 1989-90 PRICES)	32.6%	28.9%	29.5%	33.3%	32.1%

1990-91					
Scale charge for 1990-91 (at 1989-90 prices)	850	1090	1720	2340	3680
Increase from 1989-90	210	245	390	585	895
ADDITIONAL TAX PAYABLE (£/WEEK) AS A RESULT OF INCREASE IN SCALE CHARGE BETWEEN 1989-90 AND 1990-91 IF EMPLOYEE CONTINUES TO PAY TAX ON FRINGE BENEFITS					
by a basic rate (25%) taxpayer	1.01	1.18	1.88	2.81	4.30
by a higher rate (35%) taxpayer	1.41	1.65	2.63	3.94	6.02
IF EMPLOYER PAYS TAX AT A RATE OF 75% (TAX EXCLUSIVE)					
excluding CT relief	3.03	3.53	5.63	8.44	12.91
after allowing CT relief (at 35%) which will be due later	1.97	2.30	3.66	5.48	8.39

1991-92					
Scale charge for 1991-92 (at 1989-90 prices)	1125	1405	2230	3115	4860
Increase from 1990-91	275	315	510	775	1180
ADDITIONAL TAX PAYABLE (£/WEEK) AS A RESULT OF INCREASE IN SCALE CHARGE BETWEEN 1990-91 AND 1991-92 IF EMPLOYEE CONTINUES TO PAY TAX ON FRINGE BENEFITS					
by a basic rate (25%) taxpayer	1.32	1.51	2.45	3.73	5.67
by a higher rate (35%) taxpayer	1.85	2.12	3.43	5.22	7.94
IF EMPLOYER PAYS TAX AT A RATE OF 75% (TAX EXCLUSIVE)					
excluding CT relief	3.97	4.54	7.36	11.18	17.02
after allowing CT relief (at 35%) which will be due later	2.58	2.95	4.78	7.27	11.06

1992-93					
Scale charge for 1992-93 (at 1989-90 prices)	1490	1810	2890	4155	6415
Increase from 1991-92	365	405	660	1040	1555
ADDITIONAL TAX PAYABLE (£/WEEK) AS A RESULT OF INCREASE IN SCALE CHARGE BETWEEN 1991-92 AND 1992-93 IF EMPLOYEE CONTINUES TO PAY TAX ON FRINGE BENEFITS					
by a basic rate (25%) taxpayer	1.75	1.95	3.17	5.00	7.48
by a higher rate (35%) taxpayer	2.46	2.73	4.44	7.00	10.47
IF EMPLOYER PAYS TAX AT A RATE OF 75% (TAX EXCLUSIVE)					
excluding CT relief	5.26	5.84	9.52	15.00	22.43
after allowing CT relief (at 35%) which will be due later	3.42	3.80	6.19	9.75	14.58
=====					
MEMORANDUM ITEM					
Amount of tax payable each week in 1990-91 by employer if employer-based tax introduced in 1990-91 (before any increase in the scale charge from 1989-90 levels)					
75% tax exclusive rate before CT relief	9.23	12.19	19.18	25.31	40.17
75% tax exclusive rate after CT relief (at 35%)	6.00	7.92	12.47	16.45	26.11

PHASING: UPDATING SCALES FOR CHANGES IN MOTORING COSTS TO 1992/93

1. As explained in paragraph 6, we have already made a broad adjustment to the 1987 AA figures in looking at 1989/90 scale charges to allow for price increases between April 1987 and April 1989. One approach would be simply to continue to make a broad estimate of the likely rises in costs to 1992/93 - say 5% per annum - and reflect that in the scale figures to be enacted.
2. This would give you a final figure for the legislation. But
 - the estimate would inevitably be broad brush and reality might be very different over such a long period
 - the figures you were legislating for would seem even higher (about 20%) in current terms
 - there would be no mechanism for change short of Finance Bill legislation if you wished to amend the scales, or for keeping the scales automatically at the right level after 1992/93.
3. An alternative would be a combination, or modification, of the present Order making power. This could be
 - a. entirely discretionary, like the present Order making power
 - b. an indexation provision, with a Parliamentary over-ride, like the personal allowance indexation provisions. (The natural link would be to the motoring expenditure index which forms part of the RPI)
 - c. discretionary up to the amount of indexation, so that further real increases would need Finance Bill legislation.

4. You would need to consider which approach is best. If you wish to get the scales automatically reflecting changing motoring costs up to 1992/93 (and beyond) without either Finance Bill legislation or a debatable Order, something on the lines of 3(b) seems to be needed. It might be possible to combine this with an Order making power (like the present one) rather than a Finance Bill override, if Ministers wished to make changes to the scale other than by indexation. Such an Order would we presume have to be open to debate, unlike an indexation Order.

5. We will let you have a further note on this if you are attracted to phasing.



FROM: FINANCIAL SECRETARY
DATE: 30 October 1987

CHANCELLOR

cc Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Scholar
Mr Cropper
Mr Tyrie
Mr Isaac IR
Mr Lewis IR
Mr Prescott IR
Miss Rhodes IR
PS/IR

CAR BENEFITS

I have discussed with officials Mr Lewis' note of 22 October, covering three papers written by Miss Rhodes.

CAR BENEFITS UNDER AN EMPLOYER BASED TAX (EBT)

Introduction and Handling

2. If an EBT is introduced to take effect from 1990/91 onwards, I think we should only contemplate a "normal" 10% increase for 1989/90. To do more than this would create a new tranche of employee losers in 1989/90 and would, in my view, look slightly odd given that the whole regime would be changed in the following year.

3. I think, however, that even if there were to be no significant increase in the scale charges announced for 1989/90, it would still be advantageous in the 1988 Budget to make clear our intentions for 1990/91 onwards on the car benefit scales. Indeed I believe it would be sensible not only to announce our intentions but also to put the necessary legislation in the 1988 Finance Bill. If we did not do this we could expect tenacious lobbying from the motor industry throughout 1988/89.

TASK FORCE SECRET

FST
→
CH/EX
30/10

Johns

TASK FORCE SECRET

Structure

4. The key questions on car benefits for the post 1989/90 regime are:

- (i) Whether to go for 50% or 100% of the AA standing charges;
- (ii) Whether to retain mileage thresholds (such that if business mileage is very high a lower scale applies - or vice versa).

(I am not attracted to the approach based on employer costs, or the IFS' rather ad hoc approach).

5. On (i) it would be easier to go for 100% under the EBT than under an employee based tax since under the former the very substantial increase in tax should be less transparent and in any case employees could be expected to protest more loudly about any increased tax burden than employers. Under the EBT, of course, employees would have to pay no tax at all, (although there might be compensating reductions in their remuneration over the longer run).

6. On (ii), we have to bear in mind the need to reduce as far as possible the compliance burden on the employer. Whether we go for 50% or 100% of the AA standing charges, any attempt to "fine-tune" tax liabilities by retention of the mileage thresholds would mean higher employer compliance costs. He would have to keep a record for each employee who had a car of how many business miles that car had done each year. The employer has to do this at present, but we are looking to reduce the burden on employers and this is one area, where at the expense of a few "rough edges", we could make progress.

TASK FORCE SECRET

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7. I conclude that we could get away with a 100% charge under the cloak of the EBT. But I would feel nervous of introducing a 100% charge without some form of let-out for heavy business users. To introduce a mileage threshold would, however, remove some of the compliance benefits which would otherwise flow from getting cars out of the P11D system. There is a clear trade-off here and you might prefer a flatrate 50% with no thresholds. Even a 50% charge would represent a sharp increase in the tax burden on company cars.

CAR BENEFITS IN THE ABSENCE OF AN EBT

Introduction

8. If we do not go ahead with the EBT, I still believe we should not bring in a large increase in the scales in 1989/90. There may be as many as 150,000 people in the kink who also have company cars. Their losses would obviously be exacerbated if in 1989/90 we sharply increased their car tax.

Structure

9. I do not think that it would be politically feasible to move up to a 100% charge if employees were paying the tax. Whatever the merits in logic of the 100% rate, I would prefer to see a main scale rate, therefore, of 50% of the AA standing charge if we retained the present tax regime.

10. However, there would be less difficulty under the existing tax structure with retaining mileage thresholds. I would favour:

- (i) A scale equal to 50% of the AA standing charge for all employees with company cars except:
- (ii) Possibly a lower threshold to penalise light business users so that for those doing less than, say, 2500 business miles each year, the scale would be increased to 100% of the standing charge.

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11. Although under this scheme we would not be taking the opportunity to minimise employer compliance costs, we would be easing the burden to some degree (one business usage threshold not two).

OTHER ISSUES

12. On the more minor issues raised by officials my views are as follows:

- (i) Whether or not we have an EBT, and whether or not we go for 50% or 100%. I would favour a three year phasing-in period (starting in 1990/91) before the "true" scale level is reached;
- (ii) The threshold for more expensive cars should be frozen - bringing more cars into this higher tax bracket;
- (iii) There is something to be said for having a higher increase in the scale charge for expensive cars. But this would generate fierce opposition from the UK motor industry which is strongly represent in the quality car market. It would be useful to get Mr Monck's views on this and possibly also, at some stage, to consult DTI;
- (iv) There should be a reduction in the present fuel scale charge as recommended by the Paymaster General;
- (v) There should not be a separate scale for diesel fuel;

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- (vi) If there is to be an EBT, the **current fuel scale charges should continue to provide the measure of the benefit;**
- (vii) The benefit of **free parking should be exempt from tax;**
- (viii) A **statement of practice** should be issued to clarify the tax treatment of car telephones;
- (ix) **On cars for family members, we should seek to prevent a double tax charge from arising.**

9.11.

11. NORMAN LAMONT

TASK FORCE SECRET

TASK FORCE SECRET

COPY NO 2 OF 19 COPIES

FROM: MISS C EVANS
DATE: 30 OCTOBER 1987

- 1. MR SCHOLAR
- 2. SIR PETER MIDDLETON

- cc
- Chancellor of the Exchequer
 - Chief Secretary
 - Financial Secretary
 - Paymaster General
 - Economic Secretary
 - Sir Terence Burns
 - Mr Byatt
 - Mr Cassell
 - Mr A Wilson
 - Mr Riley
 - Miss Sinclair
 - Mr Cropper
 - Mr Tyrie
 - Mr Call
- PS/IR

Mus 30/10

Thanks. V. helpful & useful. I'm glad to hear of this. (NW 6, 1 that).

TASK FORCE TIMETABLE: MEETINGS

You asked us to construct a timetable for the main decisions which need to be taken. Following consultation with the Revenue we suggest the following for the next month:-

we'd try to slot this in.

- X | week beginning 2 November : benefits-in-kind - decision in principle on main shape of an employer-based tax
- between 5-11 November : meeting on MIR and independent taxation
- 12 November : strategy meeting on CGT to decide on rebasing, adding to income, CGT deferral on gifts
- week beginning 16 November : NICs: to decide basis of consultations with DHSS on UEL and NICs at lower end
- week beginning 23 November : meeting on covenants and maintenance
- week beginning 30 November : possible further meeting on benefits-in-kind in light of Australian/New Zealand visit.

2. We will submit the next scorecard for the meeting on CGT on 12 November.

3. I also attach a sketch timetable, with tentative dates for decisions on all the measures currently in the scorecard.

Carys Evans

MISS C EVANS

TASK FORCE SECRET

ProposalDecisions needed by

Basic rate)	mid February assuming package along
Higher rate threshold)	lines of current proposals (earlier
Higher rates)	decisions might be needed if options
	emerged involving significant
	structural change)
Independent taxation	as soon as possible
Small companies' CT rate	mid February
CGT rates and exemption	New Year
CGT rebasing and adding to income	mid November (in practice firm decisions needed at 12 November meeting)
CGT deferral on gifts	mid December
NICs: UEL	need for discussions with DHSS in November -only they can advise on practicability of October 1988 start
NICs at lower end	need to decide on preferred option before discussions with DHSS in November
Mortgage Interest Relief	by mid November
Forestry	Christmas
Covenants/Maintenance	end November (need to instruct Counsel before Christmas on potentially complex legislation)
Benefits in Kind	decisions on details by early December
IHT thresholds and rates	New Year
Stamp duty threshold	mid February



COPY NO. 16 OF 17.

FROM: J M G TAYLOR

DATE: 2 November 1987

MISS C EVANS

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir T Burns
Mr Byatt
Mr Cassell
Mr A Wilson
Mr Riley
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Call
PS/IR

TASK FORCE TIMETABLE: MEETINGS

The Chancellor was grateful for sight of your minute of 30 October to Sir P Middleton, which he thinks is very helpful and useful.

2. He is afraid that we shall need to have the benefits in kind meeting on the morning of this Friday, 6 November. This office will be in touch with precise arrangements.

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

J M G TAYLOR



Inland Revenue

Policy Division
Somerset HouseFROM: P LEWIS
DATE: 2 NOVEMBER 1987

PS/Chancellor

CAR BENEFITS: IFS STUDY

1. Perhaps I could just comment briefly on Mr Barnes' minute to you of 29 October, in case there should be any misconception about our approach to the AA figures underlying the various scale charges discussed in Miss Rhodes' submission of 22 October.
2. First, some specific points on the AA figures
 - we exclude parking costs from the calculations
 - we also exclude AA membership
 - and we reduce insurance costs by 50% (the AA take no account of no claims bonus)
3. Second, the IFS approach to depreciation. It is not clear whether the sale proceeds taken into account are a nominal figure, or have been reduced to take account of inflation over the period of ownership. To the extent that were done, it would increase the amount of depreciation, and thus tend to increase the IFS figures as compared with the AA figures.

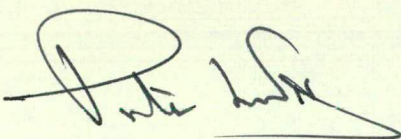
cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Scholar
Mr Cropper
Mr Tyrie

Mr Battishill
Mr Isaac
Mr Painter
Mr Beighton
Mr Lewis
Miss Rhodes
Mr Weeden
Mr Stewart
PS/IR

4. This is one of a number of points on which we are seeking clarification from the IFS. But in general our present impression is that differences between the IFS figures and our own are less a matter of methodology than the underlying data being used. Broadly speaking the data the IFS are using seems more appropriate to a car in the lowest category, and on that basis there is much less difference between our figures.

5. It may be worth also commenting briefly on the AA figures for repairs and depreciation. They calculate both over an 8-year life. Their annual depreciation figure on a straight line basis is thus 12.5% of cost - distinctly low for a company car kept for only 2 or 3 years (perhaps about 75% fall into this category). On the other hand, their depreciation is based on the cost of a new car, and is thus a bit too high for other cars; and averaging repairs and maintenance over 8 years probably also means that the figures are too high for a new or nearly new car. These factors go in opposite directions; we have no means of making adjustments for them, and we have thus, necessarily, taken the view that they are broadly self balancing.

6. We use the AA scales because we have not been able to find any better, regularly up-dated independent source of information giving sufficient detail about motoring costs. But we would certainly not wish to argue that they provide a precise valuation of average private motoring costs. So if Ministers were attracted to scale charges reflecting 100% of standing costs we would recommend a fair degree of rounding down to take account in some measure of the underlying uncertainties - for example, the rate of interest to take in calculating interest forgone - on which there will always be room for debate. But if there was already a major rounding down by taking only 50% of standing charges such lack of precision in the underlying figures could probably be regarded as covered by that, and it would only be necessary to go to the nearest convenient round number for the scales.



P LEWIS



FROM: J M G TAYLOR

DATE: 5 November 1987

CHANCELLOR

BENEFITS IN KIND

There is a mass of papers for this meeting. I have divided them, in this folder, into two parts:

- i. Papers on an employer-based tax - in the front half of the folder;
 - ii. Papers on car and other automotive benefits - in the back half (behind the manila divider).
2. I have put background papers on to a separate folder.
3. On the **employer-based tax**, the main questions are listed in **Mr Isaac's minute of 20 October**. You should also see **Mr Scholar's minute of 28 October**, (in particular paragraph 2 and the table in paragraph 3) which comments on Mr Isaac's paper. Mr Isaac's paper, with Mr Scholar's glosses, can serve as an annotated agenda.
4. Other papers which you will want to see are:
- i. **Mr Tyrie's minute of 29 October** (top of the folder) - not copied to all;
 - ii. **Financial Secretary's minute to you of 28 October** - not copied to all;
 - iii. **Mr Isaac's minute to the Financial Secretary of 28 October**;
 - iv. **Mr Cropper's minute of 30 October** (in the red folder - enclosed - again not copied to all) - paragraphs 7 to 9 only.



5. On car benefits, Mr Lewis' minute of 22 October encloses an annotated agenda. You will also want to see the Financial Secretary's minute of 30 October which discusses the issues raised in Mr Lewis' minute, and suggests a way forward (a) if we introduce an employer-based tax (b) if we stick to the present system.

6. You may also like to see:

i. Mr Lewis' minute of 2 November, and PS/Economic Secretary's minute of 29 October;

ii. Mr Lewis' minute of 30 October.

J M G TAYLOR

CONFIDENTIAL

6/11



CHANCELLOR OF THE EXCHEQUER'S OFFICE: MEETING

SUBJECT	BENEFITS IN KIND
DATE AND TIME	10.15 AM FRIDAY 6. NOVEMBER.
VENUE	Chancellor's Room, Treasury/ Mail /Conference Room/ House of Commons
PAPERS	<u>All RECENT PAPERS.</u>
THOSE ATTENDING	CST FST PMG. SIR P MIDDLETON SIR T. BURNS MR CASSELL MR KEMP MR SCHOLAR MISS SINCLAIR MR MICHIE MR CROPPER MR TYRIE MR BATTISHILL MR ISAAC MR LEWIS MISS RHODES MR PRESCOTT } I.R. CL. EST MR TAYLOR.

